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Marlborough

January 2022

2022: outlook and positioning

Following nearly two years of uncertainty and lockdowns that resulted in the largest drop in global GDP in history, the outlook for 2022 is looking brighter from an economic perspective as we move from pandemic to endemic, and the world economy adjusts itself to new ways of working.

Nathan Sweeney, Deputy Chief Investment Officer of Multi-Asset

We believe the global reopening will produce a solid cyclical recovery, a return of global mobility as travel restrictions are eased, and strong consumer and corporate spending growth within the backdrop of still-easy monetary policy. For this reason, we remain positive on equities and negative on bonds.

> ***Here are some of the key themes we expect to dominate the outlook for 2022***

Recovering supply chains

Supply chains have adapted to disruption throughout the pandemic and each new Covid variant has had less of an impact. As a result, we expect supply chains to continue to improve as we move through 2022. This will lead to less price pressure and a likely fall in inflation from recent high levels.

Focus on valuations

Central banks have begun to reduce support as economies have rebounded since the onset of the pandemic. This is likely to focus investors' attention on valuations as a measure of opportunities in markets, instead of central bank support. Some stock markets look more attractive than others on this basis: these tend to be exporting nations impacted by restrictions and supply chain disruptions. With supply chains set to recover in 2022, exporting countries will get a boost, particularly when you factor in cheap relative valuations.

Geopolitical tensions

This is always a risk in markets and can impact investor sentiment. There are rising tensions between the US and Russia, with talks set to take place early in 2022 amid an alarming Russian military build-up on its border with Ukraine, echoing events leading up to Moscow's 2014 invasion of Crimea. Markets may have some short-term reactions to such events, as they assess the impact on companies or sectors located in the regions affected. We would tend to avoid making calls around such events, as de-escalation is the most likely outcome, which makes market timing incredibly difficult.

Inflation and rising rates

While central banks have been slow to react to inflation, we expect developed market central banks to raise interest rates in 2022. However, the pace of anticipated rates rises will be subject to changes in inflation, which could fall from its recent highs. Central banks will be in a precarious position, as they walk the fine line between raising interest rates and not choking off growth. One of the clear risks for 2022 will therefore be central bank policy error.

> *"The outlook for 2022 is looking brighter from an economic perspective as we move from pandemic to endemic. We believe the global reopening will produce a solid cyclical recovery."*

China/Evergrande

Chinese stocks did not perform well in 2021, as the markets grappled with slowing economic growth and continuing fears of a Covid resurgence. Since the summer, when President Xi Jinping rejuvenated the idea of 'common prosperity' to address income inequality, the market declines have only continued, and are being exacerbated by concerns regarding one of China's largest real estate developers, China Evergrande Group, which seems on the verge of default. Therefore, China's central bank is expected to provide economic stimulus in 2022 to provide a boost to the economy. Given the fact that the market lagged in 2021, there is a potential valuation opportunity here and we are closely monitoring this area.

In summary, supply shocks are easing, and this is expected to continue throughout 2022. While inflation has been at levels higher than many investors have seen before, we believe price growth will soon peak, and then retreat, as supply chain pressures ease and prices for many commodities normalise. But consumer spending should also increase as economies reopen. As noted above, this may create a policy dilemma for central banks, who need to be seen to be acting on inflation, but who will also fear cutting off the economic rebound. In this context, we don't expect to see any drastic rate hikes. But we will see the withdrawal of other monetary policy measures, in particular the large-scale purchases of bonds by central banks, as the restart does not need ongoing stimulus. As these quantitative easing measures fade, investors will once again focus on fundamentals, and export-led economies stand to benefit, while also looking attractive from a valuation perspective.

In our portfolios, we have three key themes in place:

Short duration

We have maintained slightly lower-than-benchmark exposure to changes in interest rates for some time, based on a view that bonds offered little real value, as well as the fact that rising inflation in a post-recession environment is entirely normal. But we need to be vigilant: if the growth outlook weakens - if lockdowns become more widespread, or if rates rise too quickly and choke off the economic recovery and threaten to usher in a new recession - then bonds would become a much more attractive investment.

Slight value bias

The value style of investing tends to favour out-of-fashion, economically sensitive shares. Many of these cyclical companies will benefit from the global reopening as normal service resumes. It looks increasingly likely that 2022 could be the year when Covid has less of an impact on markets, further variants and outbreaks notwithstanding. We are overweight in Japanese and UK equities, as both of these markets have high cyclical exposure and stand to benefit as the global economy reopens. If inflation subsides, interest rate rises will be less of a concern, which will be favourable for the growth style, so we may need to moderate this view.

Small and mid-cap bias

Smaller companies tend to be more domestically focused and have been impacted by Covid restrictions and supply chain disruptions. Investors are likely to reassess the opportunities in this space if risks recede, particularly given that valuations look attractive on a relative basis.

As always, risks abound. Markets are said to climb a wall of worry, and there's plenty to worry about. But worries also often create opportunities. It's our job - and that of the managers whose funds we hold - to assess the ever-changing balance of risk and return. As always, we'll continue to strive to deliver the best possible outcomes for the levels of risk targeted by the Marlborough multi-asset portfolios.

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Capital is at risk. The value and income from investments can go down as well as up and are not guaranteed. An investor may get back significantly less than they invest. Past performance is not a reliable indicator of current or future performance and should not be the sole factor considered when selecting funds. Our funds invest for the long-term and may not be appropriate for investors who plan to take money out within five years. The funds may have exposure to bonds, the prices of which will be impacted by factors including; changes in interest rates, inflation expectations and perceived credit quality. When interest rates rise, bond values generally fall. This risk is generally greater for longer term bonds and for bonds with higher credit quality. The funds invests in other currencies. Changes in exchange rates will therefore affect the value of your investment. The funds may invest a large part of its assets in other funds for which investment decisions are made independently of the fund. If these investment managers perform poorly, the value of your investment is likely to be adversely affected. Investment in other funds may also lead to duplication of fees and commissions. In certain market conditions some assets may be less predictable than usual. This may make it harder to sell at a desired price and/or In a timely manner. All or part of the fees and expenses may be charged to the capital of the funds rather than being deducted from income. Future capital growth may be constrained as a result of this.

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