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MARKET COMMENTARY
AUGUST 2021

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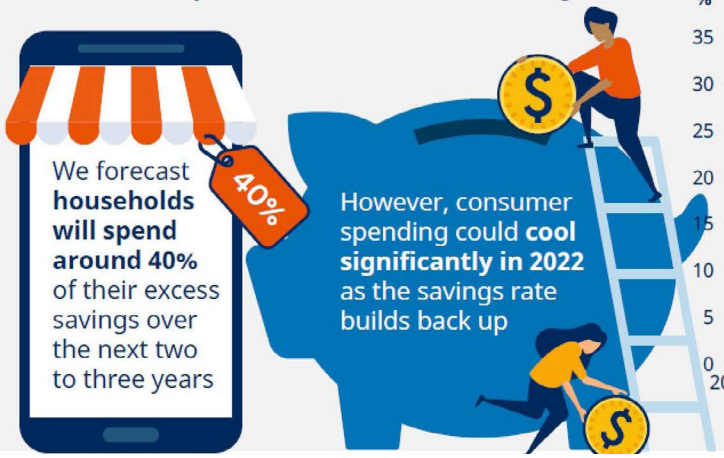
Pension TRANSFER Gold Standard

INFOGRAPHIC: THE GLOBAL ECONOMY

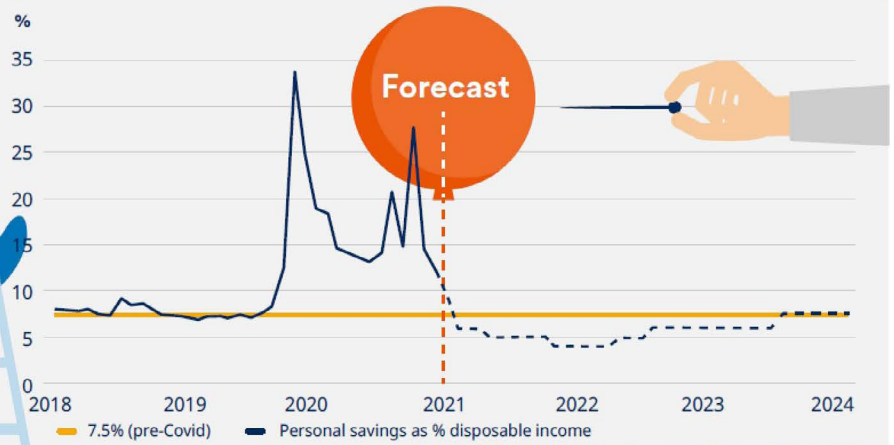
Could pent-up US demand create 'boom and bust'?

Read article here

Likely substantial boost to growth as households spend their lockdown savings



The US savings rate – actual and projected

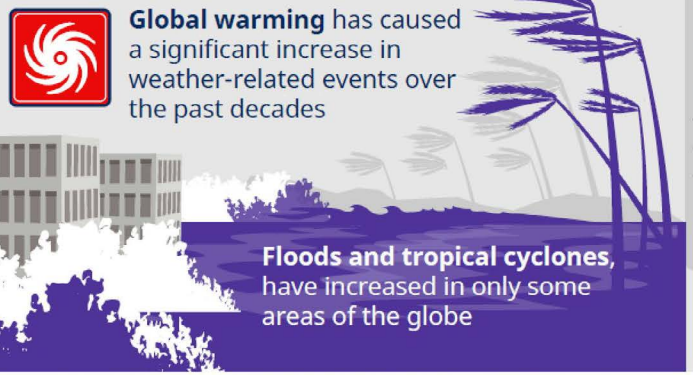


Source: Refinitiv, Schroders Economics Group, 20 July 2021.

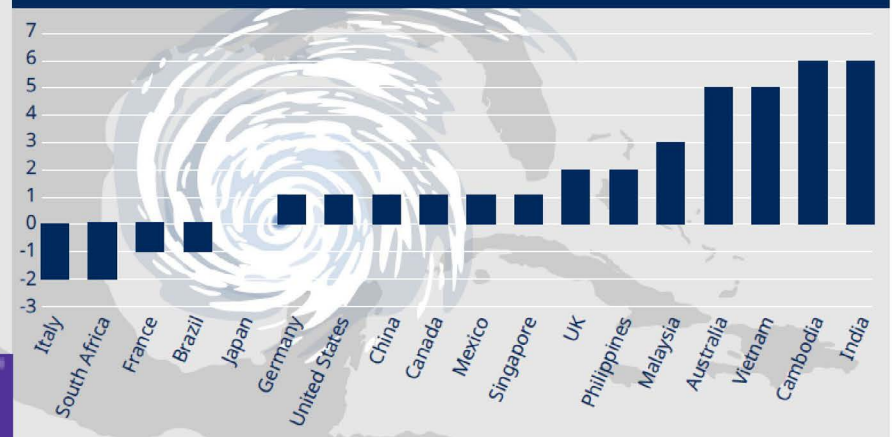
Climate change will impact different regions of the world unevenly

Visit our Insights page here

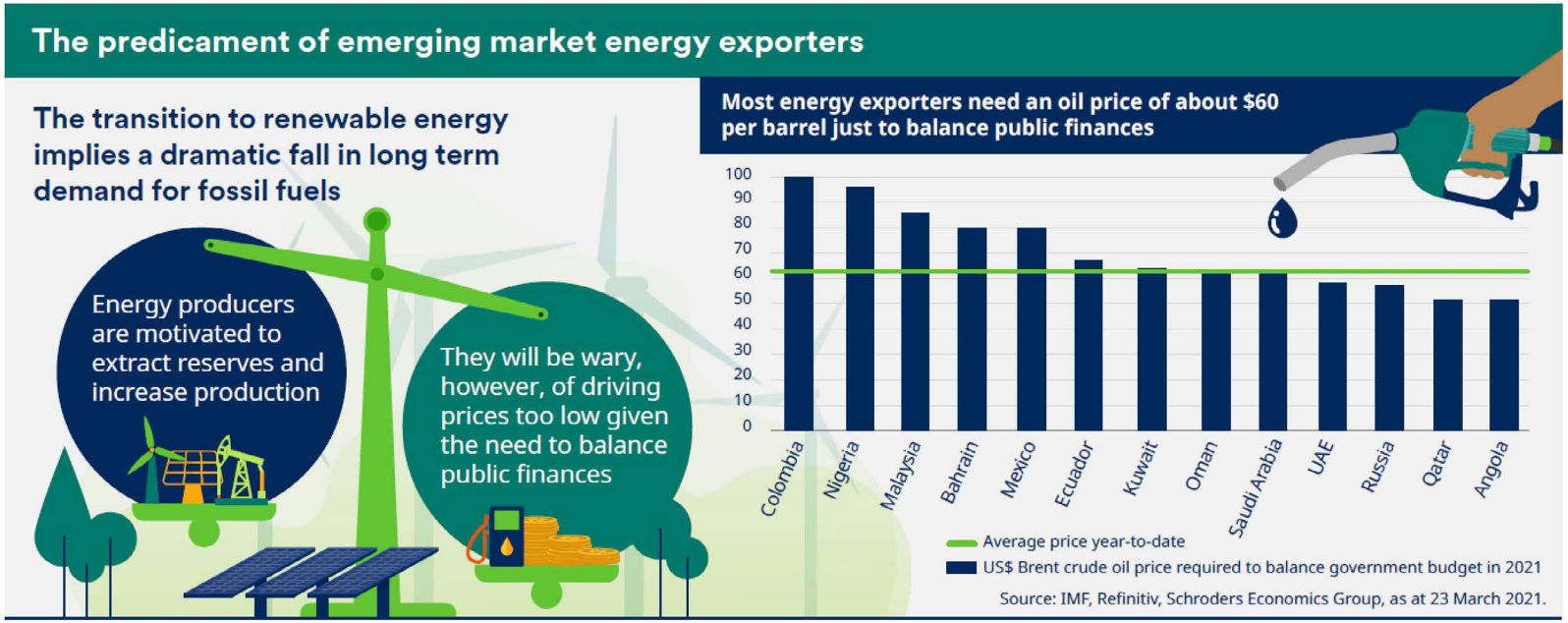
According to the World Meteorological Organization, the past six years (2015–2020) were the warmest on record



Change in the number of floods and tropical cyclones (2000s-1980s)



Source: The political economy of natural disaster damage. Eric Neumayer, Thomas Plümper, Fabian Barthel, 2014. Global Environmental Change; Schroders Economics Group 14 June 2021.



Source: Schroders as at August 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	We remain positive, but maintain a more neutral stance between economically sensitive/lowly valued areas of the market versus growth areas, alongside a bias to quality.
	Government Bonds	Negative	After the recent rally valuations look expensive. The strength of economic momentum has diminished and peak liquidity (when the availability of funds is at its most ample) may already be behind us.
	Commodities	Positive/ Neutral	We remain positive, with the market positioned for an economic recovery fuelled by central bank stimulus. Commodities tend to perform well in the "expansion" phase of the economic cycle.
	Credit	Negative	We maintain our negative score, and although fundamentals are improving, valuations remain expensive and close to extreme levels.
Equities	US	Positive/ Neutral	Although Q2 earnings have been strong, we are only seeing minor upgrades to expectations, setting a low bar for continued surprises.
	UK	Neutral ▼	We have downgraded our view in line with our moderation of bias towards economically sensitive areas of the market. The positive vaccination situation has encouraged the pound to rise, weighing on the market.
	Europe	Positive	Vaccination rates continue to surprise to the upside and we are confident that Europe will avoid winter lockdowns.
	Japan	Neutral	The impact of the resurgent virus is weighing on an economically sensitive market with the likelihood of tighter lockdowns restricting mobility.
	Pacific ex-Japan	Positive/ Neutral	We continue to favour Korea and Taiwan as their manufacturing outlook remains bright, with low semiconductor inventories and an environment of high global demand.
	Emerging Markets	Neutral ▼	Although valuations are attractive, vaccination rates remain low in many markets, suggesting their economic recoveries will be uncertain.
Government Bonds	US	Negative ▼	If, as we expect, the Federal Reserve (Fed) starts to taper in Q4, it should provide a catalyst for higher yields (lower prices). We have therefore downgraded our view.
	UK	Negative	Gilt yields remain close to their historic lows despite the economy rebounding as the reopening continues. Additionally the Bank of England continues to taper its quantitative easing (QE) program.
	Germany	Negative	We remain negative on German Bunds because of the likely divergence in monetary policy between a dovish European Central Bank (ECB) and a "hawkish" Fed (policymakers are often described as hawkish when expressing concerns about limiting inflation).
	Japan	Negative	The Bank of Japan continues to manage the yield curve. Newly announced Covid-19 restrictions will likely weigh on activity in Q3.
	US Inflation Linked	Neutral	Flows increased recently on the view that recent rises in inflation will be transitory. However, the hawkish comments from Fed monetary policymakers on tapering indicate inflation expectations are priced in.
	Emerging Markets Local	Neutral	Potential strengthening of the US dollar, poorer handing of Covid-19 and concerns over fundamentals in some emerging market (EM) countries mean we maintain our neutral view.

	Category	View	Comments
Investment Grade Credit	US	🔴	Comments from the latest Fed meeting are likely to increase volatility and market uncertainty. Valuations are also at extremely high levels, creating upside risk to returns.
	Europe	🟡	Despite stronger technicals underpinned by ECB action, credit spreads remain tight and therefore valuations appear increasingly stretched.
	Emerging Markets USD	🟢 ▲	Valuations stand out as attractive in the global corporate credit universe with credit conditions broadly benign, bolstered by a slight shift in stance towards easing in China.
High Yield Bonds (Non-IG)	US	🔴	Although the increasing incidence of rising stars (HY credit upgraded to IG credit) means spreads could tighten further, we remain negative. This is because the impact is likely to fade as the market outlook for interest rates and liquidity is set to reverse.
	Europe	🔴	Improved fundamentals and low default rates are offset by deteriorating valuations and the lack of a coordinated fiscal recovery programme (fiscal programmes, like monetary policy, are means by which policymakers attempt to manage economic fluctuations).
Commodities	Energy	🟢	The global energy market remains in deficit and inventories continue to be depleted. With demand expected to continue to increase, we remain positive.
	Gold	🟡	We remain neutral as we see opportunities for the price to rise from current levels and converge with higher real yields.
	Industrial Metals	🟢	Demand outside China is picking up strongly amid the global recovery. This offsets the moderation in Chinese demand reflected in domestic data.
	Agriculture	🟡 ▼	We have downgraded our view as we expect bullish supply factors will begin to fade following recent solid gains in the sector.
Currencies	US $	🟡	We remain neutral on the US dollar as we wait for a clearer catalyst for a sustained trend. However we see value in using the US dollar for diversification.
	UK £	🟡	Our view remains unchanged. While economic growth and monetary policy are positive in the UK, the pound is expensive with valuations at a three-year high.
	EU €	🔴 ▼	We are negative on the euro given the ECB's dovish stance and the negative carry.
	JAP ¥	🟡 ▲	We have upgraded the yen to neutral as valuations look cheap and the economic backdrop becomes less supportive.
	Swiss F	🟡 ▲	Upgraded to neutral as the economic backdrop becomes less supportive, however we wait for price action to be less stretched for a positive score.

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, August 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 August when global equities advanced with US shares hitting new highs.

HIGHLIGHTS

- Global equities gained in August, supported by a well-received speech from Federal Reserve chairman Jerome Powell at the Jackson Hole symposium. US equities were among the top gainers
- Global sovereign bond yields rose in August (i.e. prices fell) while high yield corporate bonds saw positive returns
- Commodities fell with the energy component underperforming amid some worries over oil demand

THE US

US equities reached new highs again in August. Market worries over the outcome of the Federal Reserve's annual Jackson Hole symposium were ultimately allayed by Chair Jerome Powell. Powell struck a cautious note in his statement, stating that while the US economy had made progress on some important targets – specifically on inflation - tapering too aggressively could derail progress at a sensitive time, reiterating a desire to see further progress in the labour market. The comments were consistent with expectations that tapering could begin this year, but were broadly perceived as dovish. The boost to sentiment overshadowed worries over Hurricane Ida and the Covid-19 Delta variant.

The Fed stated more specifically that "provided that the economy were to evolve broadly as they anticipated, they judged that it could be appropriate to start reducing the pace of asset purchases this year." All FOMC participants assessed that the economy had made progress toward the maximum-employment and price-stability goals since last December, although most participants believed that "substantial further progress" toward maximum employment had not been achieved yet. The bipartisan infrastructure deal of roughly $1 trillion passed in the Senate. The deal includes $550 billion in new federal investments in physical infrastructure, spread over five years. The infrastructure bill now moves to the House for approval.

Financials, especially diversified financials such as Goldman Sachs, Blackrock and Morgan Stanley, performed well as revenues for major investment banks returned to (or surpassed) pre-pandemic levels. Communications services – including giants such as Google parent Alphabet, Facebook and Netflix - were also amongst the strongest performers after announcing strong earnings at the end of July. Energy companies lagged the index.

EUROZONE

European equities gained in August, supported by a positive Q2 earnings season and ongoing economic recovery from the pandemic. The Delta variant of Covid-19 continued to spread but most large eurozone countries have now vaccinated around 70% of their population against the virus.

Information technology was among the strongest performers with semiconductor and semiconductor equipment firms continuing to benefit from high demand. Other top performing sectors included communication services and utilities.

Consumer discretionary saw a negative return. Luxury goods stocks came under pressure amid suggestions that China could seek greater wealth redistribution, which could hit demand for

luxury products. Consumer staples also underperformed amid weakness in beverages groups.

Annual inflation in the eurozone was estimated at 3.0% in August, up from 2.2% in July. The European Central Bank had said in July that it would tolerate any moderate and transitory overshoot of its 2.0% inflation target. The eurozone composite purchasing managers' index for August slipped to 59.5 from its 15-year high of 60.2 in July. Slower manufacturing production growth was mainly linked to supply chain constraints. (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). The European Commission's economic sentiment index also slipped but remained at a high level.

UK

UK equities rose over August. Small and mid cap (SMID) equities performed very well as they continued to be a sweet spot for M&A activity. In contrast, the wider UK market lagged other developed regions as global asset allocators remained indifferent towards UK equities as a whole.

There was some encouraging data around interest in UK equities from domestic UK investors (according to the Investment Association), in addition to the ongoing M&A interest of overseas buyers. However, according to the latest Bank of America global fund manager survey, global asset allocators remained uncommitted, despite the signs of growing interest earlier in the year.

A headline-grabbing bid for the UK-based aerospace and defence equipment supplier Meggitt – at a 71% premium – proved a talking point. Commentators noted the persistent and pervasive discount across multiple sectors and individual UK listed stocks – see What does Meggitt's bid premium tell us about UK shares?

Mid cap industrial stocks were an important overall contributor to UK equities in August, and the sector was the best overall monthly performer. This was driven by both internationally focused stocks (not just Meggitt, but a number of other globally diversified mid cap aerospace and defence stocks performed well too) as well as the domestically focused industrial areas.

Top performers in the latter group included the support services sub sector and a number of the SMID construction and materials companies. These areas of the market performed well despite signs of some slowdown in UK domestic industrial activity over the summer.

Resources sectors – including energy and basic materials – lagged as a result of weaker commodity prices. Sterling fell back over the month, although remained one of the best performing developed market currencies in the year to date.

JAPAN

Japanese shares made gains in August, despite growing worries over Covid-19. Throughout the pandemic, Japan has consistently seen a lower infection rate than most developed countries but is now facing a more serious test as infections are picking up rapidly. Although the mortality rate remains low, there are growing concerns over hospital capacity. Public criticism of the government's response has therefore ratcheted up again, and the approval rating of Prime Minister Suga and his cabinet has declined precipitately. The inconsistencies in government policy were particularly stark in August with successive extensions in

the state of emergency, in an attempt to restrict social activity, while simultaneously hosting the Olympic and Paralympic Games.

Although equity investors were still digesting a very positive set of corporate results for the most recent quarter, sentiment was impacted in August by the announcement from Toyota Motor of production cuts over the next two months. This is mainly due to the global shortage of semiconductors. Elsewhere for corporate Japan, order trends and capital expenditure plans look strong and the initial estimate of GDP for the June quarter is likely to be revised up in early September.

Following the conclusion of the Olympics, a clearer political timetable seemed to emerge, with the ruling Liberal Democratic Party (LDP) announcing its leadership contest will be on 29 September, to be followed by a general election in October. However, on 3 September, Prime Minister Suga announced his intention to resign without contesting the LDP leadership election. This surprise decision introduces some additional uncertainty over the next few months although, at this stage we would not expect any change in policy direction.

ASIA (EX JAPAN)

Asia ex Japan equities recorded a positive return in August as rising vaccination levels and declining infection rates helped many markets in the region recover from a Covid-19 sell-off. Investor sentiment has also been boosted as the global economic recovery gathers momentum. Thailand was the best performing index market in August as Covid-19 infection rates declined and the government announced the reopening of restaurants and shopping malls.

The Philippines and India also achieved robust growth in August, with all three countries achieving double-digit gains and strongly outperforming the index. India's stock market rally comes on the back of an ultra-easy monetary policy by the country's central bank and the injection of a significant amount of extra liquidity to stimulate the economy following the Covid-19 crisis. Malaysia, Taiwan and Indonesia also achieved positive performances in August and outperformed the index.

Chinese equities were flat overall in August amid concerns over increased regulation. Meanwhile, official data showed factory activity grew at a slower pace in the month, suggesting a slowdown in the country's economy. Pakistan was the worst-performing index market as political upheaval in neighbouring Afghanistan weakened investor sentiment towards the country, with fears that violence and unrest could spill over into Pakistan. Equity markets in Hong Kong, South Korea and Singapore were also slightly lower in August.

EMERGING MARKETS

Emerging market equities registered a positive return in August. This was despite a mid-month sell off on concerns over the spread of the Delta variant of Covid-19 in Asia, and as the dollar strengthened amid concerns over Federal Reserve tapering. Argentina, aided by strong performance from Globant, was the best-performing market in the MSCI EM index.

Thailand and the Philippines recorded strong gains, amid optimism towards economic reopening and a recovery in tourism following the announcements of an easing in lockdowns. India posted a robust return, with sentiment boosted in part by the recent stream of initial public offerings, as well as the easing in crude oil prices. Malaysia and Indonesia both finished ahead of

the MSCI EM index. The emerging European markets of Hungary, the Czech Republic, Poland and Greece all outperformed, as did Colombia.

Pakistan, Brazil, where domestic concerns dragged on market performance, and South Korea, where weakness from DRAM prices weighed on several large index stocks, were the only markets to finish in negative territory. Chinese equities were flat on the month as uncertainty over regulatory action continued to dampen investor appetite. The government re-imposed lockdown restrictions in some cities in August although these began to be eased towards month-end.

GLOBAL BONDS

Global bond yields rose in August. While there were signs of slowing growth momentum and ongoing concerns over the Covid-19 Delta variant, inflation and the withdrawal of monetary policy support were the main focus of markets.

The Federal Reserve's Jackson Hole annual symposium took place toward month end. Bond investors exhibited some nervousness ahead of the meeting, at the prospect of an announcement on asset purchase tapering. However, Fed Chair Jerome Powell's comments were perceived as dovish overall.

The US 10-year yield was eight basis points (bps) higher at 1.31%, having twice come close to 1.38% during the course of the month. Data showed still healthy levels of expansion, but with momentum moderating. US consumer price inflation remained elevated in July, but rose more slowly.

The UK 10-year yield was up from 0.57% to 0.62% due to a move on the last day of the month. European yields pushed a bit higher, the German 10-year yield rising from -0.46% to -0.38%, while Italy's increased from 0.63% to 0.71%.

For corporate bonds, investment grade made small negative returns, in line with government bonds. High yield made steady gains, mainly due to coupon income, as spreads (the level of yield above similar maturity government bonds) held in. High yield did well following the news from Jackson Hole, the US market in particular, which reversed earlier widening. 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) government and corporate bonds (US dollar-denominated) made positive returns, led by high yield. Asian bonds had their strongest month since last November. EM currency performance was mixed against the US dollar, with a number of Asian currencies performing well, but weaker performance in Latin America.

Convertible bonds benefitted from the positive equity background as global equities moved higher. The Refinitiv Global Focus index, which measures balanced convertible bonds, gained 0.7%. After a seasonal downturn in July, the primary market for convertibles swung back into action and more than $7 billion of new convertibles found strong interest. Valuations in convertible bonds cheapened across all regions, especially in Europe.

COMMODITIES

The S&P GSCI Index recorded a negative return in August, driven by a sharp decline in the energy component of the index as a spike in the Delta variant of Covid-19 in many parts of the world

threatens to slow the recovery in demand for oil. Energy was the worst-performing component, with sharp falls in the price of crude oil and Brent crude. Heating oil and Gas oil also declined, but the falls were less pronounced. The price of natural gas, however, achieved a strong gain in August; the only sector in the energy component that gained in the month.

The precious metals component of the index also declined, following a strong fall in the price of silver. Gold achieved a very small price increase during the month. The livestock component recorded a small gain in August, with higher prices for feeder cattle and lean hogs. The price of live cattle was slightly down in August. The agriculture component also recorded a small gain in August, with higher prices for sugar, coffee and cocoa offsetting weaker prices for corn and soybeans. The industrial metals component also achieved a modest overall gain, with a strong gain in the price of aluminium offsetting declines in the prices of copper, lead and zinc.

TOTAL RETURNS (NET) % – TO END AUGUST 2021

	1 MONTH			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	2.5	3.0	3.5	29.8	31.5	26.2
MSCI World Value	1.6	2.1	2.7	31.4	33.1	27.8
MSCI World Growth	3.3	3.8	4.4	28.1	29.8	24.7
MSCI World Smaller Companies	2.4	2.9	3.5	41.6	43.5	37.8
MSCI Emerging Markets	2.6	3.1	3.7	21.1	22.7	17.8
MSCI AC Asia ex Japan	2.3	2.8	3.3	17.6	19.2	14.4
S&P500	3.0	3.5	4.1	31.2	32.9	27.6
MSCI EMU	2.0	2.5	3.0	30.7	32.4	27.2
FTSE Europe ex UK	1.8	2.2	2.8	30.9	32.7	27.4
FTSE All-Share	1.6	2.1	2.7	30.5	32.2	27.0
TOPIX*	3.1	3.5	4.1	19.5	21.1	16.3

	1 MONTH			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	-0.1	0.3	0.9	-2.4	-1.2	-5.1
JPM GBI UK All Mats	-1.8	-1.4	-0.8	0.8	2.2	-1.9
JPM GBI Japan All Mats**	-0.2	0.3	0.8	-2.9	-1.7	-5.6
JPM GBI Germany All Traded	-1.0	-0.5	0.0	-1.4	-0.1	-4.1
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	-0.4	0.1	0.6	2.4	3.8	-0.3
BofA ML US Corporate Master	-0.2	0.3	0.8	2.7	4.0	-0.1
2.8BofA ML EMU Corporate ex T1 (5-10Y)	-0.9	-0.5	0.1	2.1	3.5	-0.6
BofA ML £ Non-Gilts	-1.3	-0.8	-0.3	5.3	6.7	2.4
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	0.6	1.0	1.6	9.1	10.6	6.2
BofA ML Euro High Yield	-0.5	0.0	0.6	5.6	7.0	2.7

Source: Thomson Reuters DataStream.
Local currency returns in August 2021: *3.2%, **-0.1%.
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Source: Schroders, August 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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