



## Investment Update January 2022

### Investment Headlines & Comment

- A poor month worldwide for many asset classes.
- UK Property was a notable exception, continuing its rally.
- UK nominal gilt yields rose in anticipation of rate rises.

### Feature Section

This month, we consider how prospective and actual Retail Price Index (RPI) inflation have evolved for the UK since the mid 1980s. There is an argument for using a longer data set but the cut off is justified by the significant change in mindset by US and UK governments in the early 1980s on the importance of controlling inflation.

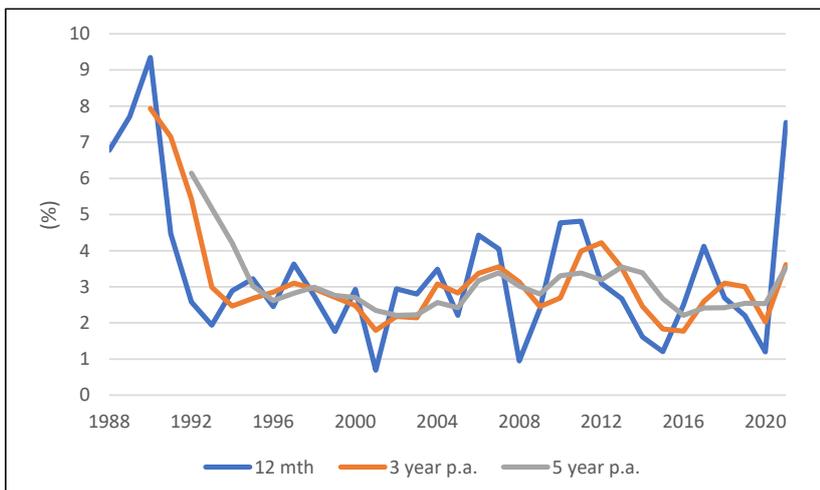
Figure 1a shows a crude measure of the prospective inflation that was expected, derived as the gap between 20-year gilt yields and the real yield on over 15-year index-linked gilts. It is a stark reminder of just how much of a change in market expectations took place in the 1990s, and the comparative stability that there has been since then.

**Figure 1a: Prospective inflation**



Source: FTSE (quarterly data)

**Figure 1b: Actual inflation**



Source: ONS (calendar year data)

It is also worth flagging that the more recent values are arguably *overstated* by the comparatively small size of the Index-Linked Gilt market and the demand created by Liability Driven Investment (LDI) approaches.

Figure 1b shows the sequence of actual inflation for each year since the ONS's current RPI series started, and also the annualized versions for rolling 3- and 5-year periods. What is striking about the yearly series is just how much oscillation there has been, with inflation varying between being unusually high and unusually low, across a wide range of global events. The extent to which this is smoothed out on a 3-year view is clear, with a 5-year view adding more smoothing, though perhaps not as much as might have been expected. There is a marked absence of periods where inflation stays unduly high or unduly low.

There's no getting away from the fact that the current inflation spike is big, fuelled by the triple shocks of Brexit, the pandemic and current energy supply issues. However, central banks have scope to raise interest rates and/or release some of their Quantitative Easing (QE) portfolios back into the market, and this may be sufficient to dampen things down. Only time will tell.



**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 31 January 2022**

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	-0.3	2.0	18.9	6.8	5.4	7.4	6.3
Overseas Equities	-4.1	-1.4	16.2	15.6	12.0	13.5	9.0
US Equities	-4.7	-0.8	<b>23.8</b>	<b>20.0</b>	<b>15.3</b>	<b>17.3</b>	7.9
Europe ex UK Equities	-5.2	-3.7	14.0	12.1	9.0	10.5	9.7
Japan Equities	-3.9	-3.7	-0.1	7.0	5.5	9.5	6.3
Pacific ex Japan Equities	-3.0	-3.7	-5.8	8.5	7.6	8.4	<b>10.3</b>
Emerging Markets	-1.0	-2.0	-4.8	6.9	7.3	6.2	9.9
UK Long-dated Gilts	<b>-6.6</b>	<b>-6.6</b>	<b>-10.7</b>	2.6	3.4	5.1	6.2
UK Long-dated Corp. Bonds	-6.0	<b>-6.8</b>	-9.1	4.9	4.4	6.4	6.2
UK Over 5 Yrs Index-Linked Gilts	-3.0	-2.8	4.5	6.4	4.4	6.6	7.6
High Yield (Global)	-1.8	-0.7	0.9	4.5	3.5	7.5	7.8
Overseas Bonds	-0.9	-0.2	-4.8	1.0	0.9	2.3	4.7
Property *	<b>3.9</b>	<b>7.9</b>	19.9	6.6	7.7	8.7	7.8
Cash	0.0	0.1	0.1	<b>0.4</b>	<b>0.5</b>	<b>0.5</b>	<b>2.1</b>
Commodities £-converted	12.7	9.4	52.8	8.1	4.0	<b>-3.1</b>	0.9
Hedge Funds original \$ basis *	1.2	0.4	10.2	10.8	7.1	5.8	5.8
Illustrative £-converted version *	<b>-1.2</b>	0.0	11.2	8.6	5.1	7.3	6.2
Euro relative to Sterling	<b>-0.5</b>	<b>-1.0</b>	<b>-5.6</b>	<b>-1.4</b>	<b>-0.6</b>	0.1	1.6
US \$ relative to Sterling	0.9	2.2	2.3	<b>-0.7</b>	<b>-1.3</b>	1.6	0.3
Japanese Yen relative to Sterling	0.9	1.1	<b>-7.0</b>	<b>-2.5</b>	<b>-1.7</b>	<b>-2.5</b>	1.0
Sterling trade weighted	0.2	0.3	3.6	1.5	1.2	0.1	<b>-1.0</b>
Price Inflation (RPI) *	1.1	2.9	7.5	3.6	3.5	2.9	3.1
Price Inflation (CPI) *	0.5	2.4	5.4	2.4	2.5	1.9	2.2
Price Inflation (RPIX) *	1.1	3.0	7.7	3.8	3.6	3.0	3.1
Earnings Inflation **	0.3	1.2	3.4	4.0	3.5	2.6	2.9
All Share Capital Growth	<b>-0.4</b>	1.5	15.1	3.1	1.7	3.6	2.6
Dividend Growth	<b>-3.9</b>	<b>-2.7</b>	0.3	<b>-8.7</b>	<b>-1.5</b>	2.4	3.2
Earnings Growth	<b>-8.1</b>	<b>-3.3</b>	51.5	<b>-5.6</b>	15.9	0.0	4.1

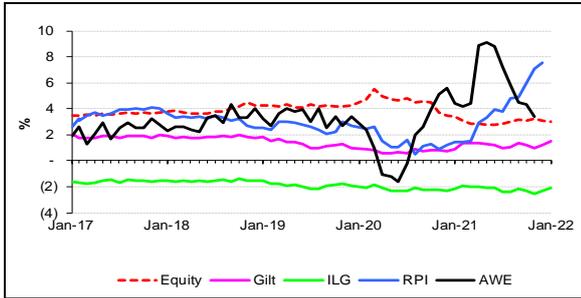
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

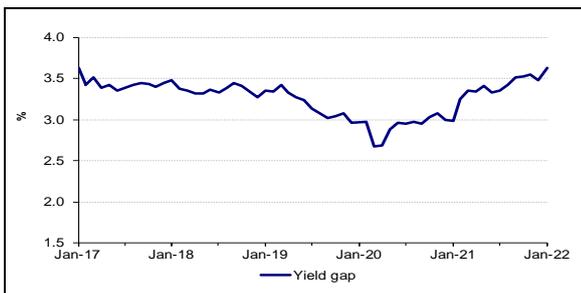


## Yields and Yield Gaps

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.

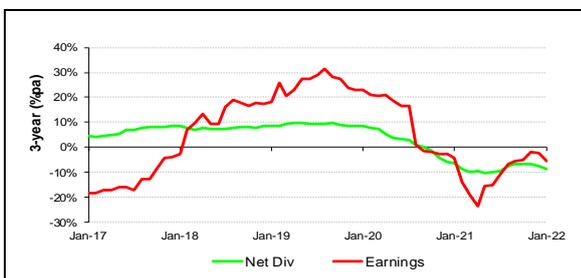
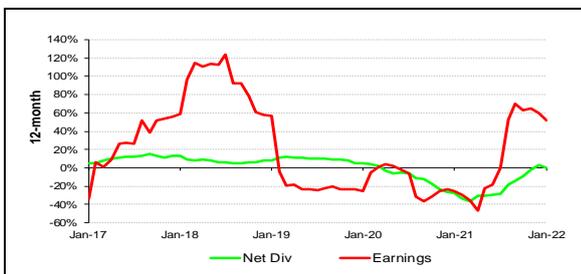


The gap gives a current expectation around 3.6% for longer-term inflation including the (unknown) risk premium for gilts, relative to index-linked gilts.

## 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]

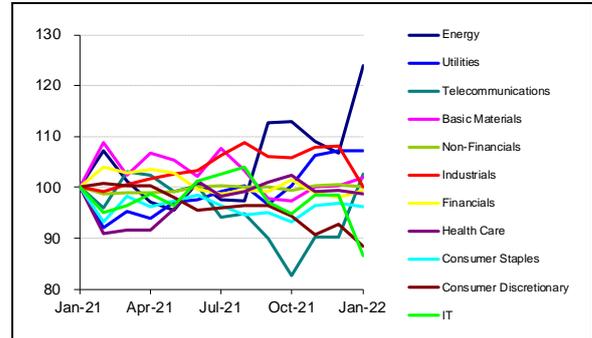
Figure 3: Dividend & Earnings Growth



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



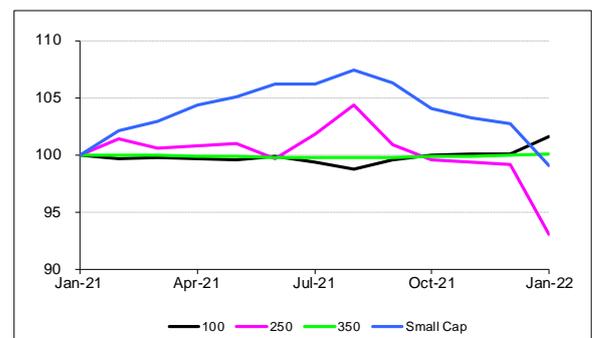
Note: Sector labels for relative lines are in end-value order

There was a rise this month in the rolling 12-month sector dispersion (up from 19% to 37%).

(% absolute return)	1 mth	3 mth	12 mth
Energy	15.8	11.9	47.3
Basic Materials	1.4	6.8	21.3
Industrials	-7.8	-3.6	18.9
Consumer Staples	-0.9	5.4	14.4
Health Care	-1.0	-1.5	17.4
Consumer Discretionary	-4.9	-4.3	5.1
Telecommunications	13.3	26.5	21.9
Utilities	-0.4	9.0	27.4
Non-Finan	-0.7	2.6	19.0
Financials	1.0	0.0	18.1
IT	-12.4	-6.8	2.9
All Share	-0.3	2.0	18.9

## UK Equity Size Returns

Figure 4b: Size groups relative to All Share



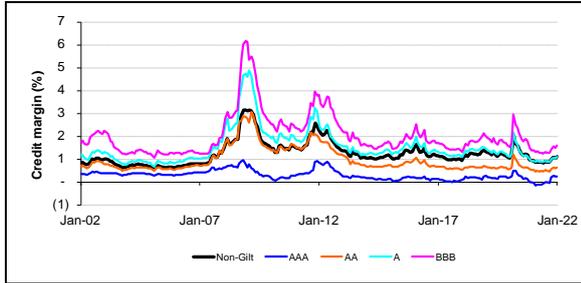
This month, Mid Cap and Small Cap both fell relative to the All Share.

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 (%)
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	1.64	1.00	0.64
Dec '21	1.89	1.20	0.69
Jan '22	<b>2.25</b>	<b>1.52</b>	<b>0.73</b>

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

Category	Mkt Val (£bn @ Jan 22 & 19, 16)			Weight (%)
Gilts (55)	1,741	1,339	1,261	73.6
Non-Gilts (1,158)	625	563	522	26.4
AAA (128)	120	111	97	5.1
AA (141)	75	81	93	3.2
A (378)	179	152	155	7.6
BBB (511)	250	219	176	10.6

Category	Mkt Val (£bn @ Jan 22, 19)		W't (%)	Dur'n (yrs)
Gilts (55)	1,741	1,339	73.6	12.5
< 5 Yrs (13)	442	350	18.7	2.8
5-15 Yrs (16)	523	351	22.1	8.1
> 15 Yrs (26)	776	638	32.8	20.9
Non-Gilts (1,158)	625	563	26.4	7.7
< 5 Yrs (442)	241	188	10.2	3.1
5-15 Yrs (484)	246	234	10.4	7.4
> 15 Yrs (232)	138	141	5.8	16.1

**Tables 2d, 2e: € Market Size and Maturity (Jan 22)**

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (434)	7,606	58.8
Non-Sovereigns	5,332	41.2
AAA (1,014)	1,378	10.7
AA (792)	1,296	10.0
A (1,327)	1,143	8.8
BBB (1,935)	1,514	11.7

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,361)	2,758	21.3
3 – 5 Yrs (1,339)	2,601	20.1
5 – 7 Yrs (1,057)	2,074	16.0
7 – 10 Yrs (942)	2,236	17.3
10+ Yrs (803)	3,269	25.3

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

Category (Number of issues)	Mkt Val (£bn @ Jan 22 & 19)		W't (%)	Dur'n (yrs)
Gilts (32)	852	678	100.0	20.9
< 5 Yrs (4)	91	59	10.7	2.3
5 – 15 Yrs (9)	222	159	26.0	9.6
> 15 Yrs (19)	540	460	63.3	28.7

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

Month End	US (%)	Euro (%)	Sterling (%)
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	4.73	3.14	4.84
Dec '21	4.46	2.99	4.80
Jan '22	<b>5.09</b>	<b>3.38</b>	<b>5.22</b>

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

**£ Gilt Market “main” Issuance**

- £3.00bn, <sup>3</sup>/<sub>8</sub>% 2026 (2.37x, 0.99%, 0%, Oct '21)
- £3.13bn, <sup>1</sup>/<sub>2</sub>% 2029 (2.39x, 1.11%, 25%, Nov '21)
- £0.60bn, <sup>1</sup>/<sub>8</sub>% IL 2051 (2.04x, -2.19%, 0%, Oct '21)

Note: Issuance amounts are nominals. The second % figure in each row is the yield or real yield. The third % 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.

