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Global economy in flux

Market Comment, January 2022

The global economy presents a mixed picture at the start of the year. Up until recently all lights were set to green, but now there are a few warning flashes. We must be prepared for a slowdown in economic growth over the next few months and quarters. The likelihood of declining economic momentum is suggested by a variety of factors: inflation, supply shortages, coronavirus complications, China. Admittedly, lower growth still means growth – which is a positive for equities and a negative for bonds. But at the same time, it may make sense to focus on less cyclical stocks that are less sensitive to market fluctuations. Swiss equities exhibit precisely these qualities.

We are currently expecting the global economy to have recorded growth of just under 6% for 2021 as a whole. This represents a huge economic recovery compared to 2020, when global economic activity slumped by 3% year on year. This powerful recovery explains both the outstanding earnings growth reported globally by companies last year, as well as the advances made by stock markets over the same period, which were well above historical averages. From today's standpoint, we expect global economic growth to come in at around 4.0-4.5% for 2022. (Figures represent the year-on-year change in real gross domestic product (GDP).) While this is a noticeable decline in the growth rate compared to 2021, it is still growth. As such – and particularly given that inflation remains at a historically high level – equities hold a clear advantage over bonds. But a slightly lower equity weighting than at the start of 2021, together with special emphasis on less cyclical stocks (with the Swiss equity market being a good example in a global comparison), makes plenty of sense.

One country that may well be staring in the face of a particularly sharp economic slowdown is China: after economic growth of around 8% in 2021, a figure of between 5.0% and 5.5% looks more likely for 2022. A major factor here is the reaction of the authorities against the highly leveraged real estate sector, which is weighing on the economy. Although more expansionary monetary policy could help other sectors, it could also see the debt mountain of the real estate sector surge to even scarier heights. What's more, the accelerated growth in consumer spending targeted by the government looks doubtful, not least since the retail sector has been exhibiting less dynamic momentum for some time now. Following the recovery in production levels and commodity prices in 2021, Japan and Latin America are also likely to grow less strongly in 2022.

> "A particular emphasis on Swiss equities looks a shrewd play right now."
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> Gérard Piasko, Chief Investment Officer

The US can also be expected to fall short of its 2021 economic growth figure this year: after growth in GDP of some 5.5% in 2021, a figure in the range of 3.5-4.0% looks more likely for 2022. While supply shortages may have the effect of pushing back a proportion of goods production from 2021 to 2022, and the infrastructure programme passed by Congress should provide additional stimulus from the public sector side, particularly strong price rises in a global comparison (in many cases between 5% and 15% on both goods and services), should drag down consumer demand. Consumer spending, which accounts for more than 70% of GDP, is by far the most important factor for the US economy. In the eurozone, the impending economic slowdown looks to be less pronounced. Specifically, we are expecting GDP growth to come in at around 4% for 2022, following a figure of around 5% for 2021. There are two reasons for this superior relative performance: On the one hand, the funds released by the EU's Recovery and Resilience Facility will help to boost the economy, particularly in southern Europe. On the other, the so-called base effect will be less pronounced – in the US, the economy benefited from extraordinary stimulus thanks to direct cheque payments from the government to the population, which will fall out of the figures in 2022. No such phenomenon occurred in the EU.

For Europe and other regions, risks remain in the form of coronavirus complications, i.e. possible restrictions as well as renewed supply problems in the event of production outages. This issue could influence inflationary developments at a global level for some months yet. As long as supply difficulties remain – and/or unless energy production (gas and oil) is ramped up by Russia and OPEC – inflation rates will remain elevated until high energy prices in the second half of 2021 feed through into inflation-reducing base effects later in 2022.

Global indebtedness will remain an issue in 2022. In China the focus is on corporate debt, which has increased massively over the last few years, particularly in the real estate sector. In a number of European countries and above all in the US, the concern since 2020 has been the striking increase in government debt. For that reason, one of the factors that must be taken into account by central banks when tackling inflation is the debt-servicing burden that this will impose on governments. In other words, they will have to be careful about increasing interest rates.

All in all, things look more promising right now for equities than bonds, as lower growth still means growth for equities, while inflation remains an obstacle for bonds. Nonetheless, investors might be wise to opt for a lower equity quota than at the start of 2021 and consider less cyclical equity markets – which makes Swiss stocks and their quality a logical choice.

Gérard Piasko

Gérard Piasko is Chief Investment Officer and head of the investment committee of private bank Maerki Baumann. Before he was for many years Chief Investment Officer of Julius Baer, Sal. Oppenheim and Deutsche

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Maerki Baumann & Co. AG
Dreikönigstrasse 6, CH-8002 Zurich
T +41 44 286 25 25, info@maerki-baumann.ch
www.maerki-baumann.ch