FINURA

MARKET COMMENTARY
JULY 2018

MULTI-ASSET INVESTMENT VIEWS - JULY 2018

KEY

▲ Up from last month ▼ Down from last month

● Positive ● Postive/ Neutral ● Neutral ● Neutral/ Negative ● Negative

	Category	View	Comments
Main Asset Classes	Equities	Neutral	Our models suggest equity valuations are fair versus long-term history but look more expensive versus recent history.
Main Asset Classes	Goverment Bonds	Neutral/ Negative	We remain negative on duration. Valuations are still slightly expensive and we see risks to the downside, but are wary of downgrading further during the summer lull.
Main Asset Classes	Commodoties	Positive ▲	We have upgraded commodities this month after the recent correction as cyclical indicators have stabilised and carry remains strong.
Main Asset Classes	Credit	Neutral/ Negative	A sharp deterioration in sentiment and rising US dollar rates has created an unfriendly backdrop for credit spreads.
Equities	US	Postive/ Neutral	The US continues to be the most resilient economy. We expect strong earnings growth to continue, offsetting potential risk de-rating.
Equities	Europe	Neutral	Despite attractive valuations and a weaker euro, headwinds such as concerns around global trade and tightening financial conditions remain.
Equities	UK	Neutral	Uncertainties around ongoing Brexit negotiations continue to weigh on UK equity growth potential.
Equities	Japan	Neutral	We remain neutral on Japan as recent weakness in macroeconomic data and cyclical indicators point to a slowdown. Further yen strengthening would be a risk.
Equities	Pacific ex-Japan	Neutral	Within the region, we have removed our positive bias for Singapore following the unexpected new property cooling measures that were announced recently.
Equities	Emerging Markets	Postive/ Neutral	Valuations are attractive compared to developed markets, though trade war escalation and a stronger dollar may be near-term headwinds.
Government Bonds	US	Neutral/ Negative	Still expensive against a backdrop of a negative term premium, a large increase in supply and higher currency-hedged yields available in Europe.
Government Bonds	UK	Neutral/ Negative	Remain negative. Gilts are still expensive after recent outperformance.
Government Bonds	Germany	Negative ▼	The European Central Bank reaffirmed its intention to end its bond-buying programme this year, and economic growth should pick-up after the Q2 soft patch.
Government Bonds	Japan	Neutral	Although yields are low and investors expect the Bank of Japan eventually to follow the Fed and ECB in reducing/ removing stimulus, it's too early to downgrade.
Government Bonds	US Inflation Linked	Postive/ Neutral	We are currently positive on US breakeven inflation but expect seasonality to turn negative, so are considering taking profits.
Government Bonds	Emerging Markets Local	Neutral	No change for now, but valuation improvements point towards a possible upgrade if the cyclical backdrop improves.

	Category	View	Comments
Investment Grade Corporate Bonds	US		Leverage is rising again in the US in spite of very strong earnings. There is increasing pressure on management to prioritise shareholders over creditors.
	Europe		European corporates are in a stronger positon, 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 fundamental path of earnings marginally favours EM corporates over sovereigns.
High Yield Bonds	US		Demand remains strong, supported by a robust domestic economy in the US. But from a valuation perspective, we believe it is expensive and vulnerable.
	Europe	▼	Political flare-ups in the eurozone look likely to cap the potential for spread tightening, hence we downgrade.
Commodoties	Energy		Oil supplies remain tight amid robust global demand, while falling Venezuelan output and Iranian sanctions continue to offer support.
	Gold	▲	We have upgraded gold as the price recently corrected and the relationship between gold and interest rates has now normalised.
	Industrial Metals		We remain positive on industrial metals, which are more attractive after the recent losses as the cyclical environment stabilises.
	Agriculture		The recent correction relates to trade war concerns rather than fundamentals, so we remain positive.
Currencies	US $		Strong US growth and political risks have fuelled the recent dollar rally, pushing USD to near-expensive levels again.
	UK £		Internal turmoil for the UK government keeps us negative, even as hard data has improved.
	EU €		European political risks and the H1 soft patch have been mostly priced in. A more confident European Central Bank and future better data could mark the bottom for EUR.
	JAP ¥		We see JPY continuing to trade range-bound as the Japanese economy improves and the Bank of Japan reduces bond purchases.
	Swiss F		Stay neutral on CHF on better European economic data, with the Swiss National Bank staying dovish.

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, July 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 JULY 2018

A look back at markets in July when global equities were supported by resilient economic data in the US and some strong corporate earnings.

HIGHLIGHTS

- Equity markets were generally higher in July, with a busy corporate reporting period indicating strong earnings across a number of geographies and sectors.
- In the US, the S&P 500 gained ground, buoyed by a slew of strong company results, ongoing strength in employment and resilient economic activity.
- July was a better month for eurozone equities as the region's trade worries receded slightly. GDP growth for the second quarter confirmed a slowdown in economic activity.
- The UK's FTSE All-Share index rose over July as the renewed sterling weakness - seen since the spring - fed through into earnings upgrades, particularly for the large-cap overseas earners.
- Japanese equities gained and the yen weakened slightly. Much focus in the month was on the Bank of Japan's monetary policy meeting.
- Emerging markets (EM) equities staged a rebound in July, led by Latin America as Brazil and Mexico posted strong gains on easing domestic political concerns.
- Government bond yields were higher over July, having mostly moved sideways in June. Speculation that the Bank of Japan (BoJ) may be preparing to reduce ultra-accommodative policy measures caused the Japanese government bond yield curve to steepen.

THE US

US equities gained ground in July, buoyed by a slew of strong company results, ongoing strength in employment and resilient economic activity. In addition, while concerns over international trade sanctions remain active, the US, Europe and China's apparent receptiveness late in the month to renegotiating trade barriers meant that the fears eased slightly. The oil price declined sharply over the month, as Russia and OPEC announced a rise in supply.

A number of key economic indicators for the US remain encouraging, particularly in relative to moderating growth in other major regions. The US ISM manufacturing index[1] for June picked up from 58.7 to 60.2, ahead of expectations. The US June nonfarm payroll also added 213,000 jobs versus expectations of 195,000, with the May figure revised upward. The three-month trend in job additions remains above 200,000, suggesting a robust hiring backdrop. GDP growth for the second quarter reached 4.1% annualised.

Of the S&P 500 firms that had reported results to the beginning of August, 86% beat the estimates. All sectors, with the exception of real estate, also reported earnings growth in excess of 10%. Financial and industrial stocks recovered from a difficult June, and both sectors were amongst the strongest performers in July. However, the broader rotation into more traditionally defensive sectors also continued, lifting the healthcare and consumer staples sectors. That said, all major sectors advanced.

EUROZONE

July was a better month for eurozone equities as trade worries receded. The MSCI EMU index returned 3.5%. Car manufacturers and other export-related sectors drew support from a meeting between US President Trump and EU President Juncker. This resulted in an agreement to work towards zero tariffs on non-auto industrial goods while new car tariffs will be put on hold while longer-term talks take place.

Top-performing sectors included financials, telecommunication services and utilities. The second quarter earnings season got under way with encouraging results from a number of banks. Information technology was something of a laggard following disappointing Q2 results from Nokia.

GDP growth for the second quarter confirmed a slowdown in economic activity, with expansion of 0.3% in Q2 following 0.4% in Q1. Inflation for July was estimated at 2.1%, up from 2.0% in June, with energy the largest contributor. Eurozone unemployment remained stable at 8.3%, the lowest rate since December 2008. Forward-looking data continued to soften slightly with the flash composite purchasing managers' index[2] easing to 54.3 in July from 54.9 in June.

UK

The FTSE All-Share index rose 1.3% over the month as the weakness in sterling seen since the spring (against a resurgent dollar) fed through into earnings upgrades, particularly for the large-cap overseas earners. Sterling continued its downward trajectory in July as fears of a "no deal" or "cliff edge" Brexit once again came to the fore after the government published proposals for leaving the EU.

After more than two years since the referendum, plans for the UK's post-departure relationship with the bloc were laid out in a white paper. However, the reaction in Westminster to the so-called "Chequers agreement" was poor and concerns over infighting in the government, and the potential consequences of this for negotiations with the European Commission, were reflected by the currency.

While sterling weakness has been a short-term fillip for the FTSE 100 (1.5% higher over July) the renewed uncertainty around Brexit weighed on domestic sectors. The FTSE 250 (ex investment companies) fell 0.1% over the month and the FTSE Small Cap (ex investment companies) generated a negative total return of -1.0%. On the positive side there was evidence of a modest rebound in the UK economy in Q2, driven by a recovery in the services sectors, with retail sales performing well as a result of the good weather and World Cup.

JAPAN

After a sharp decline in early July, the Japanese market subsequently recovered to record a gain of 1.3% for the month as a whole. The yen again weakened slightly against a generally stronger US dollar.

For the second consecutive month, the market was led by the oil & coal sector. The bank sector also performed well, driven partly by speculation ahead of the Bank of Japan's policy meeting. There was no particular pattern among other sector returns, with the weakest areas being food stocks and retailers.

Overall trade concerns receded slightly after signs emerged of a more productive dialogue between the US and Europe. This allowed investors to focus on the initial stages of the quarterly results season for Japanese corporates. Although only a small

proportion of companies had released number by the end of the month, there is already a bias in favour of moderate positive surprises. As always at this stage of the fiscal year, companies are very reluctant to revise their full-year numbers, but this could become a more positive trend after September.

The Bank of Japan's policy committee meeting generated a few days of intense speculation, despite the fact that the vast majority of observers had been expecting no changes to be announced. The central bank flagged some incremental changes, which were seemingly designed to produce a more sustainable monetary expansion over the next few years. The main issue was a widening of the band within which government bond yields can fluctuate while still being "close to zero" according to the Bank of Japan's policy. This particular issue was communicated to financial markets rather poorly, leading to some significant intra-day volatility in bond yields.

ASIA (EX JAPAN)

Asian ex Japan equities eked out a marginal gain. The weak performance of index heavyweight China was a drag on returns as concerns over its trade dispute with the US continued. The Korean market also weighed on index performance, falling amid anxiety over the effect the weak Korean won will have on earnings should export growth be hampered by global trade tensions.

On the positive side, ASEAN members performed strongly, particularly Thailand, where banks and electronics stocks outperformed. Also, the Thai finance minister stated there was no need for rate hikes as inflation had returned to the central bank's target range, and said any impact from a trade war is expected to be small. The Indian market also gained strongly, boosted by cuts in the goods and services tax (GST) and a pause in outflows from foreign investors. It also benefited from declining crude oil prices and a stabilising rupee. Meanwhile, strong performance from the semiconductor industry helped drive Taiwan higher. The Australian market gained for the fourth consecutive month, led higher by the telecoms sector.

EMERGING MARKETS

Emerging markets (EM) equities staged a rebound in July, led by Latin America as Brazil and Mexico posted strong gains on easing domestic political concerns. In Brazil, a number of centre parties announced that they would support the candidacy of Geraldo Alckmin of the Brazilian Social Democracy Party (PSDB) for president, providing him with greater allotment of TV and radio airtime. Strong Q2 earnings results were also beneficial. In Mexico, peso strength was supportive of returns as domestic political uncertainty eased following elections. Poland also outperformed with financials among the strongest index names.

In contrast, China was firmly down on continuing US-China trade uncertainties as the Trump administration followed through on its threat and declared another $200bn tariff plan. Late in the month, China announced a range of targeted economic support measures, including a shift to fiscal stimulus and credit easing. Turkey was the weakest index market, primarily due to lira weakness. Inflation climbed to 15.4% in June but the central bank unexpectedly held its key policy rate at 17.75%. Meanwhile relations with the US showed signs of deterioration.

GLOBAL BONDS

Bond yields were higher over July, having mostly moved sideways in June. Speculation that the Bank of Japan (BoJ) may be preparing to reduce ultra-accommodative monetary policy measures caused the Japanese government bond yield curve to steepen. Japan's 30-year yields increased from 0.71% to 0.76% while two and 10-year yields were little changed.

The BoJ speculation rippled through global bond markets. US 10-year Treasury yields rose 10 basis points (bps) to 2.96%. Ten-year Bund yields rose from 0.30% to 0.44% and UK 10-year yields rose from 1.28% to 1.33%.

Italian 10-year yields rose from 2.68% to 2.72%, Spain's from 1.32% to 1.40%. Initially, lowered concerns over the impact of trade tariffs on Europe seemed to support investor sentiment.

Corporate bonds had a constructive month, generating positive total returns. High yield[3] outperformed investment grade, notably in euro denominated credit, as insurance saw improved performance after a difficult run. In investment grade, US dollar credit was strongest, as the media and telecoms sectors saw a rebound.

Emerging market (EM) bonds performed well especially hard currency, which returned 2.5%. Local currency EM returned 1.9% and corporates 1.4%.

Global convertible bonds, as measured by the Thomson Reuters Global Focus Convertible Index, were broadly flat in July, despite modest gains for equity markets. A combination of the asset class's weighting towards Asia, particularly China, and a technical cheapening of valuations largely offset a stronger showing of the broader US tech-related universe.

COMMODITIES

The Bloomberg Commodities index fell again in July, with US dollar strength weighing. Base metals – with the exception of tin - were lower across the board. Zinc, lead and nickel were especially weak. The energy sector was also lower, with the oil price dipping after OPEC announced supply increases. The agricultural component recovered, with material rises in the price of soy beans, wheat and corn. In precious metals, gold and silver both fell.

[1] The ISM Manufacturing Index is based on surveys of more than 300 manufacturing firms by the Institute for Supply Management. The index monitors employment, production, inventories, new orders and supplier deliveries.

[2] 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.

[3] 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, July 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 JULY 2018

	1 MONTH			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	3.1	2.9	3.8	11.9	12.7	12.4
MSCI World Value	3.7	3.4	4.3	7.0	7.8	7.6
MSCI World Growth	2.6	2.4	3.3	16.7	17.6	17.3
MSCI World Smaller Companies	1.2	1.0	1.9	13.6	14.5	14.2
MSCI Emerging Markets	2.2	2.0	2.9	4.4	5.2	4.9
MSCI AC Asia ex Japan	0.8	0.6	1.5	5.2	6.0	5.7
S&P500	3.7	3.5	4.4	16.2	17.1	16.8
MSCI EMU	3.7	3.5	4.4	5.7	6.5	6.3
FTSE Europe ex UK	4.4	4.2	5.1	5.3	6.1	5.8
FTSE All-Share	0.6	0.4	1.3	8.6	9.4	9.2
TOPIX*	0.2	0.0	0.9	9.2	10.0	9.8

	1 MONTH			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	-0.5	-0.7	0.2	-1.2	-0.5	-0.7
JPM GBI UK All Mats	-1.0	-1.2	-0.4	0.8	1.6	1.3
JPM GBI Japan All Mats**	-1.3	-1.5	-0.6	-0.2	0.5	0.3
JPM GBI Germany All Mats	-0.4	-0.6	0.3	0.7	1.5	1.2
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	0.6	0.4	1.2	-0.6	0.2	-0.1
BofA ML US Corporate Master	0.8	0.5	1.4	-0.7	0.1	-0.2
BofA ML EMU Corporate ex T1 (5-10Y)	0.6	0.4	1.3	0.1	0.9	0.6
BofA ML £ Non-Gilts	-0.5	-0.7	0.1	-0.4	0.4	0.2
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	1.4	1.2	2.1	1.8	2.6	2.3
BofA ML Euro High Yield	1.7	1.5	2.4	0.7	1.4	1.2

Source: DataStream.
Local currency returns in July 2018: *1.3%, **-0.2%.
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