# Will Omicron Derail the Global Cycle?

## The effects of the Omicron variant are already being widely felt. Here's what we know—and what we don't.

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In my view, Omicron warrants some level of concern (though not panic). Here's what we know and don't know at this point, and my thoughts on some of the potential implications.

### What We Know

Omicron is a new variant of COVID-19 that was first identified in South Africa, where it's now the dominant strain of the virus. As of this writing, it has already spread to a number of other countries and regions, including Botswana, Hong Kong, Europe, and Israel. According to initial reports, most of the cases seen so far are concentrated among younger patients, who tend to be either unvaccinated or not fully vaccinated. (For context, South Africa's vaccination rate is approximately 25%.)

Our healthcare analysts here at Wellington Management tell me that the mRNA vaccine is best positioned to be modified to provide protection from new COVID-19 variants. An Omicron-specific version of the mRNA vaccine could be available in as little as six weeks, but clinical testing, mass production, and distribution of it would likely take up to six months—even for developed countries.

### What We *Don't* Know

Three key questions around the Omicron variant center on: 1) its transmissibility; 2) its virulence; and 3) vaccine efficacy against it. While it's too soon to have any definitive answers, early data suggest a potential base case of high transmissibility and largely unknown virulence (due to the relatively small number of cases right now), but at least some degree of vaccine efficacy. We should have more clarity on these and other characteristics of the variant by mid December.

Another critical question: Could the Omicron variant usher in a third wave of the pandemic? It's hard to say with what we currently know, but it's possible. Much will depend on the above answers. For example, if it turns out to be a less virulent strain, and if existing vaccines prove even somewhat effective against it, we'd already have a leg up on it (unlike in previous COVID episodes).

### Macro Implications

- **The global cycle:** Omicron fallout could reduce global economic activity to some extent, especially in countries with the lowest vaccination rates and/or the most stringent COVID restrictions. However, I believe the effects will most likely be short-lived, perhaps impacting one quarter of growth. Higher vaccination rates, improved COVID surveillance, helpful anti-viral treatments, and other factors make me cautiously optimistic that Omicron won't derail the current global cycle and lead to a recession.

### Key Points

- Omicron is a new variant of COVID-19 that was first identified in South Africa; more details about the characteristics of this variant are expected in the next few weeks.
- The three key questions concerning the Omicron variant are transmissibility, virulence, and vaccine efficacy.
- While we are better equipped to handle this new variant, Omicron could still have some implications for markets.

- **Inflation:** A weaker cycle could put a dent in global inflation from the demand side, but supply-chain disruptions and worrisome labor shortages have also been contributing to higher inflation and could endure for the foreseeable future. They could even worsen if mounting Omicron fears force temporary economic lockdowns or port closures. This is a particular risk in Asia, where there is little to no tolerance for rising COVID cases. Bottom line: Even with some economic slowing, supply-driven inflation will persist.
- **Monetary policy:** If supply-induced inflation remains high and demand softens, it could leave global central banks caught between a rock and a hard place. I've heard two theories. The one I subscribe to is that policymakers may be a little less eager to tighten policy early on (e.g., in December 2021), which would be a net positive for risk assets.[1] The other is that Omicron likely won't change central banks' tightening plans due to higher, sticky inflation.
- **Fiscal policy:** We could see increased backing for the US fiscal support included in the "Build Back Better" plan, potentially leading to stronger GDP in 2022. There could also be additional support for fiscal stimulus measures in Europe and Japan.

### Investment Implications

- **Expect lower liquidity/higher volatility into year-end.** As we enter December, I expect liquidity to remain challenged in some global-market sectors, which, in turn, may trigger more bouts of market volatility similar to what happened the day after Thanksgiving.
- **Look at volatility as an opportunity.** For longer-term investors, negative news headlines and related market turmoil may present opportunities to add to risk exposures in some cyclical sectors (e.g., travel, leisure, hospitality) and to pare back on more growth-focused sectors such as technology.
- **Consider reviewing your allocations to growth, recession, and inflation scenarios.** Do you have appropriate investment allocations to all of these economic scenarios? Do your current risk exposures align with your perceived economic probabilities? If not, consider adjusting them to help hedge your portfolio for a variety of potential outcomes in the period ahead.
- **Near term, expect growth to outpace value and US markets to outperform.** Consistent with the market reaction to the Delta variant, in the very short term, I expect growth-style sectors to outperform their cyclical and value-oriented counterparts, and US markets to generally outperform other global regions. I also see the US dollar appreciating and bond yields hovering more or less around their current levels. Longer term, however, I expect the opposite—value over growth and non-US markets over the US.



## What I'll Be Watching Most Closely

Of all the wildcards at play here, of which there are many, I think vaccine efficacy against the Omicron variant is going to be the most important data point to keep an eye on going forward. Efficacy of more than 50% would, in my view, bode well for further progress on COVID-19 vaccination rates and booster shots, as well as for the resumption of the economic recovery.

[1] Risk assets refer to assets that have historically exhibited a significant degree of price volatility, such as global equities, commodities, high-yield bonds, real estate, and currencies.

**Talk to your finanical professional about how you can position your portfolio for potential market volatility.**



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