THE TWO 'KNOWN UNKNOWNS' OF 2022

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In history there are decades where not much happens, and there are months where decades happen. Covid has had far reaching effects on how economies function, where we work and how firms do business, and that process is on-going.

While the dust has not fully settled, the early picture emerging in the post-pandemic economy is that household behaviour, labour markets, correlations between asset classes, and the sensitivity of all those factors to policy changes, have notably changed. These factors have, in turn, altered the growth and price trends in most economies, and this will have significant implications for risk and return dynamics within portfolios going into 2022 and beyond.

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Central banks' partly right on inflation

Central banks claim that the inflation rise is transitory, and that is certainly the case in energy and goods markets where prices remain elevated despite a clear weakening in demand. The price rise in these sectors has been driven by limited production and scant spare capacity which will ultimately prove transitory. The two "known unknowns" here is when these supply issues will be resolved –and some estimates have it well into 2022 at the earliest – and also whether the new Omicron variant of Covid is set to weigh on growth or exacerbate cost side pressures, or both.

The macro economy and outlook

The anticipated 2022 central bank pullback comes at a challenging time as the global economy is slowing anyway. A sizable reduction in fiscal support and labour market slack is likely to see 2022 end with 'trend-like' growth in most major advanced economies. Another growth challenge is China, which is seemingly going through a regime change with President Xi more interested in the distribution of growth, rather than its size. Over the past year Chinese authorities have been tightening monetary policy which has seen China's credit impulse signal that a large and prolonged nominal growth moderation is underway.

2022: A challenging year?

Overall, 2022 is looking to be a challenging year for investors as central bank tapering, rising inflation and any subsequent policy hike are likely to spark higher bond yields which should weigh on equity valuations. Meanwhile rising rates, fiscal policy withdrawal, slowing growth and rising costs are set to weigh on earnings growth. Accordingly, 2022 is set to be a transitional year where the world tries to get off its stimulus addiction, and investors question the floor that central banks have put under rich asset valuations.

Investment and portfolio implications

A lot has changed in the past two years, and the investment environment ahead is very different to what we've seen since the early 1980s. Investors are facing a terrain characterised by low prospective rates of return and higher volatility and with bond yields so low, investors will not only have to identify undervalued assets, but will also be seeking new portfolio diversifiers. While the biggest asset for asset accumulators is still 'time', the dilemma for retirees is quite profound as central bank policy has seen yields on all income producing assets fall to record lows.

Find out more about the Perpetual Diversified Real Return Fund