A Month in the Markets

By Stefano Amato

March 2022

Stefano Amato

Head of Systematic Research
for TAA and Alpha

Month of February

Market Review

Global stock markets as a whole declined in February[1] continuing the increasing volatility experienced in January.[2] We had already seen investment market focus being driven primarily by two key risks: inflation and rising interest rates, but Russia's invasion of Ukraine has not only added a third geopolitical risk, in our opinion it is also likely to put pressure on both of these risks through rising commodity prices.

At the beginning of the month, the prospect of persistently high inflation and tighter monetary policy from the US Federal Reserve (Fed) were already taking their toll on stock markets.[3] They were sent spiralling when Russia followed through with its invasion of Ukraine.[4] This resulted in major global stock markets falling in February, with Europe and China seeing the sharpest declines.[5] This was followed by falls in emerging markets, the broad Asia Pacific region and Japan.[6] Russia's stock market was one of the worst performers in February, falling by more than 35% over the month.[7]

UK and Europe

For the most part, the economic situation in the UK and Europe improved in February as disruptions related to the Omicron variant of COVID-19 began to ease.

In the UK, activity in the private sector accelerated at its fastest pace for eight months[8]. On the European continent, the services sector - which includes restaurants and leisure companies – rebounded, while the manufacturing sector improved[9]. Nevertheless, inflation remained an ever-present concern, with consumer price inflation running at 5.5% in the UK[10] and 5.1% in the eurozone[11].

At the beginning of February, the Bank of England (BoE) sought to temper higher inflation by raising its benchmark interest rate from 0.25% to 0.5%[12]. It was the first time since 2004 that the BoE raised interest rates at consecutive meetings[13]. This raised expectations that it paves the way for a further increase in the coming months.[14]

US

Much like the UK and Europe, business activity rebounded in the US as COVID-19 disruptions began to ease. The US economy was in fairly good shape in February, with increased activity in the services and manufacturing sectors[15]. Throughout February, companies announced corporate earnings reports for the fourth quarter of 2021. While many companies beat estimates, they were not as strong as previously expected.[16] Inflation continued to be a focal point for investors throughout the month with consumer price inflation hitting 7.5%[17]. It is broadly expected that the Fed is readying to raise interest rates in the coming months.

PLEASE REMEMBER THAT ALL INVESTMENTS CARRY VARYING DEGREES OF RISK TO YOUR MONEY. THE VALUE OF INVESTMENTS AND ANY INCOME FROM THEM CAN GO DOWN AS WELL AS UP AND YOU MAY GET BACK LESS THAN THE FULL AMOUNT YOU INVESTED. PAST PERFORMANCE IS NOT A RELIABLE INDICATOR OF FUTURE RESULTS.

A Month in the Markets

By Stefano Amato

March 2022

Global

While high inflation and imminent interest rate hikes were omnipresent concerns for investors in February, these issues were mostly overshadowed when Russia invaded Ukraine. The move sent stock markets tumbling and caused the price of safer-haven assets, such as gold, to spike. The price of gold briefly reached more than $1,970 per troy ounce on the day of the invasion. It subsequently fell back to a level around $1,887 per troy ounce[18]. Oil prices also surged, on fears that countries reliant on Russian oil and gas would face supply issues. The price of Brent Crude broke above the US $100 per barrel barrier for the first time since 2014[19].

The European Union, along with the North Atlantic Treaty Organisation (NATO) and other key allies in the West, responded to Russia's move by announcing a series of economic sanctions[20] placed on the Russian government, government officials and private citizens. Along with this, several Russian banks were cut off from the SWIFT messaging system[21]. The US and UK also cut off Russia's major banks, as well as its central bank, from dollar and sterling clearing.[22] The asset management industry is working together with the UK Government to support their efforts, whilst collectively working to put in place measures to mitigate impacts for investors.

Outlook

Given the sudden resurgence of geopolitical tensions and the uncertainties that this has created, we have a cautious view of the months ahead. COVID-19 is no longer the primary risk on the horizon, having been replaced by inflation, rising interest rates and the Ukraine crisis.

We expect that interest rates around the world will continue to move higher in 2022, which will have a short-term impact on stock markets. Rising rates have already taken the wind out of the sails of high-growth areas of the market, such as technology companies,[23] and we see this continuing in the months ahead. Overall, we expect to see a higher degree of market volatility in the coming weeks and months. We also anticipate heightened political tensions as governments around the world seek an end to the aggressions.

Considering this investment landscape, we believe our portfolios are currently well positioned and we will continue to monitor the landscape, how these major risks progress and will make any adjustments as necessary.

Portfolio management position from the Multi Asset Solutions team

Throughout February, we chose not to make any major changes to portfolios as we felt they were positioned appropriately for the current environment. To reflect our cautious stance, the portfolios continue to have a neutral position across all asset classes. In Shares we are slightly underweight, with this reduction in allocation coming from our US and European holdings. In Bonds we have a large underweight position in corporate bonds and a smaller underweight position in European government bonds.

While outbreaks of war can be concerning for investors because it can cause stock markets to fall sharply, it is important to remember that these periods of volatility tend to be short-lived and financial markets recover fairly quickly[24]. We have very little exposure to Russian securities on the UK sanction list, with our investment solutions* as at 4 March 2022 holding 0.005%, and therefore in our opinion are likely to see minimal impact from recent events. However, we will continue to assess the risks from the evolving Ukraine crisis as well as the overall investment landscape and implement changes where appropriate.

*Investment solutions include all Santander Asset Management UK funds and the Santander Vista Model Portfolio Service.

Portfolio management position from Quantitative Investment Solutions (Santander Asset Management Spain)

During the month of February, the investment strategy of the Santander Max 30% Shares, Santander Max 50% Shares and Santander Max 70% Shares Portfolios transitioned from a fundamental to a systematic approach. Therefore, portfolio management commentary for these funds will move away from discussing the fundamental backdrop behind our investment decisions and instead describe how and why the models are indicating any changes in the portfolio allocation of the funds.

It is important to highlight that the models do not focus on interpreting market news and providing investment forecasts but are focused on assessing how the market reacts to that market news and acts accordingly.
The main inputs to our decision-making process are statistical measures such as volatility, correlation between asset classes (diversification) and the strength behind price moves.

A Month in the Markets

Private Banking

By Stefano Amato

March 2022

In the current highly volatile environment, the systematic models started to change course from their maximum underweight positioning in shares, which was reached during the first week of February, and a maximum overweight positioning in bonds, to progressively load up on riskier assets (shares) during the last part of the corrections caused by the Ukraine crisis. While the Risk Parity** component of the models have reduced allocation to riskier assets since the first spikes in volatility started back in December 2021, the magnitude of price changes since then has driven the most opportunistic filter of the Momentum** strategy to see them as tactical opportunities.

Within stock markets, whilst UK shares, in recent decades, have typically underperformed their peers[25] there has been a significant shift since the start of 2022 with the UK market outperforming[26] which has prompted the models to reduce the underweight positions back towards neutral relative to the benchmark.

On the bonds side of the portfolio, the exposure to corporate bonds has been cut significantly (mirroring the increase in shares), while government bonds are still favoured. Shares and corporate bonds are starting to show high correlation in the current risk off environment[27] and this is something the model penalises.

In the last week of the month, in response to the changing values of both shares and bonds[28], the portfolios were adjusted aligning more closely to their neutral positions in comparison to respective benchmarks.

** For more information on Risk Parity and Momentum please refer to the Fund's Prospectus which can be found within Santander Asset Management UK's Fund Centre here.

1 Refinitiv Datastream, 28/02/2022
2 FE Fund Info 2022, 31/01/2022
3 Refinitiv Datastream, 28/02/2022
4 Refinitiv Datastream, 28/02/2022
5 Refinitiv Datastream, 28/02/2022
6 Refinitiv Datastream, 28/02/2022
7 Refinitiv Datastream, 28/02/2022
8 Markit Economics, 21/02/2022
9 Markit Economics, 21/02/2022
10 Office for National Statistics, 16/02/2022
11 Eurostat, 2/03/2022
12 Market Watch, 3/02/2022
13 Market Watch, 3/02/2022
14 Reuters, 23/02/2022
15 Markit Economics, 22/02/2022
16 CNBC, 3/02/2022
17 Trading Economics, 28/02/2022
18 Reuters, 25/02/2022
19 CNBC, 23/02/2022
20 BBC News, 27/02/2022
21 Swift, 1/03/2022
22 City A.M. 28/02/2022
23 Refinitiv Datastream, 28/02/2022
24 Reuters, 31/12/2021
25 Bloomberg, 24/02/2022
26 Bloomberg, 24/02/2022
27 Bloomberg, 24/02/2022
28 Bloomberg, 24/02/2022

*Please note this does not apply to Santander Max 30% Shares, Santander Max 50% Shares and Santander Max 70% Shares Portfolios as the funds have now transitioned to a new investment strategy. Due to the differences in investment strategies, we will be providing separate views through A Month in the Markets from the March edition.

Note: The Portfolio Investments and Atlas Portfolios are Multi-asset, globally diversified portfolios. Although the portfolios may share similar underlying investments in terms of asset and fund selection, they will differ in terms of the way the funds are managed and the proposition in which they are held. Please refer to the Key Investor Information Document (KIID) for details on the objectives of the individual funds. If you have any questions relating to specific differences of the Portfolio Investments or Atlas Portfolios fund ranges, please contact your Private Banker.

The views expressed in this document are of Stefano Amato and the Multi Asset Solutions Team at Santander Asset Management UK Limited, are subject to change and do not necessarily reflect the views of Santander Asset Management UK Limited or Santander UK plc (as a whole or any part thereof).