JAGGER & ASSOCIATES

Investment Update
January 2008

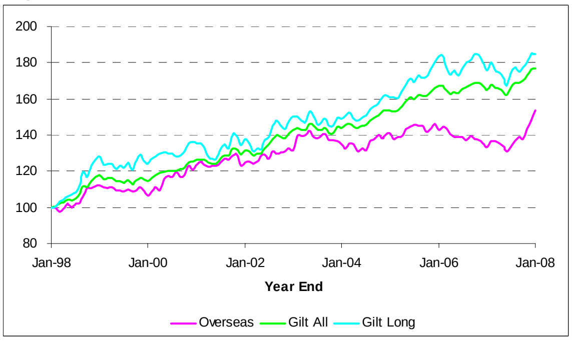
Investment Headlines & Comment

- **Equity volatility** and (alleged) banking derivatives fraud at **Soc Gen** led to wild markets this month. Interestingly, most UK Equity sectors were very tightly bunched, supporting the theory that a lot of the equity volatility was coming from index futures having to be unwound by Soc Gen (and by other innocent investors as well?).
- **Property** saw the IPD index's newest worst-ever single month – just 'beating' November 2007 – as sentiment continues to dominate, even though voids remain low.

Feature Section

Overseas Bonds have just enjoyed their strongest 3 months' return since late 1992 – back then, it was in the wake of the UK's exit from the ERM, and major currency movements were coupled with yields falling. This time round, the two effects were both less marked, but since their combined effect was over 11%, and may renew interest in the asset class, we thought it worth updating the data on this market from our November 2003 edition.

Figure 1a: Government Bond Total Returns



Sources for all charts: JP Morgan, Financial Times

Figure 1a shows the total returns on three different types of government bond (Overseas unhedged, UK All Dated and UK Long Dated), starting from a notional 100 in January 1998. Returns on Overseas Bonds have lagged UK bonds over the last 5 years because of the shorter dated nature of most Overseas Bond markets, and the increased downward pressure on the long end of the UK yield curve (see last month's *Update* and the yield chart on page 3 for a reminder on that!). The sharp rise in returns for Overseas Bonds in the last 3 months is in stark contrast to the rest of their returns data shown.

Figure 1b: Split by Market Cap at 31 Jan 08

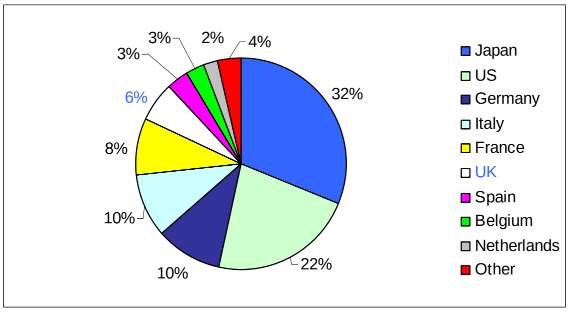


Figure 1c: Gov't Bond Durations at 31 Jan 08

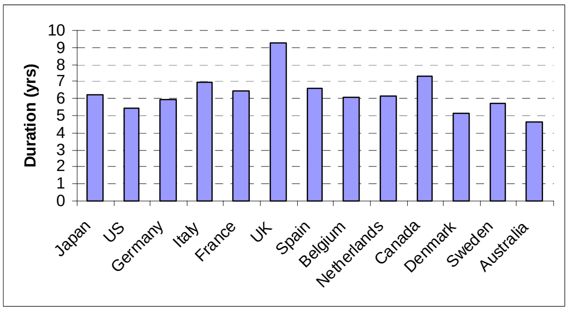


Figure 1b shows the current split of the JP Morgan Global Index. Japan and the US still dominate this market, with the three main continental European economies following. The UK's weighting is still well below its equivalent in world equity markets. Interestingly, none of the weights have changed materially since our 2003 analysis. From Figure 1c, as at January 2008, UK Government Bonds still have the longest duration in the GBI Global Index, at 9.25 years – given the € bond data reported on page 4 each month, it should not be a surprise that the UK market is longer than that of the Eurozone, but it is interesting to note how much shorter-dated the Japanese and US markets are.

Whilst most of the countries shown have increased the longevity of their bonds slightly (such as through 30-year and longer-dated bonds), the UK index has increased by double that on anyone else's index (other than the Netherlands) – well over a year's duration has been added since our 2003 analysis. There is something perverse about the way buyout legislation and accounting measurement have "conspired" to push the UK market even further out from other markets, but no amount of squeaking by us (or anyone?) is going to get that Pandora's box shut again.

Asset Class Returns

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 this.
[**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 January 2008

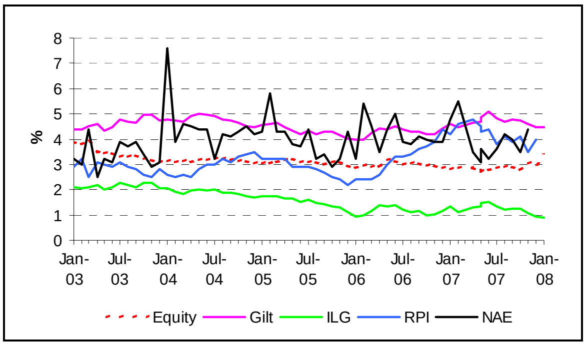
Asset Class	1 month (%)	3 months (%)	12 months (%)	3 years (% p.a.)	5 years (% p.a.)	10 years (% p.a.)
UK Equities	-8.7	-12.8	-3.6	10.6	15.5	4.7
Overseas Equities	-7.9	-8.7	1.3	11.1	13.3	5.2
US Equities	-5.8	-6.3	-3.5	6.0	8.2	3.2
Europe ex UK Equities	-11.4	-10.3	2.4	16.2	19.5	7.5
Japan Equities	-4.0	-5.4	**-10.8**	5.3	10.4	**1.8**
Pacific ex Japan Equities	-12.1	**-16.1**	21.1	23.3	24.0	11.1
Emerging Markets	**-12.8**	-14.7	**22.1**	**27.2**	**29.0**	**12.3**
UK Long-dated Gilts	-0.0	4.3	5.3	4.7	4.2	6.3
UK Long-dated Corp. Bonds	-2.0	0.0	-0.7	**2.8**	4.3	6.7
UK Over 5 Yrs Index-Linked Gilts	1.7	6.9	12.5	7.6	7.3	7.4
High Yield (Global)	-1.5	0.8	-1.1	3.6	6.5	3.5
Overseas Bonds	**4.0**	**11.4**	15.1	2.9	**3.1**	4.4
Property *	-3.7	-8.5	-5.5	9.9	11.8	11.3
Cash	0.5	1.5	6.1	5.3	4.9	5.3
Commodities £-converted	-0.4	6.4	34.0	7.8	8.7	7.4
Hedge Funds original $ basis *	0.6	1.3	10.1	10.8	12.1	10.0
Illustrative £-converted version *	4.4	4.6	8.7	9.6	7.5	7.9
Euro relative to Sterling	1.4	6.9	12.1	2.5	2.7	-
US $ relative to Sterling	-0.4	4.5	-1.3	-1.8	-3.7	-2.0
Price Inflation (RPI) *	0.6	1.4	4.0	3.6	3.4	2.8
Price Inflation (CPI) *	0.6	1.3	2.1	2.3	2.0	1.6
Price Inflation (RPIX) *	0.5	1.3	3.1	3.0	2.8	2.5
Earnings Inflation **	1.5	1.1	4.4	3.8	3.8	4.1
All Share Capital Growth	-8.7	-13.1	-6.6	7.1	11.7	1.7
Net Dividend Growth	0.7	3.7	9.9	10.7	8.4	4.6
Earnings Growth	0.7	3.2	20.4	22.4	22.8	8.2

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 subindices*
- *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 – Barclays Capital Non-Gilt **Over 15 Year** index (all credit ratings combined)*
- *High Yield – Merrill Lynch Global, £ Unhedged*
- *Overseas Bonds – JP Morgan Traded Unhedged World ex UK*
- *Property – IPD Monthly 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 the National Average Earnings Index (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.*

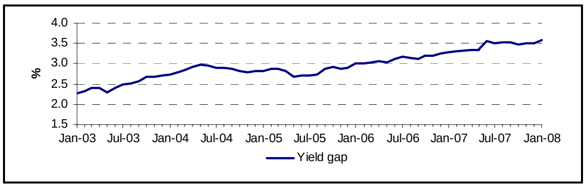
Yields and Yield Gaps

Figure 2: Yields, Inflation and Yield Gaps



Index-linked yields went down *again*.

The yield gap is a measure of expected average future inflation, derived as long bond yield minus ILG yield.

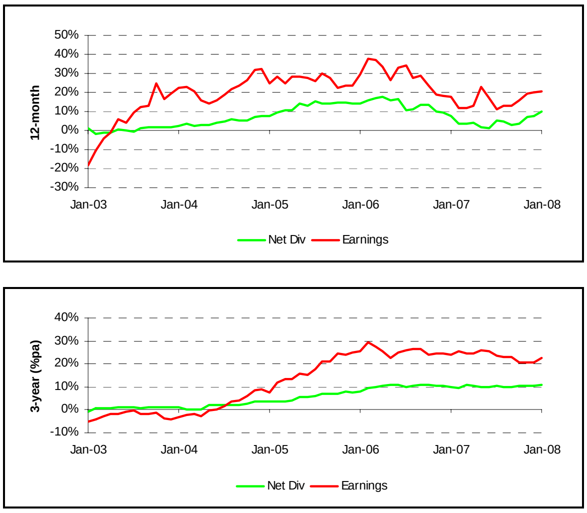


The gap is staying at the 3.5% level, suggesting expectations of higher longer-term inflation as well as an increased risk premium for conventional bonds, relative to index-linked.

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*]

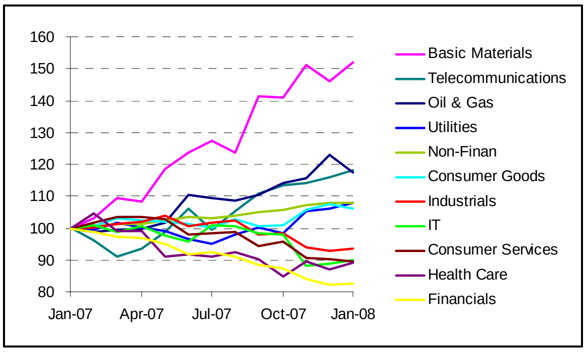
Figure 3: Dividend & Earnings Growth



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

UK Equity Sector Returns

Figure 4a: Sectors relative to All Share



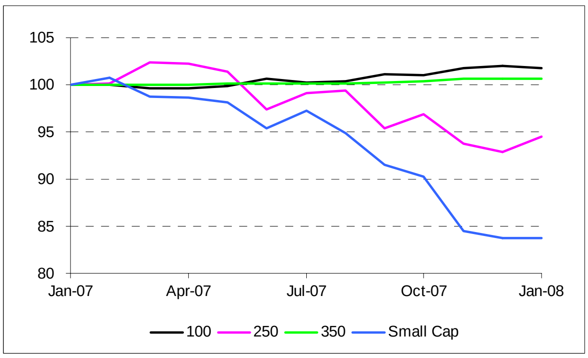
Note: Relative lines' labels for sectors in end-value order

Basic Materials were strongest over the last 12 months by a very large margin. Most sectors were bunched this month.

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-13.0	-10.3	13.1
Basic Materials	-5.0	-5.9	46.5
Industrials	-7.9	-17.1	-9.8
Consumer Goods	-9.8	-8.3	2.3
Health Care	-6.2	-8.0	-13.9
Consumer Services	-9.3	-18.4	-13.6
Telecommunications	-6.8	-9.1	14.1
Utilities	-7.0	-4.4	4.0
Non-Finan	-8.8	-10.9	3.9
Financials	-8.2	-17.7	-20.4
IT	-7.8	-20.0	-13.4
All Share	-8.7	-12.8	-3.6

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid Cap rallied slightly in relative terms.

FRS17 volatility indicator

A scheme whose actives on average now have 15 years to retirement will have seen their FRS17 liability value change by approx -7% over the last 12 months, and grow by 7% over the last three years, which is 2% per annum.

Bond market information

Figure 5: Credit Margins for last 15 Years

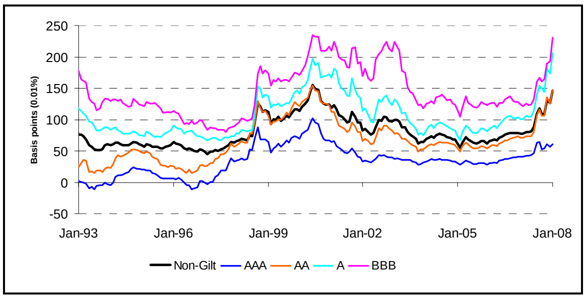


Table 2a: Trends in Long-dated AA Margins

Month End	AA rated Yield (%)	(Barclays) Gilt Yield (%)	Credit Margin (%)
Aug 07	5.66	4.53	1.13
Sep 07	5.69	4.62	1.07
Oct 07	5.63	4.58	1.05
Nov 07	5.80	4.50	1.30
Dec 07	5.58	4.34	1.24
Jan 08	**5.85**	4.37	**1.48**

Tables 2b, 2c: £ Market Size and Maturity

Category	Mkt Val (£bn @ 31 Jan 08 & 06, 04)			Weight (%)
Gilts (27)	347	317	236	45.4
Non Gilts (1,112)	416	373	283	54.6
AAA (283)	155	142	101	20.3
AA (202)	61	58	37	8.0
A (389)	131	111	92	17.2
BBB (224)	67	58	47	8.8
Not rated (14)	3	4	6	0.3

Category	Mkt Val (£bn @ 31 Jan 08 & 06)		W't (%)	Dur'n (yrs)
Gilts (27)	347	317	45.4	9.3
< 5 Yrs (8)	95	94	12.5	2.6
5–15 Yrs (9)	115	102	15.0	7.2
> 15 Yrs (10)	137	122	18.0	15.6
Non Gilts (1,112)	416	373	54.6	7.4
< 5 Yrs (330)	130	101	17.0	2.7
5–15 Yrs (465)	161	134	21.1	7.2
> 15 Yrs (317)	125	138	16.4	12.6

£ Gilt Market Issuance and Coverage

- £2.25bn of 4¾% 2030 (1.39x, yield 4.42%, prev Nov 07)
- £1.1bn of ILG 1 7/8% 2022 (2.01x, r.yield 1.13%, Dec 07)
- £0.725bn of ILG ¾% 2047 (2.06x, r.y. 0.74%, Nov 07)

- **iBoxx Sterling corporate:** 14 new sterling corporate issues (£3.3bn) from 11 issuers across the world, and aggregate net funding or redemption (+£4.7bn) by 11 (mostly non-UK) corporate or sub-sovereign issuers. 11 bonds redeemed early or eliminated. 17 bonds fell within 1 year of maturity.
- **iBoxx Euro:** New euro issues €66bn (including €28bn governments), and aggregate net funding or redemption (€43.8bn) of existing bonds (of which €39.1bn by governments). 36 bonds fell within 1 year of maturity. One early redemption.

Tables 2d, 2e: € Market Size and Maturity

Category	Mkt Val (€bn @ 31 Jan 08)	Weight (%)
Sovereigns (235)	3,202	60.4
Non Sovereigns	2,104	39.6
AAA (611)	1,109	20.9
AA (421)	450	8.5
A (448)	376	7.1
BBB (220)	169	3.2

Category	Mkt Val (€bn @ 31 Jan 08)	Weight (%)
1 – 3 Yrs (479)	1,381	26.0
3 – 5 Yrs (451)	1,114	21.0
5 – 7 Yrs (378)	812	15.3
7 – 10 Yrs (406)	1,002	18.9
10+ Yrs (221)	998	18.8

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ 31 Jan 08 & 06)		W't (%)	Dur'n (yrs)
Gilts (14)	161	116	91.0	12.7
< 5 Yrs (2)	23	8	13.0	2.6
5 – 15 Yrs (5)	72	67	40.7	8.4
> 15 Yrs (7)	66	41	37.3	20.7
Non Gilts (56)	16	12	9.0	15.5

Sources: Barclays Capital, DMO, iBoxx, Jagger & Associates

JAGGER & ASSOCIATES

Contact: Simon Jagger, Jagger & Associates, 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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