



Investment Update April 2020

Investment Headlines & Comment

- The US Federal Reserve has extended its **Quantitative Easing** programme to include investment grade debt, and certain ‘fallen angels’ (investment grade before March 22, but then downgraded to no lower than BB-). This led to a sharp rally in corporate debt.
- More “undesirable firsts” – the 5-year gilt yield and the 15-year US Treasury real yield both end the month negative (albeit not by very much). For gilts, that prompts the question of whether pension fund Trustees should ever hold an investment that is guaranteed to give them a loss.
- The expanded **gilt issuance** programme kicked in this month, to cover the emergency measures announced in March – there were 18 auction / tender exercises this month, so the DMO staff will have been extremely busy! A summary of the issuance is [here](#).

Feature Section

This month, we consider the impact of the Q1 2020 market turmoil on the risk-return profile of absolute return / diversified growth managers. The peer group involves 18 managers (using one fund per manager, even if they have multiple funds, and using gross of fees data). This subject was last looked at in our [April 2018](#) edition.

Figure 1a shows the peer group plotted as groups at the end of Q4 2019 and at the end of Q1 2020, looking at the annualized 5-year return, and the associated volatility. Figure 1b then links up the quarter ends’ points pairwise by manager (in every case the 5-year return reduces, so each line can be thought of as moving downwards from Q4 2019 to Q1 2020). It is worth flagging that the average return in Q1 2015 was around 4.5% - this is the quarter that drops out from the rolling 5-year view to be replaced by the (generally poor) Q1 2020. Figure 1c shows the longer-term peer group at Q1 2020 (which only involves 12 funds, as not all managers have 10-year records yet).

Figure 1a: Peer group by date

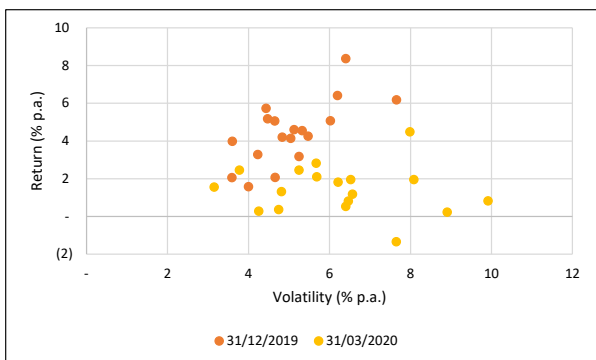
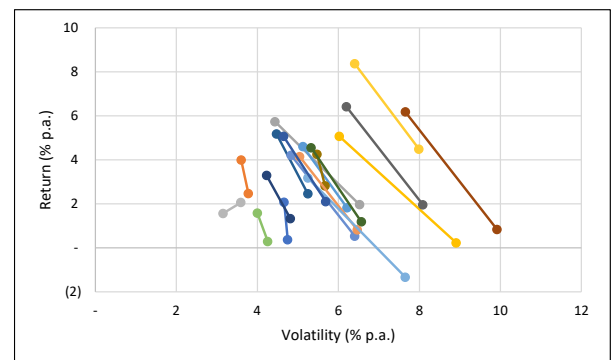
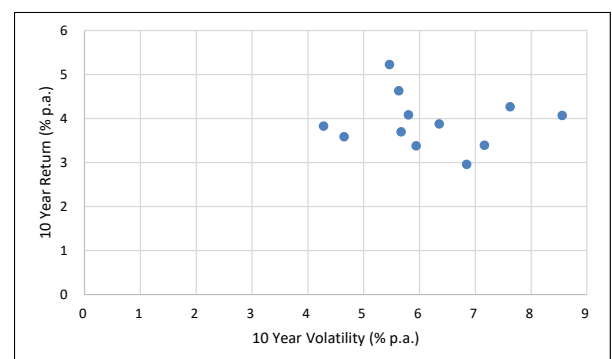


Figure 1b: Peer group movement by manager



The range of movements involved in Figure 1b is quite striking. For those managers fully (or near fully) invested and operating without downside protection, they were clearly vulnerable. The scale of the movements for them is quite marked, with long lines in a south-easterly direction. By contrast, some other managers had relatively little direct market exposure, e.g. because of having “relative value” positions in their portfolios, or they employed protection strategies. For these managers, their lines are much shorter, and generally fairly southerly. Coupled with the outputs from Figure 1c showing a wide range of volatilities, manager diversification seems a sensible strategy. For reference, 10-year equity returns were 4.4% p.a. (UK) and 8.9% p.a. (World ex UK), whilst volatility was 12.4% p.a. (UK) and 11.4% p.a. (World ex UK).

Figure 1c: 10-year peer group at Q1 2020





Asset Returns and Financial Measures [in Sterling unless marked otherwise]

The cells in bold with light shading show the best and worst performing asset classes from each column. The commodities and \$-based and unhedged-£-conversion hedge fund returns are excluded from that.

[NB Future returns cannot be inferred from this table alone, but coupled with other items within *Update*, readers can make inferences as to whether they should be higher or lower than the past returns shown below.]

Table 1: Investment Data to 30 April 2020

Asset Class	1 month (%)	3 months (%)	12 months (%)	3 years (% p.a.)	5 years (% p.a.)	10 years (% p.a.)	20 years (% p.a.)
UK Equities	4.9	-18.8	-16.7	-2.6	0.9	5.0	3.9
Overseas Equities	9.0	-7.4	-0.4	6.3	9.7	9.9	6.0
US Equities	11.2	-5.2	4.4	10.0	13.4	13.8	4.9
Europe ex UK Equities	4.7	-12.7	-7.4	0.8	4.9	6.2	6.8
Japan Equities	3.8	-6.5	0.3	3.4	6.8	6.9	2.3
Pacific ex Japan Equities	8.1	-5.9	-5.6	2.6	5.5	6.3	8.6
Emerging Markets	7.3	-8.5	-8.7	1.8	4.3	3.8	7.6
UK Long-dated Gilts	5.6	10.4	27.3	9.8	10.0	10.4	7.4
UK Long-dated Corp. Bonds	10.9	-0.3	15.5	6.9	7.7	8.8	7.4
UK Over 5 Yrs Index-Linked Gilts	5.6	2.8	9.7	3.9	7.6	9.1	7.4
High Yield (Global)	2.8	-6.3	-2.1	2.2	7.2	7.4	7.8
Overseas Bonds	-1.0	7.0	12.4	5.3	7.5	4.5	5.9
Property *	-2.0	-1.4	0.1	5.6	6.4	8.4	7.5
Cash	0.0	0.2	0.7	0.7	0.6	0.6	2.5
Commodities £-converted	-11.2	-39.0	-46.5	-14.9	-13.0	-9.8	-3.0
Hedge Funds original \$ basis *	-8.2	-10.6	-6.4	-0.1	0.8	2.7	4.2
Illustrative £-converted version *	-5.4	-4.5	-1.6	0.2	4.5	4.7	5.6
Euro relative to Sterling	-1.9	3.3	1.0	1.0	3.6	0.0	2.0
US \$ relative to Sterling	-1.7	4.5	3.3	0.8	4.0	2.0	1.1
Japanese Yen relative to Sterling	-0.8	5.9	7.6	2.3	6.4	0.6	1.1
Sterling trade weighted	1.6	-2.8	-1.0	-0.2	-2.8	-0.1	-1.4
Price Inflation (RPI) *	0.2	0.2	2.6	2.8	2.6	2.9	2.8
Price Inflation (CPI) *	0.0	0.1	1.5	1.9	1.7	2.0	2.1
Price Inflation (RPIX) *	0.2	0.3	2.7	2.8	2.7	2.9	2.9
Earnings Inflation **	0.8	4.5	2.3	2.6	2.3	1.6	2.8
All Share Capital Growth	5.0	-19.6	-19.8	-6.3	-2.8	1.3	0.4
Dividend Growth	-5.3	-5.4	-3.3	5.2	6.0	5.8	4.6
Earnings Growth	3.2	6.8	3.5	21.0	4.0	3.4	4.1

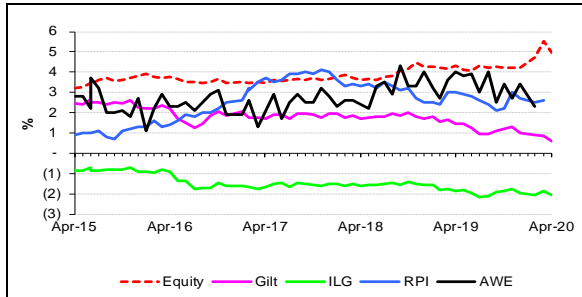
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- UK Equities (incl. dividends and earnings) – FT-A All Share.
- Overseas Equities (incl. regions) – blend of FT All-World / World sub-indices
- Emerging Markets from MSCI US \$ based total return index (overall Index to 31 Oct 2001, Free Index from 1 Nov 2001 to take account of foreign investment restrictions), conversion to UK £ by J&A.
- UK Bonds – FT-A indices (Gilts Over 15 Years, ILG Over 5 Years)
- UK Corporate Bonds – iBoxx Non-Gilt **Over 15 Year** index (all credit ratings combined)
- High Yield – ICE Global, £ Unhedged
- Overseas Bonds – JP Morgan Traded Unhedged World ex UK
- Property – MSCI IPD UK Monthly Property Index
- Commodities – GSCI Total Return, converted to UK £ by J&A
- Hedge Funds Composite – HFRI US \$ based total return index plus converted to UK £ by J&A. NB A smooth “cash + x%” return will only be shown in the base ‘hedged’ currency, here the US \$.
- Cash – an indicative index based on the three-month London Interbank Sterling mid-rate, calculated internally by J&A
- Price and earnings inflation – RPI, CPI, RPIX, and Average Weekly Earnings (whole economy, not seasonally adjusted, latest provisional data)
- Currency data – London close, from the Financial Times
- * denotes data lagged by 1 month, ** by 2 months – these reflect the later publication dates of these data items.

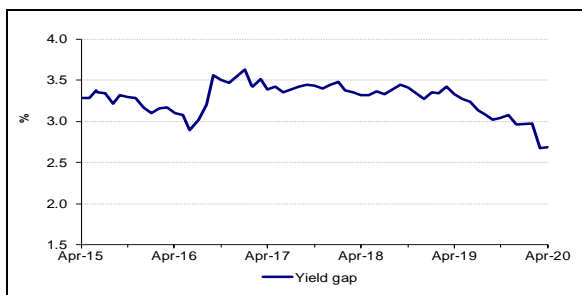


Yields and Yield Gaps

Figure 2: Yields, Inflation and Yield Gaps



The yield gap is a measure of expected average future inflation, derived as long bond yield minus ILG yield.

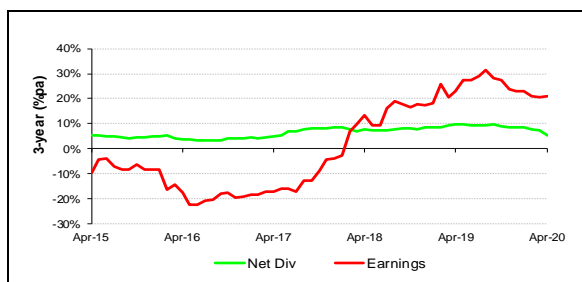
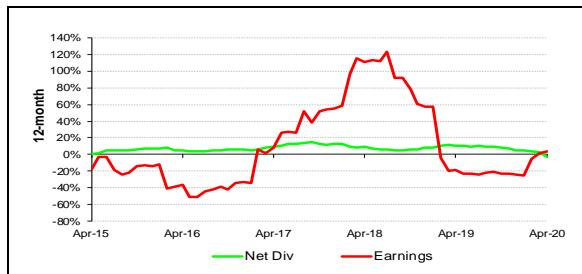


The gap gives a current expectation around 2.7% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

Growth in Earnings and Dividends

These charts show movements in rolling 12-month and 3-year dividend and earnings growth for UK Equities over the last 5 years. [NB the charts have different scales]

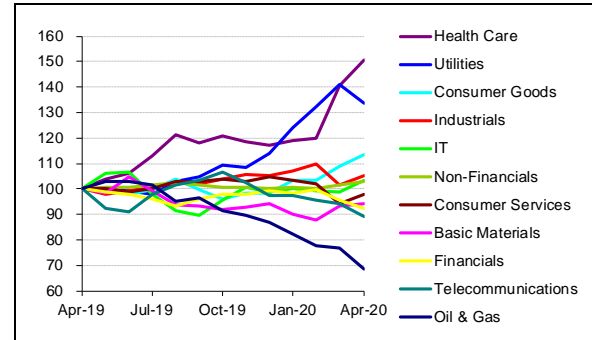
Figure 3: Dividend & Earnings Growth



Note: Earnings data from mid-2015 onwards is no longer reliable as one-off events may be affecting the prospective P/E ratios

UK Equity Sector Returns

Figure 4a: Sectors relative to All Share



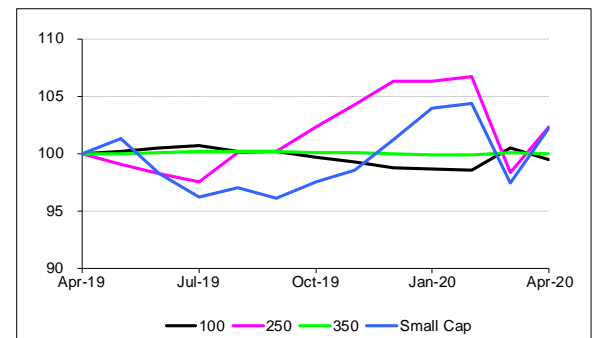
Note: Sector labels for relative lines are in end-value order

There was a sharp rise this month in the rolling 12-month sector dispersion (from 59% to 82%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-6.5	-32.6	-43.1
Basic Materials	6.0	-14.8	-21.5
Industrials	8.8	-20.1	-12.4
Consumer Goods	9.0	-11.0	-5.7
Health Care	12.4	2.5	25.3
Consumer Services	8.9	-23.1	-18.4
Telecommunications	-0.9	-25.7	-25.8
Utilities	-0.5	-12.5	11.4
Non-Financials	6.2	-17.0	-14.3
Financials	1.2	-23.7	-23.2
IT	9.8	-16.5	-14.0
All Share	4.9	-18.8	-16.7

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid and Small Cap both rose in relative terms this month.

Sources for charts on this page:
Financial Times, Office for National Statistics, J&A



Bond market information

Figure 5: £ Non-Gilt Credit Margins

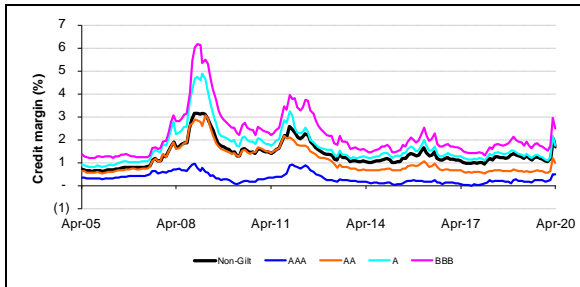


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Nov '19	1.94	1.18	0.76
Dec '19	1.99	1.30	0.69
Jan '20	1.66	1.00	0.66
Feb '20	1.69	0.91	0.78
Mar '20	2.30	0.83	1.47
Apr '20	1.57	0.60	0.97

Tables 2b, 2c: £ Market Size (£bn) and Maturity

Category	Mkt Val @ Apr 20 & 17, 14			Weight (%)
	20	17	14	
Gilts (42)	1,512	1,359	1,085	69.7
Non-Gilts (1,175)	656	564	530	30.3
AAA (161)	141	110	101	6.5
AA (164)	86	88	87	4.0
A (364)	188	171	169	8.7
BBB (486)	242	195	172	11.2

Category	Mkt Val (£bn @ Apr 20 & 17)		W't (%)	Dur'n (yrs)
Gilts (42)	1,512	1,359	69.7	14.0
< 5 Yrs (10)	322	385	14.8	2.8
5-15 Yrs (11)	399	342	18.4	8.0
> 15 Yrs (21)	792	632	36.5	21.5
Non-Gilts (1,175)	656	564	30.3	8.0
< 5 Yrs (434)	225	165	10.4	2.7
5-15 Yrs (511)	274	241	12.6	7.4
> 15 Yrs (230)	157	157	7.2	16.6

Tables 2d, 2e: € Market Size and Maturity (Apr 20)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (374)	6,766	58.8
Non-Sovereigns	4,747	41.2
AAA (971)	1,308	11.4
AA (770)	1,168	10.1
A (1,206)	1,072	9.3
BBB (1,532)	1,200	10.4

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,224)	2,595	22.5
3 – 5 Yrs (1,274)	2,342	20.3
5 – 7 Yrs (945)	1,787	15.5
7 – 10 Yrs (815)	1,927	16.7
10+ Yrs (595)	2,863	24.9

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Apr 20 & 17)		W't (%)	Dur'n (yrs)
Gilts (28)	759	670	100.0	22.5
< 5 Yrs (3)	70	51	9.2	3.5
5 – 15 Yrs (8)	187	150	24.6	10.2
> 15 Yrs (17)	503	469	66.2	29.8

Table 2g: High Yield bond yields (BB-B indices)

Month End	US (%)	Euro (%)	Sterling (%)
Nov '19	5.45	3.08	5.25
Dec '19	5.15	2.92	4.94
Jan '20	5.23	2.90	4.84
Feb '20	5.64	3.29	5.15
Mar '20	8.26	6.51	8.75
Apr '20	6.94	4.94	7.38

Sources: DMO, FTSE, iBoxx, J&A, MLX

£ Gilt Market “main” Issuance

- o During the expanded gilt issuance programme, there is insufficient space to list all the auction / tender exercises here, so please click [here](#) for the details.

Note: Issuance amounts are nominals. The first % figure in each row is the yield or real yield. The second % figure is the additional amount taken up under the Post Auction Option Facility (PAOF), as a % of the amount of the issue. No PAOF applies for tender or syndication cases.

