



## Omicron induced volatility

31 December 2021

For a third year in a row, global stock markets finished 2021 with double-digit gains, and the rise in stock markets has been particularly impressive in the US. Over the past year, the S&P 500 rose 27% (with top contributors to performance being the big tech names, such as Microsoft, which was up 51%); the Dow Jones rose 19%; and the Nasdaq rose 21%. European stock markets also advanced, with the EuroStoxx 50 index gaining 21% over the year.

| Equities              | Level  | Dec-21 | YTD    | Yields, FX and commodities | Level | Dec-21 | YTD    |
|-----------------------|--------|--------|--------|----------------------------|-------|--------|--------|
| MSCI World            | 3,232  | 4.19%  | 20.14% | 10Y US Treasury Yield      | 1.51  | 0.05   | 0.60   |
| MSCI Emerging Markets | 1,232  | 1.62%  | -4.59% | US Dollar Index            | 96    | -0.34% | 6.37%  |
| MSCI AC Asia ex Japan | 789    | 1.21%  | -6.36% | Gold (\$/oz)               | 1,829 | 3.08%  | -3.64% |
| S&P 500               | 4,766  | 4.36%  | 26.89% | WTI Crude Oil (\$/bbl)     | 75    | 13.64% | 55.01% |
| Nasdaq comp           | 15,645 | 0.69%  | 21.39% |                            |       |        |        |
| FTSE 100              | 7,385  | 4.61%  | 14.30% |                            |       |        |        |
| Eurostoxx 50          | 4,298  | 5.79%  | 20.99% |                            |       |        |        |
| SMI                   | 12,876 | 5.89%  | 20.29% |                            |       |        |        |
| CSI 300               | 4,940  | 2.24%  | -5.20% |                            |       |        |        |
| Nikkei 225            | 28,792 | 3.49%  | 4.91%  |                            |       |        |        |

Figure 1: Data as at 31.12.21 (local currency returns)

Despite the persistent Covid headwinds over 2021 (even with the vaccine rollouts); supportive monetary and fiscal policy, along with a bounce back in corporate earnings, have helped propel stock markets higher over the year.

This 2021 equity rally occurred even despite the spike in Covid cases, and uncertainty caused by the new omicron variant in December, which led to pronounced market volatility. Volatility last month was also added to by the shift from global central banks to tighten monetary policy. Therefore, as mentioned in our last investor letter, the road to a post-Covid world will not be straightforward, and unexpected pandemic news (such as new variants) can unsettle investors.

As we go into 2022, we expect equity returns to be more muted. The favourable market conditions which propelled financial markets last year, most notably supportive monetary policy, and ultra-loose fiscal policy, are expected to be scaled back this year. Inflation is currently above target, and it is expected to be a focal point this year, which will put pressure on central banks to start to raise interest rates. We have already seen central banks adopt a more aggressive stance to dampen inflationary pressures, such as the Bank of England, which hiked interest rates for the first time since the pandemic started on 16<sup>th</sup> December (to 0.25%, from 0.1%). The US Federal Reserve has indicated three interest rate rises this year, along with plans to double the pace at which its bond-buying programme is withdrawn. Therefore, this hawkish central bank stance presents a prospective headwind for the year ahead, and the Fed's shifting policy will be important to watch in 2022.

## Our summary recommendations

Despite the factors which present headwinds for markets going into this year, we remain constructive on equities, albeit with more muted returns expected. We continue to favour the US market, expecting robust corporate earnings; however, we also continue to favour diversification globally, with emerging markets showing some signs of recovery, for example. Diversification by equity market capitalisation is also favoured, as we may see small-cap and mid-cap stocks catch up this year, after lagging large-caps in 2021. For example, higher bond yields will favour financials; whilst on the other hand, higher bond yields will impact technology companies where their high valuations are based on future profits (and therefore very sensitive to the rate at which their cash flows are discounted).

With equity market returns expected to be more muted this year overall, we continue to look for other areas of potential returns and opportunities in portfolios. Alternatives are one of our favoured asset classes, due to their diversification benefits and reduced sensitivity to shorter term market movements. [↗](#)

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