Santander Asset Management

A Quarter in the Markets

Q3 2021

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

Several major factors were at the forefront of investors' minds throughout the third quarter, each of which had an effect on global stock market returns. In developed economies, such as the UK, Europe and the US, the focal point was the continued spread of the Delta variant and rising COVID-19 cases, as well as supply chain disruptions, rising inflation, and concerns about a slowdown in growth.

In Asia Pacific, there were similar concerns about economic growth, supply chains and rising infection rates. But there was also negative news from China that rattled stock markets throughout the quarter. First among these was the Chinese Government's continued regulatory crackdown on technology, education and gaming companies.[1] In addition, investors were also worried about the possible default of a major Chinese property developer and its potential fallout on domestic and international stock markets. This had an adverse impact on China's stock market over the quarter.[2]

So, what happened during the quarter?

Stock markets in developed economies were mostly flat after negative returns in September erased gains recorded in July and August. The US and Europe produced very small positive gains in local currency terms, while the UK saw small single digit returns. Japan led the way among developed economies with a solid positive return. Asia Pacific excluding Japan and the emerging markets were broadly negative for the quarter. This was mainly because they were dragged down by heavy losses in China's stock market. Nevertheless, there were some bright spots in Asia Pacific, such as India.

Throughout the first part of the quarter, stocks in developed markets performed well. Supportive policies from central banks and governments played a role, as did the global rollout of COVID-19 vaccines and the reopening of economies. It appeared that stock markets were largely resilient to news about the virus. In September, however, sentiment eroded as supply chain disruptions and rising inflation took their toll and investors started to worry that economic growth had peaked. In addition, the US Federal Reserve (Fed) signalled that interest rates may soon start to rise and its asset purchasing programme, known as quantitative easing, will be gradually slowing down. The Bank of England (BoE) expressed a similar view on interest rates, causing government bond yields in the US and UK to go up, meaning that prices fell, as investors sold out of the asset class.

How did different economies react?

The third quarter was notable for several reasons. For starters, there was another spike of COVID-19 cases around the world as vaccination programmes gave governments the confidence to ease restrictions. Hospitalisation rates also went up during this time, but to a much lower degree than earlier in the pandemic. Economic activity accelerated during this time, with demand often outstripping supply and many retailers and manufacturers around the world experiencing supply chain constraints and a rise in the cost of materials and goods.

The UK started the quarter with solid economic growth.[3] The UK Government withdrew all remaining COVID-19 restrictions in England, house prices were rising, and business confidence was the highest it had been since 2017.[4] Inflation was also on the rise but was not immediately seen to be an issue: it was widely believed to be short-term in nature rather than a long-term trend. By the end of September, inflation reached 3.2% and the BoE hinted that interest rates would have to go up in 2022 to rein in rising prices.[5] On top of this, workforce shortages remained a concern, namely the truck driver shortage which led to some petrol stations running out of fuel towards the end of September.

In Europe, there was a similar recovery story early in the quarter. There had been concerns in the spring that Europe's vaccination programme was behind that of North America and the UK, but this soon changed. Later in the quarter, high vaccination rates and an easing of restrictions meant that consumers felt more confident about leaving their homes to go shopping, travel and visit restaurants. While consumer confidence was high,[6] businesses were beginning to worry about supply chain bottlenecks, rising costs due to unprecedented demand, and the spread of the Delta variant. Yet even though inflation reached a decade-high of 3% in August,[7] the European Central Bank hinted that it is unlikely to raise interest rates any time soon given the potential for a slowdown in growth.

For the US, the situation was not dissimilar to other developed economies. COVID-19 cases spiked in parts of the US in the summer, driven by the spread of the Delta variant. Business activity continued to grow, and consumer confidence was high.[8] However it could not escape the issues afflicting the rest of the world, namely supply chain issues, higher material costs, rising inflation and the continued spread of the virus. Moreover, despite an improving labour market, the US continued to have sections of the population still out of work due to the pandemic.[9] With inflation topping at 5.4% during the quarter, the Fed hinted at the possibility of raising interest rates.[10]

Asia Pacific and the emerging markets had a more complex quarter than developed markets. Much of this was down to the situation in China, where the Government continued its regulatory crackdown on companies in the technology, education, and gaming sector. Among other actions, it forced some educational companies to convert to non-profit status, effectively wiping billions off the market value of some of the country's largest companies.[11] Away from the regulatory environment, China's manufacturing sector began to slow down during the second quarter, with growth fading in July and August, and an outright contraction in September.[12] Much like the rest of the world, the manufacturing sector has had to deal with many of the same issues following the pandemic, namely supply chain bottlenecks and rising costs. In addition, it was also affected by electricity rationing.

Supply chain disruptions were being felt elsewhere in Asia Pacific too, with Japan's industrial output having fallen for two months in a row.[13] While other parts of the world are trying to deal with too much inflation, for much of the past year Japan has seen too little. Figures released in September showed that core consumer prices in Japan went up for the first time in 12 months in August.[14]

What is the outlook for markets?

We continue to have a mainly positive outlook for stock markets and economies and prefer shares over bonds. There are concerns about the spread of the Delta variant and rising COVID-19 infections as we head into autumn and winter. However, the continued rollout of vaccines around the world should help economies to reopen and return to normal levels of activity. There are legitimate concerns about disruptions in the global economy, rising inflation, interest rate hikes and a potential slowdown of economic growth, and this could result in some volatility along the way. Given this environment, we continue to monitor stock markets and economies, and are positioned to respond to events as they arise.

Find out more

Listen **here** to the latest **Market Views** from our Head of Multi Asset Solutions UK, Stefano Amato, as he shares his thoughts on the main themes dominating markets.

[1] Reuters - Factbox: China crackdown wipes hundreds of billions off top companies' values, 16/9/21
[2] Reuters - Analysis: China's house of cards: Evergrande threatens wider real estate market, 15/9/21
[3] Trading Economics - United Kingdom GDP Growth Rate, 6 /21
[4] BBC - UK business confidence jumps to more than four-year high, survey finds, 31/8/21
[5] Office for National Statistics – CPI Annual Rate, 8/21
[6] European Commission - September 2021: Economic Sentiment stable in the EU and the euro area, Employment Expectations further up, 29/9/21
[7] Eurostat - Inflation in the euro area, 1/10/21
[8] Trading Economics - United States Consumer Sentiment, 9/21
[9] US Bureau of Labor and Statistics - Employment Situation Summary, 8/10/21
[10] Trading Economics - United States Inflation Rate, 7/21
[11] SupChina - China's after-school tutoring crackdown goes nuclear , 23/7/21
[12] Trading Economics - China NBS Manufacturing PMI, 9/21
[13] Reuters - Japan's factory output extends declines on car production cuts, 30/9/21
[14] Reuters - Japan CPI halts 12-month decline, still well below BOJ target, 24/9/21