



Investment Update December 2022

Investment Headlines & Comment

- A down month for 2022 to end on for almost all asset classes.
- A rather mixed month for Sterling, but overall a negative.
- 2022's main UK development was the collapse in bond values.

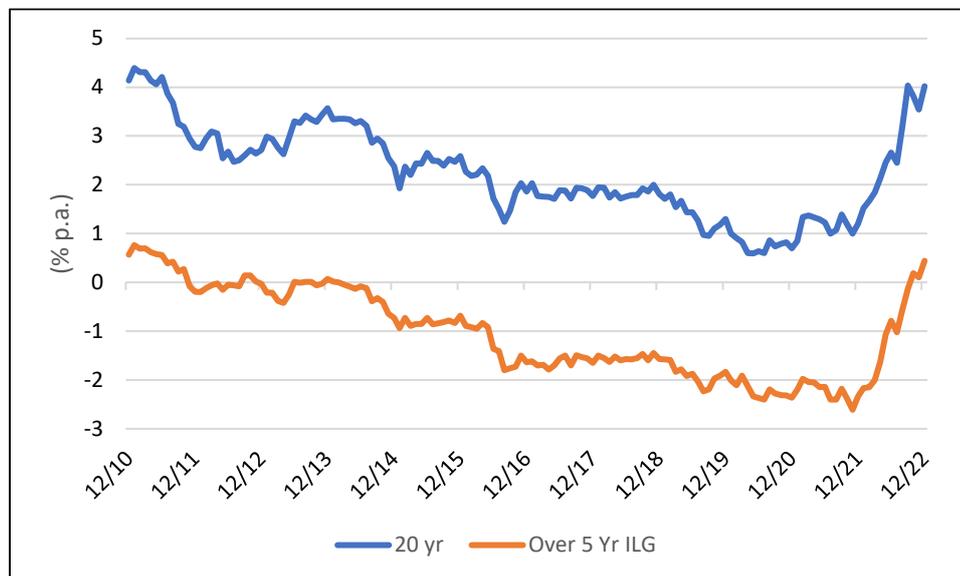
Feature Section This month we look at the levels nominal and real UK gilt yields have reverted to, following the significant change in market sentiment during 2022, and we consider when these yield levels were last seen, and how markets have evolved in the intervening period.

One of the striking things from Table 2b (on page 4) is the apparent lack of change in the *market* value for UK conventional gilts at the year ends for 2022, 2019 and 2016. However, if you look at the nominal value, the amount that has to be repaid in due course, this jumps from £1,165bn at the end of 2019 to £1,722bn at the end of 2022. Of course, much of this is due to Covid expenditure, but as has been shown in our [November 2022](#) edition, ongoing government borrowing isn't exactly helping.

The UK 20-year gilt yield has ended 2022 at 4.02%, a month-end level last seen in May 2011 (ignoring the yield seen in the 2022 mini budget fiasco) and readers may remember 2011 was when there was a post-credit-crunch Eurozone crisis. Many cans have been kicked down the proverbial road since then. In terms of real yields, the Over 5 Year index-linked real yield ended 2022 at +0.44%, a month-end level also last seen in mid 2011.

For completeness, therefore, Figure 1 below shows the movement in these two yield measures since the end of 2010. There is little doubt that much of the trend seen in the first 10-11 years of the chart comes from blind obsession with Liability Driven Investment (LDI) for UK pension funds, by the Regulator, many consultancies, and many professional trustee firms. To be fair, those pension schemes that implemented LDI early enough may still be "ahead", given that low borrowing costs and strong market returns (albeit mainly through Quantitative Easing support) will have been enough to offset their losses in 2022. However, for many schemes pressured into LDI (or into increasing hedging levels) at a later stage, the degree of £ damage may have been considerable. Selective "LDI was a positive influence" case studies, as presented to the [Work and Pensions Committee](#) in December 2022, have unfortunately to be described as disingenuous at best.

Figure 1: The gilt bubble and its bursting



Source: FT

So, what are the next gilt-related headaches to deal with? Two are staring out at us at the moment – first, defining the maturity of a scheme by a fixed duration *regardless of where yield levels are* (i.e. saying 12 years just about made sense a year ago, but it doesn't now) and second, defining a self-sufficiency return as gilts + a fixed 0.5% p.a., *regardless of where corporate bond credit margins are on corporate bonds of comparable maturity to the liabilities.*

Time to find a dark corner for a lie down as the pensions world continues to be, frankly, bonkers.



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 December 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	-1.4	8.9	0.3	2.3	2.9	6.5	7.6
Overseas Equities	-4.8	1.8	-7.8	8.2	8.5	12.2	10.5
US Equities	-6.8	-0.5	-9.1	10.8	11.8	15.9	9.2
Europe ex UK Equities	-0.6	12.0	-9.4	4.8	4.9	8.8	11.5
Japan Equities	-0.4	4.8	-4.8	2.7	2.8	9.3	7.1
Pacific ex Japan Equities	-1.3	4.0	-5.9	3.9	3.3	7.2	11.4
Emerging Markets	-2.3	1.9	-9.6	0.9	1.3	4.9	10.7
UK Long-dated Gilts	-8.4	-1.8	-40.1	-14.1	-6.6	0.3	3.5
UK Long-dated Corp. Bonds	-5.3	7.0	-34.4	-10.8	-4.4	1.6	4.0
UK Over 5 Yrs Index-Linked Gilts	-6.0	-7.5	-38.0	-10.1	-5.0	2.0	4.8
High Yield (Global)	-0.4	-0.7	-2.3	1.5	3.3	6.3	8.6
Overseas Bonds	-0.8	-4.0	-5.6	-1.9	0.3	2.2	4.1
Property *	-5.5	-13.6	-3.4	3.4	4.2	7.7	6.9
Cash	0.3	0.9	2.0	0.8	0.8	0.6	2.0
Commodities £-converted	-2.4	-4.0	41.9	14.1	9.0	-0.3	1.1
Hedge Funds original \$ basis *	1.2	0.1	-2.8	6.5	4.7	4.9	5.7
Illustrative £-converted version *	-2.2	-2.2	8.0	9.4	7.4	8.0	7.1
Euro relative to Sterling	2.6	1.1	5.7	1.5	0.0	0.9	1.6
US \$ relative to Sterling	-1.0	-7.2	12.6	3.3	2.4	3.1	1.5
Japanese Yen relative to Sterling	4.7	1.8	-1.7	-3.2	-0.8	-1.2	0.9
Sterling trade weighted	-1.4	1.9	-5.8	-1.3	-0.2	-0.7	-1.3
Price Inflation (RPI) *	0.6	3.8	14.0	7.2	5.4	3.8	3.6
Price Inflation (CPI) *	0.4	2.9	10.7	5.3	3.9	2.7	2.7
Price Inflation (RPIX) *	0.5	3.5	13.5	7.2	5.4	3.9	3.6
Earnings Inflation **	-0.1	0.6	6.1	4.7	4.2	3.1	3.0
All Share Capital Growth	-1.6	8.3	-3.2	-1.0	-0.7	2.8	3.9
Dividend Growth	0.4	1.5	12.5	-5.2	-0.7	2.9	4.0
Earnings Growth	-0.9	-19.6	-27.0	-3.6	1.4	-1.6	4.0

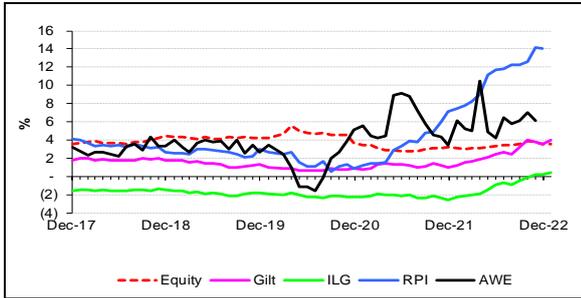
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

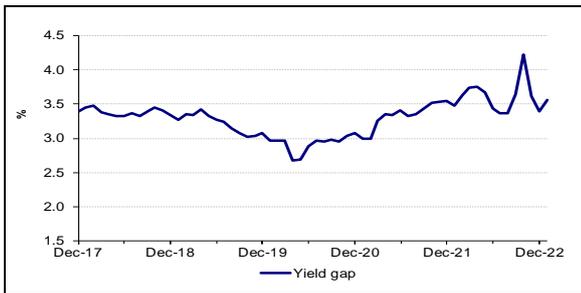


Yields and Yield Gaps

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.

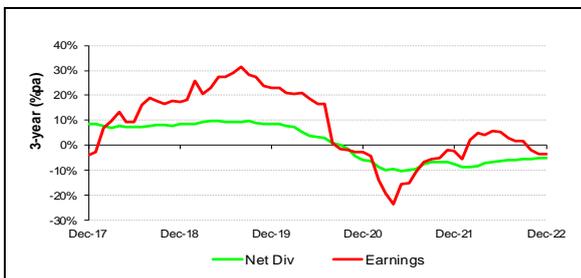
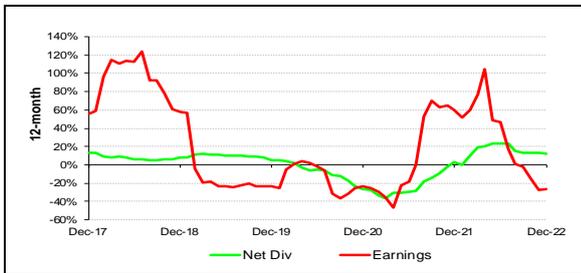


The gap gives a current expectation of around 3.6% p.a. for longer-term inflation including the (unknown) risk premium for gilts, relative to index-linked gilts.

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]

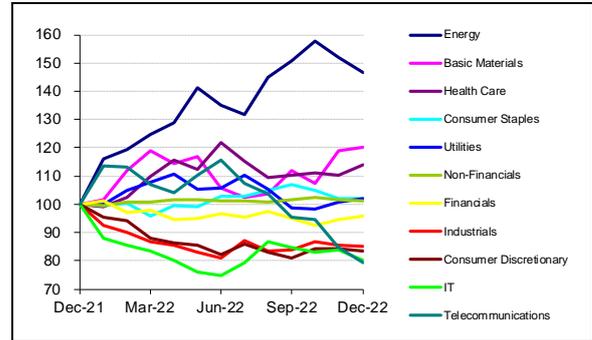
Figure 3: Dividend & Earnings Growth



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



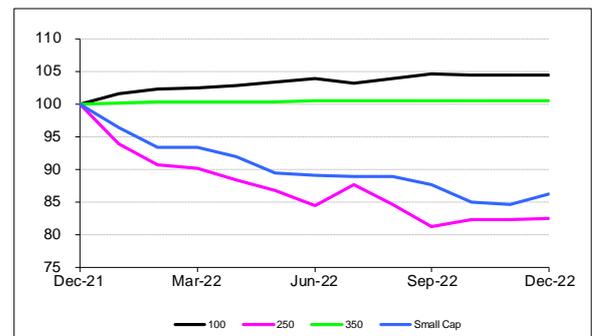
Note: Sector labels for relative lines are in end-value order

There was a small rise this month in the rolling 12-month sector dispersion (up from 65% to 68%).

(% absolute return)	1 mth	3 mth	12 mth
Energy	-4.7	5.9	47.1
Basic Materials	-0.4	16.8	20.4
Industrials	-2.0	10.3	-14.7
Consumer Staples	-1.6	3.5	2.2
Health Care	1.8	12.3	14.2
Consumer Discretionary	-2.5	11.7	-16.5
Telecommunications	-7.8	-9.6	-20.6
Utilities	-0.4	12.4	2.2
Non-Finan	-1.8	8.6	1.6
Financials	-0.2	9.8	-3.8
IT	-5.7	3.1	-19.7
All Share	-1.4	8.9	0.3

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



This month, Mid Cap was flat relative to the All Share but Small Cap rose.

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



Bond market information

Figure 5: £ Non-Gilt Credit Margins

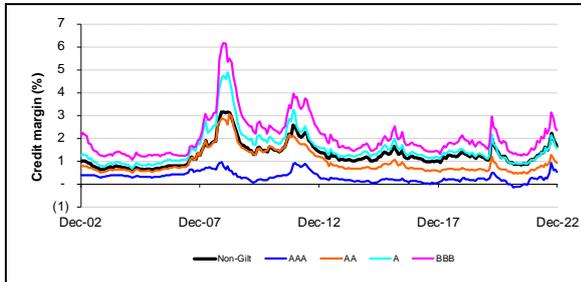


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Jul '22	3.45	2.45	1.00
Aug '22	4.18	3.20	0.98
Sep '22	5.07	4.03	1.04
Oct '22	4.68	3.82	0.86
Nov '22	4.26	3.54	0.72
Dec '22	4.72	4.02	0.70

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

Category	Mkt Val (£bn @ Dec 22 & 19, 16)			Weight (%)
	22	19	16	
Gilts (54)	1,390	1,381	1,341	71.9
Non-Gilts (1,216)	544	643	559	28.1
AAA (146)	119	133	110	6.1
AA (180)	72	88	92	3.7
A (401)	148	179	169	7.6
BBB (509)	205	242	187	10.6

Category	Mkt Val (£bn @ Dec 22, 19)		W't (%)	Dur'n (yrs)
Gilts (55)	1,390	1,381	71.9	9.9
< 5 Yrs (12)	403	310	20.8	2.6
5-15 Yrs (16)	478	402	24.7	7.7
> 15 Yrs (27)	510	670	26.4	17.8
Non-Gilts (1,216)	544	643	28.1	6.0
< 5 Yrs (502)	258	215	13.3	2.7
5-15 Yrs (486)	198	277	10.2	7.0
> 15 Yrs (228)	88	151	4.5	13.7

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

Category	Mkt Val (£bn)	Weight (%)
Sovereigns (448)	6,460	57.2
Non-Sovereigns	4,832	42.8
AAA (1,131)	1,482	13.1
AA (796)	970	8.6
A (1,449)	1,080	9.6
BBB (1,961)	1,300	11.5

Category	Mkt Val (£bn)	Weight (%)
1 – 3 Yrs (1,470)	2,748	24.3
3 – 5 Yrs (1,512)	2,544	22.5
5 – 7 Yrs (1,074)	1,828	16.2
7 – 10 Yrs (943)	1,849	16.4
10+ Yrs (786)	2,324	20.6

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Dec 22 & 19)		W't (%)	Dur'n (yrs)
Gilts (31)	569	729	100.0	16.9
< 5 Yrs (4)	95	94	16.7	2.7
5 – 15 Yrs (9)	191	152	33.6	9.6
> 15 Yrs (18)	283	483	49.7	26.7

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

Month End	US (%)	Euro (%)	Sterling (%)
Aug '22	7.64	6.51	9.07
Sep '22	8.69	7.85	11.39
Oct '22	8.21	7.37	10.86
Nov '22	7.86	6.72	10.07
Dec '22	8.17	7.11	10.32

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

£ Gilt Market “main” & “Green” Issuance

- £3.62bn, ¼% 2025 (2.11x, 3.81%, 11%, Nov '22)
- £4.06bn, 4½% 2027 (2.20x, 3.47%, 25%, Oct '22)
- £0.74bn, ½% IL 2031 (3.24x, -0.56%, 6%, Sep '22)
- £3.75bn, 1% 2032 (2.21x, 3.33%, 25%, Oct '22)
- £2.81bn, 1½% 2039 (2.25x, 3.51%, 25%, Jul '22)
- £2.81bn, 1¼% 2051 (2.10x, 3.41%, 25%, Oct '22)

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 Green Gilt (Gr), tender or syndication cases.

