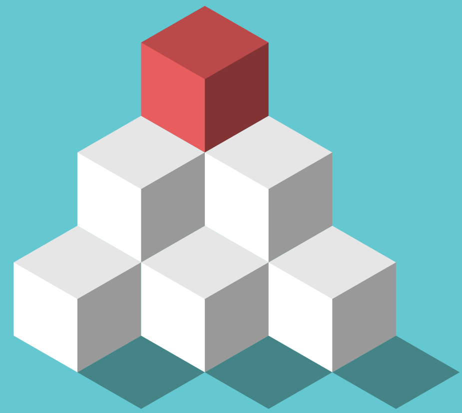


A bumpy ride higher for equities

Melda Mergen, Global Head of Equity

The coronavirus continues to introduce uncertainty, but investors should expect cyclicals to outperform in the first half of the year. Here we identify key catalysts for equity markets.

Covid-19 will continue to impact the economy and markets

We entered 2021 with the prospect of new vaccines taming Covid-19 and that effort proved transformative in developed markets. The coronavirus persists, however, and its impact will continue to be felt in 2022 as the pandemic plays out. New therapies to prevent serious illness are very promising, but expect a focus on Covid and a return to normal life to continue in 2022.

Gauging a company's exposure to lingering Covid impacts – and lasting Covid changes – will be an important component of research in 2022. Another important Covid carry over is that we expect cyclicals to outperform in the first half of the year, especially given expected ongoing economic reopening and above-average GDP growth.

Supply chain disruptions will start to improve – eventually

The pandemic was the proximate cause of supply chain disruption, shuttering manufacturing facilities globally. For industries with "just-in-time" inventory practices this was extremely challenging, as replenishing exhausted inventories proved nearly impossible, or at the very least very expensive. We expect elements of the supply chain to improve over the course of 2022, but there is still a significant backlog and wide variation among companies in their access to materials and success in passing costs on to consumers.

The seized gears of the supply chain caused many to speculate that the world would move manufacturing away from China or even onshore production. But the considerable cap ex required to drive that radical change seems unlikely. What is likely to change, however, is how much inventory companies decide to hold, and that means that focusing on inventory levels and pricing power as part of fundamental research takes on heightened importance. There will be clear winners and losers in this environment, and active positioning will set investors up for success, especially in the context of cyclical opportunities in the first half of the year.

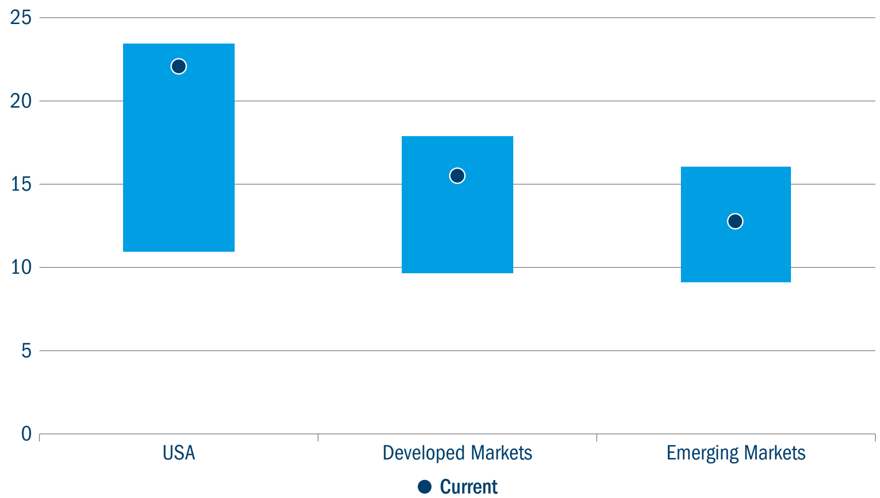
Higher rates, lower valuations?

Historically, higher interest rates have correlated with lower equity valuations. Higher rates in 2022 could put equity multiples under pressure, which means it is important to know what you are paying for. For investors whose value exposure is below their strategic allocation, 2022 could be a good environment to increase that allocation. That said, cheap is not an investment thesis; in an environment of greater dispersion, understanding the fundamentals of a company relative to the price is essential.

Investing in the US versus elsewhere

Equities are expensive in most regions, but on a relative basis valuation metrics are more attractive in Europe and emerging markets (EMs) than the US (Figure 1). Headlines around China and inflationary pressures may cause some anxiety regarding EMs, but a strategic allocation still makes sense as long as it fits your risk tolerance.

Figure 1: Global equity valuations – few places to hide



Source: Columbia Threadneedle based on IBES estimates. Charts show global P/Es high/low/current from 10/2011-10/2021. P/E is calculated using the following indices: US, MSCI USA Index, designed to measure the performance of the large and mid-cap segments of the US market. Developed markets: MSCI Europe, Australasia, Far East (EAFE) Index is a capitalisation-weighted index that tracks the total return of common stocks in 21 developed-market countries. Emerging Markets: MSCI Emerging Markets Index (EMI) is a free float-adjusted market capitalisation index designed to measure equity market performance in the global emerging markets. It is not possible to invest directly in an index.

Real capital is flowing to responsible investment

Investor interest in responsible investment has been rising over the past few years, and this should accelerate in 2022. Environmental challenges such as a warmer climate, limited water or wildfires each pose risks to companies, and thinking about those risks as you conduct your fundamental research is a way of protecting your portfolio.

A bumpy ride higher

I expect headline risk in 2022, especially around inflation, interest rates and energy prices. I don't see a catalyst for a big equity swoon, but that doesn't necessarily mean we get to a place that is higher than the beginning of the year smoothly. I expect greater dispersion among winners and losers because of the stresses of supply chains, inflation and the cost of doing business, and higher rates. Investors need to be selective about what they own. The highest growth stocks are likely to be subject to greater volatility as interest rates rise.

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