



October 2021 Winter is Coming?

CUSTOMISED SOLUTIONS GROUP | GLOBAL BALANCED RISK CONTROL TEAM | PATH | 1 October 2021

Markets became jittery over September, with the realisation that summer has come to an end and winter is coming. The S&P 500 and MSCI Europe Index experienced their first monthly fall since January 2021, moving down -4.7% (USD) and -2.9% (EUR) respectively¹. In contrast to the other developed markets, the MSCI Japan Index was up over the month at 4.5% (JPY)¹. The best performing sector was energy, with the MSCI ACWI Energy Index up 9.1% (USD)¹ on the back of rising energy prices, whilst most other sectors moved down. Energy prices could in part be to blame for the move up in yields, as the closely watched US 10-Year yield moved up to 1.5 from 1.3 at the end of August². In turn, the VIX moved up to 23² by month end, the highest since May's market jitters.



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1. Bloomberg, 1-month performance as of 30 September 2021.
2. Bloomberg, as of 30 September 2021.

A focus on Japan and China

The surge in Japanese equities, which began the last week of August, continued in September as Prime Minister Suga resigned due to the handling of the pandemic. By month end, Fumio Kishida had been voted in by the ruling Liberal Democratic Party, as the new Japanese Prime Minister, indicating that there is likely to be more of the same. Therefore, this could be interpreted as not necessarily a negative or a positive catalyst. The exuberance seen earlier in the month appears to have been short-lived as a debt crisis involving one of China's largest property developers began dominating headlines, leaving Japanese equities to languish the second half of the month. Indeed, the giant Chinese property developer rocked markets across the globe, especially in Asia. The MSCI China Index (HKD), was down -5.0%¹ over September, as it continued to be one of the worst performing countries year-to-date.

Growth slowing, but likely to remain healthy

As we had been expecting, there has been a material slowdown in the rate of change of growth. However, this is from a high level to normal, but still healthy growth. Whilst inflation has been a concern for some time in the wake of global reopenings, the August US headline CPI rose 5.3% YoY, and 0.3% over the month³, which is less than expected. That said, rising energy prices are not likely to feed into inflation immediately and supply shortages are also not going away, raising the question of whether inflation is in fact transitory. Valuations and positioning suggest caution with many market indicators continuing to show stretched levels. The S&P 500 12-month forward PE is currently 20.7, compared with the median of 15.0⁴. Moreover, we expect that the move up in rates is not positive for US equities, which tend to be high duration. Indeed, this has impacted rate sensitive sectors, whereas energy stocks in contrast have done well. We are keeping an eye on key events on the horizon, including the looming US debt ceiling and the upcoming US earnings season.

Investment implications

We have reduced risk over the month in two stages, as we believe there is likely to be limited upside to equities for the remainder of the year. Given high valuations and fragile, risk-off sentiment, we are concerned that there could be a market correction and elevated volatility. At the same time, we are seeking opportunities to take advantage of any excessive weakness.

Chinese Internet Equities

We have implemented a modest initial overweight to Chinese Internet Equities. Whilst China has been hard hit this year, there are some potential pockets of opportunity. Regulatory headwinds to China Internet seem to be stabilising, with fundamentals of key companies remaining strong. Since the February 2021 peak, there has been a more than 50% decline in China Internet⁵, making valuations fairly attractive. While volatility is likely to

3. U.S Bureau of Labor Statistics, Economic News Release, Consumer Price Index Summary – August 2021, released 14 September 2021. Year-on-year (YoY) figure is before seasonal adjustment, August month-on-month (MoM) figure is on a seasonally adjusted basis.

4. Thomson Reuters. Based on the S&P 500 Composite, as of 1 October 2021. The median is since 1 January 1987.

5. As measured by the KraneShares CSI China Internet UCITS ETF. From 16 February 2021 to 30 September 2021 there was a drop of -55%. This is for illustrative purposes only and should not be deemed as a recommendation to buy or sell the ETF shown.

remain high in the near-term, the disconnect between fundamentals and valuations makes the risk rewards of the trade skew slightly to the upside.

Tactical positioning

We have provided our tactical views below:

Asset Class	--	-	=	+	++
Equity					
US			■		
US Value				■	
US Growth		■			
Eurozone			■		
UK			■		
Japan			■		
Asia ex Japan			■		
China Internet				■	
Emerging Markets			■		
LatAm			■		
Global Infrastructure			■		
Global Property			■		
Global Financials				■	
Global Energy				■	

Asset Class	--	-	=	+	++
Fixed Income					
IG Credit		■			
US High Yield			■		
European High Yield			■		
EM Sovereign Debt HC			■		
EM Sovereign Debt LC			■		
US Treasuries		■			
US Inflation			■		
German Bunds		■			
EU Peripheral Bonds			■		
JGBs			■		
Commodities					
Gold			■		
Industrial Metals			■		

Source: MSIM GBaR team, as of 30 September 2021. For informational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The tactical views expressed above are a broad reflection of our team’s views and implementations, expressed for client communication purposes. The information herein does not contend to address the financial objectives, situation, or specific needs of any individual investor.

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Consumer Price Index: The Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

Forward P/E: Price-Earnings (P/E) is the price of a stock divided by its earnings per share for the past 12 months. Sometimes called the multiple, P/E gives investors an idea of how much they are paying for a company's earning power. The higher the P/E, the more investors are paying, and therefore the more earnings growth they are expecting. Forward to price earnings (P/E) is a measure of the price-to-earnings ratio (P/E) using forecasted earnings for the P/E calculation.

KraneShares CSI China Internet ETF seeks to measure the performance of the investable universe of publicly traded China-based companies whose primary business or businesses are in the Internet and Internet-related sectors.

MSCI China Index: This free-float adjusted capitalization-weighted index is designed to measure the performance of China-based equities.

MSCI ACWI Energy Index includes large and mid cap securities across 23 Developed Markets (DM) and 27 Emerging Markets (EM) countries*. All securities in the index are classified in the Energy as per the Global Industry Classification Standard (GICS®).

MSCI Europe Index: The **MSCI Europe Index** captures large and mid-cap representation across 15 Developed Markets (DM) countries in Europe.

MSCI Japan Index: The MSCI Japan Index is designed to measure the performance of the large and mid-cap segments of the Japanese market.

S&P 500 Index: The Standard & Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalization US stocks.

VIX®: This is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 Index options. Often referred to as the fear index or the fear gauge, it

represents one measure of the market's expectation of stock market volatility over the next 30-day period.

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