JAGGER & ASSOCIATES

Investment Update
May 2021

Investment Headlines & Comment

- Another good month for Sterling.
- ILG real yields fell as inflation fears increased.
- There was strong demand for the new 2039 ILG.

Feature Section

This month we outline some changes to funds and benchmarks which will be coming in at or before the end of 2021. Most readers will be familiar with the cash rate known as LIBOR (the London Interbank Offered Rate), and may also be aware that LIBOR was calculated as an average of what each bank *estimated* it would be charged were it to borrow from other banks on the LIBOR panel.

Readers may also recall the 7-year investigation by the Serious Fraud Office across 2012-2019 into the systematic rigging of LIBOR (which was only possible because of the use of estimates), and that malpractice may well have been going on prior to 2012. To the average investor, the scale of the distortion would not have been material for the interest rate earned on their savings, but for the derivatives market it was another matter entirely. It is estimated that LIBOR underpins approximately $350 trillion in derivatives, so a small nudge in LIBOR could often have been very significant.

Since the global financial crisis in 2008-09, activity in the markets that LIBOR measures has reduced. The low volume of underlying transactions means that LIBOR is no longer viewed as sustainable and thus it needs to be replaced. Risk-free rates (or RFRs), which are seen as robust alternatives to LIBOR, are already available. These include the Sterling Overnight Index Average (SONIA) benchmark, which is produced by the Bank of England. SONIA is an index which is based on *actual transactions* and thus reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and from other institutional investors. It is already in widespread use in many financial markets.

This month it was confirmed that new Sterling-based LIBOR exchange traded derivatives expiring after 2021 should cease to be written from mid June 2021, other than for the risk management of any existing positions. This could be relevant for some contracts used in Liability Driven Investment (LDI) strategies, although many of these are governed by standardised Master Agreements issued by the International Swaps and Derivatives Association (ISDA).

The general move away from LIBOR will also be relevant for investors in many Cash or Liquidity funds, and also for some Diversified Growth funds, because of its use in those funds' benchmarks or performance targets. For all these funds, there will be updates required for fund documentation and reporting materials. The move away from LIBOR could also be relevant for some hedge funds where there is a performance fee calculated relative to outperformance of LIBOR in some way (and for any other investment mandates where a comparable structure is used).

It is also important to note that this is not just a UK-based initiative. It is part of a global approach by regulators to move away from all forms of interbank offered rate (IBOR). For example, in the US, the Federal Reserve's Alternative Reference Rates Committee (AARC) is promoting the Secured Overnight Financing Rate (SOFR) as the new risk-free rate instead of USD LIBOR.

In terms of actions that will need to be taken by institutional investors, as opposed to by the financial institutions, the main ones are going to be making the appropriate edits to their communication materials (e.g. pension schemes' member booklets, or the Statement of Investment Principles) and also updating any LIBOR or IBOR references in their annual report & accounts (hence action is potentially applicable for charities as well as pension schemes). It could also be applicable for updating the "late payment" terms in some suppliers' contracts.

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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 31 May 2021

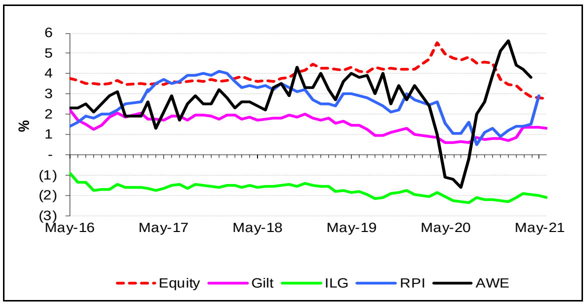
Asset Class	1 month (%)	3 months (%)	12 months (%)	3 years (% p.a.)	5 years (% p.a.)	10 years (% p.a.)	20 years (% p.a.)
UK Equities	1.3	9.6	23.1	1.9	7.0	6.3	5.4
Overseas Equities	-1.1	7.2	24.1	12.5	15.8	12.2	7.9
US Equities	**-2.1**	8.2	23.0	**15.9**	**18.1**	**16.2**	7.0
Europe ex UK Equities	1.9	**11.1**	26.3	9.6	12.6	8.2	8.5
Japan Equities	-1.1	-0.1	9.0	4.2	10.6	9.4	4.2
Pacific ex Japan Equities	-1.1	0.9	**32.9**	8.7	15.1	8.4	**10.8**
Emerging Markets	0.4	1.6	31.8	7.7	14.8	6.0	10.3
UK Long-dated Gilts	0.9	1.9	**-13.2**	3.8	4.9	7.7	6.7
UK Long-dated Corp. Bonds	0.2	1.6	-0.2	6.8	6.8	7.9	7.1
UK Over 5 Yrs Index-Linked Gilts	**3.8**	6.2	-3.7	5.1	7.4	8.1	7.6
High Yield (Global)	-1.8	0.0	2.2	4.8	7.9	7.7	7.6
Overseas Bonds	-2.0	**-2.0**	-12.2	1.4	2.9	3.1	4.7
Property *	0.9	2.6	4.9	2.9	4.7	7.6	7.2
Cash	0.0	0.0	0.1	**0.5**	**0.5**	**0.6**	**2.2**
Commodities £-converted	0.6	6.8	37.9	-5.7	1.4	-6.0	-2.1
Hedge Funds original $ basis *	2.3	6.9	30.9	8.3	7.7	4.7	5.9
Illustrative £-converted version *	1.2	5.2	18.4	7.8	8.8	6.6	6.0
Euro relative to Sterling	-1.0	-0.9	-4.4	-0.7	2.4	-0.2	1.8
US $ relative to Sterling	-1.9	-1.6	-13.0	-2.2	0.5	1.5	0.0
Japanese Yen relative to Sterling	-2.3	-4.2	-14.3	-2.4	0.7	-1.5	0.4
Sterling trade weighted	1.5	1.1	7.2	1.6	-1.3	0.3	-1.0
Price Inflation (RPI) *	1.4	2.2	2.9	2.5	2.9	2.5	2.8
Price Inflation (CPI) *	0.6	1.0	1.5	1.5	1.9	1.7	2.0
Price Inflation (RPIX) *	1.5	2.3	3.2	2.6	3.0	2.6	2.9
Earnings Inflation **	6.7	7.2	3.8	2.5	2.5	2.1	3.0
All Share Capital Growth	1.0	8.5	19.4	-1.7	3.2	2.6	1.8
Dividend Growth	-1.2	-2.8	-30.4	-10.1	-2.9	1.8	2.6
Earnings Growth	38.7	8.5	-22.6	-15.3	10.4	-3.1	1.9

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

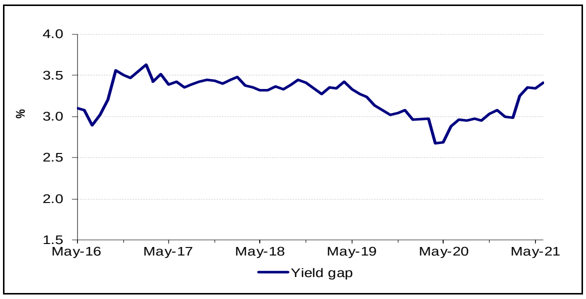
- *UK Equities (incl. dividends and earnings) – FT-A All Share.*
- *Overseas Equities (incl. regions) – blend of FT All-World / World sub-indices*
- *Emerging Markets from MSCI US $ based total return index (overall Index to 31 Oct 2001, Free Index from 1 Nov 2001 to take account of foreign investment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

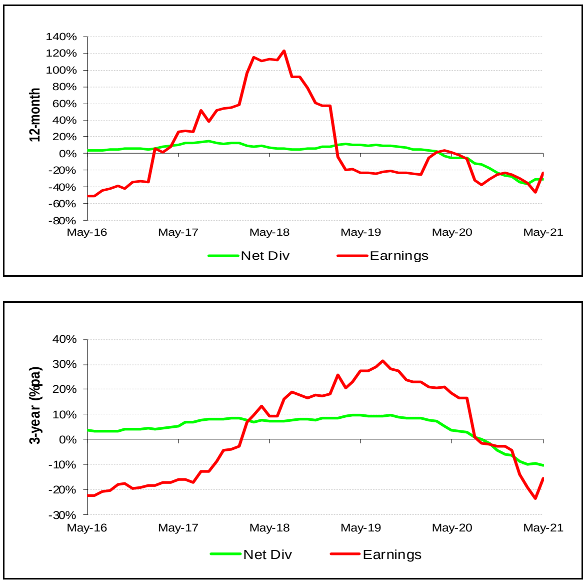


The gap gives a current expectation around 3.4% for longer-term inflation *including the risk premium for gilts, relative to index-linked gilts.*

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*]

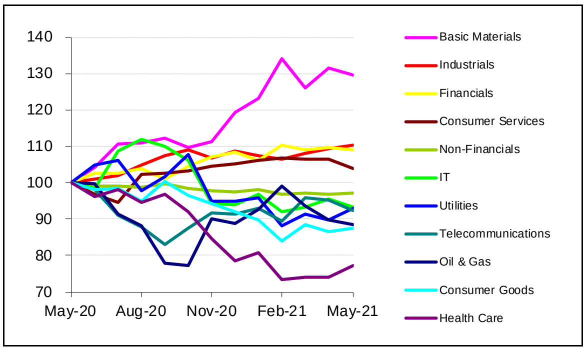
Figure 3: Dividend & Earnings Growth



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



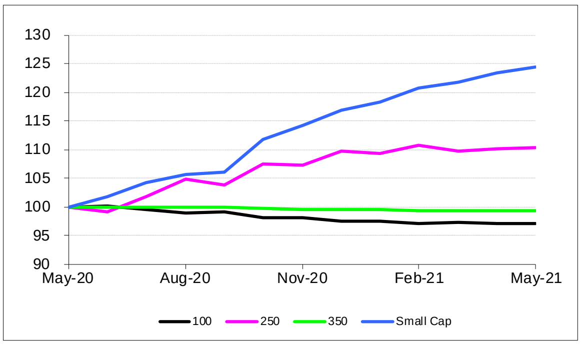
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (down from 70% to 52%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-0.3	-2.4	8.7
Basic Materials	-0.1	6.0	59.7
Industrials	2.2	13.6	35.7
Consumer Goods	2.4	14.3	7.6
Health Care	5.9	15.5	-4.8
Consumer Services	-1.1	6.6	28.0
Telecommunications	-2.0	13.3	13.6
Utilities	4.8	15.7	14.4
Non-Financials	1.5	10.1	19.6
Financials	0.6	8.3	34.2
IT	-1.1	11.1	14.7
All Share	1.3	9.6	23.1

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



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

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

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Bond market information

Figure 5: £ Non-Gilt Credit Margins

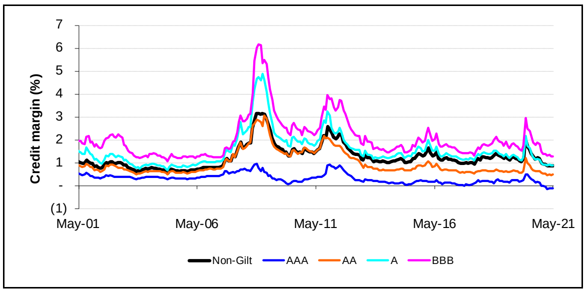

Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
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
Apr '21	1.94	1.33	0.61
May '21	**1.93**	**1.29**	**0.64**

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

Category	Mkt Val (£bn @ May 21 & 18, 15)			Weight (%)
Gilts (51)	1,746	1,356	1,210	72.6
Non-Gilts (1,171)	658	567	547	27.4
AAA (131)	123	110	100	5.1
AA (148)	79	76	95	3.3
A (369)	187	163	178	7.8
BBB (523)	269	217	174	11.2

Category	Mkt Val (£bn @ May 21, 18)		W't (%)	Dur'n (yrs)
Gilts (51)	1,746	1,356	72.6	12.6
< 5 Yrs (12)	428	360	17.8	2.9
5–15 Yrs (15)	551	377	22.9	8.3
> 15 Yrs (24)	767	619	31.9	21.1
Non-Gilts (1,171)	658	567	27.4	7.8
< 5 Yrs (415)	225	184	9.4	2.8
5–15 Yrs (526)	284	237	11.8	7.4
> 15 Yrs (230)	149	146	6.2	16.3

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (423)	7,480	58.9
Non-Sovereigns	5,218	41.1
AAA (986)	1,381	10.9
AA (771)	1,213	9.6
A (1,249)	1,116	8.8
BBB (1,841)	1,508	11.9

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,269)	2,641	20.8
3 – 5 Yrs (1,311)	2,562	20.2
5 – 7 Yrs (1,049)	2,031	16.0
7 – 10 Yrs (871)	2,173	17.1
10+ Yrs (770)	3,291	25.9

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ May 21 & 18)		W't (%)	Dur'n (yrs)
Gilts (31)	805	665	100.0	21.5
< 5 Yrs (4)	88	59	11.0	2.9
5 – 15 Yrs (8)	184	152	22.8	9.6
> 15 Yrs (19)	533	454	66.2	28.7

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

Month End	US (%)	Euro (%)	Sterling (%)
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
Apr '21	4.35	2.66	4.08
May '21	**4.35**	**2.66**	**4.12**

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.

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