FINURA

MARKET REPORT Q1 2018

QUARTERLY MARKETS REVIEW - Q1 2018

An overview of markets in Q1 2018 when worries over US interest rates and trade weighed on global equities.

– Global equity markets declined in Q1 with investors unnerved first by concerns about the path of US interest rate rises and then worries over trade. Global bond markets reflected higher inflation, with most major government bond yields climbing.
– US equities began the year strongly, boosted by tax reforms, but ended the quarter lower amid concerns over inflation and the impact of US-China trade sanctions.
– Eurozone equities posted negative returns as worries over US rates and trade affected other markets. Italy's election was inconclusive but had limited impact on the equity market.
– UK equities were negatively impacted by sterling strength amid expectations that the Bank of England may lift rates sooner and faster than the market had previously anticipated.
– Japanese equities followed a similar pattern to other global markets and ended the quarter lower. The heightened uncertainty resulted in a generally stronger yen against major currencies.
– Emerging market equities outperformed, delivering a positive return in US dollars. Brazil gained amid expectations that former president Luiz Inácio Lula da Silva will be prohibited from participating in October's presidential elections.
– US Treasury yields rose markedly across the curve over the quarter. Corporate bonds made negative total returns and underperformed government bonds.

THE US

US equities began 2018 strongly, buoyed by ongoing strength in economic data, robust earnings and the confirmation of a major tax reform package. Indeed, macroeconomic prints remained broadly positive throughout Q1. US business confidence reached an unexpected, multi-decade high in March. GDP for Q4 2017 was revised upwards to show growth of 2.9%, and while industrial activity slowed – as measured by the ISM manufacturing index[1] – it continued to indicate expansion.

However, the latter part of the quarter saw a marked increase in volatility. Investors first digested the destabilising potential of an elevated US inflation reading and the possibility that the Federal Reserve (Fed) may need to become more proactive in raising interest rates in order to keep upward price pressures under control. The Fed did indeed raise rates by 25 basis points (bps) in March, to a range of 1.5% to 1.75%. It did not, however, alter its overall rate projection of three hikes for 2018. The announcement quelled some concerns, but escalating US-China trade sanctions precipitated a renewed bout of turbulence in March.

Overall, the S&P 500 declined in the period. Cyclical[2] sectors performed more strongly in January and February, when the market was focused on faster rate hikes. In March, the broader decline in risk appetites saw more defensive areas outperform. Over the quarter, the weakest performance was in telecoms and consumer staples, although most sectors fell. Technology and consumer discretionary stocks were the only positive sectors over the quarter.

EUROZONE

Eurozone equities delivered negative returns in the first quarter, with the bulk of the declines coming in March. The region's stockmarkets began the year on a firmer footing but worries about the path of US interest rates and the outlook for global trade led to declines for the period overall. The worst performers in terms of sectors were healthcare and telecommunication services. These sectors are typically thought of as "bond proxies" offering stable returns and are much sought after when bond yields are low. However, amid expectations of rising US rates, and therefore rising bond yields, such sectors fell out of favour in the quarter. Energy was the only sector posting a positive return while information technology and consumer discretionary saw only modest declines.

The economic backdrop in the eurozone remained encouraging over the three months. GDP growth for Q4 2017 was confirmed at 0.6% quarter-on-quarter. Unemployment was stable at 8.6% in January 2018. However, forward-looking surveys painted a picture of slower future growth. The composite purchasing managers' index (PMI)[3] hit a 14-month low in March, albeit the reading of 55.3 still implies solid growth. Annual inflation was 1.1% in February, below the European Central Bank's (ECB) target. ECB chairman Mario Draghi reiterated that interest rates would not rise until well past the end of the quantitative easing programme.

On the political front, the key event of the quarter was Italy's election, which yielded no overall winner. The anti-establishment Five Star Movement emerged as the largest single party. President Mattarella will now mediate talks to form a new government. Germany formed a new government after its inconclusive elections in September 2017. Angela Merkel remains as chancellor after her centre-right CDU/CSU agreed another grand coalition with the centre-left SPD.

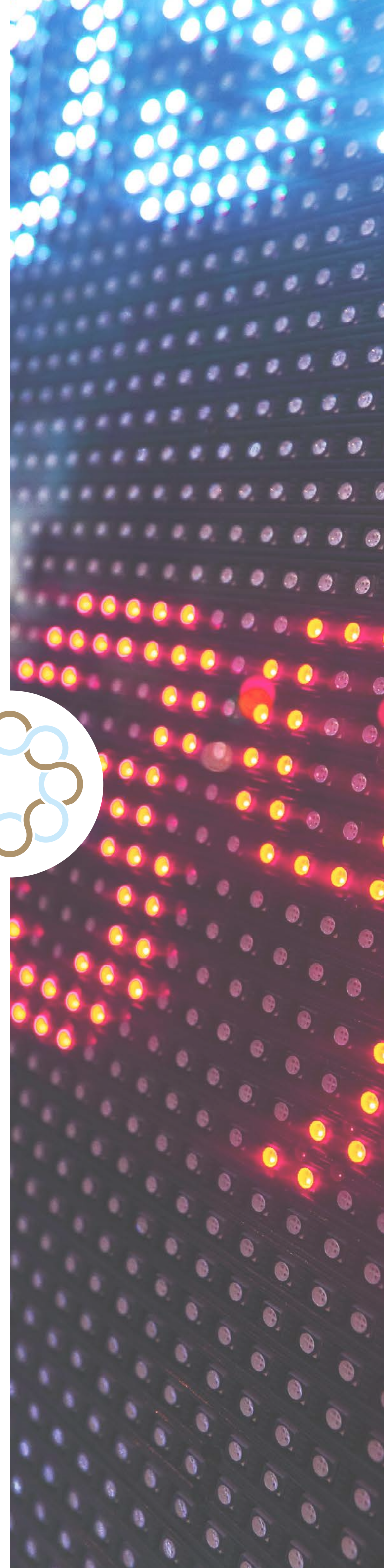
UK

The FTSE All-Share fell 6.9% over the period under review. UK equities performed poorly as gilt yields rose in line with a broad-based sell-off in global bonds. Bond market yields rose amid signs that the world economy is moving from the recovery to expansion phase of the economic cycle, with a consequent increase in inflationary pressures and tighter monetary policy.

As bond yields rose there was a rotation away from more stable and defensive areas of the market, a trend which was exacerbated by sterling strength. Sterling was supported by expectations that the Bank of England could increase base rates faster than previously anticipated, albeit the currency's relative strength was partly a function of weakness in the US dollar.

Sentiment towards UK equities struck new lows in the period as overseas buyers continued to shun the market amid ongoing political uncertainty and a weak outlook for economic growth. Despite this, the trend for inbound merger and acquisition activity remained in train with a number of UK quoted companies becoming the subject of bids from overseas trade buyers.

While UK economic growth remained sluggish it continued to surpass low expectations. In its February inflation report the Bank of England nudged up its growth forecast for 2018, from 1.7% to 1.8%. There was further progress with Brexit negotiations over the period with an initial agreement struck on the terms of a transition period for after the UK formally exits the EU.



JAPAN

After a strong start to the year, Japanese equities followed a similar pattern to other global markets and ended the quarter 4.7% lower. The heightened uncertainty resulted in a generally stronger yen against major currencies. Corporate results covering the period to December 2017 showed very positive trends. However, there was little scope for differential stock performance within sectors as investor sentiment was dominated by political events both domestically and globally.

The most pervasive influence came from the switch in US policy towards increased protectionism. The initial moves are likely to have little impact on the fundamental outlook for Japanese companies, although the level of the yen remains an important transmission mechanism for stockmarket sentiment. Investors were also taken by surprise by an abrupt change in apparent stance of all players engaged in discussions on North Korea's nuclear ambitions. Although the ultimate outcome remains opaque at best, investors should welcome any reduction in regional tension.

Domestically, new twists in the controversy surrounding the Moritomo Gakuen land sale have seriously dented Prime Minister Abe's approval rating. Meanwhile, the decision by the ruling Liberal Democratic Party to recommend the reappointment of Mr Kuroda for a second term as Governor of the Bank of Japan has eliminated one area of potential uncertainty and should ensure a stable policy environment.

The Japanese economy experienced a slightly soft patch for economic growth in Q1 2018 with many indicators of production and consumption slipping slightly. However, the longer term trend of economic improvement appears intact. The rapid spikes up in market volatility seen in February and March - coupled with a focus on potential trade disruption - led to stark divergence in sector returns. Any sectors which could be considered as trade-related, together with all cyclical areas, declined most, while relatively defensive sectors such as pharmaceuticals and utilities outperformed significantly.

ASIA (EX JAPAN)

Asia ex Japan equities saw a rise in volatility linked to global trade concerns in Q1, but finished in positive territory. The MSCI Asia ex Japan Index generated a positive return and outperformed the MSCI World.

Thailand was among the best-performing markets, supported by strong performance from energy and utilities stocks. Taiwan, where technology stocks led the market higher, and Malaysia also recorded strong returns. Chinese equities generated solid gains and finished ahead of the index as macroeconomic data was more resilient than expected; GDP growth for 2017 accelerated to 6.9% year-on-year and higher frequency data was relatively firm.

In contrast, the Philippines and Indonesia posted sharp falls. In the Philippines, currency weakness was a headwind amid rising inflation and as the current account moved into deficit. In Indonesia, signs of deterioration in policy and ongoing subdued growth weighed on sentiment. India also lagged, owing to concerns over a reported fraud at a state bank and weak performance from the ruling Bharatiya Janata Party in state by-elections. The market also faced headwinds from higher oil prices and global interest rate tightening.

EMERGING MARKETS

Emerging markets equities registered a positive return in the first quarter, despite a rise in market volatility stemming from tensions over global trade. The MSCI Emerging Markets Index recorded a positive return and outperformed the MSCI World.

Brazil generated the strongest return as former president Luiz Inácio Lula da Silva saw his criminal conviction upheld, increasing the chances that the left-wing candidate is prohibited from participating in October's presidential elections. Despite falling back later in the quarter, Russia recorded a strong gain as the central bank cut interest rates and the country's debt was upgraded to investment grade by ratings agency S&P. Although Chinese equities were volatile towards the end of the quarter, given rising trade tensions with the US, the market recorded a positive return and outperformed. Macroeconomic data remained broadly stable, albeit there were ongoing signs of a gradual slowing in momentum, with official PMI easing to 50.3.

In contrast, Indian equities lost value, in part due to concern over a reported fraud at a state-owned bank. Weak performance from the ruling BJP in two state by-elections in March also weighed on sentiment. Emerging European markets were also weaker, notably Poland where state-controlled enterprises led the market lower.

GLOBAL BONDS

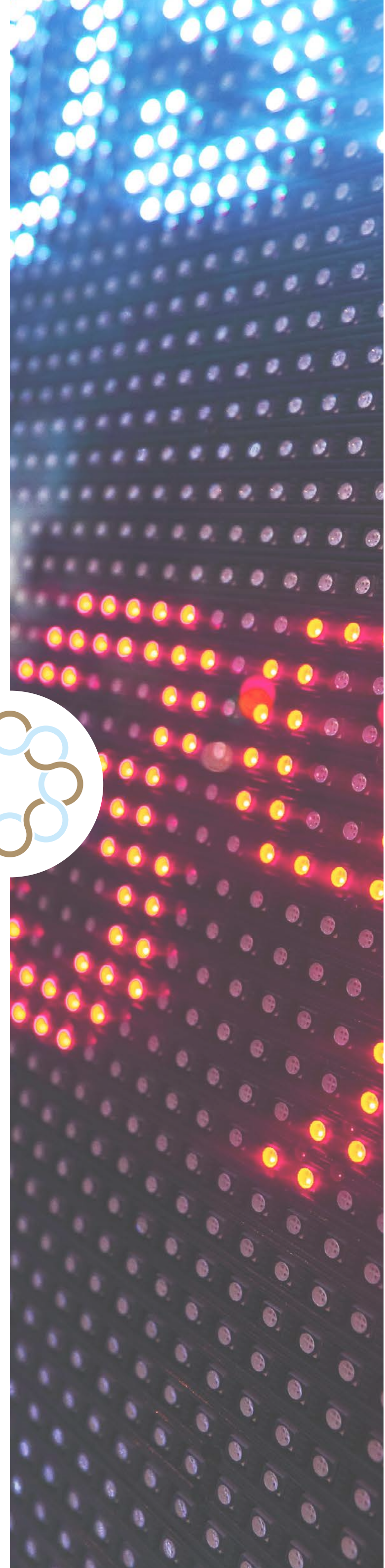
US Treasury yields rose markedly across the curve over the quarter as expectations of growth, inflation and interest rates shifted higher. Volatility returned to markets, picking up sharply from low levels and impacting risk assets. In March, sentiment was negatively impacted by rising trade tensions between the US and China.

The US yield curve continued to flatten modestly with shorter-dated maturities impacted by a rate hike and substantial issuance in March. Ten-year yields increased from 2.41% to 2.74%, reaching a high of 2.95% in February, five-years from 2.21% to 2.56% and two-year yields from 1.88% to 2.27%. UK gilts saw more pronounced curve flattening as 10-year yields rose from 1.19% to 1.35%, while five and two-year yields rose by 39 and 38 basis points (bps).

Bund yields rose slightly, 10-year yields increasing from 0.43% to 0.50%, five-year yields from -0.20% to -0.10% and two-year yields edging up from -0.63% to -0.60%. French 10-years were modestly lower. Italian and Spanish 10-year yields fell, with Spain's down from 1.57% to 1.16% as it drew strong demand for a series of new issues. Italian 10-year yields were down from 2.02% to 1.79%. The Italian election resulted in the undesirable outcome of a hung parliament, given the need for reform.

Corporate bonds made negative total returns and underperformed government bonds. Investment grade[4] (IG) credit saw larger negative returns than high yield (HY), notably in US dollar, while sterling HY performed well. In emerging markets, local currency sovereign bonds made strong total returns as the US dollar declined, but hard currency sovereign and corporate bonds saw negative total returns.

Stockmarkets suffered a setback in the first quarter of 2018. Global equity markets shed just under 9% from peak to trough, giving up some of the fast-earned gains from the recent rally. Convertible bonds offered good protection with the maximum



drawdown for the global index at only -2.6%. Over the full quarter convertibles, as measured by the Thomson Reuters Global Focus Convertible Index, delivered a positive return of 0.3% in US dollar terms against falling equity markets.

COMMODITIES

The Bloomberg Commodities index posted a modest negative return in Q1. This was attributable to weakness from industrial metals amid rising global trade tensions and concern that further escalation could impact demand. Copper was particularly weak, down 8.3%. Conversely, the energy and agricultural components recorded solid gains. In agriculture, corn (+10.6%) and soy bean (+9.8%) prices were notably strong. In the energy segment, Brent crude (+5.1%) rallied into quarter-end amid rising confidence that Opec would maintain its production cuts through the full year 2018. In precious metals, gold (+1%) posted a positive return but silver (-5.1%) lost value.

[1] The ISM Manufacturing Index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production, inventories, new orders and supplier deliveries.

[2] Cyclical stocks are those whose business performance and share prices are directly related to the economic or business cycle. Defensives are those whose business performance is not highly correlated with the larger economic cycle - these companies are often seen as good investments when the economy sours.

[3] The eurozone purchasing managers' index is produced by IHS Markit and based on survey data from around 5,000 companies based in the euro area manufacturing and service sectors. A reading above 50 indicates expansion.

[4] Investment grade bonds are the highest quality bonds as determined by a credit ratings agency. High yield bonds are more speculative, with a credit rating below investment grade.

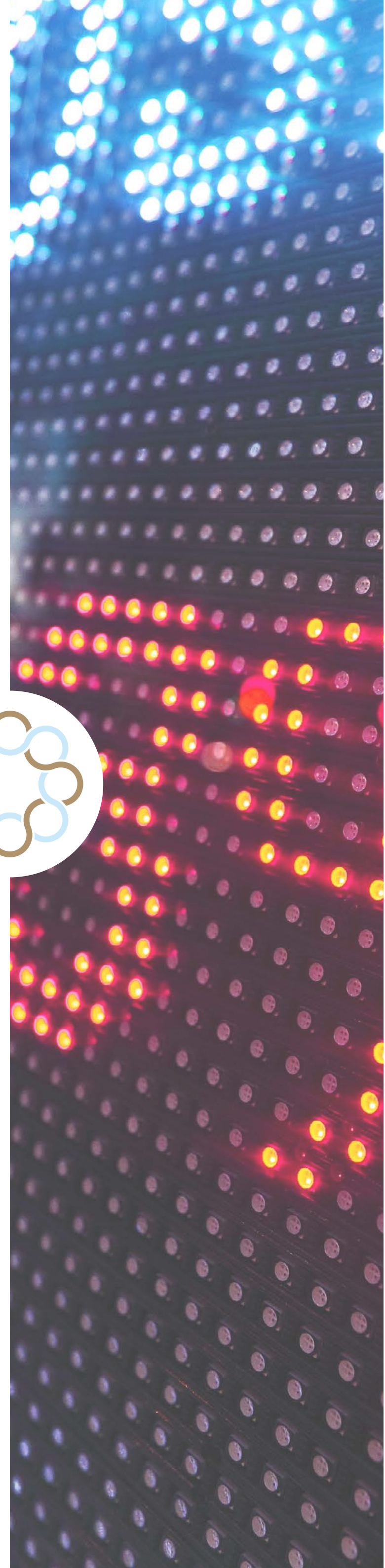
Source: Schroders Quarterly markets review - Q1 2018. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested.

TOTAL RETURNS (%) – TO END MARCH 2018

	3 MONTHS			12 MONTHS		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	-1.3	-3.6	-4.8	13.6	-1.2	1.3
MSCI World Value	-3.2	-5.5	-6.7	8.8	-5.4	3.1
MSCI World Growth	0.6	-1.8	-3.0	18.5	3.1	5.7
MSCI World Smaller Companies	-0.6	-2.9	-4.1	15.9	0.8	3.3
MSCI Emerging Markets	1.4	-1.0	-2.2	24.9	8.6	11.4
MSCI AC Asia ex Japan	0.7	-1.7	-2.9	25.8	9.4	12.2
S&P500	-0.8	-3.1	-4.3	14.0	-0.9	1.6
MSCI EMU	-0.5	-2.8	-4.0	17.4	2.1	4.6
FTSE Europe ex UK	-1.2	-3.5	-4.7	17.0	1.7	4.3
FTSE All-Share	-3.4	-5.7	-6.9	13.6	-1.2	1.3
TOPIX*	1.0	-1.4	-2.6	21.4	5.6	8.2

	3 MONTHS			12 MONTHS		
Government Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	-1.2	-3.6	-4.8	0.5	-12.6	-10.4
JPM GBI UK All Mats	4.0	1.5	0.3	12.8	-1.9	0.6
JPM GBI Japan All Mats**	6.4	3.9	2.6	6.0	-7.8	-5.5
JPM GBI Germany All Traded	2.7	0.2	-1.0	14.5	-0.4	2.1
Corporate Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	-0.8	-3.1	-4.3	6.6	-7.3	-5.0
BofA ML US Corporate Master	-2.2	-4.5	-5.7	2.7	-10.7	-8.5
BofA ML EMU Corporate ex T1 (5-10Y)	1.8	-0.6	-1.9	17.8	2.4	5.0
BofA ML £ Non-Gilts	2.5	0.1	-1.2	13.6	-1.2	1.3
Non-investment Grade Bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	-0.2	-2.6	-3.8	6.7	-7.2	-4.9
BofA ML Euro High Yield	1.9	-0.5	-1.7	20.1	4.5	7.1

Source: DataStream.
Local currency returns in Q1 2018: *-4.7%, **0.5%.
Past performance is not a guide to future performance and may not be repeated.



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