



## Investment Update February 2023

### Investment Headlines & Comment

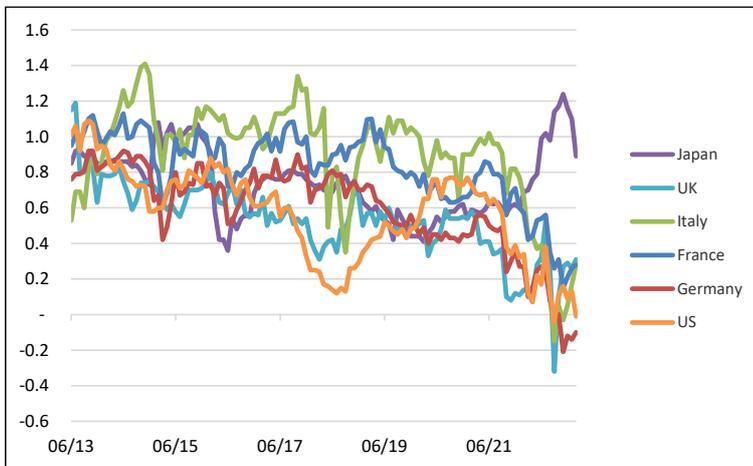
- A poor month for bonds globally, as yields ticked up.
- It was also a poor month for Far East equities.
- UK property's run of poor months seems to have paused.

### Feature Section

This month we consider how global yield curves have varied over time, by looking at the gap between 10- and 30-year bond yields. Standard theory would lead you to expect positive values, because of Keynes's liquidity preference theory, but how have things been over the last decade?

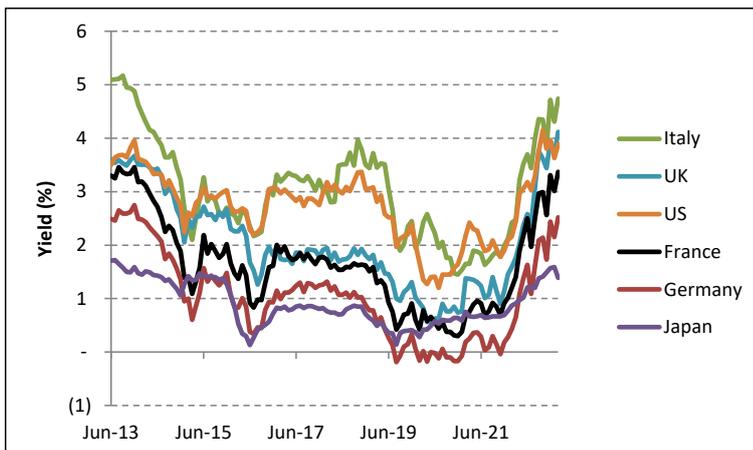
Figure 1a shows the yield gap outputs for the six main bond markets. It is quite striking how little uniformity there is, and also how rapidly the outputs can vary. They have generally been positive, but in the past few months there have been instances of close to zero values, and some negative values (e.g. for the UK in the aftermath of the September 2022 mini budget). We last looked at the 30-year yields in our [January 2020](#) issue, so Figure 1b is included to show just how rapidly they have moved over the last year and a half.

**Figure 1a: 30-year yield relative to 10-year yield (%)**



It is arguable that 10-year yields are currently higher than might generally be expected, because of cash rates having been pushed up in a bid to curb inflation. So, in due course, if that policy is successful and 10-year yields fall back a bit, then you might expect the outputs in Figure 1a to rise. (For example, prior to the absolute bond yields starting to rise rapidly from late 2021 onwards, the average value for the UK's yield gap was around 0.5%-0.6% p.a.)

**Figure 1b: 30-year yields (%)**



However, there must be material continuing uncertainty on just where government bond yields could go in due course, because of the gradual unwinding of Quantitative Easing programmes over the next few years.

The divergence of yields within the Eurozone is something we have commented on before, and the continuing range from German to French to Italian 30-year yields in Figure 1b remains a clear signal of market concerns.

All in all, long-dated bonds look rather risky, unless being held to match off liabilities.

Sources: FT, JP Morgan, labels in end value order

Notes: In Figure 1b, the FT's Japan data is 20 year for 2013 and 2014, but they switch to 30-year for 2015.



**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 28 February 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	<b>1.5</b>	4.6	7.3	8.8	5.3	6.3	8.3
Overseas Equities	-1.3	-1.7	2.0	11.4	9.2	11.3	10.8
US Equities	-0.7	-3.6	1.5	<b>13.8</b>	<b>12.5</b>	<b>14.7</b>	9.9
Europe ex UK Equities	0.9	<b>7.0</b>	<b>8.4</b>	10.0	6.6	8.4	<b>11.8</b>
Japan Equities	-2.0	0.9	1.2	5.9	2.9	8.0	7.2
Pacific ex Japan Equities	-5.1	-0.8	-1.5	5.7	3.5	6.2	11.4
Emerging Markets	-4.9	-2.1	-5.7	3.2	1.1	4.2	10.8
UK Long-dated Gilts	<b>-6.0</b>	<b>-10.5</b>	<b>-35.4</b>	<b>-17.1</b>	<b>-6.6</b>	<b>0.4</b>	3.3
UK Long-dated Corp. Bonds	-5.0	-4.6	-25.8	-12.0	-3.7	1.8	4.0
UK Over 5 Yrs Index-Linked Gilts	-5.7	-7.9	<b>-37.0</b>	-12.6	-4.9	1.4	4.5
High Yield (Global)	-0.1	1.4	3.4	1.4	4.0	5.6	8.3
Overseas Bonds	-1.5	-1.9	-5.0	-4.4	0.3	1.6	3.8
Property *	-0.2	-8.8	-11.3	2.0	3.0	7.2	6.6
Cash	0.4	1.0	2.6	1.0	0.9	0.7	<b>2.0</b>
Commodities £-converted	-2.2	-6.8	10.5	18.7	8.4	-1.5	-0.2
Hedge Funds original \$ basis *	2.7	3.6	0.5	6.8	4.5	4.7	5.8
Illustrative £-converted version *	0.3	-3.1	9.5	9.2	7.6	7.4	7.3
Euro relative to Sterling	-0.7	1.3	4.6	0.6	-0.2	0.2	1.2
US \$ relative to Sterling	1.7	-1.6	10.8	1.8	2.6	2.3	1.3
Japanese Yen relative to Sterling	-2.9	0.8	-6.3	-5.8	-2.3	-1.6	0.6
Sterling trade weighted	0.3	-0.2	-4.8	-0.4	0.0	-0.1	-1.0
Price Inflation (RPI) *	0.0	1.2	13.4	7.4	5.5	3.9	3.6
Price Inflation (CPI) *	-0.6	0.2	10.0	5.3	3.9	2.7	2.7
Price Inflation (RPIX) *	-0.2	0.8	12.6	7.3	5.4	3.9	3.6
Earnings Inflation **	3.1	5.3	5.3	5.7	4.6	3.4	3.1
All Share Capital Growth	1.1	4.0	3.5	5.4	1.6	2.5	4.6
Dividend Growth	0.9	1.9	17.5	-4.9	-0.3	2.9	4.1
Earnings Growth	16.0	15.2	-10.5	0.3	-1.9	1.1	4.7

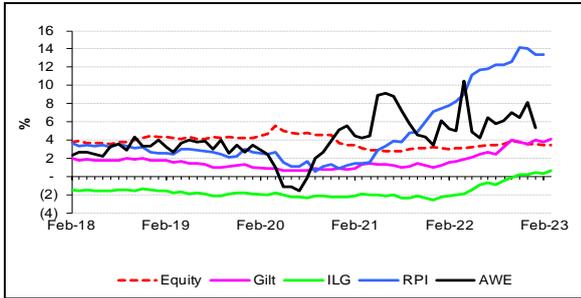
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

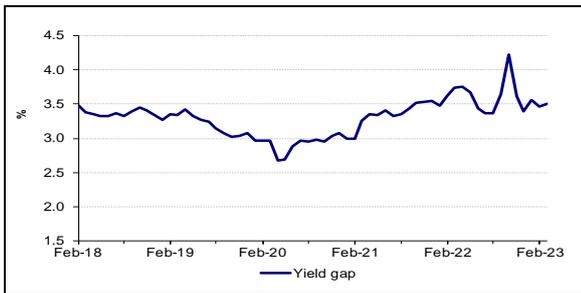


## Yields and Yield Gaps

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.

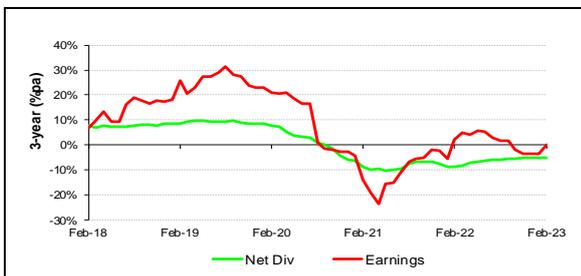
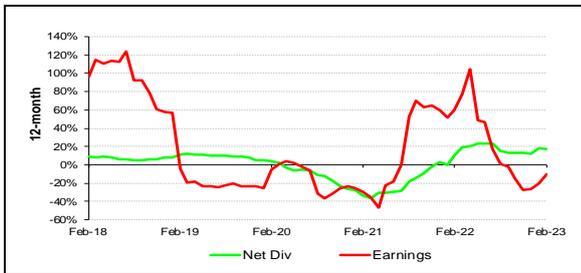


The gap gives a current expectation of around 3.5% p.a. for longer-term inflation including the (unknown) risk premium for gilts, relative to index-linked gilts.

## 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]

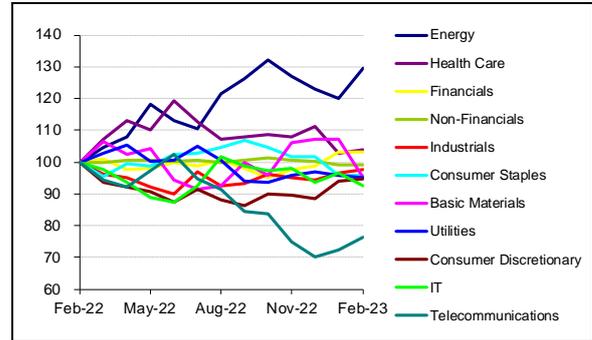
Figure 3: Dividend & Earnings Growth



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



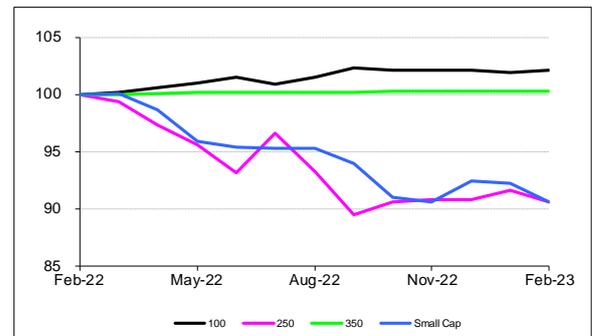
Note: Sector labels for relative lines are in end-value order

There was a small rise this month in the rolling 12-month sector dispersion (up from 51% to 53%).

(% absolute return)	1 mth	3 mth	12 mth
Energy	9.3	6.5	38.9
Basic Materials	-9.9	-6.3	2.0
Industrials	2.4	7.4	4.6
Consumer Staples	1.2	-1.8	2.6
Health Care	2.7	0.9	11.6
Consumer Discretionary	2.0	10.6	1.5
Telecommunications	7.0	6.7	-18.1
Utilities	0.8	3.5	1.9
Non-Finan	1.6	2.9	6.3
Financials	1.3	10.4	10.6
IT	-2.5	-1.1	-0.7
All Share	1.5	4.6	7.3

## UK Equity Size Returns

Figure 4b: Size groups relative to All Share



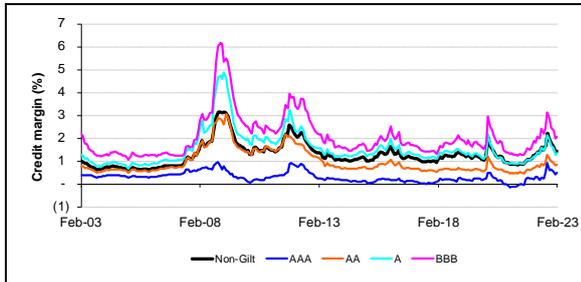
This month, Mid Cap and Small Cap both fell relative to the All Share.

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 (%)
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
Jan '23	4.40	3.77	0.63
Feb '23	<b>4.81</b>	<b>4.14</b>	<b>0.67</b>

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

Category	Mkt Val (£bn @ Feb 23 & 20, 17)			Weight (%)
	2023	2020	2017	
Gilts (58)	1,408	1,439	1,376	72.3
Non-Gilts (1,208)	540	661	556	27.7
AAA (139)	110	137	107	5.6
AA (157)	72	87	87	3.7
A (407)	151	186	169	7.7
BBB (505)	207	250	192	10.6

Category	Mkt Val (£bn @ Feb 23 & 20)		W't (%)	Dur'n (yrs)
Gilts (58)	1,408	1,439	72.3	9.7
< 5 Yrs (14)	452	278	23.2	2.6
5-15 Yrs (17)	456	431	23.4	7.9
> 15 Yrs (27)	499	730	25.6	17.6
Non-Gilts (1,208)	540	661	27.7	6.1
< 5 Yrs (505)	255	222	13.1	2.8
5-15 Yrs (476)	197	281	10.1	6.9
> 15 Yrs (227)	88	158	4.5	13.6

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

Category	Mkt Val (£bn)	Weight (%)
Sovereigns (468)	6,535	57.2
Non-Sovereigns	4,895	42.8
AAA (1,150)	1,519	13.3
AA (808)	963	8.4
A (1,459)	1,083	9.5
BBB (1,990)	1,331	11.6

Category	Mkt Val (£bn)	Weight (%)
1 – 3 Yrs (1,494)	2,742	24.0
3 – 5 Yrs (1,559)	2,597	22.7
5 – 7 Yrs (1,099)	1,863	16.3
7 – 10 Yrs (939)	1,875	16.4
10+ Yrs (784)	2,352	20.6

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

Category (Number of issues)	Mkt Val (£bn @ Feb 23 & 20)		W't (%)	Dur'n (yrs)
Gilts (31)	560	775	100.0	16.4
< 5 Yrs (4)	94	94	16.9	2.6
5 – 15 Yrs (9)	193	184	34.5	9.4
> 15 Yrs (18)	272	497	48.6	26.2

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

Month End	US (%)	Euro (%)	Sterling (%)
Oct '22	8.21	7.37	10.86
Nov '22	7.86	6.72	10.07
Dec '22	8.17	7.11	10.32
Jan '23	7.48	6.47	9.54
Feb '23	<b>7.97</b>	<b>6.76</b>	<b>9.46</b>

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

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

- £3.50bn, 4<sup>1</sup>/<sub>8</sub>% 2027 (2.36x, 3.35%, 0%, Dec 22)
- £3.50bn, ½% 2029 (2.20x, 3.60%, 0%, Oct 22)
- £3.00bn, 7<sup>7</sup>/<sub>8</sub>% Gr 2033 (2.22x, 3.43%, n/a, Nov 22)
- £3.00bn, 3<sup>3</sup>/<sub>4</sub>% 2033 (2.36x, 3.53%, 0%, Jan 23)
- £2.00bn, 1<sup>1</sup>/<sub>8</sub>% 2039 (2.42x, 3.74%, 0%, Dec 22)
- £2.00bn, 1<sup>1</sup>/<sub>2</sub>% Gr 2053 (2.42x, 4.02%, n/a, Sep 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.

