CS INVESTMENT MANAGERS

VIEW FROM THE SQUARE

November/December 2021

A Fine Balance

As the year draws to an end the customary "Santa rally" for stocks may be on hold this year as uncertainty surrounds the new COVID strain – Omicron. Markets have become relatively immune from COVID news over the last six months, even as new strains have emerged and waves of infection come and go. However, this latest strain appears to have the attention of markets. It will be a couple of weeks yet before we have a clearer picture on the speed of transmission and severity of the new strain. In the meantime, investors are likely to remain on edge. In this environment, we have seen continued support for "COVID winners" (e.g. technology and healthcare sectors). Elsewhere, inflation isn't going away and finally central banks (notably the Federal Reserve) are starting to accept this. More entrenched inflation next year will likely favour cyclical areas of the market. As we prepare for a new year, true portfolio balance – blending assets associated with growth and inflation – becomes even more important.

Just when we thought we were out of the woods, along comes another COVID curveball in the form of the Omicron strain which, at this early stage, appears to be one of the most infectious yet. Equity markets sold off aggressively on the news but stabilised somewhat into month end. As has become customary on COVID news, certain sectors fare better and worse as COVID sentiment swings. For now, we don't think this is cause for a major market meltdown but an element of caution on the pace of recovery is merited. The base case is that this new strain becomes manageable.

When we began the year we were confident that this would be a year of economic growth, but with some uncertainty of the magnitude and pace. Overall, it looks likely to be a very solid year for economic expansion globally as the world recovers from the pandemic and equity markets have, broadly, responded in a positive manner for the year. However, the second year of a recovery can often be more volatile for investors and returns not as strong. As we enter 2022, investors also have to contend with a macro environment not seen for several decades – that of significantly higher inflation. The narrative (from most central banks) for much of 2021 was that of "transitory" inflation, caused by idiosyncratic effects of the virus (such as a boom in used car sales). However, we have long argued that inflation is likely to be more entrenched and higher than central banks are giving credit. It appears that the US Federal Reserve has come round to this view – now looking to drop the "transitory" narrative from their inflation outlook and consider taking action to curb inflationary forces. In the event that inflation continues to run above trend and economic growth continues to rebound – our base case for 2022 - this will favour cyclical sectors. However, investors should balance inflation protection in portfolios with exposure to structural trends that continue to evolve in areas such as clean energy transition and ongoing digitalisation. These trends tend to favour *quality growth* sectors.

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Important Information

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