SECOR Asset Management

Quarterly Macroeconomic Outlook Update

October 21, 2021

Global Macroeconomy: October Update

- **Outlook for Global Growth Unfolding Largely as Expected at Time of August Meeting**
  - We believe we are still on track for solid above-trend growth in 2021 and 2022
  - Economic activity continuing to increase
  - New COVID cases declining/vaccinations increasing
- **Evolving Risks (Largely Downside) Have Arguably Increased**
  - *Near-term inflation higher than expected/ longer-term expectations still appear to be anchored but…*
    - Central Bankers seemingly becoming more forgiving in how they interpret the word *transitory*[1]
    - Supply-side constraints/bottlenecks greater than expected
    - Commodity prices up 13% since August report and crude oil prices up nearly 20%[2]
    - Most major DM 10-year sovereign yields up ~25 bps -~ 50 bps from their summer lows[3]
  - China concerns increasing: Q3 growth lower than expected
    - Regulatory reset continuing/Evergrande default/rash of energy-related shutdowns
  - Pending major US legislation for tax policy and social spending[4]
    - Impact could be nuanced– stimulate growth, while increasing corporate tax drag

1. Baseline CPI outlook now calls for inflation to be 3% or greater in the US and UK in 2022 and not approach the central bank's 2% target until 2023.
2. GSCI index +13% between August 11 and October 15. Crude oil prices up 19% over the same period.
3. Between August 11 and October 15 US 10-year yield +24 bps, UK 10-year +54 bps, DE 10-year +30 bps, and Japan 10-year +5 bps.
4. We expect the debt ceiling to be raised by the December and an infrastructure package along with a new multi-year social spending program with accompanying tax increases to be passed. However, the intense partisan debates over the social spending plan and tax increases suggests there is a non-zero chance that it will not be passed. Our best guess for the new plans are: $2.5 trillion multi-year plan including $500 bn. of new infrastructure spending. The new tax and spending initiatives on clean energy and infrastructure could create some corporate winners and losers. With spending likely to exceed tax by a wide margin, the program should be a plus for cyclical growth.

Global Baseline Cyclical Outlook (2021 and 2022)

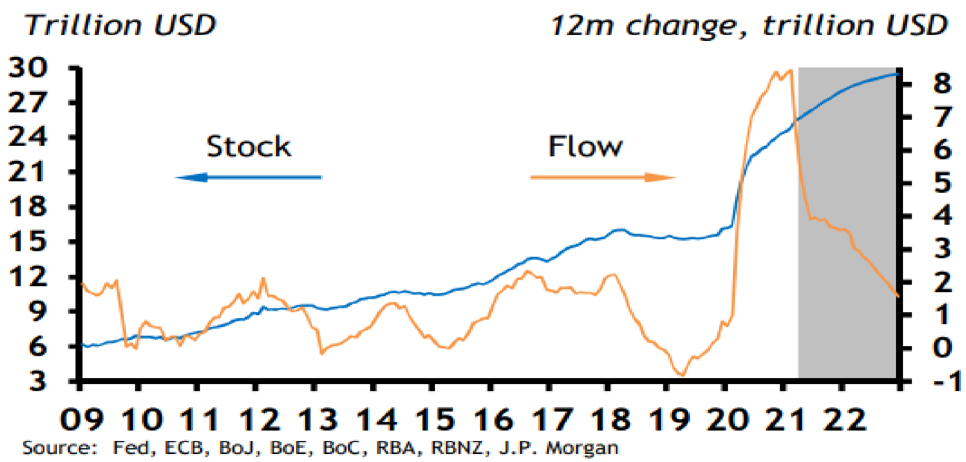
- **Exiting Deepest/Shortest Postwar Recession with Exceptional Above-Trend Growth**
  - Unprecedented global stimulus
  - Strong private sector
  - Learning to live with Covid
- **Expect 2022 Global Growth to Be Solid and Still Above Trend but Less Robust Than This Year's**
  - Fiscal policies, in particular, expected to be less stimulative
  - Spending expected to become better balanced and rotate toward services gradually
    - As pent-up demand for goods diminishes

	Expected Real GDP Growth		
	Global	DMs	EMs
2020	-3.2	-4.9	-1.8
2021	6.0	5.2	6.8
2022	4.5	4.1	5.0

Source: SECOR Forecasts

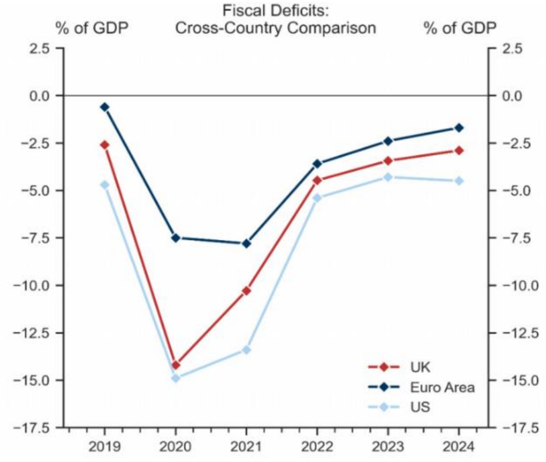
Policy Backdrop Evolving But Expected to Remain Stimulative Through 2022

Central Bank Balance Sheets



- Major Central Bank balance sheets expected to remain at elevated levels, despite QE tapering
- Real policy rates to stay negative even if some banks start to edge up their nominal rates

Deficits



- Fiscal policy will be less stimulative going forward
- Public deficits for major DMs are expected to narrow significantly for over '22- '23 period[1]

1. US deficit estimate incorporates an assumption of additional fiscal spending of about $3 trillion over 10 years in connection with the infrastructure and social spending packages.

Source: Haver Analytics, OBR,GS

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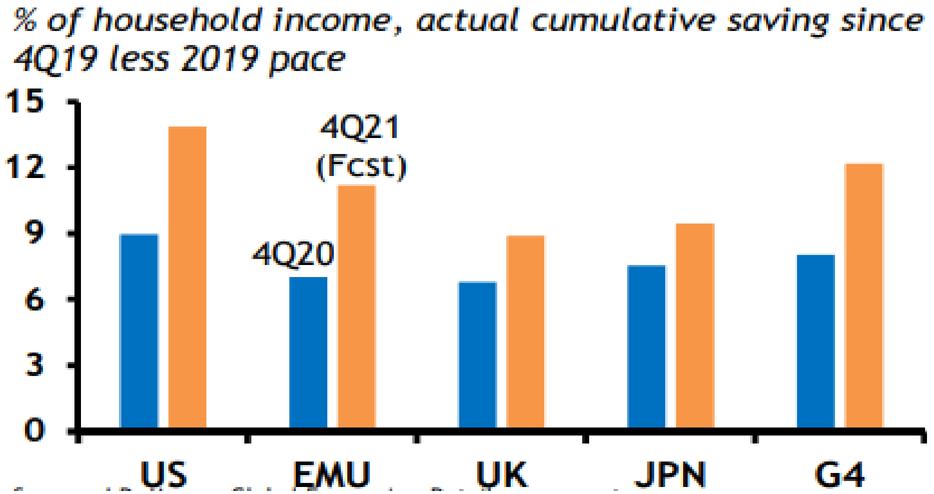
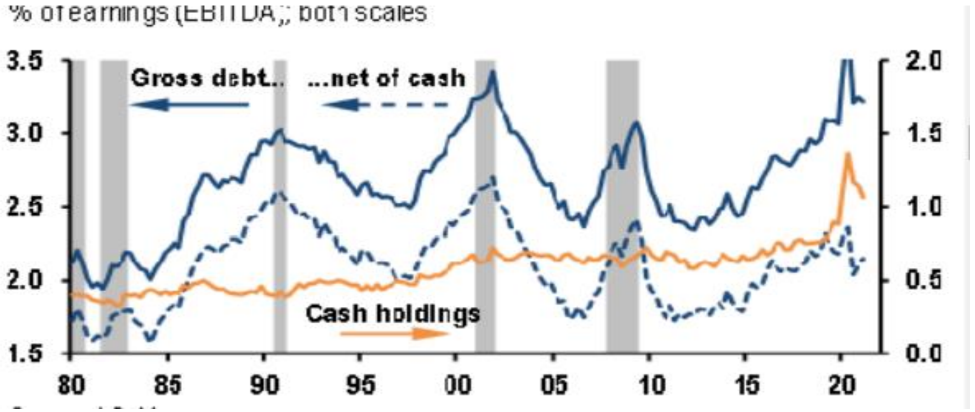
Private Sector in Strong Position/Limited Scarring from Recession

Record G4 Excess Savings



- Unlike most prior recessions, consumers are exiting pandemic recession in strong financial positions
- Saving balances at unprecedented levels

US Non-Financial Corporate Balance Sheets



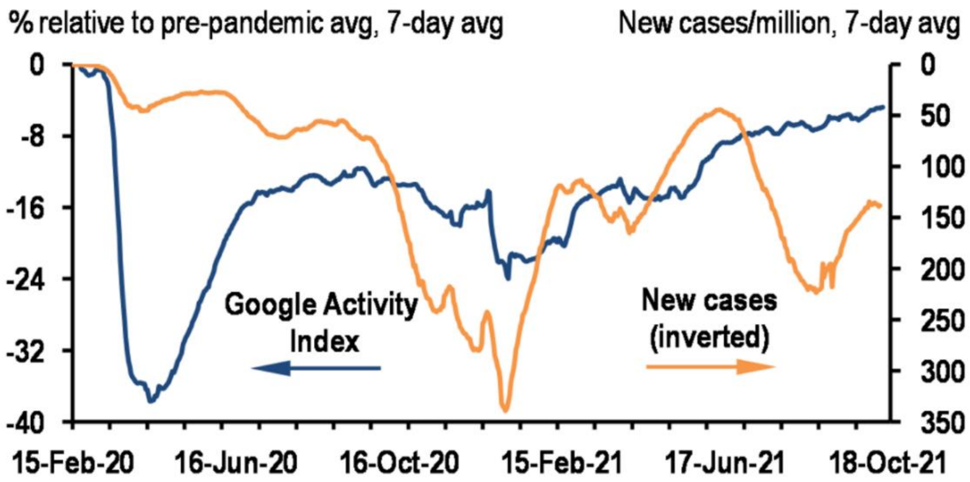
- Corporate cash holdings (gold line) have increased about in line with debt, leaving corporate cash holdings in a relatively strong position

1. US deficit estimate incorporates an assumption of additional fiscal spending of about $3 trillion over 10 years in connection with the infrastructure and social spending packages.

Source: JPM

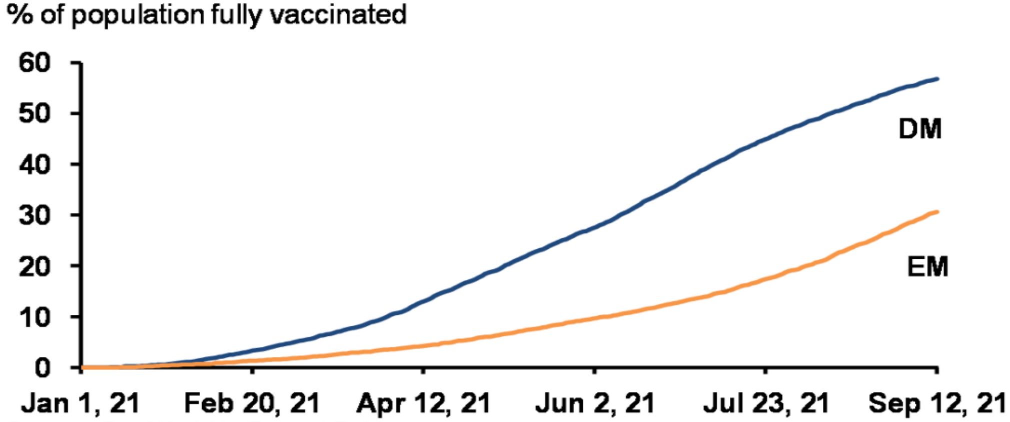
Coping with COVID: Global Mobility / Virus / Vaccinations / Efficacy

Global: New COVID-19 Cases and Mobility



- Global mobility (blue line) continuing to edge up but still below pre-pandemic level
- New global COVID-19 cases (gold inverted scale) have declined from recent peak in the summer

Vaccinations



- Vaccinations continuing to increase
- ~55% of DM population and nearly 30% of EM population fully vaccinated[1]
- Latest research confirms vaccines highly effective in preventing severe illness[2]

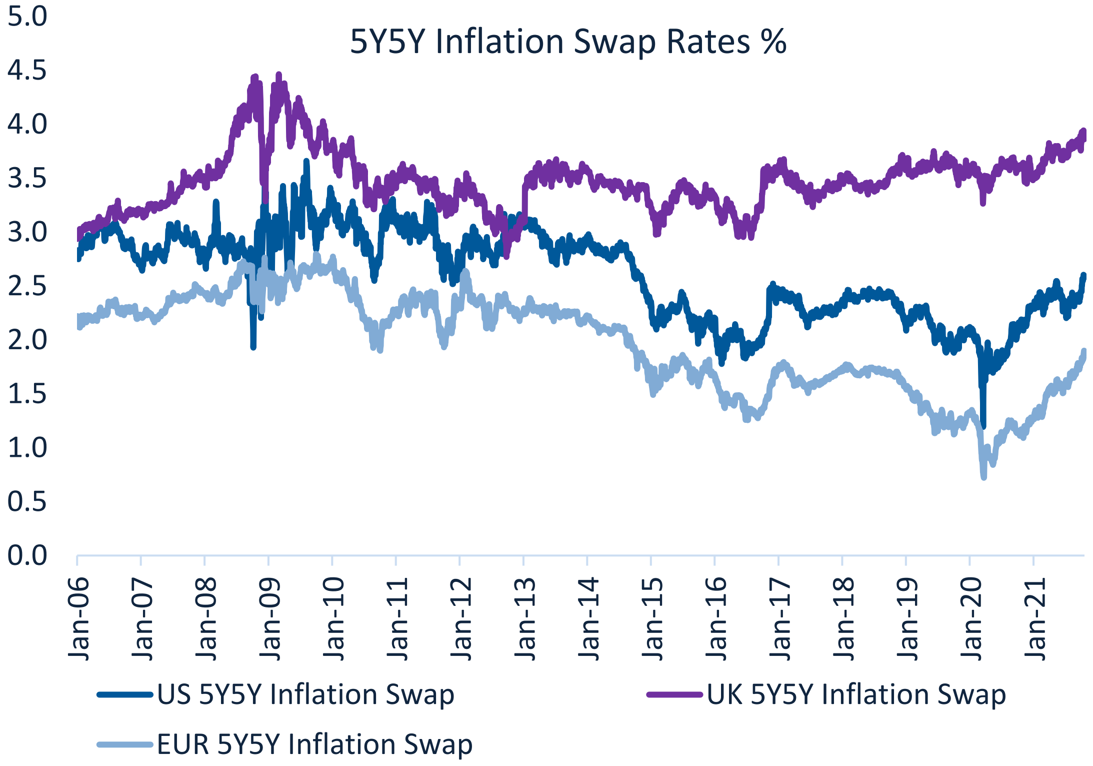
1. Within European major DMs (80%- 64%) have received 1st dose and in US 62% have received 1st dose
2. Major vaccines (Pfizer, Moderna, Astra Zeneca, J&J) after 150 days shown to be 90% effective in preventing hospitalization

Source: Google, Our World in Data, JPM

Markets Now More Fearful of Near-Term Inflation Risks vs August 2021

- Breakevens rose sharply amidst soaring commodity prices and supply chain bottlenecks
- Some persistent inflation measures may be somewhat impacting long term markets as well
- UK 5Y5Y inflation nearly 1% above the long run inflation target
- US/EUR fair to slightly rich

Change in Implied Inflation Since 13 August 2021					
(bps)	1Y	2Y	5Y	10Y	30Y
US	31.7	31.7	20.6	20.4	13.9
UK	**198.5**	**120.9**	**71.5**	40.3	30.5
EUR	0.5	8.6	28.5	36.9	19.7



Source: FTSE, Barclays, Bloomberg

Representative “Official” Views on Rising Inflationary Pressures

- *US (Fed’s September Report*) **Core PCE inflation now expected to increase 3.7% this year compared with 3% forecast in June.** Fed’s updated median ‘22 and ‘23 forecasts: 2.3% vs 2.1% and 2.2% vs. 2.1%.
- *UK (Bailey’s October comments*) **Consumer prices likely to rise slightly above 4% this year largely due to energy shock. Recent acceleration expected to be temporary but need to prevent higher inflation expectations from becoming entrenched**.
- *Euro Area (Lagarde et al October comments)* Inflation will slow once supply-demand imbalance ease. Euro zone’s high level of structural unemployment and ageing populations should act as cap on inflation prospects. **ECB expects inflation to average 2.2% this year before easing back to 1.7% next year and 1.5% in 2023.**
- *OECD (September Report)* **G20 inflation expected to hit 4.5% in Q4, 1.5%-points due to higher shipping costs and commodity prices.** Since June OECD has raised its 2021 and 2022 inflation forecasts for most countries by >0.3%-points
- *IMF (October Report)* Reiterates recent surge due to commodity prices and bottlenecks which should subside by 2022 but notes: “…uncertainties are fueling worries that inflation could persistently overshoot central bank targets and de-anchor expectations, leading to a self-fulfilling inflation spiral.”

Inflation Outlook: Pivotal Consideration for Investors

Baseline Inflation Outlook*

	'19	'20	'21	'22	'23
US	1.8	1.2	4.3	3.3	2.2
Euro area	1.2	0.3	2.3	2.0	1.9
UK	1.8	0.9	2.5	3.0	2.1
DM	1.5	0.7	2.9	2.6	2.0
EM**	3.5	3.4	3.6	3.4	3.0

- **Baseline Outlook Calls for Inflation to Moderate Over'22-'23 Horizon**
  - Above-target inflation more persistent than previously expected but…
  - If outlook is on target, Central Bankers should be able to normalize rates at measured pace
- **Key Questions for Our Outlook Discussion**
  - Will inflation overshoot our baseline '22-'23 inflation outlook?
  - Will long-run inflation expectations become unanchored?
- **Affirmative Answers to These Interrelated Questions Likely to Result In…**
  - Central bankers and/or bond vigilantes raising rates significantly

* Headline CPI **EM excludes Venezuela, Argentina
Source: SECOR, various external sources

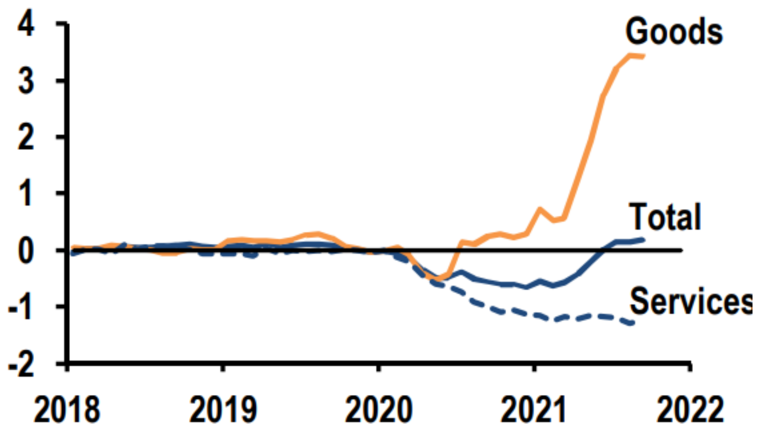
No Easy Answer to Our Inflation Questions

- **Market Measures and Central Banks' Historical Performance Somewhat Reassuring**
  - Long-run inflation expectations up from recent low but roughly in line with targets
  - Measures of long-run underlying inflation used by central bankers also consistent with targets
    - Central Bankers 30-year history of keeping inflation in check provides some credibility
- **Latest Data Nuanced Including Both Reassuring and Concerning Factors**
  - Potentially reassuring factors include:
    - Demand pressures on goods prices may be starting to abate
    - Crude oil price futures in backwardation/ "base effects" could be a moderating factor in '22
    - Manufacturing input prices and popular measure of shipping costs appear to be peaking[1]
  - Areas of potential concern include
    - Sharp rise in house prices likely to put upward pressures rents and rental equivalents
    - Labor shortages a global phenomenon and wage rates, particularly in US, starting to rise
    - Shortages of some key components such as semiconductors likely to persist[2]

1. Freightos Baltic Index (FBX): Global Container Freight Index
2. IH Markit analyst: semiconductor supply not likely to catch up to demand until late '22 and shortfall for some advanced function chips could persist into '23

Inflation Composition/Demand Pressures May be Starting to Abate

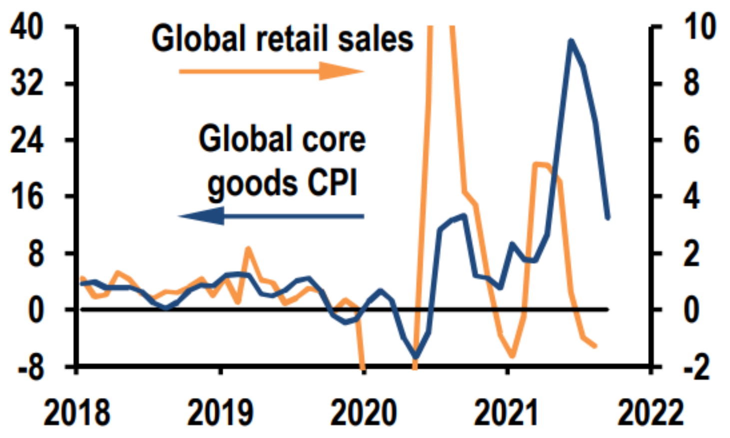
Global Core Inflation



- Post pandemic surge in core inflation concentrated in goods
- Services inflation still below pre-pandemic trend

Core Goods CPI & Retail Sales

%3m, saar, both axes

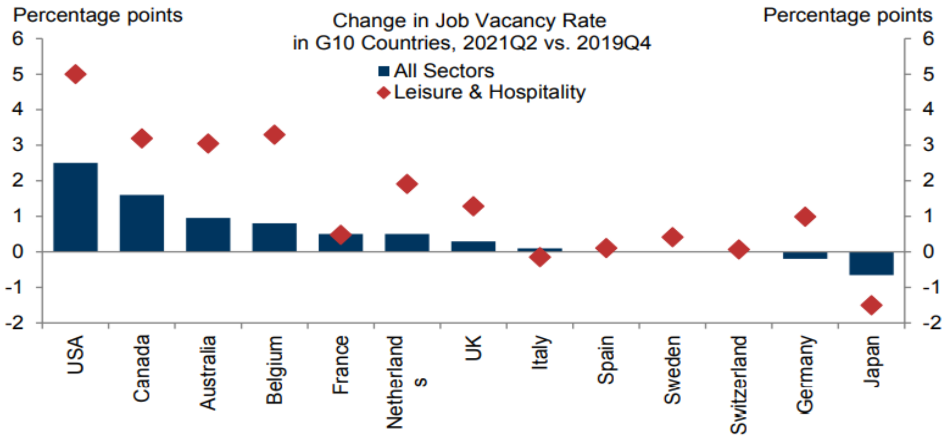


- Global retail sales growth (gold line) has moderated in recent months which should …
- Reduce demand pressures on core goods prices

Source: JPM

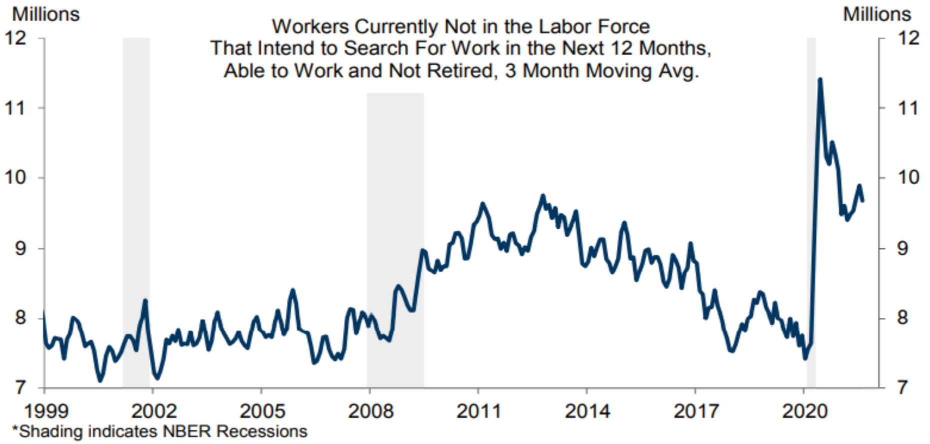
Inflation Backdrop: Labor Shortages

Labor Shortages Widespread



- Labor shortages currently widespread across DM economies[1]
- Leisured & hospitality shortages acute in most countries
- Three possible explanations for labor shortages: (i) increased income and wealth[2], (ii) health concerns, and child-care responsibilities

Many Former Workers Expected to Return



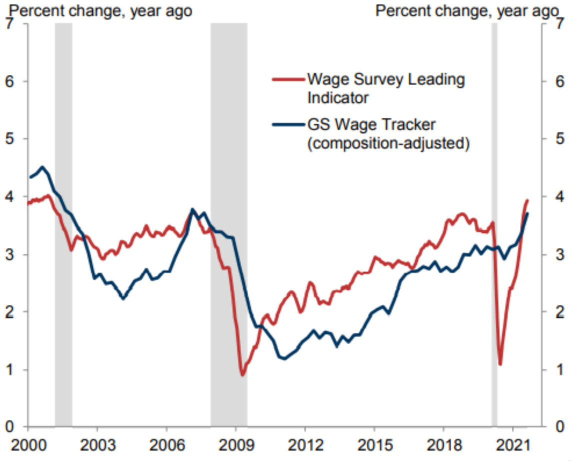
- Most former US workers expect to return to labor force
- Surveys also show that concerns related to health are diminishing and child-care responsibilities are decreasing as schools reopen
- Retirees[3] and decreased number of immigrants, however, could be a source of lingering restraint

1. Income raised by pandemic-related supports should diminish as a constraint but wealth-increases due to stock market and house appreciation could foster early retirements.
2. GS economists estimate early retirements will account for ~1 million hit to the US labor force at the end of ’22
3. IMF (Oct 2021) Outlook indicates that labor participation rates in both DMs and EMs are still below pre-pandemic levels.

Source: GS, BLS

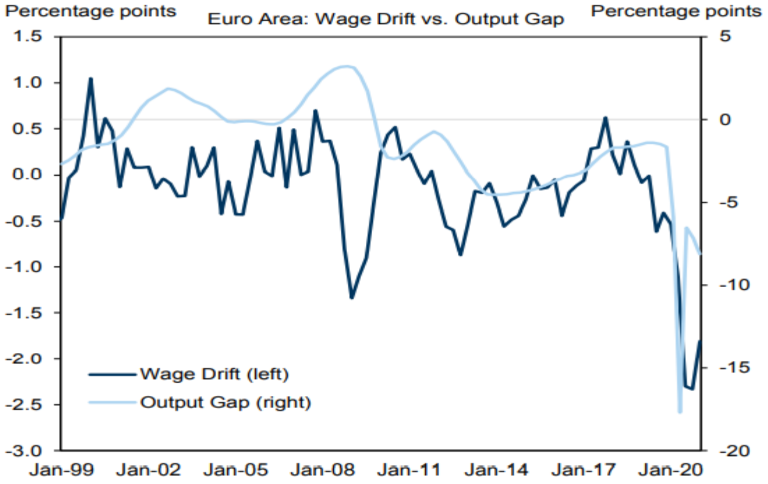
Inflation Backdrop: Wage Pressures Building in US/Still Restrained in Europe

US Wage Growth



- Wages have increased roughly 4% over the past year in the US but …
- Unit labor costs which take account of productivity growth have increased about 2%
- Recent wage pressures particularly intense at the lower end of the wage spectrum where wages are up 6% over a year ago

Euro Area Wage Drift[1] and Output Gap



- Still considerable slack in Euro area/stimulus significantly less than in US/wage pressures subdued
- Area-wide negotiated wage increases: 2.2% (‘19), 1.8% (‘20), 1.4% (Q1’21)

1. Wage drift is defined as the difference between compensation per employee and negotiated wage growth.

Source: Haver Analytics, GS

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China: Recent Growth Slowdown/Evergrande Default/Regulatory Reset

- **Growth slowed to 4.9% over a year ago in Q3 vs. 7% over a year ago in Q2/slowing attributed to:**
  - Property sector weakness, power shortages and rationing
  - Export sector, however, continued its solid growth, while retail sales were up somewhat in September
  - GDP now/forecast to increase 7.9% this year and ~5% in 2022
- **Evergrande's Default Likely to be Manageable for Domestic Economy and Not Material for Global Economy**
  - Total liabilities equivalent to <3% of China's property liabilities
  - Regulators have successfully managed number of prior defaults
    - Likely to redouble efforts to slow credit growth and tighten macroprudential policies
- **Regulatory Reset Over Last Nine Months Far Reaching**
  - Short to intermediate term effects for China's economy likely to be small[1]
  - But long-term implications could be significant[2]

1. Tightening affecting: Fintech, big tech, private tutoring, cryptocurrency and carbon emissions. Also, providing support for advanced manufacturing, tech localization and renewable energy
2. Implications for longer-term economic growth more problematic. With China's unfavorable demographics and need to contain credit excesses major headwinds, China will need to increase productivity growth to meet its economic growth objectives. However, the historical record of China's SOEs underperforming their private counterparts raises serious questions concerning the ultimate success of the reset.

Concluding Thoughts

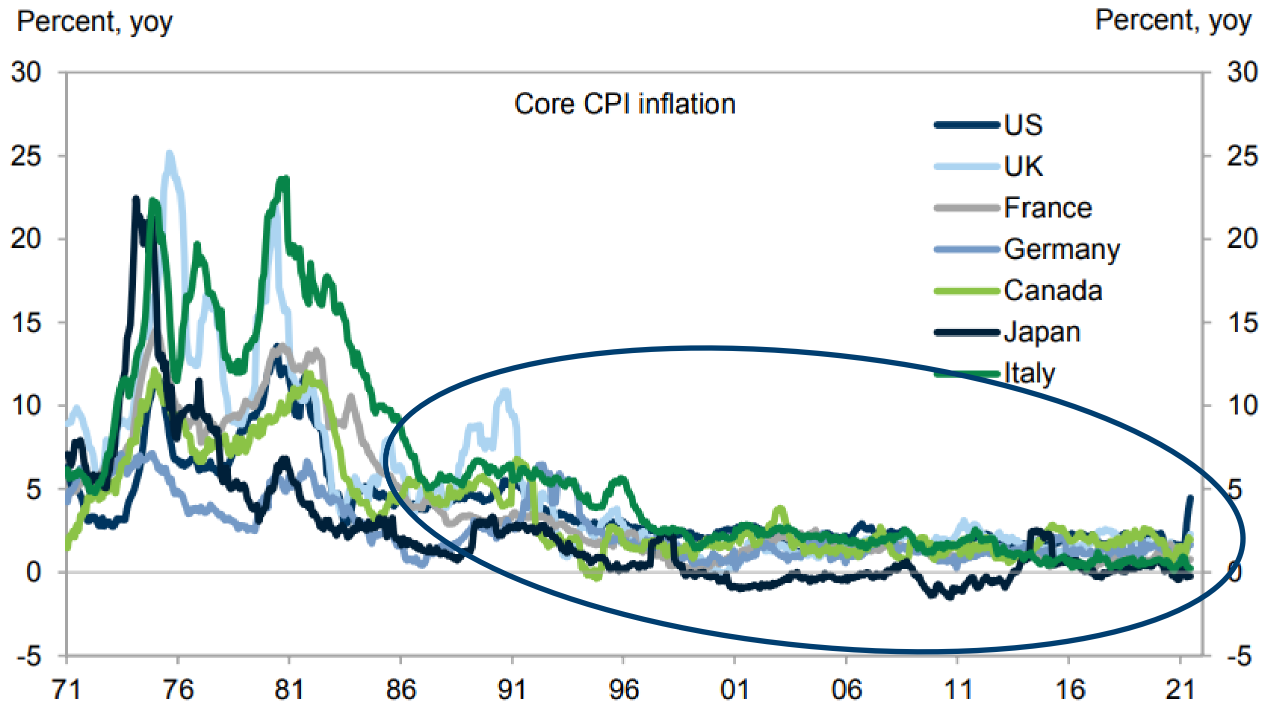
- **We Cited Three Interrelated Macro Factors That Bear Watching at the End of the August Update**
  - Unfolding expectations for continuing expansion
  - Course of virus and vaccinations
  - Evidence that inflationary reopening surge is, indeed, transitory
- **Events of the Past Two Months Have Been Reassuring for Two of the Factors**
  - Recent macro data continue to support the outlook presented in August
    - Aside from a few minor teaks, ‘21 and ‘22 growth appears to be unfolding as expected
  - “Learning to live with virus” / Economic activity is continuing to edge toward normal
    - New Covid-19 case growth is down from recent peaks / vaccinations continuing to increase
- **Inflation Concerns, However, Have Increased**
  - With much of the recent spike due to commodity prices and bottlenecks…
  - If, indeed , supply- demand imbalance start to moderate confidence in the “transitory case” should build
  - But downside risks have increased for rates staying “low for longer,” a linchpin in the market outlook
  - Some preliminary signs surfacing that inflation has peaked but it is still significantly above central bank targets
  - Until we have more convincing evidence that inflation will moderate
    - We can’t be assured that inflation expectations will remain anchored

Appendix

Impressive Historical Record of Major Central Banks in Containing Inflation

- DM inflation has stayed low over the last 30 years following the ‘70s & early-‘80s surge
- Low inflation attributed to: sound monetary policies anchoring inflation expectations, technological advances, better inventory control and globalization (e.g., China entering WTO)

DM Inflation: Last 50 Years



Source: Haver Analytics

Fed Measures of Underlying Inflation

Atlanta Fed's Underlying Inflation Dashboard

Measure of underlying inflation	6-month window		1-year window		2-year window		4-year window		6-year window		8-year window	
	Aug-20	Aug-21	Aug-20	Aug-21	Aug-20	Aug-21	Aug-20	Aug-21	Aug-20	Aug-21	Aug-20	Aug-21
Core CPI	1.3	6.8	1.7	4.0	2.0	2.8	2.0	2.5	2.0	2.4	1.9	2.2
Cleveland Fed Median CPI	2.4	3.1	2.5	2.4	2.7	2.5	2.6	2.6	2.6	2.6	2.4	2.5
Cleveland Fed 16% Trimmed-Mean CPI	2.4	4.7	2.4	3.2	2.4	2.8	2.2	2.5	2.1	2.3	2.0	2.2
Atlanta Fed Sticky CPI	2.0	3.8	2.4	2.6	2.5	2.5	2.4	2.5	2.4	2.5	2.3	2.4
Core PCE	1.3	5.6	1.5	3.6	1.7	2.6	1.7	2.2	1.6	2.0	1.6	1.9
Market-Based Core PCE	1.3	5.1	1.4	3.3	1.5	2.3	1.4	2.0	1.4	1.7	1.3	1.6
Dallas Fed Trimmed-Mean PCE	2.0	2.6	2.0	2.0	2.0	2.0	1.9	2.0	1.9	1.9	1.8	1.9
San Francisco Fed Cyclical Core PCE	-	-	2.9	3.8	3.1	3.3	2.9	3.2	2.9	3.1	2.7	2.9
Cyclically Sensitive Inflation (Stock and Watson, 2019)	2.2	4.5	2.2	3.0	2.0	2.6	2.0	2.3	1.9	2.1	1.8	2.0

Green	Measure is within target range (-/+0.25 ppt from target)
Blue	Measure is between 0.25 and 0.50 ppt below target
Purple	Measure is more than 0.50 ppt below target
Yellow	Measure is between 0.25 and 0.50 ppt above target
Red	Measure is more than 0.50 ppt above target

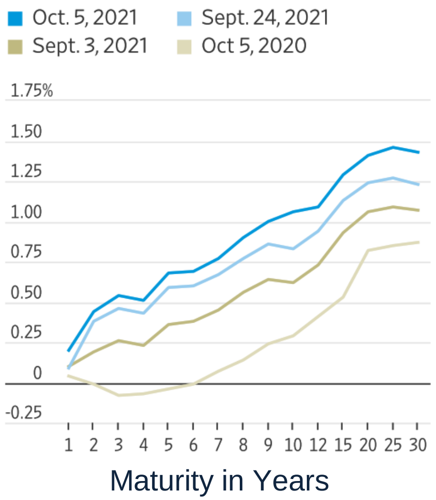
- Most measures of underlying US inflation over short to intermediate term (6 months to 2 years) now in red zone (50 bps. > target), vs. none a year ago
- Over the longer term (4-8 years) most in green zone and no longer any below target (blue zone)

Source: Atlanta Fed, Deutsche BK

Inflation Expectations

US & EUR Inflation Expectations

UK Government Bond Yields



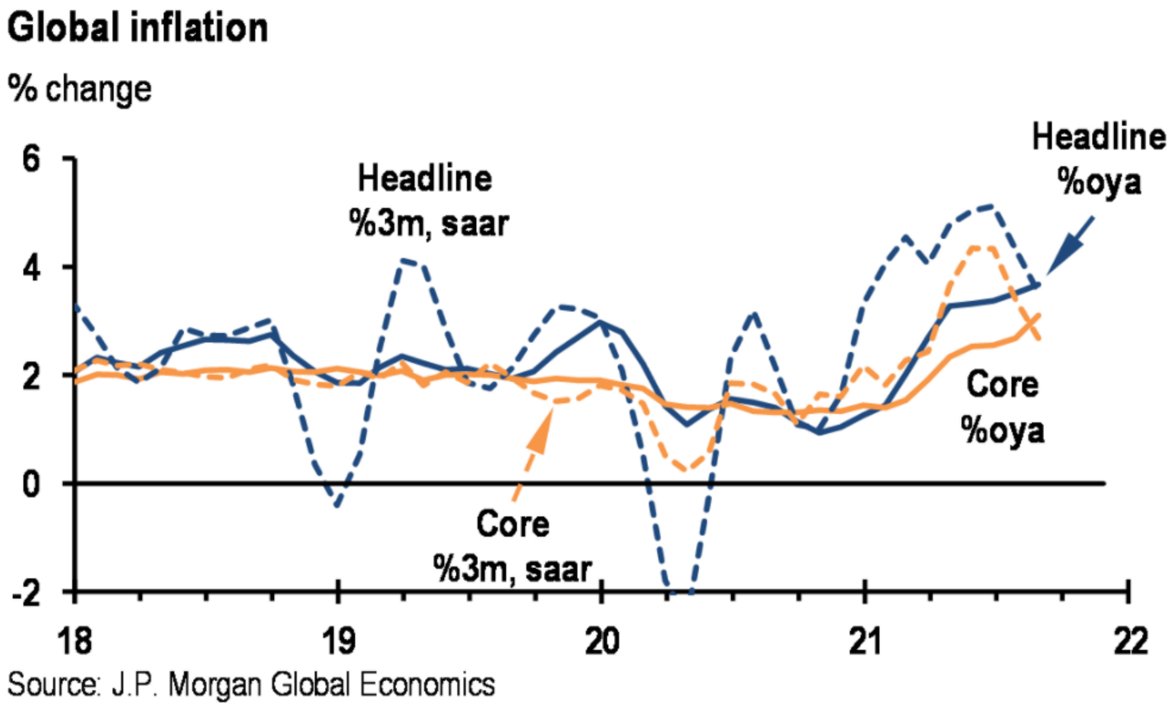
Source: GS, FactSet

- US and Euro area 5y/5y inflation swaps are at top end of their post-2014 ranges but…
  - Still below their 2010-2014 ranges

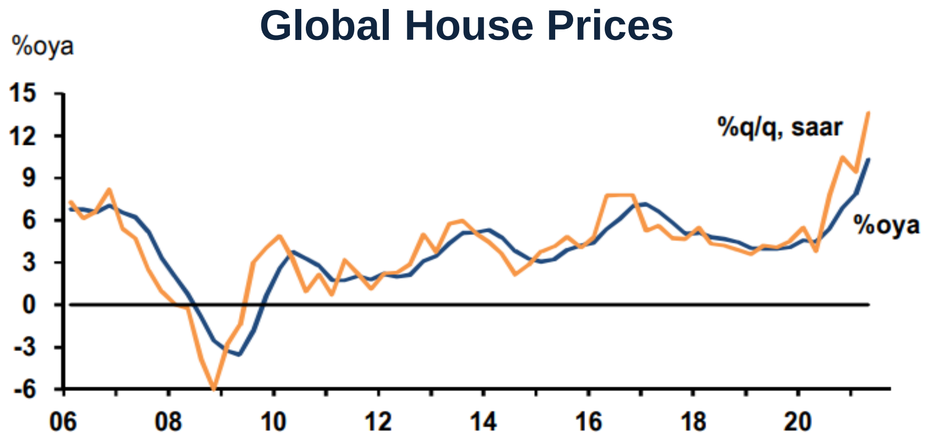
- UK inflation expectations and bond yields rising
  - Longer-term government yields currently ~1.4%, up ~80 bps from a year ago

Global Inflation: September Releases

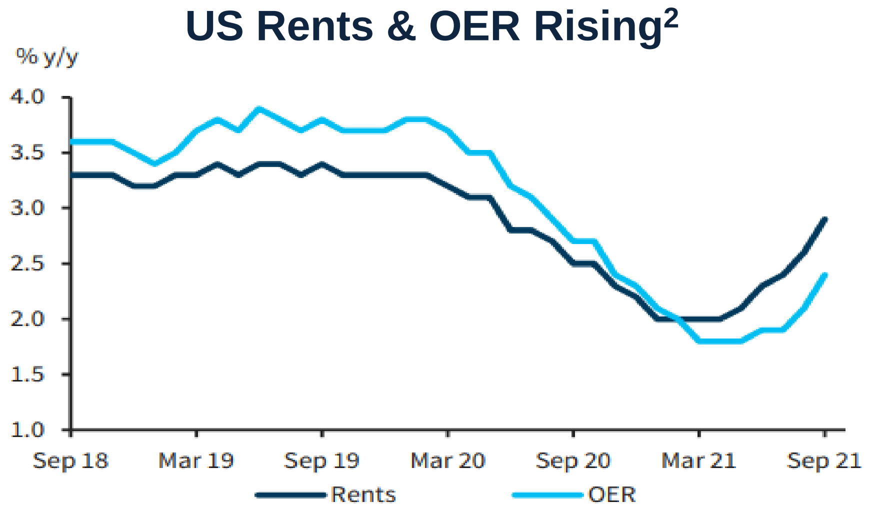
- September global inflation reports mixed
- Direction of travel remains to the upside on a year ago basis
- But the run rate has cooled recently– 3-month annualized paced of core inflation has slowed to 2.7%, while this headline has moderated to 3.5%--both 1.5% points below recent peaks



Global House Prices/US Rent and OER



- Global house prices rising sharply[1]
- Demand supported by: low rates, fiscal stimulus and mobility restrictions
- Supply constrained by: shortages of construction material and labor

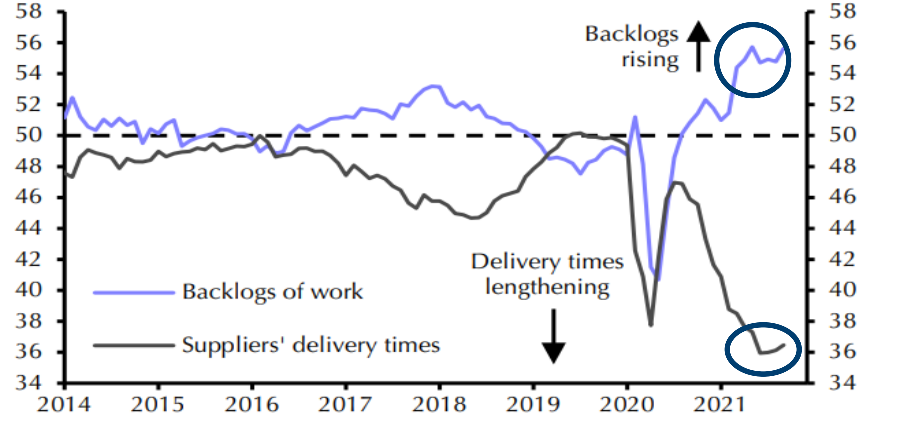


- Rising home prices starting to affect CPI
- Rents (+0.5% m/m) and owners equivalent rent (+0.4% m/m) in September

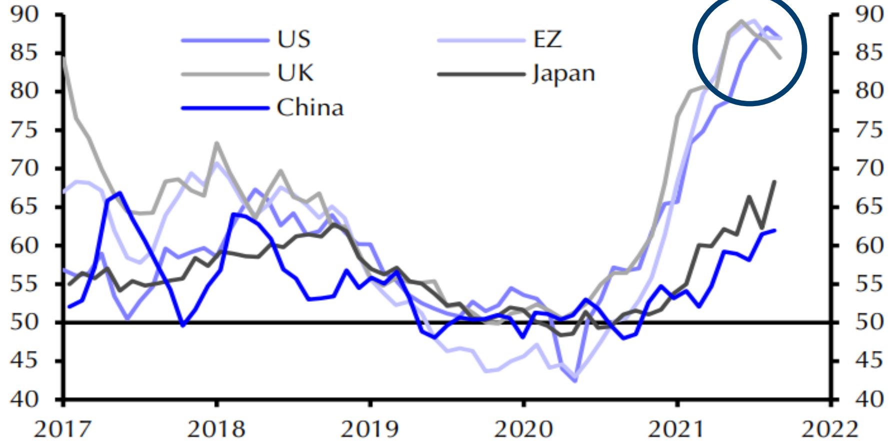
1. Global prices ~9% oya with DM 12.7% oya and EM 6.2% oya.
2. OER – Owner's Equivalent Rent. In general, a 10% rise in house prices in the US translates into a2% rise in US housing servicing costs –e.g., deflator service price inflation rose 3.5% in July. Housing services comprise nearly one-third of CPI and ~15% of PCE deflation.

Source: JPM, BLS, Ham Analytics

Global Backlogs/Delivery Times/Manufacturing Input Prices



- Strong demand and shutdowns resulting in:
  - Order backlogs and labor shortages, constrained output, increased transportation costs[1] and lengthened delivery times for traded goods



- Input prices up significantly for US, Euro area, and UK manufacturers –though latest survey data show some signs of peaking
  - Remains to be seen, however, whether higher input prices will be reflected in goods prices, absorbed in margins, or offset by higher productivity

1. Large retailers (e.g., Home Depot, Costco, Target and Walmart) are reported to be chartering smaller ships at premium prices to transport goods and avoid congested ports. Some other retailers are reported to be switching to air carriers which are much more expensive than ships.

Source: IHS Markit, CE

Selected Country/Regional Forecasts

	GDP Growth %		
Major DMs	**2020**	**2021**	**2022**
US	-3.4	~~6.1~~ 5.7	~~4.1~~ 4.0
Euro Area	-6.4	~~5.2~~ 5.0	~~4.6~~ 4.5
UK	-9.7	7.0	~~5.0~~ 4.8
Japan	-4.6	~~2.6~~ 2.4	~~3.7~~ 3.2
Major EMs			
China	2.3	~~8.3~~ 7.9	~~5.6~~ 5.0
India	-7.3	~~9.0~~ 8.7	~~7.5~~ 8.5
Brazil	-4.1	5.0	~~2.5~~ 1.7
Russia	-3.0	~~3.7~~ 4.3	~~3.0~~ 2.8

Source: SECOR Forecasts

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