



Deuterium Global Dynamic Allocation

Quarterly Strategy Report Q1 2022

31 December 2021

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DGDA Investment and Economic projections for Q1 2022

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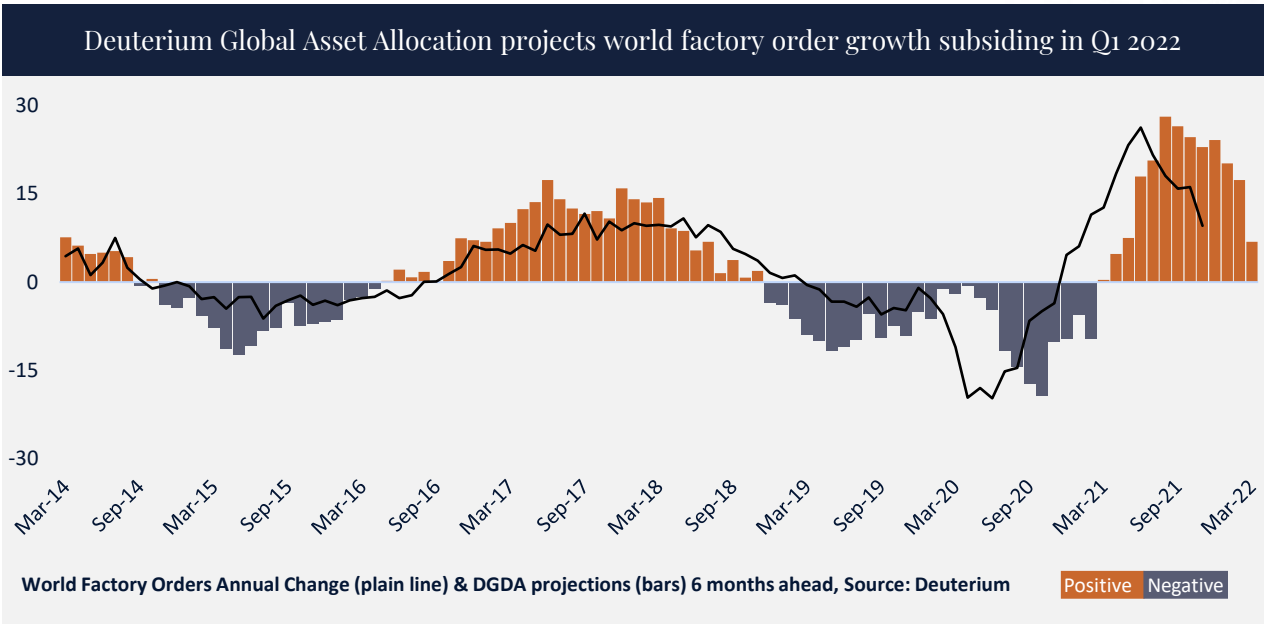
All data in this report are sourced from Deuterium Global Asset Allocation proprietary models.

Deuterium Global Dynamic Allocation Outlook for Q1 2022







The outlook for risk assets likely will continue positive to begin the new year, with equity valuations still benefitting from the rebound in global output; yet support will flatten and fade towards end Q1 2022. Sector rotation will become a major investment theme during the quarter when at its start technology stocks will no longer outperform the market, and by quarter end they will have underperformed significantly. This shift for technology shares from outperformance to underperformance will come because the current high expectation for their earnings depends upon strong growth materialising in both US consumption and investment, while our models project for Q1 2022 not only much slower expansions in US retail sales and personal income, but slower growth for US production, factory orders, and exports as well. **Q1 2022 will bring at least a temporary reversal of the technology sector valuation boom that lifted firms such as APPL and MSFT to the world’s largest market capitalisations.**

In the first quarter of next year, the global environment will change from one in which central banks have tolerated very high output growth and very high inflation without raising directed interest rates much above zero, to a global environment in which central banks will be hard pressed not to raise interest rates because inflation will stay very high even though economic growth rates will be flattening. The steady rise in goods and producer prices will keep upward pressure on long term bond yields, and with major central banks having kept short-term rates near their lows to support the ongoing global cyclical rebound, monetary authorities will be looking to move when they can to monetary tightening.

Global central banks provided sufficient liquidity and fiscal support over the past 21 months to counter the unprecedented employment and real economy contractions through Q2 last year. Risk-asset valuations recovered to reflect very high nominal GDP and earnings expansions with record low interest rates, and the narrowest corporate credit spreads for decades. **The shift now is towards a late cycle context in which sectors favoured by higher prices and rising interest rates such as financials and industrials fare best, along with shares in the price-sensitive materials, energy, and real estate sectors.**



DGDA Market Projections for Q1 2022

DGDA projections for Q1 2022	At 31 December 2021	Market moves projected for end Q1 2022
USA		
3 Month yields	0.03%	--
10 Year yields	1.51%	
US Dollar Index	95.7	--
S&P 500 Index	4766	
China		
3 Month yields	2.5%	
Chinese Yuan	0.157	
MSCI China	84	+
Japan		
3 Month yields	-0.13%	
10 Year yields	0.07%	
Japanese Yen	0.009	--
Topix Share Index	1992	--
EMU		
3 Month yields	-0.71%	--
10 Year yields	-0.18%	
Euro	1.14	+
Euro Stoxx 50 Share Index	4298	
UK		
3 Month yields	-0.05%	--
10 Year yields	0.97%	--
British Pound	1.35	
FTSE 100 Share Index	7385	
Commodity Markets		
All Commodities	99	
Oil & Energy	31	
Gold & Precious Metals	219	--

Source: Deuterium, Bloomberg

bearish		negative	-	neutral		positive	+	bullish	
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DGDA Global Investment Conclusions

1. The global business cycle recovery will show signs of decelerating growth in Q1 2022 while inflation will remain too high for major central bank policies to stay accommodative. Equity valuations will be supported as central banks take initial, probably measured steps to reign in high inflation rates. This suggests that as economic growth expands and then flattens, the effects initially will be positive for risk assets, despite rising short-term and long-term interest rates, but will be less so later in the quarter as output growth slows.

Market Projections	Major Equities	Positive	++
	Developing Equities	Negative	--
	Oil, Industrial Commodities	Positive	++
	Major Bonds	Negative	--
	Developing Bonds	Negative	--
	US Dollar	Neutral	
	Japanese Yen	Neutral	
	Euro	Positive	++
	British Pound	Negative	--

2. The US Federal Reserve provided extraordinary liquidity to the US financial system, and to US banks in particular, so that corporate lending growth recovered while investment grade credit spreads hit new lows. QE purchases are subsiding, and both US employment and inflation now look high enough to have the Fed tightening policy soon. The ECB still looks to be counting on monetary policy to support domestic activity and prices, while the PBoC has reversed its monetary policy to begin supporting domestic credit growth.

Monetary Policy Projections	USA	Tightening
	China	Loosening
	EMU	Loose
	Japan	Loose
	UK	Tightening

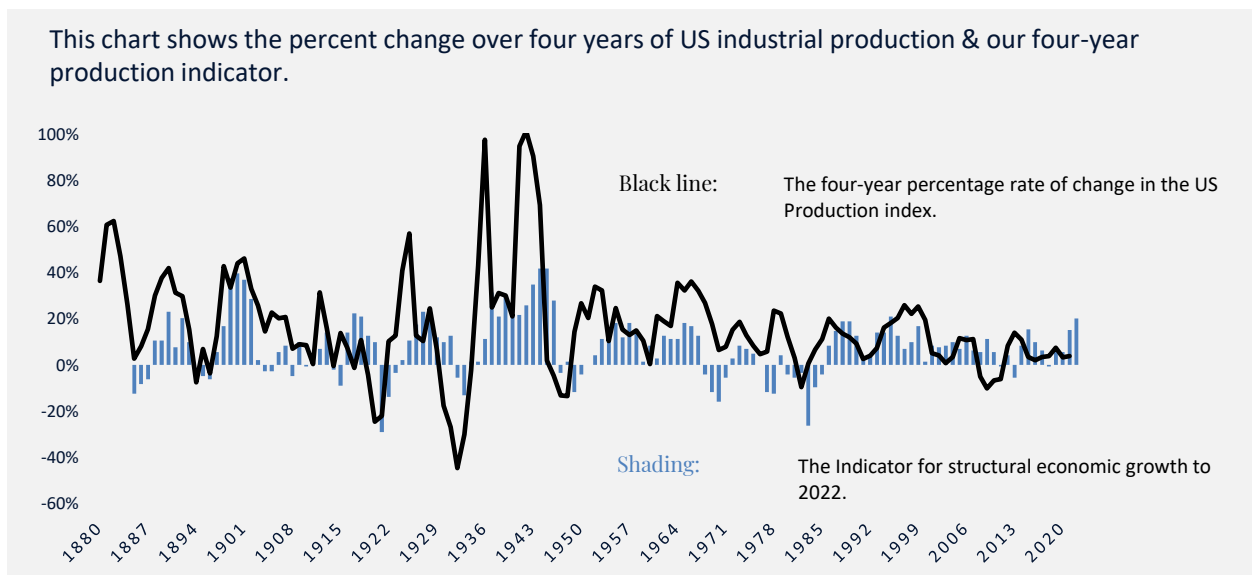
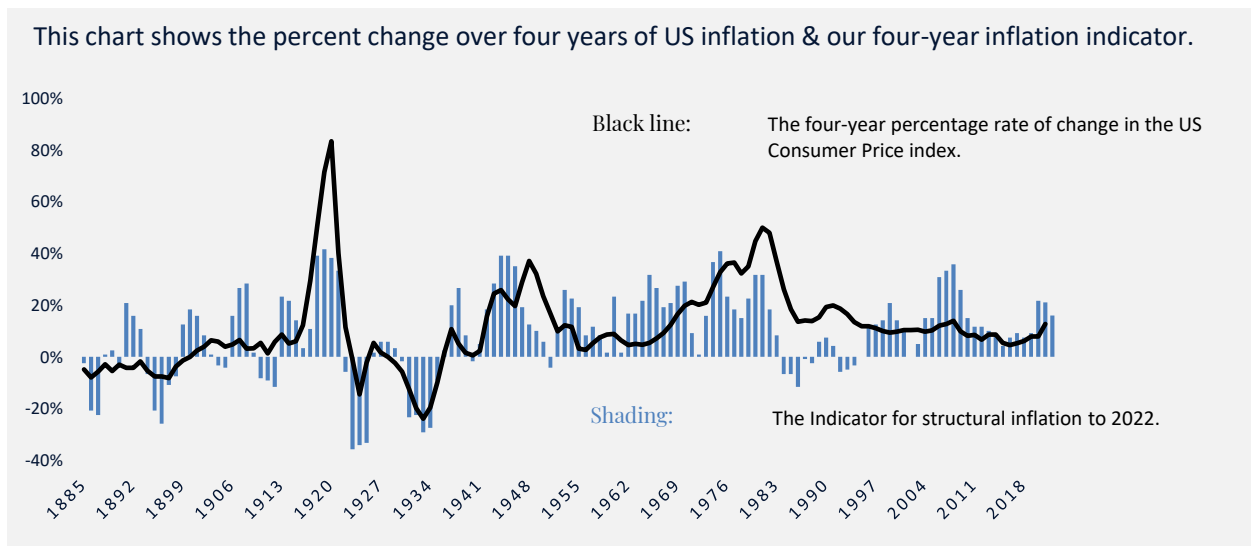
3. In Q1 2022 the US and European economies will have continued expansions in aggregate demand over the quarter, yet eventually will show signs that their output accelerations are beginning to fade. In this they will be joined by the Far-East and developing economies. Monetary and fiscal interventions have given sufficient liquidity and income support to keep the global recovery in place, but its pace will be substantially slower.

Economic Projections	USA	Expansion
	China	Moderate Expansion
	EMU	Expansion
	Japan	Moderate Expansion
	UK	Expansion

Deuterium Global Dynamic Allocation Outlook for Q1 2022

Our Q1 2022 projections for inflation to remain high and industrial activity to continue to expand during the quarter match our structural projections for US CPI and Production through end 2022, based on our 150-year historical analysis (published separately).

The charts below show our predictive Indicators for US Structural Inflation and Growth for 1885 to 2022.



Sources: Deuterium, Bureau of Labor Statistics, U.S. Department of Labor, Board of Governors of the Federal Reserve System (US), Quarterly Journal of Economics (1700-1919)

The key measures that underpinned the historical evolution of prices and industrial activity were money supply, commodity prices, interest rates, fiscal policy, and output. These therefore lay behind the booms and bust in the equity, precious metals, and bond markets. Our quarterly projections for a cyclical upswing align well currently with our historical projections, available on our website.



Current Global Economic Accelerations shifting to mixed signals by end Q1 2022

DGDA projections for production, orders, and exports show that current strong industrial activity growth will decelerate across most regions, with mixed signals by end Q1 2022,

Global Short Term Production Monitors (+/- 1) ↗

Production Monitor	Production	Orders	Exports	Direction	Average
USA					0.00
Europe					0.13
Japan					-0.22
UK					-0.01
Canada					-0.07
France					-0.07
Switzerland					-0.11
Germany					-0.03
Australia					-0.06
Netherland					-0.01
Spain					-0.16
Sweden					-0.44
Italy					0.05
China					0.16
South_Korea					0.27
Taiwan					0.16
Hong_Kong					-0.04
Singapore					-0.21
Indonesia					-0.20
Thailand					0.07
India					0.01
Brazil					-0.29
Russia					0.13
Mexico					-0.16
South_Africa					-0.04

Source: Deuterium

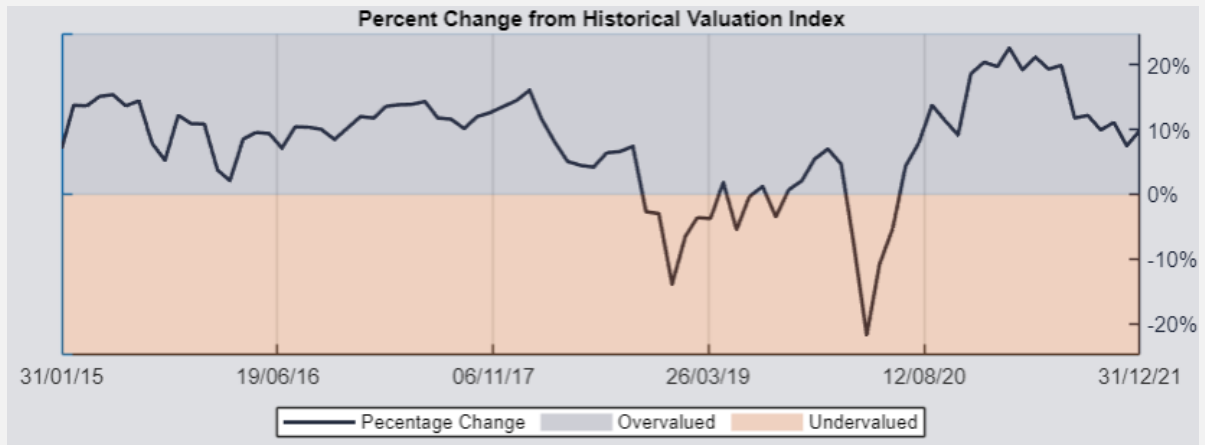
Best Worst

Our short-term indicators for industrial activity are strong to start Q1 2022 but shift to mixed signals by quarter end, with output growth slowing in the US, Eurozone countries, Far East and developing economies. Fiscal measures in the major economies will continue to support incomes as labour market shocks ease, but the monetary interventions that have provided depth and liquidity to the debt markets are bound to lessen.

US disposable income and housing market price support for consumption and production growth will start to fade, while the ECB will continue to provide liquidity for EMU output growth, and China appears to have adopted looser monetary policy.

US Equity Markets and G5 Bond Markets are overvalued

Corporate earnings have risen strongly, leaving most major markets at fair value with the exception of the US, where shares remain sufficiently expensive to make world equities overvalued.



Source: Deuterium

US equities show as very expensive, with the US market the primary major market to be materially above fair value at present. UK, EMU, Far-East, and Emerging market equities stand out as attractively valued.

COUNTRY	Current Price	Target Price	Price Move required to get to target price
World	3167	2854	-9.9%
EAFE	2300	2523	9.7%
United States	4669	3838	-17.8%
EMU	4168	4597	10.3%
Japan	28546	31044	8.8%
United Kingdom	7280	8882	22.0%
Canada	20740	20416	-1.6%
France	6954	7445	7.1%
Switzerland	12706	12580	-1.0%
Germany	15528	18406	18.5%
Australia	7304	7311	0.1%
Netherlands	772	768	-0.5%
Spain	8324	9699	16.5%
Sweden	2298	2732	18.9%
Italy	26537	33142	24.9%
Asia Ex Japan	717	727	1.3%
China	85	94	11.0%
South Korea	3018	3151	4.4%

COUNTRY	Current Price	Target Price	Price Move required to get to target price
Taiwan	17813	16848	-5.4%
Hong Kong	23193	28337	22.2%
Singapore	3112	3093	-0.6%
Indonesia	6602	7344	11.2%
Malaysia	1502	1994	32.7%
Thailand	1642	1565	-4.6%
Philippines	7298	7848	7.5%
Emerging	1224	1350	10.3%
India	57012	61403	7.7%
Brazil	108326	162489	50.0%
Russia	3721	3655	-1.8%
Mexico	51384	61137	19.0%
Turkey	2377	1994	-16.1%
Resource	326	467	43.1%
South Africa	71818	98671	37.4%
Colombia	448	451	0.6%
Chile	4392	5714	30.1%
Argentina	82995	87199	5.1%

Source: Deuterium, Bloomberg

Negative Positive

US Equities and G5 Bond Markets remain overvalued

➤ US equity markets continue to show valuation extremes. Share prices have risen strongly on anticipations of continued sales and earnings growth, while trailing fundamental measures have moved up quickly as US real output and employment rebounded towards long term trends. Most major equity markets, nevertheless, currently are undervalued on their trailing price to earnings metrics. These settled around five year averages after corporate earnings followed the major economies in their renewed expansions. Present non-US equity valuations continue to show as attractive, given very low worldwide interest rates and narrow credit spreads.

➤ Q1 2022 will show good fundamental support for shares during the initial weeks of the quarter, with a continued poor outlook for bonds worldwide, as consumer and producer price inflation rates remain high. Upward pressures on interest rates likely will last throughout the quarter as central banks shift to less accommodation across the major regions, while current strong consumption, industrial production, and export growth will show signs of slowing somewhat towards quarter end.

➤ Given high inflation and rising interest rates in Q1 2022, price-sensitive sectors such as financials, industrials, materials, energy, and real estate likely will provide better returns than larger sectors such as technology, communications, and consumer discretionary. Utilities, telecommunications, consumer staples, and healthcare may continue to do poorly as well when faced with rising interest rates.

Deuterium Global Asset Allocation Conclusions for Q1 2022

Continued global cycle expansions will give additional support for corporate earnings during Q1 2022, and along with fiscal and monetary policies still underpinning incomes and output, will benefit risk asset valuations through most of the quarter. Sustained consumer inflation rates will put more upward pressure on short term and long term interest rates, while producer and commodity price inflation likely will remain substantial throughout Q1 2022, contributing to a floor under yields.

During the coming quarter, the global context will be one where high inflation likely will have investors anticipating that central banks will shift sooner rather than later away from extraordinarily loose monetary policies. Consumption and industrial activity expanding at a slower rate will give mixed signals from the major economies towards quarter end, and will mean that the global context will become less supportive of risk asset valuations at that point in the quarter.

Investors may do well to maintain high allocations to risk assets to start Q1 2022, as continued economic growth worldwide will provide support for corporate revenue and earnings projections for much of the quarter. Decelerations in US consumption and retail sales growth, as well as in US production and export growth likely will have technology share valuations moving significantly lower by quarter end. Short term and long term interest rates will adjust higher as central banks eventually look to prevent current high inflation rates shifting even further above target.

USA Regional Investment Conclusions

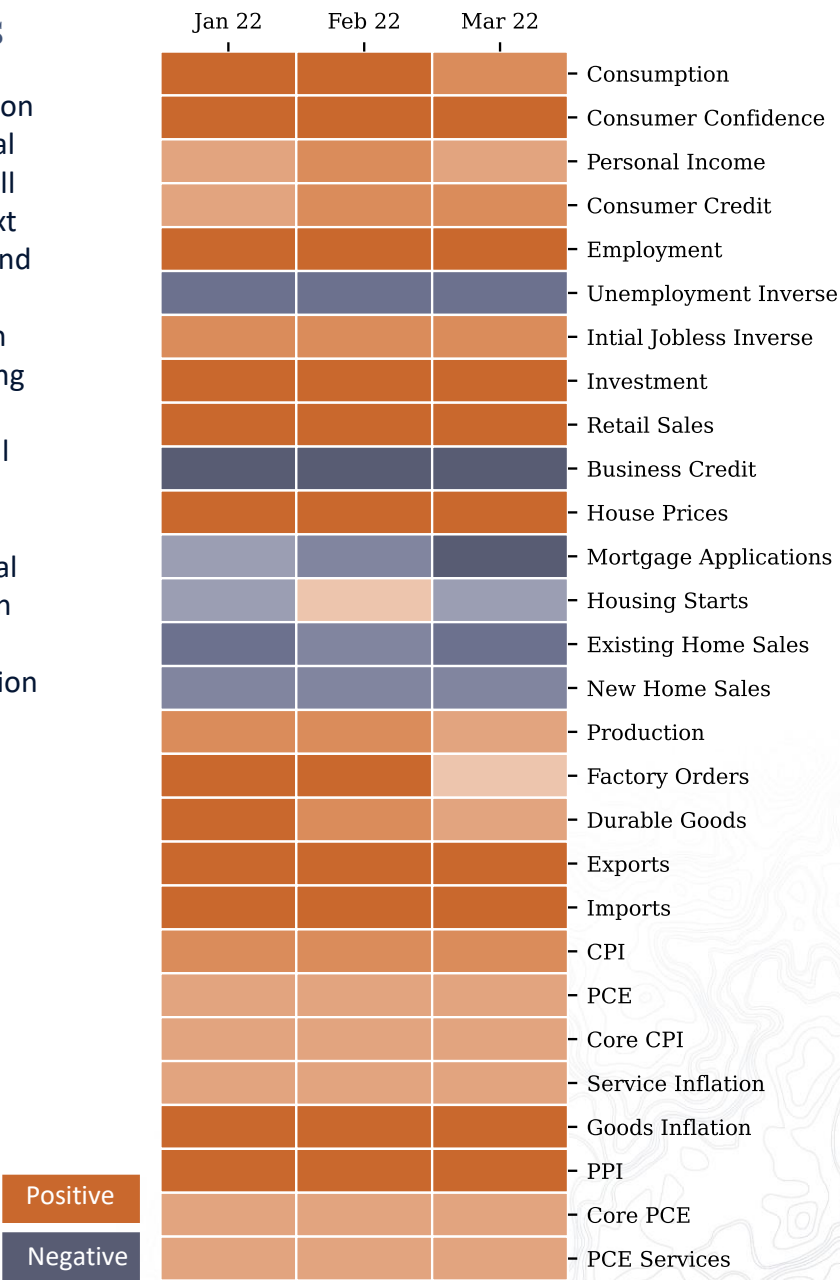
Q1 2022:

DGDA Economic Projection Surfaces



Economic Projections

Deuterium Global Asset Allocation models project that US industrial production and trade growth will continue positive during the next quarter, with US consumption and personal income expanding at slower rates. US housing growth looks to be slowing while housing prices continue to move higher. During Q1 2022, US inflation will be sustained, with further accelerations in goods inflation and producer prices the principal problem for US authorities, even as core CPI and personal consumption expenditure inflation stop accelerating from here.




USA Economy Surface Projections Q1 2022

Source: Deuterium, Refinitiv


Market Valuations

Outlook Summary


USA



Equities



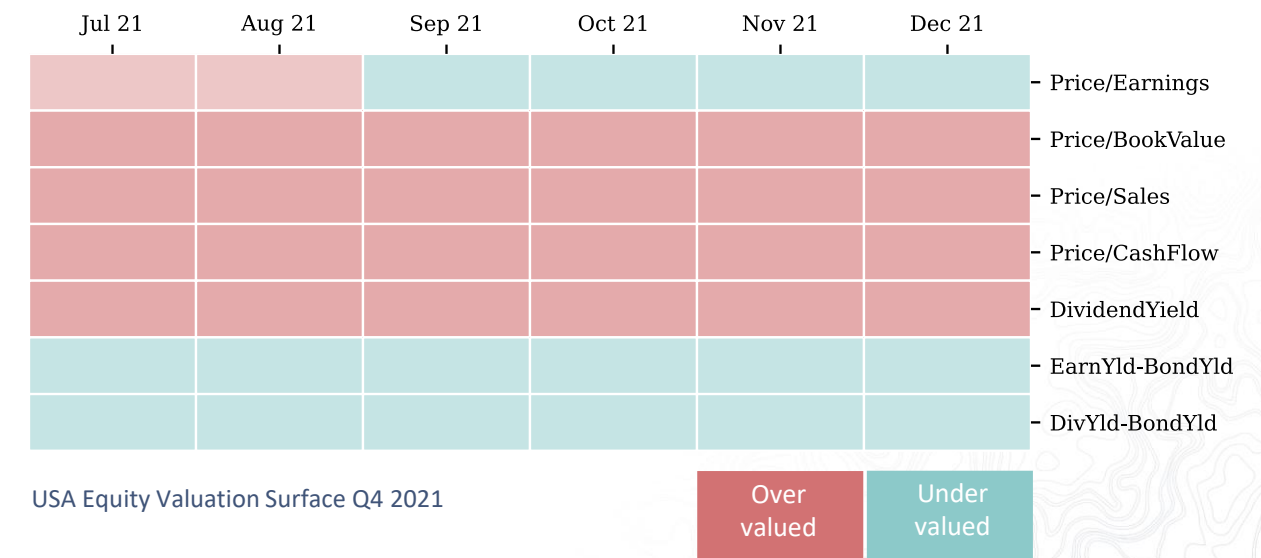
Three Month Bills



Market Valuations

Equity valuation metrics show US shares to be overvalued, the sole exception to fair valuations among major markets. Comparisons of US trailing earnings and dividend yields against low but positive US bond yields are within average bounds, but most other measures show marked overvaluations.

The Federal Reserve’s policy interventions and high inflation mean that US bond valuations are expensive compared to long term averages and are likely to correct. The US Dollar is undervalued on inflation and external account differentials.



DGDA Models show US equities to be overvalued on metrics such as price/sales and dividend yields, while earnings yields compared to bond yields are more aligned to historical averages

Monetary Policy and Transmission

Outlook Summary

USA



USD

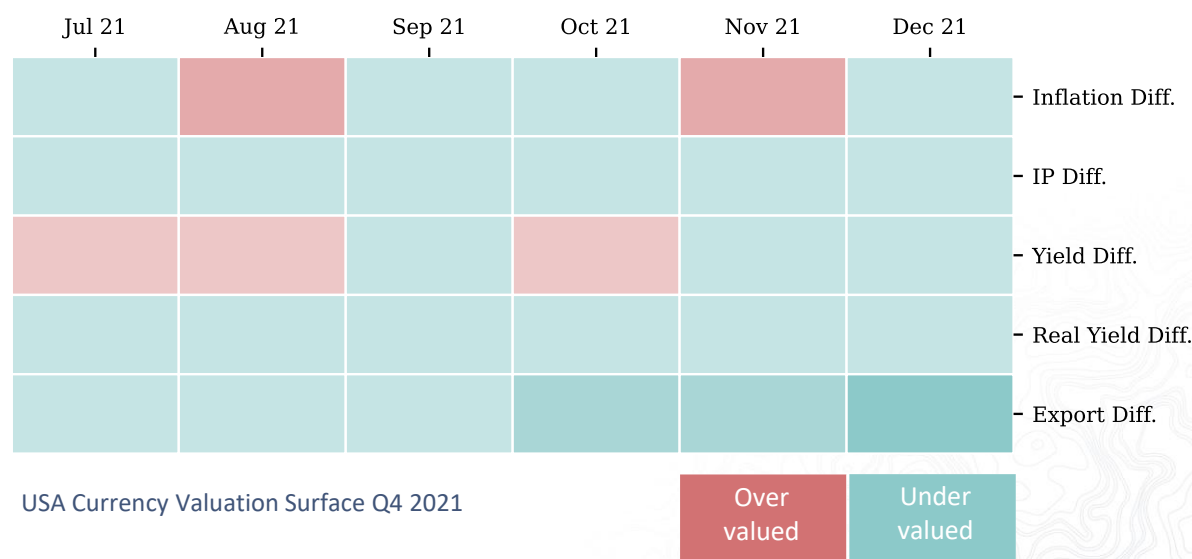


Ten Year Bonds



Monetary Policy and Transmission

DGDA Models suggest that USA inflation will stay high over the course of Q1 2022, and that the Federal Reserve’s extensive policy measures designed to support output growth, provide financial system liquidity, and facilitate credit market functioning have had sufficient positive effects on economic activity and employment to have the US central bank begin a sustained shift towards policy tightening.



Source: Deuterium, Refinitiv

DGDA Models show the USD to be undervalued on international real yield comparisons and external account measures

China Regional Investment Conclusions

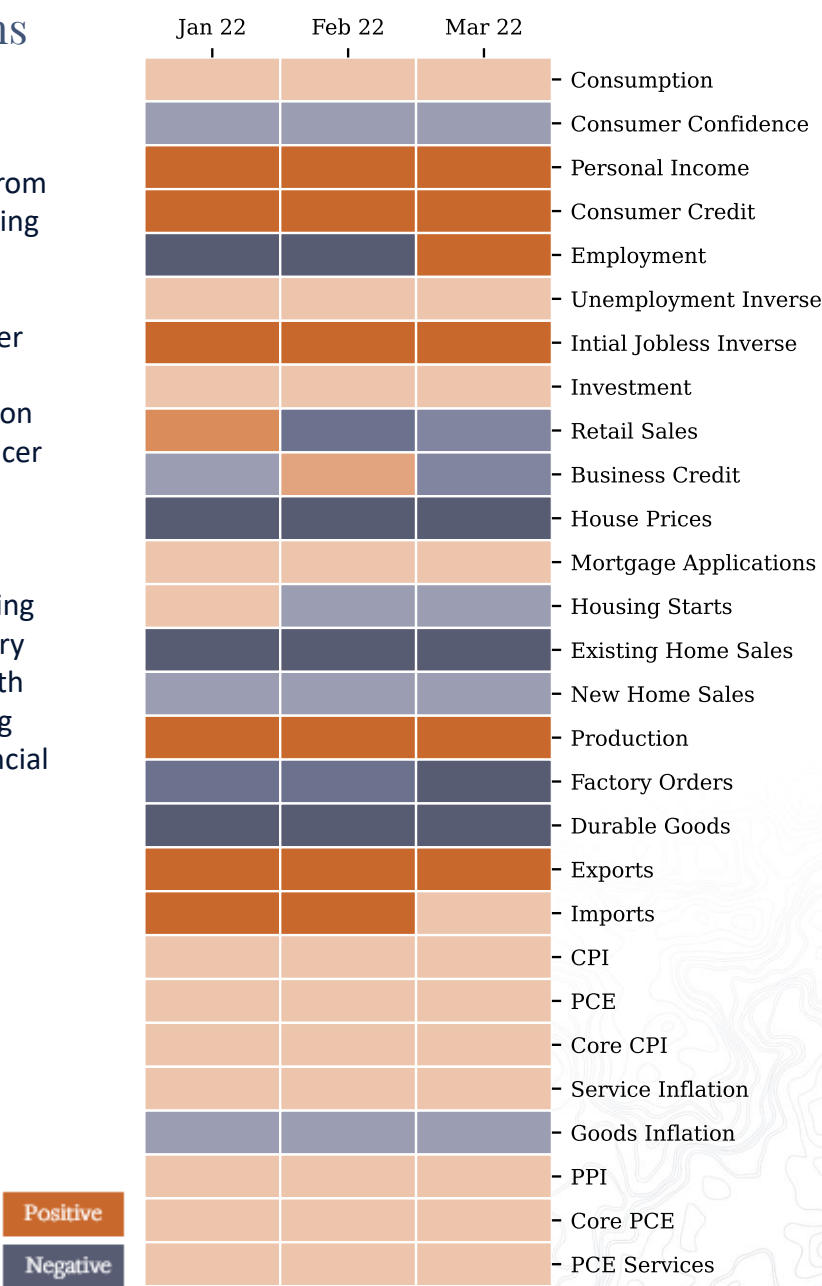
Q1 2022:

DGDA Economic Projection Surfaces



Economic Projections

DGDA Models show that real output growth in China will continue to have headwinds from poor business credit and housing conditions. Expansions in consumption and personal income look to be on track over the quarter, with continued accelerations in both production and exports. Flattening producer prices in combination with slowing factory orders and durable goods production will have Chinese authorities shifting further toward looser monetary policy, now that difficulties with property and credit are putting marked stress on China’s financial system.



China Economy Surface Projections Q1 2022

Source: Deuterium, Refinitiv

Market Valuations

Outlook Summary

China



Equities



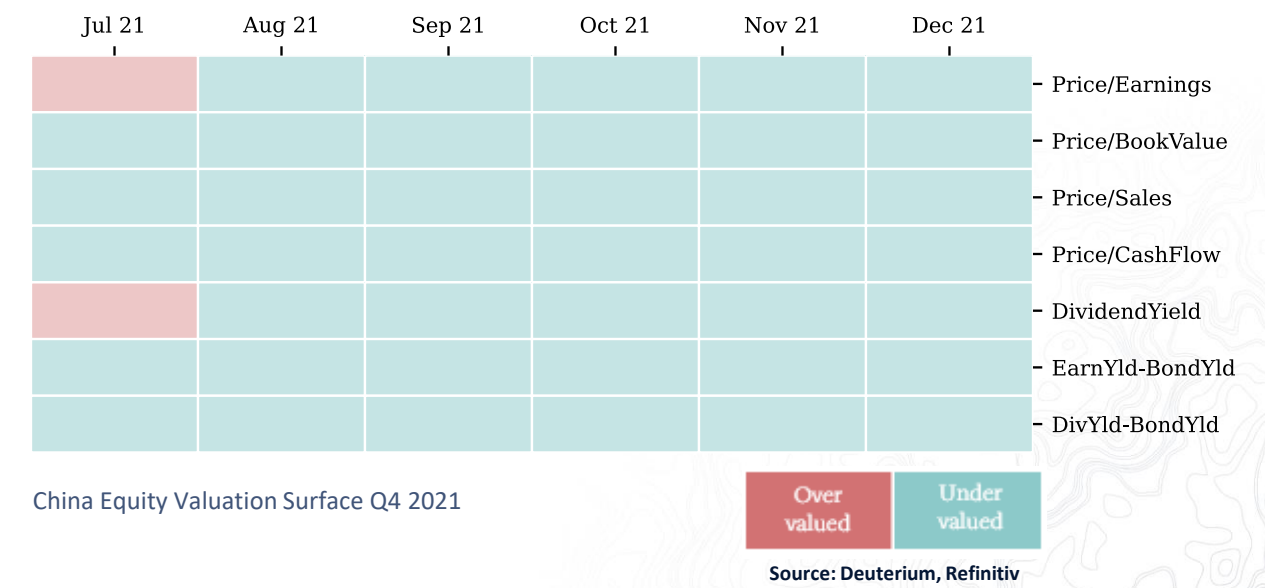
Three Month Bills



Market Valuations

Valuation tools suggest that Chinese shares in mainland indices have moved to significantly undervalued levels compared to long-term measures for trailing cash flow and earnings yields, while Hong Kong equities now are at very inexpensive valuations compared to fundamentals.

Chinese bond market valuations are unattractive, while the Yuan remains somewhat attractive on international comparisons.



DGDA Models show Chinese equities as undervalued on historical price to earnings, dividend yield, and cash flow measures

Monetary Policy and Transmission

Outlook Summary

China



CNY

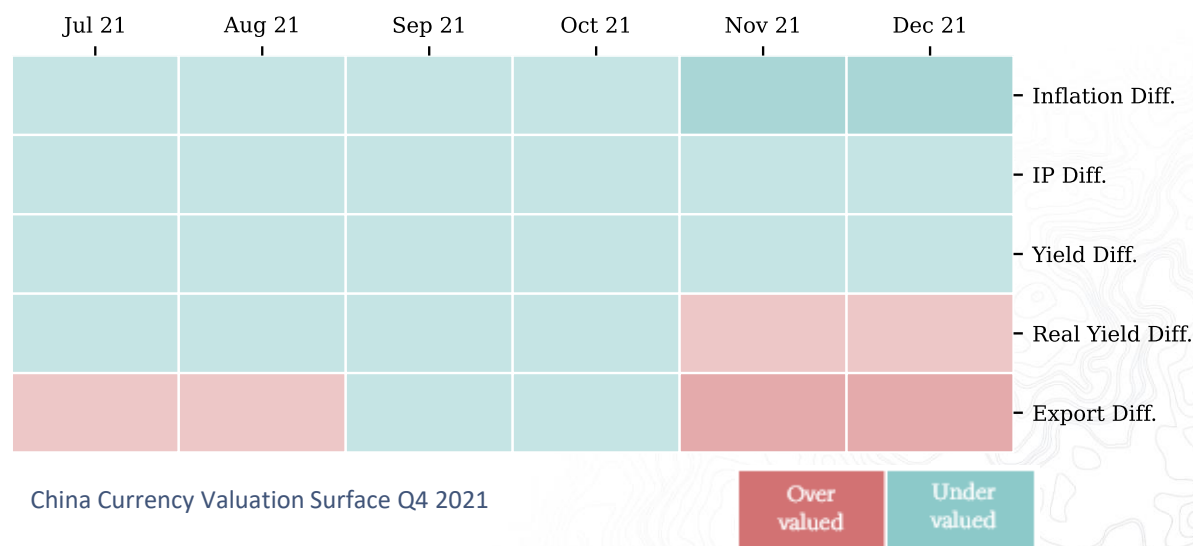


Ten Year Bonds



Monetary Policy And Transmission

Chinese monetary authorities have been slowing or reversing their significant steps to contain credit expansion, responding in part to lesser domestic inflation subsequent to the Yuan’s strengthening, and to financial system stress from negative effects on Chinese property markets. China’s monetary channels now have begun to show positive transmission effects into the real economy, which should lead through positive effects on consumption, production, and external trade to support for real GDP growth.



DGDA Models show the CNY to be somewhat undervalued on interest rate and domestic cycle comparisons

Japan Regional Investment Conclusions

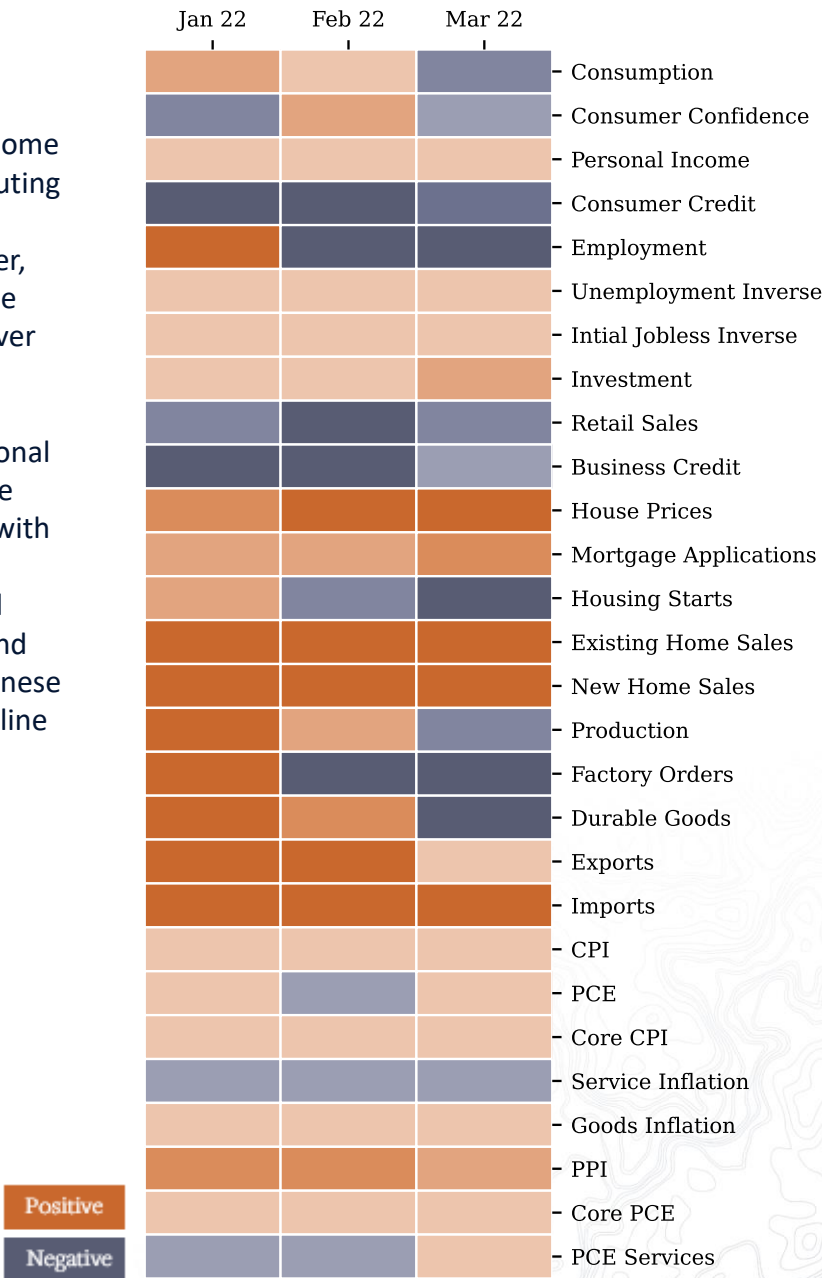
Q1 2022:

DGDA Economic Projection Surfaces



Economic Projections

DGDA Models show significant accelerations in Japanese new home sales and housing starts contributing to further Japanese investment growth. Production, factory order, and durable goods growth on the contrary will fade significantly over Q1 2022, likely reducing overall Japanese output growth for the quarter. Consumption and personal income expansions also will have peaked early in Q1 2022 in line with poorer employment prospects. Japanese inflation measures will show positive consumer price and goods inflation rates, while Japanese producer prices will stay high in line with world PPI measures.



Japan Economy Surface Projections Q1 2022

Source: Deuterium, Refinitiv

Market Valuations

Outlook Summary

Japan



Equities

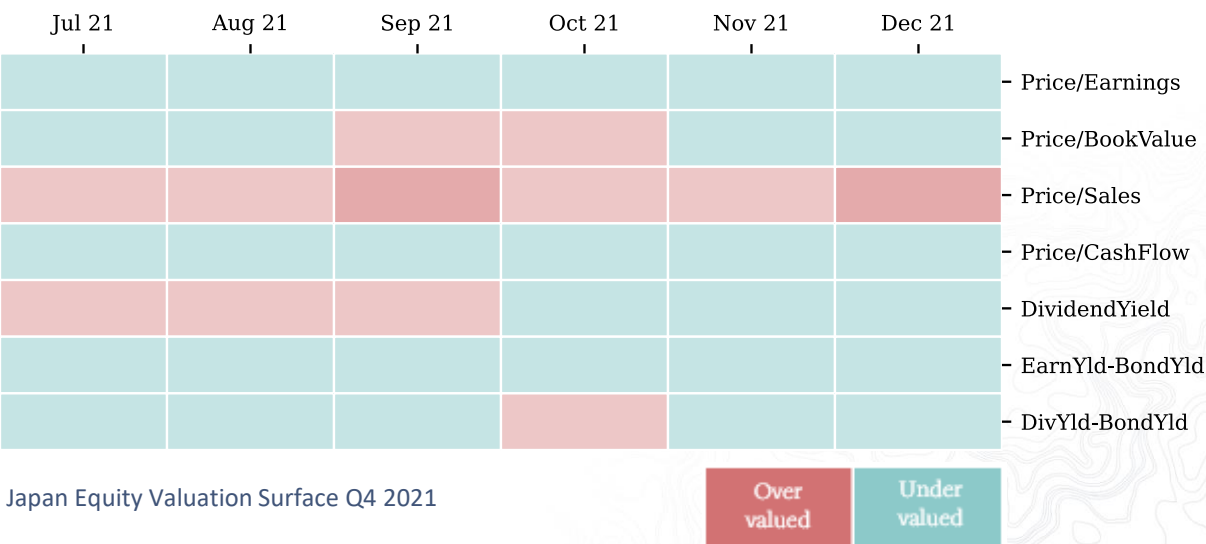


Three Month Bills



Market Valuations

Japanese shares are undervalued, with several metrics including earnings yields and dividend yields compared to long bond yields in line with their historical averages. The Yen looks to be fairly valued.



Source: Deuterium, Refinitiv

DGDA Models show that Japanese equities are undervalued on most historical metrics

Monetary Policy and Transmission

Outlook Summary

Japan



JPY

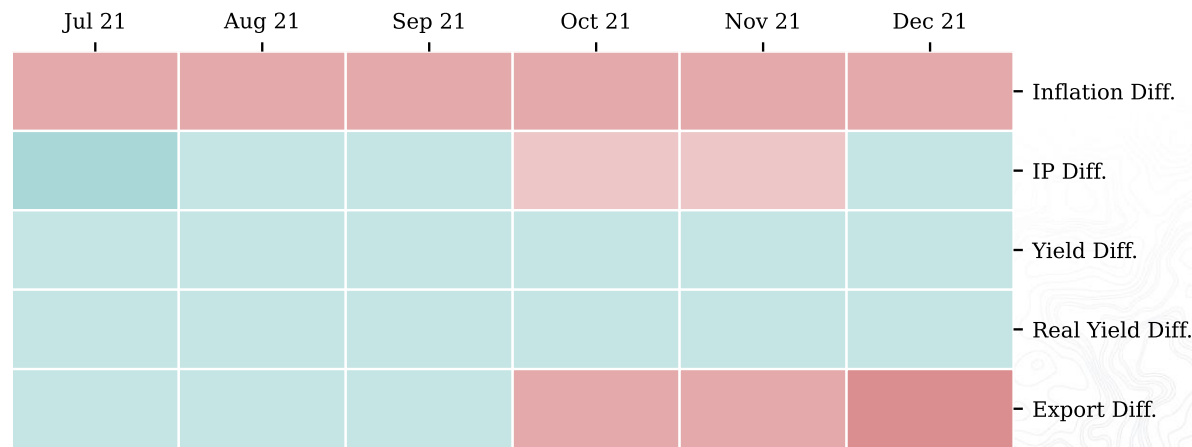


Ten Year Bonds



Monetary Policy And Transmission

DGDA Models indicate that Japanese monetary policy will continue to be supportive of prices and real economy growth, in line with BoJ policies of the past several months. The BoJ has kept policy loose enough for Japan to benefit as well from the implicit reflationary pressures that stem from a weaker Yen and rising world commodity prices.



Japan Currency Valuation Surface Q4 2021



Source: Deuterium, Refinitiv

DGDA Models show the JPY to be fairly valued on international fundamentals

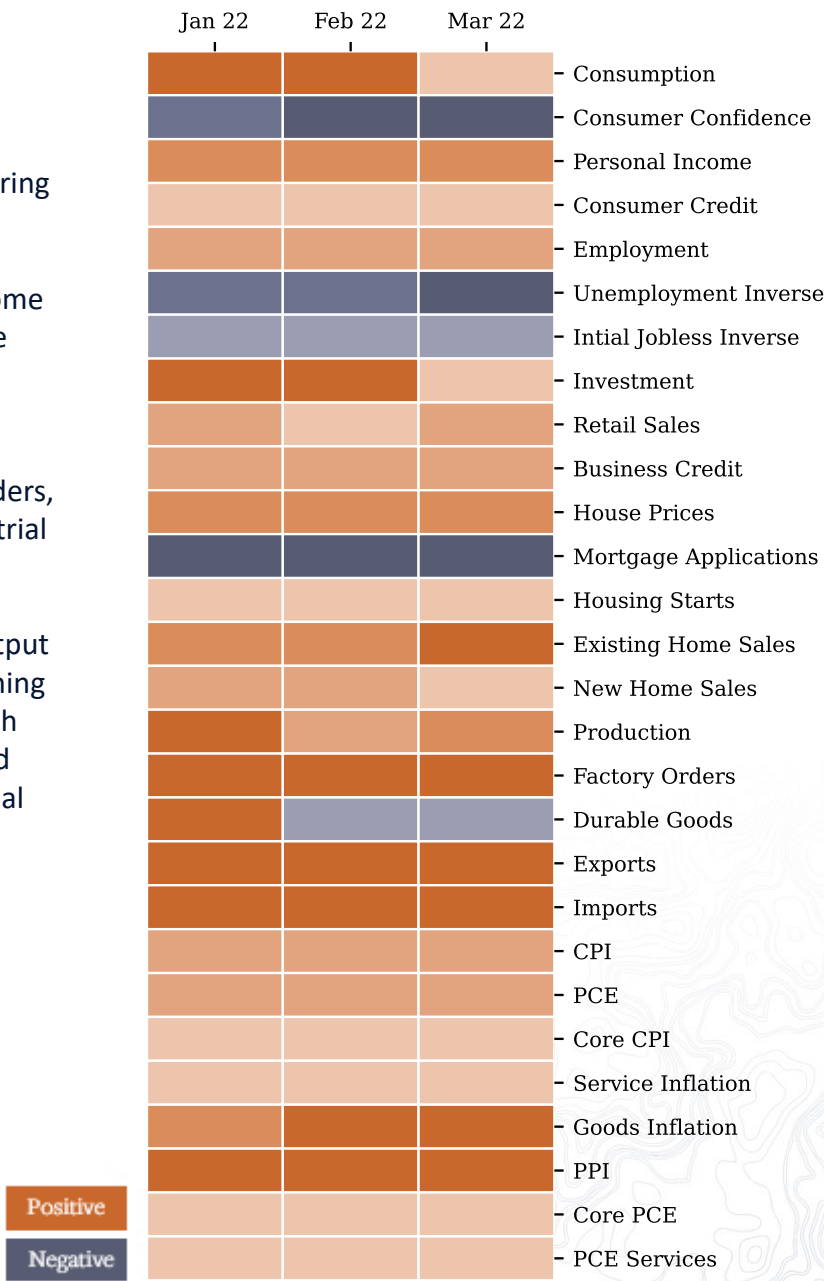
Eurozone Regional Investment Conclusions Q1 2022: DGDA Economic Projection Surfaces



Economic Projections

DGDA Models show that economic growth in the Eurozone will reflect expansions in housing and trade during Q1 2022. Our models show fading readings for the EMU consumption surface, with flat growth rates to come over the quarter in personal income and employment.

After several quarters of severe weakness in production, factory orders, and durable goods, Eurozone industrial activity and trade will normalize, moving these to their historically positive contributions to overall output growth. EMU inflation over the coming quarter will be modestly higher, with accelerations in producer prices and goods inflation fostered by the global economic expansion.



Eurozone Economy Surface Projections Q1 2022

Source: Deuterium, Refinitiv

Market Valuations

Outlook Summary

Eurozone



Equities

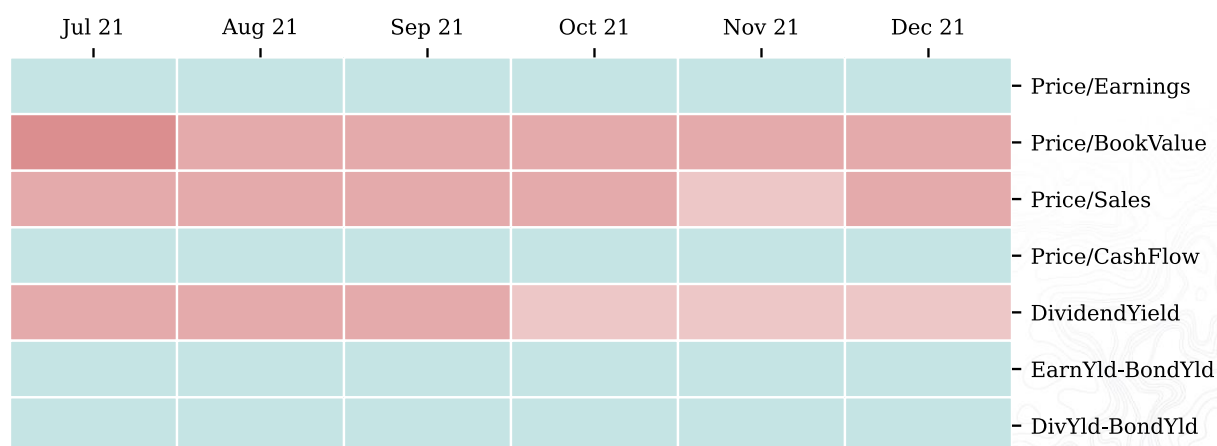


Three Month Bills



Market Valuations

Eurozone equity valuations, like those of Japan, are fairly valued according to measures comparing trailing earnings yields and dividend yields to long-maturity bond yields and are more attractive than US shares on most comparisons. Eurozone bonds look to be overvalued at present given the Eurozone’s likely higher inflation and output growth, while the Euro is attractive.



Eurozone Equity Valuation Surface Q4 2021



Source: Deuterium, Refinitiv

DGDA Models show EMU equities to be reasonably valued on price earnings, and on dividend yield and earnings yield to bond yield comparisons

Monetary Policy and Transmission

Outlook Summary

Eurozone



EUR

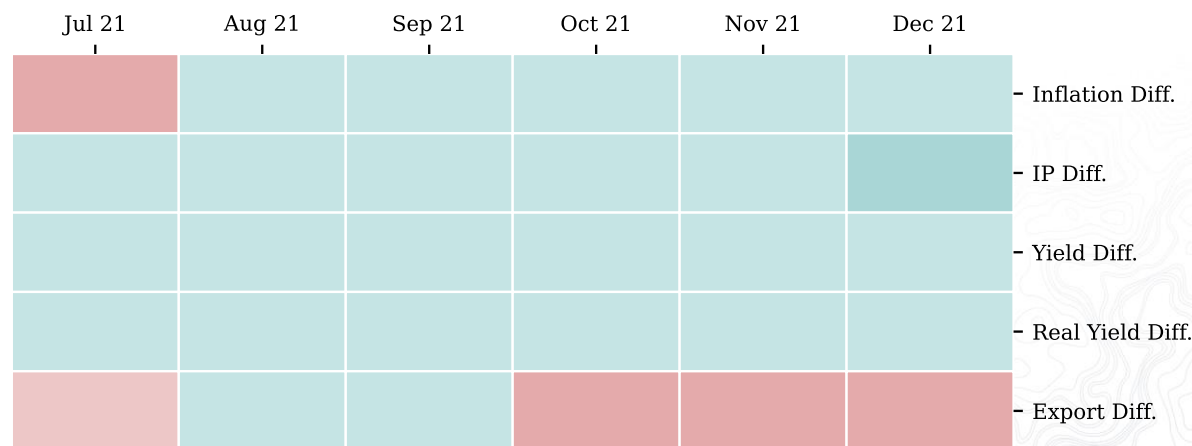


Ten Year Bonds



Monetary Policy And Transmission

The ECB provided significant monetary policy loosening in support of the Eurozone’s financial system, and the ECB at present appears to show a firm commitment to further monetary stimulus. The ECB president’s clear backing for additional fiscal measures in the major Eurozone economies has met with positive responses, and Europe’s monetary authorities look to continue working with political leaders to boost EMU income and output.



Eurozone Currency Valuation Surface Q4 2021



Source: Deuterium, Refinitiv

DGDA Models show that the Euro looks to be attractively valued on historical comparisons

UK Regional Investment Conclusions

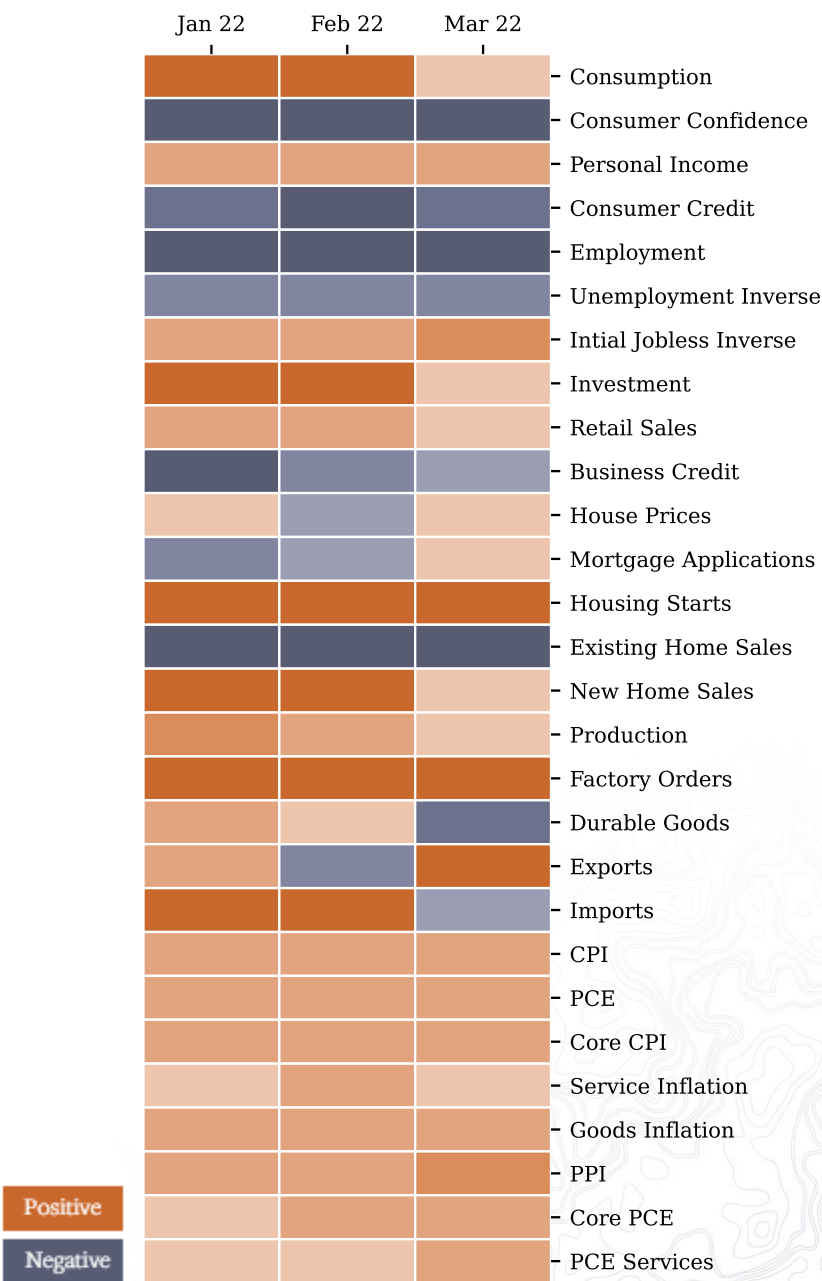
Q1 2022:

DGDA Economic Projection Surfaces



Economic Projections

DGDA Models show economic output expansions in Britain during Q1 2022, with the rebound in consumption constrained by weak confidence and poor labour markets. Next quarter’s production and trade growth look to be mixed, with some slowing in production and durable goods growth while export and import expansions remain unsteady. Construction and housing will grow somewhat less quickly, having dampening effects on overall UK investment. UK inflation will remain positive, with consumer, goods, and producer price inflation all moving up during the quarter.




UK Economy Surface Projections Q1 2022

Source: Deuterium, Refinitiv


Market Valuations

Outlook Summary


UK



Equities



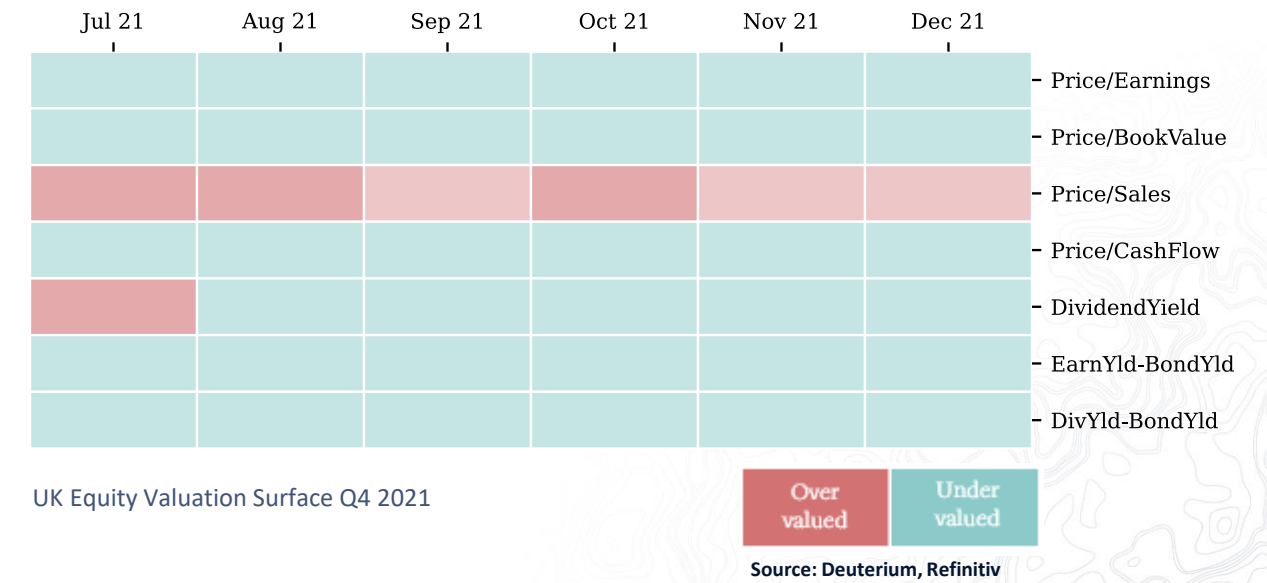
Three Month Bills



Market Valuations

UK shares have attractive valuations, better than those for most major equity markets. The prior deep contractions in UK GDP, along with FTSE 100 companies often having global earnings tied to developing markets, have made UK shares undervalued across most metrics.

The Pound is attractive against the USD at its current exchange rate, and may find better support if UK trade agreement negotiations show progress. UK bonds look to have expensive valuations given their low yields in both nominal and real terms.



DGDA Models show UK equities to be attractively valued on nearly all measures including price to earnings and price to cash flow comparisons

Monetary Policy and Transmission

Outlook Summary

UK



GBP

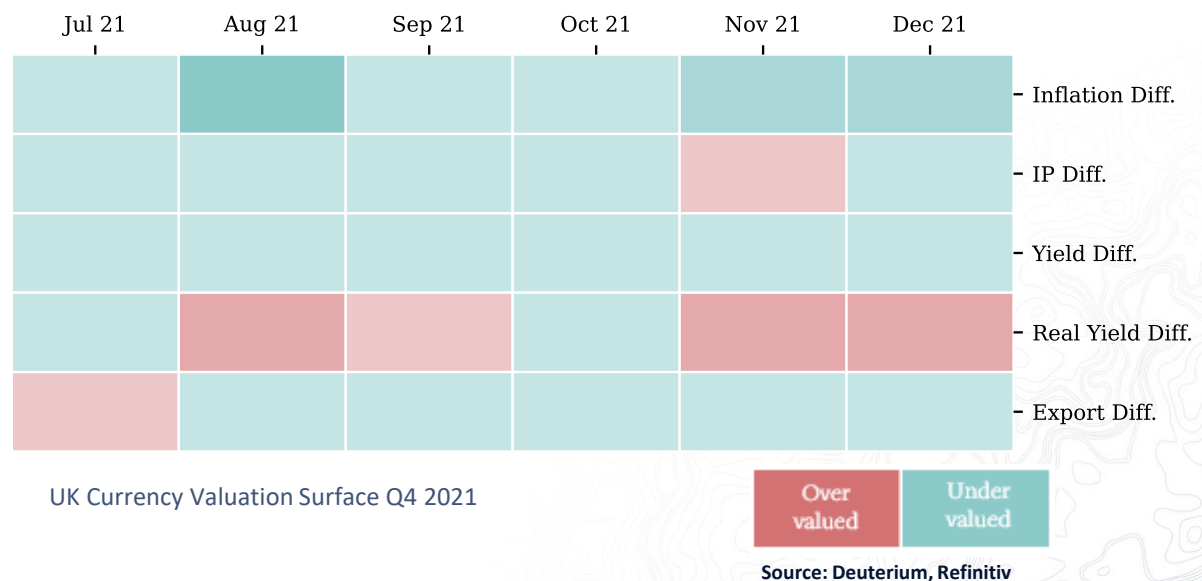


Ten Year Bonds



Monetary Policy And Transmission

The BOE joined the rest of the world’s central banks in supporting output and prices over the past eighteen months, but given the UK authorities’ difficulties in controlling domestic inflation during past cycles, were along the first to abandon those very loose monetary policies for a directed rate hike. Domestic political stability has allowed the UK authorities to set monetary policies adapted to the UK’s needs, which now appear to be working through domestic transmission channels to help promote expansions in Britain’s nominal GDP.



DGDA Models show the Pound to be undervalued on most international inflation and trade comparisons

Emerging, Far East ex Japan, and Commodity Markets

Regional Investment Conclusions Q4 2021



Outlook Summary

Emerging Equities



Far East Equities



Commodities



Economic Projections

Growth in global demand during the coming quarter will benefit developing market economies that rely upon commodity exports to accumulate international reserves, but these probably won't be enough to counter the contractions in global liquidity from major central banks raising rates. Valuations for developing equity markets have stayed low and very attractive even as world output has rebounded over the past year, translating into one of the largest historical divergences between major and emerging market performances. This has meant that Brazilian, Mexican, and other developing resource equity markets are currently at discounts to long term valuations, showing significant relative valuation advantages compared to major markets. Nevertheless, world prices will continue to rise in Q1 2022, and while relieving pressure on such countries' external accounts, will be matched on the downside by negative effects of the major central banks' policy shift towards tightening. Growth in Far East economies such as those of Taiwan or South Korea moreover will slow further, and that downward shift probably will also be to the detriment of developing market equity valuations worldwide.

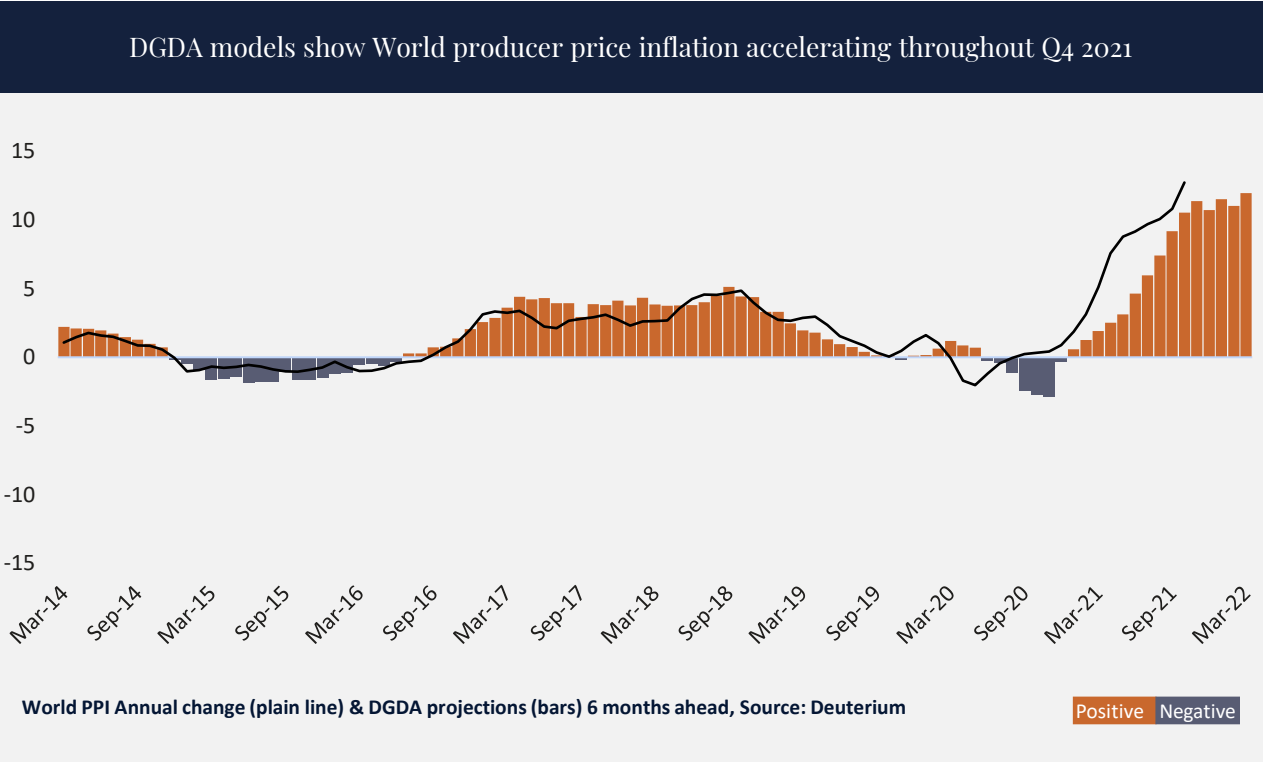
Monetary Policy And Transmission

For most of this year, central banks around the world aligned their monetary policies to unprecedented loosening, with the Federal Reserve having implemented rapid rate cuts and expanded its balance sheet, the ECB having extended its quantitative easing, and only the PBoC withholding domestic monetary support. Now it appears that in the principal regions directed short-term interest rates will be lifted off their all-time lows as monetary authorities look to reign in their consumer price and producer price inflation. The authorities clearly consider that unbridled inflation currently is the most potent threat to the real economy expansions still lifting output, trade and commodity prices around the world. The global shift to monetary tightening will not be to the advantage of risk assets in the Far East and developing regions.



Market Valuation And Sentiment

Shares for Far East ex Japan countries such as South Korea and Taiwan are near fair value compared to historical measures, while those of developing markets such as Mexico and Brazil are showing as very inexpensive compared to their long-term averages.



About the Author: John Ricciardi

Lead Manager of the Deuterium Global Dynamic Allocation Fund
Head of Global Asset Allocation, Deuterium Capital Management, LLC

Before joining Deuterium in January 2021, John was the Head of Global Asset Allocation at Merian Global Investors (MGI). John co-founded Kestrel Investment Partners LLP in 2011, whose global asset allocation business was acquired by MGI. Prior to Kestrel, John served as the Head of Asset Allocation at Iveagh Limited between 2006 and 2011, where he launched the Iveagh Wealth Fund.

Earlier in his career, John cofounded Cursitor Management. Cursitor was one of the first firms to offer top-down, global asset allocation solutions for institutions. Upon the sale of Cursitor to Alliance Capital in 1996, John became the Head of Global Asset Allocation for AllianceBernstein, where he served until 2003. With AllianceBernstein, John also cofounded Bullrun Financial in 2000, a pioneer of quantitative portfolio strategies for institutions and advisers. John chaired the business through to 2010 when it was sold to Quantal International Inc.

About Deuterium

Deuterium Capital Management, LLC has been in business as a US registered investment adviser since April 2018. The firm provides comprehensive investment management solutions through both direct relationships and partnerships with family offices and/or similar institutions. Deuterium also provides investment management services to an umbrella Irish Collective Asset-management Vehicle. Deuterium Investment Advisers Limited is Deuterium's UK presence and is an Appointed Representative of Kroll Securities Limited which is authorised and regulated by the Financial Conduct Authority in the UK. Deuterium's website can be viewed at www.deuterium.us

Online

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