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YOUR MARKET COMMENTARY
MAY 2022

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INFOGRAPHIC: THE GLOBAL ECONOMY

Schroders Recession Dashboard: what is it telling us?

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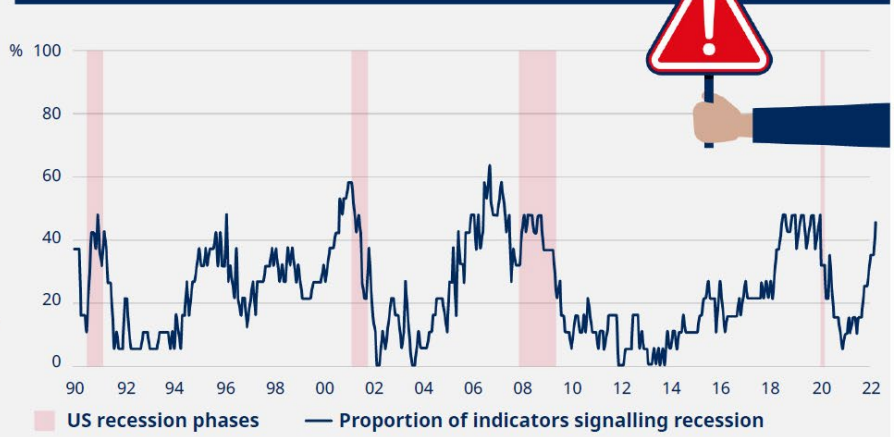
Recession warning in the US on the Schroders Recession Dashboard

US economy is often the biggest swing factor in determining the outlook for the world economy

>1/4

US accounts for over a quarter of all output and is still the globe's largest economy

Recession risks have climbed for the US economy



Note: US recession phases defined by the National Bureau of Economics Research (NBER).
Source: Schroders Economics Group, 29 April 2022.

Deforestation: what could be the market impact of new EU ban?

Read article here

The EU "imports" carbon dioxide (CO2) emissions

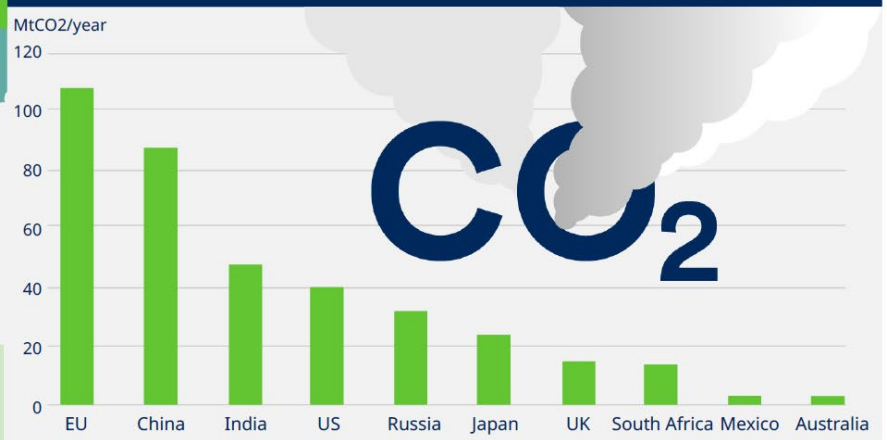
Tropical forests are cleared to raise cattle and cultivate crops destined for the bloc

New laws aim to foster more sustainable consumption habits and curb deforestation

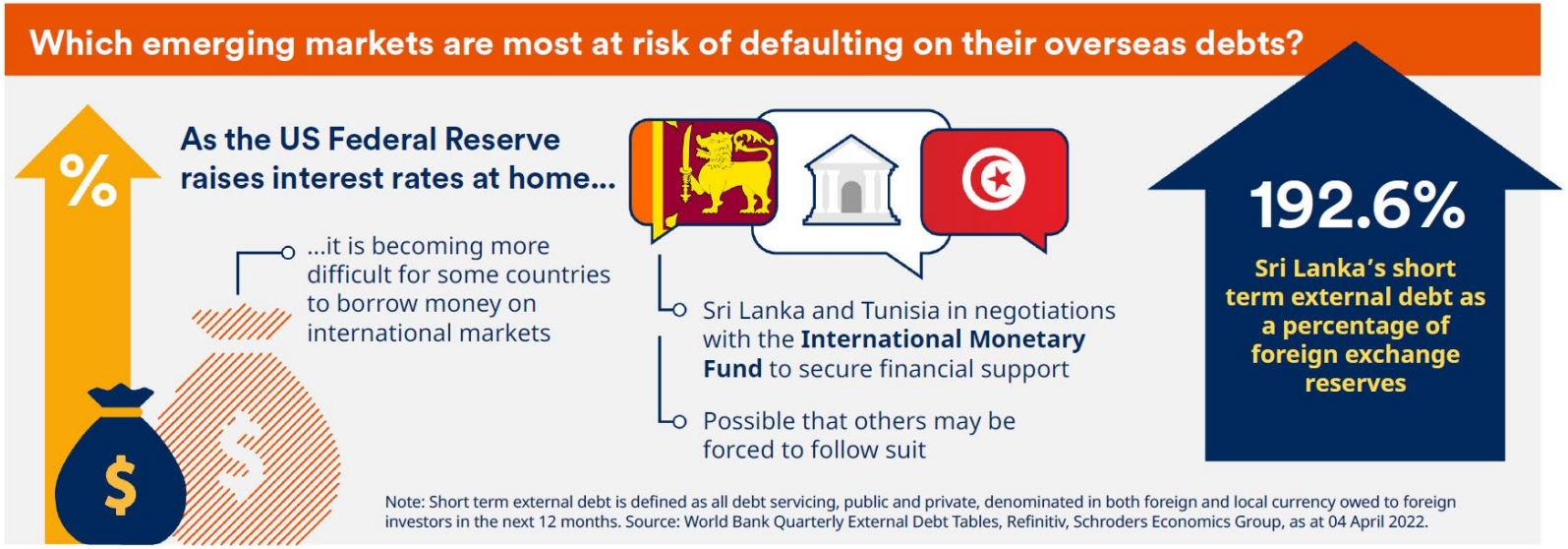
1/3

"Natural climate solutions" could deliver more than **one-third of the greenhouse gas emission savings** to meet climate change targets

Annual imported deforestation emissions, 2005-2018



Note: Imported deforestation emissions are defined as changes to carbon stocks due to forest loss and the impact of the subsequent land use. Source: Pendrill et al. 2020, Schroders Economics Group, April 2022.



Source: Schroders as at May 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	🔴	We remain negative on equities as markets are caught in the cross currents of concerns about rate increases and recessionary risks.
	Government Bonds	🟡	We remain neutral on bonds as recent moves have priced in a significant amount of monetary tightening for the year. Monetary tightening describes a situation where the availability of funds becomes less ample, which is presently occurring as many central banks around the world are tightening liquidity conditions.
	Commodities	🟢	We remain positive as heightened geopolitical risks stemming from Russia's invasion of Ukraine, combined with the imbalance between supply and demand, remain tailwinds.
	Credit	🟡	Given "stagflationary" concerns, our outlook remains cautious, with a preference for quality in developed markets. Stagflation describes a combination of slowing growth and accelerating inflation.
Equities	US	🔴	We remain negative; valuations in the US suggest that this is a market that is particularly vulnerable to the withdrawal of liquidity (tighter liquidity conditions) and the widening of the "equity risk premium". The equity risk premium is the return from equities in excess of that from "riskless" asset such as cash.
	UK	🟡	The defensive and commodity biases in the FTSE index mean that the UK market should better withstand the geopolitical headwinds compared to other markets.
	Europe	🔴	We remain negative, although acknowledge that negative earnings momentum may have reached a low point, as much of the bad news appears to be priced in from Russia's invasion of Ukraine.
	Japan	🟡	The Bank of Japan (BoJ) is pledging to keep bond yields down and is welcoming "imported inflation". We remain neutral as we wait to see if Japan can lift itself out of deflation. Consumer inflation (rising prices) has recently returned, however, partly as a result of weakness in the yen, itself a consequence of the BoJ's "yield curve control" policies. Yen weakness has increased the cost of imported goods and services giving rise to imported inflation.
	Global Emerging Markets[1]	🟡	Although the region is not immune to the tightening of global financial conditions, we remain neutral due to attractive valuations and supportive policy.
	Asia ex-Japan & China	🟡	Lockdowns and supply bottlenecks continue to negatively impact trade flows, however Chinese policymakers have recently shifted their focus to support growth via easing of monetary policy. Monetary policy covers measures taken by central banks designed to regulate economic growth and include changes in interest rates.
	EM Asia ex China	🔴	We believe that other regions in the emerging market (EM) universe appear more attractive.
Government Bonds	US	🟡 ▲	We upgrade to neutral to reflect the rapid repricing of rate rises by the market. As controlling high inflation remains the primary concern of the Federal Reserve (Fed) we expect them to continue their policy of aggressive monetary tightening.
	UK	🟡	We remain neutral as we believe too many rate hikes are currently priced in and recession risk is not imminent.
	Germany	🔴	The European Central Bank (ECB) has performed a U-turn on a number of statements this year, and we now expect a rate rise as early as July.
	Japan	🔴	The market continues to offer negative yields, which provide poor value in a portfolio context.
	US Inflation Linked	🔴	We remain negative as uncertainty from the Russia/Ukraine crisis appears to have peaked and now the Fed's top priority is to contain inflation.
	Emerging Markets Local	🔴	Our view is unchanged as the economic environment remains challenging with stagflationary as well as recessionary risks mounting.

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

	Category	View	Comments
Investment Grade Credit	US	● ▲	We upgrade US investment grade (IG), with robust fundamentals and widening credit spreads making valuations attractive. 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	●	We retain our positive score in European IG due to attractive valuations combined with easing rates volatility and the continued risk of volatile equity prices.
	Emerging Markets USD	●	We have a preference for developed market IG as recent strength in EM has left credit spreads unattractive in comparison.
High Yield Bonds (Non-IG)	US	● ▼	We have downgraded as credit spreads have not materially widened and offer poor value given the equity and market backdrop.
	Europe	● ▼	We downgrade EU high yield to neutral as there has been no explicit support from the ECB, which is prioritising raising rates and ending asset purchases. The major central banks have accumulated large quantities of assets (mainly government bonds) under quantitative easing programmes – the purchase of such bonds was used to inject money directly into the financial system. Many have ended these schemes and the ECB is following suit.
Commodities	Energy	●	We remain neutral, because although the supply and demand deficit remains, the continuing lockdowns in China are likely to dampen demand.
	Gold	●	We remain positive on gold as it tends to be resilient in an environment of rising rates and geopolitical tension.
	Industrial Metals	●	Although lockdown in China is a headwind to demand, policy stance remains supportive and geopolitical risk brings upside surprise to metals, of which Russia is a large producer.
	Agriculture	●	India is considering restricting wheat exports after severe heat waves damaged crops, exacerbating stretched global supplies and price rises following the war in Ukraine.
Currencies	US $	●	We have retained our positive score due to the US dollar's safe haven status and the increasing divergence in monetary policy between the Fed and the ECB.
	UK £	●	The Bank of England's Monetary Policy Committee delivered a rate hike with surprisingly "hawkish" comments but the hiking cycle may be curtailed if downside risks to growth materialise. Monetary policymakers are often described as hawkish when expressing concerns about limiting inflation.
	EU €	●	Inflation risks in the eurozone have increased due to the rise in energy prices and slowing growth momentum. We have therefore kept our negative score.
	CNH ¥	●	We remain negative, as we expect a slowdown in exports, renewed Covid-19 related lockdowns and interest rate cuts to lead to a depreciation in the renminbi (offshore).
	JAP ¥	●	We have retained our neutral score based on the safe haven status of the currency and its attractive valuation, however we have a preference for the US dollar.
	Swiss F	●	In terms of safe haven currencies, we prefer the US dollar over the Swiss franc as we have more conviction in the Fed's path to normalisation.

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, May 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 look back at markets in May, when global equities remained largely flat and inflation continued to rise.

THE MONTH IN SUMMARY

Global shares ended May largely flat in US dollar terms. Markets continued to be dominated by worries over rising inflation and a potentially faster pace of central bank tightening, as well as the ongoing war in Ukraine. The MSCI Value index outperformed its growth counterpart. In fixed income, US Treasury yields fell (meaning prices rose). Higher oil prices helped commodity markets advance.

THE US

US equities ended May largely flat overall. The Federal Reserve's (Fed) tone grew increasingly hawkish over the month while growth concerns mounted. Chair Jerome Powell stated said that policymakers will "keep pushing" until inflation falls convincingly, while adding that this may require the central bank to move "more aggressively".

The Fed's stance has shifted in response to inflationary pressures, and in spite of signs of slowing growth. The central bank's preferred measure of inflation (PCE) rose again in April, albeit by a more modest 0.2% month on month, versus the previous 0.9% increase. Industrial activity as measured by the purchasing managers' index (PMI) fell from 56 to 53.8 in May, while GDP was confirmed to have contracted in Q1. Consumer confidence also maintained its downward trend. (The PMI indices are based on survey data from companies in the manufacturing and services sectors. A reading above 50 signals expansion).

The S&P 500 was flat over the month. The energy sector was lifted by strong performance from oil & gas constituents. Utilities and financials also made gains. Consumer-linked sectors – both discretionary and staples - were weaker, with major food and household product retailers declining on concerns over inflation's effect on households.

EUROZONE

Eurozone shares registered a modestly positive return in May. The energy sector was among the strongest performers amid ongoing robust demand for oil. The financials sector also saw gains, with banks particularly strong. Certain defensive sectors, including consumer staples and real estate, were among the main laggards. Information technology stocks also underperformed.

Euro area annual inflation is expected to be 8.1% in May 2022, up from 7.4% in April according to a flash estimate from Eurostat. This added to pressure on the European Central Bank to raise interest rates, potentially starting from the meeting on 21 July. The flash eurozone composite PMI for May came in at 54.9, indicating positive growth albeit down from April's 55.8 reading.

As the war in Ukraine continued, EU leaders agreed a partial embargo of Russian oil imports which is due to take effect by the end of this year. Russia's Gazprom said it would halt gas supplies to Shell in Germany after the UK-based oil firm refused to use the Kremlin's rouble payment mechanism.

UK

Large cap equities outperformed over the month led by the energy, financials and basic materials sectors, in line with the trend seen since the beginning of 2022. Small and mid cap equities continued to underperform.

It was confirmed that annual UK inflation based on the consumer price index measure surged to a 40-year high in April, reaching 9% compared to 7% year-on-year in March. The latest jump was primarily due to the rise in the government's energy price cap, which had previously sheltered households from rising wholesale energy prices.

Meanwhile, it was revealed that an easing of coronavirus restrictions resulted in the UK economy growing 0.8% over the first quarter. But this respectable outturn masked a deterioration in the monthly profile for March. After a 0.7% expansion in January, GDP was unchanged in February before going on to contract by 0.1% in March. This was contrary to expectations for economic growth to be steady for the month and raising fears of a recession later in the year. In a bid to tackle a cost of living crisis, chancellor Rishi Sunak unveiled an additional package to help households facing an expected further rise in energy bills this autumn.

The Bank of England (BoE) raised UK base interest rates – the so-called "Bank Rate" – from 0.75% to 1% at the start of May. It simultaneously published its latest forecast for the Bank Rate, which it expected at the beginning of May to be around one percentage point higher over the next three years.

JAPAN

After initial weakness, the Japanese stock market rose in May to record a total return of 0.8%. The yen briefly reversed some of its recent weakness against the US dollar before losing ground again to end May close to the previous 130 level.

As the human tragedy in Ukraine ground on through another month, equity markets were focused primarily on the US inflation outlook and its impact on interest rates. Japan's equity market largely reflected movements in the US, although domestic sentiment was helped by the corporate results season for the fiscal year that ended in March. Given the current macro background and global uncertainty, it was not surprising to see some companies making overly conservative forecasts for the coming year, but the overall tone of results and guidance was still slightly better than expected.

The debate continues to grow around the likely path for Japanese inflation. Numbers released in May showed core CPI (excluding only fresh food) jumped to 2.1% as the significant reduction in mobile phone charges finally dropped out of the year-on-year numbers.

Some clarity was provided on policy emphasis under Prime Minister Kishida's "New Capitalism". There had been some concerns that Mr Kishida himself might put more emphasis on income redistribution. However, the basic outlines of policy released at the end of May have shifted the focus more clearly to economic growth, which was broadly welcomed by the equity market.

ASIA (EX JAPAN)

Asia ex Japan equities were almost unchanged in May, with modest gains in China and Taiwan helping to offset declines in India and Indonesia. India was the worst-performing index market driven lower amid selling by foreign investors. Financial services and information technology stocks bore the brunt of the selling pressure from foreign investors. Share prices were also weaker in Indonesia, Malaysia and Singapore in May.

Taiwan was the strongest-performing market in the MSCI Asia ex Japan index in May, despite periods of volatility in the month, as investor sentiment towards the country turned increasingly positive. Chinese shares also achieved a positive return in May as authorities in Shanghai, the country's commercial hub, announced plans to ease Covid-19 lockdown restrictions. City officials also unveiled plans to boost the economy, supporting hopes for improved growth and demand from the world's second-largest economy. Hong Kong shares also ended the month in positive territory amid a volatile trading month as lockdowns in China hit corporate earnings. Share prices in South Korea and Thailand were also modestly higher in May.

EMERGING MARKETS

Emerging market equities posted a modest gain in May, with US dollar weakness beneficial. Concerns over the impact of more aggressive Fed policy tightening and Covid lockdowns in China eased as the month progressed.

Latin American markets generated robust gains, led higher by Chile which was the best-performing index market. In Chile, the publication of the draft new constitution boosted sentiment, removing some uncertainty, and opinion polls suggest that it will be rejected by a requisite referendum.

China recorded a positive return as lockdown measures in Shanghai began to be lifted, and the government stepped up stimulus. Taiwan, driven by a rally in IT names, South Korea, Thailand and the Philippines also outperformed. By contrast, Hungary posted a negative return and was the weakest index market as Prime Minister Orban announced windfall taxes on banks and other large private companies.

Despite a rise in spot prices, net crude oil exporting emerging markets lagged, with the UAE, Saudi Arabia, Qatar and Kuwait all finishing in negative territory. The EU agreed a embargo on Russian oil, albeit with some exceptions, with implementation expected to cover 90% of imports by year end. However, pressure on OPEC to raise production increased. India also underperformed as the central bank unexpectedly hiked its policy rate by 40bps to 4.4%, in response to accelerating inflation which hit 7.8% in April.

GLOBAL BONDS

Bond markets diverged over the month. US fixed income markets found support following the fierce rise in yields over recent months. Treasury yields were fairly choppy but ultimately rangebound. Federal Reserve (Fed) rhetoric remained hawkish, but against this risk sentiment soured, benefiting safer assets.

Yields in Europe and the UK rose further, with concerns over inflation and interest rate rises remaining to the fore. The US 10-year Treasury yield fell from 2.94% to 2.85% and the 2-year from 2.73% to 2.56%. There were pockets of weakness in recent activity data, with a notable fall in housing market indicators relative to expectations.

In Europe, the German 10-year yield rose from 0.94% to 1.13%. European Central Bank President Christine Lagarde again indicated readiness to begin raising interest rates in July. The eurozone consumer price inflation (CPI) index preliminary reading for May was a record 8.1% annualised.

The UK 10-year yield rose from 1.91% to 2.10% though the 2-year yield was down from 1.61% to 1.58%. The UK CPI saw a year-on-year rise of 9% in April, a 40-year high.

Corporate bond markets diverged too. US investment grade (IG) saw a positive total return, ahead of Treasuries, while European IG declined and underperformed government bonds. High yield underperformed government bonds as spreads widened. The US saw a small positive total return but Europe declined. (Investment grade bonds are the highest quality bonds as determined by a credit rating agency; high yield bonds are more speculative, with a credit rating below investment grade).

Emerging market (EM) bond performance was likewise mixed. Local currency denominated bonds performed well as EM currencies rallied, particularly Latin American commodity exporters, with the US dollar broadly weaker.

Among hard currency sovereign bonds, investment grade saw positive returns while high yield fell. EM corporate credit declined.

Although global equities finished the month of May with a slight gain, convertible bonds could not benefit and ended the month with a loss. The Refinitiv Global Focus convertible bond index shed -4.1% in US dollar terms. New issuance of convertible bonds remains lacklustre with a volume of close to US$12 billion since the start of the year. This compares to a volume of more than US$76 billion for the same period last year.

COMMODITIES

The S&P GSCI Index achieved a positive return in May as higher energy prices offset weaker prices for industrial metals and precious metals. Energy was the best performing component of the index during May amid rising demand and supply constraints due to the ongoing conflict in Ukraine.

Within the agriculture component, higher prices for wheat and Kansas wheat offset a decline in the price of corn during May. Sugar and coffee prices rose in the month, while the price of cocoa slipped. In industrial metals, prices for nickel and aluminium were sharply down in the month, while price declines for zinc, lead and copper were less pronounced. In precious metals, gold and silver prices were both lower in May compared to a month earlier.

TOTAL RETURNS (NET) % – TO END MAY 2022

	1 MONTH			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	0.1	-1.4	-0.3	-4.8	8.6	7.4
MSCI World Value	2.1	0.5	1.7	1.0	15.3	13.9
MSCI World Growth	-2.3	-3.7	-2.6	-11.4	1.1	-0.1
MSCI World Smaller Companies	-0.2	-1.7	-0.6	-13.1	-0.9	-2.0
MSCI Emerging Markets	0.4	-1.1	0.1	-19.8	-8.5	-9.6
MSCI AC Asia ex Japan	0.5	-1.1	0.1	-21.6	-10.5	-11.6
S&P500	0.2	-1.3	-0.2	-0.3	13.8	12.5
MSCI EMU	2.1	0.6	1.7	-16.0	-4.1	-5.2
FTSE Europe ex UK	0.6	-1.0	0.2	-12.6	-0.3	-1.5
FTSE All-Share	1.1	-0.5	0.7	-4.0	9.6	8.3
TOPIX*	1.5	-0.0	1.1	-13.4	-1.2	-2.3

	1 MONTH			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	0.2	-1.3	-0.1	-7.1	6.0	4.8
JPM GBI UK All Mats	-2.6	-4.1	-3.0	-21.7	-10.7	-11.7
JPM GBI Japan All Mats**	0.5	-1.0	0.2	-16.7	-5.0	-6.1
JPM GBI Germany All Traded	-0.1	-1.6	-0.5	-20.1	-8.8	-9.8
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	0.4	-1.1	0.0	-13.4	-1.1	-2.3
BofA ML US Corporate Master	0.5	-0.1	0.2	-10.3	2.4	1.2
BofA ML EMU Corporate ex T1 (5-10Y)	-0.3	-1.8	-0.7	-23.1	-12.3	-13.3
BofA ML £ Non-Gilts	-1.0	-2.5	-1.4	-20.0	-8.7	-9.8
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	-0.0	-1.6	-0.4	-11.0	1.6	0.4
BofA ML Euro High Yield	1.5	0.0	1.2	-12.4	0.0	-1.2

Source: Thomson Reuters DataStream.
Local currency returns in May 2022: *0.8%, **-0.2%.
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Source: Schroders, May 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.

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