



Investment Update July 2023

Investment Headlines & Comment

- A good month for most equity markets.
- Commodities produced a strong return.
- Credit margins on corporate bonds have fallen.

Feature Section

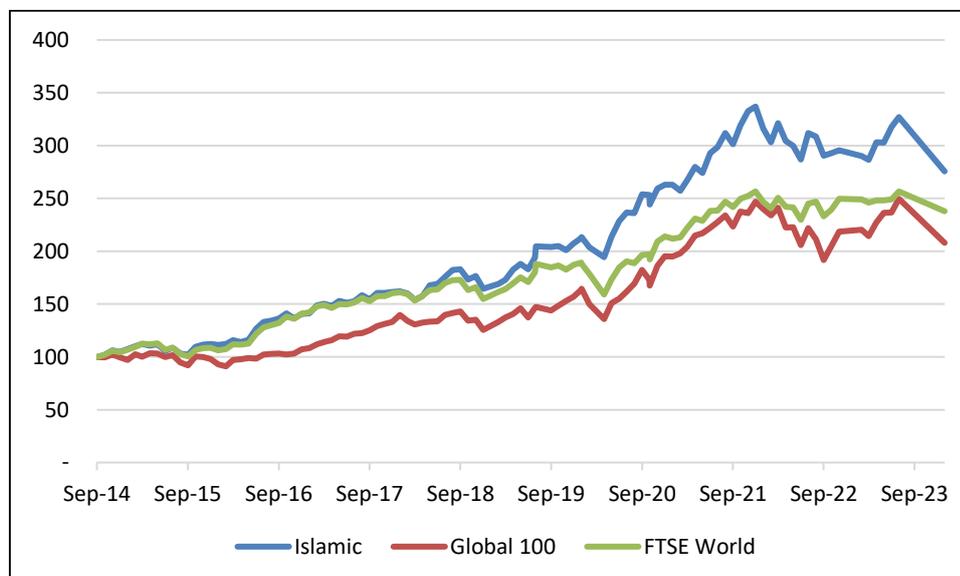
This month we consider the subject of Islamic Finance. With the rise of Defined Contribution (DC) schemes, and with approximately 7% of the UK's population being Muslim (*source: UK 2021 census*), DC schemes of all formats are likely to face requests for funds to be available that meet the principles of Islamic Finance.

The Islamic Finance principles can be summarised as a set of negative principles and a set of positive principles. On the negative front, there is a ban on interest (Riba), a ban on uncertainty (Gharar), and a ban on speculation and gambling (Maisir). For the positive front, there is a requirement that risks and profits are shared among all parties, the investments must be ethical and enhance society, and any underlying assets must be tangible and identifiable.

To meet the requirement of Riba, Islamic banking has provided several workarounds to accommodate financial transactions without charging explicit interest, such as equity participation systems which are broadly similar to profit sharing. Examples of Gharar in modern finance include excluding the use of futures and options contracts that have dates of delivery in the future.

As you might imagine, these Islamic Finance principles require a lot of scrutiny of individual companies just to construct an index that is compliant with the principles. The main such equity index is the Dow Jones Islamic Market Titans 100 Index, and HSBC's index-tracking fund for this index has assets in excess of USD \$2bn. Figure 1 shows the total return index for this index and two general comparator indices - S&P Global 100 and FTSE World.

Figure 1: Total Return indices



Sources: FTSE Russell, HSBC, S&P

It is quite striking how similar the Islamic and World indices are for the first few years, but they briefly diverge in late 2019 and 2020, before settling down again to be moving broadly in parallel.

There is much less similarity though for the Islamic 100 and the Global 100. Their returns have 73% correlation, whereas the Islamic and World indices have a much higher 91% correlation.

As things stand, there appear to be no Islamic annuities for paying UK pensions in retirement, even though workarounds exist to meet the requirement of Riba. Drawdown arrangement thus look likely to be used.



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 July 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	2.6	-1.2	6.1	12.3	3.4	5.5	7.4
Overseas Equities	2.5	6.3	7.3	11.6	9.4	11.3	10.3
US Equities	2.2	8.3	7.0	13.9	12.5	14.4	8.9
Europe ex UK Equities	2.0	0.3	16.1	10.1	6.4	8.1	11.4
Japan Equities	2.0	6.2	9.0	8.4	4.2	7.7	7.1
Pacific ex Japan Equities	4.5	4.3	1.3	3.8	3.7	7.1	10.5
Emerging Markets	5.0	6.1	2.9	2.5	2.5	5.6	9.8
UK Long-dated Gilts	-0.1	-5.1	-27.7	-19.9	-7.8	0.2	3.2
UK Long-dated Corp. Bonds	2.0	-2.5	-16.4	-13.7	-3.9	1.7	3.9
UK Over 5 Yrs Index-Linked Gilts	-0.7	-4.0	-25.0	-15.2	-5.7	1.4	4.4
High Yield (Global)	0.4	-0.1	0.9	1.1	2.7	5.3	7.7
Overseas Bonds	-1.1	-4.6	-9.2	-6.5	-1.2	1.3	3.6
Property *	0.0	1.0	-16.9	3.9	2.5	7.1	6.5
Cash	0.5	1.3	4.1	1.6	1.3	0.9	2.0
Commodities £-converted	10.0	6.6	-9.7	28.9	6.1	-1.3	0.5
Hedge Funds original \$ basis *	2.1	2.2	5.0	8.1	5.0	4.7	5.4
Illustrative £-converted version *	-0.4	-0.5	0.3	7.1	5.8	6.6	6.8
Euro relative to Sterling	-0.1	-2.4	2.3	-1.7	-0.8	-0.2	1.0
US \$ relative to Sterling	-1.2	-2.3	-5.4	0.7	0.4	1.7	1.1
Japanese Yen relative to Sterling	0.5	-6.4	-11.0	-8.8	-4.3	-2.0	0.3
Sterling trade weighted	0.2	3.3	3.2	1.8	1.2	0.4	-0.7
Price Inflation (RPI) *	0.3	2.5	10.7	8.7	6.0	4.2	3.7
Price Inflation (CPI) *	0.2	2.0	8.0	6.6	4.4	3.0	2.8
Price Inflation (RPIX) *	0.2	2.3	9.6	8.4	5.8	4.2	3.7
Earnings Inflation **	-1.8	-1.4	7.2	6.8	4.6	3.3	3.2
All Share Capital Growth	2.5	-2.0	2.2	8.6	-0.3	1.8	3.7
Dividend Growth	0.3	2.8	10.4	-1.0	0.1	2.8	4.2
Earnings Growth	-15.7	-30.9	-19.2	-2.0	-7.7	-0.6	3.3

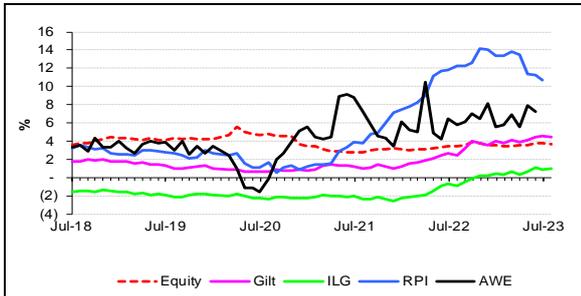
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

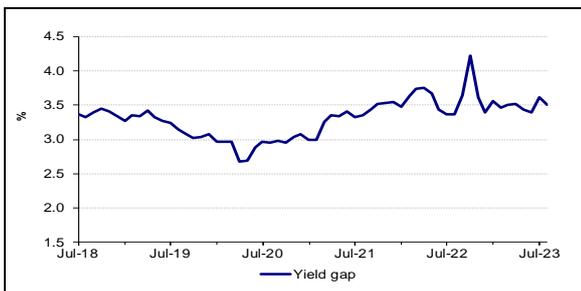


Yields and Yield Gaps

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.

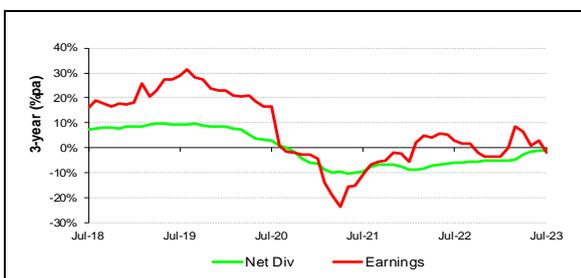
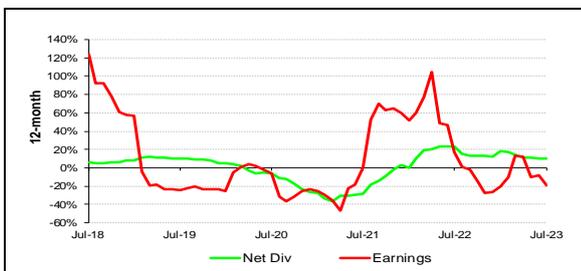


The gap gives a current expectation of around 3.5% p.a. for longer-term inflation including the (unknown) risk premium for gilts, relative to index-linked gilts.

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]

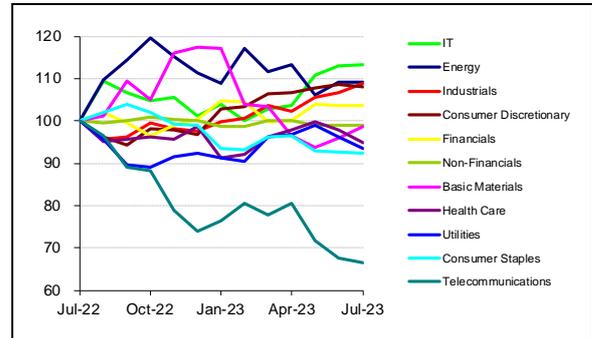
Figure 3: Dividend & Earnings Growth



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



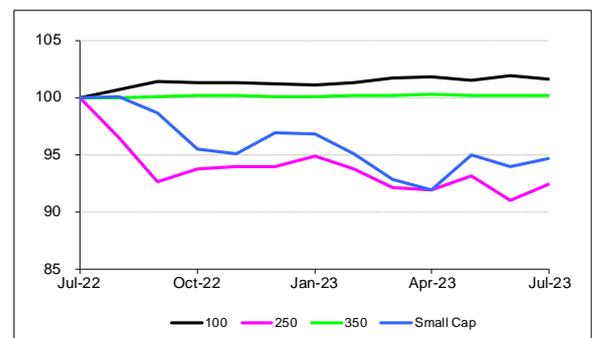
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (down from 57% to 47%).

(% absolute return)	1 mth	3 mth	12 mth
Energy	2.7	-4.7	15.8
Basic Materials	5.5	1.0	4.7
Industrials	4.7	5.3	15.6
Consumer Staples	2.4	-5.2	-1.9
Health Care	-0.3	-4.1	0.7
Consumer Discretionary	2.1	0.0	14.5
Telecommunications	0.7	-18.6	-29.5
Utilities	-0.1	-4.4	-0.8
Non-Finan	2.7	-2.1	5.0
Financials	2.5	2.3	9.8
IT	2.9	7.8	20.1
All Share	2.6	-1.2	6.1

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



This month, Mid Cap and Small Cap both rose 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

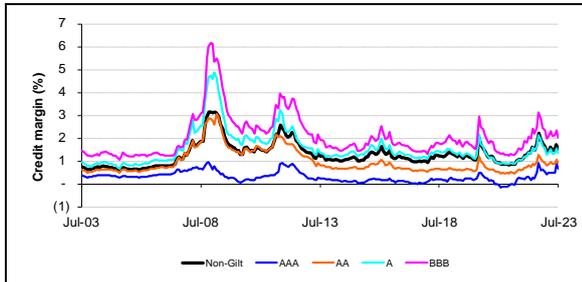


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Feb '23	4.81	4.14	0.67
Mar '23	4.67	3.84	0.83
Apr '23	4.78	4.06	0.72
May '23	5.20	4.47	0.73
Jun '23	5.08	4.50	0.58
Jul '23	4.99	4.48	0.51

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

Category	Mkt Val (£bn @ Jul 23 & 20, 17)			Weight (%)
Gilts (58)	1,370	1,676	1,357	71.5
Non-Gilts (1,243)	547	673	564	28.5
AAA (150)	115	135	109	6.0
AA (157)	71	85	87	3.7
A (431)	162	184	166	8.4
BBB (505)	199	268	201	10.4

Category	Mkt Val (£bn @ Jul 23 & 20)		W't (%)	Dur'n (yrs)
Gilts (58)	1,370	1,676	71.5	9.5
< 5 Yrs (14)	434	373	22.6	2.6
5-15 Yrs (16)	447	465	23.3	7.7
> 15 Yrs (28)	489	837	25.5	17.2
Non-Gilts (1,243)	547	673	28.5	5.8
< 5 Yrs (542)	269	224	14.0	2.6
5-15 Yrs (479)	195	283	10.2	6.9
> 15 Yrs (222)	83	166	4.4	13.5

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

Category	Mkt Val (£bn)	Weight (%)
Sovereigns (486)	6,819	56.8
Non-Sovereigns	5,178	43.2
AAA (1,212)	1,687	14.1
AA (814)	977	8.1
A (1,556)	1,199	10.0
BBB (1,972)	1,316	11.0

Category	Mkt Val (£bn)	Weight (%)
1 – 3 Yrs (1,586)	2,916	24.3
3 – 5 Yrs (1,633)	2,663	22.2
5 – 7 Yrs (1,103)	1,933	16.1
7 – 10 Yrs (969)	2,000	16.7
10+ Yrs (749)	2,485	20.7

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Jul 23 & 20)		W't (%)	Dur'n (yrs)
Gilts (33)	563	813	100.0	15.7
< 5 Yrs (4)	95	70	17.0	2.1
5 – 15 Yrs (10)	196	198	34.8	9.0
> 15 Yrs (19)	271	546	48.2	25.4

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

Month End	US (%)	Euro (%)	Sterling (%)
Mar '23	7.75	6.85	9.93
Apr '23	7.70	6.86	10.11
May '23	8.11	6.94	10.28
Jun '23	7.92	7.01	10.62
Jul '23	7.72	6.86	10.20

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

£ Gilt Market “main” & “Green” Issuance

- £3.75bn, 4½% 2028 (2.19x, 4.58%, 0%, Jun '23)
- £3.50bn, 3¼% 2033 (2.75x, 4.60%, 0%, Jun '23)
- £3.00bn, 3¾% 2038 (2.56x, 4.45%, 0%, Jun '23)
- £2.50bn, 3¾% 2053 (2.33x, 4.48%, 0%, Jun '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.

