



Deuterium Global Dynamic Allocation

Quarterly Strategy Report Q2 2022

31 March 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 Q2 2022

The outlook for risk assets likely will be poor during most of Q2 2022, with inflation remaining high, central banks raising rates while moving towards quantitative tightening, and corporate earnings expectations falling when global output suddenly slows. Worldwide instabilities in the wake of the conflict in the Ukraine have accelerated the global rise in energy and commodity prices underway since last year. Elevated producer prices will keep upward pressure on bond yields for much of the quarter, while higher headline inflation will reduce real disposable income growth, weighing on consumption and retail sales growth across the major economies.

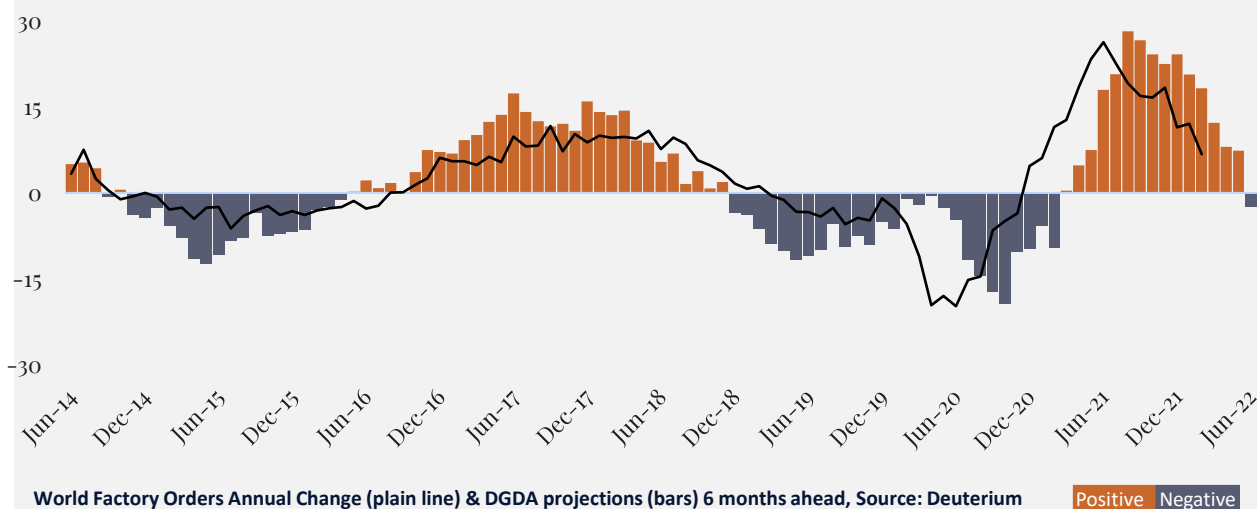
Central bank support mechanisms were put in place during the March 2020 covid crisis, and so far have mitigated the negative financial system liquidity effects of international sanctions banning Russian institutions and blocking access to Russian sovereign reserves. A global liquidity crisis is unlikely, given the US central bank FX swap liquidity lines with major central banks, Russian banks' ability to clear positions between themselves in Rubles, and the ECB's willingness to support French, Italian, and German banks that will have to account for higher potential default risk in their Russian credits.

Sector rotation will again be a major investment theme during the quarter when US technology, communications, and consumer discretionary stocks, still overvalued despite their selloffs this year, will correct further as global financial conditions deteriorate.








For the end of Q2 2022, nonetheless, our same models that warned of upward pressures on bond yields over the past 18 months are signalling that those upward pressures will fade as inflation flattens, world output growth slows, and central banks tighten.

The late cycle context favouring financials, materials, energy, and real estate sectors likely will shift late in Q2 2022 to favour shares in interest-sensitive sectors such as healthcare and consumer staples.

Deuterium Global Asset Allocation projects world factory order growth falling by late Q2 2022



DGDA Market Projections for Q2 2022

DGDA projections for Q2 2022	At 31 March 2022	Market moves projected for end Q2 2022
USA		
3 Month yields	0.48%	
10 Year yields	2.34%	--
US Dollar Index	98.3	--
S&P 500 Index	4530	--
China		
3 Month yields	2.37%	
Chinese Yuan	0.158	+
MSCI China	73	
Japan		
3 Month yields	-0.11%	
10 Year yields	0.22%	
Japanese Yen	0.008	--
Topix Share Index	1946	--
EMU		
3 Month yields	-0.74%	
10 Year yields	0.55%	
Euro	1.11	+
Euro Stoxx 50 Share Index	3903	--
UK		
3 Month yields	0.56%	--
10 Year yields	1.61%	--
British Pound	1.31	
FTSE 100 Share Index	7516	--
Commodity Markets		
All Commodities	124	
Oil & Energy	46	
Gold & Precious Metals	234	--

Source: Deuterium, Bloomberg

bearish		negative	-	neutral		positive	+	bullish	
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DGDA Global Investment Conclusions

1. The global business cycle will be in a strongly decelerating trend in Q2 2022 while inflation will remain high enough to have major central banks aggressively raising directed interest rates. Downward revisions to projected earnings will weigh upon equity valuations even as financial conditions worsen with monetary policy tightening and higher discount rates. This suggests that the initial effects of slowing output growth will be negative for risk assets, yet will be less so late in the quarter when upward pressures on bond yields eventually begin to abate.

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

2. The US Federal Reserve has entirely reversed its provision of extraordinary liquidity to the US financial system, now that two years after enormous monetary expansion, annual headline inflation has moved up to several times its targeted rate. Major monetary authorities are aligned with those of the US in raising rates and projecting quantitative tightening, even if they do not have the USA's full employment. All central banks will face conflicting policy pressures when output growth will slow rapidly during the quarter while inflation stays very high.

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

3. In Q2 2022 the US and European economies will show marked decelerations in aggregate demand and production, and industrial activity will continue to slow in Far-East economies with the exception of China's. Last year's monetary and fiscal interventions gave sufficient liquidity and income support to keep the global growth rate positive, but its pace will be much slower even as central banks shift to global tightening.

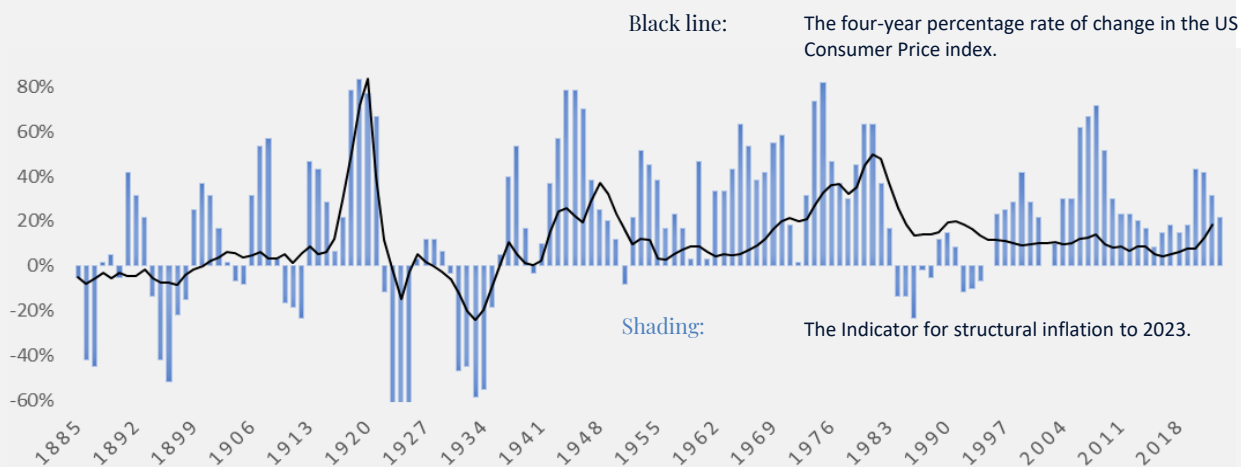
Economic Projections	USA	Moderate Expansion
	China	Expansion
	EMU	Moderate Expansion
	Japan	Moderate Expansion
	UK	Moderate Expansion

Deuterium Global Dynamic Allocation Outlook for Q2 2022

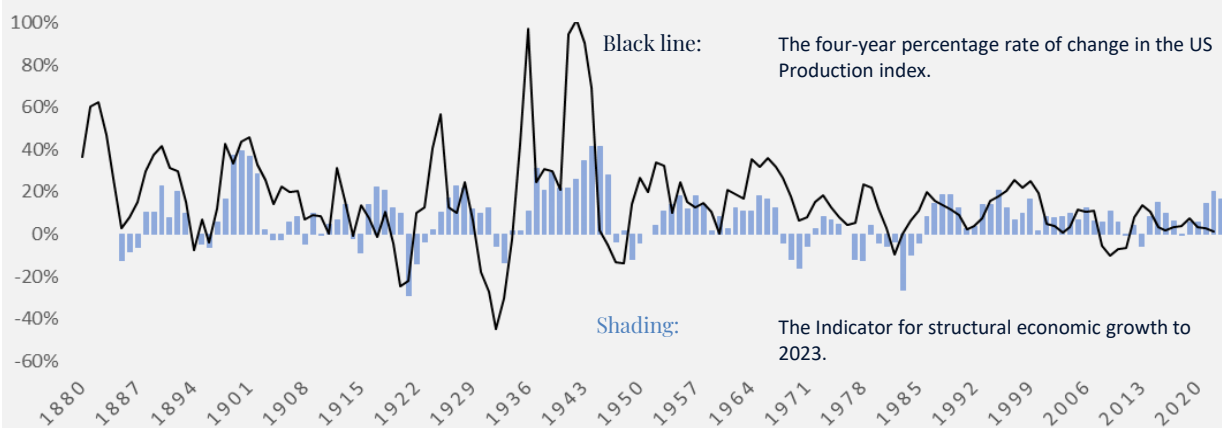
Our Q2 2022 projections for inflation to remain high and industrial activity growth to remain positive but to decelerate during the quarter are aligned with our structural projections for US CPI and Production through end 2023, based on our 150-year historical analysis (published separately).

The charts below show our predictive Indicators for US Structural Inflation & Growth from 1885 to 2023.

This chart shows the percent change over four years of US inflation & our four-year inflation indicator.



This chart shows the percent change over four years of US industrial production & our four-year production indicator.



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.



Global Economic signals shifting to negative by end Q2 2022

DGDA projections for production, orders, and exports show that industrial activity growth will decelerate across nearly all regions, with signals negative by end Q2 2022,

Global Production Monitors (+/- 1) ⤴

Production Monitor	Production	Orders	Exports	Direction	Average
USA					-0.27
Europe					-0.14
Japan					-0.38
UK					-0.17
Canada					-0.53
France					-0.12
Switzerland					-0.09
Germany					-0.22
Australia					-0.45
Netherland					-0.20
Spain					-0.26
Sweden					-0.20
Italy					-0.23
China					0.12
South_Korea					-0.25
Taiwan					-0.24
Hong_Kong					-0.19
Singapore					-0.18
Indonesia					-0.06
Thailand					-0.15
India					-0.24
Brazil					-0.22
Russia					0.01
Mexico					-0.26
South_Africa					0.04

Source: Deuterium

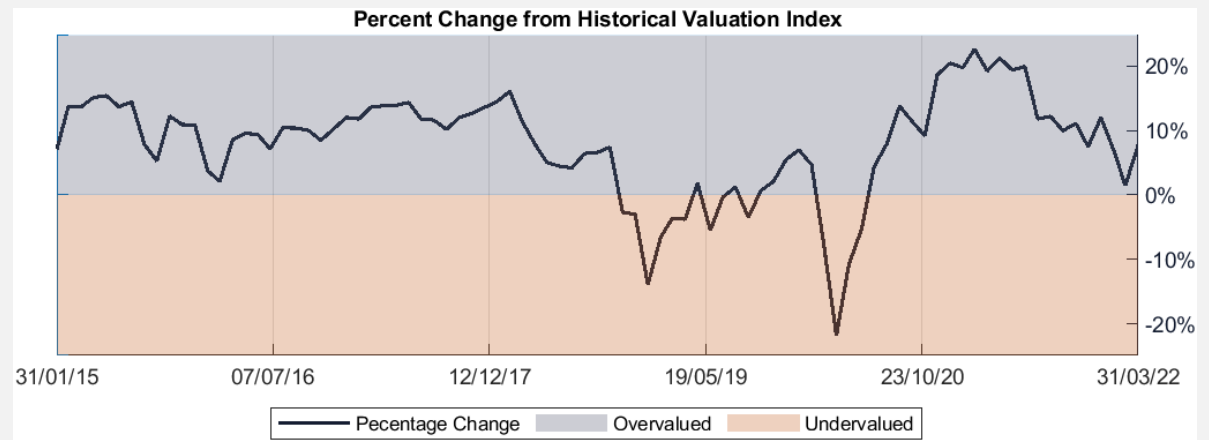
Best Worst

Our indicators for industrial activity are negative in Q2 2022, signaling decelerations in all but three of the regions shown. These widespread, poor projections for production, factory orders, and durable goods suggest a global slowdown for this quarter. Higher energy prices, deteriorating trade relationships, and worsening financial conditions were headwinds to worldwide demand even before central banks made rate hikes and quantitative tightening their priority.

Lower US disposable income and less housing market price support for consumption and production growth will have a negative impact, while the ECB and BoE will be tightening into slowing growth for their economies at less than full employment.

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.



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

COUNTRY	Current Price	Target Price	Price Move required to get to target price
World	3011	2853	-5.2%
EAFE	2157	2588	20.0%
United States	4463	3888	-12.9%
EMU	3902	4489	15.0%
Japan	26827	30682	14.4%
United Kingdom	7405	9089	22.7%
Canada	21818	20260	-7.1%
France	6620	7711	16.5%
Switzerland	12185	15092	23.9%
Germany	14413	16978	17.8%
Australia	7294	8088	10.9%
Netherlands	716	778	8.6%
Spain	8418	10383	23.3%
Sweden	2179	2800	28.5%
Italy	24222	31648	30.7%
Asia Ex Japan	648	729	12.4%
China	72	94	30.8%
South Korea	2707	2725	0.7%

COUNTRY	Current Price	Target Price	Price Move required to get to target price
Taiwan	17457	19057	9.2%
Hong Kong	21412	27713	29.4%
Singapore	3331	3630	9.0%
Indonesia	6955	8171	17.5%
Malaysia	1591	1971	23.9%
Thailand	1679	1765	5.2%
Philippines	7008	7344	4.8%
Emerging	1123	1280	14.0%
India	57864	60814	5.1%
Brazil	115311	172601	49.7%
Russia	2470	3569	44.5%
Mexico	55467	65897	18.8%
Turkey	2144	1918	-10.6%
Resource	389	537	37.9%
South Africa	74848	102692	37.2%
Colombia	544	558	2.5%
Chile	4854	6682	37.6%
Argentina	89058	91161	2.4%

Source: Deuterium, Bloomberg

Negative Positive

US Equities and Major non-US Bond Markets remain overvalued

- US equity markets continue to show as significantly overvalued on standard measures, with shares in large capitalization sectors such as information technology, communications, and consumer discretionary still markedly above five-year averages for their prices compared to earnings, sales, book value, cash flow, and dividends. Investors in US shares may be disappointed when fundamental measures deteriorate as US consumption and real output growth slow. Despite US shares keeping world equities overvalued, 32 of the 34 non-US equity markets under review show attractive valuations at present. US shares would underperform markedly this quarter were they to move in line with EAFE equity valuations.
- Q2 2022 will show poor fundamental support for shares during much of the quarter, with continued upward pressure on short-term interest rates from central banks worldwide, as consumer and producer price inflation rates remain elevated. Even as central banks tighten policy across the major regions, consumption, industrial production, and export growth will show significant slowing, so much so that by quarter end the upward pressures on long-term yields likely will subside.
- Given persistent high inflation and rising short-term interest rates during Q2 2022, large US sectors such as technology, communications, and consumer discretionary may again underperform when both US consumption and industrial activity show much slower growth.

Deuterium Global Asset Allocation Conclusions for Q2 2022

Support for corporate earnings will fade during Q2 2022. The fiscal and monetary policies that boosted incomes and output will no longer be in effect, and the global cycle expansion that lifted risk asset valuations last year suddenly will show signs of an imminent slowdown. Sustained consumer inflation will keep upward pressure on short term interest rates, while producer and commodity price inflation likely will remain substantial throughout Q2 2022, contributing to a floor under yields, and a reduction in disposable incomes worldwide.

During the coming quarter, the global context will be one where high inflation likely will have investors anticipating that central banks will tighten aggressively even into decelerating output growth, thereby increasing the risk of policy errors that would drastically affect corporate earnings growth to the downside. This will mean that for most of the quarter the global context will not be supportive of risk asset valuations, despite attractive levels for most non-US shares.

Investors may do well to maintain low allocations to risk assets for most of Q2 2022, as fading economic growth worldwide will lower corporate revenue and earnings projections. Further decelerations in US consumption and retail sales growth, as well as in US production and export growth, likely will have technology, communications, and consumer discretionary share valuations again underperforming, Short-term interest rates will adjust higher as central banks look to prevent current high inflation rates shifting further above target, yet slower output growth may well cap bond yields by quarter end.



USA Regional Investment Conclusions

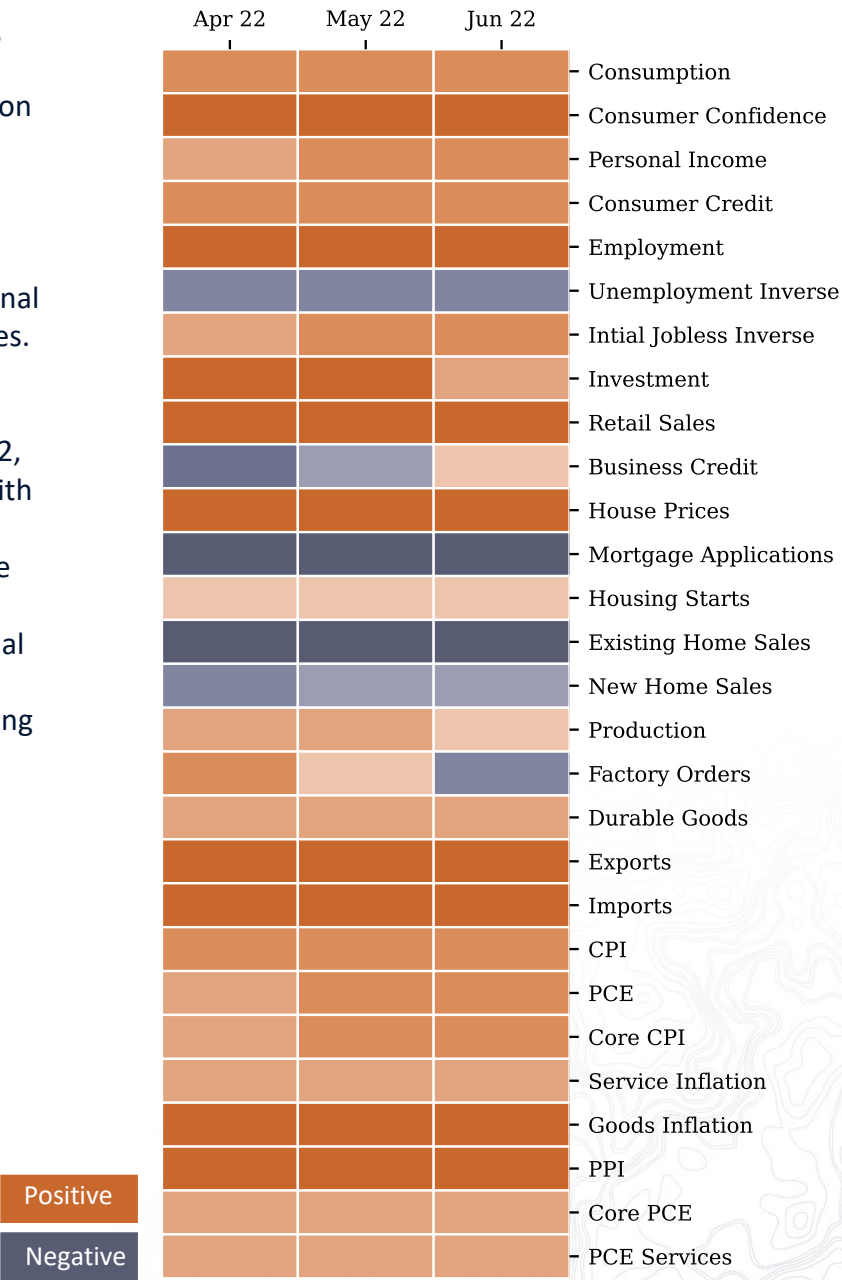
Q2 2022:

DGDA Economic Projection Surfaces



Economic Projections

Deuterium Global Asset Allocation models project that US trade growth will continue positive during the next quarter, with contracting factory orders and with US consumption and personal income expanding at slower rates. US housing growth looks to be slowing while housing prices continue higher. During Q2 2022, US inflation will be sustained, with further accelerations in goods inflation and producer prices the principal problem for US authorities, even as core personal consumption expenditure and services inflation stop accelerating from here.




USA Economy Projection Surfaces Q2 2022

Source: Deuterium, Refinitiv


Market Valuations

Outlook Summary


USA



Equities



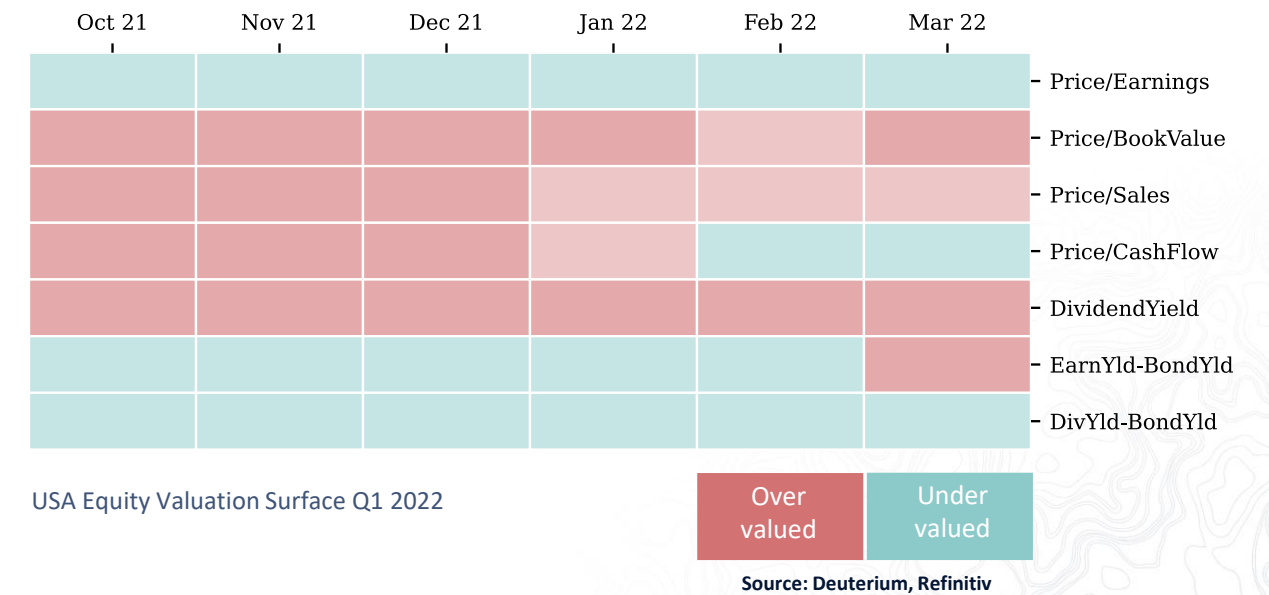
Three Month Bills



Market Valuations

Equity valuation metrics show that US shares are overvalued and are the sole exception to attractively valued major equity markets. Comparisons of US trailing earnings and dividend yields against US bond yields are within average bounds, but most other measures show marked overvaluations.

The Federal Reserve’s policy interventions and high reported US inflation have brought US bond yields up to the point that US bond valuations now are in line with their long-term averages. 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 price/cash flow is more aligned to historical averages

Monetary Policy and Transmission

Outlook Summary

USA



USD

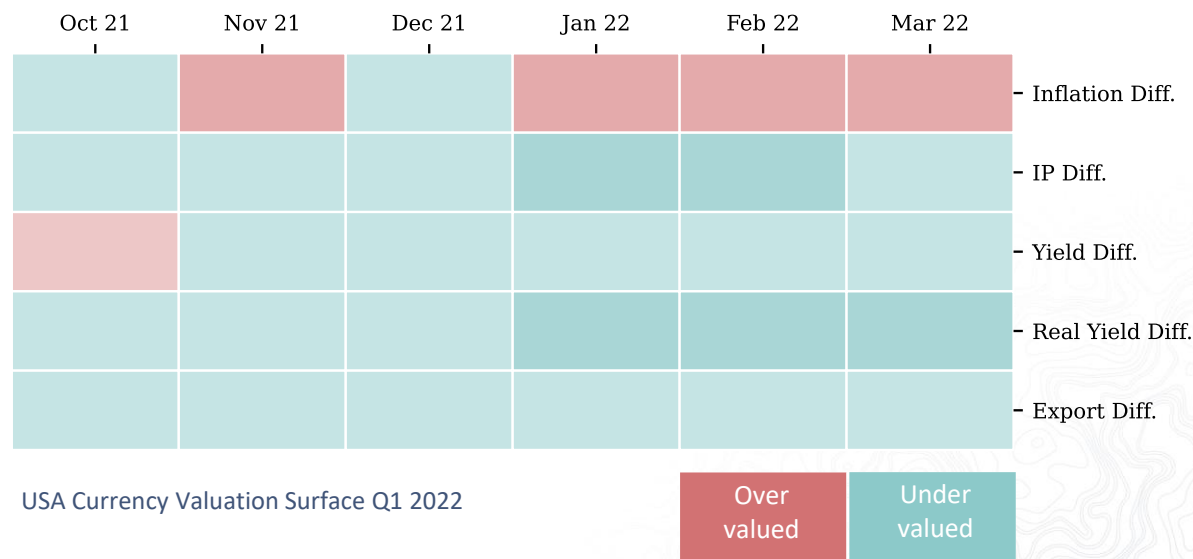


Ten Year Bonds



Monetary Policy and Transmission

DGDA Models suggest that USA inflation will stay high over the course of Q2 2022, and that the Federal Reserve’s sustained shift towards policy tightening will keep upward pressures on US short-term interest rates even as signs of significant slowdowns in US consumption and production growth appear during the quarter.



Source: Deuterium, Refinitiv

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

China Regional Investment Conclusions

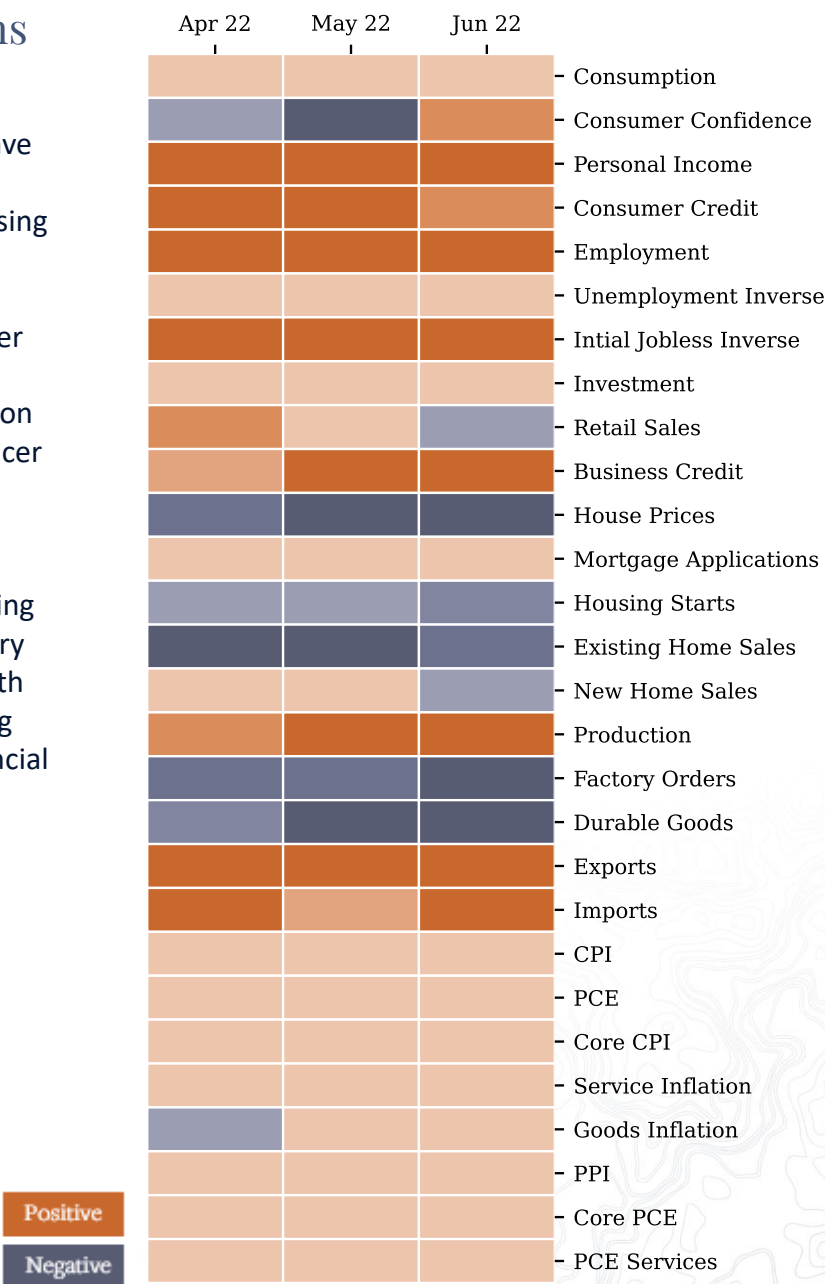
Q2 2022:

DGDA Economic Projection Surfaces



Economic Projections

DGDA Models show that real output growth in China will have headwinds from weaker retail sales and continued poor 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 Projection Surfaces Q2 2022

Source: Deuterium, Refinitiv

Market Valuations

Outlook Summary

China



Equities



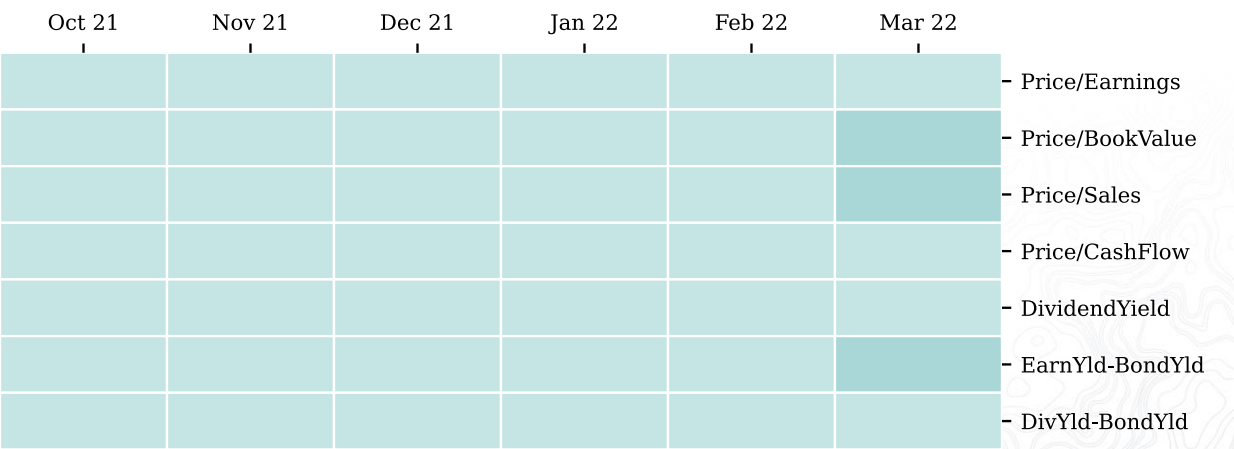
Three Month Bills



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 are at very inexpensive valuations compared to fundamentals.

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



China Equity Valuation Surface Q1 2022



Source: Deuterium, Refinitiv

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

Monetary Policy and Transmission

Outlook Summary

China



CNY

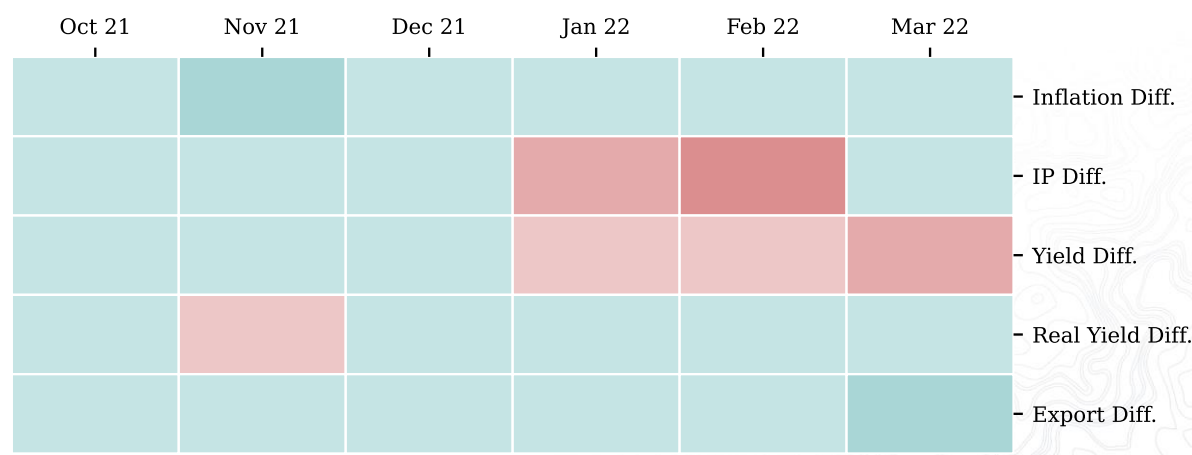


Ten Year Bonds



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.



China Currency Valuation Surface Q1 2022



Source: Deuterium, Refinitiv

DGDA Models show the CNY to be undervalued on inflation, real interest rate and domestic cycle comparisons

Japan Regional Investment Conclusions

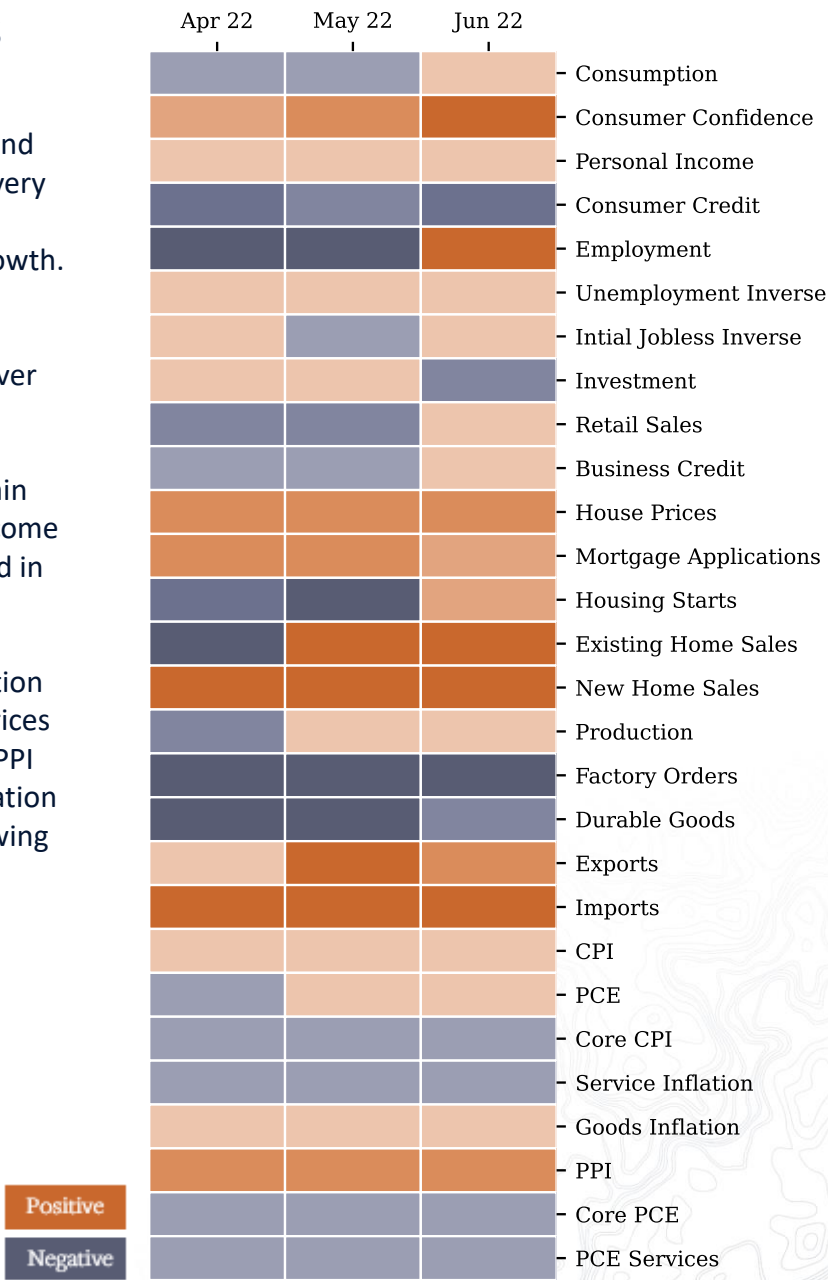
Q2 2022:

DGDA Economic Projection Surfaces



Economic Projections

DGDA Models show significant accelerations in Japanese new and existing home sales with a recovery in housing starts contributing to further Japanese investment growth. Production, factory order, and durable goods growth on the contrary will fade significantly over Q2 2022, likely reducing overall Japanese output growth for the quarter. Consumption will remain relatively weak and personal income expansions also will have peaked in Q2 2022. Japanese inflation measures will show positive consumer price and goods inflation rates, and Japanese producer prices will stay high in line with world PPI measures. Core and service inflation measures nevertheless are showing the signs of historical Japanese deflation.



Japan Economy Projection Surfaces Q2 2022

Source: Deuterium, Refinitiv

Market Valuations

Outlook Summary

Japan



Equities

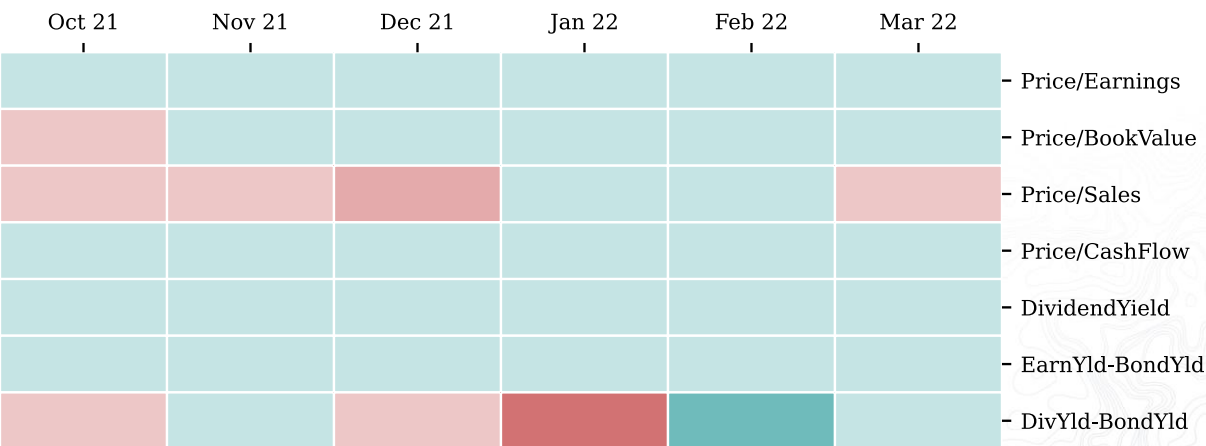


Three Month Bills



Market Valuations

Japanese shares are undervalued, with several metrics including earnings yields and dividend yields compared to long-term bond yields attractive when measured against their historical averages. The Yen looks to be fairly valued.



Japan Equity Valuation Surface Q1 2022



Source: Deuterium, Refinitiv

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

Monetary Policy and Transmission

Outlook Summary

Japan



JPY

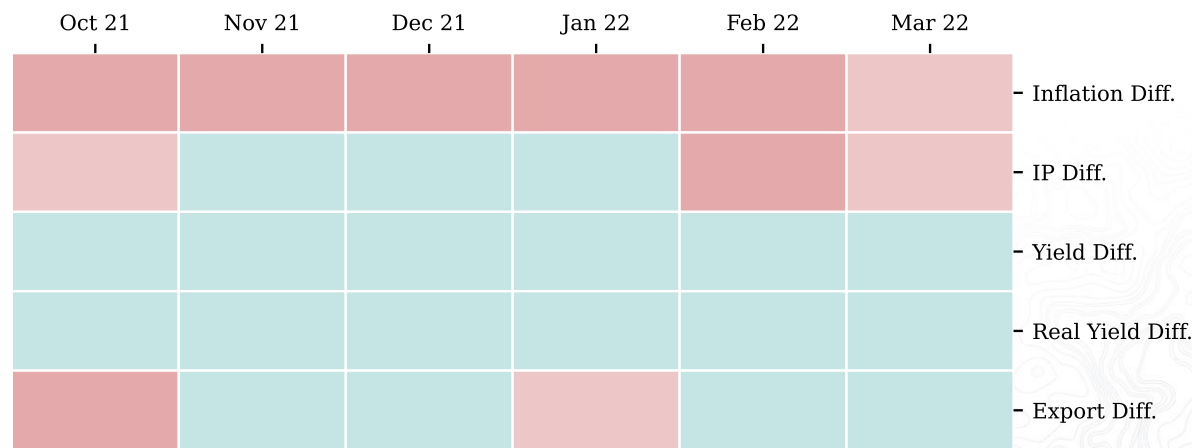


Ten Year Bonds



Monetary Policy And Transmission

DGDA Models indicate that Japanese monetary authorities will continue to be supportive of prices and real economy growth, in line with BoJ policies of the past decades. The BoJ has kept policy loose enough to have the implicit reflationary pressures that stem from a weakening Yen and rising world commodity prices put a floor under Japanese headline prices.



Japan Currency Valuation Surface Q1 2022



Source: Deuterium, Refinitiv

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

Eurozone Regional Investment Conclusions Q2 2022:

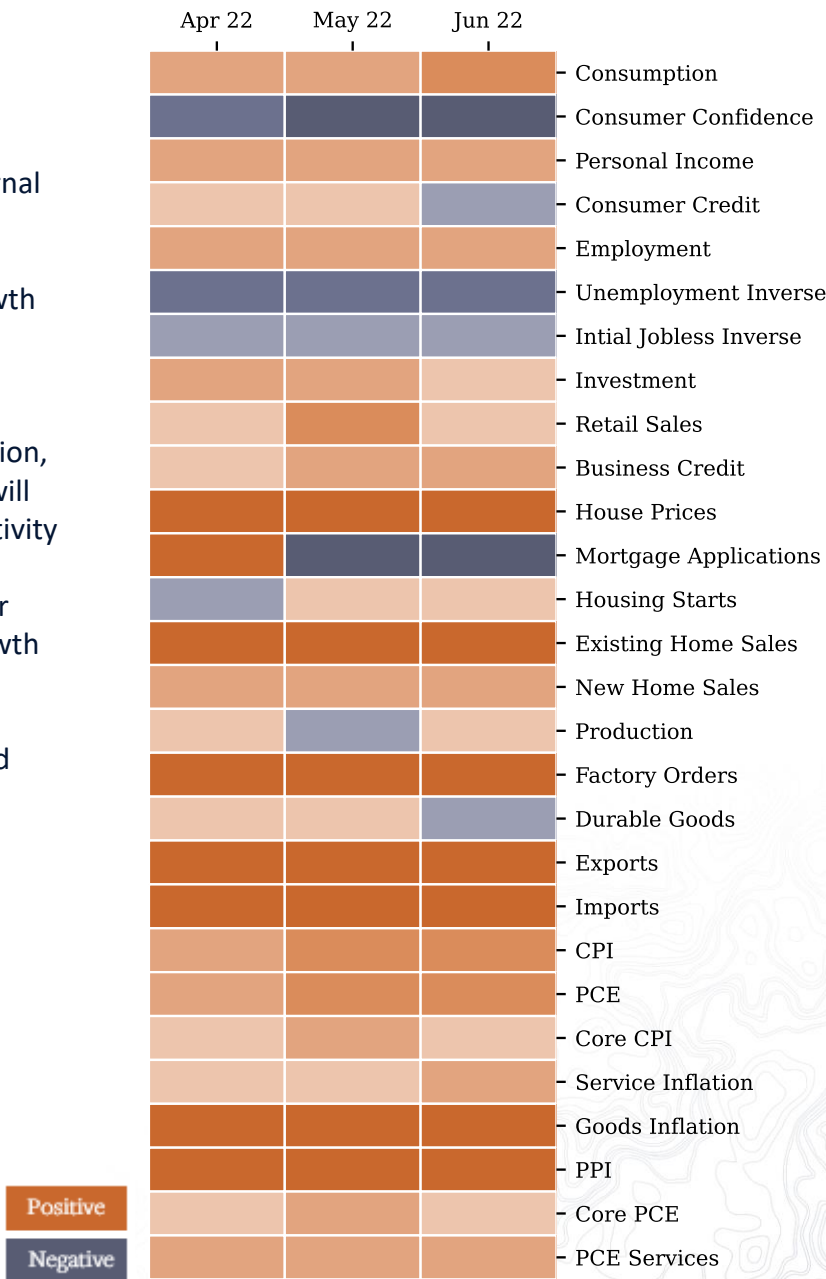
DGDA Economic Projection Surfaces



Economic Projections

DGDA Models show that economic growth in the Eurozone will reflect expansions in home sales and external trade during Q2 2022. Our models show mixed readings for the EMU consumption surface, with flat growth rates to come over the quarter in personal income and employment.

Positive annual changes in production, factory orders, and durable goods will suggest that Eurozone industrial activity and trade have normalized, but our acceleration models show that their contributions to overall output growth will fade late in the quarter. EMU inflation will stay high, with accelerations in producer prices and goods inflation in line with global pressures.



Eurozone Economy Projection Surfaces Q2 2022

Source: Deuterium, Refinitiv

Market Valuations

Outlook Summary

Eurozone



Equities

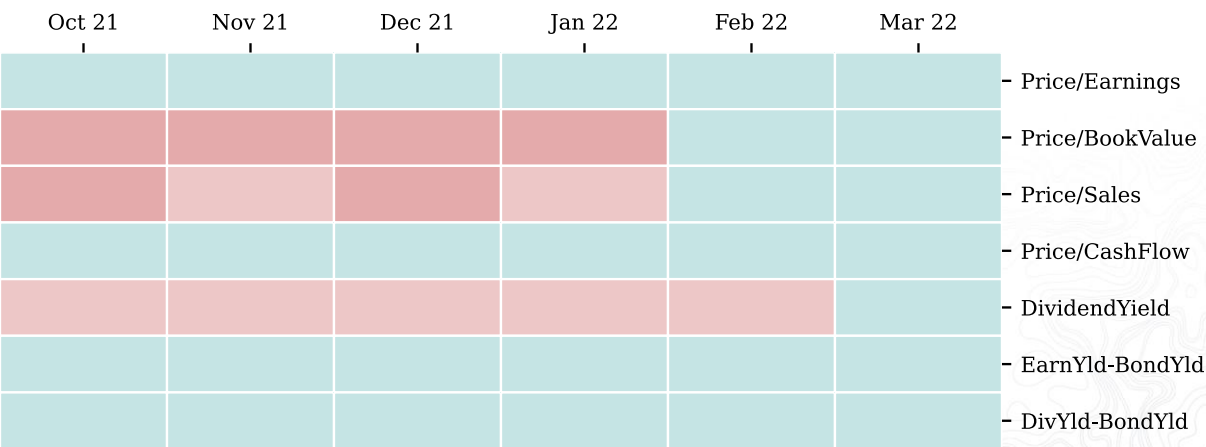


Three Month Bills



Market Valuations

Eurozone equities are undervalued according to all measures, including comparisons of trailing earnings yields and dividend yields to long-maturity bond yields, and are more attractive than US shares on most metrics. Eurozone bonds look to be overvalued at present given the Eurozone’s likely higher inflation, while the Euro remains attractive.



Eurozone Equity Valuation Surface Q1 2022



Source: Deuterium, Refinitiv

DGDA Models show EMU equities to be attractively valued on all measures including price to earnings, dividend yield, and earnings yield to bond yield comparisons

Monetary Policy and Transmission

Outlook Summary

Eurozone



EUR

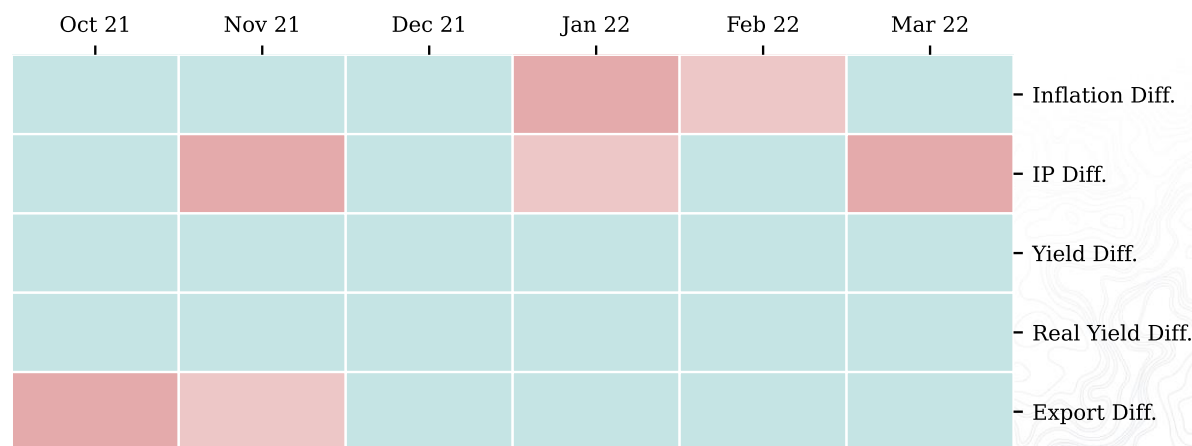


Ten Year Bonds



Monetary Policy And Transmission

The ECB has entirely reversed its significant monetary policy loosening previously in support of Eurozone growth, and at present has declared a firm commitment to further tightening in order to counter Eurozone inflation. The ECB's full alignment with the US Federal Reserve's aggressive policy shift will keep upward pressure on EMU short-term interest rates, whatever the ongoing support for European financial institutions saddled with exposure to Russia.



Eurozone Currency Valuation Surface Q1 2022



Source: Deuterium, Refinitiv

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



UK Regional Investment Conclusions

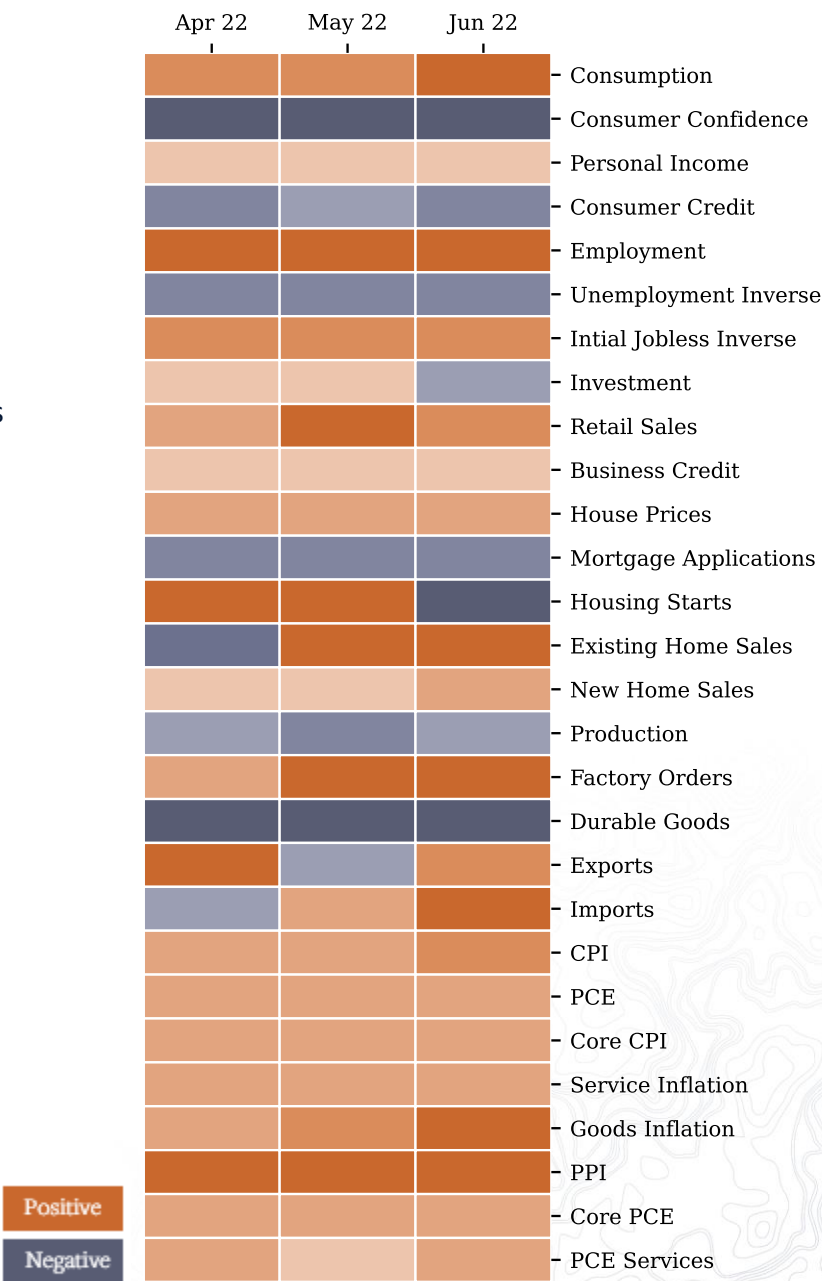
Q2 2022:

DGDA Economic Projection Surfaces



Economic Projections

DGDA Models show mixed output expansions in Britain during Q2 2022, with the rebound in consumption somewhat constrained by weak confidence and poor credit growth. Next quarter’s production and durable goods growth look to be slowing, 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 Projection Surfaces Q2 2022

Source: Deuterium, Refinitiv


Market Valuations

Outlook Summary


UK



Equities



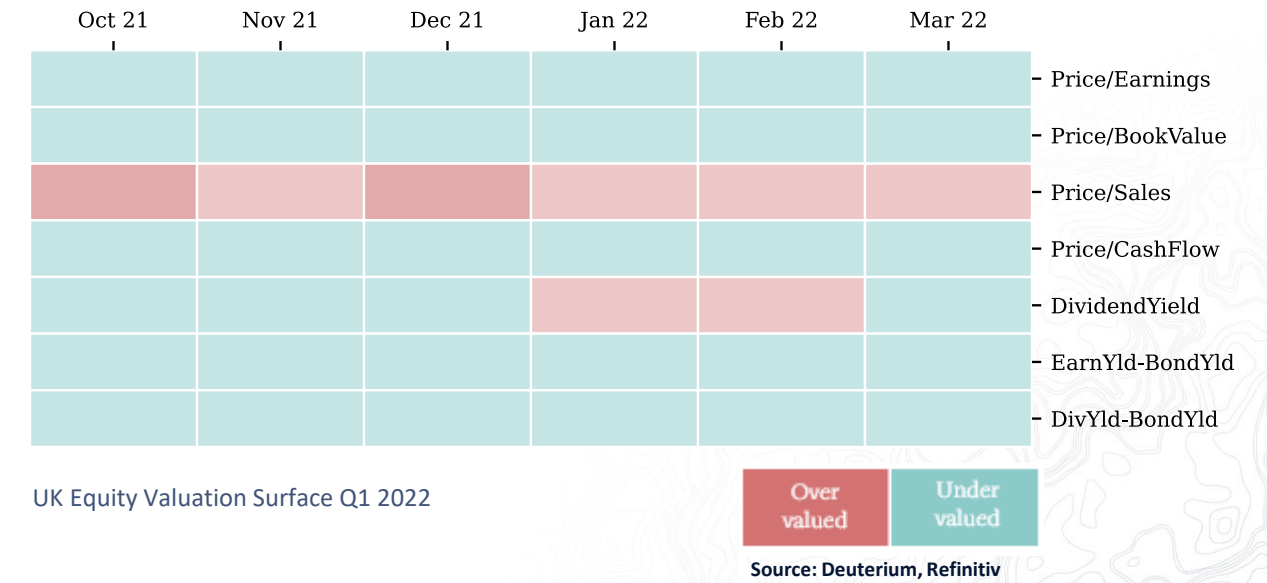
Three Month Bills



Market Valuations

UK shares have attractive valuations, similar to those for most major non-US 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 fairly valued 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 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

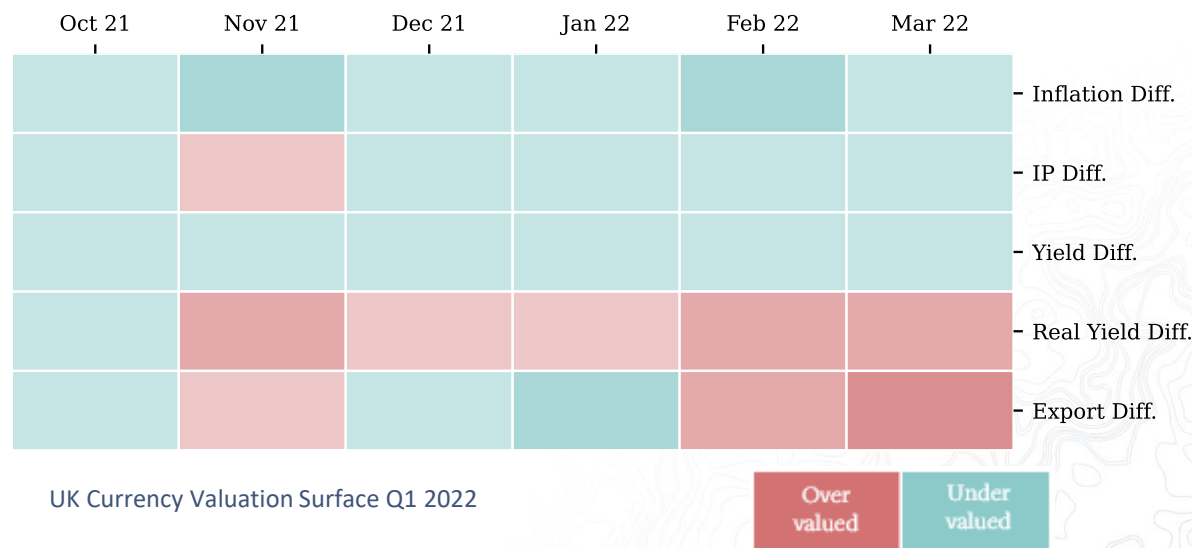


Ten Year Bonds



Monetary Policy And Transmission

The BOE was early in the worldwide central banks’ pivot to rate hikes when faced with rapidly rising headline inflation, perhaps reflecting the UK authorities’ difficulties in controlling domestic inflation during past cycles. A period of political stability has allowed the UK authorities to set monetary policies adapted to the UK’s needs, which appear now to be working through domestic transmission channels to promote sustained expansions in Britain’s nominal GDP.



DGDA Models show the Pound to be fairly valued on international inflation and business cycle comparisons

Emerging, Far East ex Japan, and Commodity Markets

Regional Investment Conclusions Q2 2022



Outlook Summary

Emerging Equities



Far East Equities



Commodities



Economic Projections

High commodity prices during the coming quarter will benefit those developing market economies that rely upon commodity exports to accumulate international reserves, but these probably will not be sufficient to counter worsening international financial conditions from major central bank rate hikes. Valuations for developing equity markets stayed low and very attractive even as world output 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 remain at discounts to long term valuations, showing significant relative valuation advantages compared to major markets. Nevertheless, both producer and consumer prices will continue to rise in Q2 2022, and while elevated commodity prices relieve pressure on such countries' external accounts, they will be matched on the downside by the negative effects of major central banks tightening. The downward shift in world consumption and export growth during Q2 2022 likely will be to the detriment of developing market equity valuations worldwide.

Monetary Policy And Transmission

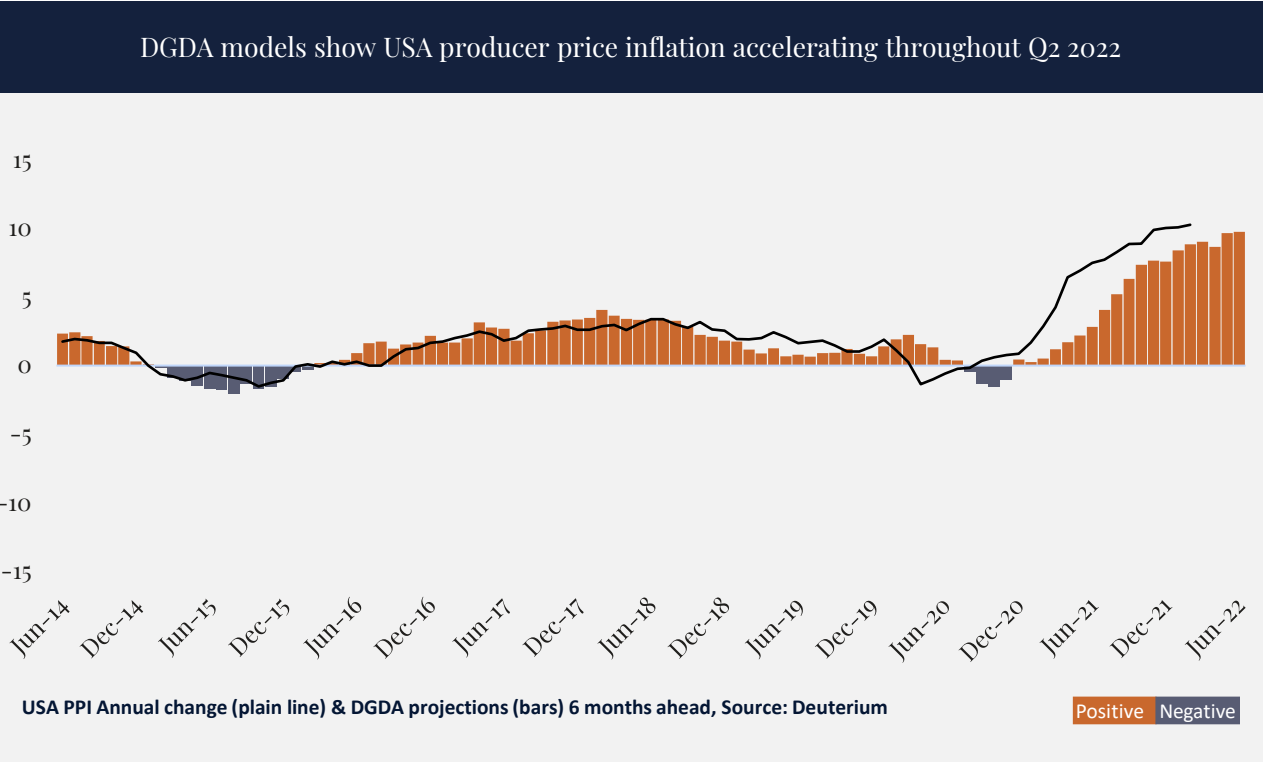
For the rest of this year, central banks around the world look to have their monetary policies set on rapid tightening, with the Federal Reserve expected to implement a long series of hikes worthy of monetary authorities who are concerned that they are already well behind the curve on inflation, even as they are about to begin an unprecedented program of QT. The BoE and ECB are well on their counter-inflationary path, with only China and Japan among the majors without rate hikes at present.

The authorities clearly consider that unbridled inflation currently is the most potent threat to economic stability, and that output, employment, trade, and commodity prices around the world are sufficiently strong to resist rapid rate hikes. 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 undervalued compared to historical measures, while those of developing markets such as Mexico and Brazil show as very attractive 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

Download fund data and read investment updates from this fund manager at **deuterium.us**

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