Santander Asset Management | Where evolution meets tradition

A Month in the Markets

JANUARY 2023

In this latest edition our Multi Asset Solutions Team look at the challenges investment markets faced in December. After a two-month rally, global stock markets ground to a halt.[1]

Market Overview

This marked a fitting culmination to a year that was the worst for US shares since 2008[2], and the worst for European shares since 2018.[3] After their rebound in October and November, bonds also lost ground[4] against a backdrop of lower than expected US growth figures and continuing concerns about interest rate hikes.[5]

Markets' performance reflected investor concern about the economy. Renewed uncertainty over what the US Federal Reserve (Fed) and other central banks will do to contain stubborn inflation, as well as rising COVID-19 infections in China that threaten to stifle economic growth were likely chief among the reasons why investors shunned shares over the festive period. The war in Ukraine has also continued to disrupt supply chains, affecting economies and markets around the world.

Added to this, the prospect of a worldwide recession may also be worrying investors, along with the notion that shares will hit new lows before rebounding in the second half of 2023.[6]

Global stock and bond markets together lost more than $30 trillion in 2022[7], leaving investors with little relief from harsh market conditions. Shares and bonds have historically often moved in opposite directions, meaning bonds can serve as a safe haven in times of stock market turmoil. However, this year inflation and high interest rates ate into bond prices.

Energy and agricultural prices recorded substantial gains over the course of the year, which contributed to much of the inflationary spikes seen in many economies.[8]

UK and Europe

In the UK, the overall economic picture is gloomy. The Office for Budget Responsibility announced that the economy has entered a year-long recession, alongside a record drop in living standards.[9] However, figures released in December indicated that UK inflation declined at its fastest rate in 16 months[10] in November, in a potential sign that the worst of the UK's inflation has passed.

Meanwhile, the UK stock market struggled, with the domestically-focused FTSE 250 Index reflecting a poor performance for UK companies.[11] Despite this, a strong performance by international mining and oil shares has allowed the FTSE 100, where these companies are largely listed, to outperform the US and Europe over the year overall.[12]

In Europe, there were encouraging signs that inflation may be cooling off, with Eurozone inflation slowing from 10.6% in October to 10% in November.[13]

However, these positive indications have not yet been fully reflected in stock and bond markets. After surging more than 16% from their October lows in November, European stock markets cooled off in December.[14]

Bonds also struggled this month. After the European Central Bank (ECB) pledged continued action to combat inflation midway through December, the yields of Eurozone bonds jumped.[15] The prices and yields of bonds move in opposite directions, so bond prices fell as the prospect of further interest rate hikes dampened investor confidence.

US

Inflation increased by less than expected for a second successive month in November, paving the way for the Fed to reduce the size of its interest rate rises. On 14 December an interest rate hike of 0.5% was announced, a rise milder than the four consecutive 0.75% rises that had preceded it. However, the central bank signalled that inflation remains a key concern, so further interest rate rises may still be forthcoming.[16]

Figures released in December also revealed that the US economy added more jobs than had been anticipated in November, contributing to upward pressure on salaries and making the work of the Fed more difficult.[17]

US shares had a disappointing month. The S&P 500 Index, which tracks the performance of the 500 largest companies on US stock exchanges, fell by almost 6% in December. This marked the end of a difficult year, with US shares falling by 19.95% across 2022 overall.[18]

Asia Pacific

China's U-turn on its strict COVID-19 restrictions sparked optimism in some quarters that shares in the world's second-largest economy will perform better in 2023.[19] Efforts to boost economic growth through stimulus measures, along with policies designed to stabilise the property sector will only further improve investor sentiment.[20] However, a fresh wave of COVID-19 infections caused economic activity in December to fall to its lowest level since February 2020.[21]

Despite this, the Hang Seng China Enterprises Index, which tracks Chinese firms listed in Hong Kong, gained just over 5% in December. However, even with this uptick, 2022's performance still marked a third consecutive year of decline for China's shares.[22]

In Japan, the Bank of Japan (BoJ) announced that the interest rate of 10-year bonds would be able to rise to 0.5%, doubling the previous figure of 0.25%.[23] Although Japan has remained committed to maintaining ultra-low interest rates while other developed nations have implemented interest rate hikes, some analysts have speculated that this move potentially signifies the first step towards interest rate rises by the BoJ.[24]

This move contributed to Japanese shares falling in December, after climbing through October and November.[25]

Outlook

Our stance remains cautious. The market downturn this month only underlines our concerns about the ramifications of the war in Ukraine, persistent supply chain issues, and economic disruption in China.

However, while we believe that central banks will continue raising interest rates until inflation is firmly under control, encouraging signs are emerging that the worst of inflation may be behind us. The Fed's decision to only raise interest rates by 0.5% this month, rather than the 0.75% of their previous four rate hikes, indicates that the interest rate hiking cycle might have peaked. Nonetheless, this is far from a certainty and our positioning remains conservative.

Asset Management

All data as at 1 January 2023.

[1] MSCI ACWI, 30 December 2022
[2] CNBC, 30 December 2022
[3] City A.M, 30 December 2022
[4] S&P Global Developed Sovereign Bond Index, 30 December 2022
[5] Yahoo! Finance, 30 December 2022
[6] Next Advisor, 23 December 2022
[7] Financial Times, 30 December 2022
[8] Financial Times, 30 December 2022
[9] The Guardian, 17 November 2022
[10] The Guardian, 14 December 2022
[11] FTSE 250, 30 December 2022
[12] Reuters, 30 December 2022
[13] Euronews, 14 December 2022
[14] The Guardian, 30 December 2022
[15] Reuters, 16 December 2022
[16] CNBC, 14 December 2022
[17] Financial Times, 2 December 2022
[18] S&P 500 Index, 30 December 2022
[19] Forbes, 31 December 2022
[20] Bloomberg, 18 December 2022
[21] Bloomberg, 31 December 2022
[22] Hang Seng China Enterprises Index, 30 December 2022
[23] Japan News, 20 December 2022
[24] Reuters, 21 December 2022
[25] Nikkei 225, 30 December 2022