Where's the weather coming from? Investment markets in 2022

By Perpetual Private Insights

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There are days when you scan the horizon from a hilltop and see a whole range of weather coming your way. There's sunshine to the West but clouds in the North. There's rain overhead – but a rainbow to the South.

That's the picture facing investors in 2022. A shifting mix of positive forces and creeping worries that make it hard to plot a clear investment strategy.

To help, Perpetual Private's Quarterly Investment Update for December 2021 looks at what happened last year and most importantly explains how we're structuring portfolios to protect and grow your wealth in 2022.

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Here's the condensed version...

2021 – A good year for equities

The past year was one of cascading good news for investors who sent their money to work in companies around the world.

- For calendar year 2021, the S&P/ASX 300 returned 17.5% including dividends.
- Global sharemarkets paid even better returns. Australian investors in unhedged international equities earned over 25% (MSCI ACWI Index).
- Listed property companies surpassed even that. Aussie investors in global Real Estate Investment Trusts (REITs) harvested returns of 33%. Locally focused REITS returned 27% for the year[1].

Reasons to be happy

What's underpinning all this good news? Australian companies continue to grow earnings, there's low interest rates and rising Chinese demand for our iron ore. Most strikingly, the unemployment rate just hit a 13-year low. Consumers have pockets stuffed with savings they're desperate to spend and whilst Delta took its toll, the Australian economy held up well.

In other developed economies, markets have enjoyed continued support – high spending governments and low rates. The re-opening trade is taking firmer hold and US equity market performance has been stellar (as at December 2021, the S&P500 is up 90% over the past three years)[2].

A bad year for bonds

Investors who took the traditionally safer fixed income path in 2021 were challenged, with the Bloomberg AusBond Composite Index losing 2.9% during the year. Investors in global bonds, as measured by the Bloomberg Barclays Global Aggregate Bond Index (Hedged) received a negative 1.5% return.

The reason? Inflation – which hit 7% in the US, its highest rate since Ronald Reagan lived at 1600 Pennsylvania Avenue. Supply chain issues proved less than 'transitory' and cashed up but homebound consumers spent big on goods not services. So goods prices rose around the world (less so in Australia) and Central Banks pushed up rates to lean against inflationary pressures. That's bad news for bonds.

Outlook for 2022 – changeable weather

F. Scott Fitzgerald said, "the test of a first-rate intelligence is the ability to hold two opposed ideas in mind at the same time and still retain the ability to function." So intelligence will be very useful for investors in in 2022 as we seek to reconcile these competing forces.

Geopolitical volatility – Taiwan/China and Ukraine/Russia are highly visible flashpoints with the potential to derail markets. On a longer-term view, geopolitical instability is here to stay while the West adjusts to a rising China – or a rising China adjusts to a resistant West.

Strong growth – we have just come off the strongest period of global economic growth in 50 years. And, while experts think global growth will slow in 2022, it's still expected to beat historic averages.

Higher inflation, higher rates, market shifts

If inflation persists, rates will rise and that resets market dynamics. There'll finally be an alternative to equities, so more money will flow into cash and bonds and less into companies with uncertain future earnings (like yet unproven tech stocks). Companies with more predictable earnings, like banks and miners, could do well. That's good news for Australia as our stockmarket boasts plenty of those.

So how do investors balance this all out – strong growth, lots of liquidity and cashed up consumers versus geopolitical risk, rising rates and inflation?

According to Kyle Lidbury, Head of Investment Research at Perpetual Private, the answer is to avoid the temptation to build portfolios based on a specific view of the future.

"The past two years taught us that events can completely unravel an investment strategy based on even the most sophisticated forecasts," says Kyle. "We build portfolios for our investors that are resilient, highly diverse and structured to perform across a range of different market scenarios. Two key elements of that approach for 2022 are a more active approach to bond markets – which are likely to be volatile. And a preference for quality companies with predictable earnings and the ability to set the price for their products and services."

Perpetual Private's Quarterly Investment Update for September to December 2021 looks at all these issues in greater depth, with detailed analysis of individual asset classes including equities, fixed income, real estate, currency and alternatives.

[Download the report]

1. *FTSE EPRA/NAREIT Developed Index and S&P/ASX 300 A-REIT (Sector) Total Return index, respectively*
2. *https://ycharts.com/indicators/sp_500_3_year_return*

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