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MARKET COMMENTARY NOVEMBER 2021

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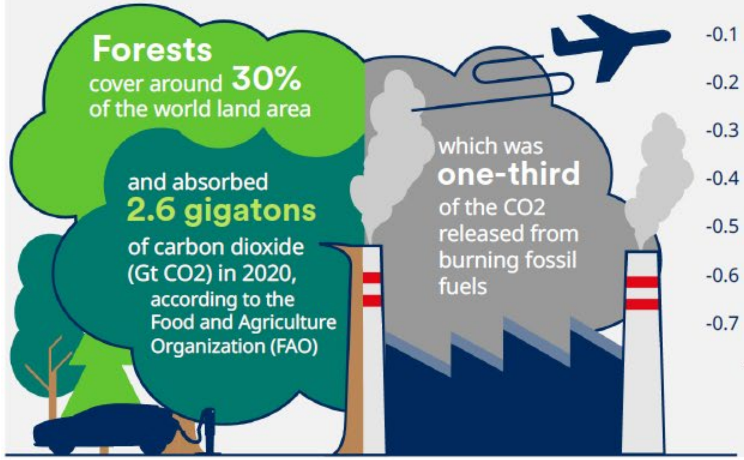
Pension TRANSFER Gold Standard

INFOGRAPHIC: THE GLOBAL ECONOMY

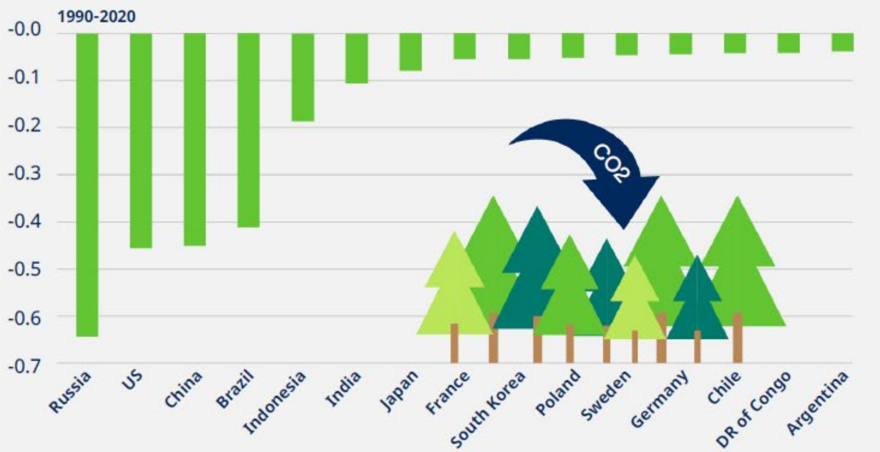
Beyond GDP growth: why natural capital matters

Read article here

Nature has a fundamental role to play in the race to net zero greenhouse gas emissions



Top countries by removals of CO2 from remaining forest land Gt CO2 per year



Source: FAOSTAT, Schroders Economics Group, 30 September 2021.

What could be the inflationary consequences of rising US wages?

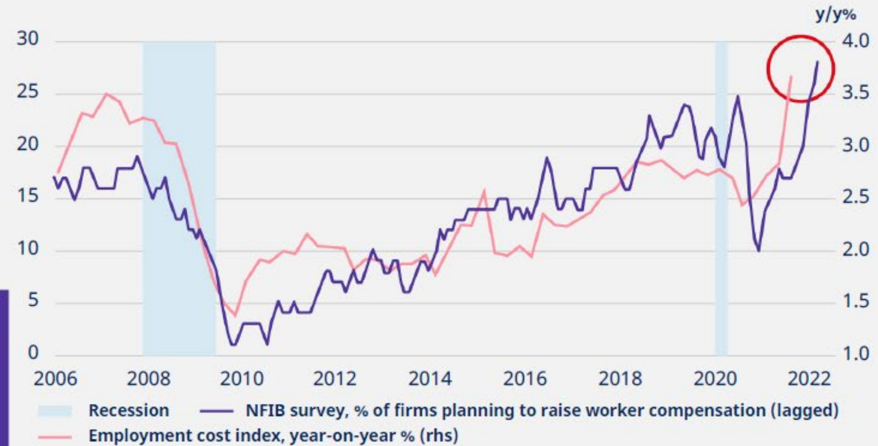
Read article here

Investors closely watching National Federation of Independent Business (NFIB) monthly small business survey

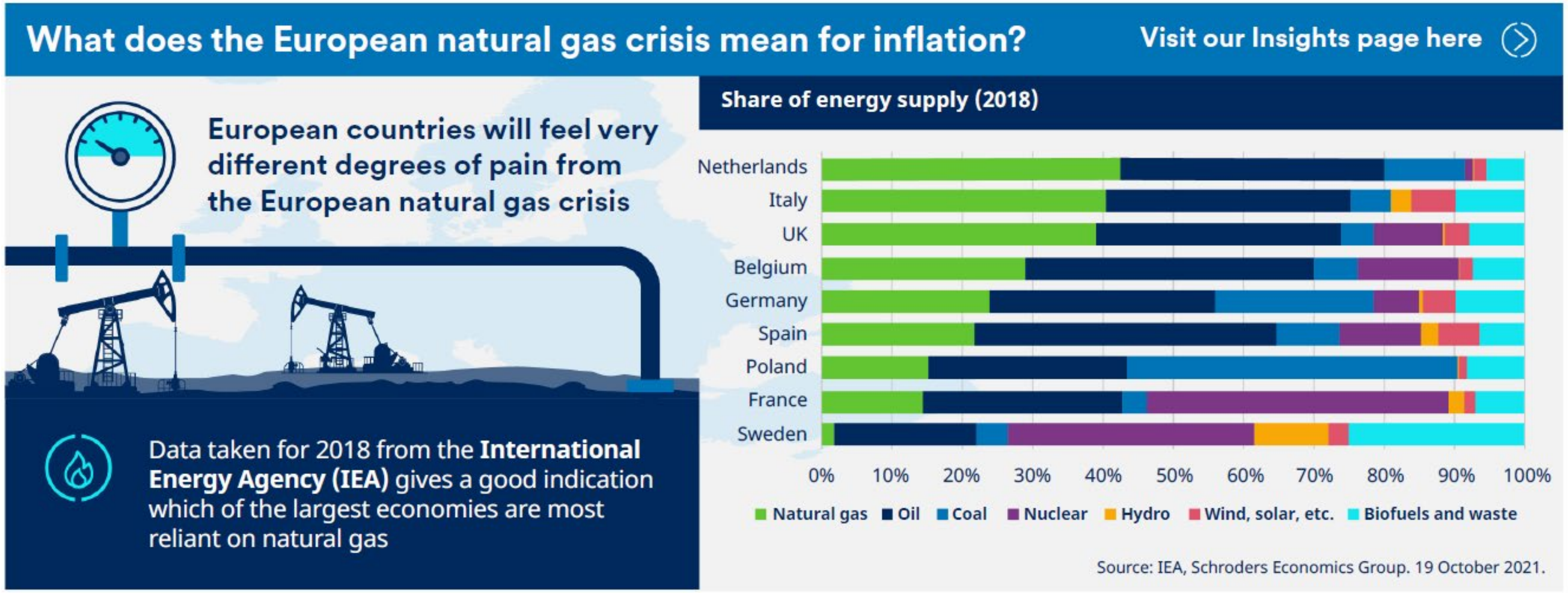
Specifically intentions to **raise worker pay**

These monthly datapoints foretold a **Q3 pick-up** in the Bureau of Labor Statistics' economy wide employment cost index

Wage pressures building at US small and independent businesses



Source: Refinitiv Datastream, Schroders, 29 October 2021.



Source: [Schroders as at November 2021.]

MULTI-ASSET INVESTMENT VIEWS

KEY

▲ Up from last month ▼ Down from last month

● Positive ● Positive/ Neutral ● Neutral ● Neutral/ Negative ● Negative

Main Asset Classes

Category	View	Comments
Equities	Positive/Neutral	While earnings surprises have not been as spectacular as in previous quarters, most companies confirmed that their earnings outlook remains positive.
Government Bonds	Negative	The month of October has reinforced our conviction that a global tightening phase in liquidity (when the availability of funds becomes less ample) is well underway.
Commodities	Positive/Neutral	Vaccine distribution and increasing global growth 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.

Equities

Category	View	Comments
US	Positive/Neutral	US earnings have beaten the low bar that was implied by expectations in the last few weeks. Earnings remain the key driver of higher returns against elevated valuations and less accommodative stimulus.
UK	Neutral	Tilts to sectors such as energy and financials make the UK more interesting but we prefer to express these themes more directly.
Europe	Neutral	Europe has been our preferred market over the medium-term. While the market has performed strongly this year, we have moderated our view that it can be the standout performer across regions.
Japan	Neutral	Much of the positivity around the Japanese elections has passed through the market. The strength of the recovery is also hampered by manufacturers struggling to boost production due to bottlenecks.
Global Emerging Markets[1]	Neutral	Fundamentals are still not attractive enough for us to change view. Vaccination rates remain low in many countries, suggesting uncertainty around the pace of their economic recoveries.
Asia ex-Japan & China	Positive/Neutral ▲	Valuations are starting to look attractive, and we expect looser monetary policy (central bank measures designed to stimulate the economy) in China next year.
EM Asia ex China	Neutral	Supply chain issues have been a drag for Korea and Taiwan, particularly for the former.

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

Government Bonds

Category	View	Comments
US	Negative	We remain underweight US bonds believing tighter labour markets will continue to stoke concerns about rising inflation resulting in the Federal Reserve (Fed) raising rates at the end of 2022.
UK	Neutral ▲	We have upgraded our view. Our expectation of central banks being slow to respond to inflationary pressures have been reinforced by the Bank of England's (BoE) recent decision not to raise rates.
Germany	Neutral/Negative ▲	We have upgraded following "dovish" comments (monetary policymakers are often described as dovish when expressing intentions to use policy to maximise employment) from the European Central Bank (ECB). The Pandemic Emergency Purchase Programme is to end as planned, but it looks increasingly likely that another support program could be introduced.
Japan	Negative	The Bank of Japan continues to manage the yield curve and is unlikely to move soon.
US Inflation Linked	Neutral	We remain neutral. A trade-off between higher oil prices and policy normalisation should keep inflation expectations around current levels.
Emerging Markets Local	Negative ▼	Concerns around higher inflation and weaker growth result in a downgrade. In a world of tightening developed market policies, emerging markets (EM) rates are unlikely to be well supported.

	Category	View	Comments
Investment Grade Credit	US	●	With low spreads and the increasing potential for rising interest rate volatility in 2022, we remain concerned investment grade (IG) bonds could be vulnerable to shifts in sentiment and market technicals.
	Europe	●	Despite credit spreads remaining tight and valuations appearing stretched, we prefer EU IG to US IG. We don't see the same drivers of supply in Europe, such as the increased level of M&A activity in the US. 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.
	Emerging Markets USD	●	From a valuation perspective, EM corporates continue to stand out as attractive despite jitters about contagion in the Chinese real estate sector becoming more widespread.
High Yield Bonds (Non-IG)	US	●	We favour high yield debt over investment grade as we expect the latter to be more vulnerable to rising interest rate volatility.
	Europe	●	We maintain our view as the sector continues to experience improved fundamentals, low default rates and has marginally wider credit spreads relative to US high yield bonds.
Commodities	Energy	●	We continue to favour energy as it provides a good hedge against the risks that rising energy prices could pose to economic growth.
	Gold	●	We remain neutral as the gold price is range-bound.
	Industrial Metals	●	The policy stance in China is more proactive amid weakening data whilst demand outside China continues to recover strongly as global activity normalises.
	Agriculture	●	We remain neutral. Expected yields on US soybean and corn crops have rebounded for this harvest but a spike in fertilizer prices risks a supply shock for the next planting season.
Currencies	US $	●	We remain positive as we recognise the value of the US dollar as a hedge against receding liquidity. As the cycle matures, it becomes more supportive of a long dollar position.
	UK £	●	Although there is pressure from headline inflation, driven by high gas prices, sterling remains expensive, so we prefer to stay on the side-lines whilst we await further data.
	EU €	●	We retain our negative view as we expect the ECB to remain dovish.
	JAP ¥	● ▼	We have downgraded our view. Fundamentals, inflation risks and monetary policy present headwinds for the currency.
	Swiss F	●	The economic backdrop has become less supportive. However, we are waiting for price changes to make valuations less stretched before we turn positive.

 Source: Schroders, November 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 review of markets in November when the identification of a new Covid-19 variant sent shares lower.

HIGHLIGHTS

- Global equities fell in November, with fears over the new "Omicron" variant of Covid-19 weighing on sentiment.
- In bond markets, weaker risk appetite led government bond yields lower (meaning prices rose).
- Commodities fell with oil prices lower amid worries the new variant could result in reduced demand.

THE US

US stocks traded slightly lower in November. Investors grappled with both a hawkish tilt to commentary from the Federal Reserve (Fed) and the emergence of a new coronavirus variant. Chair of the Fed, Jerome Powell, noted that the strength of the US economy combined with the threat of persistently higher inflation meant a swifter tapering of asset purchases – currently under way at a rate of $15 billion a month – is under consideration. At the same time, the emergence of the Omicron variant of Covid-19 has cause some to question the sustainability of the economic strength and advocate for more patience.

As it stands, unemployment in the US is low, having fallen to 4.6% in the latest (October) release from 4.8% in September. Retail sales have been growing for several months and industrial activity, as measured by composite PMI data, is robust. But pent-up demand continues to vie with supply constraints, adding to other contributing factors in higher inflation such as stimulus measures.

Consumer price index inflation (CPI) rose 0.9% last month after gaining 0.4% in September, significantly higher than expectations.

The S&P500 declined slightly over the month, as investor sentiment stabilised towards month end. The financials, communication services and energy sectors were amongst the weakest areas of the market. The technology and consumer discretionary sectors held up better, eking out small gains. In particular, US chipmakers gained strongly on expectations that despite current supply constraints, robust demand should ultimately be reflected in future earnings.

EUROZONE

Eurozone shares fell in November as rising Covid-19 cases saw some countries re-introduce some restrictions on activity. At the end of the month, the discovery of a new "variant of concern" added to investors' worries that more restrictions may be needed, potentially damaging business activity.

The weakest sectors for the month were energy and financials. Sectors that are sensitive to the economic reopening and recovery fell on fears the new Omicron coronavirus variant could result in lower demand. The best performing sector was communication services amid merger & acquisition activity. Private equity group KKR launched a €33 billion takeover offer for Telecom Italia.

The flash November estimate put eurozone annual inflation at 4.9%, up from 4.1% in October and well above the European Central Bank's 2% target. It is the highest inflation level in the single currency era. However, the European Central Bank (ECB) remained reluctant to tighten monetary policy. Christine Lagarde, president of the ECB, said that the current price pressures would fade by the time tightening measures took effect.

Germany's coalition talks reached a conclusion. Olaf Scholz of the Social Democrats (SPD) will succeed Angela Merkel as chancellor with his party in a coalition government with the Greens and Free Democrats (FDP). Climate targets are expected to be a key focus for the new government. Meanwhile, the EU released its first ever estimates of quarterly greenhouse gas emissions. This showed emissions for Q2 2021 were up 18% on the previous year, when activity was hit hard by Covid-19 lockdowns.

UK

UK equities fell over November. In line with many other markets, economically sensitive areas underperformed, including the energy (sharp decline in oil prices) and financial sectors. Areas reliant on reopening, such as the travel and leisure sector (airlines, hotels) performed particularly poorly. This occurred as international travel restrictions as well as domestic measures were reintroduced in response to Omicron.

Financials lagged due to a combination of factors related to the news that the Covid variant was of concern to world health authorities. These related factors included fresh uncertainty as to when developed market central banks might raise interest rates. Additionally, the expectation that China would maintain a zero tolerance approach to the virus added to fears the variant would have a severe impact on business activity, and on UK quoted companies exposed to the country.

At the beginning of November the Bank of England (BoE) refrained from increasing base lending costs, confounding expectations it would become the first major developed market central bank to do so. Some domestically focused areas of the market proceeded to bounce back on this news, reversing underperformance of recent months, when it was thought the BoE would be forced to cool economic activity to get a handle on consumer price inflation.

Consumer-facing domestic sectors, such as housebuilders and retailers, and domestically focused travel and leisure stocks, such as pub companies, helped small and mid-cap (SMID) equities recoup some of the ground lost since the summer – up until the point of the Omicron news. Many of these companies then experienced very sharp sell-offs as some Covid restrictions were reintroduced, including the wearing of face masks, which contributed to UK SMIDs underperforming over the month as a whole.

JAPAN

The Japanese stock market declined by 3.6% in November as initial optimism over the reopening of Japan's domestic economy was reversed sharply in the final week on news of the Omicron variant. Currency markets also changed direction, with yen weakness in the early part of the month quickly reversed as investors sought safe-haven assets during a period of greater uncertainty.

Renewed short-term uncertainty over the new Covid variant has temporarily obscured an increasingly positive outlook for Japan. Prior to this, a stable political situation had emerged as Prime Minister Kishida formed his new cabinet after the general election at the end of October.

Details also gradually emerged in November of a substantial fiscal stimulus package, which is slightly larger than previous expectations and could have a significant impact on GDP in 2022.

The government is making a significant effort to reinforce the recovery in the domestic economy following the lifting of the state of emergency at the end of September. Within the stimulus package, there is a particular focus on boosting consumption, by giving direct cash handouts. Although the timing of the package was not a surprise, the actual content has been influenced somewhat by the change in prime minister and the strength of the LDP's victory in the general election.

Economic data released in November provided few surprises as higher commodity prices and supply-chain constraints continue to impact the economy. Industrial production numbers are also influenced by the production cuts announced by Japanese auto makers as a result of the global semiconductor shortage. Historic data for Q3 GDP, released in mid-November, showed a contraction in the overall economy, primarily due to the state of emergency that remained in place throughout the quarter, but this result had no major influence on sentiment. Meanwhile, inflation crept back into positive territory as several one-off factors begin to drop out, but there is still little chance of Japan experiencing a short-term inflation spike as seen elsewhere.

ASIA (EX JAPAN)

Asia ex Japan equities declined in November amid a broad market sell-off following the emergence of the Omicron variant of Covid-19. Investors feared the new variant could derail the nascent global economic recovery. The news comes amid a surge in new Covid-19 cases in some parts of the world.

Singapore was the worst-performing index market in November as investors continued to track developments surrounding the new Covid-19 variant and whether existing vaccines would prove to be less effective. There were fears that the city-state's government may have to scale back some recently relaxed curbs. Chinese stocks were also sharply lower in November, along with neighbouring Hong Kong, on fears that new lockdown measures would be instigated following the rapid spread of a new Covid-19 variant.

Share prices in Thailand, South Korea and Malaysia recorded significant declines in November. Share prices were also weaker in Indonesia and India in the month, although the declines were less pronounced than in some index markets. Taiwan and the Philippines were the only index markets to achieve a positive return during November, although the gains in both markets were modest.

EMERGING MARKETS

Emerging market equities were down in November as early month gains were more than erased. Market expectations for earlier Fed policy tightening, together with uncertainty over the outlook for growth and inflation created by the Omicron variant, weighed on risk appetite.

Turkey, where the lira depreciated by more than 27%, was among the weakest markets in the MSCI EM index. During the month the central bank continued to cut its policy rate, despite ongoing above target inflation. Hungary and Poland underperformed amid concern that more rapid interest rate hikes could be required. Net energy exporters, notably Russia but also Saudi Arabia and Colombia, lagged as crude oil prices fell. China underperformed the index, while markets which were set to benefit from ongoing economic reopening, such as Thailand and Greece, also finished behind the index.

Conversely, the UAE was the best performing market in the MSCI EM index, supported by strong performance from telecoms company Etisalat Group. Chile, where first round presidential election results were well received by markets, the Philippines and Taiwan all posted positive returns and outperformed. Taiwanese equities were led higher by semiconductor related names which benefitted from rising expectations for metaverse, or augmented reality, demand growth.

GLOBAL BONDS

The emergence of the Omicron Covid-19 variant punctured risk sentiment in November. Government yields fell and the US dollar rallied, while stocks and high yield credit sold off. The oil price fell sharply due to concern over global demand.

Yields were buffeted through the month, as inflation indices in the US, Europe and UK remained elevated. The US consumer price index rose 6.2% year over year in October, the highest level since 1990.

The US Federal Reserve rhetoric turned increasingly hawkish over the course of the month. Chair Powell and other members of the policy committee suggested tapering could be accelerated and that they may stop referring to inflation as “transitory”.

Nevertheless, the US 10-year Treasury yield fell from 1.56% to 1.46% over the month, with an intra-month high of 1.69%. The yield curve flattened further, as the 2-year yield rose from 0.50% to 0.57%.

The German 10-year yield fell from -0.09% to -0.34%. The Italian 10-year yield from 1.13% to 0.98%. European Central Bank (ECB) President Christine Lagarde told the European Parliament that rate rises next year are unlikely. Eurozone inflation rose 4.1% year on year in October.

The UK 10-year yield fell from 1.03% to 0.81%, moving markedly lower as the Bank of England left the policy rate unchanged, against market expectations.

The risk-off move was reflected in corporate bonds. Investment grade credit saw flat total returns (local currency), but underperformed government bonds. High yield (HY) declined, with spreads widening sharply in the final week of the month. US HY fell -1.0% while the euro market declined -0.6%. 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.

There was mixed performance across both hard and local currency emerging market (EM) debt. EM currencies declined. The Turkish lira fell sharply as the central bank cut rates despite a double digit rate of inflation.

Convertible bonds were dragged down by equity market headwinds and shed -2.6% for November. Primary markets were strong and $17 billion of new convertibles were launched. The combination of falling equity markets and strong primary market supply resulted in a general cheapening of convertible bonds. Valuations of European convertibles were hit the most.

COMMODITIES

The S&P GSCI Index recorded a negative performance in November, driven lower by sharp declines in the price of oil following a broad market sell-off triggered by the emergence of the Omicron variant of Covid-19.

Energy was the worst performing component of the index in November. The industrial metals component also recorded a negative performance in November, with lower prices for zinc, lead, aluminium and copper. The precious metals component also declined in November, with lower prices for both silver and gold. The agriculture component was negative overall, with a sharp decline in the price of cocoa. Conversely, the price of coffee was significantly higher in November. Livestock was the only component of the index to record a positive performance in November.

TOTAL RETURNS (NET) % – TO END NOVEMBER 2021

	1 MONTH			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	-2.2	0.6	1.3	21.8	29.4	22.9
MSCI World Value	-3.8	-1.1	-0.3	18.5	25.9	19.6
MSCI World Growth	-0.7	2.1	2.9	24.6	32.4	25.7
MSCI World Smaller Companies	-4.9	-2.2	-1.4	19.8	27.4	20.9
MSCI Emerging Markets	-4.1	-1.4	-0.6	2.7	9.1	3.6
MSCI AC Asia ex Japan	-3.9	-1.2	-0.4	0.4	6.7	1.3
S&P500	-0.7	2.1	2.9	27.9	35.9	29.1
MSCI EMU	-5.9	-3.3	-2.5	11.7	18.7	12.7
FTSE Europe ex UK	-5.1	-2.5	-1.7	14.7	21.9	15.8
FTSE All-Share	-5.7	-3.0	-2.2	16.3	23.6	17.4
TOPIX*	-3.2	-0.5	0.3	3.1	9.5	4.0

	1 MONTH			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	0.8	3.6	4.4	-2.2	3.9	-1.3
JPM GBI UK All Mats	-0.5	2.3	3.1	-2.0	4.2	-1.1
JPM GBI Japan All Mats**	0.7	3.5	4.3	-8.1	-2.4	-7.3
JPM GBI Germany All Traded	-0.9	1.8	2.6	-7.0	-1.2	-6.1
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	-0.8	2.0	2.8	-2.0	4.2	-1.1
BofA ML US Corporate Master	0.1	2.9	3.7	-0.3	6.0	0.6
2.8BofA ML EMU Corporate ex T1 (5-10Y)	-2.4	0.3	1.1	-6.8	-1.0	-6.0
BofA ML £ Non-Gilts	-2.3	0.5	1.2	-1.3	4.9	-0.4
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	-1.7	1.1	1.8	2.0	8.4	3.0
BofA ML Euro High Yield	-2.7	0.0	0.8	-3.2	2.9	-2.3

Source: Thomson Reuters DataStream.
Local currency returns in November 2021: *-3.6%, **0.2%.
Past performance is not a guide to future performance and may not be repeated.

Source: Schroders, November 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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