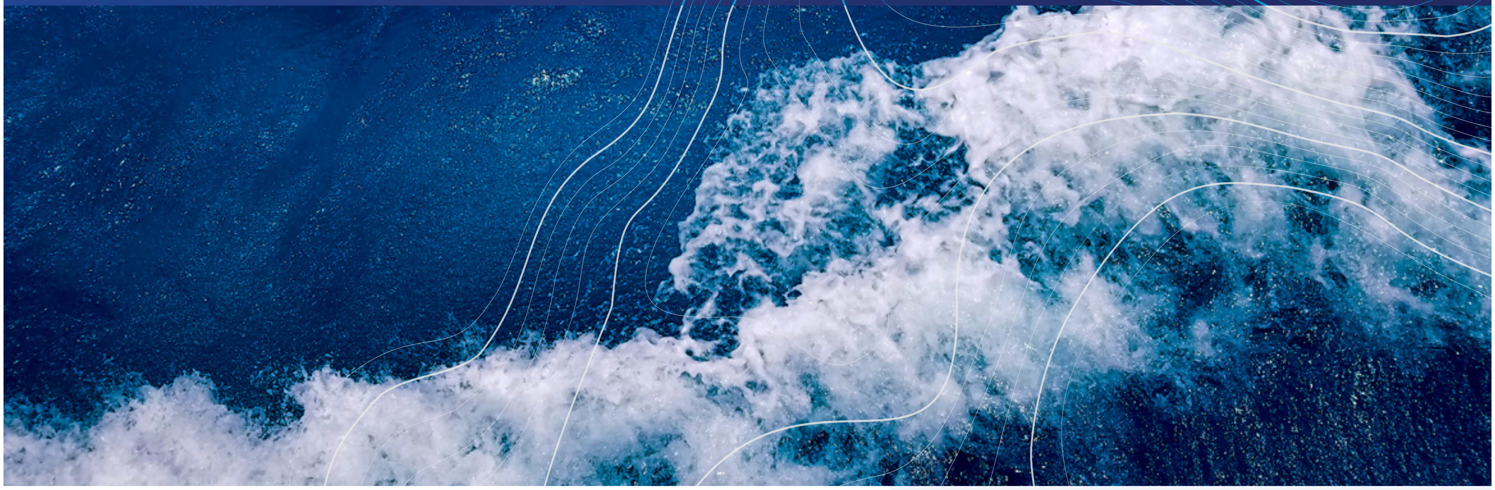

4Q21 Market Overview: Even an End Has a Start

Though robust fourth quarter gains capped off what was another banner year for developed equities, markets grew a bit choppy into year-end as monetary policy normalization loomed.

Strength during the quarter continued to be led by the US; the MSCI World Index gained 7.8% on the back of an 11.0% climb in US stocks (as represented by the S&P 500) while the MSCI EAFE Index's 2.7% gain lagged. Emerging markets had a more difficult time, as persistent weakness in China continued to weigh on the MSCI Emerging Markets Index, which fell 1.3%.[1]

The fourth quarter's success came despite the arrival of new risk factors to cloud the investment horizon. This included the emergence of the Omicron variant of Covid-19, whose November appearance suggested the coronavirus had no intention of receding into the background despite global vaccination campaigns and other measures to halt its spread. Though financial markets reacted negatively to initial reports of the Omicron outbreak, fears eased as early indications suggested that this new variant, while highly transmissible, may be less virulent than the ones that preceded it.

Covid-19 and its mutations remain among the potential wildcards for economic activity going forward, but an increasingly hawkish Federal Reserve suggests that the most pressing concern entering 2022 may be the reaction of markets and consumers to waning fiscal and monetary stimulus.

1. Source: Factset; data as of December 31, 2021.

KEY TAKEAWAYS

- Developed stock markets pressed forward in the fourth quarter despite the emergence of the Omicron variant and a hawkish turn from the Federal Reserve. Elevated equity valuations, especially in the US, suggest little room for error as policymakers seek to tame decades-high inflation without waylaying economic growth.
- One major consequence of the easy-money environment of recent years has been significant concentrations of certain stocks, sectors and markets within indexes—and correspondingly high risks to portfolios benchmarked to them.
- Current distortions in relative performance—between US and non-US stocks and between growth and value names—may represent greater potential to benefit from normalization trends, especially if the underlying drivers of US outperformance begin to fade, as it seems they may.
- First Eagle seeks to invest in companies that combine sound business positions—or, even better, an engine to improve their current positions—with modest market expectations as reflected by valuation multiples, ultimately striving to construct vibrant, all-weather portfolios that position our clients for the long term.

Views expressed are as of January 14, 2022.

Factors Supporting US Dominance May Be Waning

The massive fiscal spending that buoyed economies worldwide through the worst of the pandemic's disruptions is slowly fading from view. In the US, for example, government spending at all levels flipped from tailwind to headwind in second quarter 2021 and is expected to continue to represent a drag on growth in 2022.[2] Meanwhile, a string of elevated inflation prints throughout the year—well above target in most G20 nations and at multi-decade highs in the US—appears to have forced the hands of monetary policymakers.

After months of contending that price pressures were "transitory" in nature and would ease of their own accord, the Fed made a hawkish pivot in the fourth quarter. At its early November meeting, the central bank introduced a plan to taper its asset purchases at a rate that would sunset the program by June 2022; in mid-December, the end date was brought forward to March. A corresponding escalation of concern could be found in the Fed's quarterly rate forecast, as the December dot plot called for three federal funds rate hikes in 2022 after September's report found no consensus for any. To date, the UK has been the only major central bank to hike rates, though a number of emerging markets—including Mexico, Brazil, Chile, Russia and Hungary—have taken action to combat rising consumer prices.

One major consequence of the easy-money environment of recent years has been significant index concentrations in certain stocks, sectors and markets. Despite accounting for less than 20% of global economic activity,[3] the US accounted for nearly 70% of the MSCI World Index at year-end, compared to 66% at end-2020 and 48% at end-2009. The index's top 10 stocks—all of which are based in the US and all except two are tech or tech-adjacent—comprise about 20% of the index.[4] Within the US, the five largest stocks in the S&P 500 Index— Apple, Microsoft, Amazon, Tesla and Google (Alphabet Class A and Class C combined)—command 27% of its market capitalization.[5] Investors in portfolios benchmarked to the MSCI World—through either passive or active vehicles—are exposed, perhaps unwittingly, to significant stock, sector and country risk.

One major consequence of the easy-money environment of recent years has been significant index concentrations in certain stocks, sectors and markets.

The US growth universe's decade-plus dominance has often been a headwind for investors that take a globally diversified, value-oriented approach to building durable, all-weather portfolios—as we do at First Eagle. However, such investors may take comfort in the possibility that the current distortions in relative performance may represent greater potential to benefit from normalization trends. This is especially true if the underlying drivers of US outperformance begin to fade, as it seems they may.

> Since the late 1960s, the price of the S&P 500 Index relative to CPI-adjusted trailing peak earnings has been as high as it is today only one other time—during the late-1990s dot-com bubble.[6]

Fiscal tightening likely will pressure corporate profit margins and earnings, while less accommodating monetary conditions may push interest rates and credit spreads—whose very low levels helped suppress the cost of capital and promoted multiple expansion in equity markets—to more normal levels. Since the late 1960s, the price of the S&P 500 relative to CPI-adjusted trailing peak earnings has been as high as it is today only one other time—during the late-1990s dot-com bubble.[6] High current multiples imply that equity market returns going forward are likely to fall short of the approximately 8% they have averaged over the past century. They also imply that passive exposure to equities may not offer returns that keep pace with annualized money supply growth, even as it slows to the low-to-mid single-digit range in the absence of quantitative easing.

A strong dollar also contributed to the strength of US equities during the quarter and the year. After falling sharply with the Covid-19 outbreak in 2020, the greenback trended higher in 2021, due in part to perceptions that the relative strength of the US economy would enable it to launch a rate-hike cycle sooner than its counterparts.[7] We view the dollar as expensive in real terms relative to most currencies, especially given the very large US current account deficit and uncertainty about how much the Fed can raise rates before the financial market pain becomes too much to bear.

2. Source: Hutchins Center on Fiscal & Monetary Policy, Bureau of Economic Analysis; data as of November 24, 2021.
3. Source: International Monetary Fund; data as of December 31, 2021.
4. Source: FactSet; data as of December 31, 2021.
5. Source: FactSet; data as of December 31, 2021.
6. Source: Standard & Poor's; Robert J. Shiller, Yale University; First Eagle Investments; data as of December 31, 2021.
7. Source: FactSet; data as of December 31, 2021.

Dear Prudence

We cannot help but notice that prudence—a key characteristic across First Eagle's product lineup—has not been rewarded of late. Our commitment to diversification, ballast like cash and gold in certain portfolios, and defensive equity positioning served as a headwind to relative performance in a period that incentivized riskier behavior. Overweighting a narrow cohort of US names may have paid off in 2021, but such positions prevent portfolios from realizing the long-term risk-return benefits diversification—whether by region, by sector or by industry—historically has provided.

Further, it appears likely to us that many of the forces that have propelled the US markets may lose their positive influence—if not become outright headwinds—as we move forward. If the cost of capital moves up, multiples could go down. If profit margins tighten, earnings comparisons may suffer. And if money supply growth moderates, the effects of nominal rebasing may fade away, potentially causing liquidity challenges in markets.

Despite markets being expensive overall, we believe there are pockets of value to be uncovered. The price of the MSCI EAFE Index relative to the S&P 500 Index, for example, currently is less than half the 50-year average. Similar historical extremes also can be seen in the differential between growth and value stocks.[8] That said, we'd caution against blindly going all-in on statistically cheap stocks in anticipation of a rebound. There are many fundamentally challenged companies in the value universe whose low valuations are deserved; likewise, there are many fine companies within the growth universe that are reasonably priced even at current levels given the persistence of their cash flows.

> We cannot help but notice that prudence—a key characteristic across First Eagle's product lineup—has not been rewarded of late.

Instead, we seek companies that combine sound business positions—or, even better, an engine to improve their current positions—with modest market expectations as reflected by valuation multiples. Agnostic to benchmarks, our approach to portfolio construction centers on estimating the intrinsic value of a business based on the particular tangible and intangible attributes that can be expected to drive its cash flows over time. Not only does this make the idea of value a much broader tent, we believe the resulting vibrant, all-weather portfolios best position our clients for the long term.

8. Source: FactSet; data as of December 31, 2021.

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Diversification does not guarantee investment returns and does not eliminate the risk of loss.

"Intrinsic value'' is based on our judgment of what a prudent and rational business buyer would pay in cash for all of the company in normal markets.

Risk Disclosures

All investments involve the risk of loss of principal.

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A principal risk of investing in value stocks is that the price of the security may not approach its anticipated value or may decline in value. "Value" investments, as a category, or entire industries or sectors associated with such investments, may lose favor with investors as compared to those that are more "growth" oriented.

One cannot invest directly in an index. Indices do not incur management fees or other operating expenses.

MSCI World Index is a widely followed, unmanaged group of stocks from 23 developed markets and is not available for purchase. The index provides total returns in US dollars with net dividends reinvested.

MSCI EAFE Index is an unmanaged total return index, reported in US dollars, based on share prices and reinvested net dividends of approximately 1,100 companies from 22 countries and is not available for purchase.

S&P 500 Index is a widely recognized unmanaged index including a representative sample of 500 leading companies in leading sectors of the US economy and is not available for purchase. Although the S&P 500 Index focuses on the large-cap segment of the market, with approximately 80% coverage of US equities it is also considered a proxy for the total market.

MSCI Emerging Markets Index is a free float-adjusted market capitalization index designed to measure equity market performance of 23 emerging markets.

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