M|A|M
MONACO ASSET MANAGEMENT

Investment Outlook

Q1 2022

Executive Summary

- **Stubbornly high inflation.** The Fed is cornered. The December 2021 FOMC minutes meeting suggest the Fed will attempt to speed-up monetary policy normalisation. This is happening at a time when the credit impulse in the US is falling and economic growth is softening. A policy mistake can very well represent a black swan event. We still believe US 10-year bond yields will rise to 2.2% in Q1 2022.

- **Developed credit markets are at historically high valuations**. The cocktail of softening economic growth and rising long-term interest rates is a clear headwind for credit markets. Emerging market credit is the only area left providing real value, especially after the weakness in Asia driven by the failure of Evergrande.

- **The USD rally has run its course.** Structurally, the environment is neutral for the USD. While we see short-term downside in the EUR/USD exchange rate to 1.10, our medium-term target of 1.25 suggests the risk/reward is skewed to being Long Euro.

- **Keeping Equities to Neutral.** We have been more cautious on equities since July/August 2021. A stagflation environment has historically been a challenge for equities, especially when trading at record high valuations. We remain positive on certain pockets of equity markets such as Value, Emerging Markets and de-rated mid-cap growth stocks geared to the new green economy. We will increase equities to a buy rating after an opportunistic 15-20% correction.

- **The Commodities super-cycle remains intact**. Commodities managed exceptional outperformance in 2021 despite a rising USD. As the USD enters a weakening phase, we strongly believe the Commodities bull market will carry on. Our over-arching positive view on inflation makes us structurally positive on precious metals. We believe the environment is ripe for a renewed outperformance of gold and silver.

2021 In Review

Following another eventful year, we wanted to take the time as part of this investment outlook to reflect on our calls and strategy of last year. Looking back at expectations, we feel our economic and macro calls were predominantly correct. GDP growth was strong with the global economy further recovering from the Covid crisis, reverting to pre-pandemic levels. We were also very early to call inflation for what it would be. Pent-up demand and sustained supply chain issues meant inflation was more than just a transitory story. Sovereign bond yield reacted to our sustained inflation call, moving up from a very low base. Commodities were the clear beneficiaries, thus despite a stronger dollar and slower economic growth out of China. They ended 2021 as the best performing asset class. Energy commodities, to which we recommended exposure through the broader commodity index and energy-driven equities, was the best performing sector and one of the best performing assets of last year.

Despite rather correctly assessing the economic picture, the market pricing mechanism in 2021 wasn't usual. Headline US equity market indices showed high double-digit returns, but underneath the surface the majority of stocks were in a bear market (down more than 30%). Investors kept on buying US large cap tech stocks for safe haven, something we did not expect as long-term interest rates rose. Emerging markets equities suffered from a sudden shift in China policy with the local government tightening financial conditions and implementing a whole new set of regulatory measures. Higher inflation expectations did not translate into rising precious metal prices which was a significant surprise to us. Instead, the stronger USD took its toll on gold and silver to which we had exposure all year.

For our portfolios, it was a disappointing year in equities but a more positive one in credit where our call to underweight the asset class proved to be the right one. We also had some successes in commodities and alternatives. Above all, we remained true to our mandate. Portfolio volatility remained well below industry standards thanks to careful portfolio construction of strongly de-correlated assets. Overall, 2021 was a frustrating year in many ways which pushes us to better our research and implementation. Looking ahead, 2022 promises to be a year of multiple rotations whether that be sector or geography. We intend to take greater advantage of these rotations.

Investment Stance Overview

Liquidity drives asset prices. We have witnessed this phenomenon over and over since the GFC. Inflation is always and everywhere a monetary phenomenon. Inflation is now the #1 concern of US investors before the pandemic. The same goes for the Federal Reserve as it finally accepts the fact that inflation is not transitory—something we have discussed at length in 2021. The liquidity punchbowl will be removed in 2022. Three rate hikes are priced in for the year. The Fed is even hinting at potentially doing more to contain inflation. In itself, rate hikes are not synonym of a market crash. However, after three years of double-digit S&P 500 Index performance, record high valuations in US equities and credit, we should acknowledge that headline index returns, especially in the US, are going to be challenging. The saving grace is the strong economic growth feeding into corporate earnings. However, overly tight financial conditions and rising wages can also put an end to this support. Based on the monetary and liquidity cycles, we are keeping equities Neutral with a strong Underweight in "long-duration" assets such as technology and Overweight in "value" assets such as energy. In Equities and Credit, value remains in Emerging Markets which should catch up economically to the rest of the World after two difficult years due to Covid. Our bullish view on commodities and alternatives remains unchanged. We are convinced that 2022 will be a year of multiple rotations. We need to stay alert to take advantage of market rotations.

	Investment Stance						Quarterly
	Very Bearish	Bearish	Neutral	Bullish	Very Bullish		Change*
SOVEREIGN BONDS						**BEARISH DM**	-
US							-
Europe (Core)							-
Europe (Periphery)							-
Emerging Markets							-
CORPORATE BONDS						**BEARISH DM**	-
US High Yield							-
US Investment Grade							-
EUR High Yield							-
EUR Investment Grade							-
Emerging Markets							-
CURRENCY						**NEUTRAL USD**	-
USD							↘
EUR							↗
EM							-
CNH							-
GBP							-
EQUITIES						**NEUTRAL**	-
US							-
Europe							↘
UK							-
Japan							-
Emerging Markets							-
COMMODITIES						**BULLISH**	-
Energy							↗
Precious Metals							-
Metals & Agriculture							↗
ALTERNATIVES						**BULLISH**	-
Hedge Funds							-
Real Estate							-
Private Equity							-

** Change compared with previous months. One arrow means the stance has moved one place to the left or the right, two arrows means a move of two places, etc.*

Model Portfolios

The following model portfolios are based on current positioning at the start of Q1 2022. Considering the volatile nature of financials markets and our outlook, their composition is likely to change throughout the quarter.

USD Based Portfolios

Asset Class	Last Price	Perf. 5D	Perf. MTD	Perf. YTD	MAM Outlook	Asset Allocation
Currencies						
Portfolio Bases						**100.0%**
EUR	1.13	0.2%	-0.4%	-0.4%	Neutral	5.0%
USD	96.00	-0.2%	0.3%	0.3%	Neutral	95.0%
Equities						**35.0%**
Developped Markets	**66.78**	**-1.8%**	**-1.2%**	**-1.2%**	Neutral	**25.0%**
Europe	479.04	-2.2%	-1.8%	-1.8%	Neutral	7.5%
North America	4,677.03	-3.4%	-2.8%	-2.8%	Neutral	13.7%
Great Britain	7,445.25	0.8%	0.8%	0.8%	Neutral	1.2%
Asia Pacific	28,478.56	-1.5%	-1.1%	-1.1%	Neutral	2.5%
Emerging Markets	**1,226.10**	**-0.6%**	**-0.5%**	**-0.5%**	Bullish	**7.0%**
Asia Pacific	693.22	-0.3%	-0.2%	-0.2%	Bullish	4.6%
EMEA	278.25	-0.1%	0.9%	0.9%	Bullish	1.7%
South America	2,103.85	0.5%	-1.2%	-1.2%	Bullish	0.7%
Thematic						**3.0%**
Asset Allocation	34.68	0.7%	0.7%	0.7%	Bullish	3.0%
Fixed Income						**12.0%**
Europe						**0.0%**
Sovereign	219.69	-0.3%	-0.4%	-0.4%	Bearish	0.0%
Investment Grade	248.47	-0.6%	-0.8%	-0.8%	Bearish	0.0%
High Yield	438.65	0.2%	0.2%	0.2%	Bearish	0.0%
North America						**0.0%**
Sovereign/Tips	2,698.83	-0.7%	-1.7%	-1.7%	Neutral	0.0%
Investment Grade	3,455.42	-0.8%	-1.9%	-1.9%	Bearish	0.0%
High Yield	2,438.28	-0.9%	-0.9%	-0.9%	Bearish	0.0%
Emerging Markets						**5.6%**
Local Currency	405.39	-1.5%	-2.0%	-2.0%	Bullish	5.6%
Hard Currency	1,247.63	-1.1%	-1.5%	-1.5%	Neutral	0.0%
Others						**6.4%**
Convertible	991.43	-0.5%	-0.5%	-0.5%	Bearish	0.0%
Trade Finance	108.75	-0.2%	-0.6%	-0.6%	Neutral	0.0%
Broad Funds	526.18	-0.5%	-1.2%	-1.2%	Bullish	6.4%
Commodities		**1.5%**	**1.8%**	**1.8%**		**10.0%**
Agriculture	93.08	0.8%	0.6%	0.6%	Bullish	1.3%
Energy	32.54	3.4%	5.3%	5.3%	Bullish	1.3%
Industrials	173.17	0.5%	0.2%	0.2%	Bullish	1.3%
Precious Metals	214.50	-0.4%	-2.1%	-2.1%	Bullish	6.0%
Alternatives						**25.0%**
Hedge Funds	1,425.27	-0.4%	-0.4%	-0.4%	Bullish	15.0%
PE/Real Assets	2,138.75	-1.1%	-1.1%	-1.1%	Bullish	5.0%
Pre-IPOs	743.18	-1.8%	-1.5%	-1.5%	Bullish	5.0%
Cash						**18.0%**

Source. MAM Research, Bloomberg

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Source. MAM Research, Bloomberg

Asset Class Returns

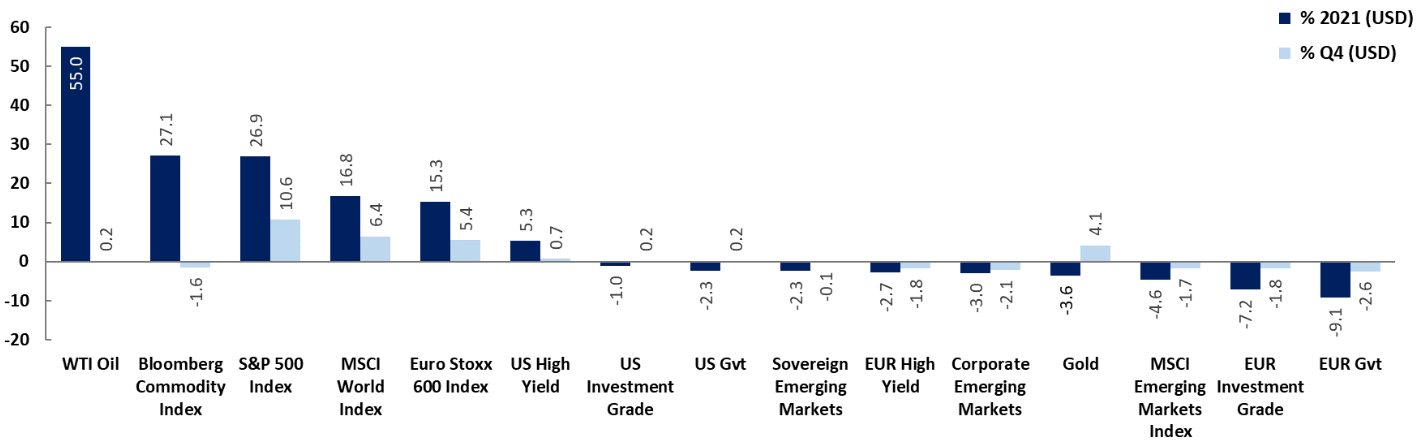
Last year was a difficult year when looking beyond the high index-level returns. The MSCI World was up 16.8% and the S&P 500 was up 26.9% in 2021, in USD terms. It marked the third consecutive year with US equities posting annual returns above 15%, with only one other such instance since 1929. A stealth bear market occurred beneath the surface with the majority of names down more than 30%. The market was entirely driven by the FANG+ stocks, without them indices would be close to flat last year. Chinese equities significantly underperformed global markets, contributing to the 20%+ underperformance of emerging markets vs. developed market equities. More supportive fiscal and monetary policy amidst a less restrictive regulatory environment should provide a better backdrop to the region in 2022.

Global sovereign bonds sold off in late December amid a flurry of hawkish monetary policy announcements after the major central banks had their last meeting for 2021. The Fed brought forward the timeline for when net asset purchases would reach zero while opening the possibility of a rate hike in March. The BoE lifted rates by 15bps. The ECB announced a cautious taper. In the end, credit was a net underperforming asset class with high yield the only segment positive within credit. US high yield was up 5.3%, investment grade was down 1.0%, and sovereign was down 2.3%. EU high yield was up 4.2%, investment grade was down 0.2%, and sovereign was down 2.2%. Emerging market debt was also a negative performer, corporate was down 3.0% and sovereign was down 2.3%.

The US Dollar appreciated with the broad dollar index up 6.4% with several factors contributing to the relative strength. (1) A more hawkish stance at the Fed with discussion over tapering, rate hikes, and tightening. In the meantime, the ECB is cautiously phasing out its monetary policy accommodation introduced at the onset of the pandemic. (2) New variant spreading and rising GDP growth rate differentials between the US and the Rest of the World remained supportive to the greenback.

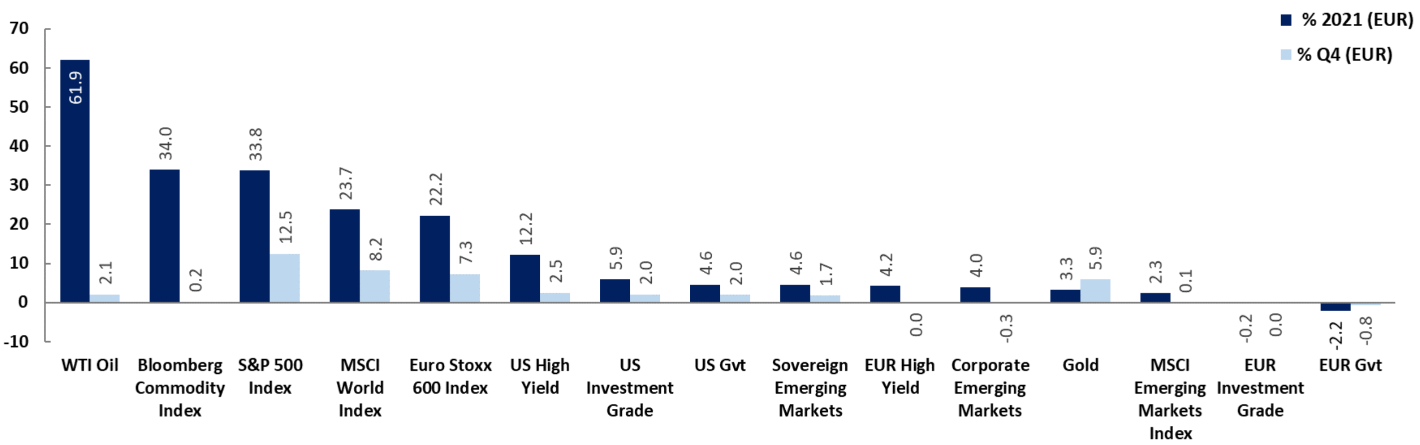
Operating costs bottomed in 2020. Cost inflation returned with a vengeance in a heavily interlinked and circular commodity market. Energy prices surged with crude oil up 55% in 2021 as the global economy reopened and mobility picked up. Precious metals were unfortunately one of the bigger losers, victim of a rise in both nominal and real yields. Gold was down 3.6% last year.

Chart 1. Asset Class Returns Q4 2021 vs. Full Year 2021 (USD Base)



Source. MAM Research, Bloomberg.

Chart 2. Asset Class Returns Q4 2021 vs. Full Year 2021 (EUR Base)



Source. MAM Research, Bloomberg.

MAM Actions

Equities

What have we done?

The combination of the emergence of Omicron and the sustained level of inflation in developed markets made us concerned that equity market record high valuations were at risk. We took advantage of strong equity markets and low volatility in Q4 2021 to hedge 50% of equity exposure. We purchased put options on the SPDR S&P 500 ETF with a strike 5% OTM and a maturity at 21/01/22. On the back of new policy easing in China, we adjusted the exposure to the region through the Quaero China Fund. Raising China exposure towards a total of 5%.

Our strategy going forward?

Equity markets have not experienced rising rates since the 2016-2018 period. While the first rate hike is not necessarily synonym of market crash, we have to remain cognisant of the risks embedded in an equity market which has printed double-digit performances for the last 3 years. Our strategy remains to be relatively more exposed to “value” regions (EM) and sectors (energy, materials, travel). As such portfolios are unlikely to see imminent shift in equity allocations. We will certainly shift towards “growth” stocks when the time is right in the next few quarters once interest rate hike expectations are starting to recede.

Fixed Income

What have we done?

We increased the allocation to emerging market fixed income and more specifically Asia though the Manulife Asia HY fund.

Our strategy going forward?

We are likely to keep credit exposures constant in portfolios throughout the quarter. The combination of rising Fed fund rates and historically low credit spreads does not bode well for this asset class. Should US 10y bond yields reach our target of 2.2%, then there will be an incentive to increase allocation to much-longer duration assets.

Commodities

What have we done?

We used the drawdown in commodity prices in Q4 2021 due to the strong performance of the USD to add to our exposure to commodities. We added 3% exposure to the iPath Bloomberg Commodity ETF. We also added selectively to gold and silver to reach a combined exposure of 7%. In addition, we have been positive on uranium since Q3 2021. We added exposure to the thematic either via straight uranium mining ETF purchases or via the sale of put options on the same underlying.

Our strategy going forward?

We are likely to keep commodities exposure constant in portfolios throughout the quarter.

Currencies

What have we done?

We had a bullish view on the USD for the best part of 2021. As the EUR/USD reached our target of 1.13, we decided to reduce USD exposure in EUR accounts to 10% (from 25% previously). We acknowledge that a retest of 1.10 is possible in the short-term. However, our long-term view of the EUR/USD at a target of 1.25 suggests the risk/reward asymmetry is in favour of the EUR at this stage.

Our strategy going forward?

We are likely to keep FX exposures constant in portfolios throughout the quarter.

Alternatives

What have we done?

Q4 2021 marked the launch of the MAM Pre-IPO Fund. We also issued certificates than enabled smaller investors unable to reach minimum investment levels to invest in the Io Macro Fund.

Our strategy going forward?

Our hedge funds’ exposure is unlikely to change meaningfully over the course of Q1 2022.

Events

Covid Pandemic

While the Omicron variant has led to an unprecedented spike in new cases across many countries, the economic fallout will be limited. The new variant has proven to be more contagious but significantly less lethal than previous ones. In South Africa, it blew through the population without triggering a major increase in mortality. Preliminary data suggests exposure to the variant confers at least partial immunity against delta.

The general tendency is for viral strains to become less lethal over time. Given that Omicron is crowding out more dangerous strains such as Delta, any future variant is likely to emanate from Omicron. Odds are this new variant will be even milder than the current ones.

At the same time, new antiviral drugs are starting to hit the market. Pfizer claims its new drug cuts the risk of hospitalization by ~90% if taken within 5 days from the onset of symptoms.

We expect peak worry around the pandemic to be in Q1 2022 and the following waves to have less of an impact. It should mark at least an interim phase of the pandemic where the virus concerns fades and hopes of a "return to normal" rise again.

FOMC Meetings

As we move to a post-pandemic world, investor focus will shift back to more traditional market cycles with the spotlight set to fall on the Fed and policy tightening over the coming months.

With the end of the taper and rate hikes coming this year, focus has turned to the outlook for balance sheet normalization. The Fed is likely to chart out a new playbook for balance sheet policy in the cycle. Key decisions for the FOMC will be around the policy specifics of how quickly the balance sheet could shrink.

The Fed will be hosting two FOMC meetings this quarter with the first one in January where we could expect an acceleration of the current monetary policy normalization meanwhile the second, in March, could kick off the first rate hike since 2018.

Russia Tensions

Geopolitical risk is becoming an important theme for 2022 after Russia stationed 100,000 troops on Ukraine's eastern border. In Moscow, the hope is for a "fairly quick result" while Washington talks of uncertain outcomes. US and Russian diplomats prepare for a summit in Geneva with Europe's geopolitical balance at stake, the difference in mood music is stark.

President Vladimir Putin has denied any plan to invade Ukraine. However, he warned of possible military action if the US and NATO ignore Moscow's demands for new defence agreements that would severely reduce US and NATO capabilities in Europe, which Russia claims are a threat to its borders.

The expectation of an agreement on new security arrangements between Moscow and the west are low. Any development in the conflict, notably on the negative end, is likely to sway markets. We view this as a big risk factor and will be watching this very closely. The impact on some commodities could be material.

China Tensions

Japan and Australia signed a landmark agreement last week to accelerate military co-operation between the two countries and respond to China's growing assertiveness in the Indo-Pacific. The treaty sets a legal framework to simplify administrative procedures for the entry of troops into each other's countries.

The sealing of the pact, which has been in the works for several years and agreed in principles in November 2020, demonstrates the efforts to enhance defence ties in the face of what analysts view as a rising threat from Beijing.

China claims sovereignty over almost the entire South China sea having rapidly built artificial islets with military infrastructure in the area while ratcheting up rhetoric and shows of strength against Taiwan.

These developments follows a series of joint exercise in October between the naval forces of Australia, Japan, India, and the US aimed at bolstering security co-operations.

The series of deals, military packs, and conflicts in the region will be a topic of interest into 2022. Geopolitical risk is becoming a more prominent theme in the current macro environment and something we most certainly need to bear in mind as investors.

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At the margin, political tensions or war might further exacerbate supply chain issues and put upward pressures on inflation. An early example of this could be uranium with the political unrest in the largest producing country, Kazakhstan. Then, fears of conflict in Russia could fuel more volatile EU natural gas prices.

Economics & Rates

Conclusion. Fed Policy Risk. Markets are now pricing in three rates hike in the US this year **(Chart 3)** with the first set to occur in the first half. This would be the first since 2018. Although it can be a source of equity market volatility, the initial is rarely a source of panic. When the previous rates hiking cycle began in 2016, equity markets suffered a 10% correction before rallying back. Inflation has now eclipsed Covid-19 as the number one source of concern to the population in the US. President Biden's popularity is sliding ahead of the midterm elections as the wealth divide continues to increase and the government has yet to successfully vote and implement the Build Back Better bill. Inflation is progressively becoming imbedded in wages, which is unlikely to change with the unemployment rate moving down towards the 3-4% range. As a result, risk is currently centred around a Fed policy mistake such as the central bank overdelivering on the monetary policy tightening front relative to market expectations. A key risk in the first half of this year would be US Treasuries 10-Year bonds rising towards 2.2% **(Chart 4)**, a feasible path from a technical perspective.

Although much has happened in the last quarter, the core story of decent growth but tighter policy remains in place. Last week's hawkish Fed minutes reinforced the idea that policy support is reversing. Global GDP became less sensitive to each subsequent pandemic wave, arguably from a mix of higher vaccination rates, greater knowledge on treating the virus, better consumer and business comfort in managing it, and a declining government appetite for new restrictive measures.

Ultimately, the Fed policy normalization timeline hinges on the inflationary dynamics. Upside inflation surprises would prompt the Fed to withdraw accommodation more aggressively with a first rate hike potentially occurring as early as March 2022.

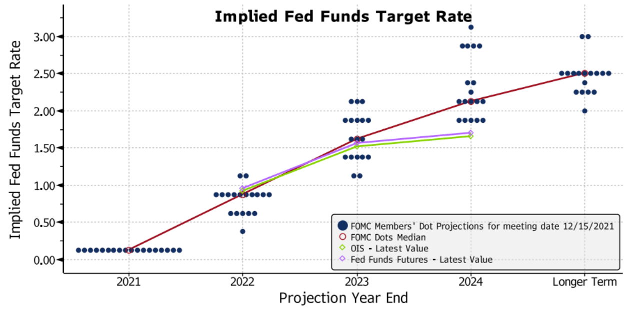
Inflation is shaped by feedback loops. If workers expect prices to increase, they will demand higher wages. In order to protect margins, firms will raise prices, thereby validating the workers' expectations of higher prices. We continue to believe in sticky inflation from higher wage expectations in an relatively tight job market. Unemployment rate projections show an even tighter market by year-end (3.5%), at or near full-employment. In the US, hourly earnings growth has already picked up substantially and trending at an above trend pace even after accounting for base effects **(Chart 5)**.

The December 2021 FOMC minutes made it explicit the Fed is considering quantitative tightening as a way to steepen the yield curve. In light of the remarks, we will use the yield curve to see if the monetary policy is too tight, which could warrant a policy pivot because a recession risk could be nearing. A steeper curve implies easier policy while a flatter curve implies tighter policy.

In Europe, the policy mix is no longer "all in". The ECB and BoE are keen to normalize, although timelines vary, thereby creating noise rather than calm from now. Inflation in the region will play a big role in how far their intention can go. After adjusting for bottlenecks and energy, the medium-term inflation outlook will be more benign in Europe. Headline and core inflation closer to 1.5% than 2% again in late 2022-2023 means the ECB is unlikely to end QE this year and hike next. Furthermore, there is room for some political noise. The outcome of the Italian and French presidential elections in January and April, respectively, matters, notably for the prospect of the EU fiscal rule reform.

China is a region of focus in 2022. PMIs firmed up further on domestic orders while services also held up despite the Xi'an lockdown. Pro-growth measures are in to support infrastructure capex. A credit growth **(Chart 6)** and economic rebound in the region in 2022 would be supportive to EM and commodities.

Chart 3. Implied Fed Funds Target Rate

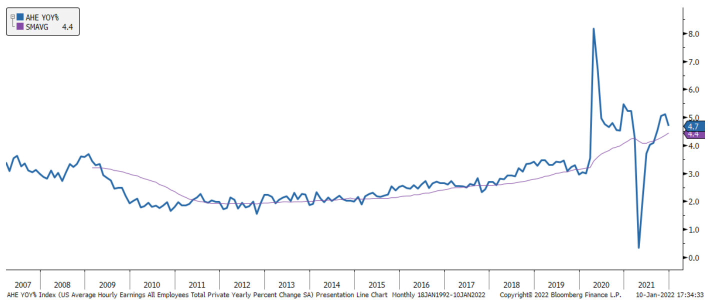


Source. Bloomberg, MAM Research

Chart 4. US 10-Year Bond Yields (Monthly)

Source. MAM Research, Bloomberg

Chart 5. Average US Hourly Earnings YoY and 24-Month SMA



Source. BCA Research, Fed NY, CBO, Fed

Chart 6. China Credit Growth Bottoming

Source. MAM Research, Bloomberg

Credit

Conclusion. Bearish DM, Looking for relative value in EM. Prospects of tighter US monetary policy and extended valuations all point to a period of near-term volatility. We call for spreads to widen modestly. The little carry one could earn would quickly be offset by spread expansions. The succession of lower lows and lower highs on the major US investment grade and high yield ETFs confirms this bearish view. Only a change in Fed tone in relation to the speed of monetary policy normalisation can change our bearish view on DM credit. This can only happen should inflation recede and economic growth worsen. This is not the case today. We continue to like emerging market corporate credit per their relative value characteristics and the upside support from favourable medium-to-long term economic growth differentials and currency strength. Following our deep dive on China, we invested in an Asia focused bond fond in order to gain exposure to a tightening of China High Yield spreads. Elsewhere, we look once again at real asset opportunities especially in real estate.

The December FOMC meeting minutes showed a stronger shift in tone at the Fed with chair Powell turning more hawkish as substantial further progress towards its inflation and unemployment goals have been met. As the market is pricing overly tight financial conditions, we expect the Fed to tiptoe around in terms of language at the January 26th meeting. Nonetheless, the path of least resistance is higher interest rates. This is being reflected in long-term bond yields with US 10yr bond yields approaching 1.8%. As discussed in the previous section, our target for US 10yr bond yields is 2.2% (**Chart 7**).

We continue to expect the coming monetary policy tightening to have a substantial impact on credit markets. The risk-reward in credit is unattractive. Moderating growth, less easy monetary policy, and higher bond yields are characteristics of a mid-cycle environment, a phase which we highlighted a few months ago. Concerns over peak growth and tighter policy could translate in volatility for risk assets. US high yield spreads **(Chart 8)** are barely higher than all time lows reached in 2014 and 2021. The market is still priced for perfection. We do not anticipate changing our bearish view on credit until long-term bond yields find a cycle top (potentially 2.2% on US 10yr bond yields) or spreads move materially higher from current levels.

EM credit still offers attractive value with a measured level of risk **(Chart 9)**. Central banks in the regions are already half way through their rates hiking cycles to contain inflation while local economic growth is improving. In turn, improving growth differentials will prove supportive to currencies, a positive for local currency bonds. Although the real estate crisis put a strain on Chinese markets, the event is no longer seen as a high risk to markets. The Huarong (an IG issuer in distress) crisis was effectively resolved, which showed China's ability to manage the spill over risks. We recently invested in Asia HY bond funds in order to express this view.

We also look for real estate projects. Real estate investments are well-suited investment during inflationary times per their relatively low correlation to other financial asset.

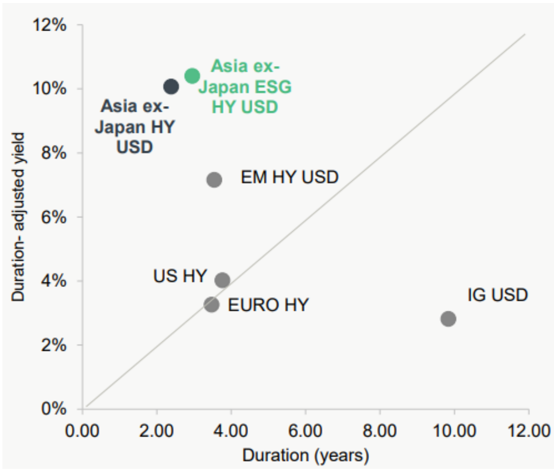
Chart 7. US 10-Year Sovereign Bond Yield (Monthly)

Source. MAM Research, Bloomberg

Chart 8. US HY Credit Spreads (Weekly)

Source. MAM Research, Bloomberg

Chart 9. US IG & HY Spread Per Unit of leverage



Source. Tabula

Currencies

Conclusion. Dollar peak nearing. 2022 will be a year of global monetary policy normalization with a growing number of central banks rolling back on their accommodative monetary policies and contemplating the prospect of tighter policies. Investor consensus starts the year with a relatively more favourable outlook on the dollar. However, it may be proven wrong. We see a little bit more dollar strength but believe we are closer to the end than the beginning. It appears the Fed is gearing up to hike rates very soon, typically a toping process for the greenback. The dollar has stopped responding to a rise in yields over the past couple weeks. The falling yield curve highlights the risk of slower growth, a driver of potential dollar weakness. We expect the euro downside to be around 1.10 before seeing a potential rally towards 1.25. We remain bullish emerging market currencies based on valuations, to the exception of the Chinese Renminbi. We expect CNH to depreciate into 2022 on the back of policy easing the region. Elsewhere, we are carefully watching the Turkish Lira for a potential asset trade post-crisis.

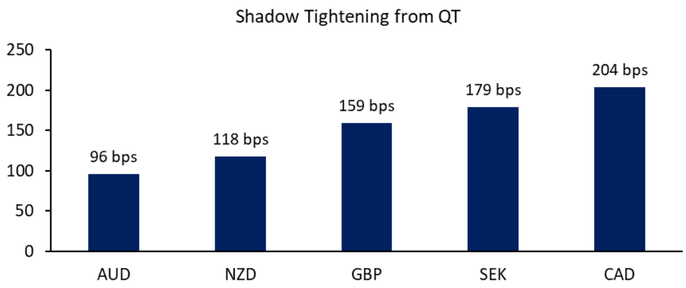
As stated, 2022 will be a year of monetary policy normalization. The BoE, BoC, Riskbank, RBA, and RBNZ may all begin reducing their balance sheets at some point this year with the balance sheet run down across these central banks potentially having the equivalent tightening effect of 100-200bps **(Chart 10)** rate hikes over the coming 4 years. Given a meaningful amount of hiking is priced in for these central banks, investors should pay extra attention to how these banks deal with their balance sheets, as more quantitative tightening may end up making the hawkish (rates) market pricing look overly optimistic.

We keep a slight bullish bias in favour of the dollar near-term, particularly against low yielders (i.e., EUR, JPY). The Fed minutes last week conveyed a hawkish tone and implied that both rate hikes and balance sheet normalization might be both earlier and faster than previously anticipated. This raises the prospect of continued focus on the policy divergence between the Fed and other major central banks, the former evidently normalizing far faster than the latter. Our conviction is not as high as it was in mid-2021 given that positioning and sentiment largely bearish dollar then **(Chart 11)**. Moreover, risks are rising around the Fed policy, particularly if inflation rolls over and the labour force participation picks up. We are not ready to call the peak on a stronger dollar just yet, but are getting closer to that point.

We are expecting the maximum downside on the EUR vs. USD to be near 1.10 **(Chart 12)**. Our view is mainly driven by the dollar leg with the increasingly more hawkish Fed pushing real yields higher, which remains supportive to the greenback. The policy divergence will remain in the driver's seat. On the euro front, the ECB is gradually turning more hawkish, but remains less so than the Fed. The next opportunity for a further hawkish shift from the ECB is also likely to be some time away in March, when new economic forecasts are available. It is when we see the euro beginning to rally back towards 1.25. The asymmetry suggests it is best to play the dollar downside from here on out.

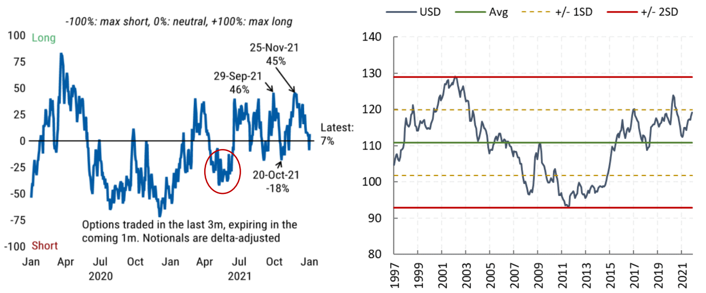
We remain relatively bullish on EM FX **(Chart 13)** on the back of cheap valuations (excl. CNH). In the first part of the last US rates hike cycle (2015-2016), emerging market currencies rallied by more than 12% against the dollar so a tightening in the US can be supportive. Several emerging markets also happen to look particularly attractive on a real effective exchange rate (REER) basis. The Mexican Peso still trades 1 standard deviation cheap and the Brazilian Real is more than 1.5 SD below mean, just to name a few. Elsewhere, we are contemplating a potential asset trade in Turkey and the Lira post-crisis.

Chart 10. QT generate in bps of rate hike-equivalent terms



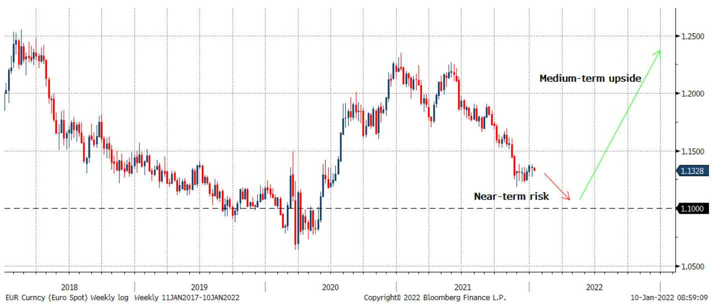
Source. MS Research, Bloomberg

Chart 11. Dollar Positioning (LHS) DXY Real Exchange Rate (RHS)



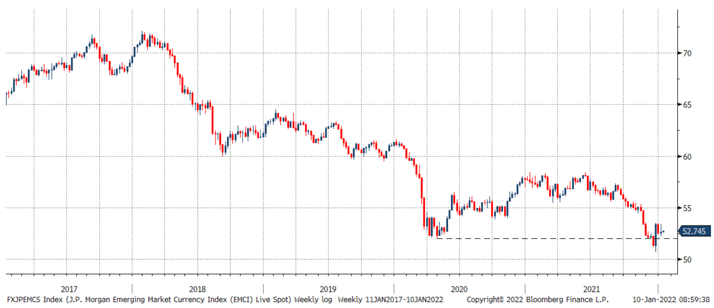
Source. MAM Research, Bloomberg

Chart 12. Euro Currency Spot (Weekly)



Source. MAM Research, Bloomberg

Chart 13. JP Morgan Emerging Market FX Index (Weekly)



Source. MAM Research, Bloomberg

Equities

Conclusion. Careful. There is absolutely no debate amongst investors that valuations are expensive. Although they are a poor timing tool, the probabilities of positive future returns over a 12-24 month horizon are working against investors at this stage in the cycle. We expect a two-tone year with value outperforming during the more hawkish Fed and strong growth period. The key risk will be for a Fed policy mistake (goes too far). Then, economic sensitive assets would start underperforming. Investors would need to switch the allocation to growth assets. Active exposure to the right factors is key in 2022. Tightening cycles imply higher market volatility. We expect to see significant dispersion amid muted index-level gains with 4-5% EPS growth and mild P/E de- or re-rating. However, the post-pandemic environment means it could be the year for EM to play catch-up with DM driven by a Chinese growth recovery in a local policy easing environment. We see travel stocks rebounding from relatively low levels. Style-wise, favour value and defensive over large cap growth in the first half. Structurally, mid-cap high growth stocks are starting look appealing. Specifically, focus on the clean tech sector. Elsewhere, we are monitoring Turkey as a potential investment candidate in a post-local crisis environment.

Value and small caps significantly lagged market indices in 2021 as capital crowded into large cap "quality growth". Reversion to the mean **(Chart 14)** may be a persistent theme this year. Value stocks like basic materials, industrials, and commodity-driven names could notably outperform. Sector-wise, we particularly like energy. It is a prime candidate to benefit from a Fed pivot, a weaker US Dollar, a Chinese stimulus, and broad mobility trend improvements. *Please refer to the following section for greater details on our bullish energy-stocks and commodity call*.

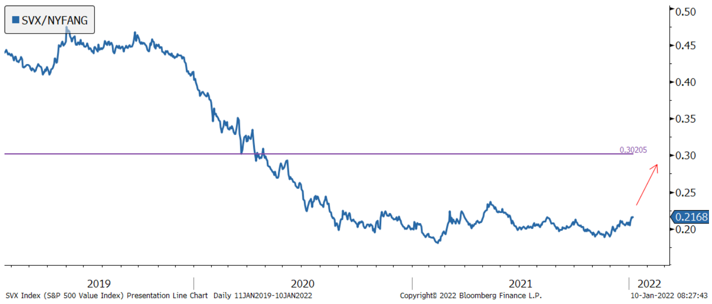
Considering yields have the technical and fundamental capacity to move towards or above 2.2%, we are cautious on crowded growth trades. Retail participation in this bull market increased margin debt and a correction in stocks could have a snowball effect. The interest rate tantrum back in 2018 precipitated the Nasdaq lower by 22%, up until the Fed changed its tune. A 20% correction would push the index down to 13,260 **(Chart 15)**, or a level last seen in mid-2021. We are cautious of the possibility for a 20% drop in major indices in the first half of the year.

Aside from our commodity trade, we continue to lean defensive amid tighter Fed policy. Leading indicators point to decelerating PMIs in the coming months. This dynamic should be supportive of a defensive outperformance relative to cyclicals. Healthcare, REITS, and staples tend to be top performers within defensives in a decelerating but elevated PMI regime. Healthcare and REITs also tend to meaningfully outperform in the first year of a Fed tightening cycle (only sectors with two-digit returns) **(Chart 16)**.

While we continue to favour defensive and commodity stocks, we recommend implementing a barbell strategy with equities severely hit last year but offering good prospects at reasonable valuations. Green transition beneficiaries substantially de-rated and are set to benefit from secular tailwinds in 2022. Then, we are adding biotech **(Chart 17)** to our list of investments because of recent de-ratings and the relative performance.

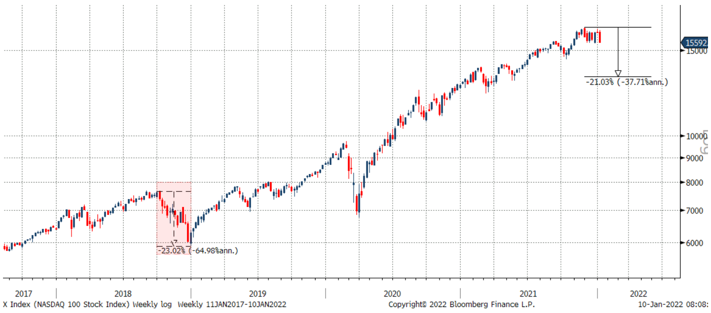
Our current sector style tends to favour non-US equities in early 2022 with increasing capital spending in developed economies and an incremental Chinese stimulus set to boost industrial stocks and other deep cyclicals. Europe and EM both have a relatively strong dependency to China economic growth. After a deceleration in 2021, China's credit growth is bottoming out. Chinese coal prices collapsed since the government instructed over 170 mines to expand capacity. China generates 63% of its electricity from coal. Lower energy prices and policy easy will support local industrial activity, onshore equities, and EMs.

Chart 14. S&P Value vs. FANG+ Index (Daily)



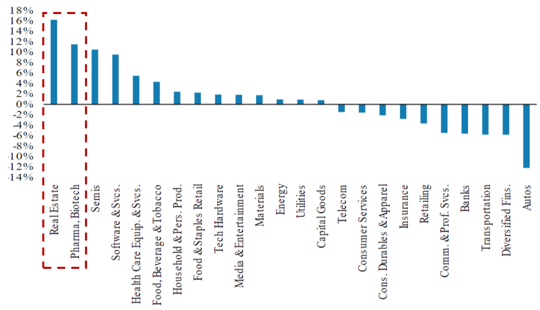
Source. MAM Research, Bloomberg

Chart 15. Nasdaq 100 Index (Weekly)



Source. MAM Research, Bloomberg

Chart 16. Sector Performance in Year 1 of Fed Tightening Cycle



Source. MS Research, Bloomberg

Chart 17. Biotech vs. S&P

Source. BCA Research, MSCI

Commodities

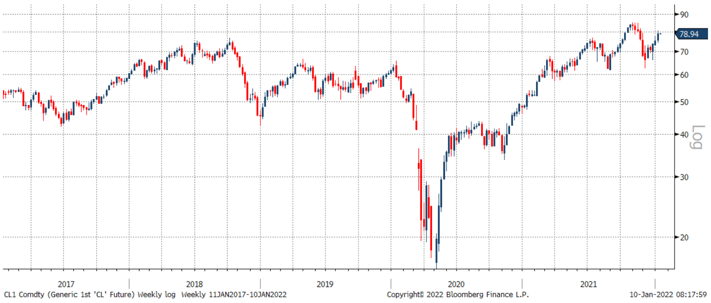
Conclusion. Bullish Fundamentals. Under-investments in commodities and ongoing energy transition needs imply supply and demand dynamics did not changed from last year. A weaker dollar in H2 2022 paired with a China growth comeback should push commodity markets higher. After operating costs bottomed in 2020, cost inflation has returned with a vengeance in heavily interconnected and circular commodity markets. Operating cost inflation ranged from 10% to 30% year-over-year for the key metals last year. This mostly reflected rising energy, freight, labour, and raw material costs. Although surging energy prices could well be transitory, there remains structural ESG-driven elements driving cost inflation, lifting cost curves and price support across the board. Sustaining capex is gradually rising, as miners are catching up with deferred maintenance from lockdowns, and decarbonization-related investment costs are increasing too. Strong market dynamics are supporting higher uranium prices for 2022 while precious metals should perform better than in 2021. The risk to our thesis would be a Fed induced recession in 2022, but we are not there yet.

Oil prices rose by 50%+ last year **(Chart 18)**, making 2021 one of its strongest years in recent history. However, we see further strength ahead. Though balances look softer in H1 2022, the oil market could observe a triple-deficit in H2 2022 **(Chart 19)**. (1) Investments are under pressure and unlikely to rebound. Of all spending categories, exploration was particularly hard-hit. Last year, the number of exploration wells completed dropped 27% and global discoveries fell to a 20+ year low. (2) Spare capacity is likely to fall below 2 mb/d by H2 2022. OPEC+ spare capacity already fell from 6.6 mb/d at the start of 2021 to 3.4 mb/d by November. From here, production should increase by 250 kb/d per month in H1 before flatlining in H2. It is far slower than the 400 kb/d monthly quota increase OPEC+ agreed upon. (3) Inventories are already low and draws may resume by H2. Observable inventories dropped by 690 mb in 2021, a rate of decline of 1.9 mb/d and are now at a 5+ year low. With a constructive demand and relatively cautious expectations for OPEC+ supply, 2022 inventories could end up lower. With prospects of low inventories and spare capacity by H2, further demand recovery in 2023, and limited investments being made, the oil market is heading for a period with little margin of safety. As such, prices will need to rise to levels where some demand erosion takes place, such as $85-90/bbl, or even $100/bbl.

After pushing the theme relatively early last year, uranium still is a sector of interest. The geopolitical tensions in Kazakhstan are of the utmost importance. The country is home to 44% of the global mine supply **(Chart 20)**. Kazatomprom is the world's leading and lowest cost uranium supplier. With most of its operations quite isolated in the south of the country, the company told Reuters there has been no stoppages and it is fulfilling its exports contracts. Kazakhstan's uranium is mined by in situ recovery, a less labour intensive process vs conventional mining. However, the country's uranium output fell by 15% in 2020 due to Covid restrictions, highlighting the operations' sensitivity to logistics disruptions. There is limited spare uranium mining capacity able to come online elsewhere on short notice to offset any potential disruptions in the region.

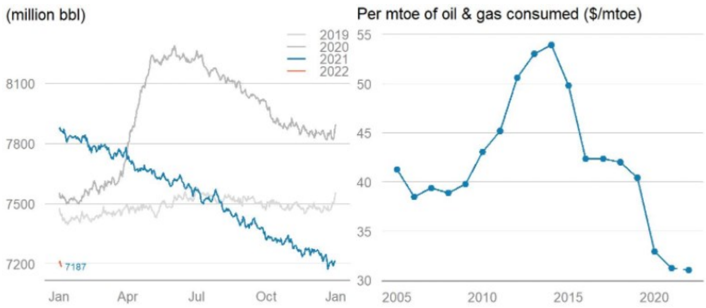
Gold has been a function of US rates **(Chart 21)**. Rising inflation was bearish through rising nominal rates in 2021. However, central banks may ultimately face limits as to how high rates will increase, which should attract buyers in the precious metal. A weaker US dollar and Fed policy risks make this a good hedge. Silver markets rebalanced on production discipline and demand for new applications. If more spending on solar panels come through, silver prices should rally above $30/oz.

Chart 18. Crude Oil Prices (Weekly)



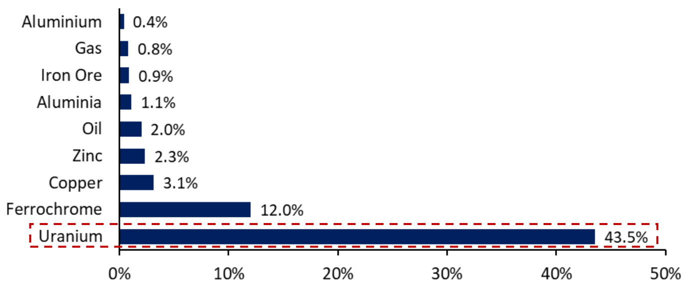
Source. MAM Research, Bloomberg

Chart 19. Observable Oil Inventory (LHS) Real-Term Capex (RHS)



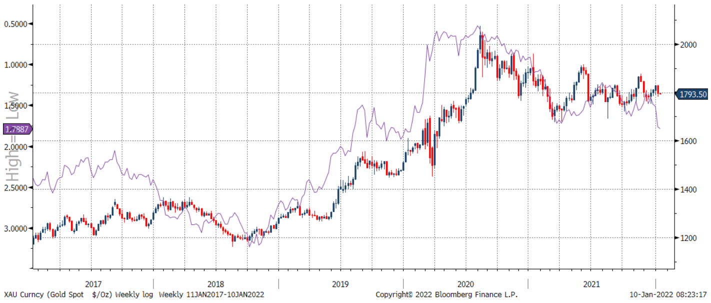
Source. IEA, EIA/DOE, PJK, IE, PAJ, Kpler, BP, HIS, Rystad, MS Research

Chart 20. Kazakhstan %-Share of Global Production



Source. MAM Research, Bloomberg

Chart 21. Gold vs. US 10-Year Nominal Yields (Weekly)



Source. MAM Research, Bloomberg

Private Equity Investments

Conclusion. Bullish. Q4 2021 marked the first close of the MAM Pre-IPO Fund. The fund completes a private market offering that MAM has been working on for the best part of 2 years and sets it apart from its peers. We continue to believe that investing with an horizon of 2-3 years in private leading technology firms is a sound strategy. That said, discipline in valuation is paramount. The high growth technology sector has seen a significant de-rating in 2021. While we believe this de-rating to be mostly complete, there is no sign of a bottom yet. The illiquidity discount due to shares being private has been extremely valuable as we explain in more details in the note below. We will continue to act cautiously in our due diligence process and invest in transformational companies.

*Please find below a brief update on some of the recent pre-IPO investments **(Table 1)**.*

Table 1. MAM Pre-IPO/Early Stage Investments

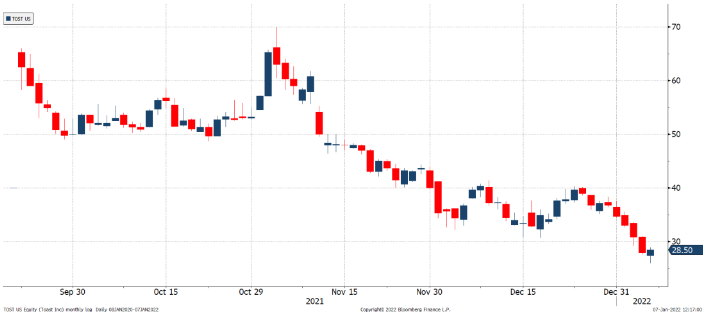
Company Name	Part of MAM Pre-IPO Fund	Sector	Transaction Type	Transaction Date	Transaction Price	Liquidity Event Type	Event Date	Current Price	Performance (ITD)	Gross MOIC	Lock-Up
Palantir	No	Software	Pre-IPO	3-Mar-2020	4.65	IPO (Direct Listing)	24-Sep-2020	16.74	260.0%	3.6x	Expired
QuantumScape	No	Auto Components	Pre-IPO	18-Aug-2020	6.57	SPAC Merger	30-Nov-2020	20.75	215.8%	3.2x	Expired
Company 1	No	Materials	Conv. Note	25-Sep-2020	3.82	-	-	-	-	-	
Company 2	No	Digital Marketing	Pre-IPO	1-Nov-2020	3.91	-	-	-	-	-	
UiPath	No	Software	Pre-IPO	18-Dec-2020	44.45	IPO (Direct Listing)	20-Apr-2021	39.61	-10.9%	0.9x	Expired
Toast	No	Software	Pre-IPO	10-Mar-2021	26.00	IPO (Direct Listing)	21-Sep-2021	28.50	9.6%	1.1x	Live
Company 3	No	Biotechnology	Early Stage	2-Apr-2021	10.00	-	-	-	-	-	
Company 4	No	Software	Pre-IPO	7-May-2021	10.00	-	-	-	-	-	
Company 5	No	Software	Early Stage	3-Jun-2021	10.00						
Company 6	No	Software	Pre-IPO	6-Jun-2021	30.30	-	-	-	-	-	
Company 7	No	Consumer Staple	Early Stage	15-Jun-2021	10.00	-	-	-	-	-	
Company 8	No	Software	Pre-IPO	8-Oct-2021	10.00	-	-	-	-	-	
Company 9	Yes	Consumer Staple	Early Stage	15-Oct-2021	10.00	-	-	-	-	-	
Company 6	Yes	Software	Pre-IPO	6-Jun-2021	28.50	-	-	-	-	-	

Source. MAM Research

The pipeline of prospective private market transactions is solid. Weakness in certain areas of the equity market has yet to slow down the influx of opportunities. We may see a temporary lull in H1 2022 as investors take the time to digest the record amount of transactions executed in 2021. This will allow MAM to focus on the 14 pre-IPOs performed so far and on the disciplined deployment of capital in the pre-IPO fund.

Our investment in Toast, the leading end-to-end restaurant management platform, is a good example of the value of the illiquidity discount offered in pre-IPOs and the importance of choosing quality companies. Toast is growing revenues at over 100% CAGR. In listed markets, this level of growth would have commanded an EV/Revenues multiple of close to 60x. The illiquidity discount meant that we entered the company at a valuation of 30x (-50%). Combined with the fact that Toast has been beating revenue expectations each quarter, it means that we had an entry valuation "cushion" that provided some comfort. Our purchase price was $26/share in February 2021. The IPO only 6 months later was priced at $40/share. The stock initially rose to a high of $70/share as broker initiations confirmed the positive outlook on the company. Then, the combination of a significant de-rating in high growth companies and the prospect of share lock-ups expiring have pushed the stock –60% from the highs to $28.50/share. Despite this sell-off in the stock, it is still trading above our purchase price less than a year ago. We hope to emulate this conservative approach in investing in other transactions. At current price, Toast is trading on a 2022E EV/Revenue multiple of 5.7x. This is much lower than Oracle's 6.7x multiple while Toast has revenue growth 10x larger than Oracle. We strongly believe the current price of Toast **(Chart 22)** is a short-term anomaly. We maintain a price target of $60/share (suggesting a potential 110% upside).

Chart 22. Toast Spot Price (Daily)



Source. Bloomberg, MAM Research

The MAM Pre-IPO fund commenced operations in November 2021. Since then, we have performed 2 investments. The first investment was in the leading microbial fermentation platform recreating the egg outside the chicken. By leveraging its industry-leading technology and platform, the company can synthesize pure protein and molecules found in the egg that cannot be economically harvested otherwise. An IPO is expected in 2024. The second investment was in a leading platform for Enterprise Artificial Intelligence (AI). We had already invested in the company in June 2021. The Fund had the opportunity to invest at a similar valuation. We will publish a Q1 2022 trading update for the fund to provide further details.

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