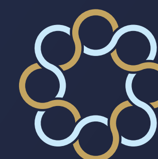


FINURA

YOUR MARKET REVIEW
JUNE 2023

Pension
TRANSFER
Gold Standard

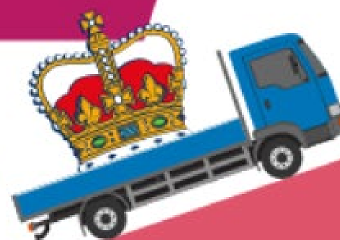
INFOGRAPHIC: THE GLOBAL ECONOMY

UK avoids recession, but economy continues to lose momentum

0.1%

UK GDP growth Q1 2023

A loss in economic momentum heading into the second quarter...



...in combination with the bank holiday to mark the coronation of King Charles III...

...means economy is likely to have contracted over Q2

But news of positive growth in Q1 means economy will have avoided...

...two consecutive quarters of negative growth, being the most commonly accepted definition of a recession

Source: Office for National Statistics, Schroders Economics Group, as at May 2023.

Read article

ECB: more work required to tame inflation

ECB seems set to continue raising rates in near term, despite recession

The eurozone is now officially in recession...

...but markets continue to expect rates to rise in the near term

They remain concerned about the inflation outlook, despite the more complex growth picture

Source: European Central Bank, Schroders Economics Group, as at June 2023.

Source: Schroders as at June 2023.

MULTI-ASSET INVESTMENT VIEWS

KEY

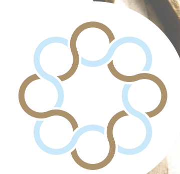
▲ Up from last month ▼ Down from last month

● Long / Positive ● Neutral ● Short / Negative

Group	Category	View	Comments
Main Asset Classes	Equities	Neutral ▲	We have moved to neutral on equities as we push out our forecast on a global economic slowdown given resilient labour markets and the strong service sector.
Main Asset Classes	Government Bonds	Neutral ▼	We have moved to neutral as the inversion of the yield curve (where long-term interest rates fall below short-term interest rates), means that bonds have a negative carry.
Main Asset Classes	Commodities	Neutral	We remain neutral as the goods sector remains weak, inventory levels remain stable, and China's reopening has been underwhelming.
Main Asset Classes	Credit	Long / Positive ▲	We have upgraded credit as the removal of the debt ceiling has improved the outlook and allocating to credit gives us access to duration with a positive carry.
Equities	US	Neutral ▲	A delay to any recession means earnings may rise in the short term. This - coupled with an already strong service sector - leads us to upgrade to neutral.
Equities	UK	Short / Negative	Upwards revisions to payroll data show growth in employment, despite the very high level of inflation. The market is expecting several more rate hikes and the delayed effects, such as higher mortgages, are yet to be fully felt.
Equities	Europe	Short / Negative	We remain negative as the eurozone plunges into recession, driven largely by a slowdown in Germany's sizeable manufacturing sector.
Equities	Japan	Neutral ▲	We have upgraded to neutral. Despite the recent rally, valuations still appear cheap. However, escaping deflation and corporate governance reforms could create potential tailwinds in the longer term.
Equities	Global Emerging Markets[1]	Neutral	We remain neutral as although EM central banks are ahead in their hiking cycles, the US Federal Reserve (Fed) maintaining a hawkish tone (advocating higher interest rates) creates headwinds for the asset class.
Equities	Asia ex-Japan & China	Neutral ▼	The rebound in the services sector has quickly lost momentum. We have downgraded to neutral and anticipate more impactful stimulus next month.
Equities	EM Asia ex China	Short / Negative	We remain negative due to the weak global manufacturing cycle and heavy reliance on the technology sector in countries such as Taiwan and South Korea.
Government Bonds	US	Neutral ▼	We have downgraded to neutral. The inverted yield curve (where short-term debt instruments have higher yields than long-term instruments of the same credit risk profile) and negative carry (where money is borrowed in a high-interest currency and invested in a low-interest currency) mean that US government bonds are unattractive to hold.
Government Bonds	UK	Neutral ▼	We have downgraded to neutral as interest rates are expected to be significantly increased to combat the persistently high inflation rate.
Government Bonds	Germany	Neutral	We remain neutral for the moment, given our belief that the European Central Bank's (ECB) pace of rate hikes has peaked, and inflation appears to have started trending down.
Government Bonds	Japan	Neutral	We stay neutral. While Japan is still battling high inflation, the Bank of Japan's new governor has pledged to maintain a loose monetary policy.
Government Bonds	US Inflation Linked	Neutral	We still prefer to take exposure through nominal bonds as we expect inflation to begin to moderate.
Government Bonds	Emerging Markets Local	Long / Positive	We remain positive as EM central banks are ahead of developed markets in their hiking cycle to contain inflation. EM inflation is falling, and we expect more cuts to come.

[1] Global Emerging Markets includes Central and Eastern Europe, Latin America and Asia.

	Category	View	Comments
Investment Grade Credit	US	●	We remain neutral as financial conditions are tightening faster in the US compared with Europe, and US spreads have unattractive valuations.
	Europe	● ▲	We upgrade to positive. There is a demand for high quality credit, spreads are above the median and financial conditions are tightening more slowly in Europe compared with the US. The sector is attractive too as it allows access to duration with positive carry.
	Emerging Markets USD	●	A soft landing would favour EM debt, but until we have clearer signals, we prefer to stay on the side-lines.
High Yield Bonds (Non-IG)	US	●	We remain neutral. Tighter financial conditions have led to an increase in US HY default rates. Additionally, recovery rates have been falling to historical lows.
	Europe	●	We remain neutral. Valuations have marginally deteriorated and uncompelling spreads lead us to stay on the side-lines.
Commodities	Energy	●	Despite production cuts from Saudi Arabia, the market appears adequately supplied. China's reopening has played out, and we expect energy markets to remain balanced.
	Gold	● ▼	We have downgraded to neutral as growth has remained resilient, the labour market has yet to crack and core inflation is still problematic, driving down gold prices.
	Industrial Metals	●	We remain neutral due to the weak global goods cycle, abated supply-side issues, and China's service-led recovery losing momentum.
	Agriculture	●	Fertiliser prices continue to fall, and good growing conditions set the stage for sturdy harvests this season. We maintain our neutral view as robust demand is balanced with strong supply dynamics, presenting limited upside.
Currencies	US $	● ▲	We have upgraded the dollar to neutral as higher than expected US growth could lead to more rate rises than previously expected. However, we remain cautious given the potential for volatility.
	UK £	● ▼	We have downgraded sterling, as although we believe the pound should benefit from high interest rates, we prefer to stay on the side-lines given potential volatility.
	EU €	● ▼	We have downgraded to neutral as we believe that the ECB's rates trajectory will be steadier in the coming months and we have reached a peak.
	CNH ¥	●	Our maintain our neutral stance due to trade cycle dynamics. Additionally, the level of carry on offer is still not deemed particularly attractive.
	JAP ¥	●	We remain neutral. Given the shift from inflation to slowing growth, the yen could be viewed as a safe haven currency.
	Swiss F	●	We remain neutral on the Swiss franc, similar to the yen this is considered a safe haven currency.



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, June 2023. 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.

MARKETS REVIEW

A look back on events in Q2, when developed markets led equities higher.

THE QUARTER IN SUMMARY

Global shares gained in the quarter with the advance led by developed markets, notably the US, while emerging market stocks lagged behind. Enthusiasm over AI (Artificial Intelligence) boosted technology stocks. Major central banks raised interest rates in the period although the US Federal Reserve elected to stay on hold in June. Government bond yields rose (meaning prices fell).

THE US

US equities ended the quarter higher, with the bulk of the gains made in June. The advance came amid moderating inflation and signs that the US economy remains resilient in spite of higher interest rates. A revision to Q1 GDP growth indicated expansion of 2% (annualised), substantially more than the previous estimate of 1.3% growth.

The Federal Reserve (Fed) raised interest rates by 25 basis points (bps) in May. However, it did not hike rates in June, adopting what economists have termed a “hawkish pause”. The “dot plot” of rate predictions indicated two further rate rises in 2023.

US inflation (as measured by CPI) declined to 0.1% (month-on-month) in May, easing from a 0.4% increase in April amid a continued decline in the cost of energy. This brought down the annual rate to 4.0%, below expectations of 4.1%. The economy more broadly remains in good health.

The US unemployment rate increased in May to 3.7% from 3.4%, a larger than expected move but the labour market nonetheless remains historically tight.

There was some investor caution around US debt ceiling concerns at the beginning of the period under review. However, Congress approved legislation that suspended the debt ceiling in the first days of June, in a deal that included concessions on spending expected to have little effect on economic growth.

The information technology (IT) sector led the stock market advance in the quarter. Fervour around AI and the potential for a boom in related technology drove chipmakers, in particular, higher. The consumer discretionary and communication services sectors also performed strongly. Underperforming sectors included energy and utilities.

EUROZONE

Eurozone shares posted gains in Q2 with the advance led by the financials and IT sectors. Underperforming sectors included energy and communication services.

The IT sector was boosted by semiconductor stocks. This came in the wake of higher-than-expected sales projections from some US chipmakers, which helped demonstrate the growth potential stemming from AI. Late in the quarter, the Dutch government confirmed that high-end chip manufacturing machines will require a licence to be shipped overseas, which could lead to reduced exports to China. The Netherlands is home to some leading chip equipment makers. Among financials, banks outperformed as their near-term earnings are expected to be strong.

The European Central Bank (ECB) raised interest rates twice in the quarter, taking the main refinancing rate to 4.0%. Headline inflation declined during the period, with annual inflation estimated at 5.5% in June, down from 6.1% in May. However, the core inflation rate (which excludes energy, food, alcohol and tobacco prices) crept up to 5.4% in June from 5.3% in May.

Growth data showed that the eurozone experienced a mild recession over the winter, with GDP declines of -0.1% in both Q4 2022 and Q1 2023. Forward-looking data pointed to slowing momentum in the eurozone economy. The flash eurozone composite purchasing managers' index (PMI) fell to 50.3 in June from 52.8 in May. That represents a five-month low and suggests the economy may be close to stagnation (50 is the mark that separates expansion from contraction in the PMI surveys).

UK

UK equities fell over the quarter. The large UK-quoted diversified energy and basic materials groups were the most significant detractors amid broad-based weakness in commodity prices and concerns over the outlook for the Chinese economy. Sterling strength also weighed on these resources sectors, as it did other significant US dollar earners such as consumer staples.

A number of domestically focused areas of the market also underperformed as the Bank of England (BoE) raised rates twice – in May and June. The 0.5 percentage points (pp) increase in June represented a reacceleration in rate hikes after an initial decision to slow the pace in March to 0.25 pp increments.

The reacceleration decision came following stronger-than-expected UK jobs market numbers, wage growth and core inflation readings which strip out volatile energy and food prices.

This data suggested the BoE remained some way off getting on top of inflation on a sustainable basis, which resulted in the sharp sell-off in UK gilts (rising yields) over the period.

Gilt yields are important for the UK domestic economy as they influence "swap rates" which lenders use when pricing fixed-rate mortgages. As a consequence of questions around the UK inflation outlook, these rates approached levels last seen during the "mini Budget" crisis of autumn 2022. This weighed heavily on some domestically focussed areas of the market such as housebuilders.

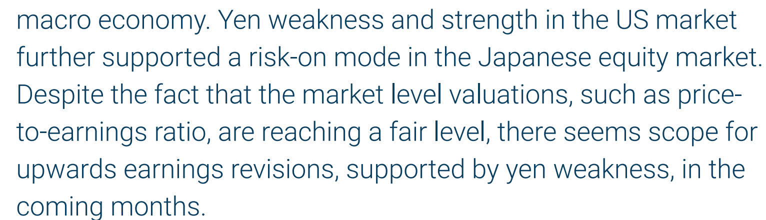
Following the June rate reacceleration, however, yields on longer dated gilts did initially fall (prices rose). This was taken to suggest a greater belief from investors the BoE is able to tame inflation, albeit at the possible cost of triggering a recession.

Read more: UK should brace for 6.5% interest rates: here's why we've raised our forecast.

JAPAN

The strong momentum for Japanese shares accelerated in June and the TOIPX Total Return index rose by 14.4% in local terms for Q2. The Japanese yen weakness also continued and it hit the levels of 188 yen and 144 yen against sterling and the US dollar respectively in June. This pulled down foreign currency denominated returns from the Japanese equity market.

The market hit the highest level in 33 years with the Nikkei reaching to 33,700 yen in June. That has partly been driven by continuous buying from foreign investors since April. In addition, the gains have come amid ongoing expectations of corporate governance reforms and structural shifts in the Japanese



macro economy. Yen weakness and strength in the US market further supported a risk-on mode in the Japanese equity market. Despite the fact that the market level valuations, such as price-to-earnings ratio, are reaching a fair level, there seems scope for upwards earnings revisions, supported by yen weakness, in the coming months.

Read more: Japanese shares have hit 33-year highs - but why?

The Bank of Japan (BoJ) held the first policy meeting under new governor Kazuo Ueda in April and the second in June. There was no change to policy, which suggested their dovish stance continues. On the other hand, the US Fed is likely to continue to raise interest rates, therefore yen weakness was also accelerated. While the BoJ maintained their cautious stance on the continuity of inflation and wage growth in Japan, the macroeconomic figures continued to suggest solid progress.

ASIA (EX JAPAN)

Asia ex Japan equities recorded a negative performance in the second quarter. China, Malaysia, and Thailand were the worst-performing index markets, while share prices in India, South Korea and Taiwan gained.

Chinese equities were sharply lower in the second quarter as the economic rebound, following the country's reopening after the Covid-19 crisis, started to cool. Factory output in China has started to slow due to lacklustre consumer spending and weak demand for exports following interest rate rises in the US and Europe. Hong Kong shares prices also fell in the quarter, as a cooling of the Chinese economy weakened sentiment towards Hong Kong stocks too.

Shares in India achieved strong gains, driven by foreign inflows and steady earnings, and as encouraging economic data boosted sentiment towards the country. Equities in Taiwan advanced, driven by gains in technology stocks as investors rushed to buy AI-related stocks. Investor enthusiasm for AI-related stocks also boosted share prices in South Korea, which also ended the second quarter firmly in positive territory. The Philippines and Singapore ended the quarter in negative territory, while Indonesia achieved a modest gain.

EMERGING MARKETS

Emerging market (EM) equities delivered a small gain over the quarter, which was behind that generated by developed markets. Tension between the US and China was a contributing factor behind EM underperformance, as were concerns about China's anaemic economic recovery. US debt ceiling uncertainty added to the negative mood, although this was resolved in early June.

Hungary, Poland and Greece were the top-performing index markets despite rising recessionary fears in Europe. Central European markets began to anticipate rate cuts as inflation eased, and Hungary cut rates in June. Meanwhile, Greece's outperformance came as the ruling New Democracy party won a second term in office in May, signalling a continuation of market friendly policies.

Brazil was also a top performer amid easing fiscal policy concerns, optimism about potentially imminent rate cuts and a better-than-expected Q1 GDP print. Improved macroeconomic data and signs that accommodative monetary policy will be ongoing were also supportive in India, which gained strongly in the quarter.

Colombia was up too, as were the UAE, Peru, Saudi Arabia and Mexico. Korea and Taiwan outperformed led by technology names on optimism about AI growth.

China underperformed amid concerns over a weaker-than-expected recovery. Kuwait and Qatar also lagged. South Africa was among the worst performers as the country's power situation continued to deteriorate, with severe consequences for economic growth. Turkey posted the largest loss in US dollar terms. This came as President Erdogan won re-election in May, extending his two-decade rule.

GLOBAL BONDS

The second quarter of 2023 saw a significant drop in market volatility. Government bond yields were on the rise again, although there was some divergence, with the UK and Australia underperforming due to higher-than-expected inflation and a greater resolve by central banks to combat inflation. With the exception of the Bo J, all major central banks kept raising interest rates over the quarter. However, the Fed was the first to pause in June, leaving rates at 5% to 5.25% after more than a year of consecutive rate increases.

Corporate balance sheets remained relatively strong, despite some uptick in default rates. Global high yield outperformed global investment grade as immediate recessionary concerns were pared back. Investment grade bonds are the highest quality bonds as determined by a credit rating agency; high yield bonds are more speculative, with a credit rating below investment grade.

US growth surprised to the upside, with a 'soft landing' scenario now being the market consensus. On the credit front, US investment grade posted negative total returns, but outperformed Treasuries over the quarter. US high yield posted positive returns. The US 10-year yield climbed back from 3.47% to 3.81%, with the two-year going from 4.03% to 4.87%, marking a further inversion of the curve.

The ECB continued to hike interest rates and announced in May that they expected to end reinvestments under their Asset Purchase Programme from July 2023. However, headline inflation has fallen significantly from the peak. Germany's 10-year yield increased from 2.31% to 2.39%. Euro high yield outperformed investment grade over the period.

Inflation in the UK has taken many by surprise. This prompted the BoE to act more forcefully, raising interest rates by a larger than expected 50 basis points in June. The UK 10-year yield jumped from 3.49% to 4.39% and two-year made even more gains by increasing from 3.44% to 5.26%. On the credit front, UK high yield outperformed UK investment grade.

As sentiment for global growth improved, lower yielding currencies, such as the Japanese yen performed poorly. At the other end of the spectrum, sterling was the best performer, supported by higher interest rates.

Convertible bonds, as measured by the Refinitiv Global Focus Index, returned 5% in Q2. Convertibles benefited from the tailwinds provided by strong performance from "big tech" stocks which were boosted by the AI narrative. However, the universe of convertibles lacks some of the big-hitting tech names and hence finds it difficult to participate more fully in the strong stock gains. The primary market was very active with US$22 billion of new convertibles reaching the market.

COMMODITIES

The S&P GSCI Index recorded a negative performance in the second quarter. Industrial metals and energy were the worst-performing sectors, while livestock prices rose in the quarter. Within industrial metals, zinc, nickel, and aluminium prices were all sharply lower in the quarter. Within energy, crude oil, Brent crude, heating oil and gas oil all declined, while prices for natural gas and unleaded gasoline were modestly higher.

In agriculture, sharply higher prices for cocoa and soybeans failed to offset prices declines for coffee, sugar, and corn. Wheat and Kansas wheat both ended the month in positive territory. In precious metals, both gold and silver ended the month in negative territory.

DIGITAL ASSETS

During Q2 Bitcoin returned 6.9% whilst Ethereum (ETH) slightly lagged at 6.0%. For the year-to-date, Bitcoin and ETH returned 84.3% and 61.6% respectively.

One of the overarching topics that continues to dominate the digital assets narrative is regulation (or the lack thereof). Q2 brought developments in this regard, and highlighted the divergent paths that different jurisdictions are taking. MiCA, the long awaited European regulatory framework around digital assets, was adopted by the European Union. This gives clarity on several areas including investor and consumer protection, and a comprehensive framework for issuers and service providers.

In the US, different institutions continue to move along on their own (uncoordinated) paths as Congress and the House are legislating on various bills that touch crypto in different ways. Most notably the Digital Asset Market Structure Draft and the Responsible Financial Innovation Act bills, if passed, would clarify the status of digital assets (mostly as commodities). The impact of SEC action against Coinbase was felt by the market in June, with liquidity in altcoins, specifically mentioned in the lawsuits, particularly hard hit.

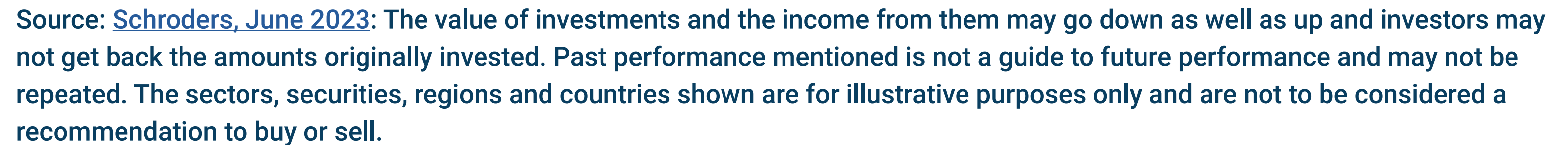
In anticipation of regulator clarity, some of the largest asset managers globally filed for US spot Bitcoin ETFs which have yet to be approved by regulators. This, together with the SEC lawsuits, further supported Bitcoin's outperformance over altcoins this year.

TOTAL RETURNS (NET) % – TO END JUNE 2023

	3 MONTHS			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	6.8	6.4	3.9	18.5	13.6	13.2
MSCI World Value	3.0	2.6	0.2	10.7	6.0	5.7
MSCI World Growth	10.4	10.0	7.4	26.4	21.1	20.7
MSCI World Smaller Companies	3.2	2.8	0.4	12.9	8.2	7.9
MSCI Emerging Markets	0.9	0.5	-1.9	1.7	-2.5	-2.8
MSCI AC Asia ex Japan	-1.3	-1.7	-4.0	-1.2	-5.3	-5.6
S&P500	8.7	8.3	5.8	19.6	14.6	14.2
MSCI EMU	3.2	2.7	0.3	29.5	24.1	23.7
FTSE Europe ex UK	3.4	3.0	0.6	25.3	20.0	19.6
FTSE All-Share	2.4	1.9	-0.5	12.9	8.2	7.9
TOPIX*	5.4	4.9	2.5	18.1	13.2	12.9

	3 MONTHS			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	-1.3	-1.7	-4.0	-1.9	-6.0	-6.2
JPM GBI UK All Mats	-3.1	-3.5	-5.7	-10.9	-14.6	-14.9
JPM GBI Japan All Mats**	-7.6	-8.0	-10.1	-5.9	-9.9	-10.1
JPM GBI Germany All Traded	0.1	-0.3	-2.6	-1.7	-5.8	-6.1
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	0.1	-0.3	-2.7	1.9	-2.3	-2.7
BofA ML US Corporate Master	-0.2	-0.6	-2.9	1.4	-2.8	-3.1
BofA ML EMU Corporate ex T1 (5-10Y)	1.0	0.6	-1.8	4.2	-0.1	-0.4
BofA ML £ Non-Gilts	-0.6	-1.0	-3.4	-2.7	=6.8	-7.1
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	1.6	1.2	-1.2	9.7	5.1	4.8
BofA ML Euro High Yield	0.4	0.0	-2.3	4.4	0.0	-0.3

Source: Thomson Reuters DataStream.
Local currency returns in Q2 2023: *14.5%, **0.4%.
Past performance is not a guide to future performance and may not be repeated.



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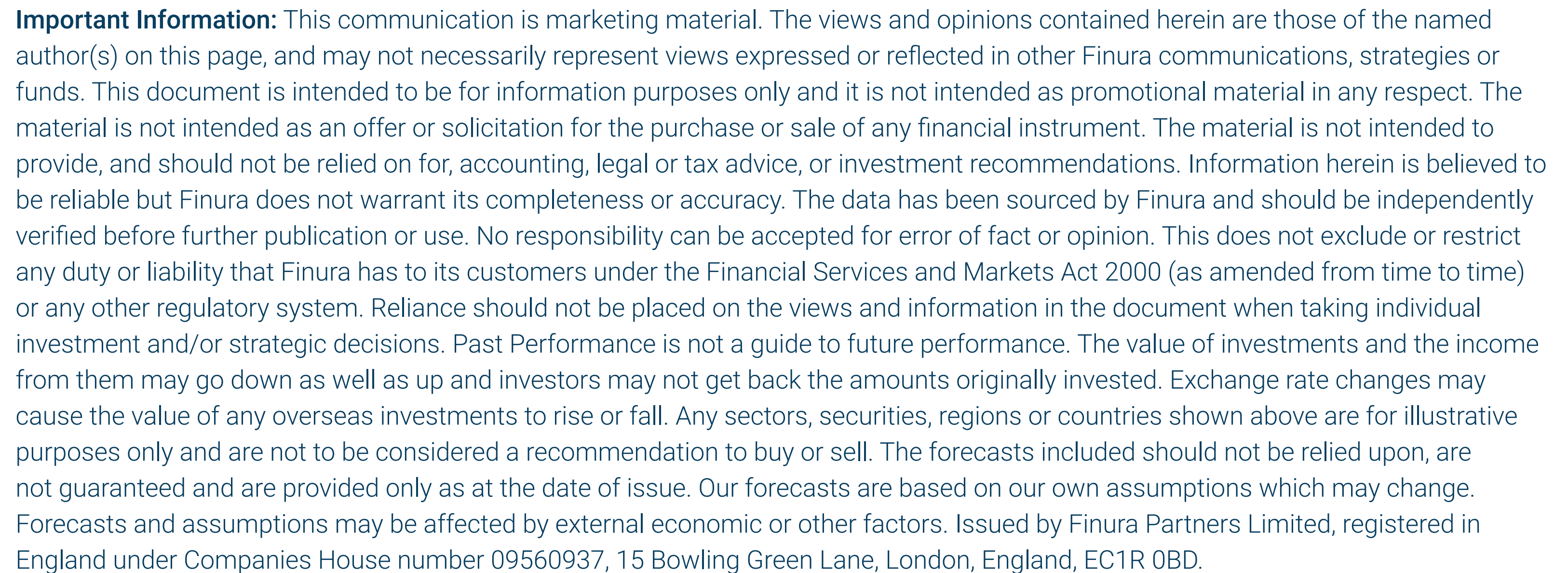

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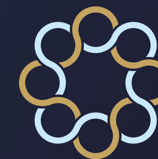

FINURA

5th Floor, 20 Old Bailey, London EC4M 7AN
T: +44 (0)20 8057 8004   E: hello@finura.co.uk   W: finura.co.uk

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