Cantab
ASSET MANAGEMENT

Investment Comment

04 January 2022

Sterling denominated returns of major indices	Year 2021 %	Year 2020 %	Year 2019 %	Year 2018 %	Year 2017 %	Year 2016 %
Equities						
UK	18.7	-11.8	18.4	-9.8	13.0	17.4
World (ex UK)	19.6	14.0	22.0	-3.5	13.3	29.3
Emerging Markets	-1.6	14.7	13.9	-9.3	25.4	32.6
Fixed Interest						
Overseas Bonds (unhedged)	-4.4	5.6	2.7	5.1	-2.3	21.9
Corporate Bonds	-3.0	8.0	9.5	-1.6	4.4	10.6
Property	20.8	-9.5	22.4	-7.8	8.1	-3.0
Cash	0.0	0.0	0.0	0.0	0.0	0.0

Source: MSCI UK IMI, All Country World Ex-UK, Emerging Markets, UK IMI Liquid Real Estate, Cash Equivalent (GBP 1W LIBOR -1%); BofA ML: Global Broad Market+, Sterling Non-Gilts. Total Return, Sterling adjusted.

It seems a long time ago that we were all plunged into a third UK lockdown in January 2021, allowed out for exercise once a day, only seeing members of our 'support bubbles' and solely shopping for necessities. It has since been a fascinating year in capital markets, with developed markets outperforming emerging markets; equities and property delivering strong returns; and fixed interest lagging. Investor sentiment over 2021 has largely been dictated by Covid-19 and the resulting lockdowns and re-openings, as well as inflationary pressure, supply chain complications across the globe and Central Bank rhetoric. But let us not forget that 2021 was also the year of the extraordinary GameStop 'short squeeze', the popularisation of cryptocurrencies and non-fungible tokens ('NFT's), strong Initial Public Offering (IPO) activity and significant sustainable fund inflows. This Investment Comment focuses on the main drivers of market movements over the 3 months to 31 December 2021.

The United States led equity markets over the quarter, with the MSCI USA Index delivering an impressive gain of 8.72%. Contributing factors were a strong third quarter earnings season, an eleventh-hour debt-ceiling rise to $31.4 trillion to avoid government default, tightening monetary policy to combat soaring inflation and a consensus forming that the Omicron Covid-19 variant is less lethal than previous variants. After inflation reached a four decade high of 6.8% in November, investors were actually encouraged by the hawkish December update from the Federal Reserve. The Central Bank is now expecting to raise interest rates three times in 2022 and will begin tapering its bond purchases by $30 billion a month in January 2022, doubling its previous pace and reassuring investors that prices will not spiral out of control. Covid-19 was, of course, another key factor influencing investor behaviour throughout the quarter, but despite volatility in both equity and bond markets as the news of the Omicron variant broke towards the end of November, US equities were largely unperturbed by Covid-19 headlines in December. Investors are now balancing the impact of a new record of nearly half a million daily cases in the US versus the emerging evidence of Omicron being a relatively weak variant.

Concluding a sluggish year for equity returns in both Asia and Emerging Markets, the MSCI Asia ex-Japan and MSCI Emerging Markets Indices fell 0.52% and 0.84% respectively over the quarter. Comprising over 30% of each index, Chinese equities have been the main

drag on performance over the year. The country has faced a number of challenges, including highly restrictive lockdown measures; extreme energy shortages; the Evergrande debt crisis and wider property sector woes; regulatory crackdowns in the technology and education sectors; and geopolitical tensions. In December, The People's Bank of China signalled its first substantial policy loosening since the start of the coronavirus pandemic, freeing up $188 billion in long-term liquidity. Whilst this provided support to equity markets in the first week of December, hawkish monetary policy announcements coming out of the US and fears around a strong reaction to the spread of the Omicron variant weighed on Asian and Emerging Market equities as 2021 came to a close.

The MSCI Europe ex-UK Index posted a gain of 6.00% in the final quarter of the year. European equities fell sharply in November due to surging coronavirus cases, even before the emergence of the Omicron Covid-19 variant. Governments across Europe took a variety of measures to reduce the spread of the virus, ranging from re-enforcing mask-wearing to initiating mandatory vaccination programmes. As Europe enters 2022, the highly transmissible Omicron variant, the re-introduction of restrictive measures across the continent and resulting supply chain complications increase the unpredictability of the inflation outlook. In addition, gas prices in Europe are hovering around all-time highs as concerns over a potential invasion of Ukraine by Russia could disrupt already stretched energy supplies over the winter. However, despite the record November inflation rate of 4.9%, the European Central Bank (ECB) remains relatively dovish, stating that it will scale back its crisis bond-buying but will continue asset purchases for at least 10 months and leave interest rates unchanged in 2022. This caused Eurozone bond markets to fall and equities to rise in the last two weeks of the year.

The MSCI UK Index rose 5.18% in the three months to 31 December. Central Bank rhetoric and a resurgence of Covid-19 cases just in time for Christmas (again) dominated headlines in the UK over the final quarter. Chancellor Rishi Sunak delivered his Budget in the House of Commons on 27 October, exuding positivity around UK debt, short-term growth and unemployment, forecasting the UK economy to return to pre-Covid levels by 2022. In November, the Bank of England stated that inflation is expected to persist into 2022 but reiterated views on the nature of this inflation being 'transitory'. However, upward cost pressure from electricity, gas and other fuels continues to drive prices up, with the inflation rate reaching a decade high of 5.1% in November. The emergence of uncertainty surrounding the new Omicron Covid-19 variant added to a more opaque growth and inflation outlook for 2022, causing significant volatility in equity and bond markets towards the end of November. In spite of December's record daily Covid-19 cases clouding the UK's economic outlook, the Bank of England became the world's first major Central Bank to increase borrowing costs since the coronavirus pandemic began, raising interest rates from 0.1% to 0.25% in an effort to ease inflationary pressure in the UK.

The MSCI Japan Index fell 2.40% over the final quarter of the year. Investors welcomed the results of Japan's lower house election on 31 October, where Fumio Kishida's ruling coalition kept a majority, reducing political uncertainties and re-introducing the potential for fiscal stimulus. The form of this stimulus was announced on 19 November as Kishida unveiled a $383 billion spending package, ranging from cash pay-outs to households, subsidies to Covid-hit firms and reserves set aside for emergency pandemic spending. This sum amounts to roughly 8% of Japan's Gross Domestic Product (GDP). However, optimism about an imminent economic recovery faded as the threat of the Omicron Covid-19 variant emerged, leading to Japan closing its borders. Adding to the waning investor confidence, data released in December showed that Japan's economy contracted by 3.6% in the third quarter of 2021, more than the expected 3.0%.

The impact of the Omicron Covid-19 variant and how Central Banks, notably the Federal Reserve, respond to inflation are likely to be the two key stories as we start the new year. 2022 brings with it a great deal of uncertainty but there is also much about which to be positive, with significant strides being made on climate and ESG factors, medical innovations, vaccines and, potentially, an easing of pandemic-related uncertainty this year. We encourage clients to remain positive and maintain a long-term investment horizon as we continue to make every effort to produce balanced and diversified portfolios, well-positioned for future growth.

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