2022 Digital Summit

Russell Investments

Global Market Outlook – The great moderation

Thursday 27 January

In this session we look at the latest insights on inflation as well as world market and economic forecasts. Discussing the economic outlook and where opportunities may arise, we have Russell Investment's Andrew Pease, Global Head of Investment Strategy, Michael Steingold, Senior Research Analyst, Vic Leverett, Head of Alternative Investment, and Hamilton Lane's Andrew Schardt, Head of Global Investment Strategy.

When do rates begin to restrict the economy?

The market offered strong returns in 2021 as vaccines allowed societies to reopen and economies to rebound. But as inflation continues to bite as 2022 unfolds, there has been much debate around where prices are going and how central banks around the world will react. Russell takes the view that though year will see a moderation of economic performance generally, growth will remain above trend and equities will continue to outperform bonds. As demand slows and supply rises, inflation will decline through the year, blunting the need for steep interest rate rises by central banks. We believe markets in general have overestimated the extent to which rates will jump. If prices moderate, expect the U.S. Fed should move from hawkish to dovish.

Though rates will rise over time, the question is when they will become a drag on the economy. Right now, while the U.S. Fed is taking its foot off the accelerator, it hasn't started tapping the brakes just yet. The earliest we see the Fed rate beginning to restrict growth is mid-2023, with a similar trajectory for the Bank of England. We therefore feel positive about the cycle for the next 12 -18 months, with a decent amount of runway left that should be supportive of asset risk. We have left the 'recovery' phase of the cycle, moving now into a new stage of inflationary pressures and tentative central bank intervention. The next phase, likely to come in 2023, is more uncertain. Once policy tightens, we will begin to look closely at yield curves to help assess where risks are building.

Plenty to worry about, but there are opportunities too.

The decisions taken by the Bank of England are a little harder to predict than the Fed. The U.K. has had a much bigger shock to its economy than the U.S. thanks to Brexit, with GDP collapsing by 10% in 2020. This was more than any other developed economy. GDP remains below where it was at the end of 2019, yet rates are already beginning to rise. On the bright side, the FTSE could offer strong returns to investors this year. Its limited exposure to tech stocks has protected it from recent volatility in that area, while the industries it does have a lot of - like financials and energy – are performing well and offering healthy dividend yields.

The emergence of new variants of Covid-19 remains a key risk facing economies this year. While the threat posed by the omicron strain of the virus appears to be fading, we know that when it comes to the pandemic, we cannot afford to be complacent. A larger challenge for investors to keep an eye on is China and the uncertainty surrounding its economic model. The Chinese government have tightened regulations on its technology sector and has moved to take leverage out of its troubled property market but has been reluctant to implement any serious easing measures. Beyond China and Covid-19, there are a plethora of geo-political uncertainties which could destabilise markets, from a Russian incursion in Ukraine to heightened hostilities in the Middle East as Iran develops its nuclear capabilities. Finally, while we are confident that inflation will decline as the year goes on, if we are wrong then a shortened economic cycle is a risk to contemplate.

Nevertheless, markets like to “climb a wall of worry” and we feel optimistic about the cycle for the next 12 – 18 months.

Private markets have had a great run. Do they still have value?

The performance of private markets has been strong on an absolute basis, but they have also outperformed public alternatives in 19 of the last 20 years. Managers in the sphere take an active, rather than a passive, investment strategy and their returns have been consistent. Crucially, the landscape of private companies is broader and more diverse than the public sector, with hundreds of thousands of companies globally for investors to choose from. Public companies simply have fewer opportunities in terms in numbers. This gap has only widened with the continuing trend of public companies choosing to go private.

The value offered looks set to grow in areas including real assets, infrastructure, and credit. Banks remain reluctant to lend on the scale they used to, so many companies in need of financing are turning to private lenders. Private markets are especially accommodating to newer investors, putting user-friendly structures in place like how they might invest in a mutual fund or EFT.

Standardised data is key to the future of ESG investing.

Managers understand that environmental, social and governance (ESG) considerations need to be embedded within their research. The drive for this focus is coming from investors themselves, though preferences in approach will vary between individuals. Some will prefer a broad approach, with impact considerations built into every product they put their money in. Others will want to carve out a piece of their portfolio with a specific, concentrated strategy.

When it comes to ESG, our due diligence needs to be as good as when we look at an opportunity’s underlying financials. We therefore need to invest even further in standarised, transparent methods of capturing information and reporting on it in ways investors can understand. Using data to help our investors construct their portfolios is hugely important, even beyond ESG. The choice of opportunities has never been greater, but risk also requires attention as factors like geographical or technology exposure grows in portfolios.

MCI-02786-2023-02-03 EMEA 2286