



FINURA

MARKET COMMENTARY
AUGUST 2018

MULTI-ASSET INVESTMENT VIEWS - AUGUST 2018

KEY

▲ Up from last month ▼ Down from last month

● Positive

● Postive/
Neutral

● Neutral

● Neutral/
Negative

● Negative

	Category	View	Comments
Main Asset Classes	Equities	●	Equities are still vulnerable to rising yields and changing sentiment in the near-term despite strong earnings momentum.
	Government Bonds	●	Whilst the rise in yields leaves government bonds looking attractive relative to recent history, we believe a further rise is required to catch up with the improved backdrop.
	Commodities	● ▼	Although price momentum remains positive, it has deteriorated in recent weeks and carry is now flat. We have downgraded commodities back to a single positive.
	Credit	●	Spreads have tightened recently across regions and credit quality tiers, and leverage is rising, making credit unattractive.
Equities	US	●	Strong earnings results continue to provide support for equities. In addition, US equities also appear to be boosted by a reacceleration of share buybacks.
	Europe	●	We continue to be cautious about eurozone equities, taking into account global trade tensions and tightening financial conditions.
	UK	●	Political division around Brexit and higher risks of a no-deal scenario detract from UK equities' appeal.
	Japan	●	Valuations are attractive, but weakness in macroeconomic data and cyclical indicators point to a slowdown, which keep us neutral.
	Pacific ex-Japan	●	Attractive valuations are offset by momentum indicators for China and Singapore having declined sharply in past couple of months.
	Emerging Markets	●	We are comfortable that economic fundamentals are still intact and that we are over the worst of the sharp losses suffered in recent months.
	Government Bonds	US	●
UK	●	Valuations remain expensive, but uncertainties around Brexit may delay further rate hikes by the Bank of England.	
Germany	●	While weaker growth has been priced, inflation risks have not. The European Central Bank remains reluctant to hike too early, but isn't as dovish as the market wants to believe.	
Japan	●	The Bank of Japan's recent changes to QE will allow it to maintain easy monetary policy for longer. So, whilst the direction of travel is clear, the pace appears slow.	
US Inflation Linked	●	We remain positive on US inflation. While seasonal effects will turn negative, our latest research suggests that stagflationary fears will trump this technical factor.	
Emerging Markets Local	●	We remain neutral as cyclical headwinds prevent us from taking advantage of the improvement in local market valuations.	



	Category	View	Comments
Investment Grade Corporate Bonds	US	●	Both merger and acquisitions (M&A) activity and leverage continue to increase. We remain negative.
	Europe	●	European corporates are in a stronger position, though the recent pickup in M&A and shareholder activism is potentially indicative of a maturing cycle in the region.
	Emerging Markets USD	●	We believe that the regional mix and positive earnings growth marginally favours EM corporates over sovereigns.
High Yield Bonds	US	●	The best performing market year-to-date. From a valuation perspective, we believe it is expensive and vulnerable, with technicals in particular unlikely to be as favourable in H2.
	Europe	●	Political instability in the region continues to linger and is likely to cap spread tightening, hence we retain our negative view.
Commodities	Energy	●	Price momentum has deteriorated but oil prices should still be supported by robust global demand and the potential for political tensions in the Middle East.
	Gold	●	We remain neutral on gold. The relationship between gold and interest rates has now normalised but a stronger USD is a threat to the gold price.
	Industrial Metals	●	Industrial metals have fallen sharply in recent weeks. We believe this is overdone given that the cyclical environment remains attractive. We remain positive.
	Agriculture	●	The recent correction relates to trade war concerns rather than fundamentals, so we remain positive.
Currencies	US \$	●	The dollar continues to push higher, fuelled by economic outperformance vs. the rest of the world, even as it has reached expensive levels.
	UK £	●	More reasonable economic fundamentals and a more assertive Bank of England are being ignored as "hard Brexit" risks are building.
	EU €	●	We have been disappointed by continued weakness in European fundamentals, compounded by a resurgence in Italian political risk.
	JAP ¥	●	Weaker signs of synchronised global deflation makes us more positive on the yen, but we await more concrete signs of the Bank of Japan relaxing Yield Curve Control.
	Swiss F	●	The Swiss franc is benefiting from greater European political uncertainty, but should be offset by the Swiss National Bank's continued dovishness.



Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested.

Source: Schroders, August 2018. The views for equities, government bonds and commodities are based on return relative to cash in local currency. The views for corporate bonds and high yield are based on credit spreads (i.e. duration-hedged). The views for currencies are relative to US dollar, apart from US dollar which is relative to a trade-weighted basket.

MONTHLY MARKETS REVIEW

AUGUST 2018

A review of markets in August when US equities advanced but other regions lost ground against a backdrop of trade tensions and a currency crisis in Turkey.

HIGHLIGHTS

- Global equities, as measured by the MSCI World index, gained in August but there were significant regional differences amid persistent US-China trade tensions and Turkey's currency crisis.
- US equities gained ground and significantly outperformed other major regions, as economic growth remained extremely robust.
- Eurozone equities declined. Banks were under pressure amid concerns over exposure to emerging markets as well as uncertainty over whether Italy's 2019 budget proposal will comply with EU fiscal rules.
- The UK's FTSE All-Share fell over the period. The Bank of England (BoE) announced a further 0.25% increase in base rates to 0.75%.
- Japanese equities saw negative returns with trade tensions continuing to dominate the global headlines.
- Emerging market equities lost value amid a currency crisis in Turkey and further escalation in US-China trade relations. Countries exposed to global liquidity tightening experienced currency weakness, notably South Africa.
- In bond markets, the wider risk aversion caused the US 10-year yield to drop from 2.96% to 2.86%. 10-year Bund and gilt yields also fell while Italian yields rose.

THE US

In a month that saw geopolitical developments weigh on share prices in most major regions, US equities rose in August. The S&P 500 returned 3.3%. Escalating US-China trade sanctions, the currency crisis in Turkey, a reinstatement of US-Iran sanctions as well as ongoing Brexit negotiations hurt sentiment in most major equity markets. However, the resilience of the US economy continues to encourage participation on Wall Street.

GDP data released in late July showed that US economic growth accelerated to 4.2% on an annualised quarterly basis in Q2, its fastest pace in nearly four years. Strong household spending was the key driver of the pick-up in growth, supported by the US administration's drive to lower taxes and increase spending. A surge in the volume of exports from the US ahead of the scheduled implementation of new tariffs also helped.

The S&P 500 stock market index also retained momentum from July's slew of strong corporate earnings results. The index's current bull run – broadly defined as a rise over time without falling more than 20% from its peak during the period – became the longest in history on 21 August.

Over the month, the consumer discretionary and technology sectors were among the strongest performers, buoyed by robust gains in Amazon and Apple (the latter becoming the first company to surpass a \$1 trillion market cap on 2 August). The energy sector was weaker, with US oil companies hurt by uncertainty surrounding China's inclusion of US crude oil in its tariff-targeted products.

EUROZONE

Eurozone equities registered declines in August with the MSCI EMU index returning -2.7%. Financials, notably banks, underperformed. In particular, lenders with exposure to Turkey came under pressure as the Turkish lira fell sharply and bond yields rose. Meanwhile, the Italian banks were also impacted by rising domestic bond yields amid worries that the new Italian government's 2019 budget may come close to breaching EU fiscal rules. The budget is due to be finalised in September and presented to the EU in October.

Elsewhere, automobile stocks fell in August amid ongoing trade worries. German tyre maker Continental reduced full-year forecasts for sales and profit margins, citing slower sales as well as higher costs and warranty claims. The information technology and real estate sectors delivered positive returns.

On the economic front, growth for the second quarter of 2018 was revised up to 0.4% quarter-on-quarter, compared to the initial estimate of 0.3%. The forward-looking composite purchasing managers' index^[1] pointed to steady expansion with a reading of 54.4 in August versus 54.3 in July. The German Ifo business climate index^[2] improved to 103.8 in August from 101.7 in July while expectations also saw an upward move.

Outside the eurozone, Norway's central bank kept rates on hold at 0.5% but restated that the first increase in seven years will be forthcoming at September's meeting.

UK

The FTSE All-Share fell against the backdrop of increased risk aversion in global markets as US-China trade relations

deteriorated and fears rose over the stability of emerging markets (EM). Sterling fell amid ongoing uncertainty around Brexit and following further strength in the US dollar. The decision by the Bank of England (BoE) to increase base rates failed to have a stabilising effect on the currency as the bank stressed that the path of future tightening was likely to be gradual.


The BoE judged the slowdown in the UK economy in Q1 as temporary and weather related, a prognosis vindicated shortly after by preliminary GDP data from the Office for National Statistics, which revealed growth had bounced back to 0.4% in Q2. However, the bank left its growth projection for 2018 unchanged at 1.4%. Meanwhile, a [build up of inventories](#) in the economy raised some questions around the sustainability of the rebound in Q2.

EM-exposed areas of the market performed poorly, including Asian financials and the mining sector, with the latter negatively impacted by disappointing Chinese macro-economic data. Meanwhile, the tobacco sector also performed very poorly, giving back all of the gains it achieved in July. Merger and acquisition activity was a rare bright spot in the month after Whitbread recommended an offer from Coca-Cola of the US for its Costa coffee chain for an enterprise value of £3.9 billion.

JAPAN

The Japanese stock market was weak in the first half of August before a partial recovery, resulting in a return of -1.0% for the month as a whole. Despite ongoing global uncertainty, the yen moved in a relatively narrow range against the US dollar. The reversal in market direction produced a very mixed sector picture.





The pulp & paper sector was the strongest performer as product prices remain at relatively high levels, while the construction sector moved sharply lower. There was an unusually wide spread between defensive sectors such as foods and pharmaceuticals which have previously tended to move together.

The other notable feature within the market was the sharp underperformance of small caps in August following a similar but less pronounced move in July. The trigger for these moves is not clear and this may be a natural short-term correction after the sustained outperformance by small caps over the past two years. However, the timing of the change, following closely after the Bank of Japan's last policy meeting, suggests that some investors may be making assumptions about the extent and impact of any change in the central bank's policy for ETF purchases.

External factors continue to be the short-term driver of investor sentiment. Although trade related issues dominated headlines throughout August there was almost no substantive news on which to base long-term decisions either for investors or Japanese corporates. Economic data also provided little direction particularly given the need to discount for extreme weather conditions across Japan last month. Meanwhile, after weathering financial scandals earlier this year, Prime Minister Abe now seems to have a reasonably clear path to the LDP leadership election on 20 September.

ASIA (EX JAPAN)

Asia ex Japan equities posted a marginally negative return, with China and Hong Kong among the weakest countries. Previously announced US tariffs on \$16 billion of Chinese goods took effect

during the month and China responded with similar measures. The two sides held fresh talks in August with little progress achieved, increasing the prospect of further sanctions. Chinese economic data was weak, notably fixed asset investment growth. Singapore also underperformed, with consumer discretionary stocks among the weakest names.

By contrast, the ASEAN³ markets of the Philippines and Thailand posted positive returns and outperformed. In the Philippines the central bank hiked its key policy rate by 50bps to 4% as inflation ticked up to 6.4%. Meanwhile Thailand, together with large index markets Taiwan and South Korea, outperformed peers given strong current account surpluses and foreign-exchange reserves.

EMERGING MARKETS

Emerging markets (EM) equities registered a negative return with US dollar strength a headwind, despite some moderation later in the month. A [currency crisis in Turkey](#) contributed to risk aversion amid concern over contagion to other EM. Uncertainty over US-China trade relations also weighed on sentiment. The MSCI Emerging Markets index decreased in value and underperformed the MSCI World.

Turkey was the weakest index market amid a sharp depreciation in the lira. The currency fell as geopolitical tensions with the US exacerbated ongoing concerns over its wide current account deficit, above-target inflation and central bank independence. Those EM exposed to global liquidity tightening experienced currency weakness, notably South Africa which lagged the index by a wide margin.

Latin American equities underperformed with currency weakness

a headwind, particularly in Brazil where domestic political uncertainty weighed on the real. China trailed the index as the US moved closer to imposing more significant tariffs on Chinese goods and domestic macroeconomic data disappointed.

By contrast, Thailand and Korea posted positive returns and outperformed. Both markets held up better than peers given strong current account surpluses and foreign exchange reserves.

GLOBAL BONDS

A degree of risk aversion returned to bond markets in August amid ongoing trade tensions, political uncertainty and idiosyncratic events, which saw a precipitous fall in emerging markets. Economic data remained strong, especially from the US.

US 10-year yields retraced to end-June levels, dropping from 2.96% to 2.86%, with the yield curve flattening as two-year yields dropped from 2.67% to 2.63%. In Europe, 10-year Bund yields dropped from 0.44% to 0.33%, while Italian 10-year yields rose from 2.72% to 3.23% and Spain's ticked seven basis points higher to 1.47%.

UK gilt yields were slightly lower on the month. This was despite a well telegraphed rate hike by the Bank of England, as Governor Mark Carney suggested that the economy required only a "modest" pace of rate hikes. UK assets also continued to be driven by Brexit related risks, with rhetoric suggesting the increasing possibility of a "no deal".

Global investment grade^[4] (IG) corporate bonds produced positive total returns, led by US dollar and sterling; euro IG

underperformed. Services and other financials made good returns, while automotive and transport, more sensitive to trade tensions, were lacklustre. Higher-rated credit outperformed.

Global high yield (HY) corporate bonds saw a small negative return, reflecting weakness from the euro-denominated market. In the US dollar market, HY outperformed IG, continuing its strong run of performance, and sterling HY was in-line with IG. Services, media and healthcare did relatively well across markets. Euro subordinated insurance and retail were notably weak.

Emerging market bonds saw renewed weakness, with fears over Turkey and Argentina again to the fore. Local currency returned -6.1%, hard currency and corporate bonds returned -2% and -1% respectively.

Global convertible bonds, as measured by the Thomson Reuters Global Focus Convertible Index, showed a positive return of 0.9%. Convertible bond valuations continued their downward trend with US bonds becoming cheaper in August. Japan and Asia ex Japan remain cheap regions for convertibles.

COMMODITIES

The Bloomberg commodities index posted a negative return in August. The agricultural and energy components both recorded negative returns. Among soft commodities, coffee and soybeans fell on currency weakness in key producer countries and favourable weather. Industrial metals prices moved lower, with the US-China trade dispute weighing on the demand outlook.

The energy component was supported by Brent crude, rising on the prospect of reduced supply from Iran due to US sanctions






initiated during the month. Gold (-1.8%) and silver (-7.2%) both lost value.

¹ The eurozone purchasing managers' index is produced by IHS Markit and based on survey data from around 5,000 companies based in the euro area manufacturing and service sectors. A reading above 50 indicates expansion.

² The Ifo Business Climate is based on around 9,000 monthly survey responses from firms in manufacturing, services, trade and construction.



³ The Association of Southeast Asian Nations (ASEAN) is a regional grouping that promotes economic, political, and security cooperation among its ten members: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

⁴ Investment grade bonds are the highest quality bonds as determined by a credit ratings agency. High yield bonds are more speculative, with a credit rating below investment grade.

Source: [Schroders, August 2018](#): The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested.

TOTAL RETURNS (%) – TO END AUGUST 2018

Equities	1 MONTH			12 MONTHS		
	USD	EUR	GBP	USD	EUR	GBP
MSCI World	1.2	1.8	2.2	13.1	15.6	12.1
MSCI World Value	-0.6	0.0	0.4	7.3	9.6	6.4
MSCI World Growth	3.0	3.6	3.9	18.9	21.5	17.9
MSCI World Smaller Companies	2.2	2.8	3.1	16.2	18.7	15.2
MSCI Emerging Markets	-2.7	-2.2	-1.8	-0.7	1.5	-1.5
MSCI AC Asia ex Japan	-1.0	-0.5	-0.1	2.8	5.0	1.9
S&P500	3.3	3.9	4.2	19.7	22.3	18.6
MSCI EMU	-3.2	-2.7	-2.3	2.0	4.2	1.1
FTSE Europe ex UK	-2.3	-1.8	-1.4	2.3	4.5	1.4
FTSE All-Share	-3.7	-3.1	-2.8	5.6	7.9	4.7
TOPIX*	-0.1	0.5	0.9	8.8	11.1	7.8

Government Bonds	1 MONTH			12 MONTHS		
	USD	EUR	GBP	USD	EUR	GBP
JPM GBI US All Mats	0.8	1.4	1.8	-1.6	0.6	-2.4
JPM GBI UK All Mats	-0.8	-0.2	0.2	0.4	2.6	-0.5
JPM GBI Japan All Mats**	0.3	0.8	1.2	-0.9	1.2	-1.8
JPM GBI Germany All Mats	0.1	0.7	1.1	-1.3	0.9	-2.2
Corporate Bonds	USD	EUR	GBP	USD	EUR	GBP
BofA ML Global Broad Market Corporate	0.2	0.8	1.2	-1.3	0.9	-2.1
BofA ML US Corporate Master	0.5	1.1	1.5	-1.0	1.2	-1.9
BofA ML EMU Corporate ex T1 (5-10Y)	-0.6	-0.0	0.3	-2.1	0.1	-2.9
BofA ML £ Non-Gilts	-0.5	0.1	0.5	0.1	2.3	-0.7
Non-investment Grade Bonds	USD	EUR	GBP	USD	EUR	GBP
BofA ML Global High Yield	-0.2	0.4	0.7	1.3	3.5	0.4
BofA ML Euro High Yield	-0.6	0.0	0.4	-0.9	1.2	-1.8

Source: DataStream.

Local currency returns in August 2018: *-1.0%, **-0.7%.

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