Santander Asset Management

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A Month in the Markets

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JUNE 2022

In this latest edition our Head of Systematic Research for TAA and Alpha, Stefano Amato, looks at how investors continued to adapt to the investment environment in May: higher inflation, rising interest rates and the ongoing war in Ukraine.

Market Overview

Stefano Amato
Head of Systematic Research for TAA and Alpha

Global stock markets were fairly turbulent in May as investors continued to grapple with higher inflation, rising interest rates and the ongoing war in Ukraine. The Bank of England (BoE) and the US Federal Reserve (Fed) raised interest rates[1] early in the month in an effort to cool economic activity and reel in inflation. On average, the world's stock markets produced a small positive return for the month, but there was significant variation in performance among geographies and individual markets.[2] After following a downward trend for much of the month, global stock markets rebounded in the closing week.[3]

Yields on benchmark government bonds went up over the month as prices fell.[4] This is because bond yields move in the opposite direction to prices.

UK and Europe

Once again, a main concern for investors over the month was persistently high inflation. The UK inflation rate reached its highest level for 40 years, at 9%.[5] Strong demand, supply chain bottlenecks and the fallout from the war in Ukraine pushed up the cost of goods.[6] Electricity, gas, automotive fuel and rising household costs were the biggest contributors to higher inflation.[7] In response, the BoE implemented the fourth consecutive interest rate rise since December 2021, increasing the rate by 0.25% to 1%.[8] With prices rising

[1] The Guardian, 4 May 2022
[2] Refinitiv Datastream, 31 May 2022
[3] Reuters, 20 May 2022
[4] Refinitiv Datastream, 31 May 2022
[5] Office for National Statistics, 18 May 2022
[6] The Guardian, 1 June 2022
[7] The Guardian, 18 May 2022
[8] The Guardian, 5 May 2022

across the board, it was perhaps not surprising that consumer confidence fell to its lowest level since records began in 1974.[9] Moreover, there was evidence that economic activity in the UK was beginning to wane. The Office for National Statistics reported that economic growth fell by 0.1% in March.[10]

For Europe, there were mixed fortunes. Much like other parts of the world, inflation continued to be high, reaching 8.1% in May.[11] Despite the onset of war on its borders and ongoing uncertainty about the COVID-19 pandemic, the economy in the eurozone appeared to be holding up better than expected. Economic growth for the first three months of the year increased by 0.3% when compared with the final three months of 2021.[12] This suggests that the war in Ukraine did not have as much of a negative impact as initially feared. Meanwhile, business activity appeared to be holding up in May, as the services sector saw solid growth and continued job creation.[13]

US

Over the month, economic challenges related to supply chains and the ongoing pandemic[15] persisted. Major ports in the US continued to experience shipping bottlenecks, as California, New York and New Jersey dealt with a surge of goods and queueing container ships.[16] There was some respite for US consumers in May as inflation fell to 8.3% from its level of 8.5%[16] in April. While there was some optimism that this might point to inflation reaching its peak, the reality for consumers remained that prices were still rising at the fastest pace since the 1980s.[16] The Fed increased interest rates by half a percentage point, its largest single increase since 2000[17], in an effort to tame inflation. Further interest rate rises are expected in the second half of the year.[18]

Asia Pacific

China's economy continued to be challenged in May as the pandemic, strict lockdowns and lower industrial output all took their toll. China's manufacturing sector contracted yet again[19], but at a slower pace than in April as the government began to lift strict lockdowns in factory hubs like Shanghai.[20]

In Japan, the lingering effects of the pandemic, as well as rising commodity prices which have pushed up the cost of goods[21], hurt the economy. While inflation remains relatively low, when compared with other countries, the most recent reading for April 2022 came in at 2.1%, which was above the Bank of Japan's target of 2%.[22] With Japan's economy having contracted in the first quarter of the year[23], there are concerns that the combination of COVID-19 and rising prices for goods, services and energy could cause a prolonged downturn in the country.

Outlook

Many of the conditions that existed last month remain in place. We continue to see rising inflation, interest rate hikes from central banks, an ongoing war in Ukraine and supply chain disruptions stemming from COVID-19. This environment has been negative for both shares and bonds, and our view is that we will likely see more volatility in the months ahead.

There will be certain areas of the economy that should perform well, such as financial companies, certain industrial sectors and energy. However, parts of the economy that are more sensitive to consumer spending will likely struggle. In particular, consumer retail and other areas of discretionary spending, such as luxury goods, may be challenged.

With interest rates rising in response to higher levels of inflation, stock markets are likely to continue following a downward trend for a short period. We expect central banks to begin easing off on further interest rate hikes as inflation peaks. While recent market moves can be distressing for some investors, it is important to mention that this is a natural response to major changes in monetary policy and global market conditions. Unlike 2008, when markets fell significantly due to serious systemic problems in the financial sector[24], we do not see any evidence of similar issues this time around.

Portfolio Positioning for the Santander Atlas Portfolios

We made few changes to portfolios over the month as we believed that asset allocation correctly matched our cautious positioning. Our current positioning is underweight shares on the whole, albeit slightly higher than previous months. We have a neutral position, in the UK, US, Japan and Asia Pacific, and an underweight position in Europe. Moving to bonds, our positioning is neutral in European and US Government bonds, neutral in corporate bonds, while we hold an overweight position in European and US high-yield bonds.

Santander Atlas Income Portfolio update

The Santander Atlas Income Portfolio's long-term investment objective is to provide a target annual income of 4% (not guaranteed) with the potential for capital growth over 5+ years, whilst operating within a defined volatility range. It aims to pay a monthly smoothed income throughout the fund year (which runs from 1 August to 31 July) over 11 months with a final balancing payment being paid on the 12th month to help meet the income needs of investors.

Due to market conditions, for the accounting year which started on 1 August 2021, we projected an annual income of 3.30% (not guaranteed) which translates to a pence per unit (PPU) of 0.60, for the Il share class.

Whilst the investment market has started to show signs of recovery with dividend incomes growing last year from the lows of the pandemic lockdowns, it has yet to reach pre-pandemic levels and with a changing financial backdrop the outlook remains uncertain. Therefore, whilst we can confirm that the smoothed PPU payment remains the same for the current month, we continue to monitor on an ongoing basis. If the payments need to be adjusted up or down throughout the year as a result of receiving more or less income than expected, we will communicate with you within these monthly updates, or with a separate income update if required. If you have any concerns or require additional information please do not hesitate to email us at IFAEnquiries@santanderam.com.

All data as at 31 May 2022.

[9] The Guardian, 20 May 2022
[10] Office for National Statistics, 12 May 2022
[11] Eurostat, 31 May 2022
[12] Reuters, 17 May 2022
[13] PMI by S&P Global, 24 May 2022
[14] Bloomberg, 2 June 2022
[15] The Wall Street Journal, 18 May 2022
[16] The Guardian, 11 May 2022
[17] The Guardian, 4 May 2022
[18] Reuters, 24 May 2022
[19] Bloomberg, 31 May 2022
[20] Reuters, 31 May 2022
[21] Reuters, 18 May 2022
[22] Reuters, 20 May 2022
[23] U.S. News and World Report, 7 June 2022
[24] McKinsey Global Institute, 29 August 2018

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Investors and potential investors should read and note the relevant risk warnings in the relevant Fund Prospectuses and NURS KIIs before making any investment decisions.

The value of investments and any income is not guaranteed and can go down as well as up and may be affected by exchange rate fluctuations. This means that an investor may not get back the amount invested. Past performance is not a guide to future performance.

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