

Investment Outlook 2022

A GLOBAL VIEW



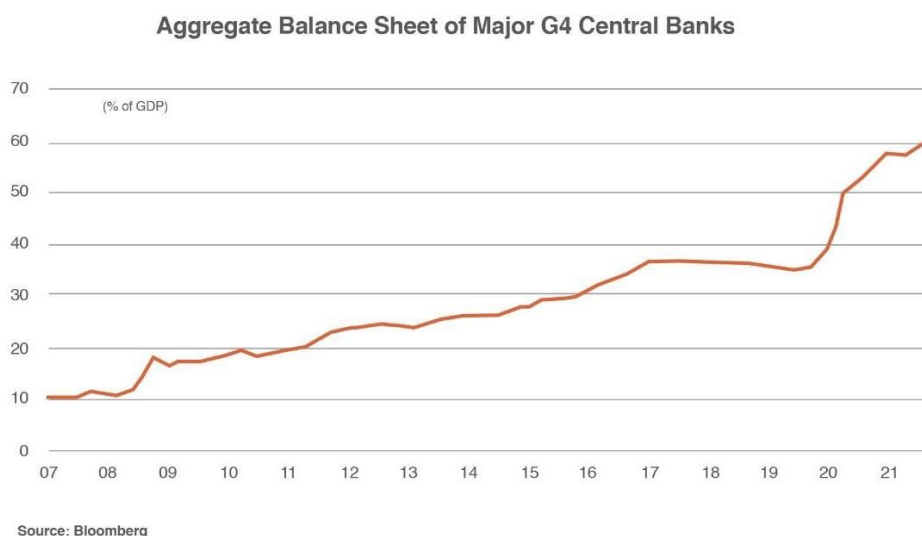
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A Global View

As we peer into 2022, ordinarily, investors would see around 4% real GDP growth for the global economy and a good level of inflation as a positive backdrop to risk markets such as equities. However, asset market returns look likely to be constrained by central banks shifting to tightening monetary policy after two years of unbridled easy money.

To be clear, we don't fear the growth outlook; we fear the adjustment that the market is likely to go through to absorb the development of higher inflation and higher bond yields. Many of the high investment returns from growth sectors such as technology have been generated by higher valuations, not necessarily higher profits. Indeed, the returns from many growth sectors have far surpassed the increase in corporate profits in recent years. Even at the aggregate level, the S&P500 is up 45% since the start of 2020, whereas projected corporate profits are up just 18%. As much as valuations have benefitted from near zero long and short rates, the rise in interest rates will likely restrict returns.

You should not underestimate the very different monetary conditions the global economy will likely face in 2022. Easy money has taken two forms, very low interest rates and quantitative easing. At the moment, US investment banks are trying to outdo each other predicting how many interest rate increases we are likely to see in 2022. It is better to keep in mind that neutral interest rates are close to 2.5% and add a percentage point to tight policies that squeeze out inflation - hence a 3.5% Fed funds rate sometime in the future is entirely possible. QE will become QT as quantitative easing through bond purchases becomes quantitative tightening. Central banks who were buyers of many of the bonds issued by their respective governments have to sell, not buy. In 2020 the ECB bought 95.5% of the bonds issued by eurozone governments. The Federal Reserve's holding of US government debt has risen from USD 2.5 trillion in Q2 2019 to USD 5.9 trillion recently in Q3 2021. Even a lack of buying could dramatically impact bond yields, let alone net selling.

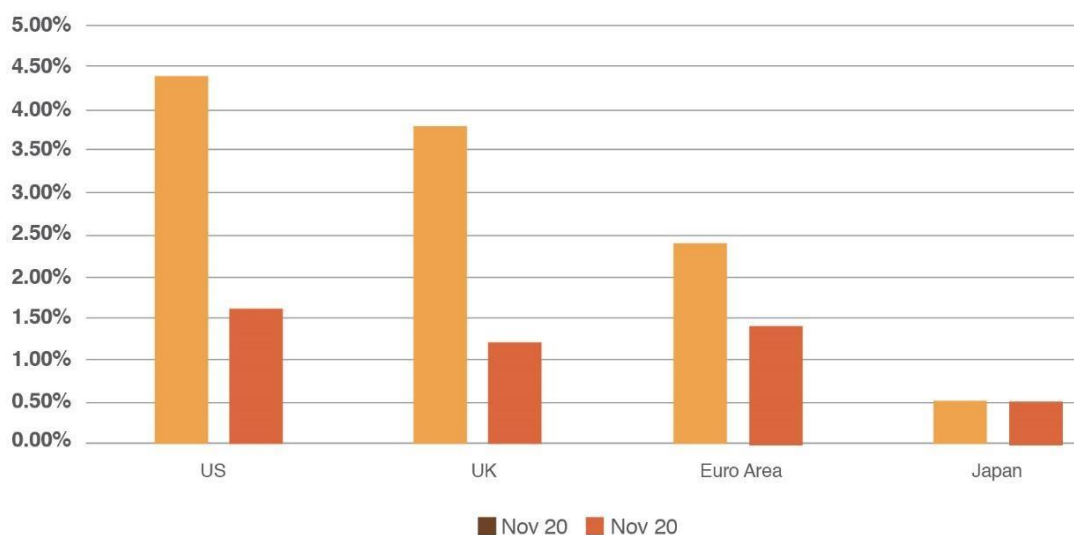


Investors need to prepare for an environment where interest rates rise quite sharply. The Fed looks set to raise rates four or more times through the year. US 10 year yields closer to 3% would be more consistent with the inflation outlook than where they currently trade well below 2%.

With higher interest rates, previous winning investment strategies may not be as successful in the future. We have already seen some unwind of the outperformance of the technology sector. We expect the underperformance to continue. Indeed, if you look back to 2021, most Nasdaq 100 stocks delivered negative returns. The index's performance was entirely due to the strong performance of just a handful of stocks. The good performance of technology as a corporate sector is far from over, but the share prices of such stocks are likely to struggle as an inevitable derating ensues.

While rising interest rates are a likely headwind to global equity markets, GDP growth will be good support. Consensus economists' forecast is for global growth of 4.4% in 2022. If you throw in global inflation of around 4%, in simple terms, your average international business should be enjoying revenue growth of, say, 8% in 2022. While corporate profit margins may be under pressure from higher input costs, corporate profits should be relatively robust.

Forecasts for Inflation Materially Higher Across the World



Source: Goldman Sachs Research

Equity markets outside of the US appear to have a decisive advantage over the US in 2022. US equities trade on stretched valuations, and the economy is set to lose some momentum through the year. In Europe and Asia, growth should be more robust, with more opportunities for positive surprises. Valuations in equity markets outside of the US are much more reasonable. Indeed, in Asia, many equity markets trade at discounts to the long term average.

There have been some signs that the omnipotence of the dollar is being challenged in the market. Around the end of the year, the dollar had its wobbles. While higher interest rates from the Federal Reserve support the currency, the political challenges with midterm elections potentially leaving a lame-duck government and an economy that might stutter under the weight of high government debt levels could start to weigh on the economy. Indeed, the concern for the global market would be that a precipitous fall in the dollar could set off another

round of rises in global commodity prices. A fall in the dollar would likely prompt OPEC+ to defend its spending power by pushing oil prices higher.

Our preferred strategy for the year is to invest in companies that are beneficiaries of higher inflation and are unlikely to suffer a derating due to higher global interest rates. By region, this argues for Asia and Europe. By sector, commodity plays such as mining companies and inflation-linked sectors such as energy, REITs and blue-chip companies with strong pricing power in the consumer and industrial sectors will do well.

Sanctum Wealth

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