The Investor

Spring 2022

2022 Investment Outlook – Ireland & the World

The outlook for equity markets over the next twelve months is positive, however the outcome will be dependent on factors such as central bank policy, inflation trajectory and the evolution of the Covid-19 pandemic.

While expectations for global growth in 2021 began at around 5%, it appears the global economy will now have grown by almost 6% last year. Alongside this strong recovery there was a significant pickup in inflation over the course of the year. US inflation rose to a 40 year high of 6.8% while Eurozone inflation rose to an all time high of 5%. The US Federal Reserve has suggested interest rates could be raised three times in 2022, while the Bank of England has already started raising interest rates.

While medical advancements and the adaptability of consumers and corporates have enabled the recovery to remain robust, the emergence of new Covid-19 variants means that the virus has not been eradicated. Risks and uncertainties around the growth outlook therefore still remain. However, given initial signs that the Omicron variant of the virus is less virulent than other variants and that existing vaccines still provide significant protection against severe illness, the negative economic impact from Covid-19 should continue to wane throughout 2022.

Equity markets generated strong returns in 2021 but they did experience a number of modest corrections, associated with:

* *Rising bond yields*
* *Concerns over higher inflation*
* *Tighter central bank policies*
* *Emergence of new Covid-19 variants*
* *Growth concerns linked to China*
* *Political uncertainties*
* *Global supply bottlenecks.*

Equities ultimately recovered from these setbacks and ended the year close to all time highs. While the outlook for equity markets in 2022 is positive, elevated absolute valuations and the array of short term risks facing markets mean volatility will likely remain an issue in the near term.

Inflation returned with a vengeance in 2021. High and rising inflation is detrimental to economic growth and current levels will cause problems if they continue. If higher inflation is persistent then central banks might have to raise interest rates which will slow the economy. This may be negative for both bonds and growth assets if rates have to be risen too much.

While inflation has proven to be more persistent than originally anticipated, investors believe it is close to peaking and that it will ease during 2022. This is due to signs that the global supply constraints evident throughout 2021 are finally beginning to abate, while inflationary pressures from significantly higher energy prices are unlikely to be repeated this year.

Looking forward, the global economy is expected to slow this year with growth of 4.3%. This however remains well above trend growth of 2.7% and exceeds levels experienced in the last economic cycle, following the global financial crisis of 2008. Growth in 2022 will be supported by improving labour markets and a strong consumer, boosted by excess savings built up during the pandemic.

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World GDP Forecasts

	2020	2021 (estimated)	2022 (forecast)	2023 (forecast)
World	-3.6%	5.8%	4.3%	3.2%
Ireland	5.8%	15.3%	7.2%	4.1%
United Kingdom	-9.4%	7.2%	4.5%	1.2%
Eurozone	-6.4%	5.2%	4.6%	3.0%
United States	-3.4%	5.7%	3.7%	2.5%
Japan	-4.6%	1.8%	3.6%	1.2%
China	2.2%	7.8%	5.0%	5.3%

Source: Bloomberg 31.12.2021

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Ireland

The Irish economy has performed extremely well during the pandemic as per headline GDP figures, being one of only a handful of countries to experience positive GDP growth in 2020, with forecast growth of 15.3% and 7.2% in 2021 and 2022 respectively. However, Irish GDP is distorted by several factors which often overstate the true level of growth in the economy, with the performance of the multinational and trade sectors contributing to a misleading picture of growth. Modified domestic demand is seen as providing a truer reflection of growth and, having contracted by -4.9% in 2020, this is forecast to have grown by 5.5% in 2021 and to grow 7.2% in 2022.

Domestic parts of the economy are being supported by a rapidly improving labour market where adjusted unemployment has fallen from a pandemic peak of 31.5% to 6.9%. Numbers employed have risen back above pre Covid-19 levels to 2.5 million. Consumer balance sheets are strong with household net worth at a record €883bn and household deposits at a record €136bn, with estimated excess savings of €14bn gained during the pandemic. Business sentiment readings have also risen sharply and are high in absolute and relative terms against global and European peers.

As is evident elsewhere, inflation rose strongly during 2021 with the most recent reading for Ireland at 5.3%, although this is expected to fall back in 2022, averaging 3.5% to 4% for the year.

Compared to quarter three of 2020, Irish GDP grew 11.4%. Industry (excluding construction) led the way with growth of 33.7% while agriculture was up 21.5% and arts and entertainment up 22.2%. Distribution, transport, hotels, and restaurants grew 8.1% over the 12 months while finance and insurance activities grew 7.2%. Construction over the year to the end of September was down -6.1%.

A strong housing market, with national residential property prices up 13.5%, has contributed to a rise in consumer confidence and retail sales. Although consumer confidence is down from a recent high of 87.2%, concerns related to Omicron are now beginning to ease and this will likely lead to a rebound in the first quarter of 2022.

'Brexit' and the risk of the UK triggering Article 16 remains a potential overhang on the Irish economy. However, the current economic and political difficulties being faced by the UK have reduced the risk of this occurring. Negotiations between the UK and EU are ongoing in an effort to reach a compromise. A compromise is likely to be reached and this would avoid the worst case scenario of retaliatory trade tariffs between the two regions.

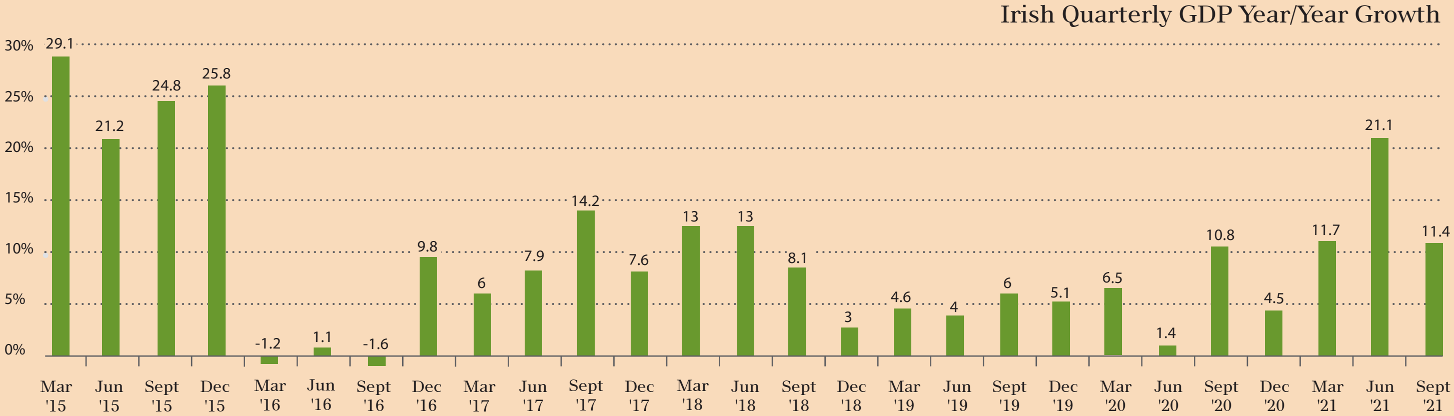
Europe

The Eurozone region suffered more than most following the onset of Covid-19. This was compounded by a relatively slow initial vaccination rollout. The recovery in the Eurozone economy from the double dip recession experienced at the beginning of 2021 gathered pace throughout the final six months of the year. The rebound seen in economic activity was broad based, with all components of domestic demand contributing to the 14.4% annualised rebound in quarter two GDP.

The economy recovered strongly in the second half of 2021 with quarter three GDP rising 3.9%. This moved the economy from the recovery phase into expansionary territory. Recent economic releases across the Eurozone area retain a positive bias despite new Covid-19 cases reaching record highs in several countries at year end, in particular France, Italy and Spain. Data on hospitalisations and deaths is continuing to show a sharp decoupling between infections and severe illness.

In 2022, the driving forces of the re-opening phase of the economy will fade, while supply bottlenecks loosen and energy prices abate. Growth is expected to be supported by an ongoing recovery in the labour market, strong consumer and company balance sheets, favourable financial conditions, and the further deployment of the EU Recovery Fund.

Irish Quarterly GDP Year/Year Growth



Source: Bloomberg 31.12.21

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United States

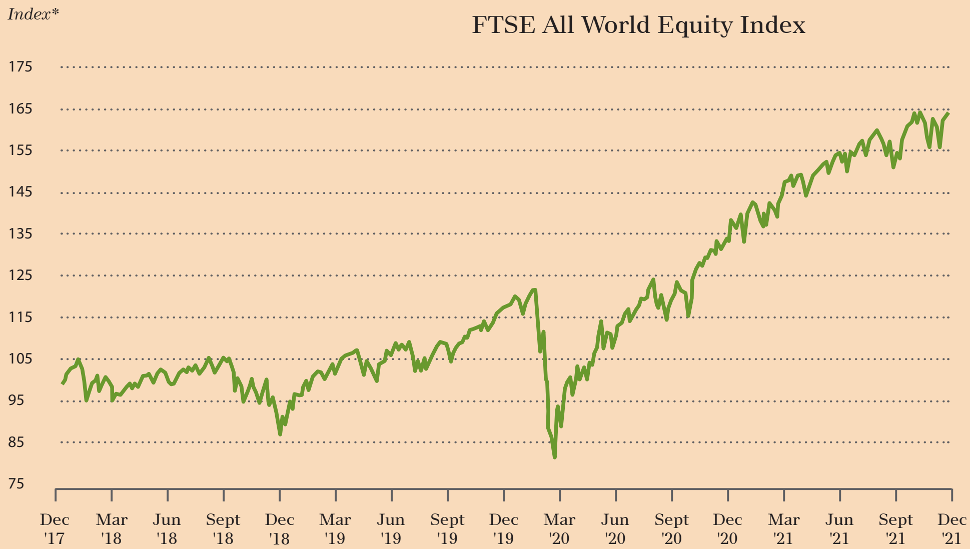
Relative to other regions, a larger and timelier policy response to Covid-19 in the US provided the economy with a strong foundation for a robust recovery from the 2020 pandemic induced recession. A fiscal stimulus package worth $900bn at the end of 2020 set the US economy on a strong footing coming into 2021.

A surge in the Delta variant of Covid-19 cases and supply chain disruptions caused growth to moderate to 2.3% in quarter three of 2021, as inflation surged. This was due to supply chain bottlenecks, semiconductor shortages and rising energy prices, all against a backdrop of rising demand and labour shortages. The modest improvement in economic activity recorded in quarter three was driven by growth in consumer spending and inventory rebuilding.

The US labour market continues to recover with the unemployment rate falling to 3.9% in December, pointing to a sustained recovery in the job market in 2022. Notably, wage pressure has been concentrated in the leisure and hospitality sectors, as well as transport and warehousing, reflecting labour shortages and elevated job openings.

Monetary policy, while turning more hawkish, continues to provide support to the economy through the low federal funds rate and ongoing central bank asset purchases. However, monthly Federal Reserve asset purchases will be tapered at an accelerated pace with net purchases set to end in March 2022, reflecting the strong recovery in the labour market and the current inflationary environment. The Federal Reserve is expected to increase interest rates three times this year.

Despite a slowdown in quarter three of 2021, the US economy is on track to record its best performance since 1984 with quarter four growth forecast at 7% and 2021 growth forecast at 5.7%. Growth is expected to moderate to 3.7% in 2022 before falling to 2.5% in 2023.



**Rebased to 100 as of 02/01/2018*

Source: Bloomberg 31.12.2021

China

Following a strong rebound in the first half of 2021, the world's second largest economy continued its robust recovery from the coronavirus pandemic with a surge in retail sales, industrial production and fixed asset investment. Economic activity slowed rapidly in the second half of the year. Recent economic releases are supportive of an improving growth backdrop.

The Chinese economy is expected to reach 7.8% in 2021 and moderate to 5% in 2022, reflecting less favourable base effects, falling export support and the government's ongoing deleveraging efforts. Fiscal policy should be more supportive of growth in 2022 while the recent cut in the reserve requirement ratio and lending rate also signals a more accommodative monetary policy stance, in contrast to monetary tightening in other major economies.

Growth is expected to moderate to 5% in the year ahead as policymakers concentrate on the quality versus the absolute level of growth in the economy and continue with their common prosperity agenda.

Japan

The Japanese economy has experienced a very sporadic recovery from the Covid-19 pandemic, with quarters of growth and contraction being interspersed throughout 2020 and 2021. Given an initial low vaccination rollout and reduced tolerance for the spread of the virus, which resulted in several phases of restrictions, growth has struggled to recover compared to other regions.

The Japanese economy is expected to have grown at an annualised rate of 8.5% in quarter four of 2021. This rebound is expected to continue into 2022 with growth of 3.6% expected for the year. An economic stimulus package of up to 10% of GDP announced by the new Prime Minister Fumio Kishida has also boosted growth. Risks to growth in Japan for 2022 relate mainly to Covid-19 developments but also to the outlook for global investment and the auto sector, both of which are important in the Japanese economy.

Overall, the Japanese economy is one of the few regions where growth is expected to increase this year, with forecast growth of 3.6% in 2022.

Market Timing

Timing the stock market is very difficult to execute in practice. To maximise growth potential, it may benefit investors to develop a simple long term investment strategy instead. In this article, we explore some of the advantages and key aspects of investing for the long term.

We have all heard the old mantra of 'Time in the market beats timing the market'. Many investors are guilty of trying to time a rising or declining market. When markets are rising and setting new highs, as they did several times during 2021, many investors waited for a pullback to allocate more of their capital. The problem with this strategy is, no one knows with certainty the bottom point of a market. When markets are falling, an investor can invest at a point which appears to be the bottom, but if markets continue to fall, the investor could see the value of their investment drop significantly over a short period of time. The secret to long-term wealth is long-term investing, and some benefits of investing for the longer term are outlined below.

Compounded Returns

Compound return is the rate of return, usually expressed as a percentage, that represents the cumulative effect that a series of investment gains or losses has on an original amount invested over a period of time. The longer your money stays invested, the greater opportunity it has to compound and grow. While compounded returns can have a significant long-term impact, there may be periods where your investments fall in value, and it is important to hold steady during such periods. The value of these compounded gains can turn out to far outweigh your original investment over the longer term.

Eliminate Timing Risk

The guesswork in trying to time the markets is removed by investing a certain amount each month. This is referred to as 'euro cost averaging'. For investors contributing to a retirement plan, this is the strategy they already have in place. Funds fluctuate in price, allowing investors to buy more units when prices are lower and to buy fewer units when prices are higher, all with the same monetary amount.

> *"Hindsight is forever 20/20, but foresight is legally blind. And thus, for most investors, market timing is a practical and emotional impossibility."*
>
> **Benjamin Graham, The Intelligent Investor**

Beat Inflation

Investing in global equities can provide investors with protection against inflation over time. As inflation increases, most companies have a certain ability to pass these cost increases on to their consumers, which protects the investor's capital. This becomes especially important when a longer time horizon is taken. The purchasing power of capital can be greatly eroded over these longer periods if the investments needed to protect your accumulated pot are not made. If you are prepared to take on risk with your investments, you will give yourself the best chance to beat inflation over the longer term.

Know Your Time Horizon

Everyone has different goals when investing, whether that be for retirement, children's education or purchasing a holiday home. Typically, longer term investing means allocating capital for a minimum of five years. If investors want certainty with the value of their investment pot, they should aim to allocate more to less risky investments such as bonds and cash.

Be Fee Conscious

The costs of investing are represented by the Total Expense Ratio (all in cost for investment in a fund) and can have a large effect on your net returns over the long term. Additionally, in years where your funds experience a loss, these losses are further exacerbated by fees. Actively managed funds are typically much more expensive than passive funds. While some active managers generate positive returns above passive funds, it is worth speaking with your Investment Consultant before deciding on an actively managed strategy.

Conclusion

An individual's time horizon is key to deciding on when and what asset classes are best suited to invest in. A shorter horizon may lead to an investment in less risky assets such as bonds and cash, whereas a longer horizon allows for a higher weighting to risk assets such as equities. Switching or selling your investment into cash at the first sign of volatility or falls in the market and other reactionary investments can hurt your investment value over time.
A long-term investment strategy can remove risks such as poor timing and consume far less of your time in researching markets.
This allows the investor to set their investments, hold for the long haul and ignore any noise in markets, while letting their pot grow over time.

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