A difficult start to 2022 for stock markets

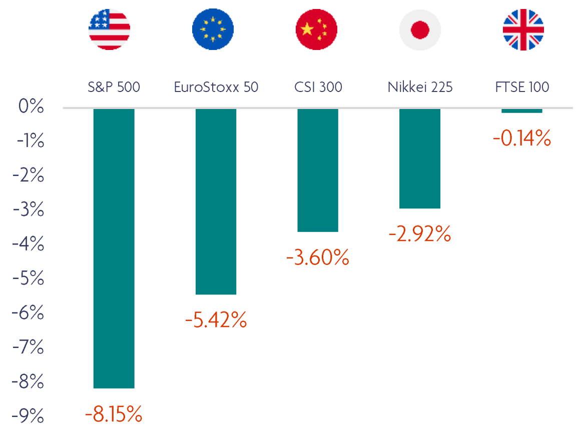
27 January 2022

Financial markets have started 2022 on a volatile note as concerns about central banks tightening their monetary policy aggressively increase and geopolitical tensions rise.

Markets start the year in the red

After a strong 2021, stock markets have fallen - in many cases, quite sharply - in the first few weeks of 2022. The falls have been driven by increasing concerns that central banks will start reining in the monetary support they gave economies through the pandemic in order to combat inflation. The Federal Reserve (the US central bank) has said it is ready to raise interest rates in March if it needs to. Meanwhile in the UK, the Bank of England, was the first major central bank to raise interest rates in December 2021 and is likely to go further this year. Rapidly rising interest rates are typically bad news for companies where the investment case rests on expectations of profits a long way into the future, such as some in the technology sector. This is because higher interest rates reduce the current value of their future profits. Furthermore, higher interest rates increase the cost of borrowing for companies, which is particularly problematic for companies who do not yet make a profit. A lot of these companies are based in the US, and it is therefore understandable that the US stock market has taken the biggest hit so far.

Major stock market returns this year, to 26th January 2022.

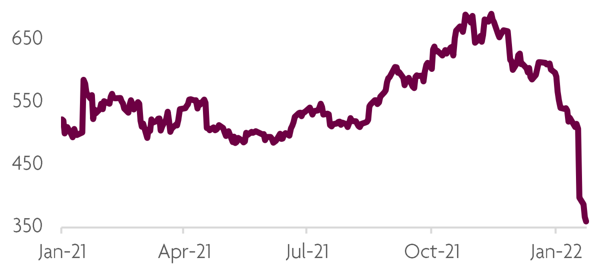


Source: FE fundinfo. All returns in GBP.

It's not just about central banks

Whilst concerns about central banks removing support abruptly has been a key driver of markets, there are of course other factors. Many companies are reporting challenges to their businesses, be that supply chain issues, higher costs or softening earnings. For example, when Netflix announced that it is forecasting to add 1.5 million fewer subscribers in the first three months of 2022 compared to 2021, its share price crashed 20% in a single day. Furthermore, escalating geopolitical tensions around the Ukraine/Russia border, weak economic data from China and rising Covid-19 cases in some parts of the world have also caused markets to jitter.

Netflix's share price drops as new subscribers slow down.

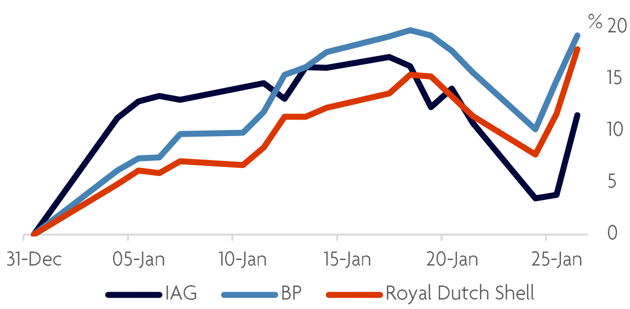


Source: Bloomberg

Not everything is down

Whilst clearly a lot of areas of the market have fallen significantly, there are other areas that are holding up particularly well against the broader market environment. For example, BP and Shell have both benefited from a rise in oil price, travel and hospitality shares are in demand as the UK eases restrictions, with British Airways owner IAG doing particularly well this year so far. Banks who typically do well in a rising interest rate environment have also done well this year.

Shares in IAG (Owner of British Airways), BP and Shell have all risen sharply this year.



Source: Bloomberg.

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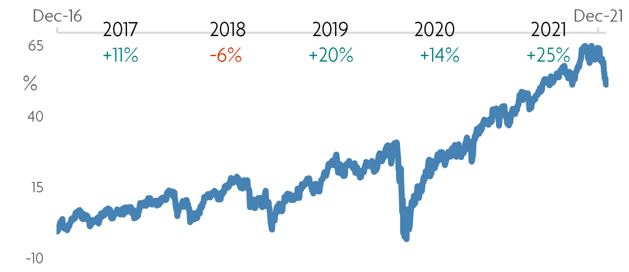
Let's not forget to think long-term

Whilst markets have had a tricky start to 2022 and as an investor you may feel nervous about the short-term market volatility, it is important to put things into the longer-term context that you are investing for. The recent fall, whilst sharp, is still modest in comparison to what equity markets have returned over the last few years. The fact that markets can have sharp dips and periods of uncertainty like the one we are seeing now means you should really be willing to invest for a minimum of five years.

Over the last few years equity markets have done particularly well. The recent correction is modest in comparison

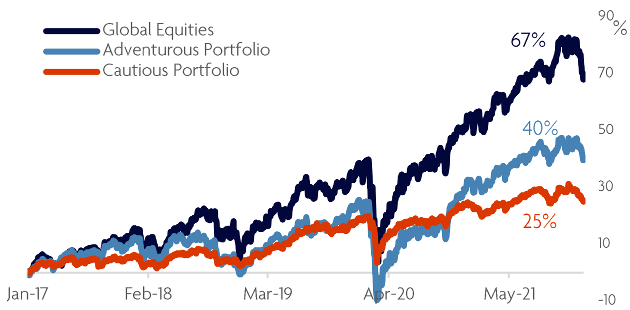


Source: Bloomberg, using Global Equities (MSCI ACWI) in GBP

You attitude to risk

Markets are like roller coasters, there will be periods of stellar market performance and periods of sharp dips. Some people enjoy the thrill of a rollercoaster whilst others prefer to go for less adventurous experiences. And of course, some people can't afford to go on a rollercoaster (for medical reasons for example). The same principles apply to your investment portfolio. Your willingness and ability to ride and tolerate the markets highs and lows, together with your investment time horizon, dictates the overall mix of asset classes in your portfolio which in turn will dictate how much of the market volatility you experience.

A well-diversified portfolio in line with your attitude to risk can help reduce the volatility of your portfolio relative to equity markets.



Source: Bloomberg and FE fundinfo. Total Returns in GBP. Global Equities is MSCI ACWI; Adventurous Portfolio is Graphene C1 Adventurous Portfolio and Cautious Portfolio is Graphene C1 Cautious Portfolio

Our 2022 Investment Outlook

The world continues to be in a state of flux, so things are likely to move in different directions at different times throughout the year. This creates uncertainty for investors who will be closely watching the likely directions of three key variables – economic growth, inflation and interest rates. As the world works its way through these uncertainties, it would be reasonable to expect a higher level of volatility in markets over the shorter term but our outlook for markets remains positive over the medium term. To help shape our view of the long term and guide our approach to investing over the year ahead, we've identified five key issues we think are going to determine the outlook for economic growth, inflation and interest rates, which you can read about here.

Five key themes will dominate the macroeconomic environment in 2022 and will have an impact on how markets behave