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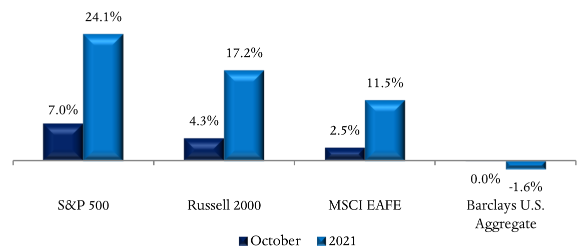
Markets

Stocks regained momentum in October with various equity indices making new highs over the course of the month. Economic growth remained solid, driven by improving manufacturing conditions, while consumer mobility increased thanks to ongoing vaccination campaigns. Equities were supported by strong earnings reports, with more than 80% of companies exceeding expectations, which helped to drive the S&P 500 higher by +7.0% during the month (+24.1% ytd). Smaller capitalization stocks, as measured by the Russell 2000 index, advanced +4.3% last month (+17.2% ytd). Overseas equities in the MSCI EAFE index rose +2.5% in October (+11.5% ytd), with the Euro Stoxx 600 remaining the most competitive foreign benchmark (+4.7% for the period; +22.4% ytd). On the other end of the spectrum, Asian indices remain laggards given political transition worries in Japan (-1.9%; +6.9% ytd) and real estate sector woes in China (-0.5%; +4.3% ytd).

Fixed income markets continued to exhibit high relative volatility. The combination of persistent bottlenecks in the global supply chain and booming energy prices drove concerns about prolonged inflationary pressures. This led investors to price in a faster pace of monetary tightening from central banks across the world. The 10-year US Treasury yield hit a high of 1.70% in October but ended the month only marginally ahead at 1.56%. There were, however, much larger increases in shorter-dated yields, leading to a flattening of the Treasury curve. The Barclays US Aggregate index declined -3 basis points (bps) last month (-1.6% ytd) while the high yield index declined -18 bps (+4.5% ytd).

The energy commodity sector continued to be driven by strong demand, coupled with supply constraints. In the US, WTI crude oil soared +11.4% in October to \$83.57/barrel, reaching a seven-year high. Europe wit-



nessed record natural gas prices after the resource leaped by 60% in a week. Thereafter, values moderated following comments from Russian President Vladimir Putin who stated the intention to increase gas supply to Europe. The extent to which this will resolve shortages remains unclear given that pipelines are already close to capacity. In China, coal shortages led to blackouts, which weighed on manufacturing. This induced Asian governments to take steps to increase production.

Geopolitics

In the US, the Biden administration finally succeeded in passing a much needed \$1 trillion infrastructure spending package, after reaching a compromise in the House of Representatives. The bill, which passed the Senate in August with strong bipartisan support, includes nearly \$550 billion in new spending above what Congress was already planning to allocate for infrastructure over the next eight years. Related to financing these proposals, the US debt ceiling was extended by Congress until December, averting any funding issues. This has, unfortunately, introduced another short-term deadline which will have to be dealt with next month.

In German politics, a coalition between the center-left SPD, the Greens and the liberal FDP remains the most likely outcome of negotiations to form a governing coalition. Initial policy proposals include a minimum wage increase as well as several social initiatives. Increased government spending is expected to be focused on digitalization and climate policies, which we view as value

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added for the economy. With regard to the greenification of European economies, the EU's inaugural green bond issuance to finance investments focused on climate change policies received stellar demand and provided a boost to the region-wide initiative.

United States

Overall the US recovery remains solid and the economy is approaching full employment (80% of people who lost their jobs due to the pandemic having been re-hired), leading to inflationary pressures. The unemployment rate declined to 4.6% in October. Data continued to show worker shortages and private-sector wages rose by a robust 4.9%. Despite the end of more generous unemployment benefits which may have postponed job searches, the labor force has declined and participation rates remain below their pre-pandemic peak. The most recent reading of the US Consumer Price Index (CPI) came in at a lofty 5.4% increase year-over-year (with core CPI rising 4.0%). Price pressures are evident in numerous areas of the economy, with a peak likely still to come. Last month's sharp acceleration in auto prices was especially notable given ongoing shortages in semiconductors. US third quarter GDP growth of 2.0% came in shy of expectations, hurt by a combination of negative effects from Hurricane Ida and persistent supply-side bottlenecks. However, more recent data offered encouragement that economic momentum is picking up again.

Consequently, the Federal Reserve announced the start of tapering this month, targeting an end by June of 2022. A gradual interest rate hiking cycle is then slated to start.

Europe

Economic growth in the EU remains on a positive track, with GDP adding 2.1% year-over-year in the third quarter, still below its potential. This is most evident in Germany, where automotive sector weakness, driven by component shortages, is weighing on industrial production. It is, however, notable that excluding the auto sector, the trajectory of eurozone industrial production is back above pre-pandemic levels. In turn, euro area inflation rose to 3.4% year-over-year in September, the highest level in 13 years, while inflation in Germany pushed above 4.0%.

October 2021 Economic Statistics

	Oct-21	Dec-20	Dec-19
Federal Funds Target Rate	***0 - 0.25%***	0 - 0.25%	1.50-1.75%
Consumer Confidence Index	***113.8***	88.6	126.5
Manufacturing PMI Index	***60.8%***	60.7%	*47.2%*
Unemployment Rate	***4.6%***	6.7%	*3.5%*
JPY/USD	***114.00***	103.24	*108.61*
USD/EUR	***1.1561***	1.2213	*1.1210*
Gold/oz.	***$1,782.80***	$1,896.49	*$1,517.01*
Oil (WTI)/bbl	***$83.57***	$48.52	*$61.06*

In an effort to boost local economies, the European Union finally kicked off the distribution of its Recovery Fund. Italy and Spain, the main beneficiaries of those resources, announced their intentions to pursue expansionary fiscal policies and to postpone austerity until much later in the recovery. At its October meeting the European Central Bank (ECB) reiterated that it expected the current rise in inflation to be transitory. In addition, the decision on how to conduct asset purchases following the end of the Pandemic Emergency Purchase Program (PEPP) was postponed until December. Interestingly, the unexpected resignation of Bundesbank President Jens Weidmann triggered speculation that his successor may be less hawkish, which, in turn, could boost the prospects of persistent cheap funding conditions in Europe.

In the UK, the labor market remains strong and unemployment fell to 4.5% last month. However, with the Bank of England growing increasingly wary of associated rising wage pressures, a first interest rate hike this year now looks quite possible.

Asia

China's GDP growth slowed to 4.9% year-over-year in Q3, after rising at a 7.9% rate previously. Total social financing growth eased and retail sales grew by a relatively slow 4.4%, well below the pre-pandemic average. On the positive side, exports rose by 28.1% over the year-ago period, thanks to rebounding global demand both in the west and regionally. The Chinese Government's 6% annual growth target, set at the beginning of the year, still seems achievable thanks to the strong start to 2021, but 2022 is likely to feature a deceleration.

Investor concerns around the Chinese property sector eased somewhat after Evergrande made interest payments at the end of their grace period. The financial market's attention is now focused on how local authorities will manage regulations in the real estate sector in an effort to avoid contagion.

In Japan, Covid-19 infections have started to decline and vaccinations are progressing well, enabling the government to reduce some restrictions on activity. As a result economic growth is expected to accelerate in the coming quarters thanks to a boom in services consumption and a rise in capital expenditures. Newly elected Prime Minister Fumio Kishida, invigorated by a surprisingly strong election victory, signaled that he would pursue defense policies aimed at deterring China, address climate change and accelerate recovery from the pandemic, to be funded by a fiscal stimulus package.

Outlook

Eighteen months ago global central banks and governments took aggressive action to preemptively combat the economic effects of the pandemic. Given the speed and magnitude of that response, economies are now in a strong reflationary cycle. Looking ahead, growth remains firmly underpinned by high levels of pent-up demand, solid corporate balance sheets and robust investment intentions. However, persistent supply chain constraints are weighing on the path to recovery and feeding fears of longer lasting inflationary pressures. Policy makers are mostly of the belief that these effects will be transitory. The risk is that such a goldilocks scenario does not come to pass. It is interesting to note that the Bank of England recently admitted that it was too dovish and is now projecting higher inflation rates for longer, bringing forward its expected timing of a rise in short-term interest rates. Investors are similarly pricing in two rate hikes in the US in 2022. The dilemma for central banks is that tightening of monetary conditions will not alleviate the various bottlenecks, and may in-fact slow the investments required for relief. Further, latent demand and accumulation of household wealth would necessitate a significant tightening response to quell inflation. Such a stringent monetary policy move is not being discounted by the market and would likely prove disruptive to financial markets. As such, we believe that global central banks will choose the less austere route, accepting higher inflation and applying a more gradual removal of liquidity and raising of interest rates than would have historically been seen.

The aforementioned scenario, which entails allowing inflation to run hotter than normal, may serve as a wake-up call to otherwise complacent bond markets. We continue to be weary of longer dated bonds, given their negative real rates of return and low reward-to-risk ratio. For investors where capital preservation is paramount, short term Treasuries now offer circa 0.5% yields, which are poised to rise during the coming interest rate cycle, allowing for improved reinvestment opportunities.

Equity markets can still run further in this mid-cycle environment, while rising interest rates could continue to support a rotation towards more value-oriented sectors of the market. In addition, high quality businesses are poised to benefit from the reflationary environment, thanks to their pricing power and flexible supply chains. The relatively high level of equity dividend yields also remains an attractive source of income for long-term oriented investors.

The coming transition in policies and conditions related to the ongoing reflation cycle are likely to offer historically large opportunities that several of our select alternative strategies aim to exploit. We retain a positive view of inflation protected investments such as real estate, energy exploration, water infrastructure, and early-stage innovative food and beverage. Further, as long-term investors with the belief that technological advancement is still in its infancy, we continue to favor select venture investments as well as our proprietary Nordic Technology and Innovation Fund.

Sources: Barclays, Bloomberg, Bureau of Labor Statistics, Conference Board, Department of Agriculture, Federal Reserve, Financial Times, IMF, Institute for Supply Management, MSCI, Reuters, Russell, Standard & Poor's, and the Wall Street Journal.

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