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MARKET COMMENTARY
OCTOBER 2020

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INFOGRAPHIC: THE GLOBAL ECONOMY

Has Covid-19 killed off populism in Europe?

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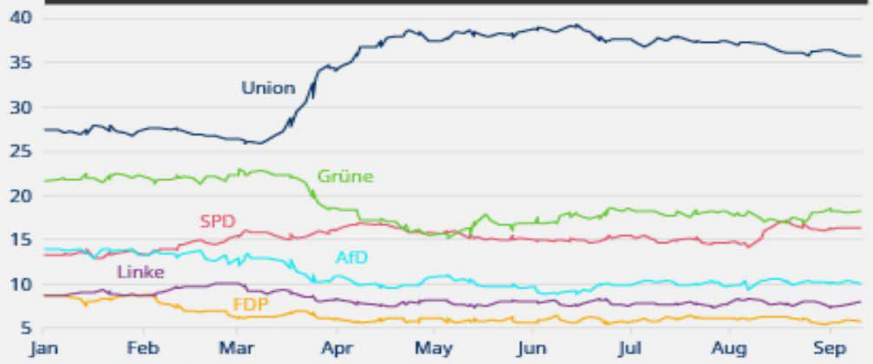
The pandemic is shifting the support of European voters towards parties seen as a safe pair of hands

In Germany, Angela Merkel's Christian Democratic Union and Christian Social Union coalition (CDU/CSU) has **opened a significant lead** over the Greens since the pandemic began

Opinion polls for the next German federal election



Source: Wikipedia, Schroders Economics Group, 25 September 2020

What the Fed's new target means for inflation

Visit our insights page here

The US Federal Reserve (Fed) now targets average inflation of 2%

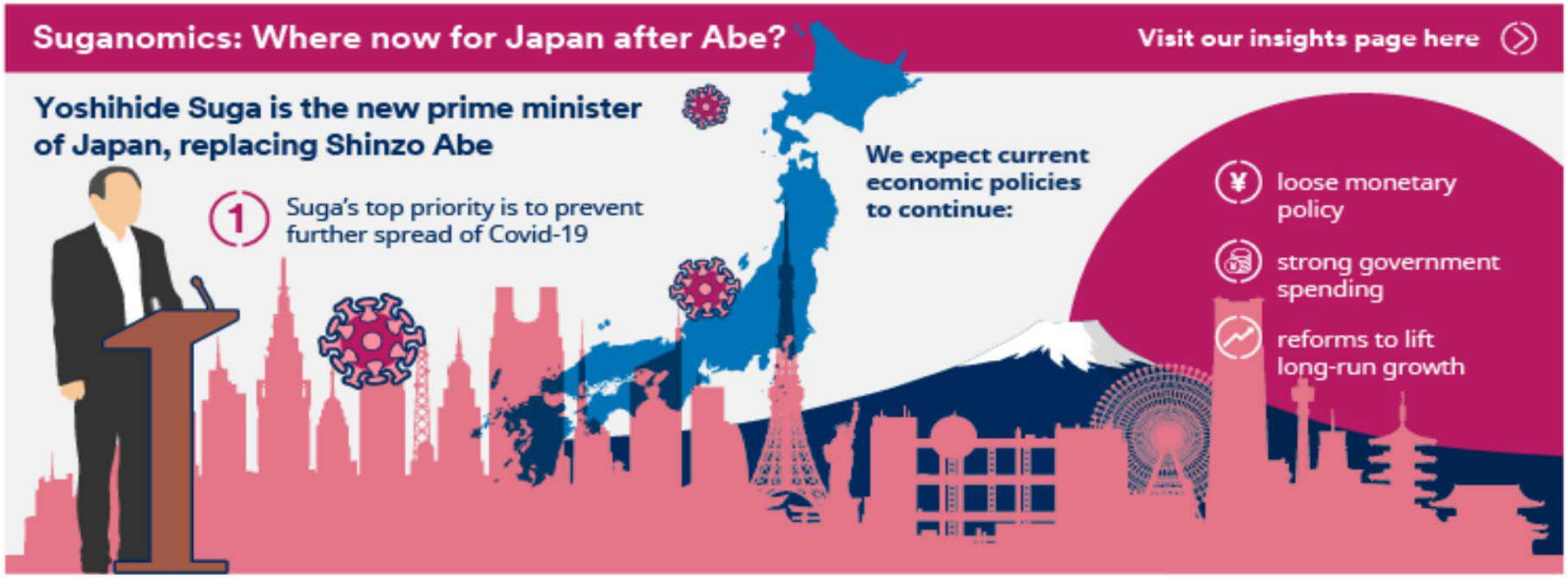
Previously, if **inflation was likely to go above 2%**, the Fed would raise interest rates to cool the economy down

But **inflation often fell below 2%**, leading to criticism that the Fed raised rates too fast and damaged growth

Now, the **Fed can wait until inflation is above 2%** before it reacts

Missing in action: actual and target inflation

Source: Schroders, Refinitiv Datastream, 14 September 2020.



Source: Schroders as at October 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	🟢	Despite ongoing pandemic risks, equities remain attractive compared to bonds and an expected shift into economic recovery should continue to support equity performance.
	Government Bonds	🟡	Although bond prices remain at historically high levels and have limited upside, central banks will likely be successful in keeping volatility low in government bond markets.
	Commodities	🟡 ▼	We have downgraded our view as we await better visibility on fiscal stimulus plans after the US presidential election.
	Credit	🟢	We retain a positive view overall, with a preference for higher quality, "investment grade" corporate bonds over lower quality non-investment grade ("high yield").
Equities	US	🟢	We continue to prefer the US equity market which should continue to outperform other regional equity markets due to ample liquidity.
	UK	🟡	Ongoing Brexit negotiations and a resurgence of Covid-19 infections make the UK our least preferred equity market.
	Europe	🟡 ▼	With Covid-19 infections on the rise, many countries have been forced to increase lockdown measures. This will likely weigh on economic activity and delay their recoveries.
	Japan	🟡 ▼	Whilst the economic recovery in Japan is underway, it remains to be seen whether the policies of newly appointed Prime Minister Suga will be different from his predecessor.
	Pacific ex-Japan	🟢	We expect the region's recovery to continue, aided by fiscal and monetary policies and hopes for a Covid-19 vaccine.
	Emerging Markets	🟢	EM remains one of our preferred equity markets, driven by the strong recovery in China, US dollar weakness and commodity prices.
Government Bonds	US	🔴	We continue to have a preference for shorter dated US Treasuries (US government bonds) as longer dated bonds are more vulnerable following the Federal Reserve's (Fed) announcement to target an average inflation rate. The prices of shorter dated bonds are less sensitive to changes in interest rates.
	UK	🔴	We maintain our view that there is less value in gilts (UK government bonds) given their poor relative returns.
	Germany	🔴	Germany remains a very expensive market. The strong euro is also creating an additional headwind for the European Central Bank.
	Japan	🔴	Our view is unchanged. With inflation still likely to remain significantly lower than target, the Bank of Japan will need to keep unconventional policies in place.
	US Inflation Linked	🟢	The Fed recently said it would move to average inflation targeting and tolerate a moderate overshoot of inflation pressures, indicating that monetary policy will remain loose.
	Emerging Markets Local	🟢	We see medium-term opportunities in Latin America and Asia as they are likely to provide higher real (inflation-adjusted) yields.

	Category	View	Comments
Investment Grade Credit	US	●	Although credit spreads have limited room to tighten further, record issuance continues in the US.
	Europe	●	We remain positive, despite valuations appearing stretched on a historic basis as fundamentals have surprised given depressed expectations.
	Emerging Markets USD	● ▲	We continue to favour higher quality corporate credit based on more attractive valuations and a weaker US dollar.
High Yield Bonds (Non-IG)	US	●	US high yield (HY) is less attractive than European HY as we see the fundamentals as weaker and recovery rates remain near record lows.
	Europe	●	This remains our preferred market as stimulus packages announced so far should support European HY bond issuers.
Commodities	Energy	● ▼	We have downgraded as supply/demand fundamentals will be less favourable over the next three to six months while volatility will remain elevated.
	Gold	● ▼	We have downgraded our view in light of the deepening bipartisan divide and the high hurdles for the Fed to further ease monetary policy. We prefer to wait for policy clarity before re-investing.
	Industrial Metals	●	Prices are supported by strong demand from China, mine supply and scrap metal constraints.
	Agriculture	● ▼	We have downgraded as prices are now falling back towards pre-Covid levels. However, research and development expenditure remains supportive for productivity gains to continue.
Currencies	US $	● ▲	We have upgraded the US dollar as it offers defensive properties at a time when government bonds offer less protection against financial loss.
	UK £	●	We remain neutral as an increase in Covid-19 cases and Brexit uncertainty are creating headwinds for the pound.
	EU €	● ▼	We have downgraded as the upcoming US elections will likely generate some volatility in the euro. With Covid-19 cases on the rise, we prefer to wait for clarity before re-investing in the euro.
	JAP ¥	● ▲	As government bonds offer less protection against financial loss, we turn to the perceived safe haven of the yen to offer a degree of protection against the risk of a growth scare and/or escalating US tension.
	Swiss F	●	We maintain our neutral stance on the Swiss franc given its high relative valuation, while acknowledging its longstanding role as a perceived "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, October 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 look back at markets in October when Covid-19 lockdowns were reintroduced in much of Europe and investors awaited the US presidential election.

HIGHLIGHTS

- Global equities declined in October. The US presidential election and rising Covid-19 cases in many countries, notably across Europe, were the main focus for investors. Corporate bonds outperformed government bonds.
- US shares fell amid rising Covid-19 cases, uncertainty over the presidential election and lack of progress on further fiscal stimulus.
- Eurozone shares declined, underperforming other regions, as Covid-19 infections rose sharply and a number of countries reintroduced national lockdown measures.
- UK equities fell amid renewed fears around a pick-up in Covid-19 cases. At the very end of the month, the UK government abandoned a tiered system in favour of uniform restrictions across England.
- Japanese shares declined, largely due to the renewed uncertainty affecting other global regions. Japan's success in containing the virus saw it announce measures to encourage consumer spending in restaurants.
- Emerging market equities gained due to expectations of additional fiscal stimulus in the US. The prospect of more stable trade relations with the US under a potential Biden presidency also proved beneficial.
- In fixed income , the US 10-year yield rose (meaning prices fell) which seemed to reflect rising hopes of economic stimulus. However, European yields fell (i.e. prices rose) as Covid-19 cases increased and lockdowns returned.
- Commodities registered a negative return. Energy was the weakest component with crude oil falling sharply on concerns over weaker demand related to the coronavirus.

THE US

US equities declined in October, primarily due to the continued rise in Covid-19 cases in many states. Market optimism over additional fiscal stimulus also waxed and waned, contributing to stock market movements. As the deadline for stimulus negotiations drew near, the unpredictability of the 3 November presidential election added to the wider sense of uncertainty. President Trump hinted more than once that stimulus would be announced post the election, should he win a second term.

From an economic perspective, data continued to indicate industrial activity was expanding in both the manufacturing and service sectors. Initial jobless claims also reached their lowest number since March. Even so, the Federal Reserve (Fed) maintained the message that it will keep rates unchanged until inflation stabilises at 2%, and will tolerate a moderate overshoot. Further, the Fed reiterated that additional fiscal stimulus was required.

The utilities sector - a relatively small component of the S&P 500 - was among the strongest performers in October, while the more significant communications sector made modest gains. All other sectors fell to one extent or another, with the technology, energy and healthcare sectors among the weakest areas of the market.

EUROZONE

October saw shares fall in the eurozone as several countries reintroduced lockdowns to try and contain rising Covid-19 infection rates. France introduced a strict new national lockdown while partial lockdowns were announced in several other

countries including Germany and Belgium. The European Central Bank kept monetary policy unchanged but indicated that more stimulus measures are likely to be announced at the next policy meeting in December.

Data showed that the eurozone economy expanded by 12.7% in the third quarter of 2020 as activity rebounded over the summer. However, this still leaves the economy 4.3% smaller than it was at the same time last year and expectations are that the new lockdowns will weigh on economic activity in the coming months. Indeed, business activity contracted in October according to the Markit composite purchasing managers' index (PMI) which fell to 49.4. from 50.4 in September. 50 is the level that separates expansion in business activity from contraction. The PMI surveys are based on responses from companies in the manufacturing and services sectors. Annual inflation remained stable at -0.3% in October.

October saw the bulk of Q3 corporate earnings' releases. These were largely positive, with many companies beating expectations. Nevertheless all sectors ended the month in the red. Information technology was among those seeing the steepest falls. German software company SAP cut its revenue and profit forecasts for the year. The energy sector also fell sharply with lockdowns likely to mean reduced demand for oil. The telecommunication services sector was among the more resilient over the month.

UK

UK equities fell over the period amid renewed fears of a pick-up in Covid-19 cases. Policymakers in Wales and Northern Ireland used devolved powers to implement new countrywide lockdowns, while Scotland introduced a tiered system. At the very end of the month, the UK government abandoned its own tiered system in favour of uniform restrictions across England, to run initially for four weeks from 5 November until 2 December.

In response to these events, the UK government announced it would extend the Coronavirus Job Retention Scheme, or furlough scheme, until December. Employees will receive 80% of their current salary for hours not worked, up to £2,500 a month. This scheme was due to be superseded by the Job Support Scheme (JSS) in November, as part of Chancellor Rishi Sunak's "Winter Economy Plan".

Expectations built that the Bank of England (BoE) would use its November policy meeting to extend quantitative easing. It also emerged that the bank's deputy governor, and CEO of the Prudential Regulation Authority, Sam Woods wrote to UK banks to ask them how ready they might be for negative interest rates (see Negative rates explained: should UK investors prepare?).

JAPAN

The Japanese equity market lost ground for most of October, ending the month 2.8% lower. The yen moved steadily stronger against the US dollar, which had a slight negative impact on sentiment.

Style factors had a smaller influence on overall performance in October, although small cap stocks were weaker than the overall market, reversing some of the sharp outperformance seen in September.

With few new incentives domestically, the primary market drivers came from pre-existing factors, including the global resurgence of Covid-19, the US presidential election, and the likelihood of additional fiscal stimulus in major economies.

Japan's experience of Covid-19, in terms of incidence and mortality, continues to be markedly different from the US and Europe. As a result, the government has been able to continue to encourage private consumption through its "Go To" campaign for domestic travel. In October, this was supplemented by the launch of "Go To Eat" discounts to support local restaurants in each prefecture. Domestic economic data continues to reflect a slow but steady recovery after a downturn seen earlier in the year that, although severe, was less dramatic then many other countries.

The corporate results season for the June to September quarter started in late October. Initial indications are good, with a significant proportion of companies beating consensus estimates. Although the full picture will not be clear until November, the announcements made so far seem to support further upward revisions to profits across many sectors in the second half of this fiscal year.

ASIA (EX JAPAN)

The MSCI Asia ex Japan Index delivered a positive return in October, comfortably outperforming the MSCI World Index. Nearer month-end, worries about Covid-19 resurfaced as did US election uncertainty. Indonesia was the best-performing index market, as parliament passed the Omnibus Law which incorporates a number of labour market and tax reforms. The Philippines, where Covid-19 related restrictions were eased, and China also delivered strong gains and outperformed the index. Hopes of a Biden win in the US election – and potentially a smoother road forward for US-China relations – were supportive of Chinese equities, as was the performance of its internet companies and a number of positive Q3 earnings surprises.

Taiwan, India and Korea all finished in positive territory but underperformed the index. Earnings forecasts for Taiwan's companies increased as the outlook for growth improved. In India, the number of daily new cases of Covid-19 continued to fall after the peak in the middle of September. The weakest index market was Singapore followed by Thailand, and Malaysia and Hong Kong SAR also lagged behind.

EMERGING MARKETS

Emerging market (EM) equities posted a solid gain as expectations for additional fiscal stimulus in the US increased. It followed a widening of Democratic Party candidate Joe Biden's lead in opinion polls, ahead of the 3 November election. The MSCI Emerging Markets Index increased in value and outperformed the MSCI World.

Indonesia was the best performing EM market, as the approval of the Omnibus Law boosted sentiment. The Philippines, where Covid-19 restrictions were further eased, Mexico and China were the only other markets to outperform the EM index. In China, strong performance from internet stocks was beneficial. The prospect of more stable trade relations with the US under a prospective Biden presidency also proved supportive for stocks.

By contrast, Poland recorded a negative return and was the weakest market in the index. Daily new cases of Covid-19 accelerated and, later in the month, protests against the government broke out across the country. Greece and Turkey also finished firmly in negative territory and underperformed the index.

GLOBAL BONDS

Markets were volatile in October, with mixed performance from bonds. Corporate bonds held up well overall. Concerns around Covid-19 were heightened. A resurgence of cases in Europe resulted in renewed lockdowns in Germany and France toward

month-end and case numbers remained elevated in the US.

The middle of the month saw a burst of investor optimism as US politicians said negotiations over a stimulus package were progressing. Democrat presidential candidate Joe Biden, who favours a large stimulus, continued to lead in the polls. Sentiment reversed sharply in the last week of the month, on concerns over Covid, with the US dollar gaining against the euro and finishing slightly higher on the month.

Government bonds diverged over the month. The US 10-year Treasury yield rose by 19 basis points (bps) to 0.87%, with the 2-year to 10-year yield curve steepening by 16bps (rising yields mean falling prices). Aside from expectations of stimulus, US data was reasonably positive. Weekly jobless claims fell below 800,000 for the first time since March.

European 10-year yields fell by 10bps across the board amid the continued resurgence of Covid-19. Germany's 10-year yield finished at -0.63% and France's at -0.34%. In the "periphery", Italy's 10-year yield dropped to 0.76% and Spain's to 0.13%. The UK 10-year yield was 3bps higher at 0.26%. Economic indicators for Europe and the UK pointed to a loss of momentum, with Europe dipping back into contractionary territory.

Corporate bonds outperformed government bonds. US investment grade debt saw a marginal negative total return (local currency), as yields rose, but was comfortably ahead of US Treasuries. Eurozone investment grade returned 0.8%. Corporate bonds held up relatively well amid the sharp reversal in sentiment in the last week of the month (Source: ICE BofAML).

The performance of emerging market (EM) bonds was mixed. Hard currency (US dollar)-denominated bonds were flat after a late pullback, mainly in high yield, while EM corporate bonds made a modest positive return. Local currency bonds were also moderately positive. EM currencies were again mixed, but slightly higher overall. The Chinese renminbi and Thai baht performed well, while the Turkish lira and Brazilian real weakened.

Convertible bonds proved very resilient versus equities. The Thomson Reuters Global Focus index, which measures balanced convertible bonds, registered a positive return in the falling equity market environment. The index returned 0.4% compared to -2.5% for the MSCI World global equity index. Convertible bond valuations became slightly more expensive, albeit from a low base.

COMMODITIES

Commodities, as measured by the S&P GSCI Index, registered a negative return. Energy was the weakest component with crude oil falling sharply on concerns over demand related to the coronavirus. Livestock and precious metals also lost ground, though they fell by less than the index. Industrial metals rose, aided by strong gains for copper and zinc, and agricultural commodities posted positive returns.

TOTAL RETURNS (NET) % – TO END OCTOBER 2020

	1 MONTH			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	-3.1	-2.4	-3.1	4.4	-0.0	4.4
MSCI World Value	-2.8	-2.2	-2.8	-12.7	-16.4	-12.7
MSCI World Growth	-3.3	-2.6	-3.3	22.6	17.4	22.7
MSCI World Smaller Companies	-0.0	0.7	-0.0	-0.0	-4.2	0.1
MSCI Emerging Markets	2.1	2.7	2.0	8.3	3.7	8.3
MSCI AC Asia ex Japan	2.8	3.5	2.8	15.9	11.0	15.9
S&P500	-2.7	-2.0	-2.7	9.7	5.1	9.8
MSCI EMU	-6.2	-5.6	-6.2	-10.1	-13.9	-10.1
FTSE Europe ex UK	-6.1	-5.4	-6.1	-4.3	-8.3	-4.2
FTSE All-Share	-3.8	-3.2	-3.8	-18.7	-22.1	-18.6
TOPIX*	-1.9	-1.3	-1.9	0.4	-3.9	0.4

	1 MONTH			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	-1.0	-0.4	-1.0	7.2	2.7	7.3
JPM GBI UK All Mats	-0.6	0.1	-0.6	5.2	0.8	5.3
JPM GBI Japan All Mats**	0.7	1.4	0.7	1.5	-2.8	1.6
JPM GBI Germany All Traded	0.3	0.9	0.2	6.4	1.9	6.5
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	-0.1	0.6	-0.1	6.4	1.9	6.5
BofA ML US Corporate Master	-0.2	0.5	-0.2	7.0	2.5	7.1
2.8BofA ML EMU Corporate ex T1 (5-10Y)	0.3	0.9	0.2	5.9	1.5	6.0
BofA ML £ Non-Gilts	0.1	0.8	0.1	4.3	-0.1	4.4
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	0.3	1.0	0.3	3.2	-1.2	3.3
BofA ML Euro High Yield	-0.4	0.2	-0.4	4.0	-0.4	4.1

Source: Thomson Reuters DataStream.
Local currency returns in October 2020: *-2.8%, **-0.2%.
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