



Monthly Market Report

April 2024

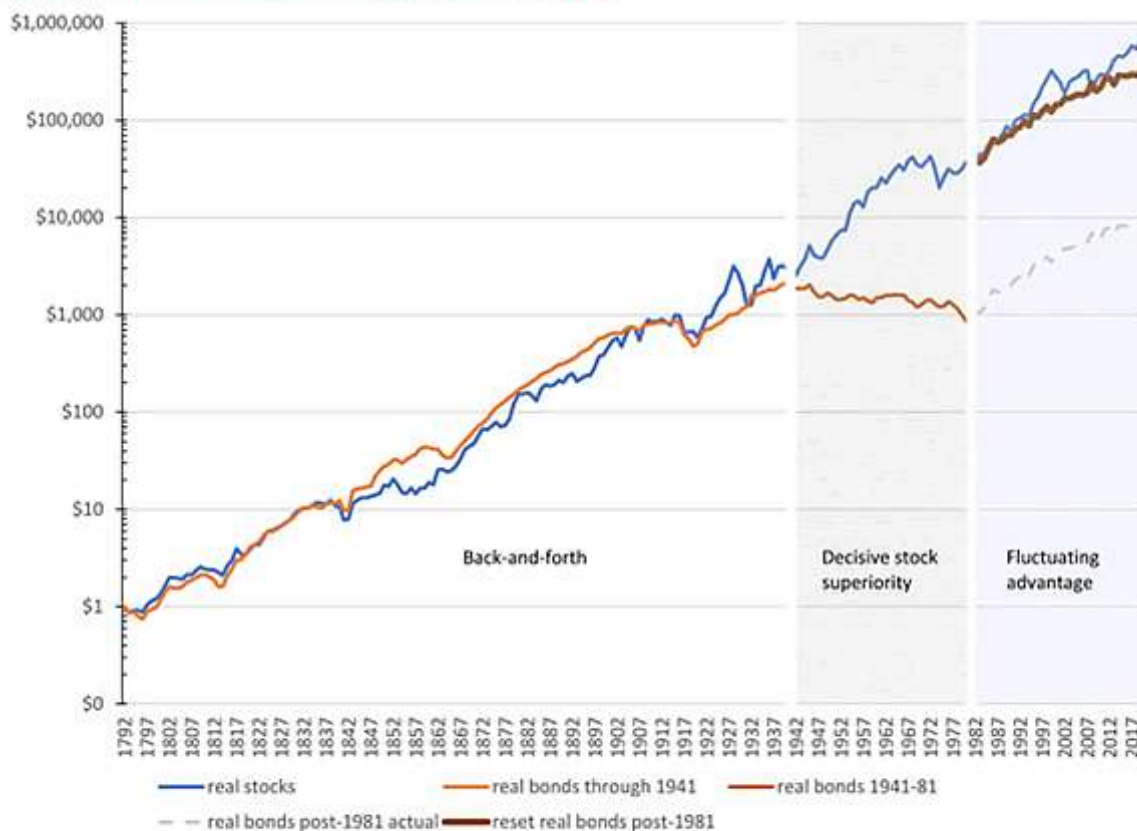
With commentary from David Stevenson



Stocks don't always beat bonds in the long run

The conventional truth for most investment professionals is that if investors stick with equities over say most 20 to 30-year periods, they will almost certainly enjoy greater returns than other less risky assets like bonds because that's what the financial history data sets tell you. More particularly, investors should expect a stock portfolio to compound in real terms at 6% to 7% per year. Right? Maybe. I recently read a cracking [academic paper here](#) by Edward McQuarrie, a US academic economist, which challenges that notion. It's called *Stocks for the Long Run. Sometimes Yes, Sometimes No*. McQuarrie's central point is that a different story emerges once you look again at recently updated long-term data sets. More specifically McQuarrie draws on a richer, deeper set of historical records - new stock and bond series - which begin in January 1793, the first month where more than three stocks were found trading regularly. The new stock series ends January 1897. The key issue here is that more data is available before 1871. The chart below beautifully summarises the key finding - it's simply not true that stocks always beat bonds over the long term. It depends.

Figure 1. Stock and Bond Performance from 1792



Note. Performance through December 2019 (pre-pandemic). The bond performance line (dark brown) is reset equal to stock wealth at the end of 1981 to facilitate comparison in the years that follow.

Another way of looking at the same point is to look at many different holding periods, as evidenced in the table below. According to McQuarrie there is *"no consistent relationship between asset outperformance and length of holding period can be extracted from Table 1. The results are better interpreted as showing changes in the regime. Prior to 1942, a regime of parity performance held sway: Sometimes stocks outperformed, sometimes bonds."*

Table 1. Odds that Stocks Beat Bonds over Rolls of Increasing Length

	Holding Period in Years					
	1	5	10	20	30	50
All data:	55.1%	62.3%	63.8%	64.4%	67.2%	68.0%
Counts:	227	223	218	208	198	178
Sub-periods:						
Rolls ending 1793-1862	47.8%	41.5%	36.7%	12.0%	0.0%	0.0%
Rolls ending 1863-1941	52.5%	63.8%	65.0%	70.0%	70.0%	53.8%
Rolls ending 1942-2019	64.1%	78.2%	83.3%	92.3%	98.7%	100.0%

Note. Annualized real returns were calculated for stocks and bonds over each holding period and then a count was taken of the number of rolls where the stock return exceeded the bond return. The percentage stated is that count divided by the total number of rolls.

Now, we can say that After World War II, a new regime of extreme stock outperformance took hold. But we can also say that there have been many periods where investors in equities have sustained lots of significant losses - *"over multi-decade holding periods, there have been repeated instances where the real total return on stocks was 2% or less."*

And what's true for US equities, is even more true for **international equities** as the next table below demonstrates. At the country level, the new record shows multiple instances where the equity premium was a deficit for decades, as seen in the new 19th-century US data. According to McQuarrie *"The larger sample of markets outside the US shows diverse outcomes for stocks and bonds. In some periods in some markets for some length of time, stocks have enjoyed strong returns consistent with "Stocks for the Long Run." In other periods in other markets over other intervals, stocks have performed weakly and/or bonds have outperformed stocks. World outcomes and 19th-century US outcomes expose a lack of stationarity that undermines the hypothesis of "Stocks for the Long Run."*

Table 3. Worst Multi-decade International Stock Returns Excluding War Losses

Nation	20 years	Ending in	Nation	30 years	Ending in	Nation	50 years	Ending in
Italy	-7.34	1979	Norway	-4.40	1978	Italy	-0.54	2011
Norway	-5.92	1977	Italy	-2.35	1991	Norway	0.43	1995
Sweden	-5.17	1932	Portugal	-1.64	1949	Austria	1.10	1996
Japan	-5.02	2009	Sweden	-1.10	1932	Sweden	1.61	1948
Switzerland	-4.39	1981	Austria	-1.02	1976	Belgium	2.04	1908
Austria	-4.26	1981	Switzerland	-0.78	1991	Spain	2.34	2020
Spain	-3.36	1983	Japan	-0.78	2019	Switzerland	2.41	2011
France	-2.98	1981						
Portugal	-2.34	1939						
SouthAfrica	-1.40	1920						
UK	-1.27	1920						
Belgium	-1.27	1976						
Germany	-1.20	1980						

Note. Table shows all negative 20- and 30-year returns found and all 50-year returns less than 2.5%. Annualized real percentage returns.

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Headline Numbers

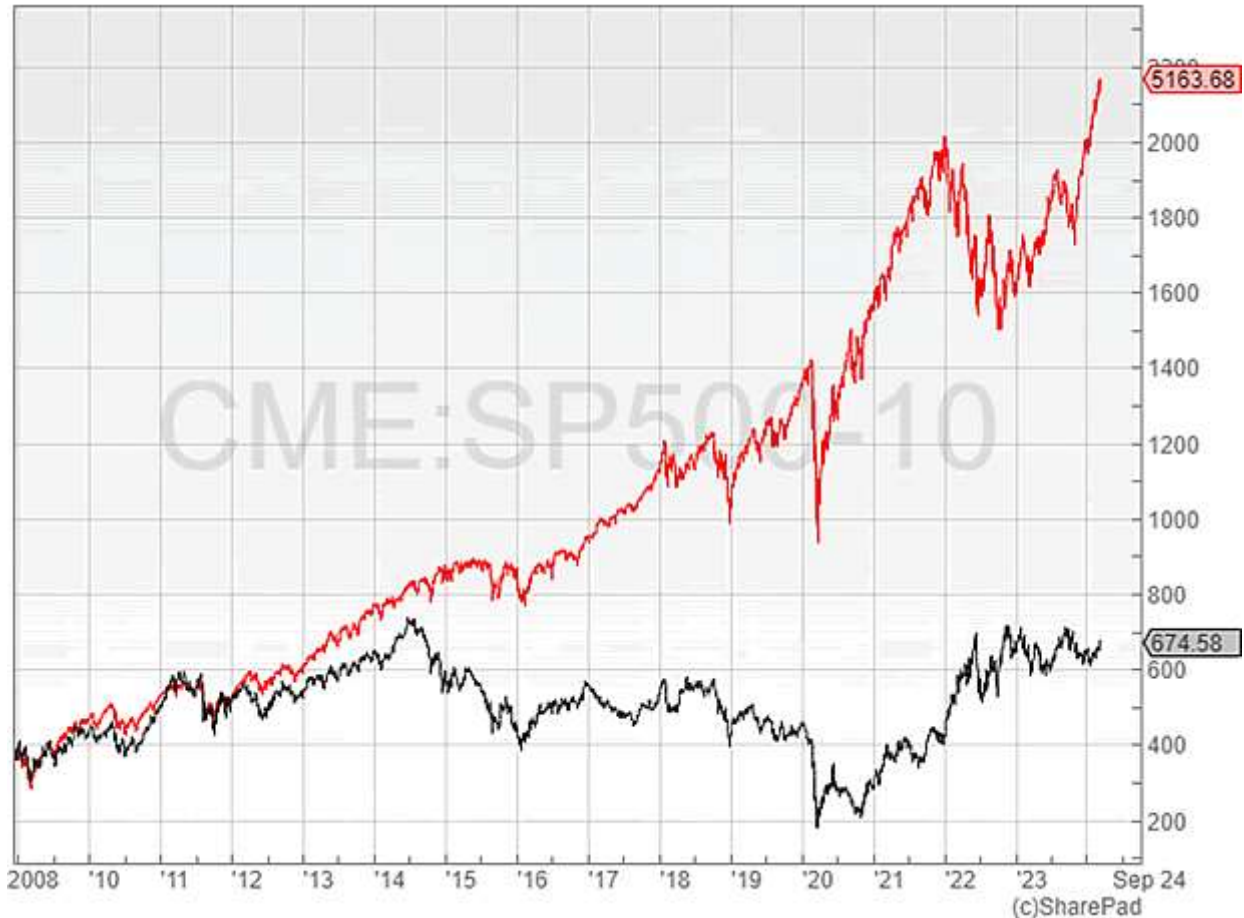
What happened to energy stocks?

In amongst the mass hysteria about AI, Nvidia and US equities generally, I tend to find the chart below compelling. The black line shows the returns from the S&P 500 Energy sector index which contains the largest collection of the world's most profitable energy companies (the world version

of this index which includes European energy majors isn't radically different). The red line is the benchmark US index, the S&P 500 since the GFC.

Just look at that chasm that has opened up over the last decade or so. Energy stocks have fallen decisively out of favour but it's worth contemplating just how cheap these energy majors have become. Let's return to the S&P 500 energy sector index: the trailing price-to-earnings ratio for these huge businesses is running at 11 times earnings, which increases to a projected PE of 12.5 while the indicative dividend yield is at 3.69%, on a price-to-sales ratio of 1.31.

Big Oil returned more cash (\$114 billion) to shareholders last year than ever before. That Big Oil return was 76% higher than during the \$100-a-barrel era.



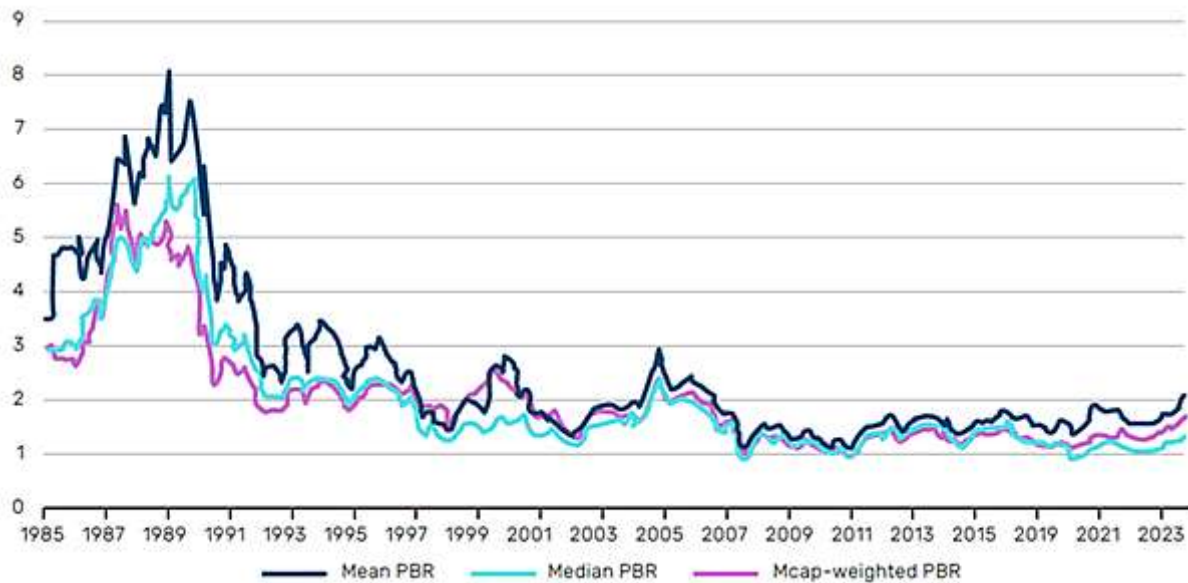
Japan

Over the last few weeks, Japanese equities have suddenly come back onto the radar for most Western investors. The local benchmark index the Nikkei 225 broke the 38,000 level for the first time in 34 years a few weeks back, but the index is just one indicator that suggests Japan's investment landscape has turned the corner. Here are some other key indicators:

- 34 years since the Nikkei 225 broke through the 37,000 level
- 41% per cent of Tokyo Prime companies have confirmed they will address undervaluation
- 26 MBO announcements in 2023 - the highest for a decade
- 54% of Japanese listed stocks have net cash on their balance sheets
- 3.2% Japanese CPI in 2023, with inflation returning following decades of deflation

- Shareholder activism has surged in the last few years. According to law firm White and Case, "During the June 2023 annual meeting season, shareholders made a total of 385 shareholder proposals made to 90 Japanese publicly listed companies. These figures represent a 16% rise in the number of companies subject to shareholder proposals and a 31% rise in the total number of shareholder proposals since the June 2022 proxy season".

Given all this positive price momentum one might presume that Japanese valuations are looking stretched. According to researchers at the Man Institute, the opposite seems to be true. They argue that valuation levels between 1989 (the last time the index peaked) and now could not be more different. The Nikkei 225 trades at around 16 times its Price-earnings ratio, twice its Price to Book ratio, and 37% of the companies included in the Nikkei 225 index have a market price that is lower than their book value.



Measure	Values as of 9th February 2024	Values as of 14th March 2024
UK Government 10 year bond rate	4.02%	4.07%
GDP Growth rate YoY	0.30%	-0.20%
CPI Core rate	3.90%	4%
RPI Inflation rate	5.20%	4.90%
Interest rate	5.25%	5.25%
Interbank rate 3 month	5.33%	5.32%
Government debt to GDP ratio	97%	97%
Manufacturing PMI	47	47.5

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Bank CDS options

As with last month, pricing for credit default swaps for the major global banks fell back across the board over the last four weeks. Only one bank, Deutsche, recorded a marginal increase with two banks - RBC and Nomura - seeing no change. Most of the falls in pricing were not substantial except for UBS which saw its swaps fall sharply in price, followed by Goldman Sachs.

Bank	One Year	Five Year	Credit Rating (S&P)	Credit Rating (Moody's)	Credit Rating (Fitch)
Santander	45.62	16.68	A+	A2	A -
Barclays	70.29	39.58	BBB	BAA1	A
BNP Paribas	35.69	13.28	A+	Aa3	A+
Citigroup	59.2	28.24	BBB+	A3	A
Deutsche Bank	111	53.99	A-	A1	BBB+
Goldman Sachs	61.7	31.76	BBB+	A2	A
HSBC	37.97	18.87	A+	A1	AA-
Investec	n/a	n/a	n/a	A1	BBB+
JP Morgan	39.7	21.27	A-	A1	AA-
Lloyds Banking Group	42.08	16.61	BBB+	A3	A
Morgan Stanley	60.23	27.97	A-	A1	A+
Natixis	36.5	16	A	A1	A+
Nomura	78.41	19.52	BBB+	BAA1	A-
RBC	50.89	19.8	AA-	A1	AA-
Soc Gen	47.45	21.57	A	A1	A-
UBS	38.85	22.93	A-	Aa3	A+

Source: Tempo Issuer & Counterparty Scorecards ('TICS') 1st March 2024 www.tempo-sp.com

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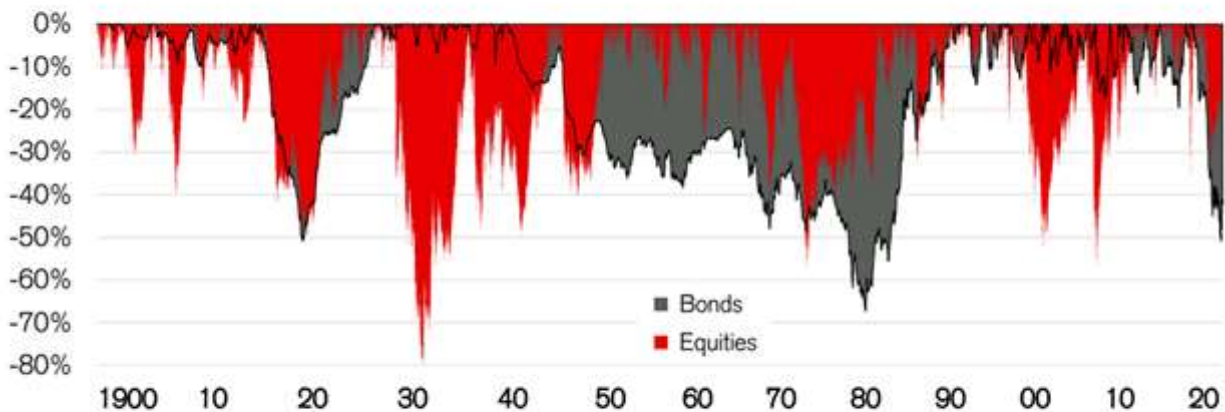
Government Bonds

We are living in a new era of Big Government with ever greater issuance of government debt. According to the S&P Global Ratings service, sovereigns' long-term borrowing will reach \$11.5 trillion in 2024, more than 50% above the pre-pandemic-levels, amid softer GDP growth, the heavy election schedule, elevated interest, and defence spending. The U.S. will account for 39% of global long-term issuance, increasing its 2024 borrowing by \$1 trillion to a total of \$4.5 trillion, the biggest nominal increase among all rated sovereigns, as growth decelerates and the upcoming elections complicate fiscal consolidation.

S&P projects China will overtake Japan as the second-largest sovereign issuer for the first time on record, with the equivalent of \$1.7 trillion of gross long-term issuance, amid government efforts to support the economy. Other major sovereign issuers, primarily G-7 countries, will keep borrowing broadly flat compared with last year, the notable exception being the U.K., which, in U.S. dollar terms, will borrow 28% more than in 2023. The S&P Global Ratings analysts reckon that even "if government borrowing costs have likely peaked, the effective rate of servicing existing debt will remain higher than the pre-pandemic level and given larger government debt stocks, interest bills for sovereigns are set to stay elevated in the years to come."

This surfeit of government borrowing isn't necessarily a positive sign for investors in gilts and Treasuries. By and large, massive debt splurges tend to result in both monetary inflation and poor bond returns. And right on cue, the UBS Global Yearbook reminds us that government bonds are certainly NOT risk-free as they can suffer from long, extended drawdowns. Just look at the massive losses from owning bonds in the 70s and 80s in the chart below.

Real return drawdowns: US equities and bonds, 1900–2023



Source: DMS Database

Bonds are not "safe". They have also had large, extended drawdowns



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UK Government Bonds 10-year Rate 4.07%

United Kingdom 10Y Bond Yield



source: tradingeconomics.com

Source: <http://www.tradingeconomics.com/united-kingdom/government-bond-yield>

CDS Rates for Sovereign Debt

Country	Five Year
France	23.5
Germany	11.41
Japan	19.41
United Kingdom	29.21
Ireland	20.87
Italy	65.3
Portugal	35.0
Spain	37.27

Eurozone peripheral bond yields

Country	March 2024	February 2024	Spread over 10 year
Spain 10 year	3.20%	3.27%	78
Italy 10 year	3.62%	3.92%	120
Greece 10 year	3.33%	3.36%	91

	S&P Rating	Moody's Rating	Fitch Rating
Germany	AAA	AAA	AAA

United Kingdom	AAA	Negative	AA1	Stable	AA+
United States	AA+	Stable	AAA	Stable	AAA

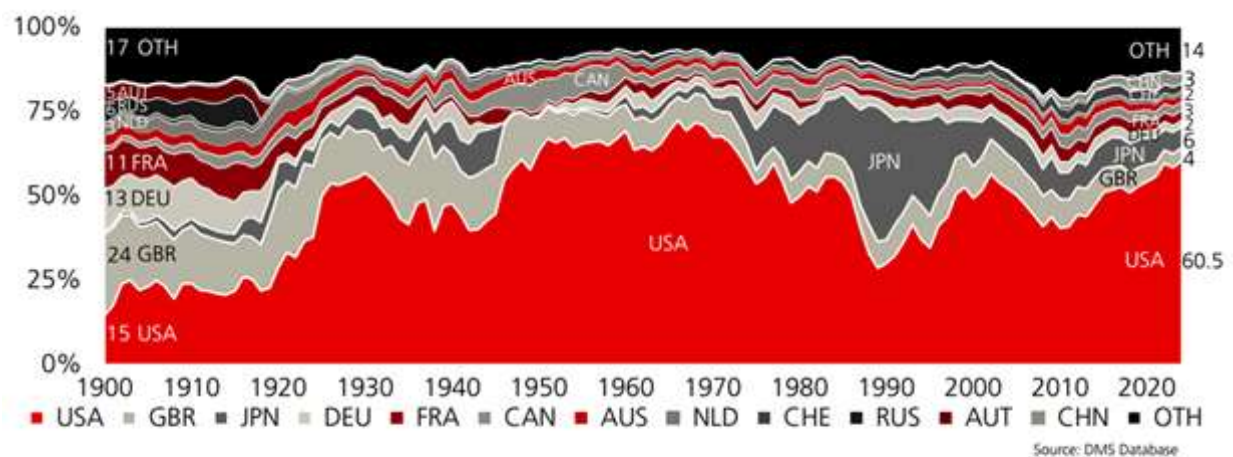
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Equity Markets and Dividend Futures

Swiss investment bank UBS has just released its invaluable Global Investment Returns Yearbook. Most investment advisers regard this as the definitive source of long-term data as it contains what's probably the most comprehensive data set in investment history. It digs into Long-run returns since 1900 for 35 developed markets, 23 of which start in 1900 with a wider though less comprehensive sample comprising 90 markets. Its main conclusions?

- The Historical equity risk premium vs. bonds has been around 3.3% per annum
- The Historical equity risk premium vs. bills has been around 4.7% per annum
- US real annualised equity returns are running at around 6.5%, with the World at 5.1% pa
- In future, we should expect the real return premium to be around 3.5% down from the current 4.5% per annum.

The report also pulls up some key research findings worth dwelling on, most notably that perhaps we should all stop worrying about just how dominant US equities have become versus the rest of the world. As the chart below shows, we have been here before (with the US well over 60% of the value of global markets), and it will happen again at some stage in the future.



UK was largest; Japan briefly became largest; US dominates



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Ironically, given this worry about concentration risk, the US and Japan have one of the least concentrated markets in global terms, despite what you hear about the Magnificent Seven or the FAANGS.

Concentration 2: Concentration within the world's 12 largest equity markets



Sources: CRSP database (US), London Share Price Database (UK), FTSE World index (other markets)

US is one of world's least concentrated markets; only Japan is less concentrated



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Index	February 2024	March 2024	Reference Index Value	Level 6 Months Ago
Stoxx 50 Dec 23 contract	158.8	161.3	4994	143
FTSE 100 Dividend Dec 2023	311.5	303	7736	298

Note changed to Dec 2024 contracts

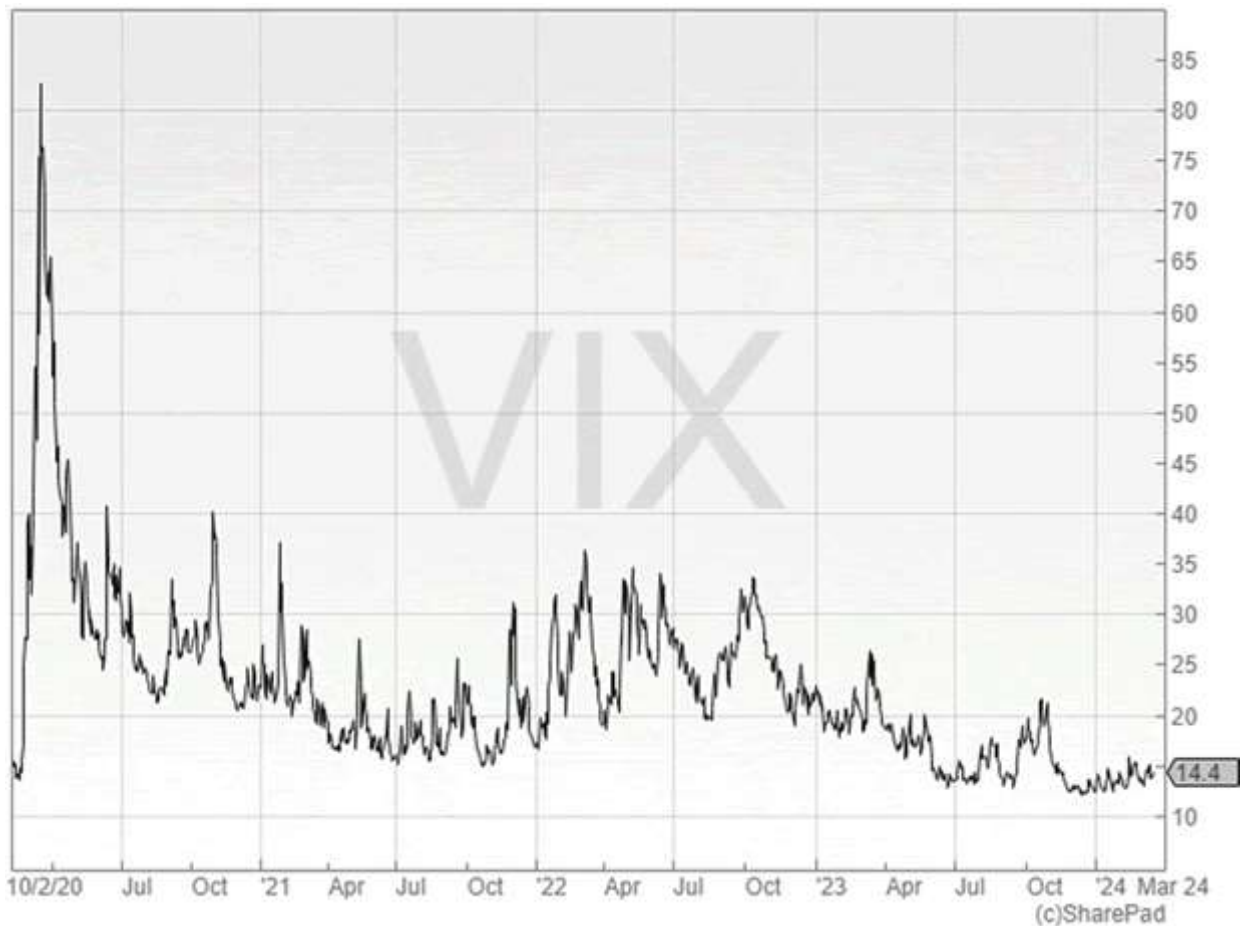
Name	Price % change						Close
	1 mth	3 mths	6 mths	1 yr	5 yr	6 yr	
FTSE 100	2.28	1.2	0.881	1.36	7.73	8.52	7740.66
S&P 500	3.17	9.32	14.5	31.6	83.7	87.6	5159.2
Gold Composite (Most Traded)	8.81	6.65	12.8	14.1	68.3	64.5	218080¢
iShares FTSE UK All Stocks Gilt	0.955	-0.723	2.06	-3.24	-22.1	-21.3	1030.25p
VIX New Methodology	-4.38	10.2	7.25	-42.1	1.85	-20.2	13.75

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Volatility

If you're interested in measures of volatility for global asset classes, then I'd suggest the chart below from Charlie Morris of research service ByteTree, is one of the most remarkable I've seen in recent years. The black line shows the volatility of Bitcoin while the golden line at the bottom

shows the volatility of gold prices. As you'd expect, gold prices remain relatively stable whereas at the start of the last decade, bitcoin volatility was eight times greater. By the end of 2023, bitcoin volatility had declined by a huge quantum and is now only twice as volatile as gold. Sure bitcoin is still more volatile than say US equities but the trend is clear. Bitcoin is becoming less volatile in terms of price.



Measure

March Level

February Level

January Level

December Level

Vstox Volatility	13.03	13.62	13.92	13.21
VFTSE Volatility	14.40	12.93	12.69	12.63

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Summary of Pricing Impact on Structured Products

Pricing Parameter	Change Impact on Structured Product Price	
	Up	Down
Interest Rates	Up	Down
Underlying Level	Up	Up (unless product offers inverse exposure to the underlying)
Underlying Volatility	Up	Down for capped return/fixed return/capital at risk products. Up for uncapped return/capital protected products.
Investment Term	Up	Down
Issuer Funding Spread	Up	Down
Dividend Yield of Underlying	Up	Down
Correlation (if multiple underlyings)	Up	Up (unless product offers exposure to the best performing underlyings only)

Source: UK Structured Products Association, January 2014

This information is provided for information purposes only, and the impact on a structured product price assumes all other pricing parameters remain constant.

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Explanation of Terms

CDS Spreads and Credit Ratings

A CDS effectively acts like an option insuring at a cost in basis points a bank or government bond in case of default. The higher the basis points, the riskier the market perceives that security. Crucially CDS options are dynamic and change in price all the time. A credit rating is issued by a credit rating firm and tells us how risky the issuer is viewed based on the concept that AAA (triple A) is the least risky and ratings at C and below are regarded as much riskier. CDS and ratings are useful for structured product buyers because they give us an indication of how financial risk is viewed by the market. Crucially a high CDS rate indicates that an issuer of a bond will probably have to pay a higher yield or coupon, which could be good for structured product buyers as bonds are usually a prime source of funding for a structured product. G8 government bonds issued by the likes of the UK and US Treasury are also sometimes used as collateral in some form of investments largely because they are viewed as being low risk. One last small note on credit

ratings and CDS rates. A is clearly a good rating for a bond (and much better than B) but AA will be viewed as even safer with triple AAA the least risky. Terms of CDS rates anything much above 100 basis points (1%) would warrant some attention (implying the market has some, small, concern about the possibility of default) while anything above 250 would indicate that the market has major concerns on that day about default.

Why does the yield matter on a bond?

As we have already explained bonds are usually used as part of a structured product. The bonds yield or coupon helps fund the payout. All things being equal a higher bond yield means more funding for the payout. But rising bond yields, especially for benchmark US and UK Treasury 10 year bonds also indicate that the markets expect interest rates to rise in the future. Rising interest rates are not usually a good sign for risky financial assets such as equities.

Volatility measures

Share prices move up and down, as do the indices (the 500 and FTSE100) that track them. This movement up and down in price is both regular and measurable and is called volatility. It is measured by stand alone indices such as the Vix (tracking the volatility of the 500), VStoxx (the Eurozone Dow Jones Eurostoxx 50 index) and VFtse (our own FTSE index). These indices in turn allow the wider market to price options such as puts and calls that pay out as markets become more volatile. In simple terms more volatility implies higher premiums for issuers of options. That can be useful to structured product issuers as these options are usually built into an investment, especially around the barrier level which is usually only ever broken after a spike in volatility. Again all things being equal an increase in volatility (implying something like the Vix moving above 20 in index terms) usually implies higher funding levels for issuers of structured products.

Dividend Futures

These options based contracts measure the likely total dividend payout from a major index such as the FTSE 100 or the Eurozone DJ Eurostoxx 50 index. In simple terms the contract looks at a specific year (say 2015) then examines the total dividend payout from all the companies in the index, adds up the likely payout, and then fixes it as a futures price usually in basis points. Structured product issuers make extensive use of dividend futures largely because they've based payouts on a benchmark index. That means the bank that is hedging the payout will want to be 'long' the index (in order to balance it's own book of risks) but will not want the dividends that come from investing in that benchmark index. They'll look to sell those future possible dividends via these options and then use the premium income generated to help fund their hedging position. In general terms the longer dated a dividend future (say more than a few years out) the lower the likely payout on the dividend future as the market cannot know dividends will keep on increasing in an uncertain future and must fix its price in some level of uncertainty.

Equity benchmarks

Most structured products use a mainstream well known index such as the FTSE 100 or 500 as a reference for the payout. For investors the key returns periods are 1 year (for most auto calls) and 5 and six years for most 'growth' products. During most though not all five and six year periods it is reasonable to expect an index to increase in value although there have been many periods where this hasn't been the case especially as we lurch into a recession. Risk measures such as the sharpe ratio effectively measure how much risk was taken for a return over a certain period (in our case the last five years using annualised returns). The higher the number the better the risk adjusted return with any value over 1 seen as very good.

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To find out more about UKSPA, please visit www.ukspassociation.co.uk.

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