FISHER INVESTMENTS EUROPE™

MARKET PERSPECTIVES
REVIEW & OUTLOOK

FOURTH QUARTER 2020

FOURTH QUARTER 2020 REVIEW & OUTLOOK

TABLE OF CONTENTS

The below table of contents contains hyperlinks allowing the reader to quickly navigate to the desired section.

FOURTH QUARTER 2020 REVIEW & OUTLOOK
EXECUTIVE SUMMARY

13 January 2021

PORTFOLIO THEMES

- We continue to favour larger, high-quality companies as our assessment is that we remain in a late bull market cycle despite the technical bear in 2020.
- Unlike many past cycles where the bull market's leading category underperformed in the subsequent bear, large Technology equities held up relatively well during the 2020 bear market and the initial recovery off the market lows.
- In our view, fundamentals such as mild economic growth expectations, modestly positive yield curve, low market breadth, and limited signs of broad inflation support our preference for growth equities.

MARKET OUTLOOK

- **Expect an Above-Average Year for Global Equities:** We anticipate a strong year for global markets tied to equities' resilience, political clarity and continued vaccine development and distribution.
- **We Believe We are Late in the Market Cycle:** The 2020 downturn behaved more like an outsized correction than a traditional bear so the market cycle did not reset. The vast majority of our sentiment and market indicators point to this being a late cycle bull market, yet many forecasters expect early-cycle leadership.
- **Investor Sentiment is Elevated but not Euphoric and can Remain High for a Long Time:** Positive sentiment can reign for a while before equities reach a euphoric peak, with strong returns along the way. Monitoring sentiment will be key for investors in 2021.

Global markets finished 2020 positively, increasing 14.7% in Q4 to bring full-year returns to 16.3%—a testament to markets' resiliency and forward-looking nature.[i] Tech, Tech-like and quality, growth-oriented equities have generally led the recovery from the March low despite several countertrend value rallies. We believe the bull market should continue in 2021, with rising optimism, increasing economic normalcy and a less political uncertainty delivering a great year for equities.

In our Q4 2019 Review, we forecasted a good 2020 for equities, and the year's returns matched those expectations. We didn't anticipate a global pandemic or governments locking down major parts of the global economy, forcing a sudden, deep economic contraction and lightning-fast bear market. The speed of the downturn was unprecedented, but matched by a remarkable rally following the 23 March low.

On paper, this is a young bull market that began after last March's pandemic induced trough. Most see it this way, presuming value equities will outperform as they normally do at the start of new bull markets, with equities potentially climbing for many years. However, from its 23 March start, we have observed something very different: Equities are acting as if 2020's bear market was a hugely oversized bull market correction. Growth equities led before the downturn, during and after—a traditional mature bull market feature. Q4's big rally tied to vaccine news and falling political uncertainty reinforced that viewpoint, as it caused rising sentiment.

i Source: FactSet, as of 06/01/2021. MSCI ACWI Index return with net dividends, 30/09/2020 – 31/12/2020 and 31/12/2019 – 31/12/2020.

As Sir John Templeton famously described: "Bull markets are born in pessimism, grow in scepticism, mature in optimism and die in euphoria." March introduced widespread pessimism stretching into early Q3. Now investor optimism abounds. Optimism can last for some time before potentially evolving into euphoria. But even euphoria's arrival doesn't trigger a bear market. It lingers first. Many of history's best bull market years came as late bull market sentiment warmed.

In our Q1 2020 Quarterly Review, we explained that equities' behavior in February – March's bear market was more like an oversized correction than a normal bear market. While big enough to qualify as a bear with an identifiable fundamental cause, its speed was correction-like. Unlike traditional bear markets, it didn't have a slow-rolling top. Sentiment did not slowly progress lower from hopeful dismissiveness to widespread fear. Instead, sheer panic ignited a sharp freefall that only lasted mere weeks.

Relatedly, the economic downturn didn't resemble normal recessions. It was a uniquely steep contraction. It came from governments forcing business closures aimed at containing Covid-19. By contrast, normal recessions develop when circumstances force businesses to work off previously developed excesses. There weren't excesses to correct this time. Businesses didn't have to get lean as they usually do—the cycle hasn't reset. Manufacturing has already recovered. Services businesses haven't yet recovered primarily due to continued Covid-19 related restrictions, not part of a normal economic cycle. Consumers' balance sheets are unusually healthy this close to the lows of a recession. Absent an economic and market reset, current equity leadership trends will most likely continue into 2021.

On the US political front fears remain, particularly with the Democratic party preparing to control both congressional chambers and the White House. Many US investors lean Republican and fear Democrats as anti-business, and the tense political environment has many especially on edge now. Contributing to the heightened emotions since the US election were multiple state recounts, legal challenges from the Trump administration and a riot that interrupted congressional hearings to certify Joe Biden as President-elect in the Capitol.

In response, the Democrats in the House of Representatives led efforts to impeach President Trump a second time on 13 January for his alleged involvement in the events at the Capitol. While historic, this effort seems largely symbolic to us as the Senate trial will not begin until after President Trump is out of office. Despite the abnormal circumstances surrounding the transition of power, President-elect Joe Biden is set to take office on 20 January and emotions likely wane as the year progresses.

US Politics is actually a reason to be bullish. Newly elected Democratic presidents' first years are usually very strong. We believe relative gridlock in the US as we have now, despite Georgia's Senate results, should support global markets. The Democrats' House majority is its smallest since 1900. The Senate is 50-50 with Vice President-elect Kamala Harris casting the tie-breaking vote, the slimmest edge possible, and its slightest majority for any first-time Democratic president taking office since Grover Cleveland in 1885—136 years ago. This renders any single swing-state Democratic senator unusually powerful in determining if legislation lives, dies or is watered down. There are five senators, focused on 2022 re-election who barely won six years ago, who will negate almost anything controversial. Usually we don't get this relative gridlock until midterms. Its unprecedented arrival now should further boost 2021 returns.

As the UK moves into post-Brexit life, it continues finalising trade deals with non-EU countries. Following its October free-trade agreement with Japan, the UK has reached agreements with countries including Canada, Turkey, Mexico, and Vietnam. With trade discussions ongoing with the US, Australia and New Zealand, the UK has strengthened its ties with the global economy—undercutting fears of a more isolated Britain post-Brexit. A no-deal Brexit scenario wasn't the negative so many feared, in our view. However, a deal removes uncertainty for businesses and likely boosts sentiment.

Emerging Markets also saw positive gains in 2020 overcoming widespread economic and political challenges throughout the year. Tech and Tech-like growth oriented equities within China, Taiwan and South Korea led the rally since the March trough. As economic data continues to improve, investor sentiment remains optimistic. Despite new lockdown measures taking place as Covid-19 cases increase, the markets have been largely insulated. With investors overall having expected a second surge—and returns to lockdown—globally, these new restrictions lack the surprise power that early-year lockdowns carried. At the same time, we believe the rally thus far has plenty of fundamental support, with global demand boosting large EM Tech firms and the recovery from lockdowns continuing. Yet returns do vary among EM countries, with those more heavily tilted toward value categories experiencing a slower recovery than growth-heavy nations.

For now, enjoy what should be a great 2021. Volatility may return, but some of markets' best late-cycle years, including 1998 and 1999, featured big corrections or near-corrections.

GLOBAL UPDATE AND MARKET OUTLOOK

02 February 2020

Q4 MARKET RECAP

THE CLANDESTINE LATE-STAGE BULL MARKET

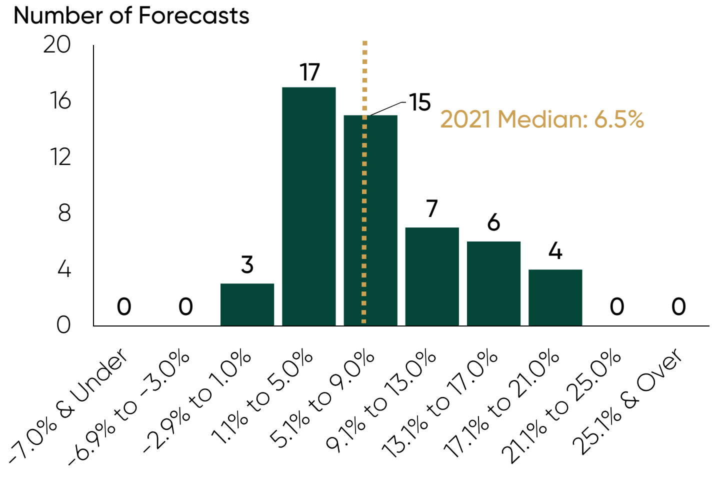
Global equities' strong Q4 return didn't just boost the full year's MSCI ACWI index return to 16.3%—it also brought the rally since 23 March to an impressive 70.5%, a rapid V-shaped recovery from early 2020's sharp downturn. Growth equities rose even more, increasing 81.5% off the bear market's trough.[ii]

Many pundits still don't understand the rally. They see only excess pumped up by central banks and government spending. Some say equities are ignoring the record-fast economic contraction and political tumult. They miss the simple truth: Markets are forward-looking. They didn't ignore the deep economic decline. Equities anticipated it in the February and March downturn. Then they moved in advance of the mid-year re-opening rebound. Now they are looking further ahead, to the day when society is vaccinated, Covid-19 has faded and economic normalcy is back.

FORECASTERS ARE OPTIMISTIC, BUT NOT OVERLY SO

Given the brighter future equities are likely looking to, we think 2021's returns should be above average. Analysts, while overall bullish, aren't forecasting huge returns. As shown in past Reviews, professional forecasts usually cluster in a bell curve and eventually prove incorrect—not because professional investors are inept, but because markets pre-price expectations, then often do something different. But equities don't simply do the opposite of what the crowd expects. For instance, if everyone expected a hugely positive year, average returns would prove them wrong (as would a negative year). This year, the median S&P 500 price level forecast is for 6.5% growth. (Exhibit 1)

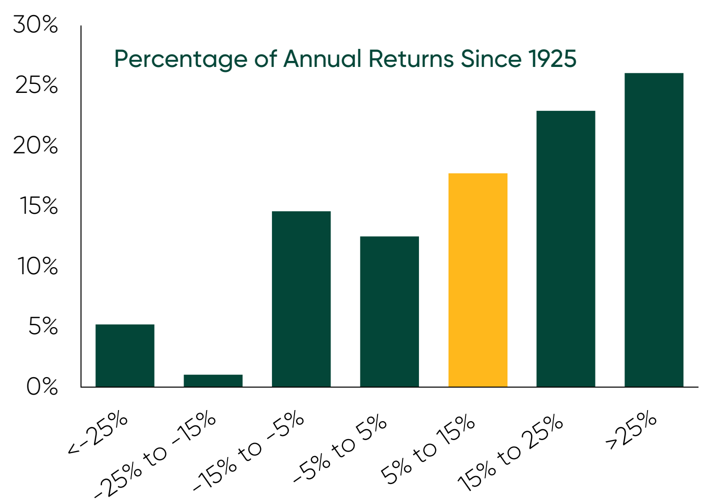
EXHIBIT 1: PROFESSIONAL FORECASTS FOR 2021



Source: Fisher Investments Research, as of 01/08/2021.

However, the forecasts seem too pessimistic, in our view. For one, average returns aren't normal. Using the S&P 500 for its long history, fewer than 20% of all calendar years since 1925 fell within plus or minus 5 percentage points of the S&P 500's long-term return of roughly 10% annualised.[iii] (Exhibit 2) Plus, it wouldn't take much for returns to land far to the right of the curve, especially with the strong and underappreciated history of big returns under first-year Democratic presidents.

EXHIBIT 2: AVERAGE RETURNS AREN'T NORMAL



Source: Global Financial Data, Inc., as of 13/01/2021. S&P 500 annual total returns 1926 – 2020.

---

ii Ibid. MSCI ACWI Index Growth return with net dividends, 23/03/2020 – 31/12/2020.

iii Source: Global Financial Data, Inc., as of 15/01/2020. S&P 500 total return index, 31/12/1925 – 31/12/2020.

Where we are in the market cycle also has a big influence on returns. On paper, we are 10 months into a bull market that began last March. Most pundits see it that way, especially with vaccines rolling out. They see a young rally that will last many years and value leading early, as it traditionally does. Commentators seem sure historical data foretell what is ahead without questioning the logic. But these data are available to anyone. In our view, anything anybody can do, in markets, holds no edge. Instead, this is a good indication that expectations are pre-priced and, in all likelihood, collectively missing something big.

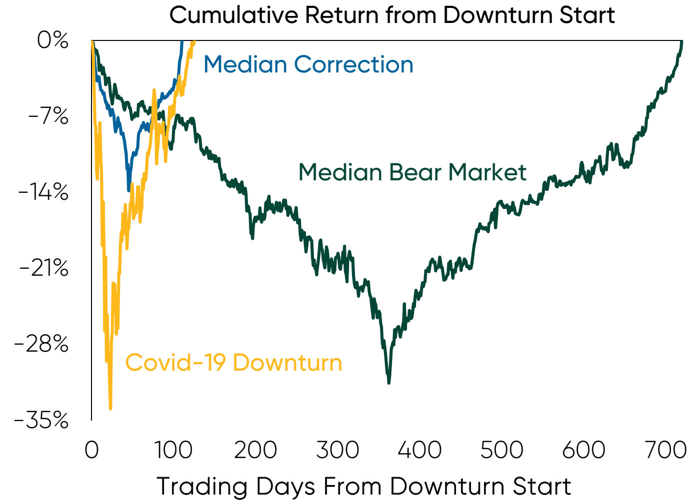
Pundits routinely argue the vaccines' rollout means the rally can finally start in earnest, predicting value-heavy sectors such as Energy and Industrials will lead. Many go further, saying value is "due" because it has lagged for such a long time and growth equities are too expensive. These views—and their supporting data—are everywhere, but rarely questioned.

In our view, the collective error is thinking this bull market is young. On paper, it is. But to us, equities are acting like this is the strong late stages of the bull market that began in 2009. Value typically doesn't lead in late-stage bull markets. Growth does.

THE BEAR MARKET THAT BEHAVED LIKE A HUGELY OVERSIZED CORRECTION

Technically, the downturn in early 2020 was a bear market. It breached -20%, and it had an identifiable fundamental cause: Covid-19 lockdowns, which forced a sharp economic decline. But usually, bear markets roll over slowly and last several months at least. This one was different, with panic selling from start to finish and lasted just weeks. In that regard, it behaved like a correction. Relatedly, the recovery back to new highs was history's fastest—much more like a correction rebound than a bear market recovery. Exhibit 3 shows the drop and rebound to record highs.

EXHIBIT 3: THE CORRECTION-LIKE BEAR



Source: FactSet, as of 13/01/2020. Median S&P 500 price index returns in bear markets and corrections from 03/01/1928 – 31/12/2019 and S&P 500 price index return from 19/02/2020 – 18/08/2020.

Consider, also, the past few years. In 2018 and 2019, we thought equities were entering the final third of the long-running bull market—a period normally featuring solid returns and growth leadership. That proved correct, despite late-2018's steep correction. Over those two years, global equities rose 14.7%, with growth leading and rising 21.9%.[iv]

Last year, we expected another good year, with growth-oriented Tech and Tech-like equities continuing to lead. That was also true, although we obviously didn't envision equities' tumultuous 2020 path. Even so, full-year returns were above average, and sector and style leadership trends persisted before, during and after equities' steep decline. That unchanging leadership isn't normal surrounding a bear market. But very normal surrounding a correction.

iv Source: FactSet, as of 25/01/2021. MSCI ACWI Index and MSCI ACWI Index Growth returns with net dividends, 31/12/2017 – 31/12/2019.

The economy, too, isn't acting like last year's troubles were a recession. Traditional recessions normally happen after businesses—particularly big businesses—build up excess. For a while they get away with it, but eventually central banks overshoot when trying to contain inflation, tightening credit conditions and forcing businesses to cut excess. The recession unfolds as they cut investment, reduce inventories, cancel projects and reduce headcount—all in an effort to eventually do more with less. This economic downturn didn't follow that blueprint. Governments forced face-to-face activity to halt, causing GDP and other major metrics to contract massively in a hurry. But before they could change investment plans or take other actions to get lean, the economy was reopening, customers were adapting and growth was resuming.

Markets anticipated this, bounced swiftly, and soon economic activity did the same. Seeing this, and after 10 months of astounding returns, sentiment has shifted from pessimism to optimism rapidly. Pockets of froth are forming. Bitcoin. Tesla. Electric and hydrogen vehicle startups. Blank-check firms going public to great fanfare. Animal spirits—optimism and confidence—are stirring broadly. This doesn't happen early in a long bull market. But froth now would be right on schedule 12 years into history's longest bull market.

This doesn't mean the bull market ends soon. Nor does it mean we are in a bubble. Economic and political drivers are showing extensive support. Optimism takes a while to spill into euphoria, and euphoria's arrival isn't a timing tool. Bear markets generally don't begin until euphoria blinds investors to deteriorating economic fundamentals.

With this likely being a late stage bull market we believe growth probably maintains leadership for the duration. The modest value rally last September – November was likely a sentiment-driven countertrend. Value tends to outperform when it is out of favour–typically early in traditional bull markets following value's underperformance during the bear. Headlines currently call for value's due rally but we don't think now is the time for a change in leadership.

"THIS DOESN'T MEAN THE BULL MARKET ENDS SOON. NOR DOES IT MEAN WE ARE IN A BUBBLE. ECONOMIC AND POLITICAL DRIVERS ARE SHOWING EXTENSIVE SUPPORT."

ENJOY OPTIMISM! BUT STAY VIGILANT

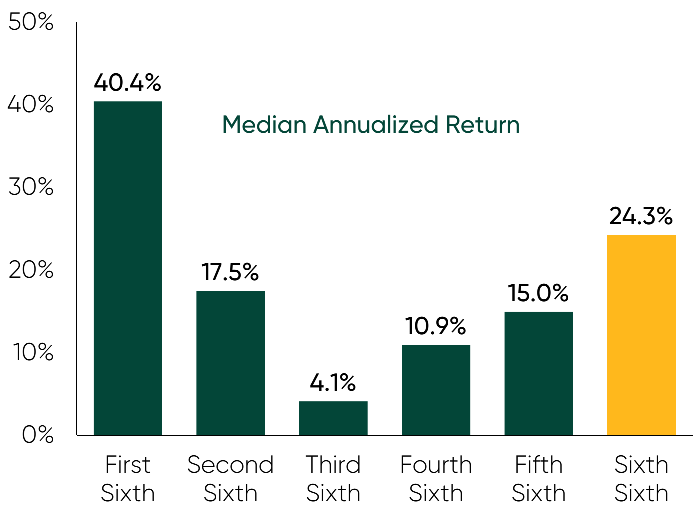
Warming sentiment is a hallmark of late bull markets and usually fuels great returns for a while after it first appears. It has been a long time since we have seen markets this optimistic, which may be unsettling. It might be easy to mistake optimism for euphoria, especially after its 20-plus year absence. Many may not recall how it looks.

When investors are optimistic, they stop positioning good news as bad. Instead, they acknowledge good news as good and can fathom a bright future. They don't overrate occasional negative news or data. They are still aware recessions and bear markets are possible, but few are actively predicting economic or market downturns. Euphoria, however, lacks that rational edge. To many, the possibility of recession goes out the window, and they grasp for increasingly outlandish reasons why the bull market must continue indefinitely. Chasing the next big thing becomes investors' primary concern, rendering market-like returns stodgy, boring and unattractive. Greed, not fear, reigns supreme.

Euphoria doesn't arrive all at once. Consider the Tech boom, which was the last bull market that ended in euphoria rather than a wallop. That euphoria arguably arrived in 1999, after 1998's Asian Financial Crisis—and over two years after former Federal Reserve chairman Alan Greenspan's December 1996 remarks about "irrational exuberance." But 1999 was a great year. Global equities rose 26.4%, and the bull market didn't crest until Tech equities started rolling over in late-March 2000 amid horrible dot-com fundamentals and, later, a widely dismissed yield-curve inversion.[v]

Strong late-bull market returns aren't just a 1990s phenomenon. Bull markets' final years are routinely excellent. Exhibit 4 shows S&P 500 bull markets from 1942 – 2007, with average returns during each one-sixth of their duration. (We excluded the 2009 – 2020 bull market due to its unprecedented, unnatural end.) The strongest returns arrive during the initial V-shaped recovery. But as Exhibit 4 shows, the second-strongest phase is the close, with the final sixth of historical bull markets sporting a median 24.3% annualised return.

EXHIBIT 4: EQUITIES TYPICALLY SURGE LATE IN A BULL MARKET



Source: Global Financial Data, Inc., as of 05/01/2020. S&P 500 price index, 28/04/1942 – 09/10/2007.

STAYING PRAGMATIC AS SENTIMENT WARMS

The last time euphoria inflated global equity markets, Amazon was just an online bookstore, Apple's flagship product was a candy-colored desktop computer with a CRT monitor and DSL internet was considered fast. We have seen pockets of euphoria in investment markets in the 21 years since then including silver in 2011, Chinese equities in 2015 and Bitcoin in 2017 (and now). But nothing market-wide. Time has seemingly faded many investors' recollections of what euphoria looks like. That leads many to mistake any and all optimism for euphoria. But there is a world of difference between rationally positive expectations and full-blown mania.

History is riddled with colorful anecdotal examples. Legend has it Hetty Green—a prominent financier—sniffed out excess just before the Panic of 1907 when she determined the Knickerbocker Trust salesmen were too good looking. Joe Kennedy smelled it before the 1929 crash when a shoeshine boy gave him investment tips—a hint echoed 71 years later when folks from all walks of life hyped hot Tech IPOs. But those are all just small symbols. More telling, in our view, is rhetoric surrounding the broader market. Consider the "Nifty Fifty" bubble of the early 1970s, when conventional wisdom said you could never, ever go wrong with the 50 largest growth equities—companies including Disney, Coca Cola, IBM and others. They were "one-decision equities." (The decision was "buy.") "Growth at any price" was the slogan. There was no such thing as too expensive, because these companies could only go up. But the bubble burst in the 1973 – 1974 bear market.

Similar rhetoric pervaded the Tech Bubble's zenith in late 1999 and early 2000. BusinessWeek and Wired covers heralded the "New Economy," where clicks mattered more than profits and the economy could go in only one direction—up. The UK's then-Chancellor of the Exchequer, Gordon Brown, famously said his department had abolished boom and bust. A CNN series explored "The New Economy" with the question: Is the internet-led expansion a "boom without end"? Many pundits said yes. These people weren't just optimistic—they were ridiculously, unrealistically so. The reporting both echoed and egged on investors.

v Ibid. MSCI ACWI Index return with net dividends, 31/12/1998 – 31/12/1999.

Also common during euphoria: spiking margin debt as retail investors lever up and make concentrated bets. This isn't about the level itself—rising equities are collateral, so it isn't uncommon for margin balances to grow alongside equities generally. But the rate of change can be telling.

Fueling investors on is fear—fear of missing out. Newspapers and financial websites run stories of everyday people who amassed unlikely returns with one well-timed, lucky pick that skyrockets in a year. This has started in recent weeks, with numerous profiles of "Teslanaires" who made millions by going all-in on Tesla last year—all encouraging folks to double down and chase heat. Similarly, the recent media coverage of companies involved in the "short squeeze" such as GameStop, AMC and others reflect pockets of shifting sentiment.

IPO's also boom, and that is one place we see froth now. Not just with their sheer number or dollar value, but their surging initial performance and the greed that inspires. In the late 1990s, everyone piled into hot IPOs in search of "the next Dell." Now, the hot thing is electric vehicle startups, the search for "the next Tesla."

We aren't yet at Tech Bubble absurdity, when companies went public with little more than a business plan, then burned through cash and racked up big losses. But the cheer surrounding Special Purpose Acquisition Companies (SPACs)—holding companies that go public for the express purpose of merging with a startup within a set period of time—is reminiscent. Monitoring the quality of IPOs will be key in the months ahead, as one telling sign of a peak is when investment bankers routinely bring marginal businesses to the public market, knowing investors are easily seduced.

Another key qualitative sign of euphoria is media sentiment. For many years, the financial news sphere's favourite pundits have been perma-bears. In euphoric times, this flips: Bulls become the heroes, and bears get ridiculed. Meanwhile, the tone of more straightforward financial reporting shifts.

"...ONE TELLING SIGN OF A PEAK IS WHEN INVESTMENT BANKERS ROUTINELY BRING MARGINAL BUSINESSES TO THE PUBLIC MARKET, KNOWING INVESTORS ARE EASILY SEDUCED."

In recent years, after equities rallied, most coverage would argue the market was overvalued. In euphoria, pundits will near-universally call it a foreshadowing of even better things to come. We are now starting to see this—not toward US companies, but toward China. China was one of the best-performing markets last year, with its own Tech and IPO boom. We have seen articles cheering this on and highlighting forecasts for 2021 IPO volume—not as a warning of excess, but as a fountain of opportunities for investors. Again, this is just one pocket, but it is an example of what we will be watching for as this year progresses.

WHAT TO EXPECT WHEN YOU ARE EXPECTING A PEAK

We are diligently watching for wallops and are keenly aware that every bull market ends, eventually. So we are watching carefully for the arrival of a euphoric peak. In addition to qualitative features like media sentiment and select surveys, we follow a wide array of market-based sentiment indicators including IPO performance, fund manager positioning, equity-based mergers & acquisitions and the rate of change in margin debt. Some measures show euphoria now, but most are mixed—hinting at optimism overall.

We don't know when a euphoric peak will arrive, but past peaks show what it will probably look like. Most likely, it won't be a sharp drop like we saw late last February—it will probably be a slow-rolling top. Historically, most bear markets decline about -2% per month, on average, from start to finish. So if a market decline starts off much steeper than that, there is a high likelihood it is a correction. This is why we don't attempt to predict a bear at the first hint of trouble. Rather, we rarely call a bear market until at least three months after a peak, giving us time to assess the market's trajectory as well as fundamentals and prevailing sentiment. Following these indicators isn't just about identifying a bear market, but to avoid mistaking a correction for a bear.

2020'S UNUSUAL ECONOMIC DOWNTURN—AND BEYOND

Covid-19 lockdowns effectively halted the global economy in late Q1 and early Q2 2020, causing record economic contractions. US Q2 GDP plummeted at a -31.4% annualised rate (the amount GDP would fall if the quarter-over-quarter rate persisted for an entire year).[vi] The eurozone (-39%), the UK (-56%) and Japan (-29%) suffered similar drops.[vii] History will undoubtedly remember this as a recession. But we think it differs markedly from a traditional recession in ways that matter for markets now.

CONTRACTION VERSUS RECESSION

Headlines call last year's economic decline a recession, and the US National Bureau of Economic Research (NBER) already declared it so. That is understandable—they have no other distinction: The economy is either in expansion or recession. But 2020's steep economic contraction—caused by governments' forced business closures to contain Covid-19—didn't resemble a traditional recession.

A traditional recession usually doesn't strike suddenly or sharply. Rather, it is the natural culmination of the boom-and-bust business cycle. During a maturing expansion, optimism rises—buoying businesses' expectations. They launch new projects, open new facilities, make acquisitions, ramp up output and hire more people. Growing optimism causes excess to build as new projects take on increasingly dubious quality. At the cycle's apex, euphoria runs rampant. Businesses spend as if bad times are a thing of the past. Many individual investors forget discipline and toss money at any idea with a grand promise—convinced it is the next big thing. As money changes hands swiftly, inflation heats up.

The distinction between recession and contraction isn't mere semantics, in our view, as we mentioned in our Q1 2020 review:

> *Since we believe this is an institutionally induced economic contraction, we hesitate to approach it as we would traditional recessions. If it is a long contraction, it may be beneficial to shift portfolios into the more cyclical categories that typically do best early in economic recoveries. But if it remains a sharper, shorter contraction—and equities keep behaving as they normally would in a massive correction (which they have) rather than a long bear—then we would expect the high-quality, growth-oriented companies that led before the downturn to continue leading in the recovery.*

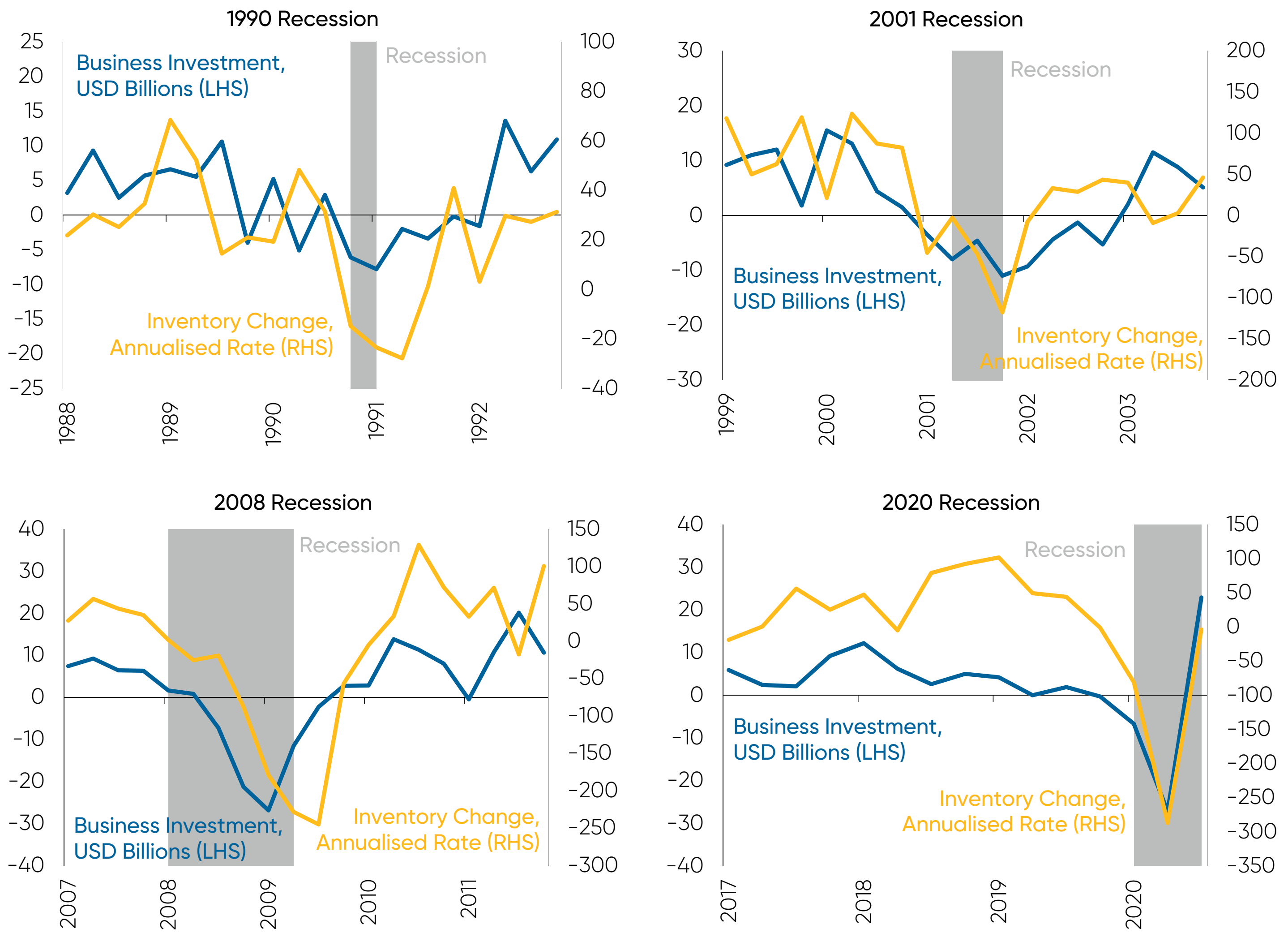
vi Source: FactSet, as of 13/01/2021. US GDP, seasonally adjusted annualised growth, Q2 2020.

vii Ibid. Eurozone, UK and Japan GDP, seasonally adjusted annualised growth, Q2 2020.

Cost cutting is why business investment and inventories usually decline throughout a recession and bottom out alongside GDP. (Exhibit 5) That didn't happen last year.

Business investment snapped back in Q3 after a Q2 plunge. Inventories also rebounded far faster than during a traditional recession. In our view, these rapid recoveries indicate the typical recession reset didn't occur.

EXHIBIT 5: HOW BUSINESS INVESTMENT AND INVENTORIES FARED IN THE PAST FOUR RECESSIONS



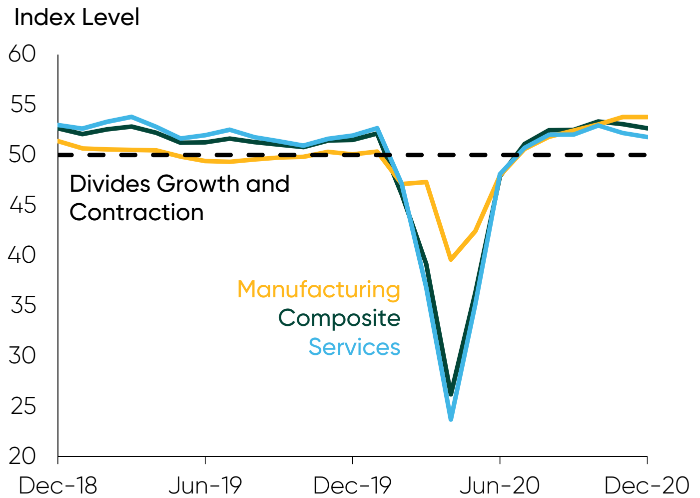
Source: Bureau of Economic Analysis and Federal Reserve Bank of St. Louis, as of 12/01/2021. Annualised percentage change in real private nonresidential fixed asset investment and quarterly change in real private inventories, Q1 1988 – Q3 2020. Recessions per NBER dating.

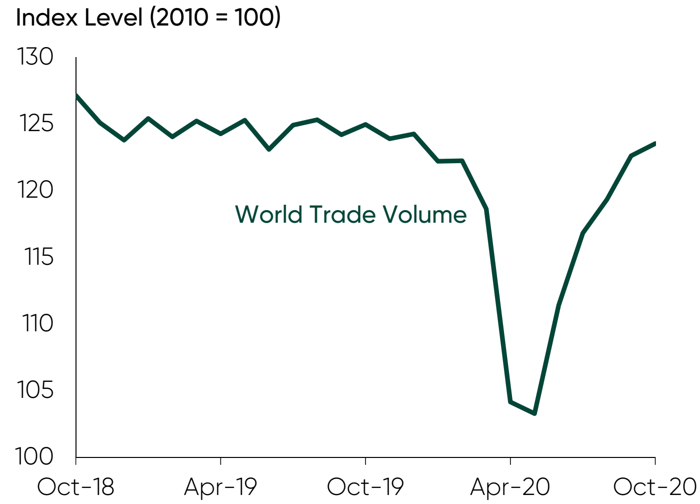
THE RECOVERY IS STRONGER THAN MANY THINK

After historic contractions, economic data surged in the second quarter—though growth has since slowed. Part of the reason is math: Growth rates were enormous when compared to a Covid-19-decimated base. Renewed restrictions and lockdowns throughout the US and Europe have also been a headwind. Regardless, we think most of the recovery is already behind us from a magnitude perspective.

Some pockets of weakness, including hard-hit industries such as airlines and hospitality, will likely persist as long as Covid-19 restrictions linger. Even so, the global economy is faring better than you might think. Global business surveys show growth, and world trade volumes are near pre-pandemic levels. Retail sales and industrial production in Western developed nations have also rebounded. (Exhibits 6 & 7)

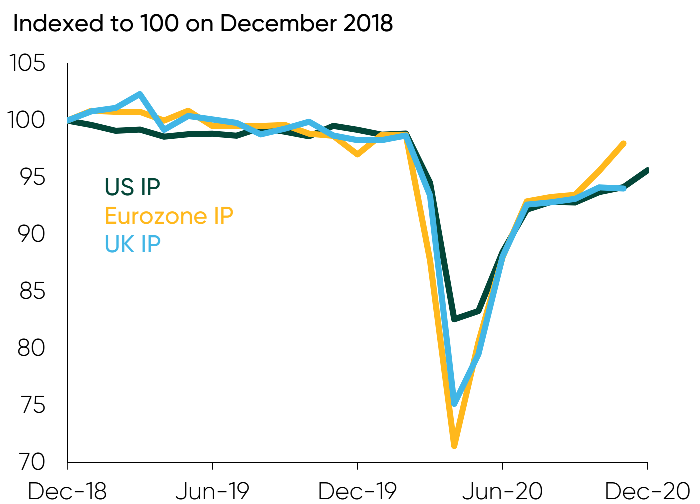
EXHIBIT 6: GLOBAL PMIS AND WORLD TRADE VOLUMES

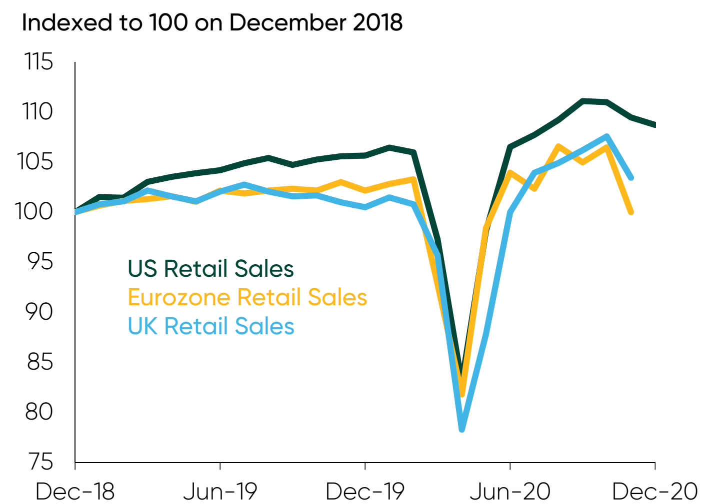




Source: FactSet, as of 12/01/2021. JP Morgan Global Composite, Manufacturing and Services PMIs, December 2018 – December 2020, and Merchandise World Trade volumes via CPB World Trade Monitor, October 2018 – October 2020.

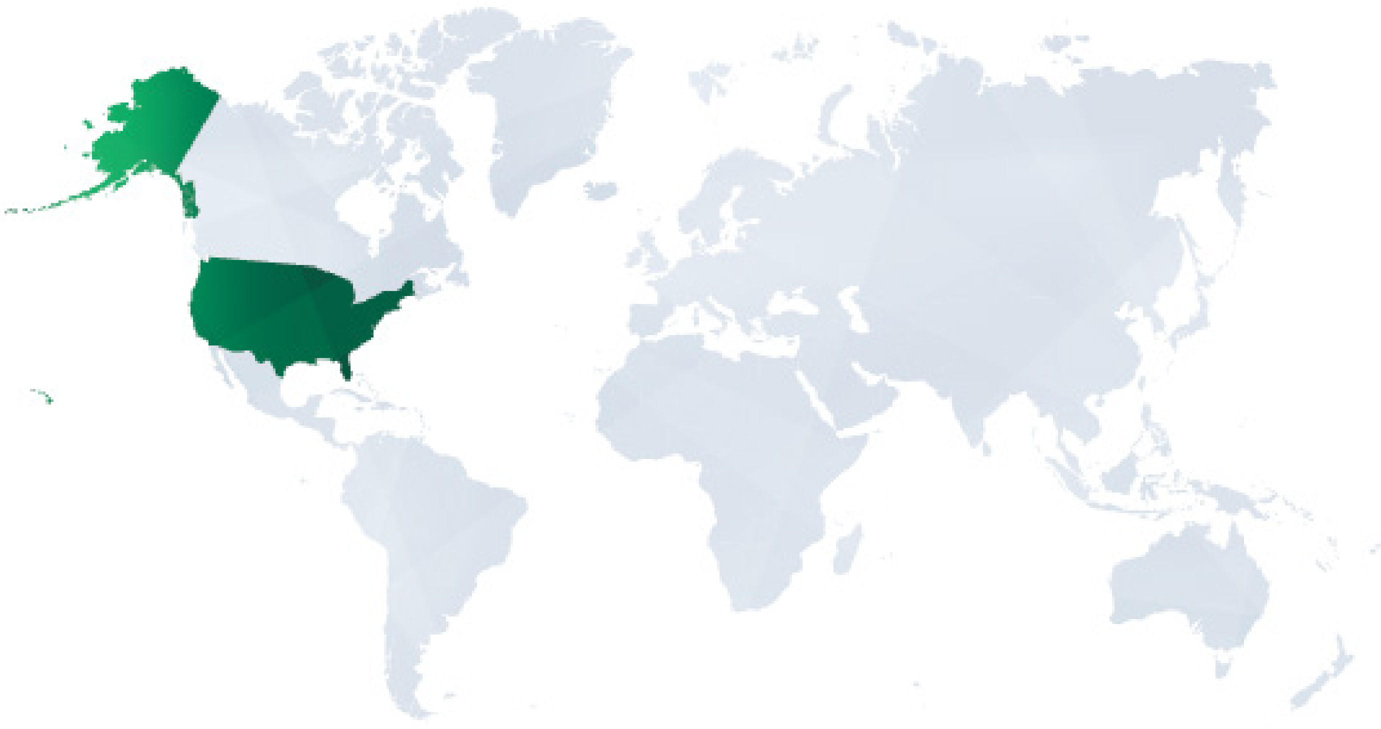
EXHIBIT 7: DEVELOPED WORLD RETAIL SALES AND INDUSTRIAL PRODUCTION





Source: FactSet, as of 15/01/2021. US, eurozone and UK retail sales and industrial production index levels, indexed to 100 at December 2018 level, US data are December 2018 – December 2020; UK and eurozone are December 2018 – November 2020 due to data availability.

UNITED STATES **COMMENTARY**



UNDERAPPRECIATED POLITICAL GRIDLOCK

Our political analysis is intentionally nonpartisan. We favour no politician nor any party and assess developments solely for their influence on markets and personal finance.

After a tense post-election period dominated by the Georgia Senate runoffs, presidential vote recounts, court challenges, talk of election fraud and a riot in the Capitol, President Joe Biden entered the White House on 20 January. With that, the last lingering bit of election uncertainty fell. Yet fears linger. Following the Democrats' Georgia runoff sweep, President Biden took office with his party "controlling" both Congressional chambers—which has many investors fearing a flood of anti-business legislation that could hurt equities. But this view is too shallow.

A deeper look reveals the historically close election brought unusual early gridlock. We think that is partly why equities rallied through the transition period—and why political drivers should be a tailwind for markets in 2021.

THE MANDATE FOR MODERATION

In our post-election commentary, we highlighted how the close election brought gridlock no matter who took Georgia's Senate seats—the Democrats' House and Senate majorities are too small for major, divisive legislation to pass. As we explained, this is unusual, as gridlock typically arrives at midterm elections.

We believe this is why markets are positive much more often in the president's third and fourth years than in the first and second. (Exhibit 8) The president, knowing midterms could stymie their agenda, packs legislation into their early years. Hence, returns are much more variable then, with lower median returns.

EXHIBIT 8: MEDIAN RETURNS AND FREQUENCY OF POSITIVITY BY PRESIDENTIAL TERM YEAR

	Year 1	Year 2	Year 3	Year 4
Frequency of Positivity	58.3%	62.5%	91.7%	83.3%
Median Return	11.2%	8.8%	22.6%	14.0%

Source: Global Financial Data, Inc., as of 12/01/2021. Annual S&P 500 total returns, 1926 – 2020.

The narrow edge brings gridlock far earlier than usual, which should augment "The Perverse Inverse"—a repeat pattern in election and inaugural years stemming from investors' political biases. Many US investors lean Republican, seeing Democrats as anti-business for their campaign rhetoric hyping higher taxes, regulation and wealth redistribution—and vice-versa. When a Republican wins the White House, these biases typically buoy sentiment—driving above-average election year returns.

A Democrat winning usually dampens election year results. But in the inaugural year this flips. The new president fails to fulfill many promises, or Congress has to moderate legislation to pass it.

Under new Republican presidents, that seeds disappointment and dampens inaugural year returns. But in Democrats' inaugural years—like 2021—failing to enact feared legislation triggers relief.

EXHIBIT 9: THE PERVERSE INVERSE

	Election Years	Inaugural Years
All Republicans	15.2%	2.6%
All Democrats	8.2%	16.2%
Newly Elected Democrats	0.7%	21.8%

Source: Global Financial Data, Inc., as of 12/01/2021. Annual S&P 500 total returns, 1926 – 2020.

In keeping with the Perverse Inverse, inaugural year returns under Democratic presidents tend to be quite good. Since reliable US equity market data began in 1925, President Biden is the 13th Democratic president elected. In the preceding 12 Democratic inaugural years, equities rose 9 times and fell three times.[viii] In those nine positive years, US equities averaged 16.2%. When the Democratic president is new to the White House, like President Biden, they averaged 21.8%.

Only one newly elected Democrat's inaugural year was down—President Jimmy Carter's in 1977. That decline was just -7.4%—and it wasn't part of a broader bear market. (Exhibit 10)

EXHIBIT 10: HISTORICAL DEMOCRATIC INAUGURAL YEARS

President	Inaugural Year	House Edge	Senate Edge	S&P 500 Total Return
Franklin D. Roosevelt	1933	D +196	D +23	52.9%
Franklin D. Roosevelt	1937	D +246	D +60	-35.3%
Franklin D. Roosevelt	1941	D +105	D +38	-11.8%
Franklin D. Roosevelt	1945	D +55	D +29	36.5%
Harry S. Truman	1949	D +92	D +12	18.1%
John F. Kennedy	1961	D +91	D +28	26.8%
Lyndon Baines Johnson	1965	D +155	D +36	12.4%
Jimmy Carter	1977	D +149	D +24**	-7.4%
Bill Clinton	1993	D +82	D +14	10.1%
Bill Clinton	1997	R +19	R +10	33.4%
Barack Obama	2009	D +79	D +18**	26.5%
Barack Obama	2013	R +33	D +8**	32.4%
Joe Biden	2021	D +10*	0	?
Overall Average				16.2%
First Term Average				**21.8%**

Source: Global Financial Data, Inc., US House of Representatives History, Art and Archives and US Senate, as of 10/01/2021. S&P 500 total return, 1926 – 2020. Shading indicates a newly elected president. *Two races are technically undecided as of this writing. **Includes independents who caucus with the Democrats. Party edge is at the beginning of the Congressional term.

viii Source: Global Financial Data, Inc., as of 12/01/2021. Based on S&P 500 total returns.

Then, too, President Carter's early years featured economically significant legislative action, including the Humphrey-Hawkins Full Employment Act of 1978 (which established the Fed's dual mandate), enabled by his large Congressional majority. By contrast, as Exhibit 10 shows, President Biden's margins are unusually small for a newly elected Democrat.

THE SENATE CAN'T BE TIGHTER

The Democrats' taking both Georgia Senate seats splits the body 50 – 50. Vice President Kamala Harris will vote to break ties, so many say the Democrats "control" the Senate. This, plus the Democrats' very vocal progressive wing, leads many investors to fear radical legislation like Medicare for All, tax hikes, the Green New Deal and more.

But there is little chance anything major passes. President Biden is the first Democratic president to take office without a Senate majority since Grover Cleveland in 1885—136 years ago. Divisive bills would require unanimity. But the Democrats are much more divided on policy grounds than many acknowledge. Moderate swing-state Democrats facing re-election in 2022 like Arizona's Mark Kelly, Colorado's Michael Bennet, Nevadas's Catherine Cortez Masto and New Hampshire's Maggie Hassan lack incentive to do anything extreme for fear of losing needed support.

New Georgia Senator Raphael Warnock is also up for re-election in 2022 in a purple state. While many fear him as further left, he may prove more practical than progressive in office—moderating to boost his re-election chances. Always remember: Politicians' primary interest is retaining their seat.

The tight margin also makes West Virginia Senator Joe Manchin the most powerful Senator. He is the most conservative Democrat from a state that just re-elected a Republican supermajority in its legislature. Already, Manchin is throwing his weight around. Last November, many argued the Democrats would eliminate the filibuster, a political strategy meant to delay or prevent a proposal, if they took the Senate. Manchin publicly rebuked that idea.[ix] He is currently siding with fiscal conservatives against a round of "stimulus" checks—which isn't even a strictly partisan issue.

"ALWAYS REMEMBER:
POLITICIANS' PRIMARY INTEREST
IS RETAINING THEIR SEAT."

The Democrats could use budget reconciliation to skirt the filibuster, but the party's internal divisions likely block that. Consider: When President Barack Obama first took the White House, he had a 59 – 41 Senate edge. That April, the late Senator Arlen Specter flipped from the Republicans to the Democrats, giving them a 60-seat supermajority—enough to end any filibuster. Yet the Democratic leadership still had to moderate healthcare and financial regulatory reform bills to pass them. If the Democrats couldn't do more with a supermajority, we think the likelihood of radical legislation is much more unlikely in the immediate future.

DEMOCRATS' HOUSE MAJORITY IS HISTORICALLY SMALL

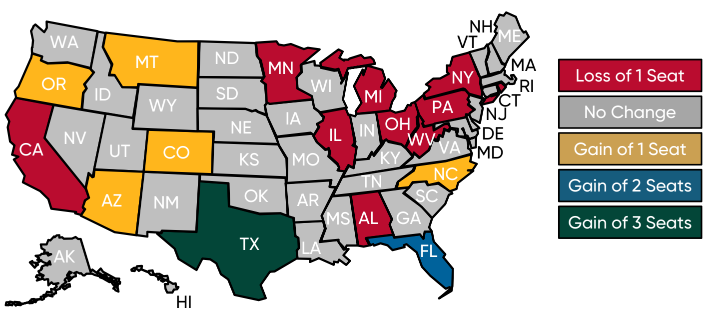
In the House, the Democrats have their smallest majority since at least 1900. They could add two more seats if the House decides to intervene in the contested Iowa 2 and New York 22 district races, but this still wouldn't change much. To pass major, partisan legislation, House Democrats must be uncommonly united—unlikely given the party's large ideological divides.

ix "'We've Harmed the Senate Enough': Why Joe Manchin Won't Budge on the Filibuster," Luke Broadwater, The New York Times, 30/11/2020.

There is another moderating feature in the House few notice: redistricting. Every 10 years, following the census, House seats are realigned to reflect population shifts. States that gain or lose seats must redraw congressional districts to account for this—which will happen before 2022's midterm elections. In most states, the legislature draws these lines, but in 11 states an independent commission does. How this goes—and how it impacts a representative's electorate—is unpredictable. This injects a great deal of uncertainty for representatives seeking re-election—particularly in swing states. A representative unsure of how their new district may vote in the next election likely won't champion radical legislation. They will play to the broadest possible audience rather than outliers.

This year, 17 states are expected to be affected by redistricting, including swing states Arizona, Florida, Michigan, North Carolina, Ohio and Pennsylvania. (Exhibit 11) With the Democrats' majority historically slim, redistricting likely means little sweeping legislation gets through the House. Further, tight margins in both legislative chambers and incumbents' motivations tied to re-election mean the party is likely unable—and possibly unwilling—to pursue extreme policies.

EXHIBIT 11: 2021 REDISTRICTING



Source: American Redistricting Project, as of 15/01/2021. 2020 congressional apportionment forecast changes (based on December 2019 population estimates).

A CLOSER LOOK AT MANUFACTURING

Manufacturing's strong recovery is particularly noteworthy. After starting 2020 with four consecutive monthly contractions—including April's historic -15.8% m/m decline—US manufacturing rose in seven of the year's final eight months and now sits -2.5% below pre-pandemic levels.[x] This underappreciated resiliency underscores the sector's long-term evolution.

The Bureau of Labor Statistics (BLS) found that between 1987 and 2019, manufacturing labour productivity greatly outpaced hours worked – one reason the job market is lagging the economy's recovery.[xi] The primary reason: Automation drives manufacturing output today, which keeps headcount low and makes it less sensitive to social distancing.

After outages in the first half of 2020, most factories have therefore stayed open. Like business investment and inventories, manufacturing's rebound is further evidence the traditional recession reset hasn't occurred. In a traditional recession, factories take a deeper, longer-lasting hit as projects get cut.

Manufacturing's resilience won't necessarily prevent renewed contraction, as it is just 11% of US GDP—far behind services' 70% share.[xii] Covid-19 restrictions impacted the services sector disproportionately, and the pain will likely continue until lockdowns end.

INTEREST RATE FORECAST

The 10-year Treasury yield started 2020 at 1.92%.[xiii] After sinking below 1.0% in early March to 0.52% in early August, yields jumped in Q4—likely due to vaccine news—and closed the year at 0.93%.[xiv] Consensus expectations call for slightly higher yields in 2021.

---

x Source: FactSet, as of 15/01/2021. US manufacturing, month-over-month percent change and cumulative change, January 2020 – December 2020.

xi Source: Bureau of Labor Statistics. "Productivity and Costs by Industry: Manufacturing and Mining Industries – 2019." Date accessed: 12/01/2021. https://www.bls.gov/news.release/prin.nr0.htm

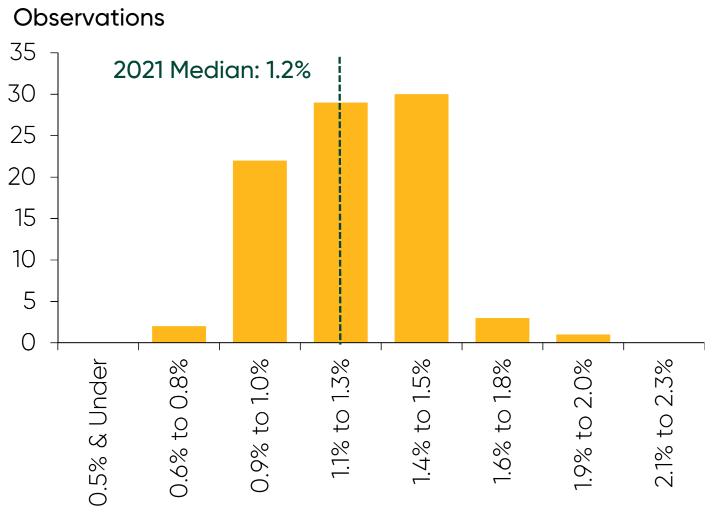
xii Source: Bureau of Economic Analysis, as of 12/01/2021. Manufacturing and private services-producing industries, value added by industry as a percentage of GDP, 2019.

xiii Source: St. Louis Federal Reserve, as of 12/01/2021. 10-Year Constant Maturity Rate on 31/12/2019.

xiv Ibid. Statement based on 10-year Constant Maturity Rate on 09/11/2020 and 31/12/2020.

We don't expect a huge move either way in 2021, but it is hard to see yields soaring far above consensus expectations. (Exhibit 12) Supply and demand issues likely pressure yields. There is a dearth of intermediate- and long-term Treasurys available to the private market. Most US debt issued recently is shorter term—five years or less. On the demand side, non-US yields remain lower than the US—drawing investors globally to US debt. Meanwhile, the Fed keeps buying long-term debt through quantitative easing.

EXHIBIT 12: THE 2021 10-YEAR TREASURY SENTIMENT BELL CURVE



Source: FactSet and Fisher Investments Research, as of 12/01/2021.

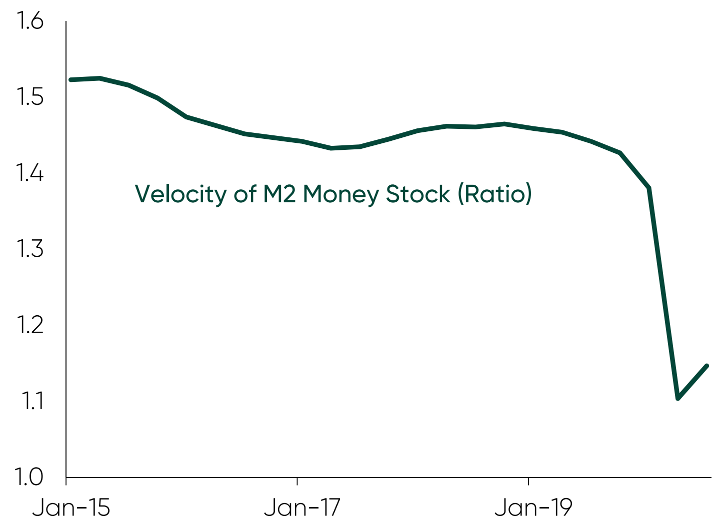
Headlines have long warned of rising inflation, yet disinflation has marked the past decade. We don't see inflation spiking higher in the near future. Though the US yield curve steepened a bit last year, it remains overall flattish—a headwind on money supply growth now that the Covid-19 assistance boom is over, arguing against much higher prices.

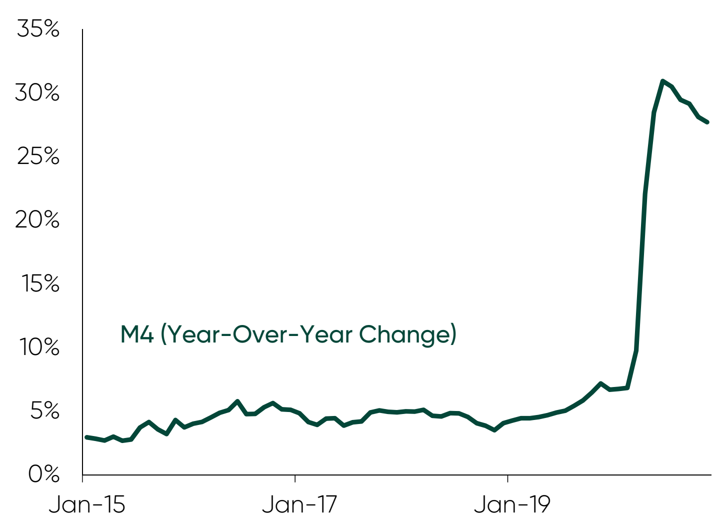
Inflation goes back to money supply and velocity. Despite the explosion of money supply, velocity remains tepid—money isn't changing hands quickly. (Exhibit 13) If the Fed doesn't absorb reserves as velocity improves, that could promote inflation, but this isn't problematic now.

Headlines are robust with speculation about President Biden's spending packages or fiscal stimulus to boost velocity. But the White House and Congress probably can't pass something huge, and the impact is probably smaller than many think. Federal spending takes a long time to hit the economy. "Shovel-ready" projects, as the Obama administration promoted in 2009, don't exist.

However, money supply's surge does mean velocity is worth watching today. It is possible velocity is coming at a lag and inflation will pick up. We are monitoring this closely, but as we wrote last quarter, prices aren't likely to spike higher suddenly.

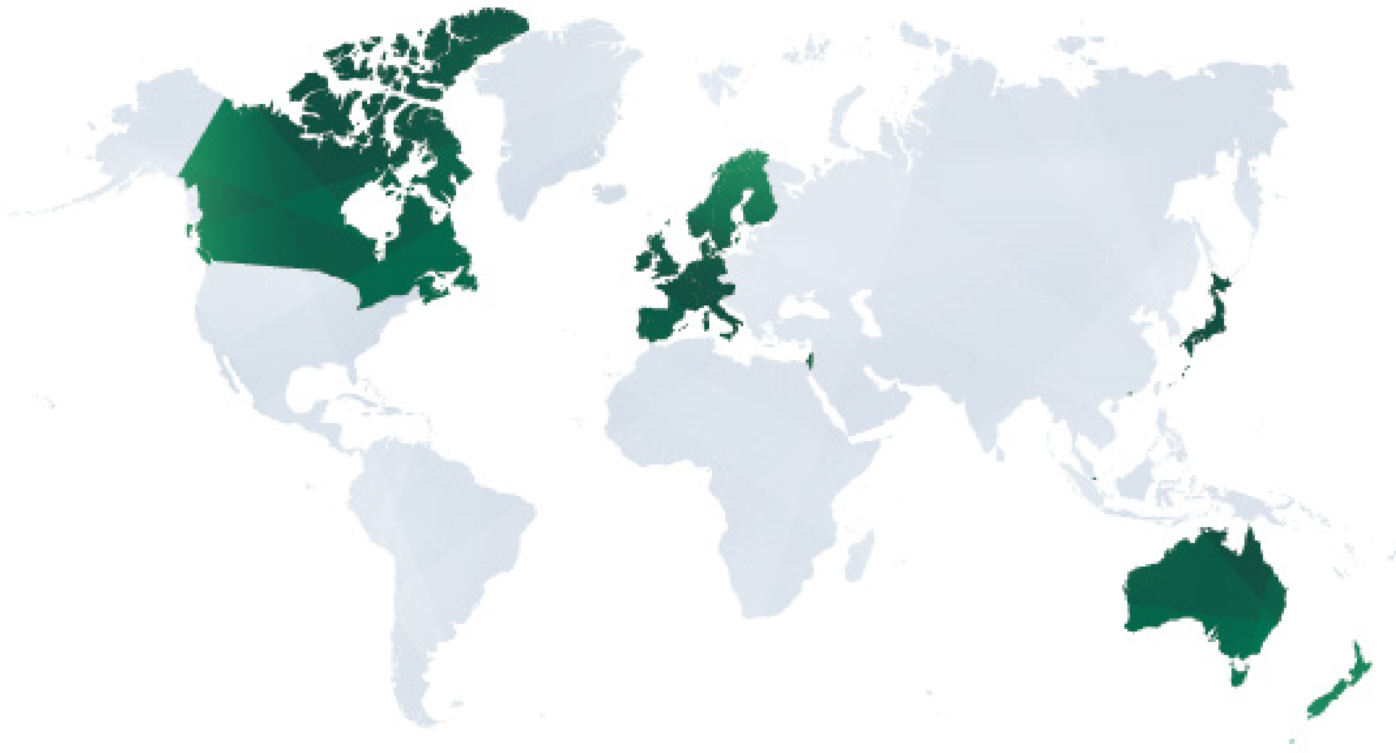
EXHIBIT 13: SOARING MONEY SUPPLY, TEPID VELOCITY





Source: Center for Financial Stability and St. Louis Federal Reserve, as of 12/01/2021. M4 Money Supply, percentage change y/y, January 2015 – November 2020. Velocity of M2 Money Stock, quarterly, Q1 2015 – Q3 2020.

GLOBAL DEVELOPED EX-US COMMENTARY



GRIDLOCK EXTENDS GLOBALLY

In a refreshing change from last year, global politics should be much quieter in 2021. Not only are the US elections and all the ensuing tumult behind us, but Brexit finally concluded on 31 December after four long years of negotiations, debate and worry. Moreover, with the EU and UK signing a free trade deal in December's closing days and few issues appearing involving customs checks at ports, Brexit appears to have gone much better than widely feared.

Looking ahead, major political events are limited. There are only a few national developed-world elections scheduled for 2021, none look poised to deliver big change.

UPCOMING ELECTIONS

The Netherlands holds parliamentary elections on 17 March. Four years ago, Geert Wilders' far-right Freedom Party (PVV), rode a populist wave to the second-most votes—but was excluded from the ruling coalition. Eight months of negotiations among four other parties yielded an unwieldy coalition unable to enact significant legislation. No single party will likely win enough votes to form a game-changing government this year, either. Though Prime Minister Mark Rutte and his cabinet resigned in January due to a child welfare payment scandal, polls project his People's Party for Freedom and Democracy (VVD) to win a plurality—giving the VVD first shot at forming a government. Regardless of whether that holds, another multiparty coalition hamstrung by gridlock—echoing its predecessor—looks likely.

With Germany's general election due in September, the centre-right bloc of the Christian Democratic Union (CDU) and the Christian Social Union (CSU) currently lead polls with about 35% of support—followed by the Greens' 19% and the centre-left Social Democratic Party's (SPD) 15%.[xv] However, the establishment parties are in disarray. The CDU and CSU have yet to choose a chancellor candidate, and none of those reportedly on the parties' shortlist possesses outgoing Chancellor Angela Merkel's popularity. The CDU just selected a new leader, North Rhine-Westphalia premier Armin Laschet, but he may not seek the post, and the party won't decide until after March regional elections in Rhineland-Palatinate and Baden-Württemberg. A strong CDU performance likely bolsters support for Laschet, but if the party falters, political observers tip CSU party leader Markus Söder or Health Minister Jens Spahn as the most viable alternatives. The SPD is similarly divided as moderate and progressive wings vie for influence. The SPD's chancellor candidate is moderate Olaf Scholz, who polls well but isn't the party leader. Whether the election results in another "Grand Coalition" between the CDU/CSU and SPD or some other coalition combination, a gridlocked government appears likely.

Japan must hold a general election by October. Though Prime Minister Yoshihide Suga's Liberal Democratic Party has a stranglehold on the Diet, Japan's bicameral legislature, polls show his government's popularity has plunged due to several Covid-19-response missteps. It seems unlikely Prime Minister Suga will put his leadership or party's parliamentary control in jeopardy with potentially divisive legislation, and Covid-19 policy appears to be the government's top priority today.

Israel heads to the polls on 23 March—its fourth vote in two years—after parliament dissolved following a failure to pass a budget. Polls currently project Prime Minister Benjamin Netanyahu's right-wing Likud party to win the most votes, though not enough to form a coalition—a similar outcome to the last election. It is possible political uncertainty lingers in Israel after the vote, but the country comprises just 0.6% of MSCI EAFE market capitalisation—unlikely to meaningfully sway developed world equity markets.[xvi]

Overall, pockets of uncertainty are small, with limited potential to impact equities. While a few events could generate some uncertainty, we see the impact as mostly local—not global. In our view, 2021 looks set to be a much quieter year politically than 2020, with little political change—a stiff tailwind for equities.

> "WHILE A FEW EVENTS COULD GENERATE SOME UNCERTAINTY, WE SEE THE IMPACT AS MOSTLY LOCAL—NOT GLOBAL. IN OUR VIEW, 2021 LOOKS SET TO BE A MUCH QUIETER YEAR POLITICALLY THAN 2020, WITH LITTLE POLITICAL CHANGE—A STIFF TAILWIND FOR EQUITIES."

POTENTIAL TURMOIL

The developed world's political landscape isn't totally calm. Scotland's May parliamentary election could rekindle a push for a second independence referendum if the Scottish National Party (SNP) regains its majority in the devolved parliament. The pro-union Scottish Conservatives lost over half their Westminster seats to the SNP in 2019's general election—a potential harbinger of things to come—and UK Prime Minister Boris Johnson's relative unpopularity may hurt Conservative candidates. A SNP majority could stir referendum speculation and renew political uncertainty. However, if Scotland pursues an independence referendum again, the process is long—and a vote to secede from the UK isn't set in stone. It would likely play out over several years, and long-running political issues usually fade into the backdrop.

xv "Germany – National Parliament Voting Intention," Politico. Polling data as of 20/01/2021. Date accessed: 25/01/2021.

xvi Source: FactSet, as of 22/01/2021.

In Italy, former Prime Minister Matteo Renzi pulled his Italia Viva party from the governing coalition, reviving fears of political chaos. The left-leaning, multiparty coalition formed in late 2019 after the previous coalition between the nationalist League and anti-establishment Five Star Movement (M5S) collapsed. Current Prime Minister Giuseppe Conte survived a confidence vote, but he didn't secure an outright majority and relied on Italia Viva's abstention. Rather than preside over an unstable government, Conte plans to resign and seek President Sergio Mattarella's approval to form a new centrist government. Some fret snap elections loom, though this is far from certain. Due to a constitutional referendum passed last year, Parliament's number of seats will be cut in half in the next election—injecting uncertainty into electoral politics and likely discouraging Members of Parliament from pursuing a vote. Italian politics likely remain in the headlines, but the government's instability suggests sweeping legislative action is far out of the reach of virtually any party or combination of parties.

Hong Kong's legislative elections—officially delayed by Covid-19 concerns—are due in September. The vote will likely be emotional, with tensions already running high following the recent arrests and jailing of opposition politicians. Unrest leading up to the vote wouldn't be a surprise, and the election could be postponed again—possibly extending uncertainty. But direct impact across developed market equities seems limited, as Hong Kong amounts to just 3.4% of the MSCI EAFE's market capitalisation.[xvii]

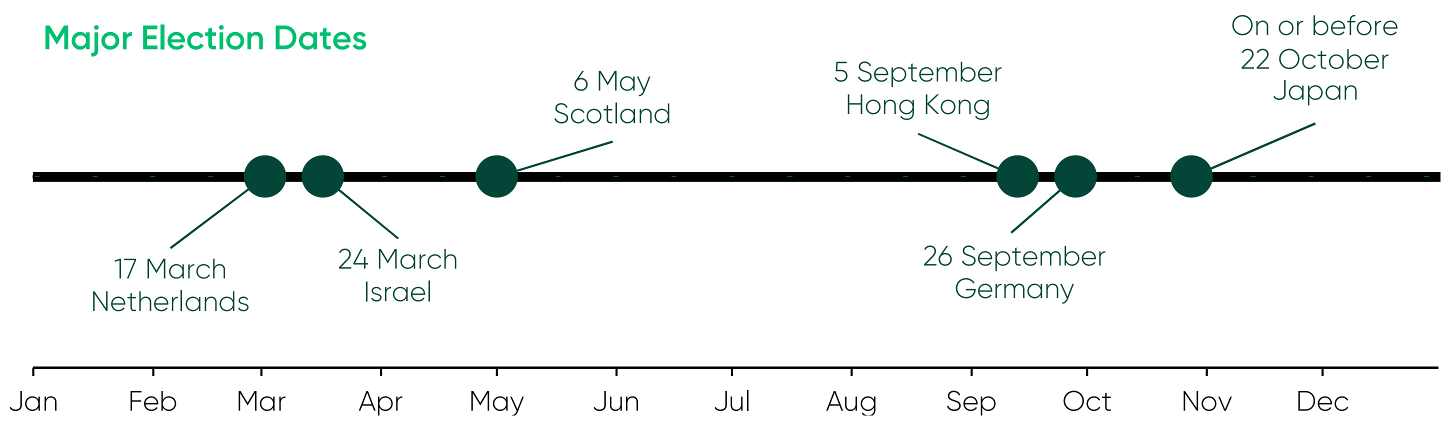
Now, China's potential interfering in Hong Kong's politics could be a touchpoint in relations between China and the West, with spillover economic effects worldwide. However, this isn't a major shift from the status quo. Only a significant escalation would meaningfully impact global developed markets, in our view. While possible, it is unknowable now.

Political developments will always grab headlines, but based on what we see today, there isn't a significant amount of political uncertainty in developed Europe and Asia.

BREXIT BECOMES REALITY, UNCERTAINTY FALLS

The big uncertainties hovering over UK markets in 2020—Brexit and Covid-19—retained their grip on headlines in Q4, dampening sentiment and extending UK shares' underperformance. But on the Brexit front, uncertainty is now falling rapidly, thanks in no small part to the trade deal agreed on 24 December. Things haven't gone perfectly smoothly since the New Year to mark Brexit's official completion, but forward-looking markets don't need perfection, as we think UK shares' outperformance in January's first few weeks attests.

EXHIBIT 14: GLOBAL ELECTION DATES



xvii Ibid.

Throughout 2020—not to mention the preceding three and a half years—the vast majority of the investment universe feared the UK would complete its departure from the EU without a trade deal, ushering in tariffs on cross-Channel trade for the first time in decades. We thought this fear was false, as the tariff schedule that would apply once WTO trade terms governed the UK and EU's relationship weren't onerous. But the last-minute completion of a trade deal negated this, erasing the remaining uncertainty. It made all goods trade between the UK and EU tariff-free, subject to rules-of-origin requirements (meaning, re-exported goods will still be subject to tariffs), and it included a compromise on fishing rights that doesn't seem to have satisfied anyone.

The trade deal helped sentiment improve rapidly, but some fears persisted as businesses raced to familiarise themselves with the new rules in 2020's final week. Many observers warned this wasn't enough time for businesses or freight operators to get ready, and they rightly pointed out that even with free trade in goods, leaving the EU's customs union would create new headaches and fees. The result, according to many, would be huge backlogs at ports when haulers arrived without the correct forms for new customs checks. The massive motorway backups seen earlier in December, when France closed its border to UK lorries temporarily due to the new Covid-19 strain, was widely seen as foreshadowing of what would happen once Brexit took effect.

While it is still early days, things don't appear to be going quite as badly as expected. Helping matters, early January was a quiet period, due partly to the post-holiday lull and partly to businesses having stockpiled goods before Brexit took effect. That helped reduce traffic at ports, enabling haulers and ports operators to begin getting used to the new procedures in a lower-pressure setting. In one anecdotal example of things getting off to a largely smooth start, Eurotunnel's operator tweeted on New Year's Day that the first two hundred or so trucks entering the tunnel from the British side had all their documents filled out correctly. Since then, some problems have predictably emerged, but it is hard to disentangle Brexit and Covid-19. In a survey by the Chartered Institute of Procurement & Supply (CIPS), respondents blamed about one-fourth of freight delays on customs' officials' needing extra time to check the new forms, and only 10% on Covid-19 testing-related delays.[xviii] But what appear to be paperwork-related delays show Covid-19's influence, as staffing at ports is reduced in order to comply with social distancing requirements. More paperwork, with fewer people on hand to check it, will naturally slow traffic.

Pundits rightly note this doesn't bode well in the very near term, as traffic likely ramps up once businesses work through stockpiles. But markets generally look over the next 3 – 30 months, not at the next few weeks. Plus, none of these fears are new, and markets have had ample time to deal with them, limiting their impact. While problems may worsen in the here and now, it isn't hard to envision things vastly improving within a few months. For one, as vaccines continue swiftly rolling out across the UK, that hastens the day when ports can return to full staffing. Additionally, the freight industry is very good at learning from its mistakes. Haulers won't repeatedly show up at ports with incorrect paperwork, and those who have been sitting on the sidelines to see how things went are taking note. Society is very good adapting to challenges like this.

The other big Brexit-related speedbump making headlines in January is the raft of unexpected customs and VAT bills, which now apply to goods traded between UK and EU. We have seen anecdotal reports of people on both sides receiving unexpected invoices. The trouble appears to be confined to small online shops that sell directly to consumers, as larger e-commerce platforms already have systems in place to handle VAT and customs at the point of sale (or behind the scenes, depending on their setup). This of course isn't great for the affected small businesses, but markets tend to think bigger-picture and understand that direct-to-consumer sales are a fraction of total trade in goods. Plus, it seems likely people will adapt to this in relatively short order. Companies already exist to help small businesses manage customs and VAT so that they needn't invoice customers directly. For them, this is a huge business opportunity—problems like this most always are. Additionally, there are already reports of UK companies racing to open distribution centres in the Netherlands, which is a fairly simple workaround.

xviii "Border Chaos May Mean Shop Shortages Within Weeks," Alan Tovey, The Telegraph, 21/01/2021.

When in doubt, trust the market. All of these problems are widely discussed and didn't take anyone by surprise. If they were hugely negative and a sign of much worse to come, equity markets would show it. Moreover, with each day that passes, uncertainty falls a bit more. A company that errs on a customs declaration learns where they went wrong and applies the lesson the next time. People adapt. Whilst there are some lingering issues remaining, it is now clear that after years of debate and fear, we are well past Brexit's climax, with finality not far off.

MANUFACTURING IS ALSO RECOVERING IN EUROPE

The economic trajectory in Europe show a similar picture to the US. Manufacturing in Germany and France, the eurozone's two largest economies, rose seven straight months through November.[xix] This is similarly true for UK manufacturing.[xx] Yet services has been more mixed due to renewed Covid-19 restrictions.

The UK may be major developed economies' weakest economy in the near term—not because of Brexit, but because the country returned to full lockdown in January. However, the latest rules permit factories to remain open—a contrast to last March's lockdown—likely leading to more divergence between services and manufacturing data ahead.

As for Brexit's impact on manufacturing, there may be some near-term hiccups, as no-deal fears pulled some manufacturing demand forward. But goods trade between the UK and EU will remain tariff-free, and businesses and consumers are adapting to new customs requirements. Any challenges should subside as people adapt to the new rules.

xix Source: FactSet, as of 12/01/2021. France and German manufacturing, month-over-month change, January 2020 – November 2020.

xx Ibid, as of 15/01/2021. UK manufacturing, month-over-month percent change, January 2020 – November 2020.

EMERGING MARKETS
COMMENTARY

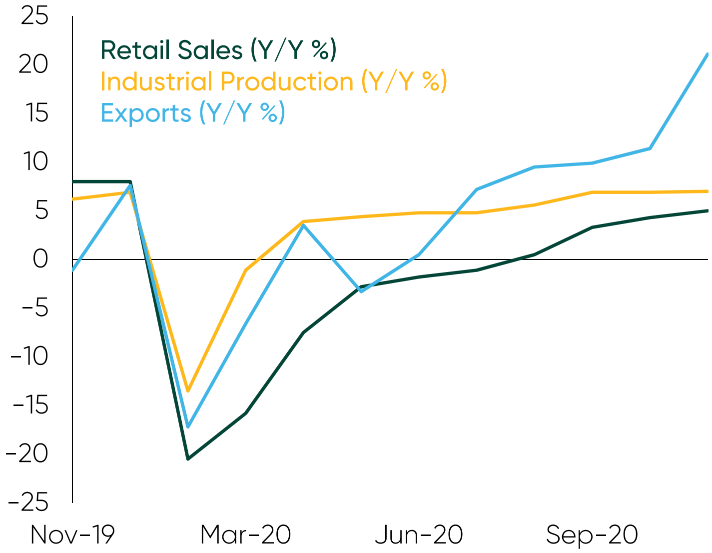
CHINA: AN ECONOMIC PREVIEW FOR THE WORLD

China made headlines for plenty of reasons last year. Its economic recovery currently serves as a preview for the rest of the world. China was the first major economy to reopen following a national Covid-19 lockdown, and Chinese equities recovered ahead of other markets still impacted by lockdowns. Equities were likely looking ahead to life returning to normal—some localised lockdowns notwithstanding—and economic data have since confirmed this. (Exhibit 15, next page)

In our view, this is good evidence the rest of the world can recover quickly—as it has already started to—notwithstanding renewed Covid-19 restrictions' near-term impact. We think equities' swift recovery anticipated this faster-than-expected economic rebound.

But China likely also previews slower growth after the initial rebound. There, a state-driven credit boom aided the recovery—likely a temporary policy shift. Credit growth slowed in recent years as the government sought to rein in "shadow" lenders. That effort probably resumes following the uptick in corporate bond defaults. Credit growth already seems to have topped, and we wouldn't be surprised if it slows further.

EXHIBIT 15: CHINA'S ECONOMIC RECOVERY

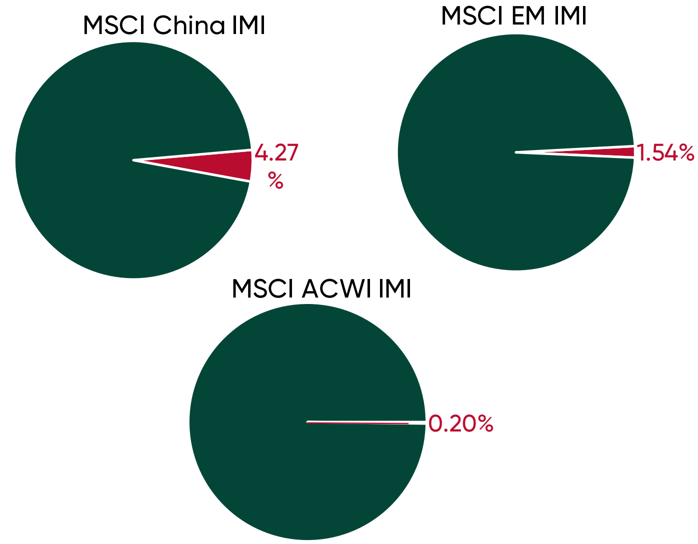


Source: National Bureau of Statistics of China, as of 12/01/2021. Retail sales, industrial production and exports, year-over-year percent change, November 2018 – November 2020. Note: China combines January and February data due to Lunar New Year skew.

ONGOING US/CHINA TENSIONS AND CHINESE SECURITY RESTRICTIONS

During former President Trump's tenure in office, tensions between the US and China ramped up significantly. On 12 November 2020 former President Trump issued an executive order aimed at prohibiting US investors from investing in certain Chinese securities deemed as being closely linked to China's military and surveillance agencies. The Chinese firms listed on the US Treasury's Office of Foreign Asset Control (OFAC) and the US Department of Defense lists represent less than 5 percent of the MSCI China IMI, and far less than 1 percent of the MSCI ACWI IMI. (Exhibit 16) With the transition of power from the Trump administration to the Biden administration, there is the possibility that this executive order is reversed. However, as there appears to be bipartisan support for a tougher stance on China, we view that as an unlikely outcome.

EXHIBIT 16: SCALING CHINESE SECURITIES RESTRICTIONS



Source: Office of Foreign Asset Control as of 08/01/2021. Shows % of equity present in respective MSCI Indices which are included in the 8 January OFAC NS-CCMC Sanctions and US Department of Defense lists. Index constituents shown as of 31/12/2020 as MSCI has since removed some of the impacted equities.

Additionally, US listed Chinese ADRs are still facing potential delisting in three years tied to the recently passed Holding Foreign Companies Accountable Act. While we will continue to monitor implementation of this law, given the length of time that companies have to come into compliance or re-list in Hong Kong, as several have already done, we feel that the impact will be minimal. The lengthy implementation should give investors time to process the information cautiously.

INDIA: REFORM PROGRESS MAY DICTATE MARKET'S FUTURE PATH

The MSCI India Index jumped 21% in Q4, topping Emerging Markets (EM) broadly, as a value countertrend tied to vaccine development spurred a sharp rally in its huge Financials sector.[xxi] As we detailed previously, we don't think this value rally is sustainable, and Indian equities are likely to lag over longer stretches—as they did in the full-year 2020. But there was one development in Q4 that we think highlights a risk to our underweight: Q4's outperformance came as the Indian government encountered great difficulty enacting much-needed but unpopular agricultural reform.

xxi Source: FactSet, as of 13/01/2021. MSCI India Index returns with net dividends, 30/09/2020 – 31/12/2020.

We think this illustrates how reform failure is now too widely known and expected to sway Indian relative performance much. Should they surprise and score successes, it could negatively affect our relative returns and is a matter we are monitoring.

> WE THINK THIS ILLUSTRATES HOW REFORM FAILURE IS NOW TOO WIDELY KNOWN AND EXPECTED TO SWAY INDIAN RELATIVE PERFORMANCE MUCH.

India's agricultural sector is notably outsized relative to its EM peers, and it has unusual political heft as a result. Hence, over the years, policymakers have made few inroads towards modernising agricultural production and opening up greater industrialisation. Prior to 2020, 1963's Agriculture Produce Marketing Committee (APMC) Act—in effect well before India began its economic modernisation and privatisation—governed the sector. It mandates that farmers can sell only to regulated wholesalers at effectively fixed prices. This gave farmers predictability, but the lack of price signals and competition is highly inefficient economically. There has long been talk of reform but little action. However, last year, Prime Minister Narendra Modi's government took it on and Parliament enacted legislation deregulating India's agricultural markets in late September.

The new laws allow farmers to sell their produce freely in the private market, bypassing state-run wholesale exchanges. Furthermore, they prohibit state governments from levying any fees on such sales, which could reduce their tax take. The legislation also permits futures contracts, potentially giving buyers and sellers more flexibility and security to better plan for their needs—a key step toward modernising Indian agriculture.

Despite lawmakers' assurances, there has been widespread opposition to reform. Many farmers fear deregulation will bring the end of guaranteed government purchases at set prices. The government maintains removing restrictions and avoiding middlemen will boost farmers' output and income.

Trading cartels have formed around state APMC monopolies, which have colluded to undercut farmers. Because they can't go directly to consumers, they have no ability to evade the cartels. Reformers argue unshackling markets will let farmers better meet demand and reduce wasteful subsidies. They also say a more entrepreneurial agribusiness community would increase India's international competitiveness.

Legislators further note the new farm acts don't abolish the government's wholesale markets—just the rule forcing sales there. However, farm organisations and opposition parties insist they will leave smaller growers at the mercy of big private buyers. They fear any exposure to market competition without minimum support prices will endanger their livelihoods.

After the bills passed, farmers took to the streets in mass protests, leading the government to begin talks with their representatives. Months-long negotiations failed to quell nationwide uprisings, which have also racked New Delhi as protestors converged on the capital. The farmers brought lawsuits against the government in an effort to upend the reform bills. On 12 January, India's Supreme Court suspended implementation of the farming laws temporarily and convened a mediation panel to help settle the dispute. But protest leaders have refused to engage with the committee, saying court-appointed members all support the legislation. The eleventh round of talks ended 21 January without any breakthrough. The government offered to suspend the new farm laws for up to 18 months to work out some form of compromise. However, farm organisers rejected the proposal, pushing for total repeal.

We see the government's latest troubles in enacting agricultural modernisation as part of a long-running reform saga. In 2016, Prime Minister Modi's government attempted a high-profile, risky maneuver canceling and replacing the entire stock of large denomination currency. It was an effort to bring currency obtained illicitly into the light and tamp down on corruption. But the effort was a failure, mostly hitting credit and money supply growth while doing little to counter corruption. In 2017, his government tried to enact a new, modern goods and services tax. This, too, underwent a messy implementation that weighed on economic growth.

Faced with these failures, Prime Minister Modi's focus has shifted to shoring up his base. Succumbing to local merchant pressure, he embraced protectionist measures at foreign investors' expense, like preventing non-Indian retailers from discounting products, hamstringing their operations. Rather than take on mismanaged state-run banks, the Reserve Bank of India (RBI)—at the Prime Minister Modi administration's behest—removed problem institutions from its scrutiny, threatening the RBI's independence.

Even after Modi's decisive 2019 reelection, reforms haven't been forthcoming, and he has become embroiled in geopolitical tensions with Pakistan and China. On trade, he took India out of the Regional Comprehensive Economic Partnership (RCEP). While we don't consider the RCEP a particularly high quality trade deal, the protectionist signal the withdrawal sends is telling, in our view.

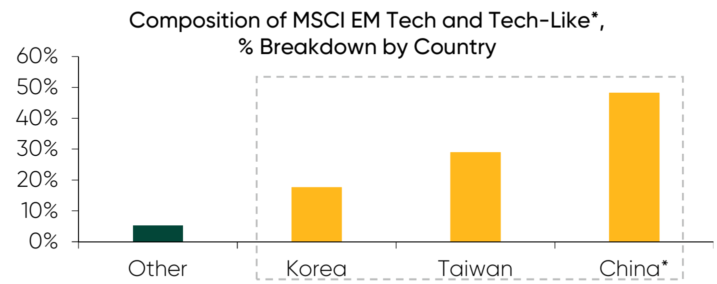
Overall, what push there has been for market friendly reforms has wilted, either coopted by entrenched interests within the government or met with fierce resistance from outside—as the latest attempt to marginally liberalise agricultural markets has shown. Ostensibly, this may seem like a negative for Indian equities. But we think markets are too well aware of this factor for it to sway them, which Q4's big gains against the agricultural reform debacle demonstrate.

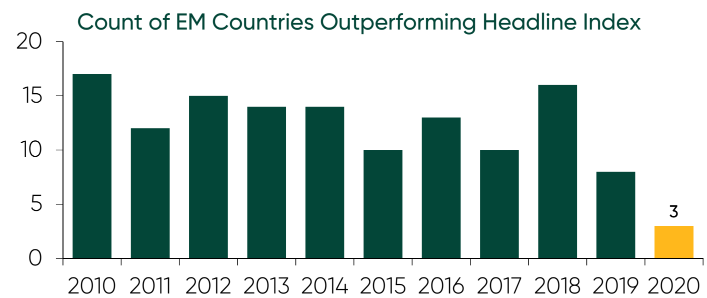
That markets have priced expectations of reform failure into Indian equities to this extent is a risk to our outlook. We believe India's value tilt makes it less appealing in later-stage bull markets—which we think this is, despite its technical age being young. But if Prime Minister Modi has reform success, it could present a major positive surprise. While we see little reason to expect that now, we think reforms like the government's latest agriculture plans are worth following closely as a result.

EMERGING ASIA

Within Emerging Markets, a vast majority of countries underperformed the headline EM index. Only Korea, Taiwan and China outperformed over the course of the year—notably the lowest mark in a decade. As the ramifications of Covid-19 hit certain categories harder than others, it's likely no coincidence that the outperforming countries are substantially more skewed towards tech and tech-like firms. (Exhibit 17)

EXHIBIT 17: TECH AND TECH-LIKE DRIVES 2020 PERFORMANCE

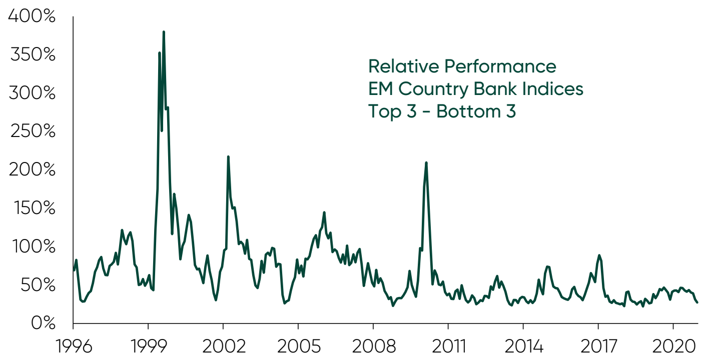




Source: FactSet. Top chart shows the count of MSCI EM countries outperforming the headline index on a calendar year basis, from 2010 – 2020. Bottom chart shows proportional country breakdown of the MSCI EM Information Technology Sector *and Baidu, Alibaba & Tencent.

In addition, looking at a more value oriented industry, such as banking, shows a trend of falling dispersion between emerging market countries throughout 2020. In our view, this is an indication of country fundamentals being attributed less importance—as opposed to the distinction between growth and value. However, we may see this spread widen during 2021 as we begin to move past Covid-19. (Exhibit 18)

EXHIBIT 18: EMERGING MARKETS BANK SPREADS



Source: FactSet as of 31/12/2020. Shows the difference between the best and worst performing select MSCI EM Country Bank indices representing 95% of the Emerging Markets Index.

As the world economy recovers from the Covid-19 outbreak, renewed growth in developed-market demand should support export-oriented countries like South Korea and Taiwan. South Korea's export growth continues to exceed expectations and recover quickly following the shock from the Covid-19 outbreak. We remain optimistic of recovery in global demand as the virus is increasingly contained, which should provide a boost to trade. Promisingly, exports to China recently recovered to pre-Covid levels. Meanwhile, Taiwan's Covid-19 mitigation was a near unmatched success, allowing the island nation to experience a relatively quick and brisk economic recovery.

Alongside China, South Korea and Taiwan constitute a large portion of tech and tech-like companies in the MSCI EM index. As we mentioned earlier, we don't see the recent 2020 downturn to be a traditional bear market. Considering we believe the current market to be a late stage bull, countries with more exposure to these categories should continue to fare well.

LATIN AMERICA

The Covid-19 outbreak disproportionately affected commodity sensitive countries in Latin America throughout 2020. Commodities demand has since rebounded off the March 2020 lows, however lower shipments of manufactured goods weighed on exports. In Brazil, Domestic growth and credit availability are improving, and economic data have been surprising to the upside despite overly dour expectations. Meanwhile, Argentina successfully avoided a messy default process after falling into its 9th default in May 2020. The government was able to restructure $66.2 billion in international bonds with credit holders in September, including a delay in interest and capital payments, which the government says should provide $33 billion in debt relief over the next 10 years, temporarily stabilising sentiment. Although we continue to believe that growth oriented countries are better positioned to outperform, Latin America's value orientation and sensitivity to commodities remains an important aspect of our counterstrategy.

In Brazil, President Jair Bolsonaro recently lost ground in the municipal elections, but he has been gaining more centralised support in Congress. His economic agenda has the potential to provide a positive catalyst if Congress can successfully resume reform efforts to overhaul the country's tax system and improve the fiscal situation in Brazil by keeping the budget contained within the spending ceiling. Proposals include the recently-passed pension reform, an overhaul and simplification of the tax system, privatisation of state-owned companies and reducing the budget deficit. But with the pandemic, those goals have been largely delayed or moderated. The reform agenda has resumed following a six-month delay while Congress focused on Covid-19 stimulus efforts, with containing the 2021 budget within the spending ceiling as the primary focus.

Further, President Bolsonaro left his political party over prolonged friction regarding his far-right social agenda and created the "Alliance for Brazil" party in November. 2020 brought about several high profile resignations within the health and economy ministries and President Bolsonaro lost ground in the recent November municipal elections amid a resurgence in more mainstream parties. However, he has been able to garner more support in Congress as his austerity-focused policies have been weakening in favour of more stimulus to support the country's recovery.

Argentina's President Fernandez has caused some concerns as he rallied against former President Macri's reform efforts, and he is expressing plans to continue rolling back austerity measures crucial to stabilising the economy and ensuring longer-term growth. Further, Argentina is also at risk of being downgraded back to a Frontier market due to strong capital controls and protectionist policies being reintroduced.

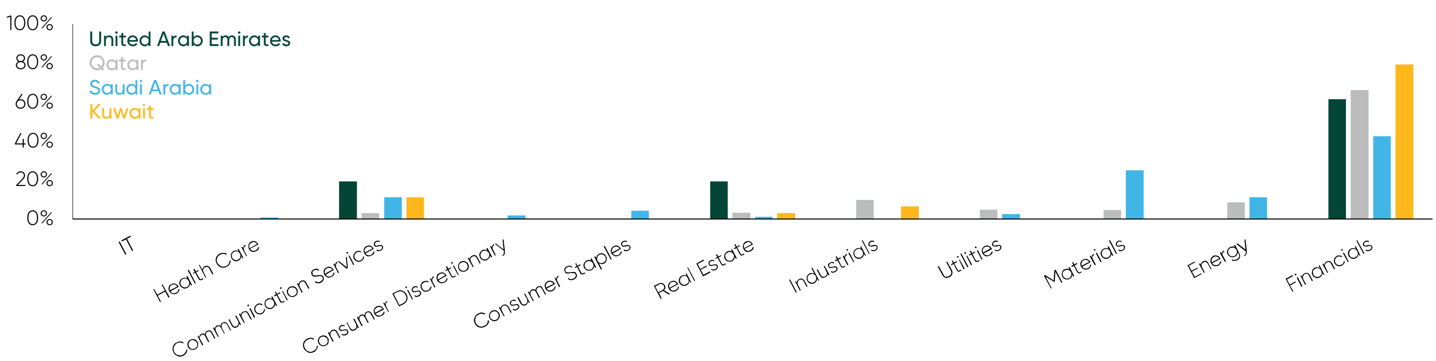
In Peru, President Martín Vizcarra was impeached and removed based on corruption charges in what critics described it as a legislative coup. The impeachment ended a months-long standoff between the president and legislature over President Vizcarra's anti-graft measures. The president of Peru's congress, Manuel Merino, was sworn in as interim president but resigned after only five days in office following mass protests. Soon after, newly elected President of Congress, Francisco Sagasti, was sworn in as President Merino's successor. He is now slated to serve out the rest of the presidential term, which ends in July 2021 following April's election. That contest will likely be contentious, and it wouldn't surprise us if volatility flared accordingly.

MIDDLE EAST: IMPROVING DIPLOMATIC RELATIONS

Among last year's geopolitical events, the realignment in the Middle East took many by surprise with its breadth and speed. First came the Abraham Accords, which established diplomatic relations between Israel, the UAE and Bahrain. Next came official ties with Sudan and Morocco, and there is speculation that Saudi Arabia may soon follow. Meanwhile, the three-and-a-half-year standoff between Qatar and Saudi Arabia, the UAE, Bahrain and Egypt came to an end, with the latter four countries lifting their blockade and restoring diplomatic ties with the former—returning cohesion to the Gulf Cooperation Council (GCC). Many wonder what this means for the region. The transition of power in the US adds more questions, as the Biden administration has floated the possibility of rejoining the Iran nuclear deal, which some speculate could erode US support for the new alliances, rendering them short-lived if old disputes return. These are fair questions, but any answers are sheer speculation. As a result, it wouldn't surprise us if sentiment stayed caught in a tug of war between geopolitical uncertainty and cheer over the long-term benefits of greater economic integration. However, we think investors would do well to look at the bigger picture and not overrate any of this as a market driver, as these countries have something else in common beyond their geography: all are relatively small markets with heavy concentrations in one or two sectors. (Exhibit 19) All have only a handful of publicly traded companies—in some cases, a dozen or less. As a result, we suspect sector and stylistic trends—not to mention company-specific issues—likely remain a larger influence on returns.

Not that we are downplaying the potential positives of warmer relations within the GCC and among Israel and Arab nations. Even as its huge natural gas industry's struggles became less acute, Qatari GDP growth slowed significantly under the blockade. Imports fell. Restoring trade ties is an obvious positive.

EXHIBIT 19: MIDDLE EASTERN SECTOR CONCENTRATION

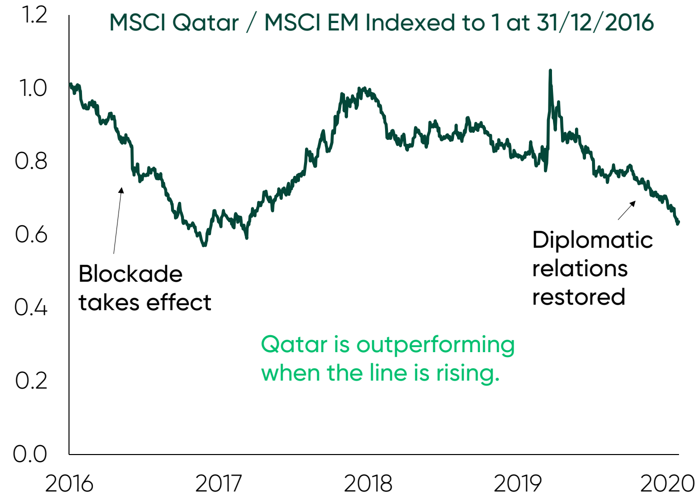


Source: MSCI.com as of 31/12/2020. Shows sector allocation for the respective EM Middle East countries.

Similarly, Israel's new diplomatic ties should open a host of new investment opportunities. Israel and the UAE offer a striking example. Companies in the two nations have long tried to do business, but the absence of diplomatic relations forced them to go through third-party intermediaries—at best adding trade costs and at worst dissuading commerce entirely. Emirati investors seeking to back Israeli startups (and vice versa) couldn't just fly from Abu Dhabi to Tel Aviv—they had to take circuitous routes through third-party countries and use a bit of subterfuge. Now, there are direct flights between the two, negating the need for complex itineraries and, in some cases, multiple passports. Entrepreneurs and investors in both countries are already pitching each other, and early delegations and conferences appear to be productive.

Yet there isn't much evidence these developments are material market drivers. Consider Qatar. As Exhibit 20 shows, it was already underperforming Emerging Markets when the blockade took effect in June 2017. That trend continued through the rest of that year, then reversed for most of 2018. But then Qatar's underperformance resumed, and the standoff's end in early January didn't drive outperformance. In our view, there is a simple answer: About two-thirds of the MSCI Qatar is Financials, making developments within that sector both domestically and regionally the primary influence on national returns. Additionally, Financials is a value-heavy sector, making outperformance unlikely as long as growth remains dominant globally.

EXHIBIT 20: QATAR'S RELATIVE RETURNS



Source: FactSet, as of 27/01/2021. MSCI Qatar and MSCI EM returns with net dividends, 31/12/2016 – 26/01/2021. Indexed to 1 at 31/12/2016.

As for Israel and its new relations, relative returns for all have been mixed since the shifts started in September. Emerging Markets UAE, Saudi Arabia and Frontier Market Bahrain outperformed their respective benchmarks initially, while developed-market Israel trailed the MSCI World Index in September. But Israel has led since early December, while the others have largely trailed. Here, too, we think sector and style considerations deserve most of the respective credit and blame. The MSCI Israel is over 50% growth-oriented Technology names by market cap.[xxii]

xxii Source: FactSet, as of 27/01/2021.

Accordingly, it trailed when value equities enjoyed a brief countertrend in November, then led again as Tech and growth regained primacy. Meanwhile, over 60% of UAE market cap is Financials, making it a huge value play.[xxiii] Also true for Bahrain (nearly 85% Financials), Saudi Arabia (over 40% in Financials, with another 35% in value-heavy Energy and Materials) and Morocco (nearly 40% Financials and another 30% in a single Telecom company).[xxiv]

Geopolitical fears and cheer may have a short-term sentiment impact as the winds change, but markets are very used to that in this region and, in our view, have long since learned to overlook regional disputes (absent, of course, the risk of actual armed conflict disrupting commerce). We don't see the last several months' changes as reason to be massively bullish or bearish on the region. Rather, we see this as a lesson in the importance of not getting distracted by headline news and letting exciting developments deter us from positioning based on longer-term sector and style expectations. Eventually market conditions will favour Gulf nations and North Africa, but that probably won't happen until all those hyping opportunities in value, Financials and natural resources capitulate.

xxiii Ibid.

xxiv Ibid.

Should you have any questions about any of the information provided above, you can find Fisher Investments Ireland Limited contact info at the below website.

https://institutional.fisherinvestments.com/en-ie/contact-us

For professional client use only.

Fisher Investments Ireland Limited is a private limited company incorporated in Ireland that trades under the name Fisher Investments Europe ("Fisher Investments Europe"). Fisher Investments Ireland Limited and its trading name Fisher Investments Europe are registered with the Companies Registration Office in Ireland under numbers 623847 and 629724. Fisher Investments Europe's registered address is: 2nd Floor, 3 George's Dock, International Financial Services Centre, Dublin 1, D01 X5X0 Ireland. Fisher Investments Europe is regulated by the Central Bank of Ireland ("CBI"). Fisher Investment Europe's parent company is Fisher Investments (FI), a U.S. investment adviser registered with the Securities and Exchange Commission. As of 31 December 2020, FI and its subsidiaries managed or sub-managed over $154 billion. FI and its subsidiaries maintain four principal business units - Fisher Investments Institutional Group (FIIG), Fisher Investments Private Client Group (FIPCG), Fisher Investments International (PCGI), and Fisher Investments 401(k) Solutions Group (401(k) Solutions). These groups serve a global client base of diverse investors including corporations, public and multi-employer pension funds, foundations and endowments, insurance companies, healthcare organisations, governments and high-net-worth individuals. FI's Investment Policy Committee (IPC) is responsible for investment decisions for all investment strategies.

Since Inception, Fisher Investments and its subsidiaries have been 100% Fisher-family and employee owned.

Unless otherwise specified, references to investment professionals, operations personnel, and middle and back office personnel are references to FI employees. "We", "our," "us" and "the firm" generally refer to the combined capabilities of FIE and FI.

The foregoing information constitutes the general views of FI and should not be regarded as personalised investment advice or a reflection of the performance of FI or its clients. This analysis is for informational purposes only. It has been formulated with data provided to FI and is assumed to be reliable. FI makes no claim to its accuracy. Investing in securities involves the risk of loss. FI has provided its general comments to you based on information they believe to be reliable. There can be no assurances that they will continue to hold this view; FI may change its views at any time based on new information, analysis, or reconsideration.