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2021 – A Year in Review

With Christmas just round the corner this marks our final market update of the year and as the festive mood takes hold it is right to take time to consider the year that is departing. Much like its predecessor, 2021 has been a challenging period for many with Covid continuing to dominate events, and yet, while the onset of Omicron has raised fears once again, the year hasn't been without its positives and nor has it been one without other major stories affecting society and the economy.

Market Movements

Overall, investment markets have experienced a positive time. The FTSE 100 ended 2020 at 6,460, and ended 21st December 2021 at 7,297. This represents a price return of just under 13%, yet if dividends are included this brings the total return level to just under 17%. Other developed markets have also experienced handsome gains, with Europe roughly matching UK returns, while the US has led the way, with a 30% return achieved by the S&P 500 in sterling terms. Not all equity markets have been so buoyant however, with the FTSE Japan index returning just 5%, while the FTSE Asia Pacific (excluding Japan) has fallen by 0.4% over this period. In other investment markets, cash continues to deliver near zero returns, while bonds have faced losses over the year and especially so in those issued by governments. The FTSE UK Gilt index fell by 4.46% over the period.

A Long Story, Short

These numbers therefore reflect a broadly positive environment, as equities deliver profits in an economic expansion while the fixed return of bonds suffer as inflation devalues their worth. While there is clearly more detail to it, this conclusion is a true reflection of the year we have experienced.

The Cavalry Came

While the spread of the Delta variant and more latterly, the Omicron variant, of Covid-19 have intensified and prolonged the pandemic, the widespread rollout of the vaccines developed in late 2020 has underpinned the economic confidence that drove the positive market movements. Wary of a potential anaemic recovery, central bankers have not simply clung to the coat-tails of the jabs, however, with interest rates maintained at record lows and quantitative easing programmes continuing to push stimulus in the system, with the aim of encouraging demand across the economy. Government policy has also been highly supportive with the US government handing out free money to all citizens while the UK furlough scheme was extended for much of the year to protect labour markets.

The Downside

Such positive monetary and fiscal policy has been impactful with economic growth showing a positive direction over the year. Where such stimulus has caused more questionable results is in inflation numbers. The demand for goods and services across the economy has been at robust levels, yet our collective ability to supply has been heavily constrained.

Supply Chains

The blocking of the Suez Canal by the giant container ship the Ever Given in March was the most high profile supply chain problem of the year, with its six day blockage creating backlogs in global trade months after the event. Brexit also played a part in supply difficulties, with a shortage of foreign workers in haulage and food preparation at least partially blamed on restricted movement of people. And, of course, Covid is also present in this story. Lockdowns and self-isolations have meant companies operating below maximum capacity across multiple sectors, with damaging impacts such as the global semi-conductor chip shortage constraining the supply of new cars and therefore leading to a surge in the price of second-hand cars.

Transitory

In investment circles while the path of the virus continues to be the dominant concern, the path of inflation has been a close second. Delta and Omicron may be the year's hot topics of public health, yet transitory has been buzzword of economists. With the added costs from the supply chain problems discussed above expected to subside as the global economy moves beyond covid, the surge in inflation it created was assumed to be a temporary, or transitory, factor. As inflation rose through the year, central bankers repeatedly referenced the transitory nature as a reason why interest rates could be maintained at their low levels.

Not So Transitory

However, as the year progressed price rises continued to surprise to the upside and became embedded in less transitory areas of the wider economy, such as in rising wages. As such, in the most recent press conferences from the UK Bank of England and its US equivalent, the Federal Reserve, the phrase transitory was side-lined and instead action was deemed necessary. In the UK we have now seen the first interest rates rise while in the US, their quantitative easing programme is to be wound up at a faster rate, paving the way for more aggressive interest rate rises next year.

Market Tolerance

While the emergence of Omicron has refocused attention on the pandemic over recent weeks, the evolving story of inflation has been big news for markets over the year. High inflation and raising interest rates have the potential to drag down equity markets if conditions are seen to be getting out of hand. Yet if managed appropriately, then a rising price level can be supportive. This has broadly been the case for much of 2021 and seems likely to persist into the New Year.

Looking East

While the path of the virus and inflation have been the dominant factors for developed markets over the past year, for emerging markets the prospects of the Chinese corporate sector have also been a key focus. Early in the year a series of regulatory crackdowns were imposed, with the private education sector heavily restricted, with technology companies limited in their behaviour and with the property development sector also subjected to greater limitations.

Overhaul

These policies are part of Beijing's drive towards "common prosperity", a policy aimed at making society more equitable, reducing the split between the haves and the have-nots. The wider impacts of these changes have been mixed. Private education has nearly been wiped out, but this has little impact on the economy overall; large technology firms have had a slap on the wrist, but are not existentially threatened, with Beijing knowing they are the goose that lays the golden eggs; in property development however, there has been the greatest fear of a spill-over event which could threaten China's overall economy and potentially even that of the world.

Dominoes

Infamously known as the world's most indebted property developer, Evergrande has been on the brink of collapse for much of this year as tighter finance restrictions imposed by Beijing limited its abilities to service its debt. Such is the firm's scale, that its failure could bring down other firms in the way that Lehman Brothers was the falling domino to trigger the Global Financial Crisis.

Pessimism Overdone

As such, confidence in Chinese equities has been low this year, preventing Asian equity markets from participating in the broader rally, as described in the opening paragraphs of this article. In our view, such pessimism is overdone as the Chinese government appears suitably active in working towards the managed decline of Evergrande without a catastrophic explosion. This view is also increasingly prevalent amongst investment markets, with the underperformance of China slowing in the latter parts of the year. This story is not yet complete, however, and therefore will likely be one which also runs into 2022.

In Summary

Covid, inflation and China have been the major stories of investment markets over the year. Of course, there have been any number of other developments that have also impacted market confidence, such as political wrangling over infrastructure spending and the debt ceiling in US, or with the remaining loose ends of Brexit, namely the Northern Ireland protocol and the threat of Article 16, looming large. Yet, despite what has been a busy year of negative headlines, investment markets have, on the whole, been positive. This reflects a global economy which has sufficient strength to continue growth despite the setbacks so far faced. While difficulties will persist and the extent of the Omicron wave's impact is yet to be seen, at this stage it seems likely that a positive global economy can be maintained. Like 2020, there have been many challenges faced, but thanks to the rollout of effective vaccines and the supportive stance of both governments and central banks, investors in 2021 have been rewarded for their patience.

Happy Christmas!

All that's left therefore is to thank you, our readers and clients, for your support throughout 2021, we wish you all a Happy Christmas and a Prosperous 2022!

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