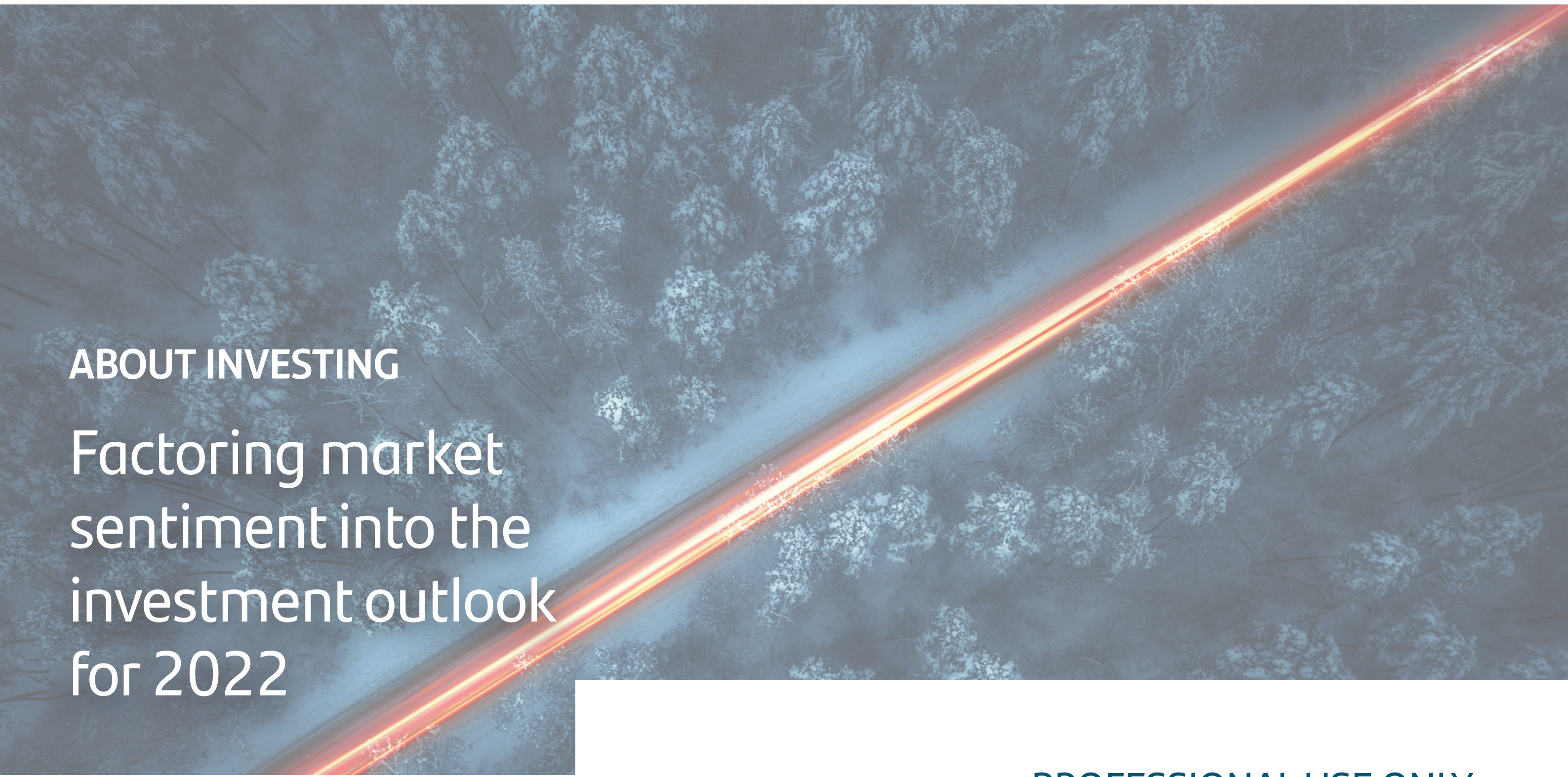

ABOUT INVESTING

Factoring market sentiment into the investment outlook for 2022

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As we reflect on 2021 and look forward to 2022, investor mood and expectations continue to exert their influence over the markets.

Investors were hoping for a year of recovery, revival and reset in 2021 as vaccines paved the way to normality. In the end, it wasn't quite that straightforward. While global markets hit record or near-record highs in 2021, there were also periods in which investment sentiment turned bearish and prices moved accordingly.[1] Inflation concerns were at the forefront of investors' minds for much of the year, as were supply chain disruptions, suggestions of a slowdown in growth and the ongoing impact of the COVID-19 pandemic.

Investment markets reflect much more than broad economic movements

In early October 2021, the US S&P 500 was close to its record high. Yet it had just recorded its biggest monthly loss since the start of the pandemic, with investors increasingly worried about factors such as rising inflation and the possibility of a US debt default.[2]

There was a similar dynamic in May, when investor concerns over the US inflation outlook prompted a sell-off in both the US and Europe.[3] Inflation worries contributed to a FTSE 100 dip in September too,[4] due largely to rising energy prices, while the July falls in global markets reflected investor doubts over the economic outlook in China and concerns about a potential removal of some of the central bank stimulus put in place during the pandemic.[5] In other words, even as economies reopened and recovered from the worst effects of the pandemic, markets were impacted by the way investors anticipated developments and interpreted signals.

Interest rate increase in response to record levels of inflation

The Bank of England increased interest rates in December from a record low of 0.1% to 0.25%.[6] The move was in response to rising inflation which hit the highest level for 30 years in December at 5.4%, with the expectation of it rising higher by this Spring.[7] The rise in interest rates is the first since August 2018 with rates having remained below 1% since March 2009.[8] Further rate rises are expected as the BoE attempts to bring down inflation over time back to their target level of 2%.

2022 got off to a cautious start but the outlook is broadly positive

If 2021 opened with a degree of optimism, the rapid spread of the Omicron variant ensured the mood among investors was more cautious as 2022 got underway.

The Omicron factor

The emergence of the Omicron variant of COVID-19 in November saw global markets tumble on fears of a dangerous new phase in the crisis. The rapid spread of infections, increased reinfection risk and the reduced efficacy of vaccines saw governments around the world reintroduce restrictions, with immediate implications for economic activity.[9] Markets rallied when initial evidence suggested Omicron might be less likely than previous strains to cause serious illness, but investors played a waiting game in December as they awaited scientific clarity on the new variant.[10]

While the full ramifications are not yet clear, there may be positives to take out of the Omicron variant, according to the World Economic Forum (WEF). It noted that it may help combat any complacency regarding vaccination efforts and lead to improved international collaboration in rolling vaccines out to developing countries. The new phase of the pandemic crisis may also encourage governments to keep their economic support measures in place for longer. In addition, the WEF said any new lockdowns and restrictions could reduce consumption and act as downward pressure on inflation.[11]

Inflation will be a key theme

Rising prices continue to weigh on investor sentiment too, and this will be a prominent theme in 2022 and beyond. The Bank of England expects inflation to remain at around 5% for the next few months, peaking at around 6% in April as household energy bills are pushed up by wholesale gas prices. While price pressures will remain, inflation is predicted to fall back to some extent in the second half of the year,[12] but still average 4%.[13]

Investors will be looking to increase the inflation protection in their portfolios and further diversify in their search for income and returns. Close attention will be paid to how central banks strike a balance between maintaining the support for the pandemic recovery and retaining sufficient flexibility to respond to shifting inflation expectations.[14] The timing and extent of any monetary and fiscal tightening - and the impact that tapering has on growth - will be dictated partly by the emerging effects of the Omicron variant.

Opportunities will arise from the race to net zero

A key theme for this year and one which will present significant investment opportunities is sustainability. Demand for sustainable investing strategies will grow rapidly as governments and companies strive to meet their net zero targets and policymakers focus increasingly on the energy transition.[15] In the US, the Biden administration's proposed Build Back Better policy bill would see a huge allocation of funds to transitioning sectors such as electric vehicles, hydrogen production and carbon capture. The European Union's Recovery and Resilience Facility offers similar potential, with its focus on meeting the challenges of the green and digital transition and the spending that will entail. The UK's Net Zero Strategy reports a total of £26bn UK Government money and £90bn of private investment by 2030.[16]

Investors need informed, expert support

The investing landscape will continue to shift and change throughout this year. Diversification may become an even higher priority, particularly for investors seeking income as well as growth. Perhaps one of the biggest risks for investors will be getting caught up in market sentiment with potentially poor outcomes. The insight and expertise of advice and investment professionals will be paramount in what is likely to be a positive but still challenging environment for investors.

Learn more

Stay up-to-date with our latest **Markets and Insights** at **santanderassetmanagement.co.uk**.

[1] Time.com – The Stock Market Keeps Hitting New Record Highs. Here's What That Means For You, 2/11/21

[2] USA Today – Is the stock market primed for an October swoon? Why investors shouldn't fear the frightful month, 1/10/21

[3] Market Watch – Stocks fall across Europe and Nasdaq slips as inflation concerns and selloff sentiment spread, 11/5/21

[4] Market Report – FTSE 100 closes in the red as markets fall globally on broad investor sell-off, 28/9/21

[5] Sky News – FTSE 100 slips below 7,000-mark as economic jitters spark global sell-off, 8/7/21

[6] Bank of England – Bank Rate increased to 0.25% - December 2021, 16/12/21

[7] Guardian – UK inflation jumps to 30-year high of 5.4% as cost of living crisis deepens, 19/01/22

[8] Bankrate – Bank of England base rate,1/3/09-31/12/21

[9] BBC – Global markets fall after Moderna Omicron warning, 30/11/21

[10] FT.com – Wall Street stocks close in on record high, 8/12/21

[11] WEF – The Omicron variant is here – what comes next? Here are 5 possibilities, 30/11/21

[12] Bank of England – Bank Rate increased to 0.25% - December 2021, 16/12/21

[13] Santander Asset Management UK – State of Play, 9/12/21

[14] Santander Asset Management UK – State of Play, 9/12/21

[15] Santander Asset Management – Market Outlook 2022, 14/12/21

[16] Gov.UK – Net Zero Strategy: Build Back Greener, 19/10/21