AUGUSTINE
ASSET MANAGEMENT

January 2022

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Market Summary

Equities

MSCI AC World	754.8
Price / Earnings	19.2x
Dividend Yield	1.9%
S&P 500	4,766
Price / Earnings	22.8x
Dividend Yield	1.4%

US Interest Rates

2 Year Treasury	0.7%
10 Year Treasury	1.5%
30 Year Treasury	1.9%
Bloomberg US Agg.	1.8%

US Corporate Spreads

Investment Grade	1.0%
High Yield	3.8%

Equity Volatility

CBOE SPX Volatility	17.2

US Economic Figures

GDP Growth 3Q21	2.3%
Unemployment	3.9%
Inflation (core)	5.5%
Fed Funds Rate (mid)	0.1%
3 Month SOFR	0.1%

Commodities

Oil (Brent)	$77.46
Natural Gas	$3.73
Copper ($/lb.)	$4.46
Gold ($/oz.)	$1,829

Foreign Exchange

Euro	$/€	1.14
Japanese Yen	¥/$	115
Chinese Yuan	元/$	6.36

Market summary data as of:
December 31, 2021

Blind Curves Ahead

Investing, like many endeavors best pursued with perspective and process, is often described with metaphors and similes. Some are dour, like economist Paul Samuelson's *"Investing should be like watching paint dry or watching grass grow. If you want excitement,…go to Las Vegas"*. Others are fun and colorful, like a Warren Buffett favorite that likens investing to swimming. *"You only find out who is swimming naked when the tide goes out"*.

Today's market environment reminds us that investing is, in many ways, like driving a car. Every investor has an overall objective, the destination, per se, as well as many options such as route and speed that are analogues to strategy and risk management. The behavior of other investors affects the journey, just like traffic. Yet, investors don't have the benefit of modern day GPS. The road ahead is always uncharted and reliably serves up twists and turns.

We appear to be at a turning point for the economy and financial markets. The highly transmissive yet less deadly Omicron wave suggests that the COVID-related speed bumps for economic activity will diminish over time. However late in recognizing the need to withdraw emergency stimulus, central banks now acknowledge the need to tighten policy. We hope to give you a sense for what this transition could mean for the economy and for financial markets in 2022.

Economic Outlook

Economic growth for 2022 suggests decent driving conditions for corporate earnings underpinned by consumer income and spending. The ongoing recovery from the pandemic shock is poised to continue as pent up demand for consumer services, industrial inventory, and capital spending combine for another year of above-trend growth. According to International Monetary Fund forecasts, the global economy is expected to grow by 4.9% this year, a deceleration from last year's estimated record high 5.9% but still very strong versus long-term trend of 3.4%. Monthly surveys of companies across 40 countries in both the manufacturing and services sectors confirm the outlook for strong growth.

Exhibit 1: Above-Trend Growth in 2022
International Monetary Fund Global Growth Forecast %

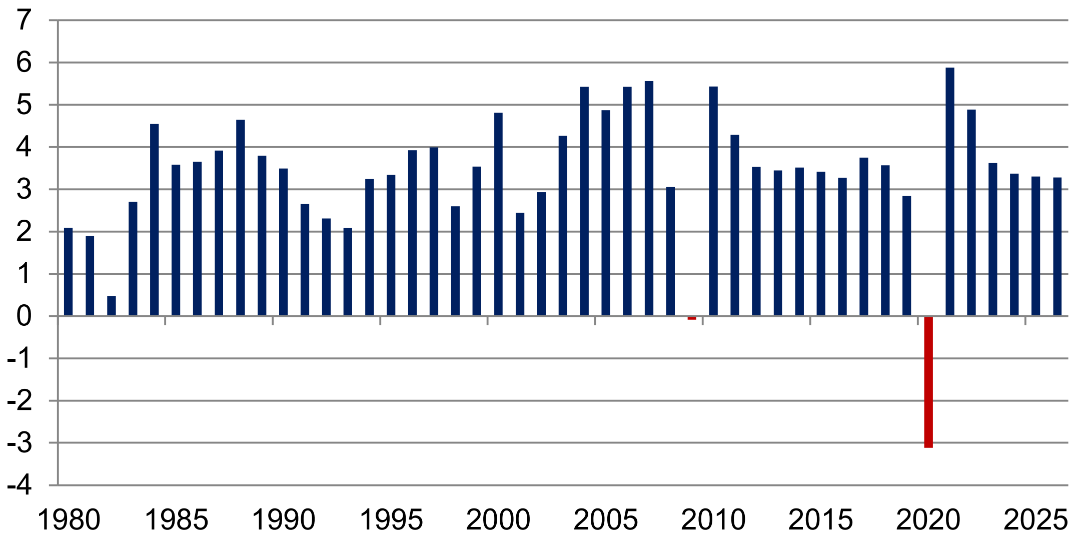
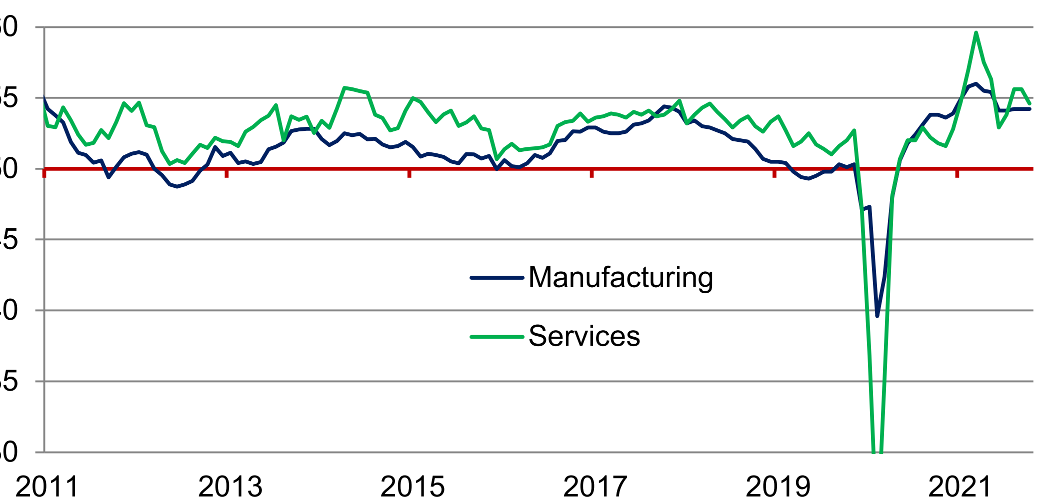


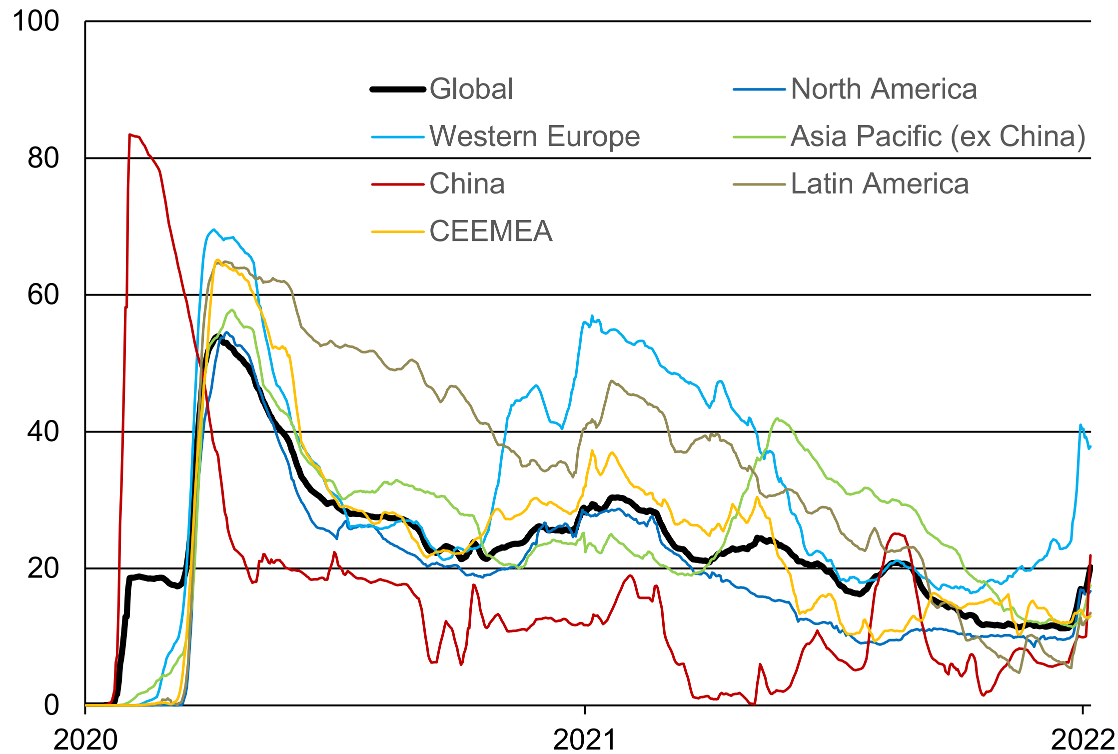
Exhibit 2: Strong Demand as We Enter 2022
JP Morgan / Markit Global Purchasing Manager Indices



Of course, any outlook on growth needs to acknowledge the ongoing effect of the COVID-19 pandemic. While infections due to the Omicron variant are surging, the rates of hospitalizations and fatalities have been lower than in prior waves, a reassuring dynamic helped by vaccinations and treatments as well as evolutionary survival that favors transmissibility over deadliness. While there's always the possibility of a variant that bucks that trend, future infection waves that are less dangerous should have a fading effect on growth as COVID-19 evolves from being an acute pandemic risk to a lingering but manageable endemic health concern.

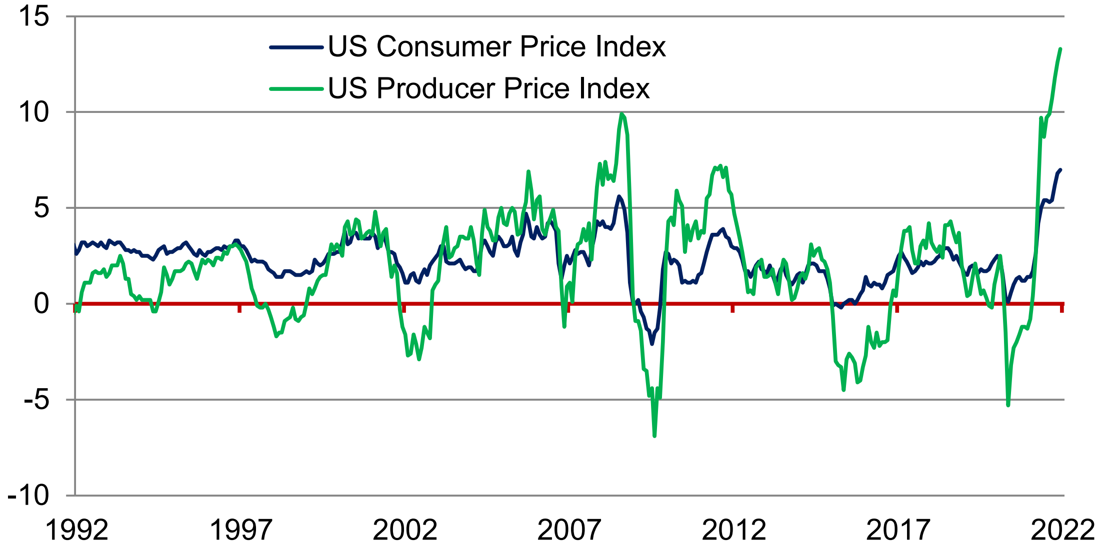
Government lockdowns and "stay-at-home" that hurt economic activity at various points in the last two years should present diminished headwinds to growth going forward. That trend is illustrated in data compiled by Goldman Sachs which combines government restrictions and high-frequency mobility data and shows the world returning to normal, albeit with temporary and successively milder reactions to waves of infection.

Exhibit 3: COVID Headwinds to Growth are Diminishing
Goldman Sachs Effective Lockdown Index



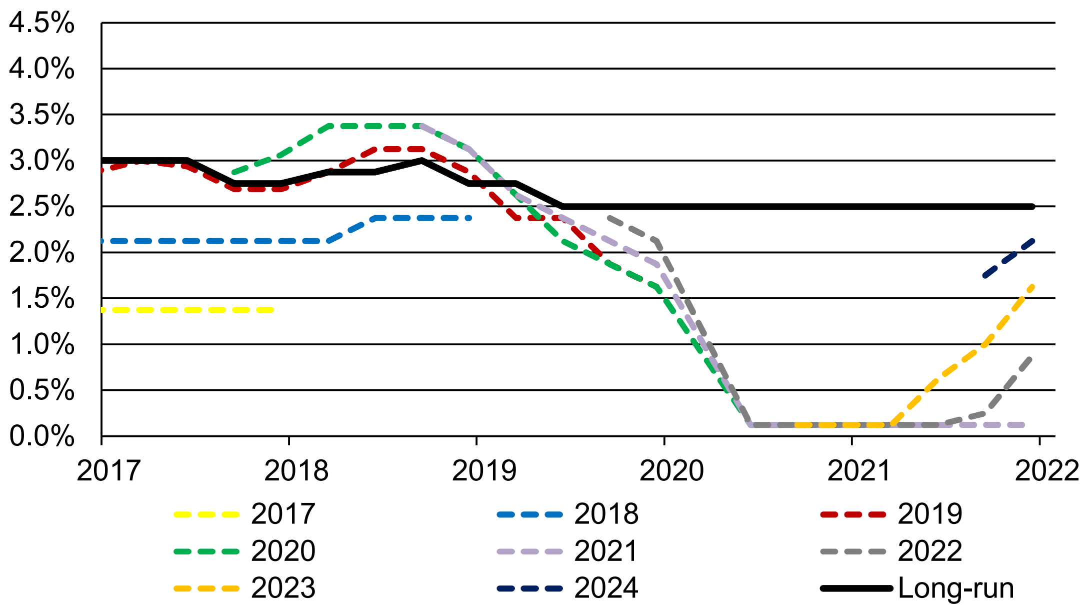
As we described in our recent letters *Some Like It Hot* and *Transitory*, the recovery and record pace of growth in 2021, combined with extraordinarily loose policy, had resulted in a surge of inflation. Rapid improvement in consumer spending and unemployment, combined with temporary and structural supply constraints, were driving prices of goods and services upward. That trend worsened in the last quarter, with the headline US Consumer Price Index rising to 7.0% at the end of last year, the highest rate of inflation since 1982. Wage growth, historically a primary driver of inflation, is running at 4.7% and suggests the possibility that a wage-price feedback loop is becoming entrenched. Healing of the global economy, especially as it relates to lowering unemployment, is undisputedly a desired outcome, but with it has emerged a problem that, left unchecked, could force central banks to aggressively tighten policy and plant the seed for the next economic contraction.

Exhibit 4: Inflation Genie Out of the Bottle?
US Consumer & Producer Price Indices %



Inflation is a policy choice made by fiscal and monetary authorities, with extreme measures on both fronts during the last two years creating the current surge in prices. Central banks around the world have now begun the process of pivoting toward moderating their amount of economic stimulus. Jerome Powell, Chairman of the US Federal Reserve, has gone from describing inflation as "transitory" a few months ago to now calling it a "severe threat" to the economy. Accordingly, the Fed has announced an accelerated pace with which it plans to lessen monetary support -- a faster reduction and sooner end to its bond purchases, increases to the Federal Funds interest rate beginning this year, and possible reduction of its dramatically expanded $8.8 trillion inventory of bonds.

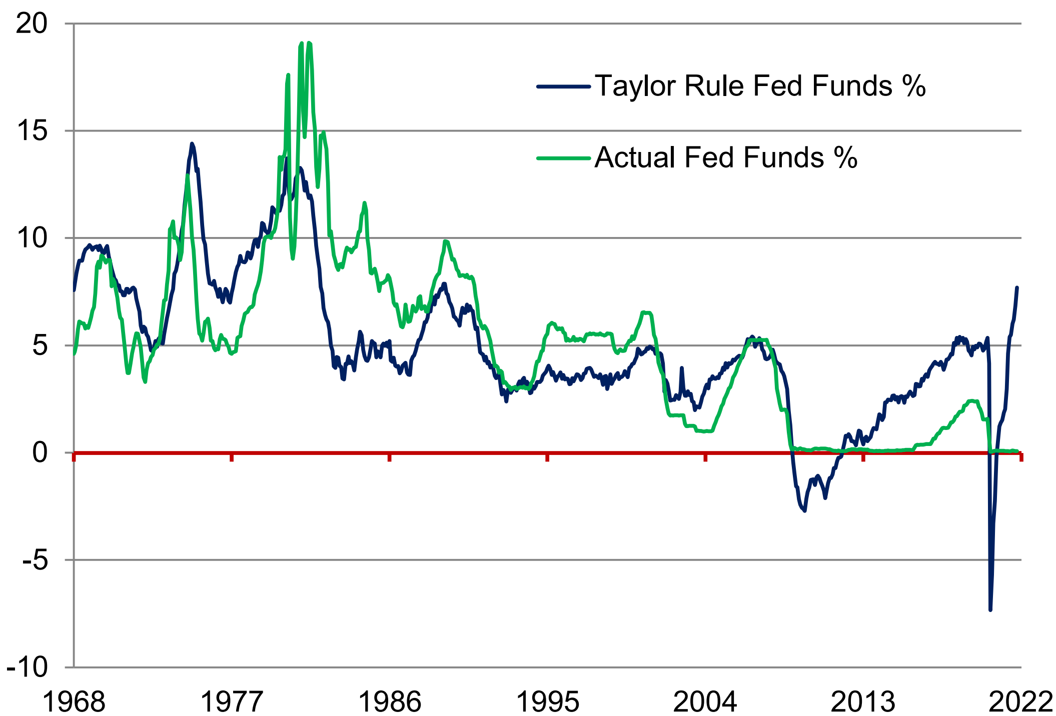
Exhibit 5: Tightening to Begin in 2022
Federal Reserve Year-End Fed Funds "Median Dot" Forecast



With inflation at a 40-year high and well above the Fed's 2.0% long-term target, a historically high rate of economic growth, and 3.9% unemployment below the latest government estimate of 4.3% as "full employment", current Fed policy of a near-zero interest rate and a still-expanding balance sheet appears incongruous with meeting its statutory objectives of price stability, full employment, and limited systemic financial risk. Furthermore, its projection for the Fed Funds rate in the next few years – to be still below its long-term "neutral" estimate – looks like a low ball. The scale and speed with which the central bank needs to shift policy and its guidance is perhaps the biggest blind curve investors face on the road through 2022.

Much will depend on how inflation behaves in the coming months. Improving supply chains should help, but we suspect more needs to be done faster than what the Fed has announced. For perspective, the Taylor Rule, a long-standing tool that monetary policy makers have referred to, suggests a wide gap between current and potentially appropriate policy, based on the current state of growth and inflation. If inflation does not subside materially, investors might face tightening financial conditions that could feel more like slamming rather than tapping on the brakes.

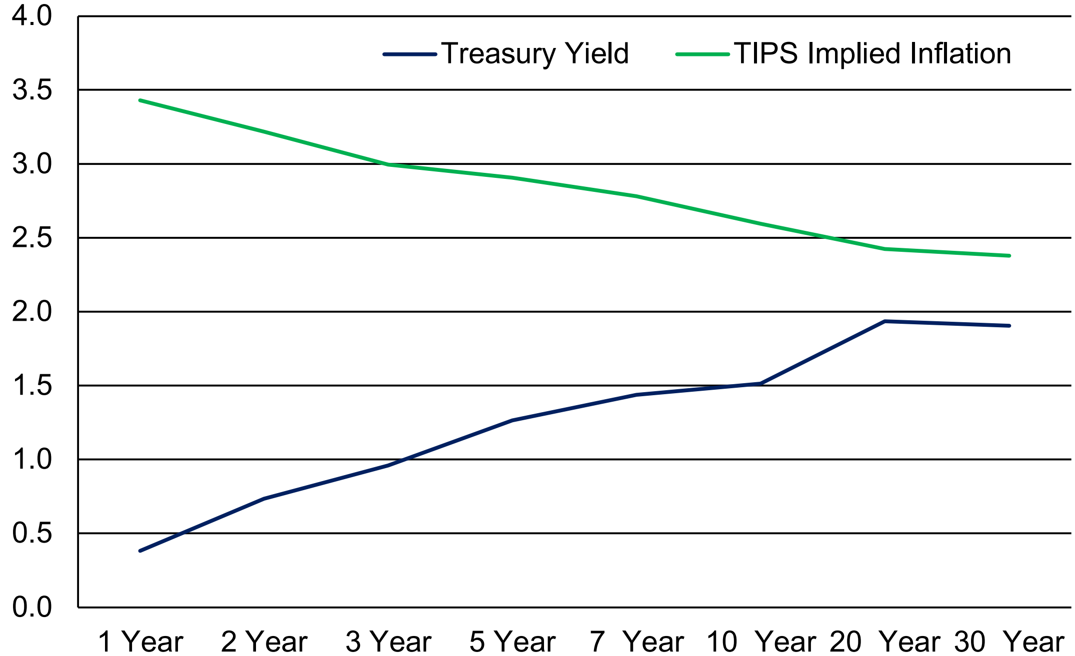
Exhibit 6: Inflation Needs to Fall
Taylor Rule Estimated Federal Funds Rate %



Investment Perspectives

The monetary pivot is sure to have an effect on financial markets, which have been supported by extraordinarily loose policy over most of the last decade and particularly during the last two years. So, what could the journey look like absent such support – fighting rather than co-investing with the Fed? If positive real interest rates are needed to whip inflation, a stronger than expected policy headwind could be in the offing. To quote Chairman Powell again, "It is really time for us to begin to move away from those emergency pandemic settings to a more normal level. It's a long road to normal from where we are."

Exhibit 7: Negative Real Yields May Need to Be Positive
Treasury Rates and Market-Based Inflation Expectations %

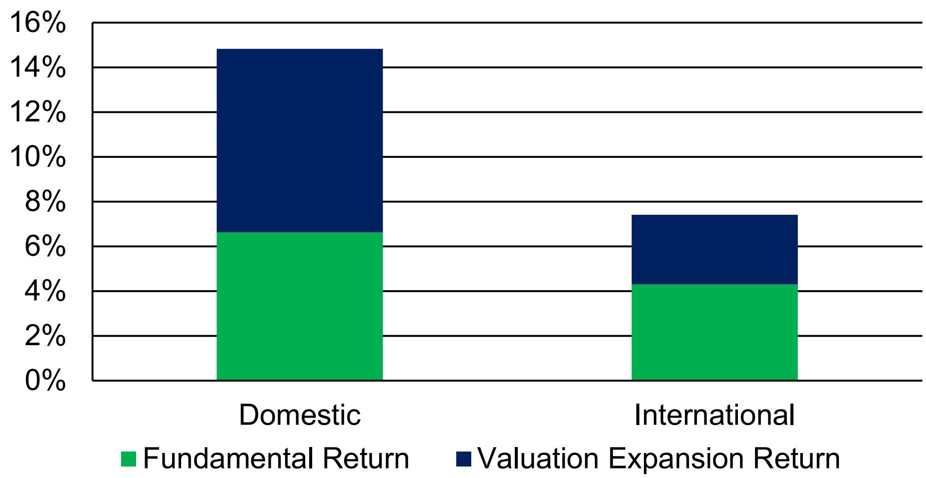


Recent investing trends abetted by prior policy -- market leadership by unprofitable technology-oriented companies with compelling narratives, massive outperformance of high valuation growth companies, “meme” stocks pumped up in the social media boiler room, record use of leverage by individual investors, record-high allocation to riskier asset classes by households and pension funds, and a general willingness to pay unusually high prices per unit of earnings -- could see a reversal in the new environment.

Exhibit 8: That Feeling When the Fed Tightens

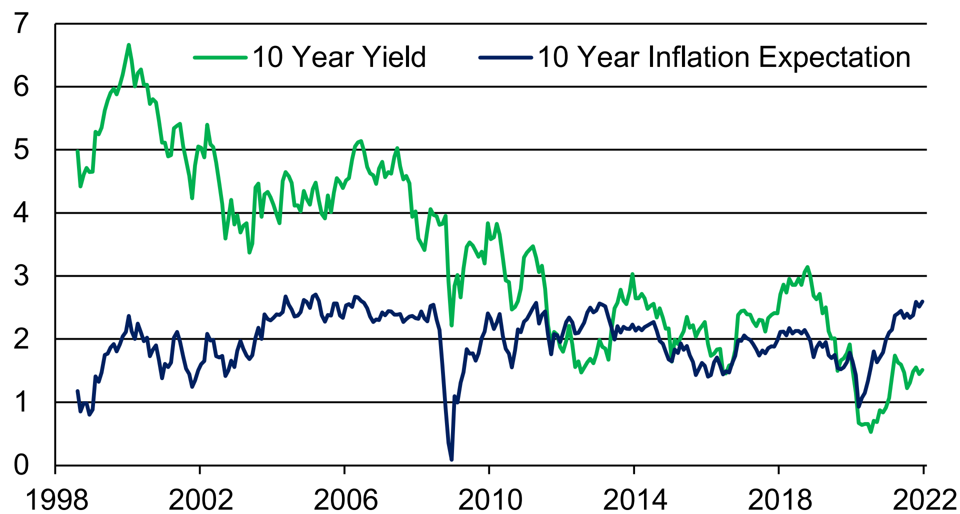
An example in recent years of greater willingness to pay up for earnings is the relative performance of domestic stocks compared with international stocks. While earnings growth in the US has edged out that of the rest of the world by 2.3% per annum over the last ten years (makes sense given a higher portion of technology companies), its 7.4% annual return premium has been driven primarily by expansion of valuations – paying more per unit of earnings. While we believe America is truly exceptional in many ways, it's hard to see this dynamic as sustainable, let alone immune to mean reversion in a monetary regime that is less supportive of speculation, the investment version of speeding.

Exhibit 9: US Exceptionalism More Valuation Than Fundamental
10 Year Annualized Return Composition of Domestic & International Stocks



Investors' willingness to accept a long-term bond devoid of term premium and offering a return below that of expected inflation is another example. This unnatural state is driven by the central bank balance sheet – rewarding when it's aggressively expanding and potentially penalizing if it's reduced.

Exhibit 10: Upward Potential to Long-Term Interest Rates
10 Year Treasury Yield & 10 Year TIPS-Implied Inflation Expectation %



With the economic backdrop supportive for corporate profits, we believe 2022 presents opportunities among companies that can participate in that growth. Policy that is shifting from tailwind to headwind for investment risk taking makes management of risk all the more important. To that end, we believe a focus on stocks of companies that can weather a future without zero interest rates and that trade at valuations that don't require the benefit of an unsustainably low discount rate applied to future earnings is the right lane for today's environment. That suggests exposure to recovery beneficiaries such as banks, industrials, commodities, cyclical tech, and global markets. Fixed income will be a challenging asset class as rates normalize. Protecting capital will be paramount and can be accomplished by keeping portfolio duration low and allocating risk instead to credit that should benefit from the above-trend pace of economic growth.

As we enter a new year and perhaps a new policy phase that will affect markets differently than in the recent past, we would like to express our gratitude for the honor of working on your behalf as prudential stewards of your capital.

We hope this review of the economy and markets helps inform you of our outlook for 2022 and how we are managing the capital you have entrusted to us. We would be pleased to answer any questions you have.

With best regards and wishes for your health, safety, and prosperity in the new year,

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