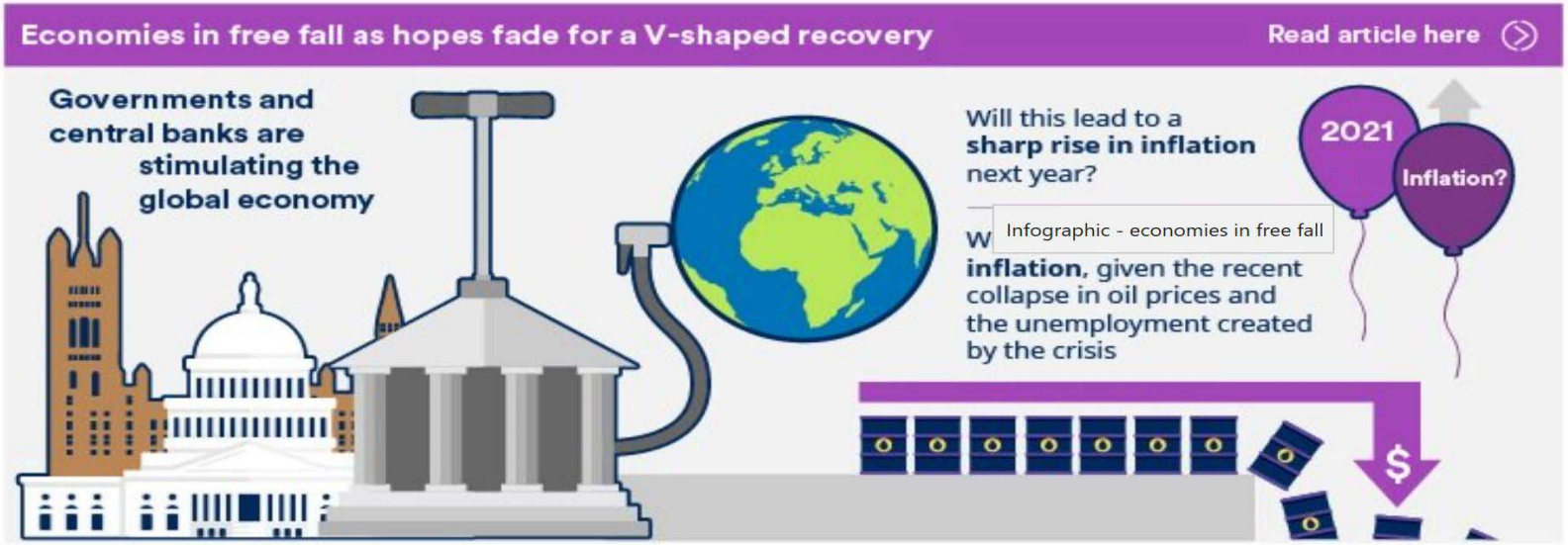
FINURA

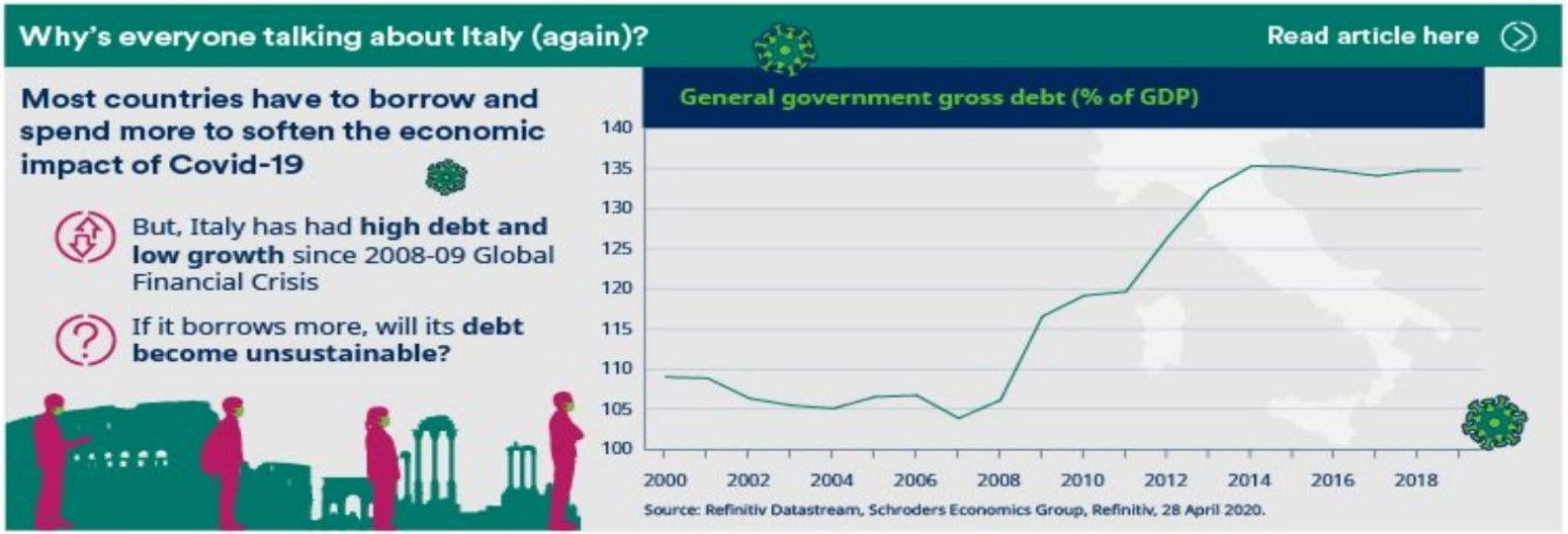
MARKET COMMENTARY
MAY 2020

Chartered Financial Planners

Pension TRANSFER Gold Standard

INFOGRAPHIC: THE GLOBAL ECONOMY





Source: Schroders as at May 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	Neutral/ Negative ▼	We remain concerned over how long the recent strong rise in the prices of equities (shares) might last. We have seen worsening economic data, as well as renewed US-China tensions and there could be lower investor interest at these price levels.
	Government Bonds	Neutral ▼	With prices remaining at historically high levels, government bonds have become less effective as a 'protection position' (lower risk investment) in our portfolios.
	Commodities	Neutral	The technical fundamentals, such as prices, are slowly improving and, as a result, we are seeing a more attractive risk-reward trade off. However, growth concerns continue to linger.
	Credit	Positive/ Neutral	We remain positive on corporate bonds overall, as central banks' monetary policy to support economies look set to remain in place for the foreseeable future.
Equities	US	Neutral	We see an ongoing preference for high quality and growth shares in the US. This should see the US continue to outperform the rest of the world's equity markets.
	UK	Neutral/ Negative ▲	We remain negative on UK equities as continued price weakness caused by the lockdown measures adds to renewed concerns over a no-deal Brexit.
	Europe	Neutral/ Negative ▲	A lack of agreement on fiscal issues – and limited potential for further action by the European Central Bank (ECB) – is challenging for a region deeply affected by lockdown.
	Japan	Negative	Concerns about supply chain disruption and reliance on global trade makes Japanese equities particularly unattractive.
	Pacific ex-Japan	Neutral/ Negative ▲	Although activity is gradually improving with support from central banks and governments, fresh trade tensions mean there is increased risk on the downside.
	Emerging Markets	Neutral	We still prefer the growth potential and cheaper share prices in EM, and continue to favour Asia over EMEA (Europe, Middle East and Africa) and Latin America.
Government Bonds	US	Neutral/ Negative ▼	Given the low level of yields, the effectiveness of US bonds as a hedge (an investment position in a related asset class intended to reduce the risk of adverse price movements) in our portfolios has deteriorated. The limits of conventional monetary policy appear to have been exhausted for now.
	UK	Neutral/ Negative ▼	We have downgraded our view, expecting UK government bond yields to be largely range bound and to provide a less effective hedge for portfolios.
	Germany	Negative	The low relative yields on offer in Germany mean we continue to avoid the region. There remains limited upside from this point forward.
	Japan	Neutral/ Negative ▲	The Bank of Japan will continue to expand monetary policy as the government tries to spend its way out of the economic pain caused by the virus.
	US Inflation Linked	Neutral	Inflation fundamentals remain challenged, particularly with respect to the US unemployment rate and the fall in the oil price.
	Emerging Markets Local	Positive/ Neutral ▲	We have upgraded our view given compelling valuations, particularly in longer maturity bonds. EM inflation also remains on a downward trend, which should support prices.

	Category	View	Comments
Investment Grade Credit	US	● ▲	Despite recent spread contraction (e.g. a smaller difference between the rates on government bonds versus corporate bonds), prices remain attractive. The Federal Reserve's (Fed) support - it has moved to buy these bonds - will be of continuing benefit.
	Europe	● ▲	Although we still prefer US investment grade (IG) corporate bonds, we expect the support which is helping to prop up the market to remain in place for the foreseeable future.
	Emerging Markets USD	● ▲	Despite a weak fundamental outlook, EM sovereign bond prices remain attractive. We also retain a positive view on EM corporate bonds.
High Yield Bonds	US	● ▼	While US central bank policy initiatives will continue to support High yield (HY) corporate bonds, we have downgraded our view to reflect less extreme prices.
	Europe	● ▼	The increasing tension between the ECB and EU member states is likely to depress prices of European HY bonds, at a time when company fundamentals are deteriorating sharply.
Commodities	Energy	● ▲	Less surplus oil and continued low energy prices have led to a better risk / reward trade-off for investors. There are also early signs of a gradual rebound in demand in Asia.
	Gold	●	Central banks will likely remain dovish, accommodative and provide ample liquidity where necessary. As a result, gold could continue to accelerate from these levels.
	Industrial Metals	● ▲	The fall in metal prices has run its course as global lockdown measures have hit supply alongside demand. However, the slow return to more normal economic conditions is set to depress demand growth.
	Agriculture	● ▲	Agriculture markets have levelled out for the time being. We remain aware of the backdrop of weaker economic demand and the re-emergence of US-China trade tensions.
Currencies	US $	●	The weak global growth outlook should support dollar strength. However, the Fed's liquidity measures and the high US dollar price mean we remain neutral.
	UK £	●	Despite the return of potential Brexit risk, we remain positive on sterling, given the UK's united fiscal and monetary policy response to the virus.
	EU €	● ▲	The outlook for the euro remains weak given the inability of the ECB and fiscal policy makers to introduce a collective economic response to Covid-19. Tensions among EU member states are also a concern.
	JAP ¥	●	There are competing forces between the market optimism surrounding Covid-19 and the increasingly poor economic outlook.
	Swiss F	●	We remain neutral on the Swiss franc given its high price, while acknowledging its continued role as a 'safe haven' currency.

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, May 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 May when shares were supported by an increasing focus on how lockdowns would be lifted.

HIGHLIGHTS

- Equity markets rose on the whole in May as Covid-19 lockdown measures began to be lifted and further support measures were announced. Escalating tensions between the US and China, however, limited emerging market equity gains.
- US shares gained ground amid optimism over the re-opening of the economy. Q1 GDP growth was revised down to -5.0%, compared to the first estimate of -4.8%.
- Eurozone equities advanced as some countries began to allow some parts of their economies to reopen. The European Commission proposed a €750 billion recovery package.
- UK equities rose in May. A number of economically sensitive areas performed well amid the improvement in investor sentiment. Sterling fell as worries over a no-deal Brexit resurfaced.
- Japanese shares posted gains, with pharmaceutical stocks leading the advance. Lockdowns across the country were lifted in stages during the month.
- Emerging market (EM) equities advanced but underperformed developed markets. Performance was dampened by the re-emergence of US-China tensions.
- Corporate bonds outperformed government bonds as the more optimistic backdrop saw investors favour higher risk assets. US 10-year government bond yields were little changed during the month.

THE US

US equities gained in May, with investors cheered by plans to ease the Covid-19 lockdown measures both domestically and in many countries around the world. Every US state had made plans to reduce restrictions by mid-May. The US dollar fell, becoming less attractive as a safe haven as risk appetites climbed. The rise in optimism came in spite of the confirmation that the economy had contracted by slightly more than expected in Q1.

Real GDP for Q1 was revised down to an annual rate of -5.0%, a bigger decline than the 4.8% drop first estimated. It was the biggest quarterly drop since an 8.4% fall in Q4 2008. Much of the weakness was due to a sharp fall in consumer spending, especially in consumer purchases of services. In addition, there were some concerns that the US-China trade relationship could sour again. However, neither issue managed to recapture investor focus, which landed on economies restarting around the world.

US equities rose in line with other world equity indices. All sectors in the S&P 500 rose with materials and industrials, more cyclically-exposed, performing strongly. IT stocks were once again notable outperformers. Consumer staples and energy lagged behind the wider market but still made positive progress.

EUROZONE

It was another month of gains for eurozone shares in May as many European countries began to ease out of lockdown. Stock markets were further supported by news of the EU's plans for post-coronavirus recovery.

European Commission president Ursula von der Leyen called for the power to borrow €750 billion for a recovery fund to support those EU regions that have been worst affected by Covid-19. This would be in addition to the €540 billion rescue package agreed in April. She also proposed a new suite of taxes to pay back the debt. The plan still needs the approval of member states, with the recovery fund expected to be on the agenda for the 19 June European Council summit. In addition, comments from European Central Bank (ECB) board members suggested that the ECB's asset purchase target could be increased at the June meeting.

All sectors saw positive returns with gains for both economically-sensitive sectors and those perceived to be more defensive. The industrials and utilities sectors were among the top gainers while energy and consumer staples saw a smaller advance. Forward-looking economic data showed how activity is picking up as lockdowns started to be relaxed: the Markit composite purchasing managers' index (PMI – a survey of companies in the manufacturing and service sectors) rose to 30.5 in May from 13.6 in April. However, this is still well below the 50 mark that separates expansion from contraction.

UK

UK equities rose over the period. A number of economically-sensitive areas of the market outperformed amid the general improvement in investor sentiment. The mining sector performed particularly well in response to a recovery in Chinese industrial activity.

The government began to ease lockdown measures with people encouraged to return to work where possible and a phased reopening of the retail industry and schools confirmed. Meanwhile, the UK's departure from the EU returned to the agenda as the end of June deadline to extend the Brexit transition period, which expires on 31 December 2020, came into view.

Renewed concerns that the country could be heading for a "no deal" Brexit weighed on sterling, as did the prospect of negative interest rates. The Bank of England governor told parliamentarians that negative rates were under "active review" while the Debt Management Office confirmed it had sold negative yielding gilts for the first time.

The Office for National Statistics reported that the UK economy had contracted by 2% in Q1 2020 as lockdowns in response to the Covid-19 pandemic took their toll on activity towards the end of Q1. The preliminary estimate was less negative than consensus estimates, though it does represent the largest fall in GDP since the fourth quarter of 2009 and the global financial crisis.

JAPAN

The Japanese market rose steadily for most of May to end with a positive total return of 6.8%. The yen was quite stable, weakening just marginally against the US dollar during the month.

Equity investors globally have responded to an assumed reopening of economic activity, although the actual path for any return to a more normal environment for corporate earnings remains very uncertain. The Japanese market was led up in May by pharmaceuticals. There was a brief recovery for some financial stocks, including leasing companies, together with airlines, which have been among the hardest hit sectors throughout this crisis. Small caps also performed relatively well and have now recouped almost all of the underperformance seen from January to mid-March.

The results season concluded for the fiscal year, which ended in March. Investors have naturally focused more on the outlook than the historical results, but only a minority of companies have provided any guidance for the fiscal year to March 2021.

Japan's statistics on both the infection rate and the mortality rate from coronavirus remain significantly better than most other developed economies. The population seems to believe this is more by luck than judgement on the part of the government: the public's approval rating of Abe's administration has fallen to its lowest levels since he became prime minister at the end of 2012. Nevertheless, the prime minister was able to announce a staged lifting of the state of emergency, starting from 14 May for some prefectures and culminating on 25 May for Tokyo. Abe's cabinet drew up a second supplementary budget in May, as expected.

ASIA (EX JAPAN)

Asia ex Japan equities bucked May's global market trend by posting a loss. Hong Kong, where a new national security law was proposed, was the worst-performing market in the region. The other Greater China markets of China and Taiwan also posted losses as Beijing's relationship with the US became strained once again amid talk of delisting Chinese companies from US markets and imposing compensatory tariffs for Covid-19.

Elsewhere, India, where the financial sector was as drag, also posted a loss, so too did Singapore. Meanwhile, a better-than-expected earnings season boosted the Korean market, while the ASEAN (Association of Southeast Asian Nations) markets of Thailand and Malaysia also posted strong gains. Across the region, the worst-performing sectors were real estate and financials, while healthcare and consumer discretionary outperformed.

EMERGING MARKETS

Emerging market (EM) equities registered a positive return in May, as lockdowns began to ease worldwide, although performance was dampened by the re-emergence of US-China tensions.

Argentina was the best-performing index market. Brazil, where the central bank promised to intervene to support the currency if necessary, and Russia, aided by currency strength and a rally in crude oil prices, also outperformed.

Chile and Egypt, which sought additional support from the International Monetary Fund (IMF), were the weakest index markets. China also lagged behind as the intensifying US-China confrontation expanded beyond trade and technology issues to broader geopolitical tensions and China moved to impose a national security law on Hong Kong.

GLOBAL BONDS

Investor optimism grew over the month, with riskier assets performing well. The rate of new Covid-19 infections continued to moderate and various countries started to ease lockdown measures.

Central banks gave assurances that support would continue and, in Europe, there was progress towards a co-ordinated agreement on fiscal support measures. Economic activity data showed some improvement, with higher frequency indicators suggesting the situation is less dire than widely feared. These factors outweighed concerns over renewed tensions between the US and China.

The 10-year US Treasury yield was little changed at 0.65%, trading in a relatively tight range throughout the month. The two-year yield finished slightly lower.

In comparison, European government yields saw meaningful moves, reflecting developments around potential fiscal support. Germany's 10-year yield rose from -0.59% to -0.45%, while Italy's fell from 1.76% to 1.49%. The Spanish 10-year yield fell from 0.73% to 0.57%.

The UK 10-year yield was slightly lower, from 0.23% to 0.18%, while sterling weakened. UK yields fell below zero in shorter maturities, reacting to speculation that the Bank of England might be considering employing negative interest rates. The UK's two-year gilt yield fell from 0.01% to -0.04%.

Corporate bonds outperformed government bonds, with global high yield (HY) returning 4.5% (source: BofAML, local currency) amid stronger demand for riskier assets. The spread on HY (the difference in the yield of a corporate bond versus a similar maturity government bond) tightened by 107 basis points (bps). Investment grade saw total returns of 1.3% (source: BofAML, local currency). Across both, positive performance was driven predominantly by cyclical sectors, which continued to recover ground. 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.

The increased demand for riskier assets also led to positive returns for emerging markets bonds and currencies, led by higher yielding markets. Currencies of oil exporters made gains as oil prices recovered. The Mexican peso and Russian rouble were among the strongest performers.

The overall MSCI equity index returned 4.5% in May. Convertible bonds as measured by the Thomson Reuters Global Focus Index, outperformed stocks with a gain of 5.4%. There was a record volume of new issues with $26 billion of new paper which kept valuations low.

COMMODITIES

There was a bounce-back in commodities markets in May. This was led by oil as Brent rose by 40% amid a loosening of lockdown measures in many countries. Precious metals, led by silver (+19.3%), and industrial metals, led by iron ore (+10%), also gained.

TOTAL RETURNS (NET) % – TO END MAY 2020

	1 MONTH			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	4.8	3.2	7.0	6.8	7.0	8.9
MSCI World Value	2.8	1.2	4.9	-6.4	-6.2	-4.6
MSCI World Growth	6.5	4.9	8.7	20.2	20.4	22.5
MSCI World Smaller Companies	7.1	5.4	9.2	-2.2	-2.0	-0.3
MSCI Emerging Markets	0.8	-0.8	2.8	-4.4	-4.2	-2.5
MSCI AC Asia ex Japan	-1.2	-2.7	0.8	0.0	0.2	2.0
S&P500	4.8	3.2	6.9	12.8	13.0	15.0
MSCI EMU	6.4	4.7	8.5	-5.5	-5.4	-3.7
FTSE Europe ex UK	6.1	4.5	8.3	-0.0	0.2	1.9
FTSE All-Share	1.4	-0.2	3.4	-12.9	-12.7	-11.2
TOPIX*	6.0	4.4	8.2	7.0	7.2	9.1

	1 MONTH			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	-0.3	-1.8	1.7	11.9	12.1	14.1
JPM GBI UK All Mats	-2.0	-3.5	-0.0	10.9	11.1	13.1
JPM GBI Japan All Mats**	-1.3	-2.8	0.7	0.2	0.3	2.1
JPM GBI Germany All Traded	0.2	-1.3	2.2	1.8	1.9	3.7
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	1.6	-0.0	3.6	6.3	6.5	8.4
BofA ML US Corporate Master	1.7	0.2	3.8	9.6	9.8	11.7
BofA ML EMU Corporate ex T1 (5-10Y)	1.8	0.2	3.8	0.1	0.3	2.0
BofA ML £ Non-Gilts	-1.2	-2.7	0.8	4.4	4.5	6.4
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	4.7	3.1	6.8	0.3	0.5	2.3
BofA ML Euro High Yield	4.8	3.2	6.9	-1.9	-1.8	-0.0

Source: Thomson Reuters DataStream.
Local currency returns in May 2020: *6.8%, **-0.6%.
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Source: Schroders, May 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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FINURA

Level 2, Juxon House, 100 St Paul's Churchyard, London, EC4M 8BU
T: +44 (0)20 3102 7730 E: enquiries@finurapartners.com W: finurapartners.com

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