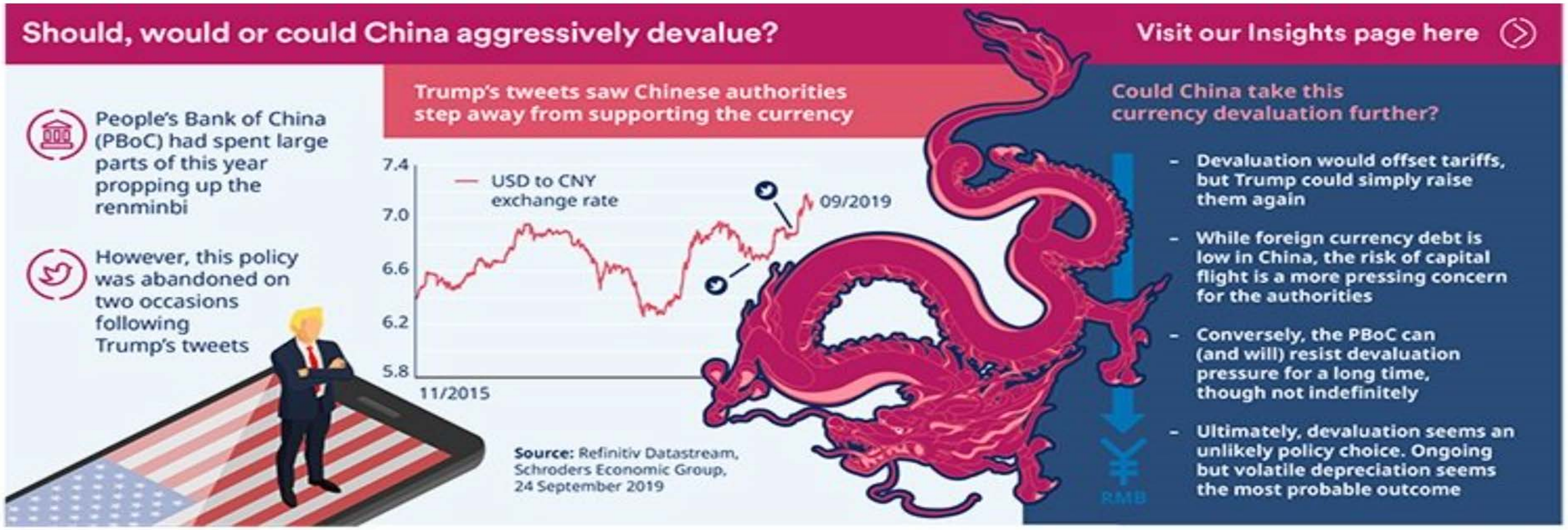
FINURA

MARKET COMMENTARY
OCTOBER 2019

INFOGRAPHIC: THE GLOBAL ECONOMY



Source: [Schroders as at October 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 given supportive liquidity conditions. We believe equities are still attractive relative to bonds, but are wary of the significant risk of corporate earnings downgrades.
	Government Bonds	● Positive/Neutral	Valuations have worsened, but strengthening momentum and weak economic indicators mean we keep bonds as defensive positions in portfolios.
	Commodities	● Positive/Neutral ▲	Upgraded commodities to positive. Our positive view on gold offsets slight weakness in the cyclical backdrop.
	Credit	● Positive/Neutral	The strong technical backdrop remains, given the broadly dovish orientation of US Federal Reserve (Fed), European Central Bank (ECB) and emerging market monetary policy.
Equities	US	● Neutral ▼	Downgraded to neutral as earnings expectations have started to slip again, though slowly. Valuation is moderately expensive but not at an alarming level.
	UK	● Negative	Uncertainties around policy direction ("hard" Brexit is still a risk) continue to pose challenges for UK markets. GBP weakness may provide support given the international nature of UK companies.
	Europe	● Negative	2019 earnings forecasts fell sharply and further downgrade risk remains. EUR weakness may provide support.
	Japan	● Neutral	Despite an improvement in the economic data, export weakness and a strong yen continue to be a drag.
	Pacific ex-Japan	● Neutral	Growth momentum in the region continues to be weak and expectations of further accommodative monetary policies are priced in.
	Emerging Markets	● Neutral	Pressures from trade conflicts continue to raise the risks for those markets with an export focus.
Government Bonds	US	● Positive/Neutral	US government bonds play an important role as a hedge against growth disappointment, and offer a higher yield relative to other markets.
	UK	● Positive/Neutral	Continued political uncertainty within the UK could further support gilts.
	Germany	● Neutral	We remain neutral as valuations continue to trade at extreme levels, and the ECB is still indicating that it has reached its limits on monetary policy.
	Japan	● Neutral	There have been no significant developments and therefore our view remains unchanged.
	US Inflation Linked	● Positive/Neutral ▲	Turned positive due to the impacts of tariffs and after a lift in shorter term core CPI.
	Emerging Markets Local	● Neutral	Remain at neutral, following last month's downgrade on significant spread tightening and cyclical risks.

	Category	View	Comments
Investment Grade Credit	US		We continue to favour the US, given the technical backdrop and dovish Fed.
	Europe		Maintain at neutral. European investment grade increasingly suffers from negative yields and high levels of supply.
	Emerging Markets USD		We retain our positive view on EM sovereigns, given the strong technical backdrop and broadly dovish orientation of EM monetary policy.
High Yield Credit	US		Despite seeing a slight pick-up in projected default rates, we remain positive, on valuation and technical grounds.
	Europe		Fundamentals are weak and there is more 'call risk' than the market is currently pricing. This is the risk that a bond issuer will redeem its bonds before they mature.
Commodities	Energy		The impact of potential geopolitical tensions offsets the effects of softening economic sentiment.
	Gold		Amidst concerns of economic growth, gold continues to be supported by the provision of liquidity by central banks.
	Industrial Metals		Price upside continues to be restrained by cyclical headwinds and downside limited by central bank dovishness.
	Agriculture	▲	We upgraded to neutral, as prices now largely reflect the lacklustre outlook. Inventory should remain elevated in 2020 and the US-China trade war shows little sign of resolution.
Currencies	US $	▼	World growth fell again with US data leading the move downwards. On the other hand, expectations for additional rate cuts have pared back more in-line with Fed's own anticipations.
	UK £		With the Bank of England continuing to push back against suggestions of future rate cuts, and the probability of a "no deal" Brexit all but priced in, we remain at neutral after upgrading our view in September.
	EU €		We remain neutral in light of increased stimulus from the ECB, but recognise potential for positive surprises, include ebbing Italian risk owing to a change in government, and increased talk of fiscal stimulus from Germany.
	JAP ¥	▼	Although our cycle models continue to point to caution, we have downgraded JPY this month to reflect the stabilisation in global macro sentiment, thanks to emerging signs of life in US/China trade talks and increased liquidity support from the Fed.
	Swiss F		Remain neutral on CHF, we believe the intended impact of weakening the currency through cuts will be limited.

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, October 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 on markets in October when risk appetite picked up amid hopes of progress on trade talks.

HIGHLIGHTS

- October saw gains for global equities amid signs of progress on a US-China trade deal while central banks remained supportive. Government bonds in general moved lower.
- US equities rallied. US-China trade negotiations saw the two sides agree the outline of a potential mini trade deal. The Federal Reserve lowered interest rates by 25 basis points, its third cut this year.
- Eurozone equities posted gains as some economically-sensitive sectors performed well. GDP growth data for Q3 defied recession worries, with the eurozone economy expanding by 0.2% quarter-on-quarter.
- UK equities underperformed against the backdrop of a very strong rebound in sterling. Sterling bounced back as the prospect of a "no deal" Brexit outcome on 31 October receded.
- The Japanese market recorded a gain of 5.0%. The yen fluctuated against major currencies, reflecting changing views on the likely action of central banks, but ended the month virtually unchanged against the US dollar.
- Emerging market equities recorded a strong return, benefiting from a pick-up in risk appetite. Positive sentiment towards US-China trade talks, further global central bank easing and US dollar weakness all proved supportive.
- In fixed income, government bond yields rose overall (meaning prices fell). Corporate bonds produced positive returns and outperformed government bonds.

THE US

US equities rallied throughout the month, lifted by cyclical stocks (i.e. those that are most sensitive to the economic cycle). Bond yields pushed higher and US-China trade negotiations improved with the two sides agreeing the outline of a mini trade deal.

The Federal Reserve (Fed) cut rates for the third time in 2019 but signalled an intention to take a pause in the easing cycle. Although the improvement in negotiations with China was a positive development, the gap between a tentative truce and a peace deal remains significant and tensions between the two countries could quickly escalate again, particularly going into the US election period. The moves to impeach US President Trump continued in the month, further adding to uncertainty.

Economic data for the US economy was mixed. The unemployment rate for September fell to 3.5% from 3.7% in August, exceeding market expectations. This takes the jobless rate to the lowest level since 1969. The economy added 136,000 new jobs, close to market expectations. However, consumer confidence weakened. The Conference Board consumer confidence index slipped to 125.9 in October from an upwardly revised 126.3 a month earlier. (The Conference Board is a think-tank. Its consumer confidence survey reflects prevailing business conditions and likely developments for the months ahead.)

Healthcare, information technology and communication services were among the best performers in the month. The energy, utilities and consumer staples sectors were the weaker areas of the market, given expectations of a more challenging demand environment.

EUROZONE

Eurozone equities posted gains as some economically-sensitive sectors performed well. Consumer discretionary, industrials and materials were among the top gaining sectors, supported by hopes of an improving trade picture. By contrast, defensive sectors such as consumer staples and utilities were weak during the month.

Within consumer discretionary, the automobiles & components sub-sector was strong. This is a part of the market that has underperformed this year amid gloom over the prospects for demand. However, Volkswagen shares gained as the group posted a 43% rise in pre-tax profits for Q3. Daimler shares also rose despite the group warning that its profits for this year will be significantly below 2018 levels. Late in the month, Fiat Chrysler and Peugeot announced plans to pursue a merger. In consumer staples, drinks firm AB InBev saw its share price fall after it had to cut its annual profits forecast. The information technology sector posted a positive return overall but networks group Nokia saw its shares fall sharply after it paused its dividend payments.

On the economic front, growth figures for Q3 defied recession worries. GDP growth for the eurozone was 0.2% quarter-on-quarter with France showing a 0.3% growth rate and Spain 0.4%. However, inflation dipped lower to 0.7%. The flash composite purchasing managers' index (PMI) ticked up marginally to 50.2 in October from 50.1 in September but the manufacturing sector PMI still points to contraction. (The purchasing managers' index is based on survey data from companies in the manufacturing and services sectors. A reading above 50 indicates expansion.)

UK

UK equities struggled to make progress as a strong recovery in sterling weighed on the internationally-exposed large cap companies. A number of the biggest stocks also performed poorly on the back of some mixed Q3 results. As a result, the FTSE 100 fell 1.9% over the period, although small and mid-cap (smid) UK equities supported the wider market, helping the FTSE All-Share to record a marginally less disappointing loss of 1.4% over October.

UK smid caps outperformed given their greater exposure to more domestically-focused companies. These companies bounced back over the month in line with sterling as the prospect of a 'no deal' Brexit outcome on 31 October receded. This occurred after the EU and UK agreed a revised withdrawal agreement, and the EU extended the Brexit deadline until 31 January 2020, under a "flextension" arrangement. In addition to these developments, parliament enacted a bill for a UK general election on 12 December. Domestically focused companies have underperformed UK overseas earners since 2016 as Brexit fears set in.

Merger and acquisition activity remained a feature of the market after cyber security specialist Sophos and food delivery platform Just Eat were subject to fresh overseas bid interest. New GDP figures showed the UK economy contracted in August by 0.1% compared to July. However, upward revisions to June and July growth rates now mean that there is an extremely low likelihood that the UK fell into a recession in Q3.

JAPAN

The Japanese market recorded a gain of 5.0% for October. The yen fluctuated against major currencies, reflecting changing views on the likely action of central banks, but ended the month virtually unchanged against the US dollar.

Japan's economic data continues to show a significant divergence between strength in the service sector and weakness in manufacturing. There are also signs that the long-running trend towards an ever-tighter labour market may be finally reaching its natural limit.

Investors are now in the period of maximum uncertainty regarding the effects of consumption tax increase on 1 October. Some evidence of front-loading demand ahead of the tax increase is visible, but the extent of the subsequent downturn in consumption is not yet in the data. With no firm conclusions available, the early indications of the inflation impact look smaller than expected, suggesting that underlying inflationary pressures have weakened slightly. This tended to raise some expectations that the Bank of Japan would cut rates further into negative territory in late October. In the event, there was no change in policy.

From late October, companies began reporting their results for second quarter of fiscal year. Initial indications look in line with expectations, or slightly positive, and may mark the end of the downward revision cycle in corporate profits.

One unexpected story hit the headlines as the Ministry of Finance proposed a tightening of regulations for foreign investors. Although at first sight this appears to run counter to the trend towards improving corporate governance, the motivation is to prevent foreign control of companies in key strategically important industries. The regulatory framework will continue to evolve over the next few months until the final implementation, which is expected around April 2020.

ASIA (EX JAPAN)

Asia ex Japan equities rallied in October, with an improvement in the US-China trade outlook, global central bank easing and stronger-than-expected corporate earnings results boosting sentiment. US dollar weakness also proved supportive. The MSCI Asia ex Japan index recorded a positive return and outperformed the MSCI World.

Taiwan was the best-performing market, amid gains from technology sector stocks as earnings expectations for the sector were revised upwards. Pakistan and Singapore also outperformed. In Singapore, this was despite a weaker-than-expected initial Q3 GDP growth reading. The Philippines and Hong Kong outperformed by a small margin.

By contrast, Thailand was the only regional market to finish in negative territory as economic data disappointed, with Q3 GDP growth slowing to 2.3% year-on-year. Malaysia and Indonesia finished in positive territory but underperformed. China and India recorded more sizeable gains but slightly underperformed. In India, high frequency macroeconomic data remained weak and the central bank cut its key policy rate by 25 basis points (bps) to 5.15%. Meanwhile, a number of corporate earnings results exceeded expectations.

EMERGING MARKETS

Emerging market equities rallied in October, amid a pick-up in risk appetite. Signs of progress in US-China trade talks, further global central bank easing and US dollar weakness all proved supportive. The MSCI Emerging Markets Index increased in value and outperformed the MSCI World for the first month since January.

Russia recorded a strong gain as the central bank cut interest rates by more than expected. Hungary was the best-performing index market, supported by strong performance from OTP Bank. Russia recorded a robust return as the central bank cut interest rates by more than expected. Poland outperformed. The ruling Law and Justice Party was re-elected, in line with expectations, but lost its majority in the upper house. Brazil outperformed as the senate passed the long-awaited pension reform bill. Those markets that benefit from stronger global trade also finished ahead of the index, including Taiwan and South Korea.

By contrast, Turkish equities fell as military incursions into Northern Syria led the US to implement sanctions on Turkey. China marginally underperformed the index but recorded a strong return. The agreement of an outline mini trade deal was positive for sentiment, albeit this is yet to be finalised and signed. The proposal is expected to demand that China significantly increase purchases of US agricultural products as well as commit to further open its financial sector. Meanwhile, the US has suspended tariff increases previously scheduled for 15 October.

GLOBAL BONDS

Government bonds declined over the month, as yields rose, reflecting a better mood in markets and increased appetite for riskier assets. US Treasuries performed relatively well as yields pulled back late in the month. The Fed implemented a third interest rate cut for the year, but disappointed investors by indicating that it would be the last for the foreseeable future. The US 10-year Treasury yield was little changed at 1.69%, having come back from the intra-month high of 1.85% in the final sessions of the month. The two-year yield was nine basis points (bps) lower.

Earlier in the month investor sentiment was buoyed by hopes of an agreement between the US and China over trade and of a relatively moderate Brexit outcome. The UK made some progress towards a withdrawal agreement and set a date for a general election, which it is hoped will pave the way to some sort of resolution.

European government yields were meaningfully higher. German and French 10-year yields increased 17bps to -0.40% and -0.10% respectively. Spanish and Italian 10-year yields were both 10bps higher. The UK 10-year yield was 14bps higher on the more constructive outlook around Brexit.

In terms of data, the US remained healthy. Manufacturing stayed in contraction but stabilised, as new orders and exports increased. Germany's leading indicator of manufacturing stabilised at a depressed level. Manufacturing in other European countries, and also the services sector, are starting to slow too, and in some cases contract.

Corporate bonds produced positive returns and outperformed government bonds. Investment grade saw stronger outperformance relative to government bonds, as spreads tightened. High yield saw a higher total return, due to returns from income.

Emerging market bonds produced positive total returns with local currency debt standing out as a number of emerging market currencies strengthened. (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.)

Convertible bonds, as measured by the Thomson Reuters Global Focus index, gained 1.2% in US dollar terms. US valuations became more expensive while on the other hand Asian, and to a lesser extend Japanese, convertibles cheapened further.

COMMODITIES

Looking at commodities, the S&P GSCI Spot Index recorded a modest gain in October. Precious metals generated positive returns, with gold and silver prices both moving higher, supported by US dollar weakness. The industrial metals component recorded a firm gain. Copper prices rose on supply concerns, as Chilean mines saw closures amid anti-government protests. Soft commodities finished in positive territory, supported by higher cotton and sugar prices. The energy component was also up, despite a slight fall in the price of Brent crude.

TOTAL RETURNS (NET) % – TO END OCTOBER 2019

	1 MONTH			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	2.5	0.2	-2.3	12.7	14.5	11.3
MSCI World Value	2.1	-0.3	-2.8	8.5	10.2	7.2
MSCI World Growth	3.0	0.7	-1.9	16.9	18.7	15.4
MSCI World Smaller Companies	2.8	0.4	-2.1	7.9	9.6	6.5
MSCI Emerging Markets	4.2	1.8	-0.8	11.9	13.6	10.5
MSCI AC Asia ex Japan	4.6	2.2	-0.4	13.2	15.0	11.8
S&P500	2.2	-0.2	-2.7	14.3	16.1	12.9
MSCI EMU	3.6	1.2	-1.4	11.0	12.8	9.6
FTSE Europe ex UK	3.4	1.0	-1.6	13.0	14.7	11.5
FTSE All-Share	3.5	1.2	-1.4	8.2	9.8	6.8
TOPIX*	5.0	2.6	-0.0	8.5	10.1	7.1

	1 MONTH			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	0.0	-2.3	-4.7	11.6	13.4	10.2
JPM GBI UK All Mats	2.9	0.6	-2.0	12.5	14.3	11.1
JPM GBI Japan All Mats**	-0.5	-2.8	-5.2	8.9	10.6	7.6
JPM GBI Germany All Traded	0.8	-1.5	-4.0	4.3	5.9	3.0
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	1.2	-1.1	-3.7	11.8	13.5	10.4
BofA ML US Corporate Master	0.6	-1.7	-4.2	15.1	16.9	13.7
BofA ML EMU Corporate ex T1 (5-10Y)	2.1	-0.2	-2.8	7.3	9.0	6.0
BofA ML £ Non-Gilts	4.6	2.2	-0.4	10.7	12.4	9.3
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	1.0	-1.3	-3.9	8.7	10.4	7.3
BofA ML Euro High Yield	2.3	-0.1	-2.6	4.9	6.5	3.6

Source: Thomson Reuters DataStream.
Local currency returns in October 2019: *-5.0%, **-0.5%.
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Source: Schroders, October 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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