JAGGER & ASSOCIATES

Investment Update
November 2024

Investment Headlines & Comment

- A very strong month for US equities, with the S&P reaching a new record high level.
- In contrast, European equities and the Euro have struggled in the face of a possible trade war.
- It is a similar story for Emerging Markets, lagging badly behind US equities.

Feature Section

This month we again consider the state of the UK gilt market. Since mid 2009 there has been a Post Auction Option Facility (PAOF) whereby additional gilts can be purchased by successful bidders in the initial auction. Originally this was for up to an additional 10%, but over time that limit has been increased and is currently 25%.

PAOF demand has certainly fluctuated over time, but it was often strong for relatively new conventional gilt issues and also for Index-Linked Gilts (given their comparatively limited issuance) as well as for so-called syndication cases (which don't have a PAOF element to them). The most likely explanation for these spikes in demand would be that pension schemes' Liability Driven Investment (LDI) portfolios were using these opportunities to improve their cashflow fitting.

There is a good example of this in action from this month's issuance of £4.25bn of Index-Linked 2054, which was 15.5x subscribed (see page 4 for details) – subscription levels are usually around 3x. However, as shown on page 4, the overall demand for the PAOF has been absolutely minimal this month (and it has been generally low in recent months as well). This might be taken as a signal that the market sees gilts as poor value and expects yields to rise. That conclusion is perhaps not so surprising when you consider the likely scale of future reissuance we reported on in our August 2024 edition.

Matters were not helped by the Budget in late October. The Office for Budget Responsibility (OBR) stated in its summary that it expected gilt yields to rise by 0.25% p.a. because of the increased borrowing required to meet the "£22bn black hole" that Labour claimed to have inherited. (Note that the OBR's separate review of matters suggests £9.5bn was the real "surprise" element with the rest of the increased borrowing being due to policies initiated since March 2024.) Given the doubts that exist about whether the Budget measures will raise anywhere near as much as was claimed, there has to be a realistic possibility that the true eventual (rather than immediate) rise in gilt yields will be more than expected. Readers may point out that nominal gilt yields actually fell in November but we think that this can be ascribed to short-term fluctuations, rather than saying the risk of rising gilt yields has gone away. (Real yields barely moved in November.)

We are also back in the peculiar situation that, since the summer of 2024, UK Government Debt has been priced on a higher yield than AAA-rated sterling-denominated non-government debt (or, in jargon terms, the credit margin has turned negative - see Figure 5 on page 4). This unusual situation has happened occasionally before now, most recently in late 2020 and early 2021, but before that you have got to go right back to the mid to late 1990s.

Meanwhile, we have just entered the third year of the unwinding of the Quantitative Easing (QE) portfolio. There is still £665bn to be sold back into the market. However, the interesting thing is that since the unwinding started in November 2022, there have been 1,200 sales attempted but only 40% of those involve offers that have been accepted. So, either the Bank of England is being exceptionally cautious in not wanting to disrupt the broader market pricing or else it is trying to avoid criticism that they are selling down the QE portfolio "on the cheap". We look to have at least another 8 or so years to go before the process concludes.

In the past, Gilts used to be thought of as a rather uninteresting asset. How times have changed!

Editor's note: This is the 300th edition of *Investment Update*, which means we have now been crunching market statistics for 25 years. The degree of automation in their production has increased markedly but the fascination remains of what the statistics are actually able to tell us.

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Investment Update

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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 30 November 2024

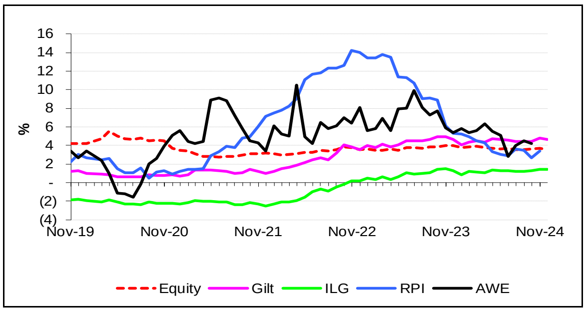
Asset Class	1 month (%)	3 months (%)	12 months (%)	3 years (% p.a.)	5 years (% p.a.)	10 years (% p.a.)	20 years (% p.a.)
UK Equities	2.5	-0.5	15.7	7.9	5.7	6.1	7.1
Overseas Equities	5.3	7.5	26.3	9.7	12.5	12.5	11.1
US Equities	**7.4**	**11.2**	**33.5**	**12.5**	**16.1**	**15.7**	8.1
Europe ex UK Equities	-1.4	**-4.8**	5.0	3.0	6.3	7.7	**13.1**
Japan Equities	1.8	-0.2	13.0	5.4	5.9	8.8	6.9
Pacific ex Japan Equities	-0.5	1.5	15.7	2.7	5.9	7.4	10.0
Emerging Markets	**-2.5**	1.8	12.0	0.5	4.0	5.7	8.8
UK Long-dated Gilts	2.5	-2.7	3.6	**-18.3**	**-9.9**	**-1.5**	2.8
UK Long-dated Corp. Bonds	2.3	-1.4	5.7	-12.0	-5.4	0.8	3.7
UK Over 5 Yrs Index-Linked Gilts	0.2	-2.6	**1.5**	-18.1	-7.6	-0.4	3.8
High Yield (Global)	1.5	4.7	11.7	4.1	3.9	6.5	8.3
Overseas Bonds	1.6	1.8	2.8	-3.8	-2.1	1.9	3.8
Property *	0.8	2.1	3.9	0.1	2.3	5.1	5.5
Cash	0.4	1.2	5.2	3.6	2.2	1.4	**2.0**
Commodities £-converted	1.2	3.8	1.9	12.6	8.3	1.5	-0.5
Hedge Funds original $ basis *	-0.5	1.1	13.9	3.4	7.2	5.1	5.3
Illustrative £-converted version *	3.8	1.0	7.5	5.6	7.3	7.4	7.2
Euro relative to Sterling	-1.6	-1.3	-3.6	-0.8	-0.5	0.4	0.9
US $ relative to Sterling	1.1	3.4	-0.4	1.3	0.3	2.1	2.1
Japanese Yen relative to Sterling	2.6	0.2	-2.0	-7.7	-5.8	-0.3	0.1
Sterling trade weighted	0.4	-0.6	2.9	1.2	1.0	-0.3	-0.9
Price Inflation (RPI) *	0.5	0.8	3.4	7.8	6.1	4.2	3.7
Price Inflation (CPI) *	0.6	0.9	2.3	5.9	4.5	3.0	2.9
Price Inflation (RPIX) *	0.5	0.7	2.8	7.1	5.7	4.1	3.7
Earnings Inflation **	1.1	-1.2	4.2	6.3	5.2	4.0	3.3
All Share Capital Growth	2.1	-1.1	11.6	4.0	2.2	2.3	3.3
Dividend Growth	-1.2	-0.9	0.1	7.6	-1.3	3.1	4.0
Earnings Growth	3.2	1.5	-7.8	2.9	6.1	3.8	3.8

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

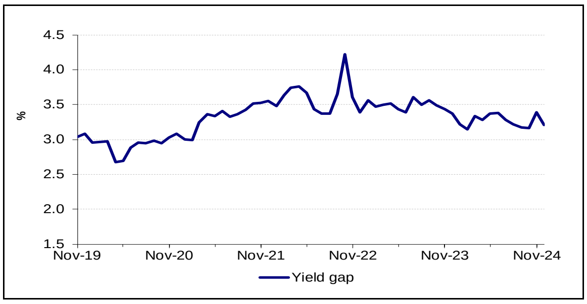
- *UK Equities (incl. dividends and earnings) – FT-A All Share.*
- *Overseas Equities (incl. regions) – blend of FT All-World / World sub-indices*
- *Emerging Markets from MSCI US $ based total return index (overall Index to 31 Oct 2001, Free Index from 1 Nov 2001 to take account of foreign investment 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, and SONIA since March 2021, 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.

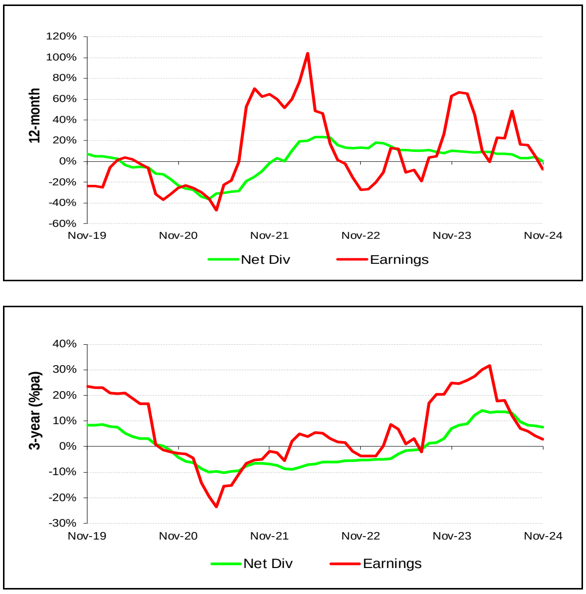


The gap gives a current expectation of around 3.2% p.a. for longer-term inflation *including the (unknown) risk premium for gilts, relative to index-linked gilts.*

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*]

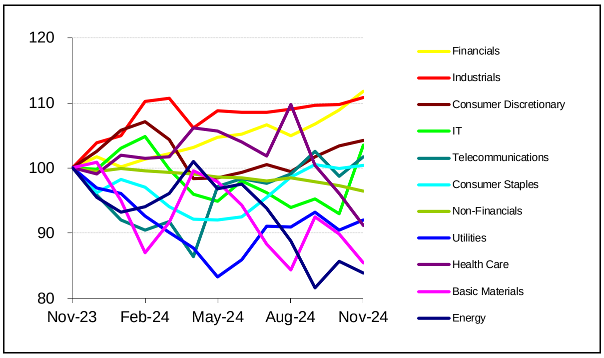
Figure 3: Dividend & Earnings Growth



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



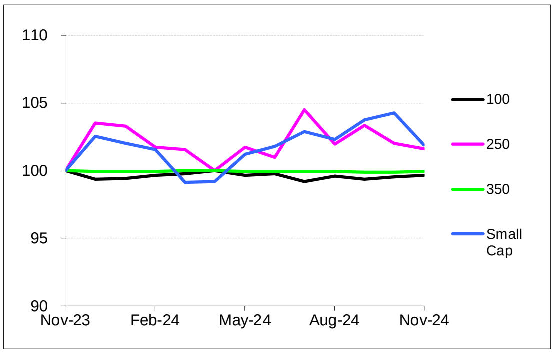
Note: Sector labels for relative lines are in end-value order

There was a small fall this month in the rolling 12-month sector dispersion (down from 33% to 28%).

(% absolute return)	1 mth	3 mth	12 mth
Energy	0.3	-6.1	-3.0
Basic Materials	-2.5	0.9	-1.1
Industrials	3.5	1.2	28.3
Consumer Staples	3.0	1.4	16.3
Health Care	-2.7	-17.4	5.5
Consumer Discretionary	3.4	4.4	20.7
Telecommunications	5.6	2.1	17.8
Utilities	4.4	0.8	6.6
Non-Finan	1.6	-2.6	11.6
Financials	5.2	6.0	29.4
IT	14.1	9.7	19.9
All Share	2.5	-0.5	15.7

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

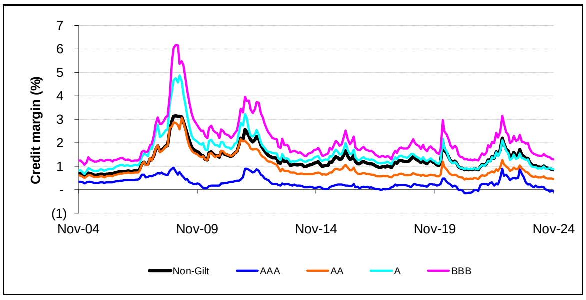


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Jun '24	5.05	4.58	0.47
Jul '24	4.90	4.43	0.47
Aug '24	4.90	4.40	0.50
Sep '24	5.00	4.45	0.55
Oct '24	5.26	4.79	0.47
Nov '24	**5.11**	**4.65**	**0.46**

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

Category	Mkt Val (£bn @ Nov 24 & 21, 18)			Weight (%)
Gilts (60)	1,499	1,858	1,295	72.1
Non-Gilts (1,254)	579	667	566	27.9
AAA (152)	122	130	118	5.9
AA (178)	80	80	82	3.9
A (440)	173	191	157	8.3
BBB (484)	203	267	208	9.8

Category	Mkt Val (£bn @ Nov 24 & 21)		W't (%)	Dur'n (yrs)
Gilts (60)	1,499	1,858	72.1	9.3
< 5 Yrs (14)	472	446	22.7	2.9
5–15 Yrs (18)	530	541	25.5	8.1
> 15 Yrs (28)	496	870	23.9	16.8
Non-Gilts (1,253)	579	667	27.9	5.5
< 5 Yrs (588)	314	237	15.1	2.6
5–15 Yrs (449)	182	276	8.8	7.1
> 15 Yrs (216)	83	154	4.0	13.3

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (519)	7,854	56.8
Non-Sovereigns	5,967	43.2
AAA (1,328)	2,040	14.8
AA (894)	1,102	8.0
A (1,587)	1,297	9.4
BBB (2,120)	1,528	11.1

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,848)	3,406	24.6
3 – 5 Yrs (1,674)	2,931	21.2
5 – 7 Yrs (1,155)	2,199	15.9
7 – 10 Yrs (999)	2,281	16.5
10+ Yrs (772)	3,004	21.7

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Nov 24 & 21)		W't (%)	Dur'n (yrs)
Gilts (32)	548	926	100.0	15.3
< 5 Yrs (4)	100	92	18.2	3.1
5 – 15 Yrs (9)	185	230	33.8	9.4
> 15 Yrs (19)	263	604	48.1	24.0

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

Month End	US (%)	Euro (%)	Sterling (%)
Sep '24	6.52	5.18	7.82
Oct '24	6.86	5.18	7.86
Nov '24	**6.75**	**5.09**	**7.81**

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

£ Gilt Market "main" & "Green" Issuance

- £2.00bn, $^1/_8$% 2026 (4.31x, 4.00%, n/a, Sep '24)
- £4.07bn, 4$^3/_8$% 2028 (3.12x, 4.50%, 2%, Jan '24)
- £3.75bn, 4¼% 2034 (2.81x, 4.48%, 0%, Sep '24)
- £3.25bn, 3¾% 2038 (2.74x, 4.56%, 0%, Aug '24)
- £2.26bn, 4¾% 2043 (3.28x, 4.84%, 1%, Aug '24)
- £4.25bn, 1¼% IL 2054 (***15.5x***, 1.57%, n/a, Jul '24)

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.

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