



Investment Update March 2024

Investment Headlines & Comment

- A good month for many equity markets.
- UK inflation continued to ease but is still above target.
- Extraordinary demand for the new 30-year Index-Linked Gilt.

Feature Section

This month we update our past feature on corporate debt default rates, using the Standard & Poor’s annual survey, which now covers data to the end of 2023. The main casualties in 2023 were again in consumer services (with 25% of the total), but the overall number of defaults was almost double that seen in 2022, probably due to the effect of rising interest rates.

Figure 1a: Average Cumulative Default Rates (%)
(Extracts from “Table 24” in S&P)

Time	1 year	5-year	10-year
Investment grade	0.08	0.78	1.72
AAA	0.00	0.34	0.68
AA	0.02	0.28	0.67
A	0.05	0.41	1.07
BBB	0.14	1.38	2.90
High Yield	3.52	13.7	19.27
BB	0.59	5.88	10.69
B	2.98	15.75	22.18
CCC/C	25.98	46.65	50.54
All ratings	1.49	5.99	8.66

Source: Standard & Poor’s (also for the Figures below)

Figure 1a shows historical default rates averages across global corporate bonds in 1-, 5- and 10-year versions. The dataset covers 1981-2023 (but the 5- and 10-year figures use rolling sets of overlapping periods, not successive distinct ones), but unfortunately it does not show recovery rate statistics. However, as per our Figure 5 for Sterling investment grade bonds (on page 4), actual default rates have still been below those priced into yields, even if with no recovery. For example, over the last 20 calendar years, the iBoxx All-Dated Non-Gilts Index returned 4.0% p.a. vs 3.2% p.a. for the FT-A All-Dated Gilt Index. This “earned credit margin” gap is similar to last year’s gap.

Figure 1b: Global Credit Rating Transitions % in 2023 in isolation
(Extracts from “Table 20” in S&P, with D = Default, N.R. = not rated)

	AAA	AA	A	BBB	BB	B	CCC	D	N.R.
AAA	100.00	-	-	-	-	-	-	-	-
AA	-	96.81	1.42	-	-	-	-	-	1.77
A	-	0.15	96.78	1.02	-	-	-	-	2.05
BBB	-	-	1.61	92.68	0.97	0.43	0.11	0.11	4.09
BB	-	-	0.17	3.92	85.67	3.83	0.25	0.17	6.00
B	-	-	-	0.10	4.24	79.07	5.84	1.24	9.51
CCC	-	-	-	-	-	7.34	47.40	30.89	14.37

Figure 1c: Profile of individual year default percentages
(Extracts from “Table 4” in S&P)

	AAA	AA	A	BBB	BB	B	CCC
Minimum	0.00	0.00	0.00	0.00	0.00	0.25	0.00
Maximum	0.00	0.38	0.38	1.00	4.24	13.84	49.46
Average	0.00	0.02	0.05	0.14	0.57	2.98	25.98

1.72%, and the worst is 4.24% (from “Table 31”, for the 10 years to 1991, when the market was much smaller than now), there still does not seem to be a reasonable case for making a deduction of more than, say, 0.2% or 0.3% p.a. from the yield as an allowance for future defaults and/or forced sales for index-trackers due to downgrading from investment grade.



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 2024

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	4.8	3.6	8.6	8.0	5.4	5.8	7.2
Overseas Equities	3.4	9.8	22.4	10.9	12.6	12.7	10.8
US Equities	3.3	11.1	27.2	14.0	15.6	16.0	9.0
Europe ex UK Equities	3.7	6.7	13.8	8.7	9.8	8.5	12.3
Japan Equities	3.5	11.6	22.4	6.8	8.5	10.1	6.6
Pacific ex Japan Equities	4.1	3.5	8.7	0.3	5.3	8.0	10.0
Emerging Markets	2.4	3.1	6.1	-1.9	3.2	6.2	8.9
UK Long-dated Gilts	2.7	-3.6	-5.0	-14.6	-8.1	0.4	3.2
UK Long-dated Corp. Bonds	2.5	-1.7	5.3	-9.5	-3.4	2.2	4.1
UK Over 5 Yrs Index-Linked Gilts	2.9	-2.4	-7.4	-12.1	-6.5	1.3	4.2
High Yield (Global)	1.2	2.4	8.7	3.4	3.8	6.4	8.2
Overseas Bonds	0.5	-1.8	-4.1	-2.9	-1.4	2.2	3.8
Property *	0.1	-0.1	0.7	2.2	1.7	5.9	6.0
Cash	0.4	1.3	5.3	2.8	1.9	1.2	2.1
Commodities £-converted	4.9	11.4	8.9	21.6	8.5	-0.2	0.4
Hedge Funds original \$ basis *	2.2	5.6	8.5	3.7	6.6	4.7	5.1
Illustrative £-converted version *	2.9	5.7	3.9	7.2	7.7	7.7	7.1
Euro relative to Sterling	-0.1	-1.3	-3.0	0.1	-0.2	0.3	1.2
US \$ relative to Sterling	0.1	0.9	-2.0	3.0	0.6	2.8	1.9
Japanese Yen relative to Sterling	-1.0	-6.0	-14.0	-7.3	-5.5	-1.1	0.0
Sterling trade weighted	0.4	1.4	4.6	0.3	0.8	-0.4	-1.1
Price Inflation (RPI) *	0.8	1.0	4.5	8.8	6.0	4.1	3.7
Price Inflation (CPI) *	0.6	0.5	3.4	6.6	4.4	2.9	2.8
Price Inflation (RPIX) *	0.7	0.8	3.5	8.2	5.7	4.0	3.7
Earnings Inflation **	-1.3	3.9	5.4	5.5	4.8	3.7	3.0
All Share Capital Growth	4.2	2.5	4.5	4.2	1.7	2.0	3.5
Dividend Growth	0.7	1.2	9.1	14.2	-0.6	3.0	4.4
Earnings Growth	-2.5	-1.4	10.5	30.0	7.5	3.5	5.2

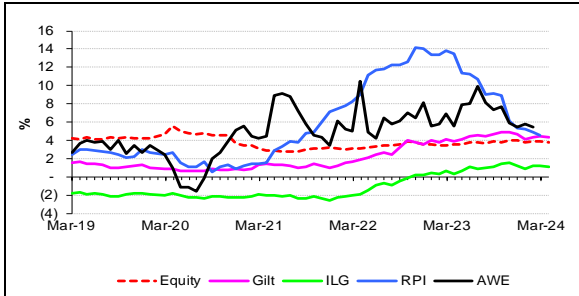
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

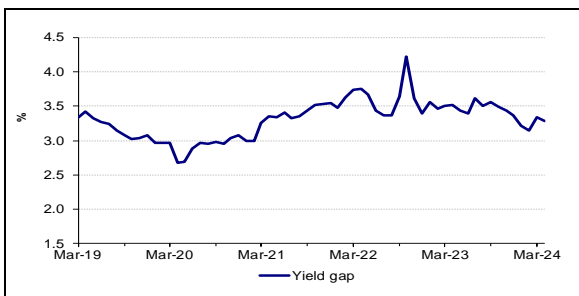


Yields and Yield Gaps

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.

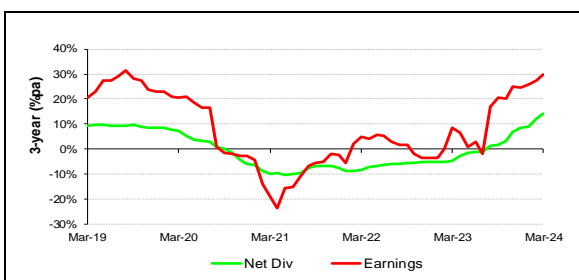
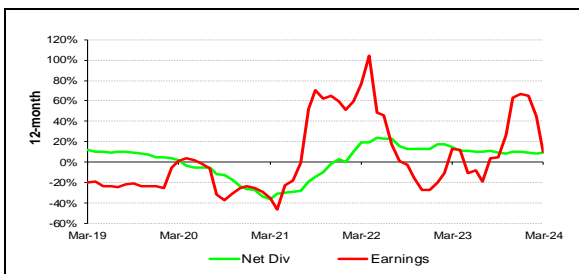


The gap gives a current expectation of around 3.3% p.a. for longer-term inflation including the (unknown) risk premium for gilts, relative to index-linked gilts.

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]

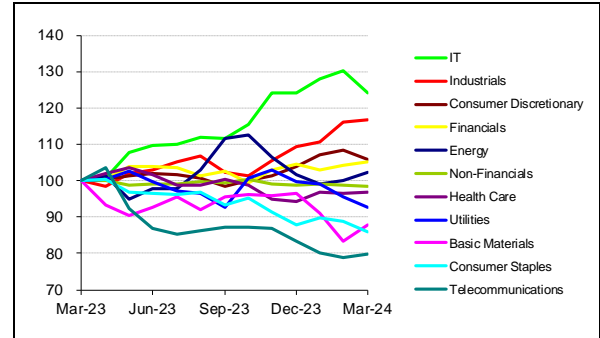
Figure 3: Dividend & Earnings Growth



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



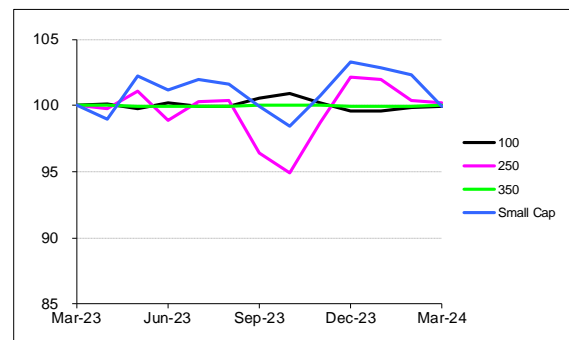
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (down from 58% to 44%).

(% absolute return)	1 mth	3 mth	12 mth
Energy	7.0	4.3	11.1
Basic Materials	10.4	-5.8	-4.6
Industrials	5.2	10.3	26.6
Consumer Staples	1.5	1.2	-6.7
Health Care	5.0	6.4	5.0
Consumer Discretionary	2.1	5.4	14.7
Telecommunications	6.2	-0.9	-13.4
Utilities	1.8	-3.8	0.7
Non-Finan	4.5	3.4	7.0
Financials	5.6	4.0	14.0
IT	-0.2	3.6	34.7
All Share	4.8	3.6	8.6

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

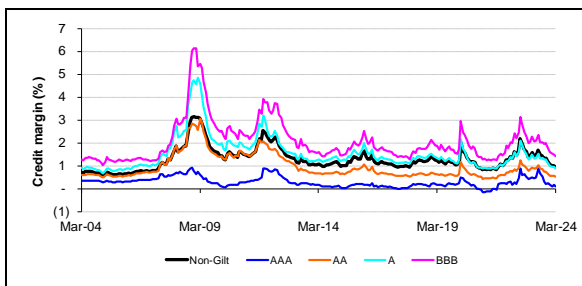


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Oct '23	5.52	4.92	0.60
Nov '23	5.06	4.62	0.44
Dec '23	4.46	4.08	0.38
Jan '24	4.77	4.37	0.40
Feb '24	4.87	4.49	0.38
Mar '24	4.74	4.34	0.40

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

Category	Mkt Val (£bn @ Mar 24 & 21, 18)			Weight (%)
Gilts (60)	1,485	1,727	1,368	71.7
Non-Gilts (1,259)	585	655	569	28.3
AAA (155)	126	126	110	6.1
AA (165)	76	79	77	3.7
A (429)	170	190	166	8.2
BBB (510)	214	260	215	10.3

Category	Mkt Val (£bn @ Mar 24 & 21)		W't (%)	Dur'n (yrs)
Gilts (60)	1,485	1,727	71.7	9.3
< 5 Yrs (16)	513	459	24.8	2.7
5-15 Yrs (16)	477	487	23.0	8.3
> 15 Yrs (28)	495	780	23.9	17.3
Non-Gilts (1,259)	585	655	28.3	5.7
< 5 Yrs (591)	309	227	14.9	2.7
5-15 Yrs (445)	186	279	9.0	7.1
> 15 Yrs (223)	90	148	4.3	13.5

Tables 2d, 2e: € Market Size and Maturity (Mar 24)

Category	Mkt Val (£bn)	Weight (%)
Sovereigns (515)	7,412	57.0
Non-Sovereigns	5,583	43.0
AAA (1,261)	1,854	14.3
AA (883)	1,064	8.2
A (1,542)	1,237	9.5
BBB (2,042)	1,429	11.0

Category	Mkt Val (£bn)	Weight (%)
1 – 3 Yrs (1,731)	3,210	24.7
3 – 5 Yrs (1,688)	2,898	22.3
5 – 7 Yrs (1,089)	1,975	15.2
7 – 10 Yrs (974)	2,096	16.1
10+ Yrs (761)	2,818	21.7

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Mar 24 & 21)		W't (%)	Dur'n (yrs)
Gilts (33)	568	767	100.0	15.5
< 5 Yrs (5)	124	88	21.8	3.0
5 – 15 Yrs (9)	176	180	31.1	10.0
> 15 Yrs (19)	267	499	47.1	24.9

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

Month End	US (%)	Euro (%)	Sterling (%)
Dec '23	7.12	5.95	8.80
Jan '24	7.24	5.94	8.49
Feb '24	7.33	5.95	8.26
Mar '24	7.15	5.91	8.41

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

£ Gilt Market “main” & “Green” Issuance

- £4.69bn, 3¾% 2027 (3.01x, 4.31%, 25%, Feb '24)
- £3.00bn, 4½% 2028 (3.48x, 3.93%, 0%, Feb '24)
- £4.69bn, 4¾% 2034 (3.61x, 3.93%, 25%, Feb '24)
- £2.50bn, 4¾% 2043 (3.41x, 4.47%, 25%, Jan '24)
- £4.00bn, 1¼% IL 2054 (**14.1x**, 1.23%, n/a, new)

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.

