A Month in the Markets

Private Banking

From the Multi Asset Solutions Team

December 2023

In this latest edition our Multi Asset Solutions Team look at the challenges investment markets faced in November. Shares experienced their biggest monthly rally in three years fuelled by investor hopes that central banks are close to winning their battle with inflation.[1]

Market Overview

There is growing optimism that the global economy may be heading for a "soft landing", which is when central banks bring inflation under control without causing a recession, which is defined as two consecutive quarters of negative growth.[2]

The upswing in markets began on the first day of the month when the US Federal Reserve (Fed), opted to hold interest rates at their current levels rather than raise them. Fed Chair Jerome Powell's comments were interpreted by investors to mean that interest rate hikes may be drawing to an end, fuelling a stock market rally.[3]

Bond markets also thrived this month. Highly rated bonds issued by governments around the world made their best monthly returns since 1997[4], while US bonds experienced their best month since the 1980s.[5]

Despite a dysfunctional October in which bond yields soared to historic highs, thereby driving down their prices because bond prices and yields move in opposite directions, November's performance was positive enough to drag US bond prices into positive territory for the year overall.[6]

Not all markets benefitted. Shares in companies based in mainland China were the worst performers among major stock markets this month, with persistent investor concerns hindering performance. This served to only deepen existing difficulties for China's stock market, as the CSI 300 Index, which tracks the performance of the 300 largest companies listed on the Shanghai and Shenzhen stock exchanges, has fallen for four consecutive months.[7]

The Organisation for Economic Cooperation and Development (OECD), a trade body comprised of 38 countries, estimates that global economic growth will slow in 2024 – although not to the point of recession – before accelerating in 2025. However, this forecast depends on central banks successfully balancing their priorities of fighting inflation and enabling growth.[8]

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.

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Baffled by bonds?

It may be worth taking some time to learn the basics to help you better understand how they work. Visit our **Basics on Bonds page** for more information.

UK and Europe

In an interview published near the end of November, the Governor of the Bank of England (BoE), Andrew Bailey, stressed that it is too early to consider interest rate cuts.[9] However, signs are emerging that inflation may be being brought under control. Data released in mid-November showed that inflation in October dropped to its lowest level in two years due to cheaper gas and electricity costs, with prices experiencing their steepest monthly decline since 1992.[10]

A survey of business leaders indicated that the UK private sector returned to growth in November after contracting for three months, thanks to a recovery in the services industry and a less severe decline in the manufacturing sector.[11] While data released this month showed that retail sales unexpectedly fell in October, consumer confidence nonetheless improved.[12]

Eurozone inflation slowed more than expected in November, bringing the European Central Bank (ECB) closer to its 2% inflation target. While investors had previously been predicting that the central bank would begin cutting interest rates in June 2024, the pace of inflation's decline prompted them to shift their prediction back to April.[13] Despite this, ECB President Christine Lagarde stressed in late November that the central bank's fight against inflation is not yet over.[14]

The debate over interest rates is occurring as Eurozone growth continues to trend downwards, suggesting that that the region's economy will enter a recession in the fourth quarter.[15] Business activity fell and firms cut headcount for the first time since January 2021, when COVID-19 lockdowns were in full effect.[16]

US

Data released on the last day of November revealed that a measure of inflation favoured by the Fed fell in October, leading investors to believe that interest rate cuts may come sooner rather than later. Investors now feel there's a 74% chance of a rate cut by May, while only a month ago this figure sat at 38%. Figures released this month showed that inflation is rising at its slowest pace since September 2021.[17]

On 30 November, data was released which showed that consumer spending, which accounts for more than two-thirds of US economic activity, eased in October. This was driven by the fact that high interest rates are encouraging consumers to save rather than spend, while growing economic uncertainty is encouraging caution.[18]

The US jobs market also appears to be cooling down, as the number of Americans on jobless rolls surged to a two-year high in mid-November.[19] This suggests that high interest rates may be beginning to slow the economy down, despite the fact that figures released in November showed that growth in the third quarter was the fastest in nearly two years.[20]

Asia Pacific

A survey of business leaders indicated that manufacturing activity in China shrank for a second consecutive month, while service sector activity dropped to its lowest level this year. Hindered by a drop in both local and foreign demand, as well as a property crisis that has damaged confidence, the slowdown suggests that more stimulus measures will be needed to boost economic growth.[21]

While the economy is forecast to reach its 5% growth target this year, Chinese government advisers are set to recommend that next year's growth targets be lowered to 4.5-5.5%. These advisers will advocate interest rate cuts in a bid to stimulate demand, and that the state should invest more – particularly in infrastructure – to drive growth.[22]

Japan's Nikkei 225, the nation's benchmark stock market index, surged to its highest peak since 1990 and enjoyed its best overall month in two years. Japanese companies reported robust earnings during the month as export-orientated firms benefitted from a weaker yen that made their products and services cheaper – and therefore more competitive – overseas.[23]

After shrinking for the time in three quarters during the third quarter of 2023, economists expect Japan's economy to return to growth in the fourth quarter due to a recovery in demand and an influx of foreign tourists.[24]

Bank of Japan (BoJ) officials have attempted to cool investor expectations that the central bank will break with its commitment to negative interest rates, which have made the nation an outlier among developed economies. Although a key measure of inflation has remained outside the BoJ's 2% target for 19 months, policymakers stressed that they want to wait until wage increases have sustainably outpaced inflation before reassessing policy.[25]

Outlook

We expect inflation to remain sticky. Major central banks may find it more challenging to cut inflation from 4% to 2% than from 10% to 6%, especially with less room to manoeuvre on interest rates because of slowing economic growth.

While we anticipate interest rate cuts, we believe the market is too aggressive in its expectations for next year. Investors are anticipating five interest rate cuts in the US next year, with some warning that the Fed needs to act soon to avoid a sharp economic downturn.[26]

We believe the global economy will continue to grow without tipping into a recession, given that central banks seem willing to provide support when needed. Our expectation is that the US economy will outperform major advanced economies.

Our cautious view on shares remains unchanged and we still prefer bonds as an asset class. We will consider diversifying some of the fund's bond holdings through buying different types of bonds, or bonds that take different amounts of time to reach maturity.

Portfolio positioning

Private Banking

As at 30 November 2023

The fundamental approach

An update on positioning for the following ranges:

- Santander Atlas Portfolios
- Santander Multi Index
- Santander Portfolio Investments, Santander Max 100% Shares, Santander Max 30% Income Shares and Santander Max 60% Income Shares Portfolios)
- Santander Vista Model Portfolios

These portfolios follow a fundamental approach investment strategy, which is based on market and economic outlook and geopolitical considerations to determine which asset or sub-asset classes, geographies and sectors to invest in, both on a longer-term (strategic) and shorter-term (tactical) basis. They are positioned with a single set of tactical asset allocation views for all regions and countries. One TAA (Tactical Asset Allocation) is driven by internal research, which is reviewed and agreed by Santander Asset Management's Global Asset Allocation Committee.

They provide a template asset allocation, which is subsequently translated to each individual portfolio by the portfolio management team in the UK, selecting the most appropriate funds and instruments in which to invest in dependent on their objectives, benchmark and investment policy whilst monitoring risk.

Discretion is exercised by the portfolio manager and there will be times where our income funds do not reflect the One TAA view as it may impact the fund's ability to deliver its income objective.

Underpinning One TAA is a modelling of market outcomes under very different economic and market scenarios. One TAA provides the benefit of a more streamlined decision-making process and a collective view.

How did the fundamental investment process change the funds' and models positioning during November?

The funds had a good month, benefitting both from holding more bonds that take longer to mature than the benchmark and the broad rally in financial markets. A surge in gold prices to a six-month high[27] also boosted returns.

There was a clear preference for bonds over shares in the funds' holdings. Among shares, there was no particular bias towards any region or sector.

We believe shares have risen in value too quickly and are now experiencing a temporary boost, known as a relief rally, before they will stabilise. Although the value of stock markets might rise in the short term, we're leaning towards a more cautious approach due to the potential risks.

Within bonds, our preference for government bonds has diminished slightly since October following the drop in yields.

Similarly, our enthusiasm for company bonds – particularly high-yield bonds – has marginally decreased. This is because you now earn less extra return on higher-yield bonds compared to government bonds. We anticipate a potential opportunity to acquire corporate bonds at lower prices.

We believe high-quality companies issuing bonds are still fundamentally strong, with no notable increase in debt defaults.

Ultimately, the shifts in our perspective are minor and our broad outlook remains unchanged.

Portfolio positioning

As at 30 November 2023

The systematic approach

An update on positioning for the following funds within the Portfolio Investments range:

- Santander Max 30% Shares Portfolio
- Santander Max 50% Shares Portfolio
- Santander Max 70% Shares Portfolio

These funds use a different investment approach to the rest of our fund range, known as 'quantitative' investing. This approach is rules based, using data with the aim of benefitting from investor bias and market inefficiencies.

The strategy uses models to interpret large amounts of data. This is then used by the investment experts to make investment decisions. This method avoids the emotion of the markets and builds a portfolio based on desired exposures. The managers rely on this 'process' and 'science' to help generate returns by applying consistent metrics.

At times, these portfolios may appear to act in an opposite way to how markets are behaving as it aims to capture opportunities. As with most styles of investing, at certain times during your investment journey, one approach may provide better outcomes than the other.

How did the systematic investment process change the funds' positions during November?

The overall positioning of the Max 30% and Max 50% Shares Portfolios remained relatively stable throughout the month.

The funds held fewer bonds than the target benchmark, particularly fewer highly rated company bonds.

The funds also maintained their overweight position in shares, relative to the benchmark. The most significant overweight share positions – areas where the fund held more shares than the benchmark – for the Max 30% Shares Portfolio were in the US and Europe (excluding the UK). The Max 50% Shares Portfolio maintained its overweight position in shares from the US, Japan and Europe (excluding the UK).

The Max 30% Shares Portfolio is the only fund in the range that includes global high-yield bonds in its holdings. While high-yield company bond returns were positive in November[28], returns fell when converted into pounds due to the value of the dollar falling against most major currencies.[29]

The fact that the Max 30% Shares Portfolio held more high-yield bonds than the benchmark hindered its overall performance this month.

The fund's overweight positions in shares from the US and Europe (excluding the UK) contributed positively to returns. Its underweight holdings of UK shares, UK government bonds and highly rated company bonds damaged performance, as these assets performed well.

The Max 50% Shares Portfolio's performance was hindered by the fact that it held fewer UK shares and highly rated shares than the benchmark, but overweight holdings of US, Japan, Asia Pacific and Europe shares compensated somewhat for those declines.

After starting the month holding slightly more shares than the benchmark and slightly fewer bonds, the Max 70% Shares Portfolio cut its holdings of shares and added government bonds as markets were rallying. While the fund started the month overweight shares, it ended November underweight. In contrast, the models reduced the fund's underweight in bonds so that it was aligned with the benchmark.

The main reason for this is bacause the value of shares rose in the rally, the models chose to sell them as they recognised that they had become over-valued.

Positive contributions to the Max 70% Shares Portfolio came from overweight positions in UK government bonds, and shares from the US, Japan and the rest of the Asia Pacific region. Underweight stances on UK and European shares and highly rated company bonds detracted from performance.

For more information on the systematic rules-based investment process, please refer to the Fund's Prospectus, which can be found within our **Fund Centre**.

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All data as at 30 November 2023.

[1] The Financial Times, 31 November 2023
[2] Bloomberg, 17 November 2023
[3] Reuters, 1 November 2023
[4] Reuters, 30 November 2023
[5] Bloomberg, 30 November 2023
[6] Business Insider, 29 November 2023
[7] Bloomberg, 30 November 2023
[8] Reuters, 29 November 2023
[9] Daily Focus, 29 November 2023
[10] The Guardian, 15 November 2023
[11] S&P Global/CIPS Flash UK PMI, 23 November 2023
[12] Reuters, 24 November 2023
[13] Bloomberg, 30 November 2023
[14] Reuters, 27 November 2023
[15] The Financial Times, 23 November 2023
[16] Reuters, 23 November 2023
[17] Yahoo! Finance, 30 November 2023
[18] Benzinga, 29 November 2023
[19] Reuters, 30 November 2023
[20] Bloomberg, 29 November 2023
[21] South China Morning Post, 30 November 2023
[22] Reuters, 22 November 2023
[23] Reuters, 30 November 2023
[24] Wall Street Journal, 15 November 2023
[25] Bloomberg, 29 November 2023
[26] CNBC, 29 November 2023
[27] Mining Technology, 27 November 2023
[28] S&P US Dollar Global High Yield Corporate Bond Index, 30 November
[29] Reuters, 27 November 2023

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.

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