Uncommon truths

What would a Labour government mean for the UK?

UK elections will be on 4 July and a change of government seems likely. We doubt Labour's proposals will shake financial markets but the long-term fiscal challenge is enormous, whoever wins.

Prime Minister Rishi Sunak has announced that the UK election will take place on Thursday 4 July and not in the Autumn, as most of us had expected.

Whatever the reason for calling the election early, **Figure 1** suggests it is a desperate roll of the dice by a prime minister perhaps about to suffer a large defeat. The gap between Labour and the ruling Conservatives has been hovering around 20 percentage points throughout 2024 (an amazing turnaround from the 11.5 percentage point lead enjoyed by the Conservatives at the 2019 election). Apart from a blip in 2021 (no doubt linked to the rollout of Covid vaccines), the Conservative share of vote has been trending down since that 2019 election, while that of Labour has been trending up (a trend accentuated by the ill-fated prime ministership of Liz Truss in September/October 2022).

Based on **Figure 1**, the only doubt seems to be the size of the Labour majority. Indeed, those surveys that have been translated into constituency by constituency outcomes (using large samples and a new technique called multilevel regression and poststratification) make difficult reading for the Conservatives. Of the four such surveys in 2024, the smallest majority predicted for Labour was 120 and the largest was 286. To put this into context, Boris Johnson won a majority of 80 in 2019, and the largest post-war majority was the 178 won by Labour's Tony Blair in 1997.

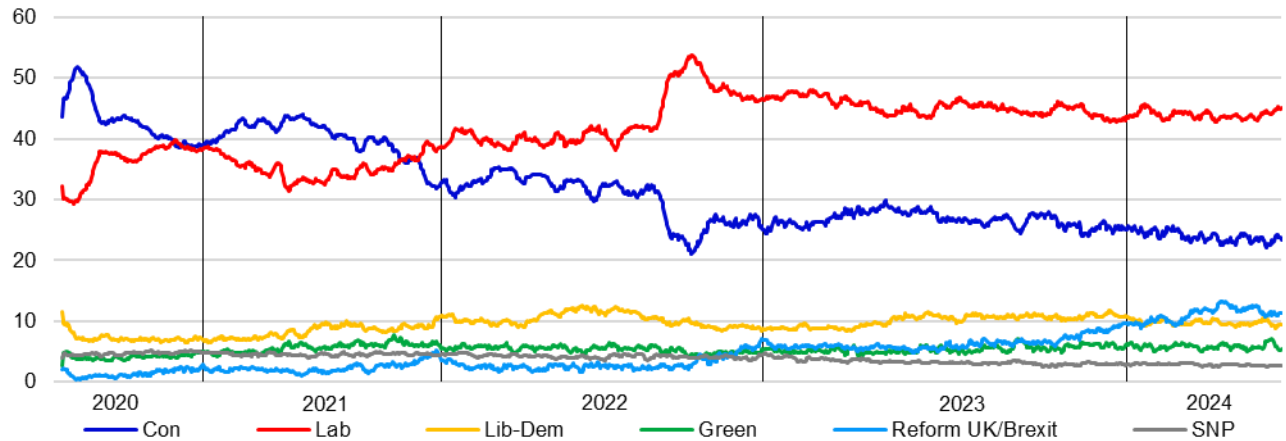
So, why is Labour so popular? It isn't to do with the popularity of its leader. Sir Keir Starmer has a negative net satisfaction rating of similar size to that of Ed Miliband in 2015. Rather, it seems to have more to do with dissatisfaction with the Conservative party after 14 years in government. The latest Ipsos survey (early May 2024) gave Rishi Sunak a net satisfaction rating of -55 versus -18 for Keir Starmer. With that degree of dissatisfaction with the incumbent, the election appears to be Labour's to lose. However, once in power, those negative net satisfaction ratings suggest Keir Starmer may have limited room for error.

What should we expect from Labour? The Labour manifesto has not yet been published but we have some pointers. Above all, their election messaging appears to be focused upon "change" (of government) and "stability" (as opposed to recent "chaos"). Importantly, Keir Starmer and his Shadow Chancellor of the Exchequer (Rachel Reeves) have been careful to stress fiscal responsibility, so we shouldn't expect big tax cuts or increases in spending.

Indeed, Labour appears to be sticking to the government's fiscal rule, that government debt should be falling (as a share of GDP) between the fourth and fifth years of the budget forecast. Given the current state of government finances, that is a real challenge. Either taxes go up (but tax revenues are already the highest since 1949, as a share of GDP), current spending falls (for which neither party has much appetite) or public investment falls.

The latter seems to be the favoured option for both parties, but Labour's plans are less draconian. According to the Institute for Fiscal Studies (see *Public investment: what you need to know,* April 2024), current government plans suggest public sector net investment (PSNI) will fall from 2.5% of GDP in 2023/24 to 1.5% by 2029/30 (investment spending will be frozen in cash terms beyond 2024-25). Labour

Figure 1 – UK opinion polls since the December 2019 election (10-poll moving average, %)



Note: Based on opinion polls from 10 January 2020 to 25 May 2024 (the first data point shows the result of the last general election on 12 December 2019). The uneven spread of calendar years is due to the different number of opinion polls in each year. "Reform UK/Brexit" shows the opinion poll results for the Brexit Party until it was superseded by Reform UK. Source: BBC and Invesco Global Market Strategy Office

plans an additional £23.7bn of investment spending over the next parliament, which the IFS suggests will bring the PSNI-to-GDP ratio down to 1.7% in 2029/30.

Other changes in fiscal policy are likely to be marginal (in my opinion), with possibilities including the imposition of VAT on private school fees, potentially raising £1.6bn per year, according to the IFS, and earmarked for the funding of more public sector teachers. The plan to scrap the "non-dom" status (whereby UK residents could avoid paying UK taxes on income earned overseas) was effectively "stolen" by the Conservative government (to fund tax cuts, rather than Labour's plan to spend more on the NHS), though Labour proposes a further tightening of the rules that they estimate could raise an extra £2.6bn during the next parliament. There is also the usual plan to reduce tax avoidance (planned to raise £5.1bn per year by the end of the next parliament), with funds earmarked for the NHS and primary school breakfast clubs.

Labour market reforms seem likely to include the outlawing of zero-hours contracts, ending "fire and rehire" and facilitating union representation in all workplaces. This may raise costs and reduce employment in some parts of the service sector. Among other regulatory changes planned by Labour is a promise to bulldoze planning regulations, thus enabling the building of 1.5 million new homes during the five years of the next parliament (just below the 1.66m homes completed in the 10 years to 2019-20).

In the realms of investment and industrial policy, Labour's Green Prosperity Plan includes: "A proper windfall tax on oil and gas companies", the creation of Great British Energy (a publicly owned company to invest in clean energy) and a National Wealth Fund (with £7.3bn of public capital, aiming to crowd-in three times that amount of private capital into priority net-zero sectors). There are also ambitions to help small businesses to "Start-Up, Scale-Up", including a transformation of the British Business Bank and an improvement of the links between UK institutional investors and venture capital funds.

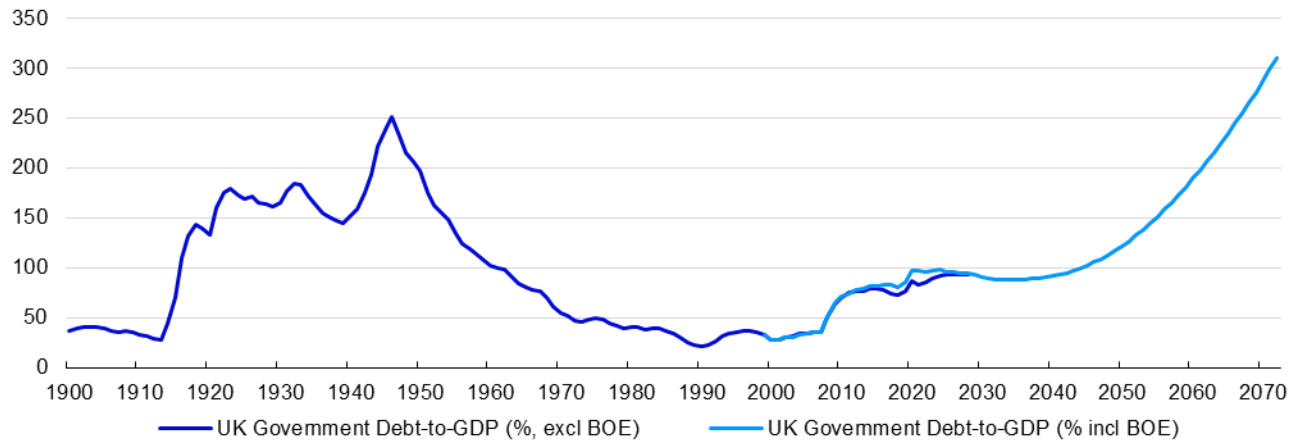
As much as anything else, UK businesses appear to want stability and consistency, especially after the uncertainties brought by Brexit and important reversals of policy in recent years (scaling back HS2 and retreating on green ambitions, for example). Labour is saying the right things, in particular about building a more constructive relationship with the EU.

In summary, I think Labour's proposals may penalise the oil & gas sector and businesses that rely on loose labour laws (the gig economy, say). The benefits seem likely to go to those enabling the greening of the economy, housebuilders and those struggling to trade with the EU. But none of this is news.

I think the macro impact will be small, though a change of government after 14 years may bring some optimism (as in 1997). Perhaps the biggest service the incoming government could provide would be to be honest about the state of government finances. **Figure 2** shows the forecast from the Office for Budget Responsibility, which suggests that debt/GDP could rise from close to 100% to around 300% by 2070. Either productivity needs to be fostered (to boost growth) or taxes need to rise and/or the government needs to provide far fewer services (or consider default in some way). The true fiscal constraints are stifling (and not just in the UK).

Unless stated otherwise, all data as of 24 May 2024

Figure 2 – The long term fiscal challenge is daunting no matter who wins (OBR baseline forecast)



Annual data for fiscal years from 1900-01 (labelled as 1900) to 2072-73. All data is provided by the UK's Office for Budget Responsibility (using the baseline forecast). Data including the BOE (Bank of England) is from 1999-00 to 2072-73 and prior to 2029-30 is taken from Economic and fiscal outlook (March 2024), while data from 2029/30 is taken from Fiscal risks and sustainability (July 2023). Data excluding the BOE is from 1900-01 to 2028-29 and prior to 1999 is taken from Fiscal risks and sustainability (July 2023), while data from 1999 is taken from OBR economic and fiscal outlook (March 2004). Source: UK Office for Budget Responsibility and Invesco Global Market Strategy Office

Figure 3 – Asset class total returns (%)

Data as at 24/05/2024		Current	Total Return (USD, %)					Total Return (Local Currency, %)				
	Index	Level/RY	1w	1m	QTD	YTD	12m	1w	1m	QTD	YTD	12m
Equities												
World	MSCI	792	-0.4	4.5	1.5	9.9	25.4	-0.2	4.3	1.6	11.4	26.3
Emerging Markets	MSCI	1083	-1.5	5.0	4.3	6.8	15.0	-1.2	4.4	4.6	9.4	17.2
China	MSCI	61	-4.8	8.0	12.6	10.1	2.9	-4.6	7.8	12.4	10.5	3.2
US	MSCI	5052	0.0	4.7	1.1	11.6	31.3	0.0	4.7	1.1	11.6	31.3
Europe	MSCI	2154	-0.6	5.4	3.5	9.0	18.2	-0.4	3.8	3.2	11.9	17.0
Europe ex-UK	MSCI	2678	-0.5	5.1	2.7	8.9	18.6	-0.2	3.8	2.6	12.6	18.0
UK	MSCI	1263	-0.9	6.4	6.2	9.5	16.9	-1.2	3.9	5.3	9.6	13.5
Japan	MSCI	3893	-1.0	0.2	-4.3	6.3	16.6	0.0	1.5	-0.8	18.4	31.7
Government Bonds												
World	BofA-ML	3.55	-0.6	1.0	-1.9	-4.8	-1.9	-0.4	0.6	-1.3	-2.1	0.2
Emerging Markets	BBloom	7.81	-1.1	2.1	-0.6	1.8	16.2	-1.1	2.1	-0.6	1.8	16.2
China	BofA-ML	2.14	-0.2	-0.2	0.6	0.8	3.0	0.1	-0.2	0.8	3.0	6.0
US (10y)	Datastream	4.47	-0.3	1.7	-1.4	-3.1	-2.1	-0.3	1.7	-1.4	-3.1	-2.1
Europe	Bofa-ML	3.18	-0.7	2.0	-0.7	-3.6	4.5	-0.4	0.5	-1.1	-1.8	3.7
Europe ex-UK (EMU, 10y)	Datastream	2.57	-0.8	1.7	-1.5	-5.2	2.4	-0.5	0.2	-1.9	-3.4	1.6
UK (10y)	Datastream	4.26	-0.6	3.4	-1.1	-3.6	7.9	-0.9	0.9	-1.9	-3.6	4.7
Japan (10y)	Datastream	1.00	-1.5	-2.3	-5.8	-12.7	-15.1	-0.5	-1.0	-2.3	-2.7	-4.1
IG Corporate Bonds												
Global	BofA-ML	5.12	-0.3	1.8	-0.4	-1.1	6.0	-0.2	1.3	-0.5	-0.4	5.8
Emerging Markets	BBloom	6.82	0.1	2.8	0.7	4.2	13.1	0.1	2.8	0.7	4.2	13.1
China	BofA-ML	2.87	-0.2	-0.1	0.4	0.0	1.5	0.0	-0.1	0.6	2.2	4.5
US	BofA-ML	5.60	-0.2	1.8	-0.5	-0.6	5.5	-0.2	1.8	-0.5	-0.6	5.5
Europe	BofA-ML	3.98	-0.5	1.8	-0.1	-1.9	7.0	-0.2	0.3	-0.5	-0.1	6.2
UK	BofA-ML	5.67	-0.5	3.7	-0.1	-0.8	12.1	-0.8	1.2	-0.9	-0.8	8.8
Japan	BofA-ML	1.08	-1.1	-1.5	-4.3	-10.8	-12.0	-0.1	-0.3	-0.7	-0.6	-0.6
HY Corporate Bonds												
Global	BofA-ML	7.90	-0.1	1.7	0.6	2.1	12.3	-0.1	1.3	0.5	2.5	12.0
US	BofA-ML	8.09	-0.2	1.2	0.2	1.7	11.5	-0.2	1.2	0.2	1.7	11.5
Europe	BofA-ML	6.60	-0.2	2.3	1.3	0.7	11.7	0.1	0.8	0.9	2.5	10.9
Cash (Overnight LIBOR)												
US		5.31	0.1	0.4	0.6	2.0	5.4	0.1	0.4	0.6	2.0	5.4
Euro Area		3.90	0.2	0.6	0.2	-1.0	1.8	0.1	0.3	0.4	1.4	3.8
UK		5.20	-0.1	0.4	-0.2	0.2	4.4	0.1	0.4	0.6	1.9	5.2
Japan		0.08	-1.8	-1.6	-2.8	-9.4	-13.7	0.0	0.0	0.0	0.0	0.0
Real Estate (REITs)												
Global	FTSE	1538	-3.4	2.4	-3.2	-4.5	7.8	-3.1	0.9	-3.6	-2.7	7.0
Emerging Markets	FTSE	1246	-3.3	8.4	3.9	-0.4	5.9	-3.0	6.8	3.5	1.4	5.1
US	FTSE	2876	-3.5	1.7	-4.5	-5.0	9.9	-3.5	1.7	-4.5	-5.0	9.9
Europe ex-UK	FTSE	2428	-2.8	8.4	3.0	-2.7	30.0	-2.5	6.8	2.6	-0.9	29.0
UK	FTSE	839	-1.8	7.8	1.7	-1.6	12.0	-2.1	5.3	0.9	-1.5	8.7
Japan	FTSE	2062	-4.4	-6.6	-9.9	-3.8	2.3	-3.5	-5.4	-6.5	7.1	15.5
Commodities												
All	GSCI	3715	-0.9	-1.5	0.6	11.0	15.1	-	-	-	-	-
Energy	GSCI	646	-2.3	-4.3	-3.7	11.5	17.2	-	-	-	-	-
Industrial Metals	GSCI	1865	-1.2	4.6	16.2	16.5	24.1	-	-	-	-	-
Precious Metals	GSCI	2643	-3.2	1.2	6.6	14.1	19.3	-	-	-	-	-
Agricultural Goods	GSCI	540	4.6	2.8	4.3	5.2	1.2	-	-	-	-	-
Currencies (vs USD)*												
EUR		1.08	-0.2	1.4	0.5	-1.7	0.9	-	-	-	-	-
JPY		157.00	-0.8	-1.0	-3.6	-10.1	-11.2	-	-	-	-	-
GBP		1.27	0.3	2.5	0.8	-0.1	3.0	-	-	-	-	-
CHF		1.09	-0.6	0.0	-1.4	-8.0	-1.1	-	-	-	-	-
CNY		7.24	-0.3	0.0	-0.3	-2.0	-2.5	-	-	-	-	-

Notes: **Past performance is no guarantee of future results.** *The currency section is organised so that in all cases the numbers show the movement in the mentioned currency versus USD (+ve indicates appreciation, -ve indicates depreciation). Please see appendix for definitions, methodology and disclaimers.
Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 4 – Global equity sector total returns relative to market (%)

Data as at 24/05/2024	Global				
	1w	1m	QTD	YTD	12m
Energy	**-0.4**	**-4.6**	**-1.6**	**-4.1**	**-8.4**
Basic Materials	**-0.9**	**0.2**	**3.0**	**-3.4**	**-4.5**
Basic Resources	-1.2	2.3	7.1	-0.9	1.9
Chemicals	-0.4	-2.8	-2.6	-7.1	-12.9
Industrials	**0.1**	**-0.8**	**-1.1**	**-0.4**	**1.0**
Construction & Materials	1.2	1.1	-0.4	1.2	8.1
Industrial Goods & Services	-0.1	-1.1	-1.2	-0.7	0.0
Consumer Discretionary	**-1.2**	**-2.6**	**-3.9**	**-3.5**	**-3.7**
Automobiles & Parts	-0.4	-3.7	-5.6	-11.1	-7.6
Media	1.1	0.3	-1.4	6.4	7.3
Retailers	-1.5	-1.3	-2.3	2.9	6.5
Travel & Leisure	-1.6	-4.8	-5.0	-7.6	-11.2
Consumer Products & Services	-2.0	-3.4	-5.1	-6.8	-11.9
Consumer Staples	**-1.3**	**-2.2**	**-1.1**	**-6.5**	**-17.5**
Food, Beverage & Tobacco	-1.6	-2.5	-0.7	-6.9	-18.9
Personal Care, Drug & Grocery Stores	-0.8	-1.7	-1.8	-5.8	-14.9
Healthcare	**-0.7**	**-0.9**	**-2.3**	**-2.4**	**-9.5**
Financials	**-0.6**	**-0.3**	**0.5**	**1.5**	**5.2**
Banks	-0.7	-0.6	1.6	2.1	5.4
Financial Services	-0.3	0.0	-0.4	-0.2	5.9
Insurance	-0.9	0.1	-0.4	3.2	3.4
Real Estate	**-2.6**	**-1.4**	**-3.9**	**-11.1**	**-12.3**
Technology	**2.6**	**5.1**	**4.1**	**9.3**	**18.4**
Telecommunications	**-1.1**	**-2.3**	**-3.2**	**-8.0**	**-11.9**
Utilities	**-0.6**	**1.9**	**6.3**	**0.8**	**-5.8**

Notes: **Past performance is no guarantee of future results.** Returns shown are for Datastream sector indices versus the total market index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 5a – US factor index total returns (%)

Data as at 24/05/2024	Absolute					Relative to Market				
	1w	1m	QTD	YTD	12m	1w	1m	QTD	YTD	12m
Growth	-0.5	2.5	-2.9	9.6	31.6	-0.6	-2.2	-4.1	-2.0	0.5
Low volatility	-1.4	0.8	-1.7	7.6	13.3	-1.4	-3.7	-2.8	-3.8	-13.4
Price momentum	0.5	4.0	-0.5	12.0	28.9	0.5	-0.7	-1.7	0.1	-1.5
Quality	-1.2	0.3	-4.4	5.6	21.9	-1.3	-4.3	-5.5	-5.6	-6.9
Size	-2.0	0.5	-4.6	0.6	19.2	-2.1	-4.1	-5.7	-10.1	-8.9
Value	-2.4	1.0	-1.3	6.2	27.4	-2.5	-3.5	-2.4	-5.0	-2.7
Market	0.0	4.7	1.2	11.8	30.9					
Market - Equal-Weighted	-1.2	2.0	-2.0	5.7	20.9					

Notes: **Past performance is no guarantee of future results.** All indices are subsets of the S&P 500 index, they are rebalanced monthly, use data in US dollars and are equal-weighted. Growth includes stocks in the top third based on both their 5-year sales per share trend and their internal growth rate (the product of the 5-year average return on equity and the retention ratio); Low volatility includes stocks in the bottom quintile based on the standard deviation of their daily returns in the previous three months; Price momentum includes stocks in the top quintile based on their performance in the previous 12 months; Quality includes stocks in the top third based on both their return on invested capital and their EBIT to EV ratio (earnings before interest and taxes to enterprise value); Size includes stocks in the bottom quintile based on their market value in US dollars. Value includes stocks in the bottom quintile based on their price to book value ratios. The market represents the S&P 500 index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 5b – European factor index total returns relative to market (%)

Data as at 24/05/2024	Absolute					Relative to Market				
	1w	1m	QTD	YTD	12m	1w	1m	QTD	YTD	12m
Growth	0.3	6.0	5.7	6.8	17.3	0.6	2.0	2.6	-3.9	-0.2
Low volatility	-0.6	4.1	3.6	9.4	10.9	-0.3	0.2	0.6	-1.5	-5.7
Price momentum	0.9	6.7	5.2	16.2	26.9	1.1	2.7	2.1	4.6	7.9
Quality	0.7	6.0	6.6	12.4	24.3	1.0	2.0	3.5	1.2	5.7
Size	-0.1	6.6	4.6	8.3	16.5	0.1	2.5	1.5	-2.5	-0.9
Value	-1.4	5.9	6.5	10.3	23.7	-1.1	1.9	3.4	-0.7	5.2
Market	-0.3	4.0	3.0	11.1	17.6					
Market - Equal-Weighted	-0.3	5.2	3.8	8.9	17.1					

Notes: **Past performance is no guarantee of future results.** All indices are subsets of the STOXX 600 index, they are rebalanced monthly, use data in euros and are equal-weighted. Growth includes stocks in the top third based on both their 5-year sales per share trend and their internal growth rate (the product of the 5-year average return on equity and the retention ratio); Low volatility includes stocks in the bottom quintile based on the standard deviation of their daily returns in the previous three months; Price momentum includes stocks in the top quintile based on their performance in the previous 12 months; Quality includes stocks in the top third based on both their return on invested capital and their EBIT to EV ratio (earnings before interest and taxes to enterprise value); Size includes stocks in the bottom quintile based on their market value in euros; Value includes stocks in the bottom quintile based on their price to book value ratios. The market represents the STOXX 600 index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 6 – Model asset allocation

	Neutral	Policy Range	Allocation		Position vs Neutral	Hedged	Currency
Cash Equivalents	**5%**	**0-10%**	↑	**6%**			
Cash	2.5%		↑	6%			
Gold	2.5%			0%			
Bonds	**40%**	**10-70%**	↓	**41%**			
Government	25%	10-40%		22%			
US	8%			13%		25%	JPY
Europe ex-UK (Eurozone)	7%			2%			
UK	1%			1%			
Japan	7%			2%			
Emerging Markets	2%			4%			
China**	0.2%			0%			
Corporate IG	10%	0-20%	↓	16%			
US Dollar	5%		↓	8%		50%	JPY
Euro	2%		↓	3%			
Sterling	1%			2%			
Japanese Yen	1%		↓	0%			
Emerging Markets	1%			3%			
China**	0.1%			0%			
Corporate HY	5%	0-10%	↓	3%			
US Dollar	4%		↓	2%			
Euro	1%		↓	1%			
Bank Loans	**4%**	**0-10%**	↑	**8%**			
US	3%		↑	6%			
Europe	1%			2%			
Equities	**45%**	**25-65%**	↓	**35%**			
US	25%		↓	10%			
Europe ex-UK	7%		↑	12%			
UK	4%		↓	4%			
Japan	4%		↓	1%			
Emerging Markets	5%			8%			
China**	2%			4%			
Real Estate	**4%**	**0-16%**		**6%**			
US	1%			2%			
Europe ex-UK	1%			1%			
UK	1%		↓	1%			
Japan	1%			1%			
Emerging Markets	1%		↑	1%			
Commodities	**2%**	**0-4%**	↑	**4%**			
Energy	1%		↑	1%			
Industrial Metals	0.3%		↑	2%			
Precious Metals	0.3%			0%			
Agriculture	0.3%		↑	1%			
Total	**100%**			**100%**			

Currency Exposure (including effect of hedging)				
USD	52%	↓	39%	
EUR	19%	↑	23%	
GBP	7%		10%	
JPY	13%	↑	13%	
EM	9%	↑	16%	
Total	**100%**		**100%**	

Notes: **China is included in Emerging Markets allocations. This is a theoretical portfolio and is for illustrative purposes only. See the latest The Big Picture document for more details. It does not represent an actual portfolio and is not a recommendation of any investment or trading strategy. Arrows indicate the direction of the most recent changes.
Source: Invesco Global Market Strategy Office

Figure 7 – Model allocations for global sectors

	Neutral	Invesco	Preferred Region
Energy	**7.0%**	**Neutral**	**EM**
Basic Materials	**3.9%**	**Neutral**	**Japan**
Basic Resources	2.3%	Neutral ↑	Japan
Chemicals	1.6%	Neutral	US
Industrials	**13.2%**	**Overweight**	**US**
Construction & Materials	1.8%	Underweight	US
Industrial Goods & Services	11.5%	Overweight	US
Consumer Discretionary	**14.5%**	**Neutral**	**US**
Automobiles & Parts	2.5%	Underweight	Europe
Media	1.1%	Neutral ↓	Japan
Retailers	5.2%	Overweight ↑	US
Travel & Leisure	2.0%	Underweight	EM
Consumer Products & Services	3.7%	Neutral	Japan
Consumer Staples	**5.4%**	**Overweight**	**US**
Food, Beverage & Tobacco	3.5%	Overweight	US
Personal Care, Drug & Grocery Stores	1.9%	Overweight	Europe
Healthcare	**9.3%**	**Overweight**	**US**
Financials	**15.6%**	**Overweight ↑**	**US**
Banks	7.4%	Overweight	Europe
Financial Services	5.2%	Overweight ↑	US
Insurance	3.0%	Underweight ↓	US
Real Estate	**2.7%**	**Neutral ↓**	**Japan**
Technology	**21.9%**	**Neutral**	**EM**
Telecommunications	**3.4%**	**Underweight**	**US**
Utilities	**3.2%**	**Underweight**	**US**

Notes: These are theoretical allocations which are for illustrative purposes only. They do not represent an actual portfolio and are not a recommendation of any investment or trading strategy. See the latest Strategic Sector Selector for more details.
Source: LSEG Datastream and Invesco Global Market Strategy Office

Appendix

Methodology for asset allocation, expected returns and optimal portfolios

Portfolio construction process

The optimal portfolios are theoretical and not real. We use optimisation processes to guide our allocations around "neutral" and within prescribed policy ranges based on our estimations of expected returns and using historical covariance information. This guides the allocation to global asset groups (equities, government bonds etc.), which is the most important level of decision. For the purposes of this document the optimal portfolios are constructed with a one-year horizon.

Which asset classes?

We look for investibility, size and liquidity. We have chosen to include equities, bonds (government, corporate investment grade and corporate high yield), bank loans, REITs to represent real estate, commodities and cash (all across a range of geographies). We use cross-asset correlations to determine which decisions are the most important.

Neutral allocations and policy ranges

We use market capitalisation in USD for major benchmark indices to calculate neutral allocations. For commodities, we use industry estimates for total ETP market cap + assets under management in hedge funds + direct investments. We use an arbitrary 5% for the combination of cash and gold. We impose diversification by using policy ranges for each asset category (the range is usually symmetric around neutral).

Expected/projected returns

The process for estimating expected returns is based upon yield (except commodities, of course). After analysing how yields vary with the economic cycle, and where they are situated within historical ranges, we forecast the direction and amplitude of moves over the next year. Cash returns are calculated assuming a straight-line move in short term rates towards our targets (with, of course, no capital gain or loss). Bond returns assume a straight-line progression in yields, with capital gains/losses predicated upon constant maturity (effectively supposing constant turnover to achieve that). Forecasts of corporate investment-grade, high-yield and bank loan spreads are based upon our view of the economic cycle (as are forecasts of credit losses). Coupon/interest payments are added to give total returns. Equity and REIT returns are based on dividend growth assumptions. We calculate total returns by applying those growth assumptions and adding the forecast dividend yield. No such metrics exist for commodities; therefore, we base our projections on US CPI-adjusted real prices relative to their long-term averages and views on the economic cycle. All expected returns are calculated in local currency and then, where necessary, converted into other currency bases using our exchange rate forecasts.

Optimising the portfolio

Using a covariance matrix based on monthly local currency total returns for the last 5 years and we run an optimisation process that maximises the Sharpe Ratio. Another version maximises Return subject to volatility not exceeding that of our Neutral Portfolio. The optimiser is based on the Markowitz model.

Currency hedging

We adopt a cautious approach when it comes to currency hedging as currency movements are notoriously difficult to accurately predict and sometimes hedging can be costly. Also, some of our asset allocation choices are based on currency forecasts. We use an amalgam of central bank rate forecasts, policy expectations and real exchange rates relative to their historical averages to predict the direction and amplitude of currency moves.

Definitions of data and benchmarks for Figure 3

Sources: we source data from LSEG Datastream unless otherwise indicated.

Cash: returns are based on a proprietary index calculated using the Intercontinental Exchange Benchmark Administration overnight LIBOR (London Interbank Offer Rate). From 1st January 2022, we use the Refinitiv overnight deposit rate for the euro, the British pound and the Japanese yen. The global rate is the average of the euro, British pound, US dollar and Japanese yen rates. The series started on 1 January 2001 with a value of 100.

Gold: London bullion market spot price in USD/troy ounce.

Government bonds: Current levels, yields and total returns use Datastream benchmark 10-year yields for the US, Eurozone, Japan and the UK, and the ICE BofA government bond total return index for the World and Europe. The emerging markets yields and returns are based on the Barclays Bloomberg emerging markets sovereign US dollar bond index.

Corporate investment grade (IG) bonds: ICE BofA investment grade corporate bond total return indices, except for in emerging markets where we use the Barclays Bloomberg emerging markets corporate US dollar bond index.

Corporate high yield (HY) bonds: ICE BofA high yield total return indices

Equities: We use MSCI benchmark gross total return indices for all regions.

Commodities: Goldman Sachs Commodity total return indices

Real estate: FTSE EPRA/NAREIT total return indices

Currencies: Global Trade Information Services spot rates

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