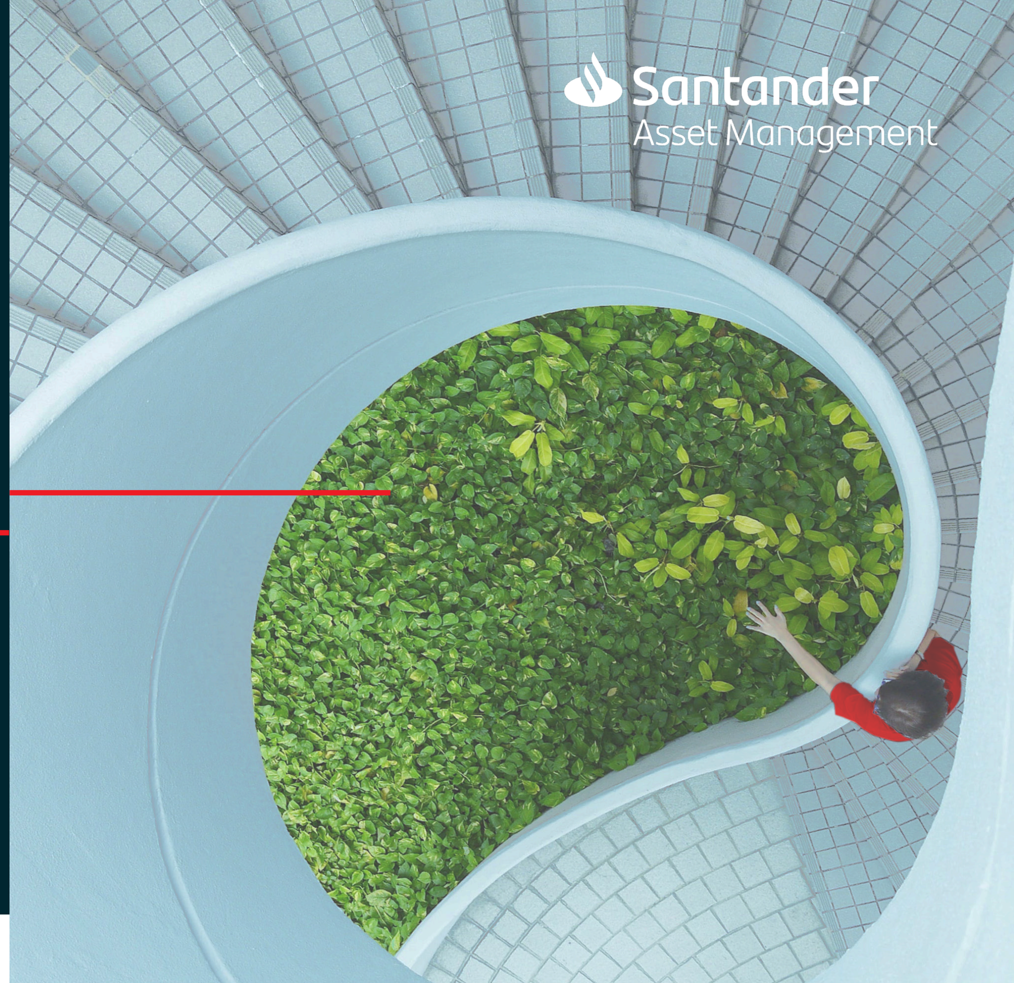

State of Play

20 January 2022

It is over two years since the first cases of COVID-19 were confirmed outside of China. Our Investment Specialist, Simon Durling, shares his thoughts on whether we have finally started to turn the corner on this devastating pandemic whilst investment markets obsess on inflation data, employment numbers and the future path for interest rates.

Learning to live with the virus

On 9 January 2020 the World Health Organisation reported that Chinese authorities had determined the recent outbreak of viral pneumonia cases had been caused by the novel coronavirus. Just four days later the very first case outside of China was discovered in Thailand before the virus spread to Europe and the rest of the world. Since then, over 330 million people have tested positive and sadly over 5.5 million people have lost their lives.

The current Omicron mutation has swept through the UK faster than any of the previous waves, albeit it appears with milder symptoms, with positive test data having broken all previous records but thankfully it has not drastically fed through into hospitalisations when compared with last winter.

Many investors may be asking what's next? You would expect that given the enormous impact the pandemic has had on both economies and investment markets that market participants would be busy working out whether the virus may return with another variant to de-stabilise our financial world yet

again. However, investment markets rarely look back in time and only obsess on what may happen in the future. In recent weeks the attention has turned primarily to inflation, economic recovery, and valuations, rather than whether a new variant will be discovered. You could argue therefore that investment markets see the pandemic as 'old news' and largely ignore the daily data as they have already concluded that they expect governments in time to ask people to learn to live with the virus in whatever form it may take in the future. Time will tell whether they are right.

Fastest price rises in nearly 30 years

According to the Office for National Statistics (ONS) the Consumer Price Index rose to 5.4% in the 12 months to December 2021, the highest since April 1992. Housing and household services were the biggest contributors to the rise, closely followed by transport, food, furniture and household goods. The figure was higher than forecast, increasing the pressure on ministers to work through intervention measures on energy prices in advance of the April energy price cap being calculated. With the current data the price cap could increase by an estimated 50% - pushing it up from the current £1,277 to £2,000 per year. Importantly, if this did happen experts are predicting inflation to hit 6-7% by April, further exacerbating the pressure on households. The only real positive from yesterday's (Wednesday 19 January) figures is that factory prices have eased from a high in November, providing a view on pressure easing in the future, albeit some months from now. This week has seen oil prices continue to rise as Brent Crude hit $89 for the first time in over seven years, putting pressure on prices at the petrol pumps and of course inflation. Markets then pushed prices higher as traders responded to an outage on a pipeline from Iraq to Turkey, squeezing supply shortages alongside political concerns about tensions building between Russia and the US over Ukraine.

Strong UK employment data

Unemployment continues to fall in the UK with a further 184,000 jobs added in November according to the ONS bringing the rate down to 4.1%. Importantly the rate is still falling despite the end of the furlough scheme last September when many were concerned about a spike in those looking for work once the scheme had ended. The numbers include a shift in those taking up part time jobs after a large fall during the pandemic. In addition to the rise in employment, the number of job vacancies in October to December 2021 rose to a new record of 1,247,000, an increase of 462,000 from its pre-pandemic January to March 2020 level, with most industries displaying record numbers of vacancies. The ratio of vacancies to every 100 employee jobs reached a record high 4.1 in October to December 2021.

The rise in inflation to 5.1% in November is starting to affect wage growth as the rise in earnings fell below the rise in the cost of living for the first time in over a year as earnings (even including bonuses) only rose by 4.2% in the three months to November. The Resolution Foundation think tank said: 'Real wages officially began to fall in November, and the current period of shrinking pay packets is likely to get worse before it starts to ease in the second half of 2022'.

Salaries, however, are still above pre-pandemic levels. Average weekly pay, excluding bonuses, rose to £550 in November compared with £510 in March 2020. The base effect on earnings data is starting to unwind as it compares from the previous 12 months which with so many still on furlough (only 80% of their normal pay) the comparison is from an artificially low point.

The vacancy numbers demonstrate the challenge faced by many employers competing for talent pushing up initial contract offers and those who actively look for a new role often negotiating a marked increase on the current remuneration package. The pandemic has triggered 400,000 people to leave the jobs market, further exacerbating the lack of applicants applying for jobs advertised. Whilst the base effects have almost fallen off the calculations, many commentators expect the large number of vacancies to shift power from employer to employee putting additional pressure on future inflation as elevated wage rise levels are expected to remain in the short-term.

Market update

So far this year markets have been very sensitive to any new news or data released, whether this be inflation, jobs data or economic indicators. Given the positive run that shares have had since they fell sharply at the beginning of the pandemic some investors remain worried about valuations, especially in the sectors which have benefited the most through lockdowns. The technology dominated NASDAQ Index fell again on Tuesday (18 January) by over 2% after making a small recovery the previous couple of trading days and now stands 7.5% below the highs of the end of last year.

This volatile theme continued throughout the week with further sharp falls in some indices after making decent gains in the previous few days. Even during the trading day, you can often observe a fall at the beginning of the day only for the index to recover and close either flat or slightly up (or vice versa). For individual investors, times such as these are far harder to bear as the reassurance that momentum brings is missing. The lack of consistency in price movements makes it very hard to read market trends or connect different bits of information that appear to be influencing sentiment.

In many ways it is clear evidence on why most investment recommendations are linked to a much longer time horizon to avoid investors potentially experiencing a loss early on in their investment journey. Clearly everyone's

circumstances may be different and needing access to capital at short notice may be the priority over short-term losses. However, investing remains an emotional journey for a lot of people and human emotions often trigger the wrong decision at precisely the wrong time.

Ultimately, investing is about putting in place an appropriate financial plan and implementing this to match your circumstances, time horizon and risk tolerance. Financially many savers arguably face harder choices now than at any time in recent memory:

- Interest rates, whilst likely to rise in the future are at near record lows.
- Bond investments at current coupon levels offer an investment return much lower than inflation whilst rising yields place some of the capital value at risk.
- The current rate of inflation means that if money is left in a bank account with low or no interest paid then the value of this money will halve in just over 12 years.

Find out more!

Click **here** to read our latest A Month in the Markets, where our Head of Multi-Asset Solutions, Stefano Amato, looks at how key themes impacted markets in December.

Note: Data as at 18 January 2022.

Important Information

For retail distribution.

This document has been approved and issued by Santander Asset Management UK Limited (SAM UK).

This document is for information purposes only and does not constitute an offer or solicitation to buy or sell any securities or other financial instruments, or to provide investment advice or services. Opinions expressed within this document, if any, are current opinions as of the date stated and do not constitute investment or any other advice; the views are subject to change and do not necessarily reflect the views of Santander Asset Management as a whole or any part thereof. While we try and take every care over the information in this document, we cannot accept any responsibility for mistakes and missing information that may be presented.

All information is sourced, issued and approved by Santander Asset Management UK Limited (Company Registration No. SC106669). Registered in Scotland at 287 St Vincent Street, Glasgow G2 5NB, United Kingdom. Authorised and regulated by the FCA. FCA registered number 122491. You can check this on the Financial Services Register by visiting the FCA's website www.fca.org.uk/register.

Santander and the flame logo are registered trademarks. www.santanderassetmanagement.co.uk.