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# YOUR MARKET REVIEW AUGUST 2023

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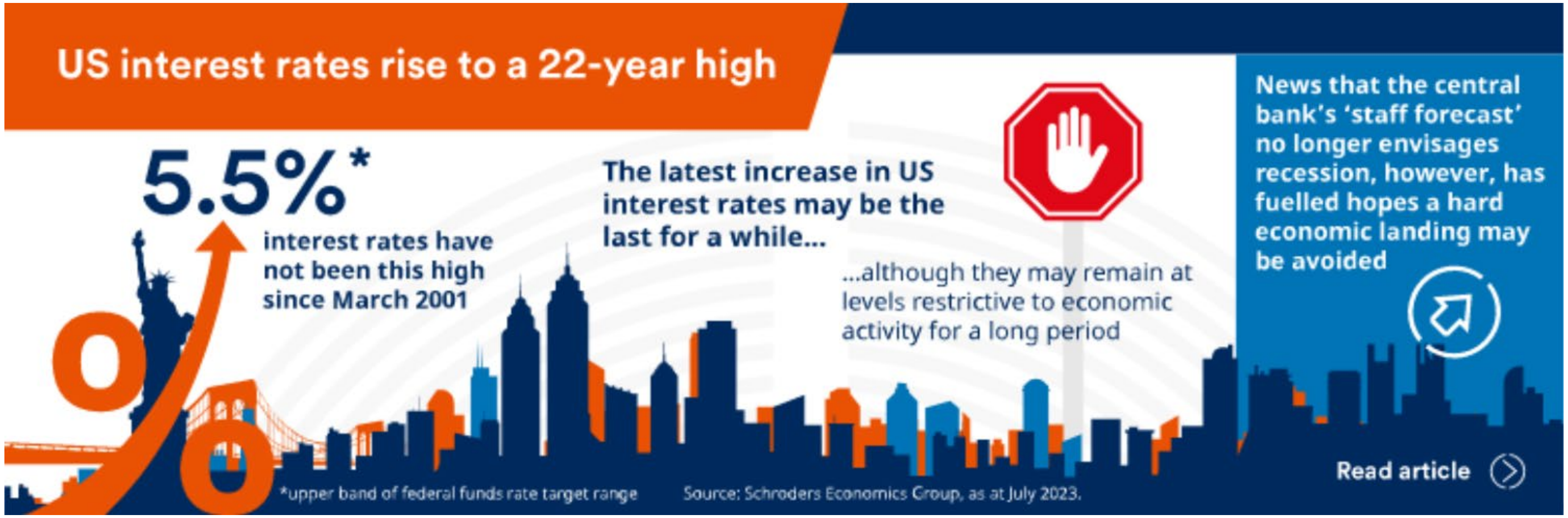
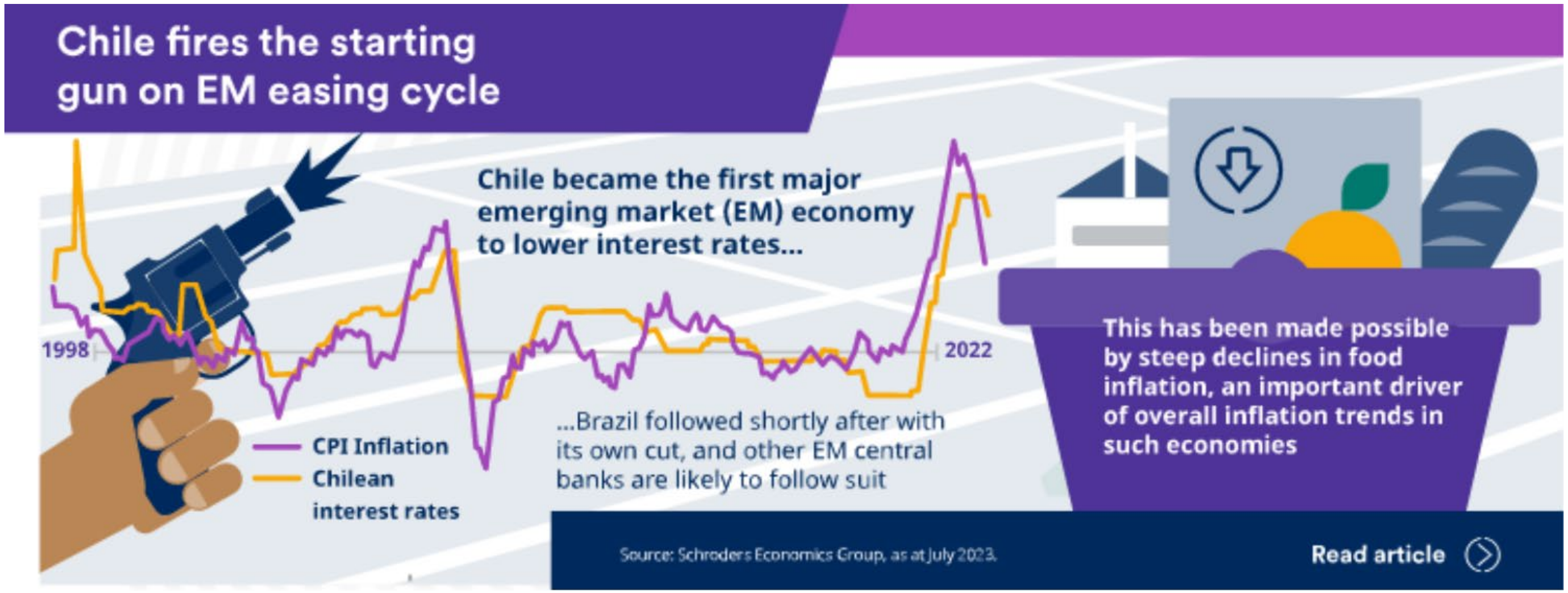
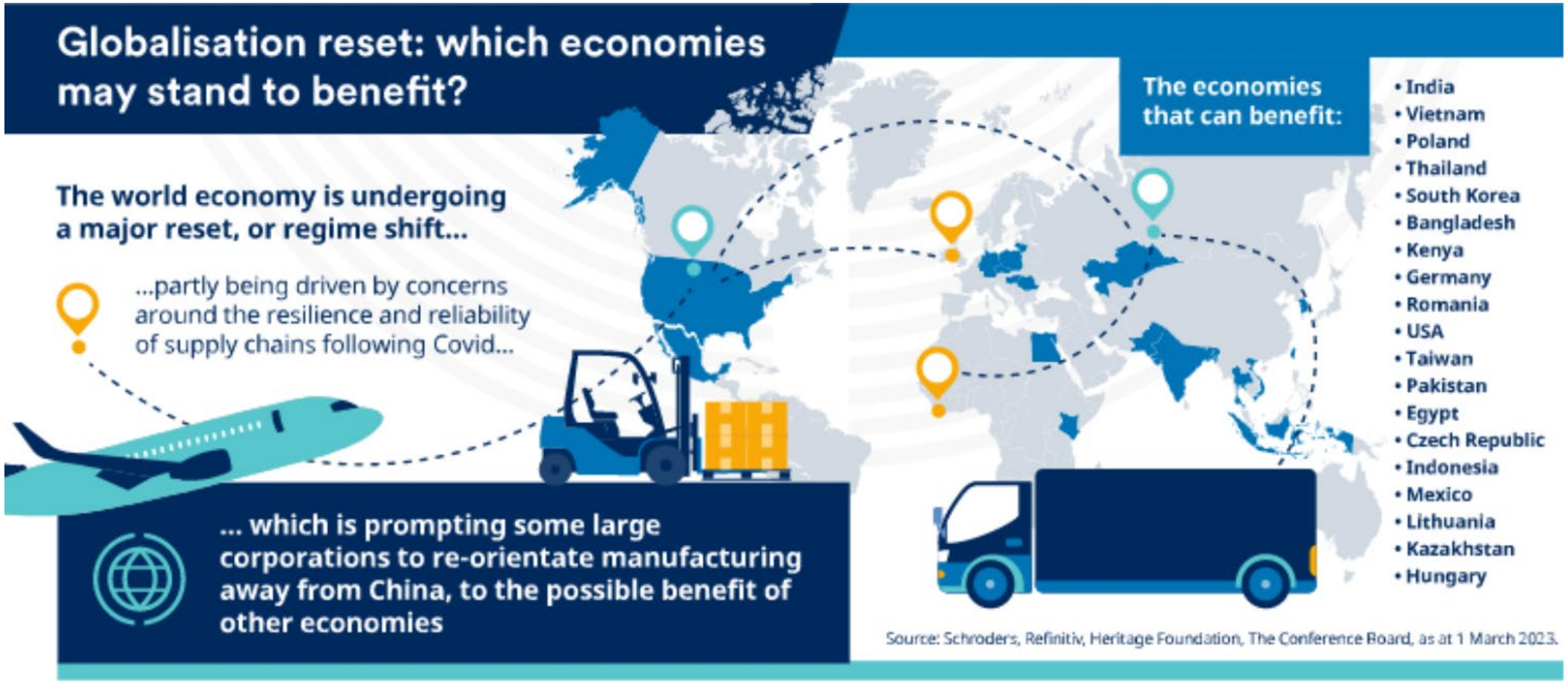
# INFOGRAPHIC: THE GLOBAL ECONOMY






Source: [Schroders as at August 2023.]

# MULTI-ASSET INVESTMENT VIEWS

KEY

▲ Up from last month ▼ Down from last month

● Long / Positive ● Neutral ● Short / Negative

**Main Asset Classes**

| Category | View | Comments |
|---|---|---|
| Equities | Neutral | We remain neutral. The soft-landing scenario is supportive of equities, but valuations are expensive, and margins are also coming under pressure. |
| Government Bonds | Long / Positive ▲ | We upgrade to positive. The recent sell-off in developed market bonds has led us to seek opportunities to increase duration in the US. |
| Commodities | Long / Positive | We maintain our positive score. Supply side pressures are set to return, offering a tactical opportunity in commodities as we wait for a recession. |
| Credit | Long / Positive | We remain positive on credit, keeping our preference for European investment grade as it offers positive carry. |

**Equities**

| Category | View | Comments |
|---|---|---|
| US | Neutral | We remain neutral. The soft-landing scenario is supportive of the US market, but valuations are stretched, and high inflation will likely put a cap on valuations. |
| UK | Neutral ▲ | We upgrade to neutral as a weaker currency and better-than-expected fundamentals should be supportive for UK equities. Valuations also look more attractive after the recent sell-off. |
| Europe | Short / Negative | We remain negative given Europe's weaker fundamentals. Manufacturing and services sector data is deteriorating while inflation is still weighing on the region. |
| Japan | Long / Positive ▲ | We have turned positive on Japan. Japanese companies' strong fundamentals coupled with good domestic demand should allow the equity market to grind higher. |
| Global Emerging Markets[1] | Neutral | A weak global goods cycle remains a headwind, but the asset class is likely to be supported by central bank policy easing, given inflation in the region has been falling, particularly in Latin American countries. |
| Asia ex-Japan & China | Neutral | We maintain our neutral score. Whilst valuations are attractive, we are looking for a catalyst (such as policy stimulus) to turn positive. |
| EM Asia ex China | Neutral ▲ | We upgrade to neutral. Evidence shows the global manufacturing cycle is starting to rebound, offering a better outlook for countries such as Taiwan and South Korea. |

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

**Government Bonds**

| Category | View | Comments |
|---|---|---|
| US | Long / Positive ▲ | Upgrade to positive. The recent sell-off presents opportunities in US government bonds, we prefer the shorter end of the curve, supported by the possibility of curve steepening. |
| UK | Short / Negative ▼ | We downgrade to negative. Gilts look vulnerable relative to other developed market bonds due to the poor supply-demand dynamics and stickier wage pressures in the UK. |
| Germany | Long / Positive ▲ | We upgrade to positive. Lower inflation surprises and a deteriorating growth outlook in Europe bode well for bunds. |
| Japan | Neutral | We keep our neutral score. Despite the recent policy change by the Bank of Japan (BoJ), it is likely to be some time before bond yields move significantly higher. |
| US Inflation Linked | Long / Positive | We are positive on inflation-linked bonds as five-year break-even rates are attractive, and the bonds will provide some protection in the event inflation fails to continue to fall. |
| Emerging Markets Local | Long / Positive | We are positive on inflation-linked bonds as five-year break-even rates are attractive, and the bonds will provide some protection in the event inflation fails to continue to fall. |

| | Category | View | Comments |
|---|---|---|---|
| Investment Grade Credit | US | 🟡 | The backdrop is challenging as yields are uncompelling compared to cash rates and duration risks. But corporate fundamentals remain strong, leading us to remain neutral. |
| | Europe | 🟢 | We continue to prefer European IG as it offers positive carry. It also stands to benefit from any stability in yields and offers better value than the US. |
| | Emerging Markets USD | 🟡 | Valuations are expensive. While fundamentals are resilient for now, these markets are exposed to Chinese growth and the global commodity cycle. The light supply of bonds is keeping technical conditions tight. On balance, we remain neutral. |
| High Yield Bonds (Non-IG) | US | 🟡 | Light issuance and a contracting market are supporting spreads. However, heightened dispersion[2] is creating a headwind for any material tightening of spreads going forward. |
| | Europe | 🟡 | Whilst European valuations are more attractive than the US, we prefer higher quality credit, and so remain neutral. |

[2] Proportion of face value in index marked outside +/-100bps of overall index level.

| | Category | View | Comments |
|---|---|---|---|
| Commodities | Energy | 🟢 | We maintain our positive score as supply remains tight and tentative signs of inventory drawdown are feeding through. |
| | Gold | 🟡 | We expect gold to benefit from peaking real rates and a peaking US dollar. However, volatility in the market is high and we prefer to hold a broad commodity basket. |
| | Industrial Metals | 🟡 | The outlook for growth remains muted, but potential for a rebound in the manufacturing cycle, combined with low inventories has set a price floor for metals. |
| | Agriculture | 🟢 | We expect prices will rise given geopolitical tensions around Ukraine exports, leading to further market volatility. Supplies are under pressure as US crop conditions are poor and are threatened by potential adverse conditions from El Nino. |
| Currencies | US $ | 🟡 | We remain neutral. The dollar is vulnerable to downside surprises in inflation data but remains a good portfolio diversifier. |
| | UK £ | 🟡 | The backdrop of poor economic outlook and high inflation remain headwinds for sterling. |
| | EU € | 🟡 | Although growth factors are pointing to a weaker euro, inflation in the Eurozone remains resilient, leading us to a neutral score overall. |
| | CNH ¥ | 🟡 | We remain neutral, due to trade cycle dynamics and because the level of carry is not particularly attractive. |
| | JAP ¥ | 🟡 | Although the BoJ's recent tightening policy removed downward pressure, appreciation of the yen seems unlikely in the short term. |
| | Swiss F | 🟡 | We keep our neutral score. Whilst growth in Switzerland is slowing down, the Swiss franc's safe haven status remains attractive to investors. |

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 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 at markets in August when shares fell amid worries over China's property sector.**

## THE MONTH IN SUMMARY

Global shares fell in August amid worries over renewed weakness in the Chinese real estate sector. Economic data from China also continued to be worse than expected and emerging markets underperformed their developed peers. Government bond yields rose (meaning prices fell).

## THE US

US equities declined in August. Investors' confidence that the Federal Reserve's (Fed) tightening cycle ended with the rate rise in July took a knock due to indications that policy makers are divided on next steps. Economic data for the US remained robust.

Minutes from the Fed's July meeting showed that while most members had agreed that a 25 basis point hike was appropriate, a minority preferred to keep rates unchanged.

On the data front, retail sales improved in July versus June, although that data was likely influenced by discount activity including Prime Day. Industrial activity slowed a little in August with the flash purchasing managers' index (PMI) dropping to 50.4 from 52 (in the PMI surveys a reading below 50 implies contraction, while a reading above 50 implies expansion). Manufacturing contracted further while service sector growth slowed The unemployment rate rose to 3.8% from 3.5% in July, far above economic projections of an unchanged reading. Inflation (CPI) ticked up slightly in July to 3.2% from 3.0%.

Several of the household-name tech giants experienced a pullback and weighed on the index overall. At the sector level, consumer staples companies were generally weaker, as were financials and real estate. Energy stocks were more resilient over the month, likely buoyed by tighter oil supply.

## EUROZONE

Eurozone shares fell in August. Energy and real estate were the only sectors to register a positive return, with all others declining. Some of the steepest declines came from sectors that are most sensitive to the economic backdrop, including consumer discretionary.

Bank shares experienced volatility after Italy announced a tax on banks' excess profits, although shares largely recovered after the government later clarified that the tax would amount to no more than 0.1% of a bank's assets.

Eurozone annual inflation was estimated at 5.3% for August, staying stable compared to July. However, "core" inflation, which strips out food and energy prices, eased. Eurozone unemployment was 6.4% in July, the same level as in June. Eurostat data also showed that money supply in the single currency area shrank in the 12 months to July for the first time since 2010.

In terms of business activity, the flash HCOB purchasing managers' index (PMI) signalled a steepening downturn, hitting a 33-month low of 47.0 in August.

The data all contributed to the debate about the European Central Bank's next move when the governing council holds an interest rate setting meeting on 14 September.

## UK

UK equities fell over the month. The market was held back by concerns around the outlook for the Chinese economy, which weighed on the basic materials and financials sectors in particular. Domestically-focused areas of the market were weak amid signs of a deteriorating UK macroeconomic outlook and mixed inflation data. While it was revealed that headline inflation had moderated further in July to 6.8% from a year earlier, the annual rate of core consumer prices index (CPI) inflation was unchanged at 6.9%, according to latest data from the Office for National Statistics (ONS).

Concerns that high inflation could become entrenched were further reinforced by other news from the ONS that annualised private sector wage growth picked up to 7.9% in the three months to June. The Bank of England increased base interest rates from 5% to 5.25% and warned that rates would need to remain "sufficiently restrictive for sufficiently long" to help tame inflation.

While it was revealed that the UK economy had grown by 0.2% in the second quarter, beating consensus expectations of zero growth, forward-looking indicators of economic activity deteriorated. The first, or "flash", reading of the composite purchasing managers' index – which tracks the performance of the services and manufacturing sectors – fell below the 50 mark in August, being the level which separates contraction from expansion.

Meanwhile, sentiment towards domestically-focused areas was further impacted by worsening prices trends in the housing market, with the consumer discretionary and real estate sectors both underperforming. Energy was the only sector to rise over the month against the backdrop of higher oil prices.

## JAPAN

The Japanese equity market rose in August with the TOPIX Total Return index up by 0.4% in local terms. The Nikkei 225 fell by -1.7%, indicating weakness in large cap growth stocks. The market started in risk-off mode, partly due to declines in US stocks. The policy adjustment by the Bank of Japan (BOJ) at the end of July triggered a modest rise in Japanese government bond (JGB) yields, which resulted in a sell-off of large cap growth stocks. On the other hand, domestically-oriented stocks in the mid and small cap space performed solidly thanks to increasing signs of inbound tourism, including from China.

The market turned more positive around mid-month. The Jackson Hole symposium of central bankers brought little news. Yen weakness continued and the yen stayed around the level of 147 against US dollar. However, there was some speculation of currency market intervention by the Japanese government, which may have prevented more extreme moves.

Japanese corporate earnings remain solid with a number of upward revisions to estimates. However, market sentiment was weakened by political tensions, both in Japan domestically as well as with China. The popularity of the Kishida administration continued to decline, largely due to persistent inflation affecting Japanese households. In addition, the release of nuclear wastewater from the Fukushima power plant drew some criticism from China. There should be no real negative from a scientific perspective; however, the increasing tension with China weighed on some areas of the market.

## ASIA (EX JAPAN)

Asia ex Japan equities recorded a sharply negative performance in August, with all markets in the MSCI AC Asia ex Japan index ending the month in negative territory. The Philippines, China and Hong Kong were the weakest index markets. Declines in India, Indonesia and Malaysia were more modest.

Chinese stocks experienced sharp declines in August, with the country's property sector performing particularly poorly as investors doubt that Beijing will deliver enough stimulus to put the world's second-largest economy back on track. Although China's official PMI manufacturing index edged up in August, it marked the fifth straight month of contraction, pointing to continued weakness. China has sought to boost confidence in the country's flagging stock market by cutting stamp duty levied on share transactions and slowing the pace of initial public offerings in Shanghai and Shenzhen, which can draw liquidity away from the wider market and weigh on share prices.

Share prices in Hong Kong were also sharply lower in August as weaker Chinese manufacturing and property sector woes weakened investor sentiment. South Korea also witnessed a sharp fall in share prices, as weaker factory output and slowing retail sales in the country spooked investors, particularly those from overseas. Shares in Taiwan tumbled on investor fears that the debt issues engulfing several Chinese property companies could trigger a financial crisis and send regional currencies lower against the US dollar. Although financial stocks led the decline in Taiwan, technology stocks were also heavily sold.

Read more: The new meme stock craze likely to end in tears in Asia

## EMERGING MARKETS

Emerging market (EM) equities fell in August against a backdrop of deteriorating risk sentiment. Much of this was related to concerns that strength in the US economy will keep interest rates higher for longer but ongoing weakness in the Chinese economy and concerns about the property sector also contributed. EM underperformed global equities, with the majority of markets posting declines in the month.

Colombia and South Africa were the worst-performing markets in the month with their currencies also depreciating against the dollar. In Colombia economic data continued to point to a slowdown in growth. South Africa's weaker currency and softer commodity prices had a negative impact on the market's performance.

China underperformed as investors worried about slowing economic growth momentum and problems in the property sector. The end of the month saw authorities announce further stimulus measures to support the economy, particularly the housing sector. These included a reduction in interest rates, a lowering of down-payment ratios and a trimming of home mortgage rates.

Podcast: Is this China's "Lehman Brothers" moment?

Brazil lagged the index despite a cut in interest rates and Congress's approval of the new fiscal framework. Korea was another laggard while Taiwan outperformed, even as the market delivered a negative return. Taiwan's July exports came in better-than-expected with tech exports growing strongly month-on-month. Some of the energy-heavy markets such as Kuwait, UAE and Saudi Arabia were ahead of the index on energy price strength.

India and Indonesia were down but by less than the index with the former helped by foreign equity inflows during the month. Inflation remains elevated, however. The only three markets that rose in August were Hungary, Turkey and Egypt. Turkey benefited from a bigger-than-expected cut in interest rates.

## GLOBAL BONDS

August saw Fitch Ratings, one of the "Big Three" credit rating agencies, downgrade the US's top-tier triple-A rating to double-A plus, citing the growing debt burden and an "erosion of governance" as reasons for its decision. The US Treasury's subsequent announcement of its higher-than-expected borrowing intentions over the coming months, led to the 10-year Treasury yield briefly rising to a nine-month high before retreating. The yield on the US 10-year rose from 3.95% to 4.10%, while the 2-year yield fell slightly from 4.86% to 4.85%.

Although the Federal Open Market Committee (FOMC) did not meet during August, Federal Reserve Chair Jerome Powell spoke at the annual Jackson Hole symposium, noting further work to be done on bringing inflation down towards target. US growth remained resilient, particularly compared to other major economies, and price pressures steadily eased, which has led markets to increasingly price-in expectations of a soft landing.

In Europe, growth dynamics remained weak, with manufacturing activity continuing to contract. Germany's 10-year Bund stayed firm at 2.47%. The 2-year yield continued to drop from 3.01% at the end of last month to 2.98%.

The Bank of England raised its policy rate by 25bps to 5.25% as expected, noting that higher interest rates were already working to slow economic activity but retained its data dependency in terms of forward guidance. In the UK the 10-year gilt rose from 4.31% to 4.36% while the two-year yield rose from 4.98% to 5.16%.

Credit markets had a relatively weak month, with European investment grade pricing in a bleaker economic outlook, leading to negative total returns and wider spreads relative to government bonds. US investment grade credit underperformed European investment grade, but spreads were broadly unchanged versus Treasuries. High yield credit markets fared better, slightly outperforming government bonds.

The US dollar strengthened against all other major currencies, benefitting from resilient domestic growth against a weak global backdrop. The market is anticipating that higher rates for longer may be required in order to bring inflation sustainable back to target.

Convertible bonds provided reasonable protection in the market falls for much of the month but then could not benefit from the AI-related recovery in the final week. The Refinitiv Global Focus convertibles index finished the month with a loss of -2.9%.

Primary markets were very active in August with $9 billion of new convertibles being launched. Despite good demand for the new issues, the overall valuation in the secondary market remains subdued. Convertibles are still trading slightly below their fair value.

## COMMODITIES

The S&P GSCI Index was broadly flat in August, with small price gains for energy and livestock failing to offset weaker prices in agriculture, industrial metals and precious metals. Energy was the best-performing component of the index amid ongoing production cuts from Saudi Arabia and other Opec+ producers (Opec+ is the Organisation of the Petroleum Exporting Countries plus some other oil producing nations).

Industrial metals was the worst-performing component, driven by lower by price falls for nickel, zinc, aluminium and copper. The agriculture component also ended the month in negative territory due to sharp falls in the price of wheat, corn and coffee. In precious metals, silver and gold prices both fell in the month.

## DIGITAL ASSETS

After a period of lower trading volumes and subdued price movements, volatility returned to digital asset markets in August, with Bitcoin (BTC) returning -11.3% to give back some of its year-to-date gains that now stand at +56.8%. The entire industry followed as this leg lower was driven by another episode of liquidation of levered positions that have characterised crypto markets in the past.

The mid-month “flash-crash” on 17 August brought about the largest single day sell-off this year, with BTC prices declining 7.2% as $2.5 billion worth of derivative contracts were liquidated in an afternoon. These are mainly future and perpetual contracts on centralised exchanges such as Binance and OKEX that are highly levered (often up to 25x), and which get automatically liquidated by the exchange as they near their collateral limits (with no such thing as a margin call ahead of liquidation). These instances were more frequent just a few years ago; now they’ve become less common, the market is maturing.

The second half of the month was marked primarily by news around expected physical Bitcoin ETFs in the US. The much anticipated SEC vs. Grayscale ruling was announced in Grayscale’s favour, increasing the odds of a US based physical Bitcoin ETF being approved.

# TOTAL RETURNS (NET) % – TO END AUGUST 2023

| | 1 MONTH | | | 12 MONTHS | | |
|---|---|---|---|---|---|---|
| **Equities** | **USD** | **EUR** | **GBP** | **USD** | **EUR** | **GBP** |
| MSCI World | -2.4 | -0.8 | -0.9 | 15.6 | 7.1 | 6.2 |
| MSCI World Value | -2.8 | -1.2 | -1.3 | 10.2 | 2.1 | 1.2 |
| MSCI World Growth | -2.0 | -0.5 | -0.5 | 20.6 | 11.7 | 10.7 |
| MSCI World Smaller Companies | -3.8 | -2.3 | -2.3 | 8.0 | 0.0 | -0.9 |
| MSCI Emerging Markets | -6.2 | -4.7 | -4.7 | 1.3 | -6.2 | -7.0 |
| MSCI AC Asia ex Japan | -6.4 | -4.9 | -5.0 | -0.6 | -7.9 | -8.7 |
| S&P500 | -1.6 | -0.0 | -0.1 | 15.9 | 7.4 | 6.5 |
| MSCI EMU | -4.6 | -3.1 | -3.1 | 29.8 | 20.3 | 19.2 |
| FTSE Europe ex UK | -3.9 | -2.4 | -2.4 | 26.2 | 16.9 | 15.8 |
| FTSE All-Share | -4.0 | -2.5 | -2.5 | 14.6 | 6.2 | 5.2 |
| TOPIX* | -2.0 | -0.4 | -0.5 | 16.2 | 7.7 | 6.7 |

| | 1 MONTH | | | 12 MONTHS | | |
|---|---|---|---|---|---|---|
| **Government Bonds** | **USD** | **EUR** | **GBP** | **USD** | **EUR** | **GBP** |
| JPM GBI US All Mats | -0.5 | 1.1 | 1.1 | -1.8 | -9.1 | -9.9 |
| JPM GBI UK All Mats | -2.0 | -0.4 | -0.5 | -1.7 | -9.0 | -9.8 |
| JPM GBI Japan All Mats** | -3.2 | -1.7 | -1.7 | -7.5 | -14.3 | -15.1 |
| JPM GBI Germany All Traded | -1.3 | 0.3 | 0.3 | 2.3 | -5.2 | -6.0 |
| **Corporate Bonds** | **USD** | **EUR** | **GBP** | **USD** | **EUR** | **GBP** |
| BofA ML Global Broad Market Corporate | -1.0 | -0.2 | 0.1 | 2.9 | -5.3 | -5.9 |
| BofA ML US Corporate Master | -0.9 | 0.0 | 0.2 | 0.8 | -7.3 | -7.9 |
| BofA ML EMU Corporate ex T1 (5-10Y) | -1.4 | -0.5 | -0.3 | 9.0 | 0.3 | -0.3 |
| BofA ML £ Non-Gilts | -1.5 | -0.6 | -0.4 | 6.9 | -1.7 | -2.3 |
| **Non-investment Grade Bonds** | **USD** | **EUR** | **GBP** | **USD** | **EUR** | **GBP** |
| BofA ML Global High Yield | -0.2 | 0.7 | 0.9 | 8.6 | -0.1 | -0.7 |
| BofA ML Euro High Yield | -1.6 | 0.0 | -0.0 | 7.9 | 0.0 | -0.9 |

Source: Thomson Reuters DataStream.
Local currency returns in August 2023: *0.4%, **-0.8%.
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**Source:** [Schroders, August 2023](): **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. Past performance mentioned is not a guide to future performance and may not be repeated. The sectors, securities, regions and countries shown are for illustrative purposes only and are not to be considered a recommendation to buy or sell.**

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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