Santander Asset Management

Where evolution meets tradition

Quarterly Perspectives

Q2 2024

This publication aims to provide an insight into the changing economic environment and importantly, how this has impacted financial markets and investments. Our Multi-Asset Solutions team at Santander Asset Management UK share their thoughts on the market outlook and how they have adapted investment portfolios to position our clients for the road ahead.

Summary of Quarterly Perspectives content:

- Review of the second quarter of 2024
- Investment performance of different asset classes
- Our expert's opinion on the investment outlook
- How have our multi-asset fund managers changed their portfolio positioning based on the outlook and our tactical asset allocation
- Summary of the quarterly perspectives

Outlook **at a glance**

Current view: ✓ Positive ■ Neutral ✗ Negative

Quarterly change since previous outlook: ▲ Upgrade ➤ Unchanged ▼ Downgrade

Asset classes	Current view	3 month change	At a glance
Shares	✓	➤	We currently hold a positive view on shares globally, with European and UK markets being our preferred choice on the back of attractive company valuations and our expectation of rate cuts by their respective central banks this year.
Bonds	■	➤	We are happy to take on additional risk within our funds and are therefore overweight shares relative to bonds. We now prefer European government bonds as the European Central Bank (ECB) has delivered its first rate cut in June and is likely to make further rate cuts this year.
Cash	✗	➤	While cash is still attractive in the short term, we have used our cash holdings to invest more in shares, given their recent performance and our positive outlook for them going forward. Cash is unlikely in the medium to longer term to provide consistent real (after the effects of inflation) returns.

Regional stock markets	Current view	3 month change	At a glance
US	✓	➤	The US economy continues to grow at or above trend levels but has cooled from growth rates seen in 2023. We hold a positive view on US shares and believe the economy will continue to perform well. As we look toward the end of 2024, we expect economic growth to moderate slightly from this past year.
UK	✓	▲	The UK economy officially came out of recession in the second quarter of the year returning to low economic growth. Our view is that UK economic growth will be low throughout the rest of the year and interest rates are likely to be cut either in August or September. UK shares had a much better second quarter than first, and we have a positive view on the UK market with the region being one of our preferred choices within shares.
Europe	✓	➤	The ECB was the first of the three major central banks to cut interest rates in June. European shares are one of our preferred choices on the back of attractive company valuations and our expectation of rate cuts by the ECB this year.
Japan	✓	➤	The Japanese stock market continued to perform strongly in quarter two, though UK investors saw the gains lost in currency translation to sterling. Japanese companies showed sales growth, pricing power, and cost control, leading to improved corporate profitability.

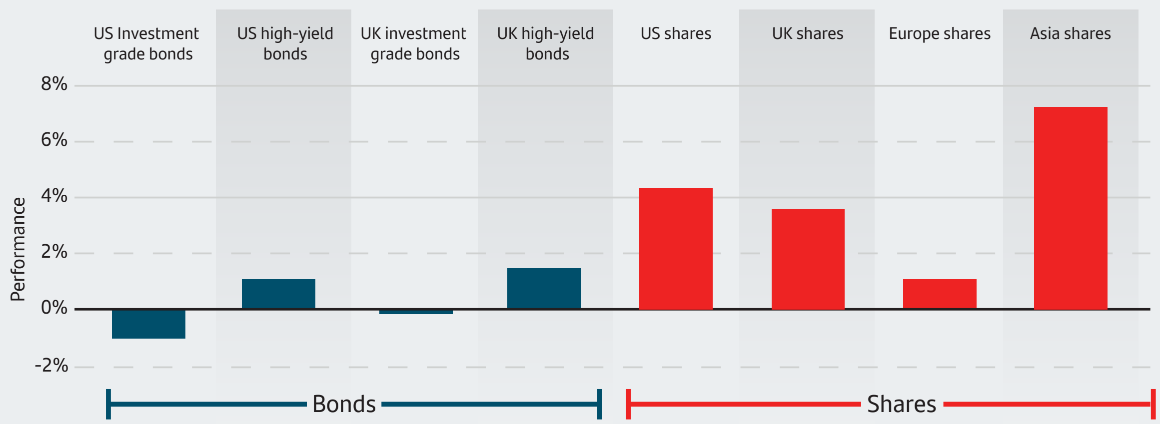
Reviewing the second quarter of the year

Global stock markets rose in the second quarter of the year, although the gains were lower than those achieved in the first quarter. Share prices continued to be supported by hopes of interest-rate cuts from the world's major central banks as global inflation moderated.[1] The ECB duly obliged in June with a 0.25 percentage point cut[2] in its benchmark rate. On the other hand, the US Federal Reserve (Fed) and the Bank of England (BoE) slightly disappointed investors by keeping their respective interest rates unchanged, citing persistent inflationary pressures. However, expectations that they would eventually cut rates supported share prices. First quarter corporate earnings growth, especially in the US, generally exceeded investors' expectations and boosted sentiment.

Many of the major share indices across the globe hit new all-time highs during the period. The US stock market produced better returns than most other global equity markets, driven mainly by large technology stocks such as Microsoft, Amazon and Nvidia, which performed particularly well. The UK also performed strongly, energised by improving economic performance, with the FTSE 100 Index hitting a record high in May.[3] Continental Europe and Japan fared less well, impacted by more varied economic data. Emerging markets – notably India, Taiwan, and China – outperformed developed world markets in aggregate. India benefited from soaring economic growth,[4] Taiwan from recovering export growth and a strong technology cycle[4] and China from improving economic data.[5]

Economic growth was mixed over the period. The US showed signs of slowdown – gross domestic product (GDP) fell to just 1.4%[4] annualised growth in the first quarter of 2024, down from 3.4% in the previous quarter, impacted by signs of an easing in its tight labour market. UK growth recovered well in the first quarter[4] after a shallow recession (defined as two consecutive quarters of negative growth) in the second half of 2023 as consumer confidence improved. Having just avoided a recession, eurozone GDP also increased,[4] but at a more subdued pace compared to the UK. Meanwhile, Japan's economy remained markedly fragile and contracted in the first quarter.[4]

2nd quarter asset class performance

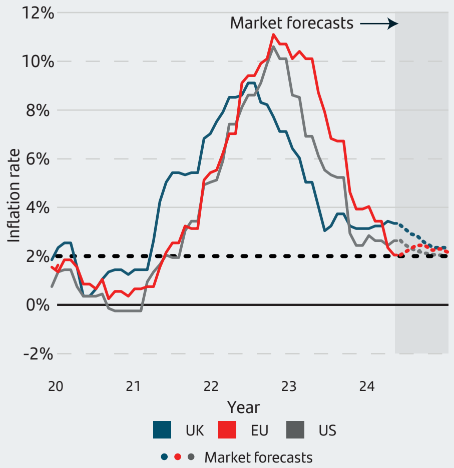


Source: Investing.com. Bond returns are in Pound Sterling, share returns are in their respective local currencies. US Investment grade bonds: Bloomberg USD Liquid Investment Grade Corporate USD. US high-yield bonds: Bloomberg U.S. Corporate High Yield USD. UK investment grade bonds: iboxx £ non-gilts. UK high-yield bonds: ICE BofA Sterling Developed Markets High Yield Index. US shares: S&P 500. UK shares: FTSE 100. Europe shares: MSCI Europe. Asia shares: MSCI ASIA EX JP. Data as at 30 June 2024.

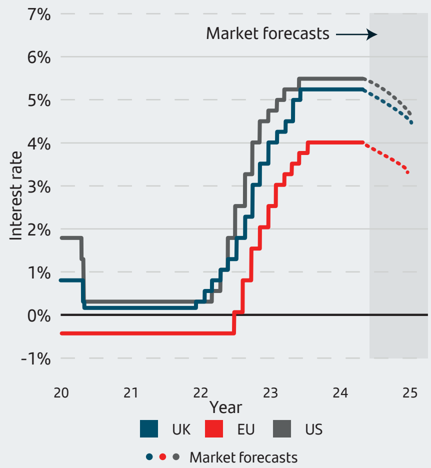
Inflation and interest rates

Inflation and interest rates have been dominating the financial news lately, and for good reason. Understanding these measures is crucial to making informed investment decisions, as they can help explain why your portfolio may be behaving in a certain way. The two charts below provide a view of historic and current trends in these areas, helping you to better understand what's going on in the current economy.

Headline inflation and consensus forecast



Official interest rates and expectations



Source: Oxford Economics & Santander Asset Management.
Data as at 30 June 2024.

When interest rates go up, it becomes more expensive to borrow money, which can lead to a decrease in consumer spending and economic growth. This can cause shares and bonds to lose value and make it harder for companies to generate profits, which can ultimately hurt your investment returns. However, rising interest rates can be a powerful tool for tackling inflation. The slowdown in spending helps to reduce the upward pressure on prices that contributes to inflation. While rising interest rates may have a negative impact, it can play an important role in keeping inflation in balance.

Inflation and interest rates outlook

The Fed and the BoE announced in their June meetings that they are making no changes to the current interest rates. Both central banks are concerned about wage growth. Although they are seeing some signs of wage growth cooling on both sides of the pond, the central banks would prefer to see some more encouraging data in the coming weeks to support a rate cut. Inflation in the US is starting to make better progress towards the central banks 2% target and currently sits around 3%[6], down from 3.3% in May. The progress on inflation in June raises the chances of a Fed interest rate cut, either in September or November.

UK inflation was over 11% in the autumn of 2022, and it is 2% now.[7] That is its lowest level in nearly three years. The pressures that were pushing up UK prices have eased, and the increases in interest rates the BoE have made during 2021–2023 have also helped to slow down those price rises. We think that UK inflation is likely to stay around 2% in the coming months, partly due to energy prices being lower than they were a year ago. UK inflation is expected to go back up slightly towards the end of the year but it is likely to fall again after that. Although UK inflation is at the BoE's target, recent inflation data came in slightly higher than expected, pushing back the likelihood of an August rate cut to September.

The ECB were the first of the three major central banks to cut interest rates in June, however in July, they decided to keep rates unchanged. Weak consumer activity is expected to suppress price pressures in the European economy, allowing the ECB to cut rates further with a cut during their September meeting on the cards.

Share outlook

Global shares were much more subdued in the second quarter of the year.

The US stock market continued to perform well over the quarter. Despite market correction in April, the S&P 500 was up over 4% for the quarter and on pace for gains of over 14% year to date.[8] The US markets' momentum continues to lie in mega-cap technology, as enthusiasm around artificial intelligence (AI) has driven tech sectors and the broader market higher.

UK shares had a better second quarter after a fairly muted start to the year, the FTSE All-Share index increased 3.7% over the period as economic conditions improved.[9]

European shares closed the quarter marginally lower, investors were concerned of the fallout of the European parliamentary elections, the subsequent announcement of a snap election in France and uncertainty over the scope of further rate cuts.

We currently hold a positive view on shares globally, with European and UK markets being our preferred choice on the back of attractive company valuations and our expectation of rate cuts by their respective central banks this year.

Bond outlook

Currently, we are happy to take on additional risk within our funds and are therefore overweight shares relative to bonds.

Where we have a preference in bonds, we favour European government bonds, as the ECB has delivered its first rate cut in June and is likely to make further rate cuts this year. At its June meeting, the Fed trimmed expectations to one interest rate cut for this year, down from three cuts at its March meeting, so we have kept our underweight position in US government bonds. At present, we have a neutral view on corporate, high yield and emerging market bonds.

Our view is that central banks are on track to bring inflation down to within their target ranges in 2024 and any subsequent rate cuts will be positive for bond investors.

Baffled by bonds?

Visit our **Basics on Bonds** page for more information.

Our tactical asset allocation

Our tactical asset allocation represents our views on the financial markets based on the current market conditions and our own market outlook over the coming months. The below chart demonstrates how our current positioning is either underweight, overweight or neutral when compared to a funds benchmark. Generally, an underweight position means that we think a sector will perform worse than others, so we hold less of it. Holding an overweight position means that we think a sector will perform better, so we hold more of it. A neutral position means that we think a sector will perform similarly to others, so we will hold a similar amount as the benchmark.

	April	May	June
Shares			
UK	Neutral	Overweight	Overweight
US	Neutral	Overweight	Overweight
Europe	Neutral	Overweight	Overweight
Emerging Markets	Neutral	Overweight	Overweight
Japan	Neutral	Overweight	Overweight
Pacific Region (Excluding Japan)	Neutral	Overweight	Overweight
Bonds			
Government Bonds	Neutral	Neutral	Neutral
Investment Grade Credit	Neutral	Neutral	Neutral
High Yield Bonds	Underweight	Neutral	Neutral
Emerging Markets Bonds	Underweight	Neutral	Neutral
Money Market			
Cash	Underweight	Underweight	Underweight

Very Overweight   Overweight   Neutral   Underweight   Very Underweight

Summary

- Inflation continues to fall and has hit the 2% target set by the BoE in the UK.
- The Fed has only signaled one rate cut this year, leading to bonds having a mixed quarter due to delayed rate cut expectations.
- Shares have performed well so far this year and we have a positive view on shares going forward.
- We are happy to take on additional risk within our funds and are therefore overweight shares relative to bonds.

Find out more

Learn more, visit our website here for more insights into financial markets.

Note: Data as at 23 July 2024.

[1]S&P Global, 18 June 2024
[2]Financial Times, 6 June 2024
[3]Reuters, 10 May 2024
[4]Trading Economics, 30 June 2024
[5]Financial Times, 16 April 2024
[6]US bureau of labor statistics, 30 June 2024
[7]Office for National Statistics, 30 June 2024
[8]Edward Jones, 30 June 2024
[9]Interactive investor, 30 June 2024