FINURA

MARKET COMMENTARY DECEMBER 2021

Chartered Financial Planners

Pension TRANSFER Gold Standard

INFOGRAPHIC: THE GLOBAL ECONOMY

US consumer key to global growth and inflation outlook in 2022

Read article here

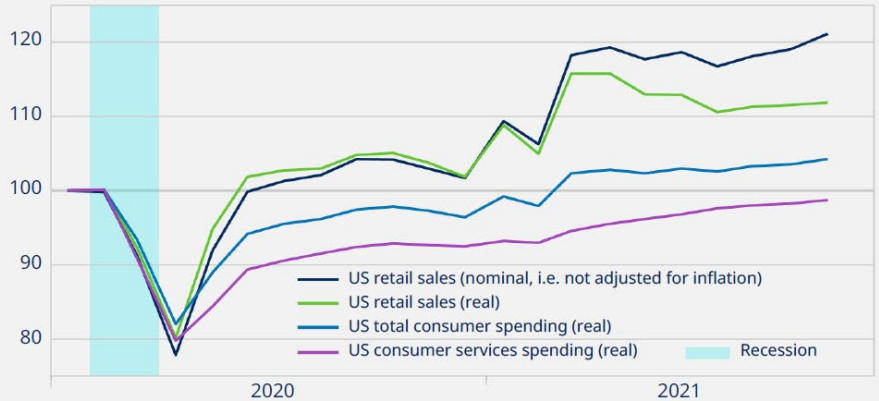
The US consumer recovery has been rapid but unbalanced

- Nominal retail sales are **up some 20%** versus pre-pandemic levels
- High goods demand is creating **supply chain disruptions** and pushing up prices
- While spending on goods has soared **Covid restrictions** have also meant that spending on services has been muted

Central banks will likely react to higher inflation by **withdrawing some policy support**

The US consumer recovery

1 January 2020 = 100



Source: Refinitiv Datastream, Schroders Economics Group, as of 25 November 2021.

Higher food prices contributed to emerging market rate hikes

Visit our Insights page here

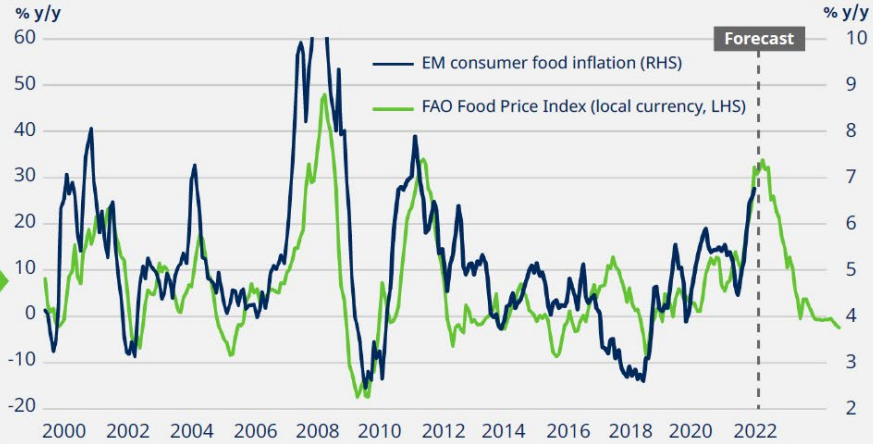
Most emerging market (EM) central banks have been forced to hike interest rates in response to above-target consumer inflation, with higher food prices a key driver

We think that inflation will subside during the course of 2022 as food and energy price trends improve

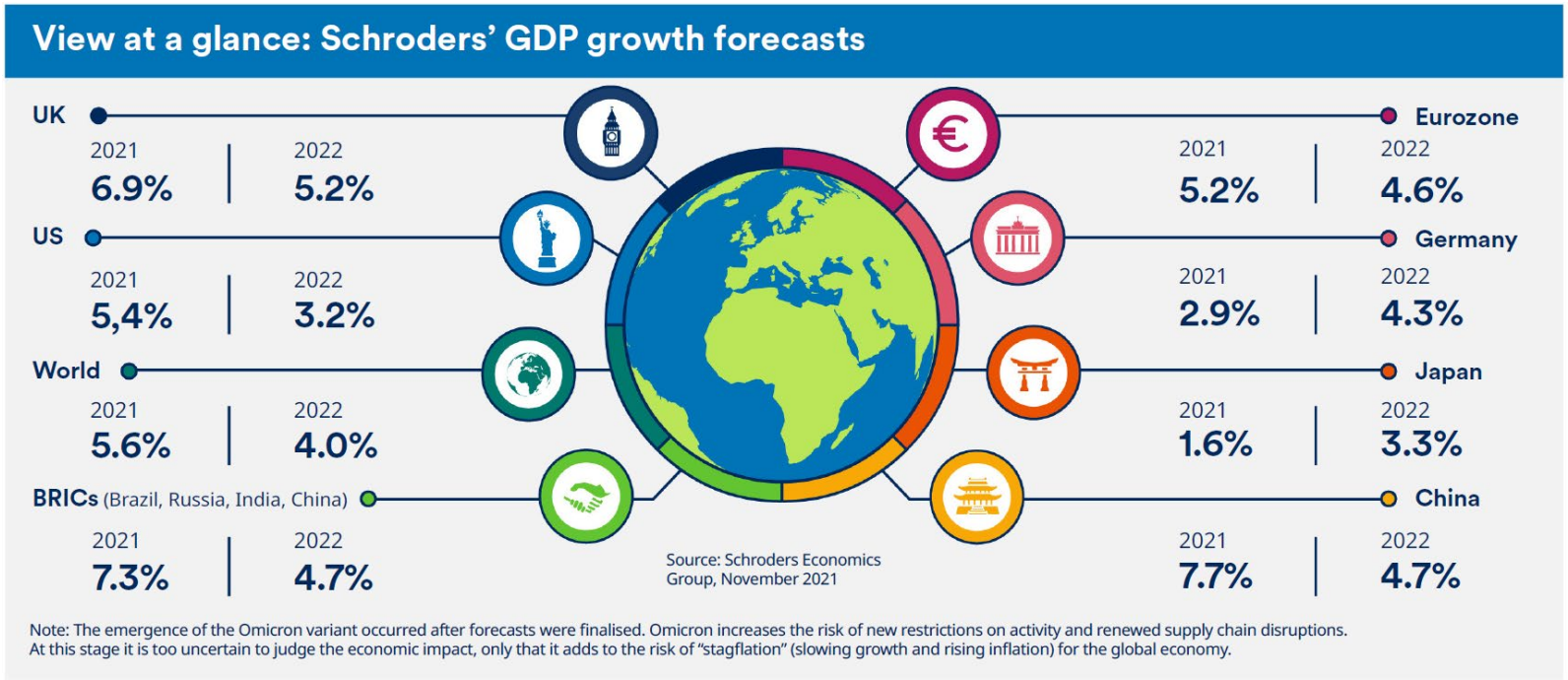
This chart illustrates the expected easing of the Food and Agriculture Organization's (FAO) Food Price Index, tracking price trends of key food commodities

Despite this, interest rate hikes that have already been delivered will hit economic activity

Higher food inflation has surprised markets, but should fall in 2022



Source: Refinitiv Datastream, Schroders Economics Group, as of 01 December 2021.



Source: Schroders as at December 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	With a solid corporate earnings outlook, we remain positive despite the Omicron variant having the potential to disrupt the road back to normality. Overall, we expect equity returns to be more muted than the last year, but still positive.
	Government Bonds	Negative	The recent rally has left valuations expensive with central bank tightening imminent. The slowing economic recovery and tighter monetary policies (central bank measures designed to stimulate the economy) have flattened real yield curves. A yield curve plots yields of bonds having equal credit quality but differing maturity dates, and its shape gives an idea of future interest rate changes and economic activity.
	Commodities	Positive/ Neutral	We remain positive with the inflationary backdrop and supply constraints supportive. Furthermore, the market correction over the past month has improved the balance of risk and reward.
	Credit	Neutral ▲	We have upgraded to neutral with credit spread widening across the board having improved valuations. Credit fundamentals continue to improve. The credit spread is the margin that a company issuing a bond has to pay an investor in excess of government yields and is a measure of how risky the market perceives the borrower to be.
Equities	US	Positive/ Neutral	The US continues to be one of our preferred markets. Valuations are rich but many companies in the market have pricing power and earnings appear robust.
	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	Despite recent fiscal stimulus announcements (government spending and taxation policies designed to support economies), uncertainty introduced by Omicron lead us to stay neutral, given the government's use of tight restrictions to control previous outbreaks. The strengthening of the currency further weighs on the market.
	Global Emerging Markets[1]	Positive/ Neutral ▲	There are some signs of recovery finally showing in the region especially in countries outside China. We are upgrading our score to positive.
	Asia ex-Japan & China	Neutral ▼	Valuations now look fair with offshore markets having corrected further. We expect looser monetary policy in China next year.
	EM Asia ex China	Neutral	Strong recovery observed in Korea led by the technology sector. Supply chain issues are still a concern in the region.
Government Bonds	US	Neutral	We are neutral on US bonds. Forward pricing reflects a flattening yield curve and dynamics characteristic of the latter part of the economic cycle. The curve also reflects an increasing pace of asset purchase tapering by the Federal Reserve. Asset purchases, or quantitative easing, were the means by which many central banks had injected additional money into the financial system in response to the pandemic.
	UK	Negative ▼	We have downgraded the UK with upside risk to yields. Inflation is well above the Bank of England's (BoE) target and the UK now has a flatter yield curve than other markets.
	Germany	Negative	The European Central Bank (ECB) remains dovish despite eurozone inflation surging to its highest rate on record, driven by a spike in energy prices. German private sector growth has also struggled after the reintroduction of Covid restrictions in December.
	Japan	Negative	The Bank of Japan continues to manage the yield curve and is unlikely to move soon.
	US Inflation Linked	Neutral	The Omicron variant presents short term risk but our medium-term view that the market is more inflationary compared to the last decade is unchanged.
	Emerging Markets Local	Negative	Some emerging market central banks are further down the inflation and hiking cycle, which has led to attractive valuations. However, with the Fed tightening policy, defaults in the Chinese property market and the Omicron variant, it is still early to change our score.

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

	Category	View	Comments
Investment Grade Credit	US	● ▲	We see some scope for credit spread stability and carry with signs of increased M&A and leveraged buy out activity. However, our long-term concerns over shifting sentiment, financing costs and technicals remain.
	Europe	● ▲	We expect credit spread stability and slight tightening in early 2022 when the liquidity from ECB's asset purchase programme comes through.
	Emerging Markets USD	●	Ongoing, near term turbulence with the Chinese property market remains, but corporate markets continue to offer attractive value.
High Yield Bonds (Non-IG)	US	●	Recent credit spread widening, improvement in fundamentals and valuations have led us to keep our neutral rating.
	Europe	● ▲	Similar to the US, fundamentals and valuations have improved. The ECB's accommodative policy offers support and we expect further credit spread tightening.
Commodities	Energy	●	We are positive on energy as supply dynamics will continue to be favourable for crude oil and natural gas prices.
	Gold	●	We have kept our neutral view as the gold price is range-bound and already reflects ultra low real (i.e. adjusted for inflation) bond yields.
	Industrial Metals	●	The policy stance in China has turned more proactive with the recent cut in the reserve requirement ratio (which determines the amount of money banks have to keep on standby). Demand outside China is recovering strongly as global activity normalises.
	Agriculture	●	We remain neutral. Expected yields on this US soybean and corn harvest have rebounded but a spike in fertilizer prices risks a supply shock for the next planting season.
Currencies	US $	●	We remain positive as the dollar continues to be a hedge against receding liquidity from the Fed. The economic slowdown will support the US dollar, which tends to perform counter to the economic cycle.
	UK £	●	Despite a high level of inflation, policy divergence between the Fed and the BoE acts as a headwind to sterling.
	EU €	●	We are still negative on the euro as we expect the ECB to remain dovish (monetary authorities are often described as dovish when using policy to maximise employment) given the weaker growth in Europe.
	CNH ¥	●	Macro backdrop is consistent with the weaker currency. Export growth is set to slow down in coming months and the trade-weighted renminbi (offshore) has strengthened.
	JAP ¥	●	Rising US rate expectations weigh on the Japanese yen as it is sensitive to rising yields compared to other currencies.
	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.

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, December 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 Q4 2021, when developed market shares posted strong returns despite the emergence of the Omicron variant and the prospect of tighter central bank policy.

HIGHLIGHTS

- Global equities were stronger in the final quarter of 2021 as investors focused on economic resilience and corporate earnings.
- In bond markets, government bonds outperformed corporate bonds. Markets began to price a faster pace of interest rate rises in the US.
- Commodities saw a positive return as industrials metals gained.

THE US

US equities rose in Q4. Overall gains were robust despite a weaker November, during which fears over rising cases of the Omicron variant of Covid-19 and the speed of the Federal Reserve's asset tapering had weighed. By year-end, these worries had largely subsided, while data continue to indicate that the economy overall remains stable and corporate earnings are robust.

US economic growth slowed sharply in the third quarter amid a flare-up in Covid-19 infections, but with activity since picking up, the economy remains on track to record its best performance since 1984. GDP increased at a 2.3% (annualised), up from the 2.1% pace estimated. This was still the slowest quarter of growth since the second quarter of 2020, when the economy suffered an historic contraction in the wake of tough mandatory measures to contain the first wave. Unemployment fell to 4.2%, the lowest since February 2020, from 4.6% in October. The participation rate rose slightly but is still about 1.5 percentage points lower than the pre-pandemic level.

Tech as a sub-sector was one of the strongest performers over the quarter, with chipmakers especially strong. Real estate also performed well, as investors expect e-commerce to continue to grow and drive further demand for industrial warehousing. Energy and financial names made more muted gains over the quarter.

EUROZONE

Eurozone shares made gains in Q4, as a focus on strong corporate profits and economic resilience offset worries over the new Omicron variant. A number of countries did introduce restrictions on sectors such as travel and hospitality in order to try and reduce the spread of the new variant. The flash composite purchasing managers' index hit a nine-month low of 53.4 for December, as the service sector was affected by rising Covid cases. However, equity markets drew support from early data indicating a lower risk of severe illness.

Utilities were among the top performers with IT stocks also registering strong gains. Technology hardware and semiconductor stocks performed particularly well. The luxury goods sector also performed very strongly, recovering from the summer sell-off which was sparked by a focus on "common prosperity" in China. Meanwhile, the communication services and real estate sectors saw negative returns.

The quarter was marked by volatile gas prices which contributed to higher inflation. The eurozone's annual inflation rate reached 4.9% in November, compared to -0.3% a year earlier. The

European Central Bank said it would scale back bond purchases but ruled out interest rate rises in 2022.

Germany's coalition talks reached a conclusion. In December, Olaf Scholz of the Social Democrats (SPD) succeeded Angela Merkel as chancellor. His party is in a coalition government with the Greens and Free Democrats (FDP).

UK

UK equities rose over the quarter. Encouraging news around Omicron during December saw a number of economically sensitive areas of the market largely recoup the sharp losses they had sustained in the initial sell-off in late November, such as the banks. Some areas reliant on economies reopening, however, such as the travel and leisure and the oil and gas sector were unable to make up November's losses and ended the quarter lower.

A number of defensive areas outperformed, including some of the large internationally diversified consumer staples groups. However, expectations China would maintain a zero tolerance approach to Omicron continued to impact sentiment towards a number of other globally exposed large cap companies. These consistently underperformed over the quarter, despite some uncertainties around increased regulatory oversight in China having abated.

Some domestically focussed area were particularly volatile and not just the travel and leisure companies directly disrupted by the latest Omicron related restrictions. The share prices of UK consumer facing sectors such as retailers and housebuilders yo-yoed inline with expectations around the timing of a rise in UK base rates, which came in December. Many retailers grappled with supply chain disruptions, resulting in some high profile profit warnings, despite strong demand.

JAPAN

After declines in October and November, the Japanese stock market regained some ground in December to end the quarter with a total return of -1.7%. The yen was generally weaker in the quarter.

Japan held a general election in October. Expectations for the ruling Liberal Democratic Party's (LDP) election performance under Mr Kishida's leadership were modest at best. However, in the event the LDP lost only 15 seats and retained a solid majority in its own right. With the election out of the way, the political focus shifted to a substantial fiscal stimulus package. This includes direct cash handouts to households in an effort to kick-start a consumption recovery in the first half of 2022.

From late November, renewed short-term uncertainty over the new Covid variant temporarily obscured the increasingly positive outlook for Japan. Japan inevitably imported its first known case of Omicron in December, but overall infection rates remain remarkably low, as they had throughout 2021.

The US Fed's discussion of accelerated tapering led to some short-term weakness in stock prices in December, despite the fact that such a move is very unlikely to be followed by Japan in the foreseeable future. The Bank of Japan's own Tankan survey, released in December, contained no real surprises, although the overall tone was reasonably upbeat. There was some evidence of a slight pick-up in corporate inflation expectations over the next two years. Meanwhile, the current inflation rate crept back into positive territory as several one-off factors begin to drop out, but

there still seems little chance of Japan experiencing a short-term inflation spike as seen elsewhere.

Among other economic data released in December, there was a genuine positive surprise in the strength of the rebound in industrial production as auto output began to recover from the temporary weakness caused by the global semiconductor shortage.

ASIA (EX JAPAN)

Asia ex Japan equities recorded a modest decline in the fourth quarter. There was a broad market sell-off following the emergence of the Omicron variant of Covid-19 which investors feared could derail the global economic recovery.

China was the worst-performing market in the index in the quarter, with share prices sharply lower, along with neighbouring Hong Kong, on investor fears that new lockdown restrictions would be instigated following the rapid spread of the new Covid-19 variant. Share prices in Singapore also ended the fourth quarter in negative territory as investors continued to track developments surrounding the new Omicron variant. There were also fears that the city-state's government might have to scale back some recently relaxed curbs on activity. India and South Korea also ended the quarter in negative territory although the declines in share prices were more modest.

Taiwan and Indonesia were the best-performing index markets in the fourth quarter and the only two index markets to achieve gains in excess of 5% in the period. In Taiwan, positive economic data and a rise in exports boosted investor confidence, with chipmakers performing well. Share prices in Thailand, the Philippines and Malaysia also ended the quarter in positive territory.

EMERGING MARKETS

The MSCI Emerging Markets Index lost value in Q4 and underperformed the MSCI World Index, with US dollar strength a headwind. Turkey was the weakest index market, amid extreme volatility in the currency. The central bank lowered its policy rate by a total of 400bps to 14%, despite ongoing above-target inflation which accelerated to 21.3% year-on-year in November. With the lira coming under significant pressure, President Erdogan announced an unorthodox scheme to compensate savers for lira weakness, in an effort to reduce the use of US dollars.

Chile lagged the index as leftist Gabriel Boric was elected president. Brazil underperformed as the central bank continued to hike rates in response to rising inflation; the policy rate was increased by a total of 300bps during the quarter. Meanwhile, concerns over the fiscal outlook, and political uncertainty ahead of October 2022's presidential election, also weighed on sentiment.

Russia lagged as geopolitical tensions with the West ratcheted up, amid a build-up of Russian troops on its border with Ukraine. China also finished in negative territory as concerns over slowing growth persisted, exacerbated later in the quarter by uncertainty created by rising daily new cases of Covid-19.

By contrast, Egypt finished in positive territory and was the best performing index market. Peru and the UAE also posted double digit gains in dollar terms. Taiwan, aided by strong performance from IT stocks, Indonesia and Mexico all recorded solid gains and outperformed.

GLOBAL BONDS

Markets were buffeted over the quarter by persistent elevated inflation, hawkish central bank policy shifts and the emergence of the Omicron Covid-19 variant. In bond markets, 10-year government yields were largely unchanged. Yields followed a downward trajectory for most of the quarter before reversing in the final weeks of the year as sentiment improved. Yield curves flattened, with shorter-dated bonds hit as central banks turned more hawkish.

Most notably, US Federal Reserve (Fed) rhetoric turned increasingly hawkish in November. Chair Jay Powell and other members of the policy committee suggested tapering could be accelerated, which it was in December, and that they may stop referring to inflation as "transitory".

The US 10-year Treasury yield was little changed for the quarter, from 1.49% to 1.51%. It reached 1.7% in October amid elevated inflation and expectations of policy tightening, then a low of 1.36% in early-December amid fears over the Omicron Covid-19 variant. The US 2-year yield increased from 0.28% to 0.73%.

The UK 10-year yield fell from 1.02% to 0.97%, dropping sharply in early November as the Bank of England (BoE) unexpectedly elected not to raise rates. The BoE did, however, raise rates in December and with fears over the Omicron variant fading, yields rose. The 2-year yield sold-off, from 0.41% to 0.68%.

Germany's 10-year yield was little changed, from -0.17% to -0.19%, but this reflected a late sell-off with the yield having fallen below -0.40% in December. Italy's 10-year yield increased from 0.86% to 1.18%. Eurozone inflation picked up considerably, rising to the highest level since 2008 and to a near 30-year high in Germany. European Central Bank President Christine Lagarde broadly affirmed dovish messages, but comments from other ECB officials were more hawkish.

Corporate bonds lagged government bonds for the quarter. In investment grade, the US market saw modestly positive total returns (local currency), but Europe weakened. US high yield was the standout performer, with positive returns and narrowing spreads. 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.

In emerging markets, local currency bond yields rose, particularly where central banks continued to raise interest rates amid elevated levels of inflation. Central and eastern Europe underperformed. EM currency performance was mixed, influenced by shifting risk sentiment, despite the prospect of higher interest rates.

EM hard currency bonds declined, with high yield significantly weaker, though investment grade sovereign bonds saw positive returns.

Global equities enjoyed a strong quarter with the MSCI World index up 6.8% but convertible bonds could not benefit from the equity market tailwind. The Refinitiv Global Focus index of balanced convertible bonds finished the last quarter of 2021 with a disappointing loss of -1.9%. Throughout the quarter, $25 billion of new paper hit the market bringing the total of new issuance to US$160 billion for 2021.

COMMODITIES

The S&P GSCI Index recorded a moderately positive return in the fourth quarter despite a sharp decline in the price of natural gas. The industrial metals component was the best-performing segment in the quarter as the global economic recovery gathered pace. There were strong gains in the prices of zinc, nickel, lead and copper.

The agriculture component also achieved a positive return in the quarter, with robust gains recorded for coffee, cotton, corn and Kansas Wheat. Precious metals also gained in the quarter, with modest price gains for siler and gold.

The energy component recorded a modest decline in the quarter, with a sharp fall in the price of natural gas offset by modestly higher prices for unleaded gasoline, crude oil and Brent crude.

TOTAL RETURNS (NET) % – TO END DECEMBER 2021

	3 MONTHS			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	7.8	9.8	7.3	21.8	31.1	22.9
MSCI World Value	7.2	9.2	6.7	21.9	31.2	23.1
MSCI World Growth	8.2	10.2	7.7	21.2	30.4	22.3
MSCI World Smaller Companies	2.2	4.2	1.8	15.8	24.5	16.8
MSCI Emerging Markets	-1.3	0.6	-1.8	-2.5	4.9	-1.6
MSCI AC Asia ex Japan	-1.2	0.7	-1.7	-4.7	2.5	-3.8
S&P500	11.0	13.2	10.5	28.7	38.5	29.9
MSCI EMU	3.7	5.6	3.2	13.5	22.2	14.6
FTSE Europe ex UK	5.5	7.6	5.1	16.3	25.2	17.4
FTSE All-Share	4.7	6.7	4.2	17.2	26.2	18.3
TOPIX*	-4.8	-2.9	-5.2	1.1	8.8	2.0

	3 MONTHS			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	0.2	2.1	-0.2	-2.6	4.8	-1.7
JPM GBI UK All Mats	2.9	4.9	2.5	-6.1	1.0	-5.3
JPM GBI Japan All Mats**	-3.2	-1.4	-3.6	-10.5	-3.7	-9.7
JPM GBI Germany All Traded	-1.7	0.2	-2.1	-9.6	-2.8	-8.8
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	-0.5	1.5	-0.9	-3.0	4.4	-2.1
BofA ML US Corporate Master	0.2	2.1	-0.3	-1.0	6.6	-0.0
BofA ML EMU Corporate ex T1 (5-10Y)	-2.8	-0.9	-3.2	-8.3	-1.3	-7.4
BofA ML £ Non-Gilts	0.9	2.8	0.4	-3.9	3.4	-3.0
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	-0.7	1.2	-1.2	1.4	9.1	2.3
BofA ML Euro High Yield	-1.9	0.0	-2.3	-5.1	2.1	-4.3

Source: Thomson Reuters DataStream.
Local currency returns in Q4 2021: *-1.7%, **-0.1%.
Past performance is not a guide to future performance and may not be repeated.

Source: Schroders, December 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