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OUT OF THE ORDINARY

07 March 2022

Market reflection

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Overview

The start of 2022 continues to be difficult for investors, who have experienced losses in both equities and bonds.

The latest test of confidence has come from Russia's invasion of Ukraine. At the time of writing the conflict is far from resolved, although market participants' evaluation is that hostilities will not spread beyond the borders of Ukraine. Indeed, while the initial incursion was met by sharp declines in the prices of riskier assets, there was an almost immediate recovery. But any comments on the situation are made with the caveat that these sands are shifting quickly.

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Furthermore, even if the conflict itself does not spread further, its economic effects almost definitely will, mainly transmitted through higher commodity prices, with the focus on natural gas, oil and grains.

Much still depends on the extent of sanctions. Eventually, the market will return to its previous concerns about monetary policy tightening. Hawkish statements from central banks in the face of persistently higher inflation were the catalyst for an upward repricing of interest rate expectations in January. This 'rates shock' undermined equity valuations as well as taking the heat out of more speculative areas of the markets. Investors were subsequently becoming more concerned about the potential for a 'growth shock' as a result of overzealous monetary policy tightening even before the events in Ukraine started to unfold. Central bankers will find their skills put to an even greater test now, especially if inflation pressures are exacerbated by higher commodity prices as a result of shortages. This comes at a time when growth, though strong by pre-pandemic standards, is declining, and when company margins and profits are under threat from rising input costs. The outlook for the next few months is uncertain, and we continue to approach markets with a degree of caution.

• Global economic growth momentum has waned but is expected to remain above trend. The consensus growth forecast for 2022 is 4.3%, followed by 3.6% in 2023.

• Corporate earnings growth remained strong in the last quarter of 2021, but we are now well past the peak of post-pandemic recovery. Historic growth of around 50% in 2021 is forecast to decline rapidly to 8% in 2022 and 5% in 2023.

• Consensus forecasts have not yet taken into account the events in Ukraine, and there is a risk that growth rates will be put under further pressure in the short term. Company margins are also under threat from rising input costs.

• Futures markets suggest that the UK base rate will be 1.2% by the end of 2022 from a current 0.5%, while in the United States the market expects six quarter-point rises, starting in March 2022, taking the Fed Funds rate to 1.5%. Central banks will also be curtailing their on-market purchases of bonds, which will remove the liquidity tailwind that has helped financial assets of all types.

• The violent rotation in favour of Value stocks and sectors that characterised markets for the first few weeks of the year has stalled as investors consider the economic risks of the Ukraine crisis and the potential for central banks to pause their policy tightening.

• Covid-19 and the Omicron variant have been replaced by Ukraine as headline news. We continue to believe that we are transitioning from a pandemic to an endemic state, with positive implications for 're-opening' plays.

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