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TPW Advisory Monthly: Kabuki Time
January 28, 2022

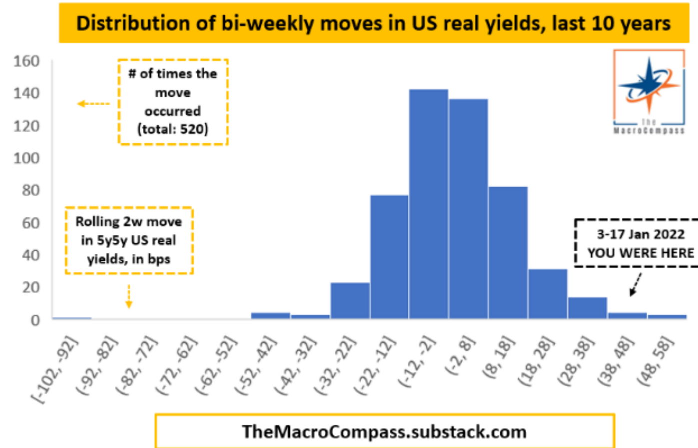
In my writing I have been drawn to Asia for the past month or so with “Look to the East” and most recently: “Be Like Water”, where I channeled my inner Bruce Lee. Much of this has been in support of our significant geographic tilt eastward in our Global Multi Asset (GMA) model portfolio with overweight positions in Asian equity and bonds focused mainly on China (China 2022 glide path) and Japan. While we are not alone in this POV, Morgan Stanley did recently note that non-Asia investor interest in Asian equity was at “trough levels”.

Today I offer: “Kabuki Time” which came to me this morning as I mused over how cross asset markets are acting amidst the drama of Fed tightening, acting so quickly and aggressively that the likelihood of the Fed doing what has been priced in has become less likely. It strikes me that this type of theatrics is also playing out in the geopolitical space with the current saber rattling & sanction threatening going on between Russia, the Ukraine and a US-led NATO. The clarity and specificity with which the potential sanctions to be leveled against Russia and even perhaps Putin himself have been laid out seem unique to me, much as the speed and ferocity of the January risk asset pullback has been unique.

Japan’s Kabuki theater has a long, rich and quite interesting history, much like financial markets. “One of kabuki’s most central dramatic themes is the **clash between morality and human emotions**…emotions like revenge and love often get in the way of familial and other duties, creating the central conflict of most plays. These **often end in tragedy.”**

We of course hope to avoid tragedy in our investing process though judging from the ferocity of the moves some fund specific tragedy seems almost a given. Hedge fund pain may be behind why equities have struggled to hold onto rallies. As the Kabuki theatre of Fed meetings and Chair Powell pressers unfold, investors are channeling the Kabuki theatre audiences of old, behaving in a rowdy and boisterous manner. For example, the spike in real rates was one of the fastest on record while XLE is up 17% YTD and Overbought with a ST RSI over 70. The QQQs on the other hand are down 13% and the most oversold since 2018!

Chart 1 – Rarely Seen Real Yield Move



It seems to me that markets and investors have very quickly raised the rate hiking stakes well beyond where the Fed is likely to go in 2022, what I call peak Fed hawkishness. A year ago for example, the market was pricing in the 1st rate hike in April 2024; as recently as last September the bulk of Fed Governors didn't expect to be hiking rates until 2023. Now the Fed is at 3 rate hikes & the market is at 4, possibly 5 plus QT.

As we have highlighted for some time (higher rates = tech kryptonite), this Fed repricing has hammered high growth stocks as rates rose both at the short and long end. This has kicked off a major equity rotation & led Marty Pring, a well-respected technical analyst, to call the end of tech equity leadership after 13 years. Rotation away from Tech to Value within the US (Value a huge OPer ytd) and away from the US to the rest of the world (ACWX has significantly OPed the US ytd) has been dramatic and if sustained suggests a whole new world of equity asset allocation & portfolio strategy. This violent rotation has been augmented by fears of conflict between Russia and NATO, leading to sharply higher oil prices and further extension of the rotation out of growth into value.

While all this was going on key technical levels were breached and further selling ensued such that both Nasdaq & the SPY entered correction territory in one of the fastest moves in S&P history from a new ATH (Jan 4th) to a 10 % correction (Jan 25th). According to LPL, the upside to such a sharp downward move is that six months later the SPY has never been lower & is up roughly 15% on average. On a valuation basis, JPM notes that the SPY forward P/E has now retraced 100% of pre-covid P/E expansion raising an interesting point given that growth this year of 3.5-4.0% will be significantly above pre Covid average growth of 2.3%.

Chart 2 – The Upside of a Sharp Down Move

The S&P 500 Index Moves Into A Correction, But That Isn't Always Bad
S&P 500 Index Performance After Fastest Corrections (Less Than One Month)

		S&P 500 Index Future Returns		
Date	Days To 10% Correction	Next Three Months	Next Six Months	Next Twelve Months
10/11/1955	12	9.7%	17.7%	14.8%
10/27/1997	14	11.5%	24.8%	21.5%
8/14/1998	20	5.2%	16.9%	25.2%
4/14/2000	15	11.3%	1.3%	-12.1%
2/8/2018	9	5.5%	10.6%	5.0%
2/27/2020	6	1.7%	16.8%	27.9%
1/24/2022	14*	?	?	?
Average		7.5%	14.7%	13.7%
Median		7.6%	16.8%	18.1%
% Positive		100.0%	100.0%	83.3%

Source: LPL Research, FactSet 01/24/2022 *Set to happen today
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

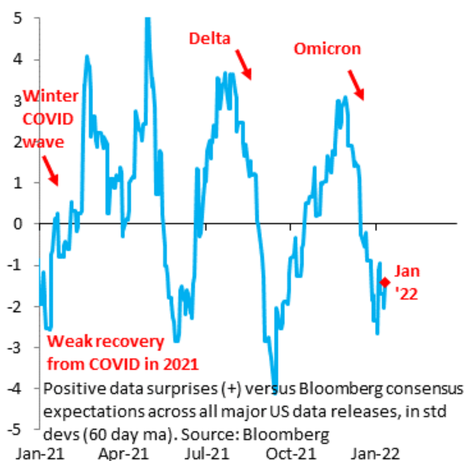
Source: LPL Research

Importantly, the credit canary has been songless. While high yield CDX is now the widest since the November 2020 election its nowhere near Q2/Q3 2020 levels and sits right where it was for the majority of 2019. The coincident collapse in much of the thematic, disruptive, ARKK type stocks, ETFs etc. seems like late bear market behavior rather than early bear market given their peak 11 months ago.

Elsewhere, Omicron has continued to spread relentlessly across the globe, adding its element of speed to the already overloaded ready player one vibe. In NY State for example, Covid cases surged over the holidays but have plunged over 85% since the peak on January 6th – a speed of spread that suggests we are in the very early stages of the shift from pandemic to endemic. Currently, this means further supply chain snafus as too many are out sick, politicized bare shelve photo shots and more. Recall though that markets focus forward; the 10 yr. UST holding above 1.75% and continued price appreciation across much of the Commodity space suggests that solid, strong growth is what lies ahead. This is the key macro question – what will the real world, not the theatre, look like with endemic Covid, Fed tightening (but PBOC easing) and all the rest.

We (and the Fed, judging from the Powell presser) do not expect the risk asset market meltdown to disrupt the global economic expansion. Our bet remains that what lies ahead is a synchronized, early cycle global expansion complete with above trend nominal growth and sustained negative real rates across the developed economies. The early cycle distinction is key – given that Delta and now Omicron have impeded the global economic recovery - we remain early cycle.

Chart 3 – Thanks to Covid, Still Early Cycle



Source: @RobinBrooks

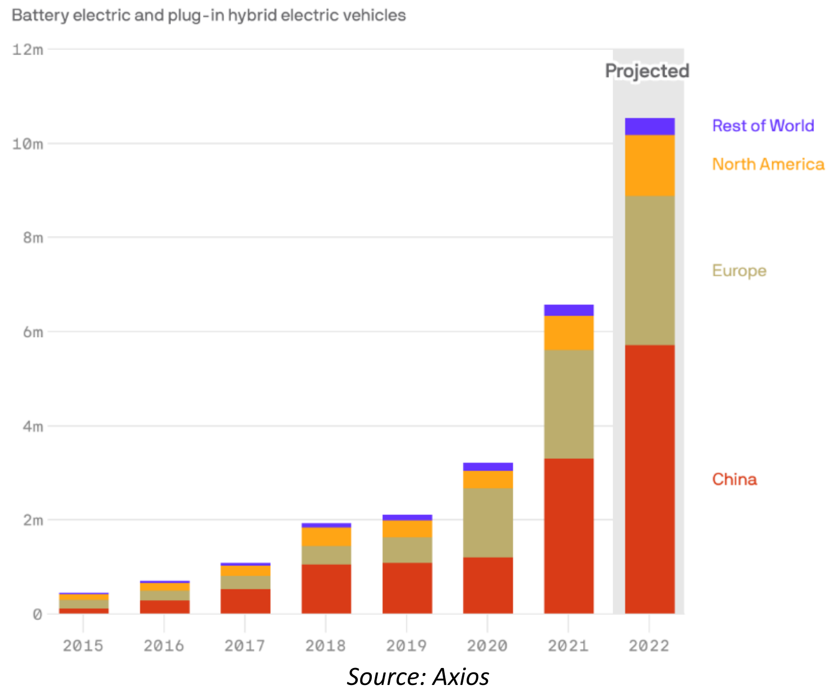
We expect the Fed to remain data dependent and raise rates 2, maybe 3 x this year. Three key market counterintuitive points to keep in mind: Fed tightening cycles typically lead to a weak USD, rising SPY and rising gold prices. Volatility spikes at the beginning (as now) and at the end as the Fed tends to tighten till things break. Such an environment should be quite constructive for corporate earnings and thus for risk assets, especially the Value segment in the US, non-US DM like Europe and Japan & select EMs such as China. The thematic space seems ripe for long term investment opportunity given massive selling pressure, horrible sentiment & resulting compelling valuations on a historical basis. USD weakness should sustain Commodity appreciation while DM Sovereigns remain in a bear market.

Let's dig in with our Global Risk Nexus (GRN) covering Climate, Economics, Politics, Policy and ending with Markets. One needs an investment plan, a process in fast moving, volatile and uncertain global cross asset markets. Our Tri Polar World framework and GRN have served as exactly that during this past year – battle tested and well honed, they will guide us forward into the market of the future. Be like water, my friend.

CLIMATE

2022 is likely to be the year Electric Vehicles go mainstream on a global basis. With Tesla turning a $5B net profit, Europe reporting more EV sales in 2021 than traditional motor engines and China selling millions of EVs the future of transportation seems quite clear. The autonomous revolution is likely to follow the EV expansion as money continues to pour into the sector while the technology advances apace. Boeing committing an additional $500M or so to Wing, an air mobility startup of which it is a part owner, is just this week's example. More broadly, McKinsey notes that total funding in the air mobility space reached $7B last year – more than double the entire amount raised in the prior decade.

Chart 4 – 2022 – The Year of The EV



Source: Axios

Climate mitigation is truly global: Europe disburses its Next Gen funds & extends its green bond financing lead, China focuses on decarbonization as Pres. Xi calls for the planning and development of a new energy supply & consumption system and Japan prepares a fiscal package to cover both digitalization and climate mitigation. The US on the other hand struggles to shoehorn its $500B in climate related spending into the Biden Build Back Better re do.

The timing is interesting – public equity markets have sold much of the Climate related opportunity set aggressively (while joining us in the old energy space) perhaps reflecting a much shorter time frame than the 5 years Cathie Woods notes is the way to think about her ARKK portfolio. The private equity markets on the other hand can't get enough of the clean tech space, pouring in money and intellectual capital on a global basis to create the Climate version of the Covid Speed model that brought multiple effective vaccines from around the globe into being in fraction of the normal time frame.

Perhaps the current moment is when a number of these time frames actually line up – the short term public market time frame given the bombed out nature of the space, the legislative time frame given the need to pass US climate legislation if the US is to have any chance of meeting its Paris Accord targets and the private equity space which understands the world is changing fast and climate change is a prime driver of such.

ECONOMICS

Growth, how much? Inflation, how high? These seem to be the operative questions. Context is key – Bloomberg notes that the US averaged 2.3% real growth in the 5 years thru 2019. Note that 2022 real US GDP growth is forecast to be around 4%, decelerating from 5.5% in 2021. This is a key point – namely the distinction between slowing growth and slow growth. The US and much of the DM has the former, virtually no one has the latter, especially if the pre Covid era is the benchmark. Current data are impacted by Omicron but even so January PMIs were better than expected in many cases, especially on the manufacturing side. As Omicron ebbs, the service side should pick up sharply.

2023 is penciled in slightly north of that pre Covid 2.3% growth rate for the US. Europe is forecast to grow faster than the US this year and roughly the same as the US in 2023 while Japan will grow close to 3% this year - its best growth rate in a decade or more before slowing back towards trend at less than 2% in 2023. China is set to decelerate from 8% growth last year to roughly 5% this year while its policy mix is set to ensure growth does not disappoint.

Chart 5 – Slowing, But Not Slow, Growth

Latest World Economic Outlook Growth Projections

(real GDP, annual percent change)	ESTIMATE 2021	PROJECTIONS 2022	2023
World Output	5.9	4.4	3.8
Advanced Economies	5.0	3.9	2.6
United States	5.6	4.0	2.6
Euro Area	5.2	3.9	2.5
Germany	2.7	3.8	2.5
France	6.7	3.5	1.8
Italy	6.2	3.8	2.2
Spain	4.9	5.8	3.8
Japan	1.6	3.3	1.8
United Kingdom	7.2	4.7	2.3
Canada	4.7	4.1	2.8
Other Advanced Economies	4.7	3.6	2.9
Emerging Market and Developing Economies	6.5	4.8	4.7
Emerging and Developing Asia	7.2	5.9	5.8
China	8.1	4.8	5.2
India	9.0	9.0	7.1
ASEAN-5	3.1	5.6	6.0
Emerging and Developing Europe	6.5	3.5	2.9
Russia	4.5	2.8	2.1
Latin America and the Caribbean	6.8	2.4	2.6
Brazil	4.7	0.3	1.6
Mexico	5.3	2.8	2.7

Source: IMF

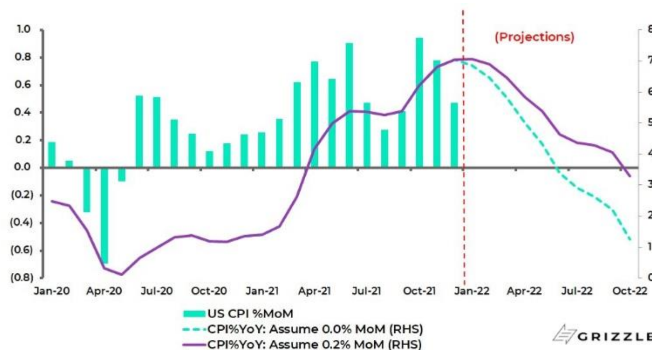
While growth is slowing it is far from slow. Q1 is likely to be an Omicron driven head fake with some forecasters penciling in zero growth for the US before a sharp and strong pickup in the middle of the year. Steve Blitz at Lombard notes the US is in the process of transiting to a trend

pace of consumer spending that will run ahead of pre-Covid trends and be fueled by leverage (households de-levered in the past 10 years). He notes that the challenge for investors is to see through this transition away from the Covid cycle, this downshift in activity, and keep confident the economy is transiting to a very different (better) economy than what existed pre-Covid. Seeing through this transition to "normal" is the immediate challenge, understanding where the economy ends up is the more critical challenge. Blitz notes he is steadfast in believing the economy ends up with a better growth profile but higher inflation – and that the Fed's coming actions will prove far less restrictive than advertised. We agree.

What about inflation? At multi decade highs in the US and Europe – not so much in Asia, it has become a clear political headache for Pres Biden. In Europe it appears that inflation peaked at 5% in December with forecasts of 4.3% this month. Consensus suggests that US inflation should peak in the coming months before easing sharply as large April – May – June 2021 inflation prints fall out of the calculation. Inflation expectations peaked last November and base effects suggest sharp falls in food and energy prices in the 1st H on a y/y basis. Recently reported Q4 ECI coming in lower than expected eases fears of a wage price spiral.

We are on the cusp of lower than expected inflation readings. Slowing growth, easing supply chain woes, more clarity and stability as Covid turns endemic all support the idea of lower inflation as does fiscal contraction & Fed tightening. The fixed income market would seem to agree with year-end one year inflation swaps priced at 3.5% roughly, a near halving from current prints. Blitz expects a relatively steady 2.5%-3.0% inflation environment.

Chart 6 – Peaking US Inflation



It's important to keep nominal growth rates in mind (inflation + real growth = nominal). Pre Covid, US nominal growth was in the 4-5% range, in 2022-23 it will be in the 5-7% range with a similar development in Europe and perhaps in Japan as well. Higher nominal growth rates typically generate higher corporate earnings and thus higher risk asset prices.

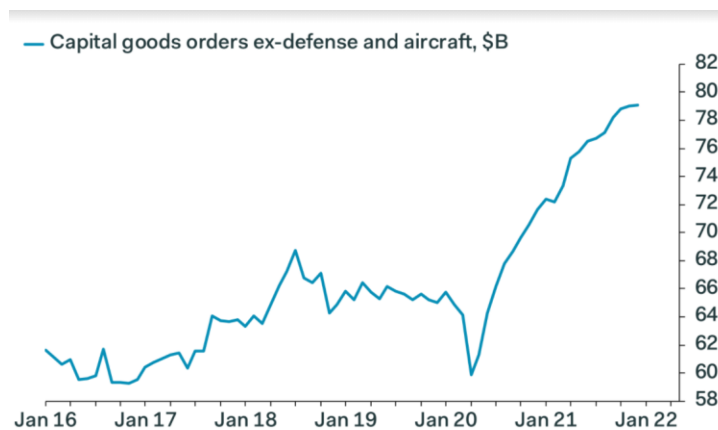
Governments have tons of money with many US states running balanced budgets for the first time in modern memory. Corporates are cashed up like never before as well – helping to keep default rates low. Consumers, flush with record house prices, high stock prices (ok not as high as 3 weeks ago but still up roughly 15% from a year ago) and low unemployment also seem in

very good shape. Prospects for a cap ex boom have rarely been better; the potential from this to be coupled with a productivity surge driven in part by the accelerated adoption of multiple converging technologies also seems quite robust.

Now that we are in 2022, the out years, 2023 and beyond, start to become important. The market, investors and policy makers alike, are all forecasting the return to the pre Covid period of roughly 4% nominal growth (2% real, 2% inflation) in the US and some derivative version in Europe and Japan. China of course is moving to adapt its dual circulation strategy as it seeks to drive growth via domestic consumption rather than foreign demand or investment spend.

We continue to feel there is a decent shot that this outlook is too pessimistic and that a period akin to the 2nd H of the 1990s awaits. Then, a cap ex boom and productivity surge drove higher growth, higher wages and stable inflation (as well as higher stock prices). Today we have all the makings of a global cap ex boom coupled with a period of accelerated adoption of multiple technologies that has been both driven & masked by Covid coupled with a more dynamic labor market.

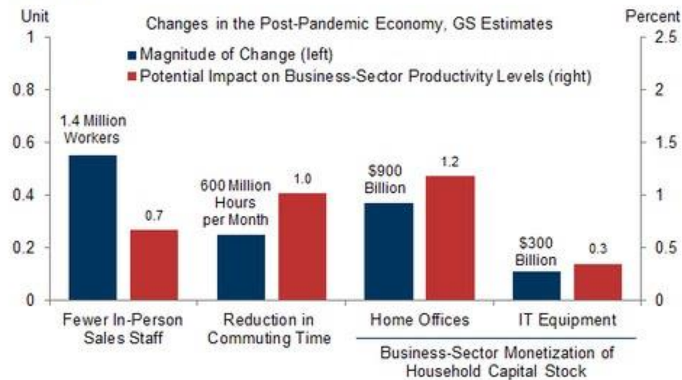
Chart 7 – Cap Ex Boom Ahead – Last Seen in The 1990s



Source: Pantheon Macro

Automation is a good example – given shrinking labor forces the potential for it to lead to higher profits, lower consumer prices, greater demand and more region-based production is real. An environment akin to 6% nominal, (3+3, 3% real growth and 3% inflation) seems feasible given the picture laid out above which doesn't even include the climate mitigation spending every govt in the world is going to be doing in the years ahead.

Chart 8 – Productivity Gains Limit Inflation, Support Margins



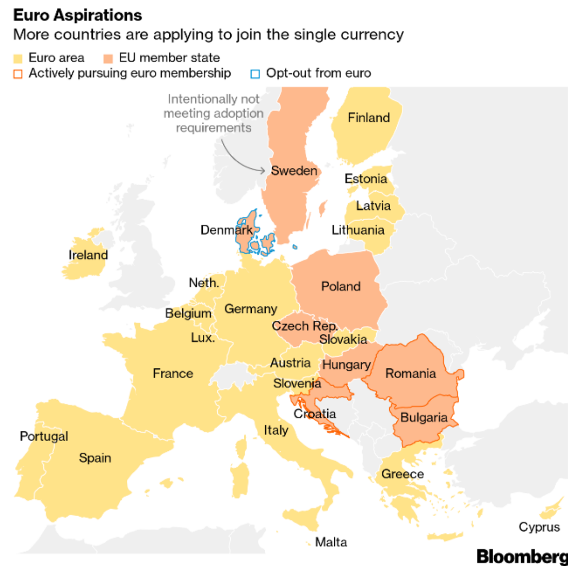
Investors need to start considering the over and under of a 2023-2025 return to pre Covid DM growth and inflation. We take the over on both, which, as we will see, has significant implications for one's asset allocation.

POLITICS

A glide path in China, lots of action in Europe and the US midterms suggest an action-packed year for politics – how much it matters for investors may be a different question. We want to invest where there is political stability and the capacity to move, legislate, take action etc. China clearly fits the bill as we have seen with the PBOC of late. It may also include Japan as it seeks to kick start its economy under a new Govt. From a Tri Polar World POV, January marks the start of Asia's Regional Comprehensive Economic Partnership (RCEP), the world's largest trade deal with China at the center. Asian integration is well under way.

Europe's political calendar is also likely to be action packed in 2022. Italian elections are ongoing as I write and the broad feeling is as long as Super Mario is involved all is good – a point not lost on the rest of the Italian political firmament. France goes to the polls this Spring and Pres. Macron is hitting out against the unvaccinated judging that the majority of voters, who have been vaccinated, are fed up with those who are not. Germany's new Govt is certainly being tested with the Russia – Ukraine confrontation, one that remains wide open. While widespread fighting seems unlikely (why wait till NATO gets its house in order) it is a reminder that Europe's neighborhood requires attention. One also has the bawdier UK-style political theatre complete with the likely takedown of the bumbling Johnson Govt over a drinks party scandal.

Chart 9 – European Integration



The US and the Americas more broadly remain stuck on a different rail siding. Political gridlock is evident on a daily basis in the US and with midterms coming this Fall its unlikely to get better soon. The failure to move on either Build Back Better or voting rights tells one all one needs to know. Polling suggests inflation is Pres. Biden's # 1 problem with voters giving him his worst grades on that issue. If and granted it's a big if, if the era of US tech led, global equity leadership is ending, at least it will allow for a syncing up of the gridlocked US political landscape and its super premium priced financial markets – the gap between the two has become unsustainably wide in the past few years.

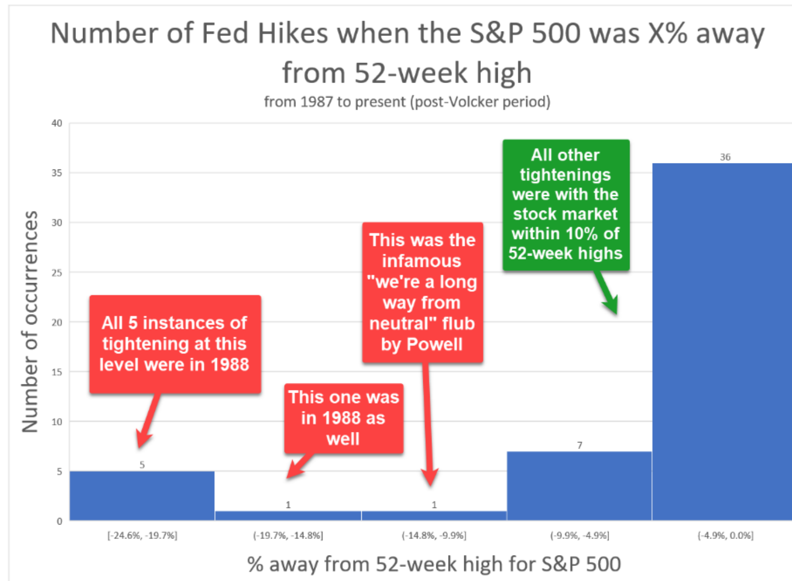
The rest of the Americas offers little hope as well, though Chile's new President is off to a good start judging from an impressive Cabinet. Brazil's Fall elections is the one to watch; the growing potential for former President Lula to defeat current Pres. Bolsonaro suggests an ugly race.

POLICY

Monetary policy headlines as the world shifts from easing to tightening, a process that has already been well under way, especially in the EMs. It is very important to keep in mind that China's PBOC is firmly in easing mode after its actions of the past month. The BOJ and ECB are likely to remain on hold this year. The BOE and BOC are in tightening mode and the Fed is likely to join them in March.

The market has gotten way ahead of itself in suggesting that there could be 5 rate hikes this year and QT as well. We expect 2, at most 3 rate hikes as the Fed notes the sharp downward shift in inflation and assesses the mid-year growth outlook. The fiscal drag in the US will be substantial this year, giving the Fed an additional reason to be data dependent throughout the course of the year.

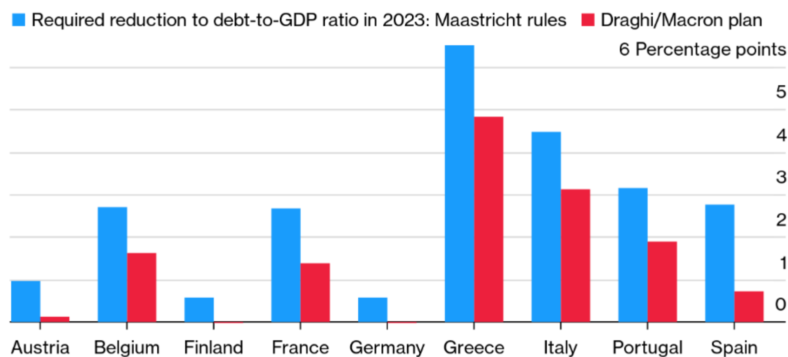
Chart 10 – Fed Tends To Hike In Strong Equity Markets



Source: The Macro Tourist

While monetary policy is unlikely to be as much in play elsewhere fiscal policy will remain quite growth supportive in Europe and much of Asia. Japan's new Govt is set to spend aggressively to accelerate the country's digital adoption and climate mitigation efforts. In Europe the Next Gen disbursements really start to kick in this year and next while there seems to be widespread understanding and agreement that a retooling of the Stability & Growth Pact is necessary and will need to include the ability to spend on climate mitigation.

Chart 11 – EU Fiscal Stimulus Supports Growth



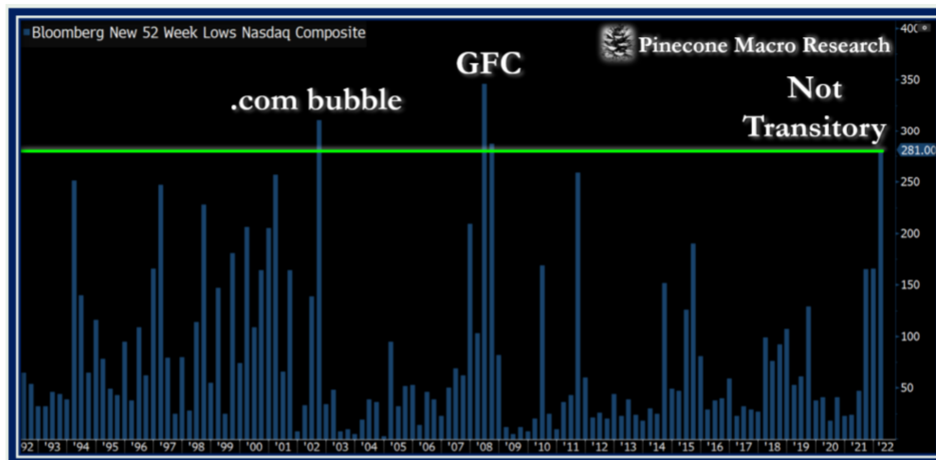
One area of concern remains China's Zero Covid approach, especially as it pertains to the global supply chain. With both Lunar New Year and the Olympics set for next week, it has made sense for China to remain hyper vigilant. What happens next remains to be seen but China has developed the ability to narrow cast its lockdowns such that it's unlikely that a major port or production center would be shut for long. We like this quote: "Zero Covid has maybe 1,000 faces in 1,000 cities" suggesting that China can and will tailor its lockdowns.

The policy picture outside the US seems more supportive of growth and risk assets, perhaps reinforcing the market mindset that change is coming and it's not all theatre. The USD will be an important indicator here – traditionally it declines as the Fed tightens and its failure to rally over the past few months as a more and more aggressive Fed is priced in is itself suggestive of a dollar decline.

MARKETS

Now we have had the January Fed meeting it seems clear that Chair Powell and the Fed recognize that 2022 is not 2018 and the economic backdrop, as we have argued, is very different. This brings both good and bad tidings for investors. The bad is that the strike price on the Fed put is far below us as the Fed recognizes the economy is strong and recent market weakness will have little effect on growth going forward as suggested by credit spreads & commodity prices. The good news is that our outlook for high nominal growth and negative real rates that will underpin earnings and hence risk asset prices has been verified - suggesting that if investors can keep their nerve the Fed put will not be needed.

Chart 12 – Nasdaq New Lows = Real Pain



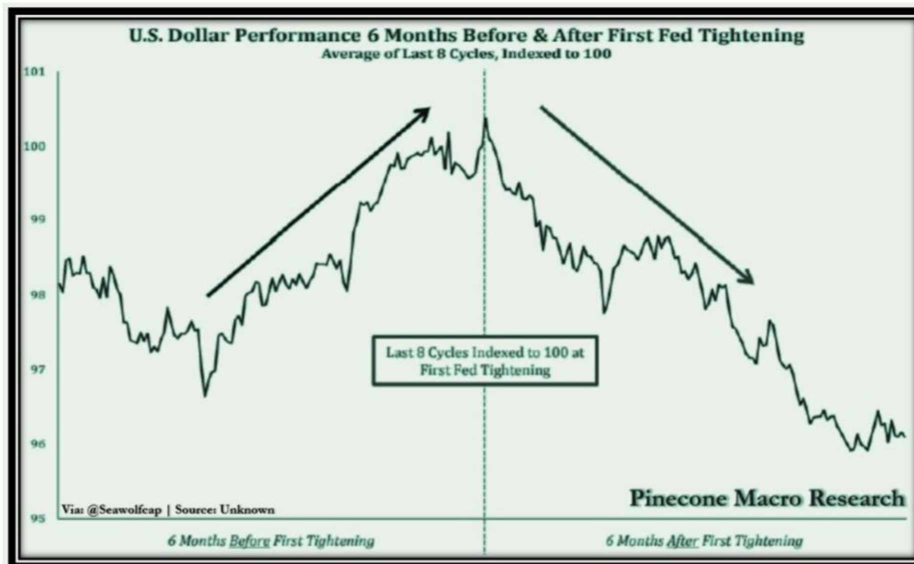
There is also the very important point that should both TPWA and the Fed be right in this outlook then the Fed will not back away as it did in 2019 and will move forward with its data dependent rate hike process which very importantly will sustain the rotation away from Growth and big cap tech and towards Cyclical and Value segments, including financials as this outlook should continue to lead long rates higher, reinforcing the rotation away from Growth and the

US. With a 300%+ world economy debt/GDP, the equilibrium levels for real yields are ever lower. The Fed is unlikely to move as far or as fast as the market has priced in.
As noted in prior Musings, foreign investors own 40% of US equity and 35% of UST. Should they decide to pull money back home or to other regions, the impact on the USD could be significant.

We see four main differences between the current environment and the environment when the Fed last raised rates in 2018. Today, we are early cycle vs late cycle; we have high nominal growth rates vs low; real rates remain quite negative vs already being positive when the Fed started its last cycle and finally we expect a weak USD vs a strengthening one in 2018-19.

Bear market talk abounds as equities fail to hold rallies & charts of how midterm years have deep corrections make the rounds. We are not unaware of this risk but nor do we see it as the base case moving forward. We have noted the history of rising stock prices and falling USD in prior Fed tightening cycles – the S&P averages roughly a 10% gain in such cycles going back to the early 1980s. A weak dollar in turn could reinforce the non-US equity upside as well as providing a leg up for Commodity prices and producers. Finally, the implications are likely to be profound if we are truly moving away from the tech led, US equity led regime in place since the GFC low in 2009. This is what investors need to contemplate and take a view on.

Chart 13 – Fed Hikes, USD Falls

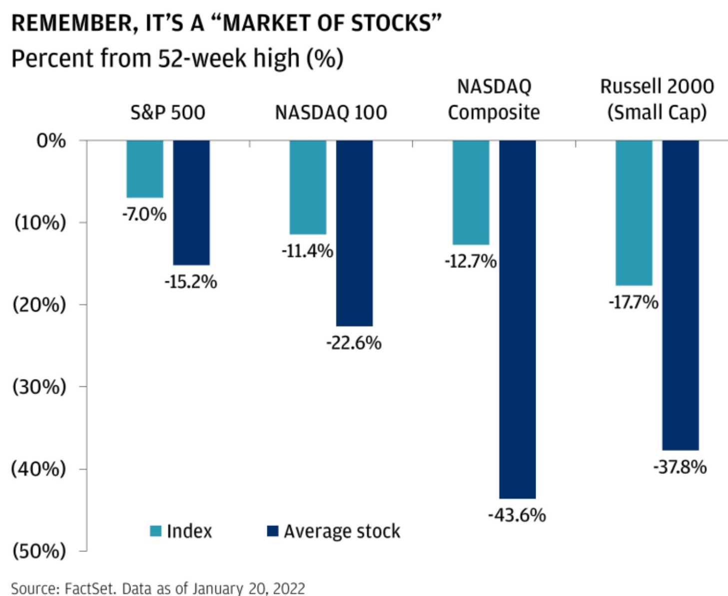


The other issue at hand is the potential for an important entry point for thematic investments like disruptive tech, climate, etc. The thinking is that January's violent rotation has served to set the coda on the yearlong decline in these segments. While the Big Cap tech rollover is new, the punishing of the ARKK type names is not, it is old and more likely late cycle. A continuation of the bull market would suggest these names can rally & provide alpha, the question is whether

they can develop sponsorship while big cap tech gradually bleeds lower, snared by rising rates, legislative threats, M&A caps and deep pocketed startups.

JPM notes that markets had their worst month since 2H20, and a combination of technical indicators approaching oversold territory and sentiment turning bearish (AAII bulls to bear ratio in the bottom 5th %ile) suggest we could be in the final stages of this correction. In addition, while the market struggles to digest the rotation forced on it by rising rates, we expect the earnings season to reassure. JPM argues that the stock market is not only in correction, it is already in bear market territory given the selloff under the indices, all without a recession in sight.

Chart 14 – Small Caps, Nasdaq Already Punished

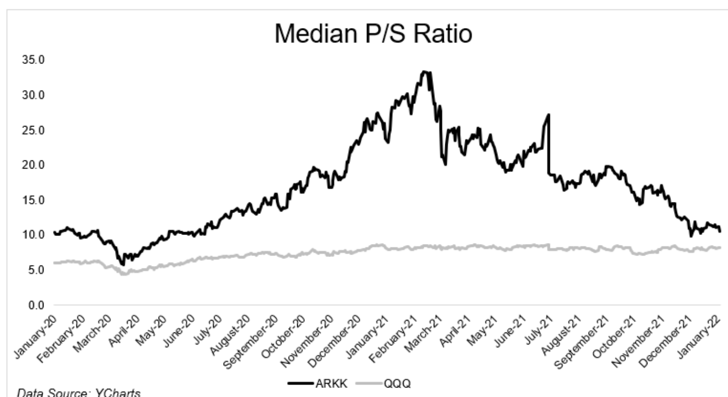


Source: J.P. Morgan

On the valuation side, JPM notes that the S&P 500 post-pandemic re-rating has almost been completely erased with PE now only 0.5x higher (largely explained by TSLA addition) vs. pre-pandemic level when rates were more restrictive and fundamentals were less supportive. Even more extreme, small-caps have seen their valuation compress to levels last seen ~20 years ago to 14.6x PE NTM (-4.5x vs pre-pandemic).

So if we are in a continued strong growth, negative real rate environment with room for upside earnings surprises and a twin engine type mkt that is able to stay afloat even as tech gradually sinks, the SPY can be flat to up – down 5-10% in 2022 which would be an excellent environment for the baton handoff to the ROW equity market and to Value with in the US. If this is the outlook then the opportunity set in late-stage bear market areas like disruptive tech could be significant, perhaps the best entry point in years given the Covid acceleration of the adoption cycle syncing up with the 2ndH of the 1990s analogue for growth.

Chart 15 – Time To Buy Thematics?



Source: The Irrelevant Investor

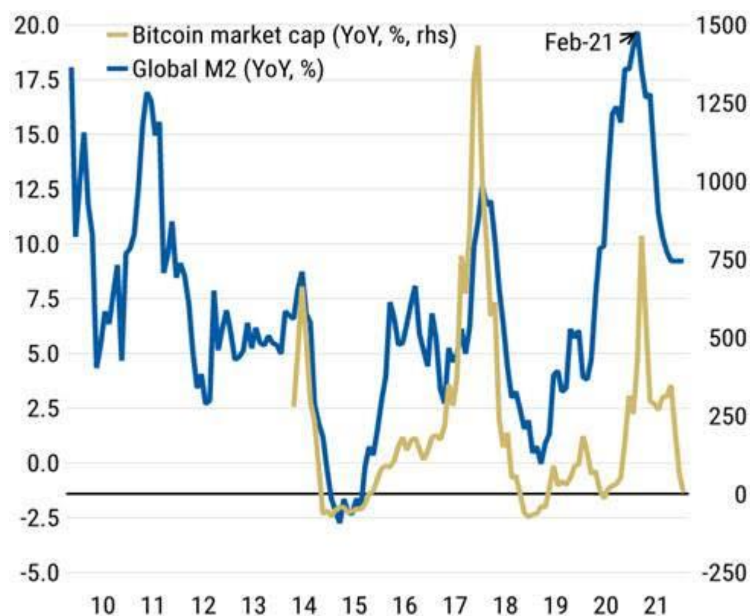
The rapid back up in real yields that kicked off the tech selloff was not matched by a blow out in credit spreads, a markdown in 2022 EPS estimates or a selloff in Commodities suggesting that the real economy can handle the market weakness. Bloomberg reports that companies also have surprisingly low debt in relation to how much income they are bringing in. The ratio of net debt to EBITDA—or yearly earnings before interest, taxes, depreciation, and amortization—was barely above 1 at the end of 2021 for S&P 500 companies, a record low, according to Bloomberg data dating from 1990. Compare that with a ratio of 4.25 in 2007, before the global financial crisis, and 3.88 in 1999, ahead of the collapse of the dot-com bubble. Credit needs to be on one's radar given that all major equity bear markets have been preceded or accompanied by blowouts in credit spreads. Speaking of earnings, 35% of the S&P reports this week – I have hardly seen any bank commentary on earnings season so far.

Chart 16 – Stocks Stumble, Spreads Snooze

Source: Bloomberg

This 2H of the 1990s as the analogue thesis remains far, far from market consensus and so it may prove quite wrong but given the brutality of the selloff – the press covers Nasdaq down 13% with blaring headlines but barely a mention of ARKK down close to 30% YTD and 55% off its 2021 high, ARKF off 54% & DAPP (the Crypto pick & shovel ETF) off 32% YTD and 61% from 21 high. Sentiment is horrid but if one thinks the bull market is intact then building a position in the thematic space in a month like this one could be the right move on a 12-24 month basis. Crypto is interesting – for all its adherents bashing the Fed and fiat money, it has turned out to be one of the most dependent assets on Fed-provided liquidity. As global monetary policy expectations have switched from accommodative to expectations of monetary tightening, crypto is in significant pain.

Chart 17 – BTC – Just a Liquidity Play?



Source: Morgan Stanley

So with the view that the risk asset selloff is in its end stages (US, EU down 4 weeks in row) as various indicators would suggest & it has not derailed the synchronized global expansion we foresee as Covid fades and services pick up we plan to maintain our current positioning. Nasdaq sentiment is lower than the Covid bottom while new lows reached levels last seen in 2008 while the NYSE is "pretty darn oversold". The Fed also tends to tighten with the S&P within 10% of its recent high with few exceptions – this is not to say that equites can't go down or the Fed won't hike in March if that occurs but it does suggest the stabilizer mechanism of equities in a Fed cycle. One risk to keep in mind is if Russia invades Ukraine the resultant oil spike could take oil to $150 a barrel and cause significant inflation pressure that the Fed and other CBs would struggle to control. This is not a base case but one worth considering.

We remain OW equity, especially Value – Cyclicals in the US, non-US DM and select EM with an Asian tilt. In the case of China the folks at Alpine Macro said it well: "the best entry point is

when growth is weak, stocks are cheap, investors are bearish and policy makers are turning stimulative. All these boxes are checked for the Chinese equity market." Similarly the Bear Trap Report noted recently that on a market cap basis 10 Ali Baba's = 1 Apple versus the past 5 year average of 1.5-2x. We remain deeply UW bonds, especially DM Sovereign debt as we expect the 20 yr. UST to break 2% & the 10 yr. Bund to break zero and stay above the zero bound. Even JGB's are getting in on the action pushing up against the .2% level it last breached in 2016. Rising JGB yields could lead to a domestic reallocation into equity. We expect China Govt bonds to continue to rally & maintain an overweight in Asian HY. As Omicron fades and the ROW recovers foreign bond yields should lift, removing a UST cap and a USD prop. We continue with a big OW of Commodities across the space, from energy to metals to miners to ag plays.

Chart 18 – Back To The Future?

Our Global Multi Asset Model is down mid-single digits YTD – given the various record-breaking aspects of the decline that is a decent result. The TPW 20 thematic model is down considerably more following a tough month in December. Investors here know to have a LT outlook – as noted above the near term could be quite good as well. Both models are very well positioned for the outlook presented above.

Chart 19 – Overweight Commodities, Underweight Govt Bonds

Source: Pinecone Macro

These are challenging times – it's often tough to distinguish what is theatre and what is reality. One last real time example of such is the gap between private market enthusiasm for all things Crypto & disruptive Tech which is at odds with the public market giveaways in the same sectors. MS notes that the discrepancy in valuations for growth names in private and public markets continues to grow. As the market continues to punish unprofitable growth stories in the public space, the private market has continued to pay a premium.

Will we see the down-trodden public tech/growth names re-rate or an inevitable correction in the private markets? Vision Fund's CFO Misra in an FT interview cited the software-as-a-service market as an example. There, private companies are often still valued at 20 times forward revenue, he said, but in public markets, SAAS company valuations have come down to about 12 times revenue. "That gap is going to tighten over the next six months," he said of the discrepancy between public and private markets.

The risk is that the Growth equity sell off spreads to Cyclicals & Value & to the global markets. This is a concern but for now the macro picture suggests it is less likely than a growth position unwind that will continue in fits & starts as the year progresses. Clarity is challenging to hold onto in the current market environment and we haven't even entered the metaverse yet!

Stick to the plan, follow the process, be like water….