



FINURA

MARKET COMMENTARY FEBRUARY 2020



Pension
TRANSFER
Gold Standard

INFOGRAPHIC: THE GLOBAL ECONOMY

Inflation bump should not dislodge emerging markets (EM) central banks [Visit our Insights page here](#)



Long term decline in EM inflation could be reversing

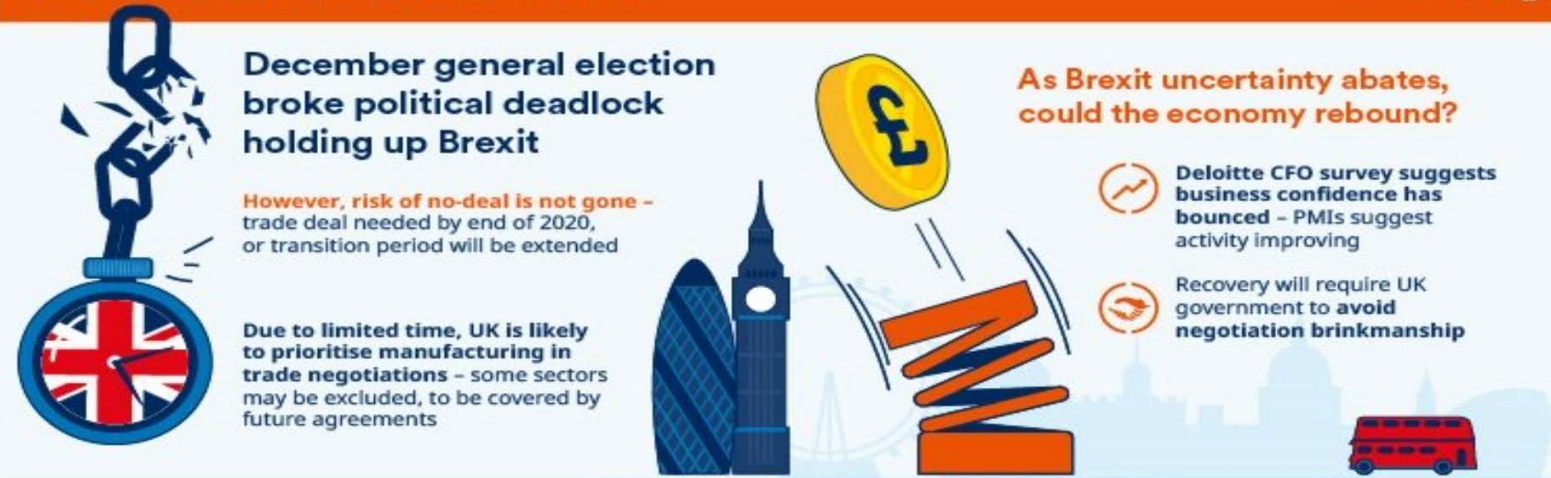
Big question – a permanent shift or a blip?

- Core inflation has continued to weaken in EM
- However, external shocks have led to spikes in food and energy prices - Iran/US tension created inflationary pressures

A trend reversal would have material consequences for monetary policy and investors

But we think drivers are temporary which should see a renewed deceleration by the middle of the year

Can the UK economy rebound after Brexit? [Read more](#)



December general election broke political deadlock holding up Brexit

However, risk of no-deal is not gone - trade deal needed by end of 2020, or transition period will be extended

Due to limited time, UK is likely to prioritise manufacturing in trade negotiations - some sectors may be excluded, to be covered by future agreements

As Brexit uncertainty abates, could the economy rebound?

- Deloitte CFO survey suggests business confidence has bounced - PMIs suggest activity improving
- Recovery will require UK government to avoid negotiation brinkmanship

Views at a glance: Schroders' interest rates forecast

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Source: Schroders, Thomas Datastream, Consensus Economics, January 2020

Source: [Schroders as at February 2020.](#)



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	●	We remain positive despite potential heightened volatility in the coming weeks as a result of the COVID-19 outbreak. Ample liquidity (i.e. readily available funds) and low bond yields continue to support elevated valuations.
	Government Bonds	●	We favour bonds with longer maturities, especially those that are inflation-linked. This is because there is ample liquidity globally and yield hunting investors are likely to keep demand high.
	Commodities	●	Global liquidity conditions, as discussed above, remain supportive. Prices remain constrained, with no increase in demand and a continued slowdown in supply.
	Credit	●	Despite spreads drifting slightly wider in January, the overall score is unchanged. Our positive view is supported by strong demand and a benign global central bank outlook.
Equities	US	●	We continue to favour the US as it is a high quality market and remains supported by ample liquidity, share buybacks and positive revisions to company profits.
	UK	●	The recent election result provided some confidence to markets. Nevertheless, little has actually been solved so far in trade negotiations with the EU.
	Europe	●	The proportion of positive to negative revisions to company profits for global equities has broadly improved since Q4 2019, with improvements observed in Europe.
	Japan	● ▼	We have downgraded Japan this month, as the outlook for company profits has steadily deteriorated in recent weeks. In addition, we expect regional uncertainty to weigh on economic recovery as companies pare back their plans.
	Pacific ex-Japan	●	Economic indicators are stabilising for both domestic and export areas, and monetary policy support continues to have a positive impact.
	Emerging Markets	● ▼	We have downgraded following the outbreak of COVID-19. The outbreak has stalled an economic recovery for now. We await evidence of containment before turning positive again.
Government Bonds	US	●	There is no change in our view as the recent pick-up in economic data balances the probability that the Federal Reserve is likely to cut rates by the end of Q2. In addition, the return from US bonds versus cash is still attractive relative to other markets.
	UK	● ▲	As the economy is forecast to rebound, the Monetary Policy Committee opted to keep rates on hold citing the reduced political uncertainty and early signs of recovery in economic activity.
	Germany	●	Germany's sensitivity to Chinese growth, combined with the European Central Bank's negative interest rate policy means we expect Bund yields to rise should the market environment improve.
	Japan	● ▲	The VAT hike and coronavirus outbreak represent risks and as a result the Bank of Japan is likely to continue to promote accommodative monetary policies. Nevertheless, inflation continues to show stable albeit weak signs of improvement.
	US Inflation Linked	●	We continue to be positive US Treasury Inflation-Protected Securities as a potential protection should growth disappoint.
	Emerging Markets Local	●	We remain neutral. While the medium-term growth outlook is largely optimistic and inflation relatively contained, yields are low (prices high) so valuations are stretched.



	Category	View	Comments
Investment Grade Corporate Bonds	US	●	We continue to favour the US corporate bond market. Low interest rates and the search for yield have driven investors to the US investment grade market and ample liquidity should support demand in the short term.
	Europe	●	While the market is reasonably valued and demand has been stronger, significant exposure to China and other risks mean we remain neutral.
	Emerging Markets USD	●	We retain a bias toward higher quality emerging market corporates as their fundamentals are more stable.
High Yield Bonds	US	●	We still prefer US high yield corporate bonds (those deemed by rating agencies to be below investment grade in quality) despite being near the end of the cycle. Nonetheless, there is still room for spreads (the difference in yield between two different bonds that are the same in all aspects except for the credit rating) to tighten and for positive returns if growth remains positive.
	Europe	●	We keep our neutral stance. Fundamentals are stretched but default rates have reduced slightly from their recent peak and technical factors are broadly supportive.
Commodities	Energy	● ▲	Whilst COVID-19 has dampened demand, we see upside in energy markets as declining oil prices have compressed profit margins. This, combined with action from the Organization of the Petroleum Exporting Countries, leads us to expect a fall in supply.
	Gold	●	Falling real US interest rates mean that owning gold is potentially an attractive hedge in the current late-cycle environment.
	Industrial Metals	● ▲	The coronavirus outbreak has been a negative. However, we believe demand will be deferred rather than lost so expect it to recover after Q1 2020.
	Agriculture	● ▲	The US-China phase one trade deal should benefit agricultural prices.
Currencies	US \$	● ▲	We have upgraded our view on the US dollar as the impact of coronavirus on the global supply chain and economic growth remains uncertain.
	UK £	● ▲	We have upgraded our view on sterling to neutral. We see Brexit politics taking a breather and growth being supported by the Conservative government's plans to increase spending.
	EU €	●	Despite promising survey data in Europe, we recognise the impact of the coronavirus is not fully reflected in markets and might trigger further volatility. The euro usually underperforms relative to the US dollar when investors are cautious.
	JAP ¥	●	As economic activity slows the Federal Reserve and Bank of Japan are likely to promote more accommodative monetary policies. However, at this point in time the outlook for monetary policy has not changed.
	Swiss F	●	Our view is unchanged. We expect a mild weakening versus the US dollar as we see the Swiss National Bank taking action to contain further appreciation in the currency, which has depressed economic growth.



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, February 2020](#). 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 review of markets in February when stock markets fell sharply amid worries over the spread of coronavirus.

HIGHLIGHTS

- Concerns over the spread of coronavirus and its potential impact on global growth dominated financial markets in February. Equity markets fell sharply and government bond yields were broadly lower (meaning prices rose).
- US shares fell with the energy and financials sectors leading the decline. Earlier in the month, the S&P 500 had set a new record high on robust jobs data.
- Eurozone equities also experienced a sharp fall amid concerns that the impact of coronavirus could send the fragile eurozone economy into recession. Data showed that German GDP saw zero growth in Q4 2019.
- UK and Japanese equities also declined. Japanese Q4 GDP growth disappointed, while UK data showed an improvement in economic growth in December.
- Emerging market (EM) equities also lost value but outperformed developed markets. Chinese shares saw a small gain for the month as coronavirus infection rates in the mainland appeared to stabilise and some activity indicators started to improve.
- Government bonds performed well as investors sought out assets perceived to be lower risk. Government bond yields declined markedly (meaning prices rose), with US 10- and 30-year Treasury yields hitting record lows.

THE US

US equities actually began the month strongly. Indeed, the S&P 500 Index set a new record high on robust economic data and

President Trump's acquittal in the final impeachment vote. However, a rising number of coronavirus cases – including in the US itself – prompted one of the sharpest US stock market sell-offs in history later in the month.

Employment data in particular was strong. Non-farm payrolls, which measure job creation outside the farming sector, showed that 225K jobs were created in January and wages edged up 0.1% (year-on-year) to 3.1%. US unemployment did tick up from 3.5% to 3.6%, but remained near a 50-year low. The increase was due in part to a pick-up in the labour participation rate from 63.2% to 63.4%.

Even so, concern over supply chain disruption and economic growth sent shares lower by month end. Amid a broad market sell-off, all areas of the market were lower, with energy and financials among the hardest hit. Utilities – traditionally more defensive – also struggled. Real estate and healthcare suffered less dramatic declines but still fell.

EUROZONE

Eurozone equities experienced a sharp fall in February with coronavirus worries weighing on shares. The MSCI EMU Index of large eurozone companies returned -7.9%. There were concerns that the coronavirus and its impact on travel and business activity could send the fragile eurozone economy into recession. Data showed the eurozone economy grew by just 0.1% in Q4 2019 with zero growth in Germany.

Sectors that are most reliant on economic growth, such as materials and industrials, were the weakest. Less economically-sensitive sectors such as utilities and healthcare proved more resilient. With companies releasing their annual results,



coronavirus worries began to dominate outlook statements. Brewer AB InBev stated that the outbreak of coronavirus has led to a significant decline in demand in China in the first two months of 2020.

In response to the coronavirus worries, European Central Bank President Christine Lagarde said the central bank is monitoring the situation. She added that the crisis is not so far having a lasting impact on inflation and so does not require a central bank response as yet. In early March, the Italian government announced a €3.6 billion stimulus package to mitigate the impact of the outbreak.

UK

UK equities fell over the period. In line with the wider trend, economically sensitive areas of the market underperformed, most notably the commodity sectors of oil & gas and basic materials. However, all areas – internationally and domestically exposed – sold off sharply.

The latest round of economic data and indicators of future UK economic activity pointed to ongoing recovery following the decisive general election result in December 2019. The latest monthly GDP data revealed the economy grew by 0.3% in December, suggesting a recovery in activity post the election, up from -0.3% month-on-month in November. The Office for National Statistics (ONS) also reported that UK retail sale volumes had increased by 0.9% in January, bouncing back from falls in the previous two months.

The preliminary estimate of the IHS Markit/CIPS composite purchasing managers' index (PMI) for February was unchanged from January's reading of 53.3, holding above the 50 mark.

The PMI is a survey of companies in the manufacturing and services sectors; a reading above 50 indicates expansion. A number of other forward looking surveys also pointed to further improvement in business and consumer confidence as well as better sentiment in the UK residential housing market. It is worth noting that these forward looking indicators published in February were based on surveys conducted before the global coronavirus crisis escalated.

JAPAN

The Japanese market fell 10.2% in February. Almost all of the decline occurred in the last four days of the month amid an increase in perceived risk surrounding the spread of coronavirus. During those four days, the Japanese yen appreciated sharply, fulfilling its traditional role as a safe haven at times of uncertainty. Immediately prior to this, however, the yen had actually weakened almost as sharply, with no obvious driver.

The initial Q4 GDP estimate released on 17 February was much weaker than consensus expectations. Even allowing for the consumption tax increase and the major typhoon, which hit Japan in October, this was a poor data point. There has also been some milder disappointment on recent inflation statistics and there is, so far, little sign of any upwards pressure on overall wages in the official statistics. . The spring wage negotiations with major companies are currently being led by relatively low demands from unions.

In the short term, the improving trend in earnings revisions, which had been playing out as expected in January, reversed abruptly in February. In economic terms, the disruption from coronavirus is likely to be transitory. As we approach the end of the fiscal year for most Japanese companies, however, there are multiple reasons for companies to be extremely cautious in their forecasts for 2020.





ASIA (EX JAPAN)

Asia ex Japan equities were down in February as the spread of the coronavirus outside China increased concerns over the impact on regional and global growth. US dollar strength also acted as a headwind to returns.

Within the MSCI Asia ex Japan index, Thailand and Indonesia were the weakest markets. In Indonesia in particular, currency weakness amplified negative returns. During the month the central bank cut its headline interest rate by 25 basis points (bps) to 4.75% in an effort to mitigate the potential impacts from the coronavirus.

The South Korean market also saw a sharp decline as the number of COVID-19 cases accelerated rapidly in the second half of the month; Korea now has the largest number of cases outside China. India and Malaysia also lost value and underperformed. In Malaysia, the unexpected resignation of Prime Minister Mahathir Mohamad also contributed to uncertainty.

By contrast, China recorded a positive return. Taiwan and Hong Kong finished in negative territory but outperformed the Asia ex Japan index.

EMERGING MARKETS

Emerging market equities fell in February as coronavirus concerns put shares under pressure. US dollar strength was also a headwind to returns. The MSCI Emerging Markets (EM) Index decreased in value but outperformed the MSCI World.

Within the MSCI EM Index, Turkey was among the weakest markets as tensions with neighbouring Syria increased. An airstrike in Syria killed more than 33 Turkish troops in February.

Russia lagged behind the index as crude oil prices fell sharply, weighing on the rouble. South Africa and Brazil, where currency weakness also amplified negative returns, both underperformed. India, where the Union Budget disappointed, and Malaysia also lost value and underperformed. In Malaysia, the unexpected resignation of Prime Minister Mahathir Mohamad added to uncertainty.

By contrast, China recorded a modest gain as coronavirus infection rates in the mainland appeared to stabilise and some activity indicators started to improve. Taiwan, where the spread of the new coronavirus has so far been more limited, and Egypt were the only other countries to outperform.

GLOBAL BONDS

The spread of the coronavirus resulted in large declines in riskier assets such as shares in February, as fears of a global recession mounted, while government bonds performed well. The final week of the month proved particularly painful for riskier assets; for some it was the worst week since 2008. Government bond yields declined markedly (meaning prices rose), with US 10- and 30-year Treasury yields hitting record lows.

The vast majority of coronavirus cases have occurred in China, where significant areas remain effectively in lockdown. While the number of new cases in China showed signs of peaking, the virus began to spread across borders. There were outbreaks in South Korea, Italy and Iran, and confirmed cases in every western European country as well as in the US, raising concerns of a possible global pandemic.

The US 10-year bond yield dropped to 1.15%, down from 1.51%, while the 30-year yield dropped from just over 2% to 1.67%. The 10-year German government bond yield fell to -0.61%, from

-0.44%, and the UK's 10-year bond yield fell to 0.44% from 0.52%. Meanwhile, the Italian 10-year yield increased from 0.92% to 1.13% and Spain's rose from 0.23% to 0.28%, selling off in the final week of the month.

Investment grade corporate bonds were to some extent cushioned by falling global yields, but substantially underperformed government bonds. High yield corporate bonds were weak, with US energy hit particularly hard, given the sharp fall in oil prices. Investment grade bonds are the highest quality bonds, as determined by a credit ratings agency, while high yield bonds are more speculative, with a credit rating below investment grade.

Emerging market bonds declined, with currencies falling sharply against the US dollar, although hard currency investment grade government and corporate bonds produced positive total returns. Higher yielding government bonds fell markedly, while the Russian rouble, Brazilian real and Indonesian rupiah were among the weaker EM currencies.

With shares under pressure, convertible bonds provided investors with effective protection from losses in February. Convertible bonds, as measured by the Thomson Reuters Global Focus index, finished the month with a loss of -1.4% in US dollar terms. In line with the market sell-off, convertible bond valuations cheapened, most significantly in US names.

COMMODITIES

Commodities were firmly lower as concerns over global economic growth continued to mount. The energy component was the main contributor to negative returns. Brent crude oil posted a double digit decline as the demand outlook further deteriorated. In agricultural commodities, cotton recorded

the largest decline. Precious metals also lost value, with gold and silver both moving lower. Industrial metals posted a more modest decline. Zinc and nickel were notably weak but copper recorded a small gain, following a sharp sell-off in January.



TOTAL RETURNS (NET) % – TO END FEBRUARY 2020

Equities	1 MONTH			12 MONTHS		
	USD	EUR	GBP	USD	EUR	GBP
MSCI World	-8.5	-7.6	-5.5	4.6	8.5	9.0
MSCI World Value	-9.6	-8.8	-6.7	-2.8	0.7	1.2
MSCI World Growth	-7.4	-6.5	-4.4	12.3	16.5	17.0
MSCI World Smaller Companies	-9.2	-8.4	-6.3	-2.6	0.9	1.4
MSCI Emerging Markets	-5.3	-4.4	-2.2	-1.9	1.7	2.2
MSCI AC Asia ex Japan	-2.9	-2.0	0.2	0.1	3.8	4.2
S&P500	-8.2	-7.4	-5.3	8.2	12.2	12.7
MSCI EMU	-8.7	-7.9	-5.8	-0.9	2.8	3.2
FTSE Europe ex UK	-8.4	-7.5	-5.4	2.3	6.1	6.5
FTSE All-Share	-11.7	-10.9	-8.9	-5.3	-1.9	-1.4
TOPIX*	-9.8	-9.0	-7.0	-0.6	3.1	3.6

Government Bonds	1 MONTH			12 MONTHS		
	USD	EUR	GBP	USD	EUR	GBP
JPM GBI US All Mats	2.8	3.7	6.1	12.8	17.0	17.5
JPM GBI UK All Mats	-1.8	-0.9	1.4	8.5	12.5	13.0
JPM GBI Japan All Mats**	1.4	2.3	4.7	6.0	9.9	10.4
JPM GBI Germany All Traded	0.5	1.4	3.7	2.4	6.2	6.7
Corporate Bonds	USD	EUR	GBP	USD	EUR	GBP
BofA ML Global Broad Market Corporate	0.3	1.2	3.5	10.9	15.0	15.5
BofA ML US Corporate Master	1.3	2.2	4.5	15.6	19.8	20.4
BofA ML EMU Corporate ex T1 (5-10Y)	-1.4	-0.5	1.8	3.7	7.5	8.0
BofA ML £ Non-Gilts	-3.4	-2.5	-0.3	5.9	9.8	10.3
Non-investment Grade Bonds	USD	EUR	GBP	USD	EUR	GBP
BofA ML Global High Yield	-1.6	-0.8	1.5	5.9	9.8	10.3
BofA ML Euro High Yield	-2.8	-1.9	0.3	1.3	5.0	5.4

Source: Thomson Reuters DataStream.
 Local currency returns in February 2020: *-10.3%, **0.9%.
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Source: [Schroders, February 2020](#): 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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