JAGGER & ASSOCIATES

Investment Update
September 2022

Investment Headlines & Comment

- A dreadful month for Sterling and the UK government and corporate bond markets.
- There were significant falls in local currency terms across overseas equity markets.
- Following on from the first Green Gilts, the government has published its first Green Report.

Feature Section

This month we consider an extraordinary sequence in which a new UK government seemingly shot itself in both feet by producing a Fiscal Statement without any supporting evidence from the Office for Budget Responsibility (OBR). The government was then probably somewhat taken aback to see just how badly the bond and currency markets responded.

Over the course of September to the day before the Statement, 20-year gilt yields rose from 3.20% to 3.83%. Over 15-year real yields rose from -0.45% to +0.14%, and Sterling's trade-weighted index (TWI) fell from 77.5 to 76.5. (It had hit a month-end low just below 75 in the aftermath of the Brexit referendum.) So, you could argue that markets were readying themselves for the twin effects of the new government's new doctrine, and the Bank of England's plan to begin unwinding its Quantitative Easing (QE) programme.

The actual scale of the tax cuts involved (and their being met in the first instance by more borrowing) meant markets had not moved nearly far enough. On the day of the Statement (Friday 23rd), 20-year gilt yields rose further from 3.83% to 4.07%. Over 15-year real yields rose from +0.14% to +0.38% (a return of -5.9%), and Sterling's TWI fell from 76.5 to 74.5. Not a great start for a new government, really.

With a weekend for market traders to digest the Statement, things went from bad to worse for the government on the next trading day (Monday 26th), as 20-year gilt yields rose from 4.07% to 4.44%. Over 15-year real yields rose from +0.38% to +0.93% (a staggering return of -13.1% in one trading day), and Sterling's TWI fell from 74.5 to 74.1. The Bank of England issued a statement noting the government's commitment to the OBR, and saying it would "change interest rates by as much as was needed … in line with its remit."

Markets continued in a similar vein on the next trading day (Tuesday 27th). The International Monetary Fund (IMF) also entered the fray, saying "we do not recommend large and untargeted fiscal packages at this juncture, as it is important that fiscal policy does not work at cross purposes to monetary policy. Furthermore, the nature of the UK measures will likely increase inequality."

By Wednesday 28th, less than a week after confirming its planned QE unwinding, the Bank then found itself announcing that it was delaying that unwinding by a month, and introducing a 2-week period of buying an unlimited amount of long-dated government bonds, to try to stabilize the market. Long-dated ILGs duly jumped by a staggering 26% in a single day, and continued to rally through to the month end.

By the end of the month, 20-year gilt yields were back down to 4.03%, Over 15-year real yields were negative again at -0.19%, and Sterling's trade-weighted index had rallied to 76.15. Since the month end, one proposed tax cut has been abandoned, but the majority remain in place (at the time of typing, at least) - it really doesn't feel like that will be the end of the matter.

The knock-on effects for corporate bond yields have been considerable (across September, all-dated credit spreads jumped from 1.7% to 2.2%), and it seems likely that new issuance will reduce as a result, and by extension, growth will be reduced. Not exactly the effect that the government was aiming for.

A few open questions: will the markets and/or the Bank and the OBR and/or the IMF end up forcing further U-turns on the new government's policy? Will the government's own MPs refuse to vote through the proposals? Will the new Prime Minister be forced out through sheer incompetence, and potentially becoming the shortest-ever serving UK Prime Minister? (**Ed.:** that unenviable record is currently 119 days for George Canning in 1827, which means she has to try to survive until 3rd January 2023.)

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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 September 2022

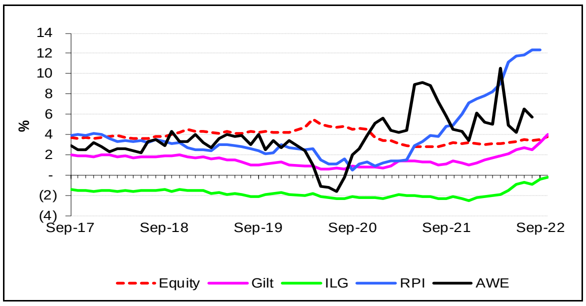
Asset Class	**1 month (%)**	**3 months (%)**	**12 months (%)**	**3 years (% p.a.)**	**5 years (% p.a.)**	**10 years (% p.a.)**	**20 years (% p.a.)**
UK Equities	-5.9	-5.3	-4.0	0.8	2.2	6.0	7.5
Overseas Equities	-5.7	1.6	-3.8	8.0	9.2	12.3	10.7
US Equities	-5.4	3.6	0.1	**11.6**	**13.2**	**15.8**	9.1
Europe ex UK Equities	-4.9	-2.3	-15.3	1.3	2.6	8.3	**11.8**
Japan Equities	-6.0	0.9	-13.6	1.2	3.4	9.3	6.4
Pacific ex Japan Equities	-8.7	-4.5	-10.2	3.5	4.0	7.4	11.3
Emerging Markets	-7.9	-3.6	-12.8	1.6	2.2	5.2	11.0
UK Long-dated Gilts	-11.1	**-18.8**	-35.5	**-15.5**	**-5.6**	**0.5**	3.6
UK Long-dated Corp. Bonds	**-13.0**	-17.8	**-37.1**	-13.4	-5.1	1.1	3.7
UK Over 5 Yrs Index-Linked Gilts	-7.8	-10.6	-29.3	-10.7	-2.8	3.3	5.3
High Yield (Global)	-0.8	**6.0**	-2.8	0.5	3.4	6.8	8.9
Overseas Bonds	-0.4	1.9	-3.2	-3.1	1.1	2.3	4.4
Property *	-1.3	-1.1	**18.3**	8.6	7.9	9.3	7.8
Cash	**0.3**	0.6	1.1	0.6	0.6	0.6	**2.0**
Commodities £-converted	-3.9	-2.4	49.3	16.0	11.8	-0.3	1.4
Hedge Funds original $ basis *	0.4	-1.2	-3.8	6.9	5.1	5.0	5.7
Illustrative £-converted version *	5.1	7.0	13.8	8.6	7.3	8.3	7.3
Euro relative to Sterling	1.6	2.0	2.1	-0.3	-0.1	1.0	1.7
US $ relative to Sterling	4.2	8.8	20.8	3.4	3.7	3.8	1.7
Japanese Yen relative to Sterling	-0.2	2.1	-6.9	-6.2	-1.3	-2.5	0.9
Sterling trade weighted	-1.7	-3.3	-5.9	-0.3	-0.6	-1.0	-1.5
Price Inflation (RPI) *	0.6	2.4	12.3	5.8	4.7	3.6	3.4
Price Inflation (CPI) *	0.5	1.9	9.8	4.3	3.5	2.5	2.5
Price Inflation (RPIX) *	0.6	2.3	12.2	5.9	4.7	3.6	3.5
Earnings Inflation **	-1.2	0.1	5.7	4.2	3.9	2.9	2.9
All Share Capital Growth	-6.1	-6.4	-7.3	-2.5	-1.5	2.3	3.8
Dividend Growth	1.9	3.9	13.1	-5.5	-0.7	2.8	3.9
Earnings Growth	0.8	-4.1	-2.2	1.6	9.8	0.5	4.9

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

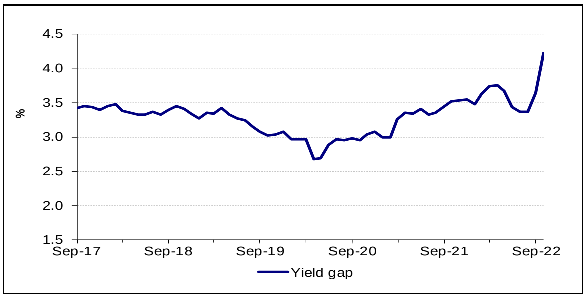
- *UK Equities (incl. dividends and earnings) – FT-A All Share.*
- *Overseas Equities (incl. regions) – blend of FT All-World / World sub-indices*
- *Emerging Markets from MSCI US $ based total return index (overall Index to 31 Oct 2001, Free Index from 1 Nov 2001 to take account of foreign investment 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.

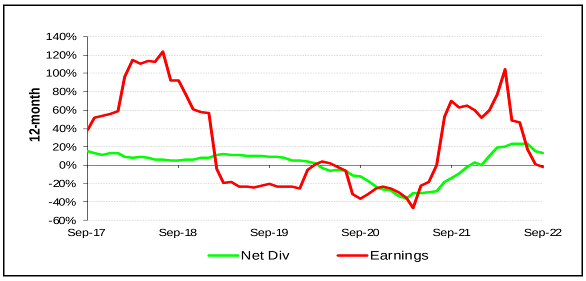


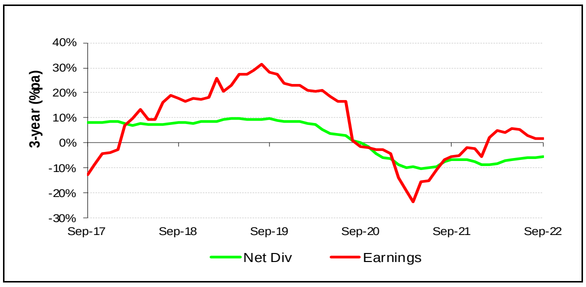
The gap gives a current expectation of around 4.2% p.a. for longer-term inflation *including the (unknown) risk premium for gilts, relative to index-linked gilts.*

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

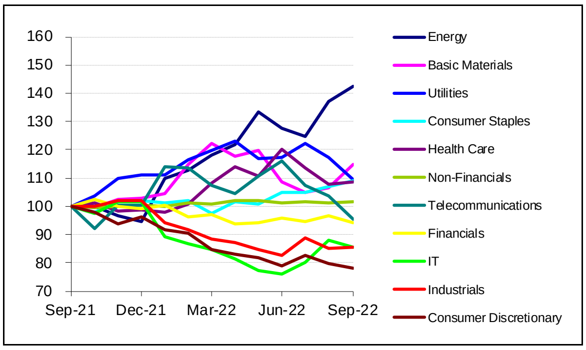




Note: Earnings data from mid-2015 onwards is no longer reliable as one-off events may be affecting the prospective P/E ratios

UK Equity Sector Returns

Figure 4a: Sectors relative to All Share



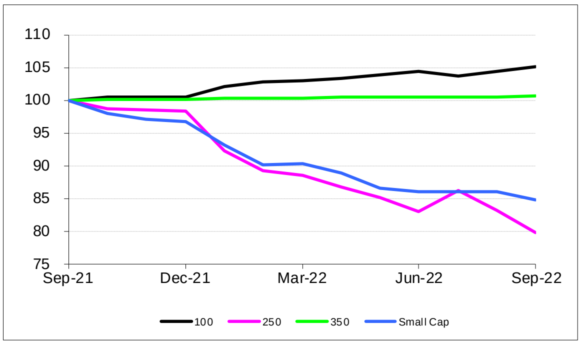
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (falling from 79% to 65%).

(% absolute return)	1 mth	3 mth	12 mth
Energy	-2.0	5.8	36.9
Basic Materials	1.6	0.3	10.3
Industrials	-5.3	-2.0	-17.9
Consumer Staples	-3.9	-1.3	4.8
Health Care	-5.2	-14.4	4.3
Consumer Discretionary	-7.8	-6.7	-25.2
Telecommunications	-13.3	-22.1	-8.3
Utilities	-12.0	-11.7	5.2
Non-Finan	-5.2	-4.9	-2.3
Financials	-8.1	-6.9	-9.6
IT	-8.3	7.0	-17.8
All Share	-5.9	-5.3	-4.0

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

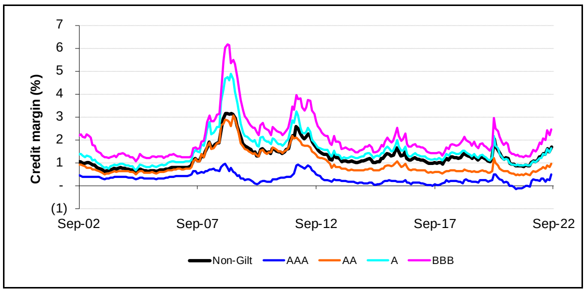


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
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
Sep '22	**5.07**	**4.03**	**1.04**

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

Category	Mkt Val (£bn @ Sep 22 & 19, 16)			Weight (%)
Gilts (54)	1,329	1,446	1,401	71.9
Non-Gilts (1,219)	519	638	579	28.1
AAA (147)	116	131	110	6.3
AA (159)	70	87	97	3.8
A (397)	138	177	180	7.5
BBB (516)	195	243	192	10.6

Category	Mkt Val (£bn @ Sep 22, 19)		W't (%)	Dur'n (yrs)
Gilts (54)	1,329	1,446	71.9	10.1
< 5 Yrs (12)	402	308	21.8	2.6
5–15 Yrs (15)	413	378	22.3	7.6
> 15 Yrs (27)	514	761	27.8	17.9
Non-Gilts (1,219)	519	638	28.1	6.1
< 5 Yrs (490)	242	210	13.1	2.8
5–15 Yrs (495)	190	274	10.3	6.9
> 15 Yrs (234)	86	154	4.7	13.5

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (446)	6,520	58.1
Non-Sovereigns	4,701	41.9
AAA (1,102)	1,453	12.9
AA (775)	952	8.5
A (1,396)	1,030	9.2
BBB (1,942)	1,266	11.3

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,443)	2,720	24.2
3 – 5 Yrs (1,424)	2,447	21.8
5 – 7 Yrs (1,033)	1,835	16.4
7 – 10 Yrs (977)	1,835	16.4
10+ Yrs (784)	2,384	21.2

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Sep 22 & 19)		W't (%)	Dur'n (yrs)
Gilts (32)	628	800	100.0	17.6
< 5 Yrs (4)	92	106	14.6	1.6
5 – 15 Yrs (9)	188	160	30.0	8.6
> 15 Yrs (19)	347	533	55.3	26.7

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

Month End	US (%)	Euro (%)	Sterling (%)
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
Sep '22	**8.69**	**7.85**	**11.39**

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

£ Gilt Market "main" & "Green" Issuance

- £4.18bn, ¼% 2025 (2.57x, 3.18%, 20%, Jul '22)
- £1.20bn, $^{1}/_{8}$% IL 2031 (2.30x, 0.28%, 0%, Jun '22)
- £3.44bn, 1% 2032 (2.40x, 3.09%, 25%, Aug '22)
- £2.50bn, $^{7}/_{8}$% 2046 (2.51x, 3.22%, 25%, Nov '21)
- £4.50bn, 1½% Gr 2053 (6.69x, 4.29%, n/a, 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 Green Gilt (Gr), tender or syndication cases.

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