Santander Asset Management

Where evolution meets tradition

Quarterly Perspectives

Q3 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 third 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. Developed market central banks have started their rate cut cycles and shares generally perform well when the US Federal Reserve (Fed) cuts rates, particularly when those cuts are not accompanied by a recession.
Bonds	■	➤	We are happy to take on additional risk within our funds and are therefore overweight shares relative to bonds. We now prefer investment grade and high yield bonds, as they are currently offering attractive returns for the associated risk.
Cash	✘	➤	While cash is still attractive in the short term, we have used our cash holdings to invest in more shares, given their recent performance and our positive outlook for the asset class. 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	✓	➤	Despite some fears earlier on in the quarter that the US economy could be heading for a recession, recently released US jobs data seems to have squashed this fear in the market. We hold a positive view on US shares and believe the economy will continue to perform well.
UK	✓	➤	Our view is that UK economic growth will continue to be low throughout the rest of the year and there could be a further two 0.25% interest rate cuts by the Bank of England (BoE). We hold a positive view on the UK market as company valuations are quite competitive when compared to other countries.
Europe	✓	➤	The European Central Bank (ECB) was the first of the three major central banks to cut interest rates in June and could speed up their future rate cuts to combat tough economic conditions. We hold a positive view on European shares on the back of attractive company valuations and our expectation of rate cuts by the ECB this year.
Japan	✓	▲	The Japanese yen continues to struggle compared to the dollar. Cheaper yen prices are helping exporters to stay competitive and is driving a tourism boom.

Reviewing the third quarter of the year

The upward trend in global stock markets continued during the third quarter, supported by long anticipated interest rate cuts from the major global central banks. While returns were reasonable in US dollar and local currency terms, the pound's strength meant that in sterling terms they were minimal.

Emerging markets outperformed developed world markets, largely due to the Chinese market's surge towards the end of the period, which resulted from a raft of new stimulus measures. Among the larger developed markets, the US again led the way, outperforming Europe, the UK and Japan in local currency terms.

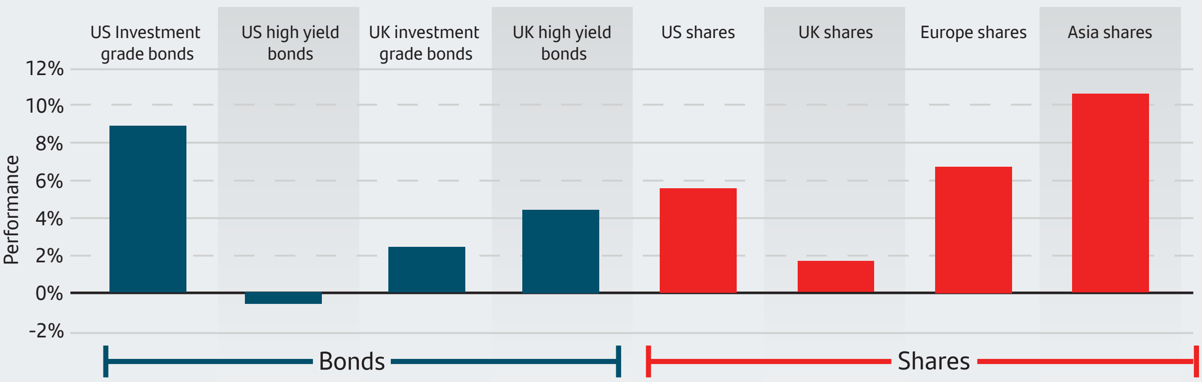
Each of the BoE,[1] the ECB[2] and the Fed[3] cut rates during the period, as expected, with the Fed cutting by more than the other central banks. Falling inflation across most countries and central banks' gradual acceptance that the current disinflationary trends were likely to be persistent led them to cut rates, with further easing expected before the end of the year. Meanwhile, the Bank of Japan (BoJ)[4] danced to a different tune and raised rates for the second time this cycle in July, following March's hike.

Many major market indices continued to set new all-time highs during the period.[5] This was driven not only by falling interest rates, but by hopes that the US economy would achieve a soft landing, and resilient corporate earnings. Geopolitical tensions, especially those in the Middle East, caused volatility but did not ultimately derail the positive sentiment towards equities.

Economic data was largely mixed. Despite signs of a slowdown, especially in its labour market, the US continued to lead developed market growth, with GDP rising by 3.0%[6] in the second quarter of the year (on an annualised basis). Recent economic data emanating from the eurozone and UK , including monthly GDP[7] and retail sales,[8] underlined the fragile nature of their respective economies. China's second-quarter GDP disappointed expectations,[9] as slowing industrial production growth[10] and its problematic housing and commercial property sectors weighed on growth. India continued to grow strongly although there were increasing signs of a slowdown.[11]

Bond markets also produced positive returns, supported by falling inflation and rate cuts. Against this background, higher risk corporate bonds performed better than government bonds.

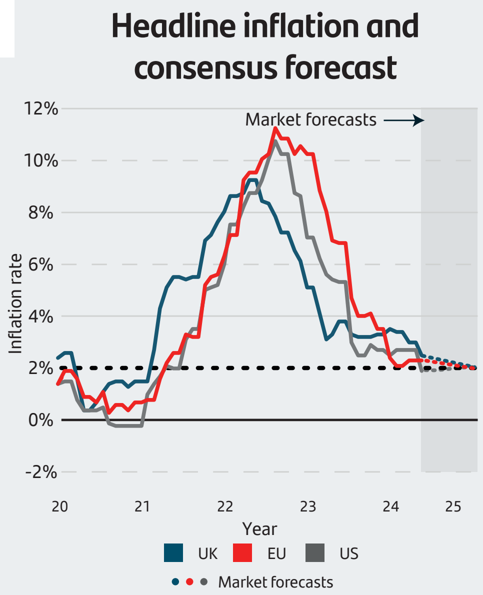
3rd quarter asset class performance

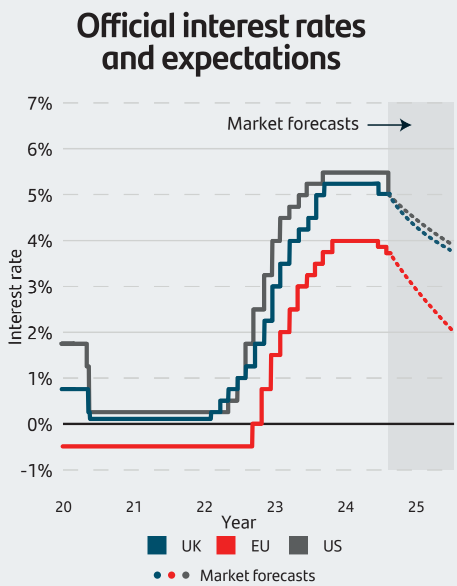


Source: Investing.com. Bond returns are in Pound Sterling, share returns are in their respective local currencies. US Investment grade bonds: Bloomberg USD Liquid Investment Grade Corporate USD. US high-yield bonds: Bloomberg U.S. Corporate High Yield USD. UK investment grade bonds: iboxx £ non-gilts. 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 September 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.





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

Expectations for interest rate cuts in the UK have ramped up after the Governor of the BoE said UK policymakers could become a 'bit more aggressive' in their approach if inflation continues to cool. The next Monetary Policy Committee (MPC) meeting is set to take place on 7 November.[12] However, even with inflation being close to the BoE's target of 2%, we think that they will be cautious in their approach of bringing rates down and believe that a cut of 0.25% is more likely in November. Rates could be cut by a further 0.25% in December, but this would depend on the economic data releases leading up to the MPC meeting.

The Fed cut its benchmark interest rate by a sizable 0.50% at its September meeting, the first cut in more than four years. There were some fears amongst the market that the US could be heading towards an economic downturn, however, jobs data released in early October thwarted these fears and painted a rosier picture of the economy. The strong US job market data along with other strong economic data points is likely to halt the likelihood of a future 0.50% cut by the Fed. We think a 0.25% cut is most likely in November followed by a further 0.25% cut in December.

Share outlook

The market has been particularly volatile during this quarter and has served as a reminder that sentiment can move markets, yet company fundamentals prevail in the end.

The final quarter of the year brings some key issues for investors to contemplate, which could cause some further market turbulence. While volatility may sound bad, it's important to remember that it involves ups as well as downs. The US election is due in November and while history shows that the winning candidate or party has little long-term bearing on market returns, it is also interesting to note that markets do tend to have a reaction (either positive or negative) on election outcomes. Elections may have short-term market impact, but the change in political regime tends to have little sway over longer-run share performance.

Also likely to influence market sentiment in the fourth quarter are the Fed's rhetoric and the extent of the rate cuts. Shares generally perform well on Fed easing, particularly when rate cuts are not accompanied by a recession.

Shares have been on a positive streak for around a year, so it wouldn't be surprising to see some form of market correction. However, we think that there is still room to run before this could happen.

Bond outlook

Currently, our strategy is to increase exposure to riskier assets, such as shares, and move away from safer assets like developed market bonds and cash.

Our strategy is driven by three key events from the past month. Recent US jobs data in the US has showed that there could be some improved momentum in economic growth than what was originally thought, reducing the likelihood of a recession, and providing great clarity on the outlook for the future. The Fed has also initiated a cycle of rate cuts, and sentiment in China has improved following stimulus measures by the People's Bank of China, aimed at stabilising the real estate market and supporting share prices. These three key events should create a more attractive scenario for shares over bonds.

We are currently in favour of slightly riskier bonds, such as investment grade and high yield bonds, as they are currently offering attractive return for the associated risk when compared to government bonds.

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.

	July	August	September
Shares			
UK	Overweight	Neutral	Overweight
US	Overweight	Neutral	Overweight
Europe	Overweight	Neutral	Overweight
Emerging Markets	Overweight	Neutral	Overweight
Japan	Overweight	Underweight	Overweight
Pacific Region (Excluding Japan)	Overweight	Neutral	Overweight
Bonds			
Government Bonds	Underweight	Underweight	Underweight
Investment Grade Credit	Overweight	Overweight	Overweight
High Yield Bonds	Overweight	Overweight	Overweight
Emerging Markets Bonds	Overweight	Overweight	Overweight
Money Market			
Cash	Very Overweight	Neutral	Underweight

Very Overweight · Overweight · Neutral · Underweight · Very Underweight

The table captures our preferences over the duration of the three months shown.

Summary

- The upward trend in global stock markets continued during the third quarter, supported by long anticipated interest-rate cuts.
- The strong US job market data along with other strong economic data points is likely to halt the likelihood of another 0.50% cut by the Fed.
- The US election could cause some short-term market turbulence.
- 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.

Asset Management

Find out more

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

Note: Data as at 15 October 2024.

[1]Bank of England, 1 August 2024
[2]CNBC, 12 September 2024
[3]CNBC, 18 September 2024
[4]Financial Times, 31 July 2024
[5]Reuters, 26 September, 2024
[6]Associated Press News, 26 September 2024
[7]Reuters, 11 September 2024
[8]Trading Economics, 30 September 2024
[9]Associated Press News, 15 July 2024
[10]Trading Economics, 30 September 2024
[11]Reuters, 30 August 2024
[12]Sky news, 3 October 2024