CS INVESTMENT MANAGERS

VIEW FROM THE SQUARE

January 2022

Waking up to Inflation?

2021 ended with a modest “Santa rally” with markets demonstrating some upside in late December on improving trading volumes, after a rather flat performance earlier in the quarter. The FTSE All-World share index rallied 16.7% (in dollar terms) in 2021, surpassing the previous year’s 14.1% gain. Concerns surrounding the Omicron variant, its relative potency and likely impact on markets were gradually weighed by investors during the final quarter which, in November, put a pause on the “risk-on” sentiment from earlier in the year. This reluctance to add to existing equity positions appeared to dissipate later in the period as concerns over the severity of Omicron started to recede.

Looking forward to 2022, we remain cautiously optimistic as the latest data surrounding the newest Covid variant increasingly points towards a lower proportion of hospitalisations and deaths, despite its greater transmissibility. The impact on the global economy is, therefore, likely to be less negative than prior variants. Meanwhile, households and corporates have built up excess savings, and credit conditions have eased. At the same time there is considerable pent-up demand in global services and inventories.

While there is much to be optimistic about, we believe that the current environment presents a strong case for active investment management, rather than simply chasing a broad market trend through passive investing. We are concerned about excessive valuations in certain sectors at a time when the US Federal Reserve is likely to tighten monetary policy and inflation is rising. These trends have historically negatively impacted the technology sector in particular, which has been a market leader for over a decade now and trades on generous valuations in the large-cap space.

The option market has historically been a more accurate predictor of interest rate movements than the aggregate view of Federal Reserve members. Option-implied interest rate expectations are based on the forward-looking interest rate expectations, which investors have speculated on via option contracts. The option market currently suggests that three US rate hikes in 2022 appear likely. This is with the intention of helping to reduce inflationary pressures, which are presenting themselves across inventory, supply chains and ultimately, consumer prices.

We have been positioned for such a trend for almost a year now, with increased allocations to value stocks and real assets (such as infrastructure and property) which should benefit investors as this trend persists. Monetary policy makers and market participants are now more broadly waking up to the possibility that the current pricing pressures may not just be “transitory”, as was previously the consensus view. With inflation and interest rate rises likely to persist throughout 2022, we are particularly focussed on businesses with strong competitive positions, pricing power and access to structural growth drivers. Although broad index valuation multiples for equities are a challenge at present, certain sectors, such as healthcare, consumer goods and financials, appear to offer plenty of opportunities. We believe that this type of selective investment approach will provide a more profitable outcome for investors, rather than passively tracking the wider market in 2022.

CS INVESTMENT MANAGERS

43 Charlotte Square
Edinburgh EH2 4HQ

T. 0131 624 7709
investments@csmanagers.com

www.csmanagers.com