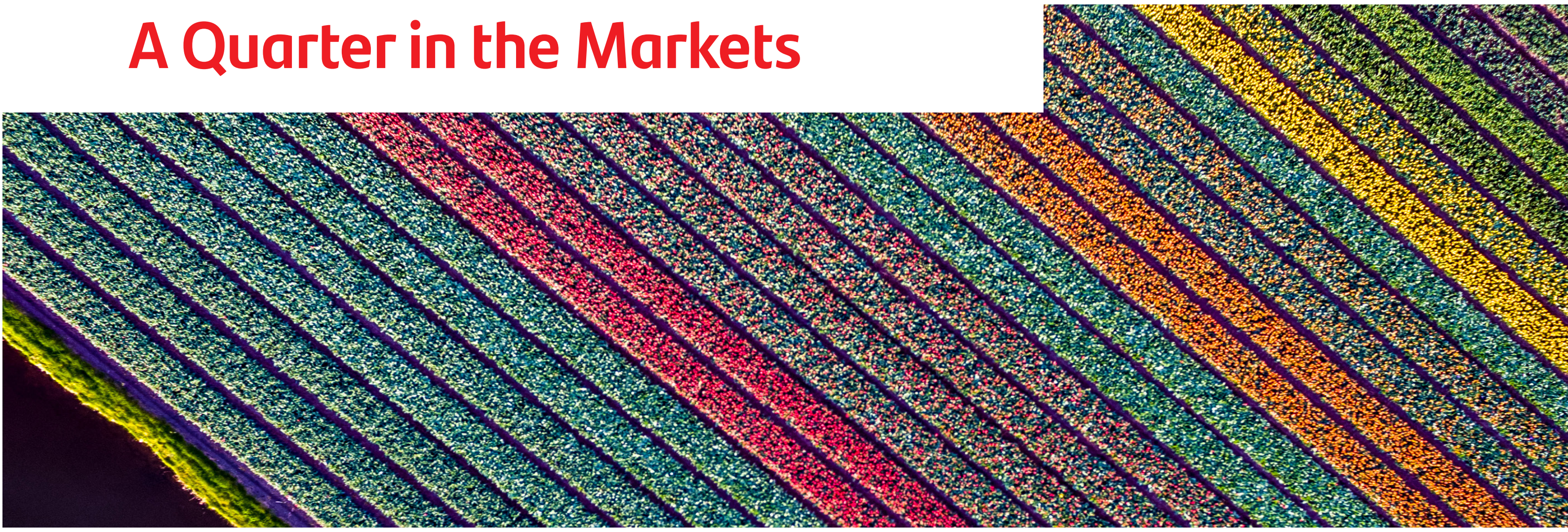
A Quarter in the Markets



Q4 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

During the final three months of the year, the COVID-19 pandemic was once again the main focus for investors. Early on, there was a sense of optimism as positive news on vaccines raised hopes of containing the virus and returning to normality. However, this was tempered somewhat by surging infection rates in many parts of the world, including Europe and the US, where governments were forced to reintroduce restrictions.

Nevertheless, global stock markets performed well over the quarter, with Shares outperforming Bonds. News of three successful vaccines, President-elect Joe Biden's victory in the US Presidential Election, as well as ongoing support from central banks and governments helped to drive market performance.

So, what happened during the quarter?

Throughout the quarter, stock markets generally benefited from positive sentiment. In October, there was a sense that a vaccine was around the corner and that Joe Biden would win the US presidency. This came to fruition in November with President-elect Joe Biden's victory and the announcements from Pfizer-BioNTech and Moderna that their vaccines were effective. Stock markets jumped sharply as a result, with many of the sectors that were previously performing poorly during the pandemic – such as energy, traditional retail and travel and leisure – rallying.

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While three major vaccines were announced over the quarter, the pandemic took a turn for the worse. Infection rates increased significantly in Europe, the UK and the US, exceeding the levels seen in the spring. This led to new lockdown measures in many jurisdictions as governments sought to curtail the spread of the virus. In Europe and the UK, the services sector, which includes restaurants and hotels, was badly hit as tighter restrictions forced many businesses to close, although other industries, such as manufacturing, remained in good shape.

How did different economies react?

After a rebound in the summer months, surging COVID-19 cases and restrictions on activity in various countries meant that economic activity was lower in the fourth quarter. In the UK, there was a mix of economic news. House prices proved robust, climbing 7.5% in 2020, the highest growth rate for six years, driven by low interest rates, government support for wages and the stamp duty holiday. However, retail sales dipped in November compared to October as a result of the month-long lockdown in England, which forced shops to close and shopping to move online. While the Office for National Statistics reported that the economy grew by 0.4% in October, the sixth-consecutive monthly increase, the rate of growth was slowing and activity remained nearly 8% below pre-pandemic levels.

More positively, the UK and European Union announced a trade agreement on Christmas Eve, with just days to spare. The new deal means there will be no taxes on goods traded between the UK and the European trade bloc, although it does mean businesses will need to complete customs declarations when importing and exporting goods. Much like the UK, the trade agreement came at a time when Europe was experiencing rising COVID-19 cases and another round of restrictions. While the manufacturing sector across the Eurozone remained in good shape, the services sector and consumer-facing companies continued to struggle. Meanwhile, the International Monetary Fund (IMF) warned that the Eurozone is in danger of a slower economic recovery in 2021 than previously expected, and central banks and governments may need to announce additional support until the pandemic is contained.

In the US, the story was largely about the Presidential Election and the pandemic. After a lengthy ballot-counting process due to record voter turnout and a wave of postal ballots, Joe Biden was deemed President-elect with a convincing margin in November, although the Democratic Party lost some ground in the House of Representatives. The outcome was positive for stock markets, as a Biden presidency is seen as removing some of the uncertainty that defined President Donald Trump's tenure in office. Despite a series of legal challenges and attempts by the Donald Trump campaign to overturn the election result, the Electoral College confirmed President-elect Joe Biden's election victory in December.

With COVID-19 cases surging, US Congressional leaders passed a long-awaited $900bn fiscal relief package designed to help the economy survive the pandemic. This was the second-largest package of its kind in US history, after the $2.2tn deal passed at the beginning of the pandemic in March 2020. The relief package was approved at a time when the US economic recovery was in a precarious position. The unemployment rate increased during December, with 787,000 people filing for benefits in the week before Christmas and the total number of people unemployed standing at 25.7m.

Unlike much of the West, some Asian countries reported much lower rates of COVID-19 over the quarter. However, Japan saw its daily reported infections surpass 3,000 for the first time in December. South Korea recorded more than 1,000 daily cases for the first time.

China was the first country to begin its recovery from the pandemic and its economy continued to improve. Another month of growth in its manufacturing sector in December helped the economy return to pre-pandemic levels, although economic growth for 2020 will likely be the weakest for 30 years. Overall, stock markets in Asia outperformed those in the US and Europe over the month, mostly driven by the results of the US Presidential Election – which is seen as positive for trade in the region – as well as a weaker US dollar.

Emerging markets, meanwhile, saw mixed fortunes over the quarter. Although a weaker US dollar and a Biden presidency are seen as positive for emerging markets, the pandemic continues to be a challenge for many economies. For example, the IMF estimated Brazil's economy will shrink by 5.8% this year, which is not as bad a contraction as initially predicted. However, if the second wave of the pandemic gets out of control, the country could face problems with its large amount of public debt.

Global Bond markets underperformed over the quarter as positive vaccine news encouraged investors to move into riskier assets. Yields on benchmark Government Bonds remained at low levels. While 10-year US Treasury yields increased slightly over the quarter, benchmark Government Bonds in the UK, Japan and Germany were down slightly. Bond yields go up when prices fall.

What is the outlook for markets?

The outlook for financial markets and economies relies largely on the outlook for the COVID-19 pandemic. With infection rates rising in many parts of the world and two new variants – deemed to be more infectious than the original strain – having emerged in the UK and South Africa, it has added pressure on governments worldwide to roll out vaccination programmes as quickly as possible, while also maintaining protective measures, such as social distancing. The combination of widespread vaccinations and a seasonal drop-off of infections in the spring should allow economies to re-open in the summer.

In the meantime, we expect central banks and governments will continue to support economies for the foreseeable future, which should be positive for financial markets. Against this backdrop, we are cautiously optimistic and continue to invest in Shares given our view that there will be significant pent-up consumer demand when restrictions are eventually lifted.

Find out more

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Important Information