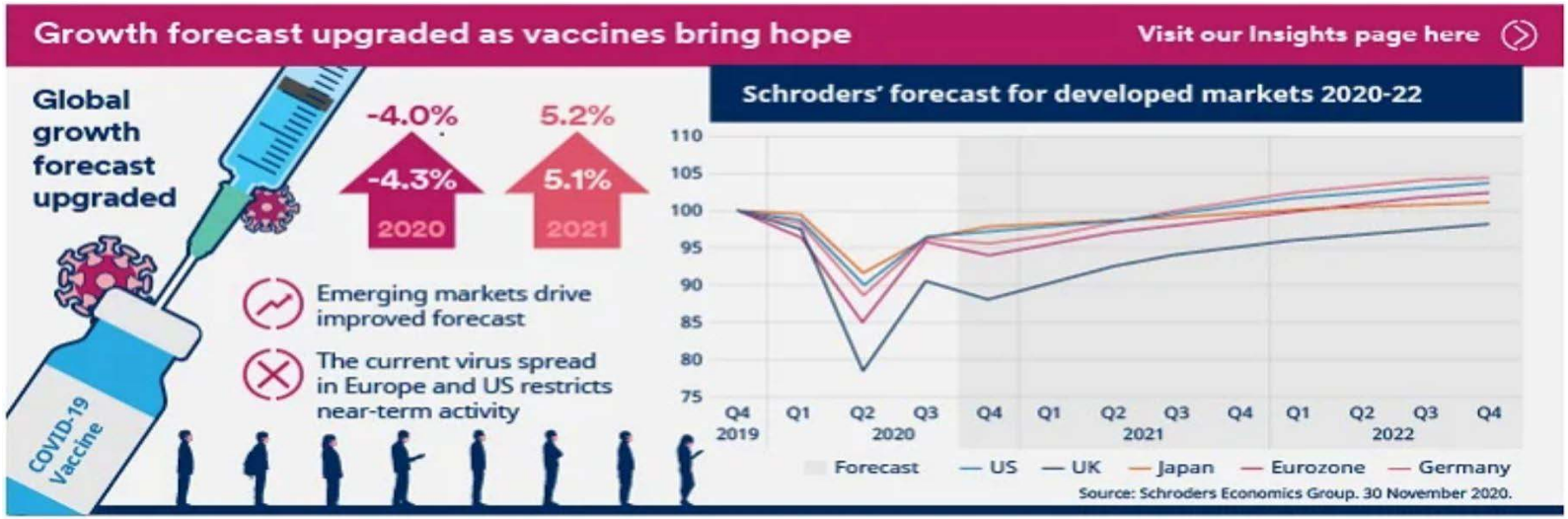
FINURA

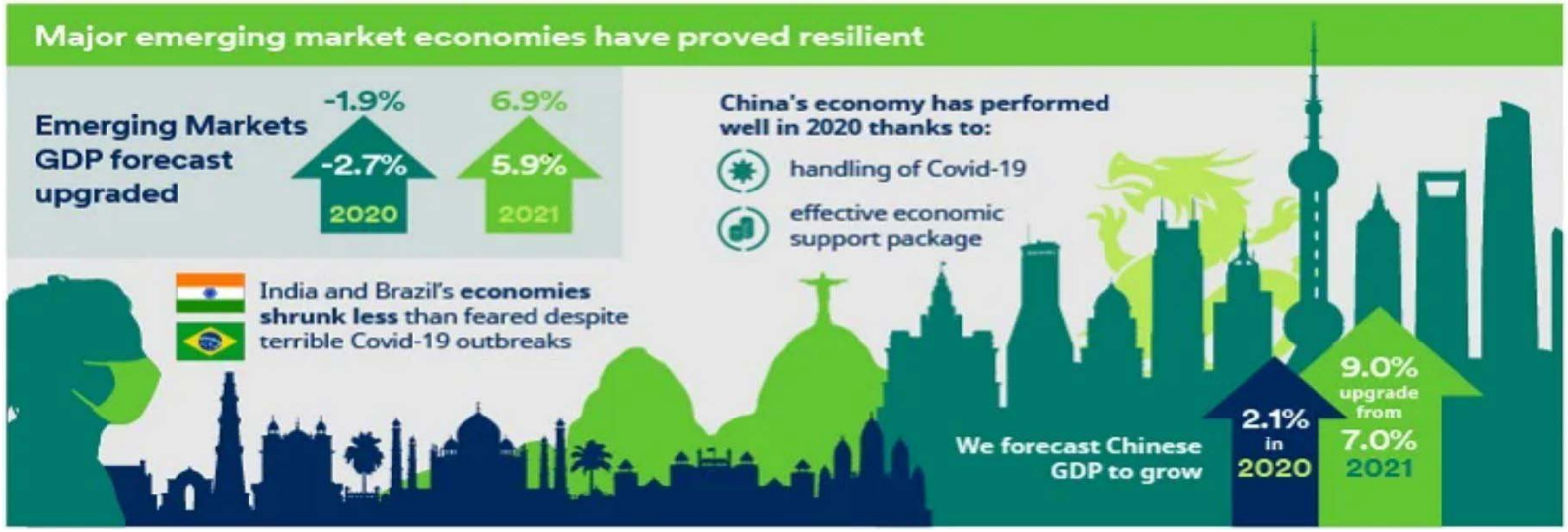
MARKET COMMENTARY DECEMBER 2020

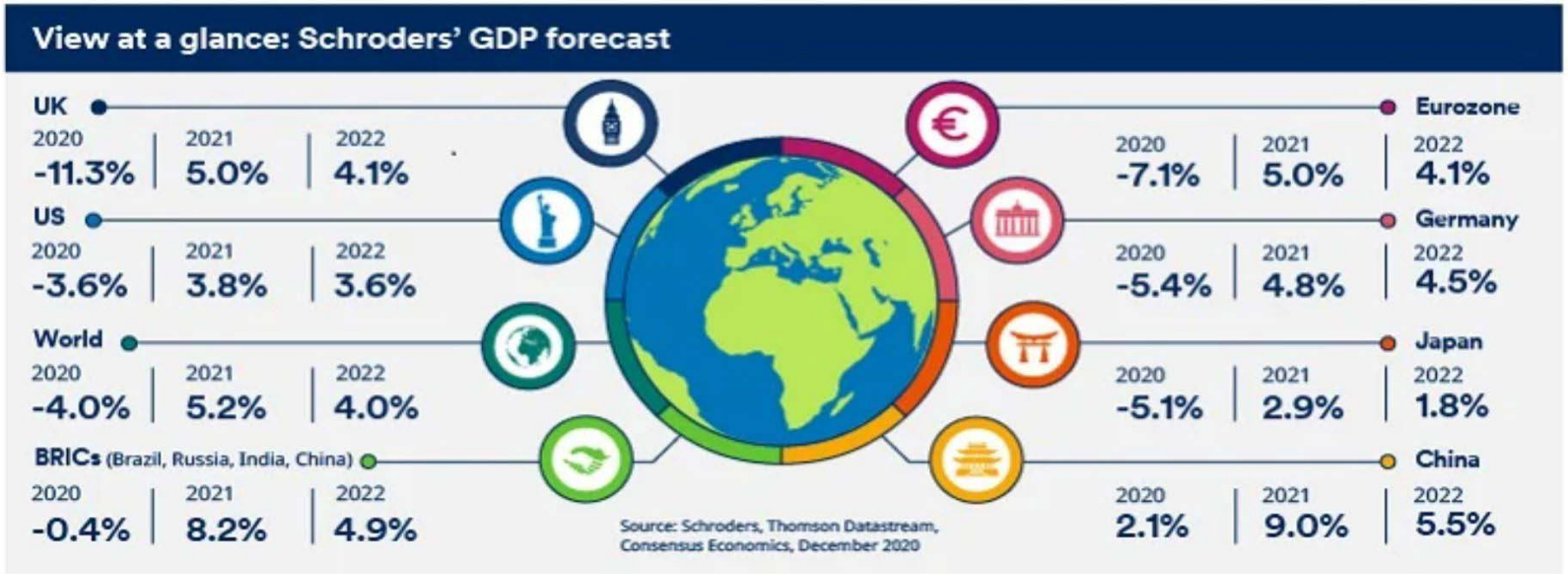
Chartered Financial Planners

Pension TRANSFER Gold Standard

INFOGRAPHIC: THE GLOBAL ECONOMY







Source: Schroders as at December 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	Positive/ Neutral	We believe liquidity (i.e. readily available funds) and recovery expectations should continue to support markets, but near term risks still persist in the form of rising fatalities, which will need close monitoring.
	Government Bonds	Negative ▼	We have downgraded as upside is limited and government bond markets remain expensive.
	Commodities	Positive/ Neutral ▲	Overall score reflects upgrades to more economically sensitive areas of the market, specifically energy and industrial metals.
	Credit	Neutral ▼	With credit spreads having narrowed substantially, credit valuations broadly now look expensive. We have downgraded our overall score to neutral due to the limited potential for future returns. The credit spread is the margin that a company issuing a bond has to pay an investor in excess of government yields and is a measure of how risky the market perceives the borrower to be.
Equities	US	Positive/ Neutral ▼	Downgraded after the recent rally and to reflect our preference for more economically sensitive markets.
	UK	Positive/ Neutral	The UK remains hampered by a resurgence in Covid-19 cases, accompanying restrictions and Brexit risk. We remain positive as we believe these negatives have been priced in.
	Europe	Positive ▲	We have upgraded Europe. The region should benefit as global activity normalises, which has potential to drive a rebound from its long-term underperformance.
	Japan	Positive ▲	Japan managed the outbreak of Covid-19 relatively well, limiting damage to its domestic economy. We believe export sectors should be the next to benefit from an economic recovery.
	Pacific ex-Japan	Positive/ Neutral	With positive news on the efficacy of the Covid-19 vaccines, we expect economic recovery to continue, aided by fiscal and monetary policy. Fiscal and monetary policy are tools used by policymakers in an attempt to manage economic fluctuations.
	Emerging Markets	Positive ▲	We continue to be positive on emerging markets (EM), with a preference for EM North Asia, but we do see scope for the more economically sensitive regions, such as Latin America and India, to catch up.
Government Bonds	US	Neutral	US Treasuries continue to offer protection in our portfolios as we need to be cognisant that the virus still has the ability to derail growth in the short term.
	UK	Negative	We retain our view that there is less value in gilts given their poor expected relative returns when compared to other developed markets.
	Germany	Negative	We maintain our view that Germany is an expensive market. Bunds offer limited protection against growth disappointment and face the headwind of EU bond issuance in 2021.
	Japan	Negative	Our view is unchanged. With inflation still likely to remain significantly lower than target, the Bank of Japan will need to keep its unconventional policies in place.
	US Inflation Linked	Positive/ Neutral ▲	Upgraded as breakeven rates have continued their rise following the announcement of the vaccine. We believe there is more scope for further improvement.
	Emerging Markets Local	Positive/ Neutral	Our view is unchanged. We still see medium-term opportunities in some markets for positive returns, although the majority of markets have priced out further rate cuts.

	Category	View	Comments
Investment Grade Credit	US	●	Improving fundamentals, the increasing probability of a vaccine driven recovery coming through in Q2 2021 and a continuing search for an alternative to expensive government bonds mean our rating is unchanged.
	Europe	●	Fundamentals are slightly stronger than for their US counterparts. European leaders have also reached a landmark $2.2 trillion budget agreement that leaves us positive.
	Emerging Markets USD	●	We retain our longstanding positive view for high quality corporates. We believe the extent of fiscal deterioration and the level of real interest rates is likely to remain the key driver of credit spreads.
High Yield Bonds (Non-IG)	US	● ▼	Downgraded as credit spreads have contracted significantly, fundamentals remain weak and the treasury secretary has made policy support less likely than in Europe.
	Europe	● ▼	Monetary and fiscal support within Europe, along with far better default and recovery rates versus the US drive our preference for Europe. However, valuations are now at very expensive levels due to further spread contraction.
Commodities	Energy	● ▲	There is potential for travel-related demand to pick up in 2021 given vaccine rollout. This, coupled with an OPEC deal to control supply, could lead to significant price appreciation.
	Gold	●	Recent optimism on the vaccine combined with signs of an economic recovery and a normalising of activity leads us to maintain our neutral view on gold.
	Industrial Metals	● ▲	The outlook for industrial metals looks promising as, despite the sector having delivered healthy performance, supply remains tight to meet the recovery in demand.
	Agriculture	●	The sector is resilient due to demand from Chinese trade commitments. Despite this, we remain neutral for the time being.
Currencies	US $	● ▼	We have been overweight the US dollar for its defensive properties compared to our pro-economically sensitive positions elsewhere in portfolios, but having reached our stop, we have kept to our discipline and reverted to neutral.
	UK £	● ▼	Whilst a Brexit deal would make us review our score, we are cautious on the longer-term outlook for sterling.
	EU €	● ▲	The euro should benefit from the global economic rebound, as well as technical flows from a rotation into international equities.
	JAP ¥	●	We remain neutral as strength in the short term has been a result of US dollar weakness, but the Japanese yen should weaken in the current positive risk environment.
	Swiss F	●	Although we have seen some strength from US dollar weakness, we expect the Swiss franc to remain range bound as this strength should be offset by the positive risk environment.

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, December 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 the final quarter of 2020 when positive news on Covid-19 vaccines helped shares make gains.

HIGHLIGHTS

- Global equities gained in Q4 as a number of vaccine breakthroughs fostered hopes of a return to economic normality.
- Government bond performance was mixed, with US yields rising (meaning prices fell). Corporate bonds gained ground.
- Commodities gained on vaccine news and a weaker US dollar.

THE US

US equities gained over the quarter, with November especially strong due to the vaccine news. The developments eclipsed Joe Biden's win in the US presidential election, as well as a $900 billion stimulus package announced in late December. The Federal Reserve nonetheless reinforced its supportive message, stating it will continue with current levels of quantitative easing. Economically sensitive sectors made the strongest gains, with more defensive sectors making more modest progress.

EUROZONE

European equities gained sharply in Q4, again on the news of effective vaccines. Sectors that had previously suffered most severely from the pandemic, such as energy and financials, were the top gainers. However, rising Covid infections saw many European countries tighten restrictions. EU leaders approved the landmark €1.8 trillion budget package, including the €750 billion recovery fund, after overcoming opposition from Hungary and Poland. The EU agreed a Brexit trade deal with the UK.

UK

UK equities performed well over the quarter reversing some of the underperformance that they suffered versus other regions during the global pandemic's initial stages. The market responded well to November's vaccine news and then again to the Brexit trade deal, with domestically-focused areas of the market outperforming.

JAPAN

Japanese equities rallied in the quarter, driven from early November by vaccine-related news and the US presidential election result. The style reversal seen in most markets has not yet materialised in Japan, with only a brief outperformance for value stocks, while small caps underperformed sharply in the quarter. The focus now is on the vaccine roll out, Japan's general election timetable and the timing of a full corporate earnings recovery.

ASIA (EX JAPAN)

The MSCI Asia ex Japan Index rallied strongly. South Korea was the best-performing index market, aided by strong gains from the tech sector. Indonesia, Taiwan, the Philippines and India also finished ahead of the index. Malaysia, China and Hong Kong generated more modest gains and underperformed. In China, tensions with the US, and anti-trust moves weighed on sentiment somewhat.

EMERGING MARKETS

Emerging market (EM) equities generated their strongest quarterly return in over a decade, with US dollar weakness amplifying gains. Korea, Brazil and Mexico all outperformed. The rally in commodity prices was supportive of EM net exporters.

Conversely, Egypt, where daily new Covid-19 cases accelerated, posted a negative return. China finished in positive territory but also lagged. The launch of an anti-trust investigation into Alibaba and further escalation in US-China tensions dragged on sentiment.

GLOBAL BONDS

Government bond yields diverged markedly. The US 10-year yield was 25 basis points (bps) higher, finishing at 0.91%, while the German 10-year yield fell by 5bps to -0.57%. Italian and Spanish 10-year yields saw significant declines of 32 and 20bps respectively, as the European Central Bank increased quantitative easing. The UK 10-year yield was little changed at 0.20%, as vaccine optimism was tempered by Brexit uncertainty and new lockdown measures.

Corporate bonds enjoyed a fruitful quarter, outpacing government bonds, with both investment grade and high yield delivering strong positive total returns. Investment grade bonds are the highest quality bonds as determined by a credit rating agency; high yield bonds are more speculative, with a credit rating below investment grade.

Convertible bonds gained 10.7%, benefiting from the tailwind of global stocks at record highs. This implies a strong 73% participation in the equity market gains in Q4. The primary market for convertibles has also reached highs not seen for the last ten years. All in all, $166 billion of new convertible bonds were issued in 2020. Valuations, especially in the US, have become more expensive, albeit from a lowly valued base.

COMMODITIES

In commodities, the S&P GSCI Index registered a robust return in Q4. Vaccine news lifted hopes for a global economic recovery in 2021. US dollar weakness was also beneficial. Agriculture was the best-performing index component, driven higher by strong performance from soybeans and corn. The energy component also posted a positive return. Crude oil prices rallied as a stronger demand outlook offset concerns over increased supply. Industrial metals also gained, driven higher by copper and nickel. Precious metals were mixed, with silver generating a robust gain while the gold price fell.

TOTAL RETURNS (NET) % – TO END DECEMBER 2020

	3 MONTHS			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	14.0	9.2	7.8	15.9	6.3	12.3
MSCI World Value	15.7	10.9	9.5	-1.2	-9.3	-4.2
MSCI World Growth	12.5	7.9	6.4	33.8	22.8	29.7
MSCI World Smaller Companies	23.9	18.7	17.1	16.0	6.4	12.4
MSCI Emerging Markets	19.7	14.7	13.2	18.3	8.5	14.7
MSCI AC Asia ex Japan	18.6	13.7	12.2	25.0	14.7	21.2
S&P500	12.2	7.5	6.1	18.4	8.6	14.7
MSCI EMU	17.6	12.7	11.2	7.9	-1.0	4.6
FTSE Europe ex UK	15.5	10.7	9.2	12.1	2.8	8.6
FTSE All-Share	19.1	14.1	12.6	-6.9	-14.6	-9.8
TOPIX*	13.7	8.9	7.5	13.0	3.7	9.6

	3 MONTHS			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	-0.9	-5.0	-6.3	8.4	-0.6	5.1
JPM GBI UK All Mats	6.3	1.9	0.6	12.5	3.2	9.0
JPM GBI Japan All Mats**	2.2	-2.1	-3.4	4.2	-4.4	1.0
JPM GBI Germany All Traded	4.8	0.4	-0.9	12.3	3.1	8.9
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	4.2	-0.1	-1.4	10.3	1.2	6.9
BofA ML US Corporate Master	3.0	-1.3	-2.6	9.8	0.7	6.4
2.8BofA ML EMU Corporate ex T1 (5-10Y)	6.9	2.5	1.1	12.6	3.3	9.2
BofA ML £ Non-Gilts	9.1	4.6	3.2	11.4	2.2	8.0
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	7.5	3.0	1.7	8.0	-0.9	4.7
BofA ML Euro High Yield	10.0	5.5	4.1	12.0	2.7	8.5

Source: Thomson Reuters DataStream.
Local currency returns in Q4 2020: *11.2%, **-0.0%.
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Source: Schroders, December 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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