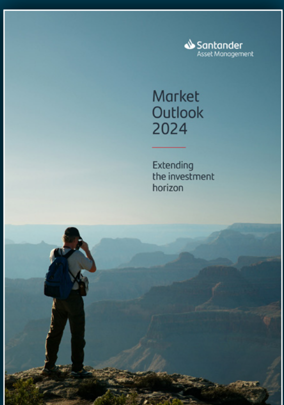
Where evolution meets tradition

Quarterly Perspectives

Q4 2023

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 shares their thoughts on the market outlook and how they have adapted investment portfolios to position our clients for the road ahead.

Market outlook 2024



Santander Asset Management has recently released the global investment outlook for 2024.

In this edition of the Quarterly Perspectives, our Mult-Asset Solutions team takes a look at the key takeaways from the report.

If you would like to read the full, in-depth analysis, please visit our website at: **santanderassetmanagement.co.uk/retail-investor/markets-insights/market-updates**

Inflation and interest rates

- Interest rates expected to fall in 2024

There has been a shift in the market consensus from expecting a recession to foreseeing a 'soft landing' – a slowdown in economic growth that avoids recession, despite high interest rates. The impact of the steepest interest rate hike cycle in decades has been more muted than expected, with the market now believing that many economies can navigate the impact of high interest rates without a major crash.

Compared to previous interest rate hike cycles, the economic slowdown has been delayed. High interest rates will eventually lead to a slowdown in growth, which ultimately should lead to a fall in interest rates this year. This delayed economic slowdown is seen as a significant factor in the market's shift from anticipating a recession to expecting a 'soft landing'.

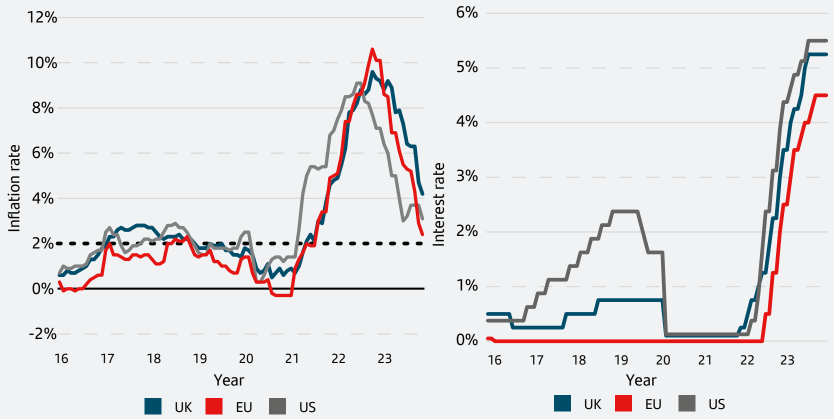
Furthermore, the resilience of growth is underpinned by a strong labour market and healthy company finances in the private sector. While a recession similar to past interest rate hike cycles is unlikely, the future environment will be one of low growth as long as financial conditions remain restrictive, as high interest rates make borrowing money more expensive for businesses.

Markets believe that interest rates have now peaked, with the Bank of England (BoE), Federal Reserve (Fed) and European Central Bank (ECB) pressing pause on interest rate hikes during their recent meetings. They are moving from wondering 'how high' to raise rates to questioning 'how long' to keep them high.

In terms of inflation, real wage growth continues to remain at high levels and is likely to support a higher inflation rate. In both Europe and the United States, the unemployment rate is slightly above its lowest levels in recent decades, which is driving demand for wage increases. This means that the BoE, Fed, and the ECB could continue to favour a policy of high interest rates for longer to allow the delayed impact of rate hikes to be reflected in the economy and help bring inflation down. We believe that inflation is likely to continue to ease throughout 2024 but remain at high levels compared to the BoE, Fed and ECB targets of 2%.

The Fed has indicated that inflation in the US is easing and three 0.25% rate cuts are coming in 2024, however, inflation in the UK has not come down as quickly, with the BoE noting that interest rates could be higher for 'an extended period of time'.[1]

Headline inflation and official interest rates



Source: Office for National Statistics,Bureau of Labor Statistics, ECB Data Portal, Bank of England, Federal Reserve and the European Central Bank.
Data as at 31 December 2023.

Shares - Long-term view

Global financial markets withstood the gloomy expectations in 2023. Shares rallied, with many major share indices recording double-digit gains during the year, helped by a strong rally in November and December as falling inflation made traders more hopeful of interest rate cuts in 2024.[2]

Going forward, we believe there are opportunities to invest in sectors and regions where valuation levels already reflect an adverse economic growth scenario. The risk-return profile of shares is less attractive than that of bonds in the short-term and company earnings may disappoint in 2024. However, our view of shares is positive over the long-term.

The energy transition, artificial intelligence revolution, and supply chain realignment require a historic level of investment. We expect to see themes linked to machine learning, renewable energies, and robotics, among others, growing their representation in portfolios to capture long-term growth opportunities.We believe these trends could deliver investment growth in the medium to long-term, as there is likely to be an acceleration in their development and implementation in the next decade.

Bonds – back in 2024

As interest rates have risen to combat inflation, investors have flocked towards government and corporate bonds, boosting prices later in 2023.[3]

We believe that bonds offer attractive investment opportunities in the current economic environment. The bond market is offering attractive yields relative to historical levels in virtually all segments and geographies. The current levels of investment-grade corporate bond yields are attractive and the quality of company finances in most sectors can withstand an economic slowdown. For the first time in many years, investment-grade bonds offer yields that are competitive with shares.

At present, lower risk bonds (government and high-quality corporate bonds) offer the best risk/return trade-off. There is a higher likelihood that interest rates have peaked, so we have higher duration in our portfolios than usual, as this has historically generated value in the period following the peak of rate hikes. We believe that longer-duration bonds provide greater resilience to our portfolios, offering attractive yields today that can be locked in over a longer time horizon and the potential benefit of price appreciation in a recession. Long-term government bonds are now attractive, with significant upside potential and limited downside.

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.

Investment-grade bonds: Issued by companies considered most financially secure and least likely to default on their loans.

Bond duration: Generally, the higher a bond's duration, the more its value will increase as interest rates fall, because when rates go down, bond values rise and vice versa.

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.

	October	November	December
Shares			
UK	Underweight	Underweight	Underweight
US	Underweight	Underweight	Underweight
Europe	Underweight	Underweight	Underweight
Emerging Markets	Underweight	Underweight	Underweight
Japan	Underweight	Underweight	Underweight
Pacific Region (Excluding Japan)	Underweight	Underweight	Underweight
Bonds			
Government Bonds	Overweight	Overweight	Overweight
Investment Grade Bonds	Overweight	Overweight	Overweight
High Yield Bonds	Overweight	Overweight	Overweight
Emgering Markets Bonds	Overweight	Overweight	Overweight
Money Market			
Cash	Very Underweight	Very Underweight	Underweight

Very Overweight · Overweight · Neutral · Underweight · Very Underweight

Summary

- We believe that interest rates will fall gradually throughout 2024.
- Our view is that economic growth will be slow due to the impacts of interest rate rises, but most economies should avoid a recession.
- We think that inflation will continue to ease throughout 2024, however, a strong labour market means that this decline will be more gradual.
- We believe that bonds offer attractive investment opportunities in the current economic environment.
- We have a positive view of shares over the long-term.

Find out more

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

Note: Data as at 31 December 2023.

[1] Investors Chronicle, 14 December 2023
[2] The Guardian, 31 December 2023
[3] Reuters, 29 December 2023