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VanEck ViewPoint™

Human after all

January 2022

Being human means many things. It means we make mistakes, it means we behave in ways psychologists often struggle to explain. In the world of investing we feel the impact of losses more than we feel the same level of gain. Loss aversion was first identified by Kahneman and Tversky. Each of us is unique, and each of us has a different frame of reference. This makes our risk tolerances diverse and we all have different goals. The last quarter of 2021 has been a lesson that has demonstrated that market participants, like the 2005 Daft Punk album, are human after all.

From the Chair of the US Federal Reserve down, we were all presented with circumstances beyond our control in 2021. While that is true of markets all the time, it did seem in 2021 we watched data releases and judged those making decisions with extra vigilance. Decisions that may have seemed right at the time, in the heat of the moment, on reflection may have been mistakes.

One thing you can say though is that participants in equity markets have been optimistic. Equities, for the most part finished 2021 higher than they were at the end on 2020. Bonds on the other hand, have been under pressure and that is not likely to dissipate in 2022.

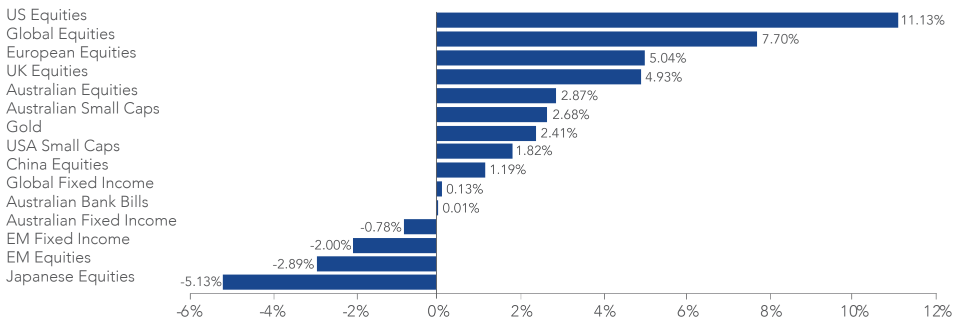
Over the final quarter of 2021, the bond market (finally) started to recognise the persistency of inflation. The transitorians all but waving a white flag. The bond market, particularly at the shorter end of the curve, seems to reflect the reality of the inflationary environment we find ourselves in. Global supply constraints don't appear to be dissipating in the near term and Omicron could prolong it. The long-end of the US yield curve has not yet reacted in a way that would be expected of an inflationary environment. Until the pandemic dissolves long-term growth will always be a concern.

Reflecting the long-term low-rates, equity markets continue their march forward. Over the quarter, US equities continued to set the pace. Not to be out done European equity markets also staged a rally over the quarter. Japan was the worst performing equity markets, while emerging market bonds also fell as rates in many emerging markets increased.

At a sector level, globally, it was IT that continued to flourish, again reflecting the long-term rates. REITs, locally continue to do well as the nation emerges from lockdowns. Materials and utilities also did well locally.

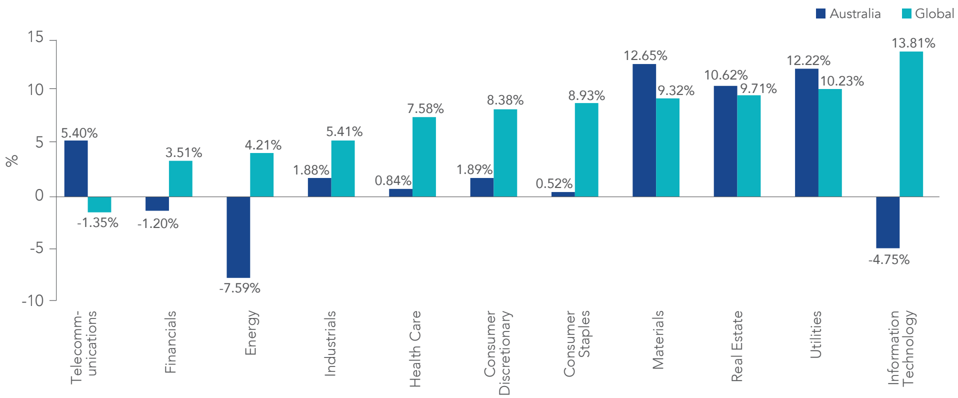
We say this often, but into the New Year all eyes will continue to be on the Fed. It has abandoned its transitory narrative but the question remains can the economy cope with higher rates? The US economy is strong, though we do have concerns about high yield debt. Investors should look out for over-leveraged balance sheets that are generally recipients of artificial liquidity. Financial conditions are tightening. Locally however, Australia is precariously placed. Prior to the initial COVID-19 lockdowns, our central bank was easing in an effort to stimulate a waning economy. Politically we seem to be in disagreement with our biggest trading partner so we may not be able to rely on China to buy our resources to get the economy moving again. It will be up to the RBA, the government, with fiscal policy, and the Australian consumer to get the Australian economy moving…all humans, therefore imperfect. But we remain optimistic.

Chart 1: Mainstream asset class returns for the quarter



Source: Bloomberg, 1 October 2021 to 29 December 2021, returns in Australian dollars. US Equities is S&P 500 Index, International Equities is MSCI World ex Australia Index, European Equities is MSCI Europe Index, UK Equities is FTSE 100 Index, Australian Equities is S&P/ASX 200 Accumulation Index, Australian Small Caps is S&P/ASX Small Ordinaries Index, Gold is Gold Spot US$/oz, USA Small Caps is Russell 2000 Index, China Equities is CSI 300 Index, Global Fixed Income is Bloomberg Global Aggregate Bond Hedged AUD Index, Australian Bank Bills is Bloomberg AusBond Bank Bill Index, Australian Fixed Income is Bloomberg AusBond Composite 0+ yrs Index, EM Fixed Income is 50% J.P. Morgan Emerging Market Bond Index Global Diversified Hedged AUD and 50% J.P. Morgan Government Bond-Emerging Market Index Global Diversified, EM Equities is MSCI Emerging Markets Index, Japanese Equities is Nikkei 225 Index.

Chart 2: Global and Australian equity sectors quarterly performance



Source: Bloomberg, 1 October 2021 to 29 December 2021, returns in Australian dollars. Utilities is MSCI World Utilities Index / S&P/ASX 200 Utilities Index, Industrials is MSCI World Industrials Index / S&P/ASX 200 Industrials Index, Materials is MSCI World Materials Index / S&P/ASX 200 Materials Index, Consumer Staples is MSCI World Consumer Staples Index / S&P/ASX 200 Consumer Staples Index, Consumer Discretionary is MSCI World Consumer Discretionary Index / S&P/ASX 200 Consumer Discretionary Index, Financials is MSCI World Financials Index / S&P/ASX 200 Financials Index, Energy is MSCI World Energy Index / S&P/ASX 200 Energy Index, Healthcare is MSCI World Heath care Index / S&P/ASX200 Heath care Index, Telecommunications is MSCI World Telecommunications Index / S&P/ASX 200 Telecommunications Index, Information Technology is MSCI World Information Technology Index / S&P/ASX 200 Information Technology Index, Real Estate is MSCI World REIT Index / S&P/ASX 200 AREIT Index.

From transitory to intransigent?

In the final weeks of 2021, the current chair of the Federal Reserve, Jerome Powell finally laid to rest the year's, and perhaps the decade's, biggest furphy: the idea that the surge in inflation the US has been experiencing is transitory. On US television, Mohamed El-Erian said "the characterisation of inflation as transitory is probably the worst inflation call in the history of the Federal Reserve and it results in a high probability of a policy mistake."

With little room for error, Mr Powell will now have to navigate the US economy beyond transitory inflation, after being re-confirmed as the Federal Reserve's Chair for another four years.

Since the death of transitory, it has been slowly dawning on markets that the days of free money are ending. The end of the US Federal Reserve's (The Fed's) bond purchases is in sight and the US curve is pricing interest rate hikes by the middle of this year.

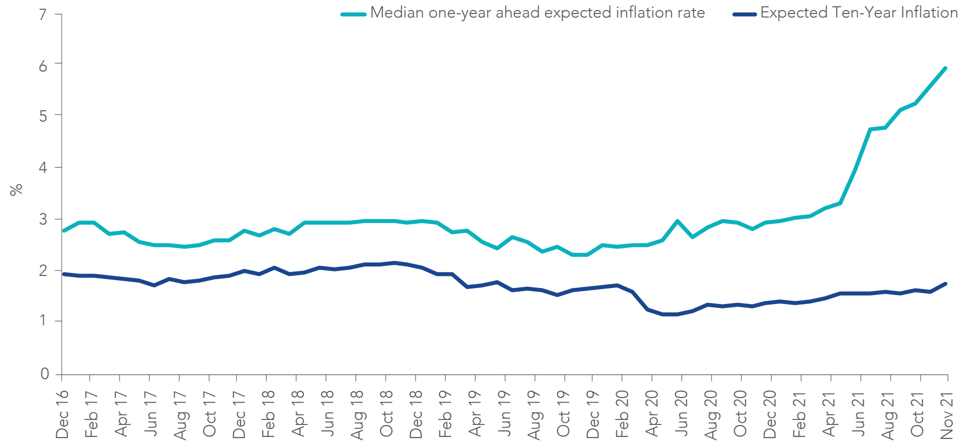
For the past few ViewPoints we have, some would say, been kicking and screaming about the persistence of inflation and the market's apparent ignorance. We had labelled this 'inflacency', and while the problem seems to be gone in the short-term, it appears the dreaming in markets has not evaporated, it has just been pushed further into the future.

What this means is that even as markets are pricing more rate hikes sooner, long-dated bond yields are going nowhere. That means markets are predicting earlier tightening will quickly come to an end, or even lead to rate cuts sooner rather than later.

To be fair, the further the Fed lets the party get out of control, the harder it will be to engineer the much-famed soft landing. So at least some of the market may be pricing a recession. Rates, though, would have to go higher than currently envisaged to trigger that.

Chart 3: The difference between short and long-term expectations

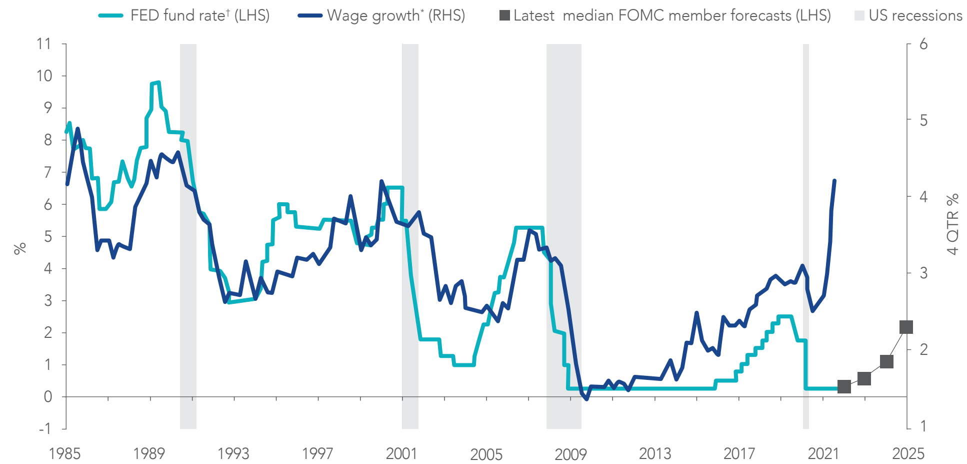
Underlying inflation measures



Source: Federal Reserve Bank of New York, Federal Reserve Bank of Cleveland.

Chart 4: The FED late – but now ahead of markets

Wages growth versus Fed fund target and market expectations



* Wages and salaries (ECI). † Target rate then ceiling.

Source: US Bureau of Labor Statistics, Federal Reserve, National Bureau of Economic Research.

Long term reluctance

Meanwhile, medium term inflation expectations are rising, not falling. What actually impacts the economy is real rates: that is, nominal interest rates adjusted for expected inflation. The higher future inflation is expected to be, the easier paying back borrowed money will be in the future.

So even as inflation is expected to stay higher for longer, long term interest rates are static, meaning that real interest rates are falling, that is, monetary policy is actually easing. Any action from the Fed is expected to be modest and temporary.

This may not be enough. The Fed has found itself in a quagmire much of its own making and the market, for the most part, has been complicit.

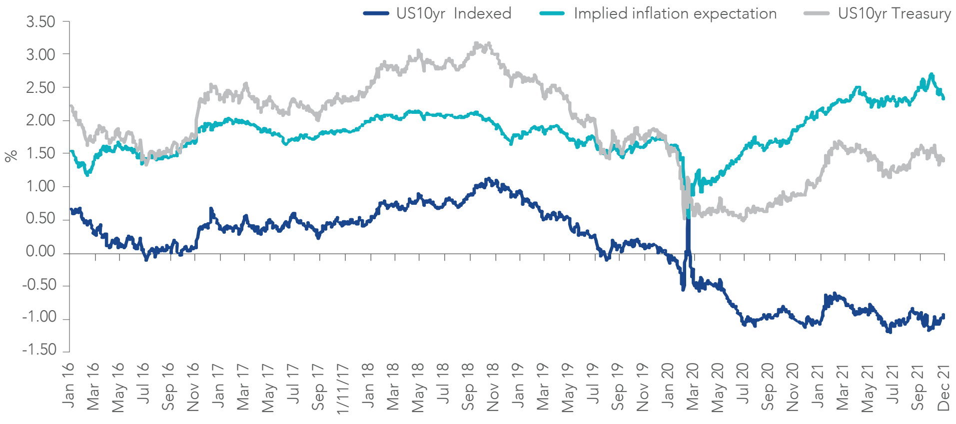
The market is made up of humans (as is the board of the US Federal Reserve), so is subject to behavioural biases. One such bias that influences markets is 'recency bias'. In markets, this plays out as the market sets prices based on where prices have recently been. This year markets did not abandon "inflation is transitory" until the overwhelming, persistent evidence, that inflationary forces were persistent and had shown itself persistently over almost for a year.

The trouble is it has not convinced the market that rates will need to go higher for longer. While it took a year to for the market to react to what is happening right now, it is impossible to predict how long it will take to convince them the future is different to what it is planning.

The reason for the bias is understandable. Central bank intervention in the wake of the 2008 financial crisis was, at the time, unprecedented. Inflation throughout the next decade remained non-existent. The wave of liquidity that flooded markets in 2020 in the wake of the COVID-19 crisis set new records. However, biases, and other factors, lead the market to be hesitant changing future predictions.

Chart 5: Bonds are intransigent

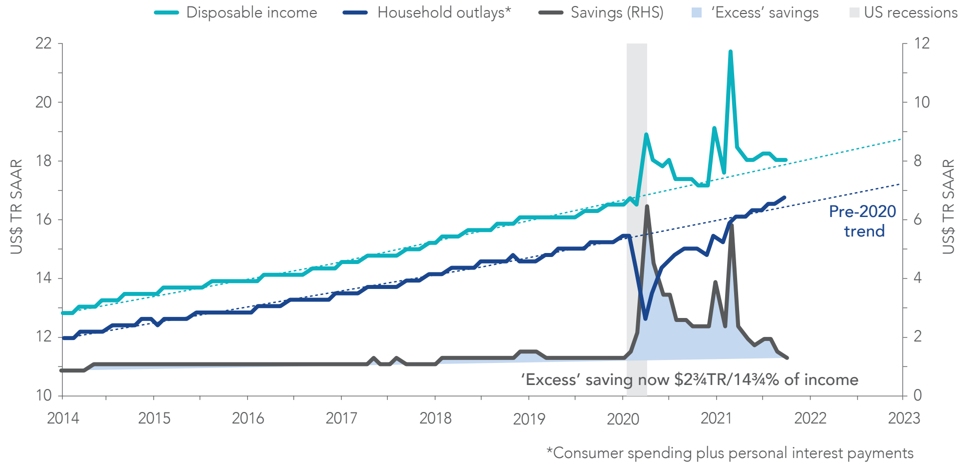
US 10 year treasuries real and nominal breakeven inflation



Source: Federal Reserve Bank of St. Louis.

Chart 6: Households have war chest of unspent savings

US household income, spending and saving



SAAR is seasonally adjusted annual rate.
Source: US Bureau of Labor Statistics, National Bureau of Economic Research.

History not repeating this time

However, if we go back to the GFC, it is possible to witness what happened in its aftermath that could lead to the market to change its current long-term prediction.

In the years following the GFC, global growth remained sluggish, even with lower than usual interest rates. The generally accepted answer to what came to be known as "secular stagnation".

Secular stagnation occurred through several mechanisms. Soaring incomes in China, a high savings rate country, pushed up global savings. Meanwhile in developing countries, increasing income disparity did the same, remembering that the wealthy spend a lower percentage of their income. Sluggish consumption, in turn, undermined real capital expenditure, exacerbating already weak nominal capital expenditure. Technology, over this period had a deflationary impact.

Strong savings and weak spending pushed down the real interest rate required to balance savings and spending, often referred to as r-star (r*).

This time the 'recovery' is different.

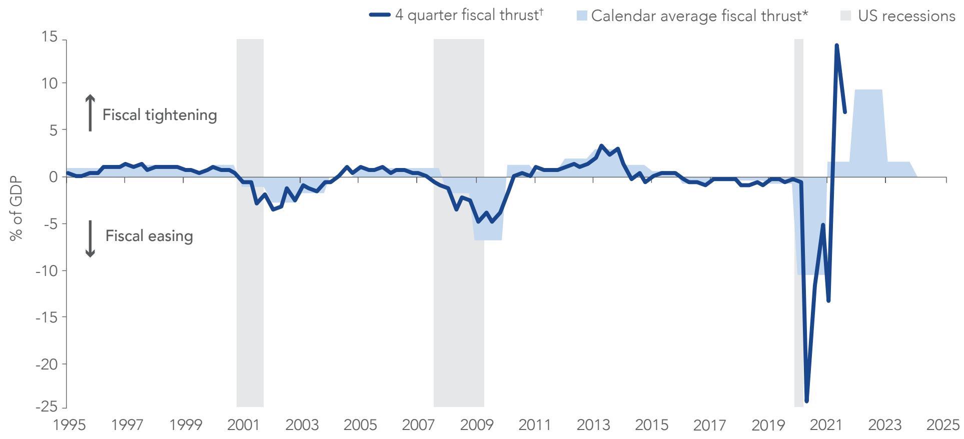
Unlike through the GFC and its aftermath, there has been a massive burst of government stimulus which directly affects both saving and spending, since the government is part of the economy.

You can see the effects of this, directly, in national savings and, indirectly, in the robustness of the recovery: as soon as the delta shutdowns and restrictions passed, growth came tearing back. With so much of stimulus still unspent, this will continue to sustain growth.

Furthermore, after a bout of desynchronisation this year, we believe that next year should see a move toward more uniform growth: Europe is pulling out of its worst COVID dislocation; on the other side of the world, China is taking the foot off the brake and moving it back to the accelerator. A rising tide should lift all boats.

Chart 7: Much of fiscal unwind has already happened

US Fiscal Thrust: Change in the budget balance

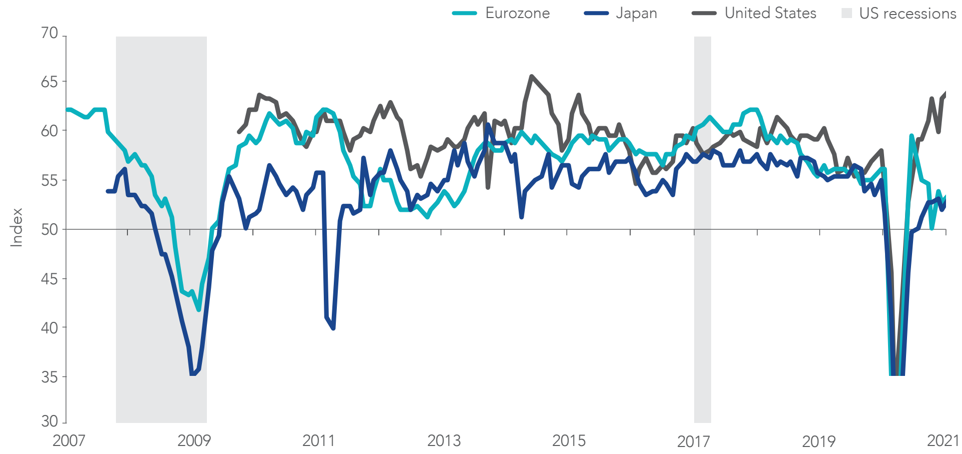


*Change in federal budget balance as share of GDP with CBO forecasts.
†Change in quarterly government net lending from net lending in 4 quarters prior.

Source: Congressional Budget Office, US Bureau of Economic Analysis, National Bureau of Economic Research.

Chart 8: Desynchronisation Fading

Composite (manufacturing and service) output PMI



Source: Markit, National Bureau of Economic Research.

Long term trends are playing out

COVID disruption has altered supply chain dynamics. In the short term, this will see higher inventory investment from "just in time" to "just in case". In the medium term, companies will rebuild new supply chains and this is a source of a surge in business investment.

The passing of the high tide of international cooperation and the build-up of the supposed 'Cold War II' will further add to supply chain re-ordering, not to mention being a secular source of price reflation.

The re-ordering of global energy supply to renewables will be a source of trillions in capital investment around the world. Joe Biden's infrastructure bill, while adding to the overall level, will be relatively small in comparison to the dynamic shift that will take place over the next ten to twenty years all around the world.

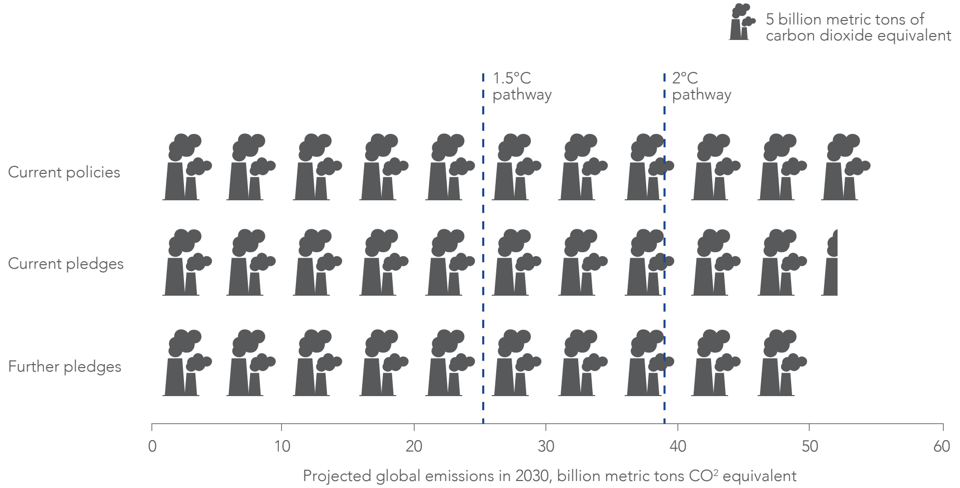
The world invested an unprecedented $500 billion in decarbonisation in 2020. Many more billions have already been allocated by the UK, US and many other economies around the world to increase clean energy capacity, energy storage and increase efficiencies in clean energy production. However, it is important for investors to note that despite the significant funding that has already flowed into this sector, we're only at the beginning of this global rotation away from fossil fuels. The gap between the latest commitments for emissions reductions and what is required for the world to avoid the most catastrophic version of climate change illustrates this future opportunity. A significant increase in climate funding and restrictions on carbon emissions will be required.

In addition, we are finally witnessing a surge in wages that is already well underway, after decades of declining wages relative to capital costs. This will lead to a substitution of capital for labour. Tobin's Q, the ratio of physical capital cost to the market price of existing capital) tells us new physical capital is cheap.

So the idea that secular stagnation will continue unabated, keeping r* down, does not appear as true as it did during the 'recent' GFC. This time long term trends are supporting capital expenditure. It is difficult to guesstimate what is the appropriate r*, the market is understandably having trouble, but the evidence points to – it is not here.

Chart 9: The emissions gap

Both in terms of policies and pledges, countries are falling far short of the cuts needed to limit global warming to 1.5°C or 2°C



Source: United Nations Environment Programme.

Chart 10: Globalisation free kick is over

Global exports/global industrial production

Source: National Bureau of Economic Research.

Bonds or equities?

US inflation-indexed 10 year bond yields are still around – 1%. What this means is that, after adjusting for inflation, people are willing to pay to lend money to the US Government. We do not think people are forecasting inflation to soar. 10 year nominal bond yields are wobbling around 1.5%. That implies inflation averaging 2.5%, perhaps surprisingly, not far from the Fed's inflation target.

If secular stagnation is receding, real yields should be moving closer to the US's trend growth rate: approximately labour force growth plus productivity growth, or around 2%. Even if we go with a conservative 1% – that's still 2% higher bond yields from here.

So if you think bond yields are nuts, can you just ignore them and stick to equities and other investments. Sadly, we believe the answer is no. Bond yields are the risk-free rate that other assets price off. Noting, of course, "risk-free" is a textbook term, if bond yields rise two percentage points it is not good for bondholders.

Looking at a table of equity valuation measures, something stark stands out, equities look expensive to very expensive against everything, except interest rates.

What this means is that potentially when interest rates re-align, being selective will be paramount.

Unfortunately, it's hard to say when the reckoning comes. It could be fast, given the market's almost-mystical belief in QE the Fed closing the spigots could be a trigger. Or it could be slowly, as the economy defies mouse-bite interest rate hikes.

Since it is a question of psychology it's safe to say there will be some irrationality. It is hard to predict so perhaps the better approach is to watch out for canaries in the coalmine.

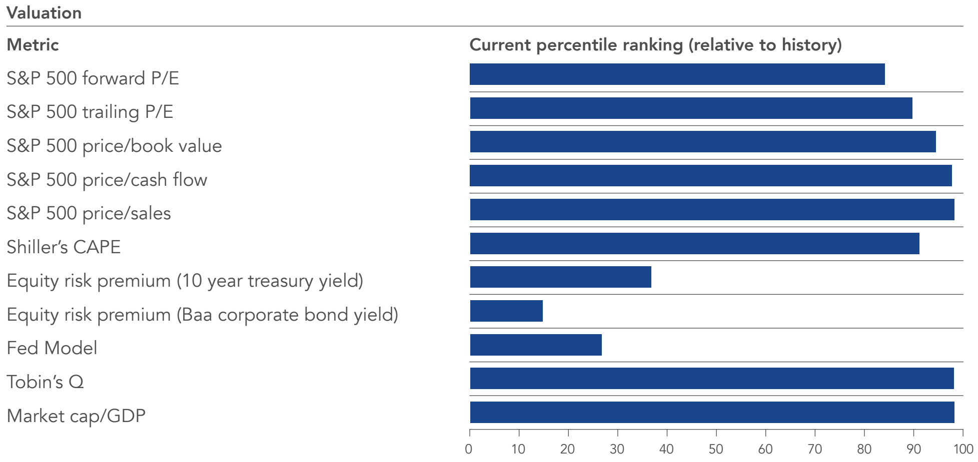
One interesting canary is high yield credit spreads, or rather, low credit rating credit spreads, since nothing is high yield anymore.

Despite corporate profit margins remaining strong, these spreads have started to move, albeit modestly, wider. An acceleration higher could indicate gathering dislocation. As an aside, it would also crimp the issue-debt-buyback-shares machine, still a massive contributor to rising equity markets.

Indexed bond yields themselves should pick up. There is some evidence that indexed bonds get an outsize benefit from QE.

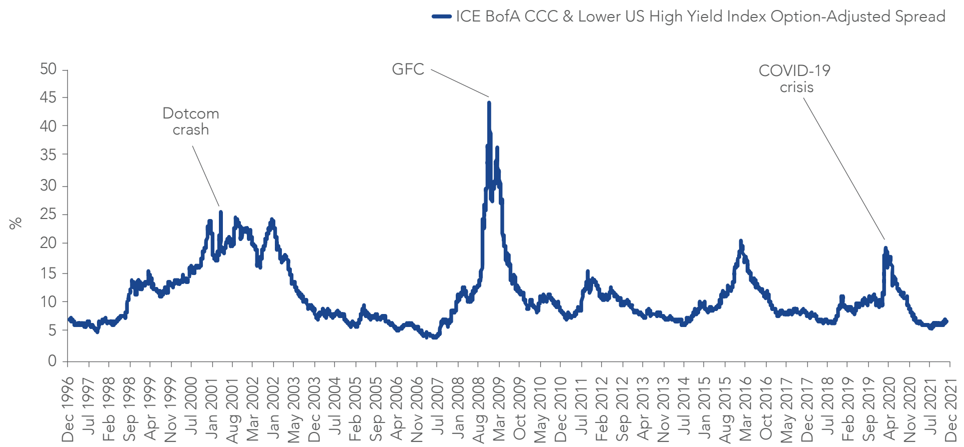
Chart 11: Equities look expensive, except against interest rates

S&P 500 equity valuation metrics



Source: Bloomberg, Federal Reserve of St Louis.

Chart 12: CCC spreads still tight, but always signal turn



Source: Federal Reserve of St Louis.

Foot off brake, on accelerator

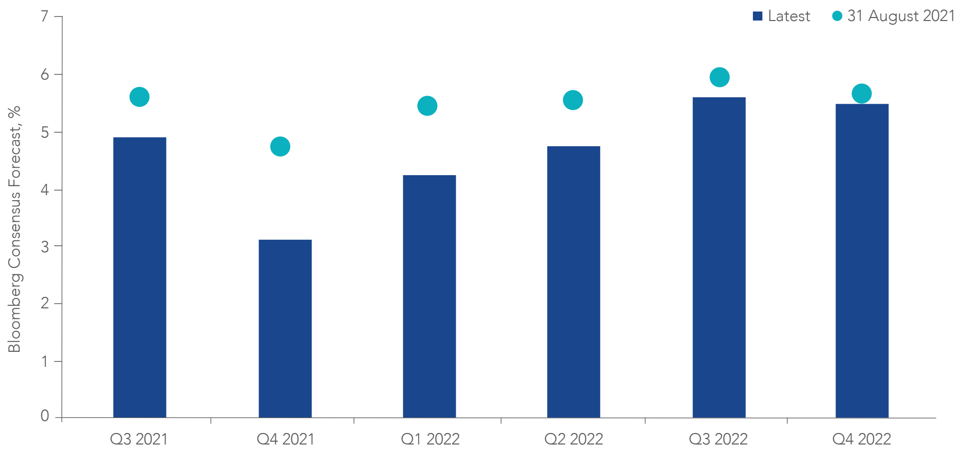
Closer to home, our most significant trading partner did not have its finest quarter. In China, the property developers' saga reached its logical conclusion, with Evergrande defaulting on its external bonds and announcing debt restructuring, and Kaisa receiving a formal forbearance proposal from bondholders. J.P. Morgan's CEMBI HY+ China Total Return Index dropped by 23% between September 30 and November 9. Domestic activity was hit by energy rationing, supply chain disruptions, and COVID outbreaks. Both the official and Caixin manufacturing PMIs slipped into contraction zone, and the near-term growth outlook (Q4-2021) was cut several times – all the way down to 3.11%. This is when authorities took notice and began to act.

In terms of real estate. The first move, back in October, was to roll back some real estate regulations and mortgage restrictions. At the same time, the central bank called on property developers to honor their debt obligations and urged banks to maintain a "stable and orderly" flow of credit to the sector. The process gained further momentum in December, with the "reasonable release" of M&A loans (to ease the acquisition of assets from struggling developers) and measures to support mortgage demand for second-home buyers. Finally, on December 6, the Politburo called for the "healthy" development of the housing market, meeting "reasonable" demand for houses, and investing more in social housing. One can say that authorities keep "blinking" despite being rightfully concerned about leverage, bubbles, and macro/market imbalances. However, real estate accounts for about 20% of GDP, together with construction. A protracted "decompression" of the sector can not only derail growth, but could also lead to social discontent and financial instability.

In addition to ring-fencing flailing property developers, authorities made a concerted effort to prop up growth, and this effort gained momentum in December. The just-concluded Central Economic Work Conference put special emphasis on growth stabilisation via countercyclical policies, which should be "actively" introduced, including "more effective and targeted" fiscal stance. The central bank has yet to make changes in major policy rates (such as the loan prime rate), but the recent communications revealed concerns about "quasi-stagflation", while the latest monetary policy report no longer mentioned the need to control "the valve on money supply". Further, the People's Bank of China (PBoC) made a 50 basis points cut in the reserve requirements for banks, which is estimated to inject CNY1.2 trillion in the economy and which is specifically aimed at supporting small and medium-sized enterprises.

Chart 13: China's near-term growth outlook got bleaker

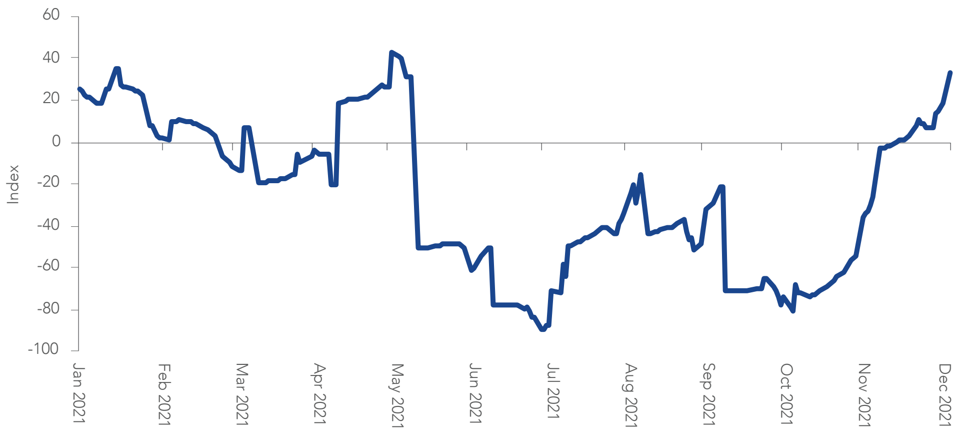
Changes in China's growth forecast



Source: Bloomberg LP.

Chart 14: Positive economic surprises are back

China economic surprise index



Source: Bloomberg LP.

China on the accelerator

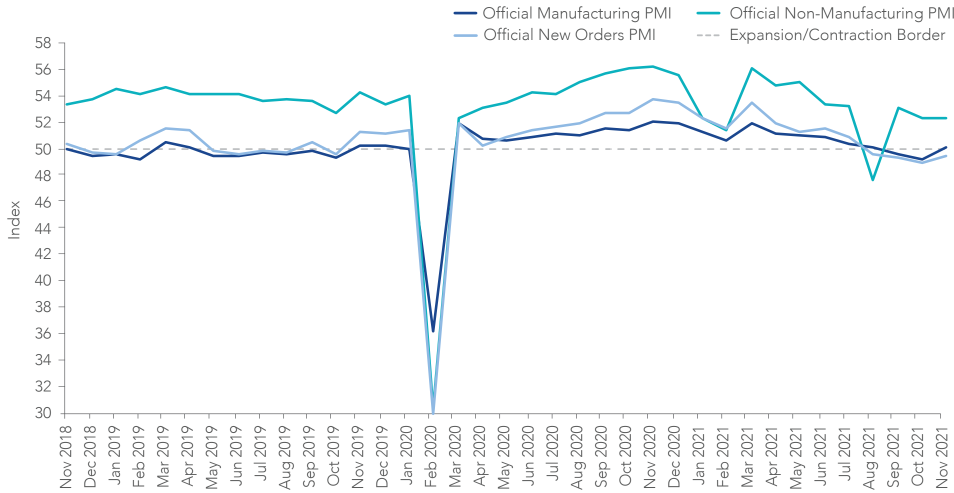
China's small private-owned companies were hit particularly hard by the lower demand/higher costs "squeeze", the small companies PMI has stayed deep in contraction zone since April. SMEs account for about 60% of GDP and more than 80% of employment, so, we were not surprised to see more targeted measures in this area, such as assistance with cloud/digital services, lower power tariffs (via local governments), better funding support from banks, lower taxes and fees. Finally, just a few days ago, the central bank cut the re-lending rate for SMEs and agricultural loans by 25 basis points.

China's exports are robust but moderating. In the meantime, import growth rebounded to 31.7% year-on-year in November, reflecting a pickup in infrastructure investment, as well as improvements in other categories, such as machinery and electronics. The end-result is that net exports, which made major contribution to China's Q3 growth (around 22%), are no longer moving in the right direction, and the currency's nominal appreciation can reinforce this trend. This needs to be kept in mind evaluating the prospects of further policy easing/support in the coming months. The central bank's decision to raise the foreign currency reserve requirement by 2%, to 9%, shows that it takes its FX trading and growth seriously.

While China's real estate drama is not over, the policy turnaround is already having an impact with the market starting to differentiate between developers' names, with higher-rated bonds staging a nice rally recently. In the real economy, we see credit rebounding in all major categories – government and corporate bonds, household lending (including long-term credit – a proxy for mortgages), and corporate lending (including long – and medium-term). The latest activity gauges (PMIs) appear to be bottoming out, and China's economic surprise index visibly improved, moving back into positive territory. These developments notwithstanding, the economy might require additional policy support going forward. Many analysts believe supply bottlenecks will extend into early 2022 despite measures to alleviate the shortages, while the harsh COVID controls, such as zero-tolerance policy will persist at least until the 2022 Olympic Games. So far, authorities have shown a lot of restraint, both on the fiscal and monetary sides. Recent reports suggest that the 2021 budget was under-utilised. In regards to monetary policy, China is the only economy where real policy rates are still positive, when adjusted by both trailing and expected inflation. All this leaves ample room for policy fine-tuning.

Chart 15: PMIs still in contraction

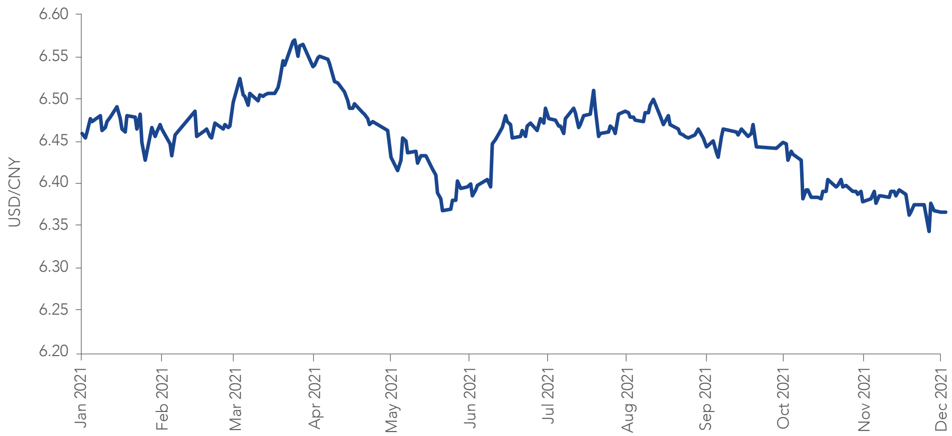
China official Purchasing Managers Indices (PMI)



Source: Bloomberg.

Chart 16: Policy makers have currency on their mind

China, US foreign exchange



Source: Bloomberg.

Rest of Asia – the tiger roars

The recovery in Asia continues. In the last quarter, declining COVID-19 cases and positive vaccine progress have allowed many economies to re-open. As a result, forward-looking PMIs rebounded in October from a sluggish third quarter, which was held back by virus outbreaks and associated restrictions. Regional has trade also picked up, with Asia's merchandise exports continuing to strengthen, outpacing expansion in global trade.

These indicators look promising. According to ANZ research, a broader and less interrupted recovery in 2022 is anticipated. Looking forward, 2022 is the 'Year of the Tiger'—some Asian economies might begin to roar.

The economic outlook for Asia is bright. While Asia's 2022 GDP growth is forecast to grow at 4.8% compared with 7.2% this year[1], this reduction reflects the slowdown in China as well as normalisation of growth in India. Excluding China and India, GDP growth is set to pick up to 4.3% in 2022 from 4.1% in 2021, with much of the impetus coming from the late recovery in ASEAN.

Other economies like Singapore, South Korea and Taiwan, which are already well into their economic recovery, are expected to have a slight moderation in growth rates. For South East Asian economies, much stronger recovery in 2022 is expected due to lower base effects as the economy normalises and activity returns back to normal levels.

Regional inflation remains manageable, which will allow monetary policy to stay supportive. The bias of most Asian central banks is still quite pro-growth, with most banks not rushing into tightening next year. On Asian currencies, these are expected to remain resilient in the face of US monetary policy tightening due to larger external buffers, in the form of continued strong trade surpluses and high FX reserves.

Some risks that would derail growth include rising inflation and new COVID-19 variants. Rising inflation could induce the US to tighten monetary policy earlier than expected and trigger financial volatility. The emergence of the highly mutated Omicron variant brings additional uncertainty, and is a sobering reminder that further outbreaks remain a possibility.

However, we are hopeful that governments are now much better placed in handling the virus. As we have witnessed in 2021, most governments have shifted their strategy from eradicating the pandemic to living with it. From pandemic to *hopefully* endemic, this is a critical turning point as it promises broader growth in 2022.

1. ANZ Research, Asia Economic Outlook Q1 2022.

Chart 17: Purchasing manager indices have picked up after outbreak-induced declines in Q3

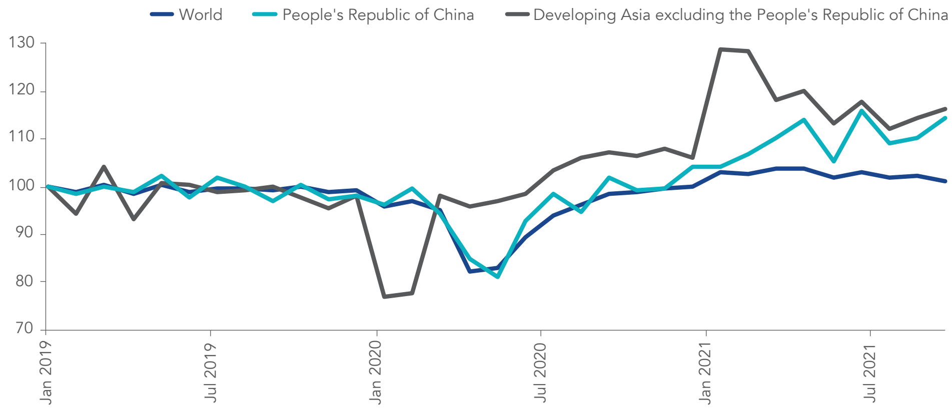
Manufacturing purchasing managers' index, seasonally adjusted

	2021										
		Q1			Q2			Q3		Q4	
Economy	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
PRC	51.5	50.9	50.6	51.9	52.0	51.3	50.3	49.2	50.0	50.6	49.5
India	57.7	57.5	55.4	55.5	50.8	48.1	55.3	52.3	53.7	55.9	57.6
Indonesia	52.2	50.9	53.2	54.6	55.3	53.5	40.1	43.7	52.2	57.2	53.9
Malaysia*	51.9	50.7	52.9	56.9	54.3	42.9	43.1	46.4	41.1	55.2	55.3
Philippines	52.5	52.5	52.2	49.0	49.9	50.8	50.4	46.4	50.9	51.0	51.7
Republic of Korea	53.2	55.3	55.3	54.6	53.7	53.9	53.0	51.2	52.4	50.2	50.9
Taipei, China	60.2	60.4	60.8	62.4	62.0	57.6	59.7	58.3	54.7	55.2	54.9
Thailand	49.0	47.2	48.8	50.7	47.8	49.5	48.7	48.3	48.9	50.9	50.6
Vietnam	51.3	51.6	53.6	54.7	53.1	44.1	45.1	40.2	40.2	52.1	52.2
Services purchasing managers' index, seasonally adjusted											
PRC	52.0	51.5	54.3	54.3	55.1	50.3	54.9	46.7	53.4	53.8	52.1
India	52.8	55.3	54.6	54.6	46.4	41.2	45.4	56.7	55.2	58.4	58.1

Source: Asian Development Bank, CEIC Data Company (accessed 8 December 2021). *For Malaysia, the series is adjusted by adding 3 points, as historical experience suggests that an index value above 47 is consistent with expansion. Pink to red indicates contraction (<50), and white to green indicates expansion (>50).

Chart 18: Asia's exports have outpaced the global recovery in trade

Real exports by volume



Source: Asian Development Bank, CPB World Trade Monitor (accessed 25 November 2021). Developing Asia excluding the PRC comprises Hong Kong, China; India; Indonesia; the Republic of Korea; Malaysia; Pakistan; the Philippines; Singapore; Taipei, China; Thailand; and Vietnam.

Not all bad news in EM bonds

Emerging markets (EM) local and hard-currency debt suffered in the fourth quarter. The causes, to us, were ongoing risks from the aforementioned Chinese property sector, initial fears over the Omicron variant and, later in the quarter, fears over inflation and a hawkish Fed.

The advent of the Omicron variant has pressured EM. EM growth suffered relative to developed market (DM) growth throughout the COVID crisis due to lower vaccination rates and because they are more resource-constrained than DM economies. Omicron brought fears of continued EM growth underperformance, particularly from countries in which lockdowns are a primary policy response such as Asia.

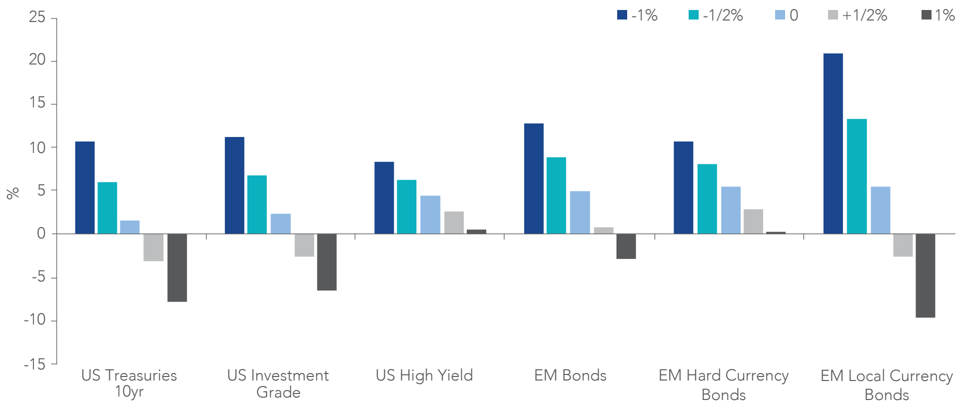
One big un-priced risks, in our view, is that of a more hawkish Fed and rising US interest rates. This does not bode well for EM local currency. During the fourth quarter, the US curve flattened, with two-year rates rising while the 10 year experienced minimal change. We think the risks are that the two-year continues to rise and that even the ten-year could see higher rates. Inflation, in our opinion, is becoming a political issue in the US. It is changing the discussion on fiscal policy making that more restrained while its impact on monetary policy is a more hawkish Fed. Moreover, hawkishness is also reflected in the US dollar, not just rates.

Although US rates it might be adverse for EM local-currency debt, it is not adverse for hard-currency debt compared to other debt asset classes. Chart 19 shows returns over the next year for the major debt categories, across a range of US interest rate outcomes – from 1% lower to 1% higher. What stands out is the EMBIG (Emerging Market Bond Index Global), where the upside downside looks the best among all the major debt categories. It also highlights that treasuries and investment grade bonds are risky. There are two EM local scenarios, because it is not just the math of duration, but an assumption on the currency impact too. Its upside/downside in both scenarios does not look compelling, whereas the upside/downside of US dollar-denominated bonds looks good.

Through all of this, EM policy and access to US dollars has been strong, as has been the case for over a decade now. EM hard-currency debt fundamentals look strong. This is one of the most important improving phenomena in EM – they run consistent current account surpluses under a range of economic conditions. Many have accumulated so many US dollar assets that they are net creditors in US dollars. This is important to note, as EM is not a monolith – there are plenty of things supportive of EM hard-currency debt even in an uncertain environment.

Chart 19: Rate changes are not a reason to avoid EM hard-currency debt

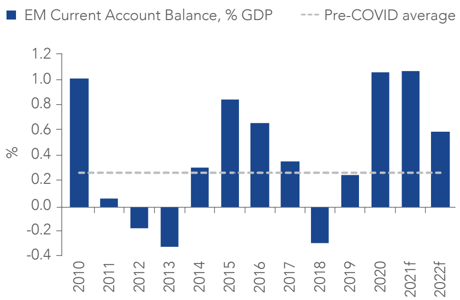
Duration impact: Returns on fixed income from one percent fall to one percent rise in yield curve



Source: Bloomberg. Indices used S&P US Treasury Bond Current 10-Year Index, FTSE US Broad Investment-Grade Bond Index; S&P US High Yield Corporate Bond Index, JPMorgan Emerging Market Bond Index Global Diversified (EMBIG), EM Hard Currency is J.P. Morgan EMBI Global Core Index, EM Local Currency is J.P. Morgan GBI – EM Global Core.

Chart 20 and 21: EM Has challenges, but ability to pay US dollar debt is not one of them

EM Current account balance, % of GDP



EM – Net public creditor status, 2021

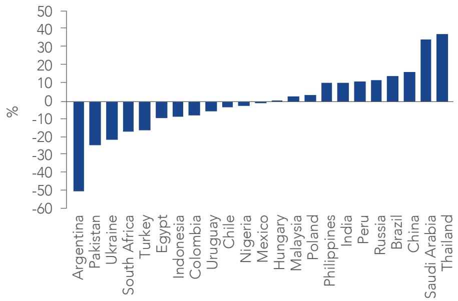


Chart 20 & 21 source: Bloomberg.

Gold: 2022 could be a miners story

Gold's consolidation around the US$1,750-1,800 range is attracting improved physical demand this year from China and India, with net purchases from central banks now approaching pre-pandemic levels. As the price action demonstrated in November, gold should respond to increasing or persistent inflation. We believe the Fed's tools to fight inflation could become a substantial risk to the economy and to the stability of the financial system. In a worst-case scenario, exposure to gold should help weather the storm. In the best case, exposure to gold, especially through the gold mining equities, could prove beneficial.

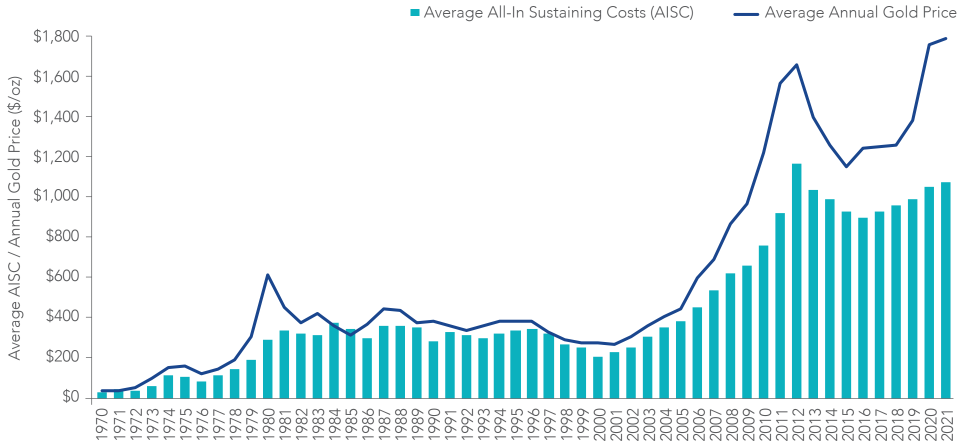
Gold mining equities perform well in a rising gold price environment, because the cash flow generated by gold companies is highly leveraged to the gold price. For example, an estimated 10% or so increase in the gold price translates into about 30% more cash flow for gold producers, which is the reason why equities' price moves can be a multiple of the gold price moves in any given period. This works both ways, when gold is up or down. The gold price is the most important parameter to monitor when investing in gold equities.

Gold has averaged around US$1,800 per ounce this year. At these gold prices, companies are generating a significant amount of free cash flow. This is because costs, the second most important variable to monitor when it comes to gold miners, are under control. Margins are very healthy and companies have excess cash to invest in their operations and give back to shareholders, even if the gold price stays right where it is today. This brings us to another valid point: Gold equities are attractive during periods of high and sustainable margins. The gold price and margins are historically high presently, yet stocks are trading at historically low valuations. Gold miners have been among the worst performers in equity markets in 2021.

In our view, to earn back their old multiples, gold miners need to demonstrate that they can sustain this level of profitability over the long-term by continuing to post good results and delivering consistent value creation. We believe that even in a scenario of sustained gold prices, miners' performance so far justifies a re-rating that brings valuations more in line with historical averages and reflects the significantly improved position of the gold mining sector. However, it may take the resumption of the gold bull market to achieve substantially higher valuation multiples for the gold mining equities.

Chart 22: Cost improvements are adding with higher margins for miners today

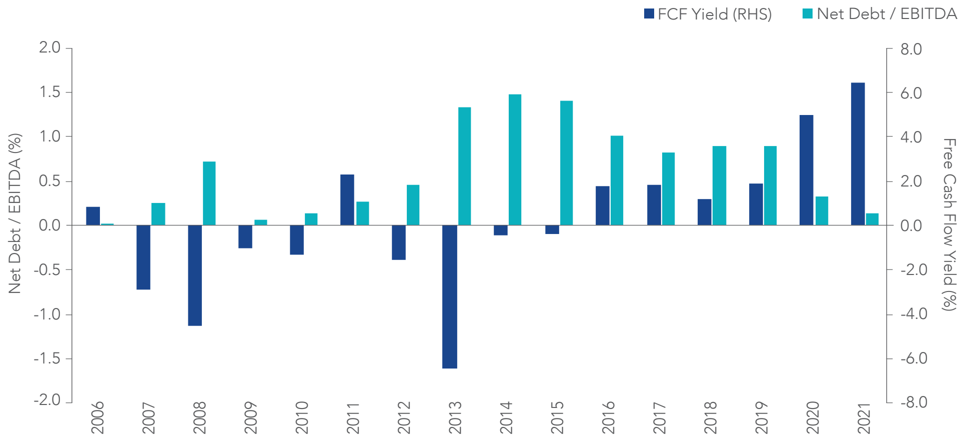
Gold price and all in sustaining costs



Source: Scotiabank. Data as of October 2021. Note: All-In Sustaining Costs generally reflect the full cost of gold production from current operations and typically include adjusted operating costs, sustaining capital expenditures, corporate, general and administrative expenses, and exploration expenses. Past performance is not indicative of future results.

Chart 23: Miners look like value

Gold miners: lower debt and higher free cash flow



Source: VanEck, FactSet. Data as of September 2021. Past performance is not indicative of future results.

The usual RBA follies

Australia is not quite in the same position as the US. Before COVID hit, the US was already growing well and at, or close to, full employment.

Australia, on the other hand, was barely keeping out of recession, struggling along with sub-par growth and facing an under-employed labour market. In turn, the soft labour market was keeping consumption and overall economic growth anaemic. After a few stubborn years, the RBA buckled in 2019 and started cutting rates, well ahead of COVID. To be fair, the RBA got no help from the Government, on the fiscal or wages front.

Coming out of the COVID years, Australia remains well behind the US in the growth cycle. In an attempt to stop markets prematurely following the US, the RBA decided to get brawny on forward guidance.

As well as the, quantitative easing and liquidity measures, the RBA specifically targeted the 3 year bond at 0.1% and said they wouldn't be tightening policy until wages were rising consistent with the 2–3% inflation target. The RBA explicitly stated it did not expect to meet this condition before 2024.

It is easy to make policy commitments, harder to keep them. As buckets of fiscal largesse landed on the economy, accompanied by cheap credit availability and lots of it, the economy surged back. Unfortunately led by surging home prices.

Rising global inflation was added to the mix and markets got skittish. First the RBA's three year bond target was blown away, forcing it to retrospectively abandon its target. With credibility already crippled, the RBA is insisting its wages condition will be met before it moves policy – while progressively walking the likely date forward from 2024… to 2023… to poof! Disappeared! Any wonder markets are sceptical.

The market is following the data. It will be an interesting to see if the RBA can stay the course. On the one hand, real wages will remain weak; on the other, households are sitting on a pile of savings, courtesy of government transfers and the difficulty of spending during lockdown.

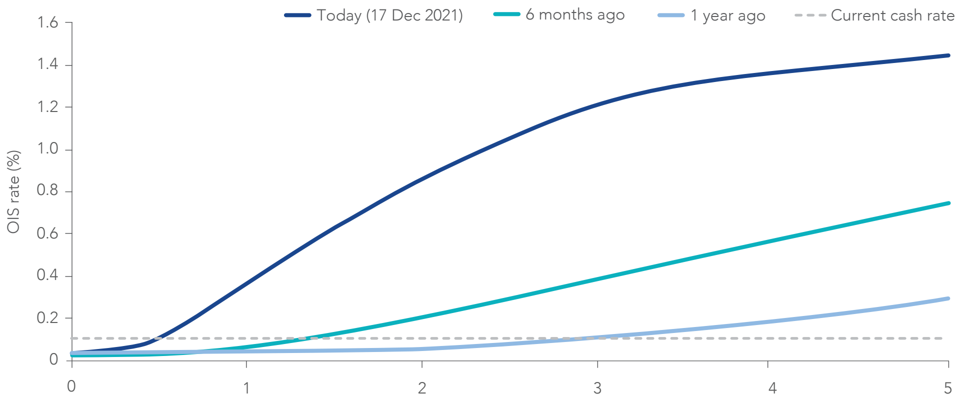
Our guess is that growth, employment and inflation will all surprise on the upside, assuming no vicious rogue COVID variants.

Re-opening borders will bring in workers, placating businesses howling about pay rises. Labour markets should tighten to meet the RBA's criterion next year. The relationship between wages and underemployment still fits well and will not need to move far to fit wages target.

All of which is just as well for the Australian dollar. A significant monetary policy divergence from the US at current relative yields could see it trashed. The fact that it is hanging in suggests markets, sensibly, do not take the RBA's 2024-ish forecasts seriously.

Chart 24: RBA Has Burnt its Credibility

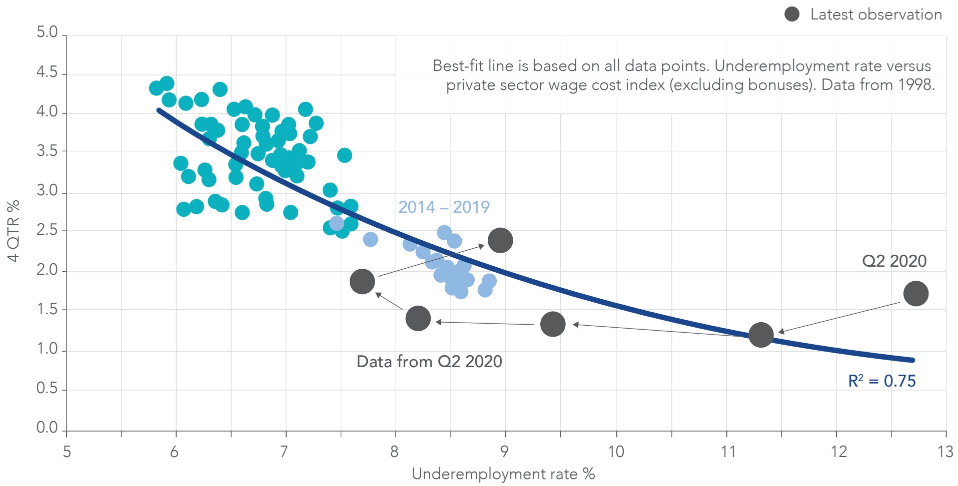
Australian overnight indexed swap curve



Source: Bloomberg.

Chart 25: Even labour market agrees

Wage and labour underemployment



Source: ABS.

VanEck's range of Exchange Traded Funds on ASX

Name	ASX code	Index	Management fees (% p.a.)*
Australian Broad Based			
Australian Equal Weight ETF	MVW	MVIS™ Australia Equal Weight Index	0.35%
Australian Sector			
Australian Banks ETF	MVB	MVIS™ Australia Banks Index	0.28%
Australian Property ETF	MVA	MVIS™ Australia A-REITs Index	0.35%
Australian Resources ETF	MVR	MVIS™ Australia Resources Index	0.35%
Australian Small and Mid Companies			
Small Companies Masters ETF	MVS	MVIS Small-Cap Dividend Payers Index	0.49%
S&P/ASX MidCap ETF	MVE	S&P/ASX MidCap 50 Index	0.45%
Australian Equity Income			
Morningstar Australian Moat Income ETF	DVDY	Morningstar® Australia Dividend Yield Focus Index™	0.35%
Sustainable Investing			
MSCI International Sustainable Equity ETF	ESGI	MSCI World ex Australia ex Fossil Fuel Select SRI and Low Carbon Capped Index	0.55%
MSCI Australian Sustainable Equity ETF	GRNV	MSCI Australia IMI Select SRI Screened Index	0.35%
International			
FTSE China A50 ETF	CETF	FTSE China A50 Index	0.60%
China New Economy ETF	CNEW	MarketGrader China New Economy Index	0.95%
MSCI Multifactor Emerging Markets Equity ETF	EMKT	MSCI Emerging Markets Diversified Multiple-Factor Index (AUD)	0.69%
Morningstar Wide Moat ETF	MOAT	Morningstar® Wide Moat Focus Index™	0.49%
Morningstar International Wide Moat ETF	GOAT	Morningstar® Developed Markets ex Australia Wide Moat Focus Index™	0.55%
MSCI International Quality ETF	QUAL	MSCI World ex Australia Quality Index	0.40%
MSCI International Quality (Hedged) ETF	QHAL	MSCI World ex Australia Quality 100% Hedged to AUD Index	0.43%
MSCI International Value ETF	VLUE	MSCI World ex Australia Enhanced Value Top 250 Select Index	0.40%
MSCI International Small Companies Quality ETF	QSML	MSCI World ex Australia Small Cap Quality 150 Index	0.59%
Global Sector			
FTSE Global Infrastructure (Hedged) ETF	IFRA	FTSE Developed Core Infrastructure 50/50 Hedged into AUD Index	0.52%
FTSE International Property (Hedged) ETF	REIT	FTSE EPRA Nareit Developed ex Australia Rental Index AUD Hedged	0.43%
Gold Miners ETF	GDX	NYSE Arca® Gold Miners Index™	0.53%
Global Healthcare Leaders ETF	HLTH	MarketGrader Developed Markets (ex-Australia) Health Care AUD Index	0.45%
Australian Fixed Income			
Australian Corporate Bond Plus ETF	PLUS	iBoxx AUD Corporates Yield Plus Mid Price Index	0.32%
Australian Floating Rate ETF	FLOT	Bloomberg AusBond Credit FRN 0+Yr Index	0.22%
Thematic			
Video Gaming and Esports ETF	ESPO	MVIS™ Global Video Gaming and eSports Index (AUD)	0.55%
Global Clean Energy ETF	CLNE	S&P Global Clean Energy Select Index	0.65%
Global Income		**Performance Benchmark**	
VanEck Emerging Income Opportunities Active ETF (Managed Fund)	EBND	50% J.P. Morgan Emerging Market Bond Index Global Diversified Hedged AUD and 50% J.P. Morgan Government Bond-Emerging Market Index Global Diversified	0.95%
Capital Securities		**Index/Benchmark**	
VanEck Bentham Global Capital Securities Active ETF (Managed Fund)	GCAP	RBA Cash Rate + 3% per annum	0.59%
Australian Subordinated Debt ETF	SUBD	iBoxx AUD Investment Grade Subordinated Debt Mid Price Index	0.29%
Alternatives			
Global Listed Private Equity ETF	GPEQ	LPX50 Index	0.65%

*Other fees and costs apply. Please see the respective PDS.

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