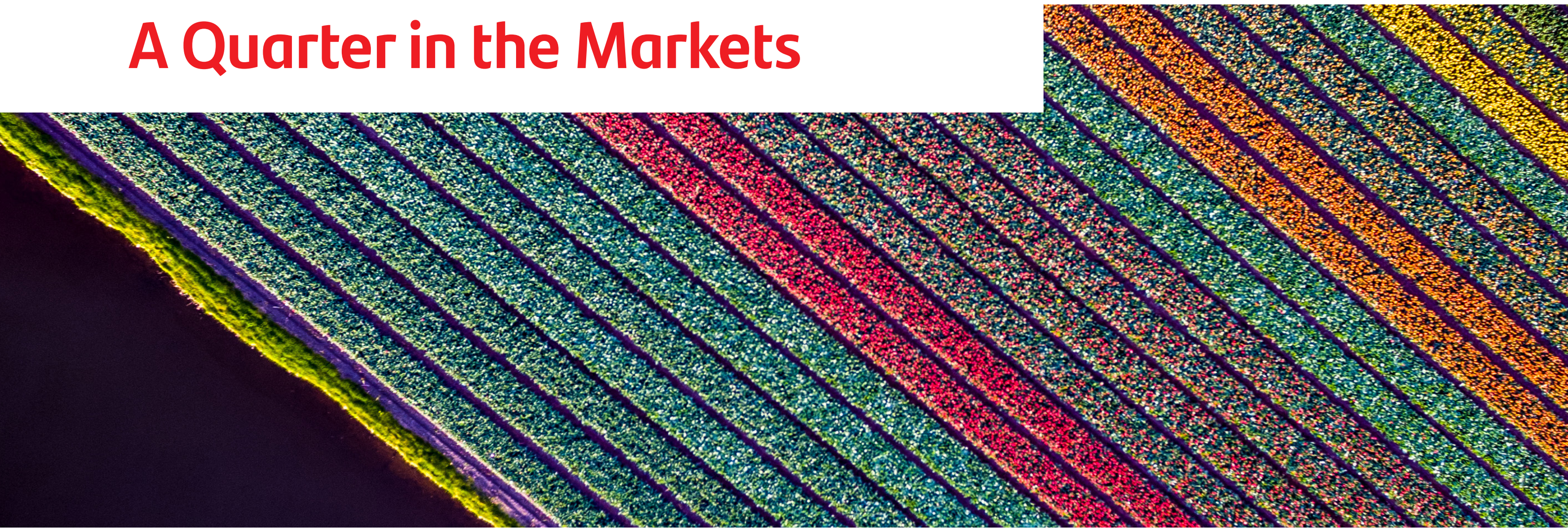
A Quarter in the Markets



Q3 2020

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.

Key factors influencing markets

The third quarter had two distinct phases for investors. During July and much of August, global stock markets delivered good performance as economies began to rebound, COVID-19 infection rates were falling, and there was promising news on a possible vaccine. However, investor sentiment changed in early September as technology shares fell, infection rates surged in the UK and Europe, and the economic rebound began to slow as worries of a second wave increased.

Over the quarter, global Bond markets generated modest positive returns, driven by low interest rates and uncertainty created by COVID-19.

So, what happened during the quarter?

The dominant issue for markets during the quarter was COVID-19. In July and August, stock markets moved higher amid hopes for a vaccine breakthrough, improving economic data, and continued support from central banks and governments. Vaccine trials continued to progress over the quarter, with the Oxford University trial starting up again after a short pause. In Asia, where countries like China have been the most successful at containing COVID-19, stock markets performed well.

While COVID-19 infection rates in the US started to decline from high levels, cases in Europe and the UK began increasing in August and September, and this had a negative effect on investor sentiment and economic activity. By the end of the quarter there were more than 34 million confirmed COVID-19 cases worldwide and in excess of 1 million deaths, according to Johns Hopkins University data. This was up from around 10 million cases at the start of July.

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How did different economies react?

Many economies saw the beginnings of a rebound during the third quarter as social distancing measures were relaxed and business activity increased. In the UK, there was generally good news at the start of the quarter. The Office for National Statistics reported that retail sales had risen above pre-pandemic levels in July, exceeding sales numbers seen in February. Meanwhile, purchasing managers' indices pointed to rising activity in the manufacturing and services sectors in July and August. However, the rate of expansion slowed down in September as COVID-19 cases began to increase.

It was also confirmed during the quarter that the UK was in the deepest recession on record, with the UK Office for National Statistics reporting that the economy shrank by 19.8% in the second quarter, in addition to the 2.5% contraction seen in the first three months of the year. Also notable during the quarter was continued slow progress on Brexit negotiations with the European Union and it was announced that the furlough scheme, that is due to finish at the end of October, will be replaced by a less generous programme.

Europe also saw an increase in COVID-19 cases in September following a decline in the summer, prompting concerns of a surge in the cooler autumn and winter months. Over the quarter, European countries saw improving economic data. Manufacturing output improved throughout the quarter and was firmly in growth territory, although the rising infection rates caused a notable downturn in the services sector in September. Earlier in the quarter, European Union leaders came to a historic agreement in July on a €750bn package designed to help member countries repair their economies. Meanwhile, after Eurozone inflation dipped to -0.2% in August, the first move into negative territory since 2016, it fell further to -0.3% in September.

The US was quick to reopen its economy in the spring and this led to an increase in consumer and business activity. It also resulted in a sharp rise in COVID-19 cases during a time when infection rates were falling in other developed economies. The Commerce Department confirmed that gross domestic product, which measures the value of goods and services in the economy, fell by 31.4% during the second quarter – the largest contraction in US history.

Throughout the quarter, political deadlock in Washington and the US presidential race dominated headlines. The uncertainty over which political party will win control of the White House and the Senate, along with rising COVID-19 infections, contributed to a weaker US dollar during this time. There were also concerns over the inability of the Democrats and Republicans to agree on a new financial support package for the vulnerable economy.

Asian economies, which have been fairly successful at containing the outbreak, continued to see a rebound in activity, led by a strong manufacturing sector in China. The world's second-largest economy reported that it grew by 3.2% in the second quarter compared to a year ago. Tensions between China and many of its trading partners flared up early in the quarter, with President Trump moving to ban social media app TikTok unless its owner agreed to sell it to a US company. In Japan, Prime Minister Shinzo Abe announced his resignation in August owing to the inflammatory disease ulcerative colitis.

Emerging Markets faced high COVID-19 infection rates over the quarter and there were concerns that the economic recovery in these economies was faltering. Economic activity in Emerging Markets fell faster than in advanced economies when the pandemic hit, with a slower recovery. Stock markets in Emerging Market countries performed well over the quarter, with the weak US dollar helping, although sentiment changed in September as COVID-19 infection rates – and generally negative investor sentiment – took their toll. Overall, the recovery is uneven as each country faced different infection rates and social distancing measures. Brazil and Turkey, for example, saw a robust expansion in activity in July and August, while Mexico remained fairly depressed.

What is the outlook for markets?

With the end of the year approaching, two major question marks hang over stock markets: the outcome of the US Presidential Election in November and the chances of a COVID-19 vaccine becoming available by the end of the year. With Joe Biden currently expected to take the White House, the big question is whether the Democrats can also gain control of the Senate, which is a much bigger challenge. On the COVID-19 front, there is some expectation that a vaccine will be ready early in the New Year, which will be a major boost for financial markets.

At present, the backdrop for stock markets is uncertain. The scale of the monetary and fiscal support from central banks and governments has been strong and economic activity is pointing towards something resembling a V-shaped recovery. However, rising COVID-19 cases remain a concern because it could derail the recovery. Overall, we believe there is room for stocks to perform well in the current climate, but we are unlikely to experience the same strong returns that we saw in the spring.

Asset Management

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

We continue to have a fairly neutral stance on risk overall in the current environment. We believe current conditions are positive for stock markets – as central banks maintain low interest rates and governments introduce fiscal supports – alongside economies rebounding and consumer spending increasing.

Over the quarter we re-allocated some of our European stock market exposure to US assets. While the outlook for Europe improved in September, the increase in COVID-19 cases has become a concern and our expectation is that this will drag down market performance.

Overall, we maintain highly diversified portfolios that are positioned for the current economic and market environment, and provide some cushion should there be further market falls.

Find out more

Listen **here** to thelatest **Market Views** from our Portfolio Manager, John Mullins, as he shares his thoughts on the main themes dominating markets.

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