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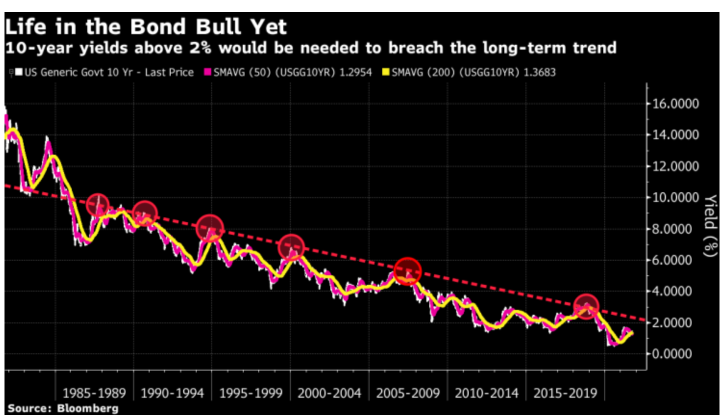
It's easy to get chopped up in markets like these – big up and down days, one after the other, 2 steps forward, one step back. It's transition time, both seasonal and market related - the shift in long standing relationships is bound to produce some chop. It's been a potholed road for sure; as investors the key is to understand the direction of change and position accordingly, using the chop to build or trim positions.

I see three very big market related transitions ahead. The first is the shift from liquidity-driven equity markets to earnings-driven markets as Central Banks start to pull back. The second is the internal equity market shift from Growth to Value after a decade long period of Growth stock outperformance; this is especially true for the US equity market vs the ROW. We had a taste of this shift last winter; I believe this time is going to be the main course, not the app. The third is even more momentous and that's the end of the 40 yr. old UST bond bull market that has stretched from the early 1980s to today. Rates have backed up with the 10 yr. over 1.5% and the 30 yr. above 2%. We have a ways to go to confirm this huge transition with charts suggesting the 10 yr. needs to break 2% to break the downtrend in yields. I think this is likely over the coming year. See Chart 1.

Chart 1 – A 40+ Year Bond Bull Market Approaches Its End



Overarching all this is the climate transition to a low carbon future with all that this implies for economic activity. Climate change is this decade's single biggest global macro trend.

From a tactical POV, investors have had multiple opportunities to sell over the past few months: mid July's Delta discount, mid August's China edict selloff, last week's Evergrande capitulation selling and this week's just chuck it out the door sale. Notwithstanding other worries, selling would seem to be pretty exhausted, especially when one notes that the S&P is oversold for the 1st time in over a year (2nd longest streak in 70 years, shows strength of trend – next 3 M positive) & roughly 86% of S&P constituents have already had a 10% correction prior to this week.

Offsetting these woes are the following positives: improving seasonality (Q4 averaging 5% gains for ACWI over the past decade), very easy financial conditions, fading Delta with no other variant behind it (47 states have reproduction rate below 1), the end of the US growth lull & Asia reopening as Japan ends its lockdown with cases down roughly 90% from peak. The potential for an equity performance chase into YE, led by underperforming hedge funds crowded into big cap tech, remains on the table.

Strategically, the synchronized global expansion, with the Tri Polar World's three regions: Asia, Europe, and the Americas all open at the same time, expected in 2H 2021 & delayed by Delta, now lies just ahead. BofA's global growth indicators remain very positive at 90% bullish, while various bodies are raising their 2022 GDP estimates around the globe from Europe to Asia. Global growth in 2022 should be roughly 2-3x better than the last decade's average of roughly 2% for DM economies. Support for such growth will come from inventory restocking and strong consumer demand with US household net worth at all-time highs, German consumer confidence at its best since April 2020 and post-lockdown Japan expected to be the only major economy to grow faster in 2022 than this year.

I would argue that that's all one really needs to know. The other stuff: US political drama around debt ceilings and shutdowns is more farce than governing. A weekend shutdown is possible, a default extremely unlikely. The Biden infrastructure plan will pass unless the Democrats form a circular firing squad and start shooting (unlikely). The energy shortages in the UK, Europe and now China, perhaps to soon spread to India, are sideshows and reflect the inability of markets to handle the uncertainty of the past 18 months, especially the energy spot markets which have been caught out from coal, to gas, to uranium… exposing in a way, the need for Big Govt to take more control. It also serves as just the latest example of what I coined "climate speed" in the last monthly… the erasure of the distinction between the short and long run. It's happening NOW; there is no going back to status quo ante.

Put it all together & I remain constructive and focused on the opportunities in US Value, Cyclicals and Small Caps, non-US DM in Europe and Japan & EM across the Tri Polar regions. Commodities, which are just beginning the transition from underperformers to outperformers, also remain attractive throughout the complex. The opportunity to make money in both fossil fuel energy and new energy – an investment opportunity I first wrote about roughly a year ago – remains true today and will remain so I expect for the foreseeable future.

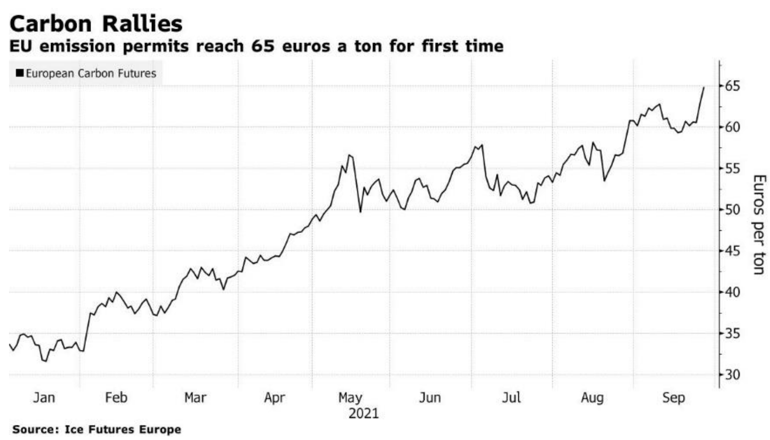
As I write all three asset classes are selling off: stocks, bonds, and commodities – take advantage to fill up your shopping cart with the items listed above. Now, let's use our Global

Risk Nexus (GRN) set up to examine: Climate, Economics, Politics, Policy & Markets across the Tri Polar regions and the globe.

CLIMATE

If the summer of 2021 was when Climate Change became an in-your-face phenomenon, it appears that fall and winter will see it become a matter of creature comfort and beyond as energy shortfalls create power shortages across the globe. One result is the rising cost of carbon as older, dirtier power plants are jumpstarted. As Chart 2 suggests the price of Carbon in Europe has never been higher. Oil is at three-year highs, coal prices and natural gas prices are skyrocketing as operators used to filling demand in the spot markets find themselves short of fuel.

Chart 2 – Energy Shortfalls Bullish for Carbon



The good news is that should help drive energy consumption down (China's efforts in this direction appear to be partial cause of some China-related shortages), push carbon costs up and reinforce the need to move with speed and in a well-planned-out manner. In Asia that means organizing blue skies for the Winter Olympics should not mean energy shortages and power outages. In Europe it means continuing to disburse the Next Gen funds and accept that the need to invest in climate change and mitigation requires the restructuring of the fiscal limits put in place under the Maastricht Accords. After all, why should debt levels seen as upper limits when rates were around 5% be appropriate for a time when rates are zero and climate change is already wreaking havoc?

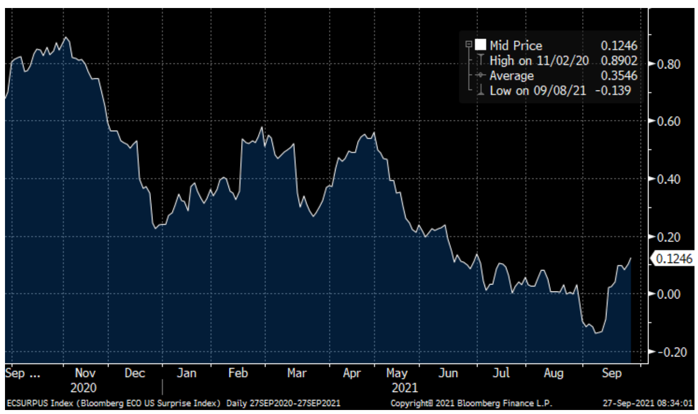
For the US it means passing the Biden "human capital" plan which includes key Climate provisions especially around the Clean Electricity Standards as well as EV and EV charging infrastructure. As I wrote recently (link) it is another example of Climate Speed, whereby if this legislation is not passed now then the likelihood of the US meeting its peak carbon goals by 2030 go out the window. So it's not like we have 8 years or so to get it done – if legislation is not passed now it is highly unlikely to occur.

Let’s not forget the COP26 Climate Summit begins at the end of October. Failure to pass the legislation ensures that Pres. Biden will attend as a limited power player, unable to get his own Govt to act as he knows it must.

ECONOMICS

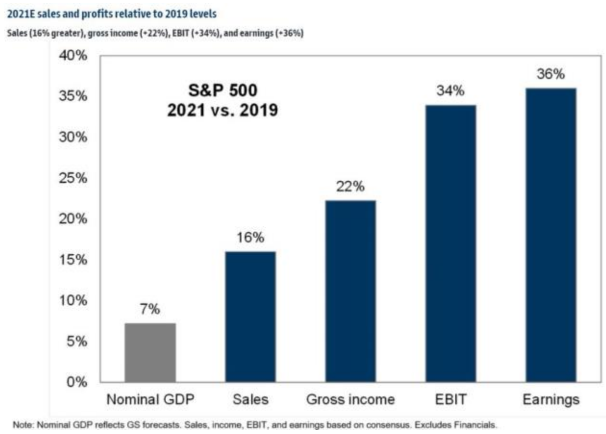
While “slow growth” headlines continue to mount, the reality on the ground is the opposite – it’s just the latest example of Covid Speed. Morgan Stanley called August the bottom of the US growth slowdown, Europe’s consumer confidence numbers continue to pop & Asia’s reopening leads to increasing 2022 GDP forecasts. Citi’s US Economic Surprise Index (ESI) has bottomed and is turning up as Chart 3 demonstrates. Record US household net worth and surging wealth in Europe as well suggest that consumption power remains a potent force for growth as we exit 2021.

Chart 3 – Headlines Scream Slowdown – Citi ESI Begs to Differ



The near-term worry is all about supply chain bottlenecks, Delta residual fears, power shortages, port backlogs etc. etc.… you name it – folks are worrying about it. It’s okay to worry just don’t let it impede your investment decision making. Here the focus should be on growth, inflation, rates etc. Thanks to the Delta lull of mid 2021, both real and nominal GDP growth rates will remain significantly above trend in 2022 while inflation will be higher, maybe by 1% or so to 3% headline in the US and maybe 2% in Europe. Recent US wage expectations data don’t support surging inflation fears - some inflation is good – it will help Central Banks get off the zero bound, allow companies to pass along some price increases and maintain margins amidst higher pay rates. See Chart 4.

Chart 4 – Margin Fears are Likely to be Overdone

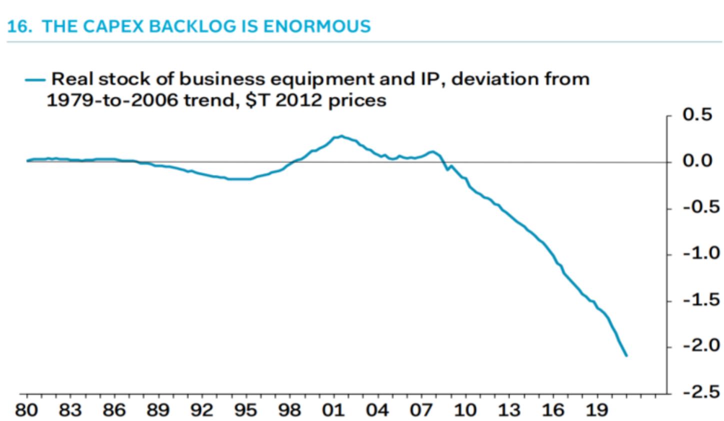


Source: Goldman

Rates will back up – the Fed will taper suggesting rates could be above 2% on the 10 yr. and approaching 3% on the 30 yr. as we reach mid-year. The ECB will be slow to move while the PBOC may well move in the direction of providing liquidity not withdrawing it.

2022 will bring about the synchronized global expansion we have written about and may also set the stage for several years of above trend growth facilitated by pro cyclical spending, a cap ex boom (the conditions for which are "just about perfect "according to Pantheon Macroeconomics) and surging productivity brought about by the accelerated adoption of technology post Covid. This opportunity is barely a glimmer in the eye of most investors – I continue to think it has a very real chance of playing out over the 2023-2025 timeframe. See Chart 5.

Chart 5 – A Cap Ex Boom Akin to Mid 1990s Ahead



Source: Pantheon Macroeconomics

POLITICS

The US political scene is front and center – replete as it is with key votes ahead to pass the Biden Infrastructure plan – together with spending authorization to avert a Govt shutdown by the weekend and a debt ceiling extension necessary to avoid a default that would surely wreak havoc in global markets. As an American it is beyond depressing how fruitless and feckless so much of our politics has become – it really is akin to hundreds of Neros fiddling while Rome burns.

There is much political action away from the US as well – some likely to be quite consequential. The German elections are over & now the coalition building begins. A 3-party coalition is most likely between the SPD, the top vote getting party, the Greens which enjoyed its best result and the FDP which is angling for the Ministry for Finance for its leader Christian Lindner (a fiscal hawk). As the likely next Chancellor, SPD leader Olaf Scholz will need to make the case for Germany to spend what is needed to address its weaknesses across the digital front, the climate landscape and the general decrepit nature of its public sector investment. The good news is that 40% of voters want fundamental change, nearly double the total in 2017. Workarounds will likely be necessary – time will tell as past history suggests the Coalition's makeup might not be known until December.

In Japan, the LDP leadership contest is over and former foreign minister Fumio Kishida has won & is the new LDP leader & likely next Prime Minister. He will lead the LDP into national elections in the coming months with a large fiscal package – rumored to be in the $270B range which would equate to roughly 5% of GDP and be quite significant.

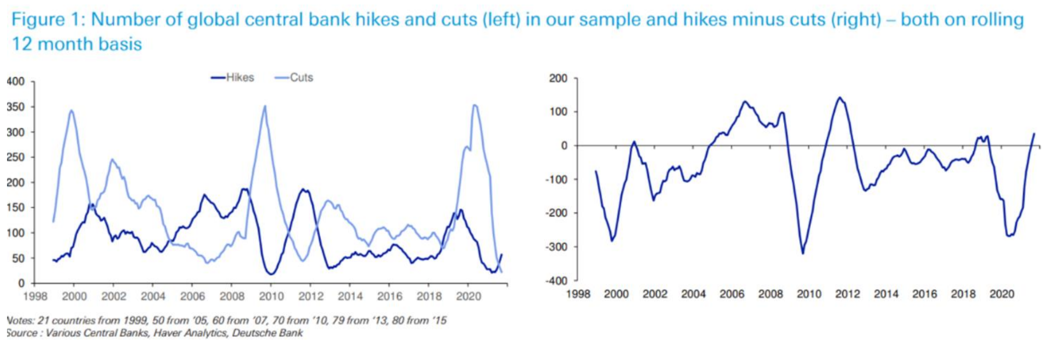
As China embarks on its Fall break (off most of next week) the reverberations from Pres. Xi's edicts on tech, social equality, tutoring etc. are compounded by the uncertainty generated by fears of Evergrande's implosion. The heavily indebted property developer has had reams written about it and we have done our share as well. Bottom line – it's not global, is not going to bring down China growth, Asian HY or other markets. The same applies to the latest China fear – that of energy shortfalls. Much like Evergrande this comes about as a direct result of the Govt ordering certain segments to slow or reduce activity to improve pollution levels before the Winter Olympics while other regional Govts are trying to fit under the rule that power consumption be reduced vs a yr. ago. Both are highly unlikely to implode the Chinese economy.

POLICY

Monetary Policy seems fairly well set: The Fed will begin to taper shortly and end by mid-year (a bit faster than expected) in order to provide as much optionality as possible. This calls into question its commitment to FAIT; I for one continue to expect it to hold to this framework, especially if Jay Powell is re upped as it seems he will be. The ECB will be content to let its Covid support program end on schedule next Spring and then remain quite loose in order to support the European economic recovery. The PBOC as noted has room to ease and may well use it to buffer the shifting tides of China’s policy shift from growth, any growth, at almost any price, to quality growth at a reasonable price.

Broadly speaking the tide has already turned to tightening with the # of CB rate hikes over the past year exceeding cuts by the most in a decade as EM Central banks seek to insulate themselves from taper risk. With the major Central Banks likely to move with some caution the likelihood of an abrupt end to the global economic expansion seems quite limited. 2022 should be a year with much less mental clutter in terms of Covid, supply chain bottlenecks, energy shortfalls etc. See Chart 6.

Chart 6 – Rate Tightening Cycle Ahead

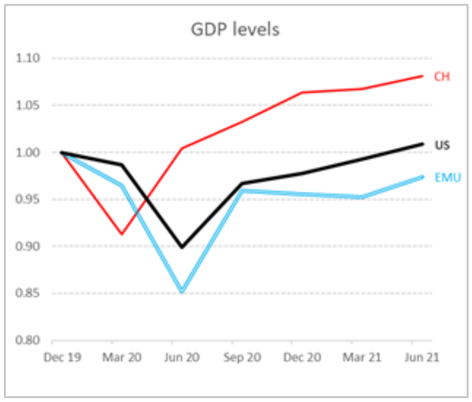


Source: Deutsche Bank

Fiscal policy also seems fairly well set with the US fiscal deficit set to rachet back by half with upcoming legislation likely to be mostly paid for via tax hikes. Europe is well anchored with its Next Gen stimulus disbursing monies for the next several years. Europe’s true fiscal battle will be over adjusting the famed Maastricht debt limits, set as noted above, in a very different rate regime, thus suggesting some room for flexibility.

China has sworn off huge fiscal stimulus post its GFC experience and as such has room to maneuver should it need to. This is something many miss – China has a plan for consumption-supported, quality growth and is moving accordingly. Very little of significance on the economic front happens without it being part of the plan– a statement that will most likely ring true for the rest of the decade as Pres. Xi seeks to reorganize the economy around Socialism with Chinese characteristics. See Chart 7.

Chart 7 – China Has Room to Focus on Quality Growth



Source: Eurizon SLJ

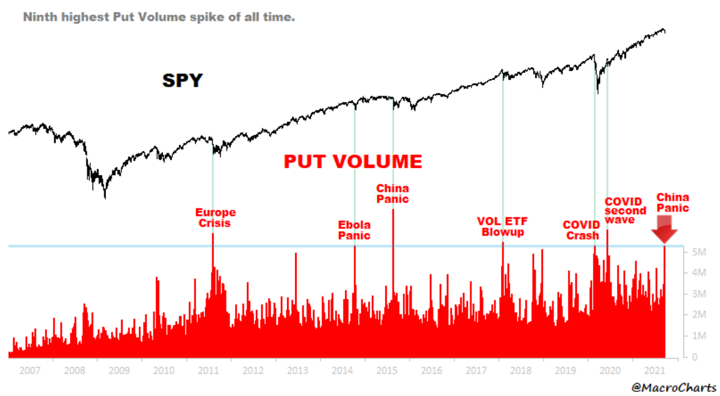
Climate policy is a wild card driver over the coming years. Its global nature, the intent of every Govt on the planet to work towards climate mitigation, the focus on the coming decade – all suggest investors need a nuanced understanding of what role Climate policy will play at both the Governmental and corporate level on both the demand & supply side. The focus should remain on decarbonization & its implications for power generation – energy shortages are likely to unwind over time but prices are likely to trend higher given the lack of any investment - replacement cycle & the need to input carbon pricing into pricing of new projects.

Corporate policy will also be worth watching. Cash rich, labor short; the set up for a public – private cap ex boom is one to watch carefully, driven by need to leverage markets gained over the past year, prepare for climate change, replace outdated capital stock, shift the labor – equipment ratio etc. It all suggests that dividends, stock buybacks may finally have a competitor in the corporate world.

MARKETS

The broad cross sector/cross asset selling in the last week of the month is a bit unnerving, coming as it does after multiple small selloffs over the past few months and the climactic selling on Sept 20th. The equity market has clearly sustained some technical damage and it's a bit worrisome from a short term POV that the transitions noted above are unfolding in the midst of political uncertainty with the S&P very close to its 100dmav which has been an important point of support. See Chart 8.

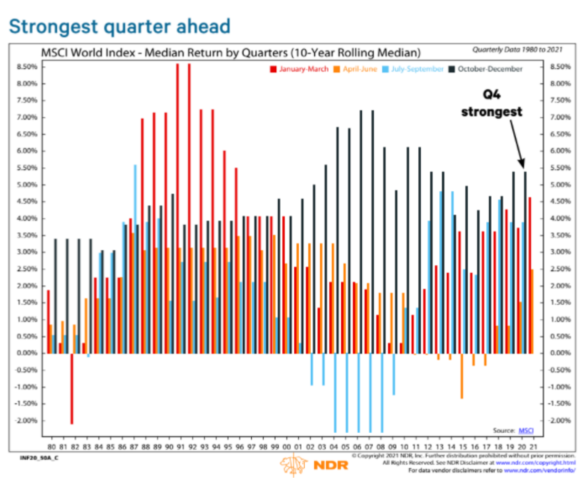
Chart 8 – Recent Selling Has Been Historic



It begs the question what would make one reverse one's positive outlook? From my POV I would need to see the following: Covid returns with a variant that defeats the vaccines, clear signs that the synchronized global expansion is not unfolding, a Fed policy mistake or clear signs that earnings outlook has turned down.

At the moment none of these apply: Delta is fading around the globe – it has been so contagious that there is no other variant out there to follow it and as every day passes 20-30m vaccines are being given globally. The expansion of economic activity in the US and Europe is clear – notwithstanding a lull over the past Quarter – the issue is not one of demand but of supply. Asia is reopening – from Malaysia vaccinating 80%+ of its population and reopening to India exporting vaccines as its own case count declines, whether it's China vaccinating close to 80% of its population or Japan ending its multi month lockdowns, it's clear that Asia is picking up. The JETS ETF outperformance over the month and especially over the past week, reinforces the reopening story. Furthermore, the multi-week back up in rates and strength in broad commodities supports a positive growth outlook. See Chart 9.

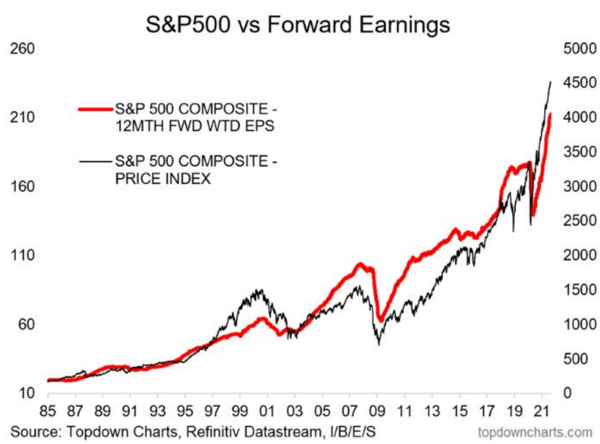
Chart 9 – Seasonality Should Be Supportive



Fed risk is something to pay attention to – the Fed is well aware that equities now make up a record 40% + of US household net worth; as Steve Blitz of Lombard notes, it's the equity investor who is today's bond vigilante. Given the rate structure the last thing the Fed wants is to spook the equity market into a significant 15-20% correction at a time when the economy is trying to pick up post Q3 lull while employment remains well short of target. The Fed will have the option of easing up on the hawkish rhetoric and perhaps going slowly on the taper to offset this fear and thus reduce Fed-related equity risk.

Q3 earnings season approaches; given the economic lull investors may want to see the color of the margins/earnings before stepping back into equities. While Q3 earnings will therefore bear watching, it will be the Q4 outlook that is most important to investors as well as the outlook into 2022. BofA's global earnings indicator has been up 13 months in row and its global earnings revision index sits very strongly at 1.9x, meaning almost 2 upgrades for every downgrade. Earnings should be solid and supportive of equity prices. See chart 10.

Chart 10 – Earnings Underpin Equity Appreciation



Given the above we plan to hold to our Equity and Commodity OWs and Fixed Income UW. We remain UW the US and OW non-US DM with particular enthusiasm for Japan which is finally breaking out after months of inaction. Schwab points out that Japan sells at a significant discount on forward PE basis to the ROW (15x forward vs 20x for World), has the best upward Earnings revision index of any major country Schwab covers and is expected to show a sharp pick up in post-lockdown Q4 growth as it's the only major economy with a Comp. PMI under 50. Our recent adds to EM in both Asia and Europe are playing out as expected with Russia benefitting from all the energy shortfall discussion throughout Europe. Our thematic exposure tends to have a growth bias and as such is challenged by rate backups; it's a good opportunity to examine the story behind the hype. Here's looking at you fintech.

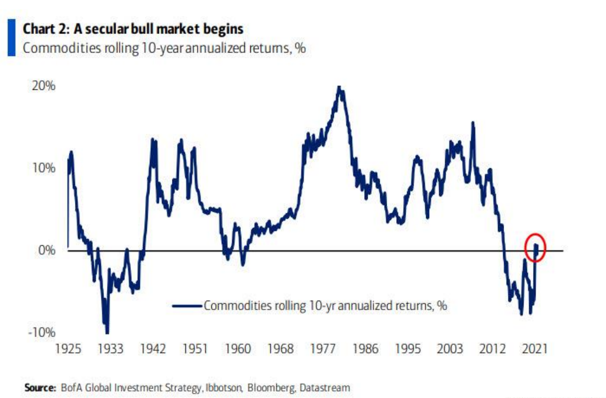
We remain deeply UW bonds, especially Govt securities, given our global growth and Fed policy views. Both bond ETFs, AGG and TLT, have broken below their 200dmav support levels. The shift from liquidity-driven equities to earnings-driven markets is upon us and should benefit the Cyclical and Value segments where earnings growth should be quite strong even if price action to date has not – that simply sets up the opportunity. Our China bond position has continued to perform well and we anticipate that continuing given China's huge CA surplus, stable currency and potential for further easing if the economy shows signs of more Evergrande or energy shortfall inspired slowdown. See Chart 11.

Chart 11 – Why Do We Fear The Taper?

Source: BofA

Oil has been on a tear leading the Commodity complex to several year highs as demand comes back and supplies ebb. One question is whether current energy supply concerns coupled with rising carbon pricing will lead to a broader embrace of nuclear power to offset renewable variability risk? Uranium has been on a tear. The metals complex has also been full of ups and downs across iron ore, copper, aluminum etc. as China's demand picture goes cloudy. It's important to keep in mind that future metal demand will be coming from all corners of the globe as all seek to decarbonize – it's hard to note now but as time passes this should become much clearer and support more consistent upward facing price action, supported by the ESG-related lack of new expansion plans across fossil fuels and minerals. Gold has been a real disappointment and as real rates start to back up one wonders if it has missed its chance to shine. See Chart 12.

Chart 12 – A New Bull Market Begins



The surprise asset mover of late has been the USD and its recent breakout (DXY). After trying numerous times the recent rate back up and hawkish Fed talk has led to success breaching the 94 level. As the synchronized global recovery unfolds I am not sure the USD continues to rally and note it's already quite strong vs many EM currencies. The Crypto space has been under pressure of late and the notable enthusiasm evident at the turn of the year has definitely faded. Rumors of a Fall approval for a US listed Bitcoin ETF continue to swirl; we continue to hold our positions.