



### Investment Headlines & Comment

- Spanish government bonds were downgraded, but their yields are still below Ireland and Greece.
- GLG has announced its sale to **Man Group** (the biggest listed manager of hedge funds).
- Staff departures at **Schroders UK Equities**, and **Scottish Widows Emerging Markets**.

### Feature Section

This month, we update our June 2008 analysis on the dispersion of corporate bond yields. Before the “credit crunch” there was already more dispersion than might have been expected, but how has that changed? Also, following on from our July 2009 analysis of issuers, just how “Sterling” is the iBoxx Sterling Non-Gilt index these days?

Figure 1a: AAA

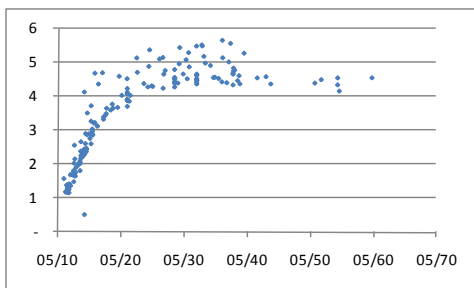


Figure 1b: AA

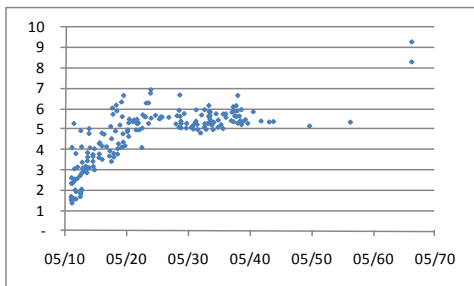


Figure 1c: A

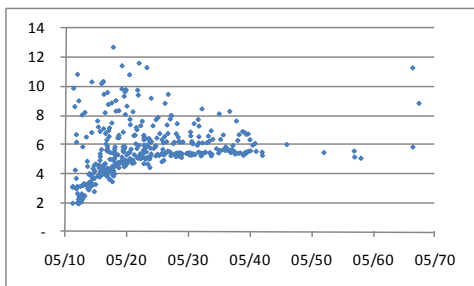
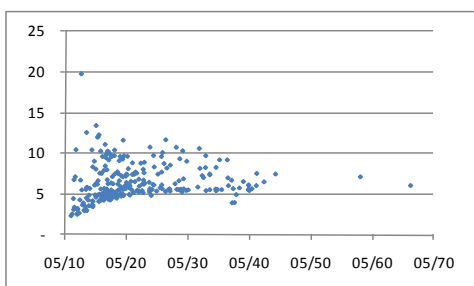


Figure 1d: BBB



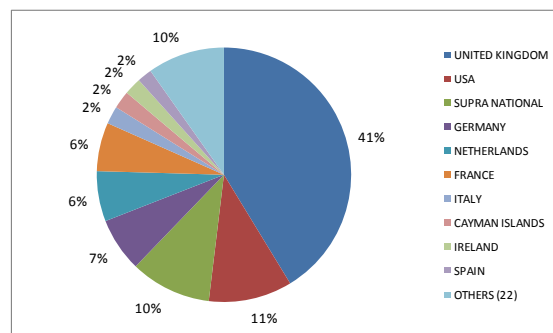
Figures 1a-1d (sourced from iBoxx) show the yields (%) against date of maturity for the four main rating bands within the investment grade bond universe (NB: horizontal marks = May every 10 years, and watch vertical scales!). In each case there is a clear grouping of a majority of bonds about a yield curve, but there are many outliers, in most cases implying significant expectation of future rating revisions, but in other cases reflecting technical quirks of the bonds involved (eg the BBB bond with a 20% yield ‘maturing’ in 2013 actually converts to a perpetual bond at that date if it is not redeemed).

The main change since June 2008 has been in the shape of the underlying yield curve – what was “flat” is now very steeply upward sloping. There is slightly more dispersion within AAA bonds than before, but slightly less within AA bonds (probably due to downgrades of formerly AA-rated bonds) Within the A- and BBB-rated areas, there is more dispersion at shorter terms.

Figure 1e below gives the current pie chart of “countries” of issuance for the iBoxx Non-Gilt index – besides the UK and supranationals, 30 other countries now have investment grade debt issued in sterling. The UK now accounts for only just over 40% of sterling non-gilt bonds (which rather blows a hole in some managers trying to market new funds off the back of claims that investors need to “diversify” into Euro- and Dollar-denominated bonds).

In the same way that being a “UK-listed Equity” no longer really means “UK-economy-related”, the sterling non-gilt bond market is no longer particularly UK-centric either. Where this quirk gets particularly anoraky is in the AA area, because two-thirds of AA-rated bonds are now not UK issues (and the UK issues are almost all Financials or Securitised bonds). Should “being an AA-rated sterling bond” really continue to drive FRS17 accounting valuations?

Figure 1e: iBoxx Sterling Non-Gilt Index - Countries of issuance





**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 2010**

Asset Class	1 month (%)	3 months (%)	12 months (%)	3 years (% p.a.)	5 years (% p.a.)	10 years (% p.a.)
UK Equities	-6.2	-1.3	22.9	-4.5	5.2	2.1
Overseas Equities	-4.5	1.6	28.4	1.5	7.9	1.6
US Equities	-3.2	3.6	34.3	1.6	5.4	-0.4
Europe ex UK Equities	-8.0	-4.7	15.1	-4.9	7.2	2.2
Japan Equities	-3.1	1.2	15.8	-1.8	4.6	-2.1
Pacific ex Japan Equities	-5.7	2.4	35.6	9.3	16.9	10.8
Emerging Markets	-3.9	4.6	36.2	10.4	19.2	11.0
UK Long-dated Gilts	3.2	5.6	8.5	6.7	4.4	4.8
UK Long-dated Corp. Bonds	0.4	4.0	21.1	4.6	3.5	6.1
UK Over 5 Yrs Index-Linked Gilts	-0.3	2.9	9.0	7.4	5.9	5.6
High Yield (Global)	0.1	4.9	43.0	16.5	12.4	7.7
Overseas Bonds	5.4	2.8	14.8	20.2	10.2	7.2
Property *	1.4	5.6	20.0	-8.0	1.6	6.4
Cash	0.1	0.2	0.7	3.6	4.2	4.4
Commodities £-converted	-7.6	-4.7	5.1	-2.0	-2.9	1.8
Hedge Funds original \$ basis *	1.2	4.5	19.7	1.9	6.6	6.3
Illustrative £-converted version *	0.3	9.3	15.8	11.4	11.4	6.5
Euro relative to Sterling	-2.8	-5.8	-3.8	7.5	4.5	3.1
US \$ relative to Sterling	5.4	4.7	11.0	10.9	4.6	0.3
Japanese Yen relative to Sterling	8.8	2.3	16.3	22.1	8.2	2.0
Price Inflation (RPI) *	1.0	2.2	5.3	2.7	3.1	2.7
Price Inflation (CPI) *	0.6	1.6	3.7	3.0	2.8	2.1
Price Inflation (RPIX) *	1.0	2.3	5.4	3.7	3.4	2.9
Earnings Inflation **	2.5	10.1	5.5	3.0	4.0	4.0
All Share Capital Growth	-6.6	-2.3	18.7	-8.1	1.5	-1.2
Net Dividend Growth	1.1	2.3	-8.9	0.1	3.3	3.6
Earnings Growth	6.1	20.9	-9.6	-9.1	3.2	5.0

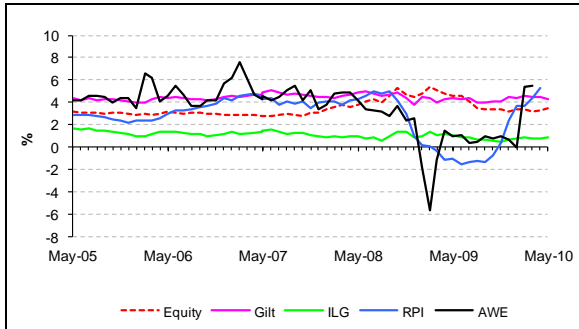
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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 – iBoxx 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 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.

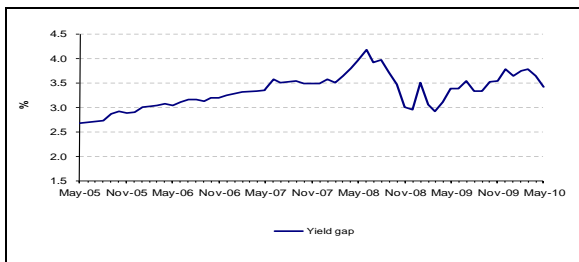


## Yields and Yield Gaps

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.

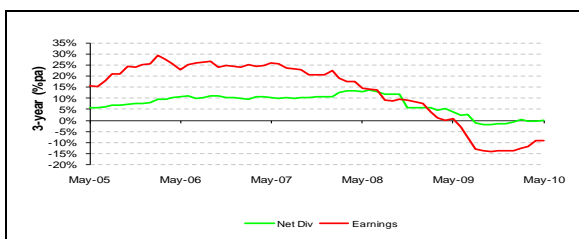
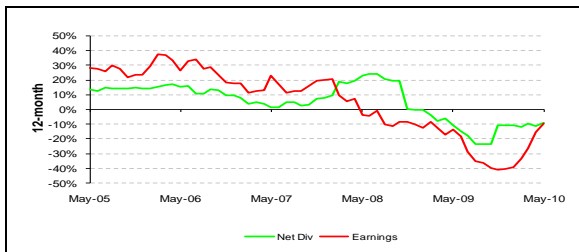


The gap gives expectations at about 3.5% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

## 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]

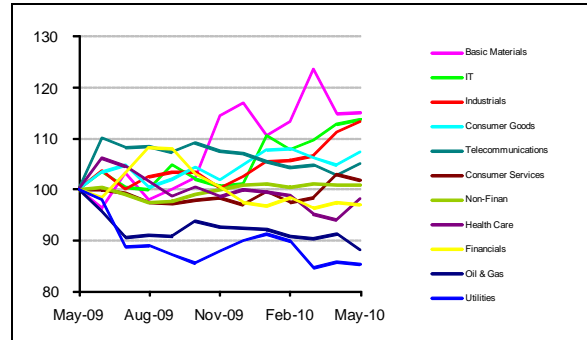
Figure 3: Dividend & Earnings Growth



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



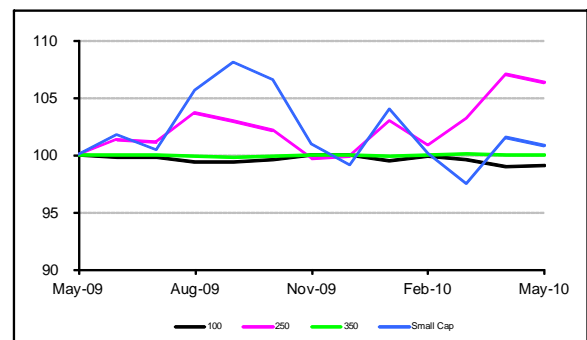
Note: Relative lines' labels for sectors in end-value order

A major decrease this month in the rolling 12-month sector dispersion (down from 33% to 30%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-9.5	-4.3	8.1
Basic Materials	-6.0	0.4	41.6
Industrials	-4.4	5.7	39.3
Consumer Goods	-4.0	-1.9	31.9
Health Care	-2.1	-2.1	20.5
Consumer Services	-7.2	3.2	25.1
Telecommunications	-4.3	-0.7	29.0
Utilities	-6.6	-6.2	4.9
Non-Finan	-6.1	-0.8	24.1
Financials	-6.7	-2.8	19.1
IT	-5.5	4.1	39.7
All Share	-6.2	-1.3	22.9

## UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid Cap and Small Cap fell slightly in relative terms this month.

## FRS17 volatility indicator

Now discontinued, but available on request.



Bond market information

Figure 5: £ Non-Gilt Credit Margins

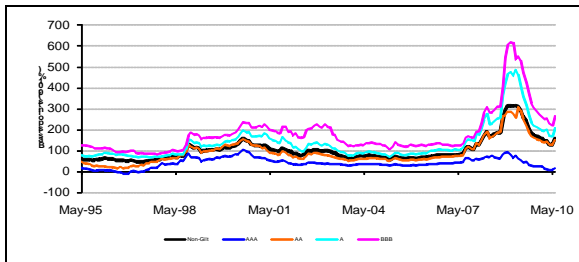


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Dec 09	5.58	4.46	1.12
Jan 10	5.46	4.38	1.08
Feb 10	5.63	4.58	1.05
Mar 10	5.42	4.49	0.93
Apr 10	5.38	4.44	0.94
May 10	<b>5.39</b>	<b>4.25</b>	<b>1.14</b>

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

Category	Mkt Val (£bn @ May 10 & 08, 06)			Weight (%)
Gilts (33)	743	342	306	61.4
Non Gilts (1,029)	467	416	386	38.6
AAA (177)	141	158	148	11.7
AA (187)	74	62	59	6.1
A (393)	163	129	117	13.4
BBB (272)	90	64	59	7.4

Category	Mkt Val (£bn @ May 10, 08)		W't (%)	Dur'n (yrs)
Gilts (33)	743	342	61.4	9.0
< 5 Yrs (9)	206	85	17.0	2.8
5-15 Yrs (11)	283	116	23.4	7.2
> 15 Yrs (13)	253	140	20.9	16.2
Non Gilts (1,029)	467	416	38.6	7.3
< 5 Yrs (264)	133	137	11.0	2.5
5-15 Yrs (479)	203	161	16.8	6.9
> 15 Yrs (286)	131	117	10.8	12.8

Sources: Barclays Capital, DMO, iBoxx, J&A, MLX

£ Gilt Market "main" Issuance

- £3.58bn 4¾% 2020 (1.76x, 3.68%, prev Apr 10)
- £2.48bn 4¼% 2027 (2.47x, 4.47%, Aug 09)
- £1.00bn 4¼% 2032 (1.93x, 4.38%, Dec 09)
- £1.15bn ILG 1<sup>7</sup>/<sub>8</sub>% 2022 (2.49x, r.y 0.77%, Feb 10)
- £4.00bn ILG ½% 2050 (1.23x, r.y 0.76%, Sep 09)

Tables 2d, 2e: € Market Size and Maturity (May 10)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (277)	4,086	58.5
Non Sovereigns	2,905	41.5
AAA (663)	1,303	18.7
AA (387)	566	8.1
A (634)	684	9.8
BBB (422)	351	5.0

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (700)	1,919	27.5
3 – 5 Yrs (710)	1,685	24.1
5 – 7 Yrs (414)	980	14.0
7 – 10 Yrs (347)	1,174	16.8
10+ Yrs (212)	1,232	17.6

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ May 10 & 08)		W't (%)	Dur'n (yrs)
Gilts (17)	230	170	90.6	14.6
< 5 Yrs (2)	36	23	14.2	2.3
5 – 15 Yrs (5)	91	75	35.8	8.8
> 15 Yrs (10)	103	71	40.7	23.9
Non Gilts (52)	24	16	9.4	17.8

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

Month End	US (%)	Euro (%)	Sterling (%)
Mar 10	7.73	7.58	9.48
Apr 10	7.54	7.51	9.31
May 10	<b>8.45</b>	<b>8.92</b>	<b>10.43</b>

