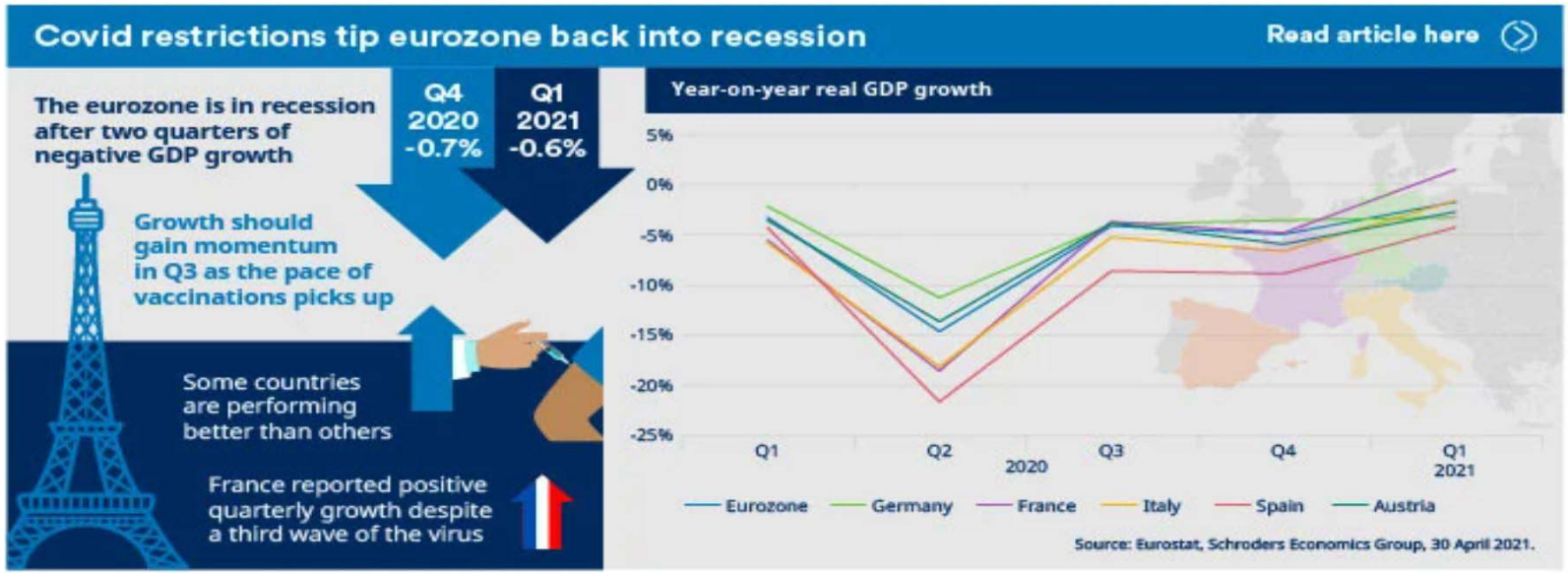
FINURA

MARKET COMMENTARY
MAY 2021

Chartered Financial Planners

Pension TRANSFER Gold Standard

INFOGRAPHIC: THE GLOBAL ECONOMY



Source: Schroders as at May 2021.

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	Company earnings look strong while the re-opening of economies continues to gather pace and bond yields remain stable. We remain positive, with a bias to economically sensitive stocks, and "value" stocks (value stocks befit the value style of investing which focuses on stocks that appear to trade at a lower price relative to their fundamentals, such as dividends or earnings).
	Government Bonds	Negative	Although valuations have slightly improved, we continue to believe break-even inflation rates will move higher and momentum with the economic recovery will be a headwind. This justifies our negative view. Break-even inflation rates are market-based measures of expected inflation.
	Commodities	Positive/ Neutral	Supplies remain under pressure as stocks have plummeted to decade lows. Vaccine distribution and fiscal stimulus continue to support the recovery. Fiscal stimulus is a tool used by policymakers in an attempt to manage economic fluctuations.
	Credit	Neutral	The probability of a vaccine-led recovery in Q2 2021 has positive implications for credit; however, the tightening in credit spread levels has made valuations less attractive. 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	Earnings continue to positively surprise while monetary stimulus (another tool used by policymakers to manage economies) remains supportive. Our preference is for economically sensitive and value stocks over defensive and the "growth" stocks (growth stocks befit the growth style of investing which focuses on stocks whose revenues and earnings are expected to increase at a faster rate than the average company).
	UK	Positive/ Neutral	The UK continues to offer attractive exposure to the economic recovery and cheap valuations, but the strength of the pound still weighs on a market with high foreign revenues.
	Europe	Positive	An increased pace of vaccinations, coupled with support by the European Central Bank (ECB), leads us to believe that Europe will benefit from an expected summer re-opening.
	Japan	Positive/ Neutral	Export growth is accelerating, which we expect to continue as the economic recovery progresses. The slow vaccine rollout, however, remains a headwind.
	Pacific ex-Japan	Positive/ Neutral	We continue to favour Korea and Taiwan as their manufacturing outlook remains bright, with low semiconductor inventory and an environment of high global demand.
	Emerging Markets	Neutral	Attractive valuations are offset by renewed virus outbreaks and China's tightening and regulatory action.
Government Bonds	US	Negative	We remain negative as we believe we haven't seen the ceiling yet for US bond yields and there is no change in the concerns over the inflation narrative that is driving the bond market.
	UK	Negative	We maintain our negative score for UK government bonds as the re-opening plan remains on track and the vaccine rollout continues to progress.
	Germany	Negative	A combination of poor returns versus cash and accelerating momentum with the economic recovery leads us to believe German bonds will underperform.
	Japan	Negative	Recent moves have been consistent with the rest of the bond market. There has been no change of view within a multi-asset portfolio context.
	US Inflation Linked	Positive/ Neutral	The economic recovery, price pressures faced by companies and the US central bank's stance continue to point to higher levels of inflation.
	Emerging Markets Local	Neutral ▲	Although the US remains a headwind, adjustments in Latin America have been material and yield curves are aggressively priced, which has led us to upgrade our view to neutral. The yield curve is the difference between the interest rate on a longer-dated bond (debt issued by a corporation or country) and a shorter-dated bond.

	Category	View	Comments
Investment Grade Credit	US	🟡	Valuations are very tight but could test all time lows. Although fundamentals are improving, the high duration of IG bonds leaves them exposed to the risks from interest rate rises. Duration is a measure of the sensitivity of the price of a bond to a change in interest rates, with short duration bonds being less sensitive.
	Europe	🟢	We prefer Europe over the US as the region is earlier in the credit cycle, has stronger technical factors underpinned by the ECB, and more appealing valuations.
	Emerging Markets USD	🟢	We maintain our positive view and believe the key driver for defaults and credit spreads is the extent of fiscal deterioration and the level of real (inflation-adjusted) interest rates.
High Yield Bonds (Non-IG)	US	🔴	Despite a positive supply and demand backdrop and benign fundamentals pushing credit spreads tighter, we retain a negative view as valuations are incredibly rich.
	Europe	🔴	While there is an acceleration in the vaccine roll-out, the lack of a co-ordinated fiscal recovery programme increases the possibility of higher future default rates.
Commodities	Energy	🟢	OPEC+ – an alliance between OPEC members (Organization of the Petroleum Exporting Countries) and other oil producing states – reiterated its goal to increase in production through Q2. However, global inventories continue to be drawn down as the market remains in deficit.
	Gold	🟡 ▼	We see little opportunity for real (inflation-adjusted) yields to compress further with growth surging and imminent talk of "tapering", the process by which central banks reduce, or taper, asset purchases associated with monetary stimulus programmes such as quantitative easing. Downgraded due to a less favourable risk to return ratio.
	Industrial Metals	🟢	Despite moderated demand in China, demand in the rest of the world should recover strongly as economic activity normalises after the vaccine rollout.
	Agriculture	🟢	Supply is under pressure, amid strong global demand and Brazilian weather disruption. However, planting is ahead of schedule and we expect supplies to improve by Q3.
Currencies	US $	🟡 ▼	Although the US growth outlook is still strong, a reversal in the US dollar (USD) this month leads us to moderate our view.
	UK £	🟡	The rollout of vaccines coupled with the anticipated removal of further restrictions has been positive; however, the yield differential between the USD versus the British pound has narrowed.
	EU €	🟡	Although vaccine progress could lead to a strong bounce in Q2, we remain neutral while we await a growth catalyst in the coming months.
	JAP ¥	🔴	This score continues to reflect the better vaccine story, higher growth, inflation and interest rate outlook in the US, along with the positive yield differential of USD versus the Japanese yen.
	Swiss F	🔴	Still negative as the outlook for Europe has improved following the acceleration in the rollout of Covid-19 vaccines as well as the ongoing recovery in global 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, May 2021. 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 May when shares moved up on re-opening and vaccine optimism, although rising inflation sparked some concerns.

HIGHLIGHTS

- Developed market equities gained in May with the ongoing vaccine roll-outs and fiscal stimulus measures helping to offset concerns about rising inflation. Emerging market shares also advanced, aided by US dollar weakness
- Government bond yields were little changed in May. US investment grade corporate bonds produced a solid total return and continued outperforming Treasuries
- Commodities gained, with precious metals the best-performing index component

THE US

US equities rose in May. Economic momentum showed further signs of acceleration as industries reopened and vaccine roll-outs continued, which lifted investor spirits.

The composite purchasing managers' index (PMI) rose to 63.5 in April, indicating significant expansion. Driven by the services component, this suggests the services recovery is now underway. The PMI is an index of business activity based on a survey of private companies in the manufacturing and services sectors. A reading above 50 means the economy is expanding.

Headline consumer price inflation rose 4.2% year-on-year (y/y) in April, the highest level since September 2008 and sparked some nascent concern it could prompt tighter monetary policy. Federal Reserve (Fed) officials have indicated cautious optimism about the recovery, with some members being open to discussing tapering "at some point in the upcoming meetings", if the economy continued to make rapid progress.

A blot on the otherwise bright landscape, non-farms payrolls added just 266,000 jobs last month compared with economists' expectations of almost one million positions created over the month. While leisure and hospitality added 331,000 jobs, there were losses in other sectors of the economy, including car manufacturing, temporary help and retail. Moreover the unemployment rate edged up to 6.1%. Car manufacturing has been hit recently by disrupted supply chains.

Corporate earnings reflected the economic vigour, with Q1 earnings on track to be the strongest in over a decade. The strongest performance was by equities sectors closely tied to economic growth such as energy and materials, which performed well. Consumer discretionary lagged, partly as a shortage of semiconductors has caused shutdowns in auto production.

EUROZONE

Eurozone shares posted another advance in May and outperformed other regions. The vaccine roll-out continued to pick up the pace in several countries. As of 31 May, 43% of the German population had received at least one vaccine dose with France and Italy on 38%, according to Our World In Data.

Restrictions on social and economic activity were generally loosened further. This resulted in greater optimism over the economic and business outlook for the rest of the year. The energy, financials, consumer staples and discretionary sectors led the advance while healthcare, information technology and utilities were laggards.

Shares were further supported by an exceptionally strong corporate earnings season, even accounting for the soft comparison with Q1 2020. Sectors that are sensitive to the economic cycle fared well in terms of earnings, benefiting from a combination of demand recovery, pricing power and supply constraints.

Forward-looking data continued to be very encouraging. The flash composite PMI rose to 56.9, a 39-month high, with the services component rising strongly as easing Covid restrictions helped fuel higher demand. Despite the improving economic outlook, European Central Bank (ECB) policymakers signalled that it is too soon to withdraw stimulus measures. Annual inflation was confirmed at 1.6% for April although this rose to 2.0% for May.

UK

UK equities rose over the month with a number of domestically focused sectors performing well as confidence grew around the re-opening of the economy.

The government pushed ahead with the latest easing of lockdown measures amid a rise in infections related to the 'Indian' variant of Covid-19. Concerns as to whether the variant might delay the removal of social distancing laws on 21 June did result in some domestically focused sectors giving back some of their recent very strong gains. However, in general, the outlook for UK consumers and businesses improved, resulting in various forecasters upgrading GDP predictions.

The Bank England announced plans to slow its quantitative easing programme. Investors were preoccupied by the potential implications should the current pick-up in inflation, from a very low base in 2020, be sustained. It was against this backdrop that the domestically focused banks and life insurance companies outperformed the overall market.

In contrast, large internationally diversified financials were negatively impacted by sterling strength and a weak US dollar in particular. Likewise, the lowly valued internationally diversified resources companies underperformed. Fears over currency impacts on their dollar earnings outweighed the ongoing strength in crude oil and industrial metal markets. The utilities sector performed very well amid rising wholesale electricity prices, in an otherwise mixed month for less economically sensitive, or defensive areas of the market. Merger and acquisition activity reaccelerated with a number of new deals announced.

JAPAN

After a sharp decline in the second week of May, the Japanese stock market subsequently recovered as global inflation fears receded to close up 1.4% for the month. The yen weakened slightly against the US dollar which provided some support for equity market sentiment.

Although the rate of Covid infections in Japan remains markedly below most other countries, the persistent increase in cases led the government to extend the state of emergency throughout May in several areas, including Tokyo. This, together with slow progress in the vaccine roll-out, further damaged the credibility of the Suga administration.

Although we could still see additional restrictions imposed, the political timing is now complicated leading into the start of the Olympics in late July. Towards the end of May we have seen a

substantial acceleration in the vaccination rate as several mass vaccination centres finally started operation.

Consumer sentiment has inevitably been impacted by the latest restrictions imposed under the state of emergency. However, real-time data suggests the real effects may be slightly milder than those seen in previous periods of restriction.

The corporate results season was completed in May with the majority of companies reporting numbers in line with, or slightly ahead of, consensus expectations. The number of companies reporting profits below expectations has been significantly lower than normal in each of the last two quarterly earnings seasons. This positive skew in results is mainly due to successful programmes of cost control across multiple market sectors. Meanwhile, the ongoing global recovery is continuing to support industrial production.

ASIA (EX JAPAN)

Asia ex Japan equities recorded a modest gain in May. Although shares were weaker earlier in the month, on the back of higher-than-expected US inflation data, equities recovered later in the month, driven by a weaker US dollar.

India was the strongest market in the MSCI AC Asia ex Japan index. This strong performance came despite the country grappling with rising numbers of Covid-19 infections and India remains one of the countries worst-hit by the pandemic. The Philippines and Pakistan also achieved strong gains in the month and outperformed the index. Gains achieved by China, Hong Kong and South Korea were more modest. In China, the slow roll-out of Covid-19 vaccines and regulatory concerns over the country's technology sector held back market returns.

Increasing Covid-19 infections in a number of countries weighed on returns in a number of markets in the index, with Malaysia, Singapore and Thailand all ending the month in negative territory. Shares in Taiwan also declined in May, as a rise in Covid-19 infections prompted the imposition of tighter restrictions.
By sector, energy, utilities and healthcare were the strongest, achieving solid gains in May. Conversely, consumer discretionary, communication services and information technology were all weaker, ending the month in negative territory.

EMERGING MARKETS

Emerging market (EM) equities generated a positive return amid ongoing signs of global economic recovery and the transition out of the pandemic. US dollar weakness was beneficial. The gains came despite a sell-off early in the month, as a higher-than-expected US inflation reading renewed concerns over the timing of global monetary policy tightening.

The euro-linked economies of Hungary, Poland, and the Czech Republic were among the best performing markets. Stronger commodity prices were supportive of a number of EM including Peru, Russia, Brazil and South Africa. India also outperformed the MSCI EM index amid signs that the current wave of Covid-19 may be peaking. By contrast, Chile registered a negative return as policy uncertainty increased. Egypt also finished in negative territory, as did Taiwan which saw an outbreak of coronavirus cases. China, where the government announced new regulations for the technology sector, and South Korea also posted slightly negative returns and underperformed the index.

GLOBAL BONDS

Government bond yields were little changed in May, consolidating having sold-off since the start of the year. The

US 10-year Treasury yield was three basis points (bps) lower at 1.59%, and the UK's 10-year fell 5bps to 0.80%, both having risen significantly year to date.

Bond yields rose earlier in the month, as data showed headline US consumer price inflation rose 4.2% year on year in April. US core personal consumption expenditure, which excludes food and energy, rose 3%, the largest increase since 2006.

European yields continued to rise initially, with the vaccine roll-out and economic recovery gaining traction, then fell in the last week of May on dovish comments from the ECB.

The 10-year Bund yield increased by 2bps to -0.19%, reaching an intra-month high of -0.11%. Italy's and Spain's finished unchanged, at 0.91% and 0.46% respectively, after declines of 12 and 8bps in the final week.

US investment grade (IG) corporate bonds produced a solid total return and continued outperforming Treasuries. European IG was marginally weaker, in line with government bonds. High yield corporate bonds saw further positive returns, but due to income. 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.

Emerging market bonds made positive returns, ahead of developed markets, led again by high yield. Commodities prices continued to rise. Emerging market currencies broadly performed well as the US dollar weakened.

Despite the tailwind of positive equity markets, the convertible bonds universe came under pressure in May. Information technology, disruptive consumer names, and the "Covid winners" in general ended the month with a loss. The Refinitiv Global Focus index, which measures balanced convertible bonds, shed -0.7%.

COMMODITIES

The S&P GSCI Index recorded a modestly positive return in May, reflecting how the economic rebound in the world's largest economies is bolstering demand for metals, food and energy while supplies remain constrained. The increase in May was more muted than in recent months on growing concerns over inflation. Precious metals was the best performing component of the index, with strong gains for both gold and silver. Industrial metals also achieved a good performance in May, led by gains for zinc and copper.

The energy component was also higher in the month, led higher by heating oil and gasoil. Crude oil and Brent Crude also gained during the month, reflecting how countries around the world are starting to return to normal patterns of consumption. In the livestock sector, prices for feeder cattle and lean hogs gained while prices for live cattle were modestly lower in the month. The agriculture sector recorded a negative performance over the month, led by sharp declines in wheat and Kansas wheat. Cotton was also lower in the month, while coffee recorded a strong gain.

TOTAL RETURNS (NET) % – TO END MAY 2021

	1 MONTH			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	1.4	-0.1	-1.2	40.6	27.9	22.3
MSCI World Value	2.9	1.4	0.3	40.8	28.1	22.5
MSCI World Growth	-0.2	-1.7	-2.8	39.8	27.2	21.6
MSCI World Smaller Companies	0.8	-0.7	-1.8	56.5	42.4	36.1
MSCI Emerging Markets	2.3	0.7	-0.3	51.0	37.4	31.3
MSCI AC Asia ex Japan	1.2	-0.3	-1.4	51.5	37.9	31.8
S&P500	0.7	-0.9	-1.9	40.3	27.7	22.0
MSCI EMU	4.1	2.5	1.4	48.5	35.2	29.2
FTSE Europe ex UK	4.5	2.9	1.8	45.6	32.5	26.6
FTSE All-Share	3.8	2.2	1.1	41.6	28.8	23.1
TOPIX*	1.3	-0.3	-1.3	23.7	12.6	7.6

	1 MONTH			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	0.3	-1.3	-2.3	-4.2	-12.8	-16.7
JPM GBI UK All Mats	3.2	1.6	-0.5	6.1	-3.4	-7.7
JPM GBI Japan All Mats**	-0.0	-1.6	-2.6	-2.1	-11.0	-14.9
JPM GBI Germany All Traded	1.4	-0.1	-1.2	7.5	-2.2	-6.5
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	1.0	-0.5	-1.6	7.7	-2.1	-6.4
BofA ML US Corporate Master	0.7	-0.9	-1.9	4.0	-5.4	-9.6
2.8BofA ML EMU Corporate ex T1 (5-10Y)	1.4	-0.2	-1.2	16.2	5.7	1.0
BofA ML £ Non-Gilts	3.0	1.4	0.3	17.6	7.0	2.3
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	0.8	-0.8	-1.8	17.5	6.9	2.2
BofA ML Euro High Yield	1.6	0.0	-1.1	23.7	12.5	7.6

Source: Thomson Reuters DataStream.
Local currency returns in May 2021: *1.4%, **0.0%.
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Source: Schroders, May 2021: 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.

FINURA

5th Floor, 20 Old Bailey, London EC4M 7AN
T: +44 (0)20 8057 8004 E: hello@finura.co.uk W: finura.co.uk