JAGGER & ASSOCIATES

Investment Update
March 2016

Investment Headlines & Comment

- A good month for equity markets.
- Credit margins narrowed as well.
- Commercial property duty rises.

Feature Section

This month we revisit the government borrowing profile last considered in our November 2012 edition, and we look at its implications for gilt issuance – the last time that profile was covered was in our December 2009 edition.

Figure 1a: Public sector net borrowing (% of GDP)

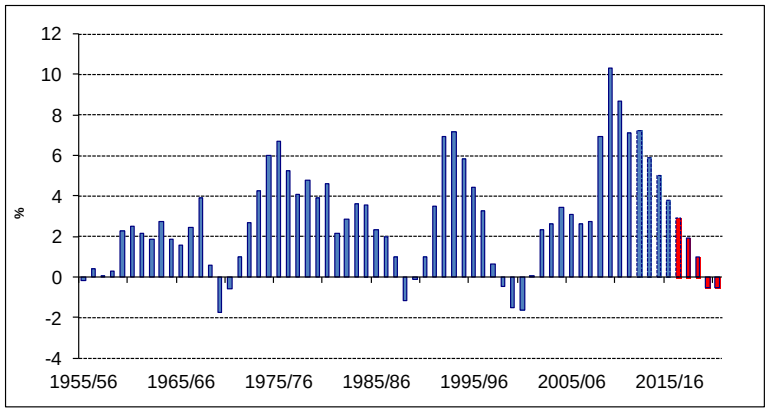


Figure 1b: Public sector net debt (% of GDP)

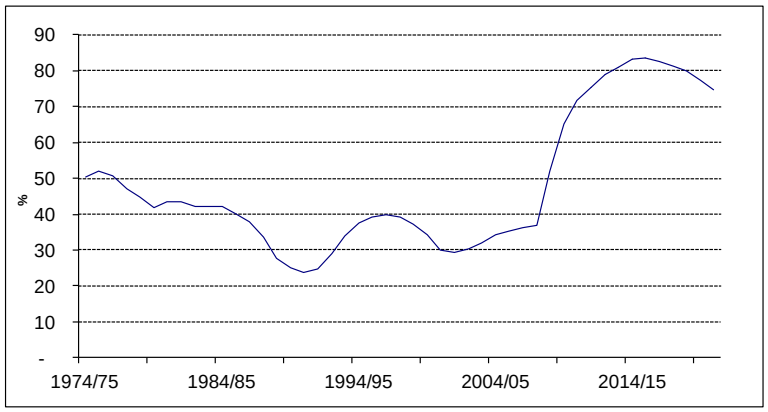


Figure 1c: Gilt market maturity profile (£m)

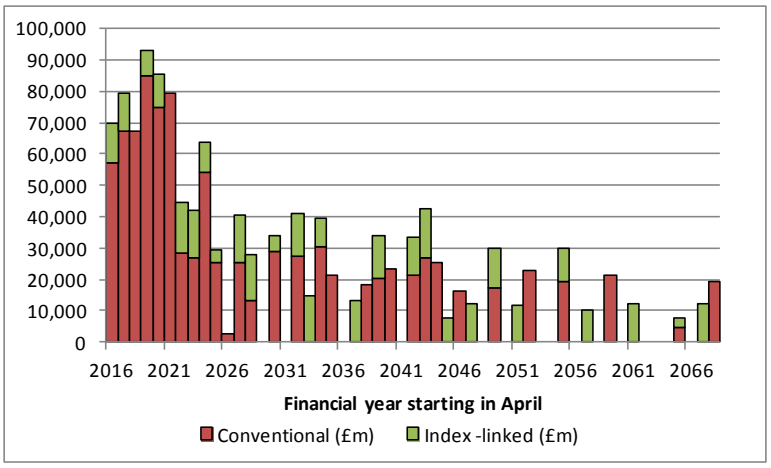


Figure 1a shows Public sector net borrowing (PSNB), which is the amount of expenditure minus the total receipts taken in by the government (on an accruals basis) – if it stays positive for too long, it suggests a government or a country which is living beyond its means (ultimately requiring corrective action). It is customary to scale it as a proportion of Gross Domestic Product (GDP), in an attempt to allow fair comparison between different time points.

The figures for 2016/17 onwards are current OBR projections (and thus may change materially over a short period), but it is quite striking how they currently resemble an extrapolation of the trend of the previous few years.

Figure 1b shows Public sector net debt (PSND), the cumulative effect of the PSNB, which is again usually shown as a proportion of GDP. Even with the current (and projected) significant decline in yearly borrowing, the OBR's projection for 2020/21 only gets the debt back to the level in 2011/12, i.e. to a level *after* the "credit crunch".

The projected surplus at the end of Figure 1a raises the prospect of a smidgeon of gilts actually being paid off rather than refinanced by issuing a new gilt. However, think about what refinancing still awaits over the next few years. Figure 1c shows the profile of nominal values of Gilts currently in issue (including those purchased by the Bank of England under QE) that would need repaying or replacing in each year. As per Tables 2c and 2f on page 4, almost £400bn could need to be refinanced over the next 5 years, which could be significant for long-term institutional investors in terms of increasing the supply of gilts of suitable maturity, and (whisper it quietly), maybe even an increase in long-dated yields.

Sources: Office for Budget Responsibility, DMO

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 March 2016

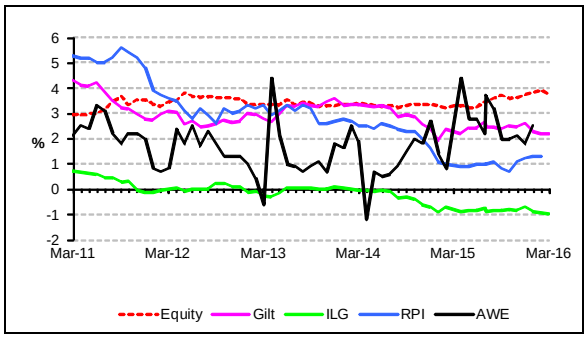
Asset Class	1 month (%)	3 months (%)	12 months (%)	3 years (% p.a.)	5 years (% p.a.)	10 years (% p.a.)	20 years (% p.a.)
UK Equities	1.9	-0.4	-3.9	3.7	5.7	4.7	6.5
Overseas Equities	4.5	3.2	-0.2	8.6	8.4	7.0	6.8
US Equities	3.6	3.7	4.2	13.6	**13.9**	**9.1**	7.2
Europe ex UK Equities	4.2	1.0	-3.9	5.9	4.2	4.6	8.3
Japan Equities	1.8	**-4.3**	-3.3	6.6	6.9	**1.7**	**0.7**
Pacific ex Japan Equities	8.4	4.6	-7.8	1.1	2.5	8.1	5.6
Emerging Markets	**9.8**	8.4	**-8.8**	**-2.4**	**-1.7**	5.3	6.1
UK Long-dated Gilts	0.2	8.2	4.0	8.6	11.1	7.4	8.6
UK Long-dated Corp. Bonds	4.0	4.9	-1.3	6.7	9.2	6.1	-
UK Over 5 Yrs Index-Linked Gilts	1.1	6.5	1.9	5.6	9.8	7.8	8.0
High Yield (Global)	2.1	6.6	2.5	3.6	6.9	**9.1**	-
Overseas Bonds	**-0.9**	**9.8**	9.8	2.6	3.6	6.5	5.1
Property *	0.6	2.4	**13.3**	**14.8**	10.7	5.2	**9.0**
Cash	0.0	0.1	0.6	0.6	0.7	2.1	3.8
Commodities £-converted	1.7	0.0	-26.3	-23.1	-15.6	-9.0	-1.3
Hedge Funds original $ basis *	0.0	-3.7	-5.4	1.8	1.4	3.4	7.3
Illustrative £-converted version *	1.8	4.1	4.9	4.8	4.6	5.8	7.8
Euro relative to Sterling	1.7	7.6	9.6	-2.1	-2.2	1.3	-
US $ relative to Sterling	-3.0	2.5	3.3	1.8	2.2	1.9	0.3
Japanese Yen relative to Sterling	-2.6	9.8	10.2	-4.0	-3.8	2.4	0.0
Sterling trade weighted	1.1	-5.2	-4.1	2.3	1.6	-1.3	0.3
Price Inflation (RPI) *	0.5	0.1	1.3	1.6	2.4	3.0	2.8
Price Inflation (CPI) *	0.3	-0.5	0.3	0.7	1.6	2.4	1.9
Price Inflation (RPIX) *	0.5	0.1	1.4	1.7	2.4	3.2	2.8
Earnings Inflation **	-0.1	3.6	2.5	1.8	1.3	1.9	3.3
All Share Capital Growth	1.5	-1.4	-7.3	0.1	2.0	1.1	3.1
Net Dividend Growth	-1.9	0.4	4.9	4.2	7.1	3.7	-
Earnings Growth	6.8	-27.6	-38.9	-14.4	-8.4	-4.3	1.0

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

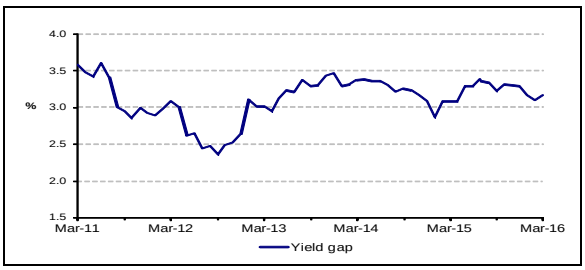
- *UK Equities (incl. dividends and earnings) – FT-A All Share.*
- *Overseas Equities (incl. regions) – blend of FT All-World / World subindices*
- *Emerging Markets from MSCI US $ based total return index (overall Index to 31 Oct 2001, Free Index from 1 Nov 2001 to take account of foreign investment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

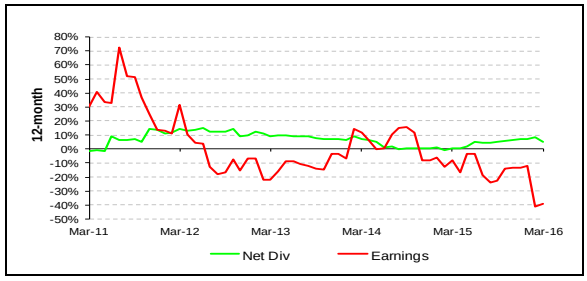


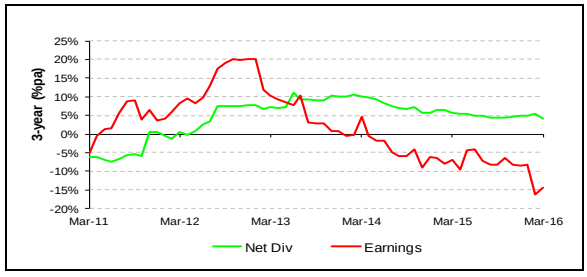
The gap gives a current expectation around 3.2% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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

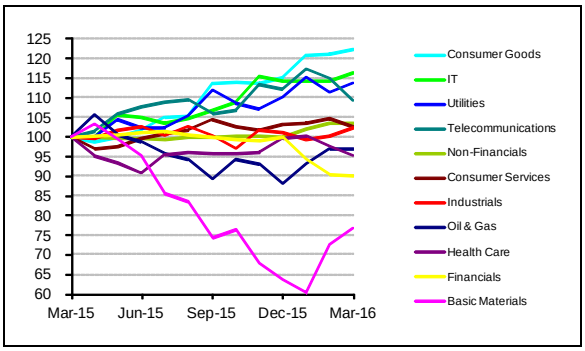




Sources for charts on this page:
Financial Times, Office for National Statistics, J&A

UK Equity Sector Returns

Figure 4a: Sectors relative to All Share



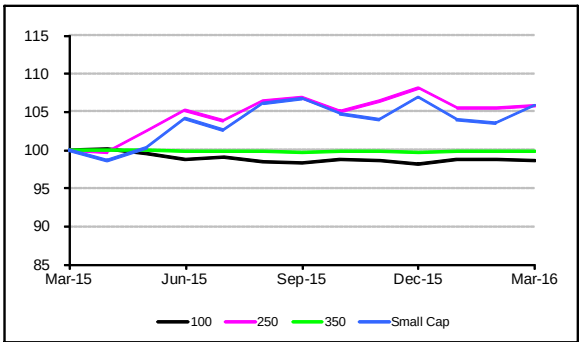
Note: Sector labels for relative lines are in end-value order

There was a slight fall this month in the rolling 12-month sector dispersion (from 50% to 46%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	2.0	9.9	-6.7
Basic Materials	7.5	20.0	-26.4
Industrials	4.0	0.7	-1.8
Consumer Goods	3.0	5.6	17.5
Health Care	-0.4	-4.9	-8.5
Consumer Services	0.0	-1.1	-1.4
Telecommunications	-3.1	-3.0	4.9
Utilities	4.1	2.8	9.2
Non-Financials	2.0	3.0	-0.5
Financials	1.7	-10.0	-13.3
IT	3.8	1.5	11.9
All Share	1.9	-0.4	-3.9

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Small Cap rose in relative terms this month, but Mid and Large Cap were effectively flat in relative terms.

FRS17 volatility indicator

Now discontinued, but available on request.

Bond market information

Figure 5: £ Non-Gilt Credit Margins

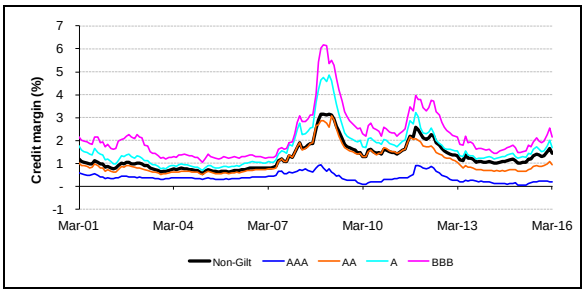


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Oct '15	3.66	2.53	1.13
Nov '15	3.49	2.47	1.02
Dec '15	3.65	2.59	1.06
Jan '16	3.52	2.27	1.25
Feb '16	3.61	2.18	1.43
Mar '16	**3.33**	**2.21**	**1.12**

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

Category	Mkt Val @ Mar 16 & 13, 10			Weight (%)
Gilts (39)	1,253	1,130	718	70.1
Non Gilts (1,019)	534	534	469	29.9
AAA (123)	104	127	146	5.8
AA (192)	97	71	73	5.4
A (329)	157	186	160	8.8
BBB (375)	177	151	90	9.9

Category	Mkt Val @ Mar 16 & 13		W't (%)	Dur'n (yrs)
Gilts (39)	1,253	1,130	70.1	11.0
< 5 Yrs (11)	337	310	18.9	3.0
5–15 Yrs (12)	388	407	21.7	7.6
> 15 Yrs (16)	528	413	29.5	18.8
Non Gilts (1,019)	534	534	29.9	7.9
< 5 Yrs (337)	156	144	8.7	2.6
5–15 Yrs (441)	231	218	12.9	7.5
> 15 Yrs (241)	148	173	8.3	14.4

£ Gilt Market "main" Issuance

- £3.85bn 1½% 2021 (1.54x, 0.86%, Jan 16)
- £1.37bn 3¾% 2052 (1.73x, 2.22%, Feb 14)
- £1.05bn $^1/_8$% IL 2036 (2.28x, ry -0.92%, new)
- £0.35bn $^1/_8$% IL 2068 (1.44x, ry -1.08%, Sep 15)

Note: Issuance amounts are nominals.

Tables 2d, 2e: € Market Size and Maturity (Mar 16)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (320)	5,830	61.5
Non Sovereigns	3,647	38.5
AAA (653)	1,072	11.3
AA (596)	965	10.2
A (766)	775	8.2
BBB (917)	835	8.8

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (764)	2,022	21.3
3 – 5 Yrs (820)	2,018	21.3
5 – 7 Yrs (748)	1,672	17.6
7 – 10 Yrs (602)	1,714	18.1
10+ Yrs (318)	2,051	21.6

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Mar 16 & 13)		W't (%)	Dur'n (yrs)
Gilts (27)	513	375	93.5	22.0
< 5 Yrs (3)	50	46	9.1	-
5 – 15 Yrs (7)	129	105	23.5	-
> 15 Yrs (17)	334	223	60.9	29.7
Non Gilts (37)	36	32	6.5	17.0

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

Month End	US (%)	Euro (%)	Sterling (%)
Sep '15	7.21	5.14	6.58
Oct '15	6.68	4.52	6.40
Nov '15	7.03	4.37	6.30
Dec '15	7.51	5.13	6.51
Jan '16	7.81	5.21	6.80
Feb '16	7.62	5.48	7.20
Mar '16	**6.95**	**4.39**	**6.67**

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

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