Lazard Multi-Asset Team

Letter from the Manager

DEC 2021

Changes to the Market Forecast (9 December 2021)

In this letter, we discuss recent developments behind the latest changes to our team's market forecast. Our multi-asset portfolios reflect our assessment of the global economy and the investment landscape 6–12 months into the future.

Current Market Forecast (Probabilities)

Deteriorating conditions	Slow, uneven growth	Sustainable, healthy growth	Overheating conditions
11% No Change	42% Up 2%	39% No Change	8% Down 2%

Bear ← → Base ← → Bull

Our Market Forecast is based on an evaluation of returns and risks across four subject areas: the macro Economy, factors impacting asset Valuation, market Liquidity, and investor Sentiment. Our process assesses the future state of each area and assigns probabilities on a forward-looking 6–12 month basis to potential outcomes ranging from bearish to bullish.

We are again making a mild shift toward less optimism in our 6–12 month forecast, primarily based on two sides of our "pandemic triangle": the behavior of the virus and monetary policy. The new COVID-19 variant Omicron poses a significant risk to key factors underlying business conditions globally (mobility and congregation). While the efficacy of existing vaccines is not yet fully understood, the risk to less vaccinated populations is likely higher. This could pose renewed challenges to critical supply chains, which have been showing some improvement after struggling through the third quarter. Meanwhile, the US Federal Reserve and other central banks are now more alert to inflation risks and are winding down extraordinary accommodation. Recent market volatility suggests investors are less willing to look through these risks.

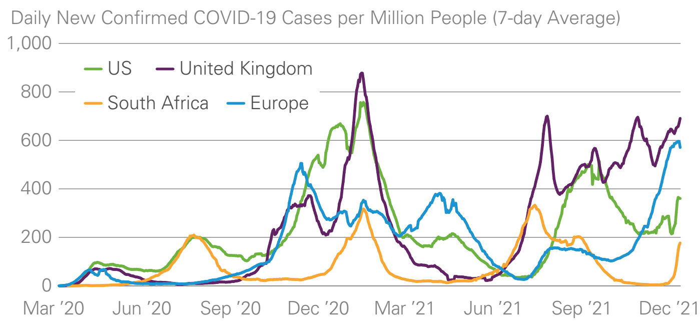
Economy

What stage of the global business cycle are we likely to be in over the next 6–12 months?

Depression/ recession	Below trend	Stable growth	Overheating
7% No change	45% Up 4%	43% Down 4%	5% No change

The pace of business activity in the United States has improved since a third quarter slowdown, but rising material and labor costs are filtering through to consumers in very visible ways. The European recovery is proceeding more slowly than expected, and the recent surge in COVID-19 cases presents a headwind. Chinese policies could soon begin to address the economy's negative trajectory, although steps may be small at first. Japanese auto production has been hurt by supply chain disruptions, which may be easing somewhat. The new prime minister has introduced a large supplemental budget to support growth.

New Cases Were Surging in Europe Even before Omicron



As of 6 December 2021

Source: Our World in Data

Valuation

What is the outlook for business costs, profit margins, and returns over the next 6–12 months?

Poor	Moderate	Positive	Bright
7% No change	36% Up 2%	46% Up 3%	11% Down 5%

Demand recovery continues to be faster than supply recovery. However, oil-consuming countries are pressuring OPEC+ to maintain production increases. Even though emergency government transfers have wound down, many employers cannot hire enough workers and are raising prices to cover increases in unit labor costs. With expected returns on fixed income instruments so low (and yields negative after inflation), risk assets like equities still have the potential to provide adequate real returns on a risk-adjusted basis.

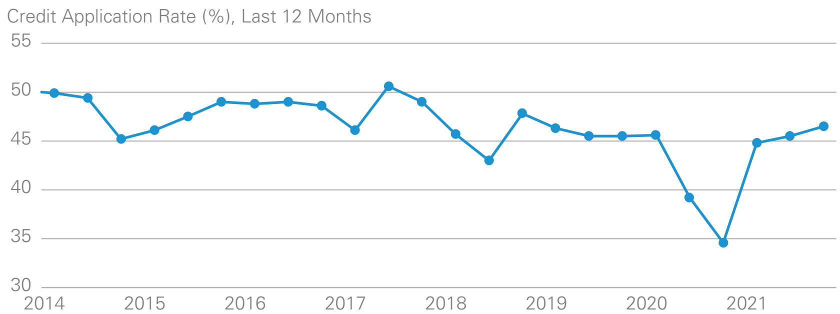
Liquidity

How are credit markets likely to be characterized over the next 6–12 months?

Very weak	Weak	Normal	Very strong
10% No change	37% No change	43% No change	10% No change

The Fed is reducing monetary stimulus and is now likely to do so more quickly than anticipated. A number of other central banks have either already raised interest rates or are contemplating doing so. Lenders are eager to expand loan balances, but we expect them to become incrementally more selective regarding credit risks as economic growth slows toward trend. Although many borrowers used government transfers to reduce debts or are carrying higher-than-normal cash balances, we expect applications for new borrowing to increase over the next several years.

US Consumer Credit Applications Hit 2019 Levels



As of 31 October 2021

Source: Federal Reserve Bank of New York

Sentiment

How supportive will politics and/or public opinion be to capital markets over the next 6–12 months?

Not at all	Somewhat	Very	Too much
19% No change	51% Up 2%	23% Up 2%	7% Down 4%

Increased uncertainty about the nature of fiscal and monetary policy support, as well as renewed concerns about COVID-19 challenges and potential future variants, is likely to limit excessive enthusiasm for risk assets over the near term. While COVID-19's spread was already worsening in Europe and the United States, Omicron's emergence has further exposed the problems of vaccine hesitancy and the need to deliver more doses to many low-income countries. The passage of the US bipartisan infrastructure bill is a policy positive, offset by delays in wrangling over the larger social infrastructure package.

Current 6–12 Month Global Market View

Many recent concerns about economic conditions can be tied to the pandemic. Overconsumption of goods and services at home contributed to tight supply chains, increasing vulnerability to periodic COVID-19 related constraints on production. While reopening has led to a surge in demand for services linked to mobility and congregation, employees in these sectors have not returned as rapidly, possibly due to infection fears, new caregiving responsibilities, and pandemic-induced early retirement. At the heart of many forecasts has been the question: How quickly will things "normalize"?

Omicron has highlighted just how much uncertainty remains. Even before it emerged, however, new waves of infections in Europe and the United States and periodic shutdowns in "zero COVID-19" economies like China demonstrated yet again that the virus and its impacts are likely to be with us for a long time—the sentiment behind Fed Chair Jerome Powell's testimony that monetary policy needs to "adapt." Many of his peers would agree: After more than a year-and-a-half, it is getting harder to preach patience. We feel it is appropriate to take some risk off the table, reduce allocations to assets more sensitive to the future pace of the recovery, and rotate into more insulated regions.

Favor

- Equities of quality companies in insulated regions
- Higher yielding credit
- Growth-insensitive commodities

Avoid

- Developed markets sovereign debt
- Pockets of equity overvaluation
- Emerging markets

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Important Information