HOSKINCAPITAL

Market Outlook

Q421-2022E

To sum up our market outlook for the remainder of 2021 and 2022, the current market risks are, "priced in, but sensitive to surprises".

Of the three major market forces taking center stage (Omicron, Fed/interest rates, inflation), all three have failed to cause any major market upset because, despite being directly counterproductive to economic growth, they are proceeding exactly as the market expected them to. As these forces continue apace, we believe the economic foundation for markets is very solid and we remain bullish on risk assets.

To caveat this claim, equity markets are particularly sensitive to surprises, with lower inflation and higher growth driving a +15-20% return by 2022E or higher inflation and lower growth driving a ~20-25% loss. In-line consensus forecasts vary from +3-8% broad index returns by 2022E.

Omicron, a hawkish Fed, and inflation sit against a backdrop of impressive economic growth (global +4% 2022E) and near-universal equity overweight by portfolio managers. We expect this trend to continue as retail investors plow money into broad-based indexes and avoid bonds as much as possible.

Omicron

The latest news on the new Covid-19 variant, Omicron, suggests that the variant is less severe but more transmissible than the previous variant, Delta. Reports have revealed that typical patients who have been diagnosed with the Omicron variant feel "mild to moderate" symptoms and, if needed, stay hospitalized for a day or two. Patients who have contracted the new variant and are vaccinated have reported mostly mild.

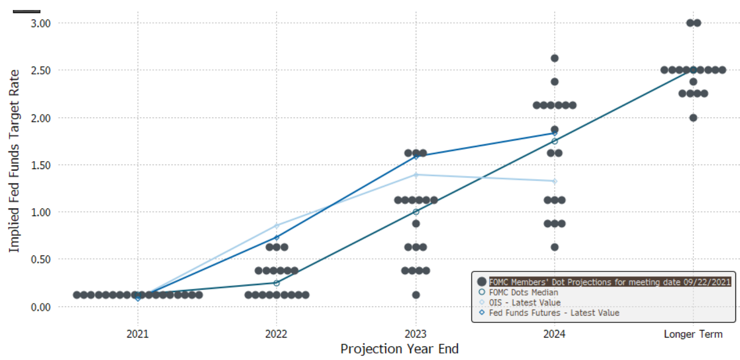
In the context of vaccines and therapeutics, Pfizer is the single manufacturer that has reported encouraging news. An additional dose of the Pfizer vaccine, that is, taking another dose beyond the standard two doses, showed to be effective at fighting the variant. In an interview with CNBC, Pfizer CEO Albert Bourla says, "A third dose will give very good protection I believe." No other vaccine manufacturer has arrived at a point to claim their currently available vaccine is effective in battling Omicron but has said they can develop one promptly and specific to the variant.

Beyond vaccines, Pfizer is in the later stages and awaiting results from clinical trials of their oral antiviral pill named Paxlovid which is expected to decrease hospitalizations and deaths by 89%. The drug is essential to the current issue of mutations and will battle against it as it developed to target an enzyme used for replication that is not susceptible to mutations. If approved, the pill can be rolled out in December, and the United States has 10 million doses already purchased with expected delivery at the end of 2021.

In conclusion, the Omicron variant does not seem to be at a dangerous level of concern, and the market reaction reflects this. As always, we will reassess as more data is available.

The Fed

The Fed has made good on their Nov 3 press release and is continuing to reduce asset purchases by $15bil (-$10bil Treasuries, -$5bil MBS). At this rate, quantitative easing (QE) would have ended in June 2022, just in time for the Fed to introduce the first rate hike at their July meeting. With the updated FOMC release, we expect the timeline to be moved up with a doubling of the taper rate and a first hike expected in March. We expect a third hike in their October meeting with the fed funds rate finishing 2022 at 0.75%.



There is notable interplay between Fed action and both Omicron and inflation. If Omicron becomes more widespread (or a more virulent variant arises) the Fed may slow tapering for a few extra months. The opposite is true with inflation, if we see a surprisingly large print the Fed may taper faster or even raise rates ahead of schedule. Right now, we do not see either occurring as the information flow on Omicron has increased and the news is generally positive, and the most recent inflation print (though high) came in right at expectations of +6.8% yoy.

Inflation

The most recent inflation print (+6.8% yoy, 12.10.21) was right in line with expectations and broad indexes traded higher on the news. Equity markets' reactions don't account for the fact that inflation has reached its highest levels since 1982 and threatens some of the most vulnerable sections of our communities. What is good for markets isn't always good for the economy, and we may see echoing repercussions from current inflation in 2H22 as the effects on labor markets and consumer spending habits become more apparent.

Climate Risks

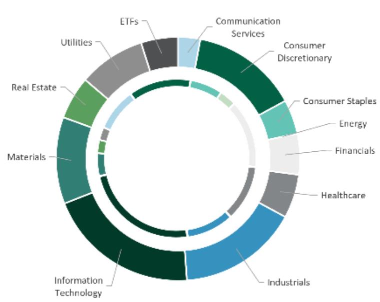
A widely discounted component of the economy is climate pressures, particularly the danger it presents to physical assets like the electric grid and water supply. With fires still raging into December, record winds causing power outages across the Midwest, and "dust-bowl-like weather" becoming a norm in many of the tornado-ridden states, climate change is creating an exacerbated risk to the economy and markets. Companies that will be tasked with rehabilitating the electric grid and strengthening national infrastructure are attractive plays here and will continue to see subsidized growth and sector investment.

The Bipartisan Infrastructure Deal

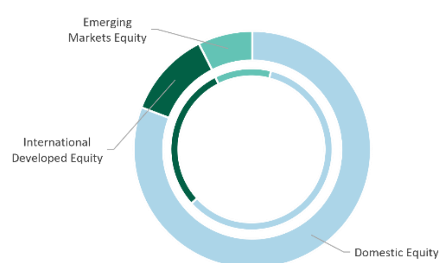
The bipartisan deal, signed on Nov 15, represents a $.21 trillion reversal of the US's addiction to short-term spending. It also signals a realization from the country's leaders that many of the supply chain, energy, and commodity issues exist because of chronic underinvestment in the nation's infrastructure beyond short-term shocks like the Coronavirus. The bill primarily focuses on roads, bridges, power infrastructure, railroads, broadband internet, and drinking water. We believe this bill will reduce climate and infrastructure risk nationally. The bill will also directly benefit the utility, commodity, and industrial sectors, hence our overweight compared to the benchmark.

Hoskin Capital Main Fund Allocation

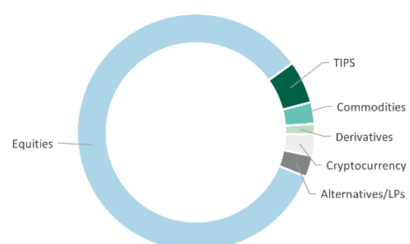
We remain overweight risk assets but are prioritizing profitable and/or high margin growth companies as well as high ROIC firms trading for valuations below index average. Considering the recent $1tril spending package signed by President Biden on November 15 we are overweight materials and industrials against our benchmark: the MSCI All-Country World Index (ACWI). We also maintain an overweight position to US equities due to the global nature of technology and financial majors. We prefer to keep the US as our country of risk even if revenues and earnings are credited to another country. This results in a slight mismeasurement of our geographic allocation (we appear more US-focused than we are).



Sector Allocation
Inner Circle: ACWI
Outer Circle: Main Fund



Geographic Allocation
Inner Circle: ACWI
Outer Circle: Main Fund



Asset Allocation
Outer Circle: Main Fund

Performance & Client Portfolios

Each client portfolio has a slightly different allocation, but for measurement purposes we have stratified our risk tolerances into four model portfolios. The performance below is pulled directly from client accounts that are assigned these allocations, meaning the performance is net of fees and accounts for position drift.

Model	Allocation	6mo Performance	Outperformance (-under)
Speculative	100% MF	5.02%	1.28%
Vertex	95/5 MF/Salvus	5.37%	1.63%
Moderate	75/25 MF/Salvus	2.77%	-0.97%
Conservative	60/40 MF/Salvus	3.14%	-0.60%
Benchmark	*MSCI ACW Index*	*3.74%*	-

Wrap-Up

We believe firms' proven ability to expand margins and revenues under pressure, complemented by tailwinds from Covid recovery and supply chain easing, will outweigh the economic battle between inflation and tightening monetary policy. We believe rising inflation and QT will both have negative effects on the real economy and will disproportionately damage underprivileged segments of our community. Much like during the Covid lockdowns, capital markets provide a source of growth and safety that is separate from the real economy and can provide shelter to client assets during turbulent times. We believe risky assets will continue to grow, but any firms that are valued only on their growth prospects and not current profitability will struggle to make gains.

We are excited to watch the effects of electric grid rehabilitation, fiscal funding for climate support, and the surge in renewable energy and electric vehicles. We seek to capitalize on these driving themes and expect to continue our outperformance through year-end and into 2022.

References

Federal Reserve. (2021, November 3). *Federal Reserve issues FOMC statement*. Board of Governors of the Federal Reserve System. Retrieved December 13, 2021, from https://www.federalreserve.gov/newsevents/pressreleases/monetary20211103a.htm.