2022 will be a tale of two halves

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The human population has reconciled to live with corona virus in last two & half years. With financial markets in the view, normalization is on the cards and is expected to happen from 2022. The year will be a tale of two halves; 1HY22 like to see volatility as markets continue to react to global monetary policies on one hand and omicron on the other. 2HY22 should see markets normalizing and continuing their earnings driven journey.

History of the financial markets in last 30 years depicts instances that whenever there has been an economic recovery, the early stages of interest rate rise has been positive for equity markets. Hence, signs of rate increase are expected to not de-rail the equity rally especially if it's done in more calibrated manner.

With respect to Omicron Virus issue, we're experiencing third phase of the COVID story. In the first wave the markets halved, in the second we saw 10-15% of correction. Finally, as we gear up to digest the third wave, markets are likely to be lot more equanimous, as the vaccinated population is high and we are well aware of the spreading pattern of the virus.

The Indian economy's K-shaped recovery has been apparent to us for a while now. In fact, at Edelweiss, we as fund managers are focused on portfolios which include companies which are leaders in segments, companies with pricing power and market share gainers in their respective sectors. Also, k-shaped recovery is driven by consolidation in Indian business environment driven by reform measures like demonetization, GST reforms, labour reforms etc. over last few years.

In 2022, time to play the macro laggards is behind us. We think it's time to focus on good stock selection, rather than analysing macro trends. In other words, in the next 12 – 18 months, market movements will be stock specific and centered around earnings upgrades rather macro-trends. In-short a bottom up stock selection will work wonders.

Based on our studies of economic expansion and earnings, the themes that we are bullish include private sector consumption demand, capex & China + 1.

Having said the positive things, there are also few factors which can affect the markets negatively, viz. the rise of interest rates out of sync with earnings, the pace of normalization matters and if it's too early and fast that could de-rail the equity markets. Second is inflation should be transient. If it turns out stickier than it may turn out stagflation. The third will be the oil prices and if they continue to rise and bring about recession which it did in the past.

Lastly, the recent geo-political situation needs to be watched carefully as well. In last 20 years, we're used to a globalized world, thus keeping a check on cost of capital. However, recent happenings in Russia and Afghanistan, the rise of global fundamentalism needs to restrict as it may affect global trade and cause flutters in equity markets.

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