



Investment Update April 2023

Investment Headlines & Comment

- Gilt yields rose this month, reversing their falls in March.
- A further base rate rise is expected to try to curb inflation.
- Major demand for the new 2045 Index-Linked Gilt.

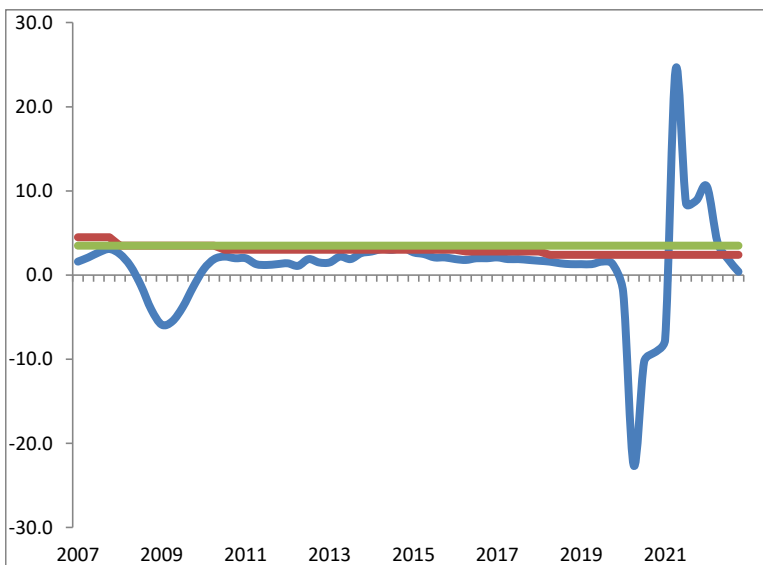
Feature Section

This month we welcome a guest contributor, the actuary and professional independent trustee Allan Martin, on the subject of public sector pensions. It follows the [Ministerial Statement](#) on 30th March confirming the methodology and actuarial discount rate for costing the unfunded defined benefit (DB) pensions for 5 million UK public sector workers.

The methodology remains based on the assumed growth in the economy - the tax base from which benefits are paid in future, as measured by gross domestic product (GDP). The SCAPE (Superannuation Contributions Adjusted for Past Experience) discount rate (used to calculate benefits and contributions and retirement ages) has however been reduced from CPI+2.4% to CPI+1.7% pa. This is possibly the most unappreciated but important actuarial assumption in the country. Have you or your MP heard of this crucial assumption? The Minister acknowledges that the reduction will lead to significant employer contribution increases in the delayed 2020 actuarial valuations but these will be *cost neutral* in department budgets, i.e. fudged. In practice the biggest immediate financial impact will be on private sector employers participating in the public sector schemes, like independent schools. Equivalent increased employee contributions, a later retirement age or reduced benefits might not have been so easily explained! It is only a ~£8bn pa deferred pay cost increase or recognition that did not get mentioned in the Budget. Any actual, potential or perceived conflicts of interest were undoubtedly appropriately addressed.

These deferred pay promises are for over 5m hugely deserving public sector employees, not just those finishing a night shift. Our Whole of Government Accounts (2020, latest available) put this accrued unfunded liability at £2,100 bn. The “fund” is the UK economy from which taxation will be levied in future.

Figure 1: Quarterly GDP growth



Source: ONS

Note: Green “expected” is the discount over CPI for pre-Hutton accrual, Red “expected” is the reformed and progressively adjusted discount rate over CPI.

The graph shows the actual and expected GDP quarterly growth since 2007. Actual is below expected, each and every year. The 2008-09 financial crisis dip was however offset by the indexation switch from RPI to CPI (~£100bn). Actual GDP shortfalls can be directly compared to funded scheme investment underperformance. A 1% GDP shortfall is approximately equal to 2p on the basic rate of income tax. The C19 plunge and recovery are roughly equal but still negative. These shortfalls imply a massive intergenerational transfer of liability to future taxpayers - you, your children and grandchildren (if they don't emigrate).

Sadly the initiating June 2021 HMT [Consultation](#) and [Response](#) failed to fully address the aspect of past service experience and whilst the lower discount rate for future benefits is a step in the right direction, we still

have a “lifetime (not triple) pensions lock” of index linked pension promises assuming GDP growth averaging CPI+3%. That 3% average real growth assumed, minus 1.7% now expected, every year over say 35 years on a (2020) liability of £2.1tn suggests the biggest DB deficit admission in UK pensions history; ~£500bn? Does this prompt an arithmetic comparison to a Ponzi scheme? Finally for any economists reading – what is the difference between repayment of index linked gilts and paying public sector pensions? The answer is “5m votes!”; In addition, the coupons on the latter are higher and they are paid for longer.



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 30 April 2023

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	3.5	1.9	6.0	13.2	4.4	6.1	7.9
Overseas Equities	-0.3	-0.5	2.2	12.7	9.7	11.1	10.5
US Equities	-0.3	0.4	2.1	14.2	13.3	14.5	9.4
Europe ex UK Equities	2.3	4.1	13.2	14.1	7.3	8.6	11.4
Japan Equities	-1.2	-1.3	5.1	6.2	3.3	7.0	7.6
Pacific ex Japan Equities	-3.0	-7.6	-5.4	6.4	3.2	6.1	11.2
Emerging Markets	-2.6	-6.6	-6.2	4.8	1.2	4.4	10.4
UK Long-dated Gilts	-3.8	-4.5	-28.6	-18.8	-6.6	0.0	3.4
UK Long-dated Corp. Bonds	-0.5	-3.1	-18.6	-11.6	-3.5	1.3	4.1
UK Over 5 Yrs Index-Linked Gilts	-5.2	-3.6	-28.5	-12.2	-4.5	1.0	4.7
High Yield (Global)	-0.6	-1.7	0.9	3.6	3.7	5.4	7.8
Overseas Bonds	-1.4	-1.5	-2.8	-5.1	0.4	1.8	3.8
Property *	0.7	0.2	-14.7	2.7	2.8	7.2	6.5
Cash	0.4	1.1	3.2	1.2	1.0	0.8	2.0
Commodities £-converted	-2.2	-7.5	-15.2	34.8	5.7	-1.4	0.7
Hedge Funds original \$ basis *	-0.8	1.2	-2.1	10.5	4.7	4.4	5.7
Illustrative £-converted version *	-3.0	-1.7	4.2	10.6	7.3	6.6	7.0
Euro relative to Sterling	-0.3	-0.4	4.5	0.4	0.0	0.4	1.2
US \$ relative to Sterling	-1.5	-2.1	-0.1	0.1	1.8	2.2	1.2
Japanese Yen relative to Sterling	-4.0	-6.5	-5.0	-7.6	-2.5	-1.2	0.5
Sterling trade weighted	1.0	2.0	-0.8	0.4	0.1	-0.1	-0.9
Price Inflation (RPI) *	0.7	1.9	13.5	7.9	5.7	4.0	3.6
Price Inflation (CPI) *	0.8	1.3	10.1	5.9	4.2	2.8	2.7
Price Inflation (RPIX) *	0.7	1.5	12.6	7.7	5.6	4.0	3.7
Earnings Inflation **	2.1	4.6	7.3	5.5	4.4	3.1	3.0
All Share Capital Growth	3.2	0.7	2.4	9.5	0.7	2.4	4.2
Dividend Growth	0.3	1.5	10.9	-2.8	-0.4	2.8	4.1
Earnings Growth	-2.1	45.1	11.9	6.7	0.5	2.7	5.4

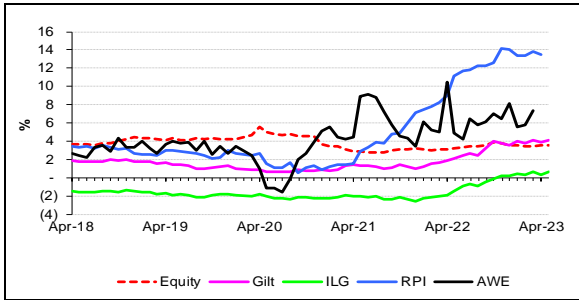
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

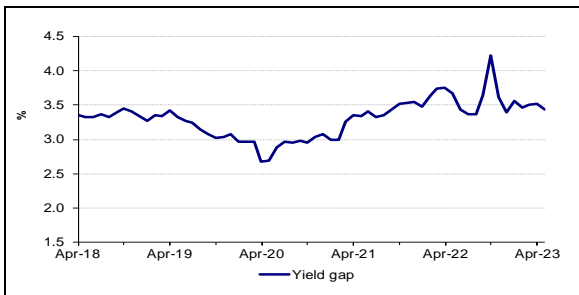


Yields and Yield Gaps

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.

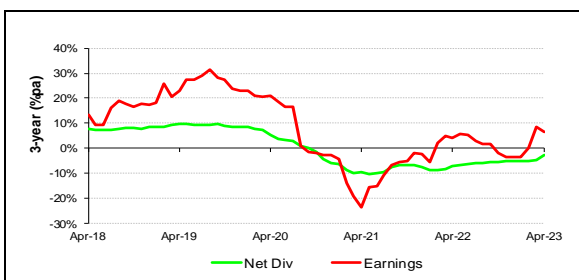
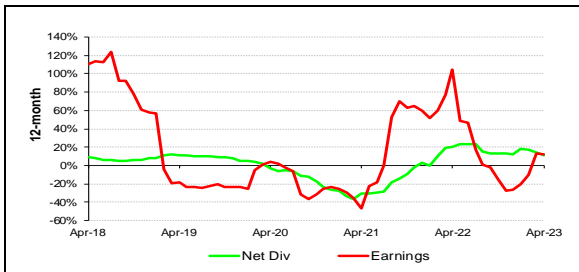


The gap gives a current expectation of around 3.4% p.a. for longer-term inflation including the (unknown) risk premium for gilts, relative to index-linked gilts.

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]

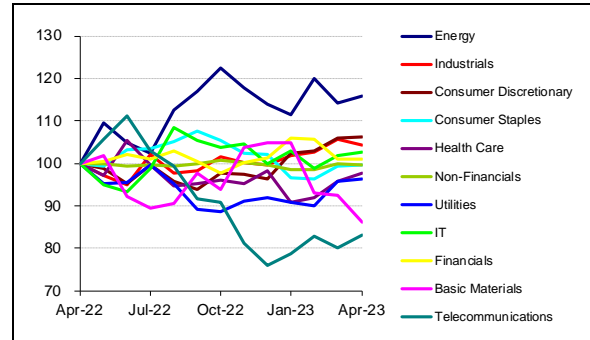
Figure 3: Dividend & Earnings Growth



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



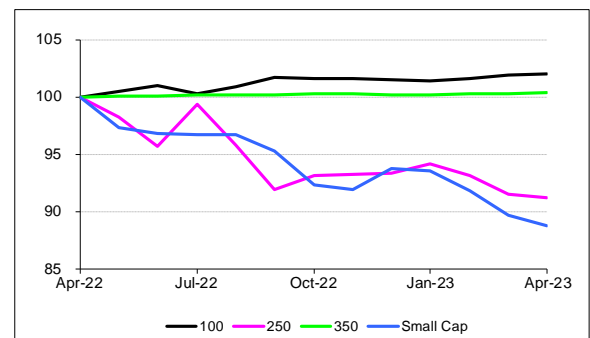
Note: Sector labels for relative lines are in end-value order

There was a drop this month in the rolling 12-month sector dispersion (down from 40% to 33%).

(% absolute return)	1 mth	3 mth	12 mth
Energy	4.9	6.1	22.8
Basic Materials	-3.4	-16.1	-8.6
Industrials	2.0	4.3	10.5
Consumer Staples	3.9	5.3	5.6
Health Care	5.4	9.5	3.4
Consumer Discretionary	3.9	5.8	12.6
Telecommunications	7.2	7.6	-12.0
Utilities	4.0	8.1	2.0
Non-Finan	3.4	3.3	5.7
Financials	3.7	-2.6	7.2
IT	4.3	1.7	8.8
All Share	3.5	1.9	6.0

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

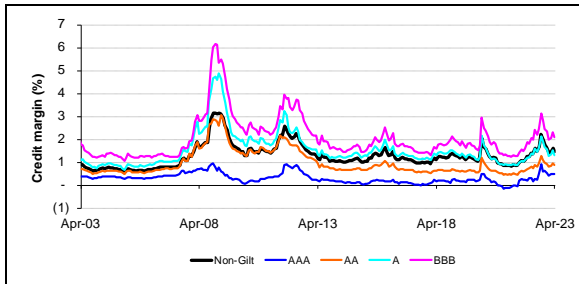


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Nov '22	4.26	3.54	0.72
Dec '22	4.72	4.02	0.70
Jan '23	4.40	3.77	0.63
Feb '23	4.81	4.14	0.67
Mar '23	4.67	3.84	0.83
Apr '23	4.78	4.06	0.72

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

Category	Mkt Val (£bn @ Apr 23 & 20, 17)			Weight (%)
	2023	2020	2017	
Gilts (57)	1,414	1,512	1,359	72.0
Non-Gilts (1,217)	549	656	564	28.0
AAA (148)	116	141	110	5.9
AA (153)	71	86	88	3.6
A (407)	152	188	171	7.8
BBB (509)	209	242	195	10.7

Category	Mkt Val (£bn @ Apr 23 & 20)		W't (%)	Dur'n (yrs)
Gilts (57)	1,414	1,512	72.0	9.7
< 5 Yrs (14)	455	322	23.2	2.7
5-15 Yrs (16)	449	399	22.9	8.0
> 15 Yrs (27)	511	792	26.0	17.5
Non-Gilts (1,217)	549	656	28.0	6.0
< 5 Yrs (512)	261	225	13.3	2.8
5-15 Yrs (479)	199	274	10.1	6.9
> 15 Yrs (226)	89	157	4.5	13.7

Tables 2d, 2e: € Market Size and Maturity (Apr 23)

Category	Mkt Val (£bn)	Weight (%)
Sovereigns (476)	6,744	57.0
Non-Sovereigns	5,083	43.0
AAA (1,182)	1,625	13.7
AA (809)	984	8.3
A (1,486)	1,122	9.5
BBB (1,999)	1,351	11.4

Category	Mkt Val (£bn)	Weight (%)
1 – 3 Yrs (1,538)	2,840	24.0
3 – 5 Yrs (1,590)	2,686	22.7
5 – 7 Yrs (1,103)	1,867	15.8
7 – 10 Yrs (942)	1,961	16.6
10+ Yrs (779)	2,473	20.9

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Apr 23 & 20)		W't (%)	Dur'n (yrs)
Gilts (32)	578	759	100.0	16.4
< 5 Yrs (4)	96	70	16.6	2.4
5 – 15 Yrs (9)	197	187	34.1	9.3
> 15 Yrs (19)	285	503	49.3	26.0

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

Month End	US (%)	Euro (%)	Sterling (%)
Dec '22	8.17	7.11	10.32
Jan '23	7.48	6.47	9.54
Feb '23	7.97	6.76	9.46
Mar '23	7.75	6.85	9.93
Apr '23	7.70	6.86	10.11

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

£ Gilt Market “main” & “Green” Issuance

- £4.24bn, 4¹/₈% 2027 (2.46x, 4.04%, 13%, Mar 23)
- £4.37bn, ½% 2029 (2.67x, 3.50%, 25%, Feb 23)
- £4.06bn, 3¼% 2033 (3.04x, 3.59%, 25%, Mar 23)
- £2.25bn, 1¹/₈% 2039 (2.58x, 3.78%, 0%, Feb 23)
- £1.12bn, 1/8% IL 2039 (2.65x, 0.33%, 25%, Oct 22)
- £4.50bn, 5/8% IL 2045 (**10.3x**, 0.65%, n/a, new)
- £2.81bn, 3¾% 2053 (2.50x, 4.08%, 25%, Mar 23)

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.

