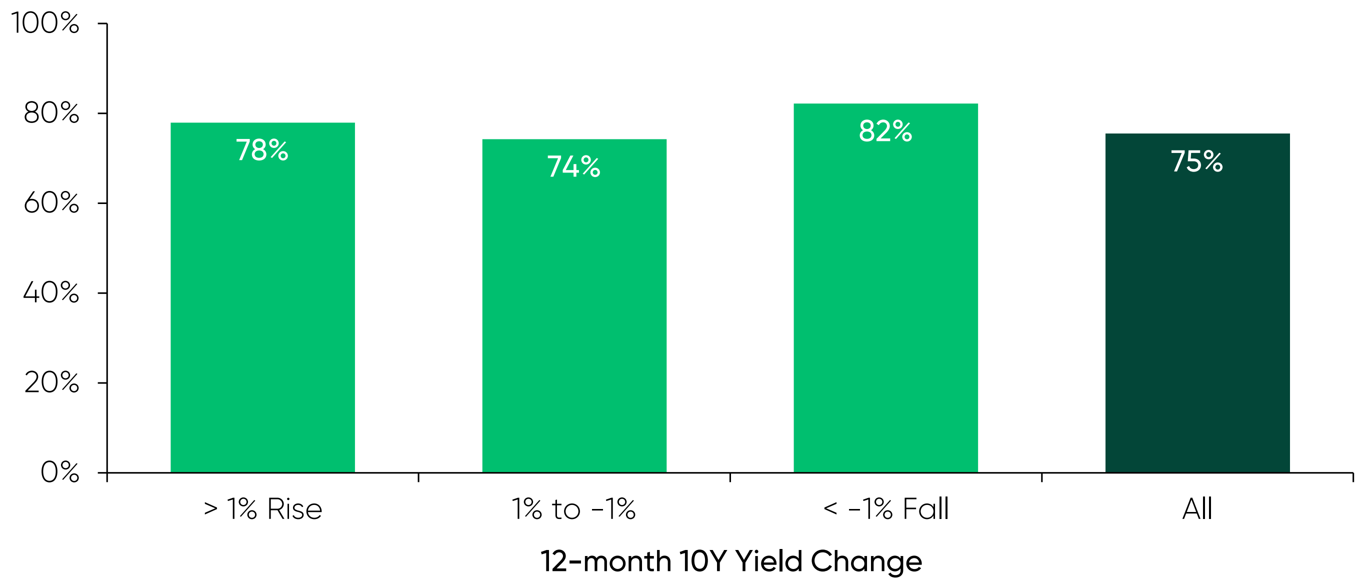
COMMENTARY ON JANUARY MARKET VOLATILITY

AS OF 21/01/2022

Equity market volatility re-emerged over the last few weeks, with the Tech and Tech-like focused NASDAQ index falling over 13% from its November 2021 high[1]. Broader indexes such as the MSCI World and S&P 500 have declined over 6% and 8% respectively so far in 2022 through Friday 21st January[2], and many investors seem increasingly worried more downside lies ahead. While investors may search for a particular cause or explanation, as we often note, negative market volatility and corrections can happen at any time for any reason, or even when no identifiable reason is apparent. Recent headlines emphasize lingering concerns over Fed policy tightening and rising US 10-year Treasury yields as the primary culprits for recent volatility, but while interest rates are important, they don't dictate equities' direction. The following chart (Exhibit 1) shows the frequency of positive US equity returns during periods when US 10-year Treasury yields rose more than 1%, rose or fell less than 1% in either direction or fell more than -1%. Regardless of changes in bond yields, equity returns are still positive most of the time.

Exhibit 1: Frequency of Positive 12-Month S&P 500 Returns

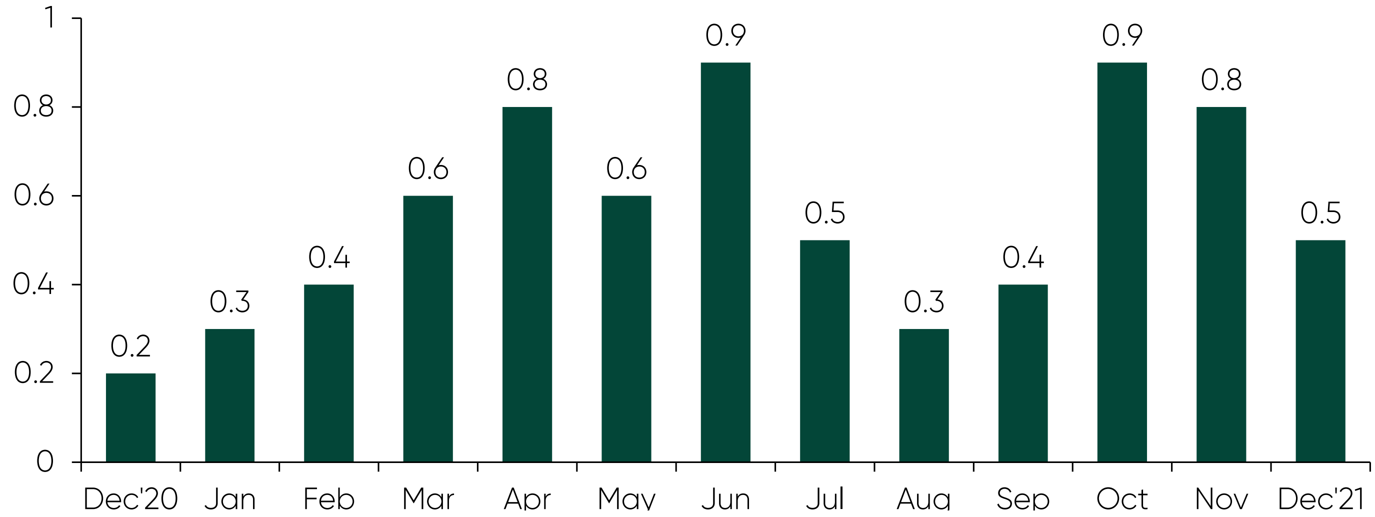


Source: Global Financial Data, as of 25/2/2021. S&P 500 Total Return Index 12-month returns and 10-year US Government Bond Index 12-month yields, monthly, 31/1/1925 – 31/12/2020.

The recently rising 10-year Treasury rate, coupled with rising long rates globally, appear tied to expectations for tighter monetary policy and inflation fears. However, we believe inflation and long yields will likely moderate ahead–albeit with possible volatility along the way. While the US December headline CPI inflation rate accelerated to 7.0% y/y (the highest reading since 1982 and in-line with expectations), on a month-over-month basis US headline CPI decelerated to 0.5% – easing further from the 0.9% m/m highs seen in October and June last year. (Exhibit 2) Similar to recent CPI readings, shelter and used cars and trucks were among the largest contributors. While it is important not to read too much into one month's data set, we believe the key takeaway is the deceleration in monthly data, which we view as continued evidence that the issues fuelling recently high inflation appear to be slowly working themselves out.

[1] *Source: FactSet. NASDAQ Composite Index % return from 19/11/2021-21/1/2022. Data in USD.*
[2] *Source: FactSet. S&P 500 and MSCI World Index % return from 31/12/2021-21/1/2022. Data in USD.*

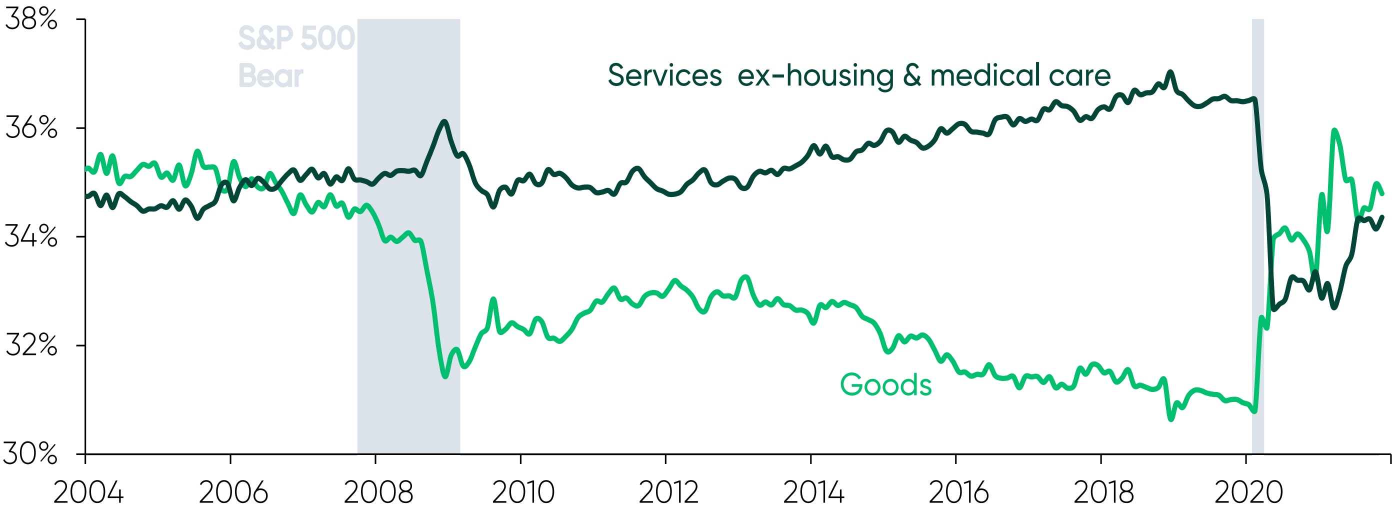
Exhibit 2: US M/M Headline CPI Rate



Source: Bureau of Labor Statistics 12/1/2022.

As we have said for months, various supply shortages may keep inflation elevated a while longer, but we believe these inflation pressures should ease with time as suppliers increase output. During the pandemic, consumption patterns shifted from services to goods, straining supply chains and causing price spikes. Over the past few months that consumption shift has begun to normalize and shift back to services (Exhibit 3), easing some of the supply chain issues that exacerbated the surge in goods consumption. Further, the rapid pace of demand growth associated with economic reopening in 2021 surprised many suppliers, who have already struggled to keep up with demand. That demand growth likely decelerates as the economy normalizes, which should also help alleviate supply-side bottlenecks.

Exhibit 3: Services & Goods as Share of US Personal Consumption Expenditure



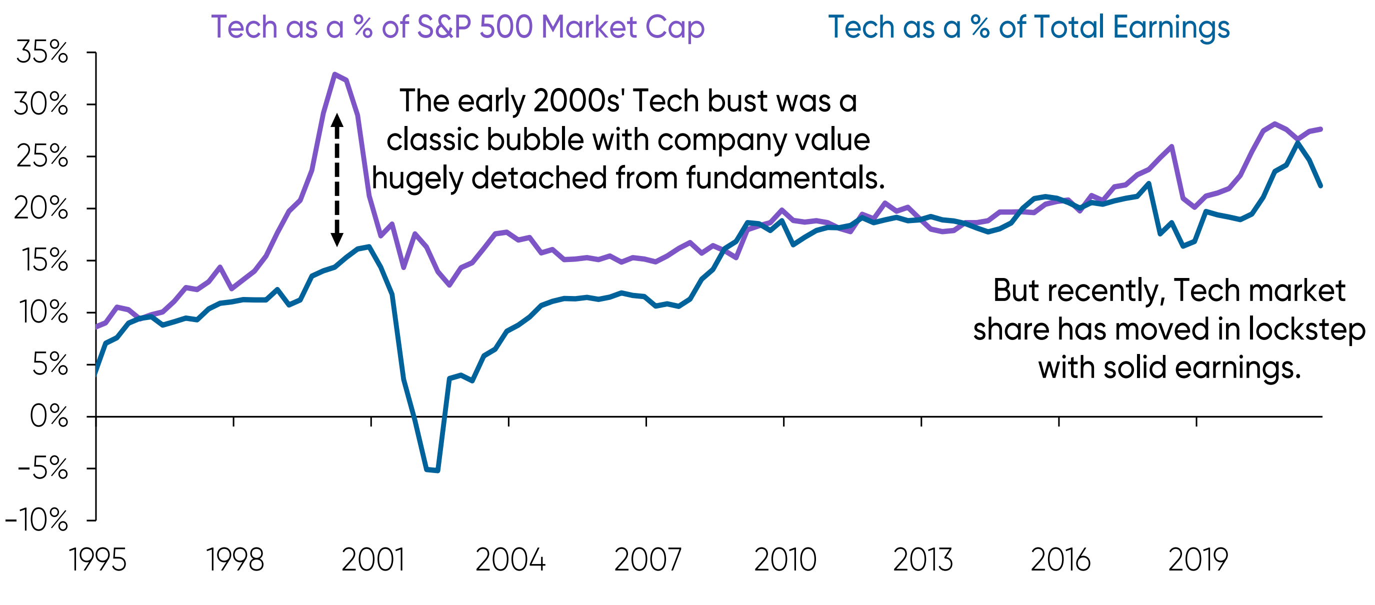
Source: FactSet, US Bureau of Economic Analysis as of 30/11/2021.

Many believe today's high headline inflation readings indicate the Fed will forge ahead with plans to tighten monetary policy. However, monetary policy actions such as QE tapering or rate hikes don't have a pre-set market impact. They don't automatically cause rising long-term yields or falling equity prices. In fact, equities often perform very well in the early stages of rate hikes. For example, while the 10-year US Treasury yield rose from ~2% to ~3% in 2013 as markets anticipated tapering, the 10-year yield actually fell throughout 2014 when the Fed conducted tapering-by January 2015 yields were back down at pre-taper talk levels. Additionally, the 2013 – 2014 Fed taper period had normal levels of market volatility and equities rose over 50% from January 2013 through to the end of 2014.

Some fear higher interest rates will undermine growth-oriented Tech and Tech-like companies' current valuations. However, Tech and Tech-like equities can outperform in a variety of interest rate environments. For example, Tech outperformed when the US 10-year Treasury yield more than doubled between mid-2016 and late 2018 (moving from 1.4% to 3.2%). Tech continued outperforming as interest rates dropped to all-time lows in 2020.

Furthermore, Tech's market share growth largely moved in line with the sector's earnings growth, undermining arguments that Tech valuations are stretched. Notably, Technology company fundamentals today are a far cry from where they were 20 years ago during the dot-com bubble. (Exhibit 4) In 2000, the market was full of speculative new Tech companies—many with no sound business plan, high cash burn rates and deep losses that investors chose to ignore. Today the Tech sector is dominated by companies with some of the healthiest balance sheets, attractive margins and strong earnings and growth prospects.

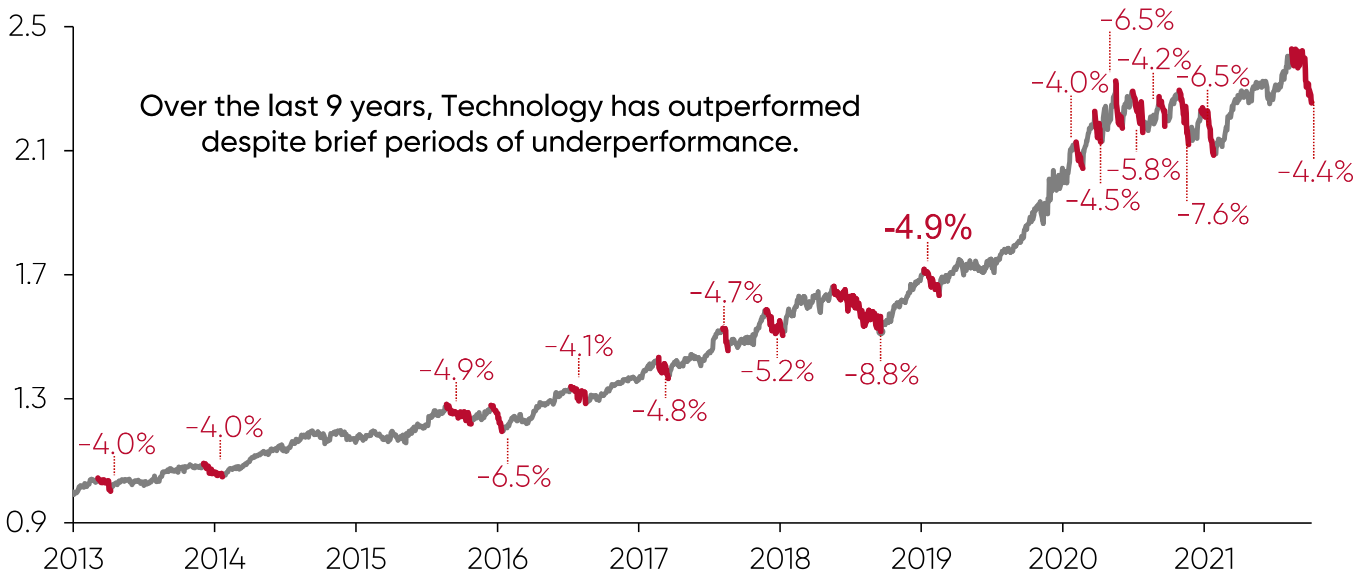
Exhibit 4: Tech Earnings in Line With Market Share



Source: FactSet, as of 1/10/2021. S&P 500 Index and S&P 500 Information Technology Index market values and net income, quarterly, 1/1/1995 – 30/9/2021.

Additionally, Tech companies have experienced numerous bouts of short-term underperformance over recent years yet still have outperformed overall. (Exhibit 5)

Exhibit 5: MSCI World Technology / MSCI World



Source: FactSet, as of 7/1/2022. MSCI World Information Technology and MSCI World Total Return Indexes (USD), daily, 18/4/2013 – 5/1/2022. Indexed to 1 on 18/4/2013.

On the geopolitical front, last November Russian troops massed along Ukraine's border, stirring invasion fears—and prompting harsh warnings from Western powers. Saber rattling escalating into violence would be terrible, sad and a human tragedy. But regional conflicts are unfortunately common and they rarely interrupt global economic activity at a sufficient scale to drive a bear market. History is filled with examples: The Korean War, Vietnam, the Bosnian War, the two Iraq Wars, Syria and Russia's seizure of the Crimea are just a few. Fear over the impact can stoke short-term volatility, normally before any actual conflict, as markets pre-price war worries. But market cycles usually aren't impacted by conflict unless it has the scope to greatly disrupt global commerce. Should conflict between Russia and Ukraine erupt, we don't think it would have anything approaching that power.

In our view, today's issues are well-known, pre-priced concerns, typically characteristic of short-term, sentiment-driven volatility. Investors and pundits have extensively discussed these topics for months, limiting their surprise power to move markets for long. While recent market negativity could descend into a full-blown correction, the market could also quickly rebound to new highs. Short-term volatility and corrections are fundamentally unpredictable, as they are ultimately driven by sentiment, which can change rapidly. We monitor a range of risk factors and will shift our portfolio positioning if needed. Looking ahead, we expect the bull market continues through 2022 and beyond. Global markets have abundant room to run and we expect persistent economic growth to help deliver strong returns this year. Increasing investor pessimism likely proves temporary and reduces the likelihood that sentiment reaches a euphoric peak in the near-term. Globally elevated political gridlock likely acts as a tailwind for markets as we progress through 2022. We believe large high-quality companies will maintain leadership in what we view as a market behaving like a late-stage bull. Tech and Tech-like firms should continue benefiting from powerful global trends driving rising demand for online products, cloud computing, growing enterprise spending, data utilization and mobile device usage.

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