January 2022 | Monthly update

Omnis Managed Portfolio Service

Omicron infection rates have hit record highs, with cases rapidly climbing globally. The good news is that early evidence suggests the symptoms Omicron causes are less severe. Combined with the rapid rollout of vaccine boosters, hospitalisation and death rates are now much lower than initially feared.

After Omicron sent shockwaves through global markets at the end of November, the year ended on a positive note as worries about the new variant dissipated. The S&P 500, Dow Jones Industrial Average and Nasdaq Composite all closed the year with strong gains despite the pandemic. The FTSE 100 recorded its best year since 2016, with shares rallying by 14.3% during 2021.

Inflation continued to rise

Rising infection rates, looming inflation and soaring energy bills have further dampened the outlook for the UK. The inflation rate rose to 5.1% in the 12 months to November, up from 4.2% the previous month, and its highest level since September 2011. This forced the Bank of England to raise interest rates for the first time in more than three years to 0.25% from 0.1%.

We expect economic conditions in the UK to remain challenging, with higher energy costs, rising National Insurance contributions and interest rate hikes hitting disposable incomes, making people worse off. Though higher inflation in the UK may prove more stubborn than elsewhere, we expect it to fade over the second half of the year. Coupled with the challenging growth outlook, this means we may see fewer than the three interest rate hikes the market is predicting for 2022.

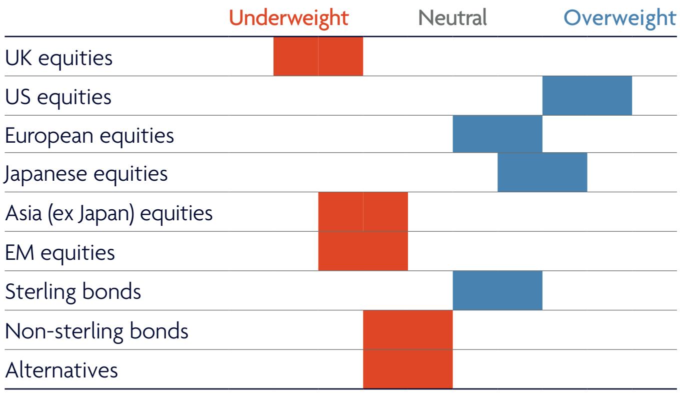
US inflation hit a 39-year high in November, putting pressure on the economic recovery. The Federal Reserve, the US central bank, said it will quicken the pace it withdraws its pandemic-era bond purchases, opening the door for higher interest rates – perhaps as soon as March – to combat rising prices.

We can expect more people to return to work. Omicron may have stalled the return to work for many, but as we move into 2022, we can expect more people to return to the labour market, which benefits the US economy.

The euro zone's inflation rate rose to a record high of 4.9% in November, putting further pressure on the European Central Bank (ECB) to review its policy of ultra-low interest rates. The ECB trimmed its emergency pandemic response policies but pledged to continue its unprecedented monetary policy support for the region's economy into 2022.

While Turkey's inflation rate has hit 36% amid financial turmoil and a slump in the lira, this is unlikely to spread to other emerging markets. China's energy crisis is now easing, allowing the economy to stabilise. However, confidence in China's property sector continues to deteriorate following tighter regulations, including limits on how much property developers can borrow.

Asset allocation



Investment strategy

The reduced threat of the Omicron variant means the global economic outlook is now looking more positive than last month. However, ongoing Omicron concerns, obstacles to fiscal support and the possibility of interest hikes pose challenges to the growth outlook.

We reduced our exposure to UK equities due to the deteriorating economic outlook. With a more favourable US outlook, we increased our US equity allocations. While we were overweight European equities for a significant portion of 2021, we marginally reduced our position as the region's catch-up story has now played out.

Amid growing economic uncertainty, we increased our position in gilts (bonds issued by the UK government) as insurance against a more volatile market. We believe inflation will fade and central banks won't tighten policy as aggressively as the market thinks – a positive outcome for bonds. While this journey might be bumpy, we're willing to accept this as high-quality bonds remain the best insurance against equity risk.