

Above-Trend Growth in 2022

Actionable Ideas Webinar Series



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Whittier Trust

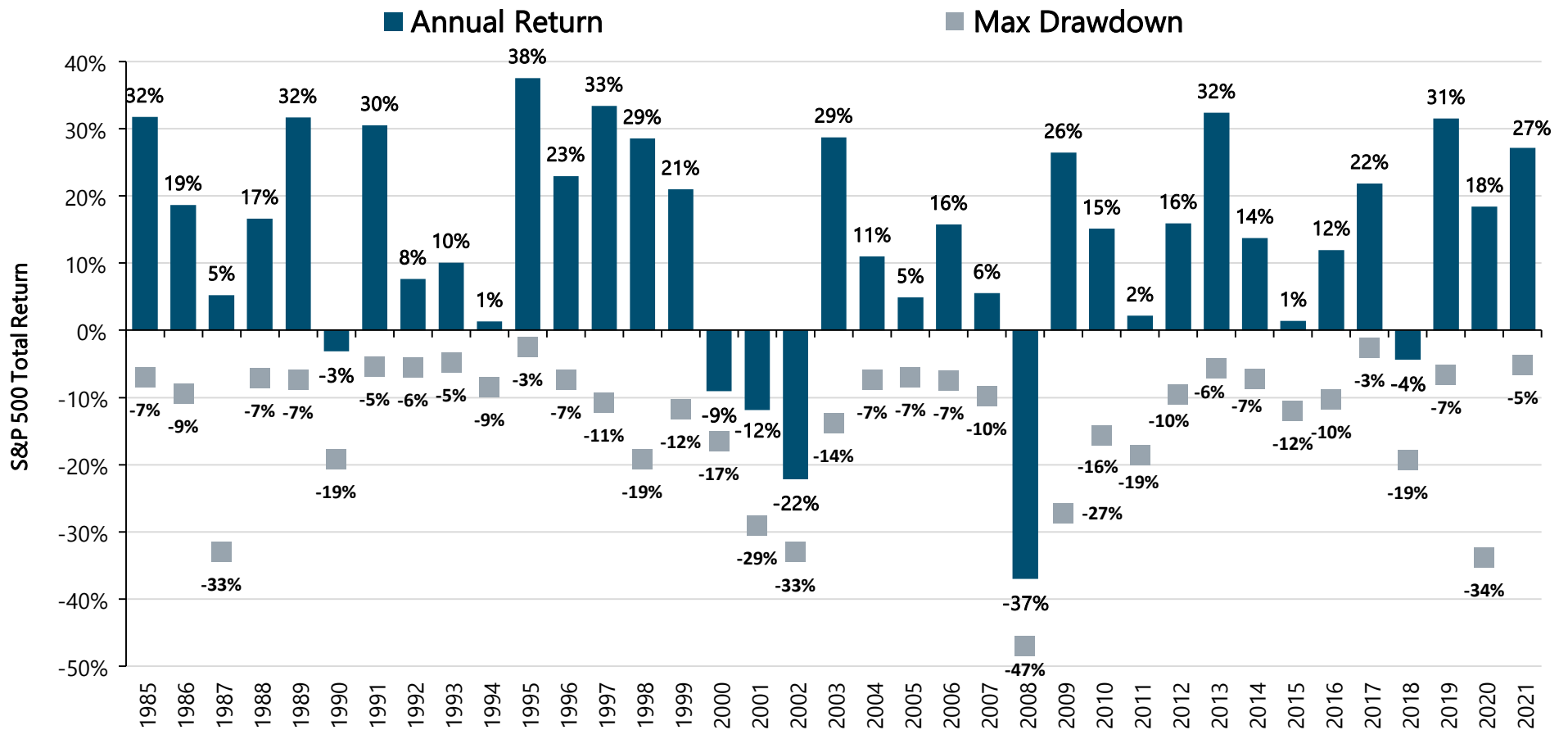
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A Remarkable Year for U.S. Equities

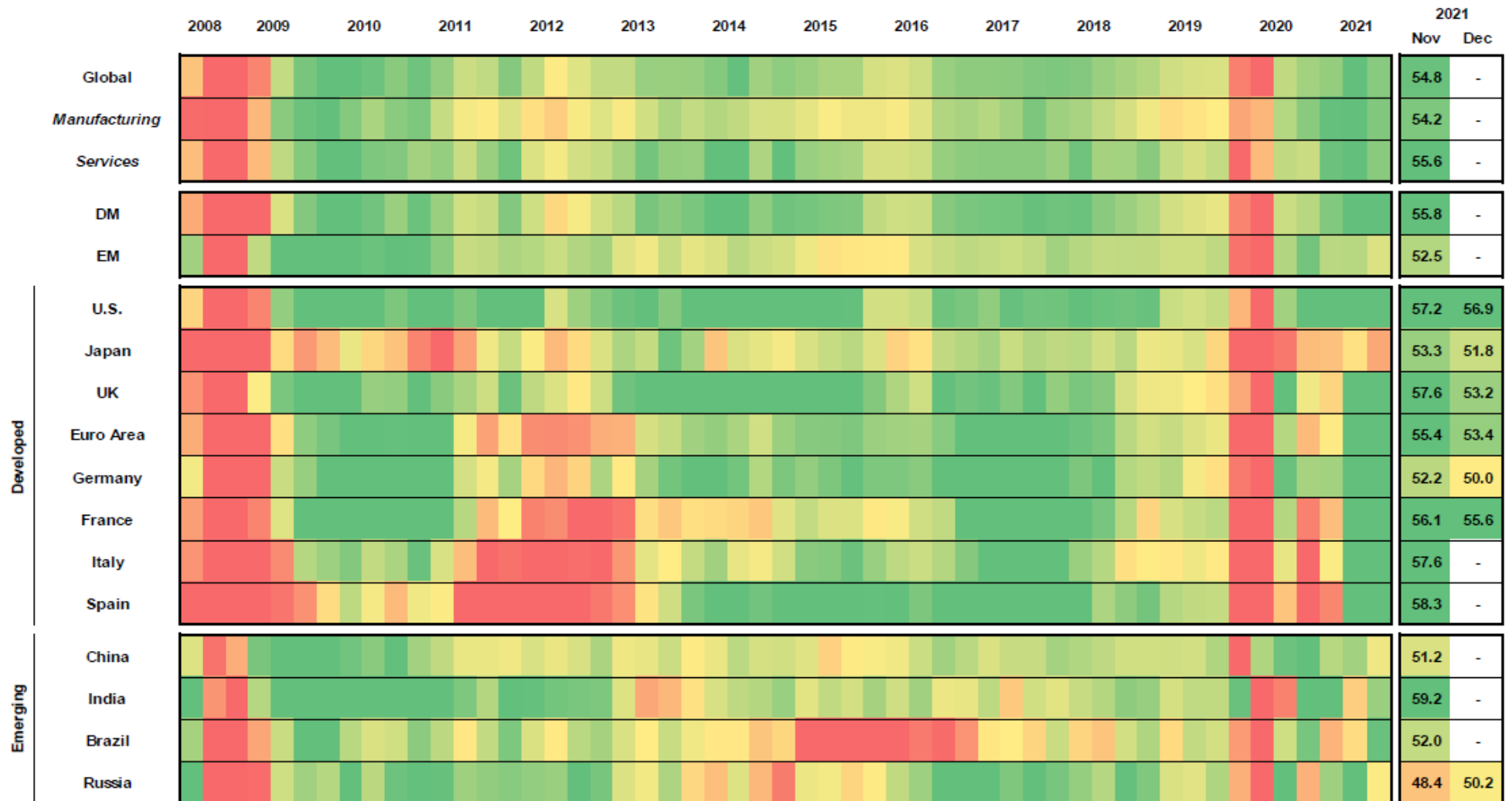
Intra-year drawdowns vs. year-end returns for the S&P 500 Index

Despite an average annual correction of 14%, annual returns have been positive in nearly 84% of the past 37 years



Global Economic Momentum

Global Composite (manufacturing & services combined) Purchasing Managers' Index, quarterly



Source: Markit, JPMAM, 12/31/21

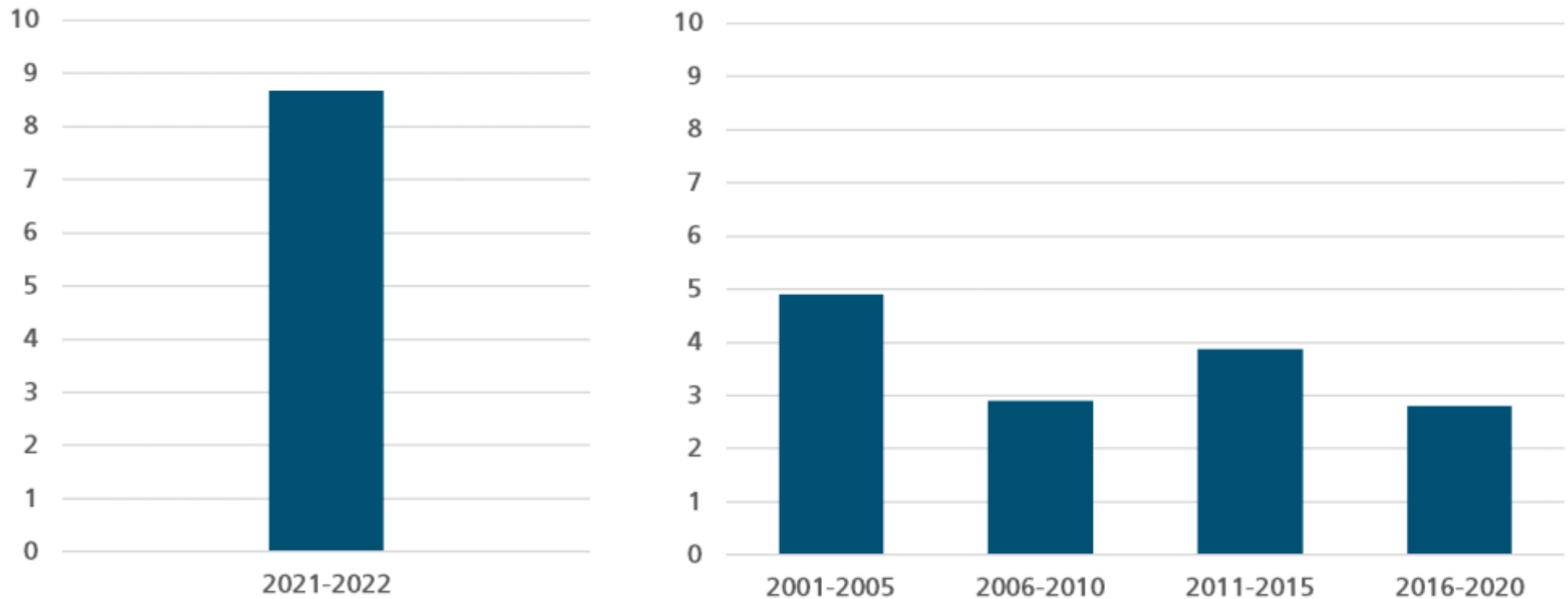
The Composite PMI includes manufacturing and services sub-indices. Heatmap colors are based on PMI relative to the 50 level, which indicates acceleration or deceleration of the sector, for the time period shown. Heatmap is based on quarterly averages, with the exception of the two most recent figures, which are single month readings. Data for the U.S. are back-tested and filled from December 2007 to September 2009 due to lack of existing PMI figures. DM and EM represent developed markets and emerging markets, respectively.

Discussion Points

- Growth Outlook
 - Pessimistic slowdown ... or optimistically above-trend?
 - Drivers of economic growth in 2022
- Risks to Growth
 - Virus variants – Omicron, Deltacron, Flurona
 - Inflation concerns
 - Policy misstep from Fed “Triple Threat”
 - Tapering of balance sheet, rate hikes, **reduction of balance sheet**
- Earnings Growth and Valuations
- 2022 Outlook

Covid Recovery Fuels Strong Economic Growth

Current and Historical **Nominal GDP Growth, %**



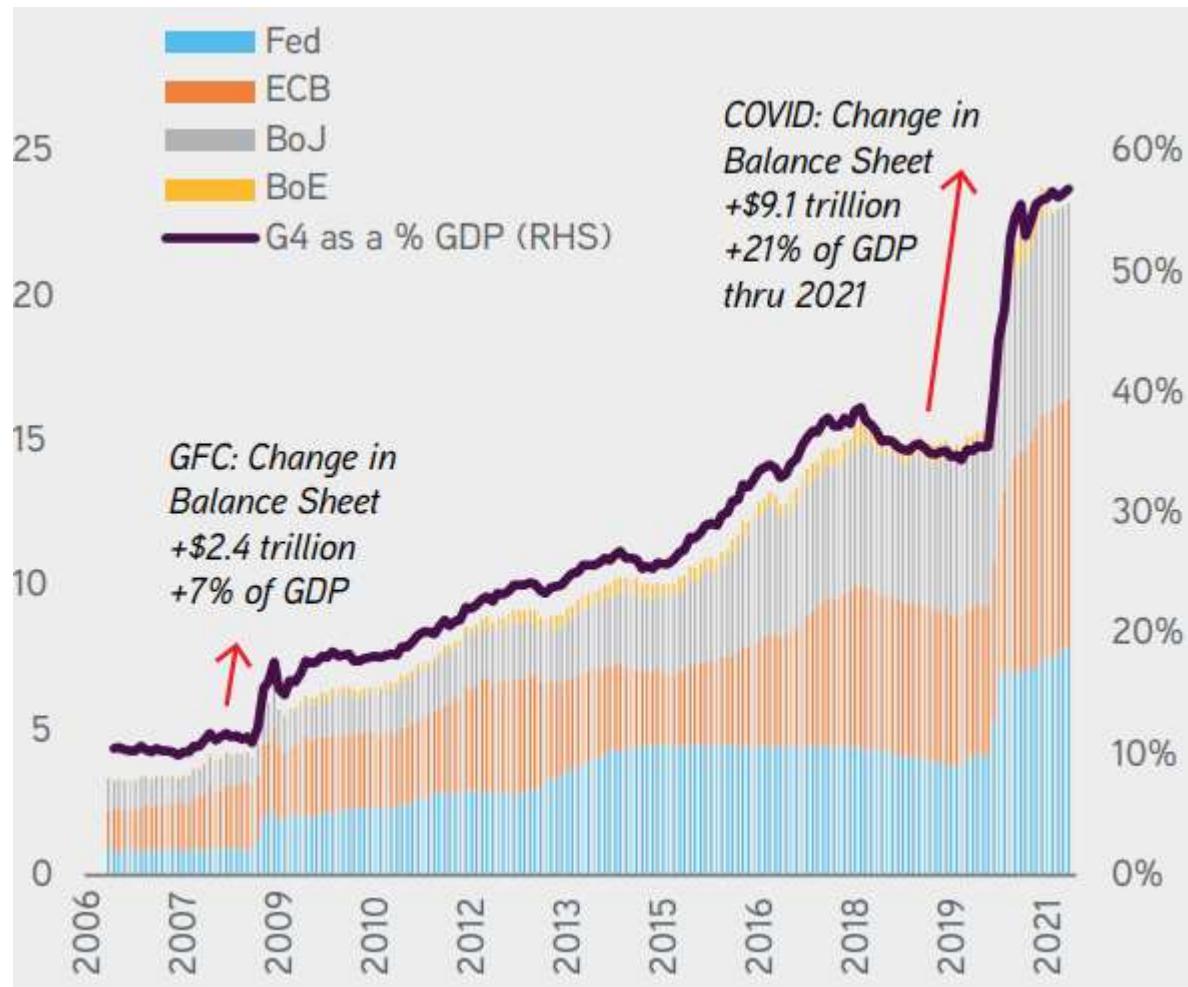
- Current nominal U.S. GDP growth is significantly higher than historical levels

Drivers of Above-Trend Growth

- Stimulus Tailwind
- Easy Financial Conditions
- Strong U.S. Consumer
- Labor Market Almost at Full Employment

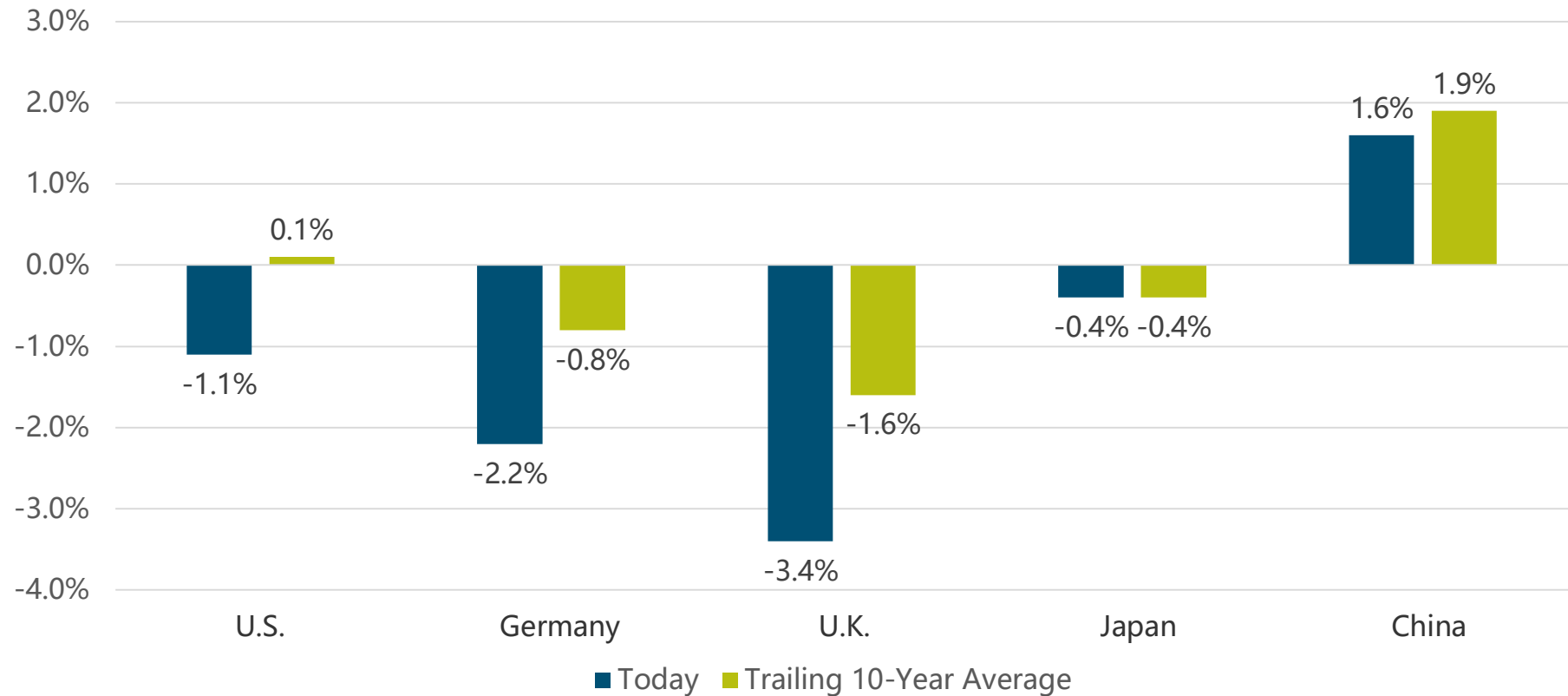
Substantial Stock of Monetary Stimulus

G4 Central Bank Balance Sheets, \$ Trillion and % of GDP



Still Stimulative Financial Conditions

Real 10-Year Government Bond Yields



- Real bond yields will rise ... but from historically low levels

Legacy of Massive Fiscal Stimulus

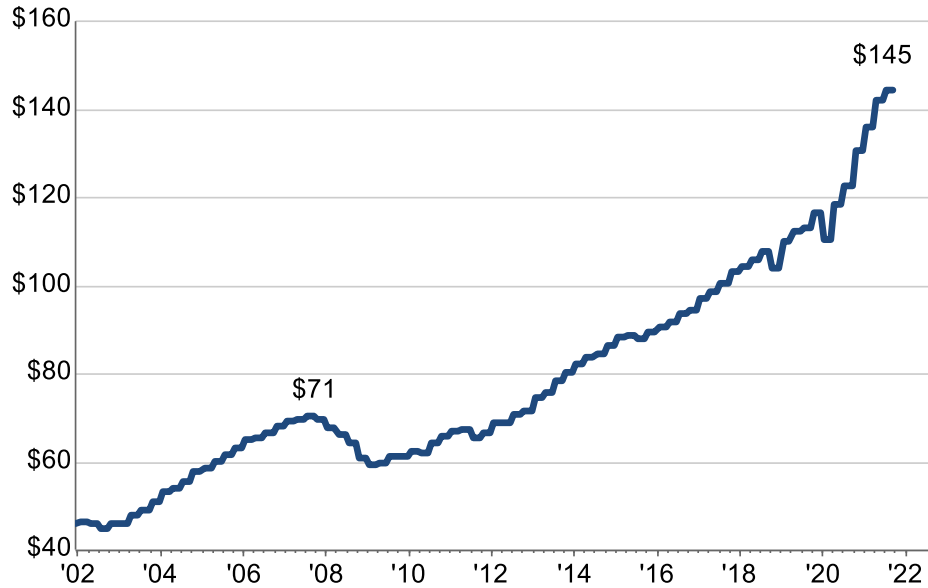
Cumulative Excess Savings as a % of 2019 PCE



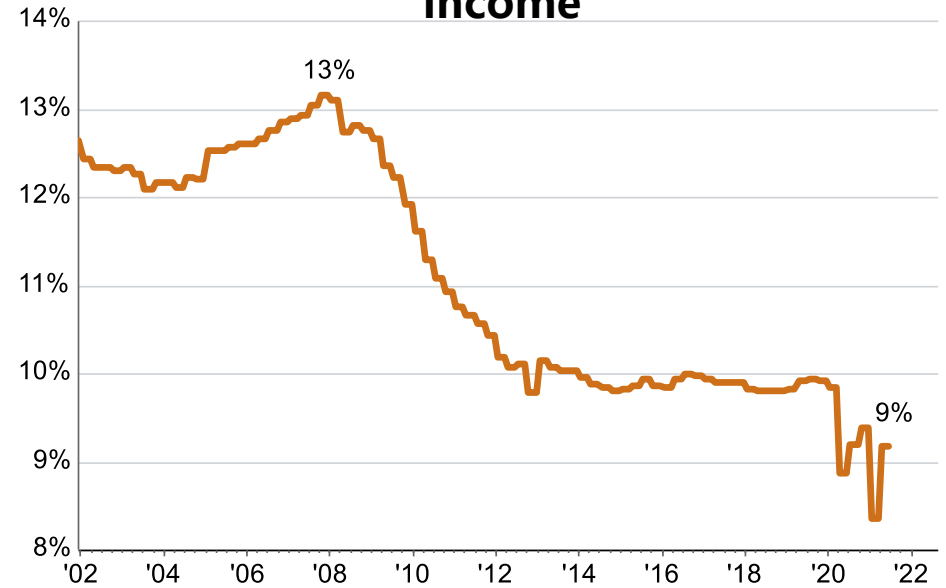
- Cumulative excess savings (greater than 7.7%) bode well for future consumer spending

Strong U.S. Consumer

US Household Net Worth (\$ tn)



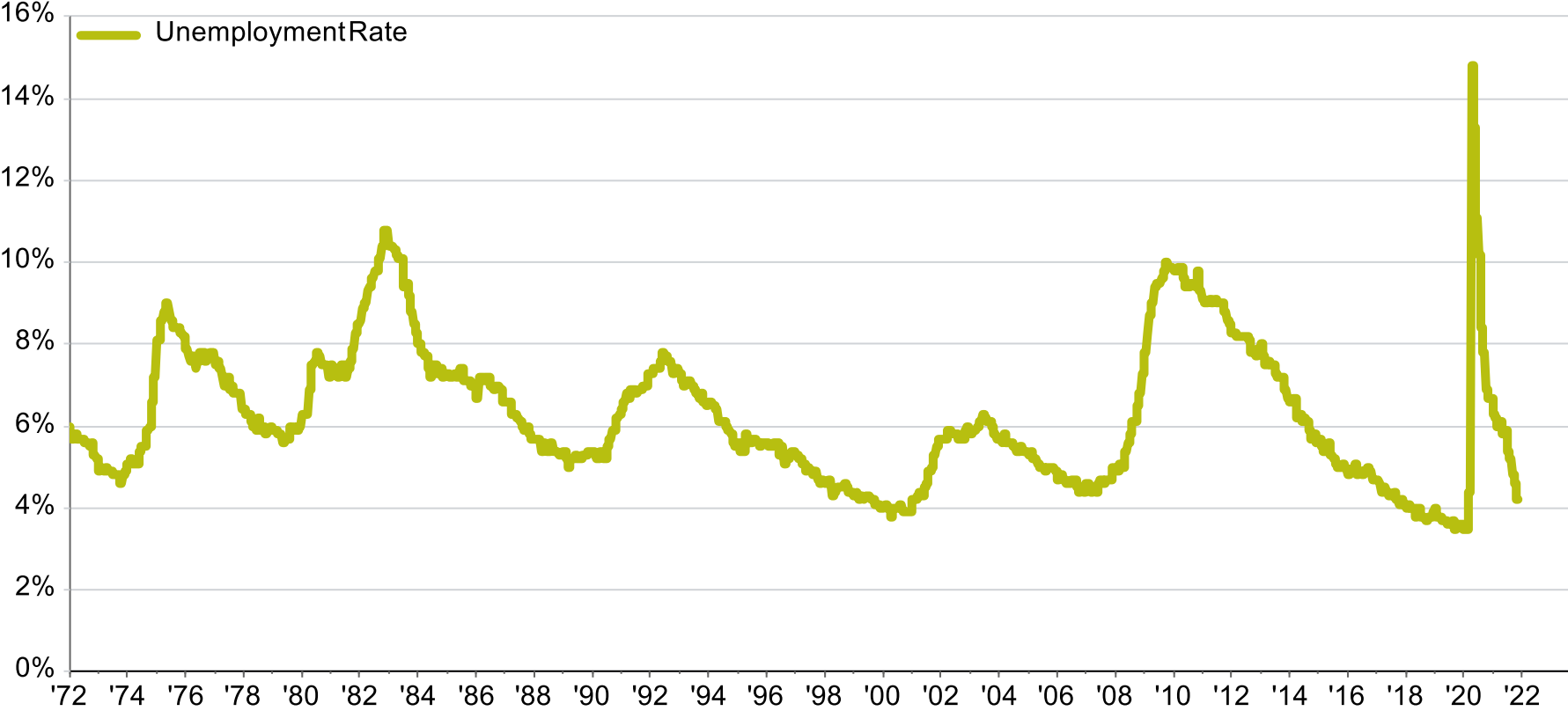
Debt Service Payments as % of Income



- U.S. consumer remains exceptionally strong

Robust Jobs Market

Unemployment Rate, %



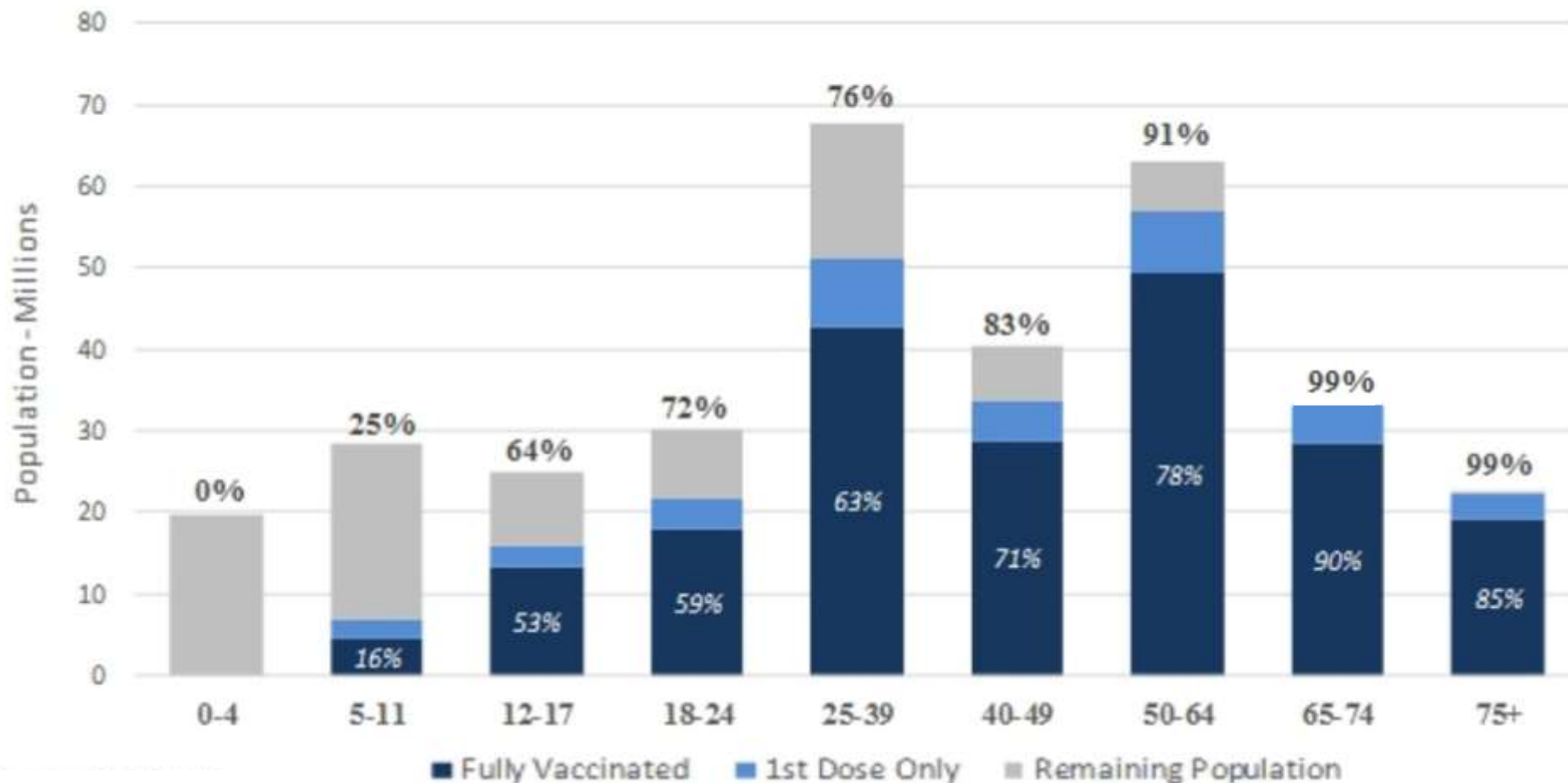
- Labor market is approaching full employment

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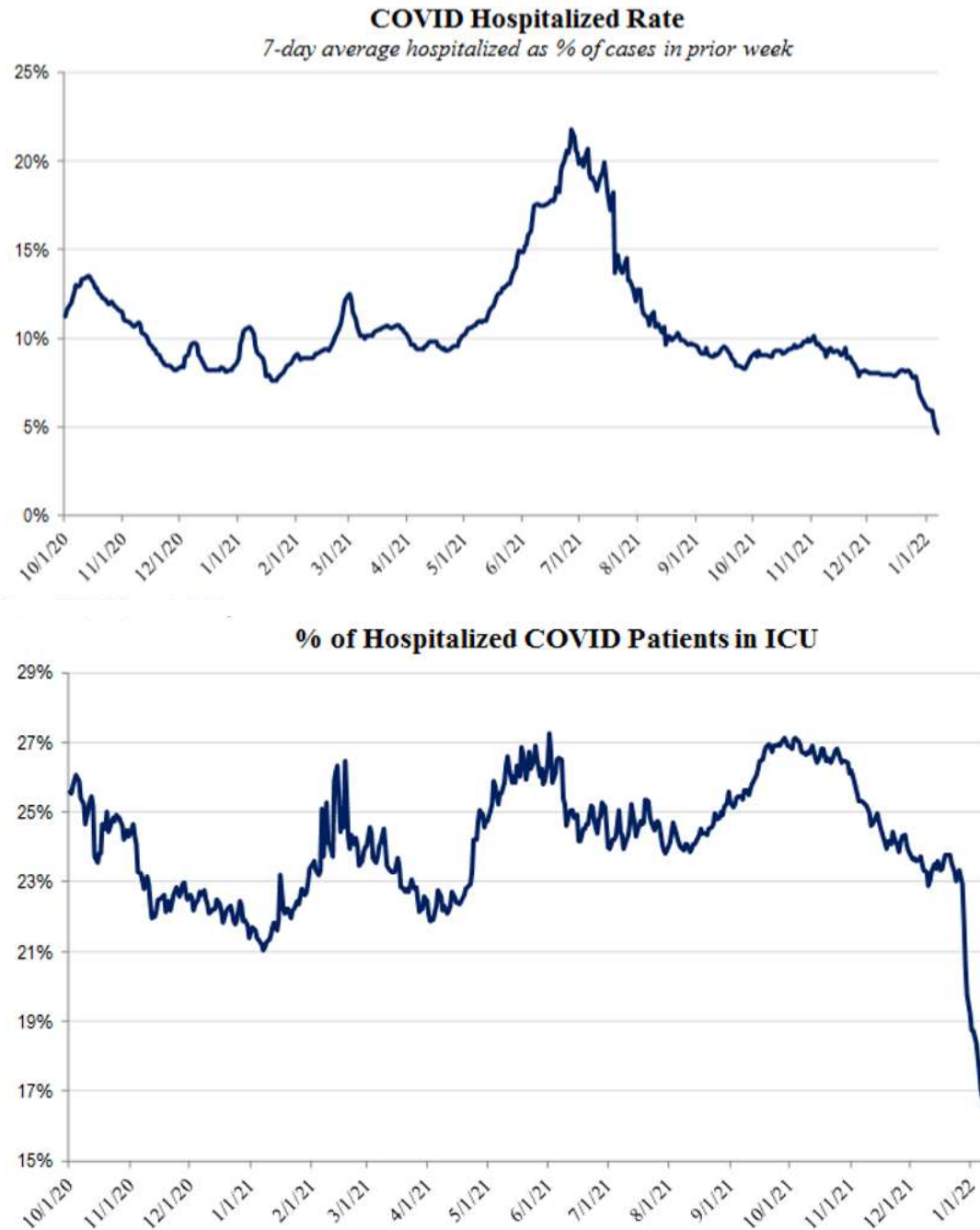
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Vulnerable Age Groups are Highly Vaccinated

Vaccination Rates by Age

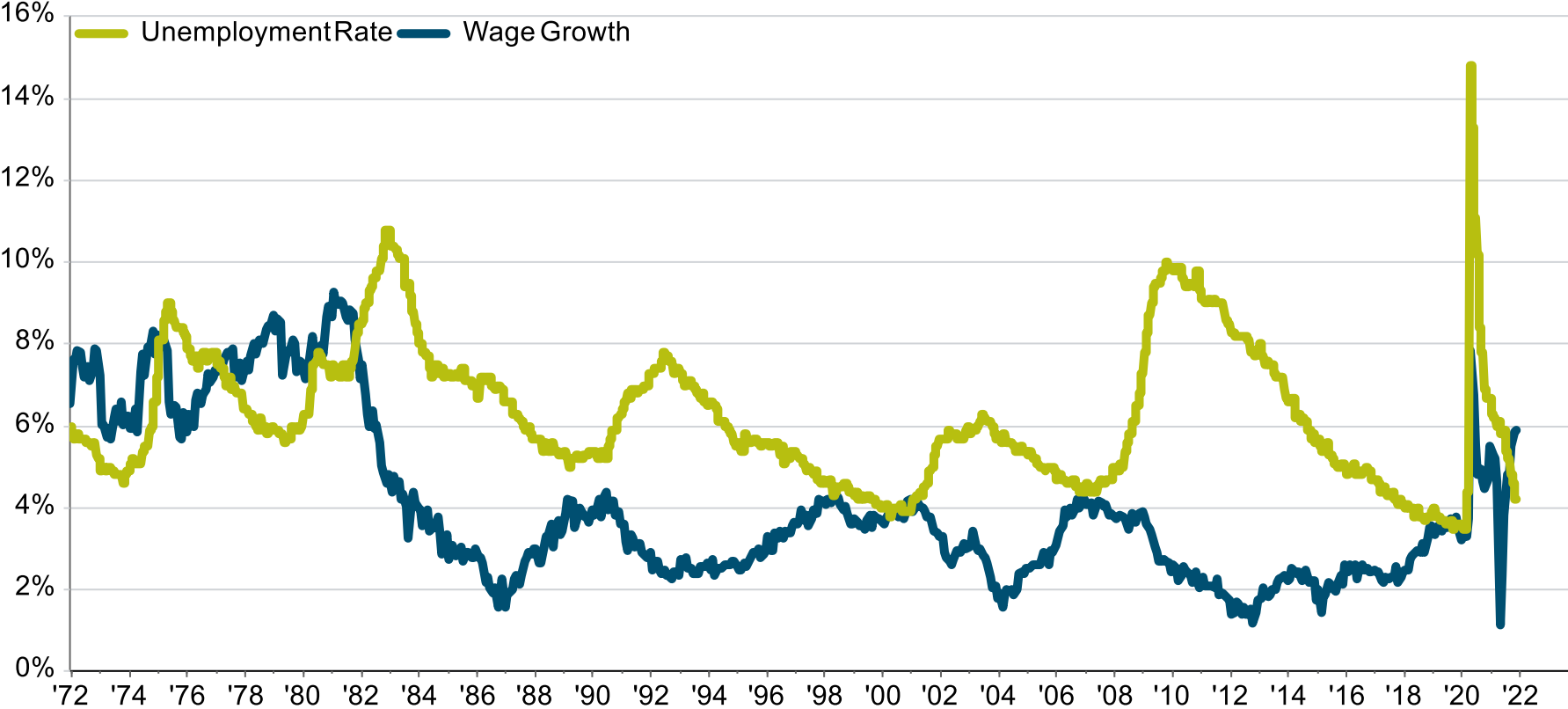


Severity of Disease from Omicron is Declining



Rising Wage Inflation

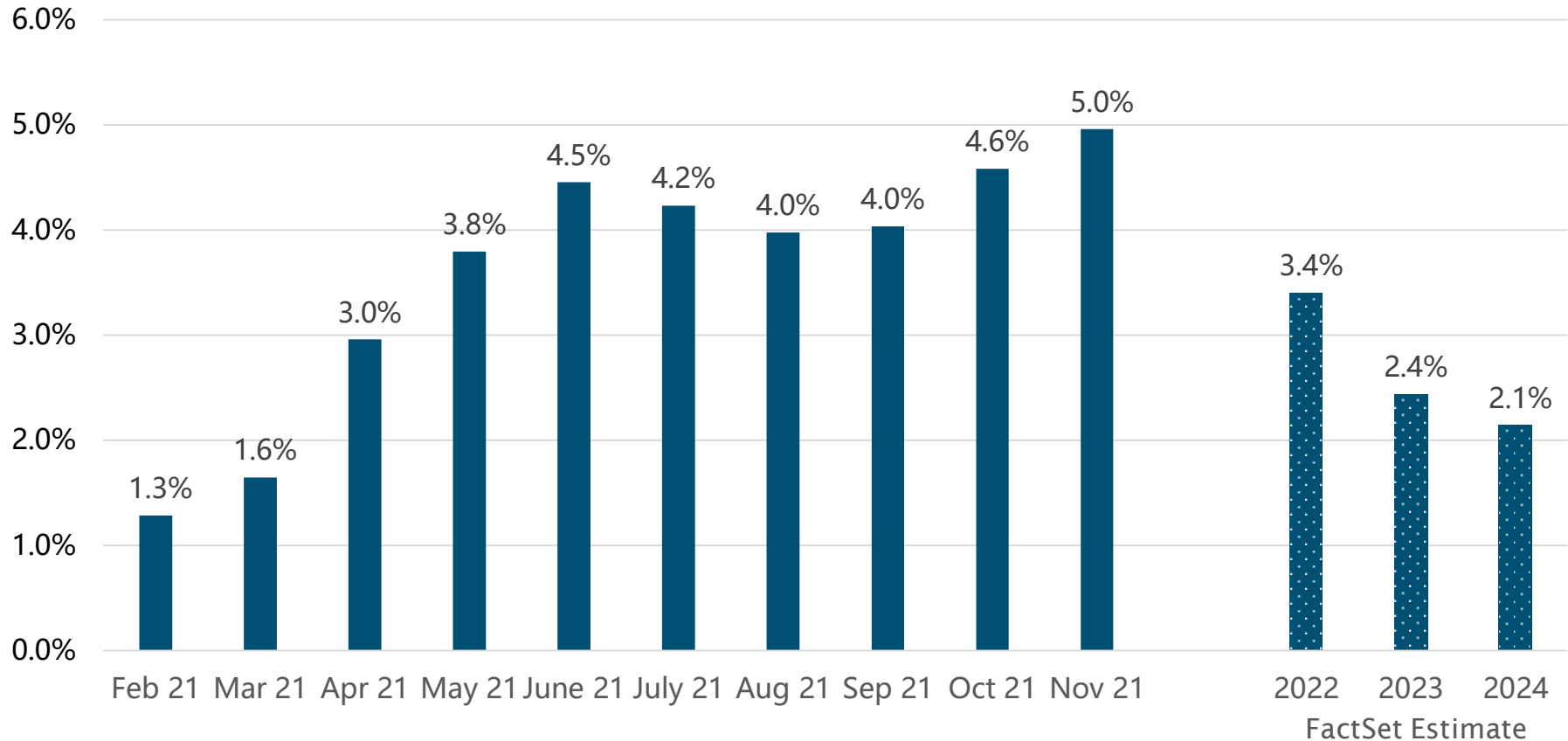
Unemployment and Wage Y/Y Growth, %



- Wage inflation is rising as unemployment falls

The Consensus Inflation Outlook

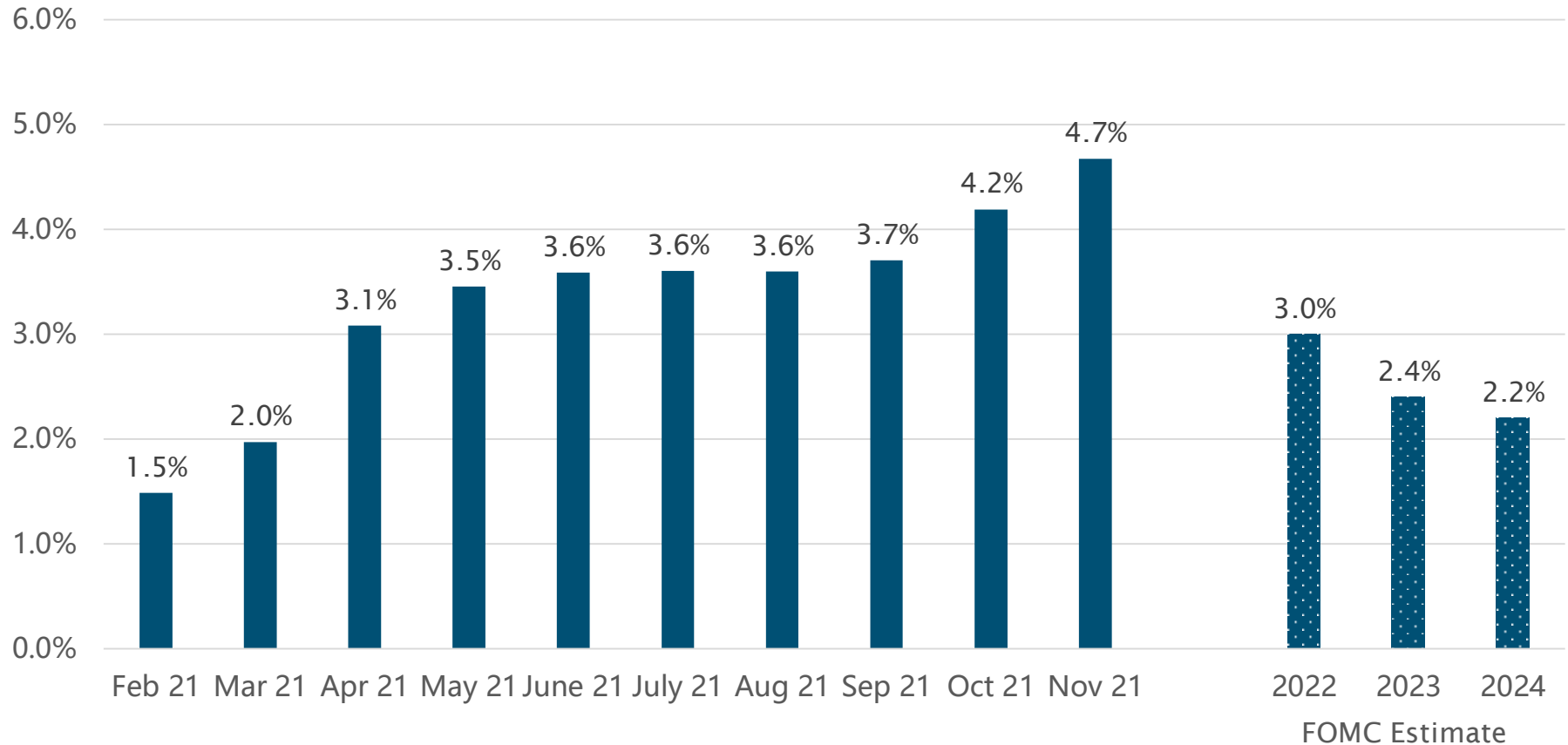
Core CPI Y/Y Inflation, %



- We expect core CPI to be higher than consensus expectations

The Fed's Inflation Outlook

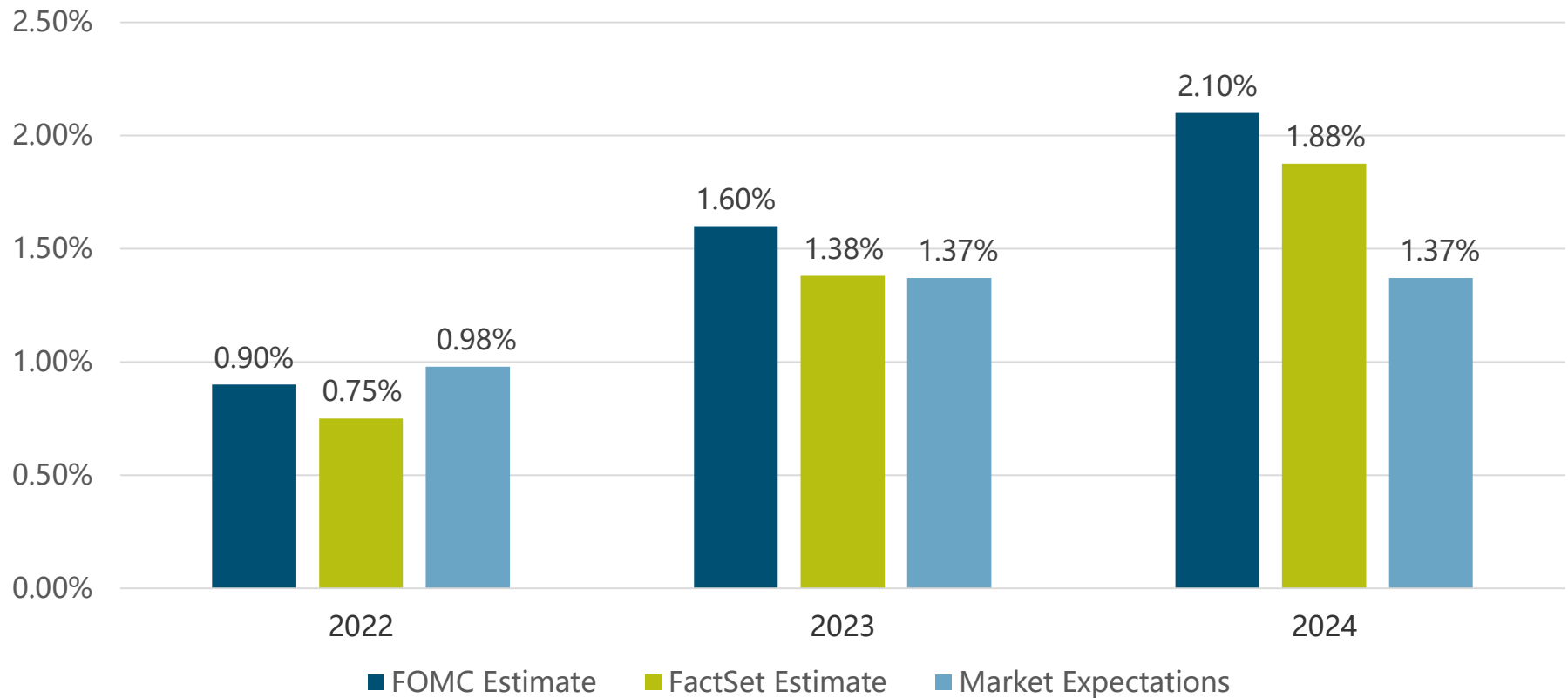
Core PCE Y/Y Deflator, %



- We expect core PCE to be higher than consensus expectations

Inflation and The Fed

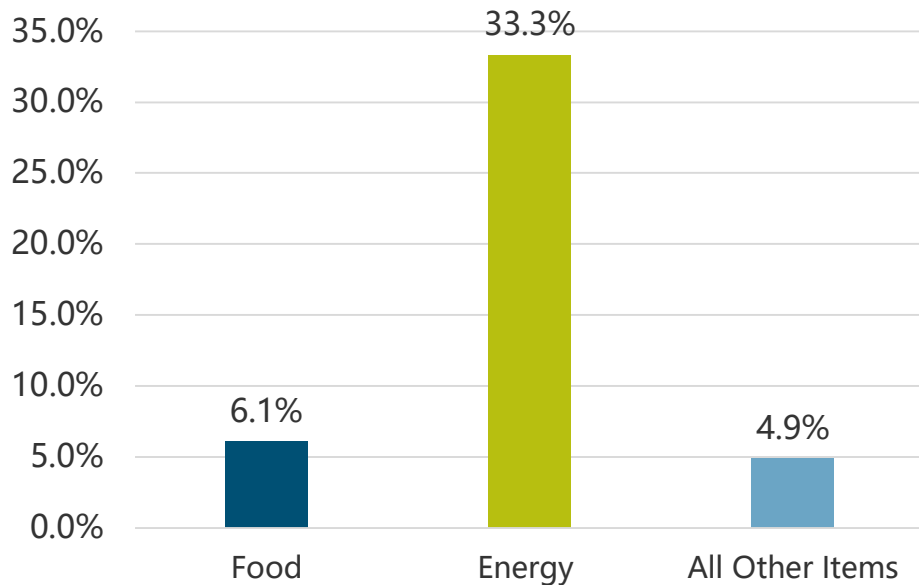
Federal Funds Rate Expectations



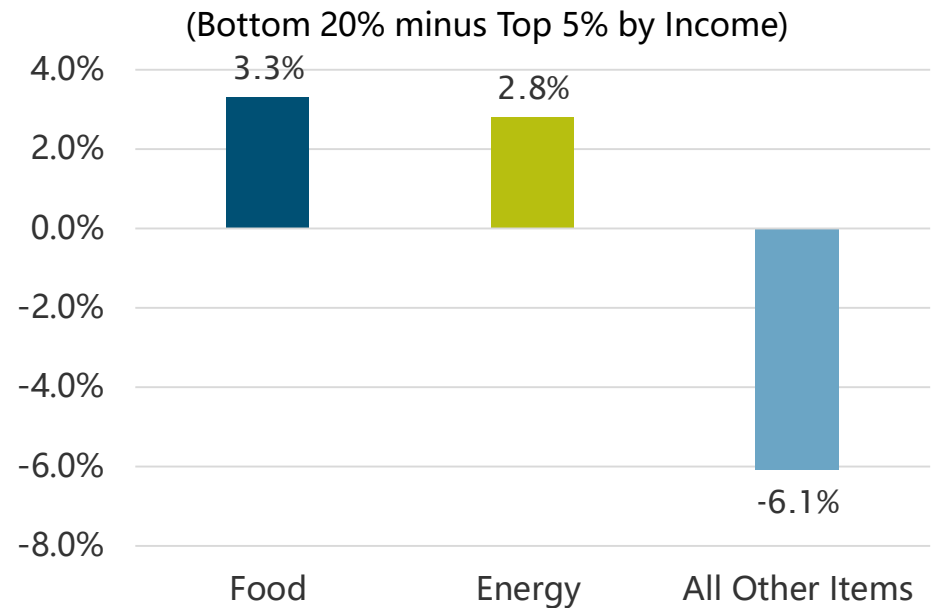
- Fed is more aligned with market and consensus expectations in 2022 and 2023

Inflation and Inequality

CPI Inflation by Component, %
(as of November 2021)



Relative Proportion of Total Expenditures, %
(Bottom 20% minus Top 5% by Income)



- Food and Energy inflation is higher than it is on all other items
- Lower income households spend proportionately more on Food and Energy

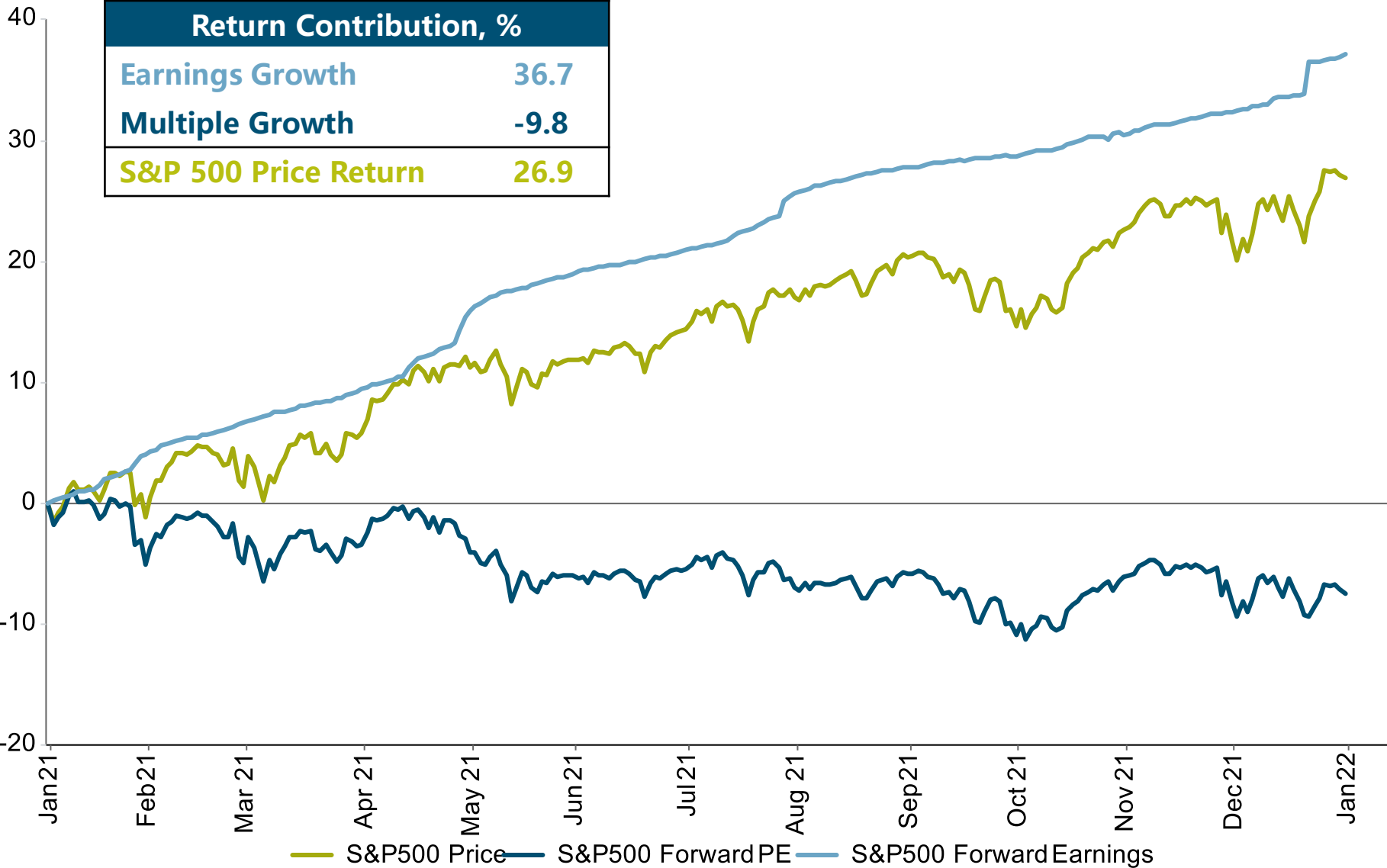
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Next Phase of the Equity Bull Market

- **Liquidity-Induced – 2020**
 - P/E multiples expand even as earnings decline or trough out
- **Growth-Driven – 2021 and Beyond**
 - Earnings growth drives prices as P/E multiples compress

Equity Returns in 2021...2022 Should See a Similar Pattern



Covid Recovery Fuels Strong Earnings Growth

Current and Historical Earnings Growth, %



- Current earnings growth is significantly higher than historical levels

Drivers of EPS Growth

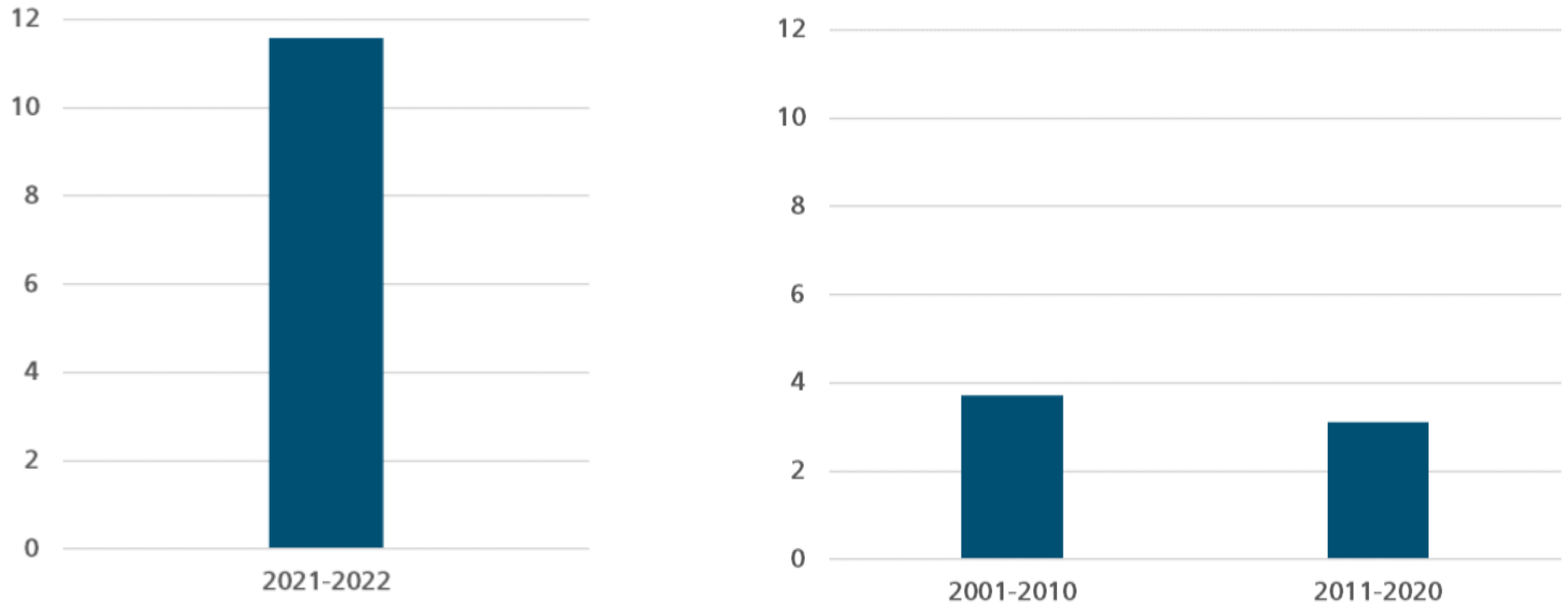
S&P 500 EPS Growth Contribution

EPS Growth Components	2021 %	Average 2001 – 2020 %
Revenue	16.9	3.0
Margin	55.3	2.8
Share Count	-0.6	0.3
Total EPS	71.7	6.0

- Revenue growth and margin growth drive earnings per share growth

Unusually Strong Revenue Growth

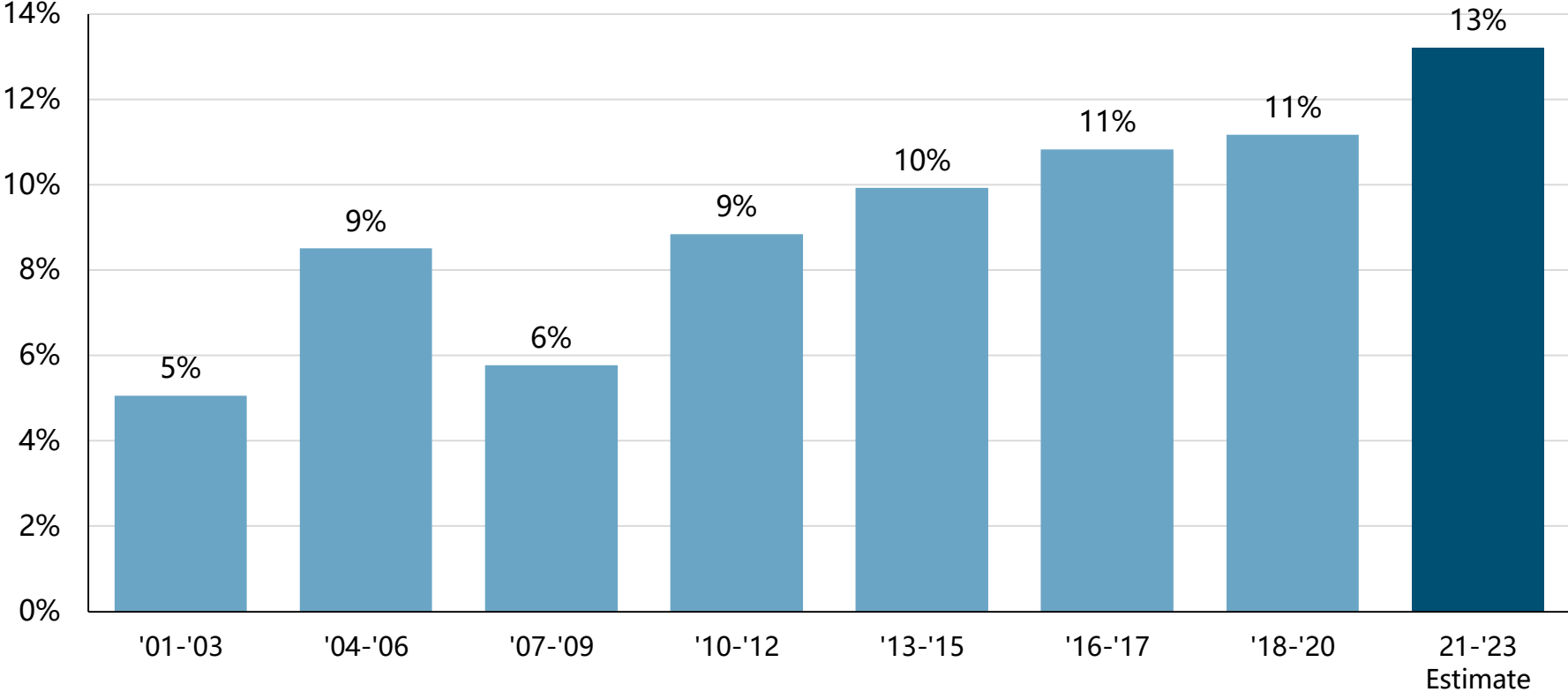
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Profit Margins Rise Over Time

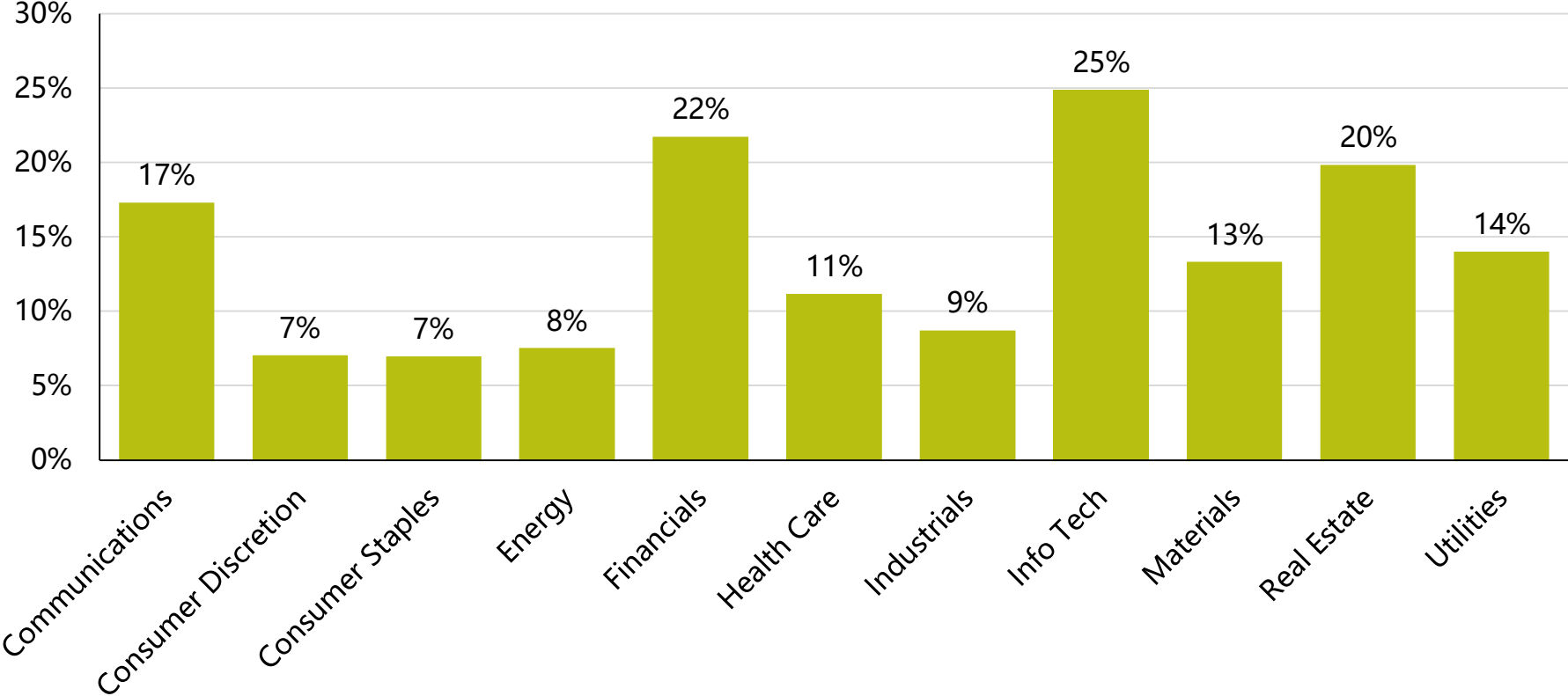
S&P 500 Net Profit Margin, %



- S&P 500 profit margins have been rising steadily

Profit Margins Vary by Sector

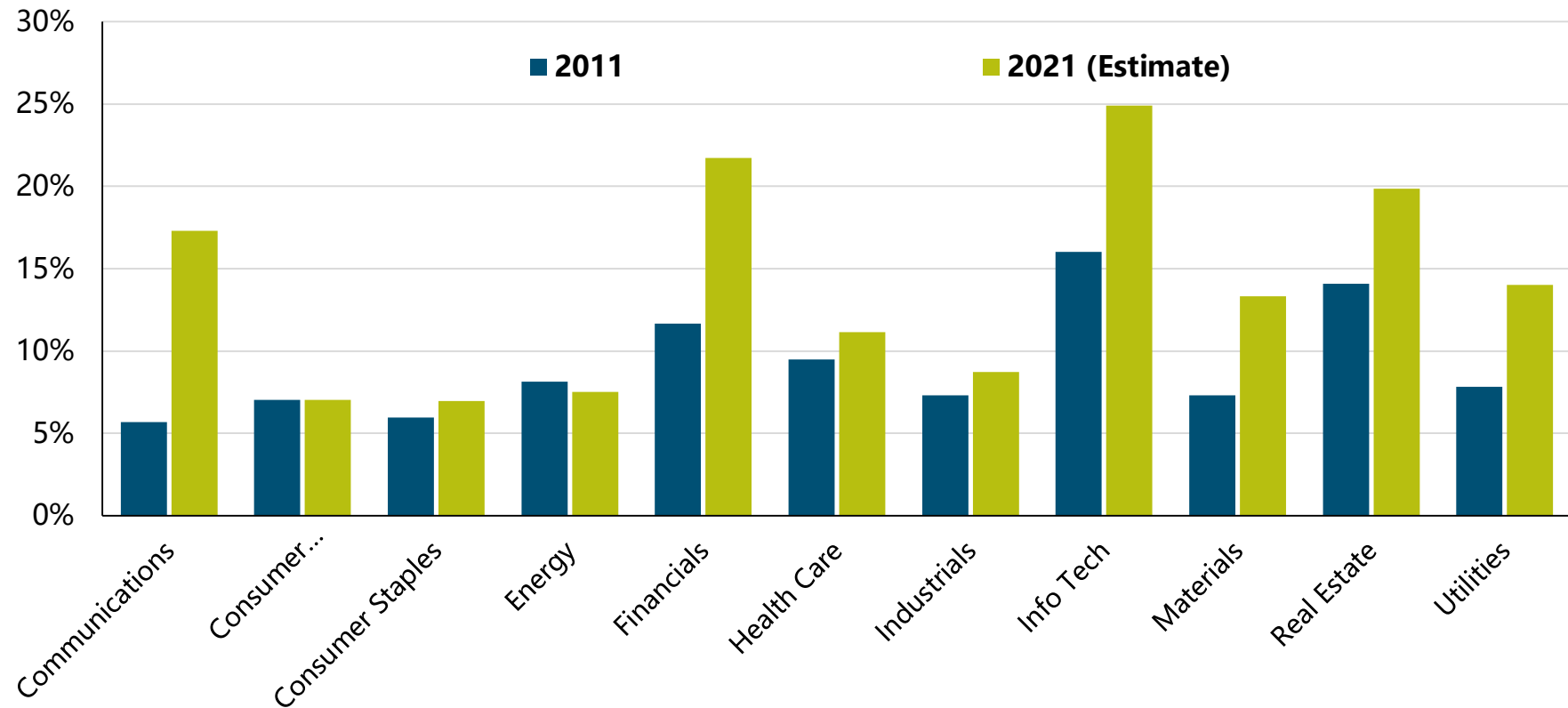
S&P 500 Net Profit Margins, %



- Profit margins vary significantly by sector

Changes in Profit Margins Over Time by Sector

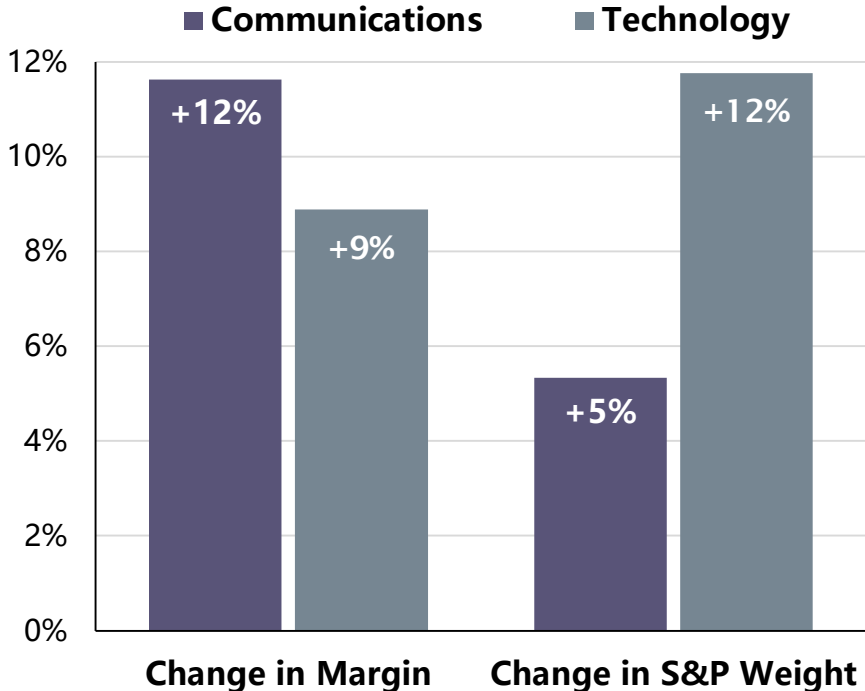
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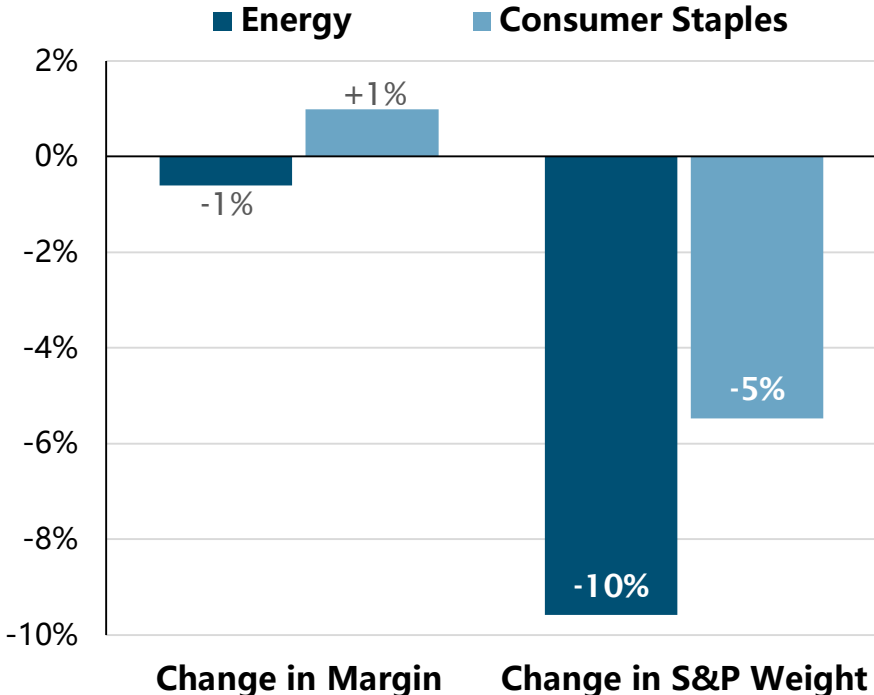
- Growth in profit margins also varies significantly by sector

Mix Shift Towards High-Margin Sectors

Sectors with High Margin Growth
(% change from 2011 to 2021)



Sectors with Low Margin Growth
(% change from 2011 to 2021)



- More profitable sectors have also become a bigger component of the index and vice versa

Better Leverage Profile ...

S&P 500 Net Debt to EBITDA



- Companies have a better leverage profile ...

... and Greater Liquidity

S&P 500 Dividend Payout Ratio, %

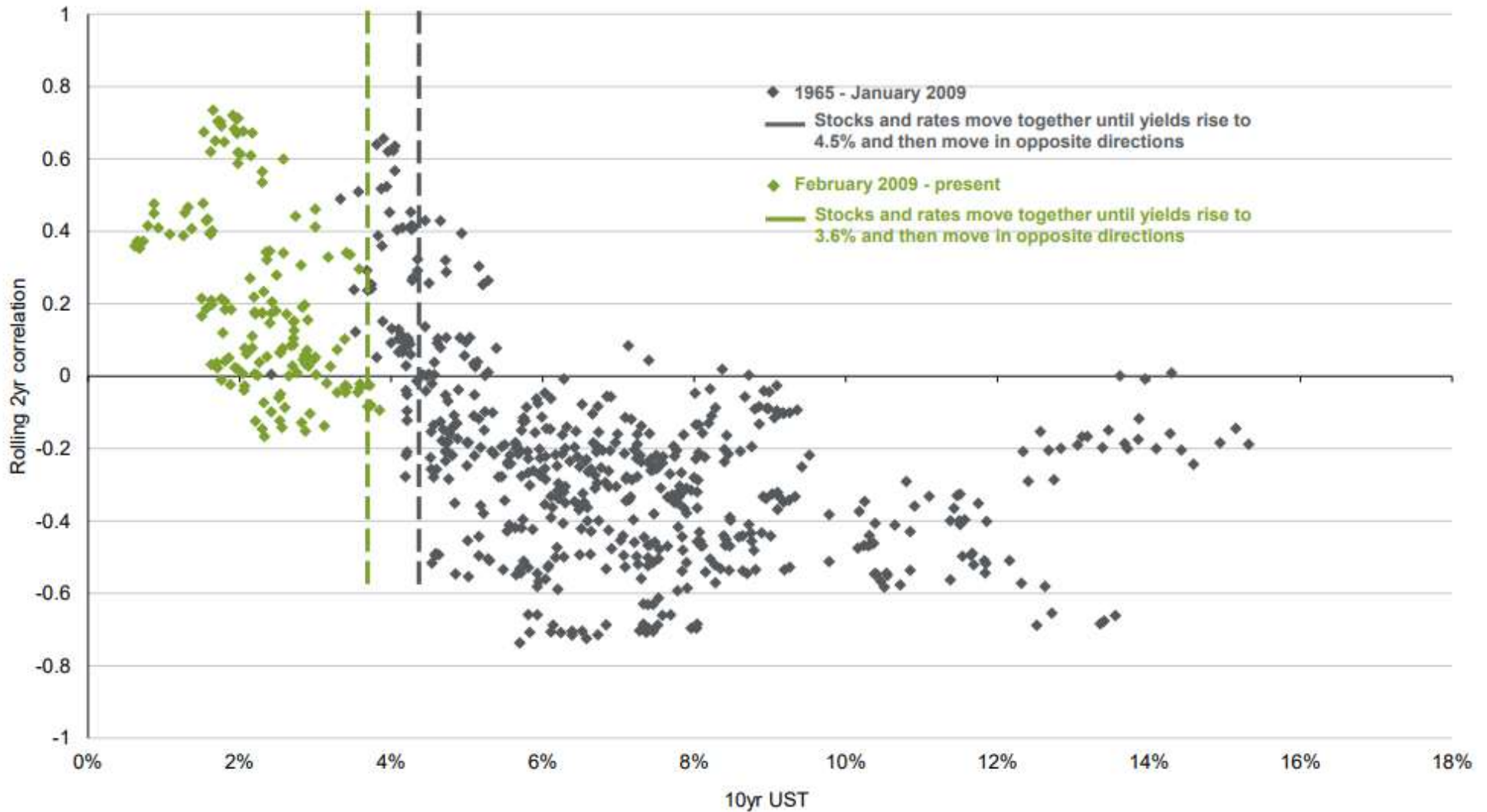


- ... and more liquidity

Interest Rates and Stock Prices

Stock returns and interest rate movements before and after the Global Financial Crisis

(Monthly S&P 500 returns, 10yr U.S. Treasury, rolling 2yr correlations, 1965 to present)



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Our Outlook on Economic Growth

We believe:

- Virus variants will continue to have limited economic impact
- Inflation will remain above consensus expectations in 2022 and 2023
 - However, current bout of reflation **will not** meaningfully impede growth or profit margins
- Fed will avoid a major misstep in 2022
- Above-trend growth in 2022 may exceed current expectations

Our Outlook on Earnings Growth, Profit Margins and Valuations

We believe:

- Earnings growth will remain significantly above trend in 2022
 - Revenue growth and profit margins will remain well above trend
- Profit margins **will not** revert to their long-term mean in the near future
 - Secular shift in profitability and sector mix

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 - Secular shift from still-low interest rates and above-trend growth
 - P/E multiples likely to compress modestly as interest rates rise gradually

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We believe:

- Stocks will handily outperform bonds and cash in 2022
 - Above-trend earnings growth will offset modest P/E compression
 - Mid to high single digit equity returns with upside potential

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 - Attractive cash yields
 - Correlation with nominal GDP creates useful inflation hedge
- Private market investments should outperform their public market counterparts
 - Private Equity, Opportunistic Credit, Absolute Return

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We believe the following sectors will perform well in 2022

- Value and cyclical stocks e.g. Energy, Financials, Industrials
- Credit over duration
 - Credit spreads will remain lower for longer
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- Real assets
- Energy transition and ESG investing
- Innovation and disruption

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