



Investment Update August 2010

Investment Headlines & Comment

- A 'bubble' month? All the fixed term **gilt yields** end below 4%.
- **Euro yield spread** at record level – Greece 9% more than Germany.
- **UK Equity earnings** rebounded very sharply this month.

Feature Section

This month, Sarah Allen takes a look at ethical investment, ten years on from the introduction of the concept into UK pension regulations (for SIPs) in July 2000.

In July 2001, FTSE International launched the FTSE4Good Index series for socially responsible investment (SRI). The series was designed with the support of UNICEF, the United Nations Children's Fund, and uses data provided by EIRIS, the Ethical Investment Research Service. Half of the FTSE fee goes to UNICEF. The FTSE4Good UK Index is a subset of the FTSE All Share. At 30 June 2010, there were 266 constituents in the FTSE4Good UK Index (net market cap £1,169bn), compared to 629 in the FTSE All Share (net market cap £1,500bn). So, by value, 22% of the All Share is excluded from the FTSE4Good UK Index. Of the 10 largest stocks in the All Share (as at 30 June 2010), the FTSE4Good UK Index only excluded one (British American Tobacco). This suggests a bias towards the larger stocks in the index, perhaps because bigger companies have more established SRI policies in place.

Companies in the FTSE4Good Index series fulfil criteria in five main areas: environmental sustainability, positive relationships with stakeholders, universal human rights, supply chain labour standards, and countering bribery. Companies seeking inclusion must conform to a best practice framework, covering policies and commitments, management systems, and performance and reporting. The FTSE4Good UK Equity Index excludes companies significantly involved in tobacco production, the manufacture of whole weapons systems or strategic parts or services for nuclear weapons, and those who operate nuclear power stations or mine/process uranium. In considering companies outside these sectors, FTSE4Good's criteria for inclusion are more stringent for companies with a high impact on the environment. The rigour applied when screening companies has consistently increased, but some ethical investors point to the inclusion of oil companies as evidence of a "light green" approach. In particular, BP was the largest constituent in the FTSE4Good UK Index at the end of Q1 10 (before the major drop in share price caused the weighting to fall), whilst the recent oil spill crisis has raised many ethical questions about the company.

Figure 1a below shows the quarterly performance of the FTSE4Good UK Index, relative to the All Share. Longer-term results are shown to the right of the chart. The chart clearly demonstrates how the ethical sub-index has tended to underperform the All Share as a whole. The ethical index's outperformance in the second half of 2008 was largely driven by the significant falls in the Mining sector of the All Share (see below for the ethical index's sector breakdown).

Figure 1a: FTSE4Good versus All Share

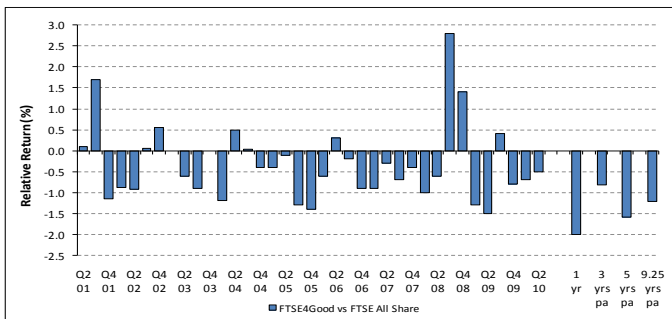


Figure 1b: Sector deviations (Source: FTSE)

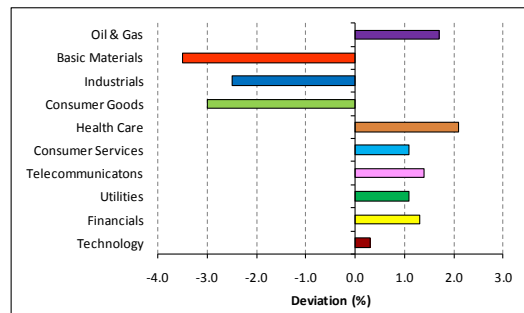


Figure 1b shows how the sector breakdown of the FTSE4Good UK Index as at 30 June 2010 differed from the All Share. The underweight positions will reflect the exclusion of certain companies as a result of the ethical screening processes. For example, companies involved in the production of weapons (represented in the All Share within Industrials), tobacco (representing 4.1% of the 12.0% Consumer Goods weighting within the All Share), and uranium mining (Basic Materials) are all excluded from the FTSE4Good UK Index. Note that none of the sectors shown in the charts are entirely eliminated from the FTSE4Good UK Index (although some entire sub-sectors, such as Tobacco, would be). The underperformance of the FTSE4Good UK Index may largely relate to the underweight positions in the Basic Materials sector, and to a lesser extent the Consumer Goods and Industrial sectors. Over 9.25 years (the period covered in Figure 1a), these three sectors have outperformed the All Share by 11.2% p.a., 8.0% p.a., and 3.7% p.a. respectively. However, as noted above, the FTSE4Good UK Index does not exclude these sectors entirely, only particular stocks or sub-sectors.



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 August 2010

Asset Class	1 month (%)	3 months (%)	12 months (%)	3 years (% p.a.)	5 years (% p.a.)	10 years (% p.a.)
UK Equities	-0.2	1.7	10.6	-2.5	3.9	1.6
Overseas Equities	-1.8	-4.6	10.3	1.2	5.4	0.3
US Equities	-2.6	-8.5	11.1	0.4	2.6	-2.2
Europe ex UK Equities	-2.8	0.4	1.0	-3.1	5.5	2.0
Japan Equities	-0.5	-6.4	-0.7	-2.0	1.4	-3.1
Pacific ex Japan Equities	0.6	1.2	22.8	7.8	15.2	9.6
Emerging Markets	-0.1	-0.2	25.5	8.1	16.4	10.8
UK Long-dated Gilts	8.4	9.4	9.5	8.8	5.7	5.9
UK Long-dated Corp. Bonds	7.5	9.7	14.5	8.0	4.7	7.2
UK Over 5 Yrs Index-Linked Gilts	5.5	5.4	9.4	7.6	6.3	6.2
High Yield (Global)	1.8	0.0	27.9	18.7	11.2	7.1
Overseas Bonds	4.0	1.0	13.1	19.7	10.1	7.0
Property *	0.8	3.0	24.2	-7.5	1.3	6.5
Cash	0.1	0.2	0.7	3.2	4.0	4.3
Commodities £-converted	-3.7	-5.3	2.1	-4.6	-8.8	-0.3
Hedge Funds original \$ basis *	1.6	-2.2	8.2	0.2	5.1	5.9
Illustrative £-converted version *	-2.9	-4.4	14.6	9.3	7.6	5.5
Euro relative to Sterling	-0.6	-2.1	-6.0	7.0	3.9	3.1
US \$ relative to Sterling	1.9	-5.5	6.1	9.5	3.3	-0.5
Japanese Yen relative to Sterling	5.1	2.5	17.1	21.9	9.1	1.9
Price Inflation (RPI) *	-0.2	0.4	4.8	2.8	3.1	2.7
Price Inflation (CPI) *	-0.3	0.1	3.1	3.1	2.7	2.1
Price Inflation (RPIX) *	-0.3	0.3	4.8	3.8	3.4	2.9
Earnings Inflation **	1.4	-9.8	1.8	2.1	3.2	3.6
All Share Capital Growth	-0.7	0.9	7.0	-6.1	0.3	-1.7
Net Dividend Growth	2.0	-3.1	3.6	-1.5	2.1	3.2
Earnings Growth	17.0	3.1	30.8	-8.6	1.9	5.1

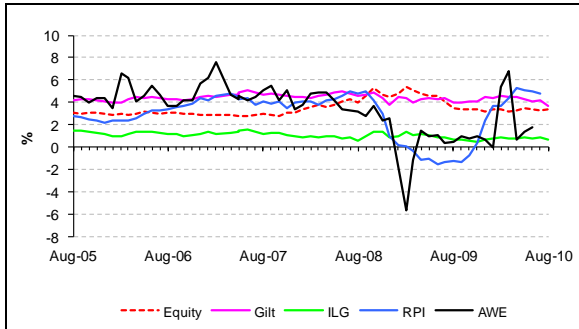
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

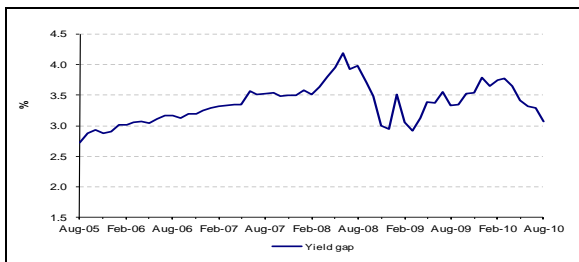


Yields and Yield Gaps

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.

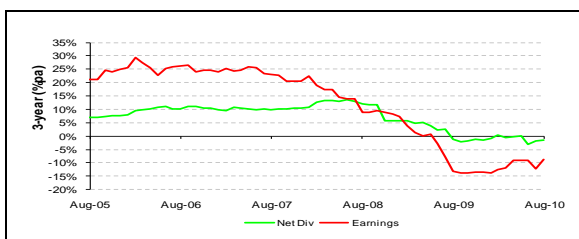
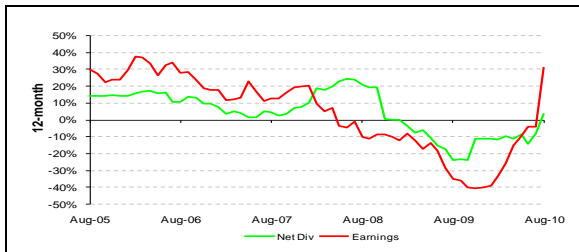


The gap gives expectations just over 3% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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]

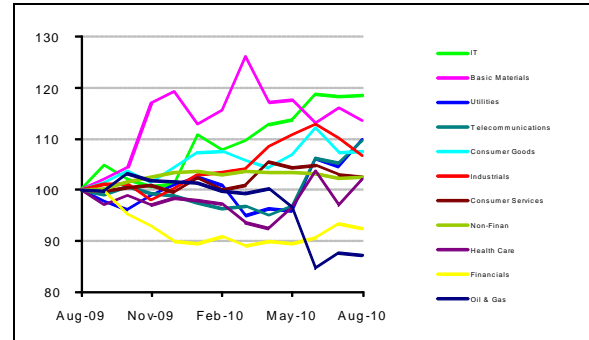
Figure 3: Dividend & Earnings Growth



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



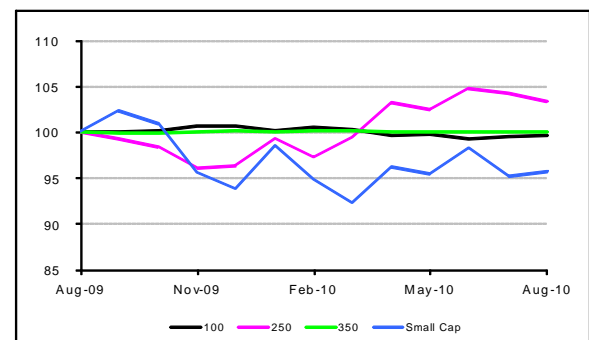
Note: Sector labels for relative lines are in end-value order

A rise this month in the rolling 12-month sector dispersion (up slightly from 30% to 32%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-0.9	-8.4	-3.8
Basic Materials	-2.3	-1.8	25.5
Industrials	-3.3	-1.9	18.0
Consumer Goods	-0.1	2.5	18.9
Health Care	4.9	7.6	12.7
Consumer Services	-0.7	-0.0	13.4
Telecommunications	3.8	15.0	21.1
Utilities	4.8	16.6	21.4
Non-Finan	0.1	0.7	13.3
Financials	-1.1	5.0	2.1
IT	-0.0	6.2	31.2
All Share	-0.2	1.7	10.6

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid Cap fell but Small Cap rose slightly in relative terms this month.

FRS17 volatility indicator

Now discontinued, but available on request.



Bond market information

Figure 5: £ Non-Gilt Credit Margins

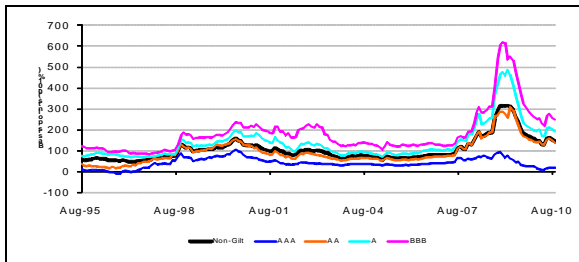


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Mar 10	5.42	4.49	0.93
Apr 10	5.38	4.44	0.94
May 10	5.39	4.25	1.14
Jun 10	5.25	4.10	1.15
Jul 10	5.29	4.18	1.11
Aug 10	4.75	3.67	1.08

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

Category	Mkt Val (£bn @ Aug 10 & 08, 06)			Weight (%)
Gilts (34)	819	369	312	62.5
Non Gilts (1,021)	491	433	395	37.5
AAA (179)	147	154	149	11.2
AA (174)	75	75	64	5.7
A (398)	175	134	119	13.3
BBB (270)	95	67	59	7.2

Category	Mkt Val (£bn @ Aug 10, 08)		W't (%)	Dur'n (yrs)
Gilts (34)	819	369	62.5	9.3
< 5 Yrs (8)	215	94	16.4	2.7
5-15 Yrs (12)	316	125	24.1	7.2
> 15 Yrs (14)	289	151	22.0	16.5
Non Gilts (1,021)	491	433	37.5	7.5
< 5 Yrs (259)	137	142	10.5	2.4
5-15 Yrs (476)	211	167	16.1	6.9
> 15 Yrs (286)	143	123	10.9	13.2

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

£ Gilt Market “main” Issuance

- £4.12bn 2¾% 2015 (1.99x, 2.06%, prev June 10)
- £3.30bn 4% 2022 (1.72x, 3.49%, March 10)
- £1.75bn 4½% 2034 (1.56x, 4.20%, June 10)
- £1.00bn ILG 1¼% 2027 (1.94x, r.y. 0.87%, June 10)

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (254)	4,097	58.3
Non Sovereigns	2,936	41.7
AAA (648)	1,312	18.7
AA (404)	598	8.5
A (618)	680	9.7
BBB (407)	347	4.9

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (690)	1,900	27.0
3 – 5 Yrs (695)	1,659	23.6
5 – 7 Yrs (399)	977	13.9
7 – 10 Yrs (331)	1,186	16.9
10+ Yrs (216)	1,312	18.7

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Aug 10 & 08)		W't (%)	Dur'n (yrs)
Gilts (16)	237	175	90.6	15.8
< 5 Yrs (1)	21	14	8.1	2.9
5 – 15 Yrs (5)	97	80	36.8	8.6
> 15 Yrs (10)	120	81	45.6	23.9
Non Gilts (49)	25	18	9.4	17.9

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

Month End	US (%)	Euro (%)	Sterling (%)
May 10	8.45	8.92	10.43
Jun 10	8.28	8.75	10.60
Jul 10	7.70	7.83	9.59
Aug 10	7.74	7.73	9.29

