GLOBAL X
by Mirae Asset

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Global X House Views – November

Expectations surrounding central bank policy and the value of the US dollar are key to investor sentiment in the final stretch of 2022. Inflation remains elevated and economic growth expectations are subdued, but shifts away from excess pessimism may start presenting opportunities beyond the U.S.

Global Macro

Interest rate differentials have reduced while European energy crisis concerns have decreased slightly as Europe seems adequately prepared for winter with almost full energy reserves. This establishes an improved backdrop for risk assets while potentially pointing to stabilization in the U.S. dollar. We upgraded international developed equities to neutral while maintaining our views on both U.S. equities (overweight) and Emerging markets (neutral).

Regional Macro

U.S. Equities	**Over**
International Developed Market Equities	**Neutral**
Emerging Market Equities	**Neutral**

United States: The Trajectory May Slow

Central banks have increased interest rates at the fastest rate on record, and there are signs that higher yields are starting to flow into the economy; however, the full impact will likely only be felt in 2023.[1] Globally we've started to see central banks pulling back on rate hikes, with the Bank of Canada slowing their hiking to a 50-basis points (bps) hike in October. While investors are hoping the Fed will soften their tone, given the recent JOLT data indicating job openings for September are meaningfully higher than consensus, that scenario seems unlikely near-term.

The Federal Reserve (Fed) unanimously decided to raise their policy rate by 75 basis points at their November meeting, which was in-line with market expectations. This marks the fourth consecutive 75 basis point hike, extending the most aggressive tightening cycle since the 1980s. At their November meeting, the Fed changed their wording, signaling they may lessen the pace of rate increases while shifting the focus to a potentially higher terminal rate and the length of time that the Fed is likely to remain restrictive. We currently expect the terminal rate to be around 5%.

We maintained our overweight tilt toward U.S. equities as the Fed is raising interest rates amid a strong U.S. economy relative to most other economies. Unemployment remains low and pandemic savings provide a buffer for consumption. It is encouraging that real disposable income and the personal savings rate remained stable in the third quarter despite elevated inflation. However, the personal savings rate is near its lowest level since 2008. Consumption and potential negative feedbacks from the employment market remain a key area to watch as economic fundamentals slow.

We believe the recent U.S. dollar strength may be close to its peak. Internationally exposed companies, including tech companies, could benefit from dollar stabilization.

International Developed Markets: LNG Did the Trick

Europe appears to be in a stronger place than expected going into winter. European natural gas prices have decreased as the continent successfully shifted gas sourcing. Valuations are starting to look attractive in Europe and we believe that this is an area that may present opportunities as the level of pessimism decreases.

While we generally expect currency stabilization against the dollar, Japan is a region that stands out from a policy divergence perspective. The Bank of Japan has not yet started raising interest rates and their currency is under pressure for moving against the global tide.

Emerging Market Equity: Beneficiary of USD Stabilization

China's President Xi has solidified his power, making sweeping changes to the Chinese Communist Party's Standing Committee. Although valuations look attractive, this increases China's country risk premium while maintaining the regulatory and economic growth uncertainties.

Any stabilization or weakening of the USD should be beneficial for commodities and generally favorable for Emerging markets countries excluding China.

Asset Class Views

We expect market volatility to remain elevated through the interest rate hiking cycle. At this stage, we prefer equities over fixed income because real yields are still in negative territory. With rising recession risks, we believe it's increasingly important to incorporate a barbel approach that includes longer-duration income, such as exposures to long duration U.S. Treasuries.

We prefer commodities over other assets, but with a somewhat more muted outlook. A strong dollar and tightening financing conditions have weighed on commodities. Chinese uncertainty also clouds the outlook for economic growth-focused commodities. However, commodities stand to benefit from a potential shift away from USD strength.

Sub Asset Class & Industry Views

We increased focus on defensive segments with strong cash flows. Preferred sectors include Health Care, Consumer Staples, and Utilities while discretionary consumption remains an area of concern. For more detail, please refer to our sector views blog post.

Inflation protection could be balanced with quality, defensive equity positions. We also view assets tied to derivatives, like covered call strategies and those targeting rising interest rates, as potentially attractive with volatility remaining elevated.

Product Opportunities

- **Lithium & Battery Tech –** In October 2022, prices for battery grade lithium carbonate in China hit an all-time high of $74,475 per tonne, eclipsing the record set just a month prior.[2] Lithium pricing trends are deeply rooted in the transportation segment's ongoing shift toward electrification. Elevated lithium prices boost the top and bottom lines for relevant miners. Albemarle, one of the top suppliers of lithium, issued guidance in Q2 2022 that recognized lithium prices will increase 225–250% for FY 2022, which could correspond to 5x year-over-year (YoY) earnings per share (EPS) growth.[3] Similarly, Chilean lithium producer Sociedad

Quimica Y Minera de Chile (SQM) reported that Q2 2022 revenue more than doubled year-over-year.[4]

- **Cybersecurity** – The cybersecurity continues to prove its resilience to the macro environment, creating a positive environment for M&A activity. This past month, merger and acquisition (M&A) activities were noticeable in the cybersecurity theme. KnowBe4 confirmed it had agreed to be acquired at an approximately $4.6 billion value basis.[5] Additionally, ForgeRock announced its agreement to be acquired by software investment firm Thoma Bravo for $2.3 billion in total.[6] Throughout the year, the cybersecurity industry has been through a period of rapid consolidation. Both public and private companies are seeking to complete their all-inclusive cybersecurity solutions or suites of services through M&A. In terms of pure deal value, mergers and acquisitions in cybersecurity are on a tear with around $111.5 billion in activity completed by the end of the Q3 2022, compared with $80.9 billion in 2021.[7] We expect further M&A activity during the rest of 2022 and beyond.

- **U.S. Infrastructure Development –** U.S. Infrastructure Development continues to be a resilient theme. The 2021 "infrastructure trade" may have passed, but the unwind has created a potential buying opportunity. U.S. infrastructure companies' valuations have compressed from 22x to 15x in 2022, but the companies are still expected to grow their topline by 16% through 2023.[8] Their market performance has been resilient year-to-date, outperforming the S&P 500 by almost 7%.[9] Longer-term, the Infrastructure Bill from 2021 only accounted for $1.2 trillion of the estimated $2.6 trillion in infrastructure spending over the next 10 years, and private sector investment may be positioned to help fund the shortfall.[10]

- **Commodities & Uranium –** Commodity assets are still well positioned as investors look for ways to mitigate inflationary risks in their portfolios. Uranium is a specific segment of the energy market with both attractive supply & demand fundamentals, and displays the traits of a commodity asset with the ability to mitigate against inflationary pressures. Additional positive developments, like those in Germany with the halted phase-out of nuclear reactors, have also been shining a positive light on uranium equities.

- **Preferreds –** Interest rates rose substantially this year with inflation and the Federal Reserve's aggressive rate hikes have caused a jump in bond yields. With the 10-year yield sitting at 4.05% as of October 31st, it's becoming increasingly possible that the Fed may need to reverse course at some point in 2023 from its current rate hiking regime. This may make duration-sensitive assets like preferreds more attractive.

- **Covered Calls –** Equity markets have been trending down for most of 2022. For investors, one way to tackle this is by taking a more nuanced approach towards equities. One solution we prefer in this market environment are covered call strategies, which benefits when market volatility increases given that call writing premiums are positively correlated to volatility. Given that the Fed has taken a hawkish stance, the potential income collected from covered call writing could be particularly attractive to offset some potential market declines. Another solution is for investors to make their equity exposure tilted towards the US, amid a strong dollar and the more positive outlook of the US economy relative to the rest of the world.

- Master Limited Partnerships (**MLPs) –** We view the Energy sector favorably in this environment, as inflation becomes embedded in the economy and elevated oil prices should persist. One pocket of the Energy sector poised to benefit could be MLPs, which are usually midstream pipeline companies. MLPs and other midstream equities do well when volumes increase, and given the energy shortfall, along with the potential for higher energy prices, we think MLPs could be poised to benefit.

Footnotes

1. Ross, J. (2022, October 6). *Comparing the speed of U.S. interest rate hikes (1988 – 2022).* Visual Capitalist. https://www.visualcapitalist.com/comparing-the-speed-of-u-s-interest-rate-hikes/
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3. FactSet: CallStreet. (2022, August 4). Albemarle Corp. (ALB): Q2 2022 earnings call.
4. FactSet. (n.d.). [Data set]. Accessed on October 28, 2022.
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8. Bloomberg, L.P. (n.d.). [Data set]. Data as of and retrieved on September 19, 2022.
9. Ibid.
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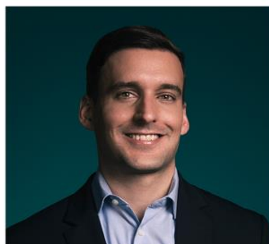

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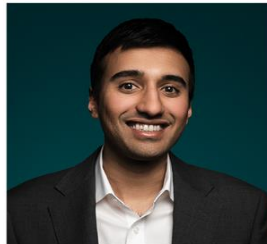

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