



Investment Update

June 2020

Investment Headlines & Comment

- Equity markets continued their recovery, albeit for several at a slower rate than in the previous two months.
- The breadth of the furlough policy's impact on average UK earnings has become clear from the latest ONS release (see p2).
- The Bank of England has announced a further £100bn on Quantitative Easing - gilt yields remain artificially low.

Feature Section

This month, we report on recent comments for the BBC by the philanthropist and investor George Soros on how debt may need to be thought of differently in the wake of the Covid-19 pandemic – the 8-minute broadcast can be found [here](#).

Mr. Soros starts with a suggestion for the International Monetary Fund (“IMF”), an entity which we last looked at in our [June 2009](#) issue. Whereas the World Bank's primary aim is poverty reduction, the IMF is concerned with macroeconomic issues and countries' public finances. The IMF supports its 189 member countries in researching the global economy and giving policy advice to governments, but George Soros's point focuses on their lending facilities.

The IMF's quota system was created to raise funds for loans. Each IMF member country is assigned a quota or contribution (measured in Special Drawing Rights, or “SDR” units), that reflects the country's relative size in the global economy, and also determines its relative voting power. Quotas are increased periodically to boost the IMF's resources. The IMF's SDR is an international reserve asset that effectively forms the “currency” of the IMF. Its value is based on a basket of five currencies (previously four). Since the renminbi was added as of 1 October 2016, the weights are U.S. dollar 41.73%, euro 30.93%, renminbi (Chinese yuan) 10.92%, Japanese yen 8.33%, British pound 8.09%. At 30 June 2020, 1 SDR = \$1.38.

The IMF reports that, so far, 102 countries have approached the IMF for assistance in respect of the Covid-19 crisis. Mr. Soros's proposal is that there should be a new round of quota increases, and that in turn the rich countries should donate their increase to the poorer ones *without expectation of repayment* (but presumably with the ability to place conditions on what the money was used for, to reduce so-called “moral hazard”). So far, whilst the IMF has been able to assist several countries (see [here](#) for global details), it seems the US has so far blocked an IMF loan request from Iran, and Mr. Soros anticipates a comparable block of the first part of his proposal. The outcome of the US Election could be significant in whether the proposal becomes more viable.

Mr. Soros's second suggestion is that the European Union should issue irredeemable (or perpetual) debt, something it has not done before (although it is fair to note it was previously suggested by the EU politician Guy Verhofstadt as a possible pandemic response). The UK first issued this type of debt in 1751 (they were known as “consols”), with the government having the option for redeeming them. The final issue was made in 1927 as part of addressing the costs of the First World War. The UK had some residual exposure to this type of gilt until as recently as 2014. By the early 2000s, they represented less than 1% of the gilt market.

However, the key drawback of these gilts for investors was that they were issued with a fixed interest rate (“coupon”), not an inflation-linked one, and as a result the returns for investors could be eroded by high inflation, particularly in the 1970s. How would modern investors therefore respond to such a bond issue?

There is a further concern. We have previously noted the dispersion in bond yields across EU countries (see for example our [January 2020](#) issue), so leaving aside the inflation issue, there has to be questions on at what yield these bonds should be issued, and also how the interest costs are to be spread across EU member states, given that the pandemic's impact on EU countries has not been uniform. Mr Soros notes that northern EU members (the German and Dutch governments) are the main opponents to the proposal. However, he thinks that if the Dutch government's concerns on practicalities can be overcome, then the German government's ideological opposition to not having to repay debt may in turn fall away. It still seems a long shot though ...



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 June 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	1.5	10.2	-13.0	-1.6	2.9	6.7	4.1
Overseas Equities	3.3	20.3	6.8	8.9	12.9	12.2	6.3
US Equities	2.3	22.0	11.6	12.9	16.3	16.2	5.2
Europe ex UK Equities	4.7	18.9	0.2	3.9	8.9	8.8	7.1
Japan Equities	0.0	12.2	6.8	4.9	9.0	8.6	2.6
Pacific ex Japan Equities	8.3	19.8	2.8	5.0	9.5	8.2	8.9
Emerging Markets	7.5	18.6	-0.1	4.0	8.3	5.6	8.0
UK Long-dated Gilts	-1.3	3.9	19.8	10.2	10.3	9.6	7.3
UK Long-dated Corp. Bonds	1.6	13.3	13.9	7.7	9.1	8.8	7.6
UK Over 5 Yrs Index-Linked Gilts	0.5	11.5	11.9	7.6	9.3	9.5	7.6
High Yield (Global)	1.9	11.9	2.4	4.7	9.8	8.5	8.0
Overseas Bonds	0.6	1.8	8.2	5.9	9.2	4.4	5.7
Property *	-0.7	-3.9	-2.3	4.3	5.5	7.9	7.3
Cash	0.0	0.1	0.7	0.7	0.6	0.6	2.5
Commodities £-converted	5.2	10.9	-31.9	-7.2	-8.2	-6.8	-3.0
Hedge Funds original \$ basis *	2.4	-2.5	-0.1	1.6	1.7	3.4	4.8
Illustrative £-converted version *	4.5	0.7	1.9	3.0	6.1	5.1	5.8
Euro relative to Sterling	1.0	2.7	1.6	1.2	5.1	1.0	1.8
US \$ relative to Sterling	0.1	0.4	3.0	1.7	4.9	1.9	1.0
Japanese Yen relative to Sterling	-0.1	0.4	2.9	3.1	7.6	-0.1	0.9
Sterling trade weighted	-0.9	-2.1	-1.1	-0.6	-4.0	-0.7	-1.3
Price Inflation (RPI) *	-0.1	0.1	1.0	2.5	2.5	2.7	2.7
Price Inflation (CPI) *	0.0	-0.1	0.6	1.7	1.6	2.0	2.0
Price Inflation (RPIX) *	0.0	0.2	1.3	2.5	2.6	2.8	2.8
Earnings Inflation **	-10.8	-3.6	-0.9	1.8	1.9	2.0	2.7
All Share Capital Growth	1.4	9.8	-15.9	-5.2	-0.9	3.0	0.6
Dividend Growth	-0.5	-7.5	-5.1	3.2	5.2	6.5	4.5
Earnings Growth	-4.5	-6.2	-2.1	16.8	-0.4	1.8	3.6

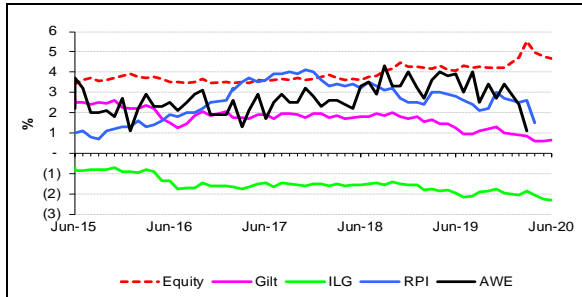
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

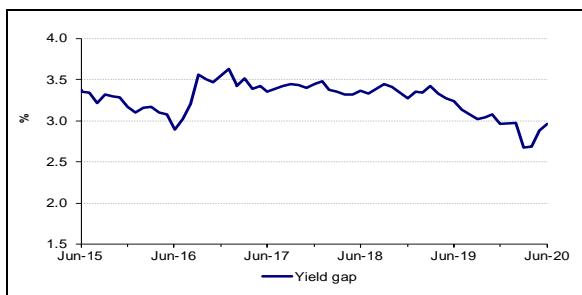


Yields and Yield Gaps

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.

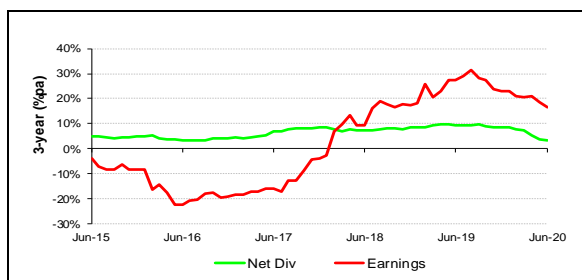
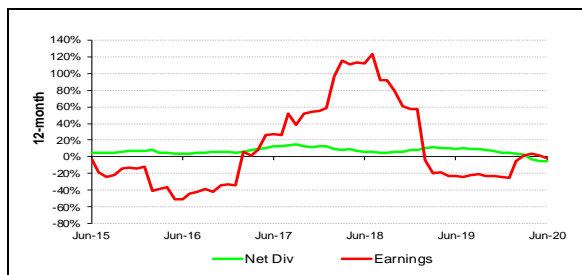


The gap gives a current expectation around 3.0% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

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]

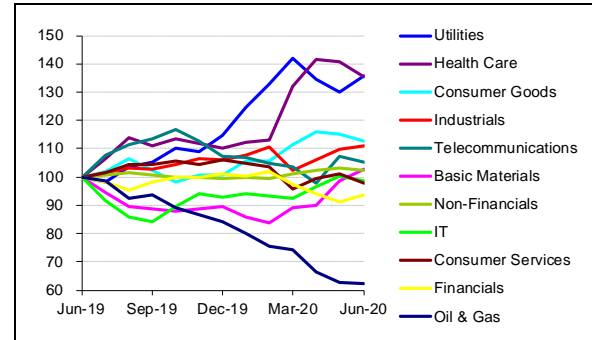
Figure 3: Dividend & Earnings Growth



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



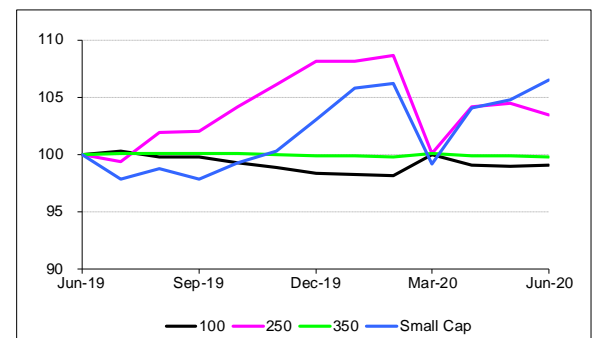
Note: Sector labels for relative lines are in end-value order

There was a slight fall this month in the rolling 12-month sector dispersion (down from 82% to 74%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	1.2	-7.7	-45.7
Basic Materials	5.8	27.0	-10.7
Industrials	2.7	19.5	-3.6
Consumer Goods	-0.5	11.5	-1.9
Health Care	-2.4	12.8	17.6
Consumer Services	-1.8	12.6	-14.9
Telecommunications	-0.3	12.3	-8.3
Utilities	6.3	5.6	18.3
Non-Financials	0.7	11.7	-11.0
Financials	4.2	5.8	-18.5
IT	-0.2	17.5	-14.3
All Share	1.5	10.2	-13.0

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Small Cap rose but Mid Cap fell 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

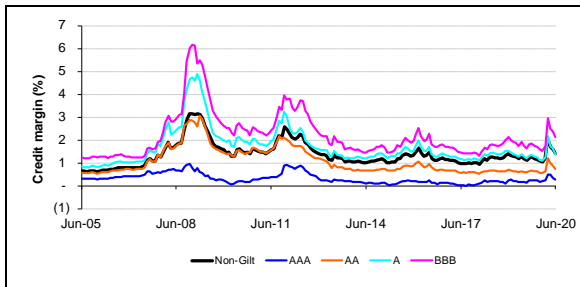


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
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
May '20	1.52	0.59	0.93
Jun '20	1.45	0.64	0.81

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

Category	Mkt Val @ Jun 20 & 17, 14			Weight (%)
	Jun 20	Jun 17	Jun 14	
Gilts (45)	1,630	1,349	1,095	71.1
Non-Gilts (1,161)	664	560	537	28.9
AAA (154)	138	108	104	6.0
AA (157)	84	87	88	3.6
A (349)	182	168	171	8.0
BBB (501)	259	197	173	11.3

Category	Mkt Val (£bn @ Jun 20 & 17)		W't (%)	Dur'n (yrs)
Gilts (45)	1,630	1,349	71.1	13.5
< 5 Yrs (11)	345	385	15.0	2.7
5-15 Yrs (12)	470	342	20.5	7.9
> 15 Yrs (22)	815	622	35.5	21.4
Non-Gilts (1,161)	664	560	28.9	8.0
< 5 Yrs (422)	224	167	9.8	2.7
5-15 Yrs (506)	279	238	12.2	7.4
> 15 Yrs (233)	161	155	7.0	16.6

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (390)	7,199	59.3
Non-Sovereigns	4,937	40.7
AAA (970)	1,334	11.0
AA (794)	1,223	10.1
A (1,218)	1,076	8.9
BBB (1,622)	1,303	10.7

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,190)	2,566	21.1
3 – 5 Yrs (1,335)	2,477	20.4
5 – 7 Yrs (973)	1,923	15.8
7 – 10 Yrs (865)	2,163	17.8
10+ Yrs (631)	3,008	24.8

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Jun 20 & 17)		W't (%)	Dur'n (yrs)
Gilts (28)	805	641	100.0	22.7
< 5 Yrs (3)	70	51	8.7	3.3
5 – 15 Yrs (8)	195	148	24.3	10.1
> 15 Yrs (17)	540	442	67.0	29.8

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

Month End	US (%)	Euro (%)	Sterling (%)
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
May '20	6.04	4.38	6.60
Jun '20	5.96	4.05	5.88

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

£ Gilt Market “main” Issuance

- o During the expanded gilt issuance programme, there is insufficient space here to list all the auction / tender exercises, 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.

