MERRION INVESTMENT MANAGERS | CANTOR Fitzgerald

Strategy & Outlook

MARKET UPDATE

DECEMBER 2021

November: This month saw volatility return with a vengeance, across bonds, equities, FX and commodities. Most of the excitement at an index level came towards the end of the month as the Omicron variant of covid raised fears about vaccine efficacy, although the relative calm at an index level before this news masked a significant pickup in single stock volatility from mid-October, with earnings misses/warnings being badly punished and some popular retail stocks going parabolic. The backdrop suggested growing complacency in the market. We witnessed the largest net speculative positioning in US index futures and call options over the last 20 months, after a 100% rally in the index, just when policy uncertainty is at the highest it has been since pre-Covid. Sentiment was beginning to look very stretched, with very low readings on the US equity put/call ratio and the NAAIM survey of active investment managers at the highest level since February, while technical indicators suggested US indices in particular were over-extended. In addition, the rally was becoming more concentrated and driven by large cap growth names, so that even as US indices pushed to new all-time-highs, the number of stocks making new 52-week lows exploded higher.

Throughout this, the “inflation is transitory” message of central banks was being increasingly challenged by the evidence, yet the Fed Chairman managed to thread the needle at the post-FOMC press conference, giving a still-dovish message. Towards the end of the month however, that complacency was shocked by two events – the emergence of the Omicron strain of Covid and an increasingly hawkish twist from FOMC members, in particular Jay Powell on the final day of the month, driven in no small part by the politicisation of the inflation narrative, the Biden administration saying that fighting inflation was now a key aim.

The result was what looks at first glance a small drawdown in equity markets on the month (-0.4%). The rally in the US dollar flattered this however, global equities being 2.5% lower in dollar terms, and more importantly an almost 4% rally in global equities was reversed in the last week of the month. Value once again underperformed, the MSCI Value Index falling by -4% vs -1% for the Growth Index. Global equities now sit more than 23% higher year-to-date in euro terms, albeit flattered by the 7% drop in the Euro vs the US dollar.

Emerging markets continue to struggle, not helped by weak results (and outlook) from Alibaba, continued uncertainty about the Chinese property sector, and the strong US dollar. The dollar’s strength has been driven by diverging monetary policies, the market now pricing almost 3 rate hikes next year from the Fed and almost nothing from the ECB. Inflation, as mentioned above, is now political and heavily influenced by energy costs, President Biden tapping the SPR to ease gasoline prices in the US. This adds to the pressure on the Fed to tighten policy either sooner or faster, whilst elevated energy prices in Europe and increasing Covid related restrictions will dampen growth expectations, giving the ECB the cover they need to remain dovish (for now). Adding confusion to the mix, the oil price has fallen by more than 20% from the recent high on Covid concerns. Much of the recent spike in inflationary pressures is likely to dissipate, but in the short-term the pressure on central banks (the Fed in particular) to take action will remain high.

Positioning

Having reduced exposure in late October we entered the month close to the mid-point of our asset allocation range, primarily via underweight positions in emerging markets. Over the first three week of November we continued to reduce exposure as risk-reward became less favourable, trimming positions that have performed very strongly and therefore reducing growth asset exposure towards the lower end of the range. Despite the many exciting medium to long term investment opportunities available, having a much-reduced level of risk is, we feel, the prudent course of action, at least in the near-term. Policy uncertainty is high - geo-politics in Europe, the covid policy response globally, the new Omicron variant, and central bank reaction functions with rates at the lower bound and inflation remaining persistent.

Despite being underweight risk and steadily reducing exposure over the month, returns remained very strong (MMA30: +1.2%, MMA50: +1.0%, MMA70: +0.9% for the month to stand +10.6%, 15.7% and +20.5% year to date respectively). This is due to the broad and exciting opportunity set available and our active management across all aspects of the funds.

WARNING: Past performance is not a reliable guide to future performance.
WARNING: The value of your investment may go down as well as up.

MERRION INVESTMENT MANAGERS | CANTOR Fitzgerald **Want to talk to us about investments? Contact us.**

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