



Investment Update February 2014

Investment Headlines & Comment

- **Standard Life** indicates its *non-Scottish* contingency plans in case Scottish independence goes ahead.
- The British Government is granting the Scottish Government the power to issue its own bonds.
- **Rothsay Life** is set to buy **Metlife's** £3bn bulk annuity business (over 20,000 pensions).

Feature Section This month we revisit the question of whether UK Equities look value for money or not. 'Conventional' analysis in our September 2001 and [July 2002](#) issues, using data since the All Share index started back in 1962, was followed by the 'unconventional' Shiller analysis in our [July 2010](#) edition. After a strong 2013 for equities, how do these contrasting methods now interpret the available data? (*Note: All equity data is sourced from FTSE, and the RPI inflation data is sourced from ONS. "P/E/D" is used as an abbreviation for Prices / Earnings / Dividends.*)

We start with the longest data set, which is for the All Share ex Financials ("FT500"). Figure 1a shows that earnings and dividends are currently roughly in line on this dataset, but prices are slightly ahead (which could be justified on the grounds of anticipating future growth). We use a log scale on the vertical axis, so that annual growth is a straight line. (The compounding involved for over 50 years means that using a conventional axis would increase the emphasis given to the most recent data.) Figure 1b looks at the equivalent data for the All Share over the last 20 years, and reaches a radically different conclusion – on this dataset, dividends and prices are currently roughly in line, but earnings have been highly unstable, and are currently about 66% ahead of prices, suggesting either a lot of optimism in UK Equity prices in the early 1990s, or a lot of caution in current UK Equity prices, or a mix of the two.

Figure 1a: P / E / D since 1962
(only published "ex Financials")

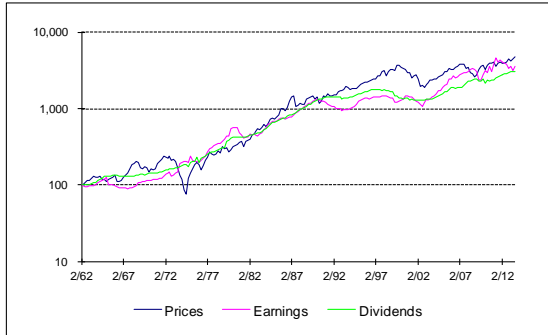


Figure 1b: P / E / D for Q4 1993 – Q4 2013
(across the All Share index)

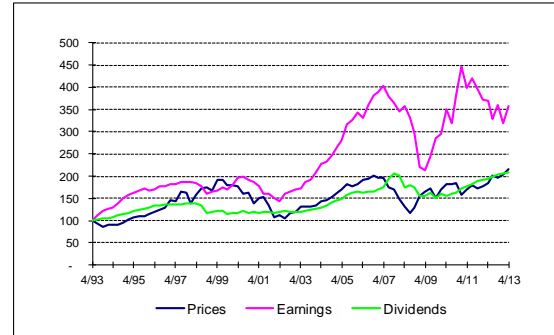


Figure 1c shows the inflation-adjusted Shiller P/E, starting from the end of the first 10 years of the index in 1972. Figure 1d shows the Shiller P/E's value relative to its historical average (which for the 41-year period is just over 15x). Crudely, when it is above the average, this suggests the market may be expensive, whereas if it is below the average, there may be a buying opportunity. At the moment it is pretty much in line, suggesting a neutral view.

Figure 1c: Shiller-based P/E since 1972
(only published "ex Financials")

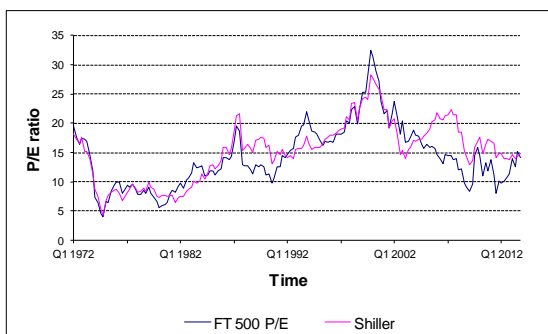
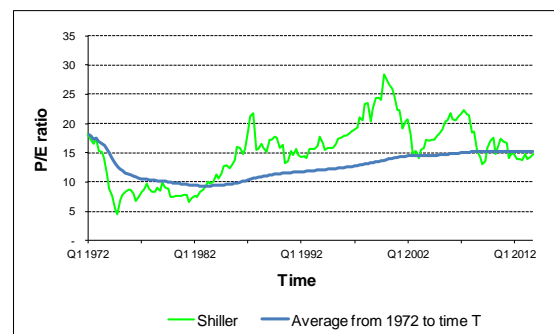


Figure 1d: Shiller-based P/E since 1972
(only published "ex Financials")



We have repeated the analysis for the All Share index (its first 10-year period ends in 2003, so there is rather less data to use). The conclusions there are there may currently be a modest buying opportunity (it is about 10% below its average).



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 2014

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	5.2	3.9	13.3	9.5	17.7	8.8	7.5
Overseas Equities	2.5	-0.2	7.1	7.7	16.4	8.7	6.7
US Equities	2.6	1.5	14.0	13.4	19.2	8.6	8.3
Europe ex UK Equities	5.0	2.3	13.8	6.5	15.9	9.2	8.7
Japan Equities	-2.5	-5.8	3.7	1.8	7.7	4.7	-0.5
Pacific ex Japan Equities	2.3	-4.3	-10.5	2.1	16.8	11.8	5.5
Emerging Markets	1.3	-6.9	-14.6	-2.6	13.5	11.4	5.3
UK Long-dated Gilts	0.2	2.2	-0.2	8.9	7.4	6.2	7.4
UK Long-dated Corp. Bonds	0.5	2.3	4.0	9.2	11.0	6.1	-
UK Over 5 Yrs Index-Linked Gilts	0.1	-0.2	-1.7	8.6	9.3	7.1	7.2
High Yield (Global)	0.5	1.1	-1.1	8.1	16.0	10.1	-
Overseas Bonds	-0.8	-0.6	-9.2	0.7	0.9	5.6	5.0
Property *	1.1	4.7	11.7	7.2	8.3	5.8	8.2
Cash	0.0	0.1	0.5	0.7	0.8	2.9	4.4
Commodities £-converted	2.5	2.4	-7.8	-3.0	4.3	1.3	3.5
Hedge Funds original \$ basis *	-0.5	1.4	5.9	2.9	7.7	5.5	8.7
Illustrative £-converted version *	0.2	-0.8	2.2	2.1	4.9	6.5	8.2
Euro relative to Sterling	0.5	-0.8	-4.3	-1.0	-1.5	2.1	-
US \$ relative to Sterling	-2.0	-2.3	-9.4	-1.0	-3.2	1.0	-0.6
Japanese Yen relative to Sterling	-2.0	-1.9	-18.1	-8.0	-4.0	1.7	-0.5
Sterling trade weighted	0.5	1.9	8.9	1.9	1.8	-1.8	0.0
Price Inflation (RPI) *	-0.3	0.3	2.8	3.3	3.8	3.3	2.9
Price Inflation (CPI) *	-0.6	-0.2	1.8	2.7	3.1	2.7	2.2
Price Inflation (RPIX) *	-0.4	0.3	2.8	3.3	4.0	3.3	2.9
Earnings Inflation **	3.1	2.5	1.6	1.6	1.4	2.7	3.4
All Share Capital Growth	4.9	3.3	9.5	5.7	13.7	5.0	4.0
Net Dividend Growth	2.7	2.4	8.8	10.6	3.2	5.8	-
Earnings Growth	8.7	5.1	14.7	-0.2	1.2	7.7	6.6

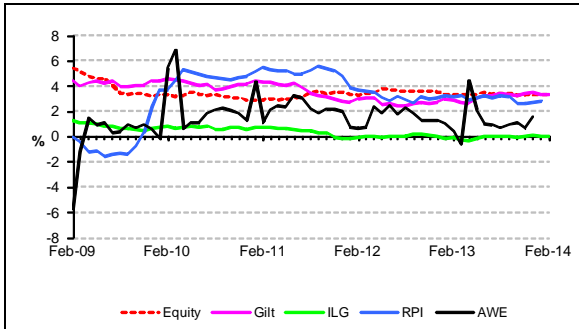
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- UK Equities (incl. dividends and earnings) – FT-A All Share.
- Overseas Equities (incl. regions) – blend of FT All-World / World 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.

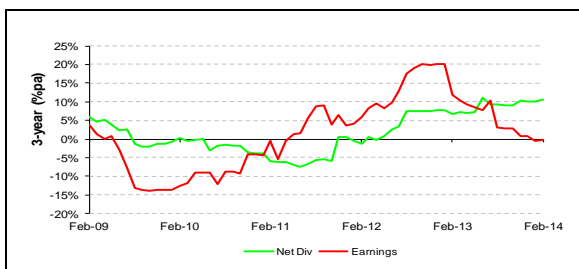
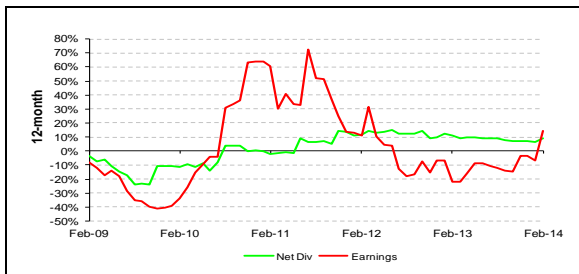


The gap gives a current expectation now around 3.2% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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]

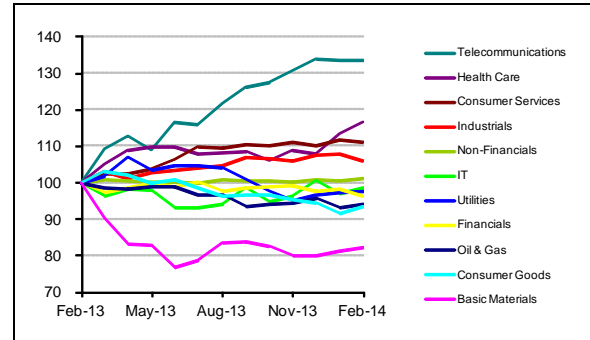
Figure 3: Dividend & Earnings Growth



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



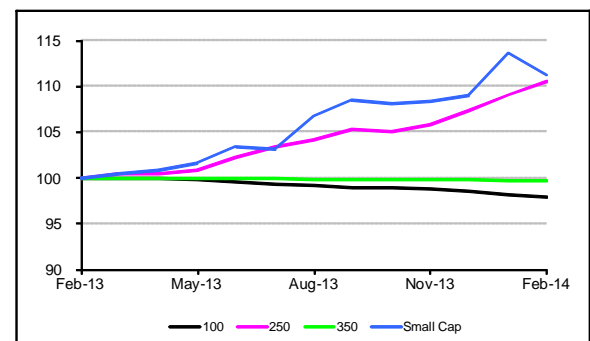
Note: Sector labels for relative lines are in end-value order

There was a small rise this month in the rolling 12-month sector dispersion (from 50% to 52%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	6.2	3.5	6.5
Basic Materials	6.1	6.8	-7.0
Industrials	3.3	3.9	20.0
Consumer Goods	7.6	2.1	6.0
Health Care	8.4	11.4	32.1
Consumer Services	4.6	3.7	25.7
Telecommunications	5.3	6.3	51.4
Utilities	5.4	6.7	10.5
Non-Financials	5.9	4.9	14.7
Financials	3.1	0.8	9.0
IT	6.8	6.1	11.5
All Share	5.2	3.9	13.3

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid Cap rose, but Small Cap fell, in relative terms this month.

FRS17 volatility indicator

Now discontinued, but available on request.



Bond market information

Figure 5: £ Non-Gilt Credit Margins

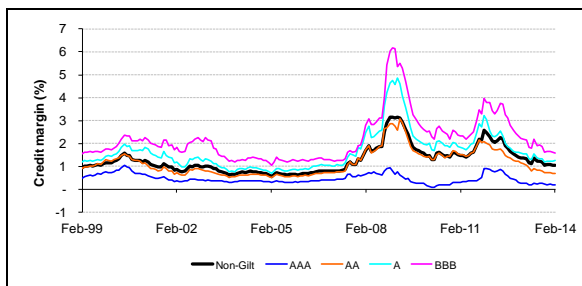


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Sep '13	4.27	3.34	0.93
Oct '13	4.13	3.29	0.84
Nov '13	4.28	3.44	0.84
Dec '13	4.37	3.57	0.80
Jan '14	4.19	3.34	0.85
Feb '14	4.17	3.35	0.82

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

Category	Mkt Val @ Feb 14 & 11, 08			Weight (%)
	Feb 14	Feb 11	08	
Gilts (37)	1,068	812	352	67.1
Non Gilts (1,029)	523	457	414	32.9
AAA (127)	100	125	158	6.3
AA (169)	86	72	60	5.4
A (354)	169	162	128	10.6
BBB (379)	168	98	65	10.6

Category	Mkt Val @ Feb 14, & 11		W't (%)	Dur'n (yrs)
Gilts (37)	1,068	812	67.1	9.7
< 5 Yrs (9)	270	261	17.0	2.8
5-15 Yrs (13)	403	269	25.3	7.1
> 15 Yrs (15)	395	283	24.8	17.1
Non Gilts (1,029)	523	457	32.9	7.9
< 5 Yrs (314)	148	124	9.3	2.8
5-15 Yrs (443)	223	197	14.0	7.5
> 15 Yrs (272)	152	136	9.5	13.6

£ Gilt Market “main” Issuance

- o £1.50bn 1¾% 2017 (2.53x, 1.03%, Feb 12)
 - o £4.18bn 1¾% 2019 (1.58x, 1.91%, Dec 13)
 - o £3.00bn 2¼% 2023 (1.82x, 2.73%, Jan 14)
 - o £1.91bn 3¾% 2052 (1.57x, 3.53%, Mar 13)
 - o £1.30bn ILG 1/8% 2024 (2.49x, r.y -0.11%, Sep 13)
- Note: Issuance amounts are nominals.

Tables 2d, 2e: € Market Size and Maturity (Feb 14)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (282)	4,966	59.6
Non Sovereigns	3,365	40.4
AAA (525)	1,006	12.1
AA (448)	744	8.9
A (765)	836	10.0
BBB (761)	779	9.4

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (796)	2,150	25.8
3 – 5 Yrs (716)	1,791	21.5
5 – 7 Yrs (543)	1,377	16.5
7 – 10 Yrs (497)	1,528	18.3
10+ Yrs (229)	1,484	17.8

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Feb 14 & 11)		W't (%)	Dur'n (yrs)
Gilts (23)	387	251	92.3	19.1
< 5 Yrs (2)	44	21	10.5	2.9
5 – 15 Yrs (6)	106	99	254.4	8.9
> 15 Yrs (15)	237	131	56.5	26.8
Non Gilts (43)	32	25	7.7	16.9

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

Month End	US (%)	Euro (%)	Sterling (%)
Aug '13	6.16	5.09	6.32
Sep '13	6.06	5.04	6.19
Oct '13	5.66	4.64	5.85
Nov '13	5.67	4.54	5.79
Dec '13	5.67	4.52	5.75
Jan '14	5.63	4.41	5.65
Feb '14	5.37	4.16	5.50

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

