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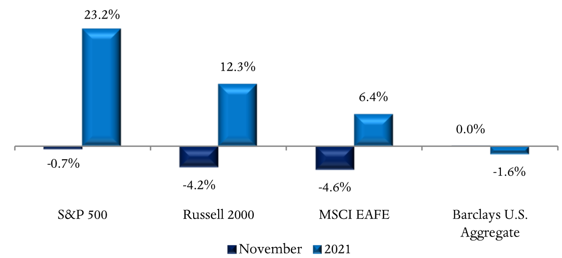
Markets

November started off well for investors, with major equity indexes reaching all-time highs. However, by mid-month, worries surrounding a potential acceleration of the Fed's tapering surfaced, dampening enthusiasm. Soon after, fears were further aggravated by the emergence of the Omicron variant of Covid-19, likely the most transmissible one yet. In the end, the S&P 500 index declined -0.7% for the month (+23.2% ytd), while the smaller capitalization Russell 2000 benchmark dropped -4.2% (+12.3% ytd). Overseas, the MSCI EAFE index followed suit, falling -4.6% (+6.4% ytd), while the Euro Stoxx 600 dropped by -2.5% (+19.3%). Chinese equities were more upbeat, as seen by the Shanghai index which advanced +0.5% in November (+4.8% ytd) but Japan's Nikkei 225 slid -3.7% (+2.9% ytd).

The US Federal Reserve rhetoric turned increasingly hawkish over the course of the month. Chairman Powell and other members of the policy committee (FOMC) suggested tapering could be accelerated and that they may stop referring to inflation as "transitory." Nevertheless, the US 10-year Treasury yield fell from 1.56% to 1.46% during the month, after reaching a high of 1.69%. The yield curve flattened further, as the 2-year yield rose from 0.50% to 0.57%. As such, investment grade credit saw flat total returns, while high yield bonds declined -0.9% (+3.6% ytd), correlated with the risk-off move, with spreads widening sharply in the final week of the month. The Barclays US Aggregate index rose less than 1 basis point for the month (-1.6% ytd).

Commodity prices fell in November, with energy leading the way. WTI crude oil dropped -20.8%, to $66.18 per barrel, during the month driven by profit taking and worries the new coronavirus variant could result in reduced demand. Industrial and precious metals were also lower during the period. Livestock was the only component of the commodity index to record a positive performance in November.



Geopolitics

The new Omicron variant of Covid-19 is extraordinary because of the sheer number of mutations, including 32 to the spike protein alone. Some of these appear particularly concerning, since they have been associated with resistance to neutralizing antibodies in other variants, indicating at least some ability to evade vaccine immunity. However, most of the mutations are probably associated with greater transmissibility. At present it is still too early to tell what the ultimate effects will be. The good news is that Omicron is relatively easy to detect with standard PCR tests, but we must now await for several more weeks of real-world infection data. In the meantime, our base case scenario is that Omicron will become the dominant variant globally in Q1 2022 and that mRNA vaccines should be able to be updated during that period. In addition, new antiviral pills, which are expected to become more widely available in the coming months, offer the promise to help reduce hospitalizations. Looking ahead, the upshot is that viruses tend to evolve over time, to become more transmissible but less deadly. Omicron is likely the next step in Covid-19's progression into an endemic disease, hopefully signaling the beginning of the end of the pandemic.

The UN Climate Change Conference (COP26) commenced, featuring a gathering of leaders from 200 countries, with an aim to take actions that will limit an in-

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crease in temperature, due to global warming, to less than 1.5°C (2.7°F) versus pre-industrial levels. While several new announcements were made in areas including coal, deforestation and methane emissions, the consensus is that progress fell short of the scale and specificity required to provide confidence that disruptive climate outcomes can be avoided. Nevertheless, soon after, the environment was one of the areas where Premier Xi Jinping and President Biden agreed to collaborate on during their virtual summit.

United States

Unemployment in the US continues to trend downward, having fallen to 4.2% in November, thanks to 210,000 new job additions. Encouragingly, 600,000 people entered the workforce and the labor-force participation rate rose to 61.8%, the highest level since the start of the pandemic. Average hourly wages were up 4.8% in November from the previous year, roughly on par with October but well above prior annual growth rates that averaged approximately 3%. This trend has aided the consumer, whose spending continues to boost retail sales. Industrial activity, as measured by composite PMI data, has also been robust. However, pent-up demand continues to vie with supply constraints, in addition to other contributing factors, which are leading to higher prices. As a result, the US Consumer Price Index (CPI) jumped by 6.2% year-over-year in October, its highest reading in 31 years.

On the monetary policy front, Jay Powell was reappointed to a four-year term as Federal Reserve Chairman. The FOMC must now weigh the strength of the economy against its fragility, amidst the fourth wave of the pandemic, in deciding whether to maintain its current quantitative easing tapering plan (which calls for monthly bond purchases to be reduced from $120 billion to zero by the end of June 2022). Several Fed members, including Powell, are seriously considering speeding up the pace of tapering but uncertainty around the Omicron variant may give them some pause.

November 2021 Economic Statistics

	Nov-21	Dec-20	Dec-19
Federal Funds Target Rate	***0 - 0.25%***	0 - 0.25%	1.50-1.75%
Consumer Confidence Index	***109.5***	88.6	126.5
Manufacturing PMI Index	***61.1%***	60.7%	*47.2%*
Unemployment Rate	***4.2%***	6.7%	*3.5%*
JPY/USD	***113.13***	103.24	*108.61*
USD/EUR	***1.1319***	1.2213	*1.1210*
Gold/oz.	***$1,773.78***	$1,896.49	*$1,517.01*
Oil (WTI)/bbl	***$66.18***	$48.52	*$61.06*

Europe

Euro area economic data was mixed in November. On the positive side, the manufacturing PMI rose slightly to 58.4% after three consecutive months of decline. Adding uncertainty to the path of recovery, there were some diverging trends as seen by the French Insee Business survey increasing, while the German IFO business climate index dropped. This is likely partially linked to variable pandemic-linked mobility constraints. In Belgium and Germany, work from home restrictions have been implemented while Austria is now under full lockdown. Further affecting consumer sentiment were higher prices. The flash November estimate put eurozone annual inflation at 4.9%, up from 4.1% in October and well above the European Central Bank's 2% target. It is the highest inflation level in the single currency era. However, the ECB remained reluctant to tighten monetary policy with President Christine Lagarde commenting that the current price pressures would fade by the time tightening measures took effect.

On the German political front, the leader of the Social Democrats, Olaf Scholz, is set to become the country's new chancellor after his party, along with the Greens and the Free Democrats, signed a coalition agreement. They agreed to ambitious climate targets, such as phasing out coal from Germany's energy mix by 2030, well ahead of the original schedule.

Economic momentum remained strong in the UK thanks to a shallower fourth wave of Covid-19. As such, consumer confidence and retail sales have increased, in contrast to what has been observed in the rest of Europe. Labor market data for October, the first month without the government's furlough scheme, continued to strengthen. In terms of business activity, manufacturing has performed better than expected, thanks to some underlying improvements in supplier delivery times.

Asia

Chinese economic data during November showed an improvement in both external demand and domestic activity. Local exports continued to surprise to the upside for the third month in a row, with growth of 27% year-over-year according to the latest data, driven by strong demand from Europe. Domestically, retail sales were also ahead of expectations, rising 4.7% year-over-year, aided by record Singles Day sales. Similarly, industrial production exceeded market forecasts with a 3.5% year-over-year rise.

Outlook

As we approach the end of the year and look forward to 2022, financial markets will have to contend with several uncertainties. While the evolution of Covid-19 is foremost on investors' minds, this may end up being a red herring, to be replaced by the worry of tighter monetary policy. Fed Chair, Jerome Powell, recently noted that the strength of the US economy, combined with the threat of persistently higher inflation, meant a swifter tapering of asset purchases, currently under way at a rate of $15 billion a month and slated to end by mid-2022, is under consideration. The inevitable spread of the highly contagious Omicron variant, which we expect to become dominant by the end of the first quarter, may lead the Fed to err on the side of caution. Irrespective of the path of tapering, we continue to expect positive economic growth and robust inflation during 2022, with monetary policy becoming less favorable over the coming year, lessening the market's beloved liquidity. However, it should be stressed that fiscal policies appear poised to take over where monetary policy leaves off, providing robust stimulation to economies. The main caveat that bears mentioning is that a downside scenario would come to pass in the unlikely event that new coronavirus mutations evade existing vaccines, necessitating further lock-downs.

Large capitalization growth oriented equities have performed strongly once again this year. Valuation multiples for the S&P 500 have, however, not expanded due to strong underlying expected earnings growth of 49.3%, leaving the index trading at 19.5x 2022 estimated earnings. The cohort of stocks driving benchmarks is rather narrow, leaving a wide swath of equities, across the market capitalization spectrum, both in the US and abroad, trading at more modest valuations, especially relative to the current historically low levels of interest rates. Looking ahead, 2022 profit growth for the S&P 500 is expected to be 7.9% (based on US GDP growth of 5%), a figure well below this year's rebound off the pandemic lows. We believe that this consensus earnings growth figure underestimates the potential for follow-through, driven by strong consumer balance sheets and rising wages, allowing for the pass through of higher costs of goods sold.

With regard to fixed income, we continue to be of the belief that the negative real-rates of return being offered to investors, in return for perceived safety and stability of capital, are to be avoided. This acts like an invisible tax. For those investors that must allocate capital to the bond market we reiterate that long-term paper should be avoided, in favor of lower returns in the short end of the yield curve, in anticipation of the eventual rise in interest rates.

For investors seeking ballast to their portfolios we instead recommend select alternative strategies. We retain a positive view of inflation protected investments such as real estate, energy exploration, water infrastructure, and early-stage innovative food and beverage. Long-term investors may also consider investing in disruptive technologies that offer long runways of high earnings growth, as seen in venture capital strategies, as well as our proprietary Nordic Technology and Innovation Fund.

We wish you and your families health and happiness during the holiday season, and look forward to communicating in early 2022.

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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