

Investment Update October 2020



Investment Headlines & Comment

- Covid concerns led to equity falls, particularly in Germany.
- Over Q3 2020, the QE portfolio rose from £613bn to £675bn.
- The QE target is £745bn – totally distorting gilt yields.

Feature Section

This month we consider the history of inflation in the Eurozone since it started in January 1999. At that time, 11 countries were involved, and another 8 have joined since then (the first being Greece from 2001, then Slovenia in 2007, through to Lithuania in 2015).

We have previously commented on the dispersion in prospective Eurozone bond yields, most recently in our [January 2020](#) edition. As of September 2020, 11 of the 19 countries are experiencing *deflationary* conditions, with the lowest of the original 11 members being Ireland with a 12-month rate of -1.2%, in contrast to the highest being Austria with +1.3%. It therefore seemed of interest to consider how much dispersion there had been in past Eurozone inflation.

Figure 1a: Cumulative inflation indices

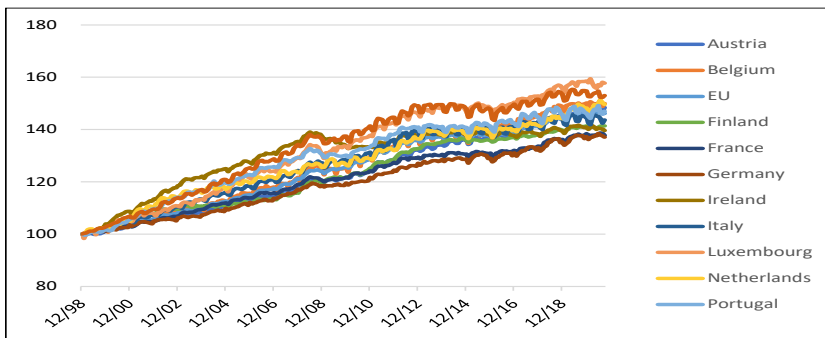


Figure 1b: Rolling 12-month inflation (%)

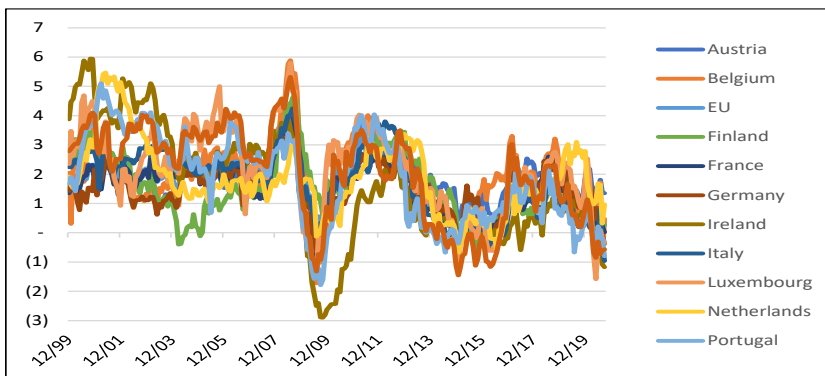
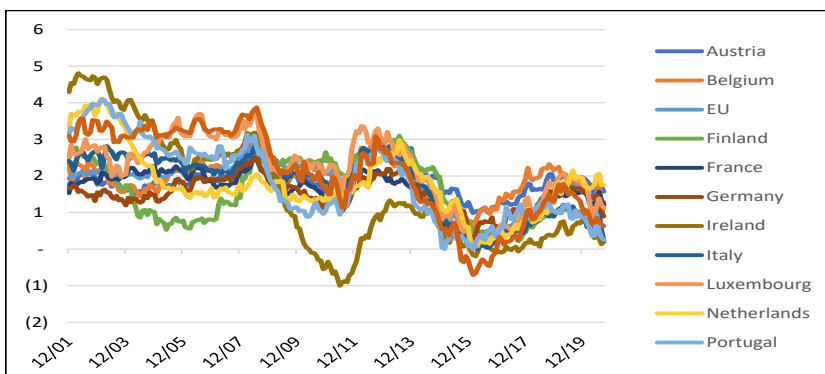


Figure 1c: Rolling 3-year inflation (% p.a.)



All data is sourced from www.sdw.ecb.europa.eu.

Figure 1a shows the cumulative Harmonised Index of Consumer Prices (HICP), rebased to 100 at the start for the original 11 members and also the overall EU rate (using the version allowing for its expanding membership). Over the 21 ¾ year period, there is actually only 0.4% p.a. between the highest and lowest original members – Belgium being the highest at 1.9% p.a. and Germany the lowest at 1.5% p.a.

Figure 1b then breaks this down into rolling 12-month inflation rates. Given different countries will have different patterns of consumption, some variation is to be expected at any given point in time.

However, Figure 1c goes on to test whether there is any greater uniformity on a rolling 3-year view. It is striking how much dispersion still remains evident, whereas back in 2000 the ECB were stating that they expected long-term convergence to be achieved (see their [December](#) bulletin from that year). Meanwhile, the Euro ploughs on regardless.



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 October 2020

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	-3.8	-3.2	-18.6	-5.0	1.7	4.4	3.6
Overseas Equities	-2.4	2.1	6.6	7.5	13.2	11.2	6.4
US Equities	-2.7	2.2	11.3	11.9	16.0	15.5	5.3
Europe ex UK Equities	-6.1	-3.6	-5.0	0.4	7.8	6.6	7.0
Japan Equities	-1.8	9.0	0.9	2.9	9.3	8.6	3.2
Pacific ex Japan Equities	2.3	5.5	12.0	4.9	13.0	7.5	10.1
Emerging Markets	2.1	4.3	8.7	3.2	12.2	5.0	9.3
UK Long-dated Gilts	-1.0	-3.9	7.5	8.9	8.9	9.0	7.1
UK Long-dated Corp. Bonds	-0.2	-2.2	7.0	7.6	9.0	8.3	7.3
UK Over 5 Yrs Index-Linked Gilts	0.8	-2.5	7.5	6.9	8.7	9.1	7.5
High Yield (Global)	0.3	1.9	3.3	4.6	9.9	8.1	8.0
Overseas Bonds	-0.3	0.7	6.1	5.5	7.8	4.0	5.5
Property *	0.3	0.7	-2.7	3.2	4.6	7.6	7.2
Cash	0.0	0.0	0.4	0.6	0.6	0.6	2.4
Commodities £-converted	-3.6	-1.4	-31.2	-10.9	-5.3	-7.5	-3.6
Hedge Funds original \$ basis *	-1.1	4.3	4.2	2.8	4.1	3.7	4.8
Illustrative £-converted version *	2.0	-0.4	-0.6	4.1	7.4	5.7	5.5
Euro relative to Sterling	-0.7	0.0	4.5	0.9	4.7	0.4	2.2
US \$ relative to Sterling	0.0	1.5	0.1	0.9	3.6	2.1	0.6
Japanese Yen relative to Sterling	0.9	2.7	3.5	3.7	6.6	-0.5	0.8
Sterling trade weighted	0.5	-0.6	-2.3	-0.3	-3.5	-0.3	-1.4
Price Inflation (RPI) *	0.3	0.5	1.1	2.3	2.5	2.7	2.7
Price Inflation (CPI) *	0.5	0.5	0.6	1.6	1.7	2.0	2.0
Price Inflation (RPIX) *	0.3	0.5	1.4	2.3	2.6	2.8	2.8
Earnings Inflation **	0.5	2.1	1.8	2.8	2.6	2.2	2.8
All Share Capital Growth	-4.0	-4.0	-21.1	-8.5	-2.0	0.7	0.1
Dividend Growth	-5.0	-10.2	-17.0	-1.7	2.6	4.6	3.9
Earnings Growth	7.5	-24.9	-31.3	-2.1	-3.6	-1.4	1.6

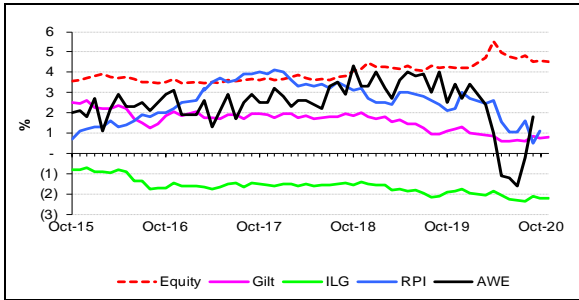
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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 – ICE 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.

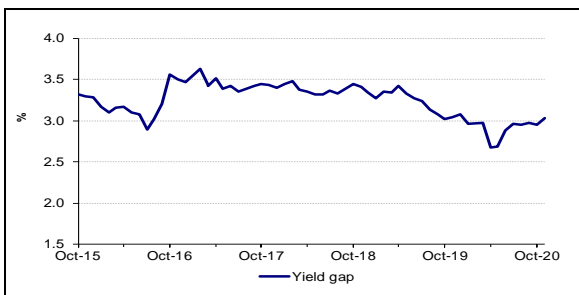


Yields and Yield Gaps

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.

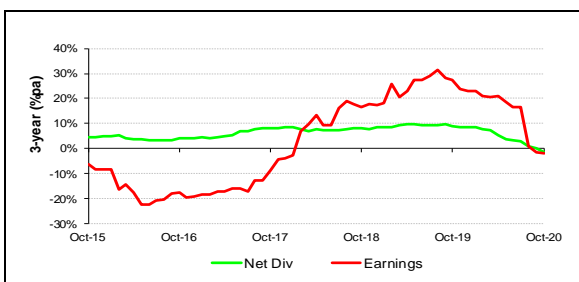
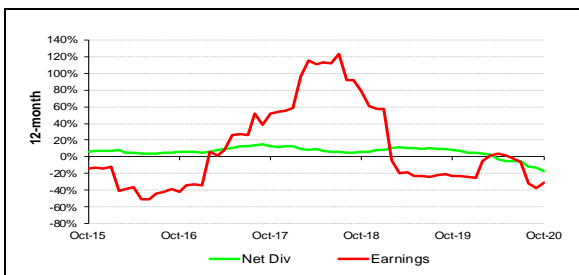


The gap gives a current expectation around 3.0% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

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]

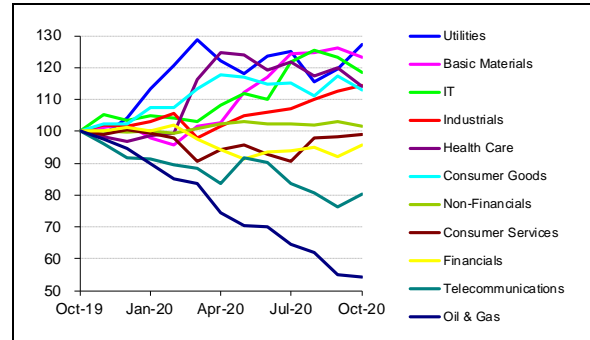
Figure 3: Dividend & Earnings Growth



Note: Earnings data from mid-2015 onwards is no longer reliable as one-off events may be affecting the prospective P/E ratios

UK Equity Sector Returns

Figure 4a: Sectors relative to All Share



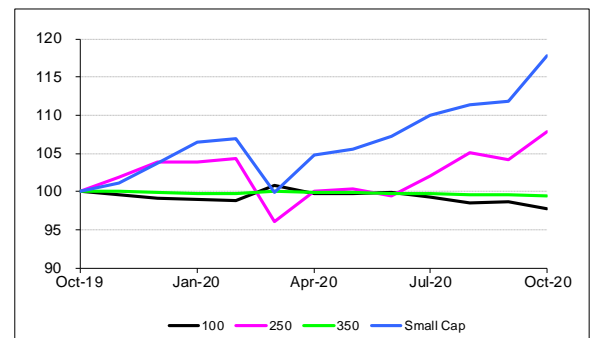
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (down from 79% to 73%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-4.9	-18.3	-55.9
Basic Materials	-6.0	-4.0	0.2
Industrials	-2.4	3.6	-6.9
Consumer Goods	-7.5	-5.0	-8.1
Health Care	-8.5	-9.3	-7.2
Consumer Services	-3.3	5.5	-19.6
Telecommunications	1.3	-6.7	-34.6
Utilities	2.1	-1.6	3.4
Non-Financials	-5.0	-3.8	-17.3
Financials	-0.3	-1.3	-22.3
IT	-7.4	-5.7	-3.6
All Share	-3.8	-3.2	-18.6

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid and Small Cap both 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

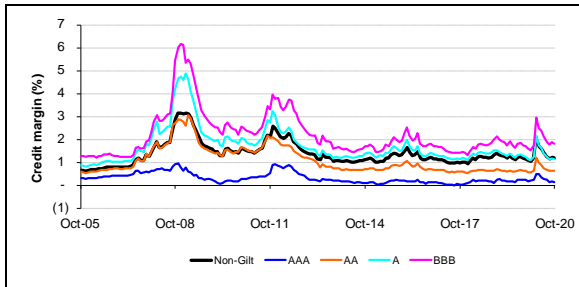


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
May '20	1.52	0.59	0.93
Jun '20	1.45	0.64	0.81
Jul '20	1.37	0.60	0.77
Aug '20	1.60	0.86	0.74
Sep '20	1.53	0.74	0.79
Oct '20	1.65	0.79	0.86

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

Category	Mkt Val @ Oct 20 & 17, 14			Weight (%)
	Oct 20	Oct 17	Oct 14	
Gilts (47)	1,731	1,332	1,153	72.2
Non-Gilts (1,159)	666	572	546	27.8
AAA (145)	133	112	104	5.5
AA (158)	85	89	91	3.6
A (361)	186	160	175	7.8
BBB (495)	261	212	176	10.9

Category	Mkt Val (£bn @ Oct 20 & 17)	W't (%)	Dur'n (yrs)
Gilts (47)	1,731	1,332	72.2
< 5 Yrs (11)	407	403	17.0
5-15 Yrs (13)	486	347	20.3
> 15 Yrs (23)	838	582	35.0
Non-Gilts (1,159)	666	572	27.8
< 5 Yrs (428)	229	186	9.6
5-15 Yrs (495)	277	238	11.5
> 15 Yrs (236)	160	148	6.7

Tables 2d, 2e: € Market Size and Maturity (Oct 20)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (400)	7,597	59.9
Non-Sovereigns	5,094	40.1
AAA (993)	1,405	11.1
AA (792)	1,171	9.2
A (1,246)	1,120	8.8
BBB (1,698)	1,399	11.0

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,255)	2,575	20.3
3 – 5 Yrs (1,335)	2,529	19.9
5 – 7 Yrs (997)	2,047	16.1
7 – 10 Yrs (863)	2,215	17.5
10+ Yrs (679)	3,326	26.2

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Oct 20 & 17)	W't (%)	Dur'n (yrs)
Gilts (28)	804	650	100.0
< 5 Yrs (3)	70	51	8.7
5 – 15 Yrs (8)	202	149	25.1
> 15 Yrs (17)	532	449	66.2

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

Month End	US (%)	Euro (%)	Sterling (%)
May '20	6.04	4.38	6.60
Jun '20	5.96	4.05	5.88
Jul '20	5.11	3.69	5.62
Aug '20	4.98	3.45	5.32
Sep '20	5.33	3.66	5.47
Oct '20	5.29	3.62	5.32

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

£ Gilt Market “main” Issuance

- o During the expanded gilt issuance programme, there is insufficient space here to list all the auction / tender exercises, so please click [here](#) for the details.

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. No PAOF applies for tender or syndication cases.

