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OUT OF THE ORDINARY

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Market reflection

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Any events that happened earlier in November were overshadowed by the emergence of the Omicron variant at the end of the month. At the time of writing markets are reflecting a balanced reaction to the news, having sold off sharply initially. However, the outlook will remain unclear until certain questions are answered more clearly, notably regarding the severity of infection and the efficacy of existing vaccines. Unsurprisingly it was sectors that have benefitted most from the “reopening” trade that bore the brunt of selling, especially Travel and Leisure.

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Investors had already been grappling with other concerns. Inflation and monetary policy tightening remain at the top of the short-term worry list. The current period of higher inflation prints is proving to be more enduring than had been predicted by the majority of economists and central banks. Supply chain disruption has lasted longer than expected and labour markets are also very tight owing to many individuals either retiring or not yet being willing or able to return to work owing to Covid-19. Furthermore, energy prices have spiked higher thanks to increasing demand for fossil fuels against a background of tight supply. And it is hard to be especially optimistic about the near-term outlook when food prices are also rising sharply on account of a combination of weather-related disruption and increased input costs. It is against this backdrop that central banks around the world have begun the tricky process of withdrawing monetary stimulus from the economy, a process that tends to create more uncertainty. And yet global equity markets remain close to all-time highs, which is testament to the very strong earnings growth that is being generated, as well as the desire by investors to generate meaningful returns in a world that still offers very low yields on cash and government bonds, a situation that is unlikely to change materially in the short term.

• The days of strong upward momentum in global economic growth casts are behind us, but GDP growth is still expected to remain above the pre-pandemic trend in 2021 (5.8%), 2022 (4.4%) and 2023 (3.5%).

• Corporate earnings growth will peak in 2021 at around 50%, re decelerating sharply in 2022 (+8%) and 2023 (+5%) based upon current consensus forecasts. A key variable will be profit margins, which have increased to new highs even during the pandemic. While this is partly down to the dominance in global indices of technology companies, it is also a result of strong cost control and the "winner takes all" nature of certain industries.

• Headline inflation levels have risen to more than 6% in the ed States and over 4% in the UK, where they are on course to continue to rise for several months yet. Central banks are generally sticking to the narrative that this is a transitory phenomenon, but their confidence is being tested.

• A cold snap in Europe and a lack of wind to drive turbines inue to squeeze natural gas and wholesale energy prices higher. This has highlighted the difficulties of negotiating the "energy transition" to a world of lower fossil fuel usage. More than 80% of global energy is still derived from fossil fuels.

• The COP26 summit in Glasgow was lacking in firm action despite strong rhetoric. The International Energy Agency concluded that even new initiatives to reduce carbon output still leave the world on track for a 1.8°C rise in average temperatures by 2100 rather than the targeted level of 1.5°C.

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