



A Month



in the Markets

MAY 2023

In this latest edition our Multi Asset Solutions Team look at the challenges investment markets faced in April. The US and European stock markets both saw gains in April, despite the fact that persistently high inflation is still a major concern.

Market Overview

Although persistently high inflation remains a key concern for economists¹, stock markets in the US² and Europe³ were able to make gains in April. Nonetheless, worries of a recession linger and investors remain cautious.⁴ Stock markets in the Asia Pacific region stalled⁵, with news of accelerated growth in China failing to spur a rally in share prices.⁶

Bonds vacillated around the same level for much of the month⁷ amid expectations that the US Federal Reserve (Fed)⁸ and Bank of England (BoE)⁹ will continue to raise interest rates, even if the interest rate hiking cycle may be winding down. Meanwhile, the European Central Bank was faced with conflicting data as a slowdown in Eurozone inflation appeared to reverse course in April, leaving the trajectory of Eurozone interest rates uncertain.¹⁰

In the UK, demand for bonds that protect against inflation reached record highs, reflecting the continuing danger

posed to investors by inflation.¹¹ A cost-of-living crisis driven by soaring energy prices and food prices rising at their fastest pace for more than 45 years¹², is applying pressure on the BoE as it attempts to bring inflation under control.¹³

In the US, regulators were forced to step in to arrange the sale of First Republic Bank, the third major US bank to fail in two months, raising fresh concerns about the financial system's health.¹⁴ According to the International Monetary Fund, this persistent instability is a reminder that the global economic recovery remains fragile.¹⁵

Precious metal markets benefitted from lower bond yields, a weaker dollar and concerns about an economic slowdown, pushing gold prices close to a record high during April as investors shied away from riskier assets.¹⁶

UK and Europe

Data released in April showed that UK inflation has surpassed forecasts to remain above 10%, serving as a sign to the BoE that it may not yet be able to halt its unbroken sequence of interest rate hikes.¹⁷ Yields on bonds that take two years to reach maturity jumped¹⁸ as investors anticipated a further rise in interest rates and hence demanded a greater return on their investment.

UK business activity increased for the third successive month in April, as rising demand in the services sector compensated for a contraction in the manufacturing industry.¹⁹

UK shares also rose in value, with gains in both the FTSE 100 Index²⁰ – which tracks the performance of shares issued by large businesses – and the FTSE 250²¹ Index – which focuses on small and medium-sized businesses. As profits increase, dividend pay-outs from large companies appear likely to climb close to record highs this year, led by financial services firms.²²

Data on European growth released late into the month revealed that the Eurozone managed to narrowly stave off a recession, growing by a disappointing 0.1% in the first quarter of 2023.²³

Nonetheless, Eurozone shares recorded gains in April.²⁴ Earnings of European companies have also proven resilient, with fewer unpleasant surprises arising than analysts had anticipated.²⁵ Yields on 10-year German government bonds, an important regional indicator, rose.²⁶ However, as bond prices and yields move in different directions, this resulted in a decline in bond prices.

US

Figures released in April showed that growth in the world's biggest economy is slowing after businesses made significant cuts to investment.²⁷

This comes as a measure of inflation watched closely by the Fed eased to its lowest level in two years in March.²⁸ Nonetheless, recently released data revealed that US labour costs rose in the first quarter, threatening to boost inflation even as consumer spending flatlines.²⁹

Economists predict policymakers will pause after a potential hike in May to avoid pushing the economy into a recession and wait to see whether previous increases have successfully brought inflation under control.³⁰ Yields on two-year bonds edged lower during April³¹ as investors gained confidence that the interest rate hike cycle may be drawing to a close.

US shares ended April higher as more than half the companies listed on the S&P 500 Index, which tracks the performance of 500 of the largest companies in the US, reported earnings, 80% of which exceeded analysts' estimates. The Dow Jones Industrial Average of 30 prominent companies also posted its best monthly figures since January.³²

Asia Pacific

Chinese economic data released in April created a varied picture of the world's second-largest economy following its reopening from strict COVID-19 lockdowns.

While a sharp rebound in consumer spending spearheaded better-than-expected growth figures for the first quarter of 2023, the cumulative effect of high youth unemployment, weak goods imports and a lack of confidence among householders regarding future incomes posed challenges to continued growth.³³

The MSCI China Index lagged behind almost every other global benchmark index in April, with simmering political tensions with the US potentially contributing to investor pessimism.³⁴

In Japan, consumer inflation accelerated faster than expected in April and began climbing back towards 40-year highs, heaping pressure on the Bank of Japan to raise ultra-low interest rates.³⁵

Japan's economy continued to expand in April as the contraction in manufacturing eased and growth in the services sector remained stable.³⁶ The Nikkei 225, which tracks the Tokyo Stock Exchange's top companies, rose for the fourth consecutive month, buoyed by a weak yen³⁷ – its longest winning streak in two years.³⁸

Outlook

Our view is that the global economy is unlikely to be headed for a full-blown recession, which is defined as two consecutive quarters of negative growth, but for a milder slowdown.

While growth is deteriorating, there continue to be flickers of business confidence. Inflation is high but remains stable, and unemployment is still low.

The difference between the economy's actual output and its potential output, known as the 'output gap', is still relatively high, which may help to alleviate inflationary pressures.

Despite these reassuring factors, investments remain subject to an elevated degree of risk.

If central banks pause their interest rate hikes, investors are likely to transition out of low-risk assets (such as cash) and back into shares and bonds. However, this will leave them exposed should growth worsen significantly.

While we don't expect a repeat of the turmoil of 2022, a substantial economic slowdown could result in the yields of riskier bonds rising more sharply than better-rated bonds, reflecting the increased level of risk they're exposed to and the larger returns investors will consequently demand in return.

All data as at 30 April 2023.

¹ Reuters, 28 April 2023

² Business Insider, 29 April 2023

³ Reuters, 28 April 2023

⁴ Reuters, 28 April 2023

⁵ S&P Asia 50, 28 April 2023

⁶ ABC News, 18 April 2023

⁷ S&P Global Developed Sovereign Bond Index, 28 April 2023

⁸ Yahoo! News, 30 April 2023

⁹ The Guardian, 20 April 2023

¹⁰ Bloomberg, 28 April 2023

¹¹ Bloomberg, 26 April 2023

¹² Office for National Statistics, 21 April 2023

¹³ CNBC, 20 April 2023

¹⁴ Reuters, 30 April 2023

¹⁵ IMF, 11 April 2023

¹⁶ Investing.com, 5 April 2023

¹⁷ Sky News, 20 April 2023

¹⁸ Trading Economics, 28 April 2023

¹⁹ S&P Global / CIPS Flash United Kingdom PMI, 21 April 2023

²⁰ FTSE 100, 28 April 2023

²¹ FTSE 250 Index, 28 April 2023

²² Trustnet, 20 April 2023

²³ Bloomberg, 28 April 2023

²⁴ S&P Euro Index, 28 April 2023

²⁵ Reuters, 21 April 2023

²⁶ Trading Economics, 28 April 2023

²⁷ Bloomberg, 27 April 2023

²⁸ MarketWatch, 28 April 2023

²⁹ Reuters, 28 April 2023

³⁰ Reuters, 20 April 2023

³¹ Trading Economics, 28 April 2023

³² CNBC, 28 April 2023

³³ Economist Intelligence Unit, 20 April 2023

³⁴ Bloomberg, 27 April 2023

³⁵ Investing.com, 28 April 2023

³⁶ au Jibun Bank Flash Japan Composite PMI, 21 April 2023

³⁷ DailyFX, 28 April 2023

³⁸ Nikkei 225, 28 April 2023

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