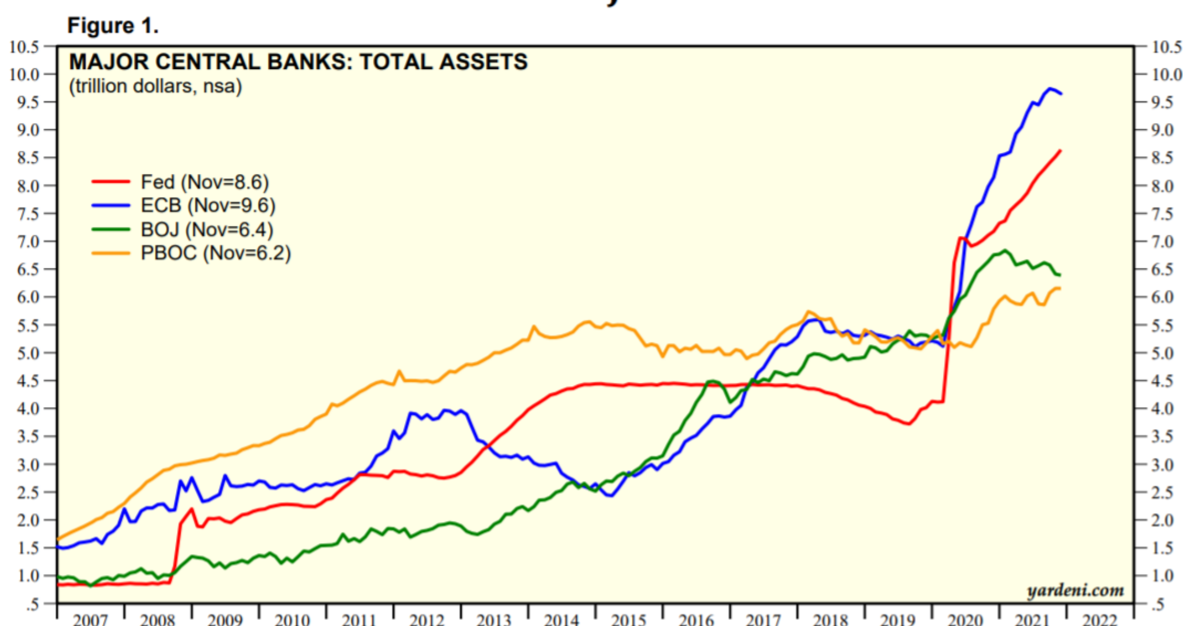
JANUARY 2022 Market Report

Investment Review

During the one-month period to 31st December 2022, major equity markets, as measured by the aggregate FTSE All – World Index, rose, with some major indices climbing by over 5%. The UK narrow and broader indices both gained about 4.5%, finishing the full year up over 14%. The VIX index fell sharply to a level of 17.22
, reversing much of the Omicron related jump that occurred during November.UK **Government Fixed Interest stocks fell over the month although there were mixed price trends amongst other bonds. The UK 10-year gilt ended the month on a yield of 0.97% with corresponding yields of 1.51%, -0.20% and 0.06% in USA, Germany, and Japan respectively.** Currency moves featured a stronger pound, especially versus the Yen, while commodities were generally firm.
In terms of global events, there have been **some small economic downgrades** in the most recent period, after the strong second quarter rebound, in both developed (especially China, USA and Europe) and emerging economies. Inflation indicators, at least in the short term, however, have continued to move upwards for any number of well documented reasons, and the Fed has finally removed the word “transitory”. The latest OECD inflation forecasts are 3.7% and 3.9% for 2021 and 2022 respectively. The IMF report predicts 6% global growth this year falling to 4.4% in 2022, while the more recent OECD projections are 5.5% and 4.5% for the two years. Both organizations highlight the considerable regional variation. COVID-19 developments during the month featured accelerating cases, of the Delta variant in some areas and the explosive growth, at least in number of cases, of the B1.1.529(Omicron). **Regarding this new variant, which has now affected over 100 countries in varying degrees, it is, still too early to have statistically significant data on transmissibility, response to existing vaccines, hospitalization, deaths etc.**

Uneven vaccination rates and levels of lockdown stringency (enforcement and adherence) as well as more conventional growth, employment and inflation statistics continue to influence government support measures and Central Bank actions. The tone of the very recent **Major Central Bank** meetings has become more hawkish re relaxing QE and interest rate moves e.g., UK and USA, while several other economies e.g., Russia, Norway, Pakistan, Hungary, Brazil, South Korea, South Africa and New Zealand have raised policy rates at least once.

Total Assets of Major Central Banks



Source: Haver Analytics.

US

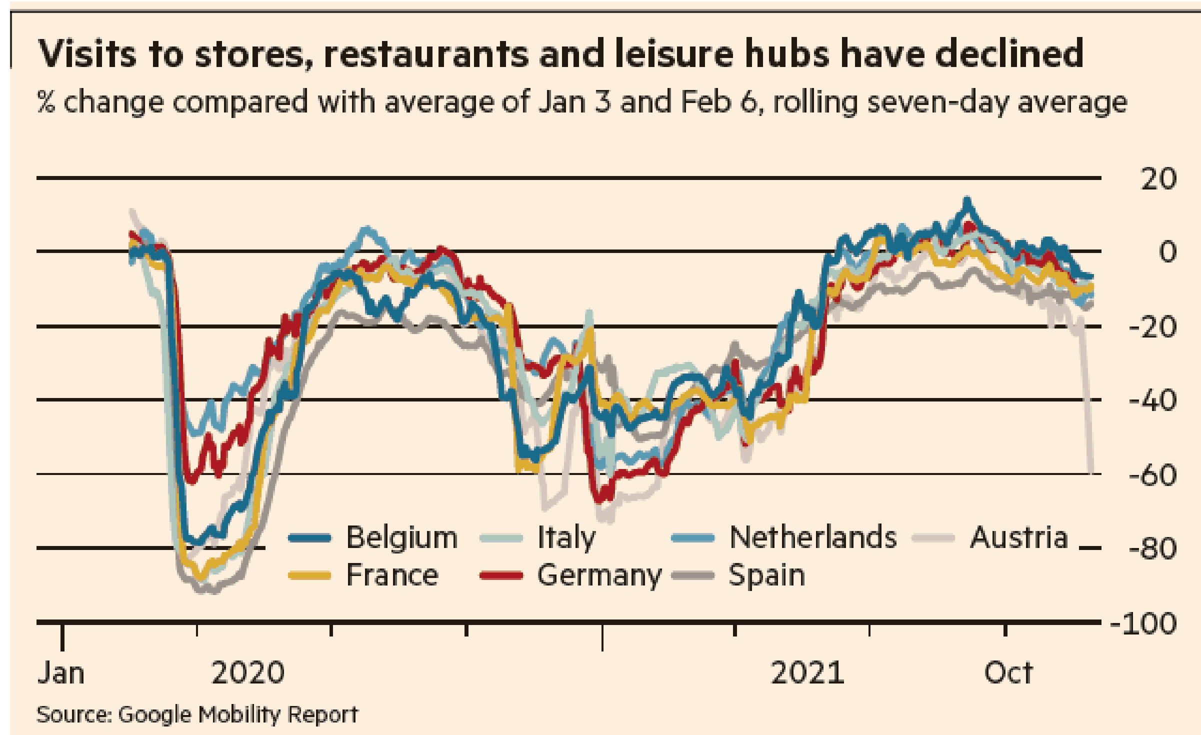
Recent **US Federal Reserve meetings have moved the emphasis** from unrestrained support for growth and financial markets to the long process of winding down stimulus and eventual tightening, the December meeting notably accelerating the above trend. This will pave the way for earlier than expected and a greater number of interest rate increases.

Recently announced inflation indicators showed headline CPI to end November rising at 6.8%, (Core 4.9%), over the year, the highest for over 30 years. Latest employment figures showed mixed trends. Provisional second quarter GDP growth of 6.5% was lower than some estimates as was the preliminary figure of +2.0% for the third quarter. Recent consumer sentiment indicators, retail sales and provisional PMI figures have all shown a pause in activity/expectations, albeit from a high level. Independent economic forecasts are now expecting over 6%-7% GDP growth for full year 2021 with the unemployment level at around 4.5%, but some downgrades may be expected in coming weeks following the expected fiscal and monetary tightening and developments surrounding Biden's proposed economic package.

EUROPE

Recent **ECB** meetings have seen interest rates maintained at -0.5% and a continuance of the pandemic bond buying programme, although slowing the pace of the first quarter 2022 purchases under the PEPP scheme compared to the previous quarter. Official second quarter GDP figures and preliminary third quarter figures showed growth of 2.2%, but recent consumer sentiment and activity surveys e.g December EC eurozone consumer confidence indicator, show sharp drops, no doubt reflecting higher COVID cases. The related re-imposition of restrictions should be monitored closely (graph below).
Current ECB staff projections foresee economic growth of 5.1% and 4.2% respectively for 2021 and 2022.
November Eurozone inflation, released on November 30th, stands at 4.9 % (Germany,5.2%), a 13-year high and surveys suggest that many companies are likely to pass even more factory gate price increases to consumers over coming months.

Political developments have been recently dominated by appropriate COVID policies against a background of more anti-lockdown demonstrations. Elsewhere French and Italian media are devoting more coverage to future leadership changes, while, in Germany, new Chancellor, Olaf Scholz, faces immediate issues in the shape of COVID outbreaks, foreign policy and the Environment.



ASIA excl JAPAN

Asia excluding Japan, led by China (across all sectors and property), continues to remain in reasonable economic shape although the recent news flow has been dominated by Covid issues, and, at the time of writing, new travel restrictions are being imposed. On July 20th the ADB released a pan-Asian 2021 growth forecast of 4.0% (compared with a projection of 4.4% earlier this year), with significant country variation e.g., Vietnam against Thailand, the latter very dependent on tourism. Differences due to vulnerability to rising US interest rates, commodity exposure and Chinese dependence will lead to further dissimilitudes. Recently, South Korea become the first big Asian economy to raise interest rates since the start of the pandemic as record household debt and soaring property prices eclipsed fears over struggles to contain Covid.

China continues to experience some significant economic "softness" after a positive start to 2021 with industrial production, factory output, retail sales, investment spending, property transactions all weaker than expected, and third quarter GDP growth just reported of "just" 4.9%. Some "self-imposed" factors e.g., earlier curbing of steel making for environmental reasons have accompanied flooding, virus breakouts, power shortages and related restrictions and the most recent manufacturing PMI dipped below 50. Direct and indirect effects of the Evergrande debacle, Kaisa default and a possible new tax are also rippling through the property sector, a significant Chinese GDP component. To kickstart some manufacturing activities, ease power shortages, the authorities have reactivated parts of the coal mining industry, granted some relief to power stations, intervened in the power pricing mechanism and recently relaxed some banking reserving requirements as well as reducing the one year prime rate to 3.8%. Some commentators have suggested that further "measures" could be taken between now (the sixth plenum of the 19th Central Committee) and the 2022 National Congress to "stabilise" the economic situation.

The regulatory crackdown which had affected a variety of sectors e.g., online tutoring, video gaming, property development, luxury goods and private equity, to name a few has quietened “somewhat” but there is a sense that controls could re-appear at any time e.g., Tencent app roll out, a few weeks ago.

JAPAN

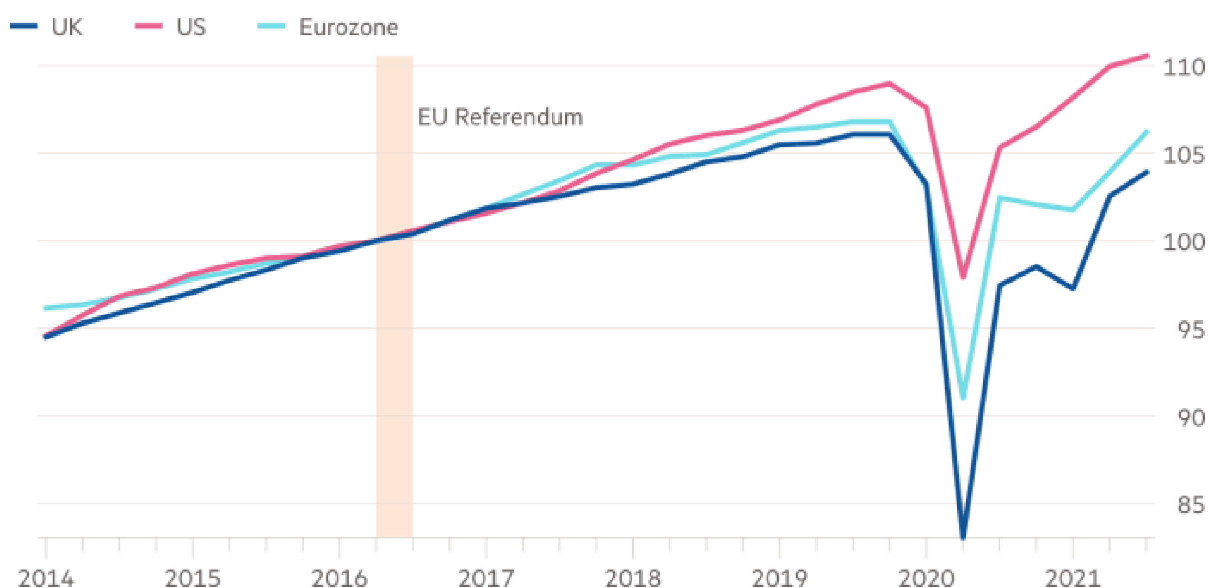
While there have been no major changes in **Japan’s** economic trajectory, politics have moved more centre stage with the appointment of a new head of the Liberal Democratic party, Fumio Kishida. Kishida has signalled that he intends to continue Abenomics for now, but he also has a longer-term goal of a fairer distribution of income. Towards the end of November, Kishida unveiled a $383 billion stimulus package including generous cash handouts for households and help for struggling businesses. This was followed, in December, by Cabinet approval of a $940 billion package for the next fiscal year. The Government estimates that the entire stimulus package could lift economic growth by 5.6%. Fiscal discipline remains loose, and the BOJ currently shows no sign of changing its ultra-low interest rate policy. Public debt is now more than twice the size of the economy.

UNITED KINGDOM

Within the UK, live activity data paints a somewhat mixed picture in activity following the buoyant second half recovery for several reasons, and certainly a change in the mix of the growth drivers. In terms of “hard “data, October GDP growth of just 0.1% was well below expectation, as was the third quarter GDP growth of just 1.1%, while more recent survey data e.g., the “flash PMI” to early December, credit card data, footfall showed consumer uncertainty. At the time of writing anecdotal evidence of hospitality cancellations and reduced transport use, clearly show renewed concerns re Omicron.

The UK's economic performance has been disappointing since the EU Referendum in 2016

GDP index: Q2 2016=100



Source: OECD
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A skills/age, geographical mis match following the end of the furlough scheme, scheduled utility bill increases, public sector strikes, EU farm payments, selected VAT hikes, fuel and shop prices and merchandise availability, tax/NI hikes, upward interest/mortgage rate pressure, insolvencies/evictions, pension triple-lock suspension, legacy Brexit issues and **renewed COVID concerns** will inevitably lead to more economic uncertainty over coming months.

Public sector net borrowing remains broadly on track for the latest forecast of £193 billion forecast for the full year 2021-2022.Recent monthly figures have shown lower spending on various job retention schemes but rising debt interest payments and vaccination programme costs. Although now past its peak of approx. 15% of GDP, the absolute numbers are still very large by normal standards.

The interest rate increase, widely expected to be announced at the November meeting, was actually made at the December meeting confounding many economists. Clearly Bailey and a large majority of the MPC committee were more concerned with inflation (latest monthly 5.1%) than the new Covid uncertainty, and in fact signalled further rate moves for the spring, alongside some expectations of inflation peaking over 6%

The average of leading independent economists now expects UK growth of 5.5% for 2021, falling to 4.7% for 2022, lower than earlier year estimates and leaving GDP still short of pre-pandemic levels. Forward looking **independent economic growth estimates cover a wide range, as the positive argument of relief/catch up spending, by an** element of the population from records savings must be balanced against the factors laid out above. An official inflation forecast of 3.1% by Q4 2022 looks rather ambitious as does an unchanged unemployment rate at around 4.3%,but most economic projections are bound to have wider error ranges over coming quarters than "normal".

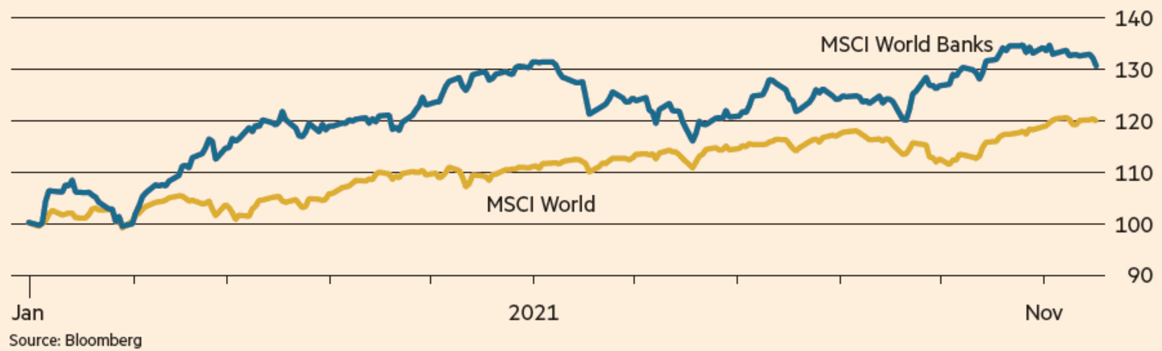
Monthly Review of Markets

Equities

Global Equities showed a gain over December 2021, the aggregate move of 2.44%, however masking considerable country variation. European indices, including the UK, and the S&P composite, were generally strong while Asian, NASDAQ and emerging markets fell in relative terms. Over the full year the UK FTSE 100 and UK-FT-All Share Indices rose 14.3% and 14.6% respectively approximately 3% behind world index in sterling adjusted terms. Chinese equities fell in December by around 3.7% rounding off a miserable year with a 12 month decline of 22.5%. The VIX index fell to a level of 17.22, showing a yearly decline of 24.3% as risk taking increased.

UK Sectors

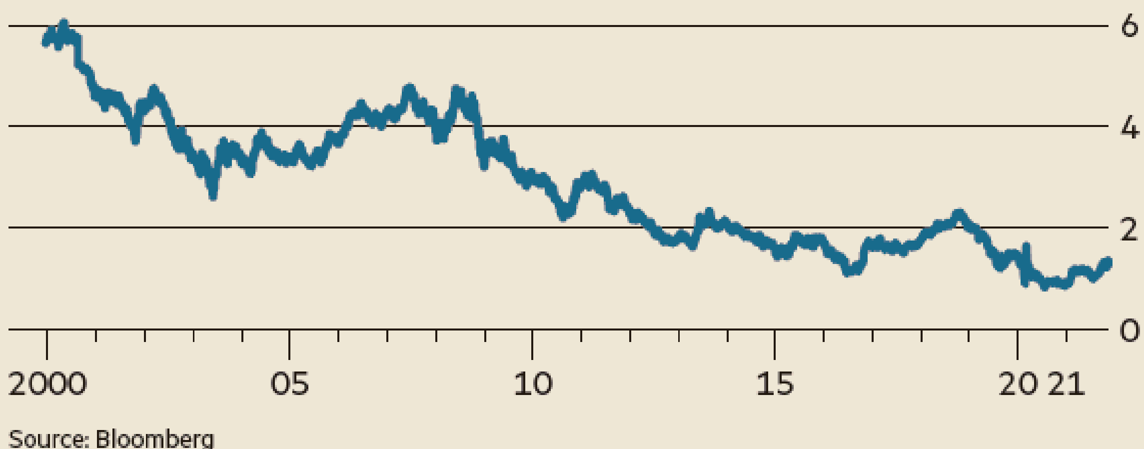
Sector moves were mixed over December with no obvious economic or style catalysts. Amongst mining shares, industrial metals were strong while precious metals dropped. Telco's, banks, household goods, travel and leisure and tobacco were reasonably strong while real estate and investment trusts underperformed. Over the full year oil, utilities, banks, real estate, retailers and construction all registered price gains over 20% while precious metals, food, travel and leisure and non-life insurance stocks declined. Since the beginning of the year, UK smaller company funds have outperformed equity "income" funds which have, in turn, matched the "average UK fund.". Mixed asset funds have shown growth of between 3% and 11%, depending on the equity weight, since the beginning of the year (Source Trustnet 30th[th] December 2021



Fixed Interest

Major global government bonds declined in price terms (yields rose) during December largely reflecting higher than expected inflation and more hawkish Central Banks., the UK 10-year yield for instance finishing the month at a yield 0.97%. Other ten-year government bond prices showed closing ten-year yields of 1.51%, -0.2% and 0.06
% in USA, Germany, and Japan respectively. Over the full year, the UK Government All-Stock Index has fallen 7.01% in capital terms, with little income offset. Quality corporate bonds also fell over December, though some more speculative grades rose in price terms. Interestingly and unusually, bond volatility increased relative to equity volatility during the year, and this is likely to continue. Core preference shares have significantly outperformed gilts in capital terms this year, while also offering income yields in the range of 5% to 6%.

Check my recommendations in preference shares, selected corporate bonds, floating rate bonds, zero-coupons, speculative high yield etc. A list of my top thirty income ideas from over 10 different asset classes is also available to subscribers.



Foreign Exchange

The pound rose significantly during December, primarily due to the BOE rate increase. The Japanese Yen lost further ground during the month and finished the full year approximately 11% weaker than both the pound and the US dollar. Major currency moves have had a significant effect on 2021 sterling adjusted returns.

Commodities

A generally stronger month for commodities to round off a positive year which saw the Bloomberg Commodity index rise by over 27%. Gold, other PGM metals, soya, and iron ore were the only major commodities to boast actual price yearly declines while oil, natural gas, uranium,aluminium and coal all climbed over 40%.The climb of over 60% by the Baltic Dry Index during 2021 clearly illustrates the freight prices, and profitability, of bulk shipping companies.

Looking Forward

There is cautious optimism regarding the **longer-term** course of the global economy, though the trajectories vary considerably by region. **Shorter term** indicators seem to point to consolidating GDP growth and higher inflation, than earlier projections, a **potentially worrying combination.**

Major central banks rhetoric (and action in the case of the UK), is clearly turning more hawkish with reducing QE and the bringing forward of rate increases. Interestingly, in a growing number of smaller economies where US contagion, politics, commodity exposure inflation/fx are also issues, several official increase rate increases have already taken effect.

For equities, the two medium term key questions will be whether/if **rising interest rates** eventually cause equity derating/fund flow switches, government, corporate and household problems, and how the rate of **corporate earnings growth** develops after the initial snapback. Going forward, withdrawal of certain pandemic supports, uncertain consumer and corporate behaviour and cost pressures are likely to lead to great variations by sector and individual company.

Great care should be exercised regarding investment portfolio construction.

Observations/Thoughts

ASSET ALLOCATION-As well as maintaining a mildly overweight position in UK and European equities, it may be worth initiating or **adding to Japanese positions within an international portfolio, perhaps by reducing overweight in USA and other Pacific. The "cheaper" stock market ratios/low global stock market correlation for Japanese equities are well known (see below), while the current political change and recently announced infrastructure package may provide catalysts. It should be remembered that many Japanese companies provide exposure to China, but without the direct associated political risk.**

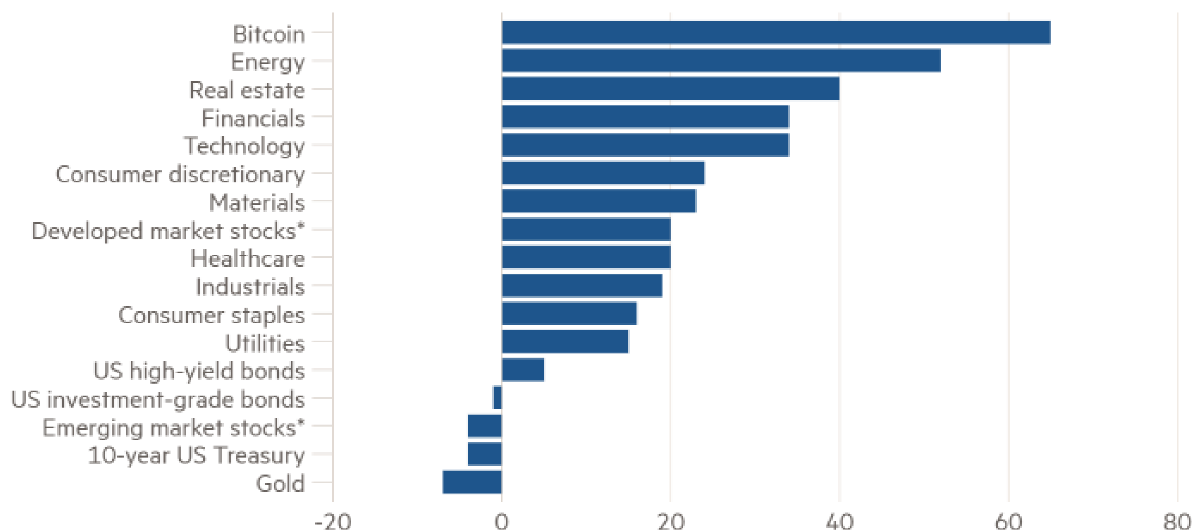
	PE	PE	P/B	P/B	Yield	Yield	Eps growth	Eps growth	Dividend growth	Dividend growth
	21	22	21	22	21	22	21	22	21	22
World	19.4	18.2	3	2.8	1.9	2.0	52.6	6.8	17	5.9
USA	23.6	22	4.8	4.4	1.2	1.3	50.7	7.1	5.4	7.4
Japan	15.5	14.3	1.4	1.3	2.2	2.3	35.8	8.3	13.9	6.6
Europe ex-UK	17.8	16.6	2.2	2.1	2.6	2.8	60.7	6.3	28	4.3
UK	12.1	11.8	1.7	1.6	4.2	4.1	83.3	2.8	30.7	-1.5
Global Emerging	13.1	12.4	1.8	1.7	2.9	3	55.4	5.5	29.4	5.4

Source: MSCI, IBES,Morgan Stanley December 17th,2021

The other major asset allocation decision would be to replace part of the conventional "fixed interest" portion with alternative income plays in the infrastructure, renewables, and specialist property areas. Many instruments in this area provide superior capital growth, income, and lower volatility than gilts for example.

Bitcoin outshines gold in 2021 as investors clamour to crypto

Year-to-date return (%)



*MSCI indices in dollar terms. Sectors refer to S&P 500. All figures are total returns, except for gold and bitcoin.
Sources: Goldman Sachs, FT calculations
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- **UK EQUITIES** remain a relative overweight in my view, based on a number of conventional investment metrics (see above), longer term underperformance since the Brexit vote, style preference (value over growth) and a vaccine/variant mix which currently supports continued economic momentum, although be aware of the numerous headwinds I have highlighted above. Extra due diligence at stock level will be required. Takeover activity is also clearly increasing with, for example, private equity snapping up UK-listed companies at the fastest pace for more than twenty years. Size does not appear to be an obstacle with for instance BT,GSK,SSE,RDS all attracting the attention of activist investors in the recent period.

- **EMERGING MARKETS-**Very difficult to adopt a “blanket” approach to the region even in “normal times”, but especially difficult now, with so many different COVID, commodity, debt, geo-political and increasingly natural disaster variables. Interestingly the rush into Emerging Market assets, both bonds and equities, at the start of 2021 has moderated as many dramas have unfolded e. g South Africa, Turkey, Ukraine, Chinese regulation. This latter factor has special relevance to those using Emerging Market Benchmark Indices., most of which are currently showing negligible or even negative performance year to date. The IMF recently warned that several emerging nations could disproportionately suffer from a combination of COVID and adverse reaction to “tapering” by developed counties e.g., FX/Interest rate pressures. Extra due diligence is required and remember to understand the currency as well as local market dynamics,Turkey being an obvious recent example.

Emerging market equities lag far behind developed market peers

MSCI global total return indices

Source: Refinitiv

- *© FT*

However, within the emerging space, I continue to have a relatively favourable longer term view on Asia, where relative COVID success, stable FX,inward investment, lower relative inflation and export mix are supportive.Vietnam,South Korea and Taiwan continue to be favoured. The active versus passive debate in 2021/2022, will take on extra significance where “China versus the rest” and appropriate tech weighting will be important considerations, especially considering the recent Chinese meltdown. More caution is required in many South American markets with poor COVID-19 situations, deteriorating fiscal balances and inefficient governments, many of which are up for change. Parts of Central Europe are currently showing some resilience, especially when linked to German exports, but the Covid-19 situation is currently worsening in some areas

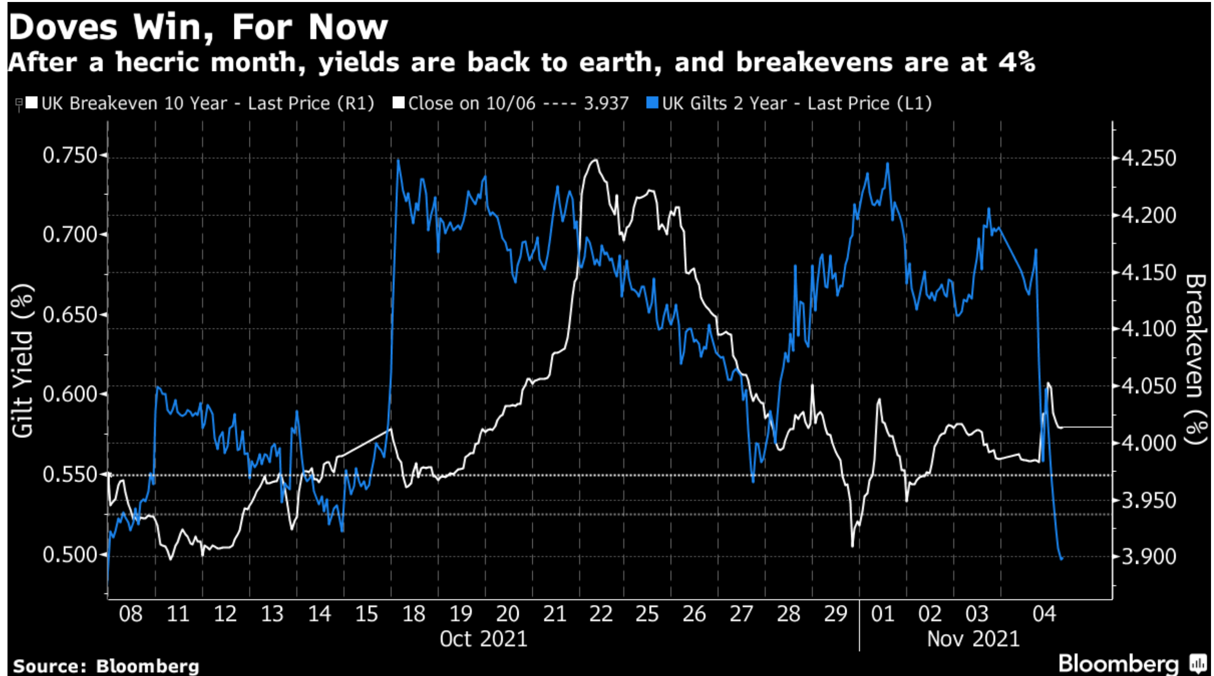
Russia remains an interesting contrarian play both for bonds and equities. While the scope for political interference remains high (e.g Ukraine?), this is not a new story, and the economy has maintained a relatively strong position. The Index has a large natural resource weighting, and Gazprom, for instance has an 18% weighting in MSCI Russia and could be a useful natural gas hedge! India, although quite highly rated, warrants inclusion in a diversified portfolio, and is currently receiving some fund flows from “overweight” Chinese portfolios.

Currency	YTD % Change
JPY	-9.25 %
EUR	-7.39 %
AUD	-6.56 %
NZD	-5.27 %
NOK	-4.56 %
CHF	-3.91 %
GBP	-2.56 %
CAD	-0.33 %
USD	6.87 %
SEK	10.42 %

US DOLLAR MOVES YEAR to DECEMBER 16th 2021

- Not on near term investor (or government!) worry lists but be aware of the **huge government DEBT problem building (tax increases sooner or later)**. Latest figures show aggregate global debt more than GDP at the global level and the mantra of extremely low servicing costs, is just that! Sunak recently estimated that UK's exposure to a rise of 1 percentage point across all interest rates was approximately an additional £25 billion in debt service costs and indeed the rising cost of servicing index linked debt was highlighted in the recent UK deficit release., and although UK borrowing is currently emerging as better than estimated during the pandemic the actual numbers are still historically large.

- Apart from occasional bouts of term haven buying, as experienced recently, and liability matching, I expect conventional government **FIXED INTEREST** to weaken in the medium term and would not be surprised to see the US 10 Year yield to trade back towards 2.0% (currently 1.51%) sometime over next months. In terms of timing, it should be remembered that targeted bond buying by several major Central Banks will rapidly slow during the first half of 2022



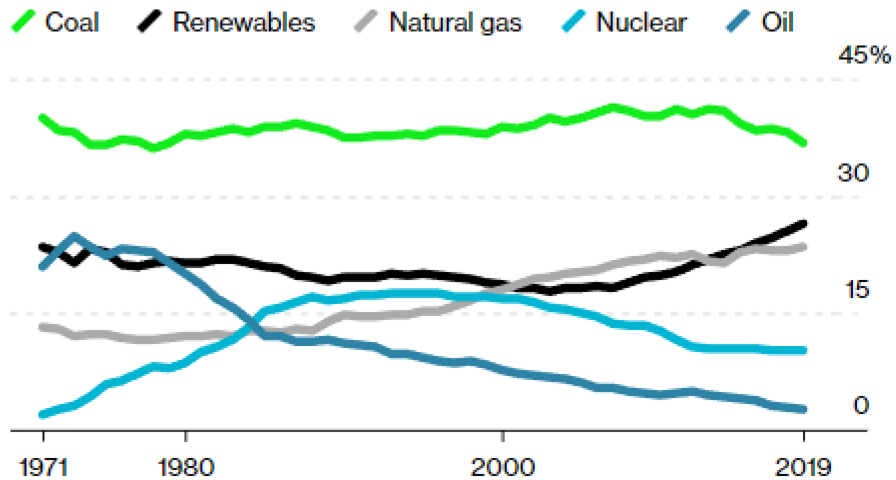
- However, other fixed interest options are available after, making appropriate allowance for risk, transparency, trading, liquidity etc. for clients seeking regular income. Fixed Interest Investors may wish to prioritise more nimble tactical bond funds rather than conventional government bonds. Several favoured UK Preference shares have shown significant total return outperformance of conventional gilts so far this year and I expect this to continue.

- **COMMODITIES**- Gold has been rangebound for several months, and while longer term inflationary reasons and diversification benefits may apply, the prospects for more cyclical plays continue to look brighter. Increased renewable initiatives, greater infrastructure spending as well as general growth, especially from Asia, are likely to keep selected commodities in demand at the same time as certain supply constraints (weather, Covid, transport) are biting. Anecdotal evidence from reporting companies RTZ, BHP and Anglo American appear to suggest that the industry is enjoying a bumper time, and with disciplined capex programmes, extra dividends and share buy-backs are commonplace! Keep exposure to this asset class either directly or through investment trusts or ETF's.My favoured one stop resource play, Black Rock Energy and Resources Income Investment Trust appreciated about 30% but it still recommended. BERI currently priced at 100p, offers a yield of 4.1% paid quarterly and stands on a discount to assets of approximately 7%

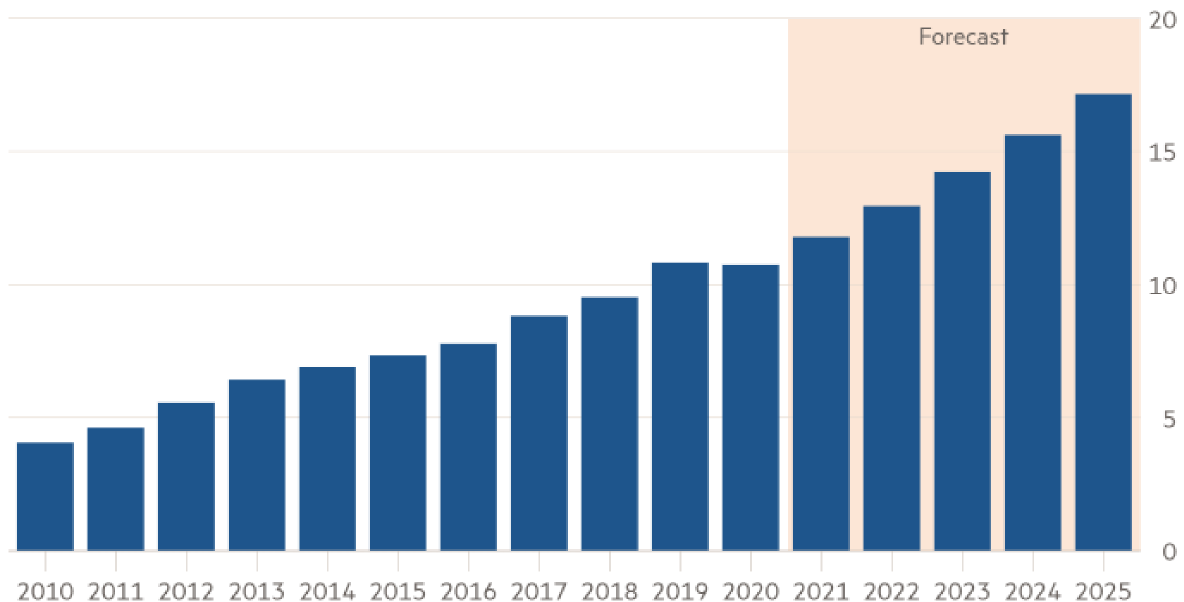
- Global climate change remains a longer-term theme, and will be built into the many infrastructure initiatives, being pursued by Europe, USA, and Asia. There are several infrastructure/renewable investment vehicles which still appear attractive, in my view, combining well above average yields and low market correlation with low premium to asset value. The recent volatility in natural gas prices has highlighted both risks and opportunities in the production and storage of energy from alternative sources. However, increasing levels of due diligence are required, in committing new money to the area overall. Financial watchdogs across the world are sharpening their scrutiny of potential "greenwashing" in the investment industry on rising concerns that capital is being deployed on misleading claims.

- Remember that some "old" economy themes can also be beneficiaries of the infrastructure/renewable band wagon e.g., cables, cement.

- For contrarians/tactical trading, there are currently enormous opportunities for investors willing to lean against the ESG wave, a trend already apparent with many private equity deals, and hedge funds one of whom has been building stakes in tobacco companies. It may also make sense not to "abandon" the traditional oil and gas companies, which are taking big steps to realign their "carbon" policies, have financial strength and are still cheaply rated. Another area currently in the ESG purist cross hairs is "nuclear". Ignoring the fact that nuclear weapons have not been used in anger since 1945, and the fact that some deterrent is needed, where should the confused investor stand when it comes to nuclear power substituting coal power? Another bombed out sector to join oil, gas, tobacco as an area, perhaps, for betting against the consensus.



- **ALTERNATIVE ASSETS**-this group, encompassing private equity, private debt, hedge funds, real estate, infrastructure, and natural resources is expected to continue growing both in actual and relative terms over coming years. I have, for a while, recommended some exposure to this area maybe as part of the former "gilt allocation". With strong caveats re liquidity, transparency, dealing process, I still adopt this stance, continuing to use the investment trust route. Please contact me directly for specific ideas



- **COMMERCIAL PROPERTY-**The most recent MSCI/IPD UK Property Index up to the end of **November 2021** showed a monthly total return of 2.2% (30.4% annualised!) across all properties, and a year-to-date return of 15.4% (10.0% capital,4.9% income). Industrials continue to be the leading sub-sector, while in retail, warehouses are strongly outperforming shopping centres where capital values are still down about 10% year to date. Land Securities recently increased its stake in Bluewater Shopping Centre paying approximately one third of the price for the same space in 2014! My view remains that investors may wish to slowly move back to a more neutral situation for the sector, if not already, with my current strong preference for **investment trusts rather than unit trusts**. According to Trustnet figures dated 21st December, the average UK commercial property investment trust has shown growth of 27.3%, year to date, while the average "UK direct property unit trust" has climbed 7.4% over the same period.

Full asset allocation and stock selection ideas if needed for ISA/dealing accounts, pensions. Ideas for a ten stock FTSE portfolio, model pooled fund portfolios (cautious, balanced, adventurous, income now available online for DIY investors), 30 stock income lists, defensive list, hedging ideas, and a list of shorter-term low risk/ high risk ideas can also be purchased, as well as bespoke portfolio construction/restructuring and analysis of legacy portfolios.

Independence from any product provider and transparent charging structure

Feel free to contact regarding any investment project.

Good luck with performance!

Ken Baksh Bsc,Fellow (UK Society of Investment Professionals)

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1st January,2022

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