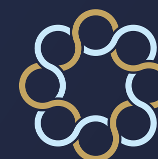


FINURA

YOUR MARKET COMMENTARY
AUGUST 2022

Pension
TRANSFER
Gold Standard

INFOGRAPHIC: THE GLOBAL ECONOMY

Companies are increasingly worried about recession...

...we know this because they were talking a lot more about one in the second quarter

Q1 Q2

?!

Indeed, the last time that US business was discussing this topic so much...

..was during the Covid pandemic, when much of the world was actually in a recession already

Read article

Source: Schroders Economics Group, Schroders Data Insights Unit (DIU), Sentieo, as at July 2022.

Europe puts end to negative interest rates

From **-0.5%** European Central Bank's **main policy interest rate** prior to July's increase

to **0.0%** where the **'deposit facility rate'** stood following decision to increase rates for first time in 11 years

Bank first introduced negative rates in JUN 2014

Despite signalling a 0.25% rise, the **ECB opted for a more aggressive** 0.50% hike

A large rise was warranted...

...as inflation trends have become more concerning

Read article

Source: Schroders Economics Group, European Central Bank, as at July 2022.

How fast will UK inflation fall back?

> 13%^
Bank of England's forecast for UK inflation in Q4 2022

The Bank expects inflation to eventually fall back after the country enters a recession...

...but Schroders does not believe it will fall back as much as the Bank is forecasting

Our economists see greater inflationary pressures building, requiring even higher interest rates

Note: ^Bank of England forecast based on the Consumer Prices Index (CPI), as used to track the price changes facing end consumers of goods and services. Source: Schroders Economics Group, as at August 2022.

Source: [Schroders as at August 2022.]

MULTI-ASSET INVESTMENT VIEWS

KEY

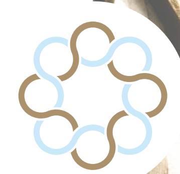
▲ Up from last month ▼ Down from last month

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

	Category	View	Comments
Main Asset Classes	Equities	Negative	A humbling month for our negative view on equities. Although company profits are weaker, headline earnings have been resilient overall.
Main Asset Classes	Government Bonds	Negative ▼	We have reverted to a negative view. The market appears to be underestimating the lingering effects of inflation and valuations at current levels are difficult to justify.
Main Asset Classes	Commodities	Neutral	Having been positive on commodities for the first half of 2022, we maintain a more balanced view today with supply constraints offset by weaker demand.
Main Asset Classes	Credit	Neutral	Given stagflationary concerns, our outlook remains cautious, with a preference for the US over European credit. Valuations are now fair, so the focus is on growth from here.
Equities	US	Neutral ▲	The US was previously our preferred market to be underweight. However, we have upgraded this view to neutral as fears of recession have traditionally been more supportive for US shares compared to other regions, due to the greater proportion of higher quality companies in the index.
Equities	UK	Negative ▼	Weaker demand is becoming an issue for energy companies in the index.
Equities	Europe	Negative ▼	The European Central Bank (ECB) recently raised interest rates for the first time in a decade to combat rampant inflation. We believe this will impact share prices, particularly if the focus turns to winter energy supplies.
Equities	Japan	Negative ▼	We have downgraded our view as recession fears are building, and Japanese equities could be weaker due to the cyclical nature of the index and the recent rebound in the yen.
Equities	Global Emerging Markets[1]	Negative ▼	We downgraded our view to negative as emerging market shares do not traditionally perform well during recessions.
Equities	Asia ex-Japan & China	Negative ▼	China was previously our preferred region but disappointing stimulus initiatives by the country's government and valuations no longer looking cheap has led us to downgrade the region.
Equities	EM Asia ex China	Negative	We retain our negative view due to rising geopolitical tensions in the region, particularly in Taiwan.
Government Bonds	US	Negative ▼	We downgraded to negative as duration (which measures how much bond prices are likely to change if interest rates rise) has become expensive and is no longer useful for diversifying equities. Our negative view is focused on the short to medium areas of the yield curve (the relationship between the time to maturity and the interest rate).
Government Bonds	UK	Negative	We remain negative as with inflation still rising there is scope for the Bank of England (BoE) to raise interest rates higher.
Government Bonds	Germany	Negative	We remain negative on German bunds, given that the European Central Bank (ECB) has been slow to raise interest rates despite rising inflation.
Government Bonds	Japan	Negative	Our view is unchanged as returns to investors are still unattractive compared to other markets. Slowing global growth also remains a risk.
Government Bonds	US Inflation Linked	Positive/Neutral ▲	We have upgraded as we believe that the market has not fully priced in inflation expectations and is overconfident that the Federal Reserve (the US central bank) will bring inflation back down to 2%.
Government Bonds	Emerging Markets Local	Negative	Our view is negative with stagflationary as well as recessionary risks growing, leaving emerging market bonds vulnerable.

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

	Category	View	Comments
Investment Grade Credit	US	● (green) ▲	With valuations at fair value, we have upgraded our view as US growth remains firm and US investment grade returns have stabilised.
	Europe	● (red) ▼	We have downgraded our view as the region is expected to experience a relatively aggressive slowdown.
	Emerging Markets USD	● (green)	We remain positive as emerging market fundamentals are looking strong, and the region has priced in European risks.
High Yield Bonds (Non-IG)	US	● (green) ▲	We have upgraded our view as spreads (the difference in yields between bonds of similar maturity but with different credit quality) have started to stabilise and sentiment has improved, with high yield outperforming investment grade.
	Europe	● (red) ▼	The outlook for growth in Europe is less favourable than the US. Uncertainties over gas supplies to Europe next winter mean that the risks are more significant.
Commodities	Energy	● (yellow)	We remain neutral as energy is the sector most vulnerable to supply problems, with natural gas supplies stretched, particularly in Europe. Although the slowdown phase is historically negative for demand, current supply issues are proving supportive.
	Gold	● (yellow)	Gold tends to perform well when fears of recession are looming, and despite the market slump in July, gold prices appear to have recovered.
	Industrial Metals	● (yellow)	Ex-China demand remains uncertain, production remains muted, and inventories are low, which could cushion the risks.
	Agriculture	● (yellow) ▼	We have downgraded to neutral as input costs have started to decline and we believe we might have finally reached a peak in fertilizer and food prices.
Currencies	US $	● (green)	We continue to favour the US dollar as we believe it is too early to expect the Fed to change its current aggressive rate hiking stance. Against a backdrop of weakening global growth and falling equity prices, the US dollar remains a safe haven currency.
	UK £	● (red) ▼	The turn in the cycle and the worsening stagflationary environment, coupled with political instability have weighed on the currency. The pound appears to have priced these factors in appropriately, leaving us neutral.
	EU €	● (yellow) ▲	While the outlook for growth is not positive, we believe that current extreme levels of negative sentiment mean there is a possibility of a tactical rebound in the currency. We therefore move our view back to neutral.
	CNH ¥	● (red)	We remain negative. The depreciation in the renminbi (offshore) is likely to continue, which should cushion the impact of reduced demand for Chinese exports.
	JAP ¥	● (red) ▼	We have taken a negative view on the Japanese yen for now as the policy of the Bank of Japan (BoJ) remains unchanged. However, some positive opportunities may arise in the fourth quarter following the appointment of two new BoJ members in July who favour higher interest rates.
	Swiss F	● (yellow)	We remain cautious on the Swiss franc after the Swiss National Bank unexpectedly increased rates.



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, August 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 August, when developed market shares fell as central banks reaffirmed their focus on inflation.

THE MONTH IN SUMMARY

Developed market equities resumed their declines in August as it became clear that further substantial interest rate rises may be needed to tame inflation. Emerging market shares posted a modest gain. Bond yields rose, meaning prices fell, with the UK underperforming other major markets.

THE US

US equities declined in August after Federal Reserve (Fed) chair Jerome Powell said the US central bank would need to keep monetary policy tight "for some time" in a bid to tackle soaring inflation. This dashed market hopes that further interest rate rises would be more modest and led to sharp falls in share prices and volatile trading throughout the month.

US Congress passed the Inflation Reduction Act which aims to reduce inflation by curbing the deficit, as well as investing in domestic sources of clean energy. US inflation, as measured by the consumer price index (CPI), increased by 8.5% year-on-year in July, down from 9.1% in June. The US jobs market remains strong with non-farm payrolls growing by a larger-than-expected 528,000 in July.

By sector, information technology, healthcare and real estate experienced some of the sharpest declines. Energy stocks achieved a robust performance amid ongoing strong demand and a curtailment of supplies following Russia's invasion of Ukraine.

Semiconductor stocks were particularly weak in August amid rising inventories of some types of chips, as well as some ongoing supply-chain issues. Consumer durables stocks also saw significant declines in the month as rising prices prompted consumers to cut back on household items.

EUROZONE

Eurozone shares fell in August amid ongoing worries over inflation, particularly in the form of high gas and electricity prices. In the MSCI EMU index, energy was the only sector to post a positive return, while underperforming sectors included real estate, healthcare and information technology. Some pharmaceutical stocks were hit by worries over potential liabilities related to US litigation around heartburn drug Zantac.

The energy crisis across Europe intensified amid worries over supply and high costs. Russia said it would halt the Nord Stream 1 pipeline, which supplies natural gas to Germany, for three days from 31 August (as of early September, the pipeline has not reopened). Meanwhile, several of France's nuclear reactors were offline for longer than expected after maintenance. Further upward pressure on power prices has come from this summer's drought as low water levels on the Rhine have affected the delivery of coal to coal-fired power plants.

Inflation continued to rise in the eurozone with annual consumer price index (CPI) inflation estimated to be up 9.1% in August. Industrial producer prices for June were up 35.8% in the eurozone compared with June 2021. Minutes from the European Central Bank's (ECB) July meeting indicated that policymakers remain concerned about inflation and that a further rise will come at the meeting in September.

UK

UK equities fell over the month. A number of large cap equities held up relatively well led by the energy and banking sectors, in line with the trend seen since the beginning of 2022. Major oil companies are anticipated to benefit from an ongoing inflationary/stagflationary economic environment, while banks are seen as a beneficiary of higher interest rates.

Consumer focused areas underperformed. This is amid fears that rising energy prices and interest rates will severely pressure the consumer, with UK households facing an income squeeze on multiple fronts in coming months. Fears around the outlook for the domestic economy more widely – and the country's fiscal position – were also reflected in a very poor performance in sterling, although in the context of continuing strength in the dollar.

Political uncertainty weighed on sentiment. The resignation of UK prime minister (PM) Boris Johnson has put a block on further major policies being introduced until a new leader of the ruling Conservative Party is elected. As a result, questions remained over how any new PM might support consumers and businesses amid an intensifying energy crisis.

In addition to consumer exposed areas performing poorly, traditionally economically sensitive ones (due to growing fears around recessionary outcome in many developed economies), and those parts of the market offering high future growth potential (due to higher rates) also lagged. These factors combined drove a poor performance from UK small and mid cap equities over the period.

The Office for National Statistics estimated that the UK economy contracted by 0.6% in the month of June, after 0.4% growth in May. A dip was expected given the extra bank holiday to celebrate Her Majesty the Queen's Platinum Jubilee. However, consensus expectations were too pessimistic, forecasting a contraction of -1.3%, which would have been more in-line with past Jubilees.

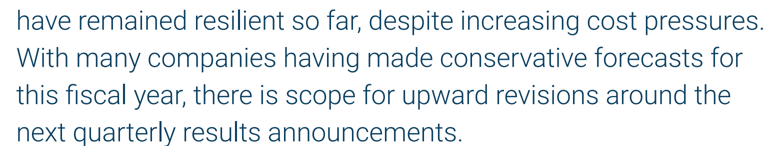
JAPAN

The Japanese stock market rose in the first half of August driven by strong quarterly results and an anticipated peak in US inflation. The yen resumed its weakening trend against the US dollar, after the brief reversal seen in the second half of July.

Investors were generally optimistic over some early signs, or hope, that US inflation may soon be approaching its peak. Conversely, but equally encouraging, are signs that Japanese inflation may be becoming entrenched at a moderate, but sustainable rate, after decades of deflation. Nationwide consumer price data released in August showed core inflation (excluding only fresh food) had edged up again to 2.4% in July.

The first estimate of GDP growth for the second quarter was also released. The quarter-on-quarter annualised rate of 2.2% was slightly lower than consensus expectations but the detailed breakdown was interpreted more positively with some resilience in consumption and capital expenditure.

Aside from macro data, the main influence on individual stocks came from the results announcements for the March to June quarter, which were completed in August. Although profit momentum slowed from the previous quarter, overall results were again ahead of expectations and profit margins appear to



have remained resilient so far, despite increasing cost pressures. With many companies having made conservative forecasts for this fiscal year, there is scope for upward revisions around the next quarterly results announcements.

ASIA (EX JAPAN)

Asia ex Japan equities were weaker in August with declines in Hong Kong and South Korea offsetting gains in India and Indonesia. Hong Kong was the weakest market in the MSCI AC Asia ex Japan index in August amid losses among Chinese carmakers. Vehicle deliveries suffered from supply chain disruptions and weak consumer confidence, undermining the corporate earnings outlook. Shares in South Korea also ended the month in negative territory as concerns over the outlook for interest rates and fears over recessions in many of the major world economies weakened investor sentiment.

Singapore and Thailand both ended the month in negative territory. Shares in China were flat in August on concerns over rising interest rates, as countries around the world battle soaring inflation. The alarming spread of Covid-19 throughout China also weakened sentiment, prompting fears of further lockdowns as the country continues to pursue a policy of zero-Covid.

Investor sentiment was also weakened after new data released during the month showed that factory activity continued to contract in the world's second largest economy following strict Covid-19 lockdowns and a record heatwave during the summer.

Thailand, India and Indonesia all achieved modest gains and ended the month in positive territory. Gains achieved in Malaysia and the Philippines were more muted.

EMERGING MARKETS

Emerging market (EM) equities posted a marginally positive return in August, significantly outperforming developed markets. This was despite weakness towards month-end as global recessionary fears increased, and as the US Federal Reserve (Fed) maintained a hawkish tone.

Turkey was the best performing market in the EM index, delivering double-digit returns. The central bank issued a surprise interest rate cut during the month, despite inflation near 80%. Brazil outperformed as opinion polls narrowed ahead of October's presidential election. Thailand and Chile also finished ahead of the index, as did India which benefited from improved macroeconomic data releases, including an easing in inflationary pressure. Despite weaker oil prices over the month, both Saudi Arabia and Qatar outperformed.

China delivered a small positive return, but slightly underperformed the index. While monetary and fiscal policies announced during the month were supportive, a resurgence in Covid-19 infections prompted further lockdowns, and macroeconomic data continued to point to sluggish domestic demand.

Hungary underperformed as the central bank hiked interest rates again - this time by 100bps to 11.75% - and raised the required reserves ratio from 1% to 5%. Taiwan and Korea both lagged the index with currency weakness weighing on returns against a backdrop of ongoing hawkishness from the Fed and concerns about global growth. Geopolitical tension, as US Speaker Nancy Pelosi visited Taiwan despite protests from Chinese authorities, was a further drag on Taiwan's performance.

The Czech Republic and Poland were the weakest EM markets, negatively impacted by the deteriorating outlook for energy supply. Not only has the European gas crisis escalated but local coal shortages in Poland ahead of winter threaten the country's power production. Coal is the main fuel for Polish power production and the government's ban on Russian imports came into effect in August.

GLOBAL BONDS

Government bond yields rose sharply, meaning prices fell, as inflation remained elevated and central banks reaffirmed a commitment to reining in price increases.

The Federal Reserve (Fed) held its annual conference at Jackson Hole against a backdrop of multi-decade high consumer price inflation (CPI) across major economies. While concerns of an economic downturn are rising, Fed Chair Powell nevertheless stuck to a hawkish message. Powell said the Fed would not "pivot", or shift course from raising rates, though the US may see slower growth for a "sustained period". Data, particularly the labour market, has so far been remarkably resilient, although the housing market continued to deteriorate. The US 10-year Treasury yield rose from 2.64% to 3.13%, with the two-year rising from 2.90% to 3.45%.

The UK gilt market underperformed most other global government bond markets. Inflation hit 10% in July, which was higher than the market expected and raised expectations of a faster pace of rate hikes. Political uncertainty and the much anticipated fiscal response to the energy crisis also weighed on the market. The Bank of England (BoE) raised interest rates by 0.5% to 1.75% at the start of the month.

Like the Fed, the BoE is prioritising the need to curb inflation. Governor Andrew Bailey predicted the UK will fall into a long recession later this year. The UK 10-year yield increased from 1.86% to 2.80% and the two-year from 1.72% to 3%.

In Europe, inflation remained high and members of the central bank's executive board, speaking at Jackson Hole, said policy would need to remain tight for an extended period. Germany's 10-year yield rose from 0.82% to 1.53%.

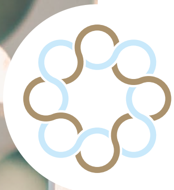
Corporate bonds saw negative returns though US investment grade (IG) and euro high yield outperformed government bonds. (Investment grade bonds are the highest quality bonds as determined by a credit rating agency; high yield bonds are more speculative, with a credit rating below investment grade).

In emerging markets (EM), corporate bonds saw modest positive returns led by high yield. Local currency and hard currency sovereign bonds were generally weaker. EM currencies were mixed versus the US dollar.

Convertible bonds protected well against the equity market headwinds with the Refinitiv Global Focus index shedding just -0.5% in August. The month saw US$7 billion in new convertible bonds coming to the market which translates into a relatively normal month in terms of new issuance. Despite the previous lack of supply since the start of the year, convertible valuations continue to be cheap, reflecting the general 'risk off' mood within the market.

COMMODITIES

The S&P GSCI Index recorded a negative performance in August, driven by weaker energy and precious metal prices. Energy was



the worst-performing component of the index, with sharply lower prices for unleaded gasoline, crude oil and Brent crude offsetting prices gains for natural gas and heating oil. Within the precious metals component, the price of silver was sharply lower, while the decline in the price of gold was more modest. Within the industrial metals component, there were significant price falls for nickel and aluminium, while declines in the price of lead and copper were more muted. Conversely, the price of zinc increased during August.

Agriculture was the only component of the index to achieve a positive result in August, with sharply higher prices for corn, coffee and cotton. The price of wheat, cocoa and sugar also rose in the month.

TOTAL RETURNS (NET) % – TO END AUGUST 2022

	1 MONTH			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	-4.2	-2.8	0.2	-15.1	-0.3	0.4
MSCI World Value	-3.1	-1.7	1.4	-7.4	8.7	9.5
MSCI World Growth	-5.3	-4.0	-0.9	-22.9	-9.5	-8.8
MSCI World Smaller Companies	-3.3	-1.9	1.2	-19.0	-5.0	-4.2
MSCI Emerging Markets	0.4	1.8	5.0	-21.8	-8.2	-7.5
MSCI AC Asia ex Japan	-0.0	1.4	4.6	-21.7	-8.1	-7.4
S&P500	-4.1	-2.7	0.3	-11.2	4.2	5.0
MSCI EMU	-6.3	-5.0	-2.1	-27.9	-15.4	-14.8
FTSE Europe ex UK	-6.5	-5.1	-2.2	-25.2	-12.2	-11.5
FTSE All-Share	-6.0	-4.7	-1.7	-14.6	0.3	1.0
TOPIX*	-2.4	-1.1	2.0	-18.7	-4.6	-3.9

	1 MONTH			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	-2.5	-1.2	1.9	-10.5	5.0	5.8
JPM GBI UK All Mats	-12.0	-10.7	-7.9	-32.6	-20.9	-20.3
JPM GBI Japan All Mats**	-3.8	-2.5	-0.6	-23.2	-9.9	-9.2
JPM GBI Germany All Traded	-6.1	-4.8	-1.8	-25.5	-12.6	-11.9
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	-3.6	-2.3	0.8	-18.0	-3.7	-3.0
BofA ML US Corporate Master	-2.7	-1.3	1.8	-14.5	0.4	1.1
BofA ML EMU Corporate ex T1 (5-10Y)	-7.1	-5.8	-2.8	-29.6	-17.4	-16.8
BofA ML £ Non-Gilts	-10.1	-8.8	-6.0	-29.7	-17.4	-16.8
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	-2.0	-0.6	2.5	-16.1	-1.5	-0.8
BofA ML Euro High Yield	-1.4	0.0	3.1	-14.8	0.0	0.7

Source: Thomson Reuters DataStream.
Local currency returns in August 2022: *1.2%, **-0.2%.
Past performance is not a guide to future performance and may not be repeated.

Source: Schroders, August 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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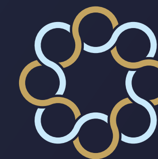

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