Five Investment Essentials for a Post-Pandemic World

As the world "gets back to business" in 2022, a cautiously optimistic outlook seems warranted. For investors, it may be a year to think thematically.

With some luck, and a bit of hope, we are cautiously optimistic that 2022 should be the year in which most of the world begins to move toward a post-pandemic era—albeit after many fits and starts along the way. From a public health perspective, COVID-19 vaccination rates and other telling numbers (including case counts, hospitalizations, and virus-related deaths) suggest that the life-altering global pandemic may finally be poised to start winding down. In addition, many world economies are growing and appear to be on a path toward recovery from the unprecedented COVID-19 shock.

To be clear, we are not out of the woods just yet. The virus, with its multiple potential variants—e.g., Omicron—and its ability to break through vaccine-induced immunity in some cases, has proven difficult to entirely vanquish. And even if next year does bring meaningful progress, as we expect, it's critical to stress that it will not be a truly "post-COVID" world in 2022, as the virus will most likely remain in global circulation for years to come. Nor will the economic and other improvements we anticipate be sudden or universal. Many countries still lack adequate vaccine coverage, whether due to ongoing supply issues or vaccine hesitancy among their populations. And lingering challenges around international travel and other activities we took for granted pre-COVID may well persist for the foreseeable future, making a full reversion to completely normal conditions an uncertain prospect anytime soon.

Nevertheless, barring a virus mutation that renders the vaccines ineffective, or some other unexpected plot twist, 2022 will hopefully mark the start of a long-overdue global rebuilding process.

The Big Picture: Shifting Tectonic Plates

One of the overarching questions we keep hearing is: What exactly are we rebuilding toward? COVID-19 has undeniably reshaped the global landscape in many ways, accelerating some long-range trends, blunting or stalling others, and indeed ushering in wholesale, lasting changes to how we live, work, and travel. Could these changes cause a return to the type of slow-growth world we experienced after the 2008 Global Financial Crisis, or are we instead pivoting to a period of sustained stronger growth? Will inflation stay stubbornly high and, if so, for how long? These are some of the vexing "head scratchers" that are coming to the fore as we head into 2022, but which will take time to fully answer.

But one thing seems fairly settled at this point: COVID-19 has hastened the onset of "big picture" structural changes to how we operate and what we value. These types of secular changes, as opposed to the cyclical changes associated with the nature of business cycles, are like the shifting tectonic plates of the investment terrain: hard to see on a day-to-day basis, but powerful longer term and, ultimately, arguably more significant than anything else. Despite the many unknowns still facing the world, here are five themes that we think should play a more prominent role in investors' toolkits as we march toward a brave new future.

Insight from sub-adviser, Wellington Management

Nick Samouilhan, PhD, CFA, FRM
Multi-Asset Strategist and
Portfolio Manager, Singapore

Andrew Sharp-Paul
Investment Director, Singapore

Key Points

- COVID-19 has reshaped the global landscape, accelerating some long-range trends, blunting or stalling others, and ushering in lasting changes to how we live, work, and travel.
- Rising inflation and bond yields will, in our view, present more opportunities for investors in more flexible fixed-income funds and in strategies focused on inflation mitigation.
- We expect a growing divergence between well-managed companies and those whose poor management and shaky fundamentals were obscured by COVID-19 turmoil.
- Among the possible investment opportunities emerging next year and beyond: secular themes such as fintech and enterprise intelligence, as well as decarbonization. China may also remain attractive for investors.

Theme 1: Adapting to Rising Inflation

We think the supply-chain bottlenecks that are plaguing much of the world these days are unlikely to be resolved very quickly. In fact, next year could easily see mismatches between supplies of many goods and demand for said goods continue (or even worsen), as more countries reopen and global economic activity picks up. Since supply constraints have been a key driver of rising inflation, we believe the most likely outlook for inflation in 2022 is that it will remain above historical average and more elevated than it has been for years. This, in turn, would likely lead to higher bond yields, especially with major central banks preparing to taper their quantitative easing (QE) programs and laying the groundwork for interest-rate hikes going forward.

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The dual specter of rising inflation and higher bond yields has potential implications for an array of asset classes (few will be unaffected), but will, in our view, offer opportunities for investors in more flexible fixed-income funds, as well as global-macro strategies and those with an explicit mandate to mitigate the effects of inflation (such as purpose-built multi-asset portfolios). **FIGURE 1** illustrates our source-based inflation "playbook."

FIGURE 1
The Source-Based Inflation Playbook

SOURCE OF INFLATION		MITIGATION STRATEGY
High growth pressuring sectors with constrained supply	Demand Pull	Cyclicals, home builders, transportation, miners, and consumer discretionary in less labor-intensive areas
Labor power driving labor costs	Supply Pull	Property, consumer discretionary, equities that benefit from higher employment, or labor substitution
Changing climate leads to increased input costs	Supply Pull	Sustainable investments, tansition-focused tools, and technologies
Pent-up capital-expenditure demand driving commodity prices	Supply Pull	Industrial commodities, commodity producers, and commodity-linked equities
Policy-driven increase in money supply and currency debasement	Monetary Pull	Exporters, assets with limited supply such as gold and real assets, firms with greater foreign revenues, and lower domestic costs

Source: Wellington Management. For illustrative purposes only.

Theme 2: Focusing on Fundamentals and Quality

While inflationary pressures are likely to influence almost all investments to some degree, an equally important dynamic that investors should not overlook is the potential reemergence of individual company factors and characteristics as a catalyst for asset prices in 2022. As COVID's far-reaching, dominant impact gradually recedes in the period ahead, we expect to see growing divergences between well-managed companies that look positioned for robust growth on the one hand, and on the other, companies whose poor management and shaky fundamentals were largely obscured by COVID-19 turmoil.

We believe seeking out quality, fundamentally sound companies that are no longer being drowned out, so to speak, by the macro forces of COVID, economic lockdowns, and government-policy support will be an increasingly desirable investment strategy next year and beyond (**FIGURE 2**). Investing in quality growth funds is one potential option.

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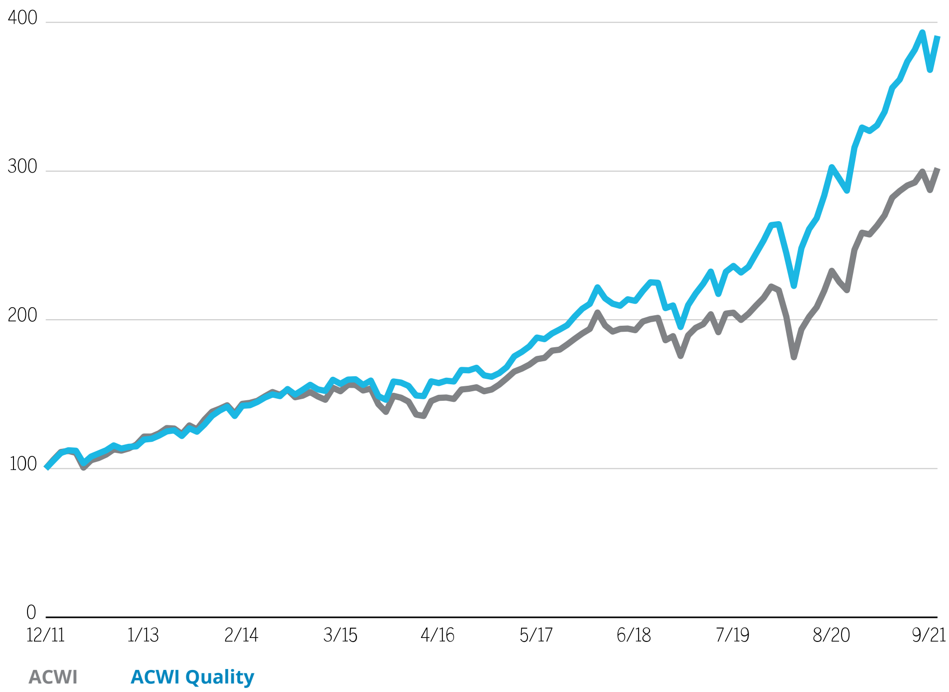
FIGURE 2

History Shows That Quality Companies Tend to Have Better Upside Capture and Better Downside Mitigation Over the Long Run

MSCI ACWI vs. MSCI AC World Quality Index - rebased to 100 at end of 2011



Past performance does not guarantee future results. Investors cannot directly invest in an index. Returns shown are net total returns in USD terms. The MSCI ACWI Index is a free float-adjusted market capitalization index that measures equity-market performance in the global developed and emerging markets, consisting of developed and emerging market country indices. MSCI index performance is shown net of dividend withholding tax. The MSCI ACWI Quality Index is based on the MSCI ACWI Index, its parent index, and aims to capture the performance of quality growth stocks by identifying stocks with high quality scores based on three main fundamental variables: high return on equity (ROE), stable year-over-year earnings growth and low financial leverage. For illustrative purposes only. Actual results may vary significantly. Sources: Bloomberg, MSCI.

Theme 3: Playing the Net-Zero Game

One of the most pervasive investment themes in today's environment is decarbonization—the global-energy transition. With more pronounced changes to the world's weather patterns becoming evident over time, many governments are moving past mere verbal commitments toward concrete regulatory steps and investment programs aimed at combatting climate risks. This so-called green revolution, to some extent a large-scale reimagining of how economies work, will obviously require capital investments in order to be successful, and we believe getting on the right side of what is likely to be a decades-long phenomenon with transformative global potential will become increasingly mainstream next year.

Climate mitigation/adaptation strategies are one way to play this theme, but investors also shouldn't underestimate the value and potential benefits of environmental-social-governance integration in general in the context of their overall investment portfolios.

Theme 4: Going Long Secular Thematic Trends

Since the arrival of COVID-19, several secular thematic trends have broadened out and gained momentum, creating compelling new investible opportunities. These include, but are not limited to, financial technology (fintech), enterprise intelligence and innovation, and a combination of these two trends that has recently helped to spawn the "metaverse" megatrend.

Not surprisingly, such trends reflect the global macroeconomic backdrop. For example, enterprise intelligence has been spurred on by mounting wage inflation and labor shortfalls that are pushing many companies toward automating more tasks where they can and making greater use of cloud-based computing capabilities. Such evolving corporate needs and decisions are becoming more apparent not only in developed-market economies, but also in their emerging-market (EM) counterparts, especially China. This will be worth watching next year.

Investors can target theme- and/or sector-specific strategies tied to the trends that most interest them. Notably, however, thematic investing of this sort is not the same as index investing. You need to do your homework to ensure you're buying what you really want.

Theme 5: Taking a Deeper Dive into China

We think China's extraordinary growth and development over the past few decades demand that it be both a topic of investment discussion and, where appropriate, perhaps a standalone portfolio allocation or the main component of an investor's total EM exposure. Of course, this is often easier said than done, given the complexity of the Chinese economy and the systemic economic, societal, and structural changes that are still going on in the country. The good news: with such seismic change comes numerous opportunities for discerning investors. However, China's recent regulatory announcements and their well-publicized negative impact on some Chinese assets have highlighted the need for investors to properly understand and carefully evaluate these opportunities.

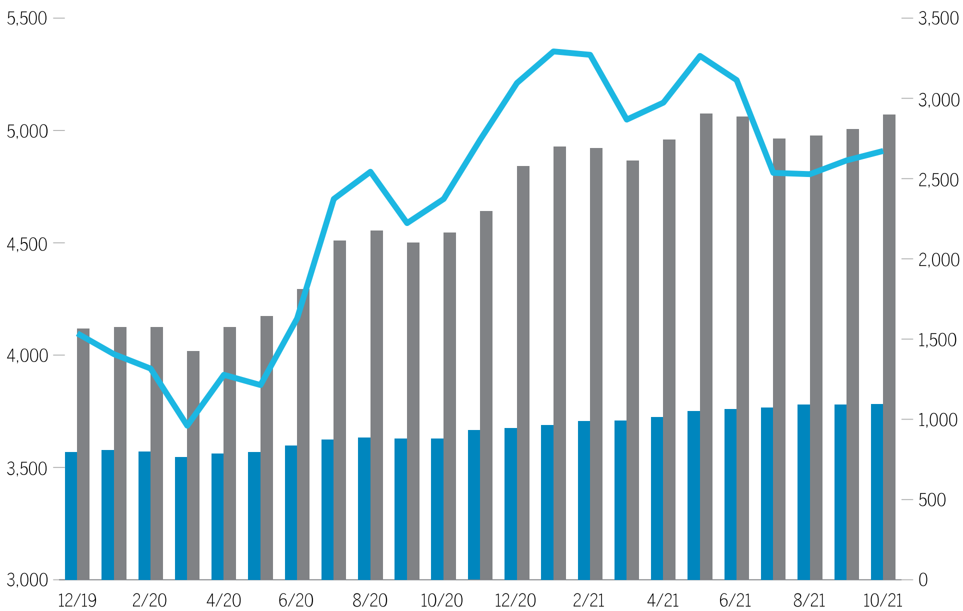
Thus, *with the right approach*, we believe investing in China should remain an attractive investment idea in 2022 and beyond, despite recent bouts of market volatility (**FIGURE 3**). Consider either a dedicated China fund or a more diversified EM strategy.

> With the right approach, we believe investing in China may remain an attractive investment idea in 2022 and beyond.

FIGURE 3

Foreign Investment into Onshore Equity Markets Did Not Seem to Be Deterred Materially, as Long-Term Growth Potential Remains Attractive

CSI 300 Index vs. Foreign Investment Into A-Share Markets



CSI 300 Index (Left-hand side)
Foreign ownership of A-shares (x 100 million shares, Right-hand scale)
Market value of foreign ownership of China A-shares (RMB billions, Right-hand scale)

Past performance does not guarantee future results. Investors cannot directly invest in an index. Actual results may vary significantly. The CSI 300 Index is a capitalization-weighted stock-market index designed to replicate the performance of the top-300 stocks traded on the Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZSE). China A-shares are the stock shares of mainland China-based companies that trade on the SSE and the SZSE. Wellington has reviewed the research and believes the findings are still valid even without the inclusion of more current data. For illustrative purposes only. Sources: Bloomberg and Wellington Management, as of 10/31/21.

For more investment ideas for 2022, talk to your financial professional.

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