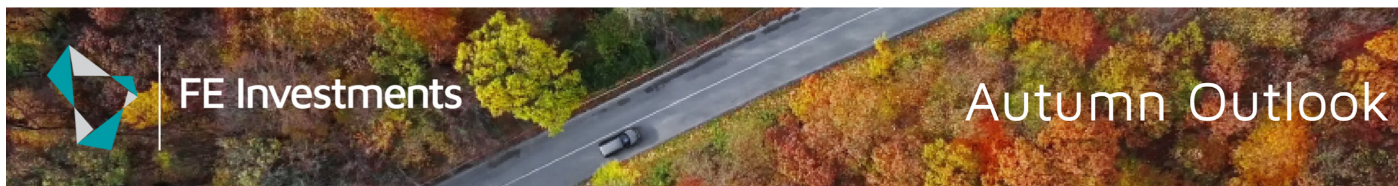
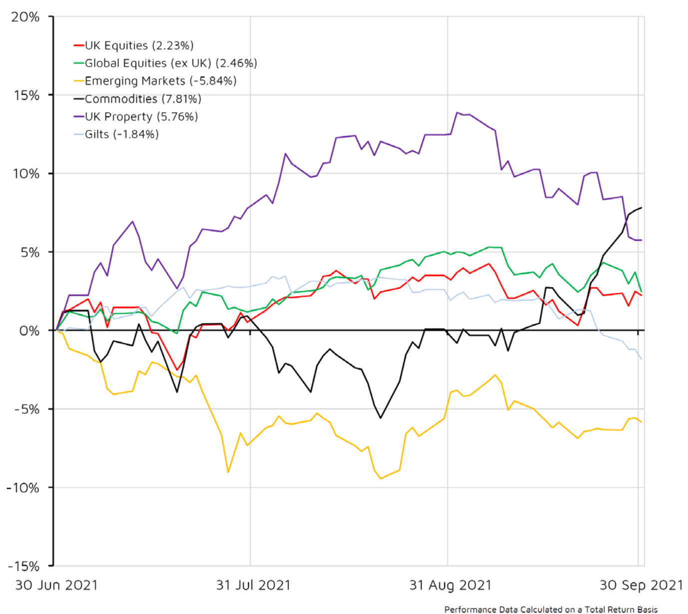


REVIEW OF THE PAST QUARTER:

Most developed equity markets produced positive returns as the ongoing economic revival outweighed concerns about the continued spread of coronavirus and growing supply-chain problems. Business confidence has remained strong as most regions have continued to recover and investor confidence has also remained robust. Signs that US inflation may be slowing down helped to reassure investors. UK inflation remained high but is mostly due to base effect as prices are compared to low prices this time last year. However, towards the end of the quarter central banks began to talk about winding-up asset purchase programmes and indicated that rate hikes are closer than expected. This caused government bond yields to rise sharply and equity markets to fall back.

Japanese equities produced the strongest returns after Prime Minister Yoshihide Suga announced his resignation following strident criticism of his government's handling of the Covid-19 outbreak. Investors became more optimistic that his replacement will introduce more financial stimulus to boost Japan's economy. In contrast, emerging market equities performed poorly. China acted as the main drag on performance as the latest outbreak of Covid-19 cases and increased government regulations against its private sectors hit company profits and investor confidence.

In the UK, mid-cap stocks had a strong quarter, although other UK equities lagged. A gradual return to offices and high streets boosted property as it continues to recover from the large losses experienced last year.



ASSET CLASS RETURNS

Cash	Government Bonds	Index Linked Bonds	Corporate Bonds	UK Equities	Overseas Equities	Emerging Markets	Property
+0.01%	-1.84%	+2.32%	-0.96%	+2.23%	+2.46%	-5.84%	+5.76%

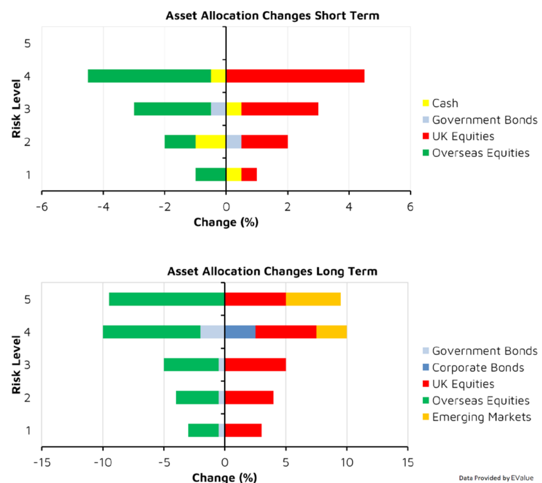
THE ACTUARIAL VIEW:

Low interest rates and strong recent performance of equities make finding returns harder, and expectations of future returns are generally lower.

Although economic fundamentals continue to improve, lower growth prospects and the potential for a widespread revaluation of assets weigh heavily on the outlook. European equities do not show quite the same signs of revision and the outlook is correspondingly less encumbered. In the UK the outlook has improved. Signs that banks have survived the pandemic relatively unscathed and a revival in the fortunes of the massive mining sector have given fundamentals a boost, and this is strong enough to overcome the drag of strong recent price performance and reduced growth prospects.

Asian equity prospects are also dominated by low bond yields and growth expectations. Outside of Asia, emerging markets are benefiting from homegrown recovery effects and the revival in demand for commodities and oil.

Lower interest rates tend to mean lower fixed income expectations and recent appreciation of corporate bonds means that goes double for credit markets.



WHAT TO LOOK FOR IN THE NEXT QUARTER:

- **UK:** The Monetary Policy Committee (MPC) announcements and minutes are set to be released on 4 November. Latest employment data to be published on 12 October. Preliminary GDP for Q3 will be available on 11 November.
- **US:** There will be interest rate decisions from the Federal Open Market Committee (FOMC) on 2-3 November. Minutes will be published three weeks after each decision. First estimate of GDP growth for Q3 to be released on 28 October. Monthly consumer inflation will be published on 13 October. Change in Nonfarm Payrolls will be out on 8 October.
- **Eurozone:** A European Central Bank monetary policy meeting has been arranged for 28 October. Quarterly GDP flash data for Q3 is set to be published on 29 October. The update on September inflation will be released on 29 October. Unemployment rate for September is to be published on 3 November.
- **Other Data:** Opec meeting scheduled for 4 October. JPMorgan Global Composite PMI is due to be published on 5 October. Bank of Japan interest rate meeting to be held on 27 October. Chinese Q3 GDP will be published on 17 October. The number of new daily coronavirus cases.

ASSET CLASS SCENARIOS:

UK EQUITY

Most Likely: Following a strong summer rebound, growth is expected to continue, albeit at a potentially slower pace, driven by continued consumption. Inflation is expected to rise next quarter due to this demand, as are rising base cost prices, although this pick-up is expected to be transitory. Despite the good news, vaccine-resistant mutations remain a downside risk. Uncertainty on fiscal policy from the upcoming budget and geopolitical tensions could also cause volatility.

Worst Case: Premature tapering signals would impact larger companies with diversified revenue streams due to a strengthening of sterling. Although less of a risk, a vaccine-resistant strain causing a return to tighter restrictions could result in a negative impact on UK equities, with small and mid caps hampered the most.

Best Case: No return to extended restrictions, few geopolitical tensions and measured, supportive fiscal and monetary policy should prove positive for UK equities overall. Domestically, the continued deployment of savings accrued during lockdown last year would remain favourable to domestically orientated smaller companies. In addition, this excess demand would reduce insolvency expectations and help prevent job losses as the chancellor looks to wind down the furlough scheme.

GLOBAL EQUITY

Most Likely: Positive earnings momentum, mainly in the US and in Europe, has led the recovery so far; however, earnings growth is expected to slow down from record highs. Overall, global equities should benefit from the reopening of economies, as both revenues and profits are expected to grow strongly. Inflationary pressure is likely to be temporary and not raise concerns about a shift in monetary policies.

Worst Case: Concerns around peak economic growth have been reinforced by Delta variant outbreaks, weakening momentum and widespread supply chain disruption. If inflation proves to be permanent central banks will start to curb ultra-accommodative monetary policies earlier than expected, potentially hampering global equities' performance. In Japan, the unexpected resignation of the prime minister, Yoshihide Suga, could signal a return to political instability.

Best Case: Global equities should continue to benefit from global recovery as vaccinations tackle the health crisis. The resignation of the Japanese prime minister has spurred hope that his successor will increase stimulus spending. The speed of vaccinations in Europe is keeping hospital admissions low, limiting the risk of further lockdowns.

EMERGING MARKET EQUITY

Most Likely: Global recovery should shift assets from 'safe havens' to riskier assets such as emerging markets, putting downward pressure on the US dollar and strengthening emerging market currencies, exports and growth expectations. Global stimulus with a focus on the green revolution will benefit due to strong commodity demand and pricing.

Worst Case: Further Covid-19 mutations could see localised shutdowns, stalling recovery and forcing central banks to maintain quantitative easing. An early increase in US interest rates could provide support for the US dollar weakening company balance sheets. Any further escalation in Chinese regulatory scrutiny or US-China tensions could materially weigh on investor sentiment.

Best Case: Vaccination programmes remaining on track, coupled with limited future waves of Covid-19, will prove supportive. The green revolution, backed by stimulus programmes, will greatly benefit emerging market economies. If core inflation within emerging markets pushes higher in the short-term but remains somewhat contained in the medium term, it will broadly provide a strong economic environment.

CASH

Most Likely: Yields available for money market instruments remain low as the official Bank of England interest rate stayed at its historic low level. Nevertheless, some market participants think the Bank could be the first central bank to initiate its tightening cycle, given its persistent high inflation problem. This has propelled yields for longer-maturity cash instruments to a higher level, improving the prospect for money investors willing to take duration risk. However, cash remains compelling for investors concerned about equity and bond valuations.

Worst Case: Although there is almost zero probability of the Bank of England exploring negative interest rates, the delay in lifting all restrictions means yields for money markets are anchored to very low levels. Any increase in Covid-19 infection rates might force investors to reassess yields to lower levels, lowering the returns expected from money market instruments.

Best Case: If inflation rises above expectations, the Bank of England may contemplate increasing rates earlier than has been expected. It is also likely that the interest rate curve will steepen, which would slightly improve the return from money market funds, as managers can lock higher rates at longer maturity dates.

FIXED INCOME

Most Likely: Although inflation continues to run higher in the UK and US, the Bank of England holds firm on its current schedule of asset purchases and government bond yields remains relatively stable through to the end of the year. As more corporates see fiscal support schemes wind down, some experience increased borrowing costs but corporate bond valuations hold steady on the whole.

Worst Case: Persistently high inflation sees a meaningful tapering of central bank asset purchases by the end of the year, leading to a spike in government bond yields. Reduced monetary support combined with weakening economic data results in heightened volatility in risk markets and corporate credit losing significant value.

Best Case: Issuance across corporate bond markets slows significantly, helping to keep downward pressure on corporate bond yields. Some pockets of fixed income markets may experience distress, such as Chinese real estate, but generally credit conditions loosen further as concerns surrounding the coronavirus subside in developed economies. Inflation remains elevated, but signs that inflationary forces are transitory allow central bankers to remain dovish.

PROPERTY

Most likely: Property companies should continue to benefit from an improvement in earnings as global vaccine coverage expands and governments continue to ease lockdown restrictions. While there is potential for further upside, this could be limited as inflation fears have now abated amid concerns over the global economic recovery.

Worst case: A correction in reopening, recovery and inflation-protection trades causes property shares to trade lower. Covid-19 threatens the return to normal operating conditions and leads to new restrictions, hampering the earnings potential of real estate companies, particularly those operating within sectors such as retail and leisure.

Best case: Improving fundamentals as the global economy recovers from the pandemic and inflationary pressures rise makes a bullish case for property. Moreover, given the sector's high-dividend and defensive characteristics, it may continue to benefit should investors adopt a more cautious stance as a result of greater market and economic uncertainty. In addition, if government bond yields continue to fall, property shares will be attractively priced on a relative yield basis.

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