

Investment Update February 2025



Investment Headlines & Comment

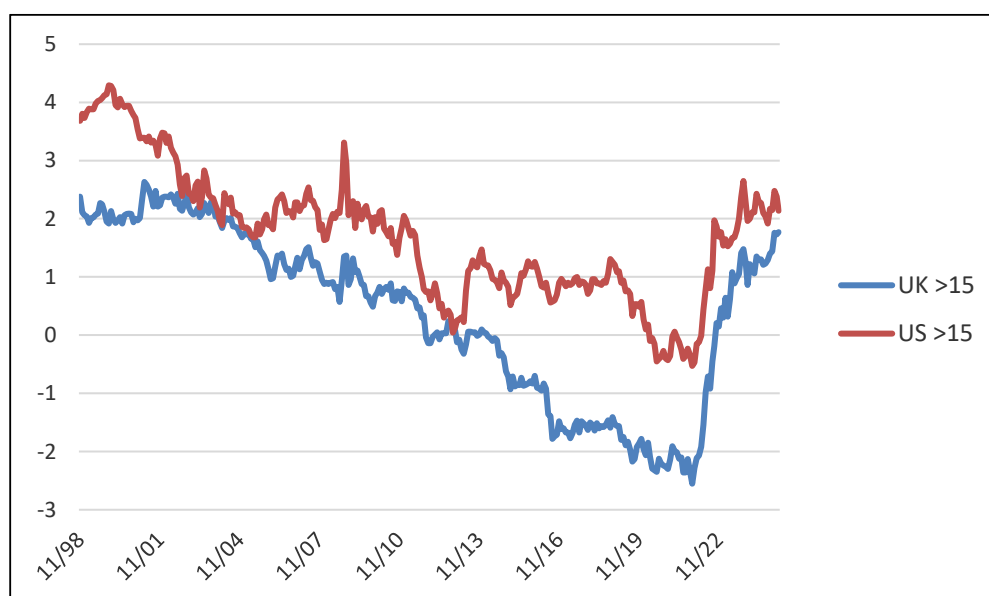
- It was a poor month for many equity markets.
- UK inflation rose slightly, denting hopes of a base rate cut.
- There was strong demand for the new 10-year gilt.

Feature Section

This month we revisit the real yields available on UK and US Government debt (ILGs and TIPs respectively). We last looked at this in our [March 2023](#) issue, when the fallout from Liz Truss's time in office was being felt, but things have evolved further since then.

Figure 1 shows the Over 15 Year real yields for ILGs and TIPs. It is quite striking that ILG real yields are now back to levels last seen in 2004, but it is the speed with which they have reverted that really stands out. For reference, measured from the lowest month-end real yield in November 2021 (a remarkable -2.55% p.a.), the unannualized total return on Over 15 Year ILGs during this reversion period has been -60%. For those investors who employed leverage, things will have been even worse.

Figure 1: Government real yields



Source: FT

So, what next for real yields? As shown in the second chart in Figure 2 on page 3, there is relatively little fluctuation in the market expectation for future inflation, so it is most likely going to be changes in nominal yields that determine where real yields go. As outlined in our [November 2024](#) edition, these yields are already under pressure from various angles and it is really not clear what the eventual stable “fair value” nominal and real yields should be. The Chancellor’s forthcoming financial statement in late March (and more importantly, the associated analysis from the Office for Budget Responsibility) should give some clue as to what to expect, although at the risk of being gloomy, it is difficult not to phrase it as “how much worse are things likely to get?”

Meanwhile, the yield on gilts now lies roughly midway between that on AAA-rated and AA-rated sterling investment grade non-government debt, which continues to be a highly unusual financial situation. The gap for gilts relative to AAA-rated has been at a record high of around 0.25% p.a. for the last couple of months.

Incidentally, the next ILG to mature will do so in just over a year’s time. By value, it accounts for about 4% of the whole market. Given the recent trend of reducing ILG issuance relative to conventional gilts, it will be interesting to see how the maturity proceeds get financed.



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 2025

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	-0.2	4.1	16.6	8.0	8.6	6.1	6.9
Overseas Equities	-2.2	1.1	15.3	12.1	13.8	12.2	11.0
US Equities	-2.8	-0.1	19.1	14.8	17.0	15.2	8.2
Europe ex UK Equities	2.3	9.8	7.4	8.8	9.6	8.4	12.9
Japan Equities	-2.6	0.7	1.8	7.5	7.8	8.0	6.7
Pacific ex Japan Equities	-3.6	-0.7	8.5	3.8	6.1	6.9	9.5
Emerging Markets	-0.8	3.2	11.2	3.1	5.0	6.0	8.3
UK Long-dated Gilts	1.3	-3.3	-2.9	-15.1	-11.6	-2.2	2.6
UK Long-dated Corp. Bonds	0.6	-0.6	0.6	-7.7	-6.3	0.3	3.6
UK Over 5 Yrs Index-Linked Gilts	-0.5	-4.6	-5.4	-16.7	-9.3	-1.0	3.5
High Yield (Global)	-0.4	2.5	9.8	6.5	4.0	6.7	8.3
Overseas Bonds	0.4	0.5	2.2	-2.1	-2.9	2.0	3.8
Property *	0.6	2.6	7.5	-1.5	2.7	5.0	5.4
Cash	0.4	1.2	5.1	4.0	2.4	1.5	2.0
Commodities £-converted	-2.6	6.3	6.2	5.6	12.3	3.7	-0.3
Hedge Funds original \$ basis *	1.3	3.3	11.0	5.6	7.4	5.4	5.3
Illustrative £-converted version *	2.1	6.9	13.7	8.3	8.6	7.4	7.5
Euro relative to Sterling	-1.3	-0.6	-3.4	-0.4	-0.8	1.3	0.9
US \$ relative to Sterling	-1.3	1.0	0.5	2.1	0.3	2.1	2.1
Japanese Yen relative to Sterling	1.4	0.6	-0.2	-6.6	-6.2	-0.3	0.3
Sterling trade weighted	1.2	0.2	2.4	0.8	1.2	-0.8	-0.9
Price Inflation (RPI) *	-0.1	0.3	3.6	7.2	6.2	4.4	3.7
Price Inflation (CPI) *	-0.1	0.3	3.0	5.6	4.6	3.1	2.9
Price Inflation (RPIX) *	-0.1	0.2	3.2	6.5	5.8	4.2	3.7
Earnings Inflation **	2.9	4.7	5.4	5.6	5.7	4.1	3.3
All Share Capital Growth	-0.4	3.6	12.6	4.1	5.0	2.3	3.2
Dividend Growth	0.7	0.7	0.2	8.6	-1.3	3.0	3.9
Earnings Growth	-3.6	-1.6	-11.4	4.7	5.3	3.6	3.6

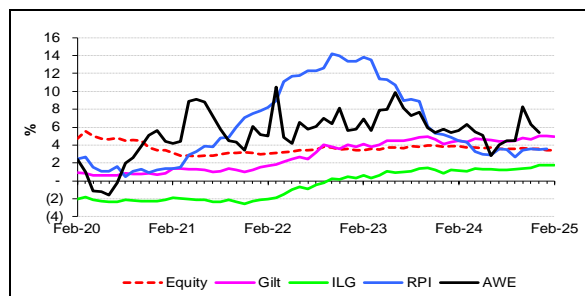
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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, 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.

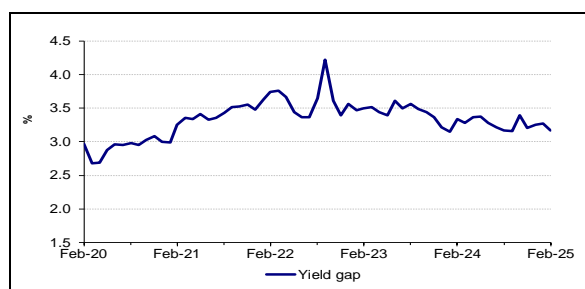


Yields and Yield Gaps

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.

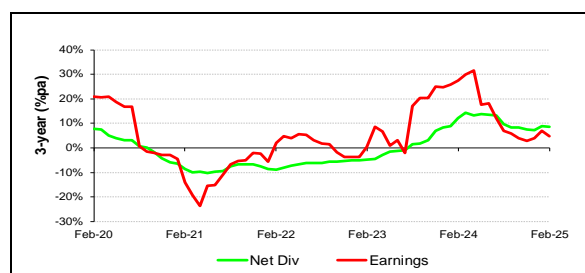
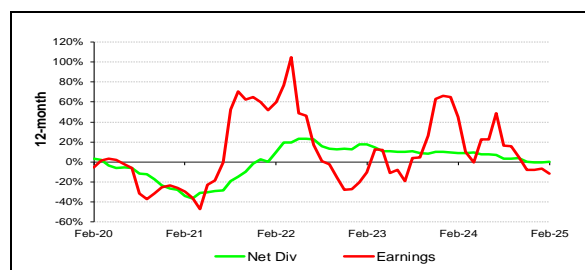


The gap gives a current expectation of around 3.2% p.a. for longer-term inflation including the (unknown) risk premium for gilts, relative to index-linked gilts.

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]

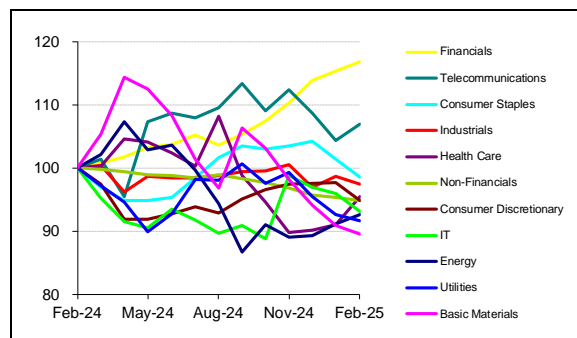
Figure 3: Dividend & Earnings Growth



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



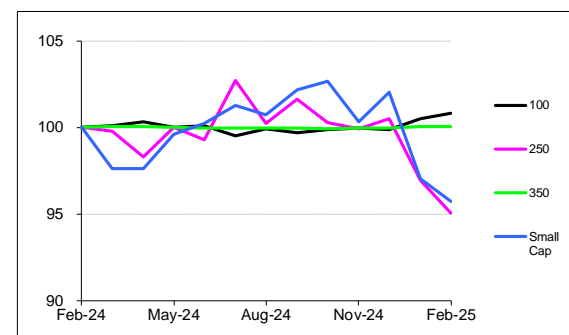
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (down from 33% to 27%).

(% absolute return)	1 mth	3 mth	12 mth
Energy	1.4	8.3	8.1
Basic Materials	-1.7	-5.1	4.4
Industrials	-1.4	0.9	13.6
Consumer Staples	-2.9	-0.9	15.0
Health Care	4.7	10.7	11.4
Consumer Discretionary	-3.1	1.4	10.6
Telecommunications	2.3	-1.0	24.7
Utilities	-1.3	-3.9	6.9
Non-Finan	-0.6	2.0	10.6
Financials	1.1	10.3	36.3
IT	-3.1	-1.8	8.6
All Share	-0.2	4.1	16.6

UK Equity Size Returns

Figure 4b: Size groups relative to All Share

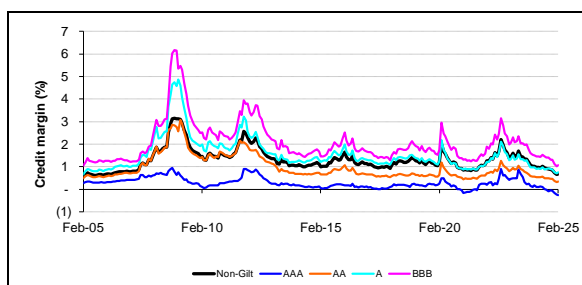


This month, Mid Cap and Small Cap both fell relative to the All Share.

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 '24	5.00	4.45	0.55
Oct '24	5.26	4.79	0.47
Nov '24	5.11	4.65	0.46
Dec '24	5.41	5.01	0.40
Jan '25	5.33	5.00	0.33
Feb '25	5.33	4.94	0.39

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

Category	Mkt Val (£bn @ Feb 25 & 22, 19)			Weight (%)
Gilts (61)	1,487	1,719	1,334	72.4
Non-Gilts (1,237)	567	622	571	27.6
AAA (155)	122	128	115	5.9
AA (157)	67	77	82	3.2
A (437)	174	166	155	8.5
BBB (488)	204	251	219	9.9

Category	Mkt Val (£bn @ Feb 25 & 22)		W't (%)	Dur'n (yrs)
Gilts (61)	1,487	1,719	72.4	9.1
< 5 Yrs (14)	449	445	21.9	2.8
5-15 Yrs (19)	549	522	26.7	7.8
> 15 Yrs (28)	489	752	23.8	16.3
Non-Gilts (1,237)	567	622	27.6	5.5
< 5 Yrs (597)	308	246	15.0	2.6
5-15 Yrs (425)	178	245	8.7	7.1
> 15 Yrs (215)	81	131	3.9	13.1

Tables 2d, 2e: € Market Size and Maturity (Feb 25)

Category	Mkt Val (£bn)	Weight (%)
Sovereigns (533)	7,850	56.5
Non-Sovereigns	6,044	43.5
AAA (1,370)	2,110	15.2
AA (823)	1,023	7.4
A (1,633)	1,351	9.7
BBB (2,161)	1,560	11.2

Category	Mkt Val (£bn)	Weight (%)
1 - 3 Yrs (1,897)	3,455	24.9
3 - 5 Yrs (1,707)	3,064	22.1
5 - 7 Yrs (1,160)	2,149	15.5
7 - 10 Yrs (985)	2,262	16.3
10+ Yrs (771)	2,965	21.3

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Feb 25 & 22)		W't (%)	Dur'n (yrs)
Gilts (33)	535	850	100.0	14.6
< 5 Yrs (4)	100	93	18.8	2.9
5 - 15 Yrs (10)	187	225	35.0	9.1
> 15 Yrs (19)	247	532	46.3	23.4

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

Month End	US (%)	Euro (%)	Sterling (%)
Nov '24	6.75	5.09	7.81
Dec '24	7.03	5.05	7.79
Jan '25	6.82	5.06	7.61
Feb '25	6.77	4.88	7.44

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

£ Gilt Market "main" & "Green" Issuance

- £4.25bn, 4³/₈% 2028 (3.09x, 4.29%, 0%, Jan '25)
- £5.31bn, 4³/₈% 2030 (3.05x, 4.28%, 25%, Jan '25)
- **£13.0bn**, 4¹/₂% 2035 (10.9x, 4.54%, n/a, new)
- £1.91bn, 1¹/₈% IL 2035 (3.52x, 1.12%, 19%, Jan '25)
- £3.25bn, 4³/₈% 2040 (2.89x, 4.84%, 0%, Jan '25)
- £1.00bn, 5⁵/₈% IL 2045 (3.48x, 1.73%, 0%, Oct '24)
- £2.00bn, 1¹/₂% Gr 2053 (3.20x, 4.98%, n/a, Oct '24)
- £2.11bn, 4% 2063 (2.80x, 5.08%, 21%, Jun '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.

