Outlook 2022. Blackfort.

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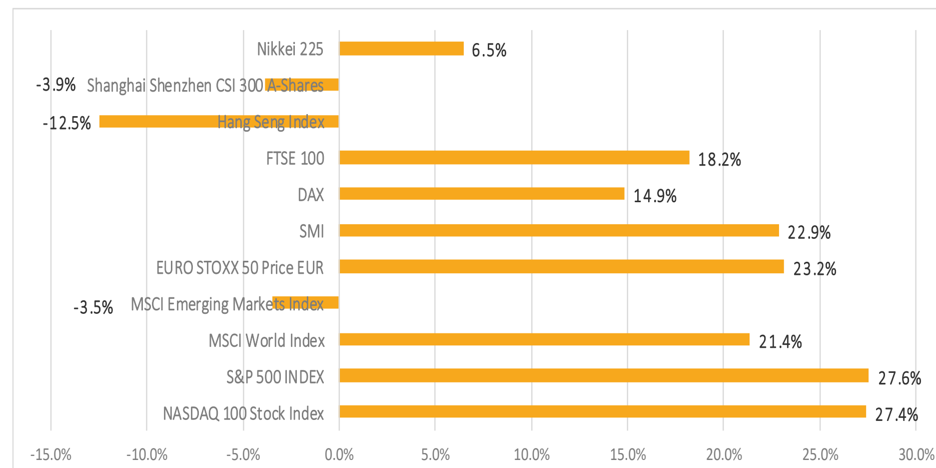
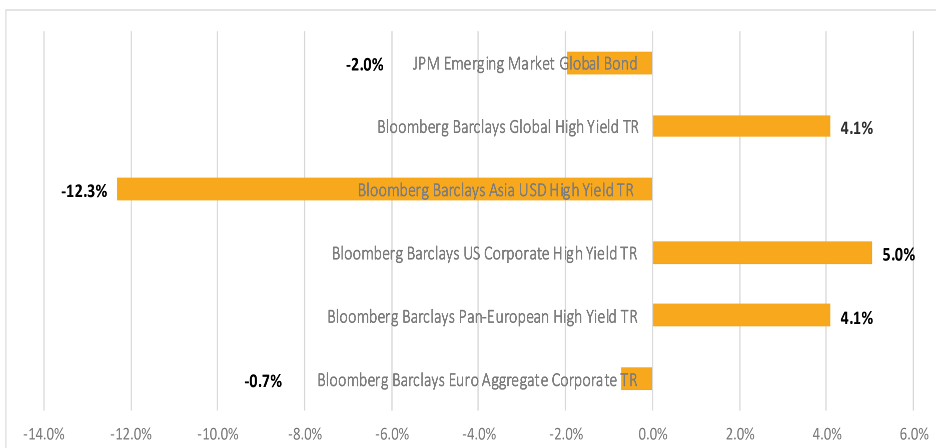
Global markets in 2021: A mixed bag

- The 2021 was a complicated year for both equities and bonds. While developed equities performed extremely well, with the US markets up around 27% again more leading the peg, on the flip side we had Hang Seng which lost 13% just to be followed by Brazilian equites which lost around 11%. Overall Emerging markets were down a touch less than 5%.
- It was rather difficult to outperform broader indices as most constituents were down while the market was hovering at recorded levels. For instance, 95% of Nasdaq 100 stocks lost value in 2021, while the index reached new records.
- Besides the negative impact of COVID-19 we have seen a lot of interest rate hikes in emerging markets being one of the key headwinds for equity markets. A stronger USD was coming on top of that.
- In the second half of 2021 we have seen more tension from the west towards Russia and China. While in China the weak performance was mainly driven by stronger regulation of various sectors, the Russian equity markets lost almost half of its gains during H2. However, with a very low Shiller PE ratio and a high dividend yield, we would argue that from a valuation standpoint Russia looks attractive. From the BRICS countries probably, only India looks more appealing, given its growth potential and especially given that they do not have a higher inflation rate than government bond yields. We do expect therefore inflow into the Indian market over the coming months.

Globe equity markets in 2021



Global corporate bond markets in 2021

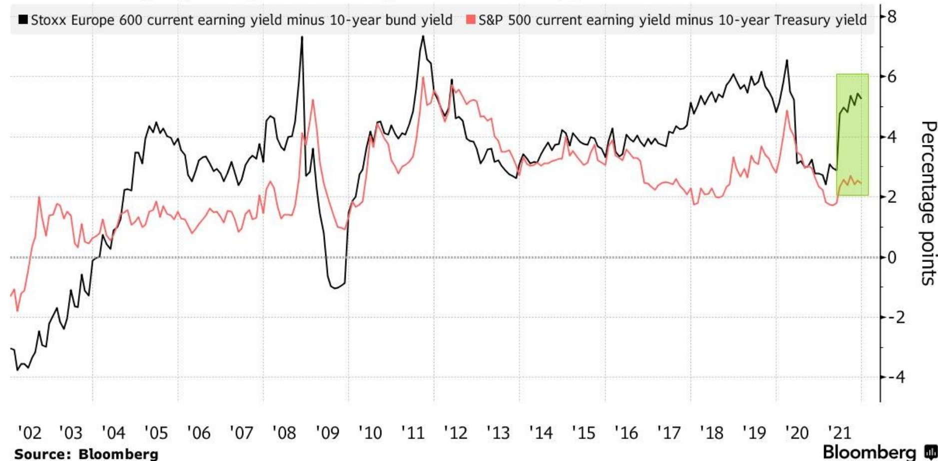


- The development of global corporate bond markets reflects the development of the global equity markets. Asian high yield bonds lost around 12% in 2021, the major part came from Chinese property corporates.
- Surprisingly resilient was the reaction of global high yield bonds. We did not see any significant spread widening and US and European corporates returned the coupons.
- High quality bonds like European corporates lost value during 2021. European investment grade bonds lost only around 0.5% while their US pendants lost 1.6%. The weak performance of this asset class was expected.
- When we turn to US government bonds which lost 2.3%, we must repeat our warning that this asset class will continue to perform poorly. If you consider US inflation with 6.8% your loss of purchasing power in 2021 was almost 9%.
- Government bonds in EUR, GBP, JPY or CHF have even a less compelling starting point as all these bonds are negative yielding and they all face high inflation pressures as well.

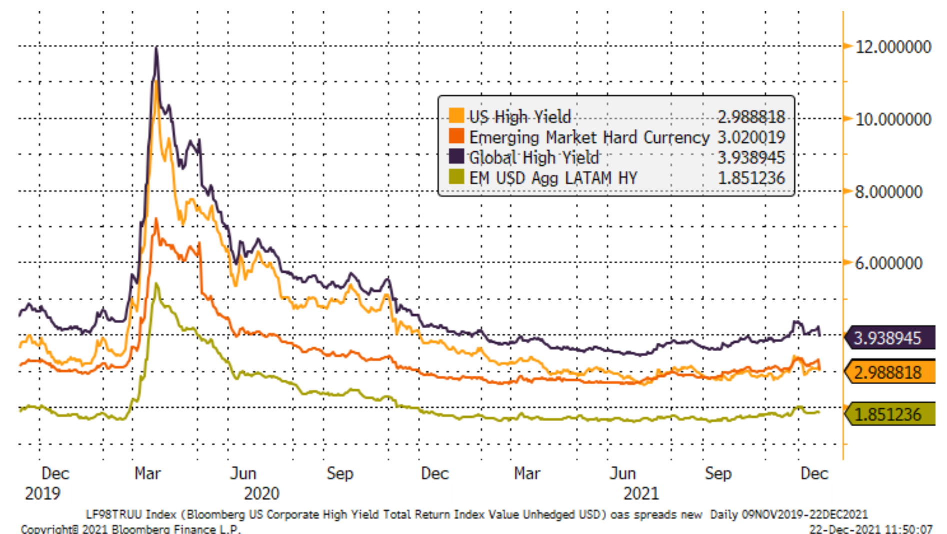
Headwinds for the global economy: No recession in sight

- Over the last trading days markets were rattled by the new omicron virus. A lot is unclear but based on two studies from South Africa there is hope that we do see on one hand a much faster spreading of the virus, but on the other hand a less severe development of the illness and fewer deaths. Even if this is rather positive tone, we might be wrong. But we can expect that people are resilient and do adapt to the crisis. Therefore, the impact on the global growth is expected to be minor. Based on the latest nowcasts from Bloomberg, Q4 GDP will be reduced by around 0.2 to 0.4% in each country. Later during 2022, we do expect a 2nd wave of pent-up demand once the economy fully opens.
- We do expect quality bonds to deliver a poor nominal return. If we were right with this assessment that there will be no global recession US and European high yield bonds might deliver the coupons and maybe lose very little due to a touch tighter corporate bond spreads. Nevertheless, even high yield bonds do offer a negative real yield and are therefore not attractive.
- We therefore expect equities to deliver roughly their EPS growth plus the dividend. For the US it means 8% growth and 2% dividend yield. The risk of this forecast lays in the development of inflation We expect it to come down during summertime and for the US to be back below 5% or may be even 4%. This could however mean that EPS might inflate, and the nominal growth could exceed the expected 8%. Therefore, with a PE ratio of around 20 times for 2022 we consider US equities and global equites as attractive. Similar conclusions can be drawn from the equity risk premia, which is still high for all markets.
- We'd rather buy real assets such as gold, commodities (and mining shares), real estates (REITs) besides equities. Convertibles bonds and other asymmetric investment which extract an equity risk premia from the market are as well part of our investment universe. It could therefore well be that 2022 will be the 2nd year in a row where equites will do well, and high-quality bonds will do poorly.

US and European equities do offer an attractive risk premium



Will we see in 2022 another year of no significant spread tightening?



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