Cave's Quarterly

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Omicron Speed Bump

2021 was a year of global recovery, driven by strong economic growth and a bounce back in corporate earnings. The fourth quarter saw the emergence of a new variant of Covid-19, labelled 'Omicron' starting to spread rapidly, having originated in South Africa. The virus continues to evolve and claim lives, but despite grabbing the headlines, the fourth wave has been characterised by a record-breaking number of infections that have so far seen less severe health implications, lower hospital admissions rates and perhaps most importantly, a lack of political appetite among authorities to reinstate mobility restrictions.

The U.S. Federal Reserve (Fed) ended the year on a more hawkish tone after Fed Chief, Jerome Powell, said inflation would stick around for longer than initially anticipated and retired the word "transitory" as a way of describing the current high rates of inflation seen across the world. In response to the U.S. Consumer Price Index (CPI) jumping to 6.8% year-over-year in November (the biggest 12-month jump in nearly 40 years), the U.S. Central Bank said it will speed up its reduction of government bond and mortgage-backed security purchases to $30 billion a month, putting it on track to conclude the program in early 2022, with interest rate hikes considered thereafter. Equity markets sold off aggressively in late November, as investors reacted to the new variant and assessed the likelihood of global Central Banks withdrawing ultra-accommodative fiscal and monetary policy stimulus, which has served as a powerful force in propping up economies and financial assets since the outbreak of the Covid-19 pandemic.

With many of us starting work in the new year from our home office, the fallout from the Omicron variant and the potential risks posed to economic activity from absent employees and further government lockdowns remains a key concern for investors. Whilst the new strain of the virus is more virulent, early data indicates it is less deadly and existing vaccines and boosters remain effective. Omicron presents a series of speed bumps for the global economy heading into 2022, but businesses and consumers have become increasingly adaptable. In a world that has, on the face of it, learned to live with the pandemic, investors and policymakers alike appear reluctant to slam on the growth handbrake.

Global Equities

UK Prime Minister, Boris Johnson confirmed a move to “Plan B” restrictions in December, which saw work from home guidance reiterated and vaccine passports required at many UK entertainment venues. Robust economic data prompted the Bank of England (BoE) to raise interest rates by 15bps to 0.25%, as the Office for National Statistics confirmed CPI had risen to 5.1% year-over-year and the unemployment rate had fallen to 4.2% (representing about 1.4 million people), despite the end of the furlough job scheme. Having lagged the global rally of 2021, UK equities, as represented by the FTSE All-Share Index, registered a positive return of 4% over the 3 month period.

Over in the US, President Biden signed the long awaited $1.2 trillion bipartisan infrastructure bill, which included $550 billion of additional spending in order to upgrade America’s railways, bridges and roads and deploy electric vehicle charging stations across the country. Whilst some of the major beneficiaries of the work from home (WFH) boom are now well below their peaks, the success of a small cohort of mega-caps and lower trading volumes through the holiday season saw stocks on Wall Street benefit from a traditional ‘Santa Claus rally’ which pushed the S&P500 and NASDAQ indices up to record highs, closing out the quarter 11% higher respectively.

Economic data was mixed in the EU with consumer confidence dipping through the fourth quarter, as several countries in Northern Europe reintroduced mobility restrictions in an attempt to quash the fourth Covid-19 wave. As initial fears over the Omicron variant subsided, Europe’s exposure to financials and cyclically sensitive sectors such as energy, materials, and industrials benefitted from expectations of improved economic activity. The Euro Stoxx 50 index added 6% in the three months to the end of December.

The latter part of 2021 was an eventful period for Asian equities, marked by intensifying regulation of the technology and education sectors in China, the maintenance of their zero-tolerance approach to virus outbreaks and, more recently, an increasing amount of stress in the property sector sparked by the ongoing Evergrande debt saga. The People’s Bank of China (PBOC) eased fiscal and monetary policy in a bid to stem a slowdown of the domestic economy, which has served as a headwind for emerging markets in recent months. The Hang Seng (China) index registered a negative return of -5% since September. The recovery in the Japanese economy remains lacklustre, with inflation subdued owing to fewer challenges with supply chains and soft consumer demand. The Nikkei 225 index was -3% lower over the period.

Commercial Property

The latest forecast for the world's major economies has the UK down for another year of above-trend Gross Domestic Product (GDP) growth in 2022. GDP growth has historically been a reliable indicator of demand and pricing for commercial property in the UK and the outlook for the domestic market is therefore encouraging going forward. Furthermore, as inflationary pressures endure, commercial property has the potential to offer investors some protection, owing to the longer-term link between property rents and general price inflation. The UK commercial property sector trended higher across the period with several Real Estate Investment Trusts (REITs) increasing dividends and reporting growth in Net Asset Value (NAV).

Alternatives

Having averaged $81 per barrel through November, reports of the new Omicron variant threw festive holiday travel plans into chaos and triggered a sharp 10% decline in the price of crude oil towards the end of the month. Prices stabilised to close out December at $78 per barrel, but markets remain cautious as it is not yet clear how Omicron will affect oil demand and the broader economy in 2022.

Sentiment towards gold ebbed and flowed amid inflation concerns, hawkish comments from the U.S. Fed, and the surge in Omicron cases across the globe. Investors turned to traditional safe-haven assets to help shield against increased volatility in equities, which helped the price of the precious metal rise to $1,829 an ounce by the end of the fourth quarter.

Fixed Interest

With the majority of global Central Banks reducing quantitative easing programmes and inflation running above target levels, government bonds remain under pressure with yields expected to rise (yields rise as prices fall) throughout 2022, delivering negative returns.

As the economic impact of the pandemic fades, growth should stabilise, and interest rate expectations have moved higher as a result. The yield on the US 10-Year Treasury Note and the UK 10-Year Gilt closed out the calendar year at 1.51% and 0.97% correspondingly.

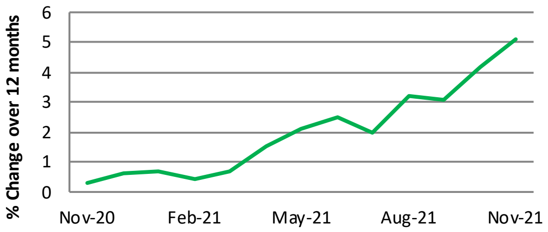
Outlook

Looking ahead, economic growth, inflation, and investment returns look set to moderate through 2022, but the outlook for corporate earnings remains constructive amid ongoing policy support, pent up consumer demand and healthy household savings rates.

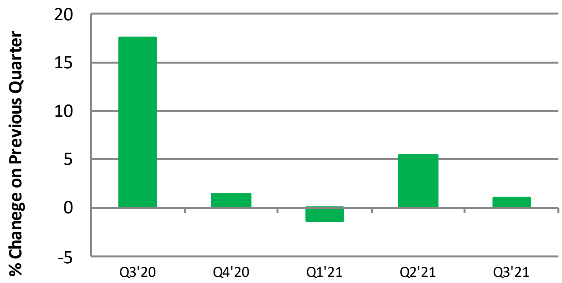
The resurgence of Covid-19 through the Omicron variant was a stark reminder of its unpredictable nature and the persistent threat posed to risk assets, particularly the frothier, more speculative corners of the equity market. Ultimately, we foresee increased volatility around 'new variant' news flow but expect the market reaction to future waves to diminish over time, as investors grow accustomed to a more endemic virus.

A year in numbers

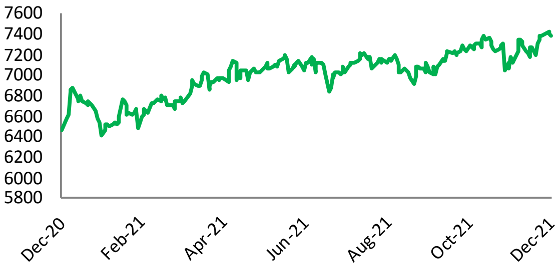
UK Consumer Prices Index (CPI)



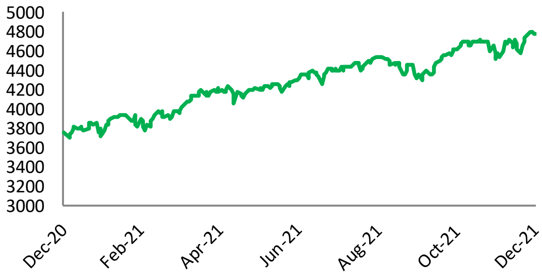
UK Gross Domestic Product



FTSE 100 Index



S&P 500 Index



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