FINURA

MARKET COMMENTARY SEPTEMBER 2021

Chartered Financial Planners

Pension TRANSFER Gold Standard

INFOGRAPHIC: THE GLOBAL ECONOMY

Has Covid actually mattered to financial markets?

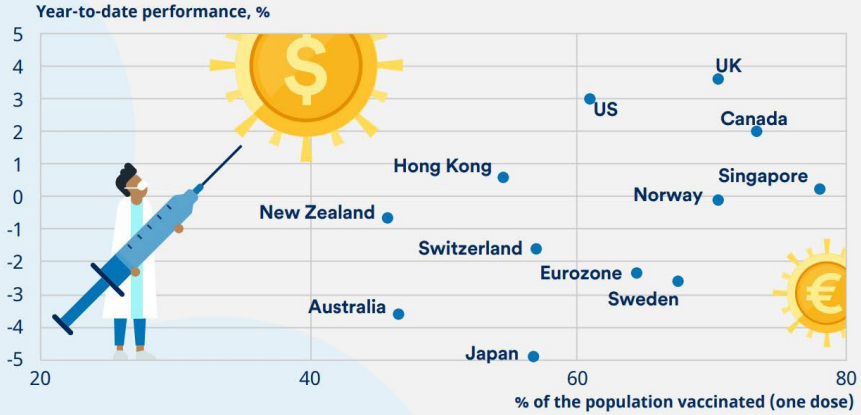
Read article here

The success of the vaccine roll-out across countries has played out through currencies

Currency winners 2021 year-to-date

Typically those countries with higher vaccination rates

Currency winners have typically benefitted from higher vaccination rates



Note: Currency performance is based on nominal effective exchange rates (NEER) except for the US which is based on the DXY index. Source: Our World in Data, Schroders Economics Group, Refinitiv Datastream, 31 August 2021.

Where have all the workers gone?

Visit our Insights page here

Many job vacancies are going unfilled as a result of worker shortages

- **Due to** a reluctance to increase social contact
- childcare considerations
- enhanced unemployment benefits (in the US)

The participation rate shows the percentage of the population working or looking for work and is a broad measure of worker availability

US participation ratio has yet to recover

Source: Refinitiv Datastream, Schroders Economics Group, Markit, 18 August 2021.

Source: Schroders as at September 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 with earnings expectations holding firm and real interest rates supporting valuations.
	Government Bonds	Negative	The strength of economic momentum has diminished whilst peak liquidity (when the availability of funds is at its most ample) appears to be behind us. This will therefore be a key headwind going forward.
	Commodities	Positive/ Neutral	Vaccine distribution and fiscal stimulus continue to drive stronger demand whilst supply conditions remain tight.
	Credit	Negative	We maintain our negative score, and although fundamentals are improving, valuations remain close to extreme levels across the board.
Equities	US	Positive/ Neutral	Upward earnings revisions are starting to moderate, suggesting a manageable hurdle for Q3 earnings. Companies continue to focus on shareholder friendly actions whilst consumer spending remains strong.
	UK	Neutral	We continue to hold our neutral view as we prefer to express our cyclical bias elsewhere.
	Europe	Positive	Europe is our preferred market as economic growth remains strong. This is supported by the rebound in the pace of vaccinations and the continued monetary support from the European Central Bank (ECB) (monetary support involves policymakers attempting to manage economic fluctuations through the use of interest rates and unconventional monetary policies such as quantitative easing).
	Japan	Neutral	Despite the strong recent rebound, we see little reason to expect the market to lead at this stage.
	Global Emerging Markets[1]	Neutral	Although valuations are attractive, vaccination rates remain low in many markets, suggesting their economic recoveries will be uncertain.
	Asia ex-Japan & China	Neutral	We remain on the side-lines. While valuations have undoubtedly cheapened recently, they were previously trading at decade highs. Current levels therefore look fair, especially for long term investors.
	EM Asia ex China	Neutral ▼	Whilst we continue to like the long-term story for Korea and Taiwan, investor sentiment has declined given global growth appears to be peaking. We therefore expect this to weigh on the market in the short term.
Government Bonds	US	Negative	We maintain our double negative score as we expect the Federal Reserve (Fed) to start tapering in Q4, therefore providing a catalyst for yields to move higher (lower prices).
	UK	Negative	Gilt yields remain close to their historic lows despite the economy rebounding following the removal of restrictions. Additionally, the Bank of England continues to taper its quantitative easing programme.
	Germany	Negative ▼	We downgraded our view as local inflationary dynamics have become more of a headwind for the region whilst communication around policy post the Pandemic Emergency Purchase Programme remains unclear.
	Japan	Negative	The Bank of Japan continues to manage the yield curve whilst Covid-19 restrictions are likely to continue to weigh on activity.
	US Inflation Linked	Neutral	Flows increased recently on the view that recent rises in inflation will be transitory. The Fed's hawkish (policymakers are often described as hawkish when expressing concerns about limiting inflation) comments on tapering indicate inflation expectations are priced in.
	Emerging Markets Local	Neutral	Potential strengthening of the US dollar, poorer handling of Covid-19 and concerns over fundamentals in some EM countries mean we maintain our neutral view.

[1] Global Emerging Markets includes Central and Eastern Europe, Latin America and Asia.

	Category	View	Comments
Investment Grade Credit	US	🔴	With low credit spreads offering small returns, we remain concerned that US IG could be highly vulnerable to shifts in sentiment, market technicals and rising rates. 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	🟡	Despite credit spreads remaining tight and valuations appearing stretched, we prefer EU IG over US IG due to the increased support from the ECB.
	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	🔴	We remain negative. Default rates are still low but are marginally higher than in the first quarter and valuations remain at extremely expensive levels.
	Europe	🟡 ▲	We upgraded our view following improved fundamentals, low default rates and marginally wider credit spreads relative to US high yield.
Commodities	Energy	🟢	We believe energy prices could grind a little higher as the demand for oil continues to return and the global energy market remains under pressure.
	Gold	🟡	We remain neutral, although we still see some opportunities for the price to rise from current levels and converge with higher real yields.
	Industrial Metals	🟢	The policy stance in China has turned more proactive amid weakening data whilst demand outside China continues to pick up strongly given the global recovery.
	Agriculture	🟡	We remain neutral as prices approach historical highs whilst weather volatility has resulted in supply disruptions.
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, our valuation models suggest that the pound is still quite expensive.
	EU €	🔴	We are negative on the euro given the ECB's dovish stance and the negative carry.
	JAP ¥	🟡	Remain neutral as valuations look cheap whilst the cyclical backdrop has become less supportive.
	Swiss F	🟡	The cyclical backdrop has become 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, September 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 Q3, which started well for shares but then saw gains erased amid rising inflation and worries over China.

HIGHLIGHTS

- Developed market shares were flat (in US dollar terms) in Q3. Declines in September erased prior gains. Emerging market equities underperformed amid a sell-off in China
- Global sovereign bond yields were little changed in the quarter. The US Federal Reserve said it would soon slow the pace of asset purchases
- Commodities gained with natural gas prices seeing a sharp spike

THE US

US equities notched up a small positive return in Q3. Strong earnings had lifted US stocks in the run up to August, when the Federal Reserve (Fed) seemed to strike a dovish tone, confirming its hesitance to tighten policy too fast. However, growth and inflation concerns late in the quarter meant US equities retraced their steps in September.

The Fed stated in September that tapering of quantitative easing (i.e. a slowdown in the pace of asset purchases) will be announced at the November meeting, as expected, and will finish by mid-2022.

Meanwhile, the fed funds rate projections now show a faster rate hiking schedule than they did in June. The median rate expectation for 2023 moved up to three hikes from two in June, with three additional hikes in 2024. Fed officials were evenly split 9-9 on a rate hike in 2022.

The shift comes in the context of revised real GDP growth - down to 5.9% for 2021 from the 7% growth estimated in the last meeting - while inflation has risen. The Fed now sees inflation running to 4.2% this year, above its previous estimate of 3.4%. The Fed raised its GDP projections for 2022 and 2023 to growth of 3.8% and 2.5%, respectively.

On a sector basis, financials and utilities outperformed. At the other end of the spectrum, industrials and materials struggled, although September's sell-off hit almost all sectors. Energy was an exception, rising as supply constraints drove prices to highs – particularly Brent crude.

EUROZONE

Eurozone equities were flat in Q3. The energy sector was one of the strongest performers, as was information technology with semiconductor-related stocks seeing a robust advance.

Consumer discretionary stocks were among the weakest for the quarter, with luxury goods companies under pressure amid suggestions that China could seek greater wealth redistribution, which could hit demand.

The quarter had started with gains amid 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 fully vaccinated around 75% of their population against the virus, enabling many restrictions on travel and other activities to be lifted.

However, as the period progressed, worries emerged over inflation due to supply chain bottlenecks and rising energy prices. Annual inflation in the eurozone was estimated at 3.4%

in September, up from 3.0% in August and 2.2% in July. The European Central Bank said that it would tolerate any moderate and transitory overshoot of its 2.0% inflation target.

The end of the period saw a surge in power prices as a result of low gas supply and lack of wind over the summer, among other factors. High power prices should be positive for utility firms. However, the sector - particularly in southern Europe - is susceptible to political intervention as evidenced by announcements of price caps in Spain and other countries. The utilities sector was a laggard in the quarter.

Germany held a general election which saw the Social Democrats (SPD) take the largest share of the votes. Coalition talks are now under way over the formation of a new government.

UK

UK equities rose over Q3 with the market driven by a variety of factors. While there were some clear sector winners (such as energy on the back of a recovery in crude oil prices) the difference between the best and worst-performing stocks, or dispersion, was quite marked. Within consumer staples, for instance, some of the more highly valued consumer goods companies performed poorly, while the more lowly valued grocery retailers performed well.

Merger & acquisition (M&A) activity remained an important theme. The period began with a recommended counter-offer for Wm Morrison Supermarkets and bid activity was seen across a variety of areas. Gaming remained an area of interest, with a proposal from US sports betting group DraftKings to acquire Entain. Within industrials there was headline-grabbing bid for aerospace and defence equipment supplier Meggitt. This in part explains the positive contribution from the consumer discretionary and industrial sectors, with the latter also helped by the easing of transatlantic travel restrictions and dollar strength against some weakness in sterling.

Small and mid cap (SMID) equities suffered in line with higher growth areas of the market more generally in September, but performed very well over the quarter a whole. SMID caps remained a sweet spot for M&A activity and made a useful contribution to overall market returns.

The Bank of England took a more hawkish tone as inflationary pressures continued to surpass expectations. Business surveys confirmed that supply bottlenecks are constraining output. Natural gas and fuel shortages made headlines towards the period end. These developments were also reflected in higher market interest rates, which helped support financials. However, Asian focused banks were lower in the period given the growing uncertainty around the outlook for Chinese markets and the economy.

JAPAN

The Japanese equity market traded in a range through July and August before rising in September to record a total return of 5.2% for the quarter. The yen showed little trend against the US dollar for most of the period before weakening at the very end of September to reach its lowest level since the start of the pandemic in early 2020.

Throughout the pandemic, Japan has consistently seen a lower infection rate than most developed countries but faced a much more serious test during early summer as infections picked up

rapidly. Public opposition towards the government's approach ratcheted up again and the approval rate for the Suga cabinet fell to the lowest levels seen since he took office in September 2020.

On 3 September, in a surprise decision, Prime Minister Suga announced his intention to resign without contesting the LDP leadership election. Mr Kishida was ultimately elected as LDP party leader and becomes Japan's 100th prime minister. An establishment politician within the LDP, Mr Kishida should be essentially a safe, if unexciting, choice to guide Japan through the next stage of its post-Covid recovery. There is unlikely to be a change in the direction of monetary or fiscal policy as a result, and the likely shape of next major stimulus package should emerge over coming weeks..

It now seems likely that the upcoming general election could be held at the earliest practical date, on 31 October or, at the latest, mid November. Mr Kishida also inherits a stronger position in the vaccination programme which has sustained strong momentum in recent months after the very slow start seen in the first half of the year.

Although corporate results for the quarter that ended in June were strong, sentiment was impacted in August by the announcement from Toyota Motor of production cuts in September and October, due to the global shortage of semiconductors. Elsewhere for corporate Japan, order trends and capital expenditure plans continue to look strong.

ASIA (EX JAPAN)

Asia ex Japan equities recorded a sharply negative return in the third quarter, largely driven by a significant sell off in China. This was partially due to concerns over the ability of property group Evergrande to service its debts. The Evergrande situation sparked global investor concerns over potential spill over risks.

Market concerns over inflation and the outlook for interest rates also dampened investor confidence during the quarter. China was the worst-performing index market, with sentiment towards the country also weakened by the government's regulatory crackdown affecting the education and technology sectors. Power outages in China and the rationing of energy also spooked investors, hurting production of key commodities. The downside risks in China have significantly increased against a backdrop of slowing economic activity and concerns that recent regulatory policies will further weigh on growth.

Pakistan was also sharply weaker as ongoing political upheaval in neighbouring Afghanistan weakened investor sentiment towards the country, with fears that violence and unrest could spill over into Pakistan. Hong Kong and South Korea followed China lower, with both markets sharply lower as market jitters over China spilled out into the wider region.

India was the best-performing index market during the quarter and achieved a strongly positive performance as accommodative monetary policy and the easing of Covid-19 restrictions boosted investor sentiment. Indonesia also achieved a positive return. Singapore was almost unchanged, while declines in Taiwan and the Philippines were modest compared with the falls seen in other index markets.

EMERGING MARKETS

Emerging market (EM) equities declined in Q3, which saw a sell-off in Chinese stocks, concern over continued supply chain disruptions, and worries over the implications of higher food and

energy prices for some markets. US bond yields rose towards the end of the quarter. Regulatory actions in China were the initial trigger for market weakness. These were compounded by the re-imposition of some Covid-19 restrictions and supply chain disruption in August, worries about possible systemic financial system risks stemming from the potential collapse of Evergrande, and power shortages.

Brazil was the weakest market in the MSCI EM index as above-target inflation continued to rise and the central bank responded with further interest rate hikes. Meanwhile Q2 GDP growth disappointed, developments in China weighed on industrial metals prices, and political rhetoric picked up ahead of next year's presidential election. South Korea also posted a double-digit fall amid falling prices of dynamic random access memory chips (DRAM) price and concerns over the impact of power issues in China on production and supply chains. Weaker industrial metals prices also weighed on performance of net exporter markets Peru and Chile.

By contrast, net energy exporters in general outperformed, most notably Colombia, Russia, Kuwait, Saudi Arabia, Qatar and the UAE. India delivered a strong gain, with sentiment boosted in part by the recent stream of initial public offerings. The economy continued to recover while vaccinations picked up – India is now on track to deliver at least one dose to 70% of its population by November.

GLOBAL BONDS

US and European government yields were unchanged for the quarter as an initial decline reversed in September amid a hawkish shift from central banks and continuing inflationary pressure. The UK underperformed, with a significant rise in yields on increased expectations for monetary policy tightening. The US 10-year Treasury yield finished at 1.49%, one basis point (bps) higher. Yields fell initially, as the rapid economic recovery appeared to be moderating.

However, as the market's focus turned to rising inflation and the prospect of the withdrawal of monetary policy support, yields rose back to similar levels seen at the beginning of the quarter. The Federal Reserve (Fed) became increasingly hawkish, suggesting that asset purchase tapering could start as early as November and that it could be wound up by mid-2022, earlier than expected.

The UK 10-year yield increased from 0.72% to 1.02%, with the move occurring in September. As with the Fed, there was evidence of a marked hawkish shift among Bank of England (BoE) policymakers, with a suggestion that rate rises might be warranted before the end of the year. Recent economic indicators came out worse than expected, while year-on-year consumer price inflation rose to 3.2% in August, the highest since 2012.

In Europe, the German 10-year yield was one basis point (bps) lower at -0.19%. Italy's 10-year yield finished 4bps higher at 0.86%. Economic activity continued at a robust pace, the region benefiting from the release of pent-up demand, having come out of lockdowns relatively late. Eurozone inflation hit a decade high of 3.4% year-on-year in August.

Among corporate bonds, high yield made positive returns, while investment grade credit was little changed. European investment grade outperformed government bonds, while the US market was in line with Treasuries. 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 government bond yields rose, particularly in September, though EM corporate bonds made a small positive return. Emerging market currencies broadly fell against the US dollar.

Over the quarter, convertible bonds could not benefit from the early tailwind provided by positive equity markets but provided some protection in September as equities declined. The Refinitiv Global Focus index, which measures balanced convertible bonds, shed -2.1% for the quarter. The valuation of convertibles cheapened slightly as a result of strong primary market activity. More than $25 billion of new convertible bonds were launched in the quarter.

COMMODITIES

The S&P GSCI Index recorded a positive return in the third quarter, driven by sharply higher energy prices caused by increased demand in the wholesale gas market.

Energy was the best-performing component in the quarter, with all subsectors achieving a positive result. The price of natural gas was significantly higher in the quarter, closely followed by gains in the prices of gas oil and heating oil. Unleaded gasoline also gained strongly on stronger demand as consumers started to return to normal consumption patterns after the Covid-19 crisis.

The industrial metals component was modestly higher, with a sharp rise in the price of aluminium offsetting price declines for lead, copper and nickel. The price of zinc was almost unchanged.

The precious metals component also declined, with the price of silver sharply lower. The price of gold was also lower, but the decline was more modest.

The livestock component also declined. The agriculture component reported a small decline in the quarter, with sharp declines in the prices of corn and soybeans offsetting higher prices for cotton, cocoa, Kansas wheat, coffee and sugar.

TOTAL RETURNS (NET) % – TO END SEPTEMBER 2021

	3 MONTHS			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	-0.0	2.3	2.4	28.8	30.3	23.5
MSCI World Value	-0.8	1.5	1.6	31.7	33.2	26.2
MSCI World Growth	0.8	3.2	3.3	26.1	27.6	20.9
MSCI World Smaller Companies	-1.4	0.9	1.0	40.2	41.9	34.5
MSCI Emerging Markets	-8.1	-6.0	-5.8	18.2	19.6	13.3
MSCI AC Asia ex Japan	-9.3	-7.2	-7.1	14.4	15.8	9.7
S&P500	0.6	2.9	3.1	30.0	31.5	24.7
MSCI EMU	-2.0	0.3	0.4	28.8	30.3	23.5
FTSE Europe ex UK	-1.7	0.6	0.8	27.3	28.8	22.1
FTSE All-Share	-0.2	2.1	2.2	33.4	35.0	27.9
TOPIX*	4.8	7.2	7.3	20.6	22.0	15.6

	3 MONTHS			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	-0.0	2.3	2.4	-3.7	-2.6	-7.7
JPM GBI UK All Mats	-4.2	-2.0	-1.9	-3.0	-1.9	-7.0
JPM GBI Japan All Mats**	-0.4	1.9	2.0	-5.6	-4.5	-9.5
JPM GBI Germany All Traded	-2.3	-0.1	0.1	-3.7	-2.6	-7.7
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	-0.8	1.5	1.6	1.6	2.8	-2.6
BofA ML US Corporate Master	-0.1	2.3	2.4	1.8	3.0	-2.4
2.8BofA ML EMU Corporate ex T1 (5-10Y)	-2.2	0.1	0.2	0.9	2.1	-3.3
BofA ML £ Non-Gilts	-3.3	-1.1	-1.0	4.0	5.2	-0.3
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	-0.3	2.0	2.1	9.8	11.1	5.3
BofA ML Euro High Yield	-2.3	0.0	0.1	6.4	7.6	2.0

Source: Thomson Reuters DataStream.
Local currency returns in Q3 2021: *5.2%, **-0.1%.
Past performance is not a guide to future performance and may not be repeated.

Source: Schroders, September 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