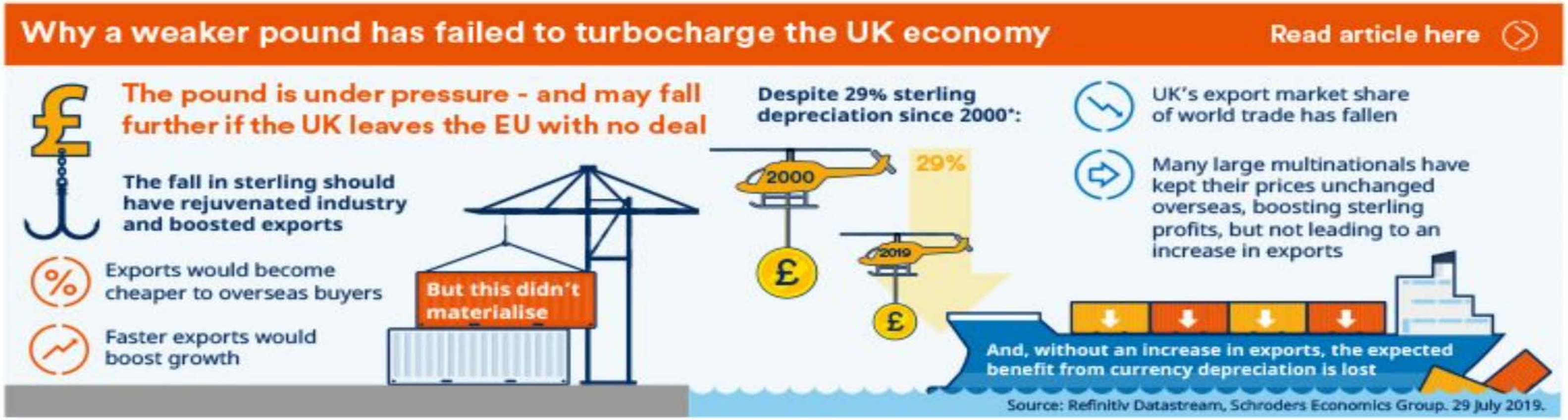
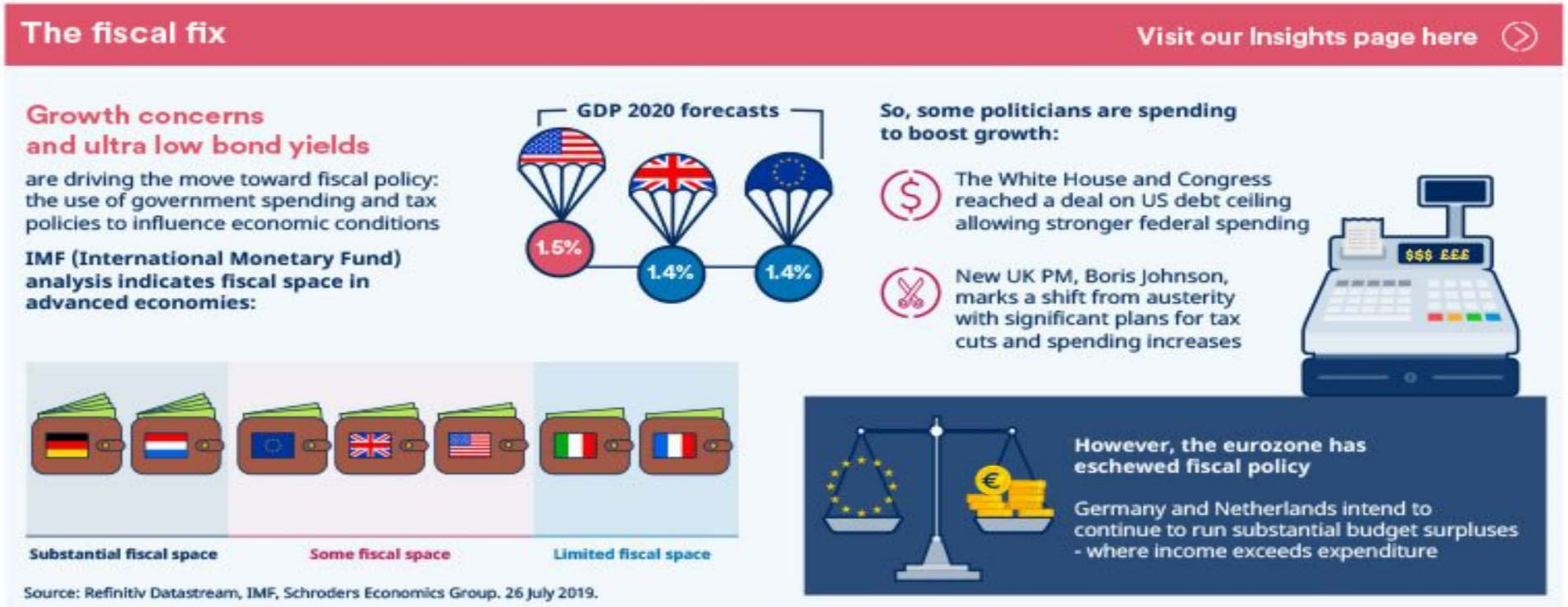
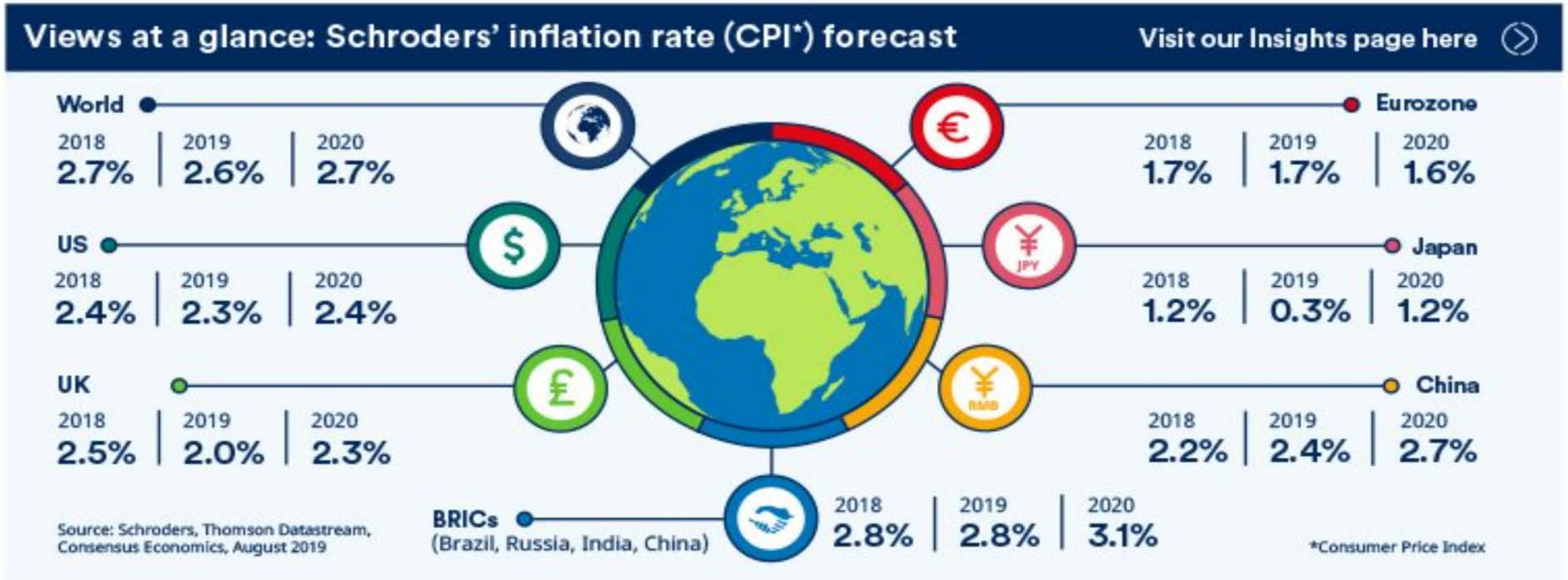
FINURA

MARKET COMMENTARY
AUGUST 2019

INFOGRAPHIC: THE GLOBAL ECONOMY







Source: Schroders as at August 2019.

MULTI-ASSET INVESTMENT VIEWS

KEY

▲ Up from last month ▼ Down from last month

Positive · Positive/Neutral · Neutral · Neutral/Negative · Negative

	Category	View	Comments
Main Asset Classes	Equities	Neutral	Remain neutral on equities, in part due to seemingly stretched valuations and an anaemic backdrop for growth.
Main Asset Classes	Government Bonds	Positive/Neutral	Although valuations look stretched, positive momentum and soft cyclical indicators point towards maintaining a positive view on bonds as defensive positions in portfolios.
Main Asset Classes	Commodities	Neutral	We remain neutral overall on commodities with negative carry and momentum offset by our positive view on gold as a hedge against increased liquidity and geopolitical risks.
Main Asset Classes	Credit	Positive/Neutral	Although credit spreads tightened in June, supportive technicals and a more benign backdrop for credit offset longer-term concerns over fundamental credit quality.
Equities	US	Positive/Neutral	Valuations have deteriorated slightly, but momentum remains amongst the strongest in the major markets.
Equities	UK	Negative	Uncertainties around political leadership may keep investors away from UK equity markets and the risk of a sterling bounce in the longer term is a concern.
Equities	Europe	Neutral	We remain neutral. A dovish Fed may lead the US dollar to weaken against the euro and cast doubt on the recently improved European earnings outlook.
Equities	Japan	Neutral	Export weakness and a strong yen continue to be a drag for equities despite of an improving domestic economy.
Equities	Pacific ex-Japan	Neutral	Singapore export weakness is a negative for the region and momentum is lagging. We continue to hold a neutral view.
Equities	Emerging Markets	Neutral ▼	Renewed pressures from trade conflicts raise risks for those markets with an export focus.
Government Bonds	US	Positive/Neutral	No change to the conditions that prompted last month's upgrade. The cyclical outlook still looks weak and US-China trade war rhetoric shows few signs of abating.
Government Bonds	UK	Positive/Neutral	Gilts could profit from further political uncertainty in the UK and in particular, the increasing threat of a "No-Deal" Brexit.
Government Bonds	Germany	Positive/Neutral ▼	Downgraded to single positive. Increased liquidity, investors seeking yields higher than cash rates and the European Central Bank (ECB) opening the door to stimulus should benefit longer duration bonds.
Government Bonds	Japan	Positive/Neutral	Given export weakness on the back of the continuing trade war situation, we remain positive.
Government Bonds	US Inflation Linked	Neutral ▼	Downgraded to neutral as declines in oil prices will limit year-on-year inflation numbers in H2 2019.
Government Bonds	Emerging Markets Local	Positive/Neutral	We remain positive. More dovish tones from major central banks should provide support as investors search for yield.

	Category	View	Comments
Investment Grade Corporate Bonds	US	🟢 ▲	Upgraded to positive as it offers slightly more attractive valuations against an unusually benign backdrop.
	Europe	🟡 ▼	Downgraded to neutral, as increasing leverage is making any deterioration in earnings or increase in interest costs a potential negative catalyst.
	Emerging Markets USD	🟡	We remain neutral. Spreads tightened again in June, leaving valuations still looking unattractive.
High Yield Bonds	US	🟢 ▲	Upgraded as although concerns over fundamental credit quality remain, they are offset by supportive technicals and a more benign backdrop for credit.
	Europe	🟡 ▼	Downgraded as valuations have become less appealing after the recent spread tightening, and fundamentals are weakening.
Commodities	Energy	🟡	As OPEC struggles to agree the next output cuts, the impact of mounting geopolitical tensions is offsetting the effects of weakening economic sentiment.
	Gold	🟢	Gold is being supported by dovish Fed comments and picked up further momentum on the back of escalating geopolitical tensions in the Middle East.
	Industrial Metals	🟡	With the upside capped by cyclical headwinds and downside limited by central bank dovishness and increased Chinese fiscal stimulus, we remain neutral.
	Agriculture	🔴	Remain negative given the decreased possibility of a trade war resolution, coupled with bad weather and a negative carry.
Currencies	US $	🟢	Our view remains unchanged, as we expect both further softness in global growth and the global central bank "race to the bottom" to keep currency volatility low and non-directional.
	UK £	🔴	Our view on the pound remains negative as the increased probability of a "No-Deal" Brexit compounds the effects of weak economic data.
	EU €	🟡	The ECB's recent movement towards increasing stimulus is a headwind for the euro so we maintain our neutral view.
	JAP ¥	🟢	The yen's safe-haven status could prove beneficial in an environment where economic weakness persists.
	Swiss F	🟡	Contagion from weak European industry is impacting Switzerland, leading us to keep our neutral position on the Swiss franc.

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 2019. 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 declined and bonds outperformed amid rising concerns over the outlook for growth.

HIGHLIGHTS

- August saw global stock markets decline while perceived safe haven assets such as bonds outperformed amid escalating worries over trade and growth. A closely-watched US bond market indicator suggested rising recession risk.
- In the US, shares fell amid growth worries. The Treasury yield curve inverted for the first time since 2007, magnifying concerns that the economy may be heading into recession.
- Eurozone shares ended lower in August. Weak economic data from Germany contributed to heightened worries over global growth.
- Shares fell in the UK, although defensive areas such as healthcare and utilities outperformed. The prospect of a no-deal Brexit rose with the government unveiling plans for a lengthy prorogation of parliament.
- Japanese shares fell, mirroring the currency market as the yen moved sharply higher against the dollar early in the month.
- Emerging market equities declined as trade tensions escalated. Those markets most sensitive to US dollar strength came under pressure. These included Turkey and South Africa, but also Argentina where a surprise primary election result triggered a major sell-off in shares and the currency.
- Government bond yields declined significantly (meaning prices rose) amid the various geopolitical concerns. The US 10-year government bond yield fell 35 basis points, closing the month at 1.50%, a three-year low, while the two-year yield also ended at 1.50%.

THE US

US equities declined in August, although the falls were less pronounced than in other major markets. The Federal Reserve (Fed) cut interest rates, as expected, at the end of July. The Fed's comments indicated that the move was an adjustment rather than the start of an easing cycle, which seemed to disappoint investors concerned about an economic slowdown. The central bankers' gathering at Jackson Hole in August offered few further clues on the outlook for US monetary policy, although the trend in economic data remained broadly unchanged.

However, the yield on two-year US Treasuries briefly rose above those on the 10-year bond. This represents an inversion of the yield curve, which is regarded as an indicator of a forthcoming recession.

Data indicated growth is slowing but that the economy is otherwise robust. US GDP growth for Q2 was revised slightly lower - to 2.0% from the advance estimate of 2.1% - in line with consensus forecasts. July employment data (the non-farm payrolls) showed a still-healthy jobs market with 164,000 jobs added and wage growth of 3.2% year-on-year. Retail sales continue to signal that the US consumer remains in good shape. President Trump announced, and then deferred, new tariffs on $300 billion of predominantly consumer goods.

Even so, wider concerns over a more meaningful economic slowdown, particularly in light of the Fed's reluctance to loosen interest rates more aggressively, were reflected in the market's moves. Investors appeared to reduce exposure to economically sensitive areas of the market such as energy, financials and materials. Traditionally defensive areas such as utilities, real estate and consumer staples were comparatively resilient.

EUROZONE

Eurozone shares ended lower in August with the MSCI EMU (Economic and Monetary Union) index returning -1.2%. Weak economic data from Germany weighed on stock markets while Brexit uncertainty remains another key concern for markets. The financials sector, a large component of the index, was among the weakest performers alongside energy and consumer discretionary. Worries over slow growth and trade wars weighed on industries such as banks, autos and IT. Sectors perceived as safe havens – such as healthcare and consumer staples – fared better.

In Germany, the composite purchasing managers' index (PMI)[1] came in at 51.4, indicating the economy is expanding. However, the manufacturing PMI came in at 43.6, well below the 50 mark that separates growth from contraction. The weak data raised suggestions that Germany's government could increase spending in order to try and fend off a recession. It also lifted investor expectations that the European Central Bank will act in September to ease monetary policy in an effort to stimulate the economy. However, this saw bank shares decline. Quarterly results over the summer showed that banks continue to struggle with low interest rates which squeeze their profit margins.

Political uncertainty was the theme of the month in Italy after the break-up of the governing coalition of the right-wing League and populist Five Star. Instead, Five Star plan to form a new coalition with the Democratic Party. Italian assets rallied late in the month on hopes this new coalition may prove more fiscally conservative and less likely to enter disputes over EU budget rules.

UK

UK equities fell over August. Sterling recovered some ground lost in July but fell in the final week of the month. The prospect of a no-deal Brexit rose with the government unveiling plans for a lengthy prorogation of parliament.

The heavyweight commodity and financials sectors led the falls amid ongoing concerns around the outlook for the global economy. On the other hand, defensive areas, including healthcare, utilities and consumer goods, held up well as investors became more cautious.

Figures from the Office for National Statistics revealed GDP fell 0.2% in Q2, following 0.5% growth in Q1. The biggest drag on growth in the quarter was a reduction in inventories in the run up to the initial 31 March Brexit deadline.

Markit's UK manufacturing purchasing managers' index (PMI) was unchanged at 48.0 in July. Meanwhile the services PMI rose to 51.4 versus 50.2 in June and away from the 50 level which demarcates contraction from expansion, allaying for a period fears of a further loss of momentum in the economy's dominant consumer-exposed sector.

The latest labour market data was robust. Retail sales grew again in July, again defying expectations for another month-on-month decline.

JAPAN

The Japanese market fell sharply in early August and then moved sideways to record a total return of -3.4%. These moves basically mirrored the currency market. The yen moved sharply

higher against the dollar in the first few days of the month following July's reduction in US interest rates.

Equity market sentiment fluctuated in line with day-to-day newsflow on the US/China trade relationship. This tended to overshadow the conclusion of the Japanese corporate results announcements for the first quarter of the fiscal year. The overall interpretation of these results was somewhat negative. This was primarily due to the loss of earnings momentum for cyclical companies in reaction to the slowing global environment. Overall, however, the number of positive and negative surprises was finely balanced and the possibility remains for some earnings recovery in the second half of the fiscal year. Inevitably, the recent renewed currency strength is encouraging investors to be cautious about near-term earnings prospects.

The main economic surprise during August came from the release of GDP data for the April to June quarter, which was well ahead of expectations, driven primarily by domestic factors. Although positive, this historic data seemed to have limited impact, with investors more focused on the potential for short-term fluctuations around the consumption tax increase in October. Meanwhile inflation data remained low, but reasonably solid, given the current downward pressure from year-on-year changes in energy prices.

Away from macro data, the most interesting developments at the corporate level came from several restructurings of long-term strategic shareholdings. There were significant announcements from companies within the printing sector and also from Sony, which unwound a long-held cross-shareholding in medical equipment specialist Olympus.

ASIA (EX JAPAN)

Asia ex Japan equities were down as the US-China trade dispute escalated. The MSCI AC Asia ex Japan index returned -4.4% in the month.

Hong Kong was among the weakest index markets as demonstrations continued. Meanwhile, Q2 GDP growth of 0.5% year-on-year (y/y) disappointed, and retail sales fell 13% y/y in July. Singapore, where industrials stocks led the market lower, and South Korea also underperformed. In Korea, rising global trade uncertainty continued to weigh on the outlook.

By contrast, Taiwan recorded a negative return but outperformed, supported by performance from real estate, communication services and IT stocks. China marginally outperformed, despite the deterioration in the trade dispute with the US.

EMERGING MARKETS

Emerging market equities lost value with further strengthening of the US dollar exacerbating wider risk aversion. The MSCI Emerging Markets Index decreased in value and underperformed the MSCI World.

Amid rising uncertainty, those markets most sensitive to US dollar strength came under pressure. These included Turkey and South Africa, but also Argentina where surprise primary election results triggered a major sell off in equities and the currency. Brazil also underperformed due to currency weakness. Q2 GDP growth was slightly ahead of expectations at 1% year-on-year (y/y) but higher frequency data continued to reflect a sluggish economic recovery.

By contrast, Egyptian equities rallied strongly as the central bank cut interest rates by more than expected. China posted a negative return but marginally outperformed. The US announced 10% tariffs on $300 billion of Chinese goods with effect from 1 September, albeit around half of these were later delayed to 15 December. The renminbi subsequently depreciated beyond the symbolic 7-per-US-dollar threshold, and in response the US Treasury labelled the country a currency manipulator. The Chinese authorities retaliated to trade actions with tariffs on $75 billion of imports from the US, and also suspended new US agricultural product purchases. Meanwhile, fresh policy support was announced in response to domestic economic weakness.

GLOBAL BONDS

Government bond yields declined significantly amid heightened concerns over US-China trade tensions and global growth (bond prices and yields move inversely). At the start of the month, President Trump unveiled a 10% tariff on another $300 billion of Chinese goods, to take effect on 1 September. The US 10-year Treasury yield fell 13 basis points (bps) in one day as a result. China retaliated by adding tariffs and allowed a significant devaluation of the renminbi.

Over the month, the US 10-year yield fell 50bps, closing the month at 1.50%, a three-year low, while the two-year yield fell 37bps, also closing at 1.50%. The two-year yield fell slightly below the 10-year towards the end of the month, a yield curve inversion, indicating significant economic pessimism among bond investors.

European yields were meaningfully lower too, with Bund yields falling further into negative territory. Activity data across the region was mixed, although the latest GDP print showed Germany's economy contracted in Q2, in line with expectations. The 10-year Bund yield fell 26bps to -0.70%. Italian 10-year yields were over 50bps lower at 1.0%, a record low, as a new coalition government was formed. Spain's 10-year yield dropped 17bps to finish at 0.11%.

Following a significant move in the previous month, the UK 10-year yield fell 13bps to finish at 0.48%. Brexit uncertainty remained heightened with Prime Minister Boris Johnson firmly maintaining that the UK will leave the EU on 31 October, with or without an agreement in place.

Corporates underperformed government bonds, even as US dollar investment grade[2] saw its strongest monthly total return in three years. Investment grade corporate bonds' positive total returns were well supported by falling global yields, while high yield saw more modest positive returns.

Hard currency emerging market bonds made positive returns, but local currency bonds declined as Argentina's currency and bonds fell sharply.

Convertible bonds, as measured by the Thomson Reuters Global Focus index, declined by -1.4% in US dollar terms compared to -2.0% for the MSCI World equity index. The overall equity exposure in the convertible market sits at a low 30% with a solid 89% bond floor. The overall credit rating is a stable BBB average, which gives comfort these companies will survive in more difficult conditions.

COMMODITIES

The S&P GSCI Spot Index lost value in August amid increased uncertainty over the outlook for global growth. The energy

component registered the steepest decline as crude oil fell 7.7%, with demand concerns outweighing ongoing supply risks. The soft commodities component was also firmly down. Corn was notably weak as higher-than-expected production boosted the supply outlook. Industrial metals also fell with iron ore prices correcting sharply amid rising demand concerns in China, and as supplies stabilised following disruptions earlier in the year. By contrast, precious metals - gold and silver - posted robust returns as investors moved into perceived safe haven assets.

[1] The purchasing managers' index is based on survey data from companies in the manufacturing and services sectors. A reading above 50 indicates expansion.

[2] 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.

TOTAL RETURNS (NET) % – TO END AUGUST 2019

	1 MONTH			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	-2.0	-1.0	-1.5	0.3	5.9	7.0
MSCI World Value	-3.1	-2.1	-2.6	-2.2	3.3	4.4
MSCI World Growth	-1.0	0.1	-0.5	2.7	8.5	9.6
MSCI World Smaller Companies	-3.4	-2.3	-2.9	-8.6	-3.5	-2.5
MSCI Emerging Markets	-4.9	-3.8	-4.4	-4.4	1.0	2.1
MSCI AC Asia ex Japan	-4.4	-3.3	-3.9	-6.3	-1.0	-0.0
S&P500	-1.6	-0.5	-1.1	2.9	8.7	9.8
MSCI EMU	-2.3	-1.2	-1.8	-5.2	0.2	1.2
FTSE Europe ex UK	-1.9	-0.8	-1.4	-1.8	3.8	4.8
FTSE All-Share	-4.1	-3.0	-3.6	-5.9	-0.6	0.4
TOPIX*	-1.2	-0.1	-0.6	-6.8	-1.5	-0.5

	1 MONTH			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	3.6	4.8	4.2	10.9	17.1	18.3
JPM GBI UK All Mats	3.3	4.4	3.8	4.9	10.8	11.9
JPM GBI Japan All Mats**	4.0	5.2	4.6	11.0	17.2	18.4
JPM GBI Germany All Traded	-1.3	1.0	2.6	1.5	6.7	8.8
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	0.1	2.4	4.1	7.3	12.8	15.0
BofA ML US Corporate Master	0.7	3.0	4.6	10.5	16.1	18.3
BofA ML EMU Corporate ex T1 (5-10Y)	-0.3	2.0	3.6	3.3	8.6	10.7
BofA ML £ Non-Gilts	-1.8	0.4	2.1	0.8	6.0	8.0
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	0.3	2.6	4.2	6.3	11.7	13.9
BofA ML Euro High Yield	-1.5	0.8	2.4	-0.2	4.8	6.9

Source: Thomson Reuters DataStream.
Local currency returns in August 2019: *-3.4%, **1.7%.
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Source: Schroders, August 2019: 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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