DAVY

January 2022

04 Global and Regional Outlook
12 Asset Class Outlook
20 Trends of 2022

MarketWatch

Outlook 2022: Cautious Optimism

Editor’s note

Welcome to the latest edition of MarketWatch.

The years after a crisis are usually nervous ones. We can’t be sure if the crisis is really behind us, or what the actions we took to solve the crisis will mean for the future. As we move into 2022, despite all the restrictions and vaccinations, COVID-19 is still with us. At the same time, after trillions of dollars of support and stimulus, we’re seeing prices rise all around us.

First, the good news. Despite the sharpest drop in decades, the economy has already grown beyond its pre-COVID-19 levels. Remarkably, unemployment is back down close to pre-COVID-19 lows, and the strain on society did not break us. We avoided a financial crash, and bank and household balance sheets are strong. Corporate earnings have rebounded fully, lifting stock markets to new all-time highs and rewarding investors for staying invested.

Of course, there are serious problems too. The economy was not ready to recover so fast, and the sudden demand overwhelmed the available supplies of goods, services, energy, and even workers. Supply disruptions are slowing the recovery, and the resulting surge in prices has brought us the highest consumer inflation in three decades. Whilst higher wages help consumers, businesses face higher costs and a battle to retain staff. On top of this, central banks are priming to raise interest rates and tighten financial conditions. Most importantly for investors, the choices on offer are as difficult as ever – negative real returns, i.e. after inflation, from so-called lower-risk assets versus unusually expensive valuations and higher risk from growth assets.

In this edition of MarketWatch, we describe our outlook for the economy and the markets in 2022 and explain why we choose to remain positive and stay invested. We also look at what could go wrong in 2022, what’s driving inflation, and what’s happening in the job market. We’re not blindly optimistic, but cautiously so.

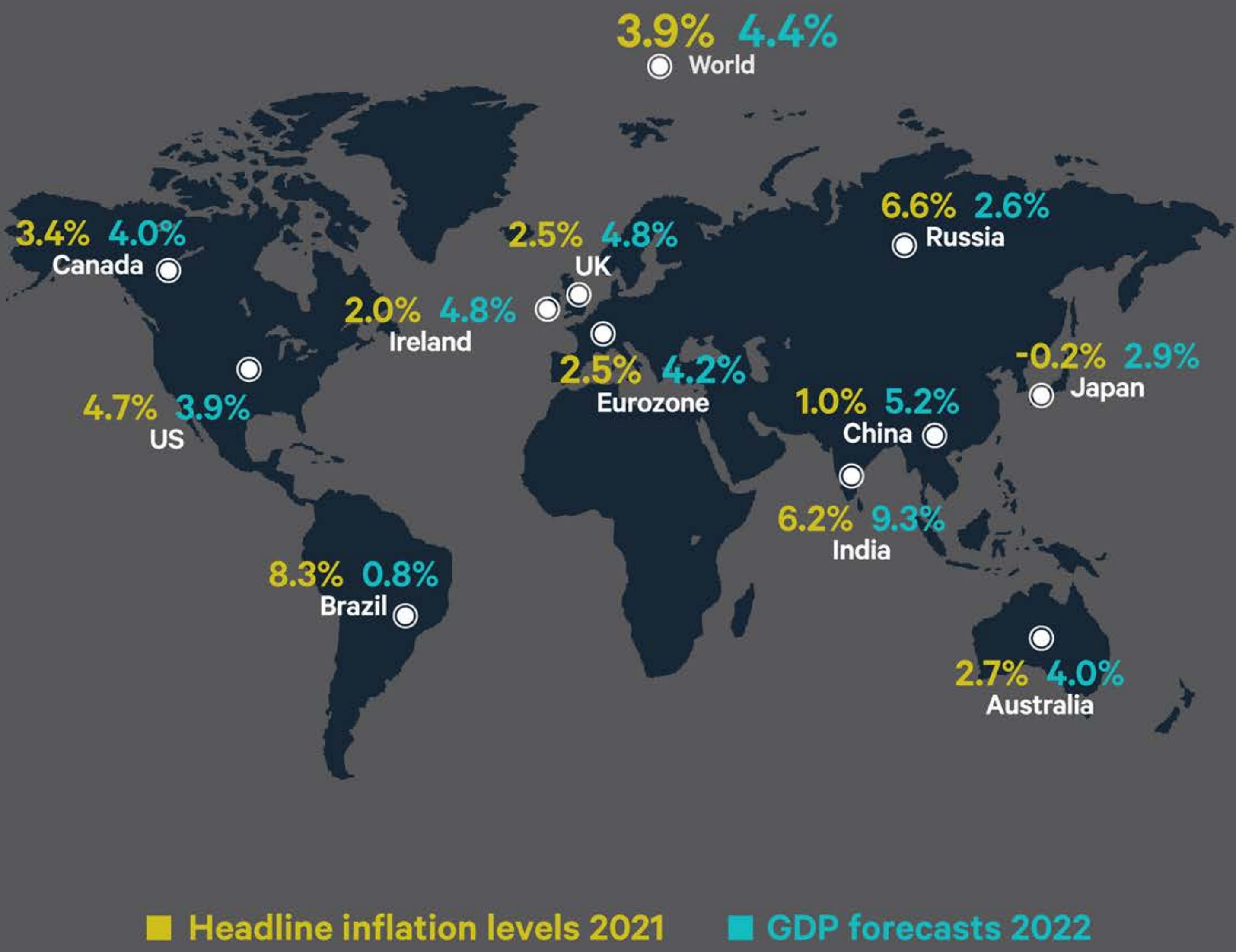
Should you have any questions in relation to the content within this quarter’s edition, please contact your Davy Adviser.

Donough Kilmurray
Chief Investment Officer

Warning: Forecasts are not a reliable indicator of future performance.

About MarketWatch MarketWatch provides investment analysis from Davy Private Clients for discussion purposes only. It is not intended to constitute an offer or solicitation for the purchase or sale of any financial instruments, trading strategy, product or service and does not take into account the investment objectives, knowledge and experience or financial situation of any particular person. You should obtain advice based on your own individual circumstances from your own tax, financial, legal and other advisers before making an investment decision, and only make such decisions on the basis of your own objectives, experience and resources. You may also contact your Davy wealth manager to discuss further any content of MarketWatch.

2021 Headline inflation levels & 2022 Global economic forecasts



Source: Bloomberg consensus as at end of 2021

Warning: Forecasts are not a reliable indicator of future results.

Donough Kilmurray
Chief Investment Officer

Global and Regional Investment Outlook - Cautious Optimism

What does cautious optimism mean – are we optimistic or cautious? We're optimistic about the world economy; that it can withstand more COVID-19 strains, that it won't be consumed by inflation, and that it can continue to grow as central banks gradually tighten policy. However, we're cautious as investors not to get carried away by market momentum on one hand, or excess pessimism on the other.

Is the economy slowing down and why?

After the enormous drop in activity came the enormous bounce. Now that the extraordinary policy support is being withdrawn, how is the economy actually doing? Perhaps the best measure of recovery is employment, and this has come roaring back, only slowed in some countries by COVID-19 restrictions or a reluctance to return to work. Despite the buoyant growth, forecasts for 2021-22 have declined since the summer, causing some to question the robustness of the recovery.

Importantly the slowdown in growth is not due to a lack of demand but to a lack of supply. Looking at the 2022 forecasts, even if we haircut for optimism, the numbers are still well above the growth we've seen in the past decade. So yes, we're slowing down, but to still above-average levels. As long as governments don't decide to lock down their countries again, the chance of recession in 2022 is remote.

Table 1: Gross Domestic Product (GDP) forecasts for 2021-22

Changes	Forecasts at Start of 2021		Mid Year Forecasts		Forecasts at End of 2021		Historical Growth
	2021	2022	2021	2022	2021	2022	2010 - 2019
USA	3.9	3.1	6.6	4.1	5.6	3.9	2.2
Eurozone	4.6	3.6	4.4	4.2	5.1	4.2	1.4
UK	5.3	4.5	6.7	5.4	6.9	4.8	2.0
Japan	2.7	1.9	2.6	2.4	1.8	2.9	0.9
China	8.2	5.5	8.5	5.5	8.0	5.2	10.6

Source: Bloomberg as at December, 2021

Is inflation here to stay?

As governments spent trillions of dollars to support the COVID-stricken economy, critics warned that this would inevitably spill out into higher prices for goods and services. Now that the US and Eurozone have their highest inflation since the 1990s, higher than most expected. The question is whether this is a persistent or temporary change. Looking at the causes, we believe the answer is both.

Energy prices, which contributed so much to inflation this year, are being held artificially high by producers holding back supply. Price increases in other fast-moving items, like raw materials, and new and used vehicles are beginning to fade, at least in the US. This means that headline inflation should fade lower in 2022. However, prices of slower-moving items, like shelter costs and wages, are moving upwards and are more persistent in nature. So while we should see inflation declining in 2022, it will fall to levels higher than we've become used to in the past decade.

Figure 1: Fast & slow inflation

Will central banks stop the recovery?

Apart from reducing the spending power of our money, the downside of inflation is that it can drive central banks to tighten monetary policy and cool down the economy. Jerome Powell at the US Federal Reserve (the Fed) told us for months that high inflation was transitory and immediate action was unnecessary, despite his colleagues and the markets bringing forward their rate expectations. Eventually, facing the facts in December, he conceded the need for faster action.

In the slower-moving Eurozone, where core inflation is several points lower, Christine Lagarde warned markets that EUR rates do not need to be increased in 2022.

At the other end of the readiness scale, the Bank of England indicated for months that higher rates were coming, and then surprised the market by not hiking in November.

Whatever the exact timing, reducing bond purchases and hiking interest rates by a quarter percent every few months is a slow way to cool down the economy. Also, if the cause of inflation is supply disruption, then higher rates are not going to solve that problem. The most immediate impact a central bank can have is to change market expectations, and therefore communication is key. It will never be perfect, but we expect the Fed and others to manage expectations for policy changes very carefully and not to upset the recovery by surprise tightening.

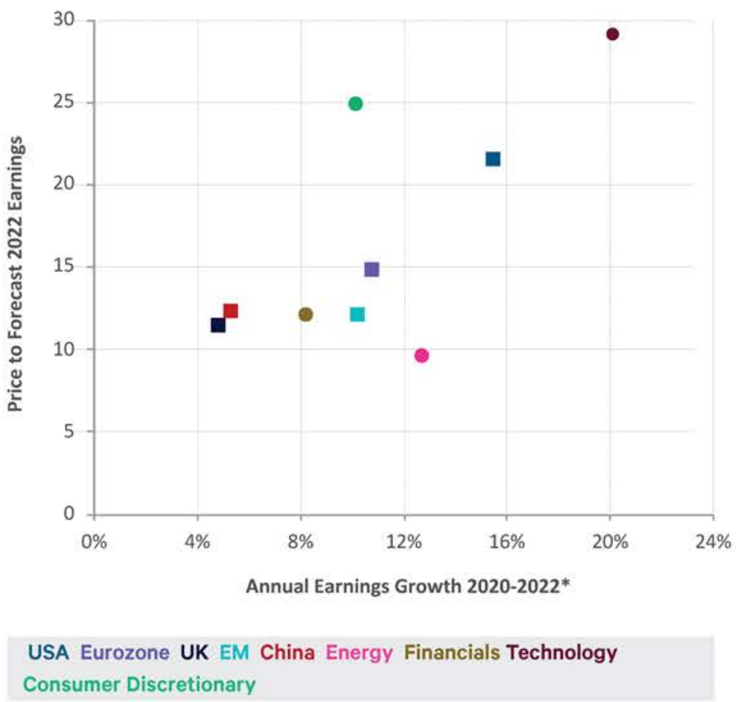
What are the market prospects for 2022?

Now that we've had the rebound, the fundamental questions for investors are (i) how much growth is left in corporate earnings, and (ii) are we paying a reasonable price for this growth? After a 20% fall in 2020, global earnings are on track to be up over 50% for 2021. Forecasts for 2022 are far more modest, in the 5-10% range.

Given that forecasts tend to be a little optimistic, and we don't expect valuations to increase in 2022, this represents a realistic cap on return expectations for the year.

As for valuations, price/earnings ratios are generally higher than historical averages, especially in the US. Looking across countries and sectors, we see a relatively consistent relationship between earnings growth and valuations. More expensive markets are growing far beyond their pre-COVID-19 earnings levels, while cheaper areas, like the UK and China, are struggling to grow as fast. Investors are clearly paying up for growth, and growth sectors have delivered. Rather than take sides in the value/growth war, we judge each sector on its own merit, and in our discretionary portfolios we maintain a slight pro-cyclical tilt going into 2022 to capture the continued above-trend growth.

Figure 3: 20-22 EPS vs P/22E



Source: MSCI, DataStream; * Combination of 2 years of actual earnings growth (2020-21) and 1 year of forecast growth (2022); based on local currency indices for each region; sectoral indices are in USD

Should we stay invested?

Assuming that COVID-19 lockdowns don't return to crush business activity, and central banks don't tap the interest rate brakes too hard, the economic cycle is set to continue. Stock markets rarely run smoothly, but absent another recession, a bear market is very unlikely. However, momentum is fading as we move further past the COVID crash, and many fear that the market may no longer have the legs to continue to outrun the various risks, not least its own extended valuation.

Looking back at previous recession-induced bear markets (down 20%), we find that returns do typically hold up in the second and third years of a recovery. Except, as in the early 1980s, when another recession quickly follows.

It's true that the post-crash rally has been much stronger this time than usual, and valuations are higher than normal. This doesn't mean another crash, but it would be reasonable to assume lower returns from here on in.

It's worth remembering that, outside of recessions, corrections (down 10%) do happen often, on average every other year. It would be completely normal to see such a correction in 2022 and still finish up 5-10% on the year. Trying to predict and time these dips is usually a losing strategy, so we prefer to focus on what we can control – ensuring that we have enough liquidity set aside to see us through any bumps, and enough growth in our portfolios to achieve our objectives, even under cautious return assumptions. In other words, a robust financial plan.

Table 2: Return stats for years 1-2-3

	US Large Cap Equity post Bear Markets*		
Market through	**First Year**	**Second Year**	**Third Year**
Jun-49	34%	28%	27%
Sep-53	46%	41%	8%
Oct-57	30%	16%	-4%
Jun-62	31%	22%	6%
May-70	35%	13%	-1%
Oct-74	26%	20%	-6%
Mar-80	40%	-13%	44%
Aug-82	44%	6%	19%
Oct-90	34%	10%	15%
Oct-02	21%	9%	9%
Mar-09	50%	16%	9%
Average	35%	15%	11%
Median	34%	16%	9%
Mar-20	56%		

This year had a correction (down 10%)
This year had a bear market (down 20%)

Source: Ibbotson, Bloomberg; * Looking at bear markets caused by recessions; Total returns measured from the end of the month of the market trough; based on USD indices

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates. Forecasts are not a reliable indicator of future performance.

Conall MacCoille
Chief Economist

Irish economic outlook

Our new forecast is that Irish GDP (gross domestic product) grew by 15.5% in 2021. Once again, this 'supercharged' GDP growth seems a little bit too good to be true. The familiar story is that the multinational sectors are performing exceptionally well, particularly information/communications technology firms, pharmaceutical, and med-tech manufacturing companies.

Multinationals inflating Ireland's GDP once again

We expect that exports have grown by an enormous 17% in 2021. This is despite global demand held back by the COVID-19 pandemic and supply-chain difficulties hurting industrial production globally. However, Ireland's export sector has always been defensive, performing relatively well during recessions. Computer services exports were up 29% in the first three quarters of 2021. Similarly, modern sector industrial output, dominated by pharmaceuticals was up 37%.

Still, double-digit GDP growth rates are not the norm. Although the multinational companies operating in Ireland are clearly doing well, some of the expansion in their recorded output is artificial. One distortion has been the transfer of intellectual property assets, to comply with new OECD (Organisation for Economic Co-operation and Development) rules to reduce tax avoidance.

Hence, Irish companies 'invested' in €140bn of intangible assets in 2020 and a further €105bn in 2021. As these assets have been transferred into Ireland, the revenues associated with them have been counted as exports, inflating Ireland's GDP figures. However, the OECD deadlines have now passed. In 2021, Irish companies have invested just €25bn into intellectual property. So these distortions could come to an end in 2022, leading to a more 'normal' GDP growth rate.

Indigenous economy also buoyant

However, it would be wrong to dismiss Ireland's economic performance as a statistical mirage. A striking development is that the level of employment is now 6% above pre-pandemic levels, whereas it remains below pre-COVID-19 levels in other countries.

The recovery in the labour market is also evident in falling numbers of Pandemic Unemployment Payment (PUP) claims, down from above 200,000 in June, to close to 100,000 at the end of September, to just 55,000 in early December.

It is true that a degree of statistical fog still surrounds the official Labour Force Survey (LFS), but the alternative Revenue PAYE measure shows that employment has fully recovered. The trend is also apparent in income tax revenues in the first eleven months, of €24.5bn, up 16% on 2019, helped by pay growth currently running at 5% per annum.

It also that appears that consumer spending has made a vigorous recovery – just 1% below pre-pandemic levels during the summer months. Further, November was the strongest month for credit/debit card spending since the pandemic began. VAT receipts corroborate the positive story, €15bn in the first eleven months of 2021, up 24% on 2020, but also 2% higher than the same period of 2019.

Of course, one headwind for consumers is the pick-up in energy prices and CPI (consumer price index) inflation. It is possible CPI inflation could rise towards 6% in early 2022. Thankfully, Irish households have saved through the pandemic – putting them in a good position to withstand the hit to their real incomes from rising prices. Indeed, Ireland is estimated to have had the second highest household savings rate in the OECD in 2020.

Irish government has room for manoeuvre
Nowhere is the buoyancy of the domestic economy more evident than in the public finances. Remarkably, we now expect that the deficit in 2021 will be just €5.8bn, or 1.3% of GDP. This is despite a high level of direct fiscal support for companies and households through the pandemic; such as the Emergency Wage Subsidy Scheme (EWSS) and the PUP. Of course, the explanation has been tax revenues have been buoyant, not only corporation tax, but also the incomes taxes, VAT, excise, capital gains and acquisitions.

Of course, the near-term threat to the Irish economy is the Omicron variant and possibility of extended restrictions into 2022. Clearly, many companies have had a difficult pandemic. The Central Bank of Ireland indicates €4.7bn of bank loans to companies and households received forbearance in the first nine months of 2021, of which 80% were business loans, especially concentrated in the real estate, hotels and restaurants and other service sectors.

It remains to be seen how many of these firms will be viable as the economy eventually exits the pandemic – and liquidations of indebted companies will inevitably rise. That said, with a small deficit, the government is in a good financial position to extend fiscal supports for firms, if needs be.

No stopping the Irish housing market
Residential Property Price Inflation (RPPI) accelerated to 13.5% in November. Whilst we expect RPPI inflation to slow in 2022 to 4.5%, most of the evidence points to the risk of stronger prices gains. The lack of housing supply is well known. There were just 11,300 properties listed for sale on MyHome in early December, a fresh record low.

However, the strength of housing demand often isn't fully appreciated. The higher paid segments of the Irish labour market are clearly performing well, particularly the multinational sector, contributing to pay growth of 5.4% in Q3 2021. Hence, the average mortgage approval rose to €269,000 in November, up 8% on the year. In this frothy environment, there seems little prospect of a meaningful improvement in housing market conditions for homebuyers in the near future.

Conall MacCoille
Chief Economist

UK economic outlook

The UK economy staged a strong recovery during 2021. In October, the level of UK GDP (gross domestic product) was just 0.6% below its pre-pandemic level, whereas it was 8% below at the beginning of 2021. Consumer spending came roaring back once restrictions were eased. Furthermore, the unemployment rate fell to 4.2% in October, albeit flattered by weak participation, but signalling there has been little adverse impact from the end of the jobs furlough scheme in September.

Nonetheless, an atmosphere of gloom still seems to hang in the air. The pessimism perhaps reflects not only the new Omicron variant and fresh restrictions, but also Boris Johnson's erratic premiership and an acceptance that Brexit is holding back the UK economy. Though labour shortages and supply-chain disruption were evident in many countries in 2021, they seemed particularly acute in the United Kingdom, during its first year outside the EU single market.

Pay growth no panacea to structural problems

One fillip seized upon by Johnson's government is that wage growth in the UK has picked-up – now supposedly part of the Brexit plan. According to the Recruitment Employers Confederation (REC) survey, the pace of pay rises for permanent placements had reached record levels in late 2021. Unfortunately, rises driven by labour shortages, rather than productivity growth have ultimately proven inflationary.

Hence, it is no great surprise that the Bank of England (BoE) was the first of the major central banks to raise rates to 0.25% in December. Markets are currently pricing a further three rate hikes to 1% by the end of 2022. This tightening of monetary policy followed the pick-up in CPI (consumer price index) inflation to 5.1% in November.

The BoE's Monetary Policy Committee (MPC) expects CPI inflation to peak at 6% in early 2022 and then fall back later in the year. However, core CPI inflation (excluding energy) was 4% in November - pointing to broader, potentially more persistent prices pressures. So there is a risk inflation could be longer lasting than the MPC is currently willing to admit.

One factor in the Bank's thinking must be that Brexit represents a significant headwind to the UK economy's supply capacity. For example, it is still too early to gauge how net inward migration of EU workers into the UK has been affected by Brexit, but has no doubt contributed to labour shortages and inflationary pressure. Put simply, Brexit is pushing the MPC to raise interest rates early.

Rishi Sunak reins in the public finances

Another headwind faced by the UK economy is that Rishi Sunak is moving to consolidate the public finances. The deficit in 2021 is expected to equal around 8% of GDP. To close, it National Insurance Contributions (NICs) will rise by 1.5% in April 2022 – to help fund social care and reduce NHS waiting lists.

This move comes on top of the decision to raise corporation tax and freeze income tax bands and credits. The UK faced more revenue raising measures in 2021 than seen from any Chancellor of the Exchequer since the 1990s.

One casualty of Sunak's restraint has been the Leeds branch of the high-speed rail (HS2) project, which will now not go ahead. This is a difficult pill to swallow for many 'red-wall' Conservative MPs worried about how they will fare at the next election. It is quite possible opposition to tax rises from many Conservative MPs in southern constituencies will lead to other elements of Boris Johnson's 'levellingup' agenda of ambitious public capital infrastructure projects being scrapped.

Indeed, the October Budget was also noticeable for increasing the size of state spending, by some measures to its highest levels since the 1950s. This is a very different picture to the low tax, low regulation nirvana, or 'Singapore on the Thames' that many Brexit supporting MPs had envisaged.

Getting Brexit done

With the ink barely dry on the EU/UK withdrawal and trade agreements, 2021 saw the UK try to re-open negotiations on the Northern Ireland protocol, frustrating the European Union by refusing to implement many of its requirements for customs controls on trade.

Many commentators had characterised the EU's Autumn proposals on medicines and to reduce border controls by 80% as generous. However, former Brexit secretary David Frost's insistence that the role of the European Court of Justice (ECJ) in overseeing the protocol be removed seemed designed to undermine any chance at compromise.

However, it appears the embattled UK government has now moved to a more conciliatory position. David Frost's resignation followed reports in the UK press that the cabinet had ordered him to engage with EU proposals and would not countenance a damaging trade war.

According to reports, Rishi Sunak, amongst other cabinet members were reluctant to risk exacerbating supply-chain disruption, especially at a time when public opinion of the Conservative government was already being severely tested by COVID-19 restrictions, energy price hikes, income tax rises, and Boris Johnson's poor handling of the Owen Patterson affair and other scandals. Hopefully, this means Frost's replacement, Liz Truss, will aim to secure a deal with the EU on the Northern Ireland protocol in the near future.

Asset Class Outlook

13	Global Equities - Where could it all go wrong?
16	Irish Equities - Every cloud has a silver opportunity
18	Currencies - Mind the gap
20	Fixed income - A test of patience for central banks

Aidan Donnelly
Head of Equities, Davy Private Clients

Global Equities - Where could it all go wrong?

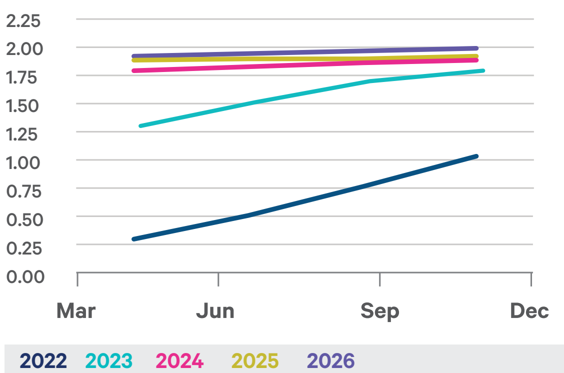
One mistake that people make when looking at investment markets is to assume that all the data that are released will point in the same direction and therefore confirm whatever conclusions are there to be seen. Nevermore is this the case than when it comes to writing outlook pieces like this – we draw a nice trend line through the past and project it out into the future. To make matters worse, we, as humans have this awful habit of seeking out only the data that prove our point of view – psychologists call this "confirmation bias" – whilst ignoring everything else to the contrary.

The reality is that there will probably never be a time when the data are so perfectly aligned that we can wrap a neat little bow around it and be 100% confident in what is going on or what will happen. So rather than trying to forecast exactly what will happen, perhaps a better endeavour is to identify some of the major factors that could swing markets one way or the other over the next year.

Given the importance they have amassed since the global financial crisis, it is inevitable that we focus on central banks, and in particular the US Federal Reserve (the Fed). As we look into 2022 perhaps one of the biggest risks to markets comes from the Fed that is forced to act too far and too fast on interest rates. Short-term interest rate markets have already priced the potential for three interest rate increases in 2022, but what could cause the Fed to go even further?

The obvious answer is inflation, or more accurately, should the wave of price increases witnessed over the last year become a political issue. Key to this will be how companies and households manage to deal with the elevated inflation that is percolating through the global economy. Having met with several companies in recent months, it seems that managements have been putting through a series of price increases in recent months, firstly, to offset raw material price increases and secondly, to try to recoup the "higher costs to serve the customer" (supply shortages, freight, labour), with little in the way of reduced demand or volumes of sales.

Figure 1: Eurodollar interest rate



Source: Bloomberg as at 31st December 2021

One might have thought that if inflation were going to bite, it would be felt by the likes of the big retailers – either they would have to take a margin hit by absorbing some of the rise in product costs or the customer base would need to rein in spending a bit. So far, there is little to no evidence that either of these is happening with revenue at both Walmart and Home Depot, for example, comfortably beating expectations while gross margins remain stable.

Figure 2: Consumer Confidence

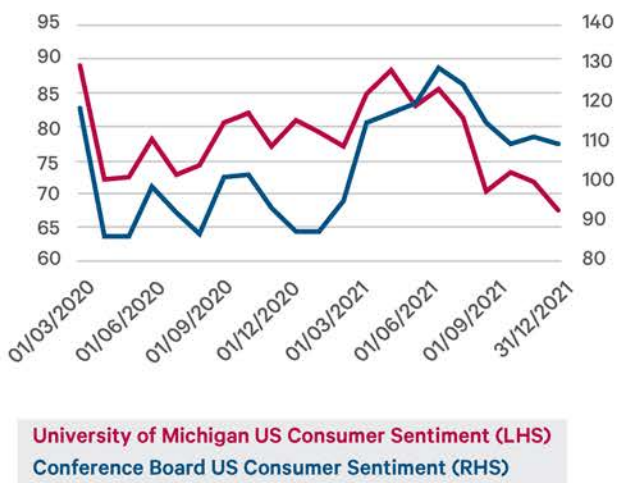
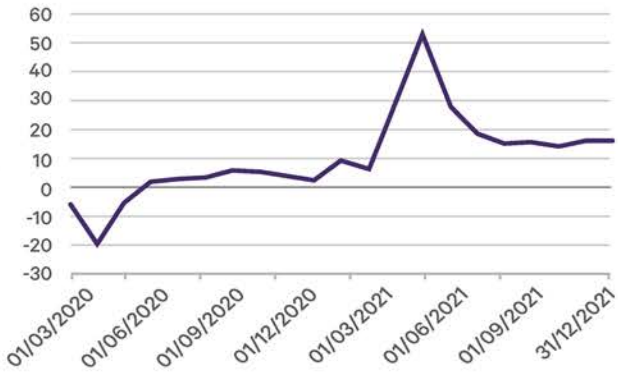


Figure 3: US Adjusted Retail Sales year on year change %



Source: Bloomberg as at 31st December 2021

On the consumer side, there is a conundrum to ponder as we try to square the apparent serious drop in consumer confidence with the recent retail sales data or these financial results from retailers. There is more than one measure of confidence (University of Michigan, Conference Board) so fixating on the worst reading might be misleading and as a general principle, it's usually a good idea to watch what people do (retail sales) rather than what they say (sentiment) and, for now at least, public behaviour would indicate that things are just fine.

Simply put, people are spending more, at least in nominal terms, but some of this may simply represent money illusion – you feel wealthier after a nominal pay rise, even if it buys you less when you go to the shops.

Official data already suggests that real wage growth is negative, workers have been slow to return to the workforce after COVID-19, and pandemic payments ended a few months ago, but spending power remains strong. So, where is this coming from?

A look at the macro data suggests two sources. The savings rate has declined significantly in recent months and is now at it's lowest level since the end of 2019. It is reasonable to posit that people are simply spending more of their monthly incomes (and possibly anything squirreled away in recent quarters) to maintain consumption amid elevated prices.

The other big change is the willingness to use revolving credit again. Households aggressively paid down credit card balances at the peak of the

Figure 4: US Credit Card Total outstanding Balance US$tn

Source: Bloomberg as at 30th September 2021

pandemic, reflecting both risk aversion and the infusion of cash from the government. However, the monthly change in credit card usage has bounced back strongly over the last few months.

The good news is that outstanding credit card balances are still below the pre-pandemic peak, so clearly there is room for credit to expand further to fund consumption.

For the time being, it looks like households have enough of a cushion in income, savings, and available credit to pay whatever retailers are asking – but that may not last forever. If the market continues to price runaway inflation without the evidence of real wage growth, then the consumer will hit a biting point at some stage – and might just start complaining to their politician.

How long it takes for the politicians to jump on the bandwagon (or soapbox) and start demanding action on inflation from the Fed is anyone's guess - as is whether the Fed will be forced to listen. Having recently secured another term in office, Fed chair, Jay Powell, might let the screaming masses howl for some time to come – but maybe he won't!

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates.

Warning: Forecasts are not a reliable indicator of future performance.

Marie Gillespie
Senior Equity Analyst

Irish Equities - Every cloud has a silver opportunity

As another year rolls on and we head into 2022, unfortunately, the spectre of COVID-19 and new variants still looms large. Markets, however, tend to look out several months in advance, and experience would tell us that equilibrium is likely to be found eventually. As for 2021, whilst at the time of writing, Ireland may have lagged its US and European peers somewhat in performance terms, the index overall still does not look cheap relative to it's history. However, when we dig behind the headlines and look at the individual stock and sector data, we can see that earnings and valuations can vary greatly.

As in life, the pandemic has not been fair to all companies in Ireland or indeed elsewhere. It's well known that certain sectors globally have been benefiting in earnings terms as demand for construction and housing amongst others has been exceptionally strong this year. For other companies that are more exposed to a resumption of a more "normalised life" (travel, tourism, the restaurant sector), earnings have not yet fully started to recover.

Naturally, Irish companies are not immune to the same supply chain and cost inflation issues that are being experienced globally at the moment. In some cases, this may be particularly acute as businesses have the double whammy of a Brexit impact , which may further influence shortages or indeed the ability to procure staff. However, as a broad statement, it's probably fair to say that, overall, Irish management teams are coping remarkably well so far in the ability to pass on costs and cope with other issues.

The imbalance in experiences for sectors has a corollary in earnings terms. Certain companies in the Irish market are expecting earnings to roll over from a very high base in 2022.

However, for the Index overall, earnings growth is actually set to accelerate into 2022, with overall index earnings growth slightly more than two times that for 2021 and higher again in 2023.

So where is the accelerated earnings growth coming from? Undoubtedly, the pandemic has led to significant disruption across the board. But this disruption can also lead to opportunity, and it is fair to say that a number of Irish companies are entering into a period of transformation. Long-term strategic thinking has come to the fore, and many companies have been positioning themselves accordingly. This transformation is coming in a number of forms:

1. **Expansion.** Whether this is geographic expansion into newer regions with further opportunities, long-considered coveted expansion, or opportunistic business expansion as competitors exit, there is no doubt we are evidencing plenty of both organic and acquisition development in the marketplace. In general, the strength of Irish balance sheets has afforded the ability for development as and when the opportunity presented itself.

2. **A refocusing and divestment of businesses that are no longer seen as core.** We have seen a number of announced divestments this year as Irish companies generally consider where they would like to be positioned in the long-term.

3. **Buybacks.** In the absence of large scale Mergers and Acquisition (M&A) opportunities, or sometimes in conjunction with M&A, a significant proportion of Irish companies are turning to Buybacks or partial tender offers as a means of enhancing shareholder returns.

4. **Return to dividends.** A number of companies, namely in the financial sector, have been precluded from paying dividends in 2021. We expect a resolution in 2022.

5. **Sustainability.** It can be argued that sustainability is actually at the heart of much of the long-term thinking that we are currently witnessing, as companies can no longer solely focus on the next quarter or next year.

   With climate change dominating the headlines, investor and employee pressures ramping up, not to mention numerous legal requirements, the trend for Irish companies to embrace sustainability in real, concrete, measurable metrics is increasingly evident.

Overall, looking out to 2022, it seems likely that we may continue to experience some market volatility. However, for both investors and companies, a long-term pragmatic approach will undoubtedly bring opportunity.

Warning: Forecasts are not a reliable indicator of future performance.

Stephen Grissing
Investment Strategist

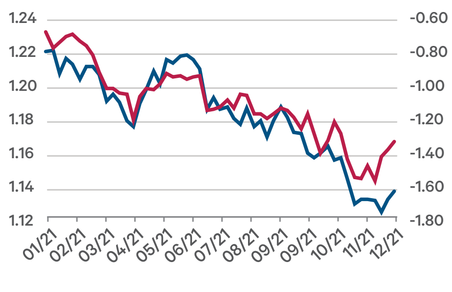
Currencies – Mind the gap

Our view on EURUSD turned less positive during the fourth quarter of 2021. In a previous edition of MarketWatch, we highlighted that there are several key drivers for currency pairs and that the importance of each driver regularly changes over time. There is little doubt that the driver with most significance for the EURUSD currency pair is currently the diverging paths of monetary policy that have unfolded (Figure 1).

Since the revised dot plot at the June 2021 Federal Open Market Committee (FOMC) meeting revealed that seven of the eighteen members viewed a rate increase in 2022 as a possibility, the market has continued to aggressively price future US interest rate increases. During this time EURUSD has drifted lower from $1.21 to $1.12 at the time of writing.

This path is unlikely to converge any time soon given the relatively weaker historic inflation backdrop in the eurozone that still prevails today. The October US core consumer price index (year-on-year) came in at 4.6%, the highest level since 1991, versus 2% in the eurozone.

Figure 1: Diverging market pricing for future interest rates



Source: Bloomberg, updated as of 31st December 2021; Note: OIS = Option-adjusted spread

EURUSD 2Y1M EUR-USD OIS (RHS)

Any signals of a more hawkish European Central Bank would pose a risk to our view; however, this is not something we anticipate for 2022.

Sterling – murky waters ahead

It is difficult to contemplate the outlook for sterling without phrases like "challenging" or "murky waters" coming to mind. Sterling is no stranger to uncertainty and 2022 appears to be no exception.

Currencies tend to benefit prior to interest rate increases being implemented, as short-term bond yields rise in anticipation. The relationship between sterling and 2-year UK gilt yields broke down in the fourth quarter of 2021 as sterling initially depreciated as yields increased. The Bank of England (BoE) is embarking on what is viewed as a "bad news" hiking cycle. With their backs to the wall, the BoE will be pushing through interest rate hikes at a time of elevated levels of stronger than expected inflation and weaker than expected economic growth.

Conditioned on the market-implied path of interest rates (a terminal rate as low as 1%), the Monetary Policy Committee's (MPC) November projections concluded that UK inflation would trend back towards their 2% target over the forecast horizon which runs to 2024. Interest rates at 1% or lower in the UK will provide limited support for sterling in the medium term, particularly versus the US dollar where higher interest rates are expected.

And there is more. Brexit risk is back in the spotlight. With discussions on the Northern Ireland protocol at a standstill, expectations for the UK to trigger Article 16 are mounting. Sterling has proven to be a reliable gauge of Brexit sentiment since the referendum in June 2016, so expect more volatility in the currency in the coming months.

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates.

Warning: Forecasts are not a reliable indicator of future performance.

Stephen Grissing
Investment Strategist

Fixed Income - A test of patience for central banks

2021 was a year to forget for government bond investors. Returns of -3.1% from global government bonds (hedged to euro) were in stark contrast to the +31.4% returns available from global equities. The prospects for 2022 are not much brighter.

The current economic cycle has been unique, maturing at a rapid pace. Recent research from JP Morgan highlighted that the current cycle has matured quicker than any in almost 40 years, twice as fast as the average of the prior four cycles. This is based on the duration between the end of each US recession and the start of the US Federal Reserve rate hikes, using forward market pricing for the current cycle. This rapid pace accompanied by stubbornly high inflation means that the focus for 2022 will be on central banks and the path to policy normalisation.

Hold, hold, hold

The varying degrees to which central banks are capitulating and losing patience for the "wait and see" approach to higher inflation is becoming clear. First to capitulate were emerging market central banks, followed more recently by the Bank of England and Bank of Canada.

The US Federal Reserve find themselves in the middle of the road. Although not an outright hawk, Chairman Jerome Powell has certainly turned more hawkish. The decision at their December meeting to speed up the pace of tapering opens the door to an earlier interest rate lift-off in 2022.

At the other end of the spectrum is the European Central Bank (ECB), who are staunchly sticking to their transitory narrative. The ECB has more to lose from a knee-jerk reaction if the inflation threat turns out to be temporary and fades during 2022. To a far greater degree than the US, Europe has struggled to consistently generate inflation in line with their target. The latest inflation projections in December, show that the ECB expects inflation to be to be 3.2% by the end of 2022 and 1.8% in 2023, reinforcing the point that interest rates in Europe are going nowhere anytime soon. Despite this, the market is pricing circa 25 basis point of a rate increase by end of 2022.

How are Davy portfolios positioned for this environment?

We expect the general direction of travel for yields to be higher in 2022. Further gradual moves higher in yields will likely result in another disappointing year for holders of developed economy nominal government bonds. To reflect this view, Davy discretionary managed portfolios remain underweight government bonds, with a preference for low duration. To finish on a positive note, the elevated market pricing for interest rates means it will be difficult for central banks to surprise the market, limiting the chance of a policy misstep and a sharp sell-off.

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates.

Warning: Forecasts are not a reliable indicator of future performance.

Trends of 2022

22 What's behind the great resignation?

24 Private Equity - the state of play

26 Crypto bulls, bears and don't cares

28 SAA & benchmark changes in 2022

30 Start your New Year financially fitter

32 Manager Selection – a key driver of future returns

What's moving the dial on inflation?

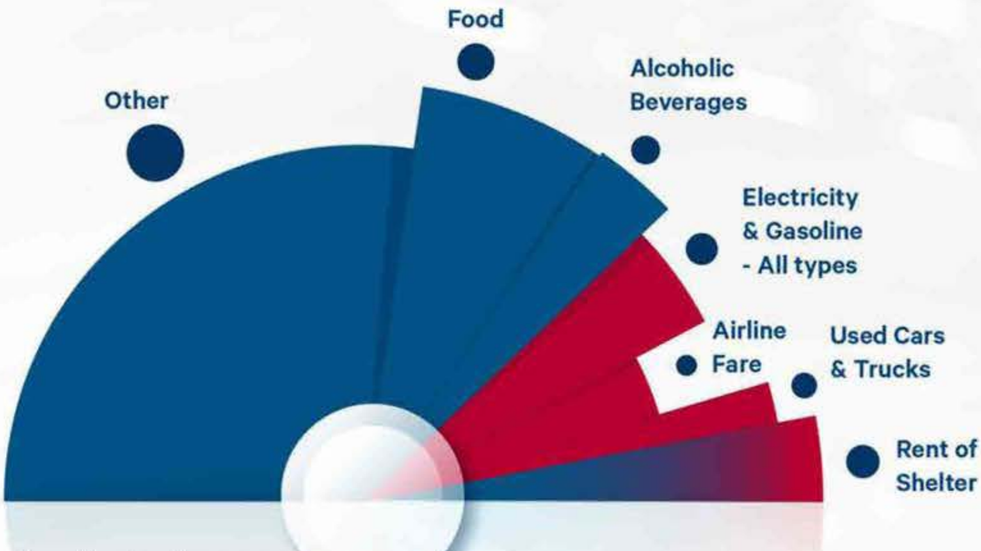
Over the year 2021 inflation has increased, which in moderation is usually seen as a good sign of a healthy macro environment.

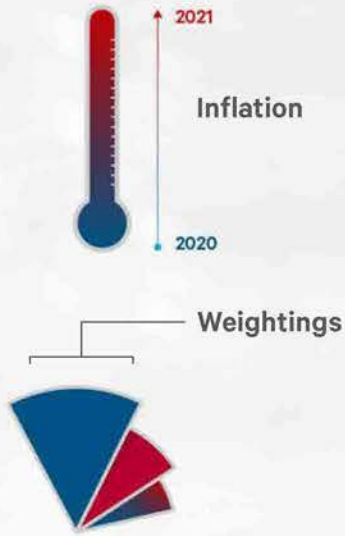
However, several inflation components with smaller index weightings have seen their prices surge over the last 12 months causing the overall inflation figure to skew higher such as electricity and gasoline.

This means that energy, for example is now a much larger contributing factor to current inflation readings.

To note: inflation components with larger index weightings have not experienced the same price surge effect leading many to believe the current bout of high inflation should be fairly transitory in nature.

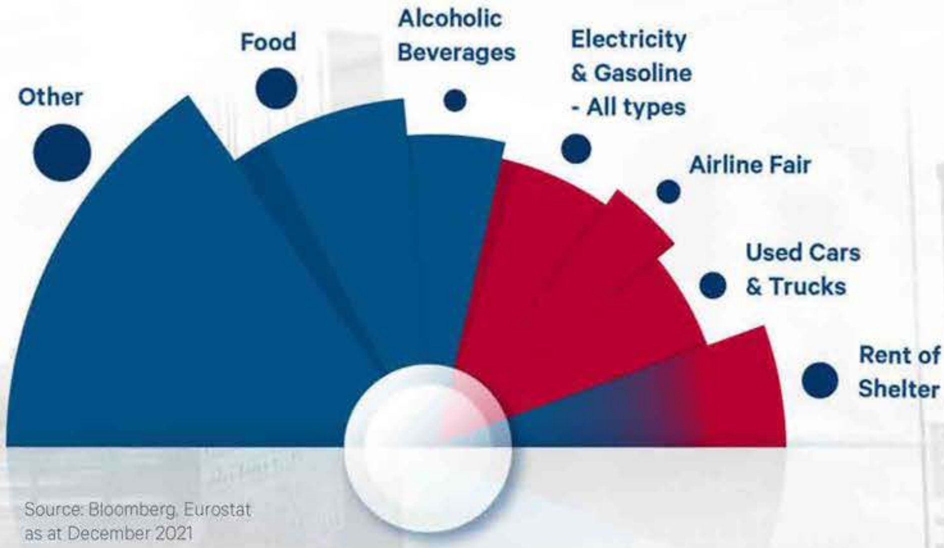
US Consumer Price Index





Source: Bloomberg, Bureau of Labor Statistics as at December 2021

EU Consumer Price Index



Source: Bloomberg, Eurostat as at December 2021

Anna Heaney
Investment Associate

What's behind the great resignation?

Chronic labour shortages have been evident across multiple industries and regions this year. In the US in particular this issue has been exceptional and in September alone, 4.4 million people voluntarily resigned, constituting 3% of the labour force. Participation rates in the region are also declining, having dropped from 67% at peak in 2000 to 62% currently. This comes at a time when there are more than ten million job vacancies in the country.

The "great resignation" isn't just a US phenomenon, in the Irish context, labour shortages have been striking, described as "the single biggest challenge to the Irish economy" and the issue is even more acute in the UK, exacerbated by Brexit and the departure of EU citizens. Job to job moves aren't the only issue causing havoc in the labour market, demographic shifts such as slowed migration and an aging population are adding to the pressure. Also, pent up anxieties from living through a pandemic have changed people's perspectives and it is predicted that record numbers of people will leave their jobs post pandemic – according to the World Economic Forum, almost half of the global workforce are already considering it. Businesses are feeling the pinch as employers are having to provide pay increases and increased flexibility to attract and retain staff – the former contributing further inflationary pressures. Currently, the idea of achieving maximum employment whilst containing rising prices seems unachievable.

"Staff needed"

COVID-19 has created a power shift to the benefit of workers, particularly in service industries and they can now be highly selective in the opportunities they take and the ones they walk away from. Resultingly, some companies have been forced to turn away business due to resource constraints which threatens the pace of the global recovery as many sectors can't rehire workers. Those that availed of furlough schemes at least kept a link to their employees, those that didn't struggle as much.
The period has been tough on the human psyche. Particularly, for those in industries not deemed "essential" such as hospitality and retail that have had to face multiple closures and loss of income throughout the period. Industries that have low location and time independence i.e., require people to be at the same place at the same time have suffered massively due in most part to workers fears of contracting COVID-19. Many employees have retrained, shifted industries, retired early, migrants returned home, or some employees have chosen to leave the labour force after a change in lifestyle through accumulating savings and clearing debt through lockdown. Government financial support is also viewed by many as a disincentive to return to work for certain sectors though even as it ended the dial didn't move significantly.

The war on talent

After almost two years of ongoing upheaval in both personal and professional lives, many knowledge-based workers across the Western world have been reassessing their approach to work and what it means to them. This is triggering people to become more aligned with their long-term goals. In this new era, virtual and remote work is perceived to have many perks, bringing with it more balance and flexibility to people's lives. For many that stay put, more autonomy is being afforded to them in terms of career development internally and an element of job crafting is being offered in an effort to retain talent. Benefits to the organisations from remote work include a global talent pool and lower fixed costs on locations. The outcome from this war on talent will hopefully be more decent and dignified work for all and more autonomous schedules, though the future of work and how it will look post-pandemic has not fully settled.

Chinese exodus

Chinese citizens whose culture is synonymous with professional advancement and competition between peers have been adopting the tang ping (lying flat) approach of late. Though quickly restricted and censored by Chinese authorities across social media (where it kick-started) and ecommerce platforms selling slogan merchandise, the philosophy in which people decide to do the bare minimum has been spreading amongst the population. Driven as a means of silent protest against an inequitable system they find themselves in, the decision to opt out of the societal pressures of modern life has become commonplace. In an interesting turn of events, the nation synonymous with a crippling "996" work schedule—9 a.m. to 9 p.m., six days a week, has recently made that work culture illegal, signaling a changing tide for Chinese employees.

The pursuit of happiness

Burnout and deteriorating mental health have been exacerbated during the pandemic and triggered action on something that has likely been building for some time across the world. With stagnated incomes, inflated housing and childcare costs and precarious work situations for some, it is little wonder that people feel the social contract that they've bought into isn't paying off. For many, the economic growth of their nations hasn't equated to an increased standard of living and they have not reaped the benefits of progress. People are now voting with their feet and making drastic changes by either deciding to resign from their jobs or the workforce as a whole.

Some believe that this stance will lead to a period of stagflation, like that witnessed in other cases of changing demographics such as the greying population of Japan. However, others view it as the emergence of a counterculture more focused on personal over professional development and wealth attainment. In white collar knowledge-based industries, companies are keenly aware of what's at stake and have been forced to move with the times and recognise that profit over anything won't suffice going forward. As ESG (Environmental, Social and Governance) factors come to the forefront, many employers have taken action towards building better work cultures, and created some good PR for themselves in the process by offering staff additional time off to destress and combat pandemic fatigue (Nike, Bumble, LinkedIn to name a few). Others that follow suit and prioritise retention strategies, will be better placed to compete for talent in the tight labour market going forward.

Michael MacGrath
Head of Global Investment Selection

Private equity - The state of play

Readers of MarketWatch will be familiar with the case for investing in private equity in the long run. For example, the asset class taps into an exceptionally deep set of opportunities, has consistently demonstrated its ability to outperform public stock markets, and has done so in a manner which is diversifying to a traditional portfolio. It is, however, an illiquid type of investment so won't be suitable to all mandates but if an investor has the ability to commit a portion of their capital to a private markets investment programme, its potential for strong performance can have a pronounced effect on the overall returns of their portfolio.

That rationale feels comfortable in the long run. But after a strong run of performance in both the public and private markets over the past decade, how should investors feel about allocating to private equity today?

Much ink has been spilled on the state of today's private markets. The strong performance of the asset class, as well as a lowered cost of debt, has attracted vast amounts of capital. In 2010, private equity assets under management amounted to $1.7 trillion; at the end of 2020 that figure was $4.4 trillion according to Prequin. As of August 2021, the top 25 private equity firms had a combined $500 billion dollars in dry powder (i.e. capital yet to be invested) as noted by S&P. Much as the valuations of public stocks have grown over that period, that inflow of capital has contributed to higher valuations on average for private companies.

The average price paid in the buyout of a private company in the US in 2010 hovered at a multiple of approximately nine times earnings, whereas today that multiple is north of thirteen as identified by CHANNELe2e. In part, this is due to a preference for companies with strong growth potential which typically trade at higher multiples of current earnings (also seen in the public markets). But in part, it's due to more buyers of private assets with more money, which has increased competition and, as a result, the price. This appetite for private assets has also supported fundraising by new managers, or the expansion of investment programmes into new areas by existing managers. In our view, the average quality of private equity manager has somewhat diminished, as it's become easier to attract investment.

How do we think about these factors when deciding whether to allocate to private equity today? As a base case, while we don't think that the returns experienced by private equity in the next decade will mirror those received in the period since 2010, we still expect private assets to return a healthy premium relative to public equity options.
For example, we expect the current transformative economic regime to continue, with every sector of the economy still adjusting to change – much of it tech-driven. Private equity investors are buying into innovation – be it in technology, healthcare, or other fields of intellectual property. Whether investing in newly-emerging business models or seeking to reposition established companies, private equity has always been much better positioned to generate and profit from transformational change. That is to say, we still expect to be compensated well for investing in these less liquid assets.

Our view is that the dispersion of returns generated by private equity investments will continue to be high and may even increase. That is to say, there will be a considerable difference between middling private equity managers and the top performers – much more so than in public equity markets. So we are exceptionally selective in picking our investment partners. Of a universe of thousands of funds, and an annual focussed pipeline of over one hundred funds that meet our initial screening criteria, we will allocate to approximately four to eight funds annually.

We avoid inexperienced management teams and also avoid managers who are showing price indiscipline, or stretching to deploy their capital. Specifically, within our buyout book we look to invest with managers who can get operationally involved in businesses and have a proven track record of creating value, as these managers have the ability to potentially deliver strong returns even in difficult market environments. The managers with whom we partner often assume valuation contraction in their investment cases, meaning that they only take on deals where, even if they end up exiting at a lower multiple, earnings growth is expected to produce profits for investors.

We continue to stress the importance of being diversified in private equity – with respect to geography, sectors, and strategy type. We seek buyout, growth, and contrarian opportunities – all of which result in widely differing investments and all of which put capital to work at different times.

For example, we saw contrarian managers call capital very quickly during the initial COVID-19 sell off to invest in dislocated markets, at a time when most other capital was sitting on the sidelines.

As a final point, we recognise that building exposure to private equity is not something that happens today or tomorrow. Phasing capital in to private assets over a longer period of time, ideally through the business cycle, helps reduce the risk of investing at the "top of the market". The best portfolios are built by establishing partnerships with good custodians of capital who will deploy that capital as and when opportunities arise. That is to say, we are not investing with just the prevailing markets in mind, but with a 5 to 10 year view. On that time horizon, we find few better opportunities for investment.

WARNING: The information in this article is for illustrative purposes only and does not purport to be financial advice as it does not take into account the investment objectives, knowledge and experience or financial situation of any particular person. Private equity investments can be illiquid and long-term in nature. You should seek advice in the context of your own personal circumstances prior to making any financial or investment decision from your own adviser.

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates.

Pete McGuigan
Investment Strategist

Crypto bulls, bears and don't cares

Holding (or "HODLing"*) cryptocurrency has never been for the faint hearted. The new asset has historically been known for its extreme volatility, regulatory troubles, digital wallet hacking and "garage band" crypto coins that disappear as quickly as they arrive.

2021 (at least for cryptocurrency) was not unlike any other year. We saw a one day 30% sell-off (in USD terms) in bitcoin, more crypto mining and tax regulation, and a $600 million USD wallet hack. The number of 'failed' cryptocurrencies surpassed 2,000 (compared to an approximate 10,000 cryptocurrencies still in existence).

Despite the headlines, money continued to pile into cryptocurrencies throughout 2021. Year-to-date, the total global market capitalisation of crypto has almost tripled, coming to just short of $3 trillion USD in November. Additionally, since the summer, despite major recent regulation announcements from Beijing and the White House, crypto investor sentiment, calculated from the Cryptocurrency Fear and Greed Index, has by and large remained bullish or extremely bullish.

Whales in the deep...

Interestingly, the number of active bitcoin addresses, a measure of demand for on-chain transactions, has fallen approximately 23% this year from an earlier high of 1.3 million. While some feel this indicates a more robust market, the counter argument remains that prices have weaker underlying market participant support.

On the flip side, following a fairly substantial volume of noise, there is a growing consensus that crypto investing is shifting from a retail-led space to an institutional one. Indeed the number of large crypto accounts, known as whale accounts (holding more than 1,000 bitcoins) reached an all-time high in November. This is not the full picture however. While it is true that large financial institutions are exploring cryptocurrency options within their holdings, the bulk of the 'whale' accounts remain largely unknown individuals that move mammoth holdings between other unknown whale accounts, distorting market prices. Yet, despite the sell offs, the increasing regulation, the market concentration and the risk of coins failing, money continues to flow in to crypto.

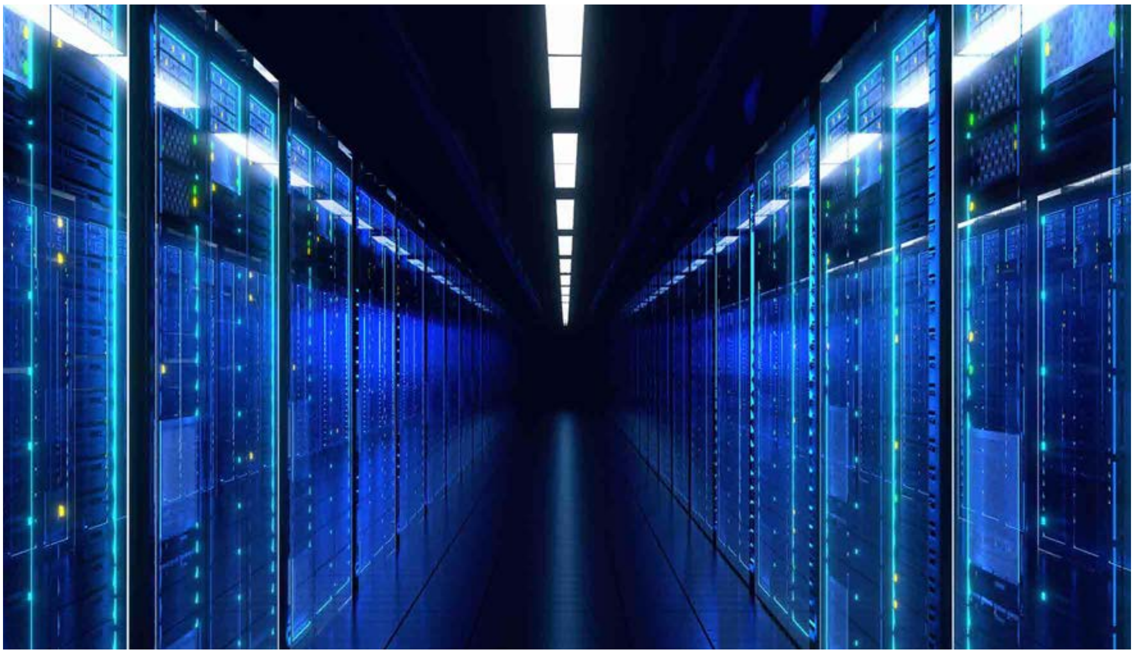
Redditors together, strong

What is driving the continued euphoria is becoming harder to pin down. A wide range of opinions exist, ranging from the technological and financial benefits that current cryptocurrency is expected to bring, through to the growing belief among new tech-savvy investors that cryptocurrency represents the only modern and fair investment vehicle to accumulate long-term sustained wealth. Another factor, which has often been overlooked until recently, is the influence of social media. Many readers will remember the Gamestop and AMC episodes from earlier this year, where social media forums with colossal retail trader following were able to coordinate their user-reach and direct them toward purchasing certain stocks.

While still a relatively new phenomenon in the stock market, the digital forum-led "pump and dump" style of investing has arguably found its feet within the crypto space. Literature over the last five years has successfully linked sentiment on social media and online forums with the prices of cryptocurrency. Such is the strength of this relationship that a large part of the Cryptocurrency Fear and Greed Index is calculated by compiling hundreds of thousands of daily social media posts using a sentiment classification machine learning model.

Moving forward...

So, why doesn't everybody stay glued to social media sentiment indicators and lock in the returns? Well, indicators work nicely until they don't. In physics, a fundamental principle taught early on is that "for every action, there is an equal and opposite reaction" and although Sir Isaac Newton would never learn of the wonders of meme coins, his third law may hold true even within the crypto-verse.
Negative technological announcements, whales taking profits, wallets being hacked etc. can all trigger large scale sell-offs. As quick as retail traders are to pump the market, they are just as quick to dump it. Remember, market capitalization doesn't equal profit. However, one glaring hole remains in a rational crypto investment discussion; none of the information described above is new information. Coin pump-and-dump groups, digital wallet hacks, regulation, questionable intrinsic value... the list goes on... have all been with the asset class for the best part of a decade now and yet crypto has only grown larger. Forget the bulls and bears, crypto holders don't seem to care.



* HODLing (hang on for dear life) refers to the action of cyrpto investors who hold investments for future profits and not selling despite price drops.

Warning: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. These products may be affected by changes in currency exchange rates.

James Costello
Head of Global Portfolio Strategies

Strategic asset allocation & benchmark changes in 2022

Strategic vs Tactical

In recent years our cautious optimism has led us to make several short-term (tactical) investments that have helped the risk/return trade off in portfolios. Most recently, we invested in procyclical sectors in equities and had an overweight equity position in portfolios since September 2020. As with any of our tactical positions, we are always keen to highlight the shorter-term nature of these positions. These Tactical Asset Allocations (TAA) are not positions we would hold throughout the cycle, but are intended to add value in certain market conditions.

These types of investments stand in contrast to strategic positions within our portfolios.

In previous MarketWatch editions, we've highlighted how we've been reviewing our Strategic Asset Allocations (SAA) and have indicated that we intended to alter allocations in client portfolios to reflect our updated view of asset classes over the coming ten years. Throughout the course of this review, we conducted a number of sessions with third party investment firms, performed significant quantitative analyses and had many debates internally around the potential risks and returns for various asset classes.

The output of this work has already begun to show in our portfolios with incremental changes being made in 2021. More recently, having increased gold allocations and included Inflation linked bonds for the first time. These holdings are expected to be held throughout the cycle and the rationale behind their inclusion is based on how we expect asset classes to perform over the long-term.

Today, however, we want to take the time to highlight some of the specific changes we intend to make in the first half of 2022 and how these allocations will help our clients achieve their financial goals.

Strategic Asset Allocation: Most important contributor to long-term performance. Provides the anchor for your portfolio from which all subsequent investment decisions.

Tactical Asset Allocation: Active management across asset classes and within asset classes to capture shorter-term opportunities in the markets. Adds risk adjusted performance over and above the strategic allocation

Investment Selection: Active managers providing stock specific active management. Adds risk adjusted performance over and above the strategic allocation

Key changes in defensive assets

Increase in inflation linked bonds. We have already begun to allocate to inflation linked bonds in recent months and these allocations will increase in the coming months as we look to provide greater protection against potentially higher inflation. We will be doing this through investments that run lower interest rate sensitivity than typical government and corporate bonds, which we believe will also help protect portfolios in the event of interest rate increases.

Increase in Gold. Gold is often held up a as a hedge against inflation, increasing in value as the purchasing power of your money declines. The reality is that gold has a mixed track record of protecting against inflation and while it may hold its value against inflation, over the very long-term we don't rely on it for outperformance in times of rising inflation. Where gold has provided a benefit in portfolios is through diversification. Gold tends to perform in an uncorrelated manner to most asset classes and this provides significant benefits in relation to how we manage risk.

Increase to liquid diversifying strategies. These strategies tend to provide uncorrelated returns to traditional asset classes. These types of strategies can be very effective at helping to protect portfolios in the market environment of today where bond yields are so low that the level of protection they provide may be more limited than it has been in the recent past. We currently hold allocations to these strategies across our portfolios and this will be increasing modestly.

Key changes to growth assets

Increase to equities in certain portfolios. Certain client portfolios will see small strategic increases to equities in 2022. Given the backdrop of a lower returning environment on all major asset classes we assessed how much short-term drawdown risk we can tolerate in order to achieve superior long-term returns.

What this means in effect is that we will be increasing equities in some portfolios whilst also optimising how we allocate the remainder of the capital to ensure the overall portfolio risk is carefully managed.

Increase to property and hedge funds

Property and hedge funds are not included in all our offerings but for certain clients they form an important part of their portfolios. These allocations come at an increased cost and decreased liquidity but importantly provide exposures that may benefit clients over time. The allocations to these asset classes in portfolios will also see increases by a small amount over the coming months.

Changes to Benchmarks

As we make these adjustments to how much risk and what type of risk our portfolios take, we will be reflecting this in new client benchmarks. Our discretionary Davy clients will see these benchmarks on their account valuations for periods beginning from the start of 2022. Communication on these benchmark changes will be sent to clients in January 2022.

Talk to your Adviser

We believe these changes will position our client portfolios more appropriately for the coming market environment and better protect against potential risks. While we've outlined the broad changes that apply centrally managed solutions for our discretionary clients, please talk to you Davy Adviser in relation to how this impacts your personal portfolio.

Warning: The information in this article does not purport to be financial advice and does not take into account the investment objectives, knowledge and experience or financial situation of any particular person. You should seek advice in the context of your own personal circumstances prior to making any financial or investment decision from your own adviser. Davy manages discretionary portfolios in accordance with agreed investment mandates and Advisory clients receive investment advice specific to their circumstances directly from their advisers.

Warning: Forecasts are not a reliable indicator of future performance.

Conor Lacey
Financial Planning Associate

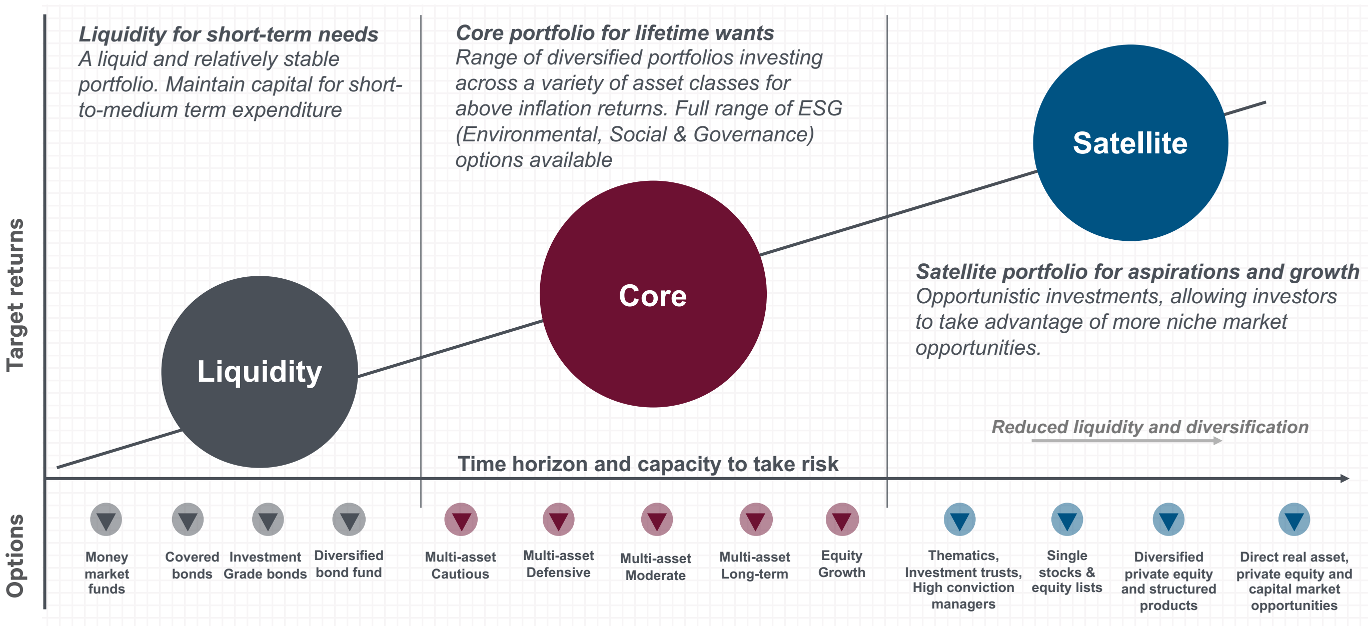
Get ahead - Start your New Year financially fitter

We're still grappling with uncertainty on the horizon, not only in relation to new information about COVID-19, but also from the investment and political landscape. In most cases of uncertainty, taking some time out to assess is worthwhile. The same applies to your financial wellbeing. Taking the time to do a financial health check to ensure you have the correct structures in place that align with your overall goals and risk preferences can put you on the path to success.

Given the investment outlook, with low (and in some cases negative) interest rates, it is worth reviewing your investment strategy and considering if the level of risk in your portfolio matches up with your financial objectives. When you combine this with high inflation, a hand on the steering wheel may be required to recalibrate investment choices to reflect a period of projected lower real returns.

The best way to gain an understanding of this is through a financial plan and the Davy wealth allocation framework, which we use to guide our clients when making investment decisions.
A financial plan aims to drive your decisions in respect of structures and investment advice that is tailored to your own personal circumstances.

Figure 1: Your wealth allocation framework



WARNING: This is for illustrative purposes only. There is no guarantee the targeted performance will be met. This variance could arise as a result of deliberate portfolio positioning or also market movements, cash flows, and varying investment performance.

Our wealth allocation framework is divided into three sections. Liquidity for your short-term needs, core assets for medium/long-term lifetime wants and satellite assets for your longer-term aspirational objectives such as passing assets to the next generation. Within this context, you can easily assess your portfolio relative to your goals, risk appetite, and risk tolerance to see what tweaks need to be made. This may result in re-risking or de-risking your investment portfolio to ensure it can meet your future needs. Investing is only one part of the overall picture.

Our framework and your health check will also help assess whether you have the right structures in place to help you meet your goals efficiently. For example, for your core lifetime needs, ensuring you have the right retirement strategy in place, including your pension, will be important.

In the Finance Bill 2021, published in November, there were some impactful changes that we find beneficial in terms of pensions and tax that may influence your choice of a pension structure for example. Below we outline what these changes are and what they mean:

Changes	What this means & who might it be relevant for?
Pension changes	
Removal of the Approved Minimum Retirement Fund (AMRF)	This means that those who are in or approaching retirement no longer need to have €63,500 in an AMRF/ringfenced portion of a Vested PRSA.
Death in service benefits for an Executive Pension Plan (EPP)/self-administered scheme.	The introduction of the ARF option on death in service for EPPs means that the capital value of the EPP can be transferred onwards to the next generation. This is a much welcomed change as in the past the EPP holder may have been forced to purchase an annuity rather than passing assets to the estate.
Removal on the prohibition on transfers from an occupational pension scheme (EPP) to a personal retirement savings account (PRSA).	All members of occupational pension schemes (including EPP clients) had been prohibited from accessing a PRSA where they have more than 15 years' pensionable service. This restriction has now been removed. A PRSA can now be accessed, where the latest retirement age is 75 (versus age 70 in the executive pension plan/personal retirement bond) and from which the individual can then split their benefits into two PRSAs if this is suitable for them, providing much more flexibility.

For longer-term aspirational objectives, it's timely to consider how best to achieve your legacy goals with the reliefs and structures available today.

A conversation with your Davy Adviser is the first step in the process to create or update your financial plan.

This can be as simple as ensuring your investment strategy aligns with your long-term financial goals and risk preferences and ensuring the structures you have in place are appropriate for you, especially given the recent changes. The New Year can be full of opportunity if you look in the right places.

Warning: The information in this article does not purport to be financial advice and does not take into account the investment objectives, knowledge and experience or financial situation of any particular person. You should seek advice in the context of your own personal circumstances prior to making any financial or investment decision from your own adviser. There are risks associated with putting a financial life plan in place. There is no guarantee that by having a financial life plan in place, you will meet your objective. The tax information contained in this article is based on Davy's current understanding of the tax legislation in Ireland and the Revenue interpretation thereof. It is provided by way of general guidance only and is neither exhaustive nor definitive and is subject to change without notice. It is not a substitute for professional advice. You should consult your tax adviser about the rules that apply in your individual circumstances.

Killian Buckley
Senior Investment Selection Analyst

Manager Selection – A key driver of future returns

In the late 1970s, the North American Soccer League experienced what proved to be a short-lived surge in popularity. In New York, the arrival of stars such as Pele led to the New York Cosmos being the best-supported team in the city attracting crowds of over 70,000 to it's home games. It's popularity also attracted celebrities whose knowledge of the sport could charitably be described as limited. This included the owner of the New York Cosmos, Steve Ross, who is alleged to have demanded that legendary German defender Franz Beckenbauer play more offensively as he didn't pay money for him to play in defence.

This episode clearly highlights a failure to understand the skill set of the player and how it could best be utilised within an overall team structure. In all sports, the responsibility of the manager is to put together a group of players with complementary skill sets, with each playing to his/her strengths. This also has parallels in investment management. At Davy, we seek to build robust, diversified portfolios using a combination of funds managed by specialist active managers and passive products. What is critical to this approach is having a deep understanding and expectation of how each of the funds will perform depending on the market environment.

Manager Selection at Davy

Within the Investment Selection team at Davy, our role is to recommend funds for inclusion in client portfolios after conducting a detailed assessment of the fund managers' capabilities. We believe that having a structured process that evaluates fund managers across a range of criteria is critical to fully evaluate a fund manager and to mitigate against behavioural biases.

The most obvious bias is to place too much emphasis on a fund's historical performance and not enough on the investment process that produced that track record. Historical performance is ultimately the outcome of qualitative factors including the stability of the organisation, the calibre of the investment team, and the clarity and repeatability of the investment process. By evaluating managers under these categories, it allows us to differentiate between performance generated through skill rather than through luck.

Importance of the Organisation

One aspect that is often overlooked when selecting funds is the stability of the organisation that the fund managers operate within. Fund managers operate across a variety of different structures that range from smaller, specialist firms to large publicly traded firms that manage hundreds of strategies.

We look for evidence that asset management is a core part of the business and that the fund managers work within a supportive environment conducive to generating outperformance. We seek to invest with firms where the growth in assets under management is the by-product of a strong investment culture rather than an explicit objective in itself. Organisations that are excessively focused on asset growth tend to be more short-term oriented and less supportive of fund managers experiencing underperformance. We favour organisations that are disciplined in ensuring that growth in assets under management does not come at the expense of performance. A common mistake made by fund managers is to allow a strong performing fund to attract excessive assets under management. This, in turn makes it more challenging to sustain good performance as a larger fund can be more limited in terms of the positions it can hold.

Blending of Fund Managers

Our role within the Investment Selection team is not only to identify those fund managers we believe can outperform in the future; it is also to understand how the managers will likely perform depending on the market environment and to effectively blend funds with complementary exposures.

Combining managers in this manner results in a smoother path of returns, better downside protection, and a portfolio that is not overly exposed to a particular market environment. To use the sporting analogy referenced above, we look to build a portfolio with a balance between offensive and defensive strategies. In the same way that successful teams require players of different skill sets, a robust long-term portfolio requires a mix of strategies that perform differently depending on the economic and market environment.

We have highlighted in recent editions of MarketWatch that future returns on equities and bonds are likely to be lower than they have been over the last decade. In this lower-return environment, manager selection will likely represent a greater component of total returns – with lower performance overall, outperformance or underperformance becomes more important. As a result, we believe it is critical to assess managers by applying a structured evaluation process, but also to consider how best to blend managers with different exposures within their portfolios.

Warning: Forecasts are not a reliable indicator of future performance.

Market data

Total Return (%) in local currency	2017	2018	2019	2020	2021
Equities (local currency)					
MSCI World	19.1	-6.9	28.1	14.1	24.7
MSCI USA	21.2	-5.0	30.9	20.7	26.5
MSCI EMU Index (European Economic and Monetary Union)	12.5	-12.7	25.5	-1.0	22.2
MSCI USA Financials	22.1	-13.6	32.9	-2.0	35.8
MSCI USA Small Cap	16.8	-10.4	26.7	18.3	19.1
NASDAQ	29.6	-2.8	36.7	44.9	22.2
NASDAQ 100	33.0	0.0	39.5	48.9	27.5
MSCI Emerging Markets (USD)	37.3	-14.6	18.4	18.3	-2.5
FTSE Europe Ex UK	14.9	-10.4	27.8	2.2	24.5
S&P 500	21.8	-4.4	31.5	18.4	28.7
Eurostoxx 50	9.2	-12.0	28.2	-3.2	23.3
FTSE 100	11.9	-8.7	17.3	-11.5	18.4
ISEQ*	8.0	-22.2	31.1	2.7	14.5
MSCI ACWI	19.8	-7.7	26.2	14.2	20.9
CSI 300	24.3	-23.6	39.2	29.9	-3.5
Nikkei Index	21.3	-10.3	20.7	18.3	6.7
Equities (EUR)					
MSCI World	7.5	-4.1	30.0	6.3	31.1
MSCI USA	6.4	-0.3	33.3	10.8	36.1
MSCI EMU Index (European Economic and Monetary Union)*	12.5	-12.7	25.5	-1.0	22.2
MSCI USA Financials	7.1	-9.3	35.6	-10.0	45.8
MSCI USA Small Cap	2.4	-5.9	29.3	8.7	27.9
NASDAQ	13.7	2.0	39.4	33.1	31.2
NASDAQ 100	16.7	5.0	42.2	36.7	36.9
MSCI Emerging Markets	20.4	-10.3	20.8	8.7	4.6
FTSE Europe Ex UK	14.9	-10.4	27.8	2.2	24.5
S&P 500	6.9	0.4	34.1	8.8	38.2
Eurostoxx 50	9.2	-12.0	28.2	-3.2	23.3
FTSE 100	7.6	-9.7	24.5	-16.4	26.1
ISEQ*	8.0	-22.2	31.1	2.7	14.5
MSCI ACWI	8.9	-4.8	28.9	6.7	27.5
CSI 300	16.3	-24.1	40.1	27.3	6.4
Nikkei Index	10.3	-3.9	24.9	13.8	3.8

Warning: Past performance is not a reliable guide to future returns and future returns are not guaranteed. The value of investments and of any income derived from them may go down as well as up. You may not get back all of your original investment. Returns on investments may increase or decrease as a result of currency fluctuations.

Total Return (%) in local currency	2017	2018	2019	2020	2021
Global Sectors					
MSCI World Energy	5.0	-15.8	11.4	-31.5	40.1
MSCI World Materials	28.9	-16.9	23.3	19.9	16.3
MSCI World Industrials	25.2	-14.5	27.8	11.7	16.6
MSCI World Consumer Disc	23.7	-5.5	26.6	36.6	17.9
MSCI World Consumer Staples	17.0	-10.1	22.8	7.8	13.1
MSCI World Health Care	19.8	2.5	23.2	13.5	19.8
MSCI World Financials	22.7	-17.0	25.5	-2.8	27.9
MSCI World IT	38.2	-2.6	47.6	43.8	29.8
MSCI World Telecoms	5.8	-10.0	27.4	23.0	14.4
MSCI World Utilities	13.7	2.0	22.5	4.8	9.8
Government Bond Yields (%)					
US 10 Year	2.4	2.7	1.9	0.9	1.5
US 2 Year	1.9	2.5	1.6	0.1	0.7
Germany 10 Year	0.4	0.2	-0.2	-0.6	-0.2
Germany 2 Year	-0.6	-0.6	-0.6	-0.7	-0.6
UK 10 Year	1.2	1.3	0.8	0.2	1.0
UK 2 Year	0.4	0.8	0.5	-0.2	0.7
Japan 10 Year	0.0	0.0	0.0	0.0	0.1
Japan 2 Year	-0.1	-0.1	-0.1	-0.1	-0.1
France 10 Year	0.8	0.7	0.1	-0.3	0.2
Canada 2 Year	1.7	1.9	1.7	0.2	1.0
Currency Rates					
EURUSD	1.2	1.1	1.1	1.2	1.1
EURGBP	0.9	0.9	0.8	0.9	0.8
EURJPY	135.3	125.8	121.8	126.2	130.9
GBPUSD	1.4	1.3	1.3	1.4	1.4
GBPEUR	1.1	1.1	1.2	1.1	1.2
USDJPY	112.7	109.7	108.6	103.3	115.1
Cryptocurrencies (vs USD)					
Bitcoin	14310.9	3674.2	7158.3	28996.3	46333.7

Source: Data is sourced from Bloomberg as at market close December 31st 2021 and returns are based on price indices in local currency terms, unless otherwise stated.
*Figures are price return as total return unavailable for certain indices.

Warning: Past performance is not a reliable guide to future returns and future returns are not guaranteed. The value of investments and of any income derived from them may go down as well as up. You may not get back all of your original investment. Returns on investments may increase or decrease as a result of currency fluctuations.

Davy. Since 1926.
The Davy Group is Ireland's leading provider of wealth management, asset management, capital markets and financial advisory services. We work with private clients, small businesses, corporations and institutional investors.

Dublin Office
Davy House
49 Dawson Street
Dublin 2
D02 PY05
Ireland

+353 1 679 7788
dublin@davy.ie

Belfast Office
Donegall House
7 Donegall Square North
Belfast BT1 5GB
Northern Ireland

+44 28 90 310 655
belfast@davy.ie

Cork Office
Hibernian House
80A South Mall
Cork
T12 ACR7
Ireland

+353 21 425 1420
cork@davy.ie

Galway Office
1 Dockgate
Dock Road
Galway
H91 K205
Ireland

+353 91 530 520
galway@davy.ie

London Office
Dashwood House
69 Old Broad Street
London EC2M 1QS
United Kingdom

+44 207 448 8870
london@davy.ie

www.davy.ie

The information contained in this document does not purport to be comprehensive or all inclusive. It is not investment research or a research recommendation for the purposes of regulations, nor does it constitute an offer for the purchase or sale of any financial instruments, trading strategy, product or service. No one receiving this document should treat any of its contents as constituting advice. It does not take into account the investment objectives or financial situation of any particular person. It is for informational and discussion purposes only. References to past performance are for illustration purposes only. Past performance is not a reliable guide to future performance. Estimates used are for illustration purposes only. Projected returns are estimates only and are not a reliable guide to the future performance of this investment. Forecasted returns depend on assumptions that involve subjective judgment and on analysis that may or may not be correct.

This information is summary in nature and relies heavily on estimated data prepared by Davy as well as other data made available by third parties and used by Davy in preparing these estimates. There can be no assurance that the entities referred to in the document will be able to implement their current or future business plans, or retain key management personnel, or that any potential investment or exit opportunities or other transactions described will be available or consummated. Statements, expected performance and other assumptions are based on current expectations, estimates, projections, opinions and/or beliefs of Davy at the time of publishing. These assumptions and statements may or may not prove to be correct. Actual events and results may differ from those statements, expectations and assumptions. Estimates, projections, opinions or beliefs are not a reliable guide to future performance. In addition, such statements involve known and unknown risks, uncertainties and other factors and undue reliance should not be placed thereon. Certain information contained in this document constitutes 'forward-looking statements', which can be identified by the use of forward-looking terminology, including but not limited to the use of words such as 'may', 'can', 'will', 'would', 'should', 'seek', 'expect', 'anticipate', 'project', 'target', 'estimate', 'intend', 'continue' or 'believe' or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events or results, the actual outcome may differ materially from those reflected or contemplated in such forward-looking statements. There can be no assurances that projections are attainable or will be realised or that unforeseen developments or events will not occur. Accordingly, actual realised returns may differ materially from any estimates, projections, opinions or beliefs expressed herein.

Economic data, market data and other statements regarding the financial and operating information that are contained in this Update, have been obtained from published sources or prepared by third parties or from the partners, developers, operators and sponsors involved with the properties and entities comprising the Investment. While such sources are believed to be reliable, Davy shall have no liability, contingent or otherwise, to the user or to third parties, for the quality, accuracy, timeliness, continued availability or completeness of same, or for any special, indirect, incidental or consequential damages which may be experienced because of the use of the data or statements made available herein. As a general matter, information set forth herein has not been updated through the date hereof and is subject to change without notice.

The MSCI sourced information is the exclusive property of MSCI Inc. (MSCI). Without prior written permission of MSCI, this information and any other MSCI intellectual property may not be reproduced, redisseminated or used to create any financial products, including any indices. This information is provided on an 'as is' basis. The user assumes the entire risk of any use made of this information. MSCI, its affiliates and any third party involved in, or related to, computing or compiling the information hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of this information. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind. MSCI and the MSCI indexes are services marks of MSCI and its affiliates.

"SPDR" is a registered trademark of Standard & Poor's Financial Services LLC ("S&P") and has been licensed for use by State Street Corporation. STANDARD & POOR'S, S&P, S&P 500 and S&P MIDCAP 400 are registered trademarks of Standard & Poor's Financial Services LLC. No financial product offered by State Street Corporation or its affiliates is sponsored, endorsed, sold or promoted by S&P or its Affiliates, and S&P and its affiliates make no representation, warranty or condition regarding the advisability of buying, selling or holding units/shares in such products. Further limitations and important information that could affect investors' rights are described in the prospectus for the applicable product.

While reasonable care has been taken by Davy in the preparation of this document, neither Davy nor any connected company nor their respective directors or employees will be responsible for any loss (whether foreseeable or not) incurred by an investor as a result of the investor acting, or deciding not to act, in reliance on the contents of this document or the information and opinions on which it is based. The investor agrees that Davy, any connected company and their respective directors or employees will not be held liable for any investment decisions made by the investor arising from the use of this document. The terms of this paragraph only apply to the extent permitted by law and do not exclude or restrict any responsibility or liability that Davy has under law and applicable regulation.

If you are a client of Davy, this communication has been sent to you as part of our service offering. If you are not a client of Davy, you can opt out of further similar communications at any stage by emailing optout@davy.ie. The Davy Group Privacy Notice can be found at www.davy.ie.

J & E Davy Unlimited Company, trading as Davy and Davy Private Clients, is regulated by the Central Bank of Ireland. In the UK, J & E Davy Unlimited Company, trading as Davy and Davy Private Clients, is authorised by the Financial Conduct Authority and with deemed variation of permission. Subject to regulation by the Financial Conduct Authority. Details of the Temporary Permissions Regime, which allows EEA-based firms to operate in the UK for a limited period while seeking full authorisation, are available on the Financial Conduct Authority's website.

FSC
www.fsc.org
MIX
Paper from responsible sources

103_256702/01/22