Market Commentary for the Period 1st October 2021 – 31st December 2021

Global equity markets ended the period broadly positive recovering from a dip towards the end of November following the discovery of the Omicron variant in South Africa. The quarterly period was a tale of two halves with the reopening of economies only to be reversed given the spread of the new variant. The most recent economic data was robust enough for principle central banks to begin tightening policy and growth forecasts remained relatively strong. Fixed income markets reacted negatively to central bank action, but moves were limited somewhat by ongoing risks around rising cases of the virus.

PM Johnson announced initially that from 4th October UK travel rules would be relaxed, where the amber and green lists would be merged into one and anyone fully vaccinated would no longer have to take a PCR test before travelling back to England from one of these selected countries. The number of countries on the red list was also reduced. The US also reopened its borders to fully vaccinated travellers from 33 countries following 18 months of travel restrictions. American pharmaceutical company Pfizer developed a Covid-19 pill which reduced the risk of hospitalisation or death by 89% in vulnerable adults and announced they would allow generic drug makers to produce versions of the pill for lower-income nations.

Coronavirus cases then began their fourth ascent from mid-October to reach new heights both in the UK and globally with the new variant later known as Omicron. The UK and parts of Europe were reporting the highest concentration of cases worldwide, while the death rate was more subdued, helped by those countries which had advanced through vaccination programmes. While initially, several pharmaceutical companies reported that it could take some time to supply new jabs of a sufficient scale, WHO officials provided some comfort following their comments that there was a lack of evidence that vaccine efficacy should be reduced.

Several restrictions were announced across European member states including Germany, Portugal, Finland and Sweden. The restrictions ranged across countries including; working from home orders, limiting numbers at private gatherings and closing of bars/nightclubs, among others. Multiple countries also put in place travel restrictions in a bid to control the spread of the virus.

In England, PM Johnson announced the adoption of 'plan B' requiring people to work from home if possible and made face masks compulsory in most public places, following the increasing spread of the Omicron variant. He also confirmed that Covid passes would be needed to get into nightclubs and large venues. In a further speech, PM Johnson brought forward his target to provide booster jabs to all adults from the end of January to the end of December as the UK's Covid alert level was raised to four. New restrictions were announced in Scotland, Wales and Northern Ireland including curbs on hospitality & leisure and social distancing rules limiting the size of gatherings. PM Johnson stuck to his policy of riding out the wave of infections without further restrictions while acknowledging parts of the NHS would be temporarily overwhelmed.

In terms of macroeconomic data, levels of unemployment generally continued to fall across the major economies with job vacancies hitting record heights in some countries, signalling tightness in the labour market. Economic growth for the third quarter was reported lower than the previous quarter for most,

although remained positive given the reopening of economies over this period. The Japanese economy however contracted with policymakers citing rising cases and supply chain disruptions as key reasons. Elevated levels of inflation persisted with the latest readings reaching their highest levels since 2011 in the UK and since 1982 in the US-driven largely by rising energy and fuel costs, as well as broader supply chain disruptions.

The OECD's latest interim economic outlook projected global growth of 5.7% over 2021 and 4.5% in 2022, little changed from their May outlook. This was following the success of vaccine rollouts and a gradual resumption of economic activity. The IMF cut its global growth forecast by 0.1% to 5.9% for 2021, while maintaining their growth forecast at 4.9% in 2022. They did however comment that the 'modest headline revision masks large downgrades for some countries as the outlook for the low-income developing country group has darkened considerably due to worsening pandemic dynamics'.

In the Chancellors Autumn budget growth forecasts were raised to 6.5% (from 4%) in 2021 and 6% in 2022. It was felt inflation would average 4% over 2022 and unemployment would peak at 5.2%. Business rates were halved for companies in the retail, hospitality and leisure sector, while simplification in alcohol duties would see tax cuts for alcoholic drinks. This led to a rise in share prices for pub chains shortly following the announcement.

The world's principal central banks took action to tighten policy measures in December despite concerns over the risks of the Omicron variant to economies. The US Federal Reserve announced they would end asset purchases in March and paved the way for three interest rate hikes by the end of 2022 voicing concerns over inflation alongside a backdrop of a steady recovery in the labour market. European and Japanese policymakers also voted to taper a portion of their asset purchases while the Bank of England raised interest rates for the first time since the onset of the pandemic. The risks of elevated levels of inflation were also fundamental to their decisions. This follows the moves of central banks in South Africa, Russia, New Zealand and Mexico which have already raised interest rates over last year in an attempt to contain overheating risks.

Incumbent Federal Reserve chairman Jerome Powell was nominated for a second term, serving another four years as head of the US central bank. President Biden reasserted his confidence that the chairman would tackle inflation, but also stressed that urgent action was required to tackle climate change and risks to the financial system. Around the same time, the President announced the US would be releasing 50 million barrels of oil from its reserve in an attempt to lower prices. Other major oil-consuming nations followed in reducing reserves, including; China, India, Japan, South Korea and the UK. This marked the first time that the US attempted to coordinate a reduction in the oil price.

The Russian central bank communicated their aspiration to ban cryptocurrencies in Russia, given their use in money laundering and terrorist financing and that their increasing popularity raised concerns around financial stability. In the same week, Deputy Bank of England Governor Jon Cunliffe warned on the threat cryptocurrency poses to the financial system.

In Germany, the centre-left Social Democrats (SPD) claimed a narrow victory in the state election. SPD leader Olaf Scholz formed a three-way coalition that ended a 16-year conservative government led by Chancellor Angela Merkel. Speeding up the move to digitalisation and fighting climate change was central to their objectives.

Investors continued to watch for any signs of default with Chinese Real Estate giant Evergrande. While the company was seen narrowly avoiding defaulting on overdue interest payments earlier in the quarter, credit ratings agency Fitch later labelled the company in restrictive default following missed payments. This led to concerns over the potential contagion of a debt crisis within the Chinese property sector. The Chinese central bank reported that the risks posed to the economy could be contained.

In fixed income markets, yields fluctuated over the period with a dip towards the end of the quarter rising following central bank action to tighten policy, which harmed bond prices. The UK Debt Management Office cancelled over half the remaining gilt auctions for the fiscal year, reducing sales by £57.8bn. Some government bond prices experienced their largest gains in one day since the height of the Covid crisis and longer-dated bonds outperformed significantly.

House View

As 2021 draws to a close, we see the year as being extraordinary for developed market risk assets. Markets have been supported by earlier optimism over vaccinations and the extension of support by both governments and central banks. We saw a colossal stimulus program implemented in the US and measures such as grants and furlough schemes extended in the UK. This was in combination with record low interest rates and central bank asset purchases, which has helped prop markets during these uncertain times.

The recent spread of the Omicron variant brought further worries across markets and while initial fears have abated with the virus proving less severe, policymakers this time have decided to tighten policy in consideration of the higher levels of inflation that have ensued. This we feel relays an important message that there is a limit to how far central banks will allow these loose policy measures to persist. Meanwhile, we also acknowledge there is also a ceiling to how high and quick they may be able to raise interest rates given the higher costs associated with servicing their debt burden. We believe the timing and scale of tightening will be of key significance to market movements in the coming years.

In summary, while we expect further policy tightening to act as a headwind to market returns, it is important to evaluate this alongside the economic backdrop where growth is elevated and labour market conditions are strong. With inflation persisting well above the target for a prolonged period, it is necessary to take action to help manage this risk and prevent markets from overheating. That said, investors are fully aware of how quick the backdrop can change and the impact this has on markets. For this reason, we maintain a high level of diversification across portfolios.

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5th January 2022

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