



Investment Update May 2022

Investment Headlines & Comment

- An awful month for most of the UK bond market.
- Property continued with its steady recovery.
- Inflation remains high, both in the UK and elsewhere.

Feature Section

This month, we start by returning to the investment impact of climate change, last considered in our [January 2021](#) issue. The reason for returning to it is a recent High Court ruling in a case brought by two charities, [Butler-Sloss & Others v The Charity Commissioner & Another](#). The charities wanted their investment manager to apply a Paris-aligned investment strategy that the charities’ trustees knew ran the risk of causing financial detriment to their trusts in the short term, but they needed to know they would be acting lawfully if they introduced the strategy.

The charities’ proposed strategy apparently excludes over half of publicly-traded companies and many pooled funds, so it clearly introduces considerable restrictions for the charities’ investment manager. The Judge considered that the trustees had followed a proper decision-making process, which balanced the trusts’ charitable objectives against the potential financial detriments of a more climate-friendly investment approach. He therefore ruled that the admitted short-term financial detriment of adopting a Paris-aligned investment strategy was not a barrier to its adoption by the charities’ trustees.

The question now arises of whether any *pension fund* trustees who in the past did not adopt such a strategy (because they were concerned by the risk of short- or longer-term financial detriment) will now seek to change their scheme’s approach. In turn, there will be the question of what the response would be from the associated sponsoring employer for any such scheme. There could well be the potential for disagreement, emerging, for example, in the employer consultation process required for updating a scheme’s Statement of Investment Principles (SIP). There has been case law back in 2004 on unsatisfactory SIP consultation (the [“Roxspur”](#) case) but the upshot of that case was that the Trustees simply had to do the consultation again. In extreme cases of impasse, given there is a statutory prohibition on the employer restricting the trustees’ investment powers in any way (section 35(5) of the Pensions Act 1995). it could involve the matter of how Trustees are appointed or removed on any particular scheme.

Market commentary One of the most striking things about 2022 so far has been the reaction of government bond markets to increased inflation, and the indication in May that the US’s Federal Reserve plans to start unwinding its Quantitative Easing portfolio. Both issues indicate an end to near-zero short-term interest rates. Figures 1a and 1b show the relevant data for the Gilt market. Many pension funds will have maintained their *leveraged* exposure through their Liability Driven Investment, so their asset losses will have been considerably more than those experienced on the unleveraged indices. Lay trustees may well be wondering why they kept holding assets that seemed so expensive.

Figure 1a: Yields and Real Yields

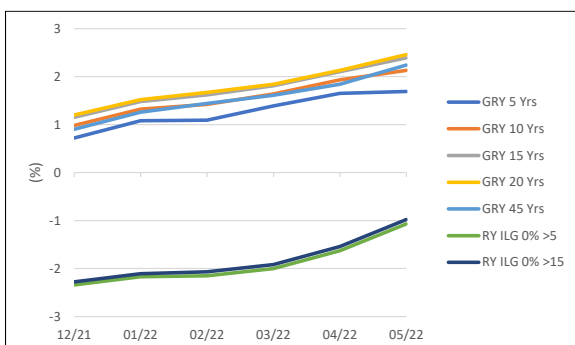
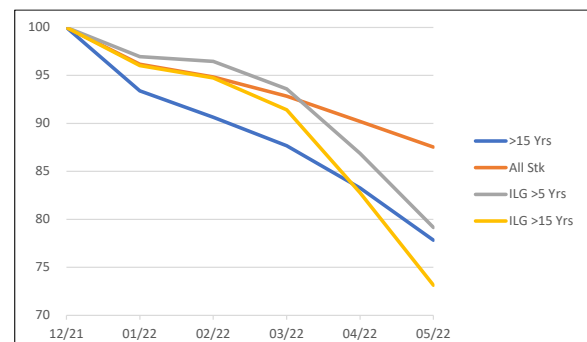


Figure 1b: Total returns (rebased Dec 21 = 100)



Source: FT



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 2022

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	0.7	2.3	8.3	5.8	4.1	8.1	6.4
Overseas Equities	-0.3	0.3	5.3	12.6	10.3	13.4	9.0
US Equities	-0.5	0.1	10.1	16.1	13.8	16.6	7.4
Europe ex UK Equities	0.2	-0.9	-3.9	7.3	5.1	10.8	10.0
Japan Equities	1.2	-1.8	-2.2	5.3	4.3	9.6	5.2
Pacific ex Japan Equities	-0.4	0.8	-6.6	7.4	6.0	9.0	10.1
Emerging Markets	0.1	-1.2	-9.3	5.4	4.6	6.6	9.5
UK Long-dated Gilts	-6.5	-14.1	-19.1	-5.2	-1.7	2.9	5.4
UK Long-dated Corp. Bonds	-4.6	-11.3	-19.4	-2.8	-0.6	4.3	5.5
UK Over 5 Yrs Index-Linked Gilts	-8.9	-17.9	-14.9	-3.3	-0.3	4.4	6.4
High Yield (Global)	-0.4	0.4	0.4	1.6	2.9	6.9	7.8
Overseas Bonds	-0.2	-2.5	-2.1	-2.2	0.1	1.8	4.4
Property *	1.7	6.2	24.9	8.9	8.6	9.3	8.0
Cash	0.1	0.3	0.4	0.4	0.5	0.5	2.0
Commodities £-converted	4.7	28.9	84.7	19.5	13.5	1.1	2.1
Hedge Funds original \$ basis *	-1.4	-0.3	-0.5	7.5	5.9	5.1	5.6
Illustrative £-converted version *	3.4	6.5	10.6	8.9	6.6	7.8	6.4
Euro relative to Sterling	1.2	1.5	-1.2	-1.3	-0.4	0.6	1.4
US \$ relative to Sterling	-0.4	6.5	12.8	0.0	0.4	2.0	0.7
Japanese Yen relative to Sterling	0.3	-4.7	-4.1	-5.5	-2.5	-2.9	0.6
Sterling trade weighted	-0.3	-2.7	-2.4	1.2	0.7	-0.3	-1.0
Price Inflation (RPI) *	3.4	5.3	11.1	5.1	4.3	3.3	3.3
Price Inflation (CPI) *	2.5	4.4	9.0	3.7	3.1	2.3	2.4
Price Inflation (RPIX) *	3.5	5.3	11.2	5.2	4.4	3.4	3.3
Earnings Inflation **	12.8	12.3	10.5	5.2	4.2	3.1	3.4
All Share Capital Growth	0.4	1.1	4.6	2.3	0.4	4.3	2.7
Dividend Growth	2.0	8.7	23.5	-6.8	-0.7	2.7	3.6
Earnings Growth	0.9	1.1	48.8	5.5	14.1	0.4	4.9

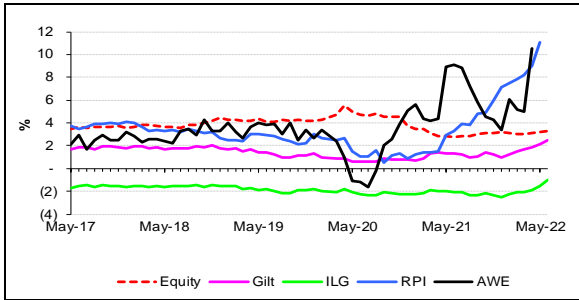
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

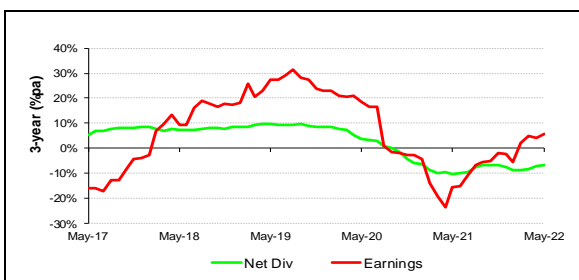
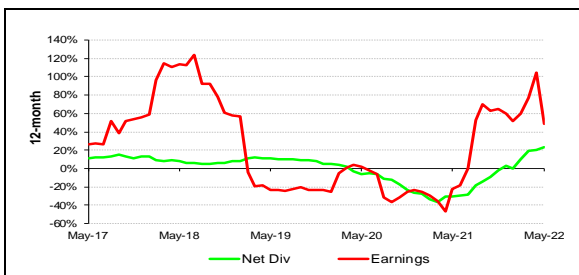


The gap gives a current expectation around 3.4% for longer-term inflation including the (unknown) risk premium for gilts, relative to index-linked gilts.

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]

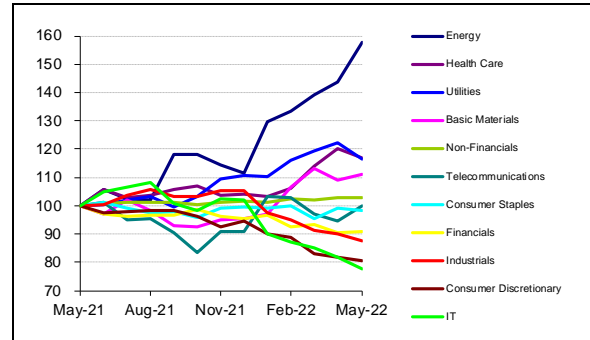
Figure 3: Dividend & Earnings Growth



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



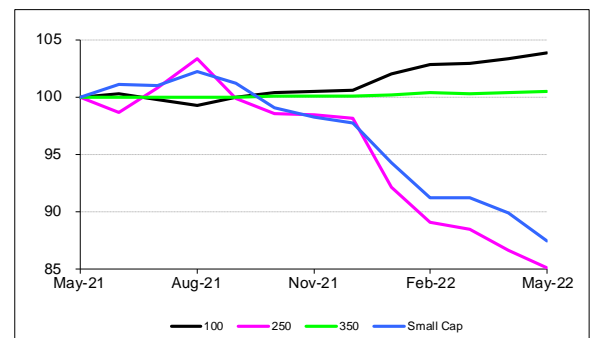
Note: Sector labels for relative lines are in end-value order

There was a rise this month in the rolling 12-month sector dispersion (rising from 62% to 80%).

(% absolute return)	1 mth	3 mth	12 mth
Energy	10.3	21.0	70.7
Basic Materials	2.6	6.7	20.4
Industrials	-2.2	-5.7	-5.4
Consumer Staples	-0.1	0.9	6.6
Health Care	-2.2	12.5	26.6
Consumer Discretionary	-0.6	-7.1	-12.7
Telecommunications	6.5	-0.4	8.4
Utilities	-4.2	2.6	26.0
Non-Finan	0.6	2.9	11.4
Financials	1.1	0.2	-1.8
IT	-4.5	-9.0	-15.9
All Share	0.7	2.3	8.3

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



This month, Mid Cap and Small Cap both fell 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

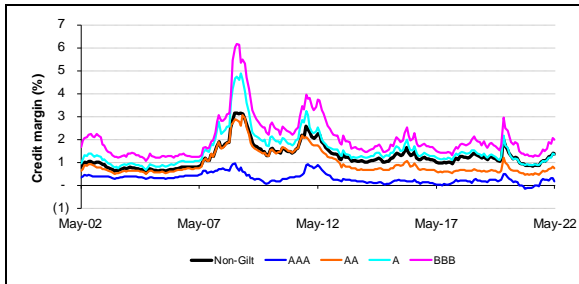


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Dec '21	1.89	1.20	0.69
Jan '22	2.25	1.52	0.73
Feb '22	2.62	1.67	0.95
Mar '22	2.71	1.84	0.87
Apr '22	3.05	2.13	0.92
May '22	3.40	2.46	0.94

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

Category	Mkt Val (£bn @ May 22 & 19, 16)			Weight (%)
Gilts (55)	1,576	1,372	1,275	72.4
Non-Gilts (1,201)	601	594	535	27.6
AAA (142)	127	122	104	5.8
AA (154)	78	85	96	3.6
A (385)	159	161	159	7.3
BBB (520)	237	225	176	10.9

Category	Mkt Val (£bn @ May 22, 19)		W't (%)	Dur'n (yrs)
Gilts (55)	1,576	1,372	72.4	11.3
< 5 Yrs (12)	414	336	19.0	2.6
5-15 Yrs (16)	505	356	23.2	7.8
> 15 Yrs (27)	657	679	30.2	19.5
Non-Gilts (1,201)	601	594	27.6	6.9
< 5 Yrs (466)	254	203	11.7	2.9
5-15 Yrs (499)	232	248	10.6	7.2
> 15 Yrs (236)	116	143	5.3	14.9

Tables 2d, 2e: € Market Size and Maturity (May 22)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (444)	6,986	58.3
Non-Sovereigns	4,995	41.7
AAA (1,039)	1,331	11.1
AA (797)	1,192	9.9
A (1,352)	1,069	8.9
BBB (1,973)	1,404	11.7

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,425)	2,770	23.1
3 – 5 Yrs (1,369)	2,508	20.9
5 – 7 Yrs (1,035)	1,954	16.3
7 – 10 Yrs (967)	1,982	16.5
10+ Yrs (809)	2,767	23.1

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ May 22 & 19)		W't (%)	Dur'n (yrs)
Gilts (32)	721	741	100.0	18.7
< 5 Yrs (4)	94	79	13.0	2.0
5 – 15 Yrs (9)	212	175	29.4	9.2
> 15 Yrs (19)	415	487	57.6	27.3

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

Month End	US (%)	Euro (%)	Sterling (%)
Dec '21	4.46	2.99	4.80
Jan '22	5.09	3.38	5.22
Feb '22	5.36	4.16	5.86
Mar '22	5.70	4.23	6.08
Apr '22	6.56	5.01	6.68
May '22	6.53	5.22	7.41

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

£ Gilt Market “main” Issuance

- o £2.50bn, ½% 2029 (2.48x, 1.64%, 0%, Jan '22)
- o £2.25bn, 7/8% Gr 2033 (2.37x, 1.95%, n/a, Sep '21)
- o £0.85bn, 1/8% IL 2039 (2.13x, -1.67%, 13%, May '21)
- o £2.19bn, 1¼% 2051 (2.91x, 2.04%, 25%, Mar '22)

Note: Issuance amounts are nominals. The second % figure in each row is the yield or real yield. The third % 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 Green Gilt (Gr), tender or syndication cases.

