



## A Quarter



## in the Markets

**Q1 2023**

We are pleased to introduce our latest edition of 'A Quarter in the Markets', which provides an insight into financial markets from the Multi-Asset Solutions team at Santander Asset Management UK.

### **What were the key factors influencing markets in the first quarter of 2023?**

Investor expectations of the path interest rates would take fluctuated during the first quarter amid mixed signals on whether inflation is easing. A banking crisis in March added to volatility, spurring uncomfortable questions regarding the health of the global financial system.

January started positively as stock markets rallied, with hopes mounting that global markets would experience a so-called 'soft landing' following the turbulence of 2022.<sup>1</sup> This optimism was compounded by China's reopening after its implementation of stringent COVID-19 lockdowns, prompting speculation that a slowdown in global economic growth may not be as severe as had been feared.<sup>2</sup>

Sentiment soured in February as economic data suggested that interest rates would remain higher than expected, for longer than expected, which contributed to that month's subdued markets.<sup>3</sup> Central bank officials in the US<sup>4</sup> and Europe<sup>5</sup> stressed that their main objective is to contain inflation, as stronger than expected economic growth, paired with labour shortages, threatened to drive prices higher.<sup>6</sup>

In March, the collapse of Silicon Valley Bank, the 16th-largest US bank, triggered mass withdrawals by depositors in medium-sized lenders, contributing to the failure of Signature Bank.<sup>7</sup> Uncertainty spread to Europe, where a Credit Suisse bankruptcy was prevented by the fact that the troubled investment bank was purchased by UBS.<sup>8</sup>

While policymakers reacted decisively to assuage concerns over the banking system's health, the International Monetary Fund (IMF) warned that geopolitical uncertainty, soaring debt, and the rapid acceleration of interest rates are increasingly undermining the financial stability of the banking sector.<sup>9</sup>

The US Federal Reserve (Fed), European Central Bank (ECB), Bank of England (BoE) and Swiss National Bank all implemented their planned interest rate rises despite the volatility fuelled by the banking failures, stressing that their banking systems are sound.<sup>10</sup>

## What happened in markets during the quarter?

---

Stock markets entered 2023 having endured their worst annual rout since the global financial crisis of 2008.<sup>11</sup> However, the MSCI ACWI, which tracks the shares of developed and emerging markets economies, posted a healthy return of 6.48% in Q1.<sup>12</sup>

Nonetheless, this figure conceals deeper disruption, with some of January's surging returns being wiped out amid continued interest rate hikes in February and successive banking crises in March.<sup>13</sup>

Despite this volatility, the intervention of regulators to prevent the banking crisis from spreading calmed investor nerves, driving a rally in shares in the latter part of the month.<sup>14</sup>

Bonds also made gains this quarter following their worst year on record.<sup>15</sup> The S&P Global Developed Sovereign Bond Index, which measures the performance of bonds issued by the governments of nations with developed economies, returned 2.79% for the quarter.<sup>16</sup> A similar gauge for corporate bonds returned 3.34%.<sup>16</sup>

Despite these positive returns, uncertainty persisted through to the end of the quarter, when US investors were evenly split between those who believed that the Fed would raise interest rates at its May meeting and those who believed rates would be left unchanged.<sup>17</sup>

The S&P 500 Index, which tracks shares of the largest companies listed on the New York Stock Exchange, rose by 7.03% in the quarter to cap off a second consecutive quarter of gains.<sup>18</sup> The Nasdaq Composite Index – which tracks more than 3,000 companies, almost half of which are in the technology sector – returned a healthy 16.77%.<sup>19</sup>

The MSCI Europe ex-UK Index, which tracks the region's stock markets, excluding Britain, gained 1.12%.

The FTSE 100 Index, which lists the shares of the 100 largest companies listed on the London Stock Exchange, ended the quarter 2.42% higher, despite its worst March performance since 2020.<sup>20</sup> In particular, banks served as a drag on the index.<sup>21</sup> The FTSE 250 Index, which is generally seen as a better reflection of the local economy and tracks the 101st to the 350th largest companies listed on the exchange, delivered a small return of 0.40%.<sup>22</sup>

## How did different economies react?

Early figures suggest that first quarter economic growth in the UK probably fell just short of 0.2%.<sup>23</sup> On 31 March 2023, the Office for National Statistics also confirmed that the UK had narrowly avoided a technical recession – defined as two consecutive quarters of negative growth – in the final quarter of 2022, which saw 0.1% growth.<sup>24</sup>

According to the IMF, the UK is likely to be the only G7 nation – which includes the US, Canada, France, Germany, Italy and Japan alongside the UK – to experience an economic contraction this year.<sup>25</sup>

The BoE raised interest rates twice during the quarter, taking its base rate to a 14-year high.<sup>26</sup> After falling for three consecutive months, inflation unexpectedly accelerated again during February, driven by food and non-alcoholic drink prices, which rose to levels not seen since 1977.<sup>27</sup>

Initial data indicates that the economy of the 20 countries that share the euro expanded by 0.3% in the first quarter.<sup>28</sup> However, record European employment figures risk stoking inflation as companies offer higher wages to fill vacancies.<sup>29</sup>

The ECB hiked interest rates twice during the three months, on the basis that inflation would otherwise remain too high for too long.<sup>30</sup>

An inflation gauge closely watched by the ECB rose to an all-time high in February.<sup>31</sup> This surge occurred even as headline inflation, the broadest measure of prices, dropped at its fastest pace on record thanks to lower energy prices, reflecting the continued danger inflation poses.<sup>32</sup>

In contrast, the latest data released during the quarter revealed that the Fed's preferred measure of inflation cooled in February after unexpectedly increasing the month before.<sup>33</sup>

The Fed implemented two interest rate hikes over the course of the period, stating that future decisions will depend mainly on incoming data.<sup>34</sup>

Data released at the end of March showed that the US economy grew more slowly in the fourth quarter of 2022 than had been initially estimated, as consumer spending tapered off.<sup>35</sup>

While the latest available data showed only a moderate increase in US consumer spending in February, consumer spending posted its largest month-on-month increase in nearly two years in January.<sup>36</sup> This is a double-edged sword, with high levels of consumer spending fuelling both growth and inflation.

---

## What is the outlook for markets?

Our view is that interest rates could be lowered in the first or second quarter of 2024, as the economy slows and inflation is brought under control.

Investors are growing more confident that interest rate increases will end this year. We expect to see one more interest rate hike from each of the Fed, BoE and ECB. However, investor expectations range from zero to two subsequent rises, fuelling market volatility.

On the whole, we're more optimistic than we have been for some time. However, we remain vigilant regarding risk.

---

## How are we positioned for the major risks to our outlook?

We gradually added shares during the quarter while significantly boosting our bond holdings by reducing cash. Our view that interest rates are close to peaking underpinned our decision.

While we still hold fewer shares than the relevant market benchmarks, we've closed the gap somewhat since the beginning of the year. Our preference shifted toward Europe and the UK at the expense of the US, where we see shares as generally being overvalued.

During the quarter, we successfully implemented call options that allowed us to buy or sell shares for a pre-determined price in the future. This means that we are able to make gains when stock market rallies occur, while also mitigating risk in the event of a downturn.

After assuming a conservative stance on bonds earlier in the year, we replaced bonds that reach maturity more rapidly with those that take longer to reach maturity. This was reflective of our increasingly optimistic stance, and faith in the increased longer-term stability of markets.

Our holdings of US government bonds increased as bond yields fell. Given that bond prices and yields move in opposite directions, we made the decision to increase our allocation to this type of bond to capitalise on their rise in price. We also expanded our holdings of high-quality corporate bonds and UK bonds.

In addition to these alterations, we added to some of our gold holdings towards the end of the quarter.

## Outlook by asset class

### Shares

Shares, especially those issued by US companies, appear expensive – despite the fact that inflation shows signs of easing, potentially leading to interest rate cuts in 2024. While we're looking to increase our holdings of shares, we will be patient and wait for the right opportunities at prices we're comfortable with.

### Bonds

Bond markets are providing opportunities as interest rates near their peak. Still, until investors are confident that inflation is under control and there is consensus on the outlook for rates, yields will remain volatile.

Find out more

Learn more, visit our website [here](#) for more insights into financial markets.

- <sup>1</sup> CNN, 31 January 2023
- <sup>2</sup> IMF, 30 January 2023
- <sup>3</sup> Reuters, 1 March 2023
- <sup>4</sup> Associated Press, 8 February 2023
- <sup>5</sup> Reuters, 2 February 2023
- <sup>6</sup> Reuters, 3 March 2023
- <sup>7</sup> NPR, 17 March 2023
- <sup>8</sup> Investopedia, 28 March 2023
- <sup>9</sup> ETF Stream, 28 March 2023
- <sup>10</sup> Associated Press, 23 March 2023
- <sup>11</sup> Axios, 31 December 2022
- <sup>12</sup> MSCI ACWI, 31 March 2023
- <sup>13</sup> Reuters, 31 March 2023
- <sup>14</sup> Associated Press, 31 March 2023
- <sup>15</sup> Forbes, 9 February 2023
- <sup>16</sup> S&P Global Developed Sovereign Bond Index
- <sup>17</sup> CNBC, 31 March 2023
- <sup>18</sup> Google Finance, 31 March 2023
- <sup>19</sup> Yahoo! Finance, 31 March 2023
- <sup>20</sup> London Stock Exchange, 31 March 2023
- <sup>21</sup> Reuters, 31 March 2023
- <sup>22</sup> London Stock Exchange, 31 March 2023
- <sup>23</sup> S&P Global / CIPS Flash UK PMI, 24 March 2023
- <sup>24</sup> Office for National Statistics, 31 March 2023
- <sup>25</sup> IMF, 30 January 2023
- <sup>26</sup> Bank of England, 23 March 2023
- <sup>27</sup> Reuters, 22 March 2023
- <sup>28</sup> S&P Global Flash Eurozone PMI, 31 March 2023
- <sup>29</sup> Reuters, 10 March 2023
- <sup>30</sup> ECB, 16 March 2023
- <sup>31</sup> Reuters, 31 March 2023
- <sup>32</sup> Eurostat, 31 March 2023
- <sup>33</sup> CNN, 31 March 2023
- <sup>34</sup> CNBC, 22 March 2023
- <sup>35</sup> Bureau of Economic Analysis, 30 March 2023
- <sup>36</sup> Reuters, 31 March 2021

## **Important Information**

For retail distribution.

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

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.

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.

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 Financial Conduct Authority (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](http://www.fca.org.uk/register).

Santander and the flame logo are registered trademarks. [www.santanderassetmanagement.co.uk](http://www.santanderassetmanagement.co.uk).