Building Better Outcomes

2022 Global Equity Outlook Favors Quality Stocks, Non-U.S. Markets

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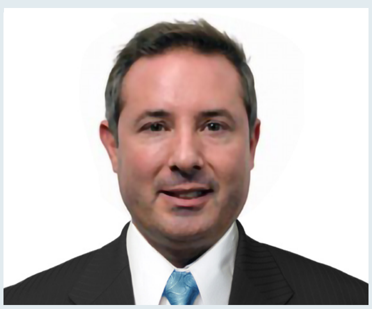

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London – The increase in market volatility, driven by the omicron variant, is another reminder that navigating global equity markets is likely to remain challenging in 2022. We believe, however, that higher-quality[1] companies, particularly those in international markets, may offer active managers attractive stock selection opportunities.

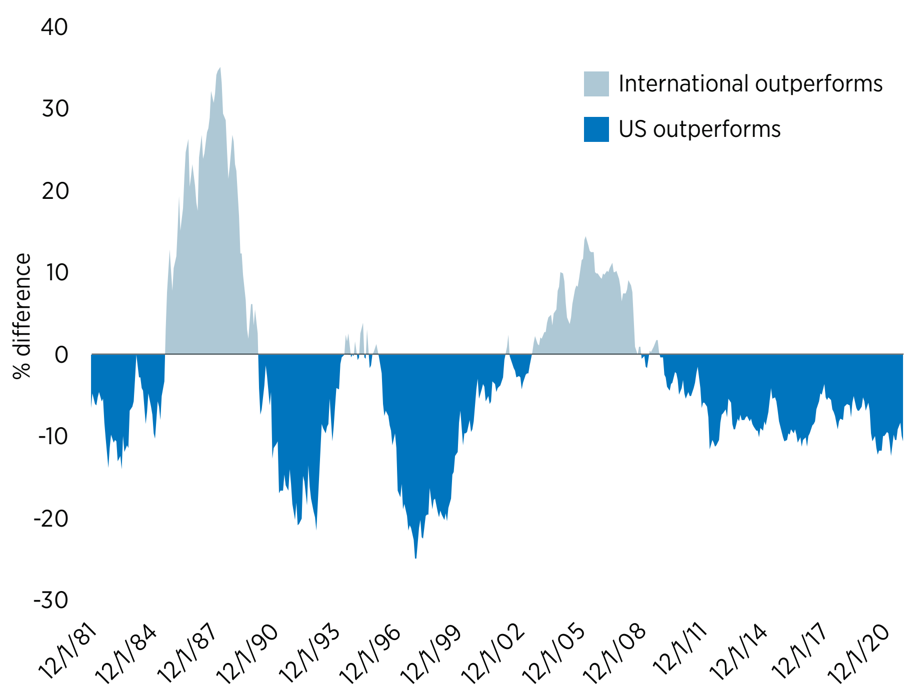
Along with COVID variants, countries and companies must contend with slower economic growth, ongoing supply chain issues and stubborn cost inflation. While uncertainties and risks persist, we think quality companies with consistent earnings growth and well-established market positions may be better equipped to withstand enduring pricing and supply pressures.

Moreover, in view of stretched U.S. stock market valuations, and the fact that international stocks have lagged the U.S. for more than a decade (Exhibit A), we think the reins of market leadership may pass to international stocks in 2022.

Exhibit A

Time for a Rotation in Leadership?

U.S. stocks have outpaced international stocks since 2009



Source: Zephyr Style Advisor, monthly data as of 11/30/2021.

Factors Weighing on Upside Potential

Although the emergence of omicron has rattled global equity markets, we believe this reaction speaks as much to a lack of confidence in the markets' near-term upside potential as it does to a fear of a new COVID variant. Some investors fear global equities, which have seen strong gains and robust valuations in recent years, may offer a much more limited range of attractive investment opportunities going forward. We expect new variants will continue to emerge in the coming years, but that updated vaccines, new antiviral treatments and stronger scientific understanding will hopefully minimize global economic disruptions.

On a regional basis, we expect potentially solid economic growth across developed economies in 2022, albeit at a slower pace than the recovery-driven levels seen in 2021. Input cost inflation has weighed on the margins of most companies in 2021. We believe higher rates of inflation will persist in the first half of 2022 but will moderate as supply chain disruptions dissipate and logistics costs and raw materials prices move lower. We think it's likely that labor shortages and higher wages will persist, but that the rate of wage growth may be lower than what we saw in 2021.

Where We See Risk

The most prominent risks we see for global equities are COVID-related economic disruptions, potential monetary policy missteps and elevated valuation levels. Equity markets generally struggle during periods of slowing economic growth and rising interest rates, both of which we expect to see in 2022.

Recently introduced restrictions in several European countries demonstrate that COVID concerns will continue to impede a return to "normal." Or is this the new normal? The pace and extent of central bank rate increases will be watched closely. If rates rise too high too quickly, that would likely hurt the prices of growth companies whose valuations have been boosted by exceptionally low interest rates. However, if inflation shows signs of easing in early 2022 and employment levels are still depressed, central banks are likely to proceed more cautiously with rate increases.

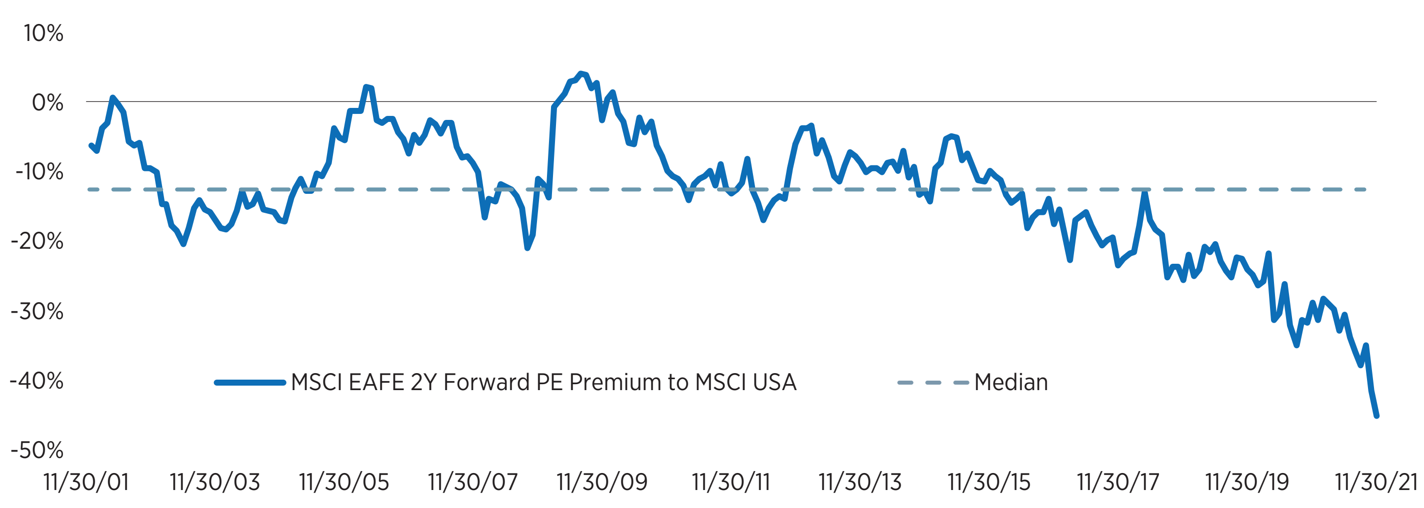
Time for a Shift in Market Leadership?

After an extended period of outperformance by U.S. equities dating back to the global financial crisis, we expect international equities may outperform in the coming years, driven by:

- More supportive fiscal and monetary policies in Europe and Japan.
- Real yields[2] rising more in the U.S. than in international markets, pressuring U.S. equity valuations in general, and U.S. growth stocks in particular.
- Attractive valuation levels – international equities trade at a multi-decade, extreme discount relative to U.S. equities (Exhibit B).

Exhibit B

International Equity Valuations at Historically Attractive Levels



Source: FactSet, MSCI, monthly data as of 11/20/2021. The **forward price-to-earnings ratio** (forward P/E) is a valuation method used to compare a company's current share price to its expected per-share earnings.

We expect the U.S. Federal Reserve will move more quickly to raise interest rates than the European Central Bank and the Bank of Japan. With inflation easing but still higher in the U.S. than in Europe and Japan, we expect U.S. real yields to rise at a faster pace than European and Japanese real yields. This could pressure U.S. equity valuations, which trade at a seemingly ever-expanding premium to their international peers.

Areas of Opportunity for 2022

Consistent with our outlook, we think there is significant potential in European markets and less opportunity in the U.S. Positioning in our global and international equity strategies reflects these views. In terms of sectors, we see potential value in select industrial and health care companies, particularly those with sustainable business models and leading market positions. We also see opportunity in high-quality companies that are likely to benefit from post-pandemic economic recovery or trade at what we believe are artificially or temporarily depressed valuations. As always, reliable compounders form the backbone of our strategies.

Bottom line: Although global stock markets will likely face a range of socioeconomic challenges in 2022, we think international equity markets may be poised to outperform the U.S., and that an active, high-quality investment approach may prove advantageous.

[1]Higher-quality companies typically have consistent earnings, strong balance sheets, significant free-cash-flow generation, growing revenues and meaningful competitive advantages, whereas the opposite is true for their lower-quality counterparts. Historically, high-quality equities have outperformed over full market cycles.

[2]Real yield is the nominal yield of a bond minus the rate of inflation.

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Definitions

MSCI EAFE Index an unmanaged index of equities in the developed markets, excluding the U.S. and Canada. Unless otherwise stated, index returns do not reflect the effect of any applicable sales charges, commissions, expenses, taxes or leverage, as applicable. It is not possible to invest directly in an index. Historical performance of the index illustrates market trends and does not represent the past or future performance of the fund. MSCI indexes are net of foreign withholding taxes. Source: MSCI. MSCI data may not be reproduced or used for any other purpose. MSCI provides no warranties, has not prepared or approved this report, and has no liability hereunder.

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Date-of Data: December 27, 2021

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