MARKET BACKDROP
A review of what's happened in markets recently

MARKET OUTLOOK
Looking ahead to the coming months

SPOTLIGHT ON
The G in ESG

The view
Summer 2021

architas

CONTENTS

Market backdrop	2
Market outlook	4
Spotlight on... the G in ESG	6
An introduction to why investing globally matters	8
Big data - what's the big story?	10
Facts & figures	12

Welcome
to The View – Summer 2021

The Summer edition of The View provides a step-by-step guide to how the political and economic environment has driven financial markets, and what this means for your investments.

When analysing environmental, social, and governance factors, the 'G' element is less discussed in headlines. But we think it's vital not to overlook it. We delve into how effective governance can make a difference in a company's destiny.

At Architas we favour a global approach – why? Just like everything else in life, it can be worth it to expand your horizons. We explain why a meaningful allocation to global investments can provide a number of benefits to investors.

Big data has proved to be a very valuable commodity in the 21st century. A new service industry has built up around the collection, collation and analysis of big data. But what can this analysis reveal and why are the results so highly prized?

Jaime Arguello
Chief Investment Officer

Market
BACKDROP

Over the last three months, markets have been driven by a lot of optimism - in the control of the pandemic, the success of the vaccinations roll out, and the continued fiscal and monetary stimulus. From a macro perspective, we saw a strong cyclical recovery and to some extent a continuation of the rebound from the very depressed levels in 2020.

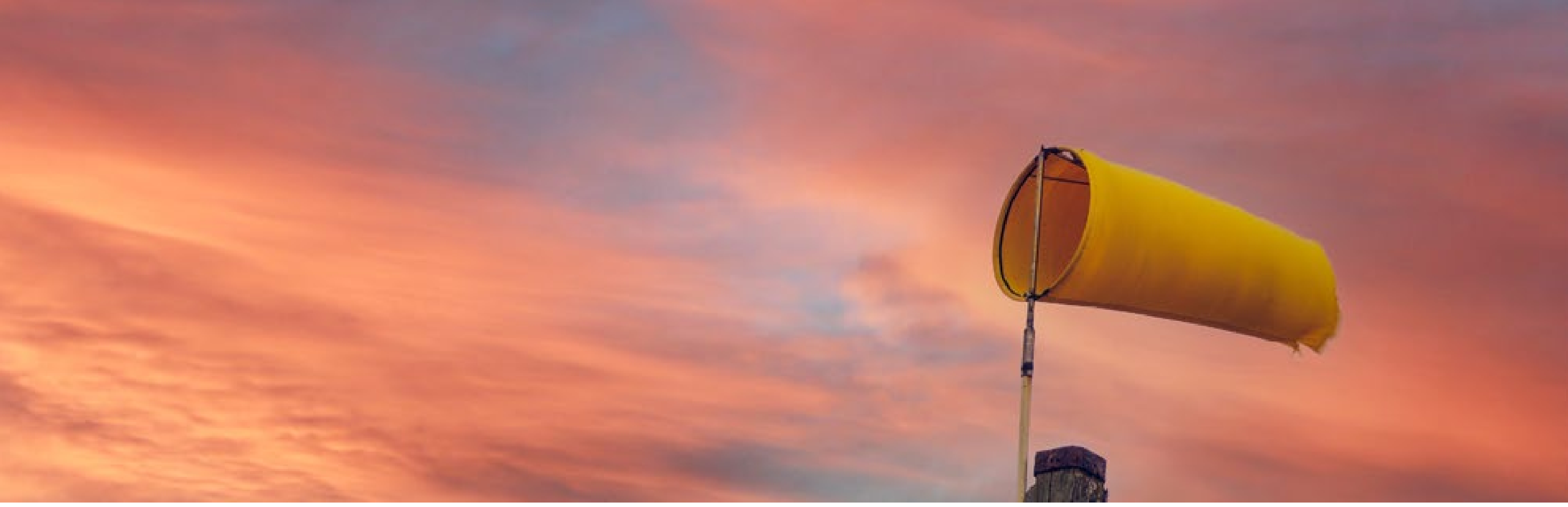
As the global economy moved in fits and starts toward a recovery, global stock and bond markets posted broad gains in the second quarter. The clear divide in performance between growth and value stocks that dominated the market since October 2020 faded in the second quarter.

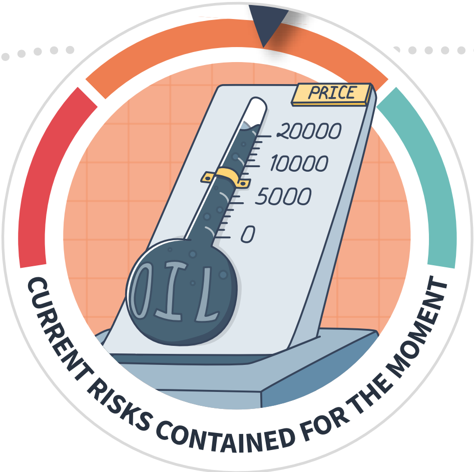
With the Fed keeping the current level of interest rates in place into 2023, markets weren't spooked. In fact, stock market volatility fell to levels unseen since before the pandemic. And the key development was the increase in inflation expectations, which led to a sharp adjustment in the US yield curve particularly, to a new trading range.

ECONOMIC FACTORS

All eyes on Fed's taper signals. The Federal Reserve was publicly committed to keeping interest rates near zero, declaring no anticipated hikes until late next year at the earliest. However, increasing inflationary pressures are making tapering a more concrete prospect and likely heightening volatility in global financial markets.

Supply shortages add pressure. Factory activity powered ahead in Europe and stayed strong in Asia as demand grew. But disruptions caused by the coronavirus pandemic are having a huge impact on supply chains, making it a sellers' market for the raw materials that factories need. Leading to huge increases in input costs and upward pressure on inflation.





RISKS

Is oil overheating? Investors appeared unfazed despite steadily rising crude oil prices, up 45% so far this year. The rise represents a recovery from the collapse in crude prices last autumn. However, oil's higher costs could push inflation higher and therefore interest rates. Endangering the fragile economic recovery in China and emerging markets.

Transitory inflation? Inflation has been the spectre stalking the markets in the first half of this year given unprecedented levels of fiscal and monetary stimulus post-pandemic. With inflationary pressures, such as surging commodity prices and a global semiconductor shortage, rattling markets at times. However, central banks have largely viewed these pressures will prove only transitory.

FINANCIAL MARKETS

Global equities advance. Supported by the accelerating roll-out of Covid-19 vaccines. Regionally the US and Europe surged ahead, emerging markets performed well, while Asian stock returns were more muted. The contrast between growth and value stocks faded as growth outperformed value. A shift that developed when the Fed indicated in June that rates might rise sooner than expected.

Investors searched for yield. High yield bonds outdid lower-risk corporate bonds. In government bond markets performances diverged as US government bonds outpaced Europe and Japan, where their negligible or negative yields fuelled demand for US Treasuries from yield-hungry, risk-averse investors.

CONCLUSION

As 2021 progresses there is much to be buoyant about. The accelerated vaccine campaigns in developed countries, additional fiscal and central bank stimulus, and the surge in business activity as industries reopen. All appear to have set the stage for robust global economic growth.

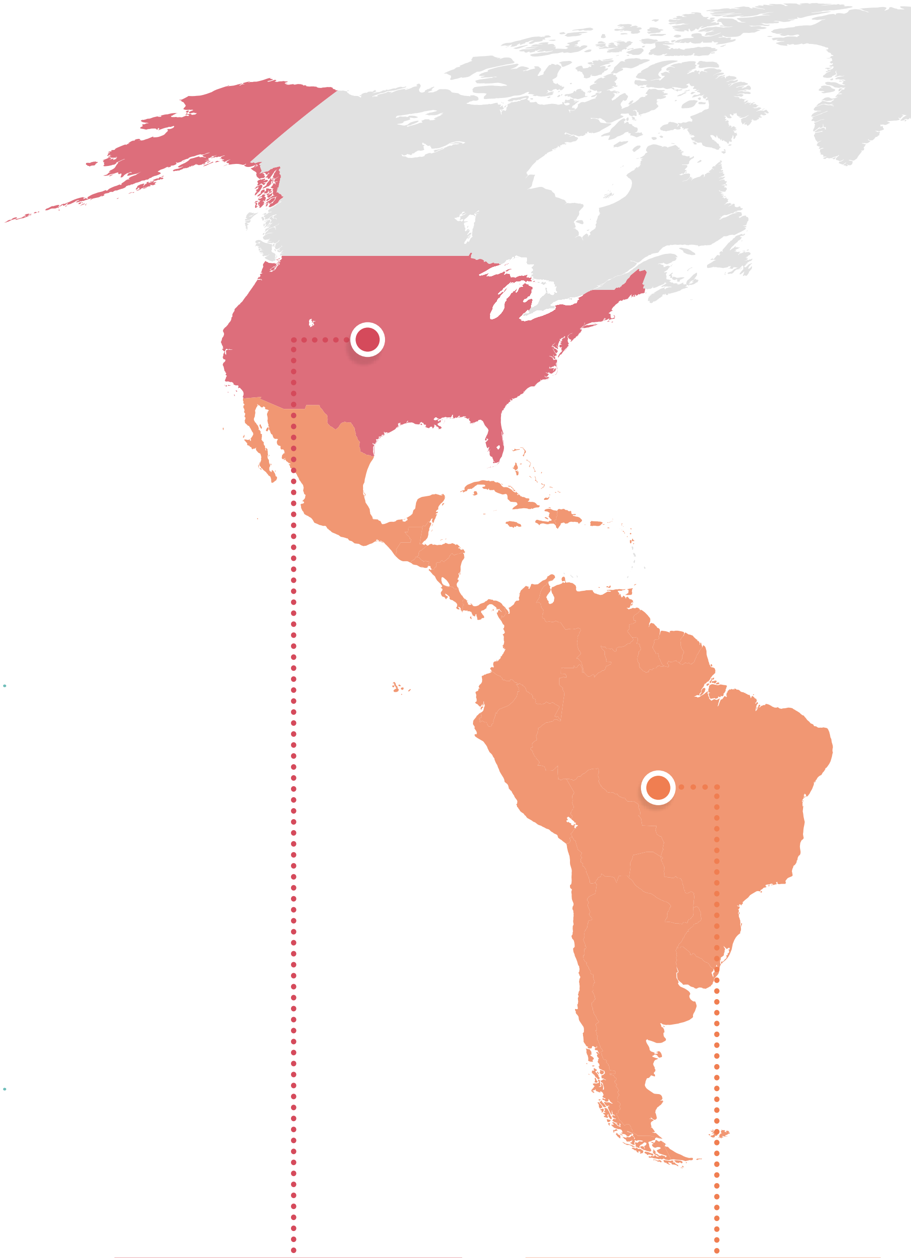
However, risks remain. Shifting from those that are pandemic related to those that are 'rebound' and 'exit related' with the changes in Fed policy as chief among these. While investors are regaining their confidence, we believe that the potential risks on the horizon underpins the importance of branching out across a range of different asset classes.

Market OUTLOOK

As we enter the second half of 2021, the global macroeconomic picture remains robust. And support from central banks and governments across the world continues to provide a strong foundation. With markets seeming to have moved on from Covid-19 worries despite the headline-grabbing Delta variant.

Rising inflation is the current pressing issue, one that could cause the global economy to overheat. Soaring commodities and supply-chain constraint challenges persist. Bond markets seem to be under-reacting to inflation fears. And stocks also appear to be at a crossroads, holding on to big gains even as new risks shape the market outlook.

We sense that US Federal Reserve policy and its accommodative stance will be the main focus for the markets in the months ahead. This increases the potential for some volatility, but investors shouldn't take too much fright. Ups and downs are routine for markets.



UNITED STATES

STOCKS ▽ BONDS ▽

- We remain less convinced about US equities compared to other regions. They are more growth oriented, and we continue to maintain a positive view on cyclical markets in the near term.
- We have moved to underweight US bonds because we feel the negative impact of rising rates may be more pronounced in the US.

EMERGING MARKETS

STOCKS ⊖ BONDS △

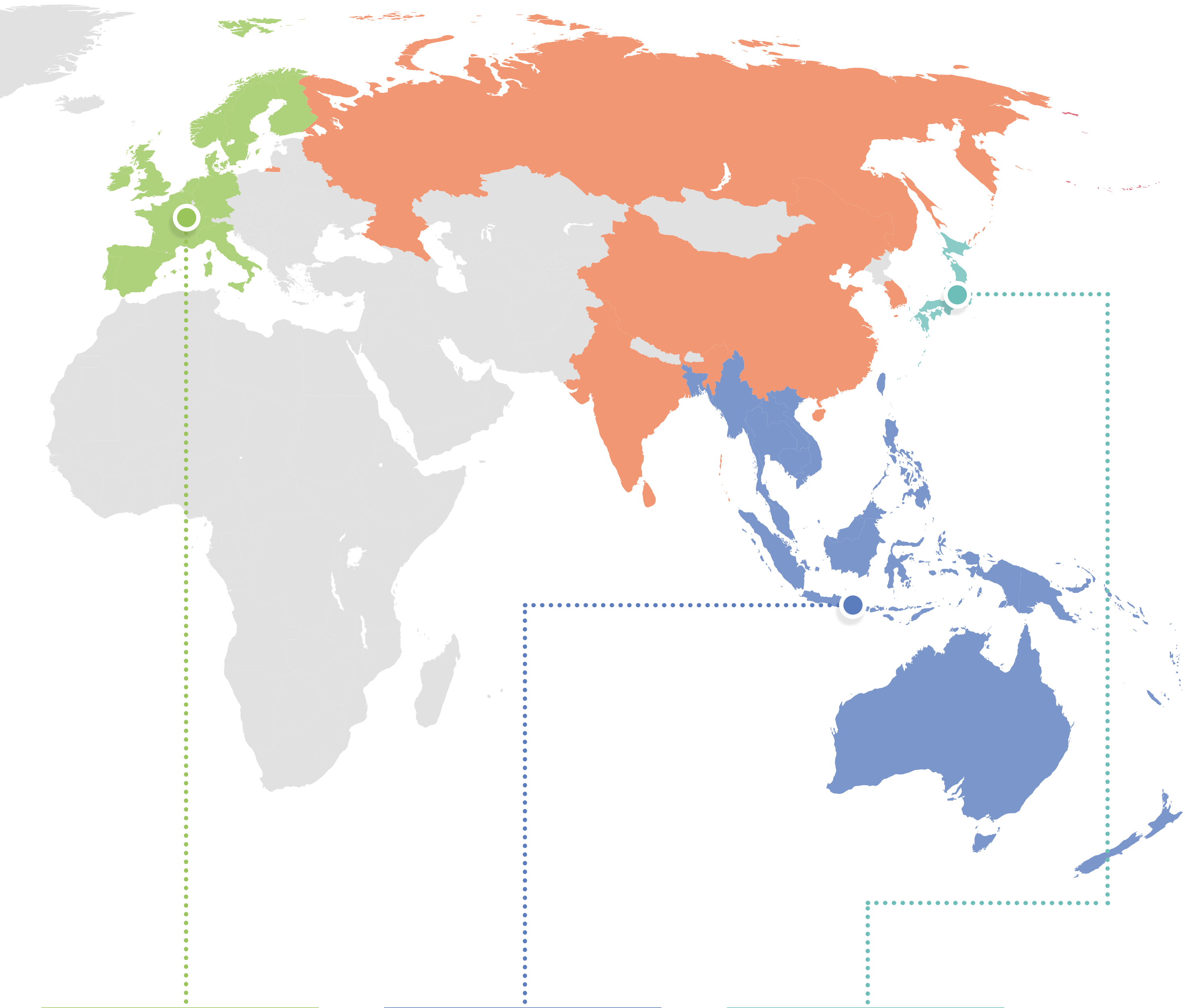
- Emerging markets are benefiting from the commodity prices boom. However, we have become less confident due to the heightened US dollar volatility and worries over the Covid-19 Delta variant.
- We are positive about emerging market bonds due to having higher yields than their US counterparts. And any impact from a rise in rates would be less pronounced than in the US.

KEY

△ Positive

▽ Negative

⊖ Neutral



EUROPE

STOCKS ⊕ BONDS ⊖

- As the global economic recovery broadens out and the vaccine rollout in Europe gathers pace, we feel the region is well-positioned to outperform in the near term.
- Overall, we remain neutral with a preference to corporate bonds over government bonds as these are better positioned to be protected from rising rates.

ASIA PACIFIC

STOCKS ⊖

- US dollar weakness continues to be supportive, although growth remains stronger in the US and Europe than in China.
- Despite the more cautious near-term outlook, the medium-term outlook for Asia remains encouraging.

JAPAN

STOCKS ⊖

- While monetary policy remains accommodative, Japan's recovery has been constrained by localised outbreaks of Covid-19 and the lagging vaccination effort is a tailwind.
- The underperformance of the Japanese market this year means that equity valuations are looking relatively more attractive.

SPOTLIGHT ON...

the "G" in ESG

ESG refers to the three key factors: environmental, social and governance, when measuring the sustainability and ethical impact of an investment in a business or company. Why are they important? These factors help to evaluate the behaviour of companies, as well as determining their future financial performance.

'E' or environmental is probably the most widely understood given the global focus towards transforming to a low-carbon economy. It considers a company's consumption of natural resources and the effect of their operations on the environment, both directly and across their supply chains.

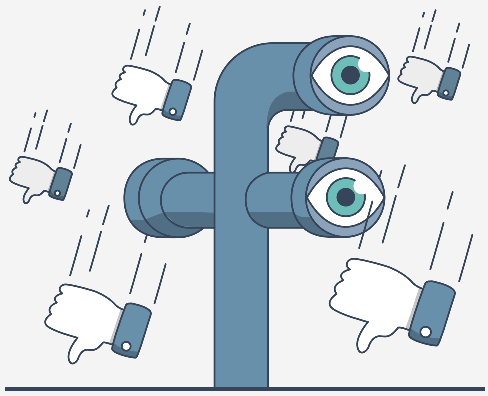
'S' or social, on the other hand, focuses on employee relations, working conditions, and interactions with the community. And it is closely linked with governance. As to deliver on the social side, you have to have a strong governance structure.

'G' or governance, for the most part deals with board structure and diversity, tax strategy, executive remuneration, political lobbying, and corruption and bribery. The tie in with social is that if you don't have an efficient and functioning board, then you won't be able to achieve good social outcomes.

DON'T FORGET THE 'G'

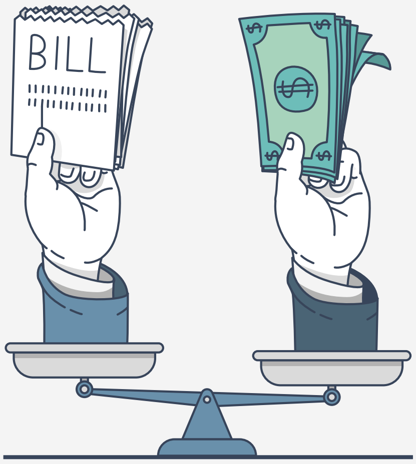
When analysing environmental, social, and governance factors, the 'G' element is less discussed in headlines. With considerations over climate risk, societal implications and other 'E' and 'S' risks and opportunities taking the spotlight. However, corporate governance is vitally important because it creates a system of rules and practices that determines how a company operates and how it aligns the interests of all its stakeholders. And it's well recognised that good corporate governance leads to ethical business practices, which leads to financial viability.

SCANDALS AND OTHER MISDEMEANOURS



Understanding governance risks and opportunities in decision-making is critical, as poor corporate governance practices have stood at the core of some of the biggest corporate scandals. Volkswagen's emissions tests fraud, Facebook's misuse of data, and Wirecard's accounting scandal and many other incidents have all raised fresh questions and thrust corporate governance into the spotlight. One common thread in many high-profile business scandals is a focus on short-term profits over the long-term health of the company.

THE SHAREHOLDER VERSUS STAKEHOLDER DEBATE



Arguably, the role of corporations is no longer to act solely in the interests of shareholders. Instead moving to a model where top executive compensation and incentives are aligned with the well-being of all stakeholders, including employees and consumers. Poor corporate governance has highlighted the need for more transparency and more dialogue-driven decisions, for companies to communicate with all their stakeholders — not just shareholders.

RESEARCH BACKS THIS UP

S&P research on governance factors has shown that companies that rank well below average on good governance characteristics are particularly prone to mismanagement and risk their ability to capitalise on business opportunities over time. While companies that invest in their employees, protect the environment, and deal fairly with their suppliers have been shown to perform better.

INVESTORS RECOGNISE THE FACTS

With this in mind, it is sensible for all investors to consider governance factors, whether they think of themselves as socially responsible or not. And indeed, research undertaken by Architas confirms this. Notably, in an Architas ESG Investor study covering 11,000 global investors across 11 countries, we asked questions on what their motivations were for investing in ESG and what the important factors were. Overwhelmingly, investors picked a governance factor as their top response. With environmental factors starting to come through in second place in Europe and social in second place in Asia.

A RENEWED FOCUS

- ✓ The past few years have seen a significant uptick in interest around ESG products, but with a much heavier focus on ethical and environmental issues.
- ✓ Factors such as the Covid-19 emergency, existing firms' disputes and a renewed focus on best practice have highlighted how much effective corporate governance can make a difference in a company's destiny.
- ✓ In fact, of the E, S and G factors governance is often the most significant to returns as it determines the overall direction of company policy and how key risks are addressed.
- ✓ ESG integration provides additional tools for investors to select companies and build portfolios with the aim of generating long-term returns for 2021 and beyond.

AN INTRODUCTION TO **WHY INVESTING GLOBALLY MATTERS**

Many investors have diverse investment portfolios of domestic stocks, bonds, and even real assets or other classes, providing an excellent start for retirement or growing wealth. However, many are surprised to hear that they're missing out if they're solely invested in home-based investments.

Unpredictable markets can react positively or negatively to events around the world. Having all of your 'investment eggs' in one basket and solely focusing on one region or sector could affect returns considerably.

VOLATILITY REDUCTION

Having a mix of home and international investments has historically damped down the volatility in portfolios. Of course, it's natural to be concerned about geopolitical risk, but having a mix can actually reduce portfolio risk.

Individual markets have unique histories and distinct natural resources that have left each one with a particular industrial structure. These differences are important because they can significantly affect your investment returns.

For example, if you invest in the European stock market you will get more exposure to stocks in banks and insurers and producers of staple consumer goods, than you would in a global portfolio*. Conversely, you will get a significantly lower weighting in real estate and communication services – areas where Europe has minimal large company exposure. It makes sense to diversify this.

**MSCI Europe versus MSCI ACWI.*

AVOID HOME BIAS

Research shows that a lot of people overlook global investments, instead choosing to concentrate on, or go overweight on, companies based in their home countries. This is called 'home bias'. This can play out in a risky way when investing, such as when you heavily invest in the firm you work for.

Human nature leads most investors to prefer a degree of home bias – and the extent of that bias will depend on individual circumstances. But these overweight exposures can mute the benefits of diversification and increase risk.

ADDING DIFFERENT CURRENCIES TO THE MIX

Investing in international securities requires investors to accept not only equity or bond risk, but currency risk as well. Which can add a layer of potential volatility.

Over the short term, exchange rate fluctuations can inflict some real damage on portfolio returns. However, if you're investing for the long term and aren't the trigger-happy type, you'll probably find that these movements eventually cancel each other out.

EMERGING MARKETS REALLY ARE DIFFERENT

Investors might wonder why they should own emerging markets when they have tended to provide a more volatile ride for investors than the developed world. And the fact that they do tend to have higher liquidity risks. That's when focusing on the long-term picture is important. In 2030 what is the globe going to look like? Are there going to be more trade barriers, or fewer trade barriers, and more of an emerging middle class or less?

Many emerging markets take their strength from strong exports which indicate a strong domestic industry. Taken together, the emerging markets comprise the largest economic bloc, accounting for around 45% of the global economy in terms of gross domestic product (GDP). Higher growth tends to lead to higher equity market returns.

KEY BENEFITS OF INVESTING GLOBALLY

- Added diversification
- Avoidance of home bias
- Wider range of investment options

KEY DISADVANTAGES OF GLOBAL INVESTING

- Currency fluctuations
- Increased liquidity risk from emerging markets
- Additional geopolitical risk

THE BOTTOM LINE

At Architas we favour a global approach – why? Just like everything else in life, it can be worth it to expand your horizons. There isn't a 'magic' number for the percentage you should allocate to any investment (because everyone has unique needs and goals). But it's a smart idea to base this on your appetite for risk, and the likelihood that you'll actually stick to your investment plan.

A meaningful allocation to international investments can provide a number of benefits to investors. Including a better diversified portfolio, the potential for higher returns and access to a much broader universe of investment opportunities.

Big data

WHAT'S THE BIG S

Data has proved to be a very valuable commodity in the 21st century. And big data even more so. Characterised by the 3 Vs, that is volume, variety and velocity, a new service industry has built up around the collection, collation and analysis of big data. But what can this analysis reveal and why are the results so highly prized?

The 'digital age' coincides with the beginning of this century, more precisely pinpointed at 2002. About this time, an individual's digital storage capacity reached a critical point, having doubled every 40 months since the 1980s. That's because electronic technology, such as handsets and laptops, became commonplace. The things we view, search for and buy online are logged, and this vast mass of data then analysed to reveal patterns of behaviour.

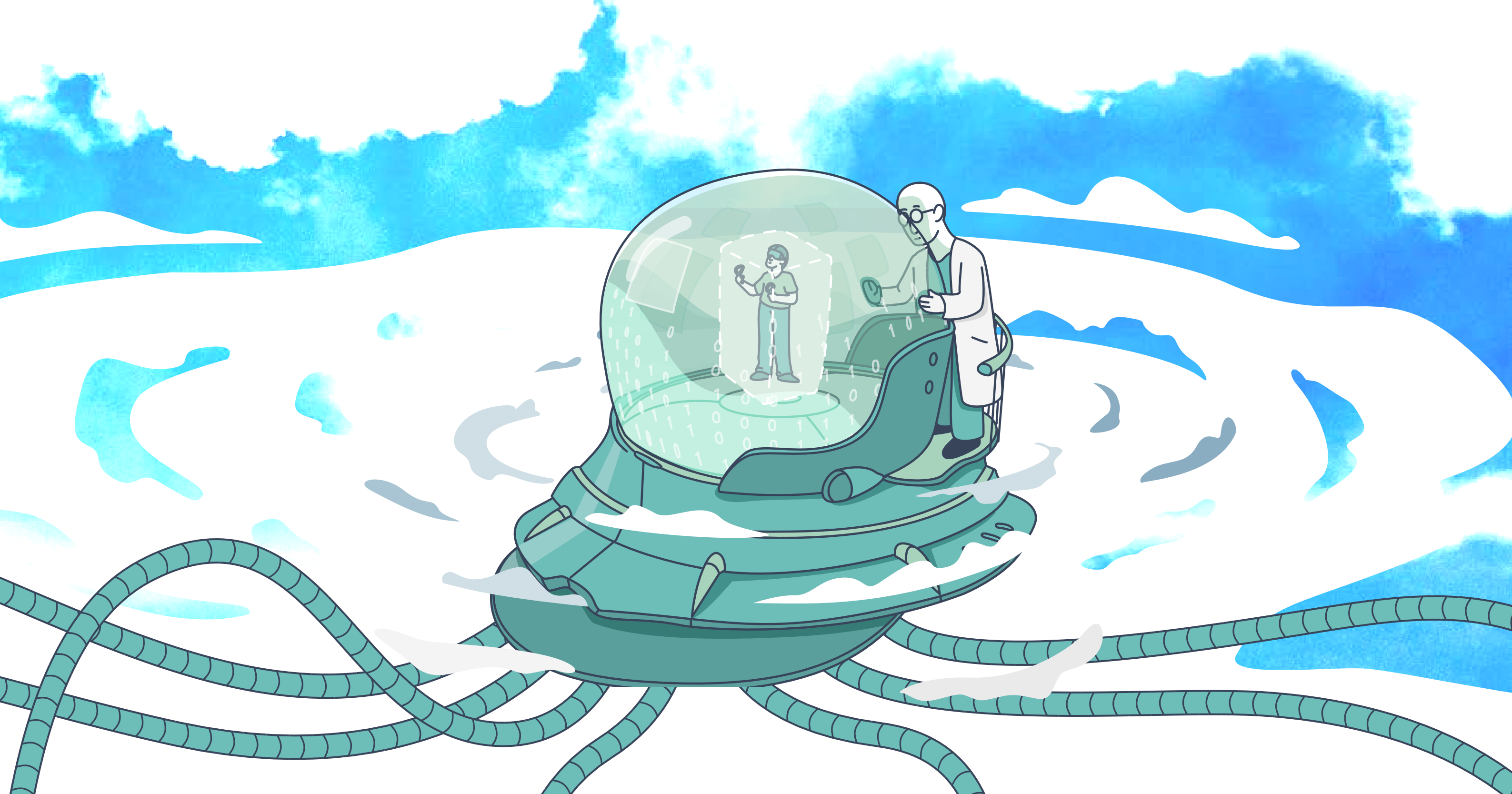
And here's where the value in big data lies. If interpreted correctly, the data can act as a predictive tool. Online searching, purchasing and social contact all feed into a new area of study called behaviour analytics. Understanding consumer behaviour allows marketing companies to get ahead of buying trends. It can even allow governments to anticipate demand for infrastructure, such as schools or hospitals.

So much so that during the Covid-19 pandemic, big data has been front and centre in trying to minimise the spread of the disease. It's a vital tool in contact tracing, as well as for case identification and even the development of medical treatments. Early adopters included China, South Korea, Taiwan and Israel. And all showed early success in controlling local outbreaks.

But there is always a downside. The skill in interpreting data lies in distinguishing clear signals from 'noise', which could lack relevance and mislead. And in the wrong hands big data can become a very powerful tool. In recent years, it has become clear that personal data, gleaned from social media, can be used to gain undue influence, for example during elections. Data protection remains critical and the opt out button an increasingly vital tool.

The digital transformation

Big data refers to data that can't be processed with traditional applications due the challenge of capturing, storing, transferring, querying, and updating data in such large amounts. This makes understanding big data a key component of the corporate digital transformation journey. In the right hands, successfully using data can transform companies and the way they do business.



Analytics is the secret sauce

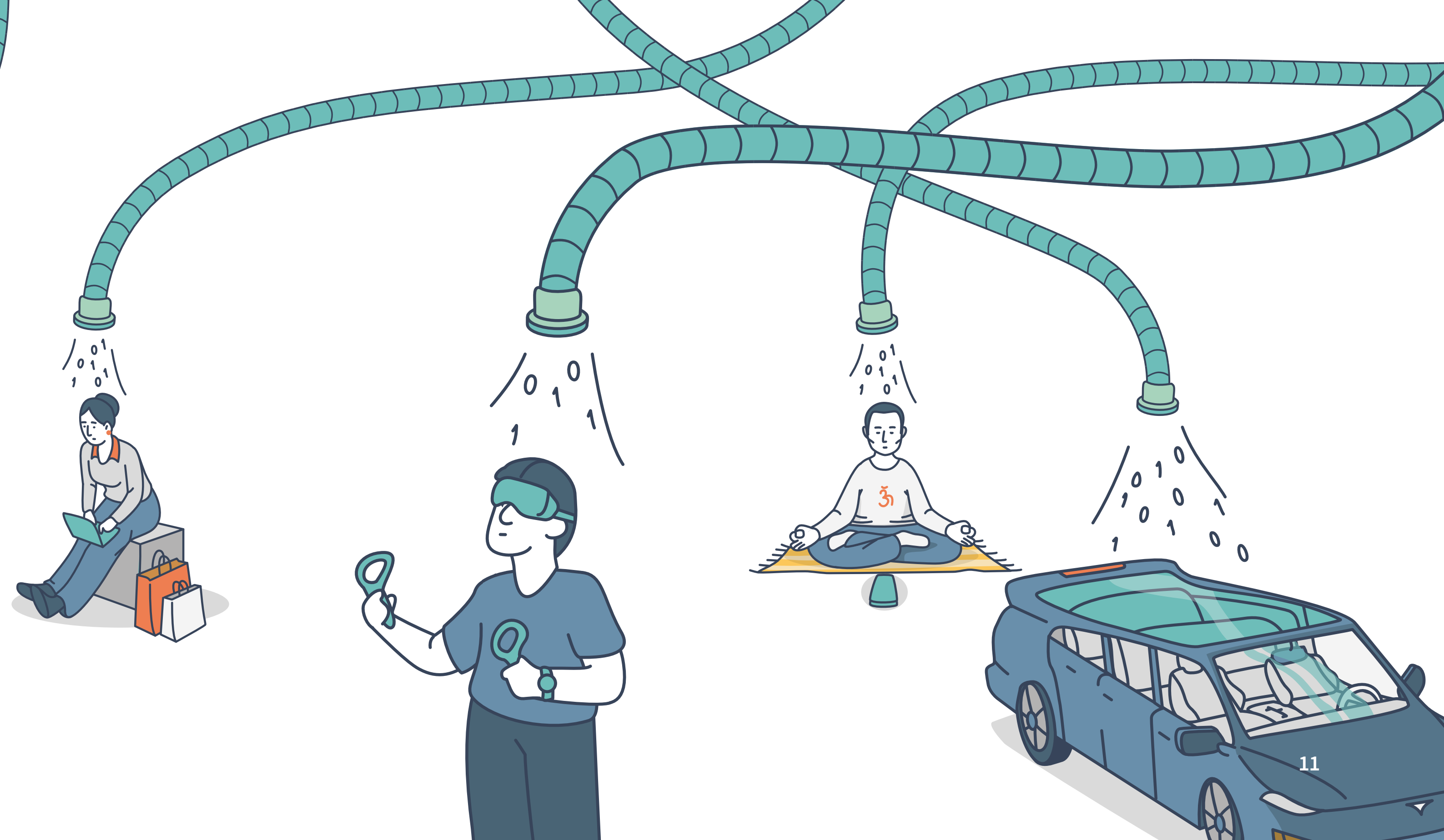
Big data analytics is the often-complex process of examining big data to uncover information – such as hidden patterns, correlations, customer trends, and other insights. In fact, this analytics is the secret sauce that makes big data so powerful. Data is valuable but if unrefined it can't really be used. The companies that are on this journey of transformation are finding that data can be one of the biggest assets they have.

The big data megatrend

Megatrends are characterised as far-reaching, global patterns related to behaviour, mobility and environment. It's easy to see that big data falls into the megatrend category. As it impacts everyone in one way or another by bringing a change to the way we run business and society. It's not about what we know. It's what we do with what we know.

Investing in megatrends

Investing in megatrends aims to provide access to market leading companies that disrupt entire industries, with unique assets, strong business models and long-term drivers. So, it's not surprising that investing in megatrends has the potential to add to performance and risk diversification. Megatrends are shaping the way we live, the global economy and even the stock market of the future. With big data playing a big part of that, creating big changes and big opportunities for the future.



Facts & Figures

QUARTERLY DATA

US stocks	European (but not UK) stocks	UK stocks	Emerging market stocks	Asian (but not Japanese) stocks	Emerging market bonds
8.5%	**8.4%**	**5.7%**	**5.1%**	**4.8%**	**3.9%**
S&P 500 Composite Index	FTSE All World Developed Europe excluding UK Index	FTSE All-Share Index	MSCI Emerging Market Index	MSCI Pacific excluding Japan Index	JP Morgan Global Emerging Market Bond Index

US corporate bonds	Global high yield bonds	UK corporate bonds	European corporate bonds	Global government bonds	Japanese stocks
3.5%	**2.6%**	**1.9%**	**1.2%**	**1.0%**	**-1.0%**
Bloomberg Barclays US Corporate Bond Index	ICE Bank of America ML Global High Yield Bond Index	Bloomberg Barclays Sterling Aggregate Bond Index	Bloomberg Barclays European Corporate Bond Index	FTSE G7 Index	TOPIX Index

To highlight the unpredictability of markets, the table below details the performance of global equity and fixed income indices over the past five years (in dollar terms).

This table demonstrates how volatile markets can be, and shows the benefits of diversifying your investment, or in other words, not putting all your eggs in one basket.

Index percentage growth (%)	1 Jul 20 - 30 Jun 21	1 Jul 19 - 30 Jun 20	1 Jul 18 - 30 Jun 19	1 Jul 17 - 30 Jun 18	1 Jul 16 - 30 Jun 17
US stocks	40.8	7.5	10.4	14.4	17.9
European (but not UK) stocks	37.5	-2.2	4.1	4.6	25.3
UK stocks	35.8	-15.5	-3.1	10.8	14.8
Japanese stocks	21.2	0.4	-7.9	8.9	18.1
Asian (but not Japanese) stocks	34.3	-12.6	8.2	8.8	19.6
Emerging market stocks	41.4	-3.0	1.6	8.6	24.2
Global government bonds	-0.1	5.4	5.6	1.6	-5.1
Global high yield bonds	15.6	-0.6	7.5	2.1	12.4
US corporate bonds	3.3	9.5	10.7	-0.8	2.3
European corporate bonds	9.4	-1.8	2.2	3.5	4.0
Emerging market bonds	6.8	1.5	11.3	-2.4	5.5
UK corporate bonds	7.1	7.0	1.6	3.3	-2.1

Past performance is not a guide to future performance. Rebased in US dollar where appropriate, i.e. all index returns are recalculated based on exchange rates to give returns for a dollar investor. Source: Morningstar Direct, June 2021.

Important INFORMATION

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