

Investment Update July 2019



Investment Headlines & Comment

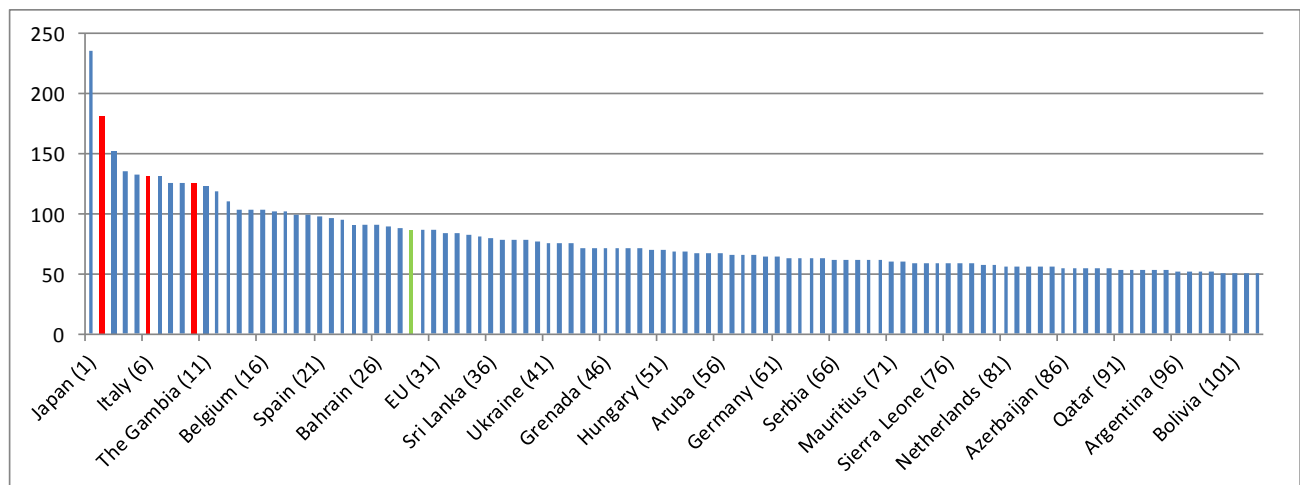
- A poor month for **Sterling**, particularly versus the US \$.
- Over £20bn of demand for the **ILG 2041 syndication**.
- J&A marks its 20th anniversary this month.

Feature Section This month we revisit the public debt ratios we last considered in our [December 2015](#) issue, to see how things have progressed. The data is once again from the World Factbook of the Central Intelligence Agency, but relates to 2017 data (due to publication lags).

Figure 1 below shows a selection of ratios from the CIA World Factbook, in descending order (the bracketed number is the country's ranking), but the data reliability has to be questioned in some cases¹, and it is only for public debt, not corporate debt as well. We have cut off the (very long) tail of values below 50% - this thus again excludes European countries such as the Czech Republic, Denmark, Norway, Switzerland, and further afield, Australia and New Zealand. However, it is worth pointing out that in 2014, this approach left us with 71 countries to consider, but by 2017 things are rather different – there are now 103 (!) countries or entities with public debt ratios over 50%. Of these, 12 are completely new entrants, including the EU, which jumps in with a ratio similar to the UK's (as a weighted average of the individual EU countries' debts).

Figure 1: Public debt to GDP ratios (%)

Source: CIA World Factbook



It is worth pointing out that there is still no single ‘magic’ constant % as to what level is sustainable for this ratio – academic studies have conflicted on this subject, but it does at least seem clear that it is a function of various factors including a country's individual reputation (= past reliability on repayments), whether it is developed or developing, and the balance between domestic and external debtholders (with Japan being a prime example of this).

It is interesting to note that Japan continues to have the highest ratio, with virtually no change from its 2010 or 2014 positions. France and Spain have % figures in the mid 90s. Ireland's position has improved since 2014 (down to 69%), but Greece, Italy and Portugal continue to have high ratios (shown as the red bars for 182%, 132% and 126% respectively). The green bar is the UK, #29, with a ratio of 87% - this is a “pre bank interventions” figure, and still higher than the US and Germany, who are at 82% and 64% respectively, but our debt profile is much longer dated, which arguably helps smooth the impact of refinancing the debt.

¹ To put this comment in context for a non-Eurozone example, the US data excludes debt issued by individual US states, as well as intra-governmental debt – this aspect of US debt consists of Treasury borrowings from surpluses in the trusts for Federal Social Security, Federal Employees, Hospital Insurance (Medicare and Medicaid), Disability and Unemployment, and several other smaller trusts; if data for intra-government debt were added, the [CIA](#) states that "Gross Debt" would increase by about a third of GDP. So, that would not be a negligible adjustment, but probably not enough to change the overall picture.



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 2019

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	2.0	2.6	1.3	8.3	6.8	9.6	5.2
Overseas Equities	4.4	7.4	11.1	14.0	14.7	13.5	7.3
US Equities	5.5	8.3	15.7	16.5	18.6	17.5	6.6
Europe ex UK Equities	2.0	7.1	5.5	11.7	10.3	9.7	7.7
Japan Equities	4.1	5.8	1.8	9.1	11.9	9.1	3.7
Pacific ex Japan Equities	2.5	4.2	5.5	11.4	10.2	10.2	9.3
Emerging Markets	2.8	3.8	5.2	11.8	9.0	8.1	9.3
UK Long-dated Gilts	3.2	8.0	11.2	3.0	9.8	9.0	6.9
UK Long-dated Corp. Bonds	3.5	7.2	13.2	4.2	8.6	9.2	7.1
UK Over 5 Yrs Index-Linked Gilts	3.9	7.6	12.8	6.9	10.7	9.7	7.5
High Yield (Global)	4.2	8.4	13.9	9.4	11.2	11.7	8.4
Overseas Bonds	3.6	10.7	13.7	3.4	8.1	5.4	5.8
Property *	0.2	0.6	4.0	6.6	9.1	10.4	8.2
Cash	0.1	0.2	0.8	0.6	0.6	0.6	2.7
Commodities £-converted	3.7	1.8	-1.9	7.8	-6.6	-2.3	1.6
Hedge Funds original \$ basis *	2.3	1.7	1.4	5.0	2.9	4.7	5.8
Illustrative £-converted version *	1.3	4.1	5.1	6.7	9.2	7.4	7.0
Euro relative to Sterling	1.6	5.8	1.9	2.6	2.8	0.6	1.6
US \$ relative to Sterling	3.9	6.5	7.1	2.7	6.6	3.1	1.4
Japanese Yen relative to Sterling	3.1	9.2	10.4	0.8	5.5	1.7	1.7
Sterling trade weighted	-2.4	-5.8	-3.6	-1.9	-3.2	-1.1	-1.4
Price Inflation (RPI) *	0.1	1.6	2.9	3.3	2.5	3.1	2.8
Price Inflation (CPI) *	0.0	0.8	2.0	2.4	1.5	2.2	2.0
Price Inflation (RPIX) *	0.2	1.6	2.8	3.3	2.5	3.2	2.9
Earnings Inflation **	-0.6	-1.9	3.9	2.8	2.7	2.1	3.0
All Share Capital Growth	1.9	1.6	-2.8	4.2	2.9	5.8	1.7
Dividend Growth	0.2	-0.3	9.9	9.3	7.2	5.7	4.6
Earnings Growth	2.4	-1.6	-24.2	28.8	-0.7	3.2	4.0

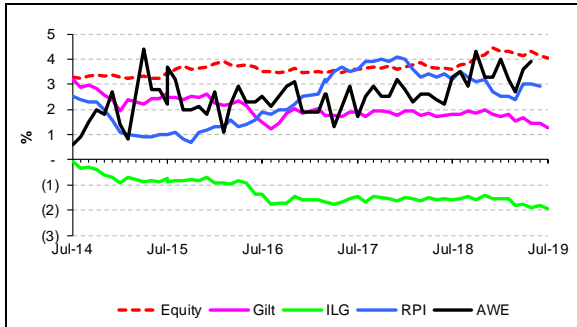
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

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

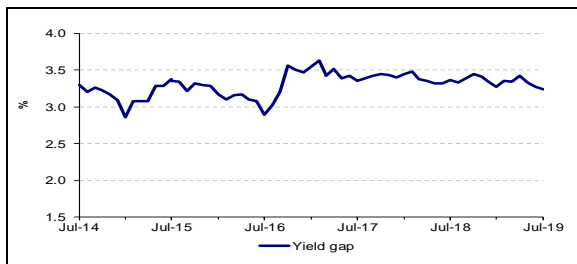


Yields and Yield Gaps

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.

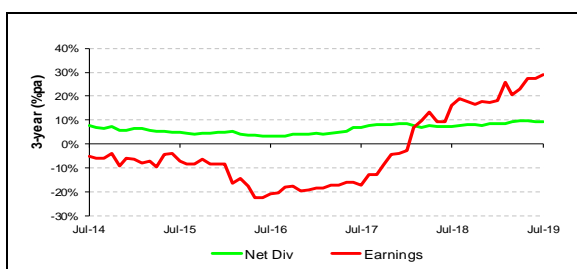
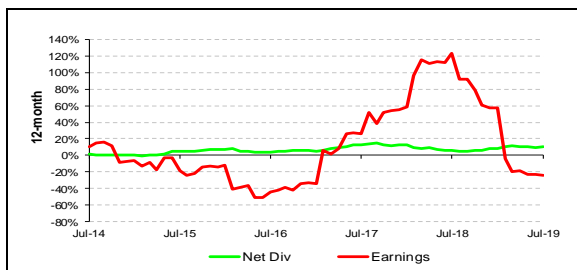


The gap gives a current expectation around 3.2% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

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]

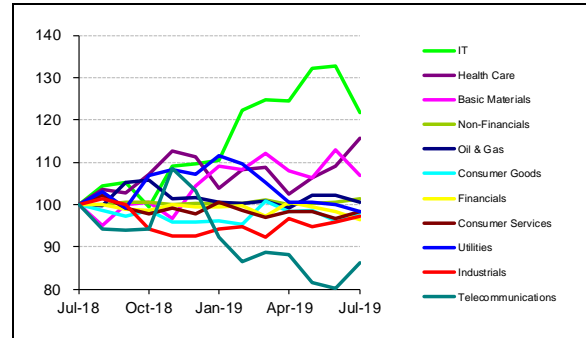
Figure 3: Dividend & Earnings Growth



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



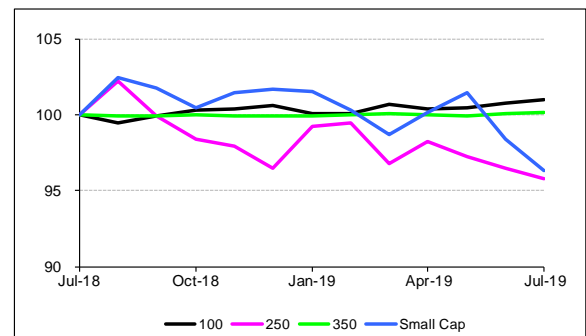
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (from 45% to 35%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	0.5	4.1	1.9
Basic Materials	-3.6	1.6	8.2
Industrials	3.4	3.2	-1.6
Consumer Goods	3.9	2.2	-0.7
Health Care	8.4	15.8	17.2
Consumer Services	3.5	2.6	-0.5
Telecommunications	9.7	0.6	-12.6
Utilities	0.3	0.3	-0.5
Non-Financials	2.7	4.0	2.5
Financials	0.0	-1.4	-2.3
IT	-6.5	0.3	23.2
All Share	2.0	2.6	1.3

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid Cap and Small Cap both fell 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

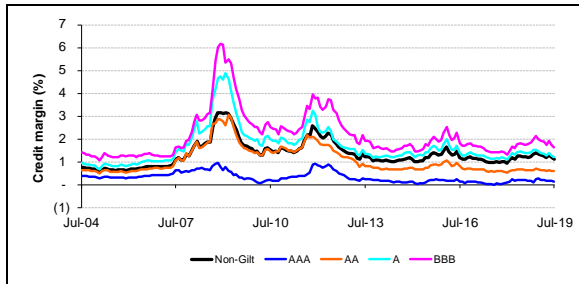


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Feb '19	2.61	1.80	0.81
Mar '19	2.34	1.54	0.80
Apr '19	2.44	1.67	0.77
May '19	2.30	1.44	0.86
Jun '19	2.24	1.44	0.80
Jul '19	2.08	1.27	0.81

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

Category	Mkt Val @ Jul 19 & 16, 13			Weight (%)
	Jul 19	Jul 16	Jul 13	
Gilts (43)	1,410	1,389	1,090	69.4
Non Gilts (1,118)	622	568	521	30.6
AAA (150)	125	113	106	6.1
AA (170)	89	99	83	4.4
A (333)	170	170	169	8.3
BBB (465)	239	186	163	11.8

Category	Mkt Val (£bn @ Jul 19 & 16)	W't (%)	Dur'n (yrs)	
Gilts (43)	1,410	1,389	69.4	12.6
< 5 Yrs (11)	342	388	16.8	2.5
5-15 Yrs (11)	364	380	17.9	7.5
> 15 Yrs (21)	704	621	34.6	20.0
Non Gilts (1,118)	622	568	30.6	8.0
< 5 Yrs (395)	205	167	10.1	2.7
5-15 Yrs (493)	268	235	13.2	7.5
> 15 Yrs (230)	149	166	7.3	16.0

Tables 2d, 2e: € Market Size and Maturity (Jul 19)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (366)	6,738	58.8
Non Sovereigns	4,717	41.2
AAA (948)	1,317	11.5
AA (774)	1,197	10.5
A (1,062)	995	8.7
BBB (1,411)	1,208	10.5

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,121)	2,445	21.3
3 – 5 Yrs (1,225)	2,442	21.3
5 – 7 Yrs (931)	1,849	16.1
7 – 10 Yrs (776)	1,984	17.3
10+ Yrs (508)	2,735	23.9

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Jul 19 & 16)		W't (%)	Dur'n (yrs)
Gilts (30)	766	582	100.0	22.0
< 5 Yrs (5)	106	51	13.8	3.1
5 – 15 Yrs (7)	155	139	20.3	10.4
> 15 Yrs (18)	505	392	65.9	29.5

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

Month End	US (%)	Euro (%)	Sterling (%)
Feb '19	6.15	3.76	6.02
Mar '19	6.03	3.57	5.78
Apr '19	5.90	3.37	5.44
May '19	6.25	3.69	5.71
Jun '19	5.68	3.27	5.51
Jul '19	5.66	3.22	5.57

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

£ Gilt Market “main” Issuance

- o £3.37bn, 5/8% 2025 (1.91x, 0.62%, 12%, new)
- o £3.16bn, 7/8% 2029 (2.22x, 0.79%, 15%, Jun '19)
- o £2.25bn, 1¾% 2037 (2.18x, 1.28%, 0%, Apr '19)
- o £2.50bn IL¹/8% 2041 (8.2x, ry -2.09%, n/a, Feb '19)

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.

