



Investment Update January 2024

Investment Headlines & Comment

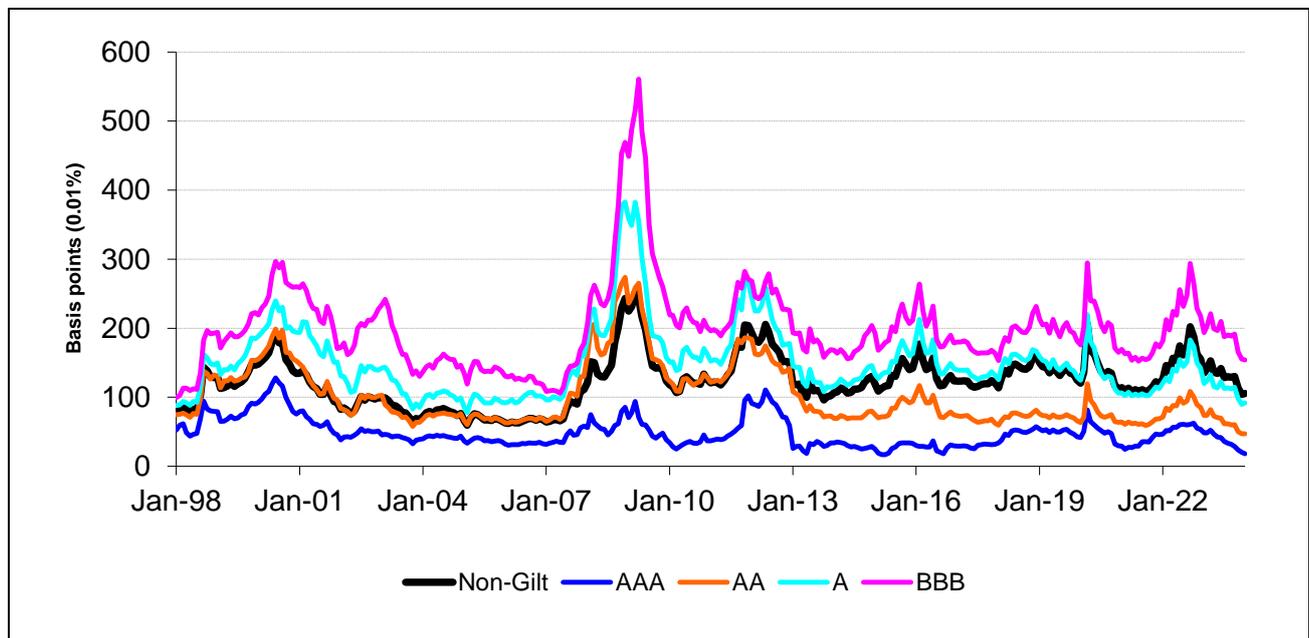
- A poor month for UK bonds and Index-Linked Gilts.
- A poor month for Far East and Emerging Market Equities.
- There was strong demand for the new 30-year gilt.

Feature Section

This month we look at the history of long-dated investment grade corporate bonds, in particular the additional credit margin offered by them relative to long-dated gilts. The dataset is from iBoxx, and goes back as far as January 1998 – back then, the overall all-dated corporate bond market was pretty small relative to the government bond market. As shown on page 4, that statement continues to be true for long-dated debt, with a January 2024 value of £87bn versus £494bn for long-dated gilts.

Figure 1 shows the credit margins for the overall non-gilt market and for the various rating levels within that over the last 26 years. Originally, the overall market rating was around AA rated, which would have influenced how the requirements were established for reporting pension schemes in company accounts. The overall market rating stayed around AA rated for around 15 years, but over the last decade that overall market rating has shifted to being around A rated.

Figure 1: Long-dated investment grade credit margins



Source: iBoxx

The credit margin on long-dated AA bonds is now at a record low of just under 0.5% p.a. This would suggest that pension scheme valuations quoted within company accounts would now be unusually high relative to valuations on other measures. It is also worth noting that there are currently only 26 bonds that are AA-rated and with a maturity exceeding 15 years. If that number of bonds reduces much further, or the market becomes overly skewed to a few sectors, then the accounting profession is surely going to have to revisit their methodology?

At the overall market level, the long-dated credit margin continues to be significantly more than that needed to compensate for downgrades to sub investment grade status (or outright defaults). Investors are therefore still incentivized to take on the credit risk.



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 January 2024

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	-1.3	6.2	1.9	8.4	5.5	5.5	7.0
Overseas Equities	1.1	10.8	12.5	9.5	11.8	12.3	10.3
US Equities	1.6	10.9	17.2	12.9	15.0	15.4	8.5
Europe ex UK Equities	0.2	11.3	8.8	8.2	9.4	8.4	11.8
Japan Equities	4.2	12.0	14.2	5.3	7.4	9.0	6.8
Pacific ex Japan Equities	-4.3	7.7	-4.3	-2.5	4.7	7.7	9.7
Emerging Markets	-4.5	2.0	-5.8	-4.8	2.0	5.9	8.7
UK Long-dated Gilts	-4.9	10.2	-7.0	-17.9	-7.7	0.3	3.2
UK Long-dated Corp. Bonds	-3.4	12.5	0.9	-12.2	-3.0	2.1	4.1
UK Over 5 Yrs Index-Linked Gilts	-5.6	6.2	-9.0	-14.2	-6.1	1.2	4.2
High Yield (Global)	0.2	3.7	5.2	2.5	4.0	6.3	8.1
Overseas Bonds	-1.5	2.1	-3.9	-4.4	-1.1	2.2	3.8
Property *	-0.4	-1.2	-0.1	2.5	1.7	6.1	6.0
Cash	0.4	1.3	5.2	2.5	1.7	1.1	2.0
Commodities £-converted	4.6	-7.3	-3.2	22.0	8.5	-0.5	0.5
Hedge Funds original \$ basis *	3.2	4.2	8.1	4.5	7.1	4.6	5.2
Illustrative £-converted version *	2.4	-0.3	2.0	7.0	7.1	7.4	7.0
Euro relative to Sterling	-1.6	-2.1	-3.3	-1.2	-0.4	0.4	1.1
US \$ relative to Sterling	0.1	-4.7	-3.3	2.5	0.7	2.6	1.8
Japanese Yen relative to Sterling	-3.5	-1.3	-14.0	-8.3	-5.1	-1.0	0.2
Sterling trade weighted	1.2	2.8	5.4	1.2	0.9	-0.4	-1.0
Price Inflation (RPI) *	0.5	0.2	5.2	8.7	5.8	4.1	3.7
Price Inflation (CPI) *	0.4	0.2	3.9	6.6	4.3	2.9	2.8
Price Inflation (RPIX) *	0.4	-0.1	4.0	8.1	5.6	4.0	3.7
Earnings Inflation **	0.7	0.7	4.7	5.4	4.9	3.7	3.2
All Share Capital Growth	-1.4	5.5	-1.9	4.6	1.8	1.8	3.3
Dividend Growth	0.2	3.1	9.4	9.0	-0.4	3.1	4.4
Earnings Growth	-0.5	18.6	65.1	25.8	2.0	4.2	5.6

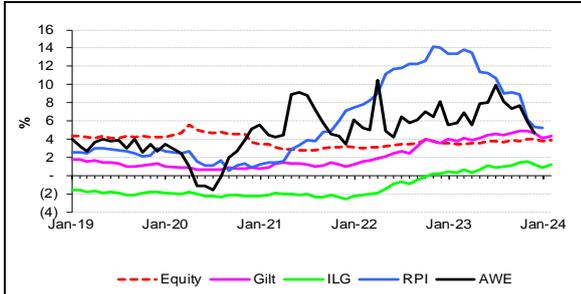
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

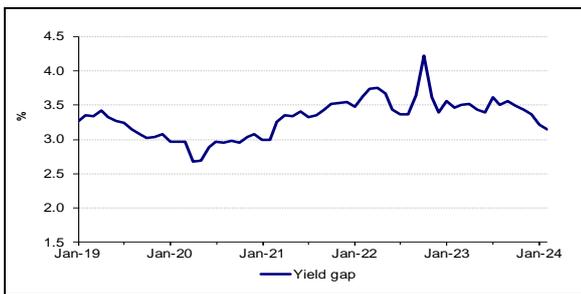


Yields and Yield Gaps

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.

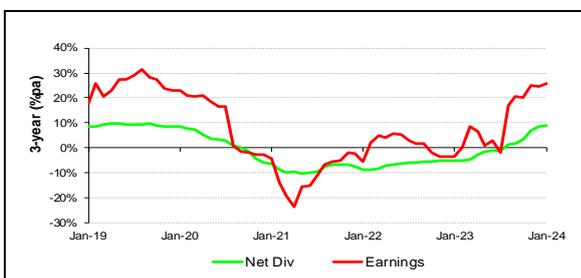
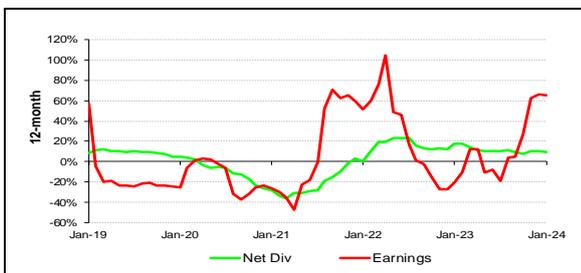


The gap gives a current expectation of around 3.2% p.a. for longer-term inflation including the (unknown) risk premium for gilts, relative to index-linked gilts.

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]

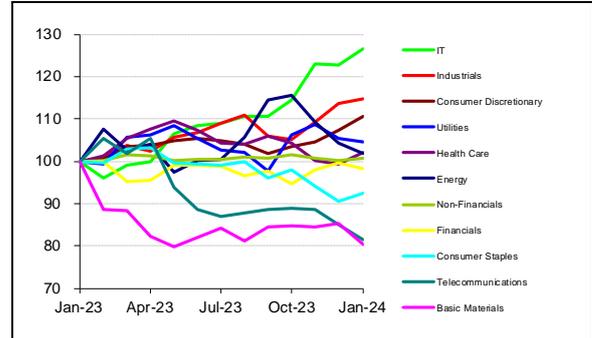
Figure 3: Dividend & Earnings Growth



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



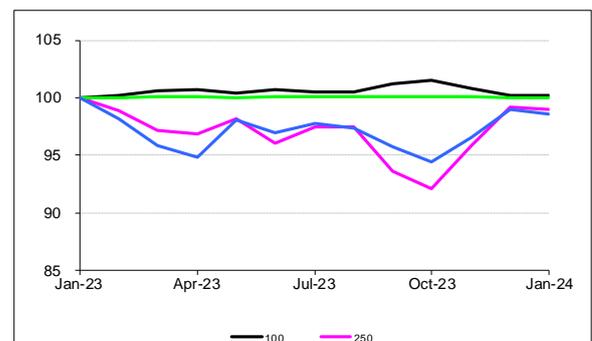
Note: Sector labels for relative lines are in end-value order

There was a rise this month in the rolling 12-month sector dispersion (up from 41% to 46%).

(% absolute return)	1 mth	3 mth	12 mth
Energy	-3.7	-6.4	3.7
Basic Materials	-7.1	0.6	-18.2
Industrials	-0.3	16.1	17.0
Consumer Staples	0.8	0.3	-5.7
Health Care	1.5	4.2	4.1
Consumer Discretionary	1.8	13.6	12.8
Telecommunications	-5.2	-2.5	-16.9
Utilities	-2.2	4.5	6.5
Non-Finan	-0.9	5.1	2.5
Financials	-2.8	10.0	0.0
IT	1.9	17.6	29.0
All Share	-1.3	6.2	1.9

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



This month, Mid Cap and Small Cap both 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

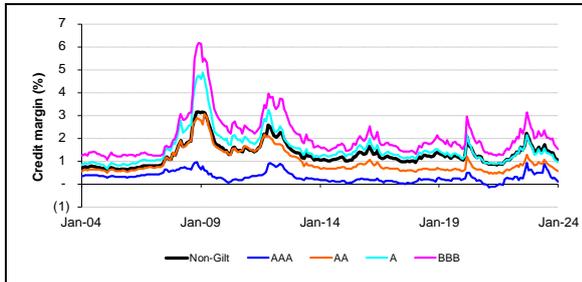


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
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	4.46	4.08	0.38
Jan '24	4.77	4.37	0.40

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

Category	Mkt Val (£bn @ Jan 24 & 21, 18)			Weight (%)
Gilts (59)	1,475	1,797	1,336	72.2
Non-Gilts (1,238)	568	669	565	27.8
AAA (141)	114	125	107	5.6
AA (159)	73	80	78	3.6
A (432)	171	192	166	8.4
BBB (506)	210	271	215	10.3

Category	Mkt Val (£bn @ Jan 24 & 21)		W't (%)	Dur'n (yrs)
Gilts (59)	1,475	1,797	72.2	9.2
< 5 Yrs (15)	506	425	24.8	2.6
5-15 Yrs (16)	475	524	23.3	8.0
> 15 Yrs (28)	494	847	24.2	17.3
Non-Gilts (1,238)	568	669	27.8	5.8
< 5 Yrs (571)	295	226	14.4	2.7
5-15 Yrs (449)	186	281	9.1	7.1
> 15 Yrs (218)	87	161	4.3	13.5

Tables 2d, 2e: € Market Size and Maturity (Jan 24)

Category	Mkt Val (£bn)	Weight (%)
Sovereigns (496)	7,272	57.1
Non-Sovereigns	5,463	42.9
AAA (1,231)	1,793	14.1
AA (846)	1,031	8.1
A (1,540)	1,236	9.7
BBB (2,013)	1,402	11.0

Category	Mkt Val (£bn)	Weight (%)
1 – 3 Yrs (1,687)	3,146	24.7
3 – 5 Yrs (1,685)	2,853	22.4
5 – 7 Yrs (1,062)	1,988	15.6
7 – 10 Yrs (958)	2,090	16.4
10+ Yrs (734)	2,657	20.9

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Jan 24 & 21)		W't (%)	Dur'n (yrs)
Gilts (33)	569	788	100.0	14.7
< 5 Yrs (5)	123	69	21.5	2.2
5 – 15 Yrs (9)	184	201	32.2	9.1
> 15 Yrs (19)	263	518	46.2	24.4

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

Month End	US (%)	Euro (%)	Sterling (%)
Oct '23	8.76	7.28	10.45
Nov '23	7.81	6.60	9.61
Dec '23	7.12	5.95	8.80
Jan '24	7.24	5.94	8.49

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

£ Gilt Market “main” & “Green” Issuance

- £5.00bn, 3¾% 2027 (3.44x, 3.89%, 25%, new)
- £4.03bn, 4½% 2028 (2.86x, 3.95%, 1%, Dec '23)
- £1.52bn, ¾% IL 2033 (3.04x, 0.42%, 1%, Dec '23)
- £3.75bn, 4½% 2034 (3.10x, 3.97%, 0%, Dec '23)
- £3.42bn, 3¾% 2038 (3.36x, 4.07%, 14%, Oct '23)
- £2.81bn, 4¾% 2043 (3.62x, 4.39%, 25%, Nov '23)
- £0.96bn 1/8 IL 2051 (3.10x, 1.33%, 7%, Nov '23)
- £6.00bn, 4¾% 2054 (**12.97x**, 4.57%, n/a, new)

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.

