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GLOBAL INVESTMENT COMMITTEE'S 2022 OUTLOOK: POSITIVE FOR RISK ASSETS

According to our Global Investment Committee, which concentrates on the intermediate term-view regarding developed markets for pension funds and other long-term investors, 2022 looks to be a challenging, but positive year for risk assets. We believe that the G-3 central banks will become more hawkish, and such pivots can often cause potholes and at the very least headwinds, but we trust that policymakers can traverse their new course successfully overall. With the main point being that even if they tighten somewhat more than commonly expected, they will remain very accommodative and should not prevent the global economy, and thus, corporate profits, from growing firmly ahead.

Of course, the virus remains a constant threat, but risk markets will not likely over-react to such unless lockdowns become widespread, which we think can be avoided now that vaccines can alleviate much of the danger. Thus, the greatest risks could well be geopolitical ones. We admit to "crossing our fingers" about such risks, believing, as we nearly always have over the past decade, that countries usually avoid crisis behaviour and concentrate on the welfare of their economies; however, the situations in the Ukraine, Iran and to a somewhat lesser extent, issues involving China, are now more dangerous than ever.

Meanwhile, we continue to expect the US to enact a moderate fiscal package in 2022, with Europe and Japan also increasing fiscal stimulus, which will be quite powerful for GDP growth. For Europe and Japan in particular, deep consumer fears shifting toward optimism should be particularly pronounced, with business confidence also boosting capex to a large degree, especially to solve supply chain issues and improve climate-related mandates. Moreover, Japan's economy should, in particular, benefit greatly from continued global tech demand and a rebound from hampered auto production. However, due to electricity rationing/pollution curtailment in China through the end of the Paralympics in March, we expect that country to remain challenged for a while. As for specific forecasts, GDP for the US, Eurozone, Japan and China should approximate consensus growth of 3.9%, 4.2%, 2.6% and 4.7%, respectively, in CY22, but these numbers are, of course, boosted by low base effects. Consensus for China is actually a bit higher than our forecast, but such includes many stale estimates (with the trend clearly falling in recent weeks) and the major global brokerage houses' estimates are closer to our forecast.

Over the year ahead, we expect that China will be able to wade through the current troubles, although it will continue to be quite rocky at times. The country has changed direction and such transitions can be very difficult, although often rewarding. Clearly, the real estate industry could not continue to be relied upon to provide rapid economic growth forever. Decreasing the gearing-risk of the property companies certainly makes sense, as it will curtail overall financial industry risks, but such will create additional potholes in what is an extremely opaque and complicated, yet important system. The leadership there likely wishes they had started these efforts earlier, but this process has been years in the making and they seem intent on maintaining the course, confident that they can prevent systemic risk and a major negative wealth effect by consumers and corporations. A key question is whether a large number of vacant apartments will be either rented out or sold. Although the former would reduce rents, matching the common prosperity theme (and coupled with a major government drive to build rental housing), the latter might depress property prices too much. Meanwhile, the regulatory crackdown on various sectors aims to reduce inequality and veer the culture away from trendy (usually foreign, including Asian) and gaming cultures. Growth in the social media sphere will be moderately curtailed for an indefinite period, but will still likely grow nonetheless. Meanwhile, China is promoting super-high technology fields so as to achieve self-sufficiency in semiconductor production equipment (which will be extremely difficult, as no country has ever achieved such). It will also seek to boost other areas where it already has achieved prowess like AI, systems integration and the medical industry. It will also likely try to keep as much foreign business involvement as possible (as long as such does not get political), as such will be needed to support the economy.

Meanwhile, global inflation should remain stubborn in the months ahead at even higher YoY levels, and with commodity prices, excluding oil, rising moderately further, but after the 1Q, global inflation should decelerate. As for our Brent forecast, we expect it to return to USD 71 in June and USD 72 in December, but clearly the Iran question looms large, both geopolitically and as regards global oil supply. Given our forecast, we expect that US headline and core CPI measures for the next two quarters will remain high on a YoY basis, although much less so, at 4.0% and 3.3%, respectively, in June (approximating consensus) and both at 2.7% in December. **On a 6-month annualized rate, both should decelerate to around 2% by June**. Housing rent should continue upward, but new and used car prices should decline fairly soon as production resurges. Lastly, corporations still seem to have huge pricing power and use shortages to rationalize price hikes that are higher than needed to maintain current profits, but the Biden Administration will likely criticize price hikes (or product shrinkage) and oligopolistic practices much more sharply, while keeping the pressure on OPEC to increase production. Alleviation of labour and logistical bottlenecks will also likely reduce price pressure.

Based on this backdrop, our fixed income and equity teams established targets that, once again, forecast good performance for global equities, with moderate weakness for global bonds. For bonds, given the hawkish stance of central banks and quite strong economic growth coupled with sharply reduced Fed purchases, many readers likely think our forecast of only mild increases in bond yields is too rosy, but many bond investors will likely assume that inflation will decelerate, and will also worry about virus scares, occasional disappointing economic data, geopolitical flare-ups and other problems during China's transition. For US 10-year Treasuries, we expect a gradual increase to 1.8% next December, while 10-year Bunds and 10-year JGBs should hit -0.15% and 0.15%, respectively. Regarding forex, due to continued high interest rate differentials, we expect the USD to rise gradually to 117 vs the yen, and to 1.09 vs the euro.

Given this backdrop, G-3 earnings growth should continue to be strong and boost their equities in CY22. Although "less dovish" central banks will be a headwind for investment sentiment, increased fiscal spending and the global vaccine-driven economic and corporate earnings recovery should more than offset such. Indeed, a major positive factor should be 4Q earnings announced in January and February and, if, as we expect, they exceed consensus, analysts will have little choice but to be even more enthusiastic in their CY22 forecasts (which they have been surprisingly reluctant to do so far). **Thus, although PE ratios look high now, the upside to CY22 earnings estimates will likely make valuations much less expensive.** One other thing to note is that EPS growth was artificially high in CY21 due to releases of bank credit reserves, which should disappear in 2022, thus making 2022 EPS growth look artificially low, but on an underlying basis, it should be very sturdy.

Aggregating our national forecasts from our base date of December 3rd, we forecast that the MSCI World Total Return Index in USD terms will rise 5.3% through March, 7.8% through June and 12.3% through next December. We expect **positive returns in each major region, with Japan's the highest among the regions:**

In the US, the SPX's PER on its CY21 EPS estimate is now about 22, which remains, by historical standards, very high. Its CY22 PER is also a bit high at about 20. However, there are clear reasons for such: fixed income yields are low (and bond returns should be disappointing ahead), buybacks are rebounding sharply and earnings growth should exceed the already strong consensus view. The wild valuations among some speculative stocks have moderated, which is encouraging, but remain very high. Although such will likely worsen ahead, Democrats have seemed unwilling to disturb Wall Street or to criticize corporate price hikes, likely hoping for asset revaluation to aid the economy and, thus, their political approval rating. Government intervention, especially among major tech stocks, is also likely to be a moderate headwind. In sum, we expect the SPX to rise to 4,742 (4.9% total unannualized return from our base date) at end-March, 4,831 at end-June (7.2% return) and 5,014 next December (11.9% return) from our base date.

European equities have recently underperformed those in the US in USD terms, with the weak euro being the main factor, but Europeans' confidence in their intermediate-term economic future has greatly improved. The Euro Stoxx PER, at 15.7 times CY21 EPS equates to its historical average (CY22 PER is about 14.9), and similarly to the US, we expect CY22 EPS to be revised upward. The market's high dividend yield should also continue to attract domestic and global investors. Thus, we expect the Euro Stoxx index to rise to 515 at end-December and FTSE to 7,700, which translates to a total return for MSCI Europe of 12.0% from our base date through December. As for "known unknowns," it will be interesting to see how the markets react to Germany's political shift to the Left, and how fast the ECB will need to pivot away from its ultra-dovish stance.

For Japan, despite the plunge in COVID-19 cases and deaths, the rebound in consumer optimism was lower in late 2021 than expected, but looks to rally ahead despite concerns about new variants and the upcoming flu season. The auto sector, which is a major portion of the stock market and economy, has suffered more production troubles than anticipated, but the situation has already sharply improved and should continue to do so greatly after November. Furthermore, Japan has low political risk and structural reform is continuing, especially in digitalisation and alternative energy, while existing and future fiscal stimulus should also boost economic growth. TOPIX's PER is now only 14.1 times its CY21 EPS consensus estimate, which is much lower than other regions, and here too, CY22 EPS estimates will likely be marked up, so its PER of 13.2 on such looks particularly attractive. Thus, we highlight Japan as a market that should outperform after its recent slumber. Other items that will boost the market are increased share buybacks, strong global GDP growth and the significant alleviation of component shortages in auto and tech production. Notably, the market's dividend yield, at 2.1%, remains attractive, even by global standards. Indeed, we expect domestic investors to return to the equity market in large fashion, based upon dividend income, and lead the TOPIX to 2,310 by next December for a total return of 16.0% from our base date. As for the Nikkei, it should hit 33,000. These returns are obviously very attractive for both Japanese and global investors.

Developed Pacific-ex Japan MSCI: clearly, this region is heavily affected by the various troubles and transitions in China. Although the Biden Administration has maintained Trump's tough actions on China, it will likely seek to retain current trade relations and accept the multipolar global construct. In fact, there is a major chance that it will eliminate some of Trump's tariffs fairly soon. However, China's recent boycott of Western firms that have expressed human rights concerns ratchets up the trade pressure, as do other tensions with global democracies, including relations with Taiwan. Australia's relations with China remain very poor, but the country is benefitting from strong global demand for commodities like metals, LNG and coal. Hong Kong's stock market, which is dominated by PRC firms, was hurt by several of China's regulatory developments, as well as Hong Kong's own troubles including the continued dearth of tourists. However, vaccines and increased global tourism will eventually help these two economies ahead. In sum, we only expect modest gains for Hong Kong over the next six months, with a much better rebound after that. Meanwhile, Australia looks very strong to us, leading to the region's MSCI index in USD terms to have a total return of 15.3% through 2022 from our base date.

In sum, the global economy should match the consensus for strong growth, thanks to vaccinations, continued fiscal stimulus, acceptable global geopolitical conditions, and continued low interest rates despite increasingly hawkish central banks. Such, via increased corporate profits, should allow equity markets to perform very well ahead, with impressive returns in each region, particularly in Japan. Meanwhile, we expect continued poor returns for global fixed income in USD terms. In conjunction with this positive forecast, however, we will be watching geopolitical risk very closely and advise our readers to do so as well.

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