JANUARY 7, 2022

AS THE TRI POLAR WORLD TURNS - THE FOG LIFTS

EXECUTIVE SUMMARY

1000 words – a 4 minute read.

OVERVIEW

2021 was a pretty good investment year; our "Golden Age of Asset Allocation" outlook piece aged well but in this Age of Speed its focus forward or get run over. Omicron is discounted & markets are at peak Fed hawkishness pricing in 80% chance of a March hike, 3 full hikes and rising odds of a 4th. Will peak Fed fear lead to peak USD? History suggests a solid outlook for equities after a strong quarter and strong year. Who are we to argue?

2022 will be a year of gradual clarity as Covid fog lifts & the pandemic downshifts to endemic. A synchronized global expansion takes wing featuring high nominal growth and sustained negative real yields which combine to support earnings growth and risk asset appreciation.

The combinatorial effects of converging disruptive technologies could surprise many. We continue to see the 2ndH of the 1990s as the analogue of choice – the last US cap ex boom and productivity surge led economy – only this time its global given infrastructure needs and climate mitigation efforts.

As such we remain OW Equity and Commodities, UW Bonds with an equity focus on US Cyclical/Value, non US DM and China in EM. Thematics remain of interest while a weak USD could propel Commodities and non US equities significantly higher. Risks include ebbing liquidity and a Fed policy mistake together with more Covid variants.

CLIMATE

Europe's recent decision to include Nat gas and nuclear power in its sustainable energy taxonomy is a game changer. Biden's Build Back Better plan and its $550B in climate funding is a key open item. Companies are not waiting for Govt action – Ford's acceleration of its Ford 150 E series is the current poster child.

ECONOMICS

December PMIs suggest a global economy that's in good shape; solid December price appreciation in both copper, oil & the A$/Y cross reinforce the point. Inflation is the main concern and while consensus suggests a sharp downshift as we exit Q1, markets have their doubts. We are with the consensus on this one.

Global growth remains early cycle as the expansion phase is just beginning. We expect high nominal growth across the DM, in many cases 200-300 bps above pre Covid levels while real rates remain deeply negative, underpinning the cap ex boom.

Cross asset markets are pricing in the return to a pre Covid, low growth, low inflation period. We disagree & are excited to see what the real economy looks like after two years of Covid accelerated technological adoption across the economic landscape. We foresee a much more compelling medium term growth outlook.

POLITICS

2022 will be a busy political year with Italian elections this month, French elections in the Spring, new Govts taking office in both Germany and Japan as well as the upcoming US mid terms. It's the one year anniversary of the attack on the US Capitol and the failure to bring any of its leaders to account virtually guarantees a repeat or worse at some point. US political gridlock is a strategic weakness in the Tri Polar World.

Pres. Xi is likely to be granted a 3rd term late this year – we maintain our well known China 2022 glide path thesis. China's Zero Covid policy is likely to remain in place.

Europe's political outlook is brighter today than it has been in many years – the idea of exiting the Euro – now 20 years old – has virtually disappeared from discussion while reform of the Stability & Growth Pact moves ahead.

POLICY

Its all about the Fed and other major Central Banks as they seek to get off the zero bound. We are in a tightening cycle with many EM's tightening proactively. We expect the Fed to move more slowly than many with only two rate hikes this year. Financial conditions are likely to remain easy and real rates to remain negative.

Fiscal policy, while seemingly moribund in the US, is active in Europe with Next Gen disbursements hitting peak levels this year and next while Japan preps a large fiscal package and China keeps its fiscal policy in reserve.

MARKETS

As noted, we retain our AA outlook & are observing the current "violent rotation" out of Growth into Cyclical/Value with interest - the question is does it have legs? We think so given our growth outlook and expectation of steeper yield curves and a weak dollar. History tells us the dollar turns down in Fed hiking cycles while the growth and policy gap between the US and other DMs should shrink as 2022 unfolds.

A weak USD would spur flows into the non US equity markets as well as Commodities, both OWs. The gap between commodity prices and representative stock prices is quite wide suggesting opportunity. We remain keen on European and Japanese equity and have built up an OW position across Chinese assets in keeping with our China glide path outlook.

Given our thematic focus, we are paying close attention to the bull – bear debate around disruptive tech & thematics more broadly. Given the late year selloff in unprofitable tech, the consensus is for the latter while our bet is more to the former as the investments of the past few years coupled with the need to continue to invest in order to stay competitive provides thematic success stories. Crypto has been disappointing – it and other parts of thematic space are becoming show me investments.

Here are a few thoughts to ponder: with Covid ebbing will history resume its powerful place in financial market analysis – will quant have a rebirth after some tough years? Many expect a more volatile year ahead – especially for equities – one can see the case for more FI volatility but couldn't equity volatility ebb given easy financial conditions & negative real rates?

Enjoy this BTV clip from earlier this week & join us as we discuss the 2022 ETF Thematic Playbook on the MoneyShow Virtual Expo next Tuesday at 3:20 EST!