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# A Quarter in the Markets

## Q4 2021

**We are pleased to introduce our latest edition of 'A Quarter in the Markets', which provides an insight into financial markets from the Multi-Asset Solutions team at Santander Asset Management UK.**

## Key factors influencing markets

During the final three months of the year, stock markets around the world continued to provide investors with strong positive returns. There was some volatility along the way as the triple threat of higher inflation, interest rate hikes and a resurgence of COVID-19 infections weighed on investors' minds. Nevertheless, strong corporate earnings helped to move stock markets higher over the period. Rising inflation and the prospect of higher interest rates caused bonds to underperform.

The Bank of England was one of the first major central banks to respond to higher inflation, raising its benchmark interest rates to 0.25% from 0.1%.[1] The US Federal Reserve (the Fed) held its interest rate. Instead, it began winding down its bond-buying programme, known as quantitative easing, sooner than previously expected. The Fed also anticipated three interest rate rises in 2022.[2] These moves caused shares in some high-growth technology companies to fall, but did not have a significant negative effect on the wider stock market.[3]

[1] The Guardian - Bank of England raises interest rates to 0.25%, 16/12/21
[2] The Guardian - US Federal Reserve speeds up taper and signals three rate hikes in 2022, 16/12/21
[3] Aljazeera - US stocks dragged down by interest rates hike fear, tech woes, 22/10/21

Overall, the main factors affecting markets over the quarter were higher energy prices, persistently high inflation and the emergence of the Omicron variant of COVID-19. The latter plunged the global economy back into uncertainty.[4]

## So, what happened during the quarter?

Generally, global stock markets were positive over the final quarter. However, much of the positive performance was driven by developed markets, while Asia Pacific and the emerging markets underperformed.[5] From a regional perspective, the US led the way, followed by Europe and the UK. Japan, the broad Asia Pacific region, and the emerging markets all saw a small negative return in local currency terms. China's stock market was the worst performer among major markets, falling by more than 6% in local currency terms.[6]

October was a firmly positive month for global markets on average, driven by a bounce-back from the turbulence we saw in September. However, the good feeling quickly ended, and November was a down month for stock markets. While inflation had been on investors' minds for some time, it became evident during November that it was not going away any time soon. Along with this, Omicron's rapid emergence and spread startled governments and health authorities alike. Compounding the issue were worries that the major vaccines might not be as effective against this variant as previous iterations – an issue that triggered major booster jab campaigns in many countries. Rumours of yet more restrictions began to swirl. Understandably, shares in travel and leisure companies, as well as other so-called reopening companies – those that benefitted from the lifting of restrictions - fell. December was a broadly positive month for shares, as the so-called Santa Claus rally (the tendency for stock markets to rally over the last weeks of December) lifted stock markets towards the end of the month.[7]

## How did different economies react?

The story for the fourth quarter was something of a mixed bag. On the one hand, it was clear economies around the world were attempting to recover and return to normal. On the other hand, there was the ongoing presence of COVID-19 and its impact on consumer behaviour and business confidence.

The UK opened the quarter with accelerated activity among private sector businesses and buoyant consumer spending.[8] There was still growth in the manufacturing sector, but it was dampened somewhat by three

[4] U.S. Energy Information Administration - Crude oil prices increased in 2021 as global crude oil demand outpaced supply, 4/1/22

[5] FE fundinfo – Market performance, 31/12/21

[6] FE fundinfo – Market performance, 31/12/21

[7] Market Watch - Santa Claus rally is off to best start in 20 years. Here's what history says about the stock market's performance when rally starts this well, 27/12/21

[8] Markit Economics - UK recovery regains momentum in October, but supply shortages hit manufacturing growth and cost inflation reaches new record high, 22/10/21

factors affecting businesses around the world: supply chain disruptions, staffing issues and higher prices for materials.[9] While business activity continued to expand through to the end of the year, it was clear that Omicron was taking its toll. By December, inflation was running at 5.1%[10] and private sector output was the slowest it had been since the last lockdown in February 2021.[11] The highly infectious Omicron variant of COVID-19 caused record numbers of infections each day. Many people cancelled or postponed plans, reduced social activities and the UK Government once again recommended that people work from home.[12]

There were similar issues in Europe. The quarter opened with supply chain issues, continuing concerns about COVID-19 and high inflation. Surging energy prices were primarily to blame for inflation rising to 4.9%, the highest recorded since records began in the eurozone in 1997.[13] While job creation was good and the business sector grew throughout the quarter, the pace of growth began to slow down in December as Omicron dented activity.[14]

Turning to the US, the situation is not dissimilar to the rest of the world. For the most part, the economy has been getting back on track. Job creation has been solid, although fewer jobs were added to the economy in November than initially expected.[15] Nevertheless, the unemployment rate continued to fall and private sector businesses saw a strong upswing in output to end the year.[16] The economy continues to face many of the same issues as the UK and Europe: high inflation, surging Omicron cases and the potential for higher interest rates in the coming year.

Asia Pacific and the emerging markets had a mixed quarter. China, in particular, grappled with subdued demand, surging inflation and a slower economy.[17] In December, the Chinese central bank responded to its faltering economy by cutting its benchmark lending rate to 3.8% from 3.85%.[18] In emerging markets, the key issues were slower vaccination rates, the Omicron variant and economic output that continued to sit below pre-pandemic levels.[19]

[9] Markit Economcis - UK recovery regains momentum in October, but supply shortages hit manufacturing growth and cost inflation reaches new record high, 22/10/21

[10] Office for National Statistics - Consumer price inflation, UK: November 2021, 15/12/21

[11] Markit Economics - Sharp slowdown in UK private sector growth in December as Omicron variant hits spending on consumer services, 16/12/21

[12] BBC - Omicron: Should I be working from home now? 14/12/21

[13] The Guardian – Inflation in eurozone soars to 4.9% – highest since euro was introduced, 1/12/21

[14] Markit Economics - Eurozone growth at nine-month low in December as COVID-19 wave hits service sector, but price pressures ease, 16/12/21

[15] CNBC - Job growth disappoints in November, with a gain of just 210,000, despite high hopes, 6/12/21

[16] Markit Economics - US sees resilient output growth in December, as service sector reports record inflation but supply shortages ease, 16/12/21

[17] Reuters - China's Nov factory activity slips back into contraction - Caixin PMI, 1/12/21

[18] CNBC - China's central bank cuts a benchmark rate for the first time since the pandemic, 19/12/21

[19] KBC Economics - Emerging Markets Quarterly Digest: Q4 2021, 22/10/21

## What is the outlook for markets?

While it remains unknown when the pandemic will come to an end, we maintain a cautiously optimistic outlook for stock markets and economies. Vaccination rates around the world are high and many countries are rolling out booster jabs in large numbers. There is evidence that vaccines are increasing in effectiveness against the virus. In addition, governments are increasingly prepared for unexpected twists and turns in the pandemic, bringing confidence to people and businesses.

As the year came to a close, we saw good levels of economic activity and the continued rollout of vaccines. Coupled with necessary government support and supportive policies from central banks, in our opinion businesses and investors can feel reassured. Given this backdrop, our outlook remains broadly unchanged from previous months. We continue to monitor stock markets and economies for further developments and are well positioned to respond when, and if, necessary.

## Find out more

Click **here** to read our latest A Month in the Markets, where our Head of Multi-Asset Solutions, Stefano Amato, looks at how key themes impacted markets in December.