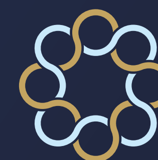


FINURA

YOUR MARKET COMMENTARY JUNE 2022

Pension
TRANSFER
Gold Standard

INFOGRAPHIC: THE GLOBAL ECONOMY

Could interest rate rises give way to cuts in 2023?

We expect the Federal Reserve (Fed) in the US to continue to tighten policy aggressively and further increase the federal funds rate target range

Higher rates dampen economic activity and it may not be long before the Fed has to reverse course as the economy slows

Source: [Schroders as at June 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	● Negative	We maintain our negative view on equities. Uncertainty around earnings is still not adequately reflected in valuations while discount rates are at best stable given the uncertainties around interest rates. Interest rates are a key component of discount rates, which are used to discount a company's future expected earnings and cashflows in order to compute its theoretical value in today's money, or "present value". Present values are considered when valuing a company's shares.
	Government Bonds	● Neutral	We remain neutral as we think the US 10-year government bond is fairly priced based on our model, but real yields (nominal yields minus inflation) look too low. With inflation continuing to accelerate while growth expectations are falling, we require higher yield levels to compensate us for the potential volatility.
	Commodities	● Neutral ▼	We downgrade our score for commodities to neutral as we are starting to see signs of demand falling, particularly in the energy sector, as global growth weakens.
	Credit	● Neutral	Our indicators increasingly suggest we are at the late stage of the economic cycle. They signal that a slowdown in economic activity may be coming ahead. Median credit spreads are usually higher and their ranges wider at such a "late cycle" stage, however valuations have improved, leading us to give credit a neutral score overall.
Equities	US	● Negative	The US continues to be the most vulnerable region to further a de-rating in valuations driven by slowing earnings growth.
	UK	● Neutral	The defensive and commodity tilts of the FTSE index continues to help the region on a relative basis.
	Europe	● Negative	Earnings momentum has turned positive in Europe. However, the recently adopted "hawkish" stance by the European Central Bank (ECB) will be a challenge for equity returns. Monetary policymakers are often described as hawkish when expressing concerns about limiting inflation.
	Japan	● Neutral	Japan is one of the few regions where inflation is welcomed. This should lead to some relative outperformance against other parts of the developed world.
	Global Emerging Markets[1]	● Neutral	While the headwinds facing China seem to be moderating, other emerging market (EM) countries face mounting inflationary pressure and we retain a neutral score overall.
	Asia ex-Japan & China	● Positive/Neutral ▲	We upgrade to positive with China finally looking to be turning a corner on lockdowns. This should ease some of the supply bottleneck issues in the country.
	EM Asia ex China	● Negative	We believe that other regions in the EM universe appear more attractive, notably commodity exporters in Latin America. Inflation is becoming a problem for the EM Asia ex China region.
Government Bonds	US	● Neutral	We maintain our neutral view. Although the sharp move higher in yields this year does now offer a better entry point as growth expectations fall, we need to see inflationary pressures abate before turning positive.
	UK	● Negative ▼	We have downgraded our score to negative as recently announced fiscal subsidies for households could push the Bank of England (BoE) to hike interest rates further.
	Germany	● Negative ▼	We have downgraded as the ECB has signalled a significant change in policy, confirming our expectation of rising rates in Europe. With inflation risks on the upside, further rate increases are expected.
	Japan	● Negative	The market continues to offer negative yields as the Bank of Japan (BoJ) maintains its policy of targeting yield levels. Under this policy the central bank is purchasing Japanese government bonds in order to hold their yields in check.
	US Inflation Linked	● Negative	We remain negative as although uncertainty from the Russia/Ukraine crisis appears to have peaked, the Federal Reserve's (Fed) top priority now is to contain inflation.
	Emerging Markets Local	● Negative	Our view is unchanged as the economic environment remains challenging, with "stagflationary" as well as recessionary risks mounting. Stagflation is a combination of slowing growth and accelerating inflation.

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

	Category	View	Comments
Investment Grade Credit	US	🟡 ▼	We have downgraded US IG, with the consumer sector under mounting inflationary pressure and recession risks rising.
	Europe	🟢	We retain our positive score in European IG as the ECB is being less proactive compared to other central banks and valuations are relatively attractive.
	Emerging Markets USD	🟡	Credit spreads do not compensate for ongoing fundamental weakness leaving valuations looking unattractive in comparison to other regions.
High Yield Bonds (Non-IG)	US	🔴	Our negative view is unchanged given the high exposure to the consumer sector. A greater number of issuers could struggle to cover interest and maturities as fundamentals deteriorate further. Maturity refers to the time when the bond issuer must repay the original bond value to the holder of the bond.
	Europe	🟡	We keep our neutral score as credit spreads are relatively attractive but there has been no explicit support from the ECB, which is prioritising raising rates and ending asset purchases.
Commodities	Energy	🟡	While supply side issues appear to be priced in, we are starting to see signs of demand destruction as high levels of inflation are subduing global growth. Meanwhile, Russian oil production has yet to fall as reduced European demand is being offset by sales to Asia.
	Gold	🟢	Gold tends to perform well after the Fed has started to raise rates and recession fears loom large. However, there is also a risk that recession worries cause a liquidity squeeze potentially creating issues around the short-term availability of money which could be negative for gold. A liquidity squeeze occurs when funds rapidly become in short supply.
	Industrial Metals	🟢	We remain constructive as we expect rising internal Chinese demand as lockdowns ease to offset decelerating developed market demand.
	Agriculture	🟢	We are positive as input cost inflation remains a key driver. Food security concerns are forcing governments of producing countries to control exports, keeping prices elevated.
Currencies	US $	🟢	We keep our positive score. Global growth prospects continue to weaken, and the recent rise in US consumer prices index (CPI) pushed the Fed to a more hawkish stance. These are supporting the US dollar with its "safe haven" currency status.
	UK £	🟡	The BoE'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.
	EU €	🔴	The ECB is facing a dilemma of having hawkish forward guidance on rates but lacking concrete measures on managing credit spread levels, which the market may well test to determine where the ECB will step in.
	CNH ¥	🔴	We remain negative as we expect the depreciation in the renminbi (offshore) to continue. This will help to cushion the impact of reduced demand for Chinese exports resulting from high energy prices that are weakening US consumer confidence and retail sales.
	JAP ¥	🔴 ▼	We downgrade the Japanese yen as the global rise in bond yields in other markets continues to weigh on the currency.
	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. Normalisation of rates is the process of increasing them from the emergency settings introduced in response to Covid-19, when they were cut close to zero to support economic activity.

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, June 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 Q2 when shares suffered steep declines and bonds also came under pressure.

THE QUARTER IN SUMMARY

Both shares and bonds were under pressure in the second quarter as investors moved to price in further interest rate rises and an increased risk of recession. Inflation continued to move higher in many major economies during the quarter. Among equities, the MSCI Value index outperformed its growth counterpart but both saw sharp falls. Chinese shares proved a bright spot as prolonged lockdowns were lifted in some major cities.

THE US

US equities fell in Q2. Investor focus was trained on inflation and the policy response from the Federal Reserve (Fed) for much of the period.

The Fed enacted its initial rate hikes during the quarter and signalled that there would be more to come. Even so, the central bank admitted the task of bringing inflation down without triggering a recession would be challenging.

The US economy looks robust, but signs of a slowdown are emerging. The 'flash' US composite purchasing managers' index (PMI) eased from 53.6 to 51.2 in June. The services component eased from 53.4 to 51.6, but the manufacturing output deteriorated from 55.2 to a two-year low of 49.6. Only twice has this fallen by more than 5.6 points; during the pandemic in 2020 and the financial crisis in 2008. (The PMI indices, produced by IHS Markit, are based on survey data from companies in the manufacturing and services sectors.) PCE inflation, the Fed's preferred price gauge, was unchanged at 6.3% y/y in May.

Declines affected all sectors although consumer staples and utilities were comparatively resilient. There were dramatic declines for some stocks, most notably in the in the media & entertainment and auto sectors.

EUROZONE

The second quarter saw further steep declines for eurozone shares as the war in Ukraine continued and concerns mounted over potential gas shortages. Higher inflation is also denting consumer confidence, with the European Central Bank (ECB) poised to raise interest rates in July.

Top performing sectors included energy and communication services while information technology and real estate experienced sharp falls.

Continued disruption to gas supplies due to the war in Ukraine saw Germany move to phase two of its emergency energy plan. The next phase would involve rationing gas to industrial users, and potentially households as well. A flash estimate from Eurostat signalled inflation at 8.6% in June, up from 8.1% in May, with energy the biggest contributor to the rise.

Ongoing elevated inflation means the ECB is poised to lift interest rates at its meeting on 21 July, with a further rise likely in September. Concerns over the higher cost of living and possibility of recession saw the European Commission's consumer confidence reading fall to -23.6 in June, the lowest level since the early stages of the pandemic in April 2020.

UK

UK equities fell over the quarter. Economically sensitive areas of the market performed poorly towards the end of the period amid rising recessionary risks. Large cap companies held up relatively well as traditionally defensive areas of the market outperformed, including the telecoms, healthcare and consumer staples sectors.

In contrast, UK small and mid caps (SMIDs) were negatively impacted by a relatively high weighting to UK consumer focused companies. Here, fears around the impact of high inflation and cost of living crisis on future earnings weighed heavily on stock valuations.

Consumer discretionary sectors, such as retailers and housebuilders, performed particularly poorly, in line with the trend seen across many other developed markets grappling with high levels of consumer price inflation (CPI). In tandem with this, many UK SMIDs suffered severe valuation declines as per the trend for growth companies in general to have suffered against the backdrop of rising interest rates.

UK chancellor Rishi Sunak unveiled additional measures to help households facing higher energy bills this autumn. These are expected to offset some of the impact of higher energy prices later this year, particularly for the hardest hit UK households.

The Bank of England increased its official rate by a combined 50 basis points (bps) with a further two consecutive 25 bps hikes to take the so-called "Bank Rate" – to 1.25%. The Bank continued to warn of higher inflation, and in June raised its estimate for the peak CPI from 10% to 11% for October.

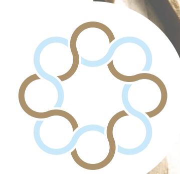
JAPAN

The Japanese stock market ended the quarter lower. The yen weakened sharply against the US dollar, breaching the 130 level for the first time in 20 years.

Japan's equity market in the quarter was primarily driven by news flow on monetary policy and currency markets, together with concerns over the growing possibility of a US recession. Comments from the Fed ahead of April's interest rate increase pointed to a widening interest rate differential with Japan materialising earlier than expected. This view was reinforced by the Bank of Japan's own policy meeting on 18 April, confirming no change in policy.

The yen's weakness coincided with a reversal of several other factors, especially mobile telecom charges. This became evident in the inflation numbers released in May, which 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.

Corporate results announcements began in late April for the fiscal year ended in March. The bulk of companies reported in May, after the Golden Week holiday period. Given the current macro background and global uncertainty, there were fewer positive surprises than recent quarters, and some companies made overly conservative forecasts for the coming year. Overall, however, the tone of results and guidance was still slightly better than expected.



ASIA (EX JAPAN)

Asia ex Japan equities registered a negative return in the second quarter. Investor sentiment turned increasingly downbeat amid concerns that rising global inflation and ongoing supply chain problems, accentuated by the war in Ukraine, could tip the world into recession.

South Korea was the worst-performing market in the MSCI Asia ex Japan index in the quarter, with financials, technology and energy stocks particularly badly hit amid fears of a global recession.

Stocks in Taiwan were also significantly lower on fears that rising inflation and global supply chain problems would weaken demand for its technology products. Indian stocks also declined over the quarter as global volatility, rising inflation and soaring energy prices weakened investor sentiment towards the market.

Share prices in the Philippines, Singapore and Malaysia all recorded sharp declines in the quarter, mirroring the share price falls seen in global markets, while declines in Indonesia and Thailand were less severe.

China was the only index market to end the quarter in positive territory, as Covid-19 lockdown measures started to be relaxed. Investor sentiment towards the country was also boosted after government data showed that factory activity in China grew in June.

EMERGING MARKETS

Emerging market equities experienced a fall in Q2, with US dollar strength a key headwind. This was despite outperforming developed market peers by a wide margin.

The Latin American markets of Colombia, Peru and Brazil were among the weakest markets in the MSCI Emerging Markets Index. A combination of rising concern over a global recession, domestic policy uncertainty, and later in the quarter weaker industrial metals prices, contributed to declines in equities and currencies.

The emerging European markets of Poland and Hungary both underperformed by a wide margin, as geopolitical risks stemming from Russia's invasion of neighbouring Ukraine persisted. The central banks in both countries increased the pace of policy tightening, while in Hungary the government announced windfall taxes on banks and other large private companies.

South Korea and Taiwan lagged as the outlook for global trade deteriorated. Conversely, China was the only emerging market to generate a positive return over the quarter. Lockdown measures in certain cities were eased and macroeconomic indicators began to pick up.

Meanwhile, additional economic support measures were announced. The authorities also outlined a significant reduction in quarantine for close contacts and visitors to China, which should help to ease supply issues even if the zero-Covid policy seems set to remain in place.

GLOBAL BONDS

Bonds continued to sell off sharply, with yields markedly higher amid still elevated inflation data, hawkish central banks and rising interest rates. Bonds rallied into quarter-end amid rising growth concerns, slightly curtailing the negative returns.

Data throughout the quarter showed inflation rates in major economies continuing to run at multi-decade highs, with various central banks raising interest rates and others signalling their intention to do so soon.

The quarter also saw mounting concerns over growth prospects, and even potentially recession later this year. Towards the end of the period economic indicators began to reflect moderating or slowing activity.

The US consumer price index increased by 8.6% year-on-year to May, accelerating unexpectedly, and showed price rises broadening across sectors. The Fed implemented a series of hikes, raising the policy rate by 75 basis points (bps) in June for the first time since 1994. At the same time, Fed officials cut 2022 growth forecasts. The US 10-year bond yield rose from 2.35% to 2.97% and the two-year yield from 2.33% to 2.93%.

European yields were volatile as the central bank indicated it would end asset purchases early in Q3 and raise rates soon after. This sparked a pronounced sell-off in Italian yields in June. The EECB sought to calm concerns, calling an extraordinary meeting to discuss an "anti-fragmentation" programme likely entailing some form of support for heavily indebted nations.

The German 10-year yield increased from 0.55% to 1.37% with Italy's up from 2.04% to 3.39%, hitting as high as 4.27% in June.

In the UK, the Bank of England (BoE) implemented further rate hikes, bringing the total to five in the current cycle, raising its inflation forecast to 11%. The UK 10-year yield increased from 1.61% to 2.24% and two-year rose from 1.36% to 1.88%.

Corporate bonds suffered in the broad bond market sell-off, underperforming government bonds as spreads widened markedly. With mounting concerns over the economic outlook, high yield credit was particularly hard hit. (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).

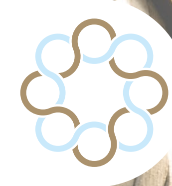
Emerging market (EM) bonds suffered significant declines. EM currencies weakened as the US dollar performed well, benefiting from broad risk aversion.

The Refinitiv Global Focus convertible bond index shed -12.2% in US dollar terms. That meant convertible bonds protected investors from some of the equity market losses. New issuance of convertible bonds remains lacklustre. There was just US$5 billion of new convertibles coming to the market in the second quarter.

COMMODITIES

The S&P GSCI Index achieved a positive return in Q2 as higher energy prices offset sharp price falls in the other components of the index. Energy was the best performing component amid rising demand and supply constraints due to the ongoing conflict in Ukraine.

Industrial metals was the worst performing component, with sharp falls in the price of aluminium, nickel and zinc. Copper and lead prices were also significantly lower in the quarter. Within the agriculture component, prices for wheat, corn and cotton were all lower. In precious metals, the price of silver was significantly lower in the quarter, while the decline in the price of gold was less pronounced.



TOTAL RETURNS (NET) % – TO END JUNE 2022

	3 MONTHS			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	-16.2	-10.8	-9.1	-14.3	-2.8	-2.6
MSCI World Value	-11.6	-5.9	-4.1	-6.6	5.9	6.2
MSCI World Growth	-21.2	-16.1	-14.6	-22.4	-11.9	-11.7
MSCI World Smaller Companies	-17.2	-11.9	-10.2	-22.0	-11.5	-11.2
MSCI Emerging Markets	-11.5	-5.8	-4.0	-25.3	-15.2	-15.0
MSCI AC Asia ex Japan	-9.0	-3.2	-1.3	-25.0	-15.0	-14.7
S&P500	-16.1	-10.7	-9.0	-10.6	1.4	1.7
MSCI EMU	-15.9	-10.5	-8.8	-24.0	-13.8	-13.6
FTSE Europe ex UK	-15.7	-10.3	-8.6	-21.0	-10.3	-10.1
FTSE All-Share	-12.4	-6.8	-5.0	-10.6	1.4	1.6
TOPIX*	-13.9	-8.4	-6.7	-19.5	-8.6	-8.4

	3 MONTHS			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	-3.9	2.3	4.2	-8.7	3.5	3.8
JPM GBI UK All Mats	-14.9	-9.4	-7.7	-24.5	-14.3	-14.1
JPM GBI Japan All Mats**	-12.0	-6.3	-4.6	-20.9	-10.2	-10.0
JPM GBI Germany All Traded	-12.0	-6.3	-4.6	-21.4	-10.8	-10.5
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	-8.5	-2.7	-0.8	-16.5	-5.2	-5.0
BofA ML US Corporate Master	-6.7	-0.7	1.1	-13.8	-2.3	-2.0
BofA ML EMU Corporate ex T1 (5-10Y)	-15.2	-9.8	-8.1	-26.6	-16.7	-16.5
BofA ML £ Non-Gilts	-13.9	-8.4	-6.7	-23.4	-13.1	-12.9
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	-11.4	-5.7	-3.9	-17.6	-6.6	-6.3
BofA ML Euro High Yield	-6.0	0.0	1.9	-11.8	0.0	0.3

Source: Thomson Reuters DataStream.
Local currency returns in Q2 2022: *-3.7%, **-1.5%.
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Source: Schroders, June 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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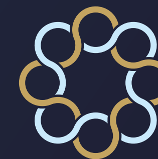

FINURA

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

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