



Investment Update February 2021

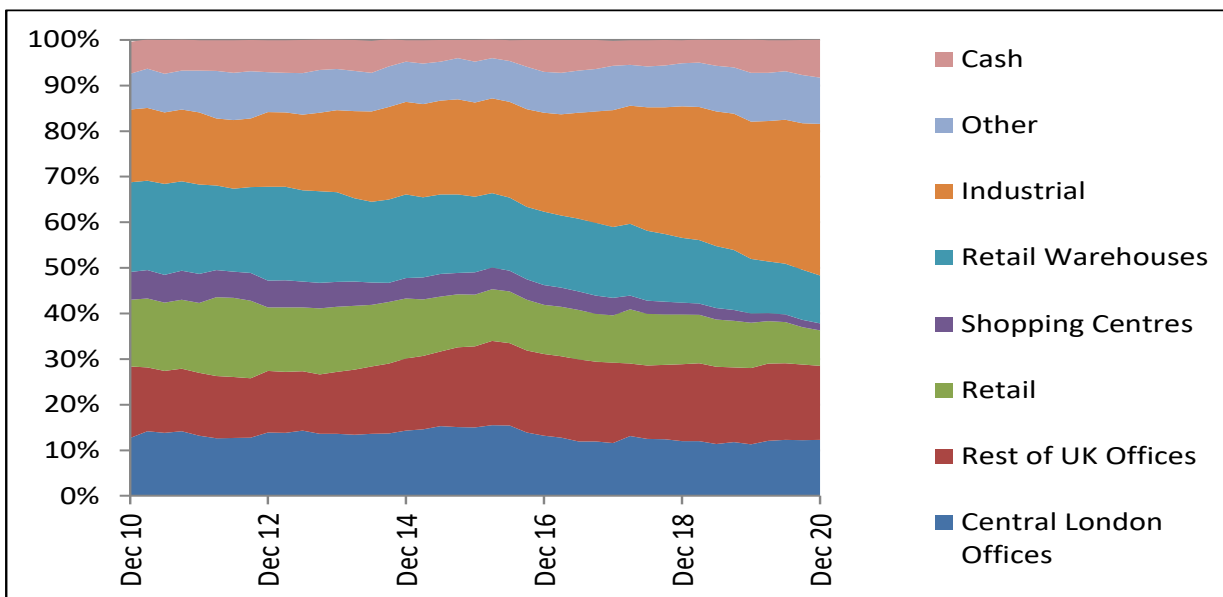
Investment Headlines & Comment

- A good month for Sterling ...
- ... and for Basic Materials / Oil
- ... but poor for gilts and bonds.

Feature Section This month we consider how the asset allocation of a typical UK commercial property fund has changed over the last decade, and to what extent this had been happening *ahead* of the 2020 Covid pandemic’s sector-specific influences coming into play.

Figure 1 shows the historic sector asset allocation for the IPD All Balanced Funds index. This covers around £30bn of property, across 27 funds aimed at institutional investors. The funds run by BlackRock and Legal & General each account for just over 10% of the index, with Royal London in 3rd place by size at around 9% of the index. For reference, once you include other pooled property funds, such as sector-specific ones, the overall pooled commercial property market is up at around £50bn (but before you add on for retail funds).

Figure 1: Sector asset allocation



Source: MSCI IPD

The pandemic may have caused temporary pricing issues during Q2 and Q3 of 2020 (with managers suspending dealing as a result), and there was certainly a gap in performance for 2020 between Industrials doing well and Retail and Offices suffering capital losses. However, the scale of that gap does not seem to have had any dramatic effect on the resulting average asset allocation. The changes in sector weightings during the overall decade shown in Figure 1 have been gradual and persistent, rather than showing any sharp swings at particular points in time.

The weightings for all three components of the retail sector have reduced considerably over the last decade, down from an initial aggregate 40% to the current 20%. Conversely, the weighting for the industrial sector has expanded considerably from the initial 15% to the current 33%. At the overall index level, there has been relatively little fluctuation in the Cash levels held, and “Other” has been relatively stable as well.

However, there are grounds to expect the weighting for “Other” to increase in future, through the increased use of Build To Rent (BTR), Purpose-Built Student Accommodation (PBSA), and leases on hotels and other leisure facilities. This increase seems most likely to be counter-balanced by pandemic-led reductions in future Office weightings, not least through “change of use” planning applications. For example, this could be through a process of converting upper floors to residential, retaining mid floors as traditional offices (although possibly with associated reconfiguration), and converting the lowest floors to retail.



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 28 February 2021

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	5.1	3.5	1.2	5.9	5.5	4.9
Overseas Equities	0.5	1.8	20.3	10.7	15.3	11.5	7.6
US Equities	0.8	1.0	21.9	14.3	17.3	15.4	6.1
Europe ex UK Equities	0.3	0.5	13.9	5.7	11.3	7.4	8.2
Japan Equities	-0.4	-0.1	18.0	4.7	11.6	8.2	4.5
Pacific ex Japan Equities	-0.2	7.0	28.4	8.8	16.1	8.9	10.5
Emerging Markets	-1.0	6.5	24.7	6.2	15.6	6.4	10.0
UK Long-dated Gilts	-9.7	-10.0	-8.1	4.7	4.9	8.0	6.3
UK Long-dated Corp. Bonds	-6.9	-6.3	-0.5	6.5	7.9	8.1	6.9
UK Over 5 Yrs Index-Linked Gilts	-5.6	-8.2	-3.9	3.8	6.2	8.0	7.0
High Yield (Global)	-1.3	-1.7	0.7	5.5	8.8	7.9	7.6
Overseas Bonds	-4.0	-7.1	-6.5	2.8	2.9	3.5	4.7
Property *	0.5	2.1	-0.8	2.7	4.3	7.5	7.1
Cash	0.0	0.0	0.2	0.6	0.5	0.6	2.3
Commodities £-converted	8.6	17.4	-1.0	-4.0	2.5	-6.6	-2.4
Hedge Funds original \$ basis *	1.3	12.1	13.8	5.2	7.0	4.3	5.4
Illustrative £-converted version *	0.8	5.6	9.2	6.5	7.7	5.9	5.8
Euro relative to Sterling	-1.9	-3.1	1.0	-0.6	2.2	0.2	1.6
US \$ relative to Sterling	-1.8	-4.5	-8.6	-0.5	-0.1	1.5	0.2
Japanese Yen relative to Sterling	-3.5	-6.5	-7.5	-0.4	1.1	-1.1	0.6
Sterling trade weighted	2.1	3.6	2.5	1.2	-0.8	0.0	-0.9
Price Inflation (RPI) *	-0.3	0.1	1.4	2.2	2.6	2.6	2.8
Price Inflation (CPI) *	-0.2	-0.1	0.7	1.4	1.8	1.8	2.1
Price Inflation (RPIX) *	-0.3	0.1	1.6	2.3	2.7	2.6	2.9
Earnings Inflation **	3.1	5.4	5.6	3.9	3.3	2.6	2.9
All Share Capital Growth	1.7	4.5	0.8	-2.4	2.0	1.8	1.3
Dividend Growth	-8.1	-12.7	-33.7	-8.7	-2.6	2.5	2.6
Earnings Growth	-2.2	-3.5	-29.5	-14.0	5.8	-3.8	1.5

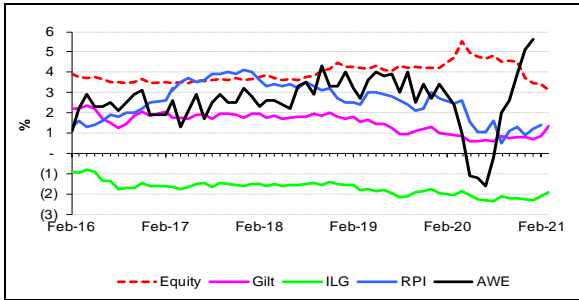
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

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

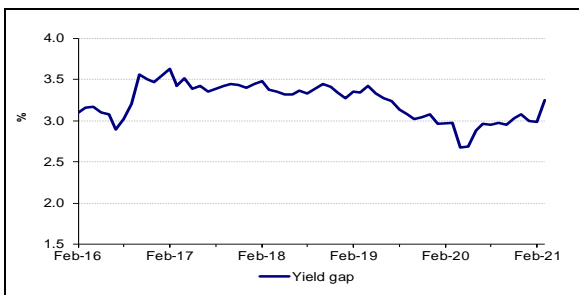


Yields and Yield Gaps

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.

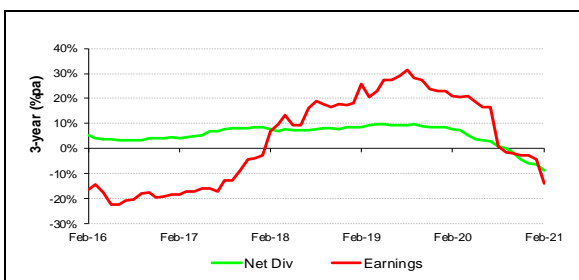
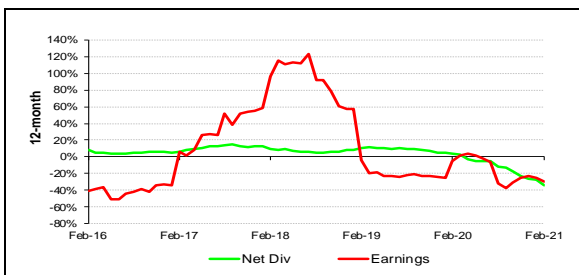


The gap gives a current expectation around 3.2% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

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]

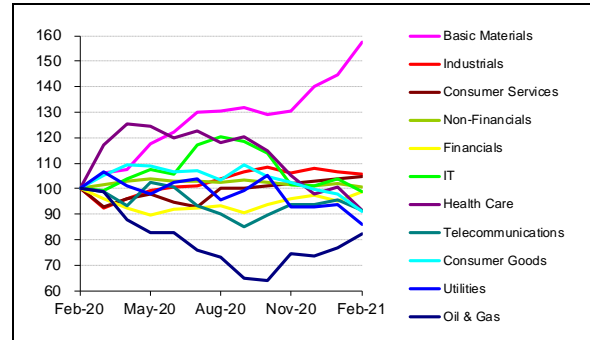
Figure 3: Dividend & Earnings Growth



Note: Earnings data from mid-2015 onwards is 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



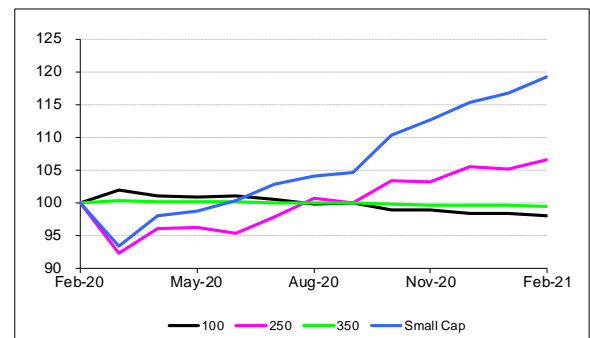
Note: Sector labels for relative lines are in end-value order

There was a rise this month in the rolling 12-month sector dispersion (up from 69% to 75%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	9.4	15.8	-14.8
Basic Materials	11.1	26.7	63.0
Industrials	1.1	4.7	9.3
Consumer Goods	-4.9	-6.6	-5.7
Health Care	-7.3	-8.7	-5.2
Consumer Services	2.8	7.6	8.2
Telecommunications	-2.1	2.5	-5.3
Utilities	-6.2	-2.4	-10.9
Non-Financials	0.6	4.0	3.9
Financials	6.0	8.2	2.4
IT	-3.1	2.4	2.3
All Share	2.0	5.1	3.5

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



This month, Mid Cap and Small Cap both rose, relative to the All Share.

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



Bond market information

Figure 5: £ Non-Gilt Credit Margins

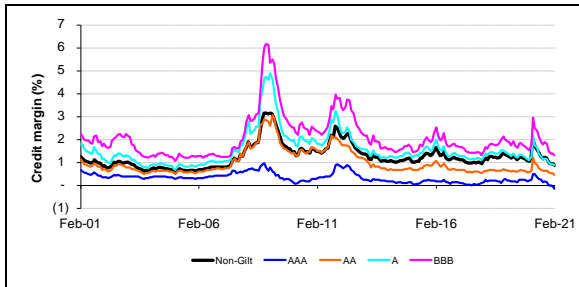


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Sep '20	1.53	0.74	0.79
Oct '20	1.65	0.79	0.86
Nov '20	1.52	0.82	0.70
Dec '20	1.34	0.70	0.64
Jan '21	1.51	0.85	0.66
Feb '21	1.97	1.34	0.63

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

Category	Mkt Val (£bn @ Feb 21 & 18, 15)			Weight (%)
Gilts (50)	1,714	1,346	1,198	72.3
Non-Gilts (1,158)	656	565	544	27.7
AAA (132)	125	110	98	5.3
AA (148)	81	76	92	3.4
A (376)	187	165	182	7.9
BBB (502)	263	213	172	11.1

Category	Mkt Val (£bn @ Feb 21, 18)		W't (%)	Dur'n (yrs)
Gilts (50)	1,714	1,346	72.3	12.3
< 5 Yrs (13)	456	399	19.2	2.9
5-15 Yrs (13)	483	360	20.4	8.1
> 15 Yrs (24)	775	587	32.7	20.5
Non-Gilts (1,158)	656	565	27.7	7.8
< 5 Yrs (419)	229	184	9.7	2.8
5-15 Yrs (506)	278	234	11.7	7.4
> 15 Yrs (233)	150	147	6.3	16.2

Tables 2d, 2e: € Market Size and Maturity (Feb 21)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (409)	7,491	59.2
Non-Sovereigns	5,154	40.8
AAA (988)	1,383	10.9
AA (799)	1,198	9.5
A (1,247)	1,118	8.8
BBB (1,761)	1,456	11.5

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,264)	2,635	20.8
3 – 5 Yrs (1,299)	2,466	19.5
5 – 7 Yrs (1,040)	2,105	16.6
7 – 10 Yrs (864)	2,186	17.3
10+ Yrs (727)	3,253	25.7

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Feb 21 & 18)		W't (%)	Dur'n (yrs)
Gilts (30)	752	648	100.0	21.2
< 5 Yrs (3)	70	59	9.2	2.7
5 – 15 Yrs (9)	196	150	26.0	9.3
> 15 Yrs (18)	487	439	64.7	28.7

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

Month End	US (%)	Euro (%)	Sterling (%)
Sep '20	5.33	3.66	5.47
Oct '20	5.29	3.62	5.32
Nov '20	4.65	2.85	4.47
Dec '20	4.38	2.74	4.32
Jan '21	4.43	2.74	4.20
Feb '21	4.44	2.69	4.12

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.

