JAGGER & ASSOCIATES

Investment Update
July 2014

Investment Headlines & Comment

- A new ultra-long **Index-Linked Gilt** issued on a negative real yield.
- **Legg Mason** acquires Edinburgh-based **Martin Currie**.
- **Argentina** defaults on government debt (again).

Feature Section

This month we consider UK workers' earnings, and whether things are quite as some politicians would assert. With Labour often repeating their claim that the UK faces a "cost of living crisis", we thought it worth a look at the actual numbers, to see how average weekly earnings (AWE) and inflation have changed over time. All data is from ONS, seasonally adjusted, using the EARN01 Average Weekly Earnings - total pay index. *Note: W, R, H&R = Wholesale, retail, hotels & restaurants*

Figure 1a shows the average weekly earnings index (AWE) for the whole economy, the public and private sectors, and the RPI and CPI inflation indices since Jan 2000 (the start of the AWE index). Earnings for both public and private sector workers are clearly ahead of the CPI index over this period, although with RPI as the measure of inflation, real wages have remained flat over the period as a whole. The Private Sector experienced sharp movements in earnings around the start of the credit crunch in late 2009, and whilst Private Sector earnings have grown since then, Public Sector pay has grown quicker than Private Sector pay over the period as a whole. Figure 1b shows the same data, but this time for the period since the lowest month end point for the FTSE All Share, which was in February 2009. This chart certainly suggests that pay has lagged inflation since the credit crunch, with RPI running at 3.8% p.a. over the whole period, versus whole economy earnings growth of just 2.1% p.a. (**Ed.:** This is of course the period Labour focuses on, conveniently ignoring the over-inflation period!)

Figure 1a: AWE and inflation comparisons
Jan 2000=100

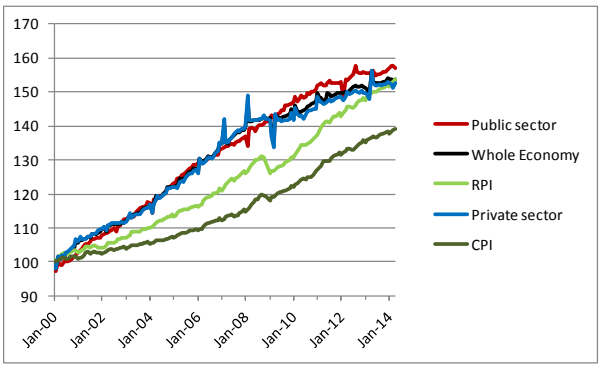
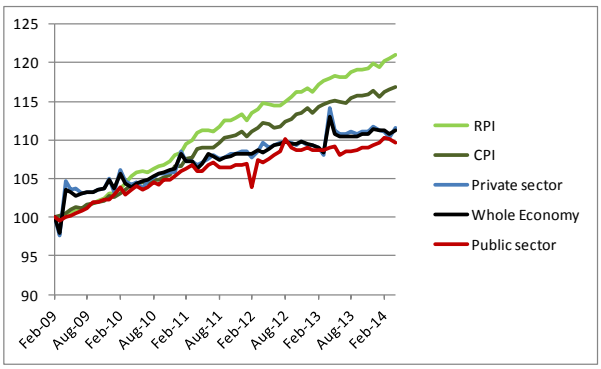


Figure 1b: AWE and inflation comparisons
Feb 2009=100



Unfortunately, the ONS does not split out average weekly earnings by salary band, so it is hard to tell if the lower paid have been more affected by this erosion in real earnings over the past 5 years than the higher paid. However, the ONS does split the data out by sector – Figure 1c shows the real terms wage growth for various sectors since January 2000, using CPI as the inflation index. Figure 1d shows the same data, but again focussing just on the period since February 2009. Figure 1d clearly shows that the Finance sector is the only sector to have seen wages rise in real terms since February 2009, although only at a real terms rate of 0.4% p.a. Construction and Public Sector ex Finance earnings have been worst hit over the period, with real term falls of -2.6% p.a. and -1.5% p.a. respectively.

Figure 1c: Real terms Sector Earnings
Jan 2000=100

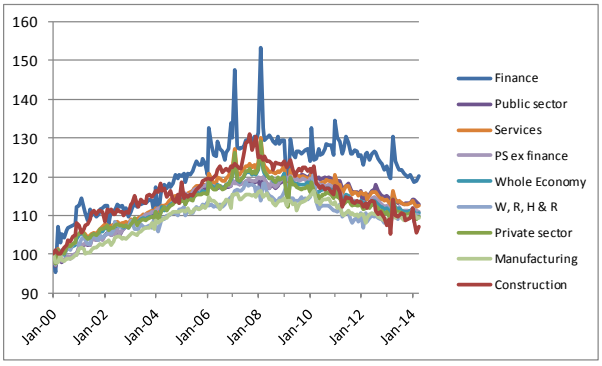
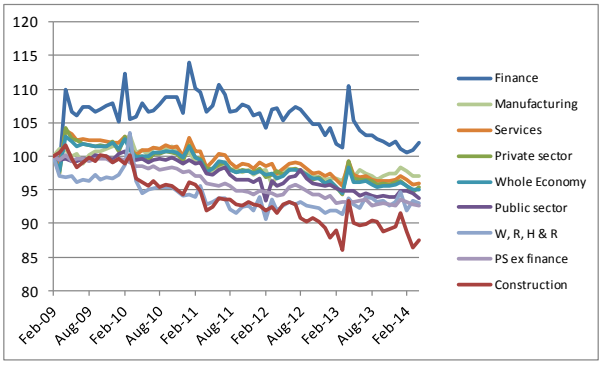


Figure 1d: Real terms Sector Earnings
Feb 2009=100



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 July 2014

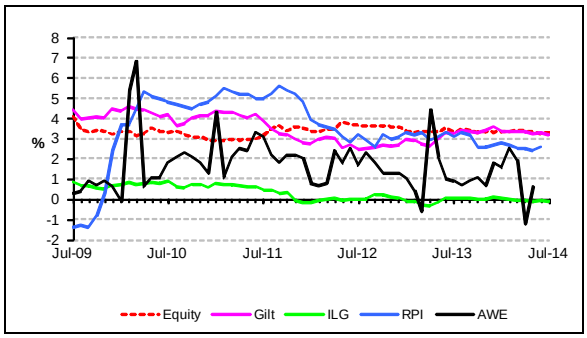
Asset Class	1 month (%)	3 months (%)	12 months (%)	3 years (% p.a.)	5 years (% p.a.)	10 years (% p.a.)	20 years (% p.a.)
UK Equities	-0.3	-0.2	5.6	9.6	12.6	8.8	7.8
Overseas Equities	0.1	3.3	4.6	10.0	12.3	9.3	7.1
US Equities	-0.2	3.1	5.1	**15.9**	**16.4**	9.1	8.2
Europe ex UK Equities	**-3.8**	**-3.7**	3.4	6.5	9.0	9.2	**9.1**
Japan Equities	1.9	**10.5**	-0.6	6.0	6.3	4.7	**-0.2**
Pacific ex Japan Equities	**4.7**	8.7	7.3	4.1	10.2	**14.0**	6.5
Emerging Markets	3.3	8.5	3.9	-0.2	7.3	13.6	6.0
UK Long-dated Gilts	2.2	3.3	6.7	7.8	8.2	6.7	8.1
UK Long-dated Corp. Bonds	1.3	3.0	8.2	8.8	9.9	6.6	-
UK Over 5 Yrs Index-Linked Gilts	1.0	1.2	5.0	6.8	8.7	7.4	7.7
High Yield (Global)	-0.2	0.5	-1.6	7.8	12.2	9.9	-
Overseas Bonds	0.4	0.2	**-6.9**	**-0.8**	2.7	5.7	5.1
Property *	2.1	5.1	**17.6**	8.6	11.6	5.8	8.1
Cash	0.0	0.1	0.5	0.7	**0.7**	**2.8**	4.3
Commodities £-converted	-4.1	-3.4	-10.5	-3.3	2.1	-0.5	3.1
Hedge Funds original $ basis *	1.3	2.0	9.1	4.0	6.5	5.8	9.0
Illustrative £-converted version *	-0.7	-0.6	-3.2	1.9	5.7	6.4	8.4
Euro relative to Sterling	-1.0	-3.5	-9.5	-3.3	-1.5	1.8	-
US $ relative to Sterling	1.3	0.1	-10.2	-0.9	-0.4	0.7	-0.5
Japanese Yen relative to Sterling	-0.2	-0.6	-14.1	-10.0	-1.9	1.6	-0.6
Sterling trade weighted	0.2	2.0	11.6	3.6	1.0	-1.5	0.2
Price Inflation (RPI) *	0.2	0.6	2.6	2.9	3.7	3.2	2.9
Price Inflation (CPI) *	0.2	0.5	1.9	2.4	2.9	2.7	2.1
Price Inflation (RPIX) *	0.2	0.6	2.7	2.9	3.8	3.3	2.9
Earnings Inflation **	-1.0	-5.8	0.6	1.5	1.6	2.6	3.3
All Share Capital Growth	-0.4	-0.9	2.2	5.8	8.8	5.0	4.3
Net Dividend Growth	0.5	-2.4	1.8	7.6	4.1	5.3	-
Earnings Growth	3.0	-0.2	10.3	-5.0	7.2	6.5	5.7

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



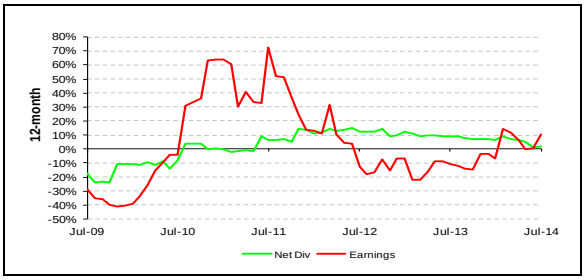
The yield gap is a measure of expected average future inflation, derived as long bond yield minus ILG yield.

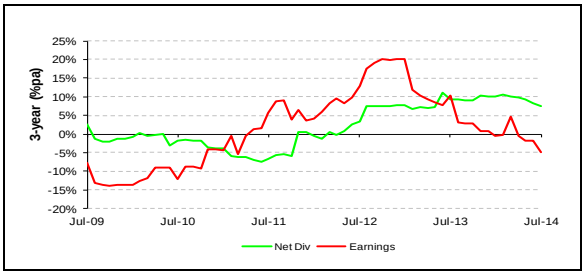
The gap gives a current expectation now just below 3.5% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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

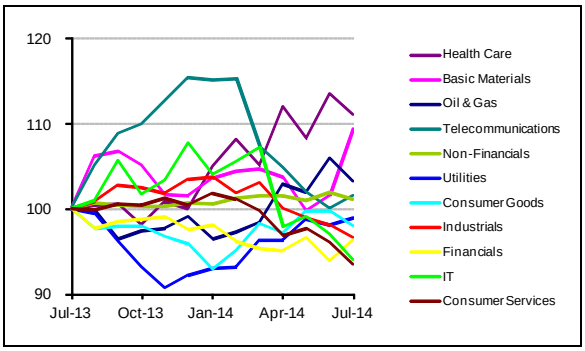




Sources for charts on this page:
Financial Times, Office for National Statistics, J&A

UK Equity Sector Returns

Figure 4a: Sectors relative to All Share



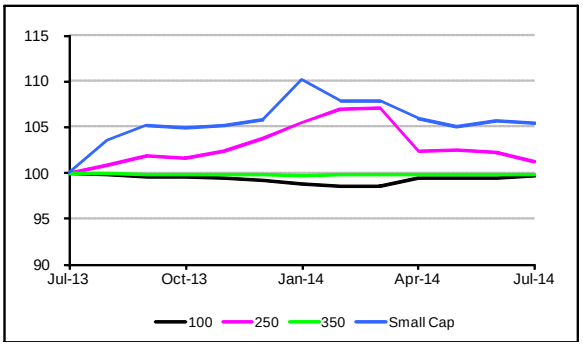
Note: Sector labels for relative lines are in end-value order

There was a slight rise this month in the rolling 12-month sector dispersion (from 17% to 18%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-2.8	0.1	9.0
Basic Materials	7.4	5.2	15.6
Industrials	-1.9	-3.7	2.0
Consumer Goods	-2.0	0.6	3.5
Health Care	-2.5	-1.1	17.3
Consumer Services	-3.0	-3.8	-1.2
Telecommunications	1.2	-3.3	7.3
Utilities	0.4	2.5	4.4
Non-Financials	-1.1	-0.6	6.9
Financials	2.3	1.0	1.7
IT	-3.5	-4.1	-0.8
All Share	-0.3	-0.2	5.6

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid and Small Cap fell slightly, in relative terms this month.

FRS17 volatility indicator

Now discontinued, but available on request.

Bond market information

Figure 5: £ Non-Gilt Credit Margins

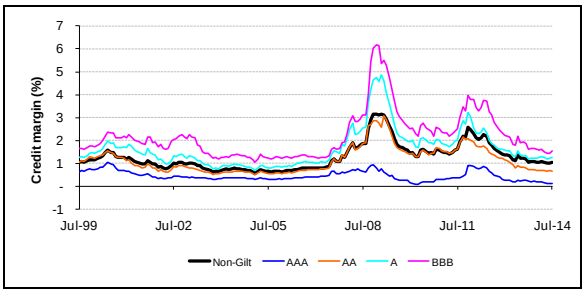


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Feb '14	4.17	3.35	0.82
Mar '14	4.25	3.35	0.90
Apr '14	4.17	3.34	0.83
May '14	4.07	3.26	0.81
Jun '14	4.12	3.31	0.81
Jul '14	**4.04**	**3.21**	**0.83**

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

Category	Mkt Val @ Jul 14 & 11, 08			Weight (%)
Gilts (39)	1,117	844	362	67.4
Non Gilts (1,064)	541	475	426	32.6
AAA (133)	104	128	151	6.3
AA (180)	90	74	74	5.4
A (367)	174	168	131	10.5
BBB (384)	173	106	66	10.5

Category	Mkt Val @ Jul 14, & 11		W't (%)	Dur'n (yrs)
Gilts (39)	1,117	844	67.4	9.6
< 5 Yrs (10)	308	232	18.6	2.6
5–15 Yrs (13)	390	301	23.5	7.0
> 15 Yrs (16)	419	311	25.3	17.2
Non Gilts (1,064)	541	475	32.6	7.9
< 5 Yrs (339)	164	117	9.9	2.7
5–15 Yrs (453)	225	216	13.6	7.6
> 15 Yrs (272)	153	142	9.2	13.9

£ Gilt Market "main" Issuance

- £4.00bn 1¾% 2019 (1.54x, 2.06%, prev Jun 14)
- £3.57bn 2¾% 2024 (1.84x, 2.70%, Jun 14)
- £1.92bn 4% 2060 (1.83x, 3.37%, Jun 12)
- £1.63bn ILG $^{1}/_{8}$% 2024 (2.72x, r.y -0.27%, Feb 14)
- £5.00bn ILG $^{1}/_{8}$% 2058 (2.90x, r.y -0.05%, new)

Note: Issuance amounts are nominals.

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (287)	5,285	60.1
Non Sovereigns	3,515	39.9
AAA (546)	1,045	11.9
AA (455)	773	8.8
A (811)	884	10.0
BBB (797)	813	9.2

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (814)	2,223	25.3
3 – 5 Yrs (705)	1,799	20.4
5 – 7 Yrs (610)	1,488	16.9
7 – 10 Yrs (510)	1,647	18.7
10+ Yrs (257)	1,644	18.7

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Jul 14 & 11)		W't (%)	Dur'n (yrs)
Gilts (24)	415	281	92.5	19.4
< 5 Yrs (2)	43	22	9.7	-
5 – 15 Yrs (7)	128	105	28.6	-
> 15 Yrs (15)	243	151	54.2	27.9
Non Gilts (43)	34	26	7.5	16.8

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

Month End	US (%)	Euro (%)	Sterling (%)
Jan '14	5.63	4.41	5.65
Feb '14	5.37	4.16	5.50
Mar '14	5.40	4.11	5.45
Apr '14	5.31	4.01	5.39
May '14	5.21	3.94	5.43
Jun '14	5.16	3.91	5.51
Jul '14	**5.55**	**4.04**	**5.72**

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

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