Key Questions

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What's the Outlook for International Equities in 2022?

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The Key Wealth Institute is a team of highly experienced professionals from across wealth management, dedicated to delivering commentary and financial advice. From strategies to manage your wealth to the latest political and industry news, the Key Wealth Institute provides proactive insights to help grow your wealth.

Last year began on a promising note for international equities. In Europe, hard-hit service-oriented countries such as France, Spain, and Italy were emerging from lockdowns related to COVID-19 and the Eurozone was sparked by fiscal and monetary stimulus. Emerging economies, particularly in Asia, leveraged their milder virus toll to lead the worldwide economic re-opening story. And a cyclical rally looked to propel old economy European companies as consumers had more capital to spend and the ability to spend it due to easing pandemic restrictions. Such outperformance fizzled though, and non-US equity securities lagged their US counterparts for the remainder of 2021.

Overheated production in China triggered worldwide supply bottlenecks and soaring energy prices later in the year. Raw Material price inflation surged during the second half of the year, and periodic lockdowns hurt production, slowing economic growth for the world's largest exporter. Elsewhere in Asia, Japan experienced a late wave of COVID-19 cases after emerging from 2020 relatively unscathed. Those cases soured sentiment, putting the Tokyo Summer Olympics at risk of cancellation for a second time. The games went on, but country leadership shifted, and a more stimulus-friendly politician was elected late in the year. Developed economies grew at a strong pace but are still below the economic growth trajectory set before the worldwide shutdown of 2020.

China maintained a zero-tolerance COVID-19 policy, shuttering ports and provinces whenever cases were discovered. China's Communist Party also increased regulations on high-flying industries – large tech, education, and highly leveraged property management companies in particular – as part of a long-term strategy shift to build a stronger foundation for economic growth and ensure common prosperity for its citizens. Investors re-rated Chinese equities leading to poor returns.

Looking forward, we believe the overarching theme for 2022 for non-US equities will be driven by central bank reactions to inflationary pressures, labor market participation rates, and slowing worldwide economic growth.

Countries that continue to institute stimulus and do not overreact to near-term pressures are more likely to outperform those with less leeway in their policy decisions. Certain developed markets and China are better positioned to weather this environment, while other emerging economies are more likely to be disadvantaged.

Developed Economies

The United Kingdom is poised to raise policy rates, and we expect interest rates to rise to pre-pandemic levels by the end of 2022. Additionally, UK equity risk premiums should fall as Brexit concerns around trade agreements and cross-border financial transactions dissipate. The Bank of England will be methodical in telegraphing interest rate rises, and the equity market should take these in stride. On the downside, labor participation rates will continue to be problematic, and the number of jobs unfilled will remain high. Strong mergers and acquisitions activity late in 2021 adds to the likelihood of relative UK outperformance as underpriced UK institutions are being taken private at attractive values. We see additional capital flowing into the UK, further lifting UK equities.

The story in the Eurozone is different. The European Central Bank has taken a laissez-faire approach to tapering stimulus measures, waiting to see what happens elsewhere in the world and then molding policy based on the outcomes. Similarly, the European Union has been slow in providing infrastructure and subsidies for stretched supply chains; it announced a committee to discuss the issue in November 2021, nearly two years after China and the US instituted such programs. While we expect supply bottlenecks to ease eventually, the outlook for Eurozone equities is not as rosy as elsewhere. Europe has little exposure to newer technology and other growth industries, and as growth becomes scarcer in 2022, the cyclical nature of Europe's stock indices becomes less attractive. We also see policymakers continuing to be too slow to act, leading to middling performance during 2022.

In Japan, we expect continued stimulus from the Bank of Japan targeted toward lower-income citizens and younger families to stimulate the economy.

The year 2022 could be a strong year for Japan. The continued stimulus comes at a time when corporate earnings are expected to reach record highs. Japan also tends to do well in rate-rising environments, something we see materializing worldwide.

Emerging Economies

China has been the most significant emerging market story since the pandemic began, and 2022 will be no exception. President Xi seeks an unprecedented third term as chairman of the Communist Party, which essentially would anoint him as president for life. Investors should also expect continued back-and-forth discussions on trade agreements as China tries to solidify its position as a global superpower and the US tries to defend its leadership position. President Xi wants to ensure he remains powerful in the eyes of his constituents, and standing up to the US is one way to do that.

China is also intentionally slowing economic growth, shifting from unchecked growth to relying more on sustainable foundations for future generations. We expect a continuation of the crackdowns on big tech, education, and highly leveraged property managers. Themes such as common prosperity and self-sufficiency will endure. China will continue to regulate bad actors and back companies that help build infrastructure for new technology.

China's central bank, the People's Bank of China (PBOC), has been conservative in its stimulus packages throughout the pandemic, leaving intact its ability to inject money into the economy if growth falters, which is unlike other emerging markets. Accordingly, following a re-rating of Chinese equities in 2021, we expect a bounce-back next year as the future path is more certain. COVID-19 resurgence is the most considerable risk to this thesis as the Communist Party continues a no-tolerance approach, shutting down areas of infestation and restraining growth.

Other emerging market economies have less of an advantage. Their central banks do not have the leeway to stimulate their economies as/when growth slows. Additionally, as interest rates rise across the world, emerging market economies must raise rates faster to maintain substantial real yield advantages to developed economies to maintain investor capital. As expected, these dynamics further pressure growth, especially if the US dollar remains strong in 2022. Thus the most likely outcome for non-China emerging markets next year is middling performance.

What’s the Outlook for International Equities in 2022?

Overall, we see non-US equity continuing to be challenged compared to US equity in 2022, with pockets of potential outperformance within the UK, Japan, and China. We favor investment managers who actively tilt toward the UK and Japan within developed markets in lieu of traditional Eurozone exposure. We are also exploring other managers who have on-the-ground knowledge of the dynamic Chinese economy because we think the opportunity set is a fertile one with both risks and opportunities.

For more information, please contact your advisor.

About the Author

Don Saverno oversees third-party investment strategies within the International and Emerging markets asset classes with the KeyBank Investment Center. He also provides oversight regarding Socially Responsible and Environmental offerings, provides investment solutions, portfolio construction, and risk management services for clients.

Before joining the KeyBank Investment Center, Don worked for RiverSource Investments as an Investment Risk Manager and Arbitrade Financial as an Options Market Maker and Proprietary Derivatives Trader. He has worked in the financial industry since 1999. Don earned his MBA from the University of Chicago Booth School of Business with concentrations in Finance, Corporate Strategy, and Managerial and Organizational Behavior.

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