MAM

MONACO ASSET MANAGEMENT

Investment Outlook

Q4 2021

Executive Summary

- **Slowing growth and stubbornly high inflation.** The Fed is cornered. The September 2021 FOMC meeting suggested the Fed will start tapering soon. This is happening at a time when credit impulses globally are 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 1.8-2.0% in Q4 2021.

- **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 is still in play.** Structurally, the environment is neutral for the USD. Yet, the greenback's rally shows signs of continued strength technically. We expect our target for the EUR/USD of 1.14 to be met in Q4 2021.

- **Downgrading 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.

- A short-term rally in the USD could exert **pressure on commodity prices in the short-term**. We look for a 5% correction on Broad Commodities Indices to add back exposure to this asset class. 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.

Investment Stance Overview

While we have certainly turned a page with regards to the Covid pandemic, the world economy is facing other challenges. China, which has been a cornerstone of global growth for decades is slowing substantially, as evidenced by the failure of Evergrande. Inflation, which many have characterised as "transitory" is proving a lot more resilient and likely to remain elevated for a prolonged period; our central thesis all year. The failure to agree on the US infrastructure plan, prospects of a potential US fiscal cliff and uncertainty with regards to the leadership of the Fed all add up to current challenges. Prospects of 1970's style stagflation are rising. Central Bankers are walking a fine line. Signs that tapering could push the global economy to a halt may have drastic consequences on financial markets. It is a good time to be cautious about equity and corporate credit allocations as both asset classes trade at all-time high valuations. This is the reason why we have downgraded our view on Equities to Neutral. We remain bearish sovereign and corporate bonds. The main areas of focus for us remains commodities and alternatives. In commodities, we believe the time is ripe for precious metals to start performing again, particularly silver. In alternatives, we continue to favour allocations to de-correlated strategies and pre-IPOs which so far have proven a great value add to portfolios.

	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						**BULLISH USD**	-
USD							-
EUR							-
EM							-
JPY							-
GBP							-
EQUITIES						**NEUTRAL**	-
US							↘
Europe							-
UK							↘
Japan							↘
Emerging Markets							-
COMMODITIES						**NEUTRAL**	-
Energy							-
Precious Metals							-
Agriculture & Livestock							-
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 Q4 2021. Considering the volatile nature of financials markets and our outlook, their compositions 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	1.16	-0.8%	0.2%	-5.0%	Bearish	5.0%
USD	93.98	0.6%	-0.3%	4.5%	Bullish	95.0%
Equities						**35.0%**
Developped Markets	**67.02**	**-2.6%**	**0.3%**	**8.7%**	Neutral	**24.9%**
Europe	451.82	-2.3%	-0.7%	13.5%	Bullish	7.5%
North America	4,357.04	-2.2%	1.1%	16.0%	Neutral	13.7%
Great Britain	7,019.05	-0.6%	-1.0%	8.6%	Neutral	1.2%
Asia Pacific	28,444.89	-5.9%	-3.4%	3.6%	Neutral	2.5%
Emerging Markets	**1,246.60**	**-1.6%**	**-0.5%**	**-3.5%**	Bullish	**7.0%**
Asia Pacific	697.05	-1.6%	-0.9%	-2.3%	Bullish	4.6%
EMEA	283.92	0.8%	0.0%	17.7%	Bullish	1.7%
South America	2,261.74	-1.5%	1.5%	-7.8%	Bullish	0.7%
Thematic						**3.1%**
Asset Allocation	35.85	-0.7%	0.4%	5.0%	Bullish	3.1%
Fixed Income						**12.0%**
Europe						**0.0%**
Sovereign	222.02	0.0%	0.1%	-1.0%	Bearish	0.0%
Investment Grade	250.39	-0.2%	0.2%	-2.1%	Bearish	0.0%
High Yield	437.57	-0.4%	-0.1%	4.1%	Bearish	0.0%
North America						**0.0%**
Sovereign/Tips	2,749.42	-0.1%	0.3%	-1.6%	Neutral	0.0%
Investment Grade	3,529.28	-0.3%	0.4%	-0.9%	Bearish	0.0%
High Yield	2,444.11	-0.3%	0.0%	4.5%	Bearish	0.0%
Emerging Markets						**5.6%**
Local Currency	413.99	-0.5%	0.0%	-2.2%	Bullish	5.6%
Hard Currency	1,273.98	-0.4%	0.0%	-1.1%	Neutral	0.0%
Others						**6.4%**
Convertible	993.44	-0.5%	-0.5%	3.3%	Bearish	0.0%
Trade Finance	110.08	-0.1%	-0.1%	-0.4%	Bearish	0.0%
Broad Funds	537.63	-0.4%	0.3%	-3.8%	Bullish	6.4%
Commodities		**0.2%**	**0.3%**	**29.5%**		**6.0%**
Agriculture	87.96	0.7%	0.4%	17.7%	Neutral	0.0%
Energy	35.47	0.7%	-0.2%	74.6%	Neutral	0.0%
Industrials	161.22	-2.0%	1.3%	21.5%	Neutral	0.0%
Precious Metals	210.77	0.0%	0.4%	-9.7%	Bullish	6.0%
Alternatives						**25.0%**
Hedge Funds	1,429.88	-0.5%	-0.4%	3.6%	Bullish	15.0%
PE/Real Assets	2,009.81	-0.9%	0.7%	13.1%	Bullish	5.0%
Pre-IPOs	712.44	-2.3%	0.4%	10.2%	Bullish	5.0%
Cash						**22.0%**

Source. MAM Research, Bloomberg

EUR Based Portfolios

Asset Class	Last Price	Perf. 5D	Perf. MTD	Perf. YTD	MAM Outlook	Asset Allocation
Currencies						
Portfolio Bases						**100.0%**
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Equities						**35.0%**
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Source. MAM Research, Bloomberg

Asset Class Returns

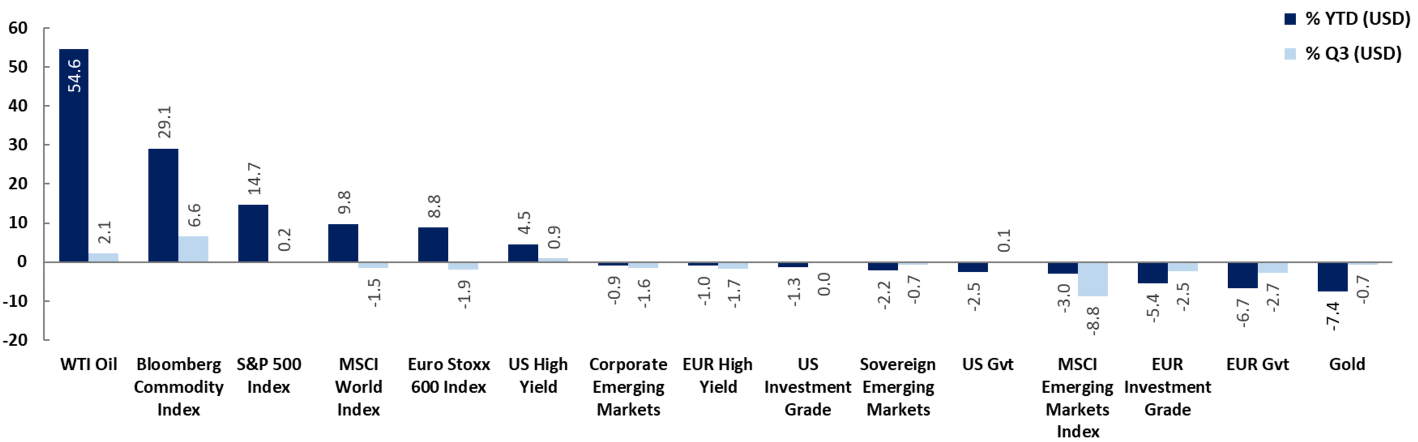
Global equities were down 1.5% in Q3, up 9.8% YTD (in USD-terms). US equities were the best performing and sole positive region with the S&P 500 index rising 0.2%, up 14.7% YTD (in USD-terms). Cyclicals and value suffered some weakness over the summer as yields initially edged lower before moving within a tight range. European equities gave back their earlier gains to close down 1.9%, but remaining up 14.0% YTD (in EUR-terms). Emerging Market risk assets were the strong underperformers down 8.8%, also turning negative for the year at -3.0% YTD (in USD-terms). The key negative contributor in the region has been falling Chinese equity prices following the crackdown on *de facto* monoploidies and credit tightening measures putting a strain on the property sector.

Corporate bonds were relatively unchanged over the summer, before giving back most of their gains accumulated since mid-March. The September FOMC meeting was the key catalyst as it marked the change in tone at the Fed. Powell turned hawkish, announcing the beginning of the tapering cycle in coming months. However, the Fed continues to emphasize two points in its communications: (1) the difference between tapering and tightening, and (2) the end of the tapering cycle does not imply an immediate hike in rates. US Sovereign bonds were up a mere 10bps. US Corporates were flat. US HY were up 0.9%. In Europe, the picture was fairly similar.

The dollar marginally appreciated with the DXY up 1.9%. Two factors can primarily explain the strength: (1) the change in tone at the Fed when the ECB and other developed markets central banks are likely to remain accommodative for longer (notably the ECB), and (2) a rising GDP growth rate differential between the US and the rest world.

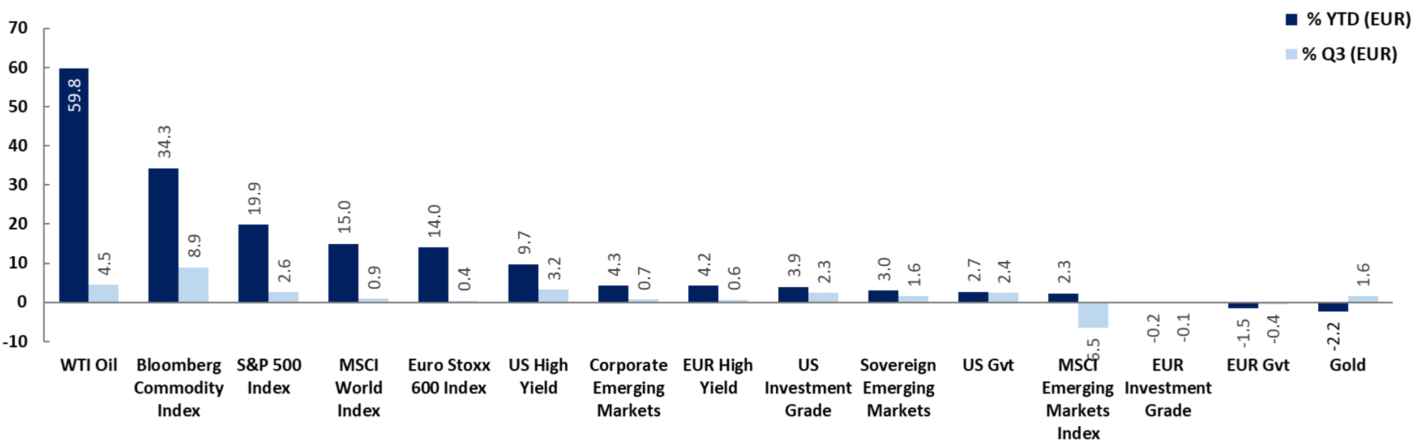
Slower economic growth, China's lower credit growth and economic slowdown, and a persistently tight supply chain weighted on industrial commodities. Precious metals continued to show weakness as the USD strengthened with gold down 0.7% (in USD-terms). Energy prices surged, notably natural gas driven by a surge in post-pandemic consumption and cold weather outlooks for the winter. Crude oil was up a more reasonable 2.1%, up 54.6% YTD (in USD-terms) driven by the continued economic reopening and pick up in mobility data gross the globe.

Chart 1. Asset Class Returns Q3 2021 vs. YTD (USD Base)



Source. MAM Research, Bloomberg.

Chart 2. Asset Class Returns Q3 2021 vs. YTD (EUR Base)



Source. MAM Research, Bloomberg.

MAM Actions

Equities

What have we done?

We took advantage of strong equity markets since the start of the year and bought Put Spreads on US and European indices to protect the performance of portfolios ahead of the more volatile period of August/September. We also sold the tactical long positions in the Nasdaq 100 ETF we had purchased in Q2 2021. The intention was to protect portfolios against a potential draw-down in Q3 and early Q4. In hindsight it was maybe early but the correct decision. Our conviction with regards to the Oil & Gas sector kept increasing over time. We increased portfolios' exposure to this thematic through ETFs and single stocks. Finally, we turned extremely bullish on Uranium as an essential source of energy. We took advantage of higher volatility to sell puts on the Uranium producers ETF.

Our strategy going forward?

Equity market exposure is unlikely to change meaningfully in Q3 2021. We have a neutral stance on equities as we fail to see a compelling risk-reward at current levels. Should equity markets drop further (-10% from all time highs) we will use the volatility to sell put options on indices and stocks; a strategy that has worked well previously.

Fixed Income

What have we done?

We have kept our underweight credit constant throughout the quarter. Exposure to China real estate credit was limited in the BlueBay EM Unconstrained Bond Fund. As such, we didn't see the need to divest.

Our strategy going forward?

Our underweight credit is unlikely to change at all in Q3 2021. However, Chinese High Yield bonds are looking increasingly attractive post the September sell-off. We are relatively bullish about Chinese assets overall. We are hunting for the right opportunities and timing.

Commodities

What have we done?

Our allocation to precious metals has not changed throughout the quarter.

Our strategy going forward?

We are likely to re-enter our Long positions in the iPath Bloomberg Commodities ETF at $25.3/share (-5%).

Currencies

What have we done?

We have raised USD exposure in EUR accounts to 20%. This is a useful hedge considering our portfolios are heavily invested in "USD-bearish" thematic (Oil & Gas, Emerging Markets, Precious Metals…).

Our strategy going forward?

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

Alternatives

What have we done?

We have increased exposure to pre-IPO opportunities (please see the last section of the Outlook for further details).

Our strategy going forward?

Our hedge funds' exposure is unlikely to change meaningfully over the course of Q4 2021.

Events

Fed Chair Powell's Re-Election

Prospects of a second term as Chair of the US Federal Reserve for Jay Powell took a hit after growing backlash from the Democratic party's left flank as President Joe Biden nears a decision on the central bank's leadership. Powell received a public lashing recently after two regional Fed Bank presidents resigned following revelations about controversial trading practices, putting a harsh spotlight on the central bank's ethics guidelines.

The Fed's indication to move relatively more quickly on its monetary policy tightening agenda last week ignited nervousness among some of the Democrats regarding Powell's commitment to aggressively pursuing full employment. A couple months ago, chances of Powell staying at the helm of the Fed after his term expires in February 2022 were bright.

The White House has remained quiet about Biden's intentions so far, but a decision is expected soon. Trump tapped Powell for his first term in early November 2017. Obama announced Bernanke in August 2009. Yellen's nomination was in early October 2013. Our take is for an announcement to be made in the coming weeks.

Although we do not aim to predict who the next chair will be, Powell continues to hold the highest chances. He is one of the most bipartisan nominees. Alternatively, Lael Brainard is often mentioned as a possible replacement. Lisa Cook and William Spriggs are the two other names being floated around recently. What works well in favour of Powell at the moment is the need for continuity. The market does not need the uncertainty brought by a leadership change at a sensitive moment for the economy and Fed.

Biden's $3.5Tn Plan & US Fiscal Cliff

The Biden administration and congressional Democrats have been locked in tense negotiations over the last few weeks to pass the president's sweeping legislative agenda. The clock is ticking. Numerous meetings have been held at the White House for crunch talks on the eve of what is expect to be a series of make-or-break votes for the president's party.

At risk are two separate pieces of legislation that Biden has stake his presidency on. First, a $1.2tn bipartisan infrastructure bill. Then, a $3.5tn investment in America's social safety net that is strongly opposed by Republicans. The passage of the bills through congress has become inextricably linked and Democrats fear they will suffer a political backlash if they fail to pass them.

The president's legislative agenda is stuttering just as the administration contends with another string of problems. After a failed stand-off recently with Republicans over a bill to fund the federal government and raise the debt ceiling, officials must now scramble to pass a "continuing resolution" to avert a government shutdown ahead of today's deadline. They must also lift the government's borrowing limit to avoid a default as soon as next month.

A continuing resolution – which would keep the government funded up to December – is likely to garner Republican support and pass both chambers of congress today. However, the debt ceiling debate remains unresolved with Schumer continuing to rule out using a complex legislative procedure known as reconciliation to lift the borrowing limit without Republican support.

In our view, the hype around the potential for a US government default seems larger than in past debt ceiling episodes. While brinkmanship could stress markets, extending the debt limit requires neither bipartisan votes nor a reconciliation bill. The so-called "nuclear option" is viable and simple, and provides a backstop strategy to prevent moving beyond the X date.

A filibuster is a way to extend debate on a bill indefinitely and thereby prevent an actual vote to occur. It takes 60 votes in the Senate to end a filibuster in a normal way , and today 60 votes are not available as the Senate is split 50/50 when counting the 2two Independents as Democrats.

Breaking the filibuster is called the nuclear option. It was first used in 2013 by Democrats to end filibuster and proceed on a vote for a presidential nominee and then again in 2017 by Republicans to begin a vote for a Supreme Court nominee. Each breaking of a filibuster via the nuclear option sets a new precedent in Senate rules for that specific type of legislation and then becomes the norm in the Senate rules. This is why the nuclear option is so rarely used as it removes filibuster power from the minority party of the day but also from the majority party if it were to become the minority in the future.

Given both the reconciliation framework and the more powerful nuclear option, the end game will almost certainly not include crossing over the X date into the unknown, and for this reason we would conclude a Treasury default risk is actually much lower in this debt ceiling episode than many might think.

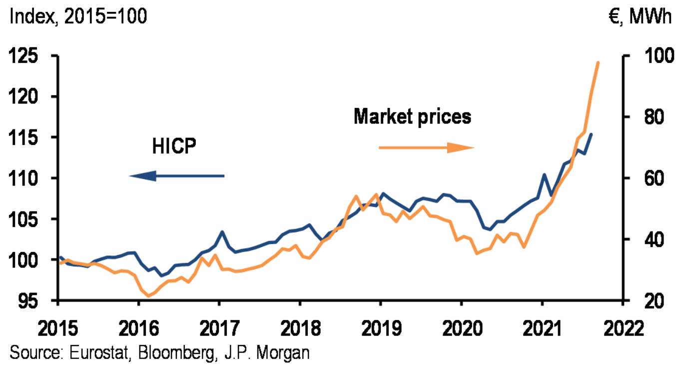
Economics & Rates

Conclusion. Stagflation risks rising. The reopening story is behind us. PMIs have peaked. The Fed is tilting more hawkish but walking a very fine line. On the one hand, it is time to taper the asset purchase programme to provide policy ammunition for the next crisis. On the other hand, economic growth is at risk of a rapidly slowing Chinese economy, and of the current energy crisis. The current environment is increasingly showing signs of resemblance with the 1970's. In 1974, the energy crisis exacerbated an elevated inflationary environment, leading to a prolonged phase of stagflation. Today, rising electricity **(Chart 3)** and gas prices can put pressure on economic growth. While Governments are stepping in to pay part of the bill, this situation is unlikely to get resolved any time soon. As such, we believe that most Central Banks will not be able to reduce the liquidity taps this quarter. Looser for longer monetary policy will continue to put upward pressure on inflation. As a result, we expect US 10-year bond yields to rise to 1.8-2.0% in Q4 2021. Should we be proven correct, this has significant impact potential across asset classes.

The credit impulse (new credit as % of GDP) in G3 countries (China, US and Europe) peaked at almost 7% **(Chart 4)**, which is clearly the biggest credit impulse provided to the economy on data since 2005. The interesting thing is that the impulse is now clearly negative (a contraction of credit on the second derivate) likely as a result of a voluntary drawdown on the revolving facilities that were widely utilized during Q2/Q3-2020. In other words, credit growth is slowing fast as (1) liquidity facilities are not as needed now and (2) the impulse from the fiscal and monetary side is weakening in YoY terms. Gravity pulls. As a result, it is not a surprise that manufacturing flash PMIs for September were weaker than expected. In the US, manufacturing PMI fell below expectation, bringing down the composite PMI by 0.9 points to 54.5. This dynamic was even more pronounced in the Euro Area, where the composite index dropped nearly three points to 56.1 versus the anticipated 58.5. More dramatic, China's manufacturing PMI fell to 49.6, below the critical level of 50 for the first time since the 2020 Covid crisis. A falling credit impulse in itself is not an issue. However, coupled with tighter central bank liquidity, it can lead to significant market impacts such as the flash crash of Q4 2018. This economic growth slowdown may be further impacted by rising energy prices. We are still far from the energy crisis of the 1970s which led Governments to restrict energy usage and transports. Most Governments have announced stepping in to "pay the bill" of higher energy prices, thinking this is temporary. We don't see any short-term fix of the current energy shortage and fear rising prices will ultimately impact households and industries.

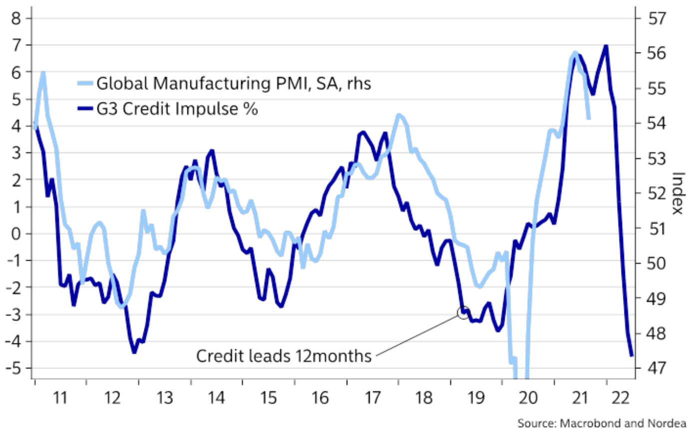
We had long argued that inflation was not transitory, however hard the Fed tried to convince us. This is becoming common thinking at this stage. At face value, the recent rise in market gas and electricity prices could increase headline inflation by 0.5% in the short run. Adding this to rising transport prices, wages, and higher broad commodity prices, we strongly believe US inflation will remain higher for longer. This supports our view of a potential period of stagflation ahead. Google Trends search also shows general public interest in this "keyword" **(Chart 5)**. The Fed is cornered and it will become increasingly difficult to achieve meaningful tapering let alone any interest rate hike. It takes time for stagflation to have a lasting effect on rates. During previous stagflation periods, sovereign bond yields traded sideways for up to 6 years until a sustained move higher. We believe US 10-year bond yields can rally to 1.8%-2.0% in Q4 2021.

Chart 3. Electricity Prices



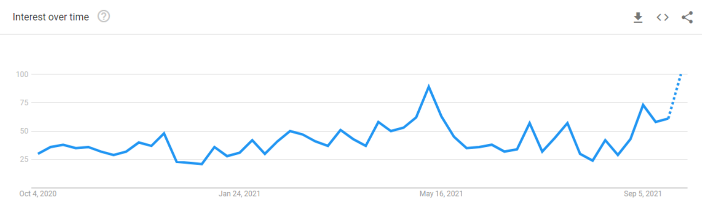
Source. Eurostat, Bloomberg, JP Morgan

Chart 4. G3 Credit Impulse % vs. Global Manufacturing PMI



Source. Macrobond, Nordea

Chart 5. Google Trends search for "Stagflation"



Source. Google

Credit

Conclusion. Bearish DM, Looking for relative value in EM and de-correlation in Real Assets. Weak data, prospects of tighter monetary policy, and extended valuations all point to a period of near-term volatility. We call for spreads to widen modestly, but expect growth-sensitive pockets of credit to reassert leadership when the economic recovery regains footing in the next quarter. HY credit spreads continue to hover around record low levels. Every ounce of value has already been sucked out of credit markets. The only reason one could argue to be long HY at the moment would be for earning carry. However, even in such an instance, the risk-reward is simply appalling ahead of a Fed tapering cycle likely to be announced as early as November. The little carry one could earn would quickly be offset by spread expansions. 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. Elsewhere, we look once again at Real Asset funds. Following our deep dive on China, we monitor for a China HY spread tightening trade.

Before the growth angst earlier this month, it was a summer of doubtful resilience in credit. Spreads compression from earlier in the year took a break with the reflation and compression beneficiaries giving back some of their gains through the months of July and August. Seeds of doubt were sown by the abrupt rally in US Treasuries through to late June **(Chart 6)**, eventually translating into scepticism over the growth/reflation narrative and concerns about an early taper. Credit markets have been scrutinizing the growth narrative closely at current valuations, but it is yet to reflect in any meaningful growth fears. The path of least resistance for spreads is wider as it solves for economic cues, policy signals, and stretched valuations.

The September FOMC meeting marked 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. We expect the chair to announce the beginning of the tapering cycle at the November meeting. However, as it has been emphasized by Powell, tapering is not tightening and the end of the tapering cycle does not coincide with rates hike.

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. At sub-90bps in IG and ~300bps in HY **(Chart 7)**, the market is not priced for a continued economic slowdown. Adjusting for a few parameters (consensus earnings growth and lower leverage) **(Chart 8)**, the story is unchanged. Valuations in credit are historically high (tight spreads).

EM credit still offers attractive value with a measured level of risk. 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 Evergrande 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 contemplate investment opportunities in Asia HY bond funds or China HY spread tightening **(Chart 9)**.

We also look for real asset funds. B2B loans, real asset lending, These particularly well-suited investment during inflationary times per their relatively low correlation to other financial asset.

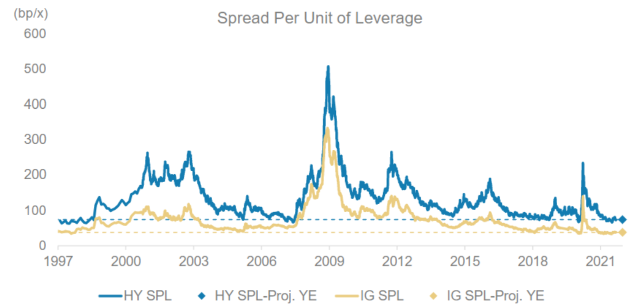
Chart 6. US 10-Year Sovereign Bond Yield (Daily)

Source. MAM Research, Bloomberg

Chart 7. US HY Credit Spreads (Weekly)

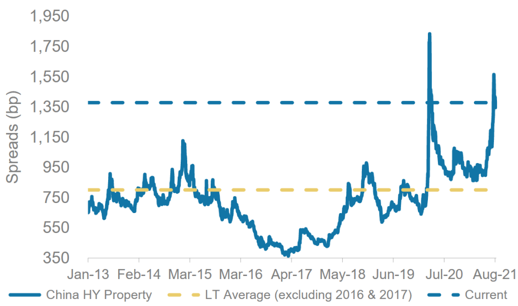
Source. MAM Research, Bloomberg

Chart 8. US IG & HY Spread Per Unit of leverage



Source. MS Research

Chart 9. Chinese HY Spreads



Source. MS Research

Currencies

Conclusion. Tug of War in FX Markets, Supportive USD. We continue to expect some US dollar strength against lower-beta currencies in the next quarter, notably against the euro where policy normalization prospects look compromised with the ECB predominantly dovish in its statements. In the meantime, the recovery in US soft data is negative for funding currencies such the Japanese Yen. Rates, monetary policy, and growth divergence will remain the main drivers of FX markets into the year-end to the extent the global slowdown and concerns around virus variants persist. Under such an environment, a broad dollar appreciation is the most likely scenario. US growth is likely to undershoot expectations in Q3, but fair relatively than the rest of the world. An acceleration in Q4 is possible at a time when EM growth remains relatively weak, exacerbated by the lasting Chinese economic slowdown. FX markets are primed for volatility into the year-end. Front-end US rates have not contributed much to the dollar strength seen in recent months. However, this could change with the reassessment of the monetary policy outlook in November and December.

The dollar currently benefits from a Chinese stimulus shortfall, a source of headwind to global growth. China's power crunch is a developing threat. A sharp deterioration in Chinese activity implies the US economy, which is relatively insulated from Chinese growth relative to peers, is likely to outperform. Additionally, the Fed is turning incrementally more hawkish and the path towards policy normalization becomes clearer, pushing US nominal rates higher and weighting down on inflation and inflation expectations. Dynamics tilt interest rates differentials in favour of the US and the USD in the near-term. Despite DXY appreciating in the second half the year **(Chart 10)**, global macro dynamics remain titled against the currency over a 9-12 months horizon. A rotation in relative growth differentials and interest rates differentials in favour of ex-US economies should generate structural medium-to-long-term headwinds to the greenback. We expect the dollar to strengthen in Q4 before resuming its trend lower next year as global economic growth dynamics turn back in favour of the rest of the world. Part of the narrative is China turning more accommodative in the near future.

The outlook remains tamed for the euro next quarter as we see the currency falling towards 1.14 against the dollar **(Chart 11)** due to monetary policy and growth divergence. The September FOMC meeting showed a hawkish Fed in contrast with the ECB. The ECB has been quick to refute media reports hinting at rate hikes starting in 2023, saying it is not in line with their guidance.

We expect a weaker JPY into the year-end. The recovery in soft US data and the peak out in pandemic-related risks is negative for funding currencies.

Markets expected EM CBs to hike their policy rates in the next 12 months back to pre-pandemic levels. They are half way there already. Then, current account positions (EM's Achilles's heel) improved dramatically. Yet EM FX dropped 4.5% YTD **(Chart 12)**. *What is going on?* Policy rates have kept up with inflation with expected real policy rates back in positive territory. They have gone up and, all else equal, support EM FX, just not enough to rally. US rates have not gone up by more. In fact, EM real carry is the highest it has been in ten years **(Chart 13)**. *So why has EM FX been weaker?* Growth differentials matter and consensus still favours US GDP growth over EM **(Chart 14)**. Socio-political risks and fiscal vulnerabilities continue to weigh in the balance. *Where does it leave us?* We believe the growth recovery in China will be one of the key catalysts. It would turn consensus more optimistic about EM FX and drive investors to rethink their view. We expect near-term headwinds, but remain positive on the longer-term outlook for EM currencies.

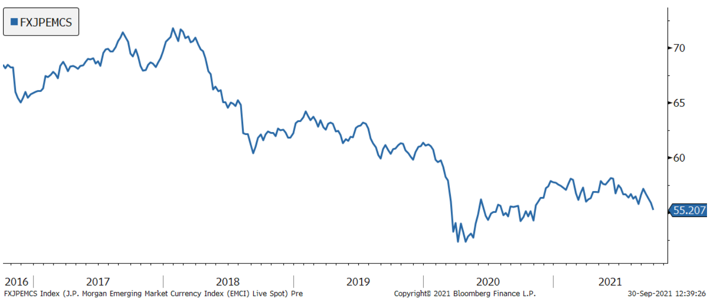
Chart 10. US Dollar Index (Weekly)

Source. MAM Research, Bloomberg

Chart 11. EUR/USD Spot (Weekly)

Source. MAM Research, Bloomberg

Chart 12. JPM EM Currency Index (Weekly)



Source. MAM Research, Bloomberg

Chart 13. EM Real Carry

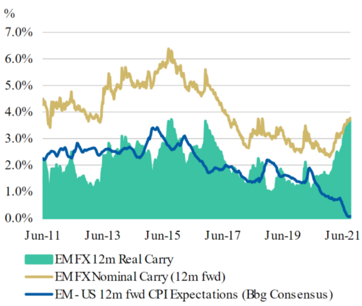
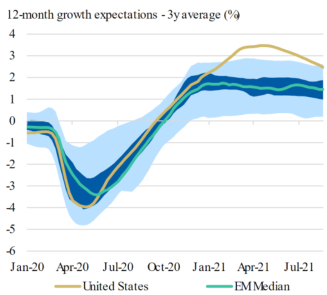


Chart 14. Growth Expectations



Source. Bloomberg, MS Research

Equities

Conclusion. Turning Neutral. We see potential for equity markets to continue edging higher in the coming quarter, but purely based on TINA flows. The risk-reward remains unattractive at the index level given slowing growth, looming liquidity tightening, and rising rates. Recent price action has been very wobbly. With the third quarter earnings season likely to bring a much more muted outcome, we remain defensive in our strategy and positioning. We continue to avoid one-sided factor exposure and recommend a barbell strategy mix between mid-cap growth and value stocks. We recommend keeping an underweight exposure to US markets relative to the rest of the world. Equities are unlikely to fall dramatically until the Fed makes the music stop through interest rate hikes or quantitative tightening. We are far from that just yet. However, some risks persist over the horizon such as the US fiscal cliff. As a result, we shall not go back to a full and more aggressive equity allocation. Instead, we look to buy options with year-end maturity while maintain a relatively stable 35% allocation to the asset class so as not to put capital at risk.

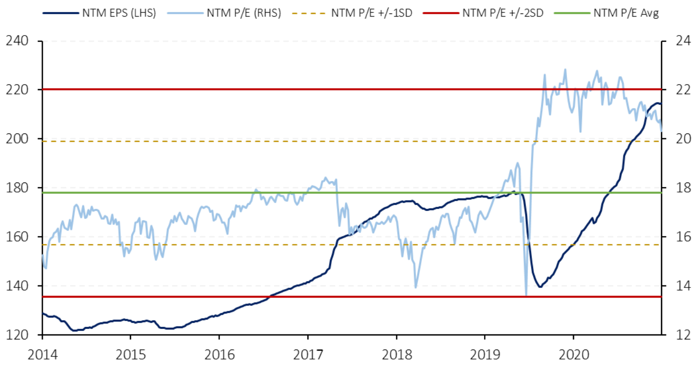
Although investor confidence remain high, rising producer costs are likely to weigh on corporate margins in the months ahead. Q3 corporate earnings season is set to kick off in coming weeks with a growing focus on profitably. As US growth decelerates and financial conditions tighten, valuations are likely to fall from their very lofty levels. The S&P 500 is trading at 20.3x NTM P/E. While it is lower than Q4 2020's 22.8x NTM P/E, it remains +1SD expensive. Not assuming a full mean reversion, 19.0x NTM P/E, using $215 2022e EPS, we see material downside risks with a target for the S&P 500 at 4,085 (-6.7%) **(Chart 15)**. Arguably, EPS estimates have downside risk with a potential Biden tax hike, a global minimum tax rate, and lower margins from rising costs.

Margins expectations for 2022 run high. The spread between GDP growth and wage growth correlates closely to operating margins over time **(Chart 16)**. Estimates suggest these spreads will decelerate in the coming quarters, meaning margins should contract not expand as bottom-up consensus currently expects. Furthermore, corporate transcripts mention of "cost pressures" and related terms are elevated **(Chart 17)**. When this occurred, margins consolidated. Although investors remain optimistic on companies' ability to pass on costs to protect margins, we are more sceptical. In several consumer end markets, prices are already at levels inhibiting demand. Wall Street analysts are slowly catching up with our view. MS has recently downgraded Amazon, reducing EBIT estimates by 19% on margins concerns.

The summer season showed declining macro growth sentiment, driven by China worries and a delta variant overhang. However, the trend is beginning to invert. Prospect of a broader macro sentiment improvement coupled with the start of the Fed's tapering cycle may continue to put upward pressure on bond yields. Additionally, room for market sentiment around inflation to shift towards our non-transitory thesis into 2022 is rising given the rise in commodity prices and strong labour markets (rising job creation and higher wage growth). Higher inflation favours O&G, financial, and cyclical sectors vs. defensives.

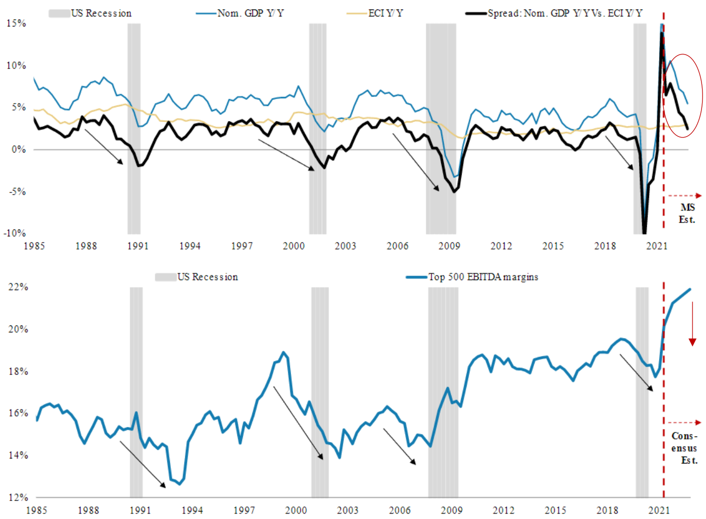
Chinese policymakers signalled organized debt restructuring for stressed housing developers, fine-tuning the pace of housing tightening, and mitigating power cuts as PMI drops below 50. Government bond issuance is accelerating and broad credit growth looks like it reached a trough, thus ending a 10-month downturn. As discussed in our *MAM Insight No. 19*, we remain medium-to-long term China bulls. We continue to monitor the developments in the region and recommend to keep current exposure constant. We seek a 5% allocation after the October holidays through the Quaero China fund.

Chart 15. S&P 500 NTM P/E and EPS



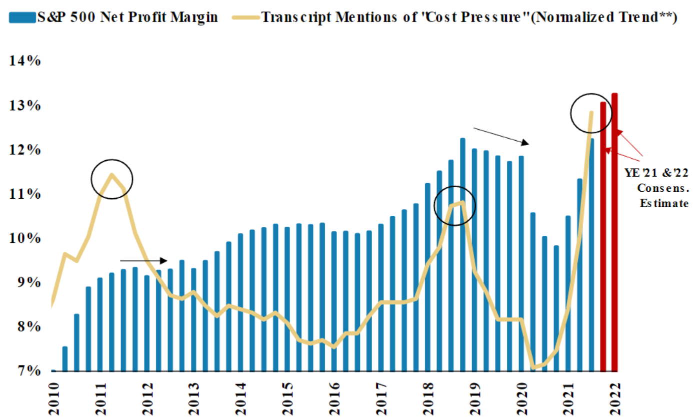
Source. MAM Research, Bloomberg

Chart 16. Margin Pressure Set To Resume



Source. Haver Analytics, MS Research

Chart 17. Surge in "Cost Pressure" Mentions To Continue



Source. AlphaSense, FactSet

Commodities

Conclusion. Long-term bulls. Once again, commodity markets have show how precariously balanced and inter-connected they are. Low investments in China coal production over the past few years as part of its decarbonization efforts slowed down thermal coal production. From reduced hydropower output due to drought and a post-pandemic recovery in electricity demand, China has been experiencing rolling power outages. The government instructed the slowdown of the electricity-intensive aluminium production as a result. Meanwhile, it boosted demand for coal and LNG ultimately sending coal and natural gas **(Chart 18)** prices to near-record levels in a matter of weeks. LNG has been diverted away from Europe in the summer leading to lower inventory builds and higher prices as we head into the winter. Energy prices have risen so rapidly they risk reaching their respective demand destruction levels and force government interventions. Industrial metal prices remain under pressure amid growth slowdowns and lower end demand. We look for broad commodities to pull back c.5-10% in the near-term to add back after investment demand outpaced fundamentals.

Crude oil inventories continue to draw at a high rate, trending down at 1.9mb/d on average YTD and accelerating to 3.0mb/d in the last 31 days. From the beginning, OPEC producers had to balance two factors: higher short-term prices or better market share. Typically, these two were mutually exclusive. If OPEC-led production cuts drove prices above break-evens for non-OPEC projects, chances were these projects would be developed and then take market share. Today, upstream capex is showing very low sensitivity to higher prices. US O&G Companies are finding it difficult to justify raising upstream capex to investors. Surely, US production will grow in 2022 but the recovery will be tempered relative to 2016. As the demand recovery carries on, US shale recovery is muted, and non-OPEC capex show little recovery, oil prices **(Chart 19)** could travel higher towards $80/bbl. a level where demand destruction should begin to kick in.

Industrial metals supply and demand risks further escalated last quarter amid debt troubles in China's property sector, China's power crisis, and soaring global energy prices. Iron ore and steel have the highest direct exposure to the property sector. Albeit to a lesser extent, slower new construction starts could be felt in other metals as well (i.e., Zinc). We maintain a cautious view on industrial metals into the year-end pending an infrastructure -focused countercyclical stimulus is announced in China.

Despite current auto supply chain tightness, we have a positive view on lithium carbonate as surging EV demand leaves supply to play catch-up, significantly tightening the market. However, we see the imbalance as transitory with prices gradually normalizing starting in the second quarter of next year.

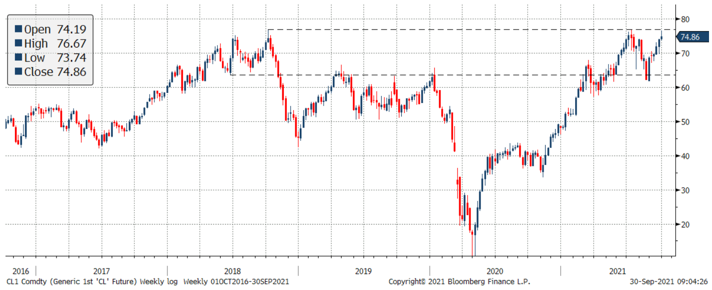
As one of the cleanest and most power efficient energy sources, nuclear power could play a key role in the transition to net zero. In our *MAM Insight No. 18*, we review the uranium opportunity. It is a very tight market. Nearly everyone who owns it intends to consume it in their reactors. However, in July, Sprott launched a physically backed uranium ETF **(Chart 20)**. Investor demands means it is buying up the free float. Incremental uranium supply can take decades to come online. Though investment demand is outpacing fundamentals, we remain medium-to-long term bulls.

Precious metals have been under quite a bit of pressure in past quarters with the strengthening of the dollar contributing to the decline. Fundamentally, we continue to like silver as the market rebalanced itself through production discipline and the demand from new applications including solar panels remains strong. Should more spending on solar panels materialize post China holidays, silver could rally above $31/oz **(Chart 21)**.

Chart 18. Natural Gas Futures Continuous (Weekly)

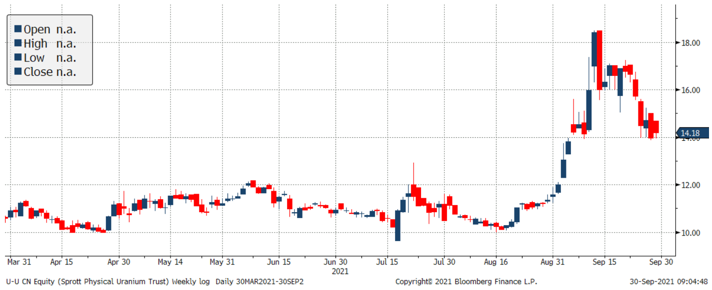
Source. MAM Research, Bloomberg

Chart 19. Crude Oil Futures Continuous (Weekly)



Source. MAM Research, Bloomberg

Chart 20 Sprott Uranium ETF (Daily)



Source. MAM Research, Bloomberg

Chart 21. Silver Spot (Weekly)

Source. MAM Research, Bloomberg

Pre-IPO Investments

Conclusion. Bullish. We have been investing in pre-IPO opportunities since mid-2020 with a special focus on high growth disrupting companies. The rational is that listed technology companies are trading at record high valuations. Buying similar companies in the pre-IPO stage allows us to take advantage of a significant discount based on (1) illiquidity and (2) buying the stock 1-year before IPO, on average. Earlier successes included Palantir and QuantumScape. UiPath's +17% return since investment is lower than expected. However, the stock has outperformed Snowflake, the listed direct competitor, by +29% during the same period. This demonstrates the value of the illiquidity discount. Toast, another investee company, recently listed. The current return is in-line with expectations. We await the lock-up expiry in March 2022. We will continue investing selectively in pre-IPO opportunities. We are launching this month a pre-IPO Fund to continue sourcing and executing transactions in the most efficient way for our clients.

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	Industry	Transaction Type	Transaction Date	Transaction Price	Liquidty Event Type	Event Date	Current Price	Performance (ITD)	Gross MOIC	Lock-Up
Palantir	Software	Pre-IPO	3-Mar-2020	4.65	IPO (Direct Listing)	24-Sep-2020	27.38	488.8%	5.9x	Expired
QuantumScape	Auto Parts	Pre-IPO	18-Aug-2020	6.57	SPAC Merger	30-Nov-2020	30.86	369.7%	4.7x	Semi-Expired
Company 1	Materials	Conv. Note	25-Sep-2020	3.82	-	-	-	-	-	
Company 2	Digital Marketing	Pre-IPO	1-Nov-2020	3.91	-	-	-	-	-	
UiPath	Software	Pre-IPO	18-Dec-2020	44.45	IPO (Direct Listing)	20-Apr-2021	52.00	17.0%	1.2x	Expired
Toast	Software	Pre-IPO	10-Mar-2021	26.00	IPO (Direct Listing)	21-Sep-2021	50.00	92.3%	1.9x	In Place
Company 3	Biotechnology	Early Stage	2-Apr-2021	10.00	-	-	-	-	-	
Company 4	Software	Early Stage	3-Jun-2021	10.00	-	-	-	-	-	
Company 5	Food & Beverage	Early Stage	15-Jun-2021	10.00	-	-	-	-	-	

Source. MAM Research

The lock-up in our investment in UiPath **(Chart 22)** expired early September 2021, just 9 months after the initial investment. Shares traded within a $70-80 range post-IPO in Q2 2021. As with most IPOs, shares started trading downward as the IPO lock-up expiry approached. Indeed, shorter-horizon traders sell their stock in fear of a potential placement from cornerstone investors. The stock currently trades at $52 and seems to have found a floor. We are still registering a positive performance at this level, which is not the case for IPO investors (IPO price of $56 vs pre-IPO price of $44.45). We are not inclined to sell the shares just yet. In order to take advantage of the high volatility on the stock, we are selling Call Options with a strike at $55 and a maturity in November 2021 for $3/contract. Should UiPath shares trade above $55 at expiry, then we would effectively sell the shares at a net price of $58, +30% since investment. If UiPath shares trade below $55 at expiry, then we would earn the $3 premium which effectively lowers our net entry price to $41.45. We would then renew our option strategy.

Chart 22. UiPath Spot Price (Daily)

Source. Bloomberg, MAM Research

The latest investee pre-IPO company to list on the NYSE was Toast. The listing happened on 21/09/21. Investor adoption of this company went very well. The initial IPO reference price of $30 was quickly moved up to $40. On the first day of trading shares rallied at $62.5 and have since drifted lower to c. $50. Shares are locked until March 2022 (c. 6 months). A similar trading pattern than UiPath is to be expected as we near the lock-up expiry. So far, we are satisfied with the current return profile of this pre-IPO investment.

As we now register a handful of pre-IPO investment successes, we are increasingly confident that this is the right strategy for us with regards to investing in high-growth disruptive companies. We are fully conscious that we will also encounter failures along the way. However, we will do our utmost to minimise them and to have successes far outweigh them. The pipeline of opportunities is very constructive for Q4 2021. We have yet to enter the quarter and we are already in the pre-screening process of 7 new opportunities. We intend to be very rigorous in our selection process and will not hesitate to turn most down.

Participating in such transactions, is a process-heavy exercise. In order to ease the administrative burden we are launching the MAM Pre-IPO fund. This Luxembourg-based fund will allow us to be more efficient. It will also allow us to broaden out our deal sourcing contacts, hopefully providing better deals to our clients in the future. This fund is a testimony to MAM's ambition to continuously innovate to service it clients.

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