



## Investment Update November 2021

### Investment Headlines & Comment

- Equity markets reacted relatively modestly to the news of the Omicron variant.
- Sterling fell as the likelihood of a near-term rise in interest rates reduced.
- Over £17bn of offers for the **new ultra-long ILG**, maturing in 2073. £1.1bn was issued.

### Feature Section

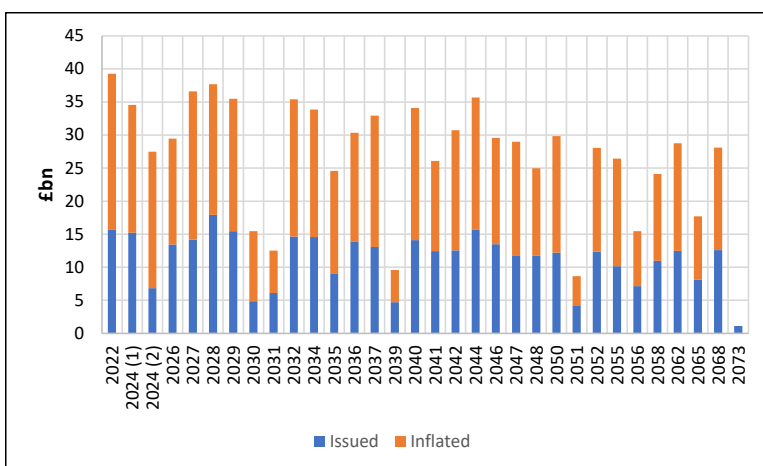
This month, we review the profile of the UK’s Index-Linked Gilt (ILG) market, which is now over 40 years old, the first ILG having been issued in March 1981.

The market has become increasingly longer-dated – in January 2005, the weighted average term was 11 years, and by November 2011 it had increased to 17 years, and now it is up to 22 years. A general history of the ILG market is available from the Debt Management Office (DMO) [here](#). However, the focus of the rest of this feature is where things have got to now, and where they may go next.

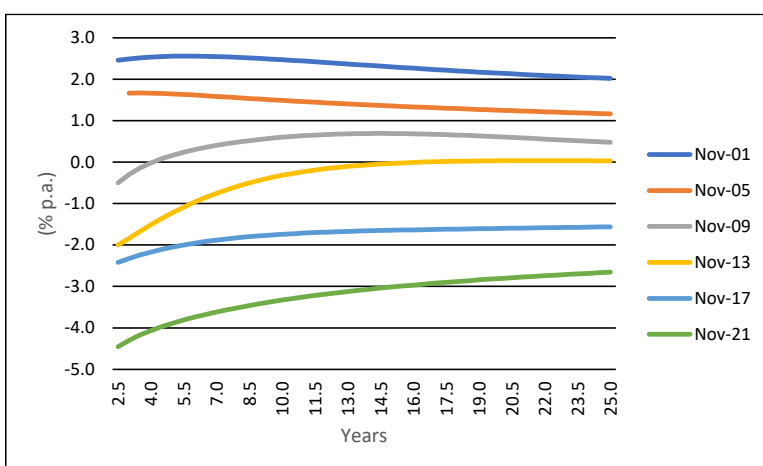
Figure 1a shows the profile of maturity payments, including the added-on inflation element since each bond was issued. The total amount is £494bn (£363bn when issued, plus £131bn from inflation), which compares with a market value of £926bn. The average coupon is now down to 0.7%. Long-dated ILG real yields first went negative in late 2011

(yes, we’ve had this oddity for a decade now). From then on, issuing ILGs at par would have led to investors paying income to the Government, rather than the other way round, so the default has been to use  $\frac{1}{8}\%$  as the coupon, and accepting that investors pay more than £100 for the initial £100 protected against inflation. It was noticeable that this month’s new ultra-long 2073 maturity had a real yield of *minus* 2.39%, and thus required investors to pay a whopping **£356** to have an initial £100 protected against inflation.

**Figure 1a: Profile by year of maturity**



**Figure 1b: The evolution of the real yield curve**



In Figure 1b the spot curve is used for real yields, although the Bank of England originally only published through to 25 years. The movement over the past 20 years has been pretty relentless.

Issues around implied future inflation were covered in our [August 2021](#) issue. Since then, we now have the prospect of the Bank of England ceasing to add to its Quantitative Easing (QE) portfolio which may lead to both rising nominal and real yields. If they go to the next stage of starting to gradually unwind the portfolio, how much further damage will this do to gilt and ILG valuations?

Bear in mind the QE portfolio is now 48% of the conventional gilt market so any unwinding could have a dramatic effect, unless pension funds continue to buy at any price.

Sources: DMO, Bank of England



## 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 November 2021**

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	<b>-2.2</b>	<b>-1.4</b>	17.4	5.3	5.5	7.3	6.0
Overseas Equities	1.2	2.3	20.7	15.5	13.6	14.4	9.1
US Equities	2.4	4.9	<b>28.0</b>	<b>19.4</b>	<b>16.8</b>	<b>18.3</b>	7.9
Europe ex UK Equities	<b>-1.9</b>	<b>-2.2</b>	16.3	12.3	11.1	11.0	9.9
Japan Equities	0.5	0.1	4.6	7.0	7.2	10.5	5.8
Pacific ex Japan Equities	<b>-0.7</b>	<b>-2.4</b>	4.2	10.0	9.1	9.8	<b>10.9</b>
Emerging Markets	<b>-0.6</b>	<b>-3.2</b>	4.0	8.3	8.7	7.4	10.7
UK Long-dated Gilts	5.3	3.9	0.3	9.2	5.9	6.6	6.7
UK Long-dated Corp. Bonds	2.4	0.5	0.5	10.7	6.7	7.9	6.7
UK Over 5 Yrs Index-Linked Gilts	<b>6.7</b>	<b>6.8</b>	11.5	11.0	7.1	8.0	8.0
High Yield (Global)	1.8	0.7	3.0	5.3	4.6	8.4	8.0
Overseas Bonds	3.7	1.6	<b>-4.1</b>	2.5	1.6	2.9	4.7
Property *	1.5	4.9	14.7	4.7	6.8	8.1	7.5
Cash	0.0	0.0	0.1	<b>0.4</b>	<b>0.5</b>	<b>0.5</b>	<b>2.1</b>
Commodities £-converted	<b>-7.6</b>	4.1	39.5	1.4	1.1	<b>-4.7</b>	<b>-0.1</b>
Hedge Funds original \$ basis *	1.3	1.8	23.0	10.1	7.6	5.7	6.1
Illustrative £-converted version *	<b>-0.3</b>	3.3	16.1	7.5	5.2	7.4	6.4
Euro relative to Sterling	0.8	<b>-0.8</b>	<b>-5.0</b>	<b>-1.4</b>	0.0	<b>-0.1</b>	1.5
US \$ relative to Sterling	3.6	4.0	0.9	<b>-1.2</b>	<b>-1.1</b>	1.7	0.4
Japanese Yen relative to Sterling	4.0	0.6	<b>-7.3</b>	<b>-1.2</b>	<b>-1.1</b>	<b>-2.1</b>	0.8
Sterling trade weighted	<b>-1.3</b>	<b>-0.4</b>	3.4	1.5	0.8	0.1	<b>-1.0</b>
Price Inflation (RPI) *	1.1	2.1	6.0	3.1	3.3	2.7	3.0
Price Inflation (CPI) *	1.1	2.1	4.1	2.1	2.3	1.9	2.2
Price Inflation (RPIX) *	1.1	2.2	6.1	3.3	3.4	2.8	3.0
Earnings Inflation **	<b>-0.2</b>	<b>-1.3</b>	4.1	3.6	3.3	2.5	2.9
All Share Capital Growth	<b>-2.5</b>	<b>-2.0</b>	13.6	1.7	1.7	3.6	2.4
Dividend Growth	0.3	5.2	<b>-1.7</b>	<b>-6.8</b>	<b>-0.8</b>	2.5	3.4
Earnings Growth	6.8	14.1	65.0	<b>-2.0</b>	18.5	0.0	4.6

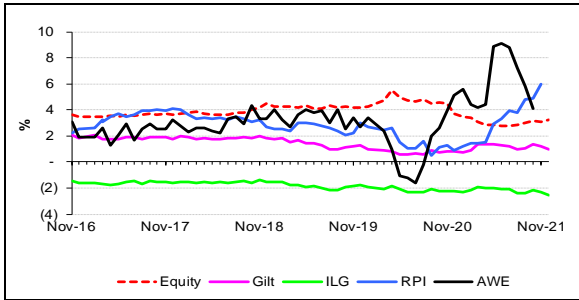
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

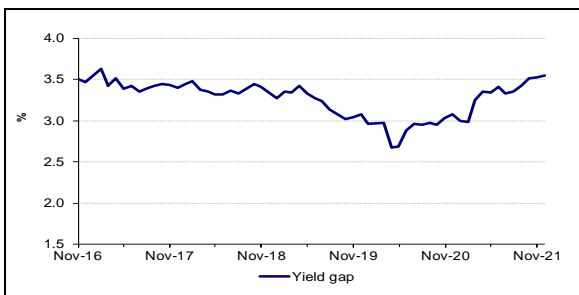


## Yields and Yield Gaps

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.

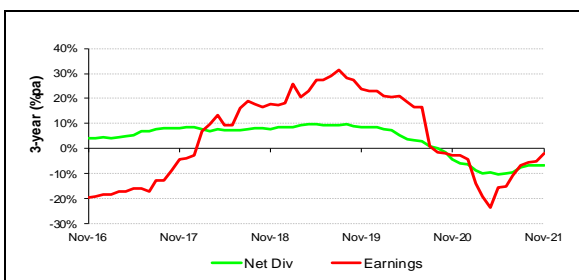
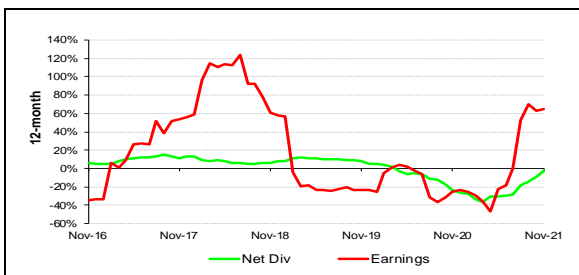


The gap gives a current expectation around 3.6% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

## 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]

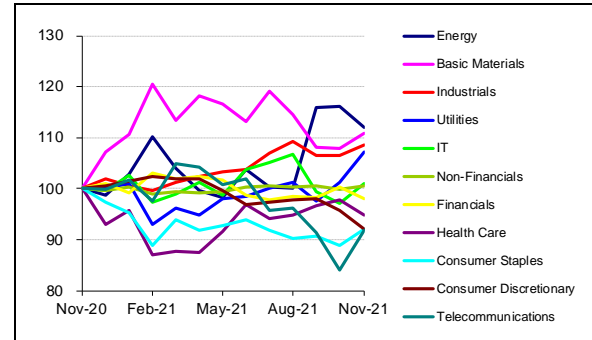
Figure 3: Dividend & Earnings Growth



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



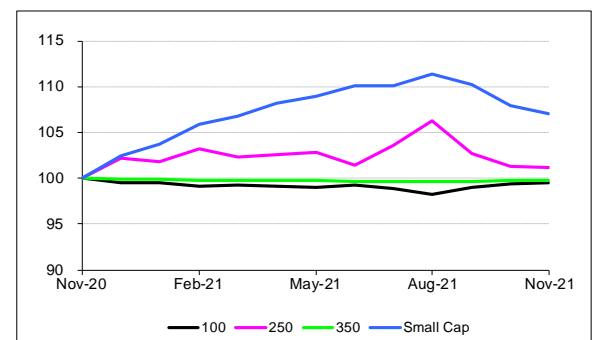
Note: Sector labels for relative lines are in end-value order

There was a large drop this month in the rolling 12-month sector dispersion (falling from 49% to 20%).

(% absolute return)	1 mth	3 mth	12 mth
Energy	-5.6	10.5	31.6
Basic Materials	0.4	-4.6	30.0
Industrials	-0.3	-2.1	27.5
Consumer Staples	1.3	0.6	8.0
Health Care	-5.2	-1.3	11.4
Consumer Discretionary	-6.1	-7.3	8.0
Telecommunications	6.8	-6.1	7.7
Utilities	3.6	4.4	25.9
Non-Finan	-1.5	-1.3	18.0
Financials	-4.6	-1.8	15.1
IT	1.7	-6.6	18.6
All Share	-2.2	-1.4	17.4

## UK Equity Size Returns

Figure 4b: Size groups relative to All Share



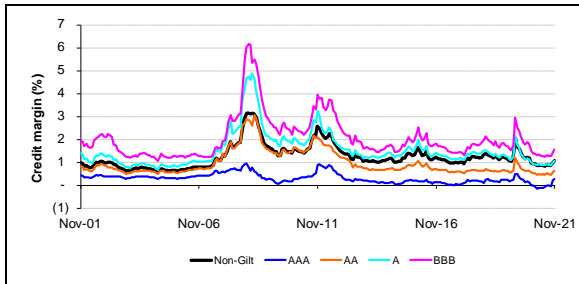
This month, Mid Cap and Small Cap both fell slightly relative to the All Share.

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 (%)
Jun '21	1.86	1.23	0.63
Jul '21	1.62	1.00	0.62
Aug '21	1.65	1.07	0.58
Sep '21	2.01	1.39	0.62
Oct '21	1.78	1.19	0.59
Nov '21	<b>1.64</b>	<b>1.00</b>	<b>0.64</b>

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

Category	Mkt Val (£bn @ Nov 21 & 18, 15)			Weight (%)
Gilts (54)	1,858	1,295	1,227	73.6
Non-Gilts (1,179)	667	566	535	26.4
AAA (131)	130	118	97	5.1
AA (144)	80	82	97	3.1
A (383)	191	157	158	7.6
BBB (521)	267	208	183	10.6

Category	Mkt Val (£bn @ Nov 21, 18)		W't (%)	Dur'n (yrs)
Gilts (54)	1,858	1,295	73.6	13.3
< 5 Yrs (13)	446	351	17.7	3.0
5-15 Yrs (15)	541	345	21.4	8.3
> 15 Yrs (26)	870	599	34.5	21.7
Non-Gilts (1,179)	667	566	26.4	7.9
< 5 Yrs (431)	237	189	9.4	2.9
5-15 Yrs (514)	276	242	10.9	7.3
> 15 Yrs (234)	154	135	6.1	16.8

**Tables 2d, 2e: € Market Size and Maturity (Nov 21)**

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (435)	7,807	59.1
Non-Sovereigns	5,412	40.9
AAA (1,009)	1,399	10.6
AA (779)	1,311	9.9
A (1,308)	1,154	8.7
BBB (1,933)	1,547	11.7

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,338)	2,718	20.6
3 – 5 Yrs (1,334)	2,616	19.8
5 – 7 Yrs (1,055)	2,092	15.8
7 – 10 Yrs (933)	2,311	17.5
10+ Yrs (804)	3,482	26.3

**Table 2f: Breakdown of £ Index-Linked Market**

Category (Number of issues)	Mkt Val (£bn @ Nov 21 & 18)		W't (%)	Dur'n (yrs)
Gilts (32)	926	658	100.0	21.9
< 5 Yrs (4)	92	59	9.9	2.5
5 – 15 Yrs (9)	230	160	24.9	9.9
> 15 Yrs (19)	604	440	65.3	29.4

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

Month End	US (%)	Euro (%)	Sterling (%)
Jun '21	4.21	2.61	4.14
Jul '21	4.23	2.60	4.18
Aug '21	4.18	2.58	4.18
Sep '21	4.25	2.69	4.32
Oct '21	4.40	2.94	4.65
Nov '21	<b>4.73</b>	<b>3.14</b>	<b>4.84</b>

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

**£ 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.

