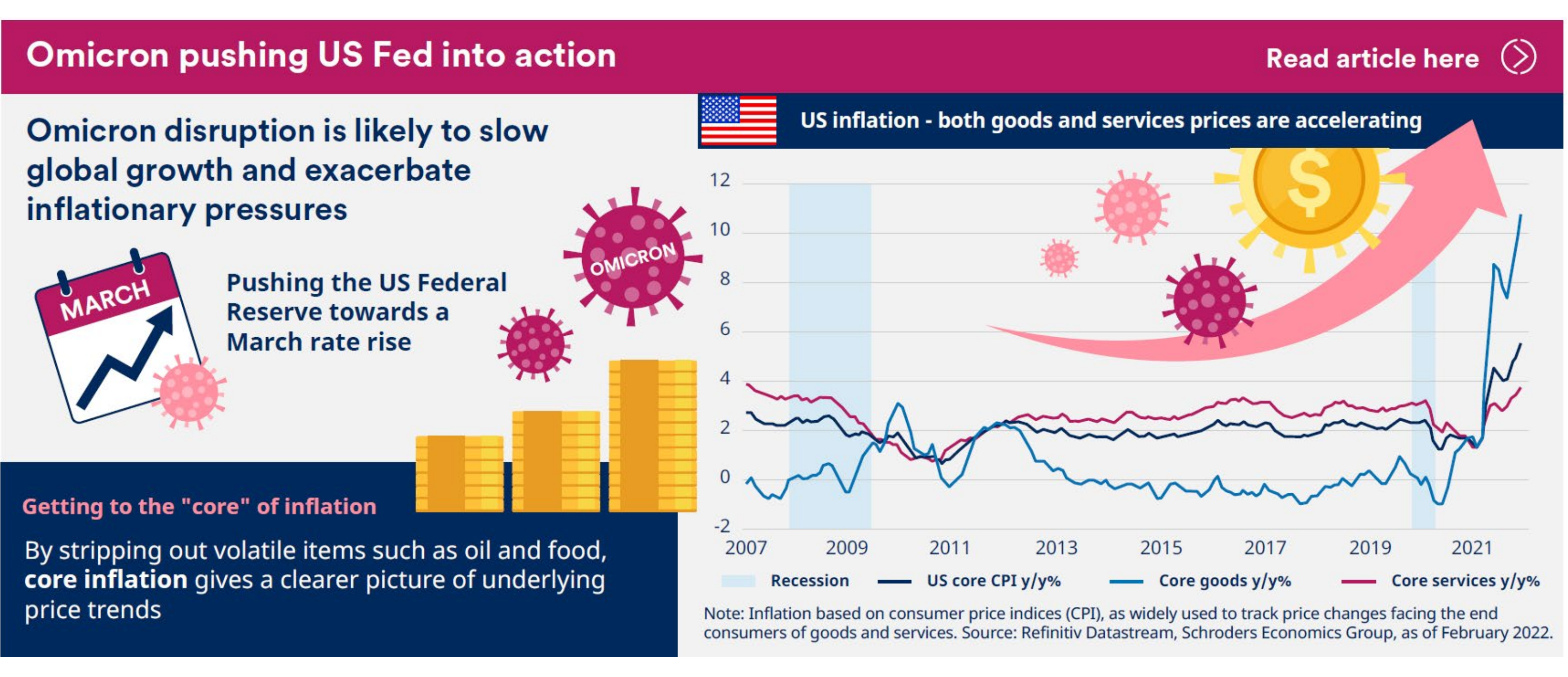
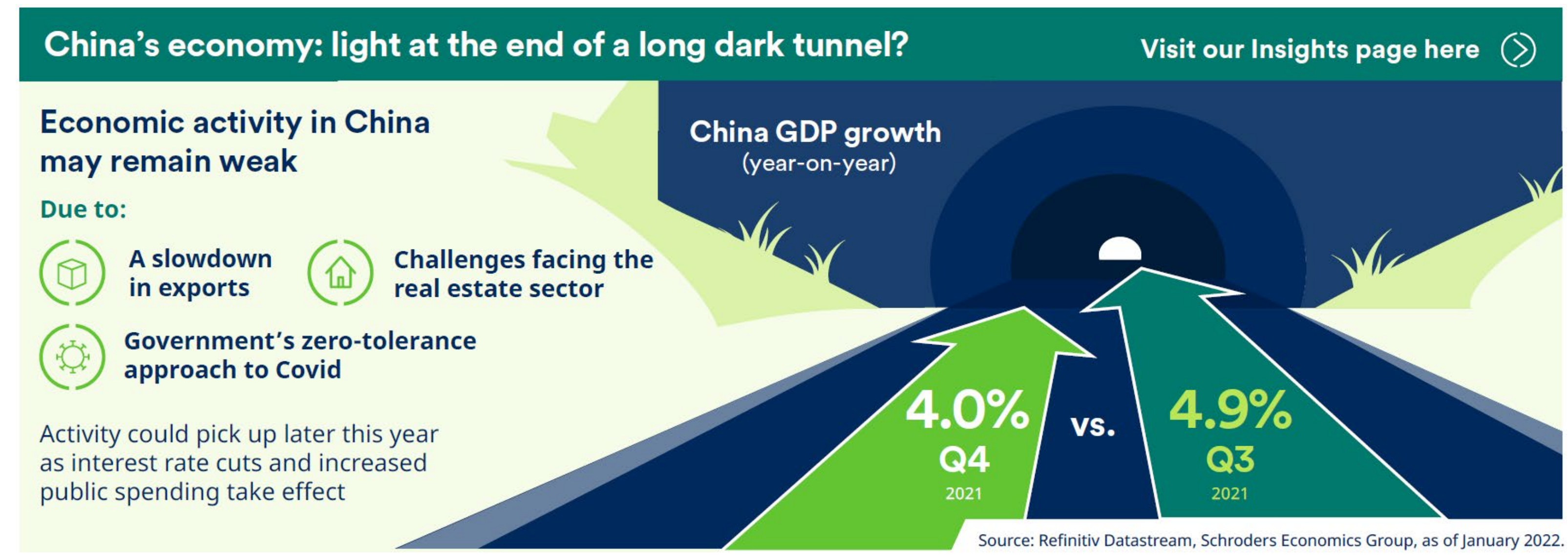
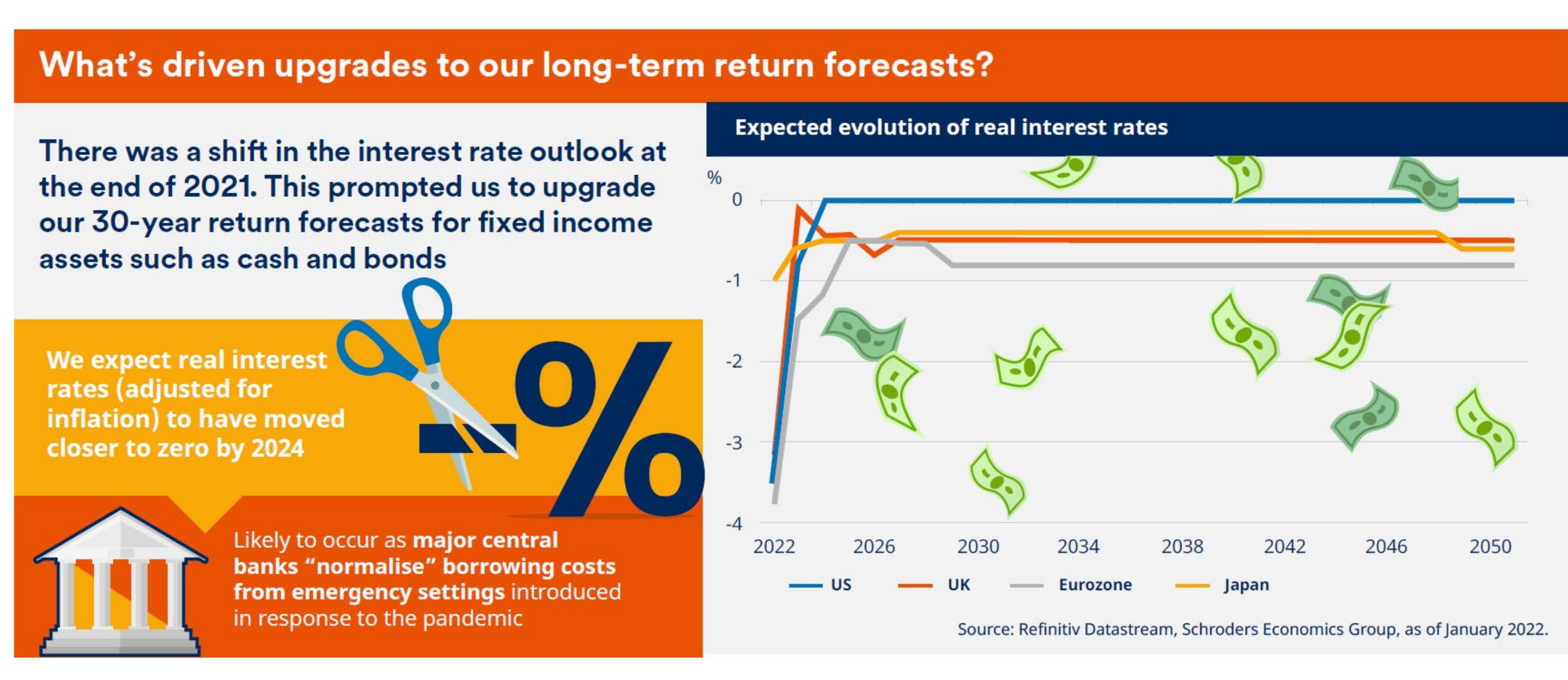
MARKET COMMENTARY FEBRUARY 2022

INFOGRAPHIC: THE GLOBAL ECONOMY







Source: [Schroders as at February 2022.]

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	Neutral ▼	We are now in a more mature phase of the economic cycle where the main challenges we face are rising interest rates and peaking growth momentum. Against this backdrop of tighter liquidity conditions (when the availability of funds becomes less ample) we downgraded equities to neutral.
	Government Bonds	Negative	Valuations continue to look expensive relative to our models as the Federal Reserve (Fed) continues to pivot in a hawkish direction (monetary policymakers are often described as hawkish when expressing concerns about limiting inflation) in response to inflation headwinds.
	Commodities	Positive/Neutral	We remain positive on commodities as countries worldwide re-open and supply remains tight given underinvestment across many sectors.
	Credit	Negative ▼	The strong fundamentals seen thus far may be peaking while escalating tensions in Ukraine present a clear and immediate catalyst in terms of deteriorating sentiment.
Equities	US	Neutral ▼	The US suffered at the start of the year due to elevated valuations and the Fed's hawkishness. Further tightening of monetary policy is likely to weigh on the market.
	UK	Neutral	The bias towards defensive and commodity stocks has supported the market; however, it remains to be seen whether it can outperform alongside the strength in in the pound.
	Europe	Neutral	Against the backdrop of rising inflation and increased geopolitical risks in Russia and Ukraine, we continue to hold our neutral stance.
	Japan	Neutral	It will be difficult for Japanese equities to outperform without a synchronised global recovery and so we remain on the side-lines for now.
	Global Emerging Markets[1]	Positive/Neutral	We continue to favour emerging markets (EM) over developed markets (DM) as most EM are in a different phase of the economic cycle. Meanwhile China's willingness to stimulate the economy as needed is very much supportive of the market.
	Asia ex-Japan & China	Positive/Neutral ▲	Chinese authorities have begun to stimulate selective parts of the economy and ease policy, albeit incrementally.
	EM Asia ex China	Neutral	Supply side bottlenecks have begun to abate, but uncertainties persist, including the upcoming Korean elections.
Government Bonds	US	Negative	We believe that the Fed is behind the curve in raising rates and therefore needs to catch up; growth is above trend, wages continue to rise and inflation is expected to remain above target.
	UK	Neutral	Gilt yields have moved significantly higher in recent weeks as investors expect more interest rate rises this year whilst inflation is expected to peak in April.
	Germany	Negative ▼	The monetary divergence between the European Central Bank (ECB) and the Fed appears to be closing as the ECB has scaled back its dovish (monetary policymakers are often described as dovish when expressing intentions to use policy to maximise employment) rhetoric.
	Japan	Negative	We remain on the side-lines with little movement expected anytime soon. The market continues to offer negative yields which provides poor value in a portfolio context.
	US Inflation Linked	Negative ▼	We have downgraded our view to negative as real rates might increase in order to control rising inflation.
	Emerging Markets Local	Neutral	Valuations and carry are compelling, with the EM versus DM yield differential trading at its highest levels since the global financial crisis. Many EM countries are also further along the path of monetary normalisation (remove emergency settings introduced in response to the pandemic).

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

	Category	View	Comments
Investment Grade Credit	US	Red ▼	We expect credit spreads to widen further as current sentiment indicators look weak whilst market volatility is likely to persist given the uncertainty around central banks and geopolitical risks. 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	Yellow ▼	We believe that market technicals will suffer as the ECB's support for credit markets is withdrawn quicker than previously expected.
	Emerging Markets USD	Yellow ▼	Valuations continue to look attractive, however, the market is very much vulnerable to shifts in sentiment. Given the risks posed around geopolitical tensions, we downgraded.
High Yield Bonds (Non-IG)	US	Yellow	While we retain a preference for high yield across developed markets, valuations and higher future supply restrict our enthusiasm for the US.
	Europe	Green	European high yield credits offers slightly more compelling valuations. Fundamentals also appear stronger than the US given lower leverage and better interest coverage.
Commodities	Energy	Green	We remain positive and expect prices to grind higher. The demand for oil continues to return whilst inventories have been drawn down further as the market remains in deficit.
	Gold	Yellow	While we remain neutral, gold appears better priced against real yields, which may be attractive should we reach peak Fed hawkishness.
	Industrial Metals	Green	Ex-China demand continues to rise whilst the policy stance in China has turned more supportive. The focus on renewable energy also brings substantial long-term upside.
	Agriculture	Green ▲	A shortage in global fertilisers and higher input costs is likely to weigh on market supply. As a result, prices are expected to surge as orders remain above historical averages.
Currencies	US $	Yellow	We remain neutral for now with significant tapering and rate hikes already priced in.
	UK £	Yellow	The market is pricing in a more aggressive stance from the Bank of England; however, recent data shows UK growth may already be slowing.
	EU €	Green ▲	The ECB have introduced a more hawkish tone, therefore leaving the door open to a rise in interest rates sooner than was previously expected.
	CNH ¥	Red	We expect a slowdown in exports and interest rate cuts to lead to a depreciation in the renminbi (offshore), something now being flagged by policymakers.
	JAP ¥	Red	Intensifying US rate hike expectations and fiscal stimulus in Japan should lead to a further leg down in the Japanese yen.
	Swiss F	Yellow	Swiss franc rates are expected to continue to be even lower than Europe and as the Fed starts hiking, the attractiveness of such low carry dwindles even more.

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, February 2022. 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.

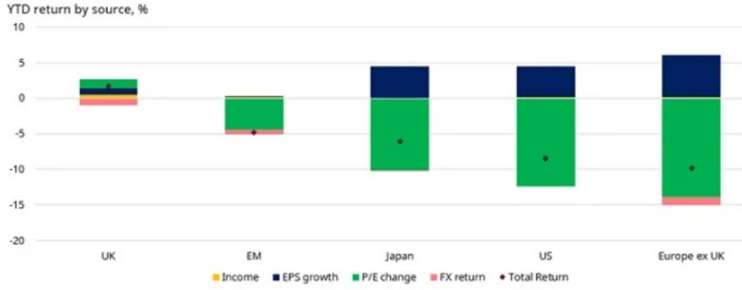
MARKETS REVIEW

A review of markets in February, when financial market activity was overshadowed by the shocking invasion of Ukraine by Russia.

THE MONTH IN SUMMARY

"Russia's invasion of Ukraine in late February shocked the world and is having a significant humanitarian impact. There are economic and financial implications too, and markets tumbled as investors assessed the potential economic impact of sanctions on Russia - a key exporter of commodities.

"The UK was the best performing market because of its high exposure to the energy and materials sectors. Meanwhile, European equities were the worst performer – a possible consequence of the region's heavy dependency on Russian energy imports." Sean Markowicz, Schroders Strategic Research Unit.



Source: DataStream Refinitiv, MSCI and Schroders. Data to 28 February 2022 in US Dollars.

Past performance is not a guide to future performance and may not be repeated.

THE US

US stocks fell in February, as investors tried to process the implications of Russia's invasion of Ukraine. The US imposed a broad range of severe sanctions on Russia after the invasion. The US has banned transactions with the Russian central bank and, in collaboration with other major governments, has sought to stop it from deploying foreign reserves.

Restrictions have been placed on the nation's key financial institutions – including Sberbank and VTB - as well as its wealthiest individuals and families. The US has also cut Russia out of the Swift International Payments System, along with similar exclusions from the system by other major economic powers.

Beyond these events, the US economic picture remained broadly unchanged. US growth continues to look robust while inflation is elevated. Industrial activity – as represented by the flash composite purchasing managers' index (PMI) - rose to 56 this month from 51.1 in January. US inflation, released early in the month, surprised to the upside. Headline CPI rose to 7.5% year on year in January; the fastest pace since 1982. Rising prices are a key contributor to weaker consumer confidence. (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.)

Most areas of the market struggled in February. Energy was the only sector to make gains, with oil and gas prices increasing steeply. All other sectors declined. The tech and communication services sectors were among the weakest.

EUROZONE

Eurozone shares fell in February, underperforming other regions. Europe has a significant reliance on Russian energy, especially gas, and the invasion saw energy prices spike higher. The consumer discretionary and financials sectors were the worst performers, reflecting expectations for pressure on consumer spending and economic activity as energy prices rise. More defensive sectors such as healthcare, communication services and utilities were among the better performers but all sectors saw losses.

The eurozone's annual inflation rate was confirmed at 5.1% in January, up from 5.0% in December 2021. Of this, energy price inflation accounted for more than half of the rise.

Early in February, European Central Bank President Christine Lagarde had declined to rule out an interest rate rise this year in response to higher inflation. However, the Ukraine crisis may now make it less likely that the central bank would tighten monetary policy.

The European Union and individual European countries announced sanctions on Russia and policy changes as a result of the unfolding crisis. These included a commitment by Germany to increase its defence spending. Germany also suspended the approval of the Nord Stream 2 gas pipeline.

Elsewhere, indicators of economic activity remained robust. The flash Markit composite purchasing managers' index for February was 55.8, up from 52.3 in January and a five-month high. The services sector continued its rebound as activity such as tourism picked up following the loosening of Covid restrictions.

UK

UK equities were broadly unchanged over February. The picture was very similar to January, with shares of larger companies rising. This was driven this month by the mining, healthcare and oil sectors, while small and mid cap equities recorded losses. One change from January was a greater presence of more traditionally defensive sectors among the market's outperforming areas. These included consumer goods, drinks and utility companies, to take three examples.

Consensus earnings growth estimates for UK quoted companies remained steady in February. Many companies reassured the market on their forecasts as they published full-year results. This was despite concerns that the full impact of inflationary trends are yet to be factored into profit margin expectations.

The latest monthly GDP data from the Office for National Statistics (ONS) revealed that UK output contracted by 0.2% in the month of December as restrictions were re-introduced following the rise in Covid-19 cases linked to the Omicron variant. Despite this, the estimated fall in activity was less severe than feared by the consensus among economists, which had predicted a drop of 0.6%. The Bank of England raised interest rates by 0.25 percentage points, to 0.5%, as the ONS revealed that the consumer price index rose by 5.5% in the 12 months to January, a 30-year high.

JAPAN

After an initial recovery from January's weakness, the Japanese stock market ended February with a loss of 0.4%. The yen ended the month little changed against the US dollar, although there was some underlying strength in the second half of the month as global uncertainty increased.

Geopolitical events dominated equity market behaviour in February. Any direct impact on Japan is likely to be limited, though this assessment is not intended to trivialise the scale of human suffering in Ukraine itself. As we have seen many times in the past, Japan's stock market reflected global market moves. The principal conduit for such uncertainty is often seen through the currency as the yen maintains its traditional role as a safe-haven asset.

Russia is a relatively small trading partner for Japan, accounting for around 1% of exports and 2% of imports. The balance is skewed by the import of energy from Russia, especially LNG, while exports are predominantly in auto-related areas. Most auto makers are now moving to suspend these links. Some Japanese companies, especially the large trading companies, have production assets based in Russia, but these generally account for less than 1% of their global exposure. Technology-related trade between the two countries is very small.

The Ukraine crisis implies energy prices could remain higher for longer than previously anticipated. This is likely to provide a boost to long-term inflationary expectations in Japan, at just the same time as the substantial negative impact of lower mobile phone charges begins to drop out of the year-on-year inflation data. As a result, we could see a temporary rise in inflation, approaching the Bank of Japan's 2% target, happening slightly earlier than previously expected.

ASIA (EX JAPAN)

Asia ex Japan equities recorded a modest decline in February following a volatile month on global stock markets after Russia's invasion of Ukraine towards the end of the month. News that Russian president Vladimir Putin had put the country's nuclear forces on high alert intensified fears that the conflict could escalate, weakening investor sentiment further.

Stocks in China and Hong Kong slipped as US and European countries started to impose economic sanctions on Russia, leading to commodity price rises and fresh concerns over higher inflation. In Hong Kong, technology stocks declined due to new concerns over changing regulatory rules in China.

Stocks in India also ended the month in the red amid weak investor sentiment due to the crisis in Ukraine. Share prices in Taiwan were lower, with a mixed performance from financial and technology stocks, while prices in Singapore also ended the month in the red. Despite periods of volatility during the month, share prices in Malaysia, Indonesia and Thailand ended the month in positive territory.

EMERGING MARKETS

Emerging market (EM) equities registered a negative return in February as geopolitical tensions took centre stage. Russian equities and the rouble plummeted as President Putin launched a full-scale invasion of neighbouring Ukraine. Risk aversion impacted other emerging European markets, specifically Hungary and Poland which also fell sharply. Egypt, which is likely to see some economic impact through the loss of tourist revenues from Russian and Ukrainian visitors, underperformed the broader EM index.

Rising energy prices as a result of Russia's war in Ukraine were a headwind for net EM importers, notably India which also lagged. China underperformed by a smaller margin. Conversely, Peru was the best-performing index market, benefitting from stronger metals prices, along with Brazil and South Africa.

Net oil exporters, particularly the UAE, but also Colombia, Qatar, Saudi Arabia and Kuwait, all generated positive returns and outperformed. Malaysia, Indonesia and Thailand all recorded strong gains. Taiwan posted a negative return but finished ahead of the broader index.

GLOBAL BONDS

February was ultimately overshadowed by Russia's invasion of Ukraine, and the threat of a major regional conflict, dire humanitarian consequences and ramifications for the global political order. Sanctions imposed by the West have essentially cut Russia off from the global financial system. The final days of the month saw heightened volatility as markets began to absorb the enormity of the situation.

Bond yields were volatile, finishing slightly higher due to moves earlier in the month. Yields initially rose sharply (meaning prices fell) on further hawkish surprises from central banks. With the market already assuming aggressive tightening in the US, moves by the European Central Bank (ECB) and Bank of England (BoE) exacerbated investor concerns. ECB comments indicated it could raise rates toward the end of the year and the BoE hiked rates a second time, despite concerns around the economic outlook.

Yields then began to decline from around mid-month as geopolitical tensions increased, with further downward moves in the days following the invasion.

The US 10-year Treasury yield was up from 1.78% to 1.82%, briefly rising above 2%, while the equivalent UK yield rose from 1.31% to 1.41% and Germany's from 0.01% to 0.16%.

In the short-end of the curve, the US 2-year yield rose from 1.18% to 1.44%, with an intra-month high of 1.6% coinciding with the day of the invasion. The UK's 2-year yield was unchanged at 1.05%, but hit 1.56% mid-month. The 2-year Bund yield initially lurched from -0.53% toward -0.2%, but finished the month little changed.

Corporate bonds saw negative returns, Europe in particular, as spreads widened. The US performed relatively well, notably high yield where there was modest spread tightening in some sectors, including energy.

Emerging market (EM) bonds saw negative total returns, selling off in the final days of the month. Hard currency sovereign bonds were worst affected. In foreign exchange markets, Latin America currencies and some in Asia held on to gains for the month, despite a late sell-off. Central and eastern European currencies weakened.

The Russian rouble was almost 40% lower as severe economic sanctions were imposed. 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.

Convertible bonds, as measured by the Refinitiv Global Focus Index, shed -1.9% in US dollar terms. In a typical reaction to lower equity prices, the primary market for convertibles remained subdued with an issuance volume of just $2.9 billion. Convertible bond valuations moved sideways with some cheapening in US convertibles.

COMMODITIES

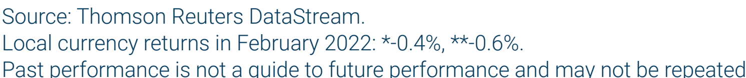
The S&P GSCI Index recorded a strong rise in February, following the Russian invasion of Ukraine. Agriculture was the best performing component of the index, with strong gains for wheat and Kansas wheat. Russia and Ukraine account for around 30% of global wheat exports. Corn and soybeans achieved more modest gains. The energy component also achieved solid gains in February, with strong price rises for crude oil and Brent crude.

In the industrial metals component, aluminium, nickel and lead all achieved strong gains, while price gains for copper and zinc were more muted. Gold and silver both ended the month in positive territory, highlighting gold's safe haven status for many investors during times of stock market turmoil.

TOTAL RETURNS (NET) % – TO END FEBRUARY 2022

	1 MONTH			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	-2.7	-2.5	-2.7	-2.5	10.7	19.7
MSCI World Value	-1.8	-1.6	-1.8	-1.6	14.3	23.5
MSCI World Growth	-3.6	-3.5	-3.7	-3.5	6.7	15.3
MSCI World Smaller Companies	0.1	0.2	0.0	0.2	0.1	8.1
MSCI Emerging Markets	-2.4	-3.0	-3.2	-3.0	-10.7	-3.5
MSCI AC Asia ex Japan	-2.1	-2.3	-2.5	-2.4	-14.4	-7.5
S&P500	-3.0	-3.0	-3.2	-3.0	16.4	25.8
MSCI EMU	-5.2	-5.0	-5.2	-5.1	1.1	9.3
FTSE Europe ex UK	-4.3	-4.0	-4.2	-4.0	4.5	13.0
FTSE All-Share	-0.5	-0.5	-0.7	-0.5	11.4	20.3
TOPIX*	-2.7	-2.5	-2.7	-2.5	10.7	19.7

	1 MONTH			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	-0.7	-0.7	-0.9	-0.7	-1.5	6.4
JPM GBI UK All Mats	-1.4	-1.4	-1.6	-1.4	-7.3	0.1
JPM GBI Japan All Mats**	-0.6	-0.5	-0.7	-0.5	-7.8	-0.3
JPM GBI Germany All Traded	-1.1	-0.9	-1.1	-0.9	-9.8	-2.5
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	-2.2	-2.1	-2.3	-2.2	-5.4	2.2
BofA ML US Corporate Master	-2.2	-2.2	-2.4	-2.2	-3.0	4.8
BofA ML EMU Corporate ex T1 (5-10Y)	-3.5	-3.3	-3.5	-3.3	-12.5	-5.5
BofA ML £ Non-Gilts	-2.1	-2.1	-2.3	-2.1	-8.0	-0.6
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	-2.1	-2.1	-2.2	-2.1	-3.9	3.9
BofA ML Euro High Yield	0.0	0.2	0.0	0.2	-6.5	1.1


Source: Thomson Reuters DataStream.
Local currency returns in February 2022: *-0.4%, **-0.6%.
Past performance is not a guide to future performance and may not be repeated.

Source: Schroders, February 2022: 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.

Important Information: This communication is marketing material. The views and opinions contained herein are those of the named author(s) on this page, and may not necessarily represent views expressed or reflected in other Schroders communications, strategies or funds. This document is intended to be for information purposes only and it is not intended as promotional material in any respect. The material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. The material is not intended to provide, and should not be relied on for, accounting, legal or tax advice, or investment recommendations. Information herein is believed to be reliable but Schroder Investment Management Ltd (Schroders) does not warrant its completeness or accuracy. The data has been sourced by Schroders and should be independently verified before further publication or use. No responsibility can be accepted for error of fact or opinion. This does not exclude or restrict any duty or liability that Schroders has to its customers under the Financial Services and Markets Act 2000 (as amended from time to time) or any other regulatory system. Reliance should not be placed on the views and information in the document when taking individual investment and/or strategic decisions. Past Performance is not a guide to future performance. 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. Exchange rate changes may cause the value of any overseas investments to rise or fall. Any sectors, securities, regions or countries shown above are for illustrative purposes only and are not to be considered a recommendation to buy or sell. The forecasts included should not be relied upon, are not guaranteed and are provided only as at the date of issue. Our forecasts are based on our own assumptions which may change. Forecasts and assumptions may be affected by external economic or other factors. Issued by Schroder Unit Trusts Limited, 31 Gresham Street, London, EC2V 7QA. Registered Number 4191730 England. Authorised and regulated by the Financial Conduct Authority.

5th Floor, 20 Old Bailey, London EC4M 7AN
T: +44 (0)20 8057 8004 E: hello@finura.co.uk W: finura.co.uk

Finura Partners is an Appointed Representative of Evolution Wealth Network Limited who are authorised and regulated by the Financial Conduct Authority and based at Holmwood House, Broadlands Business Campus, Langhurstwood Road, Horsham, West Sussex, RH12 4QP.

Finura Partners Limited are registered in England under Companies House number 09560937, 15 Bowling Green Lane, London, England, EC1R 0BD.