



## Investment Update August 2023

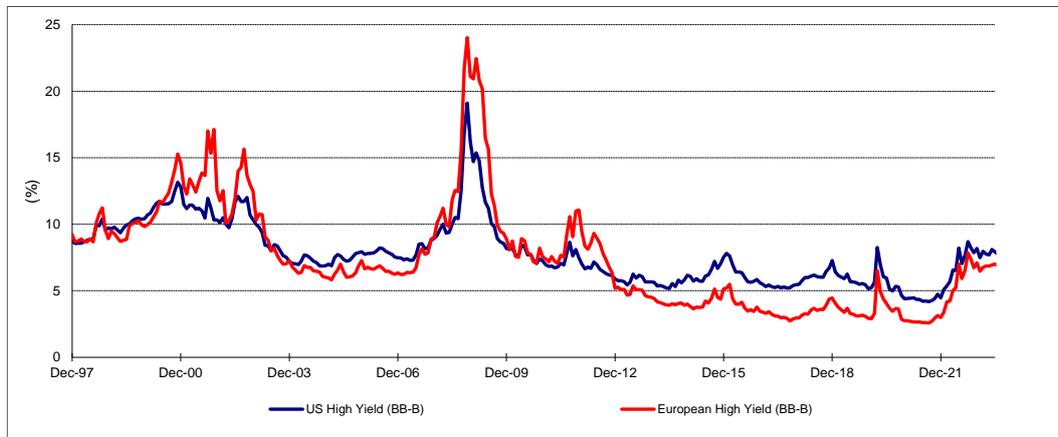
### Investment Headlines & Comment

- A poor month for most equity markets, particularly the Far East and Emerging Markets.
- Gilt yields rose again, with long-dated now up at levels last seen in 2010.
- Increased regulations coming on [DC governance](#), particularly in respect of illiquid assets.

### Feature Section

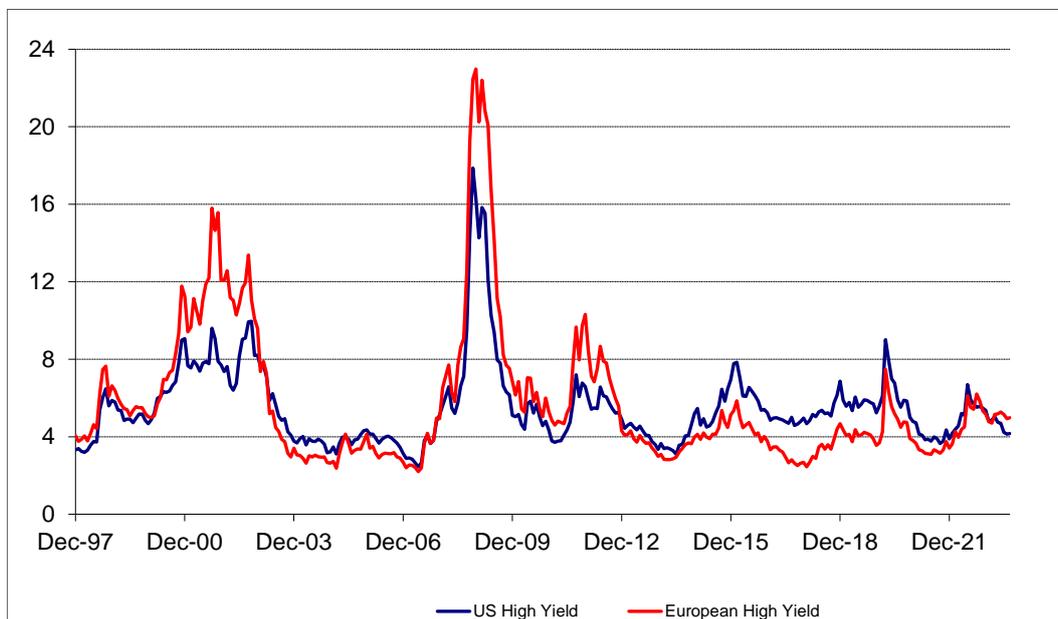
This month we consider the longer-term history of High Yield bonds, and the credit margins on them relative to 10-year government bonds. The focus is on US and Euro bonds, as they have much more diversified markets than the UK. For example, using the BB-B indices that we use in Table 2g on page 4 of *Update* each month, then as of 31 August 2023, the Sterling index only involved 93 issues with a total value of £37bn. This is in stark contrast to the Euro market where 663 issues account for a €350bn market, and the US market where 1,601 issues make up a \$1,079bn market.

**Figure 1a: Long-run yield history**



After the two panic periods for the tech bubble and then for the epic “credit crunch”, the yields have been within a fairly narrow range for much of the last decade.

**Figure 1b: Long-run credit margin history**



There was a mini spike at the time of the Covid pandemic, and more recently the rise in yields as the period of near-zero cash rates ended.

Even with the recent government bond market yield rises, the position for the credit margins is pretty good for investors.

Source: ICE, JP Morgan



**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 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	-2.5	1.1	5.2	10.5	3.4	5.5	7.2
Overseas Equities	-1.1	4.5	5.1	9.6	8.7	11.7	10.0
US Equities	-0.1	<b>6.0</b>	6.4	<b>11.8</b>	<b>11.5</b>	<b>14.9</b>	8.6
Europe ex UK Equities	-2.4	2.0	<b>15.8</b>	8.4	6.2	8.2	<b>11.2</b>
Japan Equities	-0.6	2.7	6.3	6.2	3.8	8.1	6.4
Pacific ex Japan Equities	-4.2	0.6	-7.2	1.7	2.9	7.0	9.8
Emerging Markets	-4.7	1.4	-6.6	0.1	1.9	5.5	9.0
UK Long-dated Gilts	-1.9	-0.4	-19.5	-18.9	-8.2	<b>0.1</b>	3.1
UK Long-dated Corp. Bonds	-1.6	0.9	-8.2	-13.2	-4.3	1.6	3.7
UK Over 5 Yrs Index-Linked Gilts	-1.5	1.5	-19.3	-14.2	-5.8	1.3	4.3
High Yield (Global)	<b>1.3</b>	1.1	-0.3	1.7	2.8	5.7	7.6
Overseas Bonds	0.2	-3.8	-9.6	-5.6	-1.3	1.6	3.6
Property *	0.0	0.4	-16.5	3.8	2.4	7.0	6.4
Cash	0.5	1.3	4.4	1.8	1.3	0.9	<b>2.0</b>
Commodities £-converted	1.6	13.7	-9.8	28.3	6.1	-1.3	0.3
Hedge Funds original \$ basis *	1.8	3.8	5.6	7.7	5.2	4.8	5.4
Illustrative £-converted version *	0.6	1.3	-0.2	8.4	5.7	6.5	6.6
Euro relative to Sterling	0.0	-0.4	-0.9	-1.4	-0.9	0.0	1.1
US \$ relative to Sterling	1.5	-2.2	-8.2	1.7	0.5	2.0	1.1
Japanese Yen relative to Sterling	-0.9	-6.1	-12.6	-8.7	-4.8	-1.9	0.0
Sterling trade weighted	-0.1	2.1	6.3	1.4	1.1	0.1	-0.7
Price Inflation (RPI) *	-0.6	0.4	9.0	8.3	5.8	4.1	3.7
Price Inflation (CPI) *	-0.5	0.4	6.9	6.3	4.3	2.9	2.8
Price Inflation (RPIX) *	-0.7	0.1	7.9	8.0	5.7	4.1	3.7
Earnings Inflation **	3.7	-7.5	9.2	8.2	5.3	3.6	3.3
All Share Capital Growth	-3.3	-0.2	1.3	6.7	-0.2	1.8	3.4
Dividend Growth	2.2	3.3	11.1	1.4	0.2	2.9	4.3
Earnings Growth	27.7	9.5	4.0	17.1	-3.1	2.3	4.4

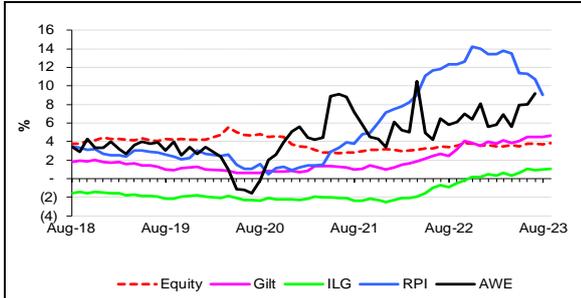
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

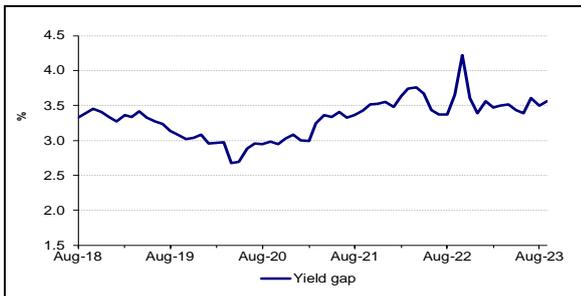


## Yields and Yield Gaps

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.

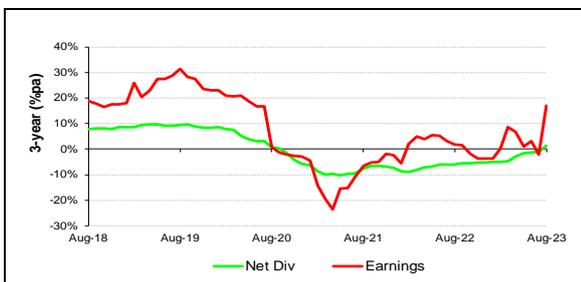
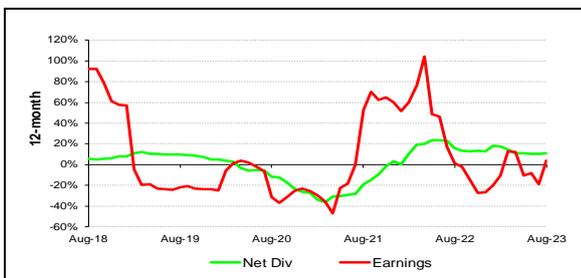


The gap gives a current expectation of around 3.6% p.a. for longer-term inflation including the (unknown) risk premium for gilts, relative to index-linked gilts.

## 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]

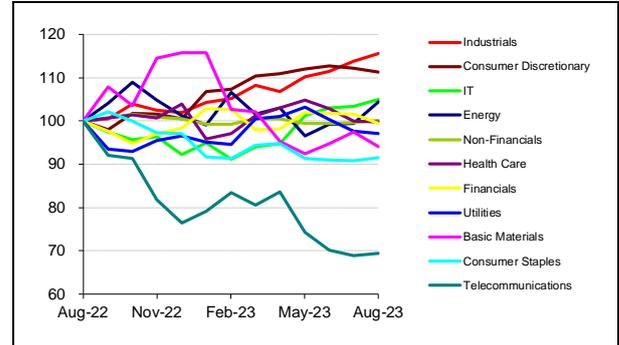
Figure 3: Dividend & Earnings Growth



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



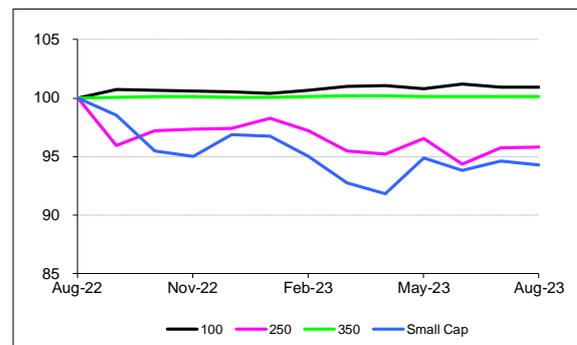
Note: Sector labels for relative lines are in end-value order

There was a small fall this month in the rolling 12-month sector dispersion (down from 47% to 46%).

(% absolute return)	1 mth	3 mth	12 mth
Energy	2.6	9.4	10.0
Basic Materials	-5.9	2.8	-1.1
Industrials	-0.9	5.9	21.7
Consumer Staples	-1.8	1.2	-3.8
Health Care	-2.7	-3.9	5.0
Consumer Discretionary	-3.3	0.4	17.1
Telecommunications	-1.6	-5.6	-26.9
Utilities	-3.0	-4.9	2.2
Non-Finan	-1.9	1.8	5.4
Financials	-4.6	-1.4	4.6
IT	-0.8	4.9	10.6
All Share	-2.5	1.1	5.2

## UK Equity Size Returns

Figure 4b: Size groups relative to All Share



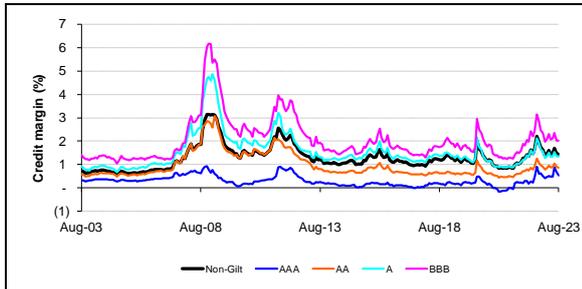
This month, Mid Cap was flat but Small Cap fell slightly relative to the All Share.

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 (%)
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
Aug '23	<b>5.15</b>	<b>4.61</b>	<b>0.54</b>

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

Category	Mkt Val (£bn @ Aug 23 & 20, 17)			Weight (%)
Gilts (58)	1,382	1,677	1,358	71.6
Non-Gilts (1,246)	547	668	579	28.4
AAA (156)	118	135	112	6.1
AA (157)	71	82	90	3.7
A (430)	160	187	164	8.3
BBB (503)	198	263	213	10.3

Category	Mkt Val (£bn @ Aug 23 & 20)		W't (%)	Dur'n (yrs)
Gilts (58)	1,382	1,677	71.6	9.3
< 5 Yrs (14)	445	388	23.0	2.5
5-15 Yrs (16)	455	486	23.6	7.7
> 15 Yrs (28)	482	803	25.0	16.9
Non-Gilts (1,246)	547	668	28.4	5.7
< 5 Yrs (547)	271	228	14.1	2.6
5-15 Yrs (476)	194	281	10.1	6.8
> 15 Yrs (223)	82	159	4.3	13.3

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

Category	Mkt Val (£bn)	Weight (%)
Sovereigns (486)	6,862	57.0
Non-Sovereigns	5,176	43.0
AAA (1,215)	1,702	14.1
AA (810)	972	8.1
A (1,551)	1,194	9.9
BBB (1,962)	1,309	10.9

Category	Mkt Val (£bn)	Weight (%)
1 – 3 Yrs (1,574)	2,950	24.5
3 – 5 Yrs (1,656)	2,682	22.3
5 – 7 Yrs (1,088)	1,910	15.9
7 – 10 Yrs (960)	2,007	16.7
10+ Yrs (746)	2,489	20.7

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

Category (Number of issues)	Mkt Val (£bn @ Aug 23 & 20)		W't (%)	Dur'n (yrs)
Gilts (33)	559	780	100.0	15.5
< 5 Yrs (5)	119	70	21.3	2.6
5 – 15 Yrs (9)	174	198	31.1	9.5
> 15 Yrs (19)	266	512	47.5	25.2

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

Month End	US (%)	Euro (%)	Sterling (%)
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
Aug '23	<b>7.84</b>	<b>6.87</b>	<b>10.45</b>

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

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

- £4.00bn, 3½% 2025 (2.67x, 5.27%, 0%, Jun '23)
- £1.84bn, ¾% IL 2033 (2.33x, 0.98%, 23%, Jun '23)
- £3.50bn, ¾% 2033 (2.60x, 4.35%, 0%, Jul '23)
- £1.10bn, 1/8% IL 2039 (2.62x, 0.99%, 23%, Apr '23)
- £2.50bn, 1 1/8% 2039 (2.51x, 4.79%, 0%, Apr '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.

