Outlook 2022 webcast summary

Key message

- Pandemic aftermath is playing havoc with inventory cycle
- Equities should outperform bonds as inventory restocks and service sector returns
- Bond yields expected to rise on inflation fears
- Central bankers tread lightly, balancing recovery and inflation
- China growth to buoy the global economy

Economic outlook

- We expect 2022's GDP growth to moderate from 2021's rebound, but remains robust, boosted by strong consumer spending and business sector investments
- Until mid-2022: We expect to see elevated production activity to meet excess demand
- Mid- to late-2022: Production will likely remain high, while PMIs slow
- In early 2023: We expect the inventory cycle to overshoot

Inflation

- After a decade of inflation below 2 per cent, we think inflation will shift to a higher level but not spiral out of control
- Supply and demand are still out of sync – while consumption has skyrocketed, labour and supply chain disruptions caused by rolling lockdowns have not yet eased
- Central banks may need to adjust their policies if inflation settles at a higher level than pre-pandemic

Central banks and interest rates

- Global central banks are in a tricky spot. Inflation persists, but any over- or under-reaction will risk derailing a fragile post-pandemic recovery. We believe central banks will take a light-handed approach
- The market has now priced in 90 bps of rate hike from the US Federal Reserve, 140 bps for the Bank of Canada, and 100 bps for the Bank of England in 2022
- We think the market has fully priced in the potential rate hikes at the front-end of the yield curve, but the mid- and longer-end of the curve could move higher as the year continues
- The pace of the Fed's balance sheet normalization should be watched closely this year

China

- After decades of focusing on growth at all costs, the world's second-largest economy is now transitioning to quality growth
- We believe that the Common Prosperity policy is medium- to long-term positive for investors
- The cut in banks' required reserve ratio, change in Politburo's messaging, coupled with the fact that 2022 is a leadership review year, the Chinese economy is set to have a better year in 2022, which can serve as a fresh catalyst for global growth, risk assets and commodities

Asset class views

Equities

- **Overweight to Canada:** With high exposure to cyclical sectors, Canadian equities will likely do well in a 4% global growth scenario, and the financial sector should also benefit from rising interest rates. With strong potential for dividends and share buybacks, combined with an attractive valuation, we are optimistic on the Canadian equities
- **Underweight to US**: We expect solid S&P 500 earnings reflective of strong GDP growth, but higher inflations will start to erode margins. Relative valuation versus Canada is now at the highest level since the 2000 tech boom
- **Neutral on international developed markets**: These regions have more value, cyclical, industrial, and global trade-oriented exposure, which should perform well against a backdrop of solid global economic growth. Financial conditions in Europe and Japan remain easier than in North America, and valuations are moderate
- **Neutral on emerging markets:** We expect present headwinds to turn into tailwinds, with the US dollar weakening, China's growth stabilizing and tempering of regulatory reform. Our two biggest concerns are the varying degrees of recovery across countries and central bank actions around the world

Fixed income

- **Underweight to sovereign bonds:** We expect bond yields to move higher as global central banks taper asset purchases and raise overnight rates. Nominal yields face upward pressure from rising inflation risk premia
- **Neutral on investment grade corporates:** We are constructive on credit markets amid a robust economy that delivers solid earnings growth, falling defaults and credit rating upgrades outpacing downgrades. However, credit spreads have tightened, providing minimal buffer from rising rates
- **Overweight to high yield bonds**: The asset class will likely outperform due to the additional spread buffer to higher interest rates. We prefer leveraged loans which benefit from rising rates and have virtually zero duration

Commodities

- Our **positive outlook on commodities** is supported by both strong demand expectations and supply constraints due to a lack of capital investments in recent years