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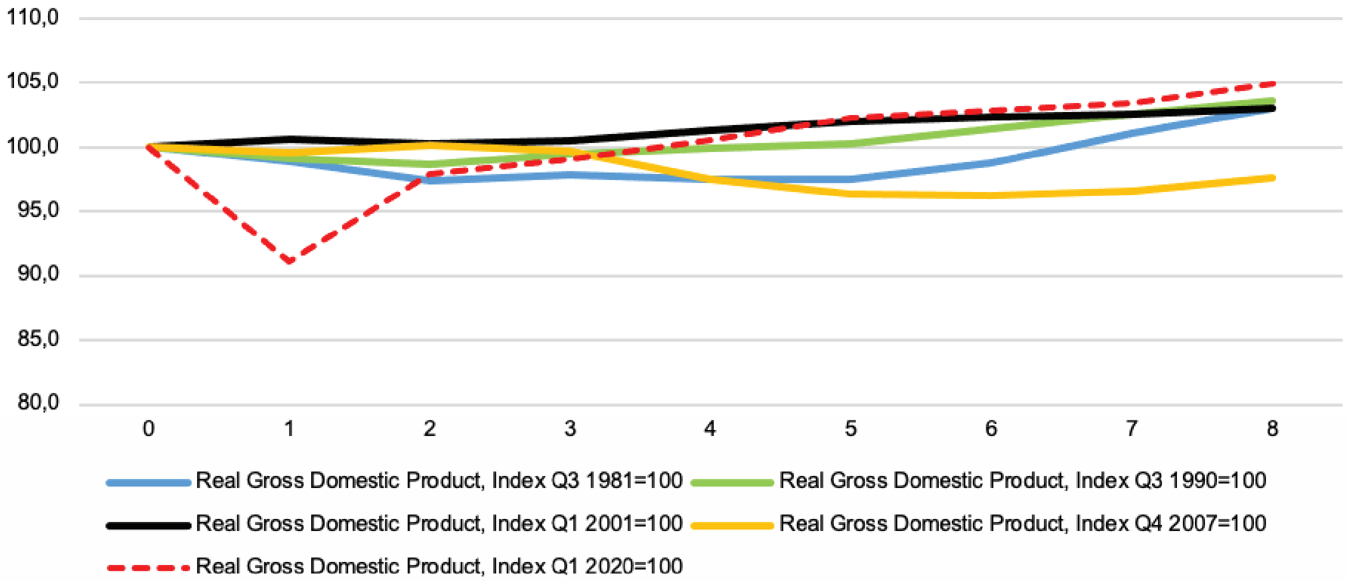
Looking back at 2021

The remedy year for Covid-19 stricken markets

History has shown repeatedly that when humanity is faced with great adversity and crisis, the human spirit manifests a resilient and resolute nature to survive and emerge stronger. The last two years have truly been testament to this with the Covid-19 pandemic all but nearly decimating our 'normal way' of life, plunging the world into panic and impacting global trade and business. However, in a monumental coordinated effort, governments around the world provided unprecedented economic support and rallied the aid of medical science to establish a vaccine specifically to minimise the blow dealt by the Covid-19 pandemic. The subsequent effect of these decisive actions has resulted in the fastest post-recession economic recovery recorded in 80 years, as depicted by the US GDP growth graph below.

US post-recession GDP growth recovery



Source: US Federal Reserve Data, 2021

This phenomenon was also experienced by countries the world over in 2021, with some even emerging with stronger GDP growth trajectories and prospects than before the Covid-19 pandemic.

As we enter into a new year, it is imperative to reflect on the recent past and take stock of the economic and market challenges that we have overcome, but also to realise the opportunities that emerged to assist investors in the arduous task of wealth creation. From the lows of the Covid-19 sell-off to the market highs experienced in 2021, investors have experienced a surreal rollercoaster ride. In hindsight, returns were there to be had as investors had the chance to buy the dip on several occasions, but this did come with volatility and uncertainty. The trend of clients de-risking their portfolios to multi-asset income and money market funds continued despite strong equity returns.

Market performance

Asset Class Returns In ZAR

2017	2018	2019	2020	2021
LOCAL EQUITY 20.95%	GLOBAL CASH 18.95%	GLOBAL EQUITY 24.11%	GLOBAL EQUITY 21.75%	GLOBAL PROPERTY 41.28%
LOCAL PROPERTY 17.15%	GLOBAL BONDS 14.80%	GLOBAL PROPERTY 20.64%	GLOBAL BONDS 14.70%	LOCAL PROPERTY 36.94%
GLOBAL EQUITY 10.81%	GLOBAL PROPERTY 10.72%	LOCAL EQUITY 12.05%	LOCAL BONDS 8.65%	GLOBAL EQUITY 32.36%
LOCAL BONDS 10.24%	LOCAL BONDS 7.69%	LOCAL BONDS 10.32%	LOCAL EQUITY 7.00%	LOCAL EQUITY 29.23%
LOCAL CASH 7.54%	LOCAL CASH 7.25%	LOCAL CASH 7.29%	GLOBAL CASH 5.74%	GLOBAL CASH 8.83%
GLOBAL PROPERTY -0.98%	GLOBAL EQUITY 6.07%	GLOBAL BONDS 3.86%	LOCAL CASH 5.39%	LOCAL BONDS 8.40%
GLOBAL BONDS -2.78%	LOCAL EQUITY -8.53%	LOCAL PROPERTY 1.92%	GLOBAL PROPERTY -3.27%	LOCAL CASH 3.81%
GLOBAL CASH -8.30%	LOCAL PROPERTY -25.26%	GLOBAL CASH -0.47%	LOCAL PROPERTY -34.49%	GLOBAL BONDS 3.54%

Source: Morningstar Direct & Graviton, 2022

With reference to the asset class returns above, barring local equity and property in 2018, and local property in 2020, one would assume that the general market was ticking along nicely. The calendar year returns mask the drawdown experienced during the Covid-19 sell-off and the subsequent bouts of volatility and drawdowns. Investors were rewarded for taking on risk during 2020 and 2021, but during these sharp drawdowns, it is extremely difficult to stay invested or to use this as an opportunity to enter the equity market.

The best performing asset class for 2020 was global equity, followed by global bonds, which can be attributed to easy monetary policy. Meanwhile, local property was the main laggard adding to the woes of previous years as hard lockdowns caused investors to question the need for large office spaces and malls. 2021 was truly a risk-on year with global property being the standout performer, while global bonds were the main laggard, despite posting a positive return for the year. Both global equity and local equity also posted stellar returns for the year.

Wave after wave

The volatility experienced in markets with each new Covid variant gripping the world brings to mind the iconic words of Robin Schultz, "Wave after wave...slowly slipping". The market, however, had an uncanny ability to look through each new Covid wave, with more information disseminated than ever before on a specific topic. This allowed investors to digest the short- to medium-term impact on global trade and corporate earnings. The effect of the widespread Covid-19 vaccination roll-out in 2021, coupled with unprecedented monetary and fiscal support, provided the perfect environment for pent-up consumer demand to translate into large scale consumer spending, causing major rebounds in profit margins. This was the main underpin that drove stock prices higher.

In the US, the S&P 500 earnings were projected to be up 45% year-on-year in 2021, according to FactSet, an unusually high rate of growth resulting from strong corporate earnings and an easier comparison to weaker earnings in 2020. Globally, the MSCI's 50-country world index added roughly 20%, thanks to the Covid recovery signs and central bank stimulus. The S&P 500 gained 27%, while the tech-heavy Nasdaq 100 was up 22%. European banks had their best year in over a decade with a 34% gain. 2021 also saw breadth return to the market as a shift in 'work-from-home' stocks to 'return-to-normalcy' stocks dictated much of the flow in capital markets. Subsequently strong recoveries were seen in the oil and natural gas, real estate, travel and financial sectors. Emerging market equities unfortunately had a dreadful year, returning -2.56% in US dollars, led by a 30% plunge in Hong Kong-listed Chinese tech hit by Beijing's moves to limit their influence. This situation was exacerbated with the Chinese property market also experiencing a crash during the year.

Monetary policy and currency moves

Global currency markets experienced bouts of strong volatility throughout the year, driven by a shift in some central banks' policies, new Covid-19 variants and escalating geo-political tensions. The US Dollar Index trended more than 6% higher in 2021, its biggest annual gain in six years. Market participants anticipate a further rise in the US Dollar Index in 2022 given strong indications of three to four interest rate hikes by the US Fed over the calendar year. The euro endured a difficult year against the US dollar, sliding approximately 6%. Given the ECB's expectations of not raising interest rates in 2022, a further decline in the euro may ensue. The British pound had a "mixed" 2021, falling more than 3% against the US dollar but rising 6% against the euro. The Bank of England also led the interest rate hiking charge amongst major central banks, lifting its funding rate from 0.10% to 0.25% in December 2021.

Emerging market central banks were more proactive in tightening their monetary policy in 2021, with countries such as Brazil raising interest rates by almost 6%, followed by Russia raising its interest rate by more than 4%. Overall, emerging market currencies endured a tough time against the US dollar, with currencies such as the Turkish lira falling 44%, the Mexican peso giving up 3.1%, the Indian rupee down 2.0% and the Russian ruble sliding 1.5%. The rand moved with emerging market peers, and continued to lose ground against most developed market currencies. This was largely driven by concerns over the present Omicron variant in South Africa contributing to its downfall.

Period up to 31 December 2021	1 year	3 year	5 year
Currency	**% change**	**Ann. % change**	**Ann. % change**
RAND vs US$	-7.97%	-3.40%	-3.03%
RAND vs EURO	-0.98%	-3.24%	-4.48%
RAND vs GBP	-7.12%	-5.37%	-4.78%

Source: IRESS & Graviton

In crypto currency news, 2021 saw a tumultuous ride for investors with Bitcoin opening the year at a level of $29 388, peaking at $67 582 in early November before simmering down to the $45 000 level at year's end. Other alternative crypto currencies such as Ethereum recorded stellar gains in excess of 400% for the year, opening at $762 and closing at a level of $3 500.

Style performance

It has been well-documented that the last decade has seen a major divergence between growth and value performance, the latter lagging the former by quite some distance. However, as the recovery in world markets was spurred by the optimism of economies re-opening on the back of widespread Covid-19 vaccination programmes, 2021 saw a major rotation from high-flying growth stocks to depressed value stocks. Globally, the MSCI World Value index (+32.50% in ZAR) outperformed the MSCI World Growth Index (+31.67% in ZAR).

However, this picture doesn't reflect the disparate performance within growth stocks as can be seen within the Nasdaq 100, where approximately 40% of constituents traded 50% lower from their 52-week highs. Exacerbating the situation was the fact that the growth index's strong returns were driven by a narrow cohort of stocks such as Tesla, Facebook, Alphabet, Amazon, Apple, Microsoft, Netflix and Nvidia.

Locally, the rotation was more pronounced with the SA Value Index (+39.34%) outperforming the SA Growth Index (+18.46%) by more than 20%. From a market cap perspective, the broader recovery in equities was led by a phenomenally strong performance in SA small cap stocks, up 59.08%. Beaten down value sectors, such as Travel (+107.40%), Chemicals (+83.28%), Pharmaceuticals (+76.33%) and Construction (+55.61%) staged an impressive recovery. Notable stock moves included strong performances from MTN (+183%), Royal Bafokeng Platinum (+161%), Tsogo Sun Hotels (+141%), Sun International (+129%), Arrowhead Properties Class B (+103%) and Sasol (+93%).

Investment Styles In ZAR

2017	2018	2019	2020	2021
SA QUALITY 35.78%	GLOBAL MOMENTUM 12.99%	GLOBAL QUALITY 32.28%	GLOBAL GROWTH 40.58%	SA VALUE 39.34%
SA GROWTH 25.56%	GLOBAL QUALITY 9.80%	GLOBAL GROWTH 29.95%	GLOBAL MOMENTUM 34.73%	GLOBAL QUALITY 36.53%
GLOBAL MOMENTUM 19.58%	GLOBAL GROWTH 8.36%	GLOBAL MOMENTUM 24.11%	GLOBAL QUALITY 28.37%	GLOBAL VALUE 32.50%
GLOBAL GROWTH 15.89%	GLOBAL VALUE 3.67%	SA MOMENTUM 23.11%	SA GROWTH 19.20%	GLOBAL GROWTH 31.67%
GLOBAL QUALITY 14.03%	SA VALUE -4.44%	GLOBAL VALUE 18.35%	SA MOMENTUM 10.73%	GLOBAL MOMENTUM 24.56%
SA VALUE 12.15%	SA GROWTH -11.51%	SA GROWTH 17.87%	GLOBAL VALUE 3.82%	SA GROWTH 18.32%
SA MOMENTUM 7.62%	SA MOMENTUM -11.72%	SA VALUE 6.14%	SA VALUE -5.94%	SA MOMENTUM 7.89%
GLOBAL VALUE 6.01%	SA QUALITY -12.75%	SA QUALITY 0.52%	SA QUALITY -7.48%	SA QUALITY 4.31%

Source: Morningstar Direct, S&P & Graviton, 2022.

This sharp cyclical rotation illustrates the importance of maintaining a diversified approach to various equity style betas through the cycle.

What are some of the risks for 2022?

The biggest risk is the one that is unexpected or one that is completely leftfield. One of the challenging aspects of the current environment is that there are no real historical parallels to compare this to. Below are some of the risks from a local and global perspective.

- Inflation – one of the buzz words for 2021 was 'transitory', and if higher inflation will indeed be short-lived. Inflation in both the US and Europe has jumped on the back of supply and demand mismatches, as well as the energy crunch. Inflation will be higher and should settle at levels above what they were pre-Covid even though supply chain bottlenecks should ease. The concern is that central banks become complacent in keeping inflation at bay and that inflation is structurally higher for longer.
- Central bank policy error – key to 2020 and 2021 was the guidance provided by global central banks to the market with respect to their policy decisions. For 2022, central banks will be withdrawing some monetary policy support and start their interest rate hiking cycle. However, global central banks are at different stages in terms of their interest rate and inflation outlook. The risk is that market participants overreact to central banks as they either act too much or too little.
- Global growth slowdown – there are various factors which could lead to a slowdown in global growth such as more supply chain disruptions and the re-imposition of lockdowns. Although global growth is expected to be lower this year with consensus estimates around 4%, it is still expected to be above trend, which is supportive of risk assets.
- Covid – the risk is that there is another variant that becomes vaccine resistant and as a result, hard lockdowns are re-imposed. The positive news around the Omicron variant is that it has less severe symptoms relative to the Delta variant despite being more contagious. With respect to China, they have imposed a "zero-Covid" policy where there is a potential risk to global supply chains that could be inflationary if more cities are locked down.
- Geopolitics – this is one that could catch investors off-guard, but could be driven by domestic polarisation, US and China competition, polarisation among society on vaccination mandates, the escalation of conflict between Russia and Ukraine, as well as the continuing wealth gap between developed and emerging market countries.
- Eskom – the continuation of load shedding will dampen SA's economic growth prospects. The big question is around the unbundling and restructuring of Eskom's debt.

- Policy reform and implementation in SA - this is both a risk and an opportunity for SA but something that investors have been pleading for over the past few years. The government cannot solve inequality, unemployment and poverty by itself as this will need to be done in partnership with the private sector. Given that the ANC's elective conference is expected to take place at the end of this year, there is a sense of optimism that some progress can be made.

In light of the aforementioned risks, we believe that 2022 will be a year of transitions and similar to 2021 a year with persistent volatility that could look like reasons to sell out of the market. It is key to remain convicted in your investment solutions as these are actively managed to take advantage of the opportunities that market volatility offers. Investors that stick to their long-term financial plan and remain invested will be rewarded – 2021 has proven that once again.

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