# ERIKSENSGLOBAL

Actuaries & Investment Strategists

## MARKET PERFORMANCE AND COMMENTARY – DECEMBER 2021

### MARKET PERFORMANCE

| Index | Index Level/Price | 1 Month % | 3 Month % | 1 Year % |
|---|---|---|---|---|
| Global Equities | | | | |
| MSCI Emerging Markets | 743.00 | 1.5 | -0.9 | -0.2 |
| S&P 500 (US) | 4,766.18 | 4.4 | 10.6 | 26.9 |
| Nikkei 225 (Japan) | 28,791.71 | 3.5 | -2.2 | 4.9 |
| FTSE 100 (UK) | 7,384.54 | 4.6 | 4.2 | 14.3 |
| DAX (Germany) | 15,884.86 | 5.2 | 4.1 | 15.8 |
| CAC 40 (France) | 7,153.03 | 6.4 | 9.7 | 28.9 |
| Trans-Tasman Equities | | | | |
| S&P/NZX 50 | 13,033.77 | 2.5 | -1.8 | -0.4 |
| S&P/ASX 300 | 85,688.02 | 2.7 | 2.2 | 17.5 |
| Bonds | | | | |
| S&P/NZX NZ Govt Stock | 1,814.15 | 0.5 | -1.8 | -6.2 |
| S&P/NZX A Grade Corporate | 5,706.40 | 0.5 | -1.4 | -4.4 |
| Barclays Global Agg (Hedged to NZD) | 425.87 | -0.4 | 0.2 | -1.2 |
| FTSE WGBI (Hedged to NZD) | 3,668.28 | -0.9 | 0.3 | -2.1 |
| Oil | | | | |
| West Texas Intermediate Crude | 76.99 | 16.3 | 2.6 | 58.7 |
| Brent Crude | 77.46 | 11.1 | -1.7 | 51.4 |
| NZD Foreign Exchange | | | | |
| AUD | 0.9417 | -1.6 | -1.4 | 0.9 |
| EUR | 0.6020 | -0.2 | 1.1 | 2.3 |
| GBP | 0.5055 | -1.5 | -1.2 | -4.0 |
| JPY | 78.8409 | 2.3 | 2.4 | 6.1 |
| CNY | 4.3537 | 0.6 | -2.2 | -6.9 |
| USD | 0.6847 | 0.9 | -0.8 | -4.9 |

Source: Nikko

Executive summary:

- Equity markets performed well in December
- Global bond yield curves steepened
- New Zealand bonds added value as yields fell
- New Zealand dollar weakened against the AUD and GBP
- Oil and gas prices rose sharply



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## ECONOMIC COMMENTARY

### GLOBAL SNAPSHOT

Markets were relatively stable in December even when the Bank of England raised its cash rate to 0.25% in mid-December. This move surprised some investors. Prominent themes over the month were inflation, tapering economic stimulus and the Omicron variant.

Currently elevated levels of inflation, and near-zero interest rates, mean that the real value of cash is eroding fast. US consumer prices rose 6.8% in the 12 months to November, the fastest rise since 1982. But even more moderate rates of inflation can lead to significant real wealth erosion over time.

Between 2020 and 2021, the stock market seemed to be ignoring mounting coronavirus cases, the loss of jobs and the lockdowns, due to Central Bank and government policies that kept it buoyant.

Is it time to say goodbye to the very stimulatory conditions? In 2022, the Federal Reserve is expected to slow down stimulus to the economy and raise interest rates to fight inflation. Analysts expect that these changes will cause investors to behave differently and take some of the hot air out of the stock market.

Indeed, the spread of the new Omicron variant sparked fears about restrictions on economic activity and prompted a 3.5% sell-off in global equities between 25 November and 3 December.

Early indications suggest that Omicron is more transmissible than Delta: a study from Kyoto University using mathematical modelling found that Omicron was 4.2 times more transmissible than Delta in its early stage, while a study by Pfizer shows that protection from two doses of the Pfizer/BioNTech vaccine is lower for Omicron than for prior variants.

It was a record year for global merger and acquisition (M&A) activity, with stacks of capital and sky-high valuations leading to a whirl of deal-making. The value of M&A globally topped $5tn for the first time ever, according to Dealogic data, beating the record of $4.42tn set in 2007, before the financial crisis.

Seasoned investors aren't buying the hype, though. Even the veteran investor Charlie Munger (Berkshire Hathaway) has said "I consider this era an even crazier era than the dotcom era."

### LOCAL SNAPSHOT

The New Zealand economy proved to be remarkably resilient over the course of 2021, despite the ongoing challenges of the COVID-19 pandemic. By several key macro-economic measures New Zealand is looking good compared to other developed economies. The unemployment rate is low compared to the rest of the world, and economic growth has held up better too. Consumer price inflation has become a major concern, and so has house price inflation. These issues are not unique to New Zealand: most central bankers around the world are wary of tightening labour markets, inflation, and housing markets during 2022.

On 15 December, after 120 days locked within the Auckland border, travel restrictions were eased and Aucklanders flooded through the country – ordering their soy lattes from Cape Reinga to Bluff. However, will domestic tourism be enough to support the tourism industry? Chris Roberts, CEO of Tourism Industry Aotearoa, urged businesses to prepare for more uncertainty in 2022 despite hopes that borders would be able to reopen without seven days of isolation later in the year. In his opinion: "For some tourism businesses, the best decision they can make may be to hibernate, not to dig a hole even deeper, and wait for when it's the right time to reopen."

The first case of Omicron was detected in December. A British DJ arrived in Auckland from Germany via Dubai on December 10 and flew to an MIQ facility in Christchurch. After leaving MIQ he was required to spend three days in home isolation but did not wait to receive a negative day-nine test – as required – before entering the community. The experts have warned that the country is not prepared to prevent the health system from being overloaded by an Omicron outbreak, with likely fatal consequences. Otago University's Dr Nick Wilson and Dr Michael Baker said it is a "matter of weeks" before such a highly transmissible variant seeps into the community due to border failures, and are calling for more restriction on international arrivals. Meanwhile, advocacy groups are calling for less restrictions for arrivals, especially those New Zealanders who chose to stay overseas in 2020 who are now struggling to get a space in MIQ. We're picking safety from Omicron could come down to personal responsibility, and we urge everyone to stay sensible given the risks involved.

## WORLD FINANCIAL MARKETS

### Equities

U.S. stocks finished their final trading session of the year just off record highs, capping off a record-setting 2021, despite COVID19 headwinds. The MSCI All Country World Index (MSCI ACWI) returned 4.0% and the S&P 500 returned 4.4% in December.

All three US indices (the Dow Jones Industrial Average, the S&P 500 and the Nasdaq Composite) finished the month higher than November. December marked the Dow's fifth-straight monthly gain and the Nasdaq recorded a six-month winning streak.

In Europe, the Euro Stoxx 50 returned 5.8% in December. Shares pulled back amid worries that central banks may reduce asset purchases and raise interest rates at a faster pace to contain persistent inflation. Germany's DAX advanced 5.2%, France's CAC 40 rose 6.5% in December, and Italy's FTSE MIB gained 5.9% in December. Switzerland's SMI returned 5.9%. In the UK, the FTSE 100 rose 4.8% in December. In Australia, the S&P ASX 200 returned 2.8% over the month. A happy New Year to all!

### Fixed Interest

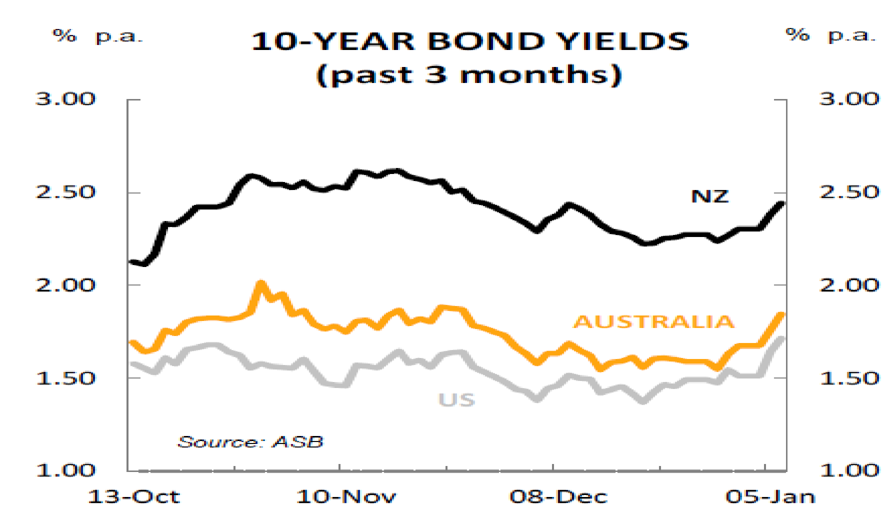
The 10-year US Treasury yield touched 1.80%, its highest level since the onset of the pandemic. Core eurozone bond yields rose with US Treasury yields. Minutes released from the Fed's mid-December meeting justified the need for a faster pace of rate hikes, contributing to a broad sell-off in developed market government bonds. Core yields also jumped in anticipation of eurozone inflation data. Peripheral eurozone bond yields also rose as part of the global sell-off and had even more upward pressure after Italy raised 7 billion euros through a 30-year bond yielding 2.16%, an offer that received 55 billion euros of demand.

US investment-grade corporate bond credit spreads tightened during the first week of January despite an active primary calendar. The usual issuance of new securities at the beginning of the year increases supply and cools down demand from investors. Historically, worsening economic conditions like rising inflation causes spreads to widen – but this hadn't happened by early January. But as investors act on the hawkish tone of the Fed's meeting notes, spreads should drift wider in response.

High yield bonds traded lower due to rates increasing and general risk-off sentiment. Investors also appeared to focus on the reopening of the primary market, which contributed to some weakness in the secondary. Broader risk markets seemed to be assessing the prospect of earlier rate hikes.

NZ Government bond yields have risen sharply over the past year, but the upward lift paused in the last couple of months of 2021. The pattern was similar in the US and Australia, with long-term yields retreating from recent peaks, but still up significantly on year-ago levels. In early 2022, the upward pressure on rates has resumed, as shown in Figure 1. The NZ 10-year government bond yield eased 12 basis points over December but remains around 1.8% higher than the lows reached during the pandemic. The five-year yield was flat over the month, but similarly, is up significantly over the past year. The lift in long term yields over 2021 has already caused significant drops in the mark-to-market valuations of bonds within portfolios.

***Figure 1***




*Source: ASB*

The Australian 10-year government bond yield dipped 27 basis points in November and another 7 basis points over December, but still traded around 70 basis points higher than a year ago. The US 10-year yield has been range-trading around 1.5% over the last quarter of the year. In early January the yield kicked up towards 1.8% and is up by around 125 basis points on the 2020 lows at the time of writing (mid-January 2022).

## INFLATION

Analysts expect inflation to reach 2.7% in Asia, 2.2% in the Eurozone, and 4.2% in the US for the year ending 31 December 2022. The Organization for Economic Cooperation and Development (OECD) says inflation in its 38 member states will reach 5.2% at the end of 2022.

The International Monetary Fund says it expects global inflation to fall back in 2022 once the effects of steep rises in sectors like energy have worked through the figures. However, contributors to the World Economic Forum's Chief Economists' Outlook in November 2021 disagreed about whether inflation would prove temporary or become a major headache for the global economy in 2022. But they added a warning that in lower- and middle-income countries with less stable central banks, price pressures had been building more quickly throughout 2021 and were "at a greater risk of getting out of hand".

Strong consumer demand, continuing supply chain troubles and the emergence of the Omicron variant of the coronavirus threaten to prolong sharply rising prices well into 2022, potentially making inflation the premier economic challenge of the new year. Prices defied many economists' expectations in 2021 by rising at the fastest pace in nearly 40 years. Everything from rent to the price of used cars to groceries climbed higher as the US economy has recovered from the pandemic.

Turkey's consumer price inflation jumped to 36.1% year-on-year in December 2021, up from 21.3% in the previous month and well above market expectations of 30.6%. It was the highest rate since September 2002, when the lira went into a free fall following the central bank's decision to slash interest rates amid soaring prices. The main contributors were food and non-alcoholic beverages, transportation, housing and utilities, furnishing and household equipment, hotels, cafes and restaurants, and clothing and footwear. The annual core inflation rate rose to an all-time high of 31.9% in December. On a monthly basis, consumer prices surged 13.6%, the largest monthly increase on record.

Some businesses may choose to pass higher costs onto consumers and artificially lengthen inflationary problems. This will require central banks to balance full employment with price stability. A rise in interest rates to control inflation may cause record-high asset prices to fall. An increase in the price of the USD may also make it more difficult for developing nations to service their debt, and it could drive economic turmoil in countries like Turkey and Argentina. Should the global economy slow down in 2022, it will be even more expensive for these countries to pay back their US debt.

## GEOPOLITICS

A key topic on the geopolitical agenda was the tension between Russia and the Ukraine, backed by Europe and NATO. Thousands of Russian troops were deployed near the Ukrainian border over recent months, escalating tensions. The reason behind the increase of deployed troops was the willingness of the Ukraine to join NATO. This goes against the Kremlin's doctrine of retaining the status quo on western borders, hence the intimidating military tactics. Ukraine's position has been to distance itself from Russia and its influence. Europe and NATO consider this situation a chance to decrease Russia's influence in the region and add the Ukraine as a buffer between old Europe and Russia.

In response (and in keeping with tradition) Russia has shown its dominance with increasing gas prices through winter. This, in combination with existing problems in the economies of Ukraine and other emerging markets being hit by lockdowns, supply chain disruptions and high year-on-year inflation creates instability. Protest movements are kicking off in these countries, and in the past, all conflicts with the participation of Russia have started with internal protests in Ukraine, Georgia, Moldova, Belarus and most recently in Kazakhstan.

Peaceful demonstrations on the 1 January against the doubling of gas prices overnight due to the removal of a government subsidy, turned into fights with police and military forces across all the major cities within a few days. Information was sporadic due to the government forcing internet blackouts, and it is still unclear how the demonstrations transitioned into bloodshed. But Russian troops, who previously refused to intervene in domestic unrest in Armenia and Kyrgyzstan, despite the Collective Security Treaty Organization (CSTO), were sent as early as 5 January to support the current President's autocratic regime and over 160 casualties and 8,000 detainments have subsequently been recorded. This has set a precedent and shows Russian military force may now be used as a punitive mechanism against protesters, ostensibly to defend the Russian speaking population, but in effect to maintain a brittle blanket of peace in Eurasia. Unfortunately, it's not a solution to the gas price hike and struggling locals who are already faced with around 9% year-on-year inflation.

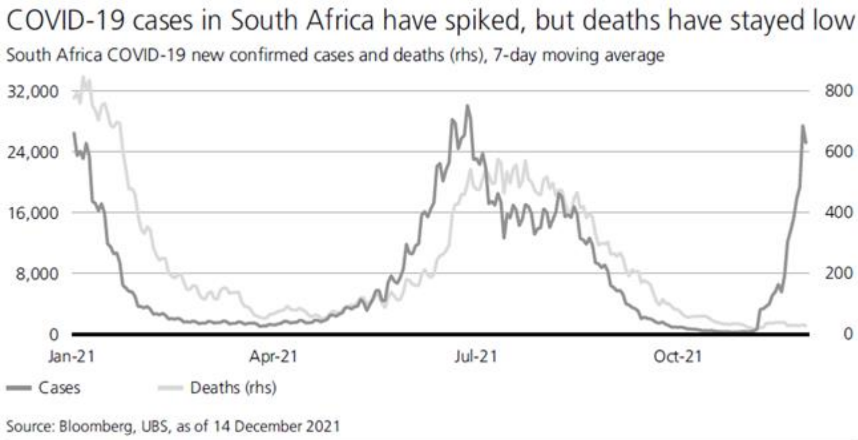
Meanwhile, China's military is developing fast. Recently, the latest the US defence department reported there was a rapid modernization of navy, air, and missile forces. The gap between the size of the US and Chinese armies is reducing and the turning point is expected to be in 2030.

## DELTA, OMICRON, AND WHAT NEXT?

The world was sent into turmoil with waves of Delta and Omicron, and now IHU has appeared on the horizon. But research on all three is progressing apace.

Initial indications suggest that the Omicron variant is relatively mild. Data presented by South Africa's National Institute for Communicable Diseases on the severity of Omicron pointed to "no dramatic increases" in the number of people who need oxygen, ventilators, or needed to be moved to intensive care units (ICU). Nor has the mortality rate increased. The share of hospitalized patients in South Africa's Gauteng province who were in ICU has been no more than 10% since the emergence of Omicron, while the proportion was more than 20% in the first stages of the delta wave (Figure 2).

***Figure 2***



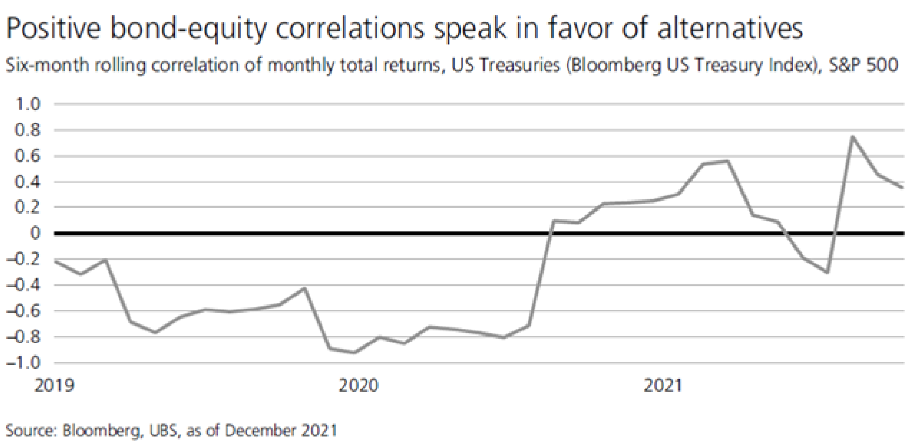

As the highly contagious Omicron variant continues to move around the globe, Raoult (of hydroxychloroquine fame) and his team of researchers at Marseille University Hospital (IHU) have also discovered a new mutation, unofficially named IHU after the hospital. The first cases were identified in Marseille, and likely originated in Cameroon.

The early findings reveal that IHU has characteristics that could make it spread more easily, but not as fast as misinformation. It's probable this "variant from hell" will have the mildest symptoms of them all.

## ALTERNATIVE INVESTMENTS

Higher positive correlations reduce the ability of bonds to act as a portfolio diversifier, and with monetary policy likely to remain a key market driver in the year ahead, equities and bonds could continue to move up and down together. Currently, the correlation between the S&P 500 total return and US Treasuries total return (Bloomberg Barclays US Treasury Index) has moved from negative 0.3 at the end of August to positive 0.35 at the end of November. It was even as high as 0.75 in September 2021 (Figure 3).

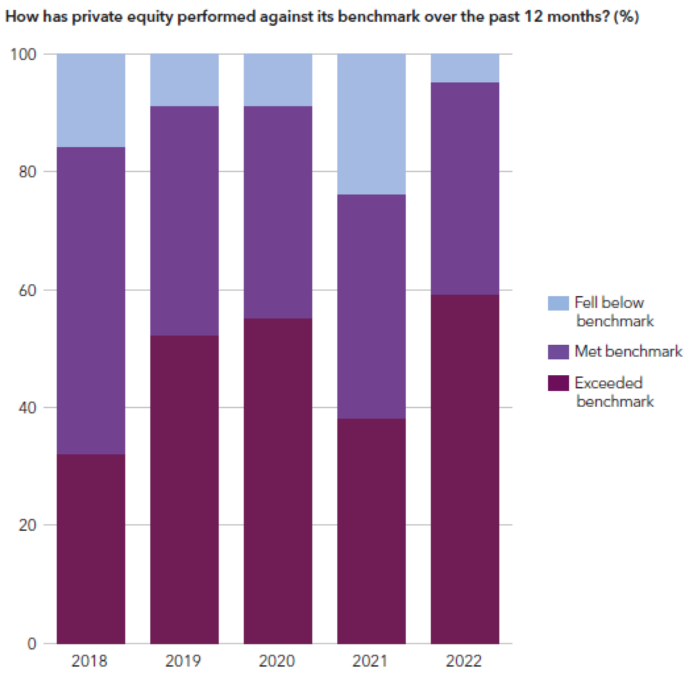
***Figure 3***



The drive to net-zero carbon emissions has emerged as a key theme for many individuals, as well as governments, businesses, and investors. Experts believe it will generate some of the best growth opportunities in the coming decade, from clean energy and carbon reduction solutions to digitalization and electrification. With 136 countries, responsible for 88% of global emissions having pledged to reach net zero, the energy transition has become a critical investment theme.

Private equity may be the only way of accessing these growth opportunities, though. Around 437,000 tech companies globally are privately held, according to PitchBook, compared with just 8,100 listed on public exchanges. Confidence in the asset class is high, and according to Private Equity International's LP Perspectives 2022 Study, 36% of respondents expect the asset class to exceed its benchmark over the next year, while only 8% believe it will fall short. The overwhelming majority (95%) say private equity met or exceeded its benchmark over the past 12 months (Figure 4). An allocation to private equity in your portfolio should confirm this.

***Figure 4***



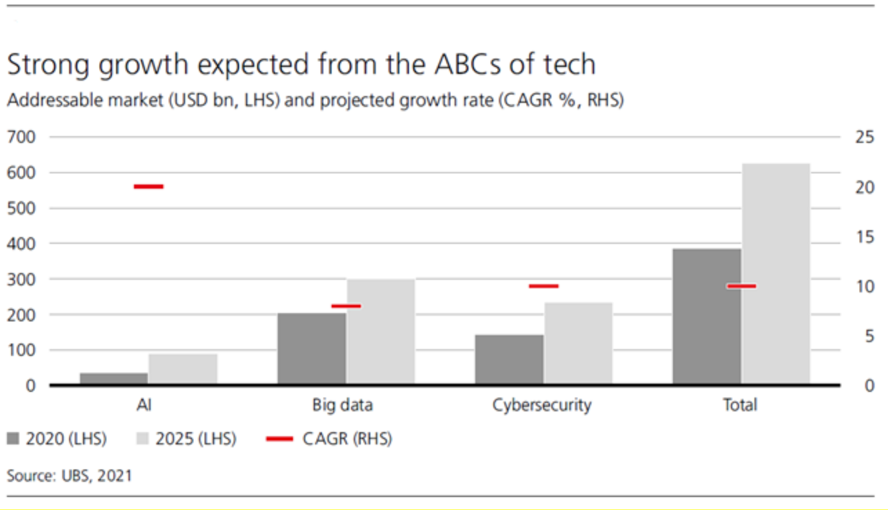

Source: Private Equity International's LP Perspectives 2022 Study

## DO YOU KNOW YOUR "ABC"?

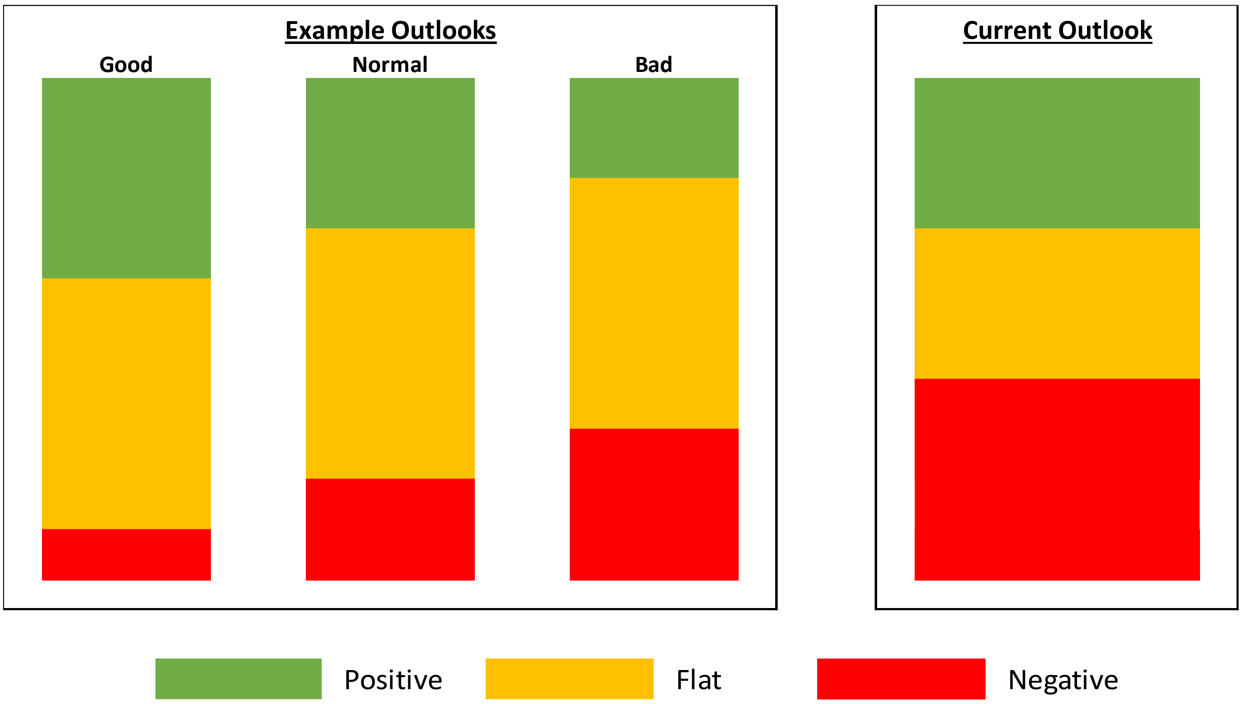
After years of talk of the FAANG stocks, tech investors in 2022 and beyond will need to learn a new language: the "ABCs of technology." The analysts expect growth in Artificial Intelligence (AI), Big Data, and Cybersecurity to outpace the broader tech sector, and investors should look to the small- and mid-cap tech space — as well as private markets — to capture the opportunities they present.

The "ABCs of tech" theme is driven by powerful secular trends in automation, analytics, and security — key strategic focus areas for many businesses. The market for AI services and hardware is expected to grow 20% a year to reach USD 90 billion by 2025 (Figure 5). The global data universe is expanding by a factor of more than 10 from 2020 to 2030, reaching 660 zettabytes—equivalent to 610 128GB iPhones for *every person* on the planet — and presenting opportunities for big data analytics. Digital lifestyles require greater investment in protecting against cybercrime: the average cost of a data breach rose from USD3.9 million in 2020 to USD4.2 million in 2021, according to the Ponemon Institute.

***Figure 5***




## MARKET OUTLOOK




The current market is more likely to have a good return (green) as an average return (amber) over the next two to three years. It is more likely to have a bad return (red). The risk of a correction has increased marginally compared to the last scenario.