



Investment Update August 2022

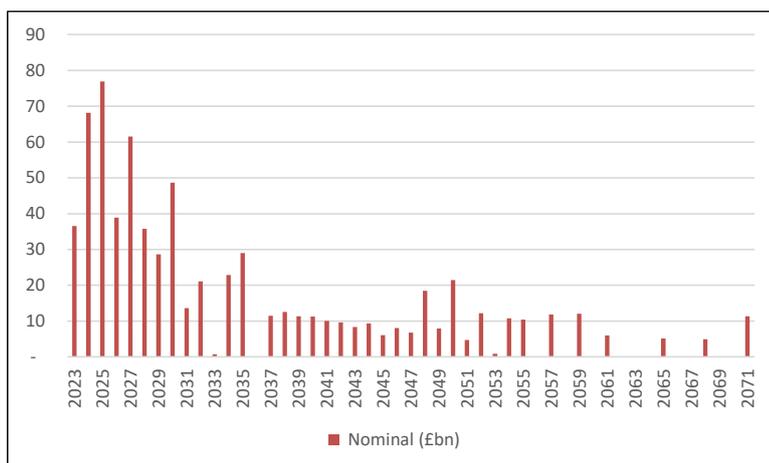
Investment Headlines & Comment

- The era of ultra-low global cash rates is disappearing rapidly.
- Sterling fell against both the Dollar and the Euro.
- Gilt nominal and real yields continued to rise.

Feature Section

This month, following on from last month's review of yield curve movements, we consider part of the [minutes](#) of the latest Bank of England Monetary Policy Committee (MPC) meeting, relating to when and how the Quantitative Easing (QE) portfolio is to be unwound. At the time of the meeting, that portfolio included £844bn of gilts and £19bn of corporate bonds. Figure 1 shows the profile for maturities in future tax years starting on each 6 April.

Figure 1: QE Maturity Profile



Source: Bank of England

so as not to disrupt the functioning of the financial markets, and in a relatively gradual and predictable manner over time. The MPC intends to commence gilt sales shortly after its September meeting, subject to economic and market conditions being judged appropriate, and with a confirmatory vote at that meeting.

Over the first twelve months, starting in September, the expected reduction in the QE portfolio is around £80bn. This is slightly below 10% of the nominal portfolio value, implying that the overall process is likely to take quite some time. Given the profile of maturing gilts over the 12-month period, it implies a sales programme of around £10bn per quarter, with details in a [provisional Market Notice](#). For subsequent years, the MPC intends to set an amount for the reduction in the QE portfolio over the subsequent twelve-month period, as part of an annual review. As such, the Committee can amend the design parameters of the sales programme as required, for example to take into account the variation in gilt maturities across those periods.

The Bank plans to set out a specific sales schedule once per quarter, accounting for prevailing market prices, the realised distribution of sales across the QE holdings in previous quarters, and the available operating dates in the quarter ahead. The Bank intends to sell gilts by holding regular multi-stock auctions, distributed evenly across short, medium and long maturity buckets. To avoid undue overlaps in gilt supply, the Bank will not sell a gilt that the Debt Management Office (DMO) has sold in the past 2 weeks, or that the DMO intends to sell in the coming 2 weeks. The Bank intends to ensure a sufficient gap between supply events of the same maturity.

There are a few caveats included about how the QE portfolio's direction of travel might be revised. For example, if potential movements in the Bank Rate alone are judged insufficient to meet the inflation target, or if markets were judged to be very distressed, the MPC would first consider amending or halting the sales programme before considering restarting reinvestments or making additional asset purchases.

The process of reducing the QE portfolio began rather tentatively in February 2022, when the Committee voted to cease gilt reinvestments (and to initiate sales of sterling non-financial investment-grade corporate bonds). The next such gilt holding affected is for a £5.9bn holding maturing in September 2022. However, thus far there had been no detail on when or how the QE gilts might actually be sold.

The Committee has stated a preference to use the Bank Rate as its primary active policy tool, so QE sales are to be viewed as very much secondary. They are to be conducted



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 August 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	-1.7	-3.6	1.0	3.9	3.3	6.8	7.1
Overseas Equities	0.9	2.5	-0.1	10.5	10.0	13.1	10.3
US Equities	0.5	4.3	2.9	14.0	14.0	16.6	8.4
Europe ex UK Equities	-2.2	-4.5	-13.8	3.3	3.4	9.1	11.4
Japan Equities	2.0	3.2	-3.7	4.3	4.3	10.1	6.4
Pacific ex Japan Equities	4.6	2.3	-3.4	6.9	4.9	8.8	11.1
Emerging Markets	5.1	1.5	-7.1	4.7	3.0	6.5	10.7
UK Long-dated Gilts	-12.0	-11.7	-32.1	-11.9	-4.1	1.6	4.3
UK Long-dated Corp. Bonds	-10.3	-10.7	-31.4	-9.2	-3.0	2.5	4.5
UK Over 5 Yrs Index-Linked Gilts	-8.5	-8.1	-27.0	-8.4	-2.1	3.7	5.8
High Yield (Global)	2.5	2.8	-0.8	0.5	2.9	6.9	8.8
Overseas Bonds	0.7	3.1	-2.6	-3.9	0.1	2.3	4.4
Property *	-0.6	1.4	21.5	9.2	8.3	9.5	7.9
Cash	0.2	0.5	0.9	0.5	0.6	0.5	2.0
Commodities £-converted	1.8	-2.7	68.2	17.7	12.5	-0.2	1.7
Hedge Funds original \$ basis *	1.3	-2.1	-3.5	6.5	5.1	5.0	5.7
Illustrative £-converted version *	1.1	1.0	10.2	6.7	6.8	7.7	7.1
Euro relative to Sterling	3.1	1.7	0.8	-1.5	-1.3	0.9	1.6
US \$ relative to Sterling	4.6	8.3	18.3	1.5	2.1	3.2	1.4
Japanese Yen relative to Sterling	0.8	0.5	-6.3	-7.1	-2.5	-2.6	0.6
Sterling trade weighted	-3.0	-3.5	-5.0	0.8	0.7	-0.8	-1.3
Price Inflation (RPI) *	0.9	2.6	12.3	5.8	4.7	3.6	3.4
Price Inflation (CPI) *	0.6	2.1	10.1	4.3	3.5	2.5	2.5
Price Inflation (RPIX) *	0.8	2.4	12.3	5.9	4.7	3.6	3.5
Earnings Inflation **	2.2	-10.8	6.2	4.4	3.8	2.8	3.0
All Share Capital Growth	-2.4	-4.6	-2.5	0.5	-0.3	3.0	3.4
Dividend Growth	1.6	3.0	15.5	-6.0	-0.8	2.7	3.8
Earnings Growth	-0.9	-6.1	1.2	1.8	9.6	0.6	4.8

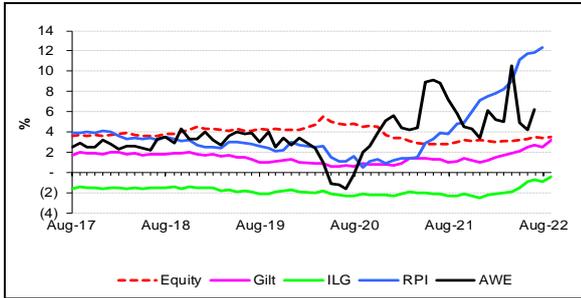
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

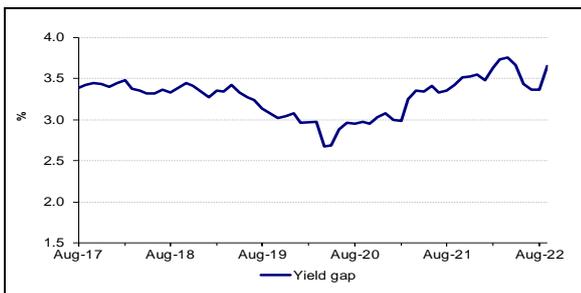


Yields and Yield Gaps

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.

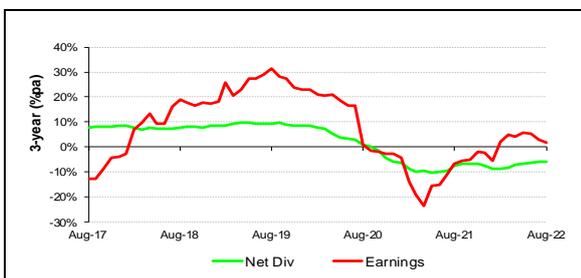
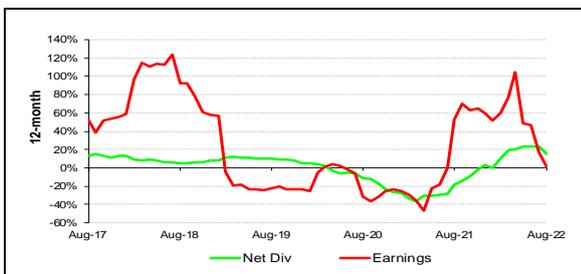


The gap gives a current expectation around 3.6% for longer-term inflation including the (unknown) risk premium for gilts, relative to index-linked gilts.

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]

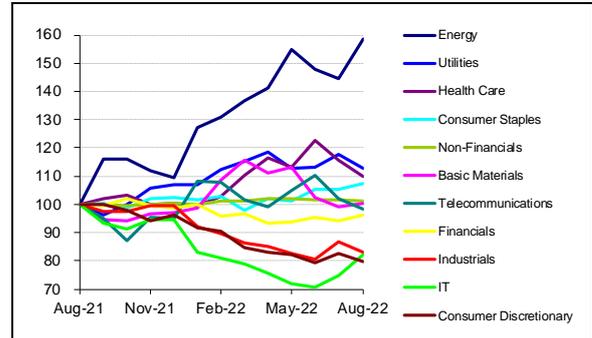
Figure 3: Dividend & Earnings Growth



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



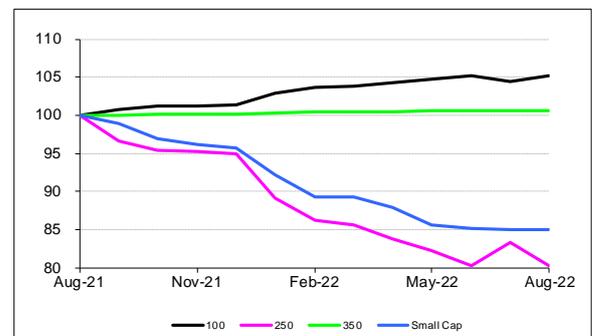
Note: Sector labels for relative lines are in end-value order

There was a rise this month in the rolling 12-month sector dispersion (rising from 68% to 79%).

(% absolute return)	1 mth	3 mth	12 mth
Energy	7.9	-1.1	60.3
Basic Materials	-0.4	-14.4	1.6
Industrials	-5.9	-3.1	-16.2
Consumer Staples	0.1	2.3	8.5
Health Care	-6.6	-6.1	11.1
Consumer Discretionary	-5.4	-6.4	-19.6
Telecommunications	-5.1	-9.4	-0.6
Utilities	-5.9	-3.4	13.9
Non-Finan	-2.2	-4.2	2.2
Financials	0.2	-1.1	-2.9
IT	7.7	10.1	-17.1
All Share	-1.7	-3.6	1.0

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



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

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



Bond market information

Figure 5: £ Non-Gilt Credit Margins

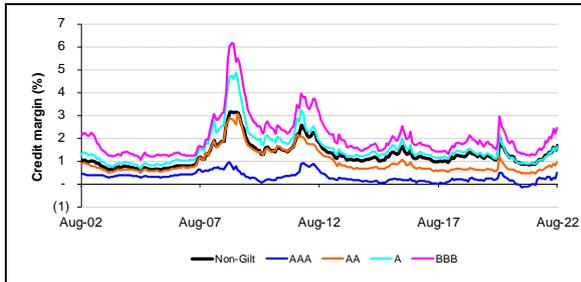


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Mar '22	2.71	1.84	0.87
Apr '22	3.05	2.13	0.92
May '22	3.40	2.46	0.94
Jun '22	3.78	2.66	1.12
Jul '22	3.45	2.45	1.00
Aug '22	4.18	3.20	0.98

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

Category	Mkt Val (£bn @ Aug 22 & 19, 16)			Weight (%)
	Aug 22	Aug 19	Aug 16	
Gilts (54)	1,455	1,438	1,452	72.1
Non-Gilts (1,209)	562	637	584	27.9
AAA (144)	121	129	114	6.0
AA (158)	75	87	99	3.7
A (393)	150	178	181	7.5
BBB (514)	216	244	191	10.7

Category	Mkt Val (£bn @ Aug 22, 19)		W't (%)	Dur'n (yrs)
Gilts (54)	1,455	1,438	72.1	10.7
< 5 Yrs (12)	418	310	20.7	2.7
5-15 Yrs (15)	451	376	22.3	7.8
> 15 Yrs (27)	587	753	29.1	18.7
Non-Gilts (1,209)	562	637	27.9	6.5
< 5 Yrs (482)	251	207	12.4	2.9
5-15 Yrs (494)	211	276	10.5	7.1
> 15 Yrs (233)	100	155	4.9	14.3

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (447)	6,803	58.4
Non-Sovereigns	4,853	41.6
AAA (1,095)	1,488	12.8
AA (776)	985	8.5
A (1,393)	1,065	9.1
BBB (1,937)	1,315	11.3

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,446)	2,775	23.8
3 – 5 Yrs (1,412)	2,479	21.3
5 – 7 Yrs (1,035)	1,887	16.2
7 – 10 Yrs (968)	1,945	16.7
10+ Yrs (787)	2,571	22.1

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Aug 22 & 19)		W't (%)	Dur'n (yrs)
Gilts (32)	674	801	100.0	17.5
< 5 Yrs (4)	95	106	14.1	1.7
5 – 15 Yrs (9)	208	160	30.9	8.8
> 15 Yrs (19)	371	535	55.0	26.4

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

Month End	US (%)	Euro (%)	Sterling (%)
Apr '22	6.56	5.01	6.68
May '22	6.53	5.22	7.41
Jun '22	8.21	7.00	9.10
Jul '22	7.03	5.92	8.50
Aug '22	7.64	6.51	9.07

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

£ Gilt Market “main” Issuance

- £1.50bn, 5/8% 2025 (3.06x, 2.65%, n/a, Aug '20)
- £2.80bn, 1/2% 2029 (2.65x, 1.96%, 2%, May '22)
- £2.77bn, 1% 2032 (2.38x, 1.78%, 1%, Jun '22)
- £0.75bn, 1/8% IL 2039 (2.03x, -1.05%, 0%, May '22)
- £1.76bn, 1 1/4% 2051 (2.52x, 2.36%, 1%, May '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.

