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

MARKET OUTLOOK
Looking ahead to the coming months

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The view

Summer 2020

architas

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Welcome

to The View – Summer 2020

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.

Behavioural biases are unconscious thoughts that can influence our investment decisions, sometimes negatively, and they are more likely to appear during times of stress or uncertainty. We highlight five common biases and show how we manage behavioural bias at Architas.

Most people require a blend of assets to meet their investment goals, but which blend suits a particular investor will depend on their risk appetite. We help you understand what is involved in identifying your risk appetite.

Covid-19 looks set to leave a trail of economic damage that will outlive the pandemic itself. Against this backdrop, it is hard to conceive the pandemic could create anything beneficial. Even so, Covid-19 may leave some positive long-term economic changes.

Jaime Arguello
Chief Investment Officer

Market BACKDROP

While Covid-19 continued to dominate news headlines, the lifting of lockdown across most major economies provided relief to many asset classes. Markets rebounded on this and the continued pledge of support from governments and central banks globally.

The pandemic fallout has arguably created the biggest global economic shock in living memory. However, the authorities' collective action to limit business failures and provide support for the unemployed seems to have had a huge influence in stemming an economic catastrophe. Also, the much reported 'global reset' to prioritise sustainable development captured the imagination of the world.

Unsurprisingly global economic growth faltered, however the timely, pro-growth policies provided a much brighter outlook for 2021. As a result, some stock markets around the globe finished June near the levels they were at before the sharp fall in prices between January and March. As well as gains for stocks, lower risk investments have also been mostly positive.

ECONOMIC FACTORS

Tightrope walk to recovery. As restrictions have begun to ease, the path to economic recovery, although promising, is still highly uncertain and vulnerable to a second wave of infections. So a global growth crisis remains a looming concern.

Shopping spree. At the first signs of lockdown easing many countries saw a record jump in retail sales figures. But the spike comes after months of drastic declines and economists warn consumer spending is not out of the woods yet.

RISKS

Fears of a second wave. Investor sentiment deteriorated at the end of the quarter, when the focus shifted from positive surprises from US data to the risk of a second wave.

No deal on digital tax risks trade war. The Organisation for Economic Cooperation and Development (OECD) warned that countries must agree on a global approach for taxing tech giants or risk a widespread trade war. But negotiations collapsed when the US withdrew and threatened to impose tariffs in retaliation.

FINANCIAL MARKETS

Stock markets were positive across the board. Healthy returns in April kickstarted the quarter's gains, with the US among the strongest performers, having been hit hard in the first quarter slump.

Lower risk investments were also positive. Signals from major central banks for years of extraordinary measures to counter the economic fallout from the coronavirus pandemic provided support to bond markets.

CONCLUSION

This quarter has brought hope and worry in equal measures. As lockdown rules ease the focus is on reopening economies and restoring livelihoods. The question right now is if the sense of optimism is overstated and if the global economy can keep up with the race to a recovery.

However it is widely accepted that the path towards post-Covid-19 normality may well be arduous and long, especially given the possibility of a second wave.

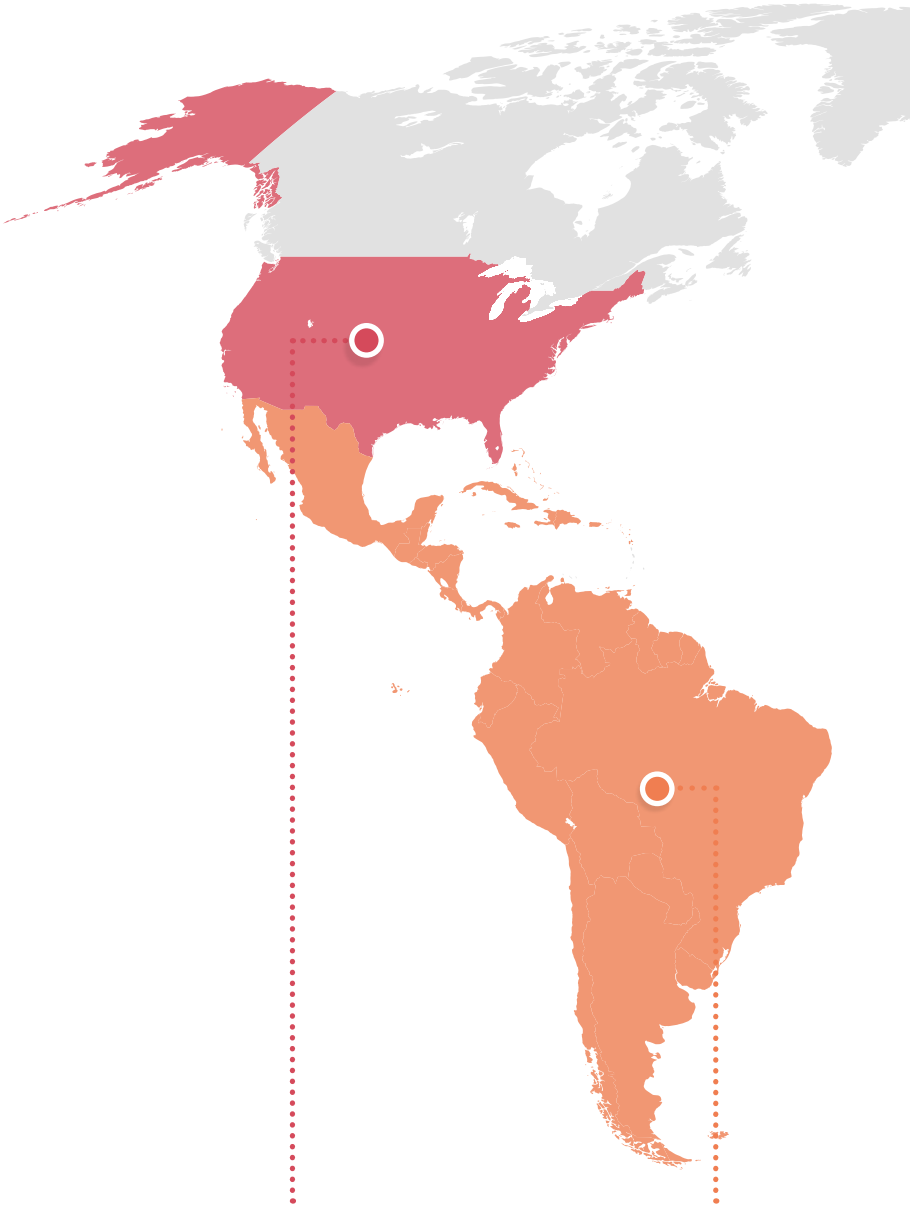
While investors are regaining their confidence, we believe that the turbulence of the second quarter reinforces the importance of being diversified across a range of different asset classes.

Market OUTLOOK

Markets jumped considerably over the quarter, mainly due to the pace and scale of the unprecedented stimulus measures delivered around the world. Investors are now looking ahead on the hopes for economic recovery and hoping for pent-up demand for consumption to come back quickly.

Business and consumer sentiment are improving, as we move out of the lockdown environment. We do not yet see signs of a robust economic recovery, apart from encouraging unemployment figures, and we believe it's too early to call.

In the meantime, geopolitical risks remain. We've had the rhetoric in the US and China ramping up recently, and Brexit negotiations are coming to a head. And there's the possibility of a second wave of the virus. What this means is that we are probably due for some volatility.



UNITED STATES

STOCKS ⊖ BONDS ⊖

- Buoyed by the extraordinary stimulus from the US Federal Reserve and government, US stocks have recovered strongly. We will be watching company earnings closely for continuing signs of improvement.
- We retain a balanced view on US bonds. Having rallied in recent months, some are starting to look a little expensive. Post-pandemic, we are likely to see a market that is prone to sharp sell-offs.

EMERGING MARKETS

STOCKS ⊖ BONDS ⊖

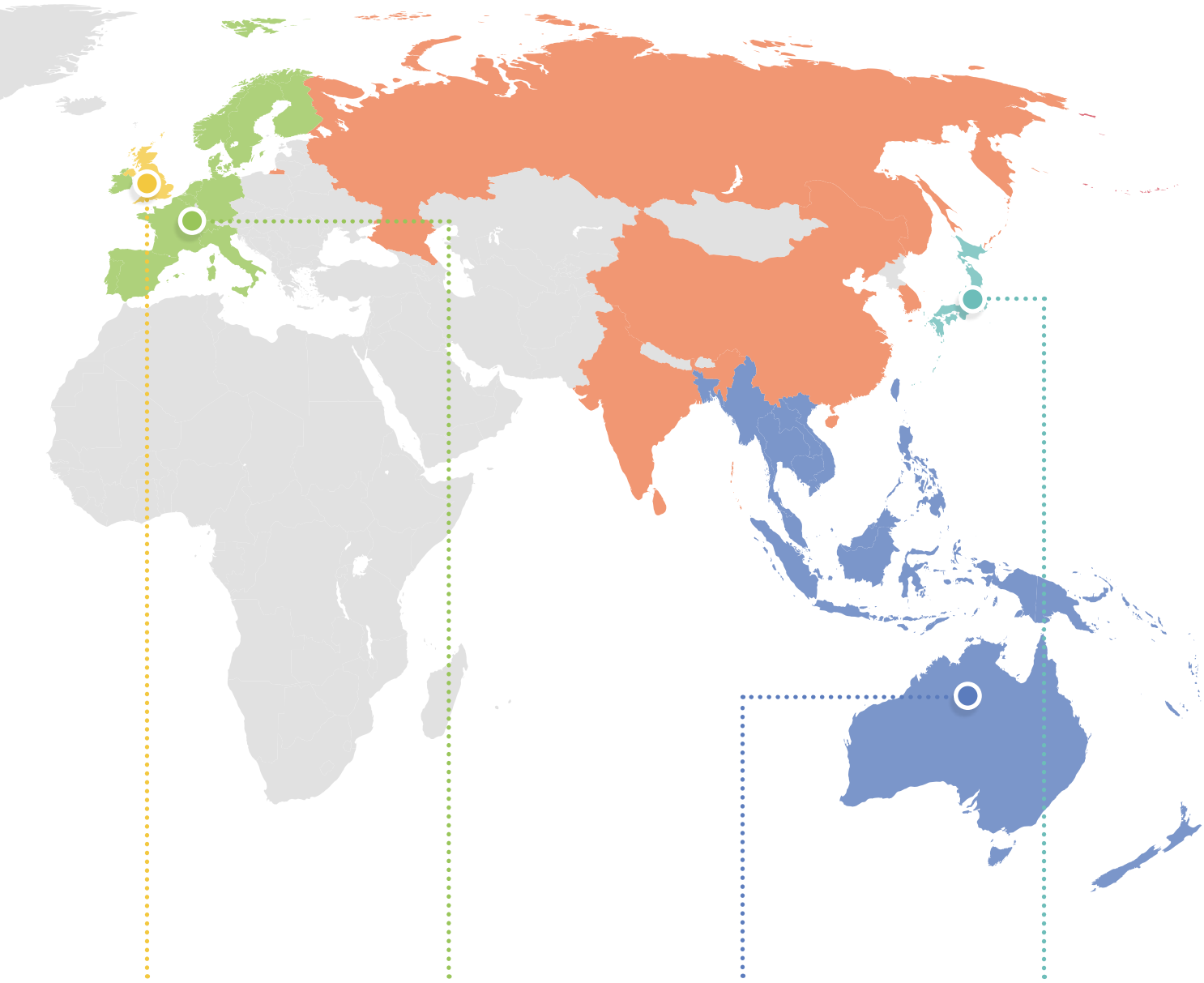
- The slowing Chinese economic growth and US trade uncertainty could hurt stocks, although they look relatively good value relative to other regions.
- If US interest rates stay unchanged, it could help support bond prices, as many companies in the region borrow money in US dollars.

KEY

△ Positive

▽ Negative

⊖ Neutral



UNITED KINGDOM

STOCKS ⊖ BONDS ⊖

- The outlook for the UK is uncertain and slightly trails other developed markets. If the political backdrop becomes clearer, it could help improve investor confidence in the region.
- Lower risk bonds are relatively attractive, providing some potential protection if stock markets become more volatile.

EUROPE

STOCKS ⊖ BONDS ⊖

- The outlook remains mixed. Earnings have dropped however this is countered by the supportive growth measures which are likely to become more prevalent.
- Interest rates remain low, a factor that has the potential to support bond prices. However, corporate bonds look less appealing compared to other regions.

ASIA PACIFIC

STOCKS ⊖

- As with emerging markets, any Chinese slowdown in growth could hurt the region, as China's export activity is a big influence.
- Swings in the oil price impact the region's significant energy industry. The oil price has being rising on improving economic data however developments will remain a focus.

JAPAN

STOCKS ⊖

- Japanese stocks have lagged other developed markets recently. Share prices look reasonably good value, but positive factors for rising prices are slightly lacking.
- While coronavirus is still the most significant issue, the impact of last year's tax rise remains an ongoing risk factor. The recent decline in tax revenue is a setback for Japan.

SPOTLIGHT ON...

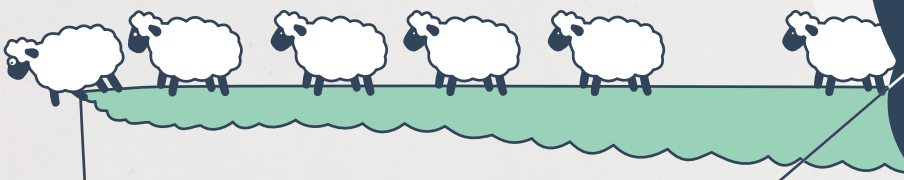
behavioural biases

when investing

Loss aversion

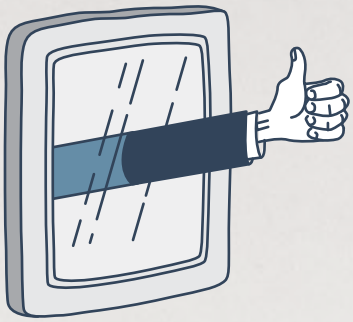
Loss aversion is a tendency to avoid losses, even if it means missing out on gains. It stems from the idea that humans reportedly experience the pain of a loss twice as intensely as the pleasure of an equivalent gain. A great example is pulling all of your money out of the stock market after a big drop, locking in losses and potentially missing out on a subsequent recovery.

Behavioural biases are unconscious beliefs or thoughts that can influence our decisions, sometimes with negative consequences. Without proper care they can affect even the most prudent investors, and they are more likely to appear during times of stress or uncertainty. Here we highlight five of the most common biases, and show you how we manage behavioural bias at Architas.



Bandwagon effect

The bandwagon effect involves following the crowd, rather than making your own judgments. In other words, you are 'jumping on the bandwagon'. It can be especially common during times of uncertainty or when people are faced with a difficult decision. The bandwagon effect might lead investors to impulse-buy a rising investment after it's received a lot of positive news coverage. Or perhaps to sell an investment after a friend or relative has sold theirs.

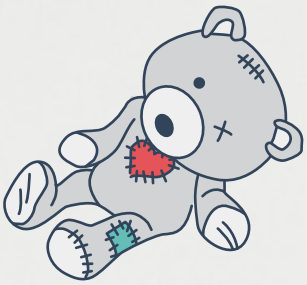


Confirmation bias

This involves focusing only on information that confirms your beliefs, and ignoring any new data that might challenge them. If you feel positive about an industry, you might decide to invest after a good run of stock market performance, while overlooking poor earnings growth or upcoming regulatory challenges.

Recency bias

Recency bias encourages short-term thinking. It causes people to place undue importance on recent events, usually while overlooking what happened further in the past. They may also take recent events as an indicator of what is yet to come. For investors, this could mean taking on too much investment risk during a rising market or selling investments after a period of volatility.



Endowment bias

This is the belief that what we own is more valuable than what we do not. Once an object – or investment – becomes our property, letting go of it can feel like a loss. Even if there is a better alternative available. This can cause investors to hold on to an investment even when it might be better to sell it.

WHAT WE DO AT ARCHITAS

At Architas we have a robust, consistent investment process that helps us to avoid falling prey to behavioural biases.

- We strive to make objective decisions based on evidence, and only after considering any counter-arguments
- We have a diverse team of analysts, each specialising in different areas. They conduct regular group discussions and are encouraged to challenge each other on their opinions
- We continually monitor the global economy, stock markets and our underlying investments. We aren't afraid to make changes if new information presents itself
- We have consistent processes for reviewing funds and sectors, so we can't focus solely on information that supports a particular view
- And we monitor the managers of the underlying funds held in our portfolios, to make sure they are doing the same.

AN INTRODUCTION TO **UNDERSTANDING YOUR RISK APPETITE**

In the world of investing, identifying and understanding your risk appetite is key to creating the best asset mix for you to achieve your investment goals.

The right blend?

Different types of assets offer different levels of risk and potential returns. Stocks and property are typically viewed as high risk with higher potential returns. At the opposite end of the spectrum, you have government bonds which are usually perceived as lower-risk investments with lower potential returns. Corporate bonds typically fall somewhere in between. Most people require a blend of these asset classes to meet their investment goals. But which blend suits which investor?

Risk appetite - what is it, and why is it important?

An investor's risk appetite is also called risk tolerance, and essentially it's their tolerance for taking on investment risk. And often a trusted expert (an adviser, broker or agent) will provide an investor with a questionnaire to determine their suitability for investing. There are a lot of factors involved, but the outcome should identify the investor's risk tolerance. Four main factors are involved here:

1

Circumstances

As an investor, your circumstances (age, salary, stability of income) greatly affect the risks you are willing to take when investing. Typically, investors far from retirement age generally have a higher risk tolerance than those nearing retirement. This is because they can benefit from a long-term investment approach which may enable them to ride out the ups and downs associated with higher risk investments. Investors with relatively stable salaries or high job security also often have a relatively high risk tolerance.

2

Investment goals

A key factor is identifying realistic goals because your risk tolerance and goals may not match! Investors with a short-term investment goal, perhaps to support children through university might seek lower-risk investments (maybe even cash) to meet this goal. These investors would possess a lower risk tolerance because there is less time to recover losses. They may, though, choose higher-risk investments for longer-term goals, such as planning for retirement or investing for grandchildren. Here they might exhibit a higher risk tolerance because there is more time to recover any losses or to benefit from potential investment growth.

3

Capacity for loss

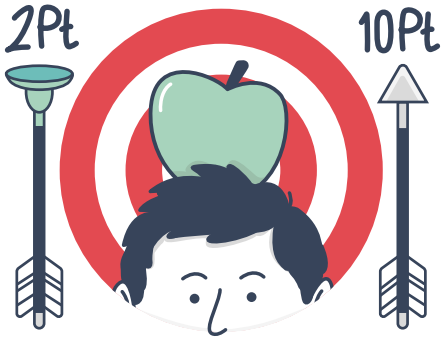
This refers to an investor's capacity to undergo losses. An investor who would not face reduced living standards from capital losses on their investments has a relatively high capacity for loss and might, in turn, have a relatively high risk tolerance (potentially by already having accumulated an emergency fund). So they may be able to take a higher-risk investment approach. Investors who cannot afford capital losses exhibit a lower capacity for loss and lower risk tolerance. They may seek less investment risk.

4

Risk temperament

Investors show varied approaches to risk: some are relatively adventurous and others more cautious. Also, another critical factor is the importance of the goal (an investor might be able to take more risk with investments for a dream holiday but less risk with investments for children's education). There are many ways to classify the risks an investor is willing to take. Cautious investors are prone to worry about their finances and might want to avoid more speculative investment areas. An adventurous investor may perhaps invest in higher-risk assets, such as stocks, and avoid lower-risk investments such as government bonds.

Achieving your investment goals with the right level of risk



Assessing your risk appetite is a great way to break down the many psychological barriers and fears involved with investing. But with a little inspiration, financial commitment and help from a trusted expert, you could achieve your investment goals while knowing you are not taking on more or less risk than you are comfortable with.

Covid-19: a catalyst for change

WHAT'S THE BIG STORY?

Covid-19 looks set to leave a trail of economic damage that will outlive the pandemic itself. Massive government and central bank stimulus packages have led to dramatic rises in debt levels. Governments may need to increase tax levels to pay off this debt. Meanwhile global supply chains fractured during lockdowns. Against this backdrop, it is hard to conceive that the pandemic could create anything beneficial. Even so, Covid-19 may leave some positive long-term economic changes.

Social support

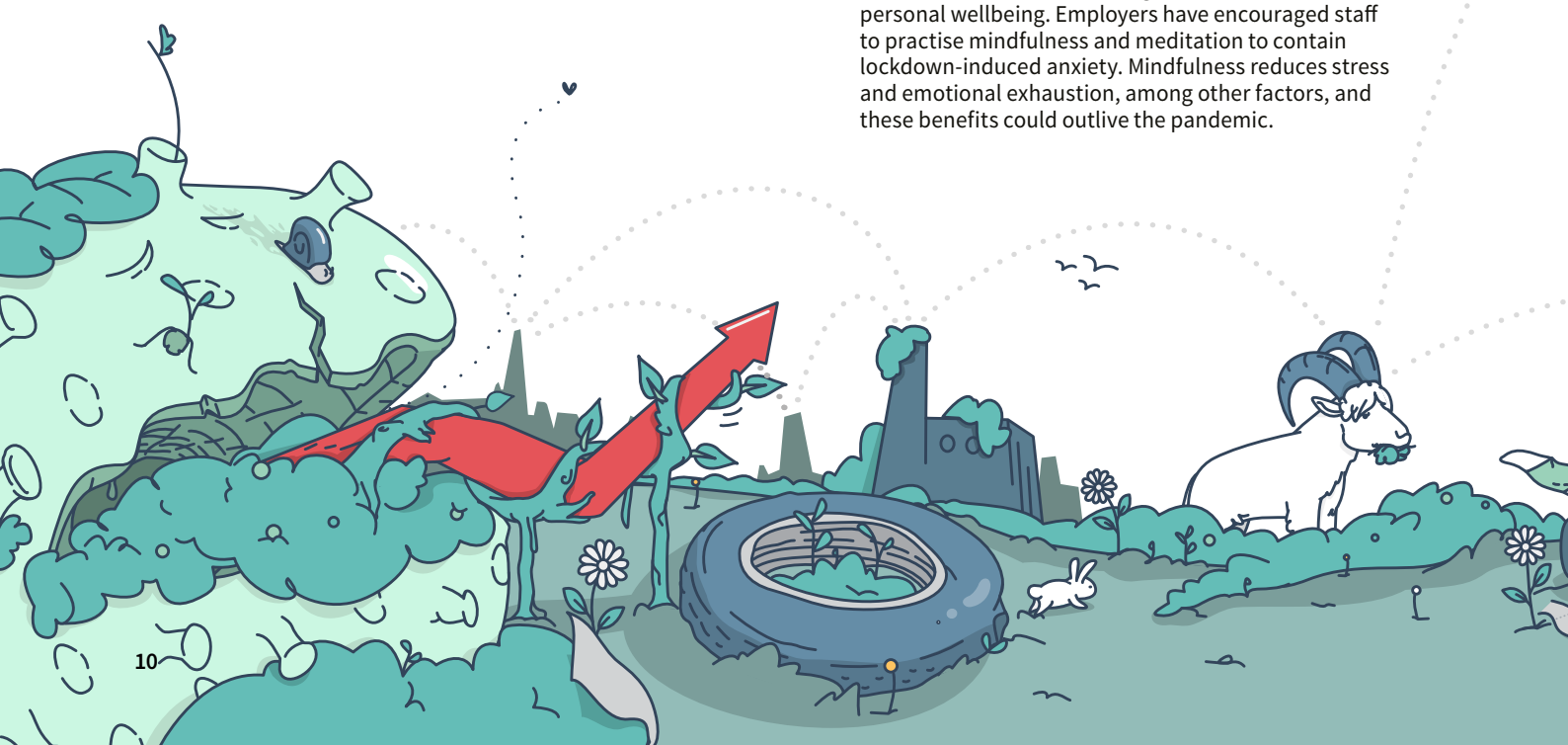
First, the Covid-19 crisis has led to a renewed focus on social issues and placed companies' treatment of stakeholders under greater scrutiny. Indeed many companies have visibly supported society, employees, suppliers and other stakeholders during the pandemic.

Danish shipping company Maersk demonstrates such support. Maersk supplied ships to transport emergency goods even when such journeys were not profitable. But the media has named and shamed some other companies, with a less socially responsible corporate culture, which could lead more ethically minded investors to shun them.

Benefits to wellbeing

Covid-19 has also driven improvements in our environmental wellbeing. So the European Union's economic plan for recovery from the virus, Next Generation EU, links massive financial stimulus to the European Green Deal. This could accelerate the trend for sustainability.

In addition, the virus is driving improvements in our personal wellbeing. Employers have encouraged staff to practise mindfulness and meditation to contain lockdown-induced anxiety. Mindfulness reduces stress and emotional exhaustion, among other factors, and these benefits could outlive the pandemic.



Supply chain changes

Global supply chain breakdowns could boost local businesses. The lockdown-driven fall in global trade ravaged global manufacturing. Consider China's Hubei province, from where Covid-19 emerged. It makes electronic, automotive and pharmaceutical parts and its shutdown impacted companies worldwide.

Whether such supply chain breakdowns will lead to massive reshoring is open to doubt. Even so, many commentators now believe firms will start to develop local supply chains in addition to existing global networks, to the benefit of local suppliers.

Moreover, recent instances of Covid-19-driven panic-buying highlighted further supply chain problems. This was because retailers struggled to match the supply of consumer goods with fluctuating consumer demand.

But digital tools, such as artificial intelligence, machine learning and big data, can make supply chains more resilient. Procter & Gamble, the consumer goods manufacturing giant, already uses such tools.

Industry commentators think such applications could soon become more widespread, with Covid-19 the tipping point for change. This could also benefit the environment, with wastage reduced as goods supply more closely matches consumer demand.

Technology trends

We could also see robots (virus-free of course!) replace waiters in restaurants. And the acceleration of remote working, online shopping and video-conferencing trends during lockdown could lead construction companies to build more data centres.

Despite Covid-19's devastating impact and continuing economic challenges, it looks set to unleash long-lasting changes, some of them positive. At Architas, our investment team constantly monitors economic developments and can adjust its funds in line with underlying trends. This can provide some reassurance to people who, like us, believe in investing for the long term.

Facts & Figures

QUARTERLY DATA

US stocks	Asian (but not Japanese) stocks	European (but not UK) stocks	Emerging market stocks	Global high yield bonds	Emerging market bonds
20.97	**20.64**	**18.87**	**18.60**	**11.89**	**11.60**
S&P 500 Composite Index	MSCI Pacific excluding Japan Index	FTSE All World Developed Europe excluding UK Index	MSCI Emerging Market Index	ICE Bank of America ML Global High Yield Bond Index	JP Morgan Global Emerging Market Bond Index

Japanese stocks	UK stocks	US corporate bonds	European corporate bonds	UK corporate bonds	Global government bonds
11.56	**10.17**	**9.37**	**8.15**	**3.86**	**1.74**
TOPIX Index	FTSE All-Share Index	Bloomberg Barclays US Corporate Bond Index	Bloomberg Barclays European Corporate Bond Index	Bloomberg Barclays Sterling Aggregate Bond Index	FTSE G7 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 sterling 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 (%)	01 Jul 19 - 30 Jun 20	01 Jul 18 - 30 Jun 19	01 Jul 17 - 30 Jun 18	01 Jul 16 - 30 Jun 17	01 Jul 15 - 30 Jun 16
US stocks	10.7	14.5	12.5	21.3	22.3
European (but not UK) stocks	0.7	8.0	2.9	29.0	6.2
UK stocks	-13.0	0.6	9.0	18.1	2.2
Japanese stocks	3.4	-4.4	7.2	21.6	7.2
Asian (but not Japanese) stocks	-10.0	12.2	7.1	23.1	9.9
Emerging market stocks	-0.1	5.4	6.8	27.8	3.9
Global government bonds	8.6	9.5	-0.1	-2.3	32.1
Global high yield bonds	2.4	11.5	0.4	15.7	20.3
US corporate bonds	12.8	14.9	-2.4	5.3	27.0
European corporate bonds	1.2	6.0	1.8	7.0	23.3
Emerging market bonds	4.6	15.5	-4.0	8.6	29.8
UK corporate bonds	10.2	5.4	1.6	0.8	12.7

Past performance is not a guide to future performance. Rebased in sterling where appropriate, i.e. all index returns are recalculated based on exchange rates to give returns for a sterling investor. Source: Morningstar Direct, July 2020.

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Call 0800 953 0197

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