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A Month in the Markets

JULY 2022

In this latest edition our Head of Systematic Research for TAA and Alpha, Stefano Amato, looks at how continued high inflation and rising interest rates affected the investment landscape around the world in June.

Market Overview

Stefano Amato
Head of Systematic Research for TAA and Alpha

Investors faced another challenging month in June as high inflation and rising interest rates weighed on most stock markets around the world. For the second month in a row, both the Bank of England[1] (BoE) and the US Federal Reserve[2] (Fed) raised interest rates as they attempted to reel in rising consumer prices. Elsewhere, despite suggestions that China may begin to ease its strict COVID-19 restrictions, President Xi Jinping reaffirmed the country's zero-tolerance approach to the virus.[3] These ongoing restrictions have hampered China's manufacturing sector and contributed to supply chain disruptions around the world.[4]

Global stock markets were, on average, negative during June[5] as inflation, higher interest rates, concerns about slowing growth and fears of recession dampened the mood among investors. The US and Europe fared the worst over the month, followed by the emerging markets, Japan, the UK and Asia Pacific excluding Japan.[6]

China's stock market was one of the rare bright spots, recording good performance following a prolonged negative period.[7]

The bond market was also broadly negative for the month as interest rate hikes caused prices to fall and yields to rise (bond yields move in the opposite direction of prices).[8] In general, government bonds outperformed

All data as at 30 June 2022.

[1] The Guardian, 16 June 2022
[2] Reuters, 28 June 2022
[3] CNN, 29 June 2022
[4] The Guardian, 9 June 2022
[5] BBC, 1 July 2022
[6] Refinitiv Datastream, 6 July 2022
[7] Refinitiv Datastream, 6 July 2022
[8] Refinitiv Datastream, 6 July 2022

corporate bonds, and both rebounded in the second half of the month. However, these rebounds were not enough to compensate for the fall in prices at the start of the month when interest rates were hiked. High yield bonds in general performed worse than corporate bonds and did not rebound in the second half of the month.

UK and Europe

The BoE raised its benchmark interest rate to 1.25% from 1% during its meeting in June[9], stating larger increases may be necessary in the future if inflation proves to be persistent[10]. The inflation rate reached a new 40-year high of 9.1%[11], with most of this driven by higher prices for food and non-alcoholic drinks. Along with higher consumer prices, the UK also faced stalling economic growth and the prospect of a recession.[12] While periods of high inflation often mean stronger economic growth, it is different this time around. Prices have risen around the world as the global economy has struggled to recover from the pandemic and the ongoing war in Ukraine has caused spikes in commodity and energy prices.[13]

There was little change to the situation in Europe, where inflation remained at high levels. What did change, however, was the European Central Bank's (ECB) announcement it would soon be raising interest rates. Previously, the ECB said it would hold off raising rates until the final three months of the year[14], but decided to change course early in an attempt to pull inflation back down to its 2% target[15]. Overall, the European economies faced several challenges in June including falling manufacturing output and demand due to the higher cost of living.[16] This has been accompanied by concerns about rising energy costs and snarled supply chains due to the war in Ukraine.

US

Any hope that consumer price inflation in the US had reached its peak were dashed in June. Official figures showed that it had in fact spiked to a new 40-year high of 8.6%.[17] The Fed announced a 0.75% interest rate hike[18] in June in its attempt to curtail price rises and signalled that similarly sized rate increases were likely in the future[19]. The Bureau of Economic Analysis also released updated figures that showed the economy shrank by 1.6%[20] in the first three months of the year[21]. Similar to other parts of the world, there are signs the US economy is beginning to slow down. There are concerns that this weaker growth, high inflation and large interest rate hikes will plunge the economy into recession.

Asia Pacific

Countries in the Asia Pacific region continued to be affected by the COVID-19 pandemic, global inflationary pressures and supply chain disruptions. China began to see some positive news after it lifted its lockdown in Shanghai, with growth in both its manufacturing and services sectors.[22] Since the beginning of the pandemic, China has sought a zero-COVID-19 policy with strict measures such as lockdowns in major cities. While it was initially believed the country would drop these policies, President Xi reaffirmed them during a visit to Wuhan in late June, stating that the policy was the most effective and economic approach for the country.[23]

In Japan, inflation continued to rise, albeit at lower levels than many other parts of the world. Up until recently, Japan struggled to generate inflation and often dealt with deflationary pressures owing to its ageing population and weak economic growth. However, in June it was reported that its inflation rate reached 2.5% in May, up from 2.1% in April, and above the Bank of Japan's target of 2%.[24] The good news for Japan was that fresh figures from the Cabinet Office showed that the economy shrank less than expected in the first three months of the year, at -0.5% as opposed to -1%.[25]

All data as at 30 June 2022.

[9] The Guardian, 16 June 2022
[10] Reuters, 29 June 2022
[11] Office for National Statistics, 22 June 2022
[12] KPMG, 27 June 2022
[13] World Bank Blogs, 5 May 2022
[14] Reuters, 10 March 2022
[15] BBC News, 9 June 2022
[16] PMI by S&P Global, 23 June 2022
[17] U.S Bureau of Labor Statistics, 10 June 2022
[18] Trading Economics, 2022
[19] Reuters, 28 June 2022
[20] CNN, 29 June 2022
[21] U.S. Bureau of Economic Analysis, 29 June 2022
[22] Reuters,30 June 2022
[23] CNN, 29 June 2022
[24] Statistics Bureau of Japan, May 2022
[25] Reuters, 8 June 2022

Outlook

There is no sugar-coating that June was a difficult month, though it was not entirely unexpected. Throughout the year so far, the general trend has been for higher inflation, rising interest rates and weaker growth. Much of what we have observed in stock markets up until now has been a direct response to all these factors, as well as the economic effect of the ongoing pandemic and the war in Ukraine.

It is clear that governments and central banks around the world have been somewhat complacent about inflation in the belief that it will resolve itself sooner rather than later. That no longer appears to be the case and central banks are now trying to determine how much firepower they need to unleash to pull back rising prices. We believe that interest rates will continue to rise throughout the year as central banks attempt to quell demand.

We remain cautious at this time and believe our decisions must be made on data and real-world factors. We are constantly monitoring the economy and financial markets, and believe there may be further downward movement in stock markets if inflation persists and global supply chains are further disrupted.

All data as at 30 June 2022.

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Important Information