JAGGER & ASSOCIATES

Investment Update
September 2017

Investment Headlines & Comment

- **Gilt yields** rose this month, as the UK's credit rating fell slightly, and Labour indicated further borrowing plans.
- This month saw the second-highest nominal demand in a gilt syndication with over £25bn of offers for £4bn of the **2065 gilt**.
- The **Post Auction Option Facility** was unused this month for any regular DMO issuance– evidence of gilts as expensive?

Feature Section

This month, we consider the investment consultants market investigation being undertaken by the Competition and Markets Authority (CMA), looking at investment advice to institutional investors and also fiduciary management services. The aim to see if there are any market features which prevent, restrict or distort competition, and then whether and – if so – what action is needed to resolve them. The opening issues statement weighs in at 40 pages alone …

The CMA is considering "whether difficulties in customers' ability to assess, compare and switch investment consultants mean investment consultants have little incentive to compete for customers". Now, any instance of the "nobody got fired for hiring IBM" mentality means it is not just about some customers having "difficulties", but for others, their fundamental preferences result in a narrowing of their selection set.

Indeed, as an initial example, it would be interesting to see for the various Independent Trustee firms practising in the UK how their (anonymised) use of advisors used has varied over time (weighting either by asset size or number of clients). This analysis could be particularly relevant given that the remedies section of the CMA's issues statement includes the possibility of introducing professional Trustees considerably more widely than at present (see p35).

One possible outcome on "switching" is that there might be a rule introduced that pension schemes above size £X must re-tender for advice services every N years, but would that actually give the desired results, or just more costs? At the smaller end of the market it would be a nuisance, tying people up in writing submissions instead of client work, and Trustees would not appreciate the additional workload (particularly if they were content with the work of the adviser in the first place). Worse, there are already anomalies in tenders that are issued, e.g. on professional indemnity levels, or turnover requirements, which can unintentionally exclude firms that would like to pitch.

The CMA is also considering whether conflicts of interest on the part of investment consultants reduce the quality and/or value for money of services provided to customers. Those providing fiduciary management services as well as investment advice could come under particular scrutiny. For example, their actions taken in the wake of key individuals leaving an investment management firm may be worth a look. There could be an issue if there have been instances of clients given one line of advice by a firm on how to react whilst the opposite was done within their fiduciary area.

Equally, there is a question on whether fiduciary managers have been able to sell their services simply because some groups of Trustees lack confidence in making investment decisions (or cannot delegate to an investment sub-committee). A conflict of interest point on the investment advice side will be for any firms where consultants are given fee income targets – how can a client be sure a particular approach is needed for them, as opposed to generating that fee income?

Finally, the CMA wants to test whether barriers to entry and expansion mean there are fewer challengers to put pressure on the established investment consultants to be competitive, which they think leads to worse outcomes for customers. On the entry point, it is worth remembering that the main reason we managed to get started in 1999 was because there was pension mis-selling review work that could be done whilst the investment side developed. Stand-alone investment firms are relatively rare, and start-up actuarial firms have generally outsourced their investment work for at least their first few years.

Along the way, there will be the question of whether to revise the definition of what is regulated advice and what is not – this crops up around p37 in the issues statement. Some readers may be surprised to find that very little of our firm's work constitutes regulated investment work, but it is because of this low proportion that we are able to be regulated by the Institute and Faculty of Actuaries in its capacity as a Designated Professional Body (DPB). (**Ed.**: Keep reading, this is not going to be as tedious as you fear!)

One key area is general investment strategy, including asset allocation. If that became regulated, not only would our regulated work rise, but also lots of Scheme Actuaries would suddenly come within the regulatory area, whereas most of them do not at the moment. So, unless the DPB rules were changed on acceptable proportions, it could force some firms to become FCA regulated, which is undesirable (and a tedious barrier) at the smaller end of the market. The next couple of years could be ever so slightly interesting …

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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 September 2017

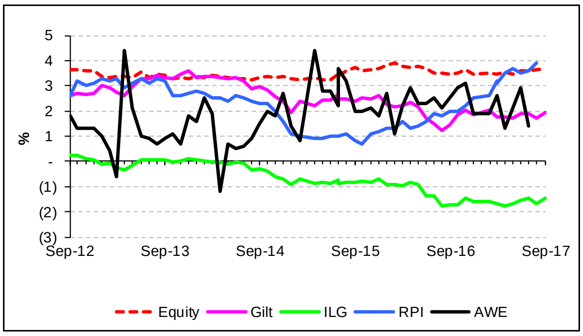
Asset Class	1 month (%)	3 months (%)	12 months (%)	3 years (% p.a.)	5 years (% p.a.)	10 years (% p.a.)	20 years (% p.a.)
UK Equities	-0.4	2.1	11.9	8.5	10.0	5.8	5.9
Overseas Equities	-2.2	1.9	15.8	15.7	15.5	9.3	7.5
US Equities	-2.0	1.2	15.0	**17.9**	**18.5**	12.1	7.4
Europe ex UK Equities	-1.0	3.9	**22.6**	13.6	14.4	6.1	8.1
Japan Equities	-2.0	0.8	11.4	15.8	15.6	6.6	3.8
Pacific ex Japan Equities	-4.3	1.8	15.8	13.7	10.9	7.8	7.8
Emerging Markets	-4.3	**4.6**	19.0	12.1	8.3	6.0	7.9
UK Long-dated Gilts	-4.0	-0.5	**-6.3**	9.5	6.9	8.5	7.5
UK Long-dated Corp. Bonds	-3.0	-0.1	-2.7	8.6	7.7	8.1	-
UK Over 5 Yrs Index-Linked Gilts	-4.3	-0.8	-4.2	10.8	9.8	9.0	8.1
High Yield (Global)	-3.1	-0.4	6.4	12.4	10.3	**12.3**	-
Overseas Bonds	**-5.2**	**-1.7**	**-6.3**	8.0	3.5	7.8	5.5
Property *	**0.8**	2.6	9.5	9.8	10.7	4.1	**8.7**
Cash	0.0	0.1	0.3	**0.5**	**0.5**	**1.3**	**3.3**
Commodities £-converted	-0.8	3.8	-1.5	-14.3	-11.1	-6.1	-1.2
Hedge Funds original $ basis *	0.6	1.9	7.2	2.9	4.9	3.3	6.5
Illustrative £-converted version *	2.9	1.7	8.9	12.0	9.3	8.0	7.7
Euro relative to Sterling	-4.5	0.4	1.9	4.2	2.0	2.4	-
US $ relative to Sterling	-4.0	-3.2	-3.2	6.5	3.8	4.3	0.9
Japanese Yen relative to Sterling	-6.1	-3.4	-12.9	5.6	-3.6	4.5	1.3
Sterling trade weighted	4.8	1.1	1.0	-3.9	-1.5	-2.7	-1.0
Price Inflation (RPI) *	0.7	1.1	3.9	2.2	2.5	2.9	2.8
Price Inflation (CPI) *	0.6	0.5	2.9	1.2	1.6	2.4	2.0
Price Inflation (RPIX) *	0.7	1.2	4.1	2.4	2.6	3.2	2.8
Earnings Inflation **	-1.7	-1.0	1.4	2.6	1.8	1.9	3.1
All Share Capital Growth	-0.6	1.2	7.8	4.6	6.2	2.0	2.5
Net Dividend Growth	1.1	3.2	14.7	8.1	6.4	4.5	-
Earnings Growth	-0.2	13.9	38.9	-12.9	-8.0	-4.5	1.5

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

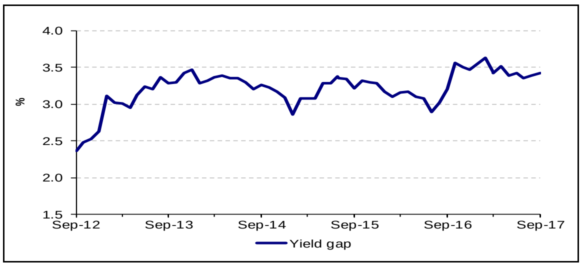
- *UK Equities (incl. dividends and earnings) – FT-A All Share.*
- *Overseas Equities (incl. regions) – blend of FT All-World / World subindices*
- *Emerging Markets from MSCI US $ based total return index (overall Index to 31 Oct 2001, Free Index from 1 Nov 2001 to take account of foreign investment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

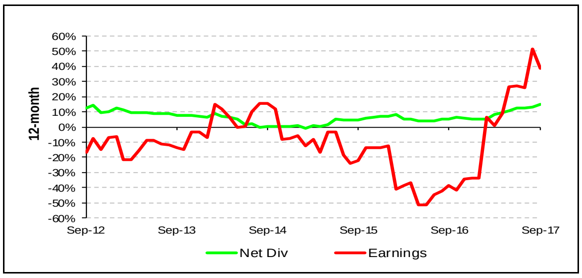


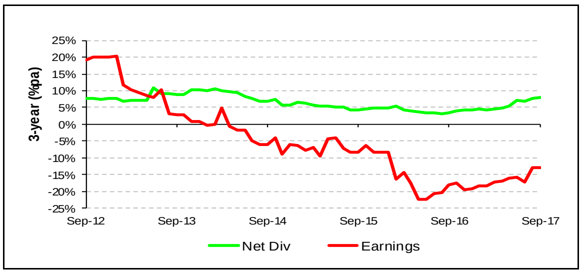
The gap gives a current expectation around 3.4% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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

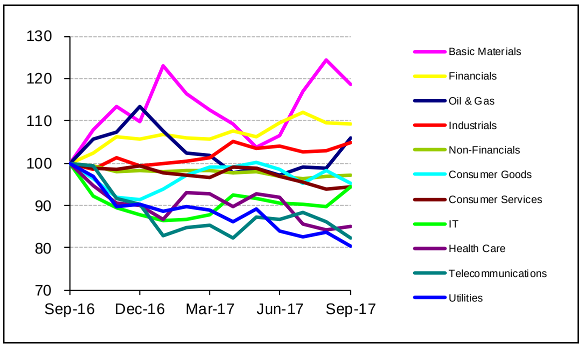




Note: Earnings data from mid 2015 onwards is under review by FTSE Russell as one-off events may be affecting the prospective P/E ratios

UK Equity Sector Returns

Figure 4a: Sectors relative to All Share



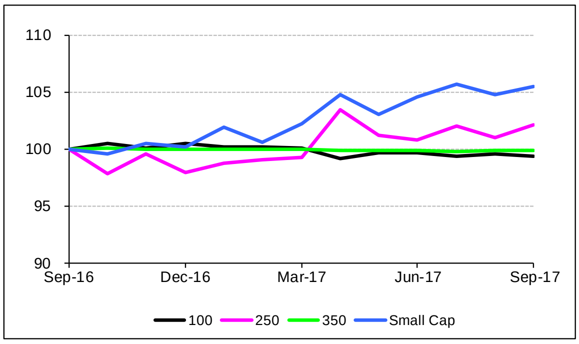
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (from 56% to 38%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	6.7	11.4	18.5
Basic Materials	-5.1	13.8	32.7
Industrials	1.6	3.1	17.4
Consumer Goods	-3.5	-1.4	6.4
Health Care	0.4	-5.5	-4.9
Consumer Services	0.3	-0.3	5.7
Telecommunications	-4.9	-3.1	-8.0
Utilities	-4.5	-2.4	-10.2
Non-Financials	-0.3	2.2	8.6
Financials	-0.8	1.9	22.3
IT	4.8	6.4	5.6
All Share	-0.4	2.1	11.9

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

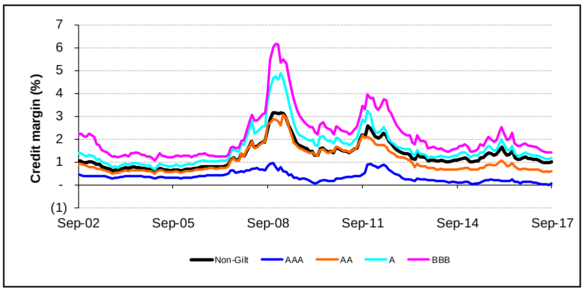


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Apr '17	2.50	1.75	0.75
May '17	2.41	1.71	0.70
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**

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

Category	Mkt Val @ Sep 17 & 14, 11			Weight (%)
Gilts (41)	1,319	1,171	902	69.9
Non Gilts (1,041)	568	549	466	30.1
AAA (133)	111	104	128	5.9
AA (170)	87	92	78	4.6
A (325)	160	175	159	8.5
BBB (413)	210	177	101	11.1

Category	Mkt Val @ Sep 17 & 14		W't (%)	Dur'n (yrs)
Gilts (41)	1,319	1,171	69.9	11.6
< 5 Yrs (11)	372	341	19.7	2.9
5–15 Yrs (12)	374	381	19.8	8.1
> 15 Yrs (18)	572	449	30.3	19.7
Non Gilts (1,041)	568	549	30.1	8.1
< 5 Yrs (372)	182	164	9.6	2.8
5–15 Yrs (446)	239	228	12.7	7.7
> 15 Yrs (223)	147	157	7.8	15.3

£ Gilt Market "main" Issuance

- £2.50bn 1¼% 2027 (2.25x, 1.16%, Aug 17)
- £2.50bn 1½% 2047 (1.97x, 1.87%, Jul 17)
- £4.00bn 2½% 2065 (**6.30x**, 1.55%, Apr 17)
- £0.95bn 1/8% IL 2036 (2.57x, ry -1.54%, May 17)

Note: Issuance amounts are nominals.

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (342)	5,923	59.4
Non Sovereigns	4,045	40.6
AAA (799)	1,158	11.6
AA (630)	1,009	10.1
A (864)	849	8.5
BBB (1,180)	1,030	10.3

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (830)	2,147	21.5
3 – 5 Yrs (1,015)	2,137	21.4
5 – 7 Yrs (802)	1,702	17.1
7 – 10 Yrs (766)	1,825	18.3
10+ Yrs (402)	2,157	21.6

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Sep 17 & 14)		W't (%)	Dur'n (yrs)
Gilts (28)	643	437	100.0	22.3
< 5 Yrs (3)	51	44	7.9	1.6
5 – 15 Yrs (7)	149	132	23.2	8.2
> 15 Yrs (18)	443	261	68.9	29.4

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

Month End	US (%)	Euro (%)	Sterling (%)
Apr '17	5.30	3.23	5.49
May '17	5.24	3.10	5.30
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**

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

JAGGER & ASSOCIATES

Contact: Ground Floor, 14 Exchange Quay,
Salford Quays, Manchester M5 3EQ
Tel.: 0161 873 9350, Fax: 0161 877 4851
web: www.jaggerandassociates.co.uk
e-mail: enquiries@jaggerandassociates.co.uk

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