Quarterly Market Update

4Q 2021

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Five Key themes over the 4th Quarter, 2021

Omicron

Arrival of Omicron, the latest variant of the Covid-19 virus put a dampener on the festive spirit that was starting to set in, as 2021 drew to a close. Markets were naturally jittery and unsurprisingly global airlines and travel related sectors were impacted. The uncertainty around the severity of the Omicron variant has come down, as more data is gathered from around the world. However, markets continue to remain cautious about the impact this variant with its 50 mutations that include more than 30 on the spike protein, the exposed part of the virus that binds with human cells, is likely to have.

These changes have made this variant more transmissible than the earlier dominant Delta variant, and potentially evade the immune protection conferred by vaccines or prior infection. However, there are signs of optimism as Omicron, although potentially more transmissible, may not be more severe than the existing variants and vaccines could continue to offer protection against severe form of the disease. New therapeutics in the form of antiviral pills from Pfizer and Merck targeted to treat mild to moderate Covid-19 also add to toolkit and optimism.

Inflation

The market's perception of global inflation risk has been a dominant theme for investors and will likely continue as a key factor of consideration looking ahead. While we believe many of the recent inflationary pressures, namely supply chain constraints and the tight supply in the energy markets, are likely to dissipate as lockdowns ease, there is mounting evidence around spillover effects into wage inflation. The market narrative in recent months was skewed towards a sense that the US Federal Reserve (Fed) was behind the curve on inflation and concerns around this leading to a path of more aggressive tightening. Recent comments from the Fed see this risk materializing as it clearly adopts a more hawkish stance and navigating this risk will be key to generating compelling investment returns.

As the inflation discussion carries on commodity prices are featuring as a watchpoint as well as they will likely go up in line with the typical decade-long cycles. Pricing pressures will result as supply falls behind demand. This phase will likely persist till we see supplies ratcheting up again. In Asia, the inflation sensitivity of the economies in the region to higher energy prices has historically been relatively muted due to factors such as price rigidities, the nature of electricity pricing agreements, and time lags. Although Asia is a commodity importer, Asian central banks have had a track record of looking past commodity price increases, viewing them as transitory and a tax on growth, rather than having sustained impact on wages or broader prices. Asia has also struggled with unemployment or under-employment since the 2008 Global Financial Crisis. The last two years of tightened mobility measures have worsened Asia's labour market slack and this will likely constrain commodity prices from broadening into more general price pressures.

Geopolitical Risks

Geopolitical risks are on the radar, in context of the energy sector. Although we are well into the winter season, there has been uncertainty around the winter weather and the La Nina effect making temperatures exceptionally colder, with the energy crisis potentially lingering on. The current supply-demand global energy balances remain tight and vulnerable to supply disruptions. This gives an upper hand to energy producers, putting the spotlight on Iran and Russia in particular. The market may potentially by underestimating Russia's aggressive stance towards the west and flare ups with Iran could lead to oil supply disruptions that will impact the energy markets.

Source: Eastspring Investments.

ESG

Investors have gone beyond the "why" of responsible investing and are increasingly focusing on the "how", with a sense of urgency on the back of intensifying climate concerns. The COP26 agreement in Glasgow had set common timeframes and put procedures in place to help keep the global temperature increase to 1.5 degrees Celsius by 2030. However, the gap in reducing carbon emission levels remains considerable.

An 80% reduction in coal energy globally is required to meet the Paris climate goal. In Asia and the Emerging Markets (EMs), a large existing stock of coal plants and mines continue to be a key source of energy and jobs. A holistic approach is needed to help the emerging economies transition away from coal. Governments need to develop transformation strategies and minimise the impact of the transition on people and communities. This may require upskilling and reskilling of people. Significant resources are also needed to build new green infrastructure or repurpose existing ones. EM governments and companies will need substantial financing to achieve the COP26 goals and timelines. Some Asian economies are making headways in building a more carbon-neutral, climate resilient world. In October 2021, South Korea proposed a 40% cut to its greenhouse gas emissions by 2030 compared with 2018 levels, up from an earlier target of 26%. Hydrogen will play a big role in achieving this outcome. While South Korea aims to reduce its carbon footprint by becoming a hydrogen-based economy, other Asian economies will forge their own paths to decarbonise the environment.

Cryptos

The future investment potential of cryptocurrencies continues to be a hotly debated topic. Enthusiasts have drawn parallels to gold while skeptics have dismissed it as a fad. Volatility around cryptocurrencies remains high and they are looked upon more as financial assets, rather than as a way to facilitate payments.

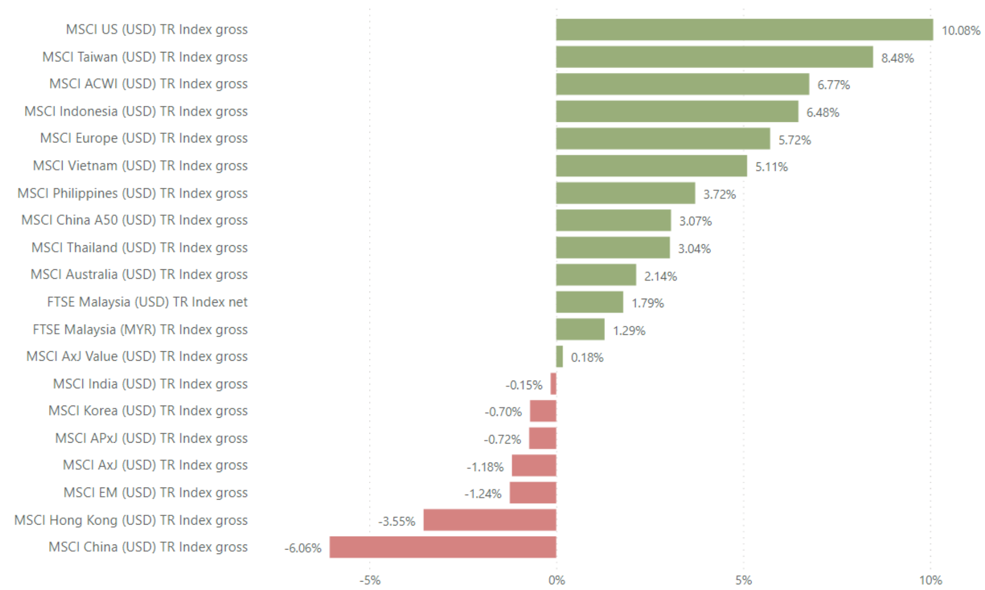
Although there appears to be a longer term potential for this asset, it may still be a little early to incorporate it into portfolios to seek diversification benefits. While gold has clearly been shown to support portfolio performance in periods when a balanced (equity -bond mix) portfolio may be suffering, the sample size is far too limited to draw any firm conclusions for cryptos. Another challenge is to find an appropriate (risk-managed) way to access this space.

Source: Eastspring Investments.

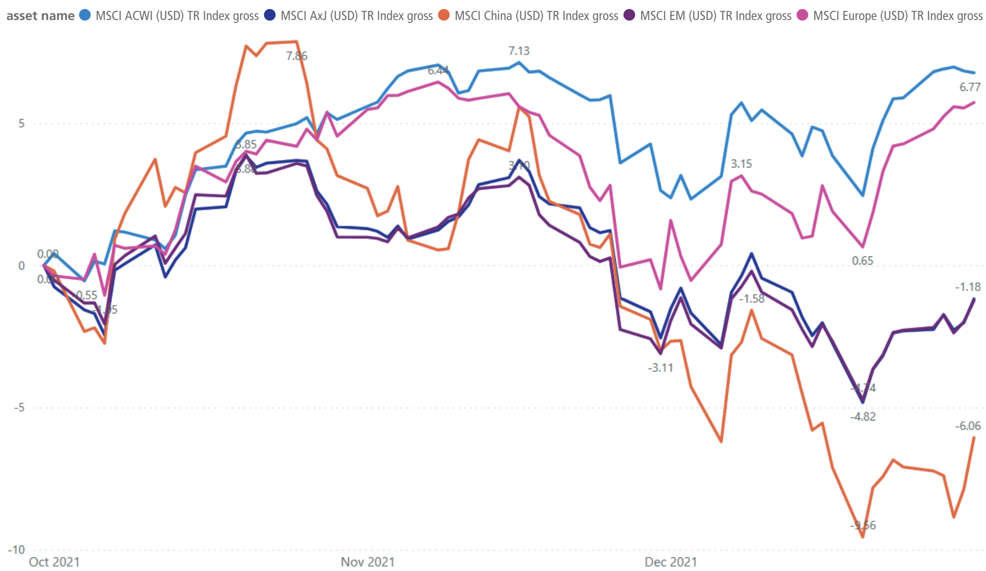
Equities

- Equity markets broadly rose over the 4th quarter, although returns were volatile and there was significant dispersion between the best and worst performing markets. Markets initially gained before falling back on the emergence of the Omicron virus variant. US was one of the strongest performing markets during the period, MSCI US (10.1%) along with MSCI Taiwan (8.5%). The broader markets represented by MSCI ACWI (6.8%) and MSCI Europe (5.7%) were in positive territory over Q4 with MSCI EM (-1.2%) being the laggard posting negative returns. MSCI Asia ex Japan (-1.2%) was in line with MSCI EM's performance and MSCI China (-6.01%) and MSCI Hong Kong (-3.4%) again had a challenging run of performance over the quarter.

Asset Performance Custom (30 Sep 21 till 31 Dec 21)



Asset Performance 30 Sep 21 till 31 Dec 21



Source: Eastspring Investments.

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Fixed Income

- In Fixed Income markets, Bloomberg Barclays Global Aggregate index ended the quarter in negative territory returning -0.7%. The JACI Index returned -1.4% in Q4 with investment grade names (0.1%) outperforming their high yield counterparts (-6.8%). From a country perspective, Pakistan was the strongest performer, adding 1.5% over the quarter, while Sri Lanka was at the other end of the spectrum, down -13.7%. China gave up -3.1% in Q4 while Hong Kong edged modestly in positive territory, finishing the quarter up 0.4%

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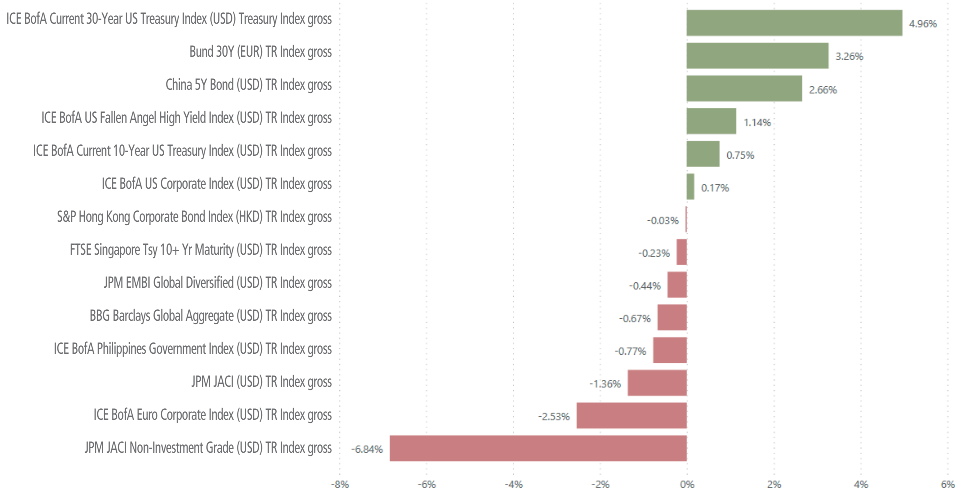

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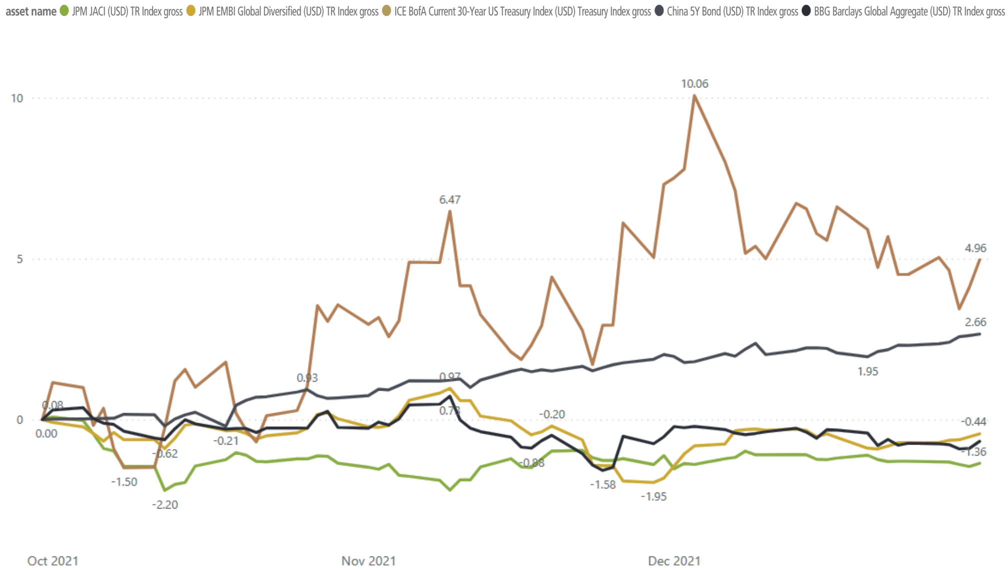

Source: Eastspring Investments.

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Currencies

- The USD Dollar Index rose 1.9% over the fourth quarter. The Dollar saw strong gains against the Japanese Yen (3.4%), Chinese Yuan (1.4%)and also edging up against the Singapore Dollar (0.6%)
- The Indian Rupee (-0.4%), British Pund (-0.4%), Malaysian Ringgit (-0.5%) and the Thai Bhat (-1.3%) all lost ground against the dollar over the quarter.

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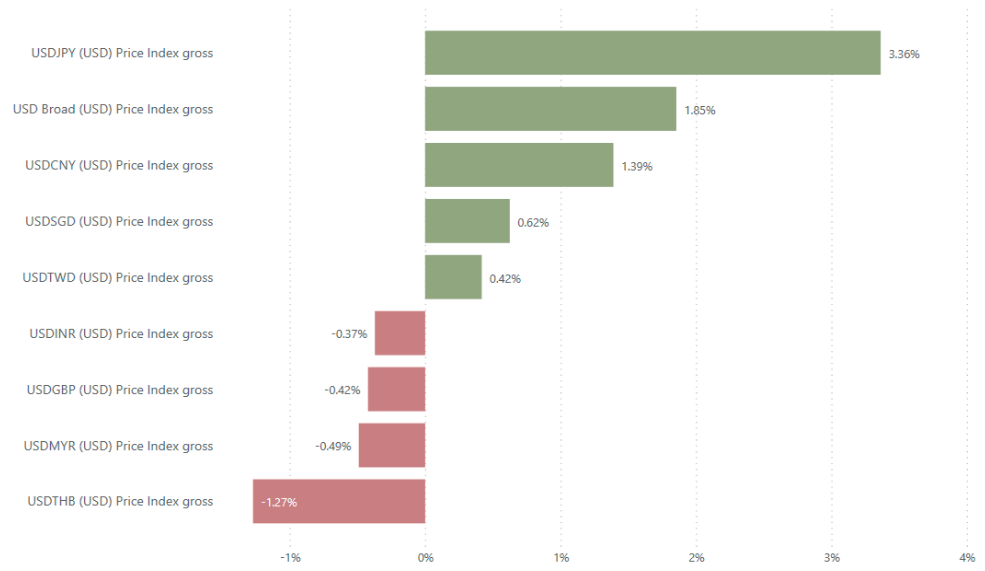

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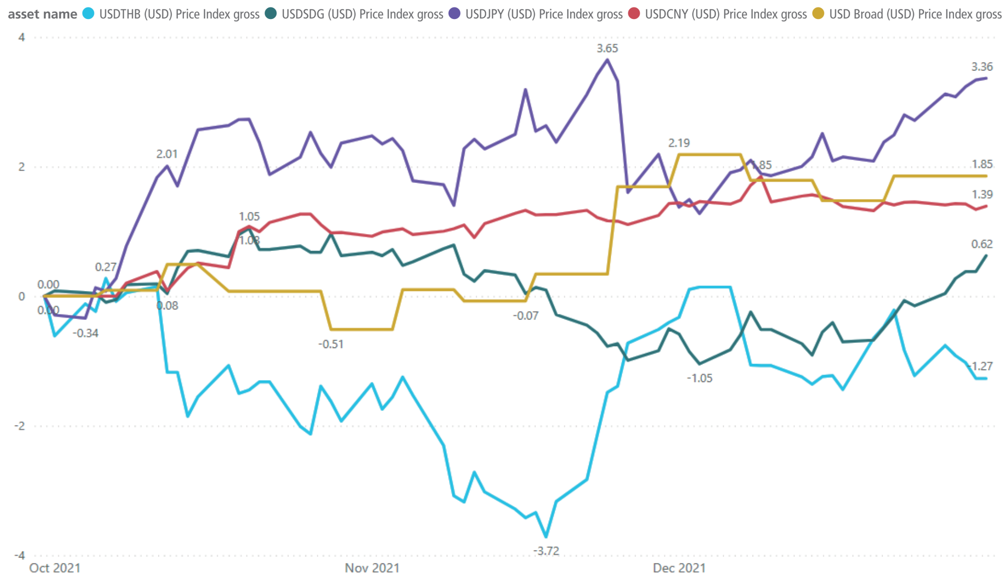

Source: Eastspring Investments.

Economics

- 2022 will likely be characterised as a 'normalisation year' much like what took place in 2004 and 2010, where monetary and fiscal policies start to become less supportive for global growth. Policy makers are expected to tighten after two years of very loose COVID support measures but fading growth momentum amidst rising inflationary pressures is likely to constrain central banks. The possibility of policy errors and changes in market perception are areas to watch.
- In its most recent report published in October 2021, The International Monetary Fund (IMF) expects the global economy to grow by 4.9% in 2022. The forecast was revised marginally lower from its earlier figure of 5.0%. Looking further ahead, the IMF expects medium term growth to moderate to 3.3%. There will likely be continued divergence between advanced economies and emerging markets as output in the former is projected to grow faster given the significant policy support and faster vaccine rollouts.

Source: Eastspring Investments.

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