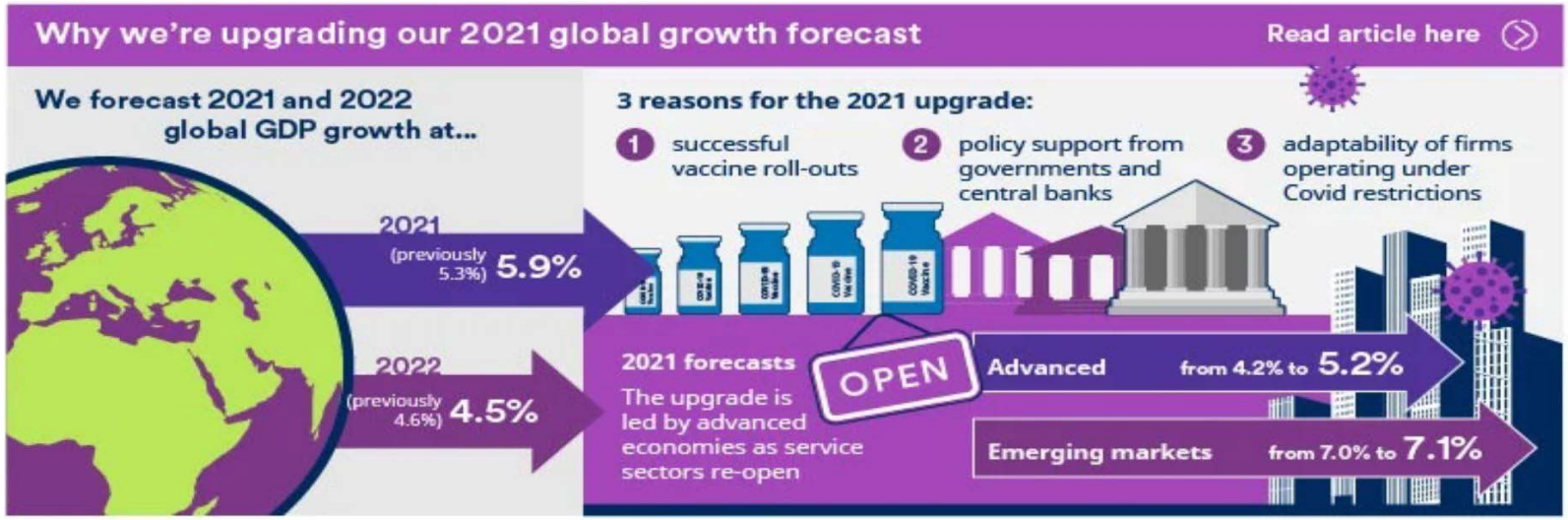
FINURA

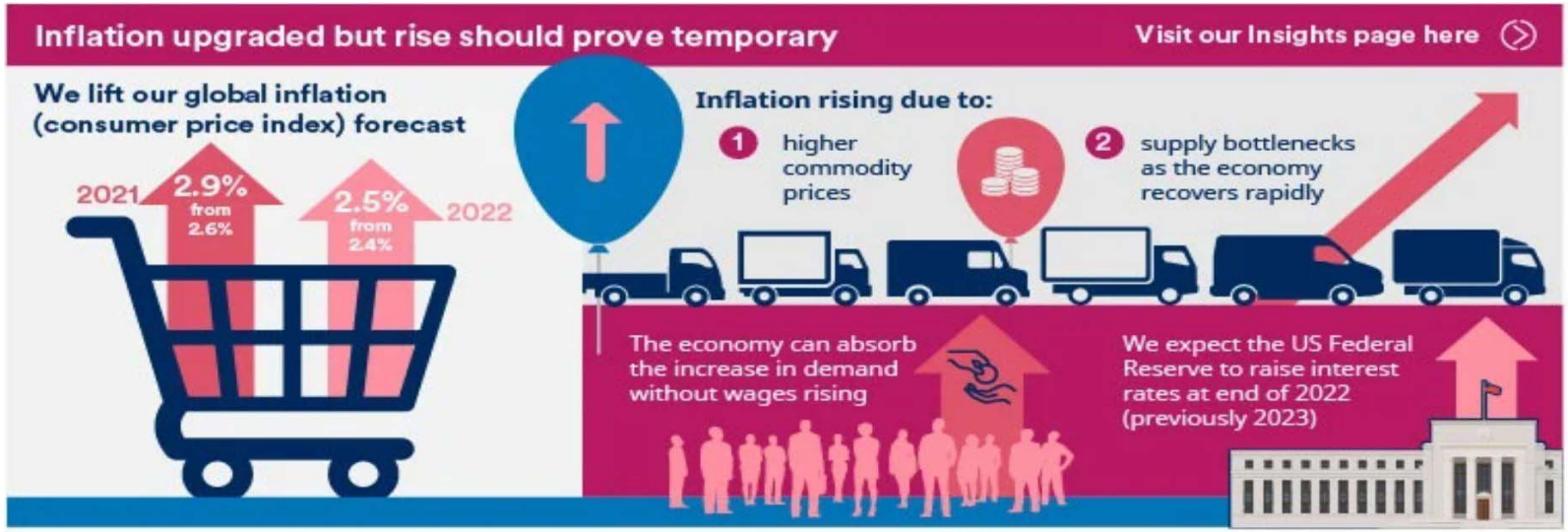
MARKET COMMENTARY
JUNE 2021

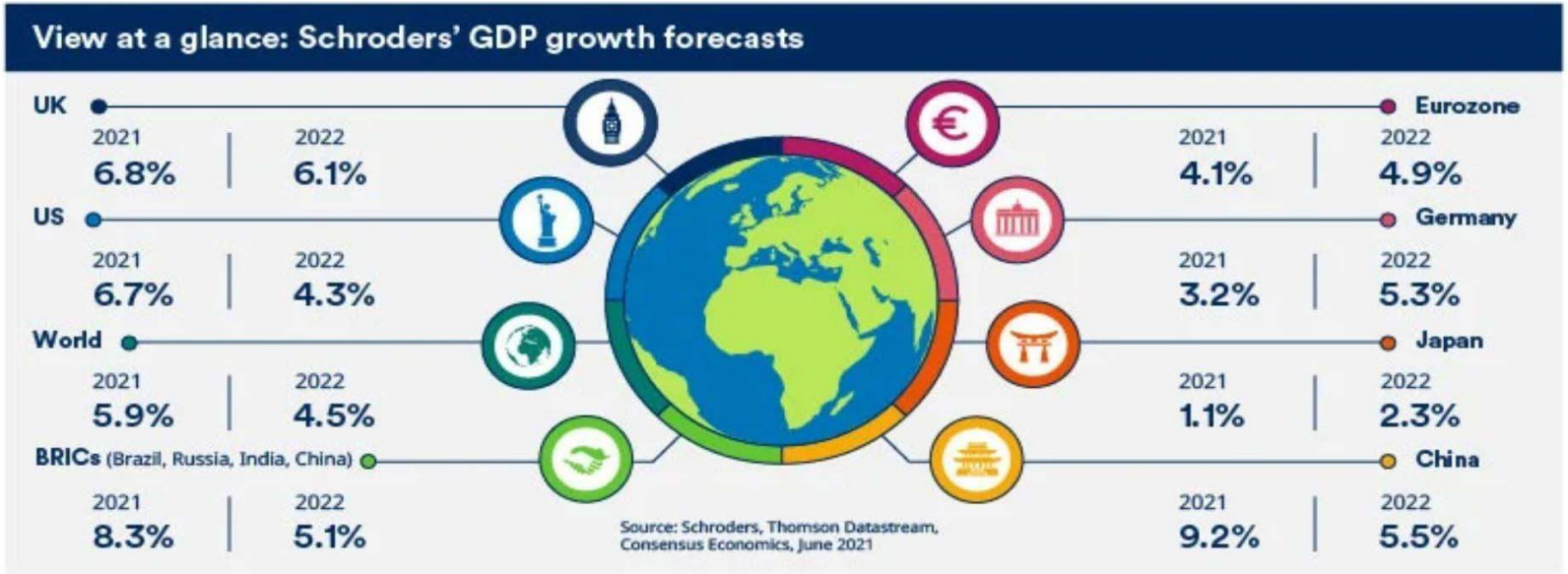
Chartered Financial Planners

Pension TRANSFER Gold Standard

INFOGRAPHIC: THE GLOBAL ECONOMY







Source: Schroders as at June 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	Strong corporate earnings, continued policy support and low bond volatility reaffirm our positive view. We continue to have a tilt in favour of economically sensitive/lowly valued areas of the market.
	Government Bonds	Negative	Although valuations have slightly improved, we continue to believe break-even inflation rates will move higher and economic momentum will be a headwind. 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 economic recovery. Fiscal stimulus is a tool used by policymakers in an attempt to manage economic fluctuations.
	Credit	Negative ▼	Valuations have increasingly become very expensive across developed markets while the outlook for technical factors appears less favourable going forward.
Equities	US	Positive/ Neutral	Corporate earnings continue to positively surprise while monetary stimulus (another tool used by policymakers in an attempt to manage economic fluctuations) remains supportive. Our preference is for economically sensitive/lowly valued over defensive/growth areas of the market.
	UK	Positive/ Neutral	The UK offers 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	A strong rebound in the pace of vaccinations coupled with support by the European Central Bank (ECB) leads us to believe that Europe will benefit from an expected reopening.
	Japan	Positive/ Neutral	Vaccine rollout is improving quickly, which is beneficial for this export-led market as we expect the economic recovery to continue.
	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	Positive/ Neutral ▲	We upgraded our view due to relatively attractive valuations as the market begins to recover from the effects of the virus.
Government Bonds	US	Negative	We remain negative as we believe we have not yet seen the ceiling for US yields. In addition, the risks of higher inflation remain elevated.
	UK	Negative ▼	We downgraded our score for the UK as we expect inflation to gently trend upwards while the vaccine roll-out continues to progress rapidly.
	Germany	Negative	A combination of poor returns versus cash and accelerating economic momentum 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 portfolio context.
	US Inflation Linked	Neutral ▼	We downgraded our view as our model suggests that the market is now fairly priced.
	Emerging Markets Local	Neutral	Although the risk of US tapering (a reduction in the rate at which central banks buy assets such as bonds as part of quantitative easing programmes) remains a headwind, adjustments in Latin America have been material and the outlook for economic growth appears to be improving.

	Category	View	Comments
Investment Grade Credit	US	● ▼	Valuations are extremely expensive, meaning the US investment grade (IG) credit market is particularly vulnerable to shifts in market sentiment and technical factors e.g. the risks from interest rate rises.
	Europe	● ▼	Despite stronger technicals underpinned by the ECB, credit spreads nonetheless remain tight and therefore valuations appear increasingly stretched.
	Emerging Markets USD	●	We maintain our positive view, but believe the key factors to monitor are any fiscal deterioration and the level of real interest rates, both of which are currently favourable.
High Yield Bonds (Non-IG)	US	●	Despite an improvement in fundamentals, credit spreads remain compressed and so we retain our negative view as valuations are incredibly rich. 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.
	Europe	●	While there is an acceleration in the vaccine roll-out, the lack of a coordinated fiscal recovery programme increases the possibility of higher future default rates.
Commodities	Energy	● ▼	We have moderated our view to reflect the extent of price rises so far. However, we remain positive as demand remains strong while global inventories continue to be drawn down as the market remains in deficit.
	Gold	●	Following the recent rebound in gold prices, the gap between gold and real yields has narrowed. In addition, the risk/return ratio appears less favourable.
	Industrial Metals	●	Despite a moderation in demand in China, demand in the rest of the world appears to be picking up as economic activity begins to normalise following the vaccine roll-out.
	Agriculture	●	Supply is under pressure amid strong global demand and weather disruptions. However, planting is ahead of schedule and we expect supplies to improve by the third quarter.
Currencies	US $	● ▼	Despite the swifter post-Covid recovery in the US, we have tactically downgraded our view. We expect currencies outside of the US to catch up over the summer as vaccination rates increase.
	UK £	●	The vaccine roll-out coupled with the anticipated removal of further restrictions has been positive; however, recent appreciation means the currency is now broadly fairly valued.
	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 US's better vaccine story, higher growth, inflation and interest rate outlook, along with the positive yield differential of the US dollar versus JPY.
	Swiss F	●	Still negative as the franc's defensive characteristics means it will be unlikely to outperform other currencies in an environment of recovering 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, June 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 Q2, when stocks made further gains and the US Federal Reserve hinted at future policy tightening.

HIGHLIGHTS

- Global equities advanced in Q2, supported by the accelerating roll-out of Covid-19 vaccines. Growth stocks outperformed more lowly valued parts of the market
- Government bond yields saw divergent performance. US 10-year yields fell (meaning prices rose) while yields rose in Europe. Corporate bonds outperformed government bonds
- Commodities gained with energy again the strongest component

THE US

The second quarter was strong for US equities, and indeed the S&P 500 reached a new all-time high in late June. Almost all sectors made gains over the quarter.

The Federal Reserve's (Fed) rate-setting meeting brought no change to policy but its projections indicated that interest rate rises could come in 2023. This seemed to wrong-foot some market participants, though subsequent comments by Fed officials sought to allay any worries over tightening monetary policy too quickly.

Overall, the economic picture remained rosy. Q1 GDP grew at 6.4% (quarter-on-quarter, annualised), which was modestly lower than the consensus of 6.7%. Growth in consumption was especially strong. Industrial activity as measured by US composite purchasing managers' index (PMI) moved from 59.7 in March, to a (flash) composite reading of 63.9 in June. The PMI indices, produced by IHS Markit, are based on survey data from companies in the manufacturing and services sectors. A reading above 50 signals expansion.

Inflation data, unsurprisingly, received a lot of attention. In May, core consumer price index (CPI) inflation rose from 3% to 3.8% year-on-year - the largest increase since June 1992, with the "reopening theme" a big driver.

In late June President Joe Biden also secured a deal on an infrastructure package worth about $1 trillion to upgrade roads, bridges and broadband networks over the next eight years. The agreement fell short of the $2.3 trillion infrastructure spending plan announced in March, and did not address the social safety-net spending proposed in April.

Tech giants like Apple, Alphabet and Microsoft made strong gains over the quarter. By sector, energy, IT, communication services and real estate were amongst the strongest areas of the market. Utilities and consumer staples lagged.

EUROZONE

Eurozone shares gained in the quarter, supported by a strong corporate earnings season and an acceleration in the pace of vaccine roll-out in the region. Many European countries saw Covid-19 infections fall over the quarter and were able to loosen restrictions on social and economic activity.

Rotations in the market between growth and value areas saw a mixed group of sectors lead the gains. The top performing sectors included defensive areas such as consumer staples and real estate, which had lagged in Q1 as investors focused on more economically-sensitive areas of the market. However,

information technology was also among the top gainers in Q2, while utilities and energy were laggards. Quarterly earnings for Q1 were generally very robust across the board, with the exception of the healthcare sector.

Economic data pointed to a strong rebound in activity in Q2. The flash Markit eurozone composite PMI rose to 59.2 in June, its highest level since June 2006. Eurozone inflation was estimated at 1.9% in June, down from 2.0% in May. The European Commission signed off on the first of the national recovery plans which will receive funding from the €800 billion Next Generation EU fund. Spain and Portugal were the first countries to have their spending plans approved.

UK

UK equities performed well over Q2, although beneath the strong headline figure the quarter was mixed. Markets were largely driven by lowly valued and economically sensitive sectors during April and May, continuing a trend in train since November which has beneficial to the UK. Amid improving sentiment global fund managers reported being "overweight" the country for the first time since 2014.

Small and mid cap (SMID) equities outperformed during this phase. Among them were domestically and internationally exposed SMIDs set to benefit from recovering global and domestic economies. The UK economic outlook brightened considerably as GDP forecasts were upgraded while the Bank England said it was to slow the pace of quantitative easing.

The market, however, struggled over June amid a rise in Covid-19 infections and falling inflation expectations. Defensive large cap equities were very much in favour in June, a trend amplified as sterling fell against a very strong US dollar. The healthcare and consumer staples industries performed resiliently over the month. While energy also performed well in June, in the main lowly valued and economically sensitive sectors did not. Financials performed poorly as market interest rates fell – the UK's banks and insurance companies, which dominate the sector, typically benefit as rates rise, as they had in Q1 due to inflationary concerns.

A number of the domestically focused areas which had performed very well on re-opening hopes also fell back quite sharply in June. This was partly due to concerns around the impact of the delta variant of Covid-19 on re-opening plans. Retailers and travel and leisure sectors in particular performed poorly as the UK government delayed the date to further lift social distancing laws.

JAPAN

Japanese shares underperformed other developed markets in Q2. Although the rate of Covid infections in Japan remained markedly below most other countries, the persistent increase in cases led the government to delay lifting the state of emergency until 20 June. This, together with initial slow progress in the vaccine roll-out, further damaged the credibility of the Suga administration. Any re-imposition of the state of emergency in the near term would be politically very difficult ahead of the planned opening of the Olympic games on 23 July.

Towards the end of May there was a substantial acceleration in the vaccination rate, as bureaucratic and logistical problems seem to have been overcome. Japan is now capable of administering one million vaccinations per day.

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.

Economic data released recently has reflected short-term negatives rather than the capacity for a faster recovery in the latter part of the year. Industrial production data was weaker than expected, primarily as a result of curtailed auto production due to the global shortage of semiconductors. This also had an impact throughout the auto supply chain. Despite the rise in global inflation expectations this year, Japan's data continues to show mild deflation due to several on-off impacts.

ASIA (EX JAPAN)

The MSCI Asia ex Japan Index recorded a positive return in the second quarter amid continued investor optimism for a return to economic normality and an end to the Covid-19 pandemic. However, stocks were more muted towards the end of the quarter as a resurgence of Covid-19 infections and lockdowns due to the delta variant curbed investor optimism somewhat. A stronger US dollar also weighed on returns in June, while a more hawkish tone from the US Federal Reserve and growing concerns over inflation further weakened sentiment.

The Philippines was the strongest index market in the quarter, while Taiwan and India also achieved positive gains during the quarter. China and Hong Kong also achieved modest gains during the quarter. By contrast, Pakistan was the weakest index market. The country has seen rising rates of Covid-19 infections during the period and its low vaccination rate has led to fears that the country could be hit by another wave of the virus. Indonesia and Thailand also ended the quarter in negative territory. Healthcare and industrials were the best-performing sectors during the quarter, while real estate and communication services were weaker.

EMERGING MARKETS

Emerging market equities registered a strong return over the second quarter. This was despite a sell-off in May as higher-than-expected US inflation renewed concerns over the timing of global monetary policy tightening. Brazil was the best-performing market in the MSCI Emerging Markets index, with currency strength amplifying gains. Central bank actions to tighten policy in the face of rising inflation, an acceleration in vaccine roll-out, an easing in fiscal concerns and renewed reform progress all boosted sentiment.

The CE3 markets of Poland, Hungary and the Czech Republic all outperformed as the outlook for economic recovery picked up. Higher crude oil prices were supportive of Russia and Saudi Arabia. India also outperformed slightly, despite suffering a surge in Covid-19 cases. Chile and Peru were among the weakest markets in the index, negatively impacted by political uncertainty. Egypt lagged, primarily due to weakness from CIB. China, where regulatory concerns broadened beyond the technology sector, and South Korea posted positive returns but underperformed the broader index.

GLOBAL BONDS

US Treasury yields declined over the quarter, with the 10-year falling from 1.74% to 1.47%, retracing some of the large move higher in Q1. The broad backdrop was a continued pronounced rebound in economic activity with annualised inflation rates rising well above target to levels not seen in over a decade. This

is at least in part reflective of very low year ago comparisons, and investors began to speculate as to whether current levels would continue or prove transitory. As the quarter continued, US activity data started to moderate from elevated levels.

The Federal Reserve (Fed) policy meeting in June was keenly watched and in the event saw a hawkish shift in tone. The open market policy committee essentially indicated through their "dot plot" projections that interest rates will likely rise earlier than expected. This provided insight to the Fed's tolerance to an inflation overshoot, removing the market's assurance of infinite policy support. The 2-year yield rose following the meeting and the 10-year yield fell, with the curve flattening. For the quarter, the 2 to 10-year yield curve flattened by 36 basis points (bps).

European government bonds underperformed the US, amid growing optimism about the region's recovery and accelerating vaccination programme. Data points, particularly for manufacturing, were strong through the quarter. The German 10-year yield rose from -0.29% to -0.20%, France's from just below zero to 0.13%. The Italian 10-year yield rose from 0.67% to 0.82%.

The UK 10-year yield fell from 0.85% to 0.72%, following a sharp rise in the previous period.

Corporate bonds performed well, outpacing government bonds. Both global investment grade and high yield credit produced a total return (local currency) of 2.4%. US investment grade rebounded well following the decline in Q1. Investment grade credit was helped by falling yields, while high yield benefited from the economic recovery and positive fundamentals, including low expected default rates. 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 (EM) bonds (US dollar denominated) had a strong quarter, led by high yield, while EM currencies performed well despite a pullback in June.

The Refinitiv Global Focus index, which measures balanced convertible bonds, advanced by 2.1% in the second quarter. Stock markets saw a rotation out of tech stocks into what is perceived as value, or perhaps more accurately the "Covid losers". Consumer names, leisure, and travel were in demand. The convertible bond universe therefore benefited only partially from the tailwind offered by stock market gains as tech and disruptive consumer names fell out of fashion. June saw another reversal of this trade, back towards tech.

COMMODITIES

The S&P GSCI Index achieved a robust performance in the second quarter. This was largely as a result of strong growth in energy prices and as the global roll out of Covid-19 vaccines continued to spur investor optimism for a global economic recovery in 2021. Energy was the best-performing index component, driven by strong performances from crude oil and natural gas as global economic activity continues to rebound after the Covid-19 pandemic. Brent crude and gasoil also achieved strong gains on the back of higher demand.

The industrial metals component also advanced during the second quarter, driven by sharply higher prices for aluminium, lead and nickel. The agriculture component also achieved a positive performance in the second quarter. The price of sugar and coffee were both sharply higher, while wheat, Kansas wheat

and corn were also higher in the quarter. However, the price of soybeans was marginally lower in the period. The precious metals component achieved a modest gain in the quarter, with higher prices for both gold and silver. Livestock was the worst-performing component in the second quarter, driven by lower prices for live cattle and lean hogs.

TOTAL RETURNS (NET) % – TO END JUNE 2021

	3 MONTHS			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	7.7	6.8	7.6	39.0	31.7	24.4
MSCI World Value	4.7	3.8	4.6	37.9	30.6	23.3
MSCI World Growth	10.9	9.9	10.7	39.7	32.3	25.0
MSCI World Smaller Companies	5.0	4.0	4.8	52.9	44.8	36.7
MSCI Emerging Markets	5.0	4.1	4.9	40.9	33.5	26.0
MSCI AC Asia ex Japan	3.6	2.7	3.5	39.6	32.3	24.9
S&P500	8.6	7.6	8.4	40.8	33.3	25.9
MSCI EMU	6.8	5.8	6.6	37.5	30.2	23.0
FTSE Europe ex UK	8.4	7.4	8.3	37.3	30.1	22.8
FTSE All-Share	5.7	4.8	5.6	35.8	28.6	21.5
TOPIX*	-0.8	-1.7	-0.9	23.8	17.2	10.7

	3 MONTHS			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	1.9	1.0	1.8	-3.5	-8.6	-13.7
JPM GBI UK All Mats	1.8	0.9	1.7	4.6	-1.0	-6.5
JPM GBI Japan All Mats**	-0.1	-1.0	-0.3	-2.9	-8.0	-13.1
JPM GBI Germany All Traded	0.5	-0.4	0.4	3.4	-2.1	-7.5
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	2.7	1.8	2.6	5.6	0.0	-5.5
BofA ML US Corporate Master	3.6	2.7	3.5	3.6	-1.9	-7.3
2.8BofA ML EMU Corporate ex T1 (5-10Y)	1.2	0.3	1.1	10.3	4.5	-1.3
BofA ML £ Non-Gilts	1.8	0.9	1.7	13.9	7.8	1.8
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	2.6	1.6	2.4	15.6	9.5	3.4
BofA ML Euro High Yield	1.4	0.5	1.3	16.6	10.4	4.3

Source: Thomson Reuters DataStream.
Local currency returns in June 2021: *-0.3%, **0.3%.
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Source: Schroders, June 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.

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