Conditions for opportunity-oriented assets will remain 'good enough' in 2022, even though performance potential will be lower than in the first year of the turbo cycle. The differences – both between and within individual asset classes – will diminish.

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Market news and expert views

Monthly report
January 2022

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The markets at a glance

Summary

Our view of the new investment year is constructive and we have therefore affirmed our moderately bullish risk positioning (RoRo meter at level 4). We believe that the global economic recovery will continue, albeit at a slower pace than in 2021 and potentially at different rates in different regions. Profit growth in the corporate sector is expected to remain strong. Advancing vaccination campaigns, effective medication and rising immunisation levels should usher in the transition from pandemic to endemic phase over the course of the year. As a result, the influence of coronavirus on the capital markets should begin to wane, although the coming winter months will be another stress test for economies and societies in the northern hemisphere. We are of the opinion that, in the medium term, these effects will have a greater impact than the change in the direction of monetary policy (which has already begun), keeping the markets supported.

Our constructive outlook is subject to the proviso that no geopolitical crises emerge (e.g. in eastern Europe) and that the pandemic situation continues to improve. At present, we do not anticipate any lasting disruption to the capital markets in connection with either of these two factors but will continue to monitor conditions very closely and take preparatory steps as necessary. This also applies to the recently identified Omicron variant of coronavirus. There is currently no solid evidence to suggest that Omicron is able to bypass the protection provided by existing vaccines. In addition, vaccine manufacturers have emphasised that they are able to respond swiftly to new situations. It is therefore likely that the emergence of this variant will further exacerbate pandemic pressures this winter and prompt the temporary reintroduction of stricter containment measures. However, we do not anticipate the reimposition of full-scale national lockdowns.

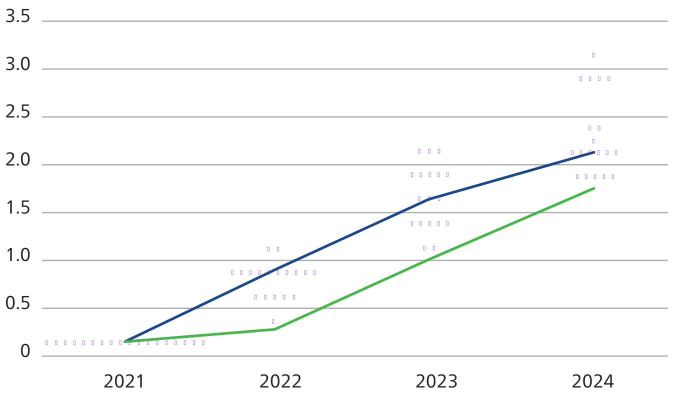
Economy, growth, inflation

Global economic conditions have recently stabilised. In the US, the recovery in the labour market has accelerated noticeably since October. Key employment indicators have improved significantly. In addition, the unemployment rate recorded another sharp fall, reaching 4.2 per cent. Over the course of 2022, unemployment is expected to move closer to the pre-pandemic level of 3.5 per cent. The goal of maximum employment will therefore come within reach sooner than previously assumed.

In Europe, several leading indicators – such as purchasing managers' indices and the ifo Business Climate Index for Germany – have deteriorated. This is a reflection of the adverse impact of the pandemic at the moment, especially in terms of how current conditions are viewed. Expectations components, on the other hand, have remained relatively stable, suggesting that the business situation in the corporate sector (especially in the industrial sector) is robust. Macroeconomic data has also stabilised in China, albeit at a weak level. The country's government and central bank have taken initial steps to shore up the economy. This has reduced the risk of a renewed downturn. However, we expect that more extensive support will be required in the first quarter of 2022 and that the authorities will most likely provide it.

Meanwhile, inflation rates have remained high in almost all countries. However, we anticipate that inflation will come down significantly over the course of 2022 as year-on-year effects drop out of the equation, supply bottlenecks ease and economic growth slows down. Most importantly, no signs of broad-based second-round effects – typically a key driver of persistently high inflation – have emerged as yet. We expect inflation rates to drop to levels within the central banks' target ranges between now and December 2022.

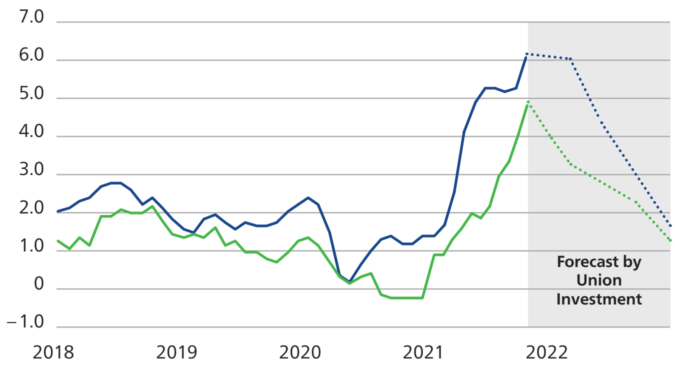
Fed to begin raising interest rates earlier than planned
Year-end interest rate projections ('dot plot') (%)



■ Median FOMC dots, 15 Dec 2021 ■ Median FOMC dots 22 Sep 2021

Sources: Federal Reserve, Union Investment, as at 17 December 2021.

Inflation likely to be a largely temporary phenomenon
Consumer price indices, year-on-year change (%)



■ US ■ Eurozone

Sources: Bloomberg, Union Investment, as at 17 December 2021.

The markets at a glance

Monetary policy: central banks scale back support

The trend towards reducing monetary policy support has been cemented worldwide. Central banks around the globe are scaling back their support measures. The 'smaller' central banks are acting particularly decisively. Chile, for example, raised its key interest rate by 125 basis points in December. The Hungarian central bank also hiked its key lending rate, by 30 basis points to its current level of 2.4 per cent, although it is still buying bonds at the long end of the yield curve.

However, the tightening of monetary policy is now no longer limited to the 'second-tier' economies. Spooked by high rates of inflation, the Bank of England (BoE) became the first of the G7 central banks to raise its key interest rates, for example. The reference rate in the United Kingdom is up from 0.1 to 0.25 per cent. In the US, meanwhile, the Federal Reserve (Fed) is scaling back the pace of its bond purchases more quickly than it had originally planned. Net bond purchases are now set to end as early as March 2022, which would pave the way for a first interest rate hike midway through the year. We currently expect the Fed to make its first move on interest rates in June, followed by two more by the end of 2022.

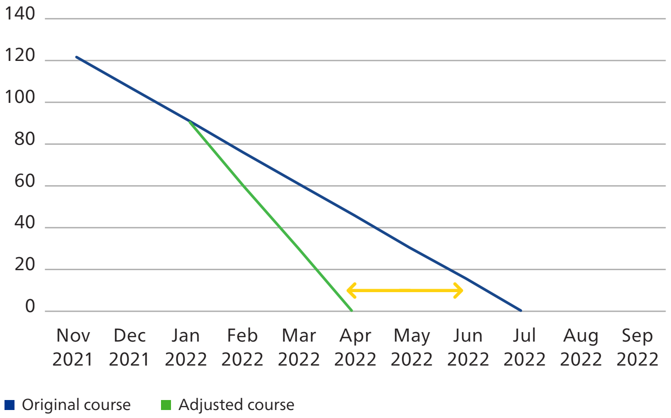
Inflation has not accelerated to quite the same extent in the eurozone, so the situation facing the European Central Bank (ECB) is less acute than for its counterparts in Washington or London. It is therefore no surprise that Frankfurt is giving itself more time to pare back support. Although bond purchases here, under the pandemic emergency purchase programme (PEPP), are also set to end in March 2022, we expect the ECB to remain an active player in the market and to continue buying paper. These purchases will be made under an older purchase programme (APP) or through the reinvestment of maturing bonds. In the case of the latter, the ECB also used its December decision to give itself greater flexibility in these actions. Nevertheless, the eurozone is still unlikely to see any interest rate hikes before 2024.

Fixed income: yields and spreads sliding again

The date of our meeting in November coincided with a high water mark for yields on ten-year German government bonds and US Treasuries. A steep drop up to the start of December (ten-year Bunds down by 17 basis points; ten-year Treasuries down by 32 basis points) saw Bund yields maintain their general downward trajectory, while the trend of rising yields on US Treasuries came to an end. The latest central bank meetings and decisions did not trigger much in the way of movement in the bond markets. For 2022, we expect yields to continue ticking upwards on both sides of the Atlantic. The trend towards widening spreads also reversed. Both in the corporate bond segments (investment grade and high yield) and in the periphery and EM government bond segments, around half of the increase in spreads that had built up since the low in November has been surrendered again since the beginning of December. We still see the greatest potential for narrowing spreads on the upper rungs of the risk ladder, but are currently looking for opportunities in asset classes other than bonds.

- **Change:** None.
- **Positioning:** We are steering clear of bonds, particularly safe-haven government bonds from eurozone core countries and the US. Our position in all other bond segments is neutral.

US central bank creates leeway for a potential move on interest rates
Projected monthly purchases (US$ billion)



Source: Union Investment, as at 17 December 2021.

EM government bonds have recently come under pressure
US bond spreads in the year to date

Source: Bloomberg, as at 17 December 2021.

The markets at a glance

Equities: Omicron only briefly weighs on equity markets in the industrialised countries

The stock markets in the industrialised countries have once again demonstrated their resilience in recent weeks. The new Omicron variant of the COVID-19 virus joined what was already a daunting set of problems (weak growth data, high inflation, loss of production due to disrupted supply chains, a fresh wave of coronavirus infections in Europe). After a brief setback, the markets rallied very quickly, and in the US they are already close to the all-time highs recorded in November. Moreover, the Fed's latest decision has removed one element of uncertainty.

Money is continuing to flow unabated into the markets in the expectation that the downside factors described above will gradually ebb away over the coming months and quarters and that corporate profits can therefore maintain their upward trajectory in 2022. With real interest rates deep into negative territory, high-yield investments remain in demand, and this means that setbacks are quickly taken as opportunities to buy. The stock markets in the emerging economies, on the other hand, saw a marked decline and registered new lows for the year. Omicron aside, this was primarily due to the ongoing slowdown in the pace of growth in China. Valuations are slowly becoming more attractive again. However, uncertainty continues to prevail in the emerging markets, which is why we are maintaining an unchanged position in equities.

- **Change:** None.
- **Positioning:** We generally favour equities. Within the equities asset class, our preference is for stocks from the industrialised countries, whereas our stance in respect of the emerging markets is neutral.

Commodities: position in industrial metals position expanded

Omicron also caused a setback in the commodity markets. Renewed restrictions on global air traffic, for example, took a particularly heavy toll on the energy sector. Despite fears of a drop in demand, OPEC+ continued with its scheduled production hikes in December (supply stepped up by 400,000 barrels per day during the month). The European gas market proved largely immune to this trend. Russia's sabre-rattling in the direction of Ukraine saw the price of gas in Europe rise to an all-time high.

We are taking advantage of the correction in industrial metals to slightly expand our position. The forward curve holds appeal for investors (backwardation), inventories are low and an improvement in credit-led demand is on the cards in China. Looking to the medium term, industrial metals also stand to gain from the decarbonisation of the economy.

Precious metals have taken a hit recently in the wake of rising real yields in the US, but for us remain the most attractive commodity sector from a fundamental perspective. The quasi-industrial metals platinum and palladium have a lot of potential, provided that automotive manufacturing picks up again. Car production is down significantly on the prior-year because of the shortage in microchips, but demand is high. Gold, on the other hand, will be faced with a modest headwind if US interest rates are hiked as expected.

- **Change:** Industrial metals are now back in favour with us.
- **Positioning:** Commodities are attractive overall. We have a preference for precious and industrial metals within the asset class, but are neutral in the energy sector.

Equities are likely to still be sought-after in 2022 – stock picking will make the difference

Number of US equities trading above their 200-day average

Source: Bloomberg, as at 13 December 2021.

Palladium still under the spell of automotive production

Palladium price (US$/ounce)

Sources: Bloomberg, Union Investment, as at 17 December 2021.

The markets at a glance

Currencies: little impetus

The fact that the Fed is winding up its ultra-expansionary monetary policy more quickly than the ECB was priced in to the currency market in November. Since then, the US dollar has largely held steady against the euro. Neither the Fed's decisions in mid-December nor those made by the ECB around the same time have given the currency pair any impetus in either direction.

Unlike other major currencies, such as pound sterling and the Japanese yen, the euro has traded within a narrow range of late, although it has tended to appreciate slightly. The euro is expected to strengthen more broadly again as the drivers for the currency markets shift in 2022. The single currency is set to be bolstered by demand for NextGenerationEU bonds, for example, while support for the US dollar is likely to wane significantly as the capital markets switch their attention to the US fiscal deficit. For now, however, this is still not reason enough to open a position in the currency sector. We do not expect these factors to begin having a tangible effect on the euro's value until a later point in time, so we are positioning ourselves on the sidelines for now.

- **Change and positioning:** None.

Real estate: office markets in Asia-Pacific

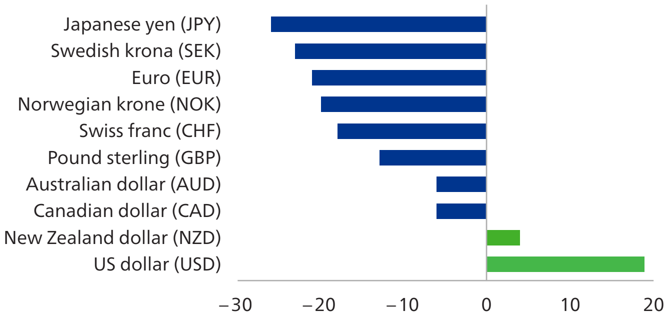
The number of coronavirus infections in many Asia-Pacific countries has been relatively low because of the very strict measures put in place to contain the pandemic. These economic restrictions meant that demand for space was low in the respective office markets, particularly in 2020. However, there were signs of a rally in this demand in the second half of 2021 thanks to progress with the region's vaccination campaigns and to the resulting easing of measures.

The major cities of the Asia-Pacific region have seen a glut of new office buildings come on to the market in the past twelve months. This increase in supply, together with an initial weakening of demand, led to a rise in unoccupied office space in most locations. Vacancy rates in this period across the six biggest office markets in Asia-Pacific were up by an average of 1.7 percentage points to 8.4 per cent. Whereas the proportion of unlet space rose only marginally in Singapore and Osaka, vacancy rates in Melbourne, Sydney and Tokyo surged due to the very high volume of new buildings. In Seoul, however, the vacancy rate was down significantly because demand for space had already returned to a high level.

The increase in supply caused prime rents in the six biggest office locations in the Asia-Pacific region to decline by an average of 1.9 per cent year on year. Seoul was the only one of these cities to record a rise in prime rents, which were 2.8 per cent higher. This was due to a combination of very strong demand for new, high-specification office space in central locations and limited supply.

We expect the markets for office space in Asia-Pacific to resume their growth trajectory in 2022 on the back of a resurgence in demand driven by the anticipated economic rally. This will be reflected in falling vacancy rates and stable to slightly higher prime rents in most of the region's office markets.

Support still in place for US dollar – but euro is likely to make gains in 2022
Deviation from fair value, based on purchasing power parity



Source: BCA Research, as at 12 December 2021.

Change in prime office rents in the Asia-Pacific region compared with the previous quarter
Average (%)*

* Average of the six biggest office markets in the Asia-Pacific region.
Source: PMA, as at 30 September 2021.

Our assessment at a glance

Our current risk assessment

- The global economic recovery is set to continue in 2022, albeit at a slower pace than in 2021.
- The influence of coronavirus on the capital markets is likely to wane, although the winter months will be another stress test.
- Inflation rates should fall sharply over the course of 2022.
- The Fed will end its bond buying in March and its first interest-rate hike could follow in June.
- Rising corporate profits and diminishing downside factors should continue to bolster equities.
- Our general risk assessment (RoRo meter) remains at level 4 (slightly bullish).

RoRo meter

Source: Union Investment, as at 17 December 2021. Last changed (from 3 to 4) on 19 October 2021.

Note: The investment strategy is established by first closely analysing the market environment. The result is reflected in a risk rating. For this, the Union Investment Committee (UIC) expresses a risk-on/risk-off decision at one of five levels (1, 2, 3, 4 or 5). It is to be interpreted as follows: a '5' indicates a strong appetite for risk while a '1' indicates a general withdrawal from risk assets.

Our view of the asset classes

- **Fixed income:** Yields and spreads have slid again. However, we see little prospect of them continuing in this vein. Opportunities will therefore be hard to come by on the bond front.
- **Equities:** Omicron only briefly weighed on equity markets in the industrialised countries. EM equities, however, are trading at a low for the year. We therefore continue to favour equities from industrialised countries and take a neutral view of stocks from the emerging markets.
- **Currencies:** The US dollar is set to experience a further tailwind initially. However, we expect the drivers to shift next year and so will remain on the sidelines for now.
- **Commodities:** Omicron-related setbacks and rising real interest rates in the US have created scope for an upturn in prices. We favour industrial metals because of low inventories, attractive forward curves and the potential for economic stimulus in China.
- Holding **cash** is currently unattractive due to low or even negative interest rates.
- Our assessment of **absolute return strategies** remains positive.
- The outlook for **real estate** has improved a little in Germany but deteriorated slightly in the US.

The → = ← signs indicate the change compared with the UIC's previous decision.

Not favoured | **Neutral** | **Strongly favoured**

Appeal of different asset classes

Fixed income	=
Eurozone core government bonds	=
US government bonds	=
Eurozone periphery government bonds	=
Investment-grade euro corporate bonds	=
High-yield euro corporate bonds	=
Emerging market government bonds	=
Equities	=
Industrialised countries	=
Emerging markets	=
Commodities	→
Currencies	
US dollar	=
Pound sterling	=
Japanese yen	=
Emerging market currencies	=
Absolute return	=
Cash	←

Source: Union Investment, as at 17 December 2021.

Note: The table above provides a **relative view of a multi-asset portfolio (excluding real estate)**. If one asset class becomes more strongly favoured, a lower level of investment in another asset class is required in return. The latter would then be classified as less favoured – or vice versa. Real estate is excluded from this analysis.

Real estate	
Germany	→
Europe (ex Germany)	=
US	←
Asia-Pacific	=

Source: Union Investment, as at 15 July 2021. Assessment is valid up to 31 December 2021.

Note: The table above provides a **relative view of the office real-estate markets** in light of current market prospects. Due to a lack of more frequently available data, it is only updated every six months.

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READ THE PROSPECTUS BEFORE INVESTING

Unless otherwise stated, all information, descriptions and explanations are dated **22 December 2021**.

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