COLUMBIA THREADNEEDLE INVESTMENTS

Gain clarity in 2022: A bumpy ride higher for equities

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Equity investors should expect headline risk in 2022.

The coronavirus continues to introduce uncertainty, but investors should expect cyclicals to outperform in the first half of the year. Here are the key catalysts for equity markets:

Global Perspectives 2022

The upcoming year is all about finding clarity so investors can concentrate on their long-term goals. Focus on insights, backed by research, as we look beyond the noise we've experienced in the past year.

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COVID will continue to impact the economy and the markets

We entered 2021 with the prospect of new vaccines taming COVID and that effort proved to be transformative in developed markets. **The coronavirus persists, however, and its impact will continue to be felt in 2022 as the pandemic plays out in developing markets and elsewhere.** New therapies to prevent serious illness are promising but we should expect a focus on COVID and a return to normal life to continue in 2022. Gauging a company's exposure to lingering COVID impacts — and lasting changes — will be an important component of research in the year ahead. Another important carryover into 2022: We expect cyclicals to outperform in the first half of the year, especially because of ongoing economic reopening and above-average GDP growth.

Supply chain disruptions will start to improve — eventually

The pandemic was the proximate cause of the supply chain disruption, shuttering manufacturing facilities globally. For industries with "just-in-time" inventory practices, the closures were extremely challenging as replenishing exhausted inventories proved nearly impossible, or at the very least very expensive. We expect elements of the supply chain to improve over the course of 2022, but there is still a significant backlog to work through and wide variation in companies' access to materials and success in passing costs on to consumers.

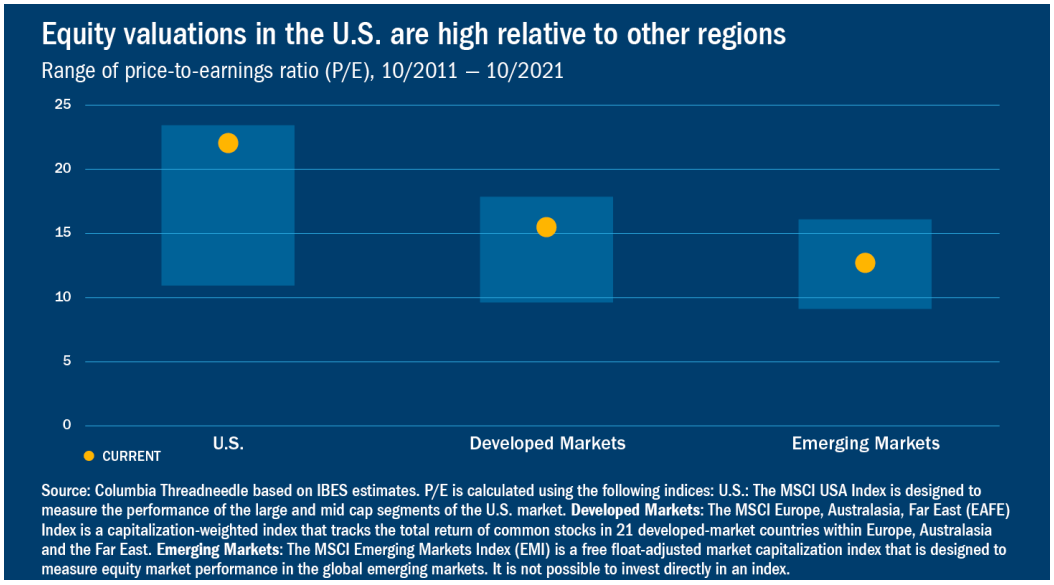
The seized gears of the supply chain caused many to speculate that the world would move manufacturing away from China or even onshore production. But the considerable capex required to drive that radical change seems unlikely. **What is likely to change is how much inventory companies decide to hold, and that means that focusing on inventory levels and pricing power as part of fundamental research takes on heightened importance.** There will be clear winners and losers in this environment; active positioning will set investors up for success, especially in the context of cyclical opportunities in the first half of the year.

Higher rates, lower valuations?

Historically, higher interest rates have correlated with lower equity valuations. Higher interest rates in 2022 could put equity multiples under pressure, which means it's important to know what you are paying for. **For investors whose value exposure is below their strategic allocation, 2022 may be a good environment to increase that allocation.** That said, cheap is not an investment thesis; in an environment of greater dispersion, understanding the fundamentals of a company relative to the price is essential.

Investing in the U.S. versus elsewhere

Equities are expensive in most regions. But on a relative basis, valuation metrics are more attractive in Europe and Emerging Markets than the U.S. Headlines on China, and inflationary pressures may cause some anxiety around investing in emerging markets. But a strategic allocation still makes sense as long as it fits your risk tolerance.



Real capital is flowing to responsible investment

Investor interest in responsible investment has been rising over the past few years and that will accelerate in 2022. Environmental challenges like a warmer climate, limited water or wildfires each pose risks to companies. And considering those risks throughout the fundamental research process may help mitigate certain portfolio risks.

A bumpy ride higher

We expect headline risk in 2022 — especially around inflation, interest rates and energy prices. We don't see a catalyst for a big equity swoon, but that doesn't mean we get to a place that's higher than the beginning of the year smoothly. **I expect greater dispersion among winners and losers, because of the stresses of supply chains, inflation (and the cost of doing business) and higher rates.** Investors need to be selective about what they own. The highest growth stocks are likely to be subject to greater volatility as rates rise.

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