

# 2022 Investment Outlook: Assessing the path ahead



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It's that time of year again, when we release our Investment Outlook for the coming year. As always, this has been a collaborative effort, reflecting the views of many investment professionals and thought leaders at Invesco. We have provided a base case scenario, which we believe is very likely, along with the potential investment implications of that scenario. In addition, we have once again provided two tail risk scenarios, which we believe are less likely but nevertheless important to contemplate. We also explore the potential investment implications of those tail risk scenarios.

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## Weekly Market Compass | December 6, 2021

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### Setting the stage

2020 and 2021 saw dramatic monetary and fiscal policy moves. Now the stage is set for 2022 to be a year of transition as policies and economies move toward a more normal state. However, issues remain that will likely define the economic and market environment, including continued supply-chain disruptions and an upsurge in demand that threaten to keep inflation high across many economies. For 2022, our outlook is centered on the question of inflation and how markets and policymakers may react to it.

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### Our base case

We expect global growth to normalize, remaining above its long-term trend but decelerating to a more sustainable rate as fiscal stimulus is gradually removed. We anticipate that inflation will peak in mid-2022 and then start to slowly moderate, backing down toward target rates by the end of 2023 as supply-chain issues resolve, vaccination levels increase, and more employees return to the workforce. We still believe the Federal Reserve (Fed) will be patiently accommodative, with a rate lift-off in the back half of 2022, although other developed countries' central banks might act more quickly. Finally, we expect volatility will increase as markets digest the transition to slower growth and a gradual tightening in monetary policy.

From a relative asset allocation perspective, our base case expectations lead us to a reduced risk posture, with a slight overweighting of equities tilted toward defensive sectors such as information technology, communication services, health care, real estate and consumer staples. We prefer quality and large caps in this scenario, given slowing growth expectations and stable (or lower) long-term bond yields. We also anticipate that alternatives such as real estate and private credit, as well as commodities, would outperform in this environment. For regional allocations, our base case indicates a preference for emerging markets (including EM currencies) due to cyclical divergence and US equities over other developed markets as the global slowdown favors regions with lower cyclical exposure and lower operating leverage.

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### Transitory inflation risk

In our transitory inflation risk scenario, current inflation fears prove to be overblown, with inflation gradually coming off its current highs toward something close to or below 2%. We see higher than normal growth in this environment, ultimately pointing to economies being earlier in the cycle than we currently judge them. In this scenario, our favored asset classes would include equities (particularly industrials, materials, energy, and financials) as well as high yield and investment grade fixed income; regionally we would prefer the US (and the US dollar) and developed ex-US markets.

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## Persistent inflationary risk

In our persistent inflationary risk scenario, developed central banks' messaging fails to convince markets that inflation is transitory, with further elevated prints throughout 2022. We see the problem as stemming from a combination of elevated demand driven by past monetary expansion and supply-side disruptions. This causes inflation expectations to become unanchored, with medium-term expectations rising above the 4% mark persistently. This would signal a loss of credibility for those central banks, requiring action that prompts a significant risk of ending the current economic cycle. In this downside scenario, we would look for gold, ex-US developed market sovereigns (hedged), and inflation-protected bonds to outperform. Within equities we would prefer defensives, communications, large caps, and quality issuers. Regionally we would favor Australia, Canada, and Japan.

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## The path ahead

We recognize that we have formed these views largely prior to the emergence of the Omicron variant and the possibility of an accelerated taper timeline from the Fed. These events at present do not alter our views in a meaningful way. Indeed, the potential for an earlier move from the Fed is a marginal event, and the Omicron variant introduces uncertainty but has not yielded a Draconian shutdown in economic activity. Omicron may prolong the recovery in tourism and some services sectors, but we do not foresee a return to harsh early-pandemic measures to manage the virus. As we have said so many times throughout this pandemic, the risks are elevated but we remain optimistic about the path forward.

*With contributions from Ashley Oerth.*

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### Important information

Not a Deposit - Not FDIC Insured - Not Guaranteed by the Bank - May Lose Value - Not Insured by any Federal Government Agency

Tapering is the gradual winding down of central bank activities that aimed to reverse poor economic conditions.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Asset allocation does not guarantee a profit or eliminate the risk of loss.

Investments in real estate related instruments may be affected by economic, legal, or environmental factors that affect property values, rents or occupancies of real estate. Real estate companies, including REITs or similar structures, tend to be small and mid-cap companies and their shares may be more volatile and less liquid.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Commodities may subject an investor to greater volatility than traditional securities such as stocks and bonds and can fluctuate significantly based on weather, political, tax, and other regulatory and market developments.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Many products and services offered in technology-related industries are subject to rapid obsolescence, which may lower the value of the issuers.

The health care industry is subject to risks relating to government regulation, obsolescence caused by scientific advances and technological innovations.

The opinions referenced above are those of the author as of Dec. 6, 2021. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.