Jagger & Associates

Investment Update
February 2012

Investment Headlines & Comment

- Another £50bn of **quantitative easing** this month – total £325bn, (over 20% of the gilt market), but gilt yields rose this month.
- January 2012 - the first time since July 2009 for the IPD Monthly Index on a negative capital return for **UK commercial property**.
- The **tPR Hugh Mackay** case has seen three Trustees breaching the Occupational Pensions Schemes (Investment) Regulations 2005.

Feature Section

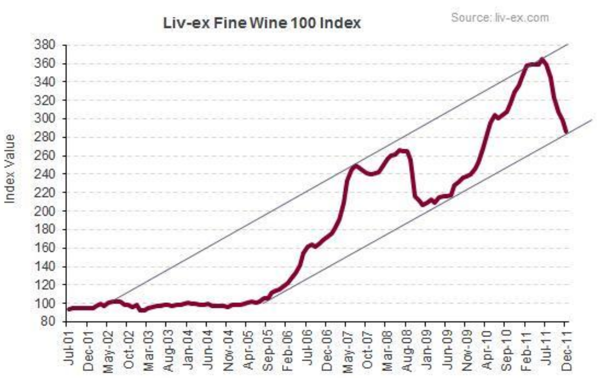
This month, we have the second part from guest contributor, Andrew Davison (Director of The Vintage Wine Fund), on the history and practicalities of investing in vintage wine. Last month, we got as far as the “credit crunch” starting to affect the wine market. Data is again sourced from Liv-ex, the London International Vintners Exchange, the main source of fine wine market information.

In late 2008, prices dropped 23% as seen in GBP, but in USD the drop was 43%. (For a commodity like wine with no natural base currency, the price action in a currency is as much about the strength of that currency as it is about the value of the wine.) Many periods of growth in wine prices in GBP have simply been periods of weak GBP where prices in EUR and USD have been totally static and GBP prices are simply adjusting in line with collapsing sterling. It is wise to bear this in mind when reading marketing materials! It was around then that the Chinese started to buy up top Bordeaux with alarming enthusiasm. Chateau Lafite was prized above all others, widely employed as a gift to impress business associates. Brand was more important than quality and “second wines” made huge leaps in value more because of their respective Grand Vin association than their intrinsic quality. Such was the frenzy that Chateau Latour and Chateau Lafite consigned wines direct to Hong Kong auctions (where all the deals were being done, especially after import duty was scrapped) – an unprecedented bypassing of the traditional Bordeaux intermediaries. Hammer prices were multiples of the market values and the degree to which the venerable chateaux were happy to exploit the irrational behaviour of these novice wine enthusiasts knew no bounds – Lafite adding a Chinese symbol to their 2008 and Mouton Rothschild commissioning a Chinese artist for their 2008.

As prices raced higher, wine flooded into Hong Kong from sellers desperate to take advantage of the situation before the tide turned. Local retailers, blind to the possibility that prices could ever come back down, stocked up with as much as they could afford. Once again the chateaux pushed *en primeur* pricing to the limit with the 2010 vintage but perhaps this time they went too far. As summer of 2011 progressed the skies darkened. Concerns over sovereign debt and global growth put equity markets into a tailspin and prices for wine stalled. The stock holders in unison decided to offload (see the right of Figure 1). Once again the limited liquidity of the wine market meant that this avalanche of stock forced prices to collapse, which in turn triggered redemptions from investment funds, which in turn added to the wave of disposals. The market is currently emerging from this period, so is now a good time to invest?

Returns from fine wine have over the long term been very attractive – top wine has a unique dynamic in that it improves with age but is consumed so becomes scarcer. There are a growing number of wealthy individuals becoming fascinated with wine particularly in emerging economies. Europe and the US, although currently subdued, are not likely to lose interest in fine wine so global demand will ultimately reach new highs, keeping the long term upward trend intact.

Figure 1: “Technical Analysis” lines



The rise of amateur traders and professional investment funds has greatly added to the volatility of what is a market with limited liquidity. Essentially the number of players is already over-stretching the capacity of the market and so volatility is going to be a permanent feature – timing entries and exits and being ahead of the curve is crucial.

Diversification has generally helped to keep volatility down without much loss in terms of return – see Figure 1b last month. The fads and trophy wines seem to come and go so a well balanced portfolio across all top wines, though more onerous to manage in terms of valuation etc, is usually a better bet. After the recent sell-off we are now nudging on the bottom edge of the long run upward trend channel – a support level if you like - see Figure 1. In the last few weeks, it looks like the market is turning and there is no doubt that buyers are beginning to feel that prices have fallen far enough. Many consumers who stayed on the sidelines while China inflated prices, are now ready to purchase again. In Andrew’s view, this might just be a good time to get on board.

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 29 February 2012

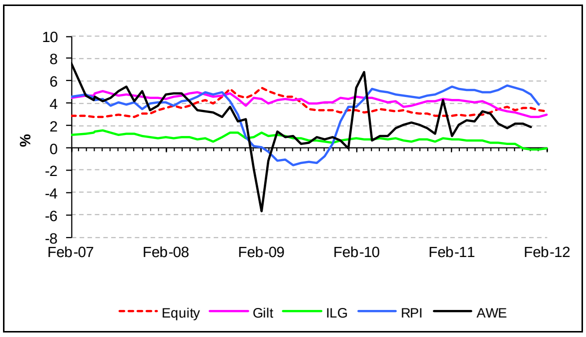
Asset Class	1 month (%)	3 months (%)	12 months (%)	3 years (% p.a.)	5 years (% p.a.)	10 years (% p.a.)	20 years (% p.a.)
UK Equities	4.3	8.0	1.5	20.5	2.7	5.7	8.3
Overseas Equities	3.8	9.6	0.7	19.9	5.2	5.2	7.8
US Equities	3.1	8.6	7.1	20.9	6.0	**3.2**	8.9
Europe ex UK Equities	**5.8**	8.6	**-9.7**	16.1	1.0	5.9	8.8
Japan Equities	3.5	8.8	-7.9	8.1	**-1.6**	**3.2**	**1.2**
Pacific ex Japan Equities	4.1	14.3	3.4	**28.3**	11.2	12.7	**9.3**
Emerging Markets	4.7	**14.9**	2.1	27.7	11.0	**14.2**	9.0
UK Long-dated Gilts	**-3.2**	**-0.6**	**25.9**	11.6	8.3	7.0	9.1
UK Long-dated Corp. Bonds	-0.5	4.2	14.3	13.9	5.5	6.1	-
UK Over 5 Yrs Index-Linked Gilts	-2.2	0.9	22.4	14.2	9.2	8.3	8.4
High Yield (Global)	2.0	7.7	7.6	21.5	**12.6**	8.5	-
Overseas Bonds	-2.4	-0.5	8.5	3.5	12.2	6.8	7.2
Property *	0.4	1.4	7.8	9.2	**-1.6**	6.6	8.4
Cash	0.1	0.3	0.9	**0.9**	2.7	3.6	5.1
Commodities £-converted	4.8	5.3	2.1	11.4	2.5	5.1	4.7
Hedge Funds original $ basis *	2.8	0.9	-3.0	8.9	2.6	6.1	10.5
Illustrative £-converted version *	1.2	3.2	-1.5	5.6	7.2	4.9	11.2
Euro relative to Sterling	0.9	-2.2	-1.3	-2.1	4.4	3.2	-
US $ relative to Sterling	-1.2	-1.5	1.9	-3.7	4.2	-1.2	0.5
Japanese Yen relative to Sterling	-7.0	-5.6	3.1	2.6	12.4	3.9	2.9
Price Inflation (RPI) *	-0.6	0.0	3.9	4.2	3.4	3.2	2.9
Price Inflation (CPI) *	-0.5	0.1	3.6	3.7	3.3	2.5	2.2
Price Inflation (RPIX) *	-0.6	0.0	4.0	4.6	3.9	3.2	2.9
Earnings Inflation **	2.1	2.2	1.9	1.3	1.9	3.0	3.6
All Share Capital Growth	3.8	7.3	-2.0	16.4	-1.0	2.1	4.6
Net Dividend Growth	1.6	-0.8	11.5	-1.2	2.0	4.0	-
Earnings Growth	5.8	-3.7	11.1	5.9	3.6	9.9	-

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

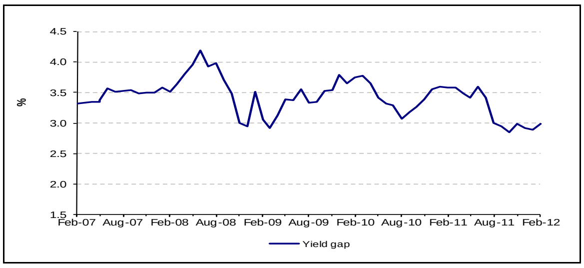
- *UK Equities (incl. dividends and earnings) – FT-A All Share.*
- *Overseas Equities (incl. regions) – blend of FT All-World / World subindices*
- *Emerging Markets from MSCI US $ based total return index (overall Index to 31 Oct 2001, Free Index from 1 Nov 2001 to take account of foreign investment 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 – Merrill Lynch Global, £ Unhedged*
- *Overseas Bonds – JP Morgan Traded Unhedged World ex UK*
- *Property – IPD Monthly 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.

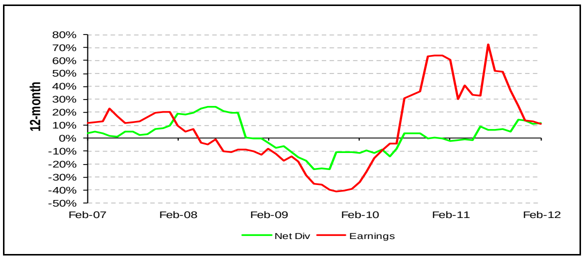


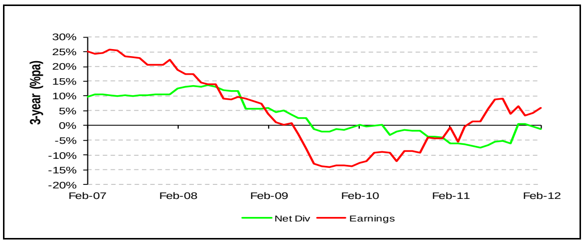
The gap gives expectations still just below 3% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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

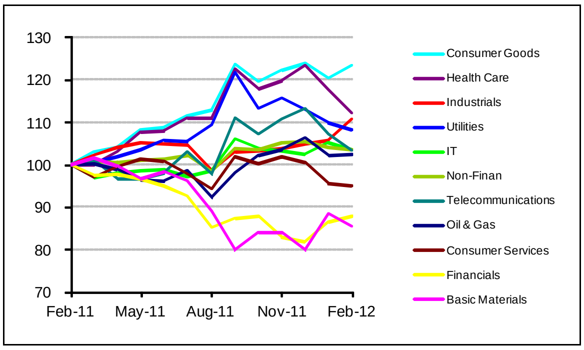




Sources for charts on this page:
Financial Times, Office for National Statistics, J&A

UK Equity Sector Returns

Figure 4a: Sectors relative to All Share



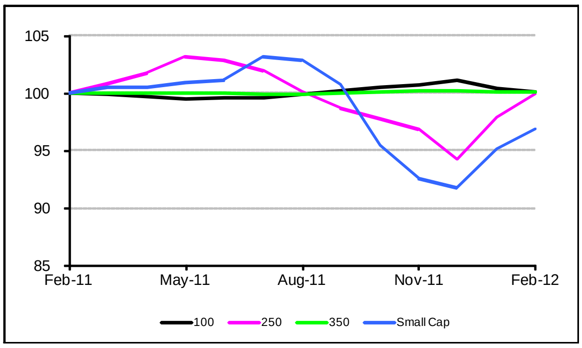
Note: Sector labels for relative lines are in end-value order

There was a slight rise this month in the rolling 12-month sector dispersion (up from 35% to 38%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	4.7	6.9	4.2
Basic Materials	0.8	9.9	-13.2
Industrials	9.0	15.2	12.4
Consumer Goods	7.0	9.0	25.4
Health Care	-0.5	1.1	13.9
Consumer Services	3.7	0.8	-3.6
Telecommunications	0.6	1.0	5.0
Utilities	2.9	1.2	10.0
Non-Finan	3.9	6.5	5.3
Financials	6.0	14.3	-10.8
IT	2.9	8.5	5.3
All Share	4.3	8.0	1.5

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Small and Mid Cap both rallied in relative terms this month.

FRS17 volatility indicator

Now discontinued, but available on request.

Bond market information

Sources: Barclays Capital, DMO, iBoxx, J&A, MLX

Figure 5: £ Non-Gilt Credit Margins

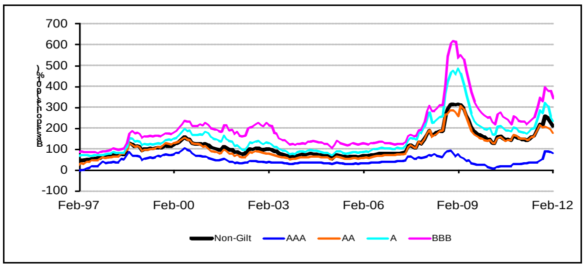


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Sep 11	5.06	3.25	1.81
Oct 11	4.89	3.19	1.70
Nov 11	4.81	2.95	1.86
Dec 11	4.63	2.78	1.85
Jan 12	4.55	2.75	1.80
Feb 12	**4.47**	**2.95**	**1.52**

Tables 2b, 2c: £ Market Size and Maturity

Category	Mkt Val (£bn @ Feb 12 & 09, 06)			Weight (%)
Gilts (35)	1,021	545	320	68.1
Non Gilts (998)	478	387	379	31.9
AAA (157)	122	142	143	8.1
AA (140)	60	55	59	4.0
A (365)	170	129	114	11.3
BBB (336)	126	59	59	8.4

Category	Mkt Val (£bn @ Feb 12, 09)		W't (%)	Dur'n (yrs)
Gilts (35)	1,021	545	68.1	9.7
< 5 Yrs (10)	307	155	20.5	2.9
5–15 Yrs (10)	320	183	21.3	7.2
> 15 Yrs (15)	395	207	26.3	16.9
Non Gilts (998)	478	387	31.9	7.8
< 5 Yrs (268)	123	135	8.2	2.8
5–15 Yrs (452)	205	140	13.7	7.0
> 15 Yrs (278)	150	112	10.0	13.1

£ Gilt Market "main" Issuance

- £4.00bn 1¾% 2017 (1.82x, 1.12%, Jan 12)
- £2.75bn 5% 2025 (1.88x, 2.36%, May 11)
- £1.75bn 4½% 2034 (1.62x, 3.12%, Aug 11)
- £1.25bn ILG $^{1}/_{8}$% 2029 (2.27x, r.y *-0.19%*, Nov 11)

Note: Issuance amounts are nominals.

Tables 2d, 2e: € Market Size and Maturity (Feb 12)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (251)	4,239	57.6
Non Sovereigns	3,122	42.4
AAA (639)	1,254	17.0
AA (417)	587	8.0
A (747)	849	11.5
BBB (505)	431	5.9

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (861)	2,090	28.4
3 – 5 Yrs (709)	1,694	23.0
5 – 7 Yrs (382)	940	12.8
7 – 10 Yrs (400)	1,365	18.6
10+ Yrs (207)	1,272	17.3

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Feb 12 & 09)		W't (%)	Dur'n (yrs)
Gilts (19)	337	165	92.2	17.4
< 5 Yrs (2)	49	33	13.4	3.0
5 – 15 Yrs (4)	88	59	23.9	8.6
> 15 Yrs (13)	200	74	54.8	24.8
Non Gilts (47)	29	17	7.8	17.5

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

Month End	US (%)	Euro (%)	Sterling (%)
Oct 11	7.62	9.05	10.31
Nov 11	8.10	10.98	11.69
Dec 11	7.48	11.08	11.43
Jan 12	6.99	9.40	10.21
Feb 12	**6.65**	**8.36**	**9.40**

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