Asset Management One Co., Ltd.

Global Market Outlook 2022

December 2021

Contents

Creating a sustainable future through the power of investment

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Forecast Summary

Economic Forecast Summary for 2022

Calendar Year		2020 (Actual)	2021 (AMO Estimate)	2022 (AMO Forecast)
US	Real GDP (YoY%)	-3.4	*5.5*	*3.3*
	Core CPI (YoY%)	1.7	*3.8*	*3.6*
Eurozone	Real GDP (YoY%)	-6.5	*5.2*	*3.8*
	HICP (YoY%)	0.3	*2.5*	*1.9*
China	Real GDP (YoY%)	2.2	*7.8*	*4.9*
	CPI (YoY%)	2.5	*1.3*	*2.4*
Japan	Real GDP (YoY%)	-4.5*	*1.8*	*3.5*
	Core CPI (YoY%)	-0.2	*-0.1*	*0.3*

* The 2nd preliminary estimates

Stock Market Forecast Summary for 2022

Calendar Year		2020 (Actual)	2021 (AMO Estimate)	2022 (AMO Forecast)
US	S&P500	3756	*4800*	*5000*
	YoY%	16.3	*27.8*	*4.2*
Eurozone	Eurostoxx50	3553	*4200*	*4500*
	YoY%	-5.1	*18.2*	*7.1*
China	Shanghai Composite	3473	*3700*	*3900*
	YoY%	13.9	*6.5*	*5.4*
Japan	TOPIX	1805	*2050*	*2200*
	YoY%	4.8	*13.6*	*7.3*

Bond Market Forecast Summary for 2022

Calendar Year	2020 (Actual)	2021 (AMO Estimate)	2022 (AMO Forecast)
UST 10-Year Yield (%)	0.91	*1.50*	*2.00*
Germany 10-Year Yield (%)	-0.57	*-0.30*	*-0.20*
JGB 10-Year Yield (%)	0.02	*0.05*	*0.10*

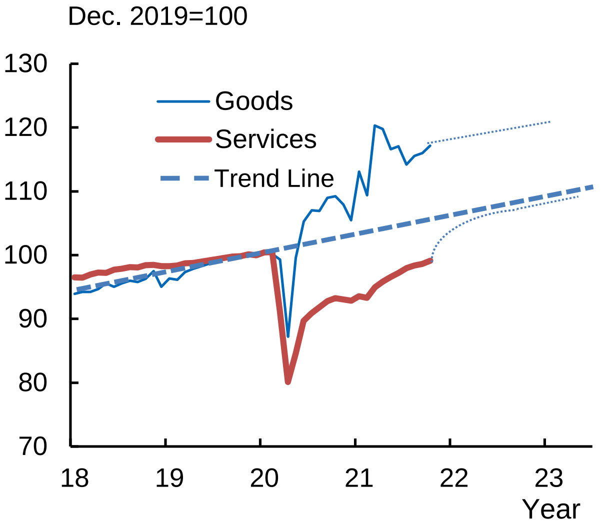
Source: Bloomberg, FactSet, AMOne

US Economic Outlook

Economic outlook

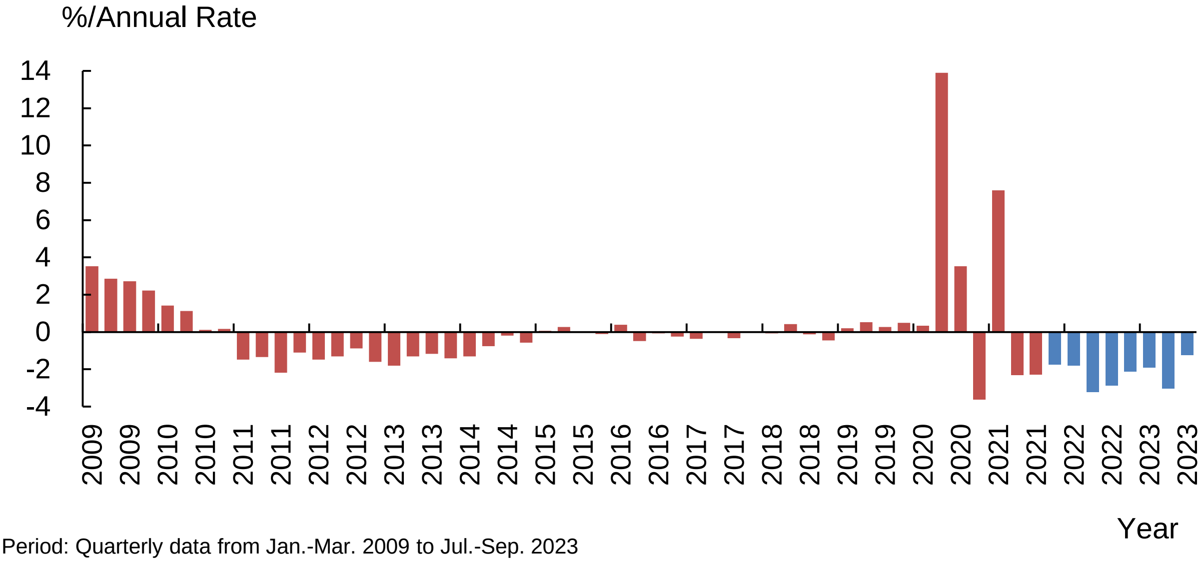
In the process of normalisation from the COVID-19 pandemic, the US economy will enjoy high growth until the end of 2021. Following a pause in the normalisation of the services sector (chart on the right), economic growth is expected to slow to around 2-3% per annum in 2022, centering on consumer spending. The pace of the labour market recovery will also slow as the industry structure continues to transform, with the unemployment rate bottoming out at around the low 4% range. The diminishing of the boosting effect of fiscal policy, which has significantly boosted growth in 2021 (chart below), will also lead to a slowdown in economic growth in 2022. Inflation, which swung sharply higher in 2021, is expected to subside to the 2% level in the second half of 2022 as economic growth slows and global supply chain pressures begin to normalise.

Real PCE of Goods and Services



Period: Monthly data from Jan. 2018 to Oct. 2021
Figures after Oct. 2021 are projections
Source: US Department of Commerce

Effect of Fiscal Policy on GDP Growth



Period: Quarterly data from Jan.-Mar. 2009 to Jul.-Sep. 2023
Figures from Oct.- Dec. 2021 are projections
Source: Hutchins Center Fiscal Impact Measure from Brookings

US Market Outlook

Monetary and fiscal policy and political developments

The Fed has clarified its intentions to curb inflation. Tapering will end in March 2022 and the central bank is now considering an expedited interest hike schedule. However, it will face a combination of slower economic growth and subdued inflation. We expect the Fed to start raising rates in the second half of 2022, when the unemployment rate, a measure of full employment, is expected to fall clearly to around 4%. We also expect the Fed to raise rates once a quarter in 2023, bringing policy rates back to a neutral level.

The Biden administration's families and jobs plans under the Build Back Better framework were passed by Congress with their size reduced by about half, and widely feared tax hikes have been mild. In the 2022 mid-term elections, the Democrats are expected to lose the House of Representatives, and the Biden administration's centripetal political power is likely to decline.

Three risk factors

While the Fed has shifted its policy focus to controlling inflation, this is likely to have been largely politically motivated. We see three risk factors: 1. The biggest risk factor is that answering to a political agenda could lead the bank to misjudge monetary policy and cause economic growth to stall earlier. 2. In addition, the increasing influence of the left-wing Democratic Party on policy and the tightening of regulations on the financial sector and high-tech companies could lead to a correction in the stock market. 3. In addition, the Biden administration's tougher foreign policy stance in the face of declining domestic support could significantly increase geopolitical risks.

Eurozone Economic Outlook

Economic and Inflation Outlook

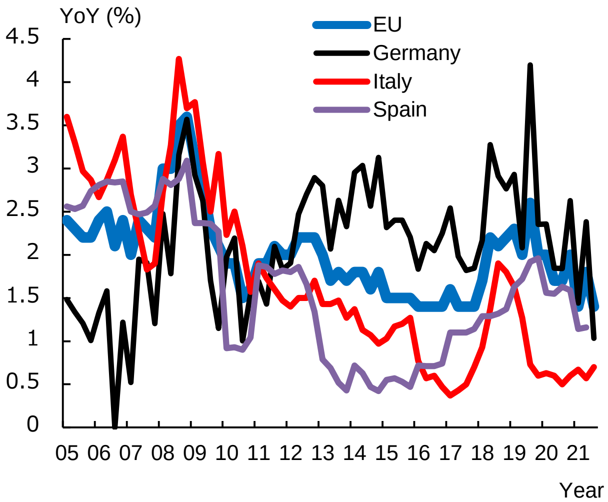
We expect the Eurozone economy to reaccelerate from mid-2022 following a temporary slowdown at the beginning of the year, and inflationary pressure to ease in 2022. Real GDP growth in the July-September 2021 quarter was 9.1% quarter-on-quarter (annualised), the second highest growth rate since the April-June 2021 quarter. In the January-March 2022 quarter, we expect the growth rate to slow due to 1. adverse effects on consumption arising from an increase in the number of coronavirus infections and soaring energy prices, and 2. supply constraints such as raw materials shortages. Thereafter, however, we believe the economy will return to a recovery trajectory due to pump-priming, investments by the Next Generation EU Fund, and easing of supply constraints.

Prices rose to +4.9% year-on-year in the preliminary HICP for November 2021. However, we expect the temporary effects of Germany's value-added tax to disappear and the rate of increase in energy prices to fall in 2022 relative to the high base in 2021. In our projections, we expect the overall HICP to decline to the 1 percent level by the end of 2022.

Monetary Policy Outlook

It is quite natural to assume the ECB is concerned about the possibility that the current rise in energy prices may spill over to higher wages and then to underlying prices. However, as the chart shown below, wage growth has been stagnant in Italy and Spain since the beginning of the 2010s. In addition, wage growth in the Eurozone was still subdued at the mid-1% level in the July-September 2021 quarter. European Commission’s labour market slack indicator has not yet recovered to pre-Coronavirus pandemic levels, so we expect it will take some time before wages rise.

Rate of Wage Growth

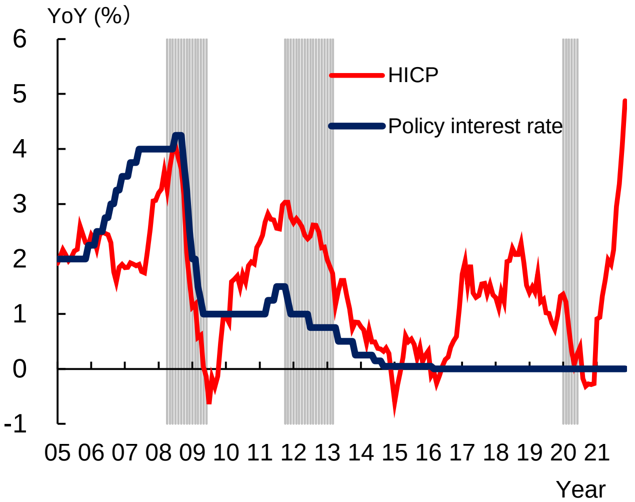


Period: Quarterly data from Jan.-Mar. 2005 to Jul.-Sep. 2021
Data for Spain available until Apr.-Jun. 2021
Source: Refinitiv

Eurozone Market Outlook

Retrospectively, the economy fell into recession before and after the interest rate hikes in 2008 and 2011 due to fears of spillover effects from soaring energy prices (chart below). The lesson learned from this experience may have led the ECB to allow for a temporary upward swing in inflation from its target in the 2021 monetary strategy review. For this reason, the ECB is likely to refrain from prematurely lifting its accommodative monetary policy, and we assume that it will not raise interest rates until 2024.

CPI and Policy Interest Rate



Period: Monthly data from Jan. 2005 to Nov. 2021
Note: Grey bars indicate a recession as determined by the Centre for Economic Policy Research (CEPR)
The policy interest rate uses the main refinancing operations (MRO) rate
Source: Refinitiv

Risk Factors

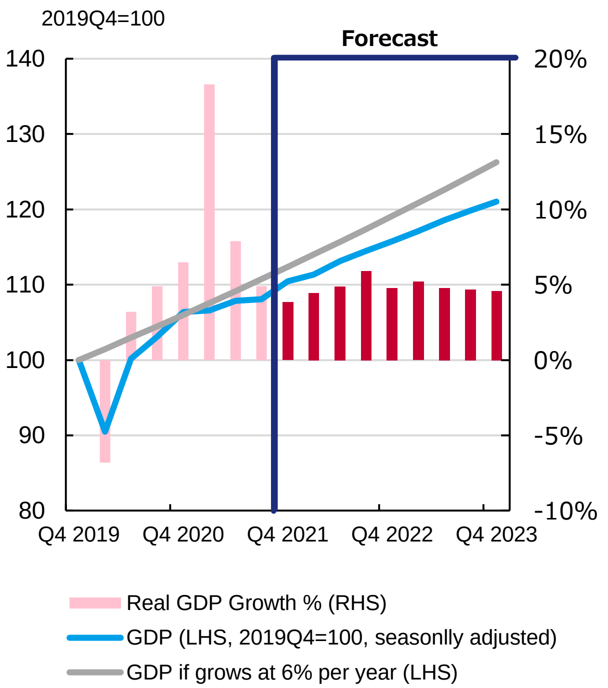
We believe that the biggest risk to our economic and monetary policy outlook is if energy prices should continue to rise in 2022. There are many uncertain factors regarding the future of energy prices, three that we think warrant attention from investors are: 1. the possibility of a shortage of renewable energy supplies in 2022 due to irregular weather patterns, 2. the possibility that Nord Stream 2 becomes unavailable in order to deter Russian military action towards Ukraine, and 3. the possibility of a rapid reduction in fossil fuel based power generation in response to the trend towards decarbonisation.

China Economic Outlook

Economic Outlook

2021 was another year of strong downturn for China's economy. Over the course of the year, the country's economy was adversely affected by a sharp slowdown in real estate investment, a decline in automobile production due to supply constraints, and restrictions on factory operations due to power shortages and restrictions on movement, in addition to ongoing disturbance from the pandemic curbing service consumption. Of these downward factors, it is encouraging to see that supply constraints and power shortages are now improving. In addition, the authorities have slightly loosened their policy stance on real estate sector, and the possibility of implementing a more stringent stance is decreasing, credit indicators are also beginning to show signs of bottoming out.

Forecast for Real GDP Growth of China



Period: Quarterly data from Oct.-Dec. 2019 to Oct.-Dec. 2023
Data for Real GDP Growth available from Jan.-Mar. 2020
Source: Refinitiv

That said, in principle, the policy stance of reining in real estate investment itself has not changed, and based on past cases, the adjustment in the real estate market and investment that has begun recently may continue for another year to come. The slowdown in real estate investment is expected to put strong downward pressure on the Chinese economy in 2022. In addition, a slowdown in demand for goods in developed countries is also expected. Therefore, we have moved our growth projection for the full year 2022 down to +4.9% year-on-year. This is distinctively lower than the 6% growth rate of the Chinese economy in the past. In addition, we believe that the slowdown in China's economic growth rate will continue over the long term due to the Xi Jinping administration's efforts to achieve high-quality growth even at the expense of growth, and the declining birthrate and aging population.

China Economic Outlook

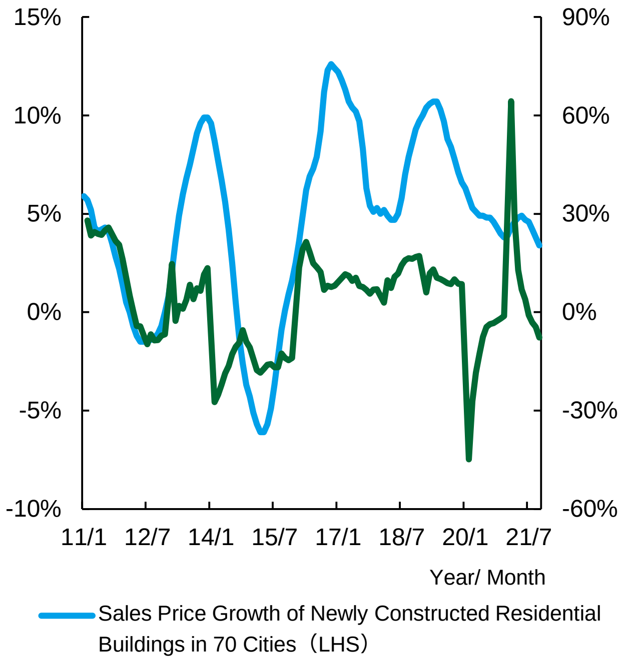
Fiscal and Monetary Policy Outlook

Despite strong downward pressure on the economy, we believe that Beijing's priority remains centered on maintaining economic stability over growth, and that stimulus measures for next year are likely to be minimal. In the past, the authorities have used real estate policies as tools to pump-prime the economy in times of economic downturn. However, this is unlikely this time around as it would mean a complete reversal of the current policy stance and is against the will of the central government. President Xi Jinping, who has consolidated his power base and is almost certain to lead the country for an unprecedented third term, has fully embraced the socialist concept of "common wealth" and income redistribution policies. It is unlikely that he will change his policy stance on real estate, which is seen as a symbol of wealth, by encouraging real estate investment. Curbing real estate investment will put pressure on local government finances, whose main source of revenue comes from the transfer of land use rights, and may limit the scale of consumption stimulus measures and other policies that local governments are able to implement within their budgets.

With regards to monetary policy, we do not anticipate the People Bank of China (PBOC) to embark on aggressive interest rate cuts in an environment of restrained real estate investment policy and persistently high producer price index (PPI). We believe that the monetary authority will continue to take a "targeted" approach, as they call it. As for monetary policy tools, we expect the central bank to adjust monetary policy by using required reserve ratio (RRR) cuts and Medium-term Lending Facility (MLF) liquidity provision rather than through traditional interest rate cuts.

As such, investors should not look to the government for pump-priming next year.

Sales Price Growth and Housing Starts



Period: Monthly data from Jan. 2011 to Oct. 2021
Source: Refinitiv

Japan Economic Outlook

Economic outlook

In 2021, the Japanese economy stagnated until the July-September quarter, weighed down by the prolonged declaration of a state of emergency (SOE) and supply side constraints, including the semiconductor shortage. The lifting of the SOE in October, following a decline in the number of new infections, and the gradual easing of restrictions on domestic activity towards the end of this year, should lead to a recovery in consumption over the next year.

Further, given that reduced automobile production, which has significantly depressed production as a whole, is expected to bottom out, we expect the economic growth rate to accelerate between December this year and next year. On the other hand, although the economic stimulus package compiled by the Kishida administration in November included JPY55.7 trillion in fiscal spending, which was larger than market expectations, more than half of this was for Covid-19 related measures, including a rehash of some previously announced economic measures.

We expect that stimulus handouts will offset some of the increased burden on households caused by the recent rise in food, gasoline and other prices, although the multiplier effect is likely to be limited due to the nature of the funds. Apart from that, while the number of new infections in Japan has been kept under control relatively well in comparison to global peers and a third round of vaccinations is due to start in December this year, the possibility of a resurgence must still be kept in mind.

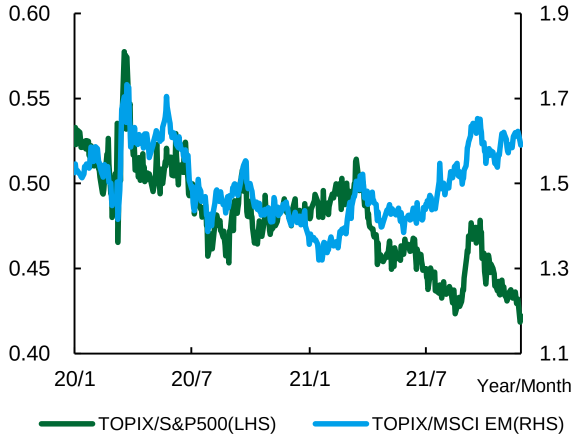
In 2022, we believe the Japanese economy is likely to exceed its potential growth rate, led by a recovery in the domestic services sector, production and capital investment, provided that the pandemic remains largely under control and progress continues to be made in resolving supply constraints.

Japan Market Outlook

Market outlook

In 2021, Japanese equities are likely to post positive returns on a calendar year basis. However, as the chart (left) shows, the major indices have noticeably lagged behind US counterparts. In early spring, Japanese stocks, which are positioned as global cyclical stocks, rose on expectations for a resumption of global economic activity. However, by the end of August, they were in a downward trend in line with US stocks. The fall in early autumn was likely due to a combination of a lull in expectations for a resumption of global economic activity, delays in domestic vaccination progress, and political uncertainty ahead of the LDP presidential and lower house elections. In the autumn, expectations surrounding the incoming new administration saw Japanese equities rapidly close the gap with US equities, but concerns about prolonged supply constraints in the manufacturing sector later caused Japanese equities to underperform US equities again. Having said that, given that corporate earnings continued to rise through the July-September quarter despite higher raw materials prices, and a recovery in consumption is expected to drive earnings growth through next year, we expect that share prices will remain firm.

Relative Index Changes

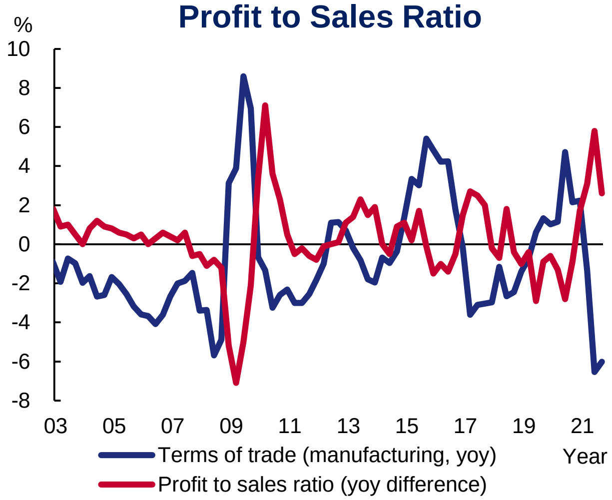


Period: From 6 Jan. 2020 to 30 Nov. 2021
Source: Bloomberg

As for the impact of raw materials inflation on earnings, the chart (right) shows that in Japan's manufacturing sector, the ratio of recurring profit to sales has tended to improve rather than deteriorate during past periods of decline in terms of trade. (Import prices rise relative to export prices and demand is also strong, so it is generally thought that profit margins will improve, as volumes may increase rather than decrease.)

In 2022, inflation and a shift to tighter monetary policy by the US and other central banks are likely to be major themes for markets, particularly in the first half of the year. However, the rise in US long-term interest rates as the Fed becomes more hawkish has historically been positively correlated with Japanese equities, and foreign investors may focus on Japan as a market that is more resilient to rising US interest rates. As shown in the chart (left), EM equities underperformed Japanese equities in 2021, partly because of concerns about the Chinese economy, but also because of concerns about the hawkishness of the Fed and a shift to a monetary tightening regime by emerging market central banks against the backdrop of weakening emerging market currencies as the dollar strengthened.

Terms of Trade and Profit to Sales Ratio



Period: Quarterly data from Jan.-Mar. 2003 to Jul.-Sep. 2021
Source: Bloomberg

Topic: Southeast Asian countries turn to Life with Covid-19

Southeast Asian countries turn to Life with Covid-19

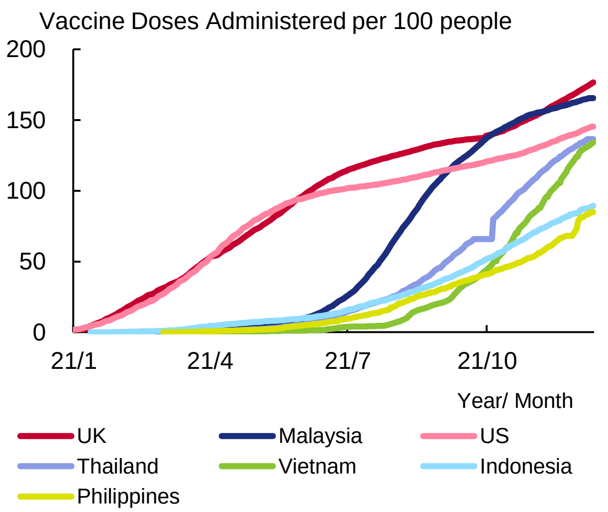
The risk of supply chain disruption originating in Southeast Asia has receded as Southeast Asian countries have shifted from Zero Covid to Life with Covid policy stances as the vaccination rollout has progressed. Despite concerns about new variants and slower growth in global demand, the recovery of economic activity and resumption of international tourism under the Life with Covid policy will be the focus of Southeast Asian economies in 2022.

i. Progress with vaccine rollout in ASEAN countries and easing of social restrictions will reduce the risk of supply chain disruption

During the July-September 2021 quarter, the spread of the delta strain of coronavirus forced Southeast Asian countries to take stricter social restrictions. Strict restrictions on economic activities in Southeast Asian countries, which are part of the manufacturing supply chain, became a factor that constrained the global supply of goods, especially intermediate goods, and the impact became more serious, affecting automobile production in major developed countries. Under these circumstances, countries have been promoting vaccination, which had been delayed and the situation has improved significantly recently. The number of people vaccinated with two doses per 100 people in Malaysia, Thailand, and Vietnam has reached the level of the United Kingdom and the United States, previous leaders in the vaccine rollout.

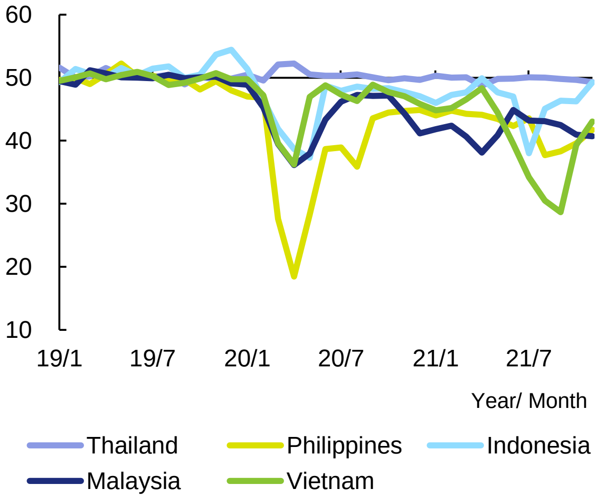
In view of progress with vaccine rollout and the economic impact, Southeast Asian countries have shifted their coronavirus response policy from Zero-Covid with strict social restrictions to Life with Covid, symbiosis with coronavirus. Following the resumption of economic activity under the Life with Covid policy, especially in the October-December quarter, activity in the major ASEAN nations has begun to recover. The status of supply chain disruptions in the supplier delivery time index in the PMI, which shows that supplier delivery times, have shortened and is gradually easing with the policy shift to the Life with Covid.

Vaccinations in Major Countries



Period: From Jan.1 2021 to Dec.10 2021
Source: Refinitiv

PMI Suppliers' Delivery Times Indices



Period: Monthly data from Jan. 2019 to Nov. 2021
Source: Refinitiv

Topic: Southeast Asian countries turn to Life with Covid-19

ii. China's Zero-Covid policy remains a risk to ASEAN

Although new variants of the virus still require caution, we believe that the risk of supply chain disruption originating in Southeast Asia is receding due to progress with vaccine rollout and the shift to the Life with Covid policy. This will also lead to a recovery in economic activity in the region. However, it should be noted that China, which has geographically and economically very close ties with the region, remains under strict Zero-Covid policy, and the possibility of supply constraints intensifying due to a resurgence in infections in China cannot be ruled out.

Growth in demand for goods in major developed countries is expected to peak out in 2022, and this environment of slowing growth in external demand will be a headwind for Southeast Asian exports. On the other hand, however, we expect services spending to stay on a recovery trajectory. Although it largely depends on the trend in number of infections, if international tourism resumes sooner, the growth rates of Southeast Asian countries such as Thailand, Malaysia, and Singapore, which received a lot of tourism income before the Covid pandemic, may swing upward.

The Regional Comprehensive Economic Partnership (RCEP) will come into effect on January 1, 2022, although China's participation in the framework has been highly politicised. The RCEP is the world's largest free trade agreement with 10 ASEAN countries, Japan, China, South Korea, Australia, and New Zealand participating, accounting for about 30% of the world's population, GDP, and total trade. In addition to the gradual elimination of tariffs among the participating countries, the RCEP aims to standardise rules for intellectual property rights and investment, and is expected to stimulate investment and trade.

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