JAGGER & ASSOCIATES

Investment Update

March 2021

Investment Headlines & Comment

- Another good month for most equity markets.
- Sterling continues to recover against many currencies.
- Inflation continues to be muted.

Feature Section

This month, given the updated data from the 2021 Budget, we return to two linked themes, the public sector finances (last looked at in our December 2019 edition), and the evolution of the Quantitative Easing (QE) portfolio (last looked at in our August 2020 edition).

Figures 1a and 1b show the history of the public sector net deficit and net debt as % of GDP. Figure 1c shows the nominal values of the gilt market by year of maturity, including the elements held by the QE portfolio. Figure 1d shows the spread of the government borrowing for the period from September 2020 through to March 2021, again with the QE portfolio element.

Figure 1a: Public sector net deficit

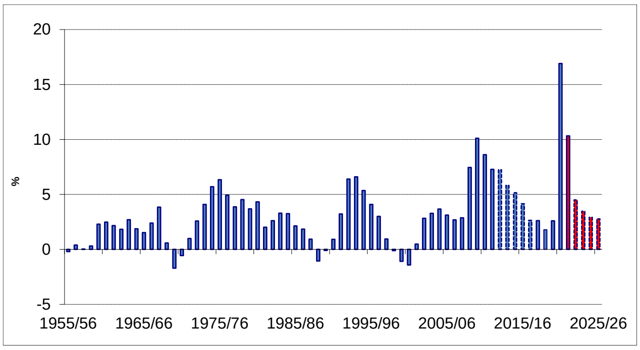


Figure 1c: The QE portfolio

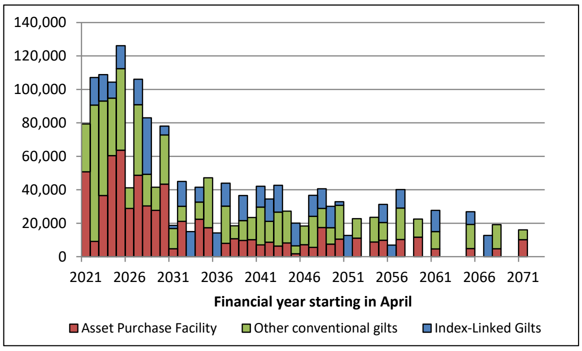


Figure 1b: Public sector net debt

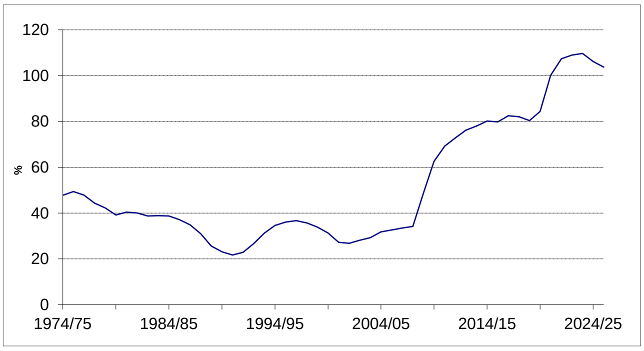
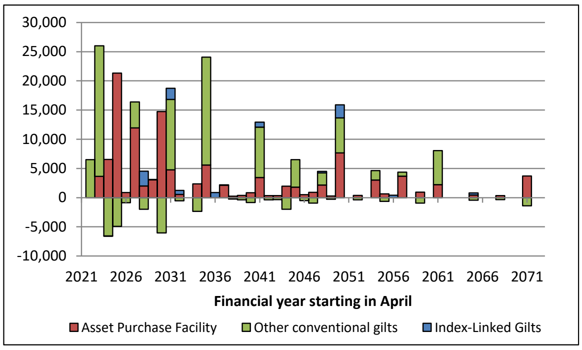


Figure 1d: Recent QE transactions



Sources: Bank of England, OBR

People instinctively already knew that the pandemic-related borrowing in the last financial year was far greater than that undertaken in the financial crisis over a decade ago, and Figure 1a confirms this. However, it is perhaps surprising that the borrowing in the next financial year is projected to be at a percentage similar to that in the 2009/10 financial year. The fact from Figure 1b that the overall debt has just gone past 100% of GDP and is expected to stay above that through to at least 2025/26 would normally be alarming to economists, but given the effective interest rate on the debt is only around 1% p.a., it is not quite so bad.

In terms of the borrowing over the last few months, shown in Figure 1c, it has been focused in a relatively small number of financial years, three of them being in the next decade. This is consistent with the way the QE portfolio has developed to be focused on that period. Figure 1d shows that around £220bn will be redeemed (or used for further purchases) over the next 5 years, and £179bn in the 5 years after that. Couple that with the £574bn due to be borrowed over the next 5 years … why would any sane investor hold gilts, let alone leverage up to do so? The promotion of gilts-led pension scheme valuations appears morally dubious.

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 March 2021

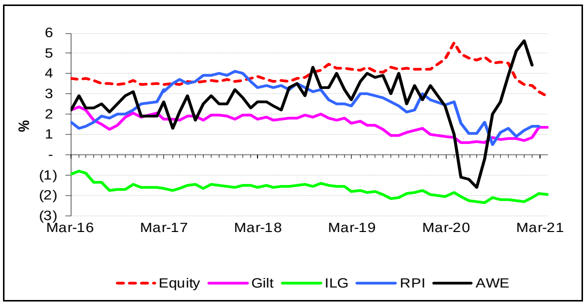
Asset Class	1 month (%)	3 months (%)	12 months (%)	3 years (% p.a.)	5 years (% p.a.)	10 years (% p.a.)	20 years (% p.a.)
UK Equities	4.0	**5.2**	26.7	3.2	6.3	6.0	5.3
Overseas Equities	4.2	3.8	40.4	13.7	15.2	11.8	8.1
US Equities	**5.3**	4.7	42.7	**18.0**	**17.7**	**15.8**	6.8
Europe ex UK Equities	4.5	2.5	34.9	8.4	11.3	7.7	8.8
Japan Equities	3.0	1.2	26.3	7.0	11.8	9.3	4.8
Pacific ex Japan Equities	-0.5	2.1	**44.8**	10.1	14.1	8.2	**11.0**
Emerging Markets	-0.2	1.4	42.8	7.5	13.4	5.6	10.5
UK Long-dated Gilts	0.0	**-12.5**	**-10.4**	3.3	4.8	7.9	6.4
UK Long-dated Corp. Bonds	-0.3	-9.4	9.2	5.9	7.0	8.1	6.9
UK Over 5 Yrs Index-Linked Gilts	1.9	-7.0	2.6	3.5	6.4	8.1	7.3
High Yield (Global)	0.7	-1.0	12.9	6.5	8.5	7.7	7.7
Overseas Bonds	**-0.7**	-6.5	-10.1	2.7	2.9	3.2	4.7
Property *	0.6	2.0	-0.5	2.7	4.3	7.5	7.1
Cash	0.0	0.0	0.1	**0.6**	**0.5**	**0.6**	**2.3**
Commodities £-converted	-0.8	12.5	35.0	-4.4	2.0	-7.2	-2.3
Hedge Funds original $ basis *	3.6	9.7	20.6	7.1	7.7	4.5	5.8
Illustrative £-converted version *	1.8	4.8	10.2	6.6	7.7	6.1	5.9
Euro relative to Sterling	-1.9	-4.8	-3.7	-1.0	1.4	-0.4	1.6
US $ relative to Sterling	1.3	-0.9	-10.1	0.6	0.8	1.5	0.2
Japanese Yen relative to Sterling	-2.3	-7.4	-12.2	-0.7	1.2	-1.4	0.8
Sterling trade weighted	0.9	4.2	5.6	1.0	-0.9	0.4	-0.9
Price Inflation (RPI) *	0.5	0.9	1.4	2.1	2.6	2.5	2.8
Price Inflation (CPI) *	0.1	0.2	0.5	1.3	1.8	1.7	2.1
Price Inflation (RPIX) *	0.5	0.8	1.6	2.2	2.7	2.6	2.9
Earnings Inflation **	-0.2	4.1	4.4	4.0	3.2	2.3	2.9
All Share Capital Growth	3.5	4.3	23.3	-0.5	2.4	2.2	1.7
Dividend Growth	-4.6	-13.6	-36.5	-10.0	-3.1	1.9	2.4
Earnings Growth	-8.1	-12.9	-35.6	-19.3	2.7	-3.0	0.9

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

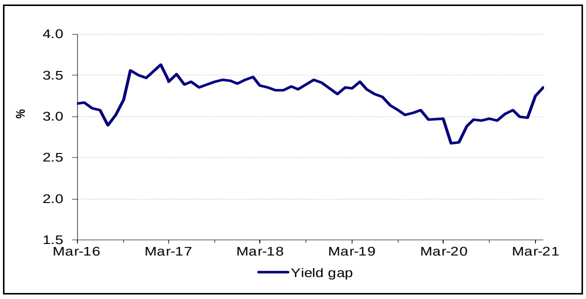
- *UK Equities (incl. dividends and earnings) – FT-A All Share.*
- *Overseas Equities (incl. regions) – blend of FT All-World / World sub-indices*
- *Emerging Markets from MSCI US $ based total return index (overall Index to 31 Oct 2001, Free Index from 1 Nov 2001 to take account of foreign investment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

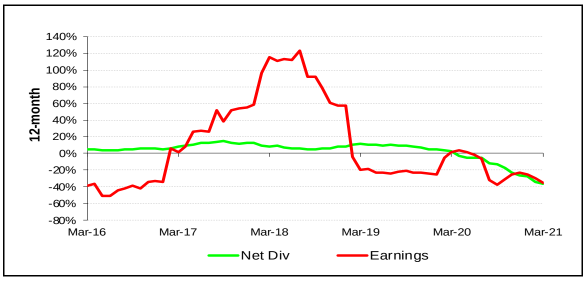


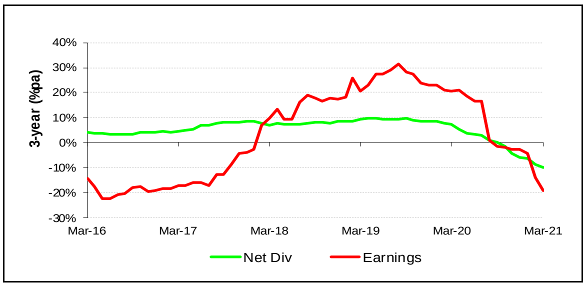
The gap gives a current expectation around 3.4% for longer-term inflation *including the risk premium for gilts, relative to index-linked gilts.*

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

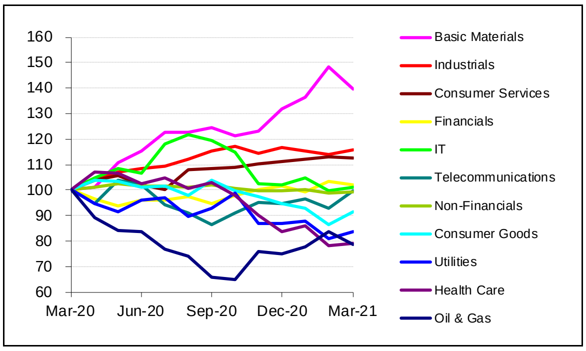




Note: Earnings data from mid-2015 onwards is no longer reliable as one-off events may be affecting the prospective P/E ratios

UK Equity Sector Returns

Figure 4a: Sectors relative to All Share



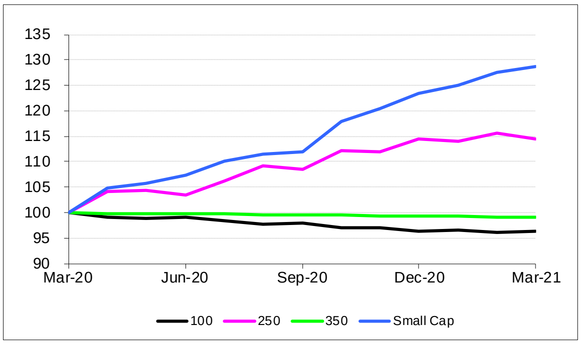
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (down from 75% to 61%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-1.8	10.9	-0.2
Basic Materials	-2.2	11.2	76.8
Industrials	5.5	4.4	46.7
Consumer Goods	9.7	1.2	15.6
Health Care	4.9	-0.9	0.0
Consumer Services	3.4	6.5	42.3
Telecommunications	11.8	10.5	26.2
Utilities	7.7	1.1	5.8
Non-Financials	4.4	4.9	25.7
Financials	2.9	6.0	29.5
IT	5.5	4.5	28.2
All Share	4.0	5.2	26.7

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



This month, Small Cap rose relative to the All Share, but Mid Cap fell slightly.

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

Bond market information

Figure 5: £ Non-Gilt Credit Margins

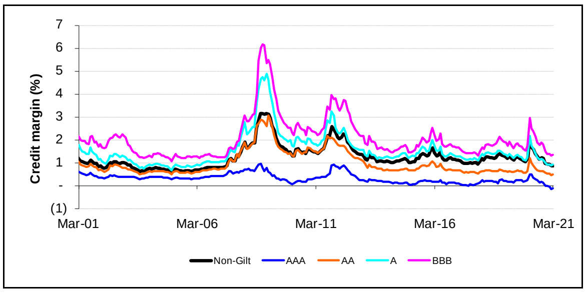


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
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
Mar '21	**2.02**	**1.37**	**0.65**

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

Category	Mkt Val (£bn @ Mar 21 & 18, 15)			Weight (%)
Gilts (50)	1,727	1,368	1,198	72.5
Non-Gilts (1,165)	655	569	544	27.5
AAA (134)	126	110	98	5.3
AA (146)	79	77	92	3.3
A (385)	190	166	182	8.0
BBB (500)	260	215	172	10.9

Category	Mkt Val (£bn @ Mar 21, 18)		W't (%)	Dur'n (yrs)
Gilts (50)	1,727	1,368	72.5	12.3
< 5 Yrs (13)	459	395	19.3	2.8
5–15 Yrs (13)	487	362	20.5	8.0
> 15 Yrs (24)	780	611	32.8	20.5
Non-Gilts (1,165)	655	569	27.5	7.8
< 5 Yrs (419)	227	184	9.5	2.8
5–15 Yrs (512)	279	235	11.7	7.4
> 15 Yrs (234)	148	149	6.2	16.2

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (415)	7,546	59.2
Non-Sovereigns	5,190	40.8
AAA (983)	1,388	10.9
AA (772)	1,197	9.4
A (1,276)	1,144	9.0
BBB (1,769)	1,461	11.5

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,275)	2,670	21.0
3 – 5 Yrs (1,301)	2,502	19.6
5 – 7 Yrs (1,049)	2,110	16.6
7 – 10 Yrs (866)	2,165	17.0
10+ Yrs (734)	3,289	25.8

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Mar 21 & 18)		W't (%)	Dur'n (yrs)
Gilts (30)	767	665	100.0	21.3
< 5 Yrs (4)	88	59	11.4	3.1
5 – 15 Yrs (8)	180	151	23.5	9.7
> 15 Yrs (18)	499	455	65.1	28.7

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

Month End	US (%)	Euro (%)	Sterling (%)
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
Mar '21	**4.47**	**2.65**	**4.13**

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

£ Gilt Market "main" Issuance

- 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.

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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