FISHER INVESTMENTS EUROPE™

MARKET PERSPECTIVES
REVIEW & OUTLOOK

FOURTH QUARTER
2021

FOURTH QUARTER 2021 REVIEW & OUTLOOK

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FOURTH QUARTER 2021 REVIEW & OUTLOOK
EXECUTIVE SUMMARY

12 January 2022

PORTFOLIO THEMES

- We continue to favour larger, high-quality companies given our assessment that we remain in a late bull market cycle.
- While value's relative strength has recently interrupted growth leadership, continued value outperformance is unlikely until the early stages of the next bull market.
- Economic growth and inflation expectations likely continue to moderate as supply and labour constraints subside, supporting our preference for growth equities.

MARKET OUTLOOK

- **Expect the Bull Market to Continue in 2022:** Global markets have abundant room to run and we expect persistent economic growth and political gridlock to help deliver double-digit gains in 2022.
- **Moderated Investor Sentiment:** Increased pessimism—partly tied to the Omicron variant—likely proves temporary, while reducing the likelihood that investor sentiment reaches a euphoric peak in the near term.
- **Global Markets Typically Reward US Political Gridlock:** The incumbent party routinely loses power during the midterm year, limiting the opportunity for extreme legislation. Increased gridlock likely acts as a tailwind for global markets in the back half of the year.

After a flat Q3, global markets rose 6.7% in 2021's final quarter, putting the MSCI All Country World Index (ACWI) up 18.5%—and confirming our expectations of a great 2021 for equities.[i] While Emerging Markets (EM) equities overall disappointed in 2021, several constituent countries had good returns.

This bull market is very likely to continue through 2022, but in a way that we haven't seen in a while. Last year was strong from the beginning, with three of four quarters delivering returns far above average.[ii] In 2022, another strong start is possible, but we think a back-end-loaded year is more likely—typical of a U.S. midterm election year. We see a higher probability than usual of flattish or slightly negative returns through the year's first half, perhaps even a bit beyond, as political uncertainty and fervid campaign rhetoric tug on sentiment.

i Source: FactSet, as of 03/01/2022. MSCI All Country World Index return with net dividends, 30/09/2021 – 31/12/2021 and 31/12/2020 – 31/12/2021.

ii Statement based on MSCI World Index calendar quarter returns with net dividends, 31/12/1969 – 31/12/2021.

As we write, this bull market has yet to experience its first correction. We could get one in 2022, with moments of genuine concern as false fears appear true. But worrying will come. It is part of midterm elections. These worries and associated turbulence should dissipate in the year's back half, as we will soon explain.

Most forecasters see a young, almost two-year-old bull market where value equities should lead, and they perceive large growth as old and tired, with no room to run. Yet as we have long stated, we believe this young bull market has an old soul—with traits mirroring a late-cycle environment.

Growth equities, which normally outperform late cycle, held their own last year despite widespread calls for value's dominance. We believe the irregular mix of skepticism and optimism, slowing economic activity and flatter yield curves point to this bull market acting like it is late stage—even though it began just 21 months ago. Aging bull markets favour growth over value. Our emphasis on high-quality equities in Tech and Tech-like industries, luxury goods, industrial automation and others should continue leading in this environment.

With that said, we think a bear market is likely further out than we anticipated a year ago. Back then, sentiment was quite optimistic—with smaller, speculative segments of equities even flirting with euphoria, which often accompanies market peaks. We shared this view as 2021 progressed and we were in the small minority expecting economic growth to slow to pre-COVID rates. But around mid-year, the froth faded amid mounting fears, including the Delta variant, inflation's surge, flaring geopolitical tensions, the Omicron variant and more. Now sentiment is bending toward skepticism—a move evidenced by SPACs' spectacular rise and fall. Bull markets climb a wall of worry. That wall seems higher now.

U.S. politics will be key to equities' trajectory. As the full Review will show, year two of the U.S. presidential cycle is similar to year one: Market performance is more variable, lowering the average historical S&P 500 return since 1925 to 8.6%.[iii] But averages are made up of extremes. Year two is usually up or down big. Positive midterm years are also typically back-end loaded. Midterms deliver gridlock, bringing powerful tailwinds—which the market pre-prices, meaning it starts going up before gridlock is clearly evident. When Congress can't pass big bills creating winners and losers, it lowers uncertainty, lifting equities no matter which party is in charge. Global equities have climbed in 85% of midterm year Q4s.[iv]

We expect to see an augmented version of this phenomenon in 2022. Redistricting hardens safe seats, bringing even more shrill campaigning than usual. But the theatrics likely end in gridlock and surprising governmental calm and quiet. While we have no party preference, history shows midterms favour the party in opposition to the president, giving Republicans an edge. Redistricting adds to this, as 2020's census added seats in traditionally Republican states while taking them from Democratic states. Today's slim Democratic margins mean even a small shift would give Republicans congressional control, bringing two years of conventional, interparty gridlock. As uncertainty fades and equities race ahead in late 2022, a big "fear of missing out" rally should blossom.

Remember this amid the early-year doldrums and fears. Equities pre-price all widely known and expected events, sapping their power over returns even if they happen exactly as feared. So we don't approach news and developments purely in terms of whether they are positive or negative, but whether they have any fundamental influence left.

iii Source: Global Financial Data, Inc., as of 21/02/2021. S&P 500 total return in the second year of a president's term, 1925 – 2020.

iv Source: Global Financial Data, Inc., as of 01/12/2021. Frequency of positive returns in midterm election year fourth quarters, MSCI World, 1970 – 2020.

China dominated headlines in EM in 2021, as uncertainty lingered over when and how property developer Evergrande would default as well as the ongoing regulatory uncertainty over offshore-listed Chinese companies. While short-term volatility in EM is unpredictable, we don't presently see fundamental negative developments with both the surprise factor and scope necessary to send EM equities far lower from here. In our view, dispersion among countries could remain, although we think EM overall should do much better in 2022 as sentiment towards China rebounds. While the rebound's timing is impossible to pinpoint, we do think the bull market is likely to reassert itself, with growth-oriented equities impacted disproportionately this year leading the charge higher.

Developed markets outside the U.S. ended 2021 with their strongest month of the year, even as some European nations reintroduced Covid restrictions. While Covid measures may weigh on growth in the near term, equities are familiar with this pattern, and we think they are looking ahead to a world in which society continues adapting to living with the virus. We expect developed nations' economic recoveries to continue and political gridlock to broadly persist, and though negative volatility can arise at any time and weigh on returns, we think conditions support more bull market ahead.

In Germany the Social Democrats (SPD), Greens and Free Democrats (FDP) reached a coalition agreement to form a new government with the SPD's Olaf Scholz as chancellor. The three parties have never governed together before, and some of the deal's ambitions—particularly on climate policy—grabbed attention. However, long-term policy goals aren't set in stone, especially given the coalition partners' vastly different ideologies. We believe the next German government will face gridlock and struggle to pass major legislation. That is similar to recent governments and an outcome equities are well familiar with. French voters will elect a new President in April, with polls suggesting incumbent Emmanuel Macron likely to win a second term. France's two round Presidential election system tends to lead to more centrist candidates winning and while Macron in unpopular with voters, he is unlikely to face a candidate with broad mainstream appeal.

Whether investors fear rate hikes, inflation, Russia's aggression, more variants or anything else, markets move on surprises. These issues are discussed endlessly. Fears may be justified at a personal or human level, but if they don't move equity prices, positioning portfolios for them is an error. Consider Omicron: Markets' reaction to the new variant was their smallest yet. Equities have long weighed fears of new variants—and increasingly widespread expectations of Covid becoming endemic. The shock power is all but gone.

GLOBAL UPDATE AND MARKET OUTLOOK

08 February, 2022

Q4 MARKET RECAP

A BULLISH, BACK-END LOADED 2022

While society endured another pandemic-dominated year in 2021, the global equity market rose 18.5% with few interruptions.[iii] All year, even professional investors presumed equities' rise was wrong and irrational. But as we show later, equities don't view the world through the lens of good and bad in an absolute sense. Markets are forward-looking and adaptive. They pre-price opinions, then weigh actual results against them. For markets, 2021's reality was simply better than feared, fueling a strong bull market year, much as we expected.

That bull market likely continues in 2022, although it should unfold differently. While 2021 was a fairly steady climb—especially early—this year should be back-end loaded, typical of U.S. midterm election years. Many of late 2021's fears—Omicron, inflation, monetary policy, geopolitical tensions and more—should persist well into 2022, weighing on sentiment. Most of these should lose their power as the year unfolds, while markets increasingly see November's midterm elections in the US delivering gridlock. This combination suggests to us the post-midterm rally could be exceptional this year.

A QUICK LOOK AT THE MIDTERMS' IMPACT

Long-time clients may be familiar with how we think the U.S. political cycle influences equity returns. But in brief, we favour no party nor any politician. Nor do markets, which mostly fear major legislative change that complicates business planning, creates winners and losers and potentially packs vast unintended negative consequences. Hence, from markets' perspective, gridlock is the optimal outcome. The less legislative activity, the less unexpected interference with markets.

As our U.S. section will detail, a president's second year in office is a turning point. The president's party almost always loses Congressional seats in midterm elections, often bringing party-line gridlock. This historical fact influences legislative activity. Presidents try to enact their signature legislation before midterms, knowing it likely only gets harder thereafter as political capital wanes. The equity market reflects all this by rising less frequently and with smaller average gains in years one and two. (Exhibit 1)

EXHIBIT 1: AVERAGE GAINS AND FREQUENCY OF POSITIVE RETURNS BY PRESIDENTIAL YEAR

	Year 1	Year 2	Year 3	Year 4
Average Gain	11.3%	8.6%	18.4%	11.4%
Frequency of Positive Returns	60.0%	62.5%	91.7%	83.3%

Source: FactSet and Global Financial Data, Inc., as of 05/01/2022.

iii Source: FactSet, as of 03/01/2022. MSCI All Country World Index (ACWI) return with net dividends, 31/12/2020 – 31/12/2021.

Year two's smaller average gain hides a nuance: equities are much more variable in midterm years. Returns are usually either up big or negative, driving the middling average. Hence, forecasts have a tendency to be very right … or very wrong. Positive years usually happen when midterms deliver party-line gridlock. Given today's even-split Senate and historically record slim Democratic margin in the House, if President Joe Biden's party loses even just a few seats, control of one or both chambers will flip Republican. The upshot: Underappreciated intraparty gridlock would shift to substantial, party-line gridlock apparent to everyone.

Before the vote arrives, expect political angst to weigh on returns. That is normal, even in midterm years that have delivered strong market returns. The first three calendar quarters are positive just 57% of the time, below average.[iv] This is markets pre-pricing fears and opinions tied to extreme campaign rhetoric.

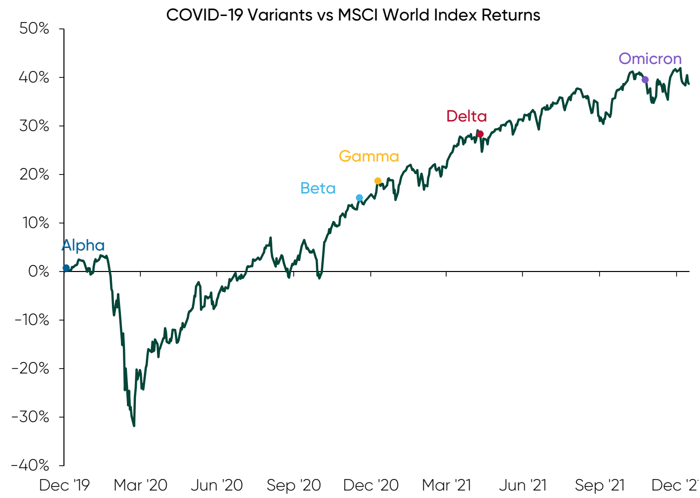
But as markets start seeing the coming gridlock, that flips. Midterm Q4s have been positive 83% of the time, far above-average.[v] We think this time will prove no exception, as white-hot political rhetoric fades into gridlock while today's non-political fears dissolve.

OTHER FEARS SHOULD FADE, TOO

Fears tied to inflation have been persistent. It is important to note that inflation is a key political issue, so please understand our comments aren't partisan or ideological. They are purely economic and market-oriented. The math underpinning inflation measures says, all else equal, inflation rates should slow in 2022's second half. Last year, depressed, lockdown-low prices were the denominator in the year-over year inflation rate. That skewed many readings. But soon they will exit the equation. Last year's higher prices will become the denominator—which, all else equal, means the year-over-year rate will slow. Reopening-related stresses on things like used car supply should fade, too, cooling month-over-month gains. Slowing inflation rates should keep long-term interest rates benign, easing fears of high rates crimping investment and growth.

Meanwhile, Covid may mutate, but markets move most on lockdowns, not virus waves. While localised restrictions occasionally returned, few approach the severity experienced in early 2020. This partly explains markets diminishing reaction to virus news, despite caseloads during both the Delta and Omicron variants easily exceeding the first wave's peak in 2020. (Exhibit 2)

EXHIBIT 2: VARIANTS' DIMINISHING IMPACT ON EQUITIES



Source: FactSet, as of 14/01/2022. MSCI World Index return with net dividends total return, daily, 31/12/2019 – 14/01/2022.

iv Source: Global Financial Data, Inc., as of 1/12/2021. Frequency of positive returns in midterm election year first, second and third quarters, 1925 – 2020.

v Source: FactSet, as of 3/1/2022. MSCI All Country World Index (ACWI) return with net dividends, 31/12/2020 – 31/12/2021.

Furthermore, emerging data show Omicron is much more contagious than Delta but far less dangerous. Deaths and hospitalisation tallies have detached from caseloads, with many who contract Omicron experiencing symptoms little worse than flu or the common cold. We were never likely to eradicate Covid—the only virus humanity has eliminated is smallpox.[vi] A mild, endemic Covid that recurs seasonally was about the best we could have reasonably targeted. Omicron may signal that is coming.

THE WALL OF WORRY

Furthermore, inflation and Covid are two of the most widely watched concerns today. These can and have hit sentiment for short periods, but markets are pre-pricing mechanisms. They weigh talk, opinions, headlines and analyses, factoring them into prices. Hence, widely known factors rarely have lasting sway over markets.

If the bad things everyone discusses now were problematic for equities, markets should have long reflected it, given these issues have dominated headlines for months. Yet markets closed 2021 near all-time highs. There is an old market adage that bull markets climb a wall of worry. Worries depress expectations, making relief or positive surprise easier to attain—sending equities higher.

That isn't to say the factors that investors fear aren't real or negative. Inflation hitting 7% y/y isn't optimal. China invading Taiwan, Russia invading Ukraine or Iran obtaining nuclear weapons would obviously be negative. Covid's stubbornness and the disparate policy responses to it aren't good. Furthermore, many of these issues have been politicised, further enflaming tensions. That makes assessing risks objectively challenging for many across the political spectrum. Those opposed are often excessively fearful; proponents are commonly too dismissive. Neither is good.

We also don't expect that today's negatives will suddenly morph into strong positive drivers. Nor that equities see some wonderfully prosperous endgame society can't envision today. But that isn't necessary. Reality being less bad than markets anticipated is sufficient to sustain the bull market cycle.

The most important thing is to focus on what equities haven't already priced in. Markets do what people don't fathom. What people commonly opine on and expect is priced. This very concept underpins our longstanding use of sentiment bell curves as one of many forecasting tools.

> "THE MOST IMPORTANT THING IS TO FOCUS ON WHAT EQUITIES HAVEN'T ALREADY PRICED IN. MARKETS DO WHAT PEOPLE DON'T FATHOM."

Each year, we gather Wall Street strategists' return forecasts for equities and bonds. We then group and plot them in histogrammes, like Exhibit 3 (next page). A pattern consistently emerges: Strategists' forecasts tend to cluster together. We think this is because most strategists use similar forecasting tools—valuations, interest rates, expected economic trends, chart patterns and more. Similar inputs yield similar outputs.

2021 illustrates this. The most optimistic forecast for full-year S&P 500 price returns was 19.8%.[vii] Yet U.S. equities easily topped this, with the S&P 500 rising 26.9%.[viii] In 2022, strategists are noticeably less optimistic, suggesting a double-digit positive year would shock even more.

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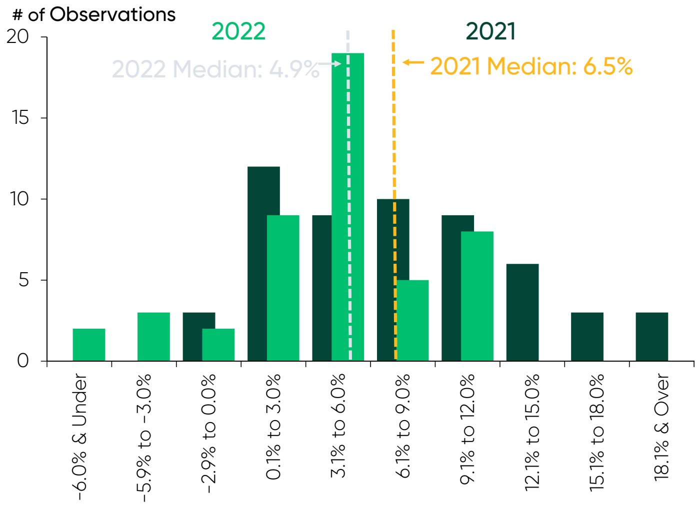
vi "Transcript: Dr. Anthony Fauci on Omicron and the Covid-19 Stalemate," Kate Linebaugh with Dr. Anthony Fauci, The Wall Street Journal, 16/12/2021.

vii Source: Fisher Investments Research, as of 29/01/2021. Highest S&P 500 forecast return among strategists tracked.

viii Source: FactSet, as of 11/01/2022. S&P 500 price return, 31/12/2020 – 31/12/2021. Price return cited as strategists forecast the index price level.

EXHIBIT 3: 2022 S&P 500 BELL CURVE OF STRATEGIST FORECASTS



Source: Fisher Investments Research, as of 10/01/2022. S&P 500 guru forecasts in January 2021 and January 2022.

EXHIBIT 4: COUNTERTRENDS ASIDE, GLOBAL GROWTH IS LEADING THIS BULL MARKET

Source: FactSet, as of 03/01/2021. MSCI World Growth and Value Index returns with net dividends Indexed to 1, 23/03/2020 – 31/12/2021.

Strategists' outlooks, published publicly, become the consensus view. This is already happening. Their middling views influence financial reporting, which assures readers repeatedly that big positive returns anywhere near last years are unlikely. Markets pre-price these views—then surprise investors by behaving differently. This year, we think either a big decline or significant rise would fall outside the bell curve, shocking strategists. That is perfectly in keeping with U.S. midterms' historical tendency. Given rampant skepticism that keeps expectations low, ongoing economic growth and political gridlock—which should be clear to all later this year—big positive returns look like the more likely surprise.

A YOUNG BULL MARKET WITH AN OLD SOUL

This bull market began on 23 March, 2020. On paper it is young, which is why so many have called for value to lead. But it isn't acting young—it is acting like an old incarnation of the bull market that began on 9 March , 2009, as the Global Financial Crisis ended. As Exhibit 4 shows, growth led the rebound and, despite some countertrends, stayed dominant through 2021. Value bulls got excited when vaccines and reopening gave that category an early-2021 boost, but this didn't last.

Value bulls now argue the market is wrong: Growth's rally is false and value will soon reassert itself. We doubt it. Yes, 2020's downturn was technically a bear market. It fell more than -20% and had a fundamental cause. History records it as such. Yet, we believe it didn't last long enough to reset the market cycle. The S&P 500's bear market lasted just five and a half weeks. The MSCI World Index's was even shorter. Usually, bear markets last several months at least. That duration is vital to resetting the cycle.

Similarly, the economic contraction met one popular definition of recession by including two straight quarterly GDP declines. Official record keepers declared it one. Yet it didn't exhibit the typical characteristics of recessions. Usually, recessions begin after companies become bloated, bringing inefficiencies that must be fixed. This usually begins when the yield curve inverts, tightening credit and forcing companies to cut back. Most of the decline comes from business investment and inventories, not consumer spending, as companies get lean to survive.

Notably, this did not occur in the past recession. The economy contracted not because businesses cut back as credit tightened, but because global governments paused the world's economic activity. When that happened, businesses weren't bloated. Additionally, Fed and Treasury assistance programmes helped companies make it through without making deep cuts. Once the economy reopened, most businesses picked up where they left off. Growth and value companies alike reaped big earnings growth as sales returned, but without deep cost cuts and the outsized fear over their survival, value companies lacked their usual early edge. Essentially, markets carried on as if the downturn were an oversized correction, and growth kept leading. Value can surely have occasional pockets of outperformance, but it probably won't meaningfully outperform until after the next traditional bear market resets the cycle. Incidentally, that will likely occur when investors will shy away from value exposure.

WEIGHING RISKS

Risks exist, always, yet most don't automatically derail markets, let alone require portfolio action. As we previously mentioned, we think the market is the world's most efficient pricing mechanism, reflecting all widely known information. Risks everyone fears are risks that are likely already pre-priced and expected. The underappreciated risks are those that can harbour a bear market.

Bull markets end in one of two ways: what we call the wall or the wallop. The first alludes to bull markets' proverbial wall of worry. Once equities reach the top, blinding euphoria often causes investors to ignore weaknesses and set unrealistic expectations equities can't meet—leading to disappointment. Euphoria alone doesn't kill bull markets, but it makes them fragile.

A wallop is a huge negative—one capable of destroying several trillion dollars of global GDP—that surprises investors. 2020's sudden global lockdown qualifies. In our view, so does FAS 157, the mark-to-market accounting rule, which cut the 2002 – 2007 bull market short. The regulation forced banks to take exaggerated, unnecessary write-downs on illiquid assets that destroyed trillions of dollars in capital. World War II's European onset in 1939 was also a wallop, as markets priced Nazi Germany's territorial ambitions spurring a massive global conflict that would wreck the world's productive capacity. Crucially, as well as being huge, wallops are often little-noticed until it is too late, giving them vast negative surprise power. Something broadly discussed by everyone lacks that powerful surprise power.

TODAY'S WIDELY DISCUSSED RISKS

After some excess optimism emerged in early 2021, froth faded as Covid variants, inflation, rate hikes and other fears returned atop headlines. Some of those persist today—as investors rehash familiar concerns consistent with what we have seen for much of the last decade. In our view, many of these concerns lack surprise power, though they can hit sentiment and stoke volatility. January's bumpiness, which many blamed on possible Fed rate hikes, seemingly exemplifies this.

INFLATION

Rising prices dominated headlines throughout 2021, with inflation surging first in the US, then Europe. It remains elevated today in the U.S., the UK, Canada and Europe, and we don't dismiss the pain of higher household costs. Politicians have turned inflation into a talking point, further enflaming the topic.

But for equities, higher inflation isn't automatically bearish, especially early on. In this instance, companies can largely adjust and pass on costs to support profits—one reason why equities are often a hedge against rising prices, as they were last year. On 10 June, the U.S. Bureau of Labour Statistics (BLS) announced May's Consumer Price Index (CPI) rose 5.0% y/y, more than double its 30-year average of 2.3%.[ix] Inflation accelerated for the rest of 2021, hitting 7.0% in December, a 40-year high.[x] Yet after inflation crossed 5.0%, the S&P 500 rose 13.3% for the rest of 2021 while global equities gained 8.2%.[xi] To argue markets missed something about inflation while prices sped for months means arguing equities are blissfully unaware of that news—a losing take, in our view.

> "TO ARGUE MARKETS MISSED SOMETHING ABOUT INFLATION WHILE PRICES SPED FOR MONTHS MEANS ARGUING EQUITIES ARE BLISSFULLY UNAWARE OF THAT NEWS—A LOSING TAKE, IN OUR VIEW."

Accelerating inflation isn't just a US phenomenon. August UK CPI hit 5.4% in December (the latest data available), the fastest since a value-added tax hike temporarily spiked inflation in the country in 2011.[xii] Eurozone CPI finished 2021 at 5.0% y/y, the fastest in the currency bloc's 20-year history.[xiii] Now, roughly half of the eurozone's hot reading is tied to one factor—energy—as Europe endures sharply volatile natural gas and electricity prices tied to wind power's low output, low storage and intermittent delays in Russian gas shipments. But this should abate, as Europe's wind generation normalises, US gas exports reach European shores and the wintertime's peak demand abates.

Beyond European energy, elevated inflation also appears unlikely to persist. This isn't a political or ideological statement. It is based on our study of inflation's drivers and math. One strong contributor being the base effect. 2020's lockdowns depressed prices. Once they entered the year-over-year calculation's denominator in 2021, they exaggerated the rate—a skew reflecting old developments. While some effects will linger due to delayed recoveries in tourism and hospitality, the major base-effect skew should fall out of the data in the second quarter.

Some pundits acknowledge this but warn tight labour markets will worsen inflation. This view stems from the Phillips Curve, which posits low unemployment drives inflation as increased competition for workers speeds wage growth. Employers pass higher labour costs to consumers, driving prices higher—a phenomenon called a wage-price spiral.

In our view, this overstates the impact of wages, which are simply the price of labour. Like all prices, they move on supply and demand and are self-regulating. Eventually, high wages pull more people into the labour force, tamping wage growth. Meanwhile, though some companies pass on higher wages, others absorb them or cut other costs to preserve margins.

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ix Source: FactSet, as of 07/01/2022. US CPI year-over-year change, monthly, January 1992 – November 2021.

x Source: Bureau of Labour Statistics, as of 12/01/2022.

xi Source: FactSet, as of 07/01/2022. S&P 500 Total Return Index and MSCI World Index return with net dividends, 10/06/2021 – 31/12/2021.

xii Source: FactSet, as of 19/01/2022.

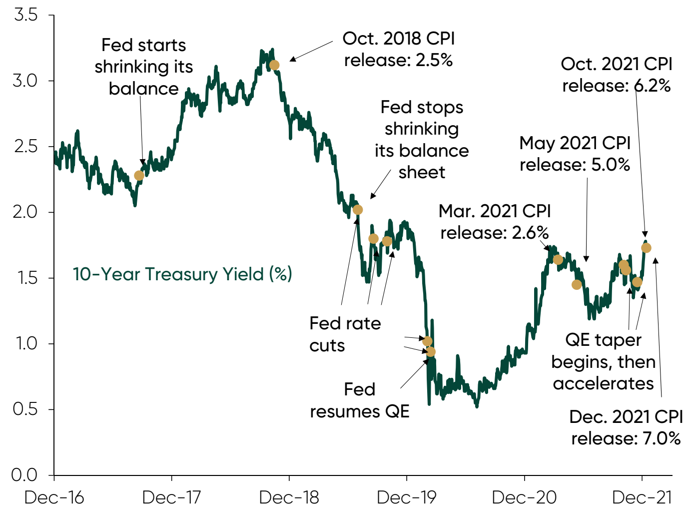
xiii Ibid.

We generally subscribe to Nobel laureate Milton Friedman's argument: Inflation is a monetary phenomenon—too much money chasing too few goods. While many tout the Covid assistance plans as a massive money supply boost, they were a one-off that consumers largely saved or used to repay debt, as we showed in past Reviews. Today's inflation largely stems from "too few goods." Lockdowns impacted production, and producers underestimated the reopening rebound's strength and speed. Cutting capacity is easier than restarting or increasing production—leaving supply short across a range of products. Businesses need time to hire, build factories and work through bottlenecks to bring the needed supply to meet demand.

But higher prices are already motivating companies to find solutions. Semiconductor firms are building new foundries, American shale drillers have increased oil production and shipping backlogs have eased. December manufacturing business surveys noted some shortages remain, but cost pressures and other headwinds are waning.[xiv] While rising supply doesn't mean prices will fall, inflation should moderate as prices rise more slowly off a higher base.

Households understandably dislike inflation, and we don't dismiss its hardships. But if today's inflation were really a major area of concern, the market would tell us. Treasury yields would likely soar since investors would demand a higher premium to offset the longer-term loss of purchasing power. That hasn't happened. The 10-year Treasury yield rose from 0.93% at 2021's start to 1.74% on 31 March.[xv] That turned out to be the year's high despite CPI's acceleration for the rest of 2021. As we write, 10-year yields are back around March 2021's levels—and well below pre-pandemic levels. (Exhibit 5)

EXHIBIT 5: 10-YEAR TREASURY YIELDS REMAIN BENIGN



Source: FactSet, as of 12/01/2022. US 10-Year Treasury Yield, 30/12/2016 – 12/01/2022.

FED 'TIGHTENING'

Many investors worry the Fed will translate the recent inflationary spike to a catalyst for a market downturn as it ends its quantitative easing (QE) programme and potentially hikes interest rates as soon as March. This wrongly treats QE as stimulus—a long-running fallacy, in our view. QE bond buying lowers long-term interest rates. Short-term rates are already near zero. Banks borrow short term to lend long, with the spread between them a key measure of lending's profitability. QE reduces that spread. The smaller the gap, the less motivated banks are to lend—reducing the velocity of money. That is anti-stimulus.

xiv Source: IHS Markit, as of 10/01/2022.

xv Source: FactSet, as of 12/01/2022. US 10-Year Treasury Yield, 31/12/2020 – 31/03/2021.

DON'T FRET HIKES

As for interest rate hikes, these aren't inherently negative for markets. (Exhibit 6). December meeting minutes suggested rate hikes could occur sooner than anticipated, but that isn't ironclad. Last time, initial rate hike chatter lasted nearly two years before the Fed acted in December 2015.

EXHIBIT 6: INITIAL RATE HIKES DON'T BOTHER EQUITIES

First Rate Hike	12 Months Prior	12 Months After	24 Months After
7/16/1971	32.0%	7.6%	4.8%
8/16/1977	-5.8%	5.8%	10.3%
10/21/1980	30.5%	-9.3%	5.0%
3/27/1984	2.6%	13.9%	51.5%
12/16/1986	18.2%	-2.2%	10.5%
3/29/1988	-12.9%	13.0%	32.5%
2/4/1994	7.5%	-0.4%	32.3%
6/30/1999	18.7%	6.7%	-9.4%
6/30/2004	16.4%	5.6%	12.0%
12/16/2015	5.1%	8.9%	29.1%
Average	11.2%	5.0%	17.9%

Source: FactSet, as of 05/01/2022. S&P 500 price returns, 16/07/1970 – 16/12/2017.

Markets have likely pre-priced an initial rate hike. Fed-funds futures, a proxy for the market's expectations, anticipate three quarter-point rate hikes this year, which would take the target rate range from 0% - 0.25% to .75% - 1.0%—just below pre-pandemic levels.[xvi] The December "dot plot" of Fed members' interest rate outlooks shows a majority expect several rate hikes in 2022.[xvii] This does not guarantee these will occur. Outlooks don't always match up with reality—and the Fed's expectations could simply be wrong. Moreover, the Federal Open Market Committee (FOMC) won't look the same this year. Regional Fed presidents rotate annually, and, the Fed's board has three open slots. How these presently unknown new members will vote is unknown.

Yet the market doesn't see a strong probability of multiple hikes that would risk sending short rates above long, inverting the yield curve. Though imperfect, it is more reliable than pundits. Thinking volume of coverage reflects something no one else knows misperceives markets' ability to discount information more efficiently than any person or group.

GEOPOLITICS

A new year brings fresh speculation about regional conflicts. Last November, Russian troops massed along Ukraine's border, stirring invasion fears—and prompting harsh warnings from Western powers. Some worry China, which sees Taiwan as a breakaway province, will try to take the island by force. Turmoil in the Middle East remains constant.

An escalation leading to violence would be tragic and terrible. But regional conflicts are common. 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. Investors must ask: Is local strife—which doesn't normally cause bear markets—likely to snowball globally? We don't presently see anything that looks likely to drive a global conflict, though we can envision possible distant scenarios. A mainland Chinese invasion of Taiwan that draws in both the US and Japan could have major global ramifications, especially given the importance of Taiwan's semiconductor industry. That seems distant today, though, and it likely wouldn't materialise overnight, giving investors time to make measured decisions.

xvi Source: CME Group, as of 06/01/2022.

xvii Source: Federal Reserve, as of 05/01/2022. Summary of Economic Projections, released on 15 December, 2021.

RISKS WORTH MONITORING

Less-discussed risks fall in two categories: Unlikely but catastrophic or more likely but less catastrophic.

CATASTROPHIC (BUT UNLIKELY) RISKS

CYBER ATTACK

In our increasingly digital world, cyberattacks can disrupt financial systems, healthcare services, the power grid and more. Take the Colonial Pipeline, which suffered a ransomware attack last April that shut down operations for nearly a week—bringing oil shortages in the East Coast of the United States. A broader attack could cause even more damage. However, while this is technically always possible, it isn't reason to adopt a bearish stance. It is impossible to base investments decisions or to assign a probability to that kind of event—not its timing, impacts or even what it would even look like.

LESS CATASTROPHIC (BUT LIKELIER) RISKS

TRADITIONAL BULL MARKET ENDINGS

As mentioned, 2020's economic contraction wasn't a traditional recession, where companies cut accumulated excess and costs to survive. Yet Covid and lockdowns could have caused people and businesses to operate inefficiently, requiring a recession to wring out costs. One possible sign: "The Great Resignation"—the record number of people quitting jobs. While this signals confidence in the jobs market, it is also a form of excess, representing a behavioral dislocation that reduces productivity. If people flock from stable firms to shaky ones, it may be another cost that must be wrung out.

Today's inefficiencies may resemble excesses accumulated during an economic boom. Companies could stockpile massively to rebuild inventories—and perhaps overshoot, reacting to supply-chain worries. Or, investing in supply chain workarounds could prove inefficient. Both could mean mistaken investment, requiring deep cutbacks. Bust always follows boom, bringing a recession that corrects inefficiencies and bloat.

Another long-absent risk: broad euphoria. Perhaps society sees a Covid "all-clear" moment, fueling euphoria. Markets demonstrated a degree of froth early last year, as pundits anticipated reopening would fuel a Roaring Twenties-style decade. That didn't materialise, and euphoria remained relegated to niches like bitcoin and digital collectibles as broader sentiment deteriorated. But we are watching sentiment closely.

> "SUPPLY CHANGES DON'T HAPPEN OVERNIGHT, BUT WE ARE MONITORING THE POTENTIAL FOR SUPPLY TO OVERWHELM DEMAND..."

An associated risk: Runaway equity supply that outpaces demand, which often signals a bull market peak. Global equity supply has accelerated since 2020. In the US, net equity supply increases (initial and secondary offerings minus buybacks, buyouts and delistings) have surpassed late-1990s peaks.[xviii] But even with this, there is a severe long-term supply deficit, making the present boom a partial recovery rather than a supply glut. Looking forward, how buybacks and other corporate activities are able to counterbalance new offerings will be worth watching. In 2021, S&P 500 executed buybacks boomed to the tune of $859 billion—well above the $536 billion annual average from 2010 – 2020.[xix]

xviii Source: Refinitiv, as of 29/12/2021. US net stock supply reflects initial and secondary offerings minus buybacks, buyouts and delistings on a trailing 12-month basis in 1996 dollars through 30 November, 2021.

xix Source: FactSet and Clarifi, as of 12/01/2022. S&P 500 buybacks in calendar year 2021 and annual average, 2010 – 2020.

Yet buybacks are in regulators' crosshairs, as the SEC proposed increasing disclosure requirements—which could impact the practice. U.S. Congress is considering taxing them. Supply changes don't happen overnight, but we are monitoring the potential for supply to overwhelm demand—and crash markets.

PAYMENT FOR ORDER FLOW CRACKDOWN

Last January's surge and crash in several "meme stocks" heaped attention on Payment for Order Flow (PFOF) in Congress. PFOF is the legal practice where retail brokers route trades for execution at electronic wholesale firms in exchange for a fee. Wholesalers profit by pocketing the spread between the bid (price a buyer offers) and ask (what the seller wants).

PFOF arguably helped reduce commissions and other trade costs. But it is controversial, as critics cite the potential for wholesalers to front-run orders—and the potential for brokers to favour wholesalers that pay the highest rather than those that will deliver overall best execution for their customers. As an investment adviser—and not a brokerage or wholesaler—Fisher Investments doesn't benefit directly from PFOF. However, we think PFOF has helped cut trading costs, which benefits all investors on balance, and it has improved market liquidity.

The SEC is weighing restricting PFOF due to the lack of transparency. A fine notion, but some care is likely in order. If the SEC severely cracks down on PFOF, we see the potential for unintended consequences, including an impact on liquidity—which could stir uncertainty and heighten volatility.

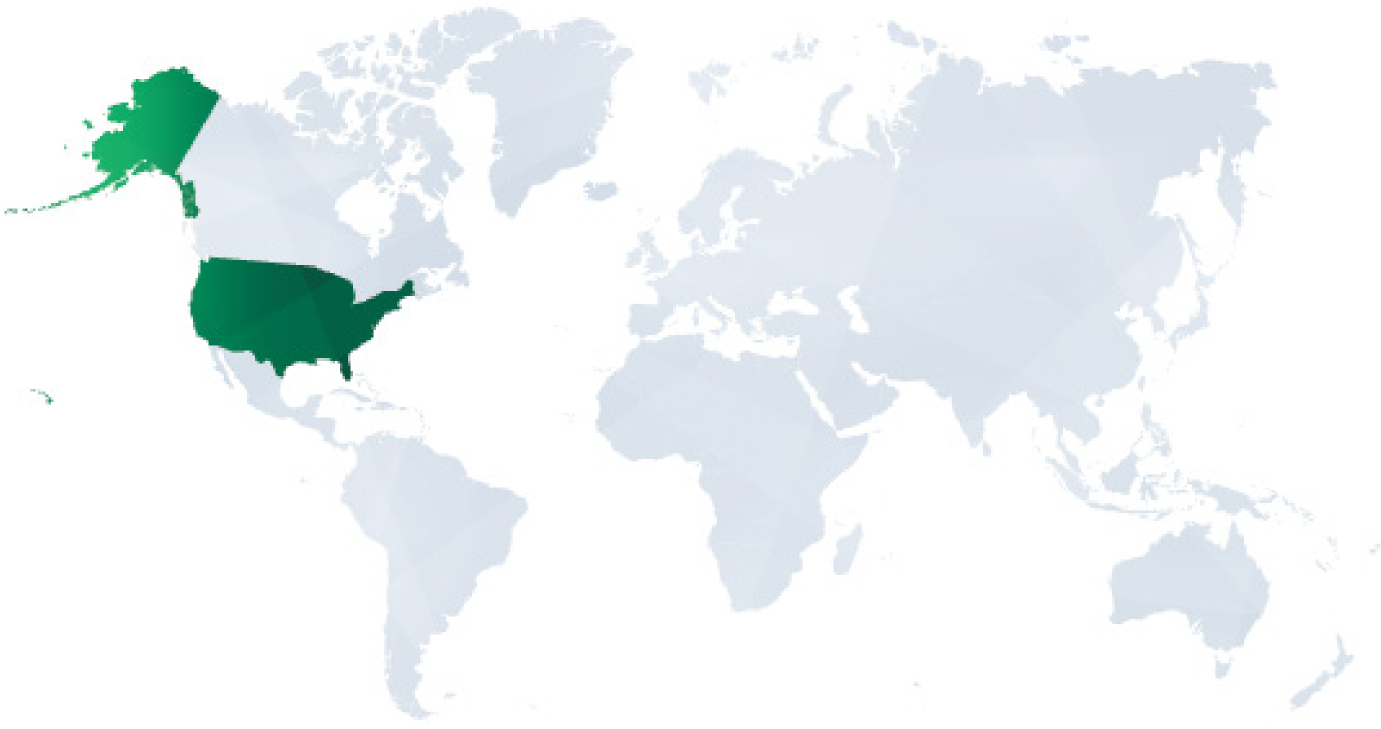
DISRUPTIVE LEGISLATION

While we anticipate a do-little U.S. Congress (discussed in the U.S. Commentary section), we see potential for a bipartisan push against Big Tech or Pharmaceuticals—two industries long criticised by both parties. Democrats have long pushed to control drug prices. They don't seem to appreciate that pharma companies dealt with Covid at lightning-fast speed. Furthermore, many object to their profits, despite the fact those earnings often fund research underpinning future treatments. Both parties also gripe about Big Tech. Republicans blame Big Tech censorship for all their ills while Democrats view them as oligopolies that must be reined in.

Whatever your personal opinions, even well-intended legislation can have harmful downstream consequences. 2002's bipartisan Sarbanes-Oxley Act (SarbOx) sought to prevent Enron-style fraud—a noble aim. But the law massively increased businesses' compliance costs, as it made CEOs criminally liable for corporate reporting inaccuracies. It also complicated the IPO process, likely motivating many startups to seek private capital rather than tap public markets—making SarbOx partly responsible for the IPO dearth in the 2000s as well as the overall fall in the number of publicly traded companies.

SarbOx also likely abetted recent bear markets. It really gained momentum in early to mid-2002. The bill's contents morphed from a more lenient version to the strict version that ultimately passed. Equities' mid-year decline corresponded with the bill's rapid passage and implementation by July 2002's close, which we don't think was a coincidence. SarbOx also likely contributed to the aggressive FAS 157 write-downs during 2008's downturn, as executives sought to avoid any air of inflated values—lest they incur a jail sentence. While SarbOx is an extreme example, the unintended consequences surrounding sweeping legislation are critical to monitor, in our view.

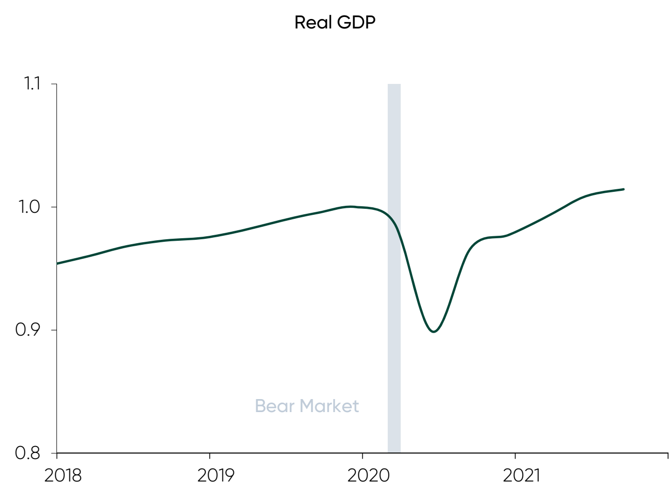
UNITED STATES
COMMENTARY

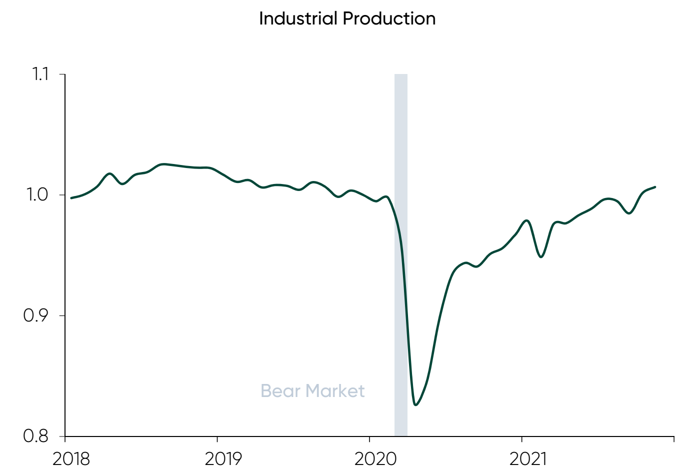


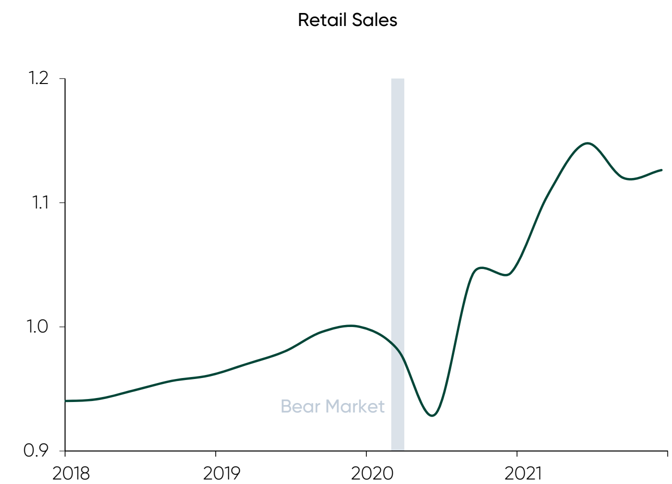
THE SHARP ECONOMIC REBOUND HAS PASSED

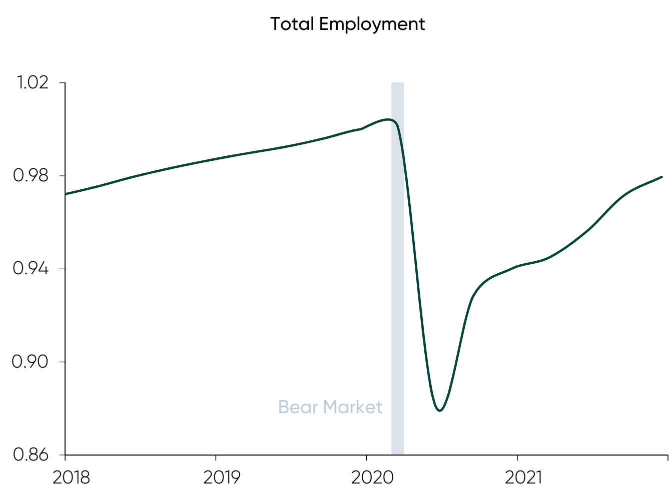
By a number of measures, the US economy has already recovered from the 2020 downturn. That likely means rapid rebounding growth is behind us, and the economy is settling into slower trend growth rates. (Exhibit 7)

EXHIBIT 7: US ECONOMIC INDICATORS: SHARP REBOUND IS BEHIND US









Source: FactSet, quarterly, 31/12/2017 - 31/12/2021.

Forecasts for 2022 global GDP growth are down meaningfully from 2021, and the range of expectations is narrowing. Slower growth can sustain the equity bull market, but it is likely to favour less economically-sensitive firms.

HOW MIDTERMS MOVE MARKETS

As always, we are politically agnostic. We prefer neither party nor any politician and assess political events for their potential economic and market impact only.

As mentioned earlier, U.S. midterm election years historically have a mixed performance history for global markets. Full-year returns are usually down or up big, without much variation. Positive years usually happen when midterms deliver robust gridlock, which 2022 looks set to do. But these years are also typically back-end loaded, with noisy campaigns hitting sentiment early—perhaps even more than usual this time. Seeing through this and fathoming a late rally will likely be key to success.

THE REGULARLY RECURRING YET UNPRICED PRESIDENTIAL EQUITY MARKET ANOMALY

As mentioned in the Market Recap section, since good equity market data begin in 1925, equities follow a familiar pattern during a presidential term. (Exhibit 8) Years one and two have more variable returns, lowering their average gains. When a term begins with heightened legislative fears, returns in years one and two tend to surprise positively as gridlock forces moderation, gradually bringing relief. This usually happens under new Democratic presidents, not because they are inherently good, but because American investors by our analysis lean, on average, more Republican than Democratic by something like a 2-to-1 margin and, hence, are biased to fear heavy legislation from Democratic administrations. By contrast, investors often have irrationally high hopes when a Republican takes office (often later dashed). Regardless, all potential legislation of size runs risks for business. When gridlock chips at or scraps campaign pledges, disappointment usually weighs on returns. Loud midterm campaigning can further knock sentiment in year two, as both parties use controversial issues to motivate voters and fundraising, raising uncertainty.

But midterms increase gridlock, calming the political backdrop in years three and four—frequently delivering above-average returns regardless of the president's party. The year three rally actually starts in midterm years' fourth quarters, as markets pre-price the outcome.

Gridlock's bullishness is hard for many to fathom, in large part because partisans on both sides presume whatever their party passes is good. But, again, markets generally don't think in terms of "good" and "bad." For equities, the question is whether Congress has a high likelihood of passing laws that sharply alter the business backdrop in property rights, regulation, taxes and more—or, create new groups of winners and losers, something even the best-intentioned legislation risks doing. Behavioral finance research shows people hate losses more than they enjoy equivalent gains. When legislation creates winners and losers, it can often create net negativity as the losers' frustration outweighs the winners' joy. Active Congresses raise this likelihood, stirring uncertainty and dampening returns. But gridlock eases this risk, rendering whatever passes less extreme than some hope and others fear and creating, compared to beforehand, relative calm, quiet and peace for businesses and investors in the intermediate term. That reduced uncertainty and markets' legislative risk aversion buoys equities.

Though gridlock is consistently bullish and returns during the presidential cycle are widely known, markets haven't priced the trend. Why is always harder to know than what, but we suspect markets haven't caught on because politics is so emotional and fuels such strong biases. Plus, elections are now routinely discussed as history's "most important," heightening urgency.

Equities' relationship with gridlock also seems more subconscious than overt. Headlines rarely hype gridlock preventing radical change. Political rhetoric rarely ceases. For equities, it is mostly a non-realisation realisation. When the rally happens, pundits manage to credit everything but gridlock, keeping its power cloaked.

EXHIBIT 8: PRESIDENTIAL TERM ANOMALY

Party	President	First Year		Second Year		Third Year		Fourth Year	
R	Coolidge	1925	29.5%	1926	11.1%	1927	37.1%	1928	43.3%
R	Hoover	1929	-8.9%	1930	-25.3%	1931	-43.9%	1932	-8.9%
D	FDR -- 1st	1933	52.9%	1934	-2.3%	1935	47.2%	1936	32.8%
D	FDR -- 2nd	1937	-35.3%	1938	33.2%	1939	-0.9%	1940	-10.1%
D	FDR -- 3rd	1941	-11.8%	1942	21.1%	1943	25.8%	1944	19.7%
D	FDR / Truman	1945	36.5%	1946	-8.2%	1947	5.2%	1948	5.1%
D	Truman	1949	18.1%	1950	30.6%	1951	24.6%	1952	18.5%
R	Ike -- 1st	1953	-1.1%	1954	52.4%	1955	31.4%	1956	6.6%
R	Ike -- 2nd	1957	-10.9%	1958	43.3%	1959	11.9%	1960	0.5%
D	Kennedy / Johnson	1961	26.8%	1962	-8.8%	1963	22.7%	1964	16.4%
D	Johnson	1965	12.4%	1966	-10.1%	1967	23.9%	1968	11.0%
R	Nixon	1969	-8.5%	1970	4.0%	1971	14.3%	1972	18.9%
R	Nixon / Ford	1973	-14.8%	1974	-26.5%	1975	37.3%	1976	23.7%
D	Carter	1977	-7.4%	1978	6.4%	1979	18.4%	1980	32.3%
R	Reagan -- 1st	1981	-5.1%	1982	21.5%	1983	22.5%	1984	6.2%
R	Reagan -- 2nd	1985	31.6%	1986	18.6%	1987	5.2%	1988	16.6%
R	Bush	1989	31.7%	1990	-3.1%	1991	30.5%	1992	7.6%
D	Clinton -- 1st	1993	10.1%	1994	1.3%	1995	37.6%	1996	23.0%
D	Clinton -- 2nd	1997	33.4%	1998	28.6%	1999	21.0%	2000	-9.1%
R	Bush, G.W.-- 1st	2001	-11.9%	2002	-22.1%	2003	28.7%	2004	10.9%
R	Bush, G.W.-- 2nd	2005	4.9%	2006	15.8%	2007	5.5%	2008	-37.0%
D	Obama -- 1st	2009	26.5%	2010	15.1%	2011	2.1%	2012	16.0%
D	Obama -- 2nd	2013	32.4%	2014	13.7%	2015	1.4%	2016	12.0%
R	Trump	2017	21.8%	2018	-4.4%	2019	31.5%	2020	18.4%
D	Biden	2021	28.7%	2022		2023		2024	
Frequency of Positive Returns			60.0%		62.5%		91.7%		83.3%
Average Return for Republicans			4.9%		7.1%		17.7%		8.9%
Average Return for Democrats			17.2%		10.0%		19.1%		14.0%
Average Return for All Periods			11.3%		8.6%		18.4%		11.4%

Source: Global Financial Data, Inc., as of 03/01/2022. S&P 500 annual total returns, 1925 – 2021.

Last year is a shining example, and it followed the typical pattern for a new Democratic president's first year. When the year began, investor sentiment toward US politics was dismal as the new administration and Congressional leadership touted major tax and spending initiatives. Democrats' plans to use budget reconciliation to circumvent the filibuster—letting them pass tax and spending measures in the Senate along party lines—added to investors' jitters.

Yet by yearend, most of these initiatives withered under intraparty gridlock. The bipartisan infrastructure bill slimmed to just $550 billion in new spending, much of it set to trickle out over five-plus years. Meanwhile, the larger spending and tax bill known as Build Back Better shrank from $3.5 trillion to around $1.5 trillion before apparently dying in December as Democratic Senator Joe Manchin (WV) reiterated his seemingly ironclad opposition.

As legislation fizzled, US markets soared. Politics is just one market driver, but we think investors' subconscious relief was a powerful tailwind. Last January, when Democrats took both Georgia Senate seats, creating a 50/50 split with Vice President Kamala Harris breaking ties, few fathomed this majority would be too narrow to pass anything radical. The more it became apparent that Democrats couldn't unite around anything huge, the more equities rose.

That tailwind may be spent for now, however. Senator Manchin and fellow Senator Kyrsten Sinema's opposition to several contentious measures is well-known. Very few people now expect anything major to pass, which has narrowed the gap between sentiment and reality on the legislative front considerably. In our view, this is one factor pointing to dampened early-2022 returns.

REDISTRICTING ELEVATES EMOTIONS—AND GRIDLOCK

Yet 2022 is also particularly prone to create strong gridlock. Our statement doesn't reflect any preference for Republicans over Democrats. Rather, midterms favour the party in opposition to the president—a fact we shared before 2018 midterms, when we anticipated Democrats making gains against the Trump administration. This year, once-a-decade redistricting augments the Republicans' edge.

As shown in prior Reviews, 2020's census added seats in traditionally Republican states. Now, this doesn't automatically increase the GOP's edge, as the redistricting process varies by state and depends on local population changes. But in states where the legislature controls the process, the majority party has a strong incentive to solidify its advantage by protecting incumbents—i.e., hardening seats that merely "lean" Democratic or Republican into "strong." That largely favours the Republicans, considering they control more state governments. Thus far, according to analysis from FiveThirtyEight and Politico, this has reduced the number of swing districts while adding more red seats than blue. Some outlets talk up gains for Democrats, but we think this misinterprets a general hardening of seats that already lean Democratic. In other words, there have been more shifts from light to dark blue than net gains for the party—an underappreciated distinction.

The reduction in swing districts has two consequences. Most immediately, it will make the campaign louder and more contentious. Politicians defending safe seats needn't appeal to a broad electorate. If they tried, they would likely face primary challengers. Therefore, safe-seat incumbents have a huge incentive to play to their party's base, which tends to be more extreme than the overall populace. On the Democratic side, expect a chorus of progressive rhetoric.

On the Republican side, expect a drumbeat of populist outcry. Candidates on each side will demonise the other party, while the handful contesting swing seats will beg everyone else to quiet down. Over-the-top rhetoric will likely weigh on sentiment and, by stirring emotions, prevent markets from seeing and pricing post-midterm gridlock early this year.

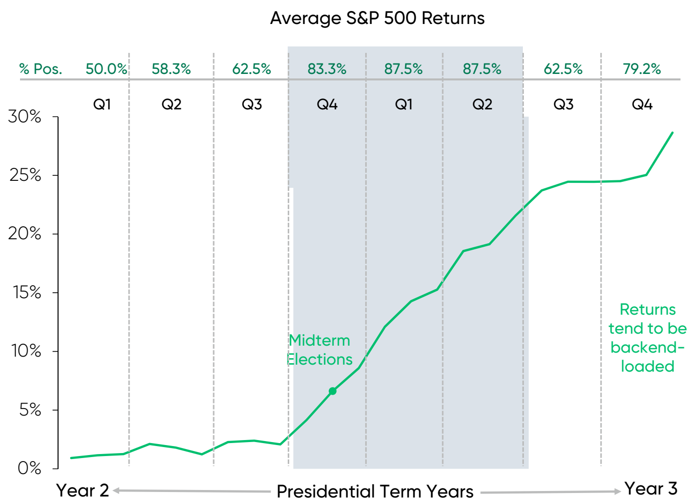
Reducing swing districts also limits the potential upside for Republicans and downside for the Democrats in 2022 and the rest of the decade. Incumbents on both sides will have stronger edges, leaving fewer contested seats, likely reducing the potential net swing. Perhaps that supports more gridlock this decade, although this is unknowable now. It is unlikely to be a cyclical driver for equities anyway—such long-term developments tend to fade into the structural backdrop.

> "THE FIRST THREE QUARTERS AFTER MIDTERMS ARE CONSISTENTLY STRONG—IN OUR VIEW, AS A RESULT OF HEIGHTENED GRIDLOCK."

THE MIDTERM MIRACLE

The likely payoff for patience through volatile early-year returns and persistent campaigning in the U.S.? A big late-year rally that carries into 2023. The first three quarters after midterms are consistently strong—in our view, as a result of heightened gridlock. This phenomenon, while statistically apparent, is never believed to be valid the next time as behavioral cognitive bias causes investors on the left and right to disbelieve it. They claim, "this time is different," dismissing the effect. So it doesn't get pre-priced and recurs. The current, extreme emotional divide between Democrats and Republicans increases the likelihood it recurs this year. Actually, this year's heightened campaign speaks to an even bigger late-year boom than usual, as gridlock will be an outsized relief. (Exhibit 9)

EXHIBIT 9: EQUITIES SOAR AFTER MIDTERMS

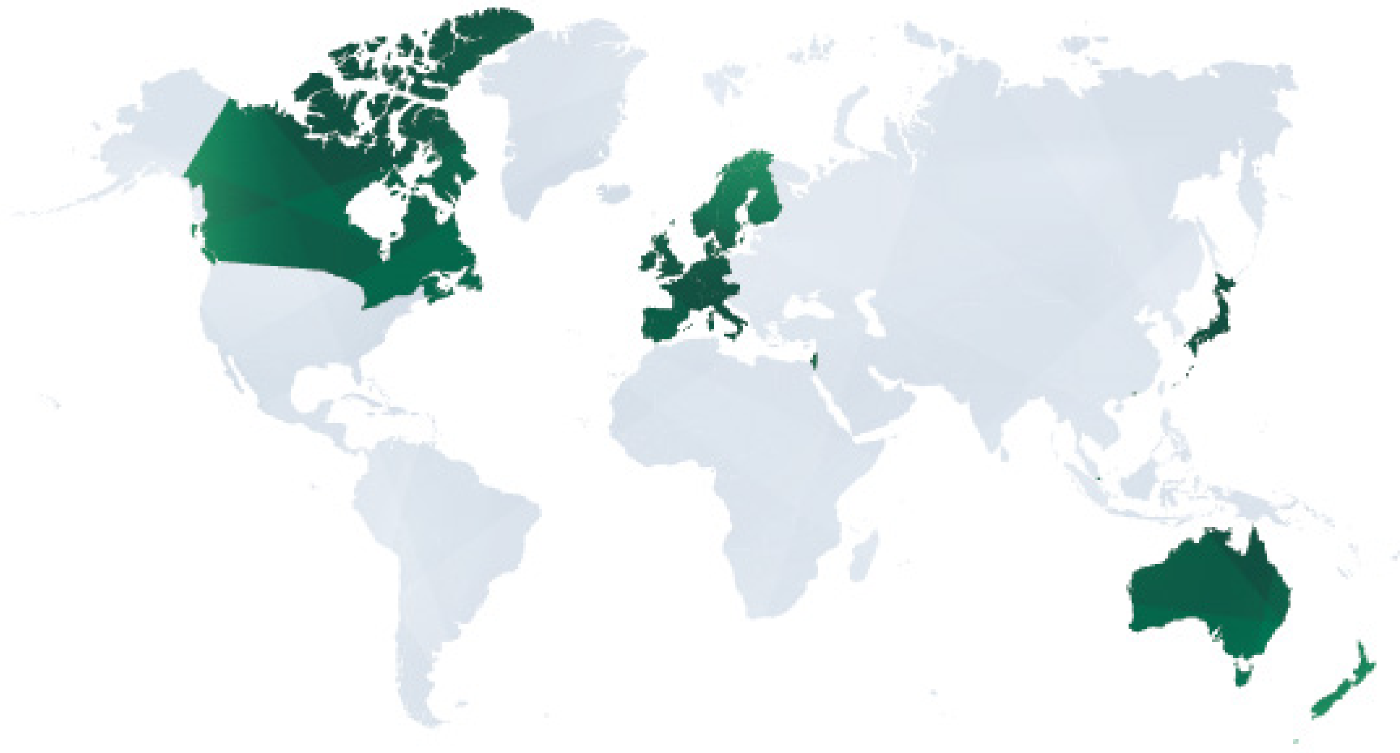


Source: Global Financial Data, Inc., as of 10/08/2021. S&P 500 total returns in the listed calendar quarters, 1926 – 2019.

U.S. Equities have fallen in just one recent midterm-year Q4, in 2018. Then, midterms delivered gridlock, but a sharp selloff as poorly performing hedge funds, as we commented on at the time, raced to liquidate or raise cash ahead of anticipated closures and redemptions truncated the traditional rally—as discussed in our Q4 2018 Review. But even then, the selloff ended quickly, and a sharp rebound began around Christmas, bringing a fantastic 2019. The selloff merely delayed the traditional rally.

While we don't think markets will price gridlock early in 2022, we also doubt they wait for Election Day in November—they usually don't. Moreover, average returns in the first three calendar quarters may be low, but they are positive and are up more often than not. While the 57% frequency of positive returns in these quarters is below equities' overall frequency of positive quarters, it is better than 50/50.

GLOBAL DEVELOPED EX-US COMMENTARY



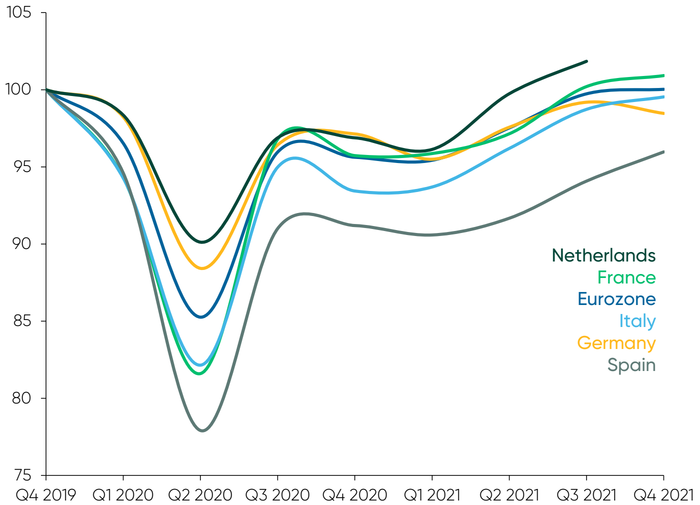
Markets' rise in 2021 came despite a number of headwinds ranging from inflation and supply-chain issues to the end of various government "stimulus" plans—and even lingering Covid restrictions. Those restrictions did impact economic activity on the margin, driving diverging growth rates and even the occasional contraction. But they are also well known. Nearly two years since lockdowns first took effect in the developed world, society is well familiar with the script. When restrictions tighten, growth tends to slow—and output can even contract. Once they ease, output often snaps back. Hence, markets saw through them and the recent economic impact.

COVID RESTRICTIONS' FLEETING IMPACT IN EUROPE AND THE UK

Though early 2020's lockdowns drove a severe economic contraction across the eurozone, growth returned once lockdowns started easing in the summer. This pattern has played out several times since then, but to a lesser degree. (Exhibit 10) When eurozone nations brought back restrictions—and in some cases, targeted lockdowns—in late 2020 and early 2021, output dipped in the short term, but countries' GDPs rebounded as economies reopened. The latest data suggest renewed Covid restrictions have again weighed on output: Germany's Q4 2021 GDP contracted -0.7% q/q, due largely to the return of Covid measures in response to the Omicron wave, according to the commentary in the Federal Statistics Office's initial press release.[xx]

xx Source: DeStatis, as of 28/01/2022.

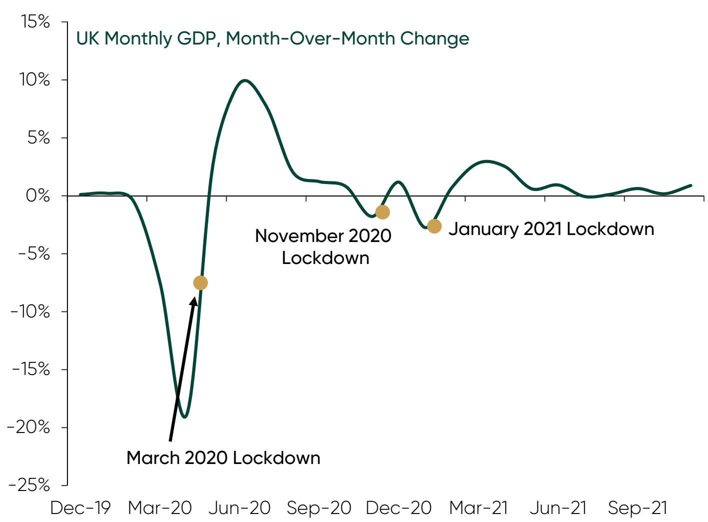
EXHIBIT 10: COVID RESTRICTIONS' FLEETING IMPACT ON EUROZONE GROWTH



Source: FactSet, as of 28/01/2022. Real GDP for eurozone, Italy and the Netherlands, Q4 2019 – Q3 2021, and real GDP for Germany, France and Spain, Q4 2019 – Q4 2021, indexed to 100 on 31/12/2019.

Though the implementation of Covid restrictions is impossible to forecast—human decisions defy prediction—their economic impact isn't long-lasting. See the UK, which imposed three national lockdowns since March 2020. On each occasion, once restrictions relaxed, growth returned. (Exhibit 11)

EXHIBIT 11: LOCKDOWNS' SHORT-TERM IMPACT ON UK GDP



Source: Office for National Statistics, as of 21/01/2022. UK monthly GDP, December 2019 – November 2021.

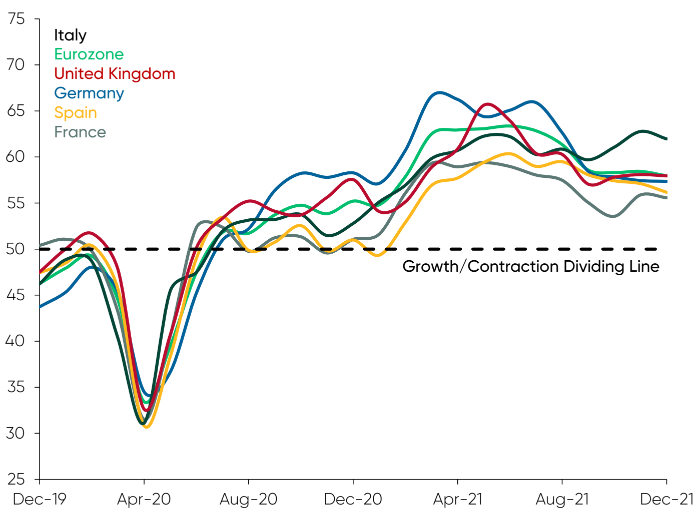
We are already seeing data support another repeat with Omicron. UK December retail sales tanked, falling -3.7% m/m, due partly to the installation of minor Covid restrictions in response to the variant's spread.[xxi] (There was also some evidence of early discounting and supply chain worries pulling holiday demand forward into November.) Though IHS Markit/CIPS' UK January flash purchasing managers' indexes (PMIs) for both manufacturing (56.9) and services (53.3) indicated ongoing expansion, the latter reported some weakness, particularly in the hospitality, leisure and travel industries.[xxii] This was the UK's weakest services PMI since February 2021's 49.5, but it still pointed to growth—the trend since early 2021. Moreover, Prime Minister Boris Johnson announced an end to restrictions on 19 January, and as the latest data emerged, almost all the coverage noted restrictions' impact would likely prove fleeting. To us, that is a sign these measures were priced in well before they ended.

xxi Source: FactSet, as of 21/01/2022.

xxii Source: IHS Markit, as of 25/01/2022.

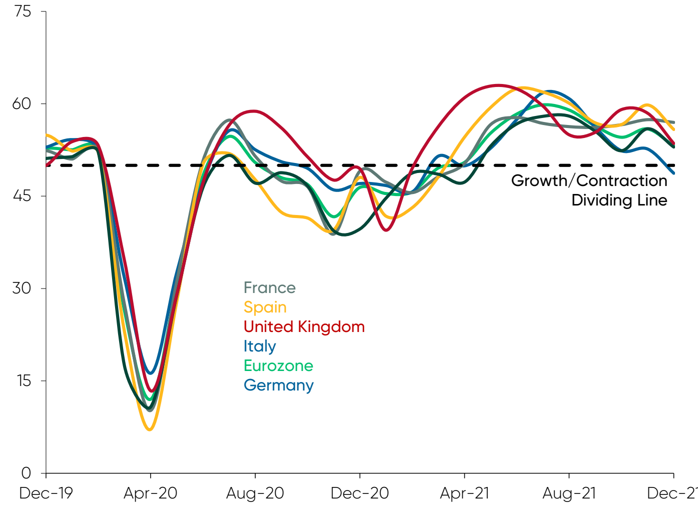
Note, too, that while Omicron-related measures may weigh on broad economic output in the short term, manufacturing and services PMIs have been slowing since 2021's reopening bounce, which we think is consistent with a return to pre-pandemic growth rates. (Exhibits 12 – 13) Now, manufacturing has held up better than services since initial lockdowns in March 2020. A big reason: Factories have been allowed to stay open and operational when Covid containment measures returned—not the case for many services businesses, especially people-facing industries. Since services comprise the majority of GDP in both the eurozone and UK (about 74% and 80%, respectively) restrictions hurt the lion's share of business activity there—but the impact is fleeting.[xxiii] Additionally, headline manufacturing readings were inflated by supplier delivery times, which soared due to the supply chain crisis—in other words, due to PMIs' construction, a sign of stress counted as a positive.

EXHIBIT 12: MANUFACTURING PMIS SINCE DECEMBER 2019



Source: FactSet, as of 28/01/2022.

EXHIBIT 13: SERVICES PMIS SINCE DECEMBER 2019



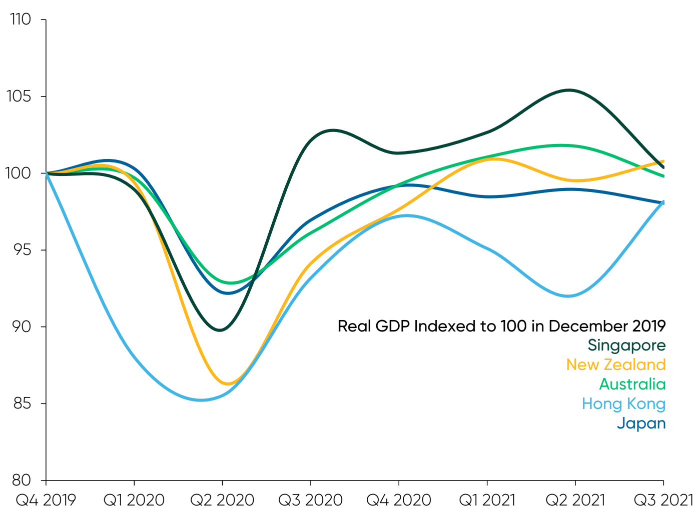
Source: FactSet, as of 28/01/2022.

xxiii Source: ECB and UK Parliament, as of 28/01/2022.

DEVELOPED EAST ASIA AND AUSTRALASIA: THE COSTS OF "ZERO COVID"

In contrast, many economies in East Asia and Australasia have faced stricter, longer-lasting Covid measures. While Japan never imposed a full lockdown, Australia, New Zealand, Singapore and Hong Kong all pursued "Zero Covid" policies: the attempt to contain the virus through closed borders and severe local, regional and national lockdowns. However, most nations ended that approach last year. Singapore signaled a shift in strategy in late June and started dropping quarantine restrictions for some travelers in August. Australia abandoned the policy in early September while New Zealand followed suit in early October. Only Hong Kong has maintained the draconian policy, and it isn't a coincidence, in our view, that the strictest Covid restrictions in the developed world—combined with political uncertainty—have coincided with a recovery that has lagged other developed economies. (Exhibit 14)

EXHIBIT 14: DEVELOPED ASIA'S UNEVEN RECOVERY



Source: FactSet, as of 21/01/2022. Real GDP for Japan, Australia, Singapore, New Zealand and Hong Kong, Q4 2019 – Q3 2021, indexed to 100 on 31/12/2019.

STATE OF AFFAIRS AT YEAREND

While new restrictions returned by 2021's yearend, we think they lack the surprise power early 2020's lockdowns packed. Consider: The IMF now projects a global GDP growth rate of 4.4% in 2022—down from its 4.9% estimate last October—due in large part to pandemic-related disruptions, including mobility restrictions.[xxiv] Markets are efficient discounters of widely known information, so if supranational organisations anticipate slower growth due to Covid restrictions, those expectations are already baked into equity prices, too, as those forecasts largely rest on incoming data. While global developed nations' return to a post-Covid normal may be bumpy, a return to pre-pandemic trends of slower economic growth still seems most likely to us. Bull markets can do fine in that environment, though certain investment styles—particularly large, growth-oriented equities—are likely to fare best, in our view.

xxiv Source: IMF, as of 28/01/2022.

A BUSY YEAR FOR GLOBAL POLITICS

Political uncertainty outside the US is also elevated as 2022 kicks off—and likely to stay that way for the next few months at least. France's presidential election commences on 10 April, with a likely runoff on 24 April if no candidate wins a majority in the first round. Australia's next general election is due by 21 May. The UK doesn't have an election scheduled presently, but a one-two punch of scandal and rising living costs is threatening to bring down Prime Minister Boris Johnson. In our view, all could very well contribute to dampened sentiment in the year's first half. But they will also resolve, bringing clarity—and in many cases, political gridlock—that should add to the US midterm tailwind later in the year.

FRANCE AND AUSTRALIA: TOO EARLY TO TELL

In France, incumbent President Emmanuel Macron of the centrist, pro-euro La Republique En Marche (LREM) party is running for re-election against a cornucopia of challengers from across the political spectrum. The top three, according to the most recent polls, are Valérie Pécresse of the centre-right Les Republicains, followed by Marine Le Pen of the nationalist National Rally (NR) and Eric Zemmour, an independent right-wing commentator. Polls presently show Macron leading in the first round, at 26.0%, with Pécresse and Le Pen tied at 17.0% and Zemmour on 13.5%.[xxv] Many view Pécresse as likeliest to reach the second round, so at present, this election doesn't feature fears of ascending populism or a French euro exit—a noteworthy change from 2017. But polls this early generally aren't predictive, as the campaign hasn't yet begun in earnest. Moreover, some on the right are urging Le Pen and Zemmour to join forces, as they are presently set to split the vote, which could vault either into the second round—a distant possibility, but not out of the question.

Regardless of who wins, the likelihood of radical policy shifts seems quite low. In our view, Macron's first term is instructive in this regard. Many of the policies he ran on—including pension reforms—fizzled after the Yellow Vests protests drained his political capital a year and a half into his term. Despite his coalition having a strong majority in the legislature, substantial legislation has mostly died on the vine, with Covid relief dominating all other initiatives for the past two years. That calculus doesn't appear likely to change for the time being.

Perhaps June's legislative elections deliver the eventual presidential victor a solid majority in Parliament, but it is too soon to know now. Even then, however, if the popular Macron couldn't pass pension and other contentious reforms, it is difficult to imagine a successor getting more accomplished, especially since the political landscape has only become more fragmented since 2017. More likely, the gridlock that has reigned in France for several years now continues, extending the status quo.

As we write, Australia hasn't yet published any opinion polls in 2022. But those taken at 2021's end saw the opposition Labour Party leading the incumbent Liberal-National Coalition by over 10 points as voters became dissatisfied over government infighting and Prime Minister Scott Morrisson's handling of the pandemic.[xxvi] His political battle with tennis superstar Novak Djokovic in mid-January further hit his political capital, leading to speculation that he will wait until the last possible moment to call the election.

In our view, it is unwise to read into any of these recent developments. Polls can shift wildly during a campaign, as Canada demonstrated last year. Regardless, the uncertainty associated with the campaign—and a potential change in government—likely weighs on sentiment in the near term, but that effect probably fades as the election comes into focus, allowing markets to price the results and move on, buoyed by clarity later in the year.

xxv Source: Institut d'Études Opinion et Marketing en France et á l'International, 1st round voting intention, 14/01/2022.

xxvi Source: Roy Morgan, as of 14/01/2022.

‘PARTYGATE’ AND THE COST OF LIVING SQUEEZE BORIS JOHNSON

The scandal known as “Partygate” continues impairing PM Johnson and the Conservatives as more revelations about Downing Street parties violating lockdown rules come to light. Labour is now polling ahead of the Tories, and several Conservatives have called for PM Johnson to step aside—including Scottish Tory leader Doug Ross. A senior civil servant is now conducting an official investigation into the incidents, and former government aide Dominic Cummings—the source of many of these allegations—has offered to give evidence under oath, which many believe could be damning.

So far, PM Johnson is hanging on and retains the cabinet’s continued support. Additionally, Tory MPs have not yet launched an effort to remove him via the 1922 Committee. It is entirely possible he emerges from this bout with his job intact. Yet another hurdle looms beyond Partygate: a hat trick of tax changes that, combined with ongoing inflation, many have termed a “cost of living crisis.”

This April, barring a late change, the increased National Insurance Contribution (NIC) takes effect, and value-added tax (VAT) relief on food and drink will end, bringing VAT back from 12.5% to 20%. Income tax bands also start a five-year freeze in April, even as inflation erodes a big chunk (if not all) of many households’ nominal wage increases. This means thousands of households will land in higher tax brackets thanks to inflation alone, adding to their burden. Now—and this isn’t a political statement—we don’t think this is a huge negative for equities, as added household costs lack surprise power, having been on the calendar for months. The amounts in question also aren’t huge from equities’ vantage point, even though they are obviously negative for individual households—particularly lower-income households.

But there is a very good chance that as households’ costs rise, their frustration with PM Johnson grows, particularly considering the NIC hikes violated the Tories’ campaign manifesto. This is also starting to split the cabinet, with some members urging Johnson to cancel the tax increases to give households some relief. The more scandals weaken his political capital, the louder those calls probably get. Even if they don’t lead to actual tax relief, they could finally foment the cabinet revolt many observers think is likely this year.

However this resolves, we see a high likelihood that uncertainty stays high through the first and second quarter, then dies down once people have clarity on who will be in charge. Whether that person is Boris Johnson, Chancellor Rishi Sunak, Foreign Secretary Liz Truss or someone else, it likely leads to more gridlock, as their main task will be to rebuild popular support for the party before the next election, which is due by 2024. That creates a strong incentive not to rock the boat with big legislation. In our view, equities should therefore enjoy a two-pronged tailwind from leadership clarity and lower legislative risk as the year rolls on.

EMERGING MARKETS COMMENTARY

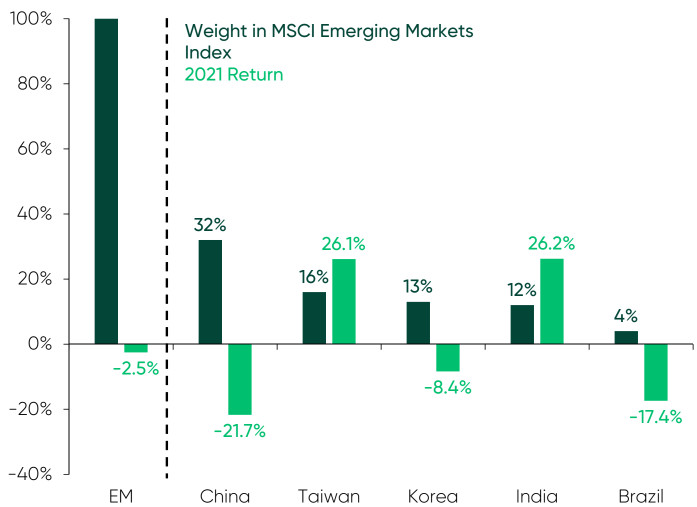
Q4 market returns were mixed across Emerging Markets (EM). Part of this is differences in market structure and other factors like politics. But it also reflects, in part, a divide between positive and negative surprise on the economic front. While major EM economies globally faced similar, well-known hurdles—e.g., supply shortages—individual nations also faced unique headwinds.

Politics will have a significant impact on equity performance in 2022 as important elections take place throughout the world. Elections in France, Brazil, South Korea and elsewhere may be contentious early but calmer once results are known.

EMERGING MARKETS' WIDE 2021 DISPERSION IN PERSPECTIVE

The MSCI Emerging Markets (EM) Index fell -2.5% in 2021, but this modest decline masks a reality: Dispersion among major EM nations was wide. (Exhibit 15) In our view, this serves as a reminder: Investors often approach EM as a uniform category, forgetting risks and opportunities can vary widely by country. Sector differences, as well as economic and political drivers are abundant in EM, and all factor into country-by-country returns.

EXHIBIT 15: WIDE DISPERSION BEHIND EM'S MILDLY DOWN 2021



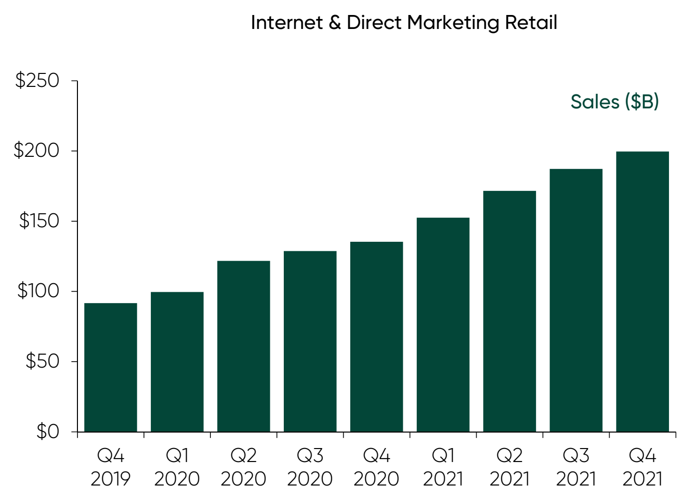
Source: FactSet, as of 28/01/2022. MSCI Emerging Markets, China, Taiwan, Korea, India and Brazil country weights, 31/12/2021, and returns with net dividends, 31/12/2020 – 31/12/2021.

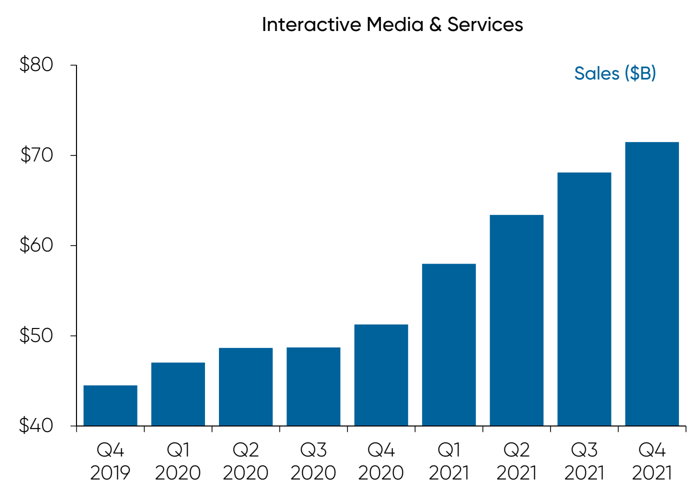
CHINA

Heavyweight China and its -21.7% decline was perhaps the most glaring outlier. Headlines were, and still are, brimming with concerns over Chinese markets. They range from authorities' zero-Covid policies shutting down whole provinces sporadically, regulators' seemingly harsh crackdown on select Chinese Tech-like firms and others, geopolitical worries, and Evergrande and other property developers' debt woes, which many blame for slowing economic growth. But, in our view, while there is a seed of fundamental truth to most of these factors, sour sentiment toward China seems to be the decline's chief driver.

On the regulatory crackdown, some moves were hard to predict and one was quite fundamental. In July, Chinese regulators barred for-profit educational services. That hit listed tutoring firms hard, and understandably so. Others, ranging from data-privacy rules and limits on young children's online gaming to tighter restrictions on Chinese firms listing abroad are marginal issues, in our view. They haven't radically altered the market landscape. China's Internet giants' business models remain largely intact—with dominant market share. They are subject to greater oversight, sometimes resulting in minor fees and penalties. But their core earnings prospects remain strong, in our view—and underappreciated. (Exhibit 16)

EXHIBIT 16: CHINESE TECH & TECH LIKE REVENUES REMAIN HEALTHY



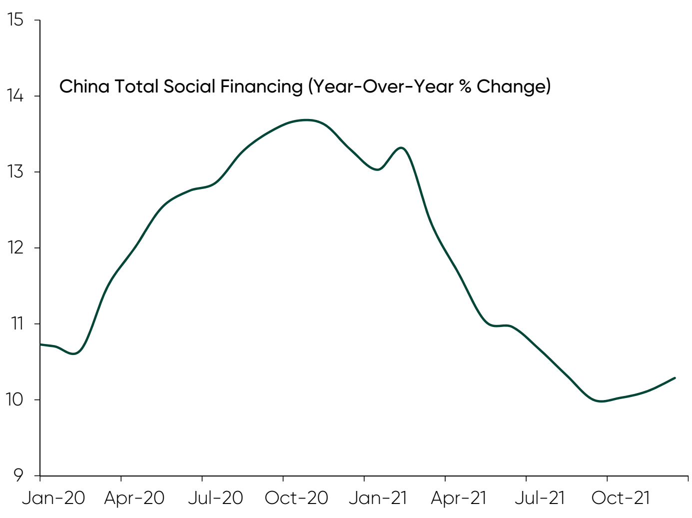


Source: FactSet, USD, quarterly, 31/12/2019 – 31/12/2021. Based on MSCI China Internet & Direct Marketing Retail index and China Interactive Media & Services index.

As for property developers, this seems like the latest twist on decade-plus-old "hard landing" fears, with some fearing an Evergrande default would amount to a so-called Lehman moment that sinks the economy. We don't think so. With Evergrande (et al), officials are injecting market discipline into what was an increasingly frothy property development sector, which should help make it more resilient—and stable—longer term. The restrictions placed on them—including China's "Three Red Lines" limits on leverage—hit troubled developers like Evergrande, to be sure. However, the situation is manageable. Defaults have been concentrated in overseas debt, leaving onshore bondholders whole. That isn't great for offshore investors, but it wasn't unexpected with property developers' offshore debts trading at cents on the dollar since last summer. Letting offshore investors take losses while ensuring domestic investors get paid, in our view, demonstrates authorities will do what it takes to ensure social and economic stability—a better-than-expected outcome than many feared. This includes pressing property developers to fulfill their contractual obligations to clients.

Meanwhile, policymakers are cutting key lending rates and easing credit to support the broader economy. Total social financing—a measure of economy-wide credit growth—appears to be reaccelerating, consistent with the government's social and economic objectives. (Exhibit 17) We think reality is likely to prove less dour than expected.

EXHIBIT 17: CHINESE CREDIT GROWTH STABILISING



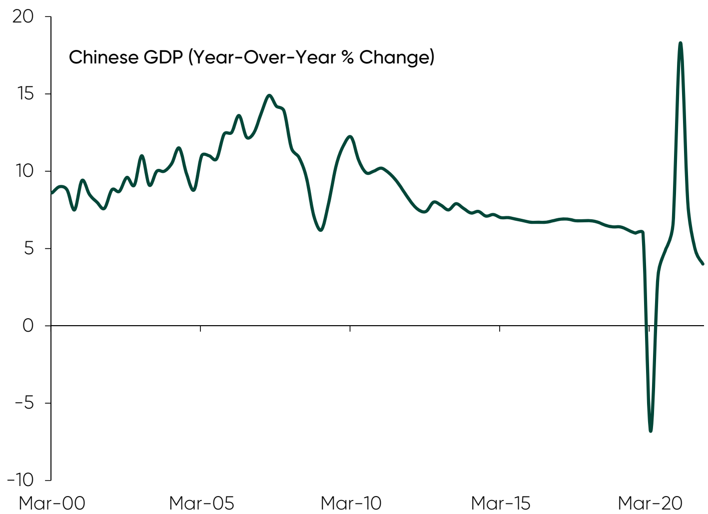
Source: FactSet, as of 28/01/2022. China aggregate financing to the real economy, January 2020 – December 2021.

Finally, consider: All these are among the most widely discussed issues in the press worldwide. They aren't new developments and have been in and out of global financial coverage for months, if not years. Very little is likely to surprise, which is what typically drives material market moves beyond unpredictable short-term volatility.

Beyond regulatory uncertainty, China's market weakness in 2021 stemmed largely from fears over weakening economic conditions late in the year. Growth did slow, but in our view, that was to be expected—especially given China's crackdown on property development. We think fears over Chinese growth trends are likely fully reflected in markets at this point, suggesting their power to move markets materially is gone.

After booming in early 2021 tied to reopening and base effects, Chinese GDP growth slowed for the rest of the year, hitting 4.0% y/y in Q4.[xxvii] While that modestly beat expectations, it still represented the weakest expansion since early 2020's national lockdowns and the second-worst mark in 12 years. (Exhibit 18)

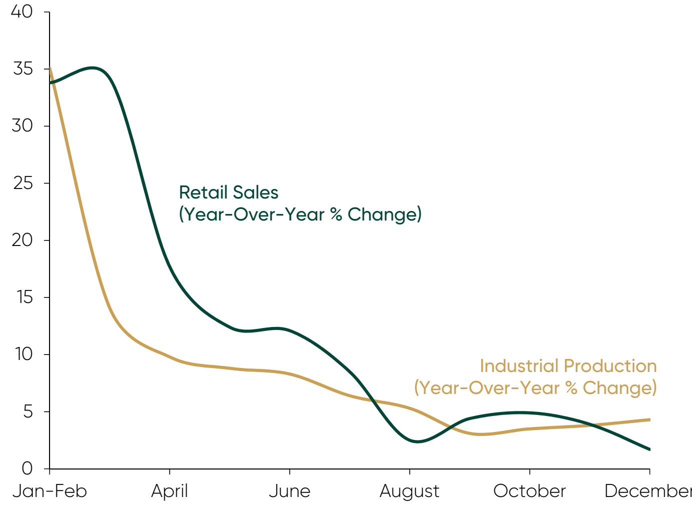
EXHIBIT 18: CHINESE GDP, Q1 2000 – Q4 2021



Source: FactSet, as of 25/01/2022. Chinese GDP, year-over-year percent change, Q1 2000 – Q4 2021.

Both industrial production and retail sales mirrored GDP's surge to start the year, followed by a slowdown throughout 2021. (Exhibit 19) Though manufacturing remains a stable contributor to growth—industrial production accelerated 4.3% y/y in December—consumption has struggled. December retail sales growth decelerated to 1.7% y/y, likely tied to large lockdowns in Xi'an and Tianjin—part of the government's "Zero Covid" policy. In our view, that likely points to reacceleration tied to reopening later in the second quarter.

EXHIBIT 19: CHINA'S 2021 INDUSTRIAL PRODUCTION AND RETAIL SALES

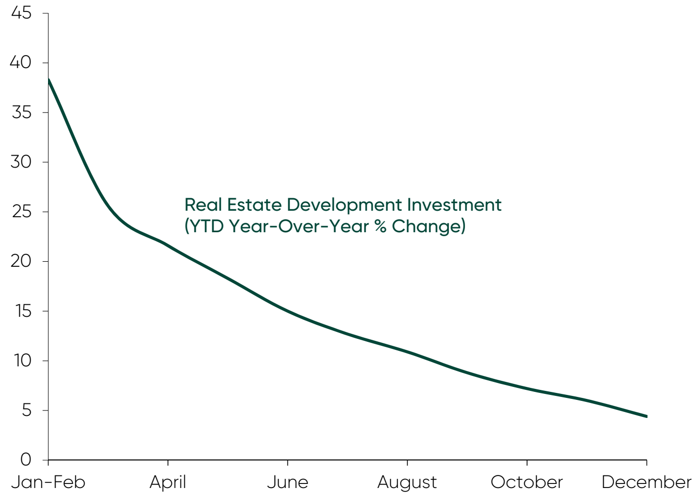


Source: National Bureau of Statistics of China, as of 21/01/2022. Monthly industrial production and retail sales, year-over-year percent change, January 2021 – December 2021. Note: January and February are combined due to the Lunar New Year's shifting calendar placement, which causes skew.

National investment in real estate development also slowed in 2021, with growth hitting just 4.4% for the year through December. (Exhibit 20) (next page) While real estate's weakness has contributed to broad growth's slowdown, it isn't a surprise. The government has prioritised tightening regulation and credit for the property market for the past several years in order to curb speculation and tamp down accelerating prices, which naturally cooled real estate investment.

xxvii Source: FactSet, as of 1/21/2022.

EXHIBIT 20: CHINA'S 2021 REAL ESTATE INVESTMENT



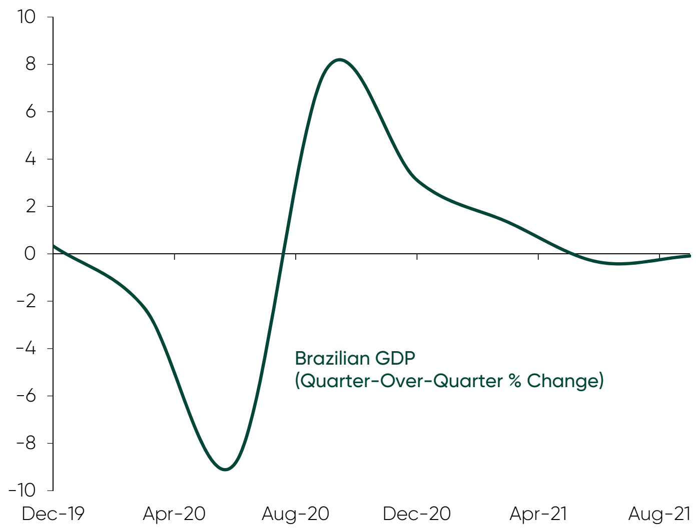
Source: National Bureau of Statistics of China, as of 21/01/2022. Real estate development investment, year to date change compared to the same period in 2020, January 2021 – December 2021. Note: January and February are combined due to the Lunar New Year's shifting calendar placement, which causes skew.

While we think slower growth is to be expected, much of China's economic slowdown is also self-inflicted and tied to the government's insistence on deleveraging the property sector and maintaining a Zero-Covid strategy. While we don't opine on the merits of either, we think it is important to note these wildcards won't necessarily linger in perpetuity, especially this year. President Xi Jinping is attempting to secure an unprecedented third term at this year's National Party Congress, and the government has a history of adjusting policy to shore up economic stability in election years. Already in January, the PBOC has cut interest and lending rates—a form of targeted monetary stimulus to support growth. Officials have also taken steps to support the property market's soft patch, including injecting liquidity into the financial system and subsidising new home purchases for qualified residents. As Chinese growth likely stabilises as 2022 progresses, we think reality is likely to turn out better than currently feared.

BRAZIL AND RUSSIA

Commodity-dependent Brazil and Russia's Q4 returns both lagged broader Emerging Markets. Brazilian GDP fell -0.1% q/q in Q3, driven by a fall in exports (-9.8% q/q).[xxviii] Weak iron ore demand, tied in part to China and its steel production curbs, drove export weakness. After GDP contracted for a second consecutive quarter, Brazil has met one common criteria for recession. (Exhibit 21)

EXHIBIT 21: BRAZILIAN GDP, Q4 2019 – Q3 2021



Source: FactSet, as of 1/21/2022. Brazil GDP, quarterly percent change, Q4 2019 – Q3 2021.

Brazil's decline seems partly like collateral damage from China. The Brazilian market is mostly commodity driven. Its largest sector is Materials at 25% of the MSCI Brazil Index.[xxix] This helped buoy first-half 2021 returns—up as much as 14.5% through 24 June—as metals prices boomed on early-year reopening optimism.[xxx] Iron ore prices soared over 40%, hitting a new record high 12 May, and then staying high through July.[xxxi] But that largely faded as the second half wore on. They fell almost -60% by November, before recovering somewhat into yearend.[xxxii]

xxviii Source: FactSet, as of 21/01/2022.

xxix Source: FactSet, as of 28/01/2022. MSCI Brazil sector weights, 31/12/2021.

xxx Ibid. MSCI Brazil return with net dividends, 31/12/2020 – 24/06/2021.

xxxi Ibid. CRB iron ore price per ton, 31/12/2020 – 12/05/2021.

xxxii Ibid. CRB iron ore price per ton, 12/05/2021 – 09/11/2021.

This was as China, which produces half the world's steel, cut production from record rates.[xxxiii] About a third of Brazil's exports go to China, and they mirrored this dynamic, rising to record highs in June, but then growth decelerated sharply. Brazil's relative returns also deteriorated, with the country underperforming EM since July. Further weighing on sentiment, optimism over big US infrastructure spending plans started fading midyear as gridlock impacted plans, reducing expectations for the US to be a big source of demand—picking up China's slack—for Brazilian resources.

Broader economic and political drivers also appear to be weighing on Brazilian markets. Inflation more than doubled last year with year-over-year Consumer Price Index growth accelerating from 4.6% in January to 10.1% in December, prompting Brazil's central bank to hike rates aggressively.[xxxiv] In 2021, the Banco Central do Brasil raised its Selic target rate seven times, from 2.0% to 9.25%, and recently increased a further 1.5 percentage points to 10.75%.[xxxv] This has dramatically flattened the yield curve, which should significantly tighten credit conditions. This, plus the drop in exports, contributed to declining Q2 and Q3 2021 GDP—technically meeting one definition of a recession.

We don't yet have Q4 GDP data, but forward-looking markets likely anticipated these economic struggles. After Brazilian equities hit their 2021 high on 24 June, they fell -27.9% from then through yearend.[xxxvi] But we think much of its economic weakness is already reflected in market pricing at this point, and maintaining exposure to the country diversifies our overall growth emphasis.

Political uncertainty could also be a factor in the lead up to Brazil's October general elections. Current polling has former left-wing President Luiz Inacio "Lula" da Silva leading right-wing incumbent President Jair Bolsonaro, enough that Lula could possibly win outright in first-round voting.[xxxvii] Although Lula appears to be tacking to the centre—and Brazilian markets largely fared fine in his 2003 – 2010 administration—renewed jitters may weigh on sentiment toward Brazil for a spell.

As for Russia, Q3 GDP contracted -0.8% q/q, as total consumption expenditures (-0.9%) and gross capital formation (-0.2%) both contracted.[xxxviii] However, the Russian economy and its markets depend primarily on oil and natural gas prices—the country's Energy sector comprises about 50% of the MSCI Russia.[xxxix] After hitting a 2021 high of $86.40 per barrel in late October, oil prices fell -20.3% to $68.87 per barrel on 1 December.[xl] Over that same timeframe, Russian equities fell -12.0%.[xli] However, though oil prices rebounded and ended the month at $77.78 per barrel, Russian equities didn't recover in December, slipping another -4.9% over the same stretch.[xlii] A big reason, in our view: sanction risk.

xxxiii Iron-Ore Prices Tank as China's Steel Output Slows," Rhiannon Hoyle, The Wall Street Journal, 24/08/2021.

xxxiv Source: FactSet, as of 28/01/2022. Brazil Extended National Consumer Price Index (IPCA), January 2021 – December 2021.

xxxv "Brazil Lending Grows in November Despite Worsening Credit Conditions," Bernardo Caram, Reuters, 28/12/2021.

xxxvi Ibid. MSCI Brazil Index returns with net dividends, USD, 24/06/2021 – 31/12/2021.

xxxvii "Lula Could Win Brazil's October Election in First Round - Poll," Anthony Boadle, Reuters, 20/01/2022.

xxxviii Source: FactSet, as of 28/01/2022.

xxxix Ibid. MSCI Russia Index, as of 21/01/2022.

xl Source: FactSet, as of 28/01/2022. Crude oil Brent ICE near term price, 26/10/2021 – 01/12/2021.

xli Ibid. MSCI Russia Index return with net dividends, 26/10/2021 – 01/12/2021.

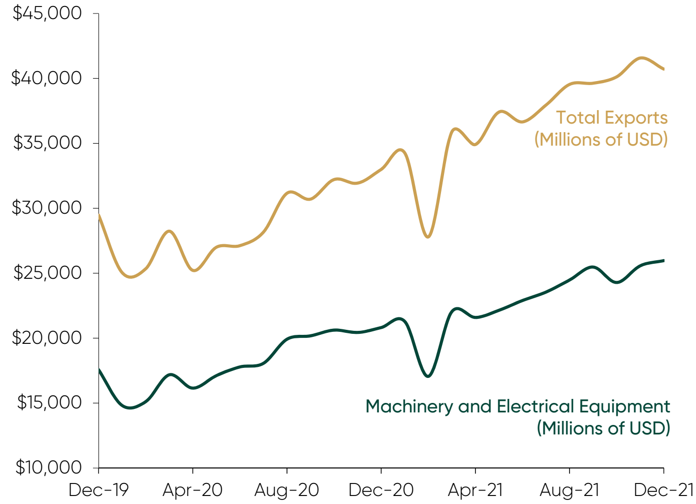
xlii Ibid. Crude oil Brent ICE near term price and MSCI Russia Index return with net dividends, 01/12/2021 – 31/12/2021.

Ever since Russian troops gathered at the Ukrainian border last November, concerns of a possible invasion have weighed on sentiment. Western powers—particularly the US—have threatened to impose significant financial punishments and targeted technology sanctions on Russia should its troops enter Ukraine. Markets likely also dealt with the possibility that Russia could further cut oil and gas supply to Continental Europe, which would hammer Energy firms' revenues. That uncertainty headwind, along with global oil supply and demand drivers—which we expect to be roughly in balance this year, keeping prices range bound—suggest Russian equities aren't likely to lead for the foreseeable future, in our view.

TAIWAN

Taiwan outperformed broader Emerging Markets in Q4 thanks primarily to robust demand for semiconductors, which buoyed the nation's huge chip industry. While much of the world experiences semiconductor shortages as a drag on growth, they are a boost in Taiwan, fueling demand for one of Taiwan's main exports and buoying economic activity. (Exhibit 22)

EXHIBIT 22: TAIWANESE EXPORTS



Source: FactSet, as of 21/01/2022. Taiwan exports, monthly, total exports and machinery & electrical equipment exports, in USD, December 2019 – December 2021.

Robust semiconductor demand has also helped investment. Taiwan Semiconductor set its 2022 capital-expenditure budget at $40 billion to $44 billion—a record high and up from 2021's $30 billion—as it invests to expand capacity. With strong semiconductor demand likely to persist for the foreseeable future, Taiwan looks well-positioned in the current economic environment. Notably, Taiwan's gains were broad and strong outside Tech. Aside from Energy, all sector returns were positive last year, and except for Consumer Staples and Communication Services, they rose double digits.

We think sentiment toward Taiwan remains favourable. All last year, it contended with worries about China's growth slowdown and geopolitical tensions with its cross-strait neighbour. These worries remain today. As they prove unfounded or Taiwan overcomes them, we expect Taiwanese Equities to keep climbing the proverbial wall of worry.

INDIA

India also had a stellar 2021. While headlines focused on its challenges controlling Covid, markets mostly looked past them. In particular, Financials—MSCI India's largest sector at 24%—benefited from a steepening yield curve. As long rates increase their margin over short, banks' margins on new lending improves, typically spurring accelerating loan growth.[xliii] Indeed, it appears they responded last year. Indian bank credit to the commercial sector accelerated from 5.6% y/y in January 2021 to 10.6% in December.[xliv] Indian Financials saw big gains—up 27.9% through the year's high on 26 October.[xlv] But returns were cut in half over the last two months, with the sector ending the year up just 13.9%.[xlvi] In our view, markets have mostly priced India's better-than-feared outcome and are looking toward a return to normal where expectations match reality more closely.

> "WHILE ECONOMIC FUNDAMENTALS ARE REBOUNDING TIED TO BASE EFFECTS, WE BELIEVE A SUSTAINED ACCELERATION IS UNLIKELY."

Notably, India's second-largest sector, Tech (20%), gained strength throughout the year, rising 48.1% on growing global demand for Indian Tech services.[xlvii] We think this underscores the need to view sector trends on a worldwide basis, assessing how they may intersect with countries' specific industry and company-level composition, which can yield overlooked opportunities.

India remains the largest country underweight within our Emerging Markets portfolios. While economic fundamentals are rebounding tied to base effects, we believe a sustained acceleration is unlikely. Further, India benefitted from a general rotation away from Chinese growth positioning in 2021, which likely reverses in 2022. Additional pro-market reforms from Prime Minister Modi's administration likely proves more challenging moving forward. Moreover, claw backs to some of the key pieces of reform implemented in his first term are concerning. India's historical premium to Emerging Markets is at a decade high tied to the economic recovery from Covid and more recently with the downturn in China. However, less positive economic growth expectations and a weakening political appetite for structural market reform make the premium level difficult to justify.

KOREA

Political stability in South Korea following a string of scandals should provide a boost to sentiment, though current President Moon's policy agenda is geared more toward welfare spending than reforms. Korean leaders can only stand for one term, and leading candidates have pledged to unveil a raft of additional welfare programmes, such as universal basic income. Meanwhile, the government announced it would invest $450 billion in the semiconductor industry over the next decade. The plan will include tax breaks, lower interest rates, eased regulation and improved infrastructure. While the exact timing is still being discussed, the amount is significantly more than proposals to support the chip industry in the US ($50 billion) and EU (€30 billion). The plan isn't likely to create overcapacity concerns, in our view, given the long timeline and increased structural demand for semiconductors across various key industries with increasingly complex applications across the automotive, industrial and technology industries.

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xliii Ibid. MSCI India sector weights, 31/12/2021.

xliv Ibid. India bank credit to commercial sector, January 2021 – December 2021.

xlv Ibid. MSCI India Financials, 31/12/2020 – 26/10/2021.

xlvi Ibid. MSCI India Financials, 31/12/2020 – 31/12/2021.

xlvii Ibid. See note X. MSCI India Information Technology, 31/12/2020 – 31/12/2021.

Korean Tech is mostly geared toward commodity hardware—e.g., lower-margin memory chips and smartphones—driven by more cyclical consumer electronics. For example, while memory chips were in short supply last year, American and Chinese companies have been steadily increasing their stockpiles, which industry watchers say is likely to lead to softer pricing sooner rather than later.[xlviii] Uncertainty from China's zero-Covid policy may also be playing a role darkening sentiment somewhat. In late December, a major Korean chipmaker warned a Chinese state's lockdown could disrupt production at one of its plants there.

These differences, ranging from economic and political drivers to sector make-up, all contributed to big dispersion in 2021. And they are a reminder not to paint EM with broad brushstrokes.

xlviii "Memory Boom Expected to Fizzle out Faster Than Expected Q4," Lee Jong-hyuk, Park Jae-young and Lee Eun-joo, Pulse, 24/09/2021.

Should you have any questions about any of the information provided above, please contact FIE by mail at Level 18, One Canada Square, Canary Wharf, London, E14 5AX or by telephone at +44 (0)207 299 6848.