The investment landscape in 2022

While bonds will suffer as rates rise, equities should deliver decent single digit gains as strong corporate profits offset a decline in stocks' earnings multiples

For all the fears that markets are at a turning point, next year is likely to result in a continuation of 2021's trends, albeit with 'less of the same'.

The economic and market recovery triggered by the removal of Covid-19 lockdown measures is intact, if in its final phases.

Record valuations, tighter monetary policy, expansionary fiscal measures and surging inflation point to modest gains for equities in 2022 following the market's robust recovery from pandemic lows.

A US rate hike next summer will push up global bonds yields, though the magnitude of the move will be mitigated by the fact that the US Federal Reserve and other central banks remain concerned about maintaining growth and employment rather than sticking narrowly to their inflation remits.

Based on our asset allocation framework, which takes into account economic conditions, liquidity, asset class valuations and technical readings, we expect equities to deliver single-digit returns for global stocks in 2022, with strong growth in corporate profits more than offsetting a contraction in equities' earnings multiples.

Conditions for bond markets will be tougher, however, with US Treasuries (which set the trend for the fixed income market generally) expected to post losses on the year even though yields on the 10-year note will struggle to rise above 2 per cent.

With real yields on inflation protected bonds at an all-time low, this part of the market will also fail to deliver for investors.

We believe the global economy will remain strong – at the very least returning to pre-pandemic trends of activity – with both growth and inflation above trend for another year.

Consumption of services should pick up, closing the gap with goods consumption – and there's significant upside here: hotel bookings and air travel reservations are still less than half of their pre-pandemic levels.

At the same time, supply bottlenecks should ease with the lessening of mobility restrictions in key Asian economies. Not only will this feed end demand, but it will also allow for depleted inventories to be restocked.

Equities: Mid-cycle tug of war

For equities, the easy road is coming to an end after three years of stellar double-digit returns.

However, we remain cautiously optimistic. Within equities, we expect cyclical value markets and sectors to outperform in 2022 as economies continue to re-open and bond yields rise.

We remain very cautious on emerging market equities (and emerging market assets in general) in the short term. The current pace of growth in developed markets, especially in the US, makes the hurdle for EM outperformance very high when adjusting for the risks inherent in investing in the developing world.

However, we think a rotation back to emerging markets is likely in the second half of 2022, contingent on improved macro-economic momentum and an end to – or significant slowdown in – the pace of monetary tightening across the developing world.

Fixed income:Another challenging year

Fixed income investors should brace themselves for another challenging year. As the global economy recovers from the Covid recession, supply bottlenecks and rising energy and commodity prices are pushing inflation higher, prompting major developed and emerging market central banks to tighten monetary policy.

Markets are pricing in the possibility that central banks in the US, euro zone and the UK will have raised interest rates by at least once by the end of next year.

In this challenging backdrop for the asset class, Chinese government bonds continue to stand out with an attractive yield, a proven track record of diversification benefits and relatively muted inflation dynamics. What is more, they are denominated in a currency that we believe should appreciate over the long-term thanks to powerful structural trends.

Written by Pictet Asset Management chief strategist, Luca Paolini

In association with

PICTET Asset Management

Information, opinions and estimates contained in this document reflect a judgment at the original date of publication and are subject to risks and uncertainties that could cause actual results to differ materially from those presented herein.