



Investment Update April 2021

Investment Headlines & Comment

- A good month for most equity markets.
- Investment grade credit margins have now halved in 12 months.
- **£69.4bn** of demand for the new 30-year gilt maturing in 2051.

Feature Section

This month we update our past feature on corporate debt default rates, using the Standard & Poor's annual survey, which now covers data to the end of 2020.

It therefore now includes the pandemic. The main Covid casualties so far have been in the Consumer Services, Energy and Resources sectors, and more Covid-related defaults may sadly well emerge in 2021.

Figure 1a: Average Cumulative Default Rates (%)
(Extracts from "Table 24" in S&P)

Time	1 year	5-year	10-year
Investment grade	0.09	0.86	1.88
AAA	0.00	0.34	0.70
AA	0.02	0.30	0.70
A	0.05	0.46	1.20
BBB	0.16	1.54	3.24
High Yield	3.71	14.64	20.81
BB	0.63	6.43	11.64
B	3.34	17.35	24.62
CCC/C	28.30	48.58	52.76
All ratings	1.53	6.25	9.12

Source: Standard & Poor's (also for the Figures below)

Figure 1a shows historical default rates averages across global corporate bonds in 1-, 5- and 10-year versions. The dataset covers 1981-2020 (and the 5- and 10-year figures use rolling sets of overlapping periods, not successive distinct ones), but it does not show comparable recovery rate statistics. However, as per our Figure 5 (on page 4) for Sterling investment grade bonds, actual default rates have been below those priced into yields, even if with no recovery. For example, over the last 20 calendar years, the iBoxx All-Dated Non-Gilts Index returned 5.9% p.a. vs 5.4% p.a. for the FT-A All-Dated Gilt Index. This gap may look smaller than the c.1% p.a. you might expect, but the Gilt index has longer maturity, so its greater gain from the prolonged fall in yields offsets about half of the credit margin from the Corporate Bond index.

Figure 1b shows 2020's moves in isolation (row = start rating, column = end rating). For investment grade it was a fair year. Most bonds retain the same credit rating at the end of the year as at the start, hence a dominant diagonal for the figures in bold. Eventually there is a *sharp* decline on the CCC row, reflecting a greater instability for bonds that have got that close to the edge – in 2019, around 30% of CCC bonds defaulted, but that jumped to 47% in 2020. In 2020, there were 10 defaulted entities originally rated investment grade by S&P, and the time between first rating and date of default averaged 21.8 years. Figure 1c gives an alternative way of looking at the 1-year data from Figure 1a, with the minimum and maximum 1-year default rates by credit rating, which in turn renews the question on what level of

Figure 1b: Global Credit Rating Transitions % in 2020 in isolation
(Extracts from "Table 20" in S&P, with D = Default, N.R. = not rated)

	AAA	AA	A	BBB	BB	B	CCC	D	N.R.
AAA	100.00	-	-	-	-	-	-	-	-
AA	-	87.27	9.63	-	-	-	-	-	3.11
A	-	-	92.88	4.05	-	0.07	-	-	3.00
BBB	-	0.05	0.59	90.13	4.47	0.22	-	-	4.53
BB	-	-	-	0.78	78.20	11.40	0.85	0.93	7.84
B	-	-	-	0.05	0.96	71.99	12.56	3.51	10.92
CCC	-	-	-	-	-	5.46	34.45	47.48	12.61

Figure 1c: Profile of individual year default percentages
(Extracts from "Table 4" in S&P)

	AAA	AA	A	BBB	BB	B	CCC
Minimum	0.00	0.00	0.00	0.00	0.00	0.25	0.00
Maximum	0.00	0.38	0.39	1.02	4.24	13.84	49.46
Average	0.00	0.02	0.05	0.16	0.63	3.34	28.30

yield as an allowance for future defaults. (If you do not yet hold the bonds, or expect to reinvest maturing proceeds, there may be an argument for reducing the yield for the risk that credit margins contract before you actually buy the bonds, but that remains quite a separate issue.) Finally, with nominal yields on BB-B rated bonds at or near historic lows for bonds denominated in US \$, the € and Sterling, investors are going to need to watch closely as to whether they are still sufficiently incentivised to take on the additional credit risk relative to that offered on investment grade.



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 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	4.1	10.4	25.7	2.4	6.9	6.1	5.2
Overseas Equities	4.0	8.9	33.9	14.2	16.2	12.2	8.0
US Equities	5.0	11.5	34.8	19.0	19.2	16.5	6.7
Europe ex UK Equities	4.4	9.4	34.4	8.7	12.2	7.7	8.7
Japan Equities	-2.0	0.6	19.3	5.4	10.8	9.5	4.3
Pacific ex Japan Equities	2.6	1.9	37.4	10.0	15.1	8.4	10.9
Emerging Markets	1.4	0.2	35.0	7.5	14.0	5.8	10.4
UK Long-dated Gilts	1.0	-8.8	-14.3	4.4	5.5	7.7	6.6
UK Long-dated Corp. Bonds	1.7	-5.5	0.1	6.8	7.2	7.9	7.1
UK Over 5 Yrs Index-Linked Gilts	0.4	-3.4	-2.4	4.7	7.0	7.9	7.4
High Yield (Global)	1.2	0.5	11.2	6.3	8.4	8.0	7.9
Overseas Bonds	0.8	-4.0	-8.5	3.0	3.2	3.4	4.8
Property *	1.1	2.2	2.6	2.7	4.6	7.5	7.2
Cash	0.0	0.0	0.1	0.6	0.5	0.6	2.2
Commodities £-converted	7.1	15.3	62.8	-4.4	1.8	-6.6	-2.2
Hedge Funds original \$ basis *	0.8	5.8	33.8	7.6	7.5	4.6	5.9
Illustrative £-converted version *	2.2	4.8	20.2	8.2	8.4	6.2	6.0
Euro relative to Sterling	1.9	-1.8	0.0	-0.3	2.1	-0.2	1.7
US \$ relative to Sterling	-1.1	-1.5	-9.6	-0.4	1.0	1.8	0.1
Japanese Yen relative to Sterling	0.3	-5.4	-11.2	-0.3	0.6	-1.2	0.8
Sterling trade weighted	-1.3	1.7	2.6	0.7	-1.3	0.2	-1.0
Price Inflation (RPI) *	0.3	0.5	1.5	2.2	2.6	2.5	2.8
Price Inflation (CPI) *	0.3	0.2	0.7	1.4	1.8	1.7	2.0
Price Inflation (RPIX) *	0.3	0.5	1.6	2.3	2.7	2.6	2.9
Earnings Inflation **	0.7	3.7	4.2	3.3	2.9	1.9	2.6
All Share Capital Growth	3.8	9.2	21.9	-1.2	3.1	2.3	1.6
Dividend Growth	3.1	-9.6	-30.9	-9.6	-2.5	2.1	2.5
Earnings Growth	-14.9	-23.5	-46.8	-23.5	0.5	-6.2	0.0

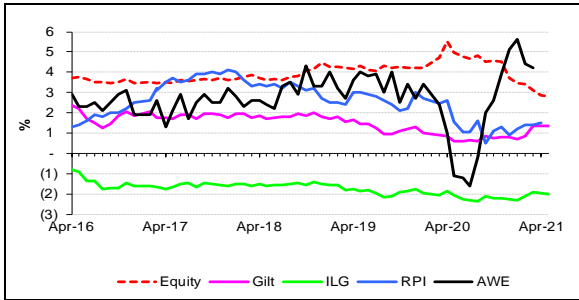
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

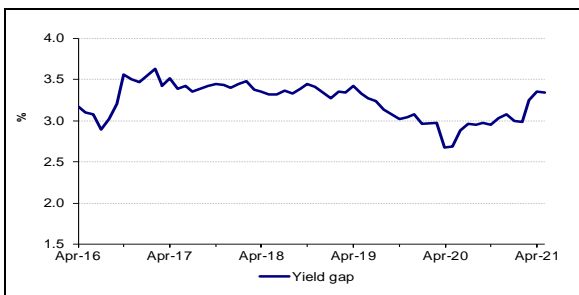


Yields and Yield Gaps

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.

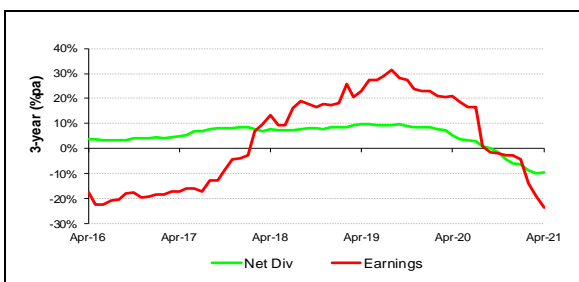
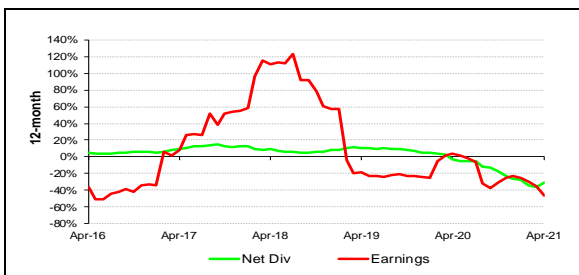


The gap gives a current expectation around 3.3% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

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]

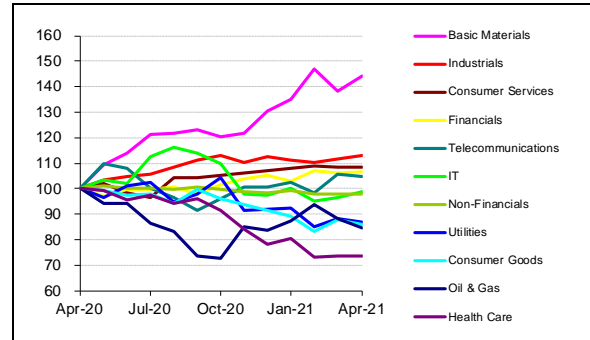
Figure 3: Dividend & Earnings Growth



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



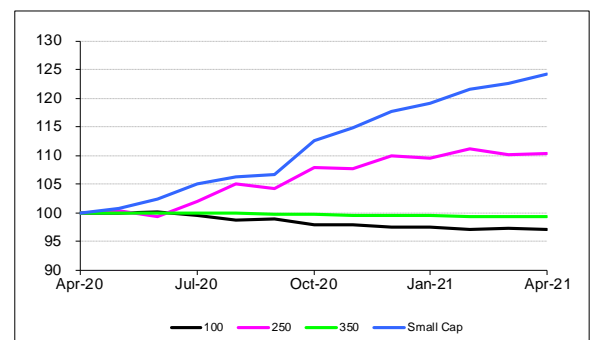
Note: Sector labels for relative lines are in end-value order

There was a rise this month in the rolling 12-month sector dispersion (up from 61% to 70%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-0.3	7.1	6.4
Basic Materials	8.5	17.9	81.0
Industrials	5.4	12.4	42.1
Consumer Goods	1.8	6.2	8.0
Health Care	3.9	1.0	-7.6
Consumer Services	4.2	10.9	36.2
Telecommunications	3.4	13.1	31.8
Utilities	2.5	3.5	9.0
Non-Financials	4.0	9.2	23.1
Financials	4.7	14.2	33.9
IT	6.5	9.0	24.3
All Share	4.1	10.4	25.7

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



This month, Mid Cap and Small Cap both rose 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

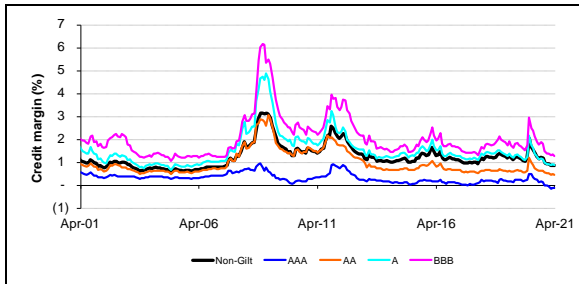


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Nov '20	1.52	0.82	0.70
Dec '20	1.34	0.70	0.64
Jan '21	1.51	0.85	0.66
Feb '21	1.97	1.34	0.63
Mar '21	2.02	1.37	0.65
Apr '21	1.94	1.33	0.61

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

Category	Mkt Val (£bn @ Apr 21 & 18, 15)			Weight (%)
Gilts (50)	1,715	1,325	1,198	72.3
Non-Gilts (1,167)	656	565	543	27.7
AAA (130)	122	108	99	5.2
AA (148)	79	75	93	3.3
A (370)	186	163	177	7.9
BBB (519)	268	219	174	11.3

Category	Mkt Val (£bn @ Apr 21, 18)		W't (%)	Dur'n (yrs)
Gilts (50)	1,715	1,325	72.3	12.6
< 5 Yrs (12)	423	358	17.8	2.9
5-15 Yrs (15)	539	366	22.7	8.3
> 15 Yrs (23)	753	600	31.7	21.1
Non-Gilts (1,167)	656	565	27.7	7.8
< 5 Yrs (417)	225	181	9.5	2.8
5-15 Yrs (517)	281	236	11.8	7.4
> 15 Yrs (233)	150	148	6.3	16.3

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (418)	7,497	59.0
Non-Sovereigns	5,208	41.0
AAA (987)	1,379	10.9
AA (776)	1,208	9.5
A (1,238)	1,109	8.7
BBB (1,837)	1,512	11.9

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,259)	2,682	21.1
3 – 5 Yrs (1,305)	2,508	19.7
5 – 7 Yrs (1,058)	2,101	16.5
7 – 10 Yrs (882)	2,149	16.9
10+ Yrs (752)	3,265	25.7

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Apr 21 & 18)		W't (%)	Dur'n (yrs)
Gilts (30)	778	648	100.0	21.4
< 5 Yrs (4)	87	59	11.2	3.0
5 – 15 Yrs (8)	181	150	23.3	9.6
> 15 Yrs (18)	509	439	65.4	28.7

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

Month End	US (%)	Euro (%)	Sterling (%)
Nov '20	4.65	2.85	4.47
Dec '20	4.38	2.74	4.32
Jan '21	4.43	2.74	4.20
Feb '21	4.44	2.69	4.12
Mar '21	4.47	2.65	4.13
Apr '21	4.35	2.66	4.08

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.

