Insights
Active Quantitative Equity

December 2021

Omicron and the End of "Transitory" Inflation

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- However, we recognize that the path out of the pandemic will be bumpy.

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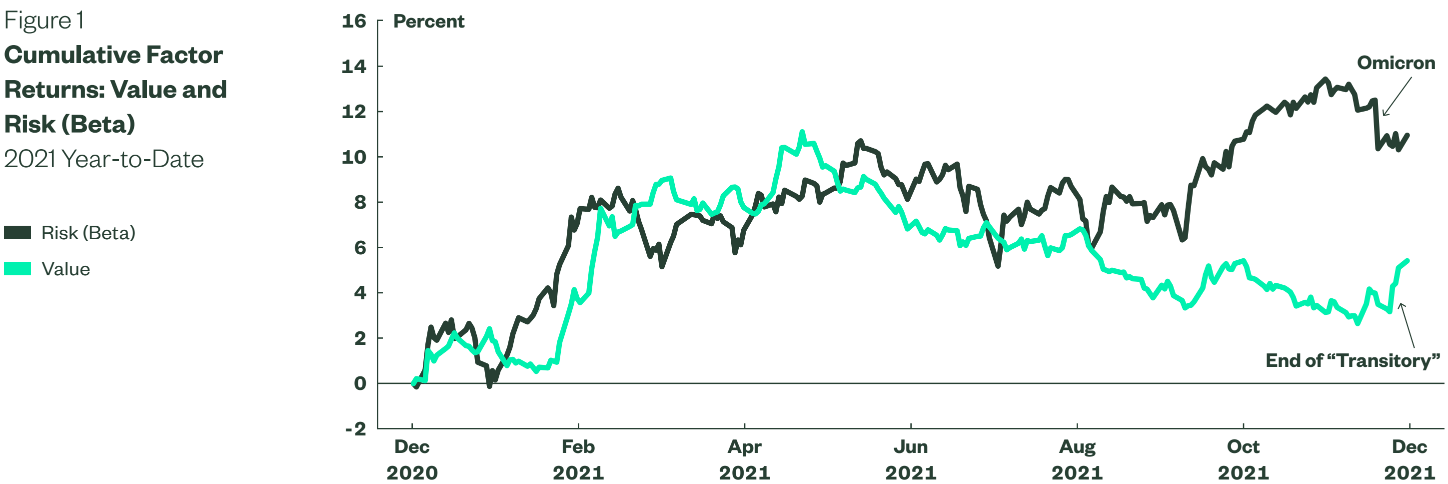
November of 2021 revealed a new period of monetary policy reassessment and an increasingly hawkish Fed. The end of the month brought a significant new concern with the discovery and spread of the Omicron variant of COVID-19. And while uncertainty about Omicron dominated the news cycle, markets were more focused on inflation and monetary policy. Fed chairman Jerome Powell suggested to US lawmakers that it was time to stop referring to inflation as "transitory."

Let's look at the impact of these events on factor returns. From mid-year through mid-November, Value had declined as market participants extrapolated low interest rates and accommodative monetary policy into the future. Over the same time frame, high-beta stocks did quite well (see Figure 1).

Figure 1
Cumulative Factor Returns: Value and Risk (Beta)
2021 Year-to-Date



Source: State Street Global Advisors, as at December 6, 2021. MSCI Companies universe.

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We have posited for some time that a return of some inflation, and a consequential increase in interest rates, would be good for Value strategies, and indeed the market has responded this way — Value has rebounded meaningfully since mid-November.

However, we also recognize that the path out of the pandemic will be bumpy, caused both by the fear of setbacks to economic growth from new variants (which could lead to further lockdowns) and uncertainty about the monetary policy response (whether it will strike the correct balance between economic growth and inflation).

As a result, among factors Value and Risk have seen the biggest volatility during November, whereas Quality and Sentiment, which have been strong throughout the year, did not take a breather at all.

The Bottom Line

The emergence of the Omicron variant and its potential to slow down the economy reminds us that markets can take a dive when (1) valuations are high and (2) scary things happen, so the AQE team continues to have a Value discipline when selecting high-quality companies with positive investor Sentiment. This balances the return opportunity with expected volatility.

Our most preferred segments, therefore, are Consumer Staples Retailers in the US, Telecoms in Asia-Pacific, Pharmaceuticals in the US and Europe, Health Care Equipment and Services in the US, and Diversified Financials in the US.

Our least preferred segments include Household and Personal Products, Consumer Services, and Transport, in all regions, as well as Media and Software in the US.

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* Pensions & Investments Research Center, as of December 31, 2020.
† This figure is presented as of September 30, 2021 and includes approximately $59.84 billion of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

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