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B Capital 2021 Market Review & 1Q2022 Investment Outlook

2021 has just ended with another strong year for growth as the global economy rebounds from the sudden stoppage in 2020. The International Monetary Fund projects that the global economy will have grown by 5.9% in 2021 and should grow a further 4.9% this year. That is a slight downgrade from the last forecast that was published in the last quarter of 2021 as the Omicron variant had started to spread rapidly around the world. At the time of writing, it appears that Omicron is becoming less of a worry and restrictions on movement and social interaction are being lifted. Thankfully our prediction in December via Twitter that Omicron would blow over quite fast has come to pass. During 2021 we urged clients to remain invested, albeit with a measure of caution, and despite the ongoing turbulence, this has paid off with another year of decent returns. So far, so good.

	INDEX PERFORMANCE — NET RETURNS (%) (DEC 31, 2021)								FUNDAMENTALS (DEC 31, 2021)			
					ANNUALIZED							
	1 Mo	3 Mo	1 Yr	YTD	3 Yr	5 Yr	10 Yr	Since Dec 29, 2000	Div Yld (%)	P/E	P/E Fwd	P/BV
MSCI World	4.27	7.77	21.82	21.82	21.70	15.03	12.70	6.72	1.66	22.74	19.46	3.39
MSCI Emerging Markets	1.88	-1.31	-2.54	-2.54	10.94	9.87	5.49	8.97	2.38	14.00	12.42	1.88
MSCI ACWI	4.00	6.68	18.54	18.54	20.38	14.40	11.85	6.68	1.74	21.25	18.31	3.11

Fig 1 - Performance MSCI World, EM, All World Indexes 2021
***Source: msci.com**

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Looking forward into 2022 and focusing on US equities being the largest contributor to the MSCI World equity index, the market looks set to grow earnings per share by 9% led by the industrials, consumer discretionary and energy sectors. According to research from JP Morgan, households and corporates have built up excess savings, and credit conditions are easing. At the same time, there is considerable pent-up demand in global services and inventories. The positive interaction of these healthy fundamentals and growth-oriented policies is a recipe for a global reflationary tilt. While inflation will remain a recurring theme, there is a compelling case to be made for inflation rotation rather than a broad-based acceleration in prices. Record corporate liquidity and strong fundamentals should continue to drive capital investment, inventory re-stocking, shareholder return and merger and acquisition (M&A) activity. We forecast that the inflation spike will moderate back to around 2.8% over the course of the year and that 3 to 4 interest-rate rises will happen but these will be gradual and may take short-term interest rates to around 1% - 1.25%. We expect the 10 year US Treasury to reach around 2% by the middle of the year, which should not be challenging for other asset classes.

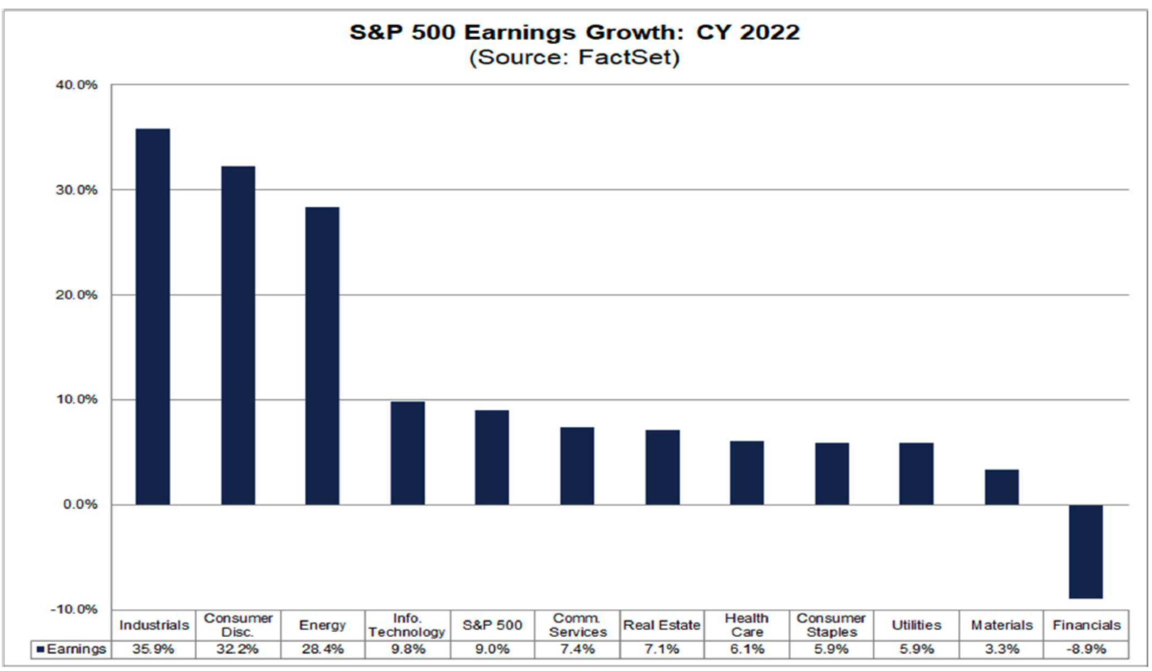

Fig 2 - S&P500 Earnings Growth 2022
***Source: Factset**

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The continued strong earnings growth in the US points to the S&P 500 attaining 5050 as the labour market recovery continues (unemployment <4%), consumers hold higher cash levels, supply chain issues ease, and the inventory cycle accelerates off historic lows. This implies a total return of between 7-9% for the region. Much of the equity upside could be seen between now and the first half of 2022. To a large extent, equities have already priced in a more aggressive Fed, while high beta stocks have already re-rated showing a bifurcation between the high profile but not-yet profitable tech stocks and those that are already making money for the shareholders.

It is likely that the trends for earnings growth in the US will largely be followed by the larger companies in the same sectors across different regions. While there are obvious differences, it is likely that the now maturing stage of the bull market will favour higher-quality companies with strong dividend cashflows. The importance of collecting and compounding the dividend yield will become more evident as growth moderates and interest rates rise with inflation. Real rates of return from cash and fixed income will be contrasted with equity total returns that include both share price growth and dividend yields.

We believe that as with the US, global markets will start to perform as restrictions ease and will continue to be supported by earnings growth in 2022, albeit at a slower pace. We could also expect modest multiple contraction to persist as the growth vs inflation mix re-adjusts. According to estimates, bottom-up analysts anticipate earnings growth to slow from 49% in 2021 to 8% this year. Given the macroeconomic backdrop, these expectations look reasonable. Factoring in some multiple contraction, to account for the risk of a growth slowdown and/or an inflation shock, would justify mid-to-high single-digit total returns across global equities in 2022.

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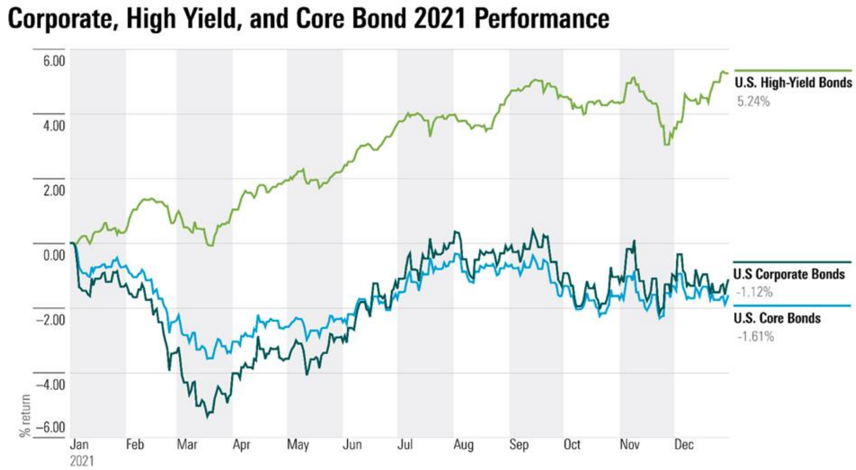

Fig 3 - Bond Index Performance (US) in 2021
***Source: Morningstar**

We remain very cautious about longer dated fixed-income, which we imagine will be prone to some volatility as the Fed continues to withdraw monetary support (bond purchases) and to raise interest rates through the year. Duration of 2 to 3 years and credits in the range triple BBB- to A- still looks like the best value on a risk-adjusted basis. US high yield, with its strong correlation to energy prices, could still perform better than investment grade issues this year.

As we start 2022, we expect the momentum of the last year to continue and this will favour equities as the asset class of preference. We continue to urge all investors to remain strategically allocated according to their objectives and risk appetite, remembering that timing the market should be avoided and that compounding dividend returns add some magic over the long-term.

We are optimistic that the pandemic crisis period is now over, and a new normal of living with COVID has begun, with greater personal freedoms, much-needed social interaction and consumer activity lie ahead of us in 2022, and not a moment too soon.

Lorne Baring
Managing Director

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