



## Investment Update December 2023

### Investment Headlines & Comment

- A strong month for the whole range of gilts, index-linked gilts and corporate bonds.
- Equity markets also saw rallies in the belief that global inflation was coming under control.
- UK property continues to drift sideways, perhaps waiting for office “change of use” clarity?

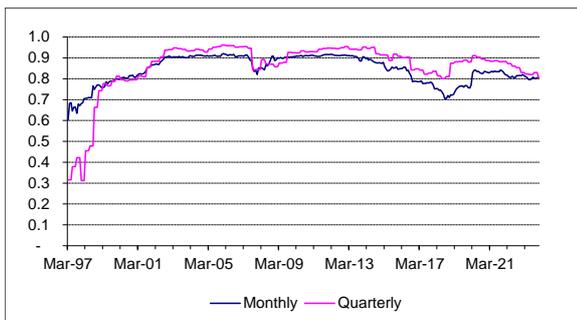
### Feature Section

This month we ponder how asset correlations may have changed as a result of external events. This follows on from our [June 2013](#) edition.

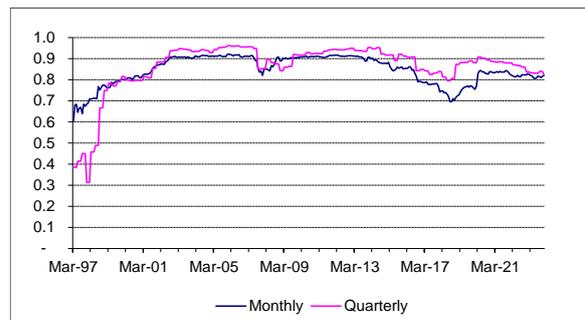
The multi-asset dataset involved goes back to 1992 (High Yield bonds don’t go back any further) and the indices involved are as per Table 1 on page 2 of this edition. The data can be analysed on a monthly basis, or a non-overlapping quarterly set (or even non-overlapping annual, but that does rather shrink the dataset!). It can be on the basis of nominal or real returns. Quite a few pairs of assets have relatively low long-term correlation on either measure, but there are some clear exceptions. For example, UK Gilts and Index-Linked Gilts, or UK Equities and Overseas Equities. Where it gets interesting is just how stable the correlations are.

The natural place to start would be UK and Overseas Equities. Figure 1a shows the rolling 5-year correlation based on both monthly and quarterly nominal returns, whilst Figure 1b shows the correlation based on real returns. (Which one you give greater weight to rather depends on what you want to use a correlation statistic for.) There is some variation, but not terribly much. Assuming 80% seems reasonable.

**Figure 1a: UK & Overseas Equities (Nominal)**



**Figure 1b: UK & Overseas Equities (Real)**



Another combination of potential interest is (Global) High Yield and Overseas Equities. Here, there is not only far more variation on both monthly and quarterly bases, but there is also a clear upward trend over time.

**Figure 1c: High Yield and O/S Eqs (nominal)**



**Figure 1d: High Yield and O/S Eqs (real)**



In an ideal world, you would like to find pairs of assets with material negative correlation, as in combination they would offer the desired effect of significantly reducing portfolio volatility. However, as cynical readers may have already guessed, that pairing just doesn’t seem to exist. The nearest you can get is with UK Property, as it has a remarkably low correlation with pretty much everything else, although that is probably rather due to the way that UK Property very rarely seems to change market value quickly.



**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 2023**

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	4.5	3.5	7.9	8.6	6.6	5.3	7.0
Overseas Equities	4.2	7.1	16.4	8.8	12.5	11.8	10.3
US Equities	4.0	7.2	<b>20.0</b>	<b>11.8</b>	<b>15.6</b>	<b>14.9</b>	8.5
Europe ex UK Equities	4.4	7.8	15.9	7.3	10.1	8.0	<b>11.7</b>
Japan Equities	3.7	3.3	13.3	3.4	7.1	8.3	6.6
Pacific ex Japan Equities	6.5	8.4	5.9	-0.1	6.4	7.7	10.1
Emerging Markets	3.2	3.3	4.0	-2.5	4.1	5.8	9.0
UK Long-dated Gilts	<b>9.8</b>	<b>15.8</b>	1.6	<b>-17.3</b>	<b>-6.3</b>	<b>1.1</b>	3.5
UK Long-dated Corp. Bonds	8.9	15.1	10.6	-11.9	-1.6	2.7	4.2
UK Over 5 Yrs Index-Linked Gilts	7.9	11.7	0.2	-13.5	-4.9	1.9	4.5
High Yield (Global)	3.0	3.1	7.0	2.3	4.1	6.4	8.1
Overseas Bonds	3.5	2.9	-2.1	-4.5	-1.2	2.6	3.8
Property *	<b>-0.5</b>	<b>-1.0</b>	<b>-3.0</b>	3.0	1.8	6.4	6.1
Cash	0.4	1.3	5.1	2.4	1.6	<b>1.1</b>	<b>2.0</b>
Commodities £-converted	-4.0	-14.6	-9.7	22.0	8.7	-1.0	0.2
Hedge Funds original \$ basis *	2.6	0.3	4.5	5.0	5.9	4.4	5.1
Illustrative £-converted version *	-1.6	0.4	-1.7	6.9	6.1	7.1	6.7
Euro relative to Sterling	0.5	0.1	-2.3	-1.1	-0.7	0.4	1.0
US \$ relative to Sterling	-0.7	-4.3	-5.6	2.4	0.0	2.7	1.7
Japanese Yen relative to Sterling	4.1	1.4	-11.7	-7.7	-4.9	-0.3	0.3
Sterling trade weighted	-0.3	1.3	5.2	1.2	1.2	-0.4	-0.9
Price Inflation (RPI) *	-0.1	0.2	5.3	8.7	5.8	4.1	3.7
Price Inflation (CPI) *	-0.2	0.3	3.9	6.5	4.2	2.9	2.8
Price Inflation (RPIX) *	-0.2	-0.1	4.1	8.2	5.6	4.0	3.7
Earnings Inflation **	-1.3	-1.1	6.0	5.6	4.6	3.6	3.2
All Share Capital Growth	4.4	2.8	3.8	4.8	2.9	1.6	3.3
Dividend Growth	0.2	2.2	9.9	8.4	-0.4	3.1	4.4
Earnings Growth	1.3	27.8	66.4	24.7	2.5	3.9	5.7

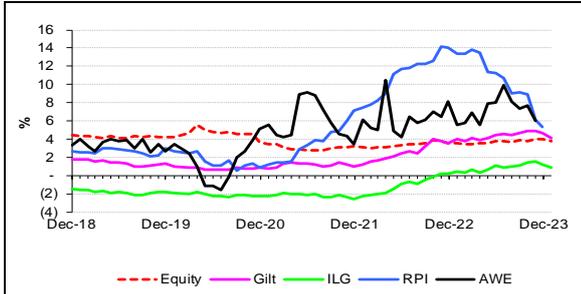
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

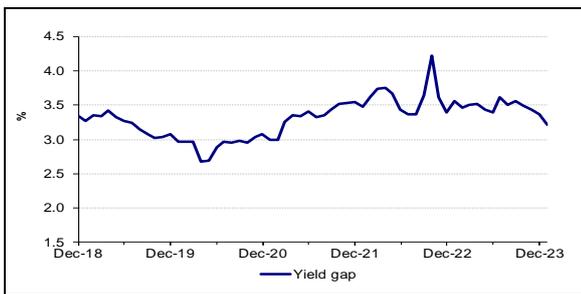


## Yields and Yield Gaps

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.

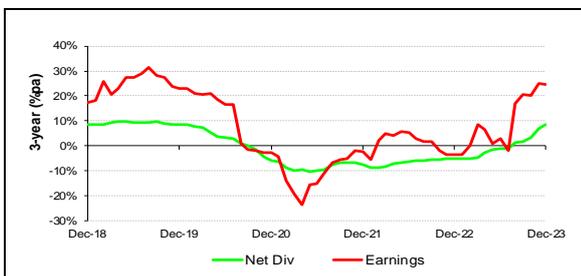
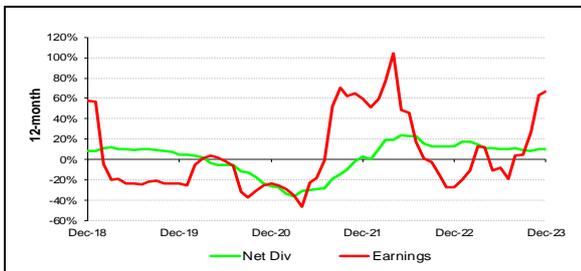


The gap gives a current expectation of around 3.2% p.a. for longer-term inflation including the (unknown) risk premium for gilts, relative to index-linked gilts.

## 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]

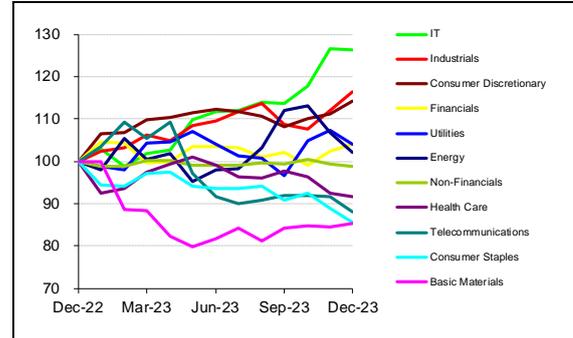
Figure 3: Dividend & Earnings Growth



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



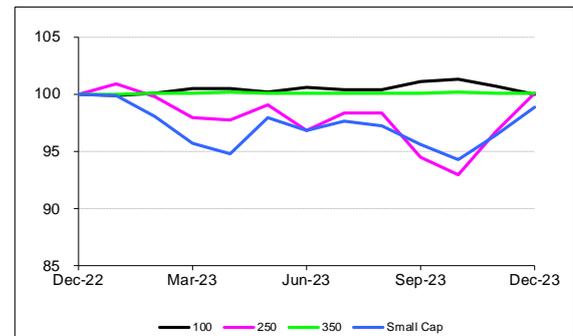
Note: Sector labels for relative lines are in end-value order

There was a slight rise this month in the rolling 12-month sector dispersion (up from 36% to 41%).

(% absolute return)	1 mth	3 mth	12 mth
Energy	-0.2	-5.8	10.1
Basic Materials	5.4	4.6	-8.0
Industrials	8.6	10.9	25.6
Consumer Staples	0.5	-2.5	-7.8
Health Care	3.6	-2.9	-1.0
Consumer Discretionary	7.2	9.1	23.1
Telecommunications	0.2	-0.9	-5.1
Utilities	1.3	11.6	12.2
Non-Finan	4.0	2.8	6.6
Financials	6.3	5.5	12.3
IT	4.4	14.9	36.3
All Share	4.5	3.5	7.9

## UK Equity Size Returns

Figure 4b: Size groups relative to All Share



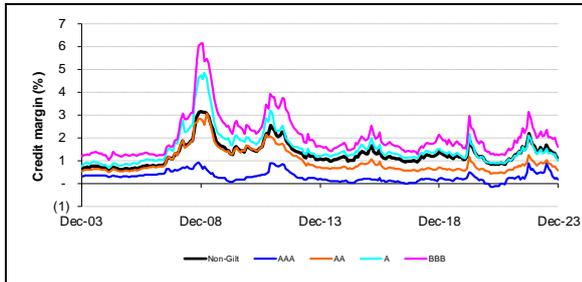
This month, Mid Cap and Small Cap both rose strongly relative to the All Share.

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 (%)
Jul '23	4.99	4.48	0.51
Aug '23	5.15	4.61	0.54
Sep '23	5.37	4.90	0.47
Oct '23	5.52	4.92	0.60
Nov '23	5.06	4.62	0.44
Dec '23	<b>4.46</b>	<b>4.08</b>	<b>0.38</b>

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

Category	Mkt Val (£bn @ Dec 23 & 20, 17)			Weight (%)
Gilts (59)	1,496	1,813	1,362	71.6
Non-Gilts (1,264)	593	689	584	28.4
AAA (154)	126	133	113	6.0
AA (166)	79	86	83	3.8
A (435)	174	195	170	8.3
BBB (509)	214	274	217	10.2

Category	Mkt Val (£bn @ Dec 23 & 20)		W't (%)	Dur'n (yrs)
Gilts (59)	1,496	1,813	71.6	9.6
< 5 Yrs (14)	477	422	22.8	2.6
5-15 Yrs (16)	473	520	22.6	7.8
> 15 Yrs (29)	546	871	26.1	17.2
Non-Gilts (1,264)	593	689	28.4	5.8
< 5 Yrs (587)	303	231	14.5	2.6
5-15 Yrs (459)	200	292	9.6	7.0
> 15 Yrs (218)	90	165	4.3	13.8

**Tables 2d, 2e: € Market Size and Maturity (Dec 23)**

Category	Mkt Val (£bn)	Weight (%)
Sovereigns (482)	7,269	57.0
Non-Sovereigns	5,487	43.0
AAA (1,235)	1,802	14.1
AA (844)	1,044	8.2
A (1,549)	1,245	9.8
BBB (2,009)	1,397	11.0

Category	Mkt Val (£bn)	Weight (%)
1 – 3 Yrs (1,682)	3,157	24.8
3 – 5 Yrs (1,683)	2,837	22.2
5 – 7 Yrs (1,067)	1,988	15.6
7 – 10 Yrs (960)	2,105	16.5
10+ Yrs (727)	2,668	20.9

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

Category (Number of issues)	Mkt Val (£bn @ Dec 23 & 20)		W't (%)	Dur'n (yrs)
Gilts (33)	594	811	100.0	15.3
< 5 Yrs (5)	123	70	20.7	2.3
5 – 15 Yrs (9)	187	202	31.4	9.2
> 15 Yrs (19)	285	539	47.9	24.9

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

Month End	US (%)	Euro (%)	Sterling (%)
Sep '23	8.32	7.06	10.31
Oct '23	8.76	7.28	10.45
Nov '23	7.81	6.60	9.61
Dec '23	<b>7.12</b>	<b>5.95</b>	<b>8.80</b>

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

**£ Gilt Market “main” & “Green” Issuance**

- £4.69bn, 4½% 2028 (2.53x, 4.04%, 25%, Nov '23)
- £3.00bn, 7/8% Gr 2033 (2.66x, 4.09%, n/a, Sep '23)
- £1.57bn, ¾% IL 2033 (2.68x, 0.72%, 4%, Oct '23)
- £3.00bn, 4½% 2034 (2.84x, 3.74%, 0%, Nov '23)
- £2.50bn, 3¾% 2053 (2.70x, 4.43%, 25%, Nov '23)

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.

