QUARTERLY MARKET UPDATE

January 2022

THROGMORTON
CAPITAL MANAGEMENT

- Equity markets delivered the goods in 2021. 14.3% from the UK's FTSE 100 and 28.7% from the U.S.' S&P 500.
- China came unstuck, and the outlook doesn't seem too bright either.
- Bonds struggle in a world of negligible, but rising, interest rates.
- Inflation takes off but is it 'transitory'? Bankers say yes, the man on the street says no.
- Gains in 2022 look set to be modest, with equities offering the best prospects.

Despite the best efforts of the omicron variant, stock markets finished 2021 in a buoyant mood having provided investors with a year of better-than-expected gains. Our own principal index, the FTSE 100, finished the year just a few points away from a twelve-month high and only 4% below its pre-Covid peak, achieved in January 2020.

Even better returns were to be had, once again, from investing in the U.S. There, the S&P 500, the country's main index, rose by almost exactly double that of the FTSE 100, notching up a gain of 28.7% for the year.

The returns delivered by U.S. equities in 2021 were notable not just for their size but also for the fact that, in contrast to the previous three years, they were the product of gains in a range of sectors, not just a small cluster of technology stocks.

Looking forwards to 2022, it appears likely to us that the U.S. equity market will continue to out-perform that of most other developed markets. A high proportion of the world's most innovative companies are listed in North America and while many are already expensively valued, their outlook for strong, sustainable earnings growth should support these valuations and allow them to continue delivering above-average returns.

The benefit to ensuring that portfolios are broadly diversified, both geographically and across a range of asset types, was highlighted last year by the significant underperformance of China whose stock market, in contrast to most others, produced a negative return for the year.

Returns in Chinese equities were weighed down in part by a property sector creaking under mountainous debts, but more significantly by the actions of the Government which undermined investor confidence in the Chinese economy. The Government has taken a disliking to the high profile of the new wave of Chinese tech entrepreneurs, and the enormous wealth they have amassed. Only the Communist Party can be allowed to influence markets and workers, and they reminded everyone of this fact last year.

We reduced our already modest exposure to China in our Growth and Adventurous portfolios over the year and our view at this point is that China is unlikely to see a near-term recovery in investor appetite; better opportunities lie elsewhere.

While better opportunities exist in other equity markets, fixed income investments, such as government bonds, look set for another tough year. In 2021, both gilts and corporate bonds struggled to make any gains at all, with the only bright spot coming in the form of index-linked Gilts where prices were pushed up by fears of higher inflation.

We were never in the same camp as the Bank of England or the U.S. Federal Reserve who regarded the current bout of inflation as 'transitory'. Both seem to have gradually retired this phrase over the last few months and it already seems remarkably naïve. The UK headline inflation figure of 5.1% is way above levels of recent years and hides the reality that the Retail Prices Index is now rising at an annual rate of 7.1%. With sharply higher energy costs and rising wages set to feed through in the coming months, we can foresee these numbers moving up from their current level.

It is fair to say that inflation is probably the issue most likely to upset our apple cart in 2022. Central Banks will want to raise interest rates to manage inflation but know they are limited in their ability to do this because of the enormous debts held by governments and companies all over the world. Those old enough to remember the 1970s will recall that rising prices lead to demands for higher wages. These costs then must be recovered by companies raising prices and so the inflationary cycle is born. This will certainly not be a good environment for bond investors so despite the greater volatility produced by equities it may be that we will have to accept a female acronym for another year, TINA – There Is No Alternative, if we are to ensure that your portfolio produces a satisfactory return by, at the very least, maintaining its 'real' value by keeping up with inflation.