



Investment Update November 2017

Investment Headlines & Comment

- A rather mixed month for world equity markets, but UK bond markets were pretty flat.
- The dispersion in UK Equity sector returns has narrowed considerably through this year.
- Record ILG £23.7bn (nominal) demand for the **new 2048 issue**, but there was just £3bn issued.

Feature Section

This month we update our analysis of the evolution of the Bank of England Quantitative Easing (QE) portfolio, in conjunction with the updated borrowing projections in the recent Budget. We last looked at these in our [March 2016](#) and [August 2016](#) issues.

Figure 1a shows the redemption profile of the gilt market, including those purchased under the Asset Purchase Facility (the QE bit). Interestingly, £106bn (nominal) of the QE portfolio will have already matured by the end of the current tax year, but of the £356bn (nominal) QE that remains, £122bn matures before the next “scheduled” General Election, and will thus get reissued, probably to new investors instead of the Bank, within an overall £343bn of reissuance. Figure 1b updates the profile of the Public Sector Net Borrowing (PSNB) Requirement as a % of Gross Domestic Product (GDP) – it shows that the continued Budget deficit is thus expected to add £137bn of new borrowing to be met by new investors over the same period of the next 4 tax years (in contrast to the position back in early 2016 when a Budget surplus was projected to exist by the 2019/20 year). Will pension fund demand be enough to prevent rising yields on this combined issuance of £480bn?

Figure 1c shows how the Debt to GDP ratio is affected by the increased projected borrowing – for example, it has the ratio for the 2019/20 year at 86.1% instead of the previous projection of 77.2%. Finally, Figure 1d shows the interest that is being paid on the debt portfolio as % of GDP. In £ terms it is already at £40bn, and although initially projected to fall (presumably as the reissued gilts are on lower interest rates than previously), it is then expected to rise to £44bn by 2022/23 (and that could then rise sharply through the impact of Corbynomics, if there is a change of governing party).

Figure 1a: Gilt portfolio redemption profile

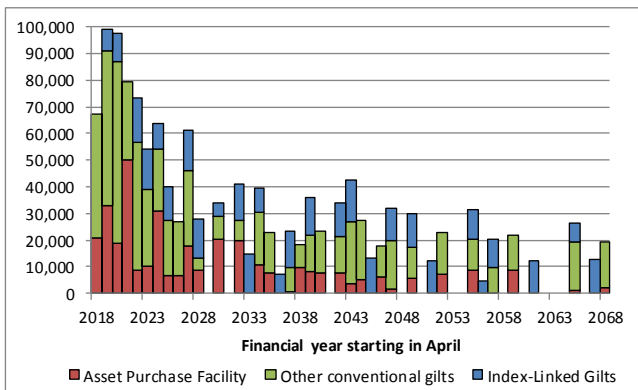


Figure 1c: Debt to GDP ratio

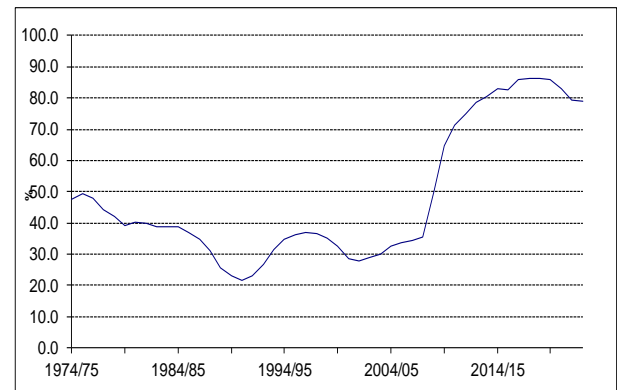


Figure 1b: Public Sector Net Borrowing

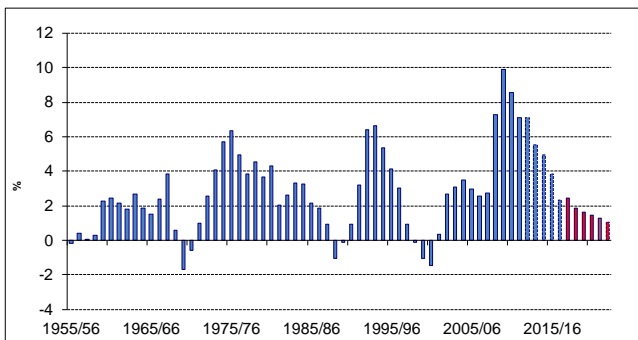
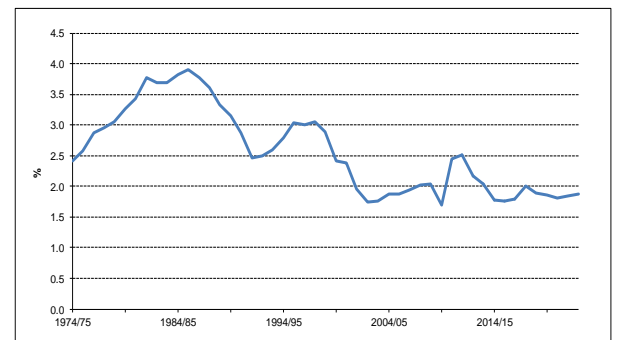


Figure 1d: Debt Interest relative to GDP



Sources: DMO, OBR



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 30 November 2017

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	-1.7	-0.2	13.4	7.8	9.5	5.8	6.3
Overseas Equities	0.2	1.2	15.9	14.6	16.0	9.8	8.2
US Equities	1.1	2.4	13.5	16.3	19.7	13.0	7.8
Europe ex UK Equities	-1.5	-1.1	24.5	12.1	13.1	5.9	8.5
Japan Equities	1.1	4.9	16.0	17.5	16.9	7.6	5.2
Pacific ex Japan Equities	-1.3	-0.7	19.6	13.3	10.9	8.1	9.8
Emerging Markets	-1.7	-1.6	23.0	11.8	8.6	6.0	9.5
UK Long-dated Gilts	0.6	-2.9	4.0	7.3	7.0	8.3	7.5
UK Long-dated Corp. Bonds	-0.1	-2.6	7.0	7.3	7.3	8.0	-
UK Over 5 Yrs Index-Linked Gilts	0.7	-2.7	4.0	8.7	9.3	8.8	7.9
High Yield (Global)	-1.8	-3.6	3.1	10.9	9.5	12.4	-
Overseas Bonds	-0.7	-5.3	-2.5	6.9	3.5	7.4	5.7
Property *	0.9	2.7	10.8	9.3	11.0	4.6	8.7
Cash	0.0	0.1	0.3	0.5	0.5	1.2	3.2
Commodities £-converted	-0.5	3.5	-2.1	-8.9	-10.0	-6.2	-0.4
Hedge Funds original \$ basis *	1.1	2.3	8.9	3.9	5.0	2.9	6.5
Illustrative £-converted version *	2.2	1.5	0.2	10.6	9.2	7.6	7.7
Euro relative to Sterling	0.4	-4.5	3.7	3.4	1.6	2.1	-
US \$ relative to Sterling	-1.9	-4.8	-7.7	5.0	3.4	4.3	1.1
Japanese Yen relative to Sterling	-0.4	-6.4	-6.0	7.1	-2.7	4.2	1.8
Sterling trade weighted	0.5	5.4	0.9	-3.1	-1.1	-2.5	-1.2
Price Inflation (RPI) *	0.1	0.9	4.0	2.2	2.3	2.8	2.8
Price Inflation (CPI) *	0.1	1.0	3.0	1.2	1.4	2.4	2.0
Price Inflation (RPIX) *	0.1	1.0	4.2	2.4	2.4	3.2	2.8
Earnings Inflation **	0.1	-2.1	2.7	2.5	1.9	1.9	3.1
All Share Capital Growth	-2.0	-1.0	9.2	3.9	5.6	2.1	2.9
Dividend Growth	0.1	1.5	11.3	8.0	6.3	4.2	4.4
Earnings Growth	7.3	17.4	53.7	-4.4	-4.9	-3.1	2.3

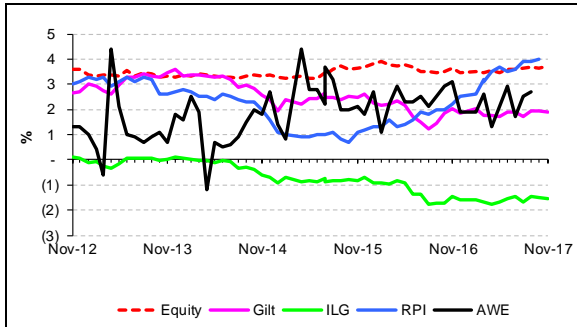
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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 – 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, 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.

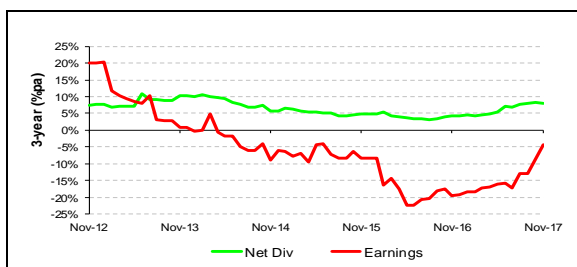
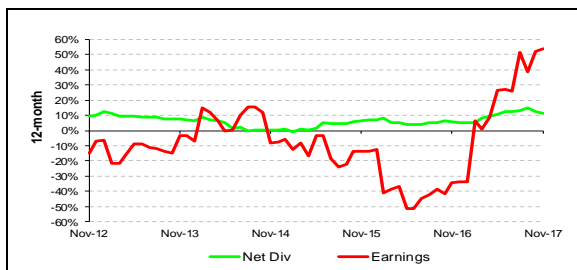


The gap gives a current expectation around 3.4% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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]

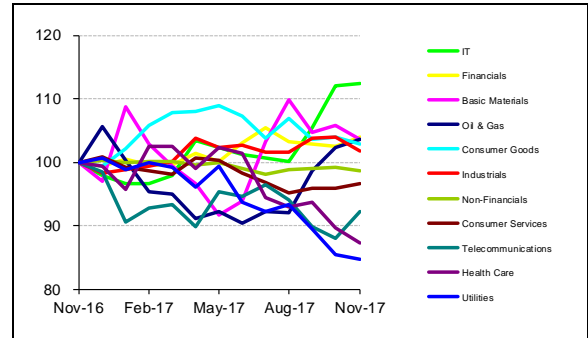
Figure 3: Dividend & Earnings Growth



Note: Earnings data from mid 2015 onwards is under review by FTSE Russell as one-off events may be affecting the prospective P/E ratios

UK Equity Sector Returns

Figure 4a: Sectors relative to All Share



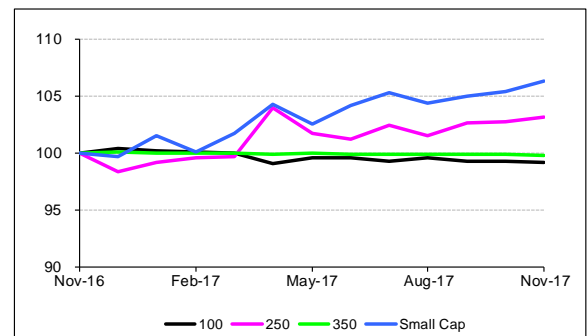
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (from 32% to 28%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-0.5	12.2	17.3
Basic Materials	-3.6	-5.9	17.4
Industrials	-3.8	-0.2	15.3
Consumer Goods	-2.7	-3.9	16.7
Health Care	-4.2	-6.3	-1.0
Consumer Services	-0.9	1.2	9.5
Telecommunications	3.0	-2.2	4.5
Utilities	-2.6	-9.5	-4.0
Non-Financials	-2.2	-0.5	11.8
Financials	-0.2	0.5	17.8
IT	-1.3	11.9	27.4
All Share	-1.7	-0.2	13.4

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid Cap and Small Cap rose in relative terms this month.

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



Bond market information

Figure 5: £ Non-Gilt Credit Margins

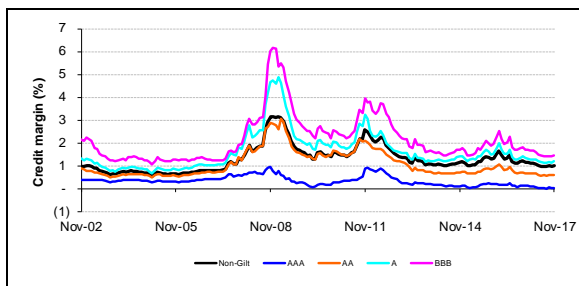


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Jun '17	2.55	1.89	0.66
Jul '17	2.53	1.88	0.65
Aug '17	2.38	1.72	0.66
Sep '17	2.62	1.94	0.68
Oct '17	2.62	1.93	0.69
Nov '17	2.64	1.89	0.75

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

Category	Mkt Val @ Nov 17 & 14, 11			Weight (%)
Gilts (41)	1,344	1,207	981	70.1
Non Gilts (1,056)	575	555	466	29.9
AAA (137)	113	105	128	5.9
AA (171)	88	94	68	4.6
A (328)	161	179	164	8.4
BBB (420)	213	176	106	11.1

Category	Mkt Val @ Nov 17 & 14		W't (%)	Dur'n (yrs)
Gilts (41)	1,344	1,207	70.1	11.7
< 5 Yrs (12)	403	337	21.0	2.9
5-15 Yrs (11)	353	377	18.4	8.3
> 15 Yrs (18)	588	493	30.6	19.8
Non Gilts (1,056)	575	555	29.9	8.0
< 5 Yrs (379)	187	161	9.7	2.8
5-15 Yrs (447)	238	235	12.4	7.6
> 15 Yrs (230)	150	159	7.8	15.3

£ Gilt Market “main” Issuance

- £2.75bn ¾% 2023 (2.53x, 0.83%, 0%, Oct 17)
 - £2.72bn 1¼% 2027 (2.32x, 1.34%, 9%, Oct 17)
 - £0.40bn 4% 2060 (2.21x, 1.63%, n/a, Jul 16)
 - £1.00bn 1/8% IL 2026 (2.99x, ry -1.85%, 0%, Aug 17)
 - £3.00bn 1/8% IL 2048 (**7.9x**, ry -1.54%, n/a, new)
- Note: Issuance amounts are nominals. The first % figure in each row is the yield or real yield. The second % figure is the additional amount taken up under the Post Auction Option Facility (PAOF), as a % of the amount of the issue. PAOF does not apply for syndication cases.

Tables 2d, 2e: € Market Size and Maturity (Nov 17)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (348)	6,042	59.5
Non Sovereigns	4,109	40.5
AAA (810)	1,170	11.5
AA (643)	1,024	10.1
A (885)	861	8.5
BBB (1,204)	1,054	10.4

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (862)	2,243	22.1
3 – 5 Yrs (1,027)	2,166	21.3
5 – 7 Yrs (815)	1,632	16.1
7 – 10 Yrs (767)	1,890	18.6
10+ Yrs (419)	2,219	21.9

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Nov 17 & 14)		W't (%)	Dur'n (yrs)
Gilts (28)	642	467	100.0	23.0
< 5 Yrs (3)	59	44	9.2	3.4
5 – 15 Yrs (7)	150	139	23.4	9.6
> 15 Yrs (18)	433	285	67.4	30.3

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

Month End	US (%)	Euro (%)	Sterling (%)
Jun '17	5.32	3.09	5.42
Jul '17	5.21	2.97	5.35
Aug '17	5.28	3.00	5.33
Sep '17	5.21	2.92	5.25
Oct '17	5.22	2.73	5.15
Nov '17	5.39	2.88	5.37

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

