Alan Boswell Financial Planners

Market Update - January 2022

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Sky-high COVID-19 cases, a volatile equity-market rally, and worry over rising interest rates can describe both the first and last weeks of 2021. An obvious difference between those two timeframes is that the prospect of widespread vaccination became reality, dealing a sharp blow to the severity of illness among the infected. A towering nine billion vaccine doses were administered worldwide through the end of 2021, rendering roughly 49% of the global population fully vaccinated.

Turning to financial markets, the fourth quarter began in the shadow of September's selloff, which was the most extended shakeout of 2021. After recovering in October, equities vaulted higher through mid-November before unrestrained inflation, tightening central-bank policy and the emergence of the Omicron variant combined for a choppy climb to finish the year.

US shares were the top-performing major market for the fourth quarter and the full calendar year. The UK and Europe also performed quite well over both time frames. Hong Kong and Japan had significant losses in the three-month period; Japan was up modestly in 2021, while Hong Kong had a full-year decline. Brazil and China were down steeply for the quarter and the year, with China delivering the deepest loss among major markets in 2021. Across the UK, eurozone and US, short-to-medium-term government bond rates increased during the fourth quarter, while long-term rates declined, resulting in flatter yield curves. Within fixed interest, fourth-quarter performance mirrored the full year: inflation indexed bonds were the top performers, followed by high yield. Most other sectors were mildly negative given the impact of rising rates, but global bonds were down by more due to currency effects. Local-currency emerging-market debt had the steepest losses for the quarter and year.

The UK government's autumn budget traded improved benefits for tax increases. It proposed a reduction in the universal credit taper rate for low-income workers (from 63% to 55%, meaning that the credit will phase out more slowly) and an annual £500 increase in work allowances. Brick-and-mortar stores will also see more relief via a temporary 50% cut in business rates and no increase in 2022. On the revenue side, a 1.25% bump in national insurance contributions was scheduled to begin in the spring, and a long-telegraphed increase in the corporation tax remained set for 2023.

Germany's new governing coalition came together in late November. The centre left Social Democrats (SPD) secured 25.7% of ballots cast in the September election, while the progressive environmentalist Greens won 14.8% and probusiness Free Democrats (FDP) received 11.5% of the votes. As of December, SPD leader Olaf Scholz heads the government as chancellor, while FDP leader Christian Lindner serves as finance minister.

The US Congress voted to raise the debt ceiling (that is, the federal government's borrowing limit) twice during the fourth quarter—first with an October stopgap hike of $480 billion, and then with a December increase of $2.5 trillion—which is expected to cover spending through early 2023.

US President Joe Biden signed the Infrastructure Investment and Jobs Act—a multi-year infrastructure funding bill—into law during November. The initiative appropriated $1.2 trillion (including $550 billion above baseline spending), with nearly $300 billion of new spending to fund transportation projects over the next decade, another $65 billion apiece dedicated to broadband internet and power grid projects, and $55 billion reserved for water infrastructure.

Economic Data

- UK manufacturing growth essentially held steady at a high level throughout the fourth quarter after peaking in May and cooling through September. Employment in the manufacturing sector improved for 12 straight months through December, and output prices increased at the highest rate on record since 2008.
- Growth in the UK services sector ground down to a modest pace in late 2021 as activity hit a 10-month low in December.
- The UK claimant count (which calculates the number of people claiming Jobseeker's Allowance) continued to decline in November, with roughly 65,000 fewer claimants compared to the prior month—representing 4.9% of the population as at November's reading.
- The UK economy expanded by 1.1% during the third quarter and 6.8% year over year through September, a steep climb down from the second quarter's 5.4% pace (and 24.6% growth in the year through June).
- The expansion in eurozone manufacturing continued at a brisk pace during the fourth quarter, but continued to soften. Inventories of input materials grew in December at the fastest rate on record since 1998. Italy had the highest pace of manufacturing growth in the eurozone at the end of the year, while France had the lowest.
- Eurozone services sector growth slowed unevenly during the fourth quarter, ending in December with the weakest expansion since returning to growth in April 2021.
- The overall eurozone economy strengthened by 2.2% during the third quarter and 3.9% year over year through September, in line with the second-quarter pace of 2.1%, although the year-over-year figure was well below the 14.2% growth measured through June.

- US manufacturing growth remained quite elevated at the end of 2021, but continued to soften throughout the fourth quarter from its peak in July. Growing lead times for materials added to order backlogs, although the increase in unfilled orders during December was the smallest in ten months.
- Services sector growth accelerated in October from an August-to-September soft patch, and remained strong through the end of the year. Input and output cost increases set a series of record highs throughout the fourth quarter.
- The weekly number of new US jobless claims continued its months-long descent in the fourth quarter—reaching the lowest levels in more than 50 years during November with less than 200,000 filings per week, and remaining close to these lows through the end of 2021.
- The US economy expanded at a 2.3% annual rate during the third quarter, significantly below the 6.7% annualised pace in the second quarter.

Summary

Equity markets stumbled in late 2021 owing to nervousness over the latest COVID-19 surge. Although there have been pockets of speculative behaviour in some areas of the financial world, there has not been the sort of widespread frenzy that would point to a serious equity correction in 2022. The economy would have to slow precipitously for reasons other than the temporary impact stemming from COVID-19 mobility restrictions; the trend in earnings would need to flat-line or turn negative.

The year ahead promises to be another one of extremely tight labour markets. People are more likely to return to the workforce as COVID-19 fears fade, but there could still be a mismatch of demand and supply. Brexit and the departure of foreign workers back to the Continent are aggravating the UK's labour shortage.

The forward earnings trend has been quite strong in the US, with analyst estimates of year-ahead earnings rising more than 30% in the past 12 months. Since the S&P 500 price-only index has appreciated by "only" 24%, the price-to-earnings ratio (PE) has fallen to a year-end 2021 reading of 21 times. Compared against the history of the past 25 years, only the PE ratios recorded during the tech bubble of 1999 and 2000 were in the same ballpark. Nonetheless, it is only when earnings estimates flatten and decline that the equity market has historically begun to struggle.

The real anomaly in the financial markets is the ultra-low levels of interest rates in the face of higher inflation and above-average growth in much of the world. This may force central banks to adopt more aggressive interest-rate policies than they and market participants currently envision

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