Aspect8

Quarterly Markets Review

Q4 2021

A look back at Q4 2021, when developed market shares posted strong returns despite the emergence of the Omicron variant and the prospect of tighter central bank policy.

- Global equities were stronger in the final quarter of 2021 as investors focused on economic resilience and corporate earnings.
- In bond markets, government bonds outperformed corporate bonds. Markets began to price a faster pace of interest rate rises in the US.
- Commodities saw a positive return as industrials metals gained.

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US

US equities rose in Q4. Overall gains were robust despite a weaker November, during which fears over rising cases of the Omicron variant of Covid-19 and the speed of the Federal Reserve's asset tapering had weighed. By year-end, these worries had largely subsided, while data continue to indicate that the economy overall remains stable and corporate earnings are robust.

US economic growth slowed sharply in the third quarter amid a flare-up in Covid-19 infections, but with activity since picking up, the economy remains on track to record its best performance since 1984. GDP increased at a 2.3% (annualised), up from the 2.1% pace estimated. This was still the slowest quarter of growth since the second quarter of 2020, when the economy suffered an historic contraction in the wake of tough mandatory measures to contain the first wave. Unemployment fell to 4.2%, the lowest since February 2020, from 4.6% in October. The participation rate rose slightly but is still about 1.5 percentage points lower than the pre-pandemic level.

Tech as a sub-sector was one of the strongest performers over the quarter, with chipmakers especially strong. Real estate also performed well, as investors expect e-commerce to continue to grow and drive further demand for industrial warehousing. Energy and financial names made more muted gains over the quarter.

Eurozone

Eurozone shares made gains in Q4, as a focus on strong corporate profits and economic resilience offset worries over the new Omicron variant. A number of countries did introduce restrictions on sectors such as travel and hospitality in order to try and reduce the spread of the new variant. The flash composite purchasing managers' index hit a nine-month low of 53.4 for December, as the service sector was affected by rising Covid cases. However, equity markets drew support from early data indicating a lower risk of severe illness.

Utilities were among the top performers with IT stocks also registering strong gains. Technology hardware and semiconductor stocks performed particularly well. The luxury goods sector also performed very strongly, recovering from the summer sell-off which was sparked by a focus on "common prosperity" in China. Meanwhile, the communication services and real estate sectors saw negative returns.

The quarter was marked by volatile gas prices which contributed to higher inflation. The eurozone's annual inflation rate reached 4.9% in November, compared to -0.3% a year earlier. The European Central Bank said it would scale back bond purchases but ruled out interest rate rises in 2022.

Germany's coalition talks reached a conclusion. In December, Olaf Scholz of the Social Democrats (SPD) succeeded Angela Merkel as chancellor. His party is in a coalition government with the Greens and Free Democrats (FDP).

UK

UK equities rose over the quarter. Encouraging news around Omicron during December saw a number of economically sensitive areas of the market largely recoup the sharp losses they had sustained in the initial sell-off in late November, such as the banks. Some areas reliant on economies reopening, however, such as the travel and leisure and the oil and gas sector were unable to make up November's losses and ended the quarter lower.

A number of defensive areas outperformed, including some of the large internationally diversified consumer staples groups. However, expectations China would maintain a zero tolerance approach to Omicron continued to impact sentiment towards a number of other globally exposed large cap companies. These consistently underperformed over the quarter, despite some uncertainties around increased regulatory oversight in China having abated.

Some domestically focussed area were particularly volatile and not just the travel and leisure companies directly disrupted by the latest Omicron related restrictions. The share prices of UK consumer facing sectors such as retailers and housebuilders yo-yoed inline with expectations around the timing of a rise in UK base rates, which came in December. Many retailers grappled with supply chain disruptions, resulting in some high profile profit warnings, despite strong demand.

Japan

After declines in October and November, the Japanese stock market regained some ground in December to end the quarter with a total return of -1.7%. The yen was generally weaker in the quarter.

Japan held a general election in October. Expectations for the ruling Liberal Democratic Party's (LDP) election performance under Mr Kishida's leadership were modest at best. However, in the event the LDP lost only 15 seats and retained a solid majority in its own right. With the election out of the way, the political focus shifted to a substantial fiscal stimulus package. This includes direct cash handouts to households in an effort to kick-start a consumption recovery in the first half of 2022.

From late November, renewed short-term uncertainty over the new Covid variant temporarily obscured the increasingly positive outlook for Japan. Japan inevitably imported its first known case of Omicron in December, but overall infection rates remain remarkably low, as they had throughout 2021.

The US Fed's discussion of accelerated tapering led to some short-term weakness in stock prices in December, despite the fact that such a move is very unlikely to be followed by Japan in the foreseeable future. The Bank of Japan's own Tankan survey, released in December, contained no real surprises, although the overall tone was reasonably upbeat. There was some evidence of a slight pick-up in corporate inflation expectations over the next two years. Meanwhile, the current inflation rate crept back into positive territory as several one-off factors begin to drop out, but there still seems little chance of Japan experiencing a short-term inflation spike as seen elsewhere.

Among other economic data released in December, there was a genuine positive surprise in the strength of the rebound in industrial production as auto output began to recover from the temporary weakness caused by the global semiconductor shortage.

Asia (ex Japan)

Asia ex Japan equities recorded a modest decline in the fourth quarter. There was a broad market sell-off following the emergence of the Omicron variant of Covid-19 which investors feared could derail the global economic recovery.

China was the worst-performing market in the index in the quarter, with share prices sharply lower, along with neighbouring Hong Kong, on investor fears that new lockdown restrictions would be instigated following the rapid spread of the new Covid-19 variant. Share prices in Singapore also ended the fourth quarter in negative territory as investors continued to track developments surrounding the new Omicron variant. There were also fears that the city-state's government might have to scale back some recently relaxed curbs on activity. India and South Korea also ended the quarter in negative territory although the declines in share prices were more modest.

Taiwan and Indonesia were the best-performing index markets in the fourth quarter and the only two index markets to achieve gains in excess of 5% in the period. In Taiwan, positive economic data and a rise in exports boosted investor confidence, with chipmakers performing well. Share prices in Thailand, the Philippines and Malaysia also ended the quarter in positive territory.

Emerging markets

The MSCI Emerging Markets Index lost value in Q4 and underperformed the MSCI World Index, with US dollar strength a headwind. Turkey was the weakest index market, amid extreme volatility in the currency. The central bank lowered its policy rate by a total of 400bps to 14%, despite ongoing above-target inflation which accelerated to 21.3% year-on-year in November. With the lira coming under significant pressure, President Erdogan announced an unorthodox scheme to compensate savers for lira weakness, in an effort to reduce the use of US dollars.

Chile lagged the index as leftist Gabriel Boric was elected president. Brazil underperformed as the central bank continued to hike rates in response to rising inflation; the policy rate was increased by a total of 300bps during the quarter. Meanwhile, concerns over the fiscal outlook, and political uncertainty ahead of November 2022's presidential election, also weighed on sentiment.

Russia lagged as geopolitical tensions with the West ratcheted up, amid a build-up of Russian troops on its border with Ukraine. China also finished in negative territory as concerns over slowing growth persisted, exacerbated later in the quarter by uncertainty created by rising daily new cases of Covid-19.

By contrast, Egypt finished in positive territory and was the best performing index market. Peru and the UAE also posted double digit gains in dollar terms. Taiwan, aided by strong performance from IT stocks, Indonesia and Mexico all recorded solid gains and outperformed.

Global bonds

Markets were buffeted over the quarter by persistent elevated inflation, hawkish central bank policy shifts and the emergence of the Omicron Covid-19 variant. In bond markets, 10-year government yields were largely unchanged. Yields followed a downward trajectory for most of the quarter before reversing in the final weeks of the year as sentiment improved. Yield curves flattened, with shorter-dated bonds hit as central banks turned more hawkish.

Most notably, US Federal Reserve (Fed) rhetoric turned increasingly hawkish in November. Chair Jay Powell and other members of the policy committee suggested tapering could be accelerated, which it was in December, and that they may stop referring to inflation as “transitory”.

The US 10-year Treasury yield was little changed for the quarter, from 1.49% to 1.51%. It reached 1.7% in October amid elevated inflation and expectations of policy tightening, then a low of 1.36% in early-December amid fears over the Omicron Covid-19 variant. The US 2-year yield increased from 0.28% to 0.73%.

The UK 10-year yield fell from 1.02% to 0.97%, dropping sharply in early November as the Bank of England (BoE) unexpectedly elected not to raise rates. The BoE did, however, raise rates in December and with fears over the Omicron variant fading, yields rose. The 2-year yield sold-off, from 0.41% to 0.68%.

Germany’s 10-year yield was little changed, from -0.17% to -0.19%, but this reflected a late sell-off with the yield having fallen below -0.40% in December. Italy’s 10-year yield increased from 0.86% to 1.18%. Eurozone inflation picked up considerably, rising to the highest level since 2008 and to a near 30-year high in Germany. European Central Bank President Christine Lagarde broadly affirmed dovish messages, but comments from other ECB officials were more hawkish.

Corporate bonds lagged government bonds for the quarter. In investment grade, the US market saw modestly positive total returns (local currency), but Europe weakened. US high yield was the standout performer, with positive returns and narrowing spreads. Investment grade bonds are the highest quality bonds as determined by a credit rating agency; high yield bonds are more speculative, with a credit rating below investment grade.

In emerging markets, local currency bond yields rose, particularly where central banks continued to raise interest rates amid elevated levels of inflation. Central and eastern Europe underperformed. EM currency performance was mixed, influenced by shifting risk sentiment, despite the prospect of higher interest rates.

EM hard currency bonds declined, with high yield significantly weaker, though investment grade sovereign bonds saw positive returns.

Global equities enjoyed a strong quarter with the MSCI World index up 6.8% but convertible bonds could not benefit from the equity market tailwind. The Refinitiv Global Focus index of balanced convertible bonds finished the last quarter of 2021 with a disappointing loss of -1.9%. Throughout the quarter, $25 billion of new paper hit the market bringing the total of new issuance to US$160 billion for 2021.

Commodities

The S&P GSCI Index recorded a moderately positive return in the fourth quarter despite a sharp decline in the price of natural gas. The industrial metals component was the best-performing segment in the quarter as the global economic recovery gathered pace. There were strong gains in the prices of zinc, nickel, lead and copper.

The agriculture component also achieved a positive return in the quarter, with robust gains recorded for coffee, cotton, corn and Kansas Wheat. Precious metals also gained in the quarter, with modest price gains for siler and gold.

The energy component recorded a modest decline in the quarter, with a sharp fall in the price of natural gas offset by modestly higher prices for unleaded gasoline, crude oil and Brent crude.

The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested.

Overview

Total returns (net) % – to end December 2021

	3 months			12 months		
Equities	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
MSCI World	7.8	9.8	7.3	21.8	31.1	22.9
MSCI World Value	7.2	9.2	6.7	21.9	31.2	23.1
MSCI World Growth	8.2	10.2	7.7	21.2	30.4	22.3
MSCI World Smaller Companies	2.2	4.2	1.8	15.8	24.5	16.8
MSCI Emerging Markets	-1.3	0.6	-1.8	-2.5	4.9	-1.6
MSCI AC Asia ex Japan	-1.2	0.7	-1.7	-4.7	2.5	-3.8
S&P500	11.0	13.2	10.5	28.7	38.5	29.9
MSCI EMU	3.7	5.6	3.2	13.5	22.2	14.6
FTSE Europe ex UK	5.5	7.6	5.1	16.3	25.2	17.4
FTSE All-Share	4.7	6.7	4.2	17.2	26.2	18.3
TOPIX*	-4.8	-2.9	-5.2	1.1	8.8	2.0

	3 months			12 months		
Government bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
JPM GBI US All Mats	0.2	2.1	-0.2	-2.6	4.8	-1.7
JPM GBI UK All Mats	2.9	4.9	2.5	-6.1	1.0	-5.3
JPM GBI Japan All Mats**	-3.2	-1.4	-3.6	-10.5	-3.7	-9.7
JPM GBI Germany All Traded	-1.7	0.2	-2.1	-9.6	-2.8	-8.8
Corporate bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global Broad Market Corporate	-0.5	1.5	-0.9	-3.0	4.4	-2.1
BofA ML US Corporate Master	0.2	2.1	-0.3	-1.0	6.6	-0.0
BofA ML EMU Corporate ex T1 (5–10Y)	-2.8	-0.9	-3.2	-8.3	-1.3	-7.4
BofA ML £ Non-Gilts	0.9	2.8	0.4	-3.9	3.4	-3.0
Non-investment grade bonds	**USD**	**EUR**	**GBP**	**USD**	**EUR**	**GBP**
BofA ML Global High Yield	-0.7	1.2	-1.2	1.4	9.1	2.3
BofA ML Euro High Yield	-1.9	0.0	-2.3	-5.1	2.1	-4.3

Source: Thomson Reuters DataStream.

Local currency returns in Q4 2021: *-1.7%, **-0.1%.

Past performance is not a guide to future performance and may not be repeated.

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