



Epoch Investment Partners, Inc.

“We understand better how little we understand about inflation”
— Jerome Powell, June 2022

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Capital Markets Macro Factors - Positioning for a Recovery

Services inflation: More pervasive, persistent and pernicious

- Watchlist: Job openings, 4th quartile wages & rents

Short & shallow recession: One risk is hidden leverage & excesses

- Something usually breaks when Fed hikes 300 bps (2007: housing finance, 2001: TMT)
 - Often a less regulated area of the market: But crypto is too small & insular
- 2nd risk: Wage-price spiral in services, forces Powell to channel his inner Volcker

Positioning for a recovery: Trough when market confident inflation is heading back to target

- Equity valuations appear fair: But bottom-up 2023 earnings estimates are delusional
- Gains are front-loaded: Best sectors typically INFT, COND, FINL vs UTIL, ENRS, CONS

Global markets

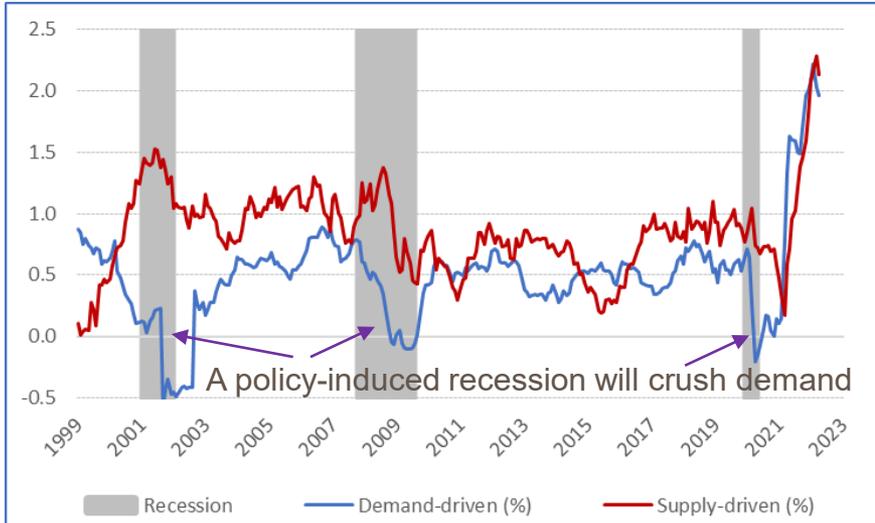
- Europe's three challenges: Inflation, Italy, Russian NG
- China: Only major market where both monetary & fiscal policy are stimulative
- USD overshoot: Expect lower USD/JPY over next 3-6 months

Next decade won't be a repeat of the 2010s

- Reflation and the 3Ds: Deglobalization, demographics, decarbonization
 - Relative to last two decades: Higher trend inflation, wage growth & labor share
- Monetary & fiscal policy: Less room for stimulus (MMT into the dustbin)
- Lower top-line growth: Implied by each of the 3Ds
- Headwind for long-duration assets: Including speculative tech, biotech, VC & real estate

Supply-driven Inflation: Macro Perspective

Core CPI (yoy, %): Decomposition



Source: SF Fed, NBER

“While supply disruptions are widely expected to ease this year, this outcome is highly uncertain”
— SF Fed

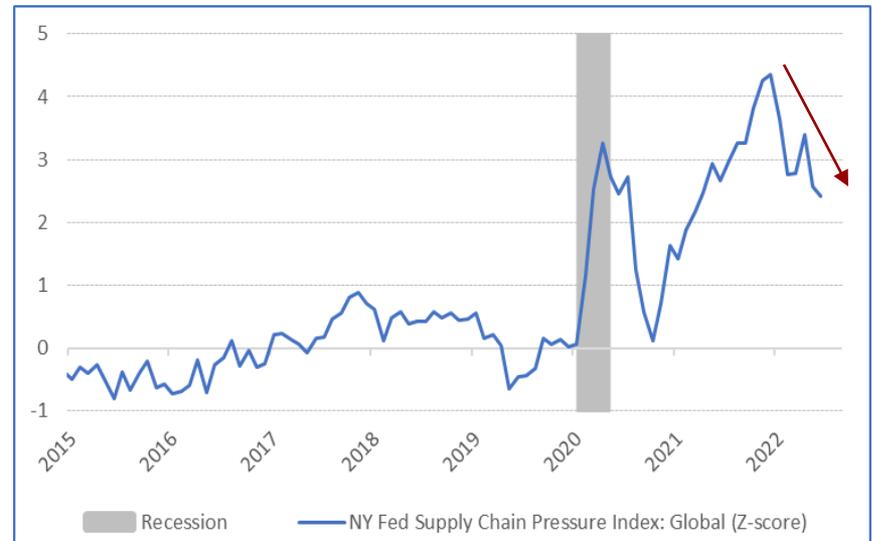
The Fed can't print chips

- But it can crush demand

NY Fed: Global Supply Chain Index

- (1) International transportation costs
- (2) PMI data
 - Backlogs, inventories, delivery times
 - US, EU, China, Japan, ...

Supply Chain Pressure: Halfway back to normal



Source: NY Fed, NBER, Bloomberg

Energy: Impact on Inflation to Drop Out in 1Q 2023

Brent futures: To remain high through 2024



Energy prices: Won't keep doubling

- Core PCE weight: 5% (vs 9% in 1980)

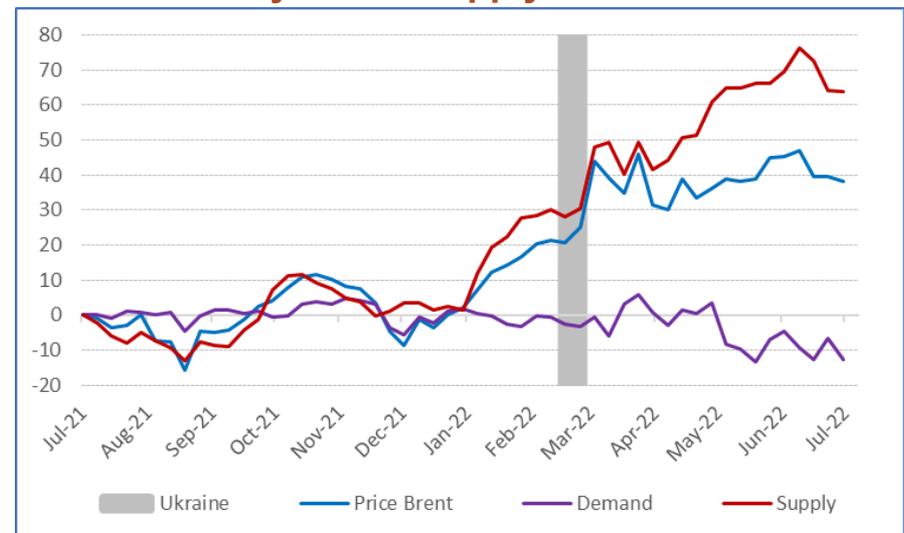
Source: NBER, Bloomberg

Commodities overall

- Unlikely to be major factor from early-2023
- Energy: The only significant risk
 - But requires a lot to go wrong
- Food: Prices have rolled over
 - Will drop out of yoy CPI prints
 - Weight in core PCE: Only 7%
 - Was 19% in 1960

Oil price dynamics:

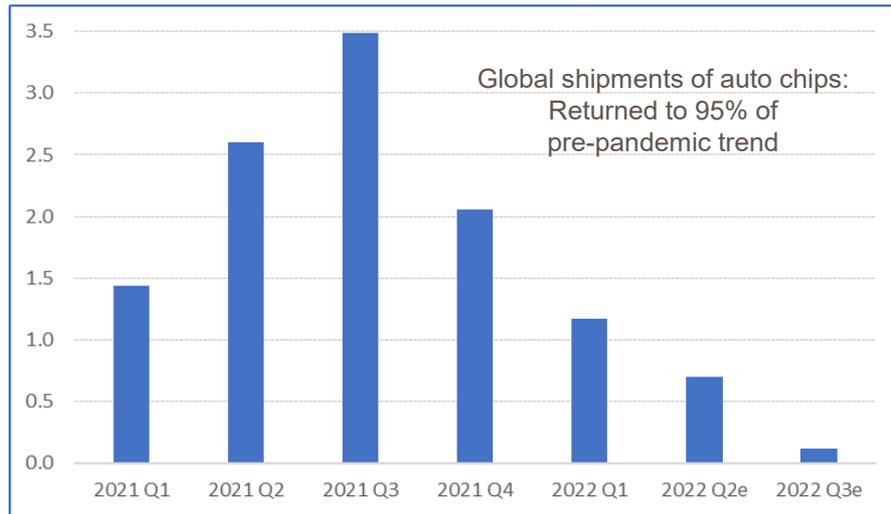
Entirely due to supply-side factors



Source: NY Fed, Bloomberg

Semiconductors: Constraint on Autos is Largely Over

Global auto production (mn) lost due to semi supply issues



Source: Bloomberg

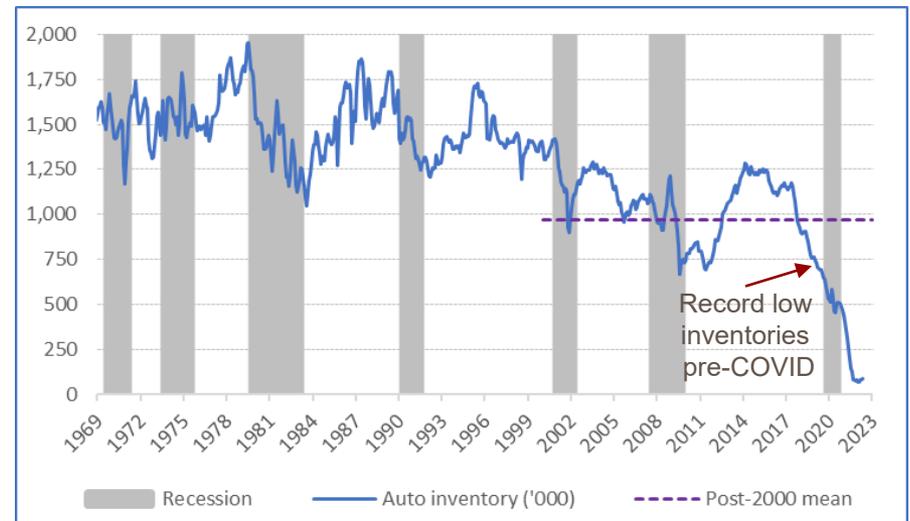
Semi prices: Peaked in 3Q 2021

- Soon to drop out of yoy CPI prints

Auto prices

- Already dropping out of inflation prints
 - 5% weight in PCE
- Plummeting demand vs low inventories

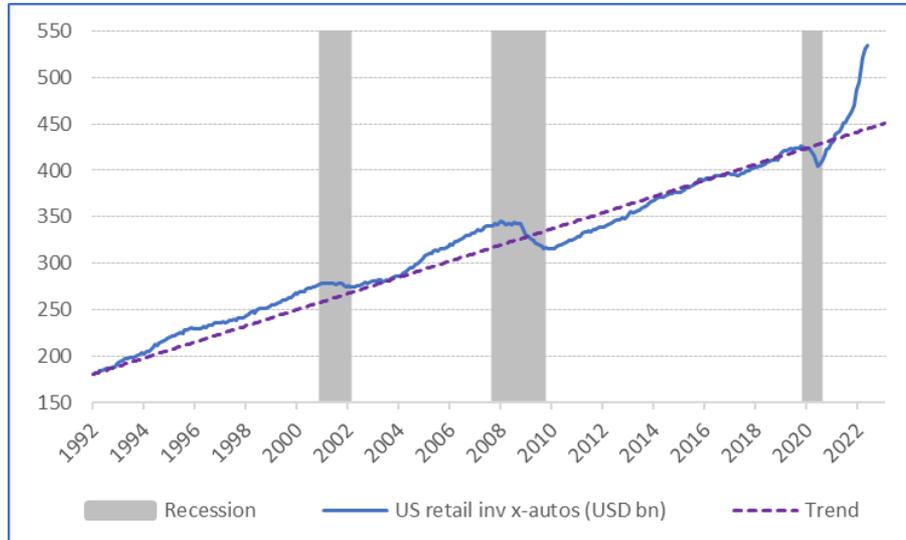
Record low inventories: Even pre-COVID



Source: NBER, Bloomberg

Inventory Bullwhip: Surplus Everything (ex-autos)

Retail inventories: Q2 earnings theme?

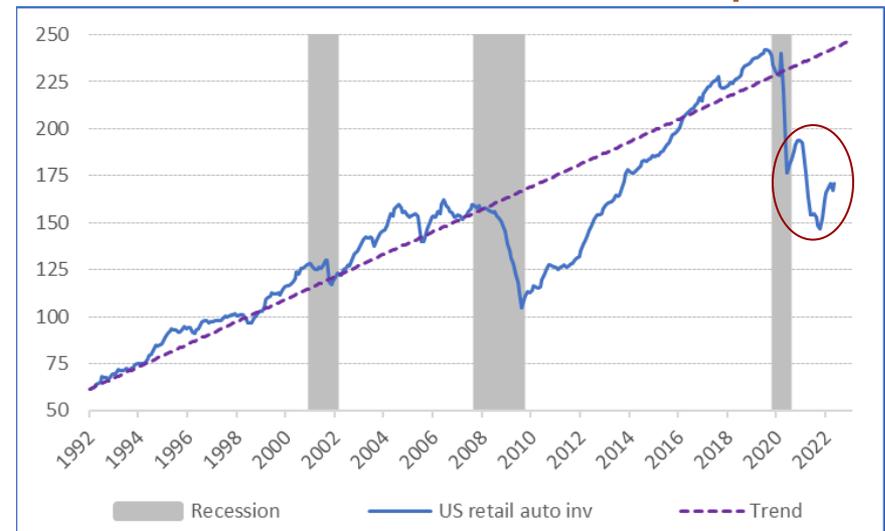


Source: NBER, Bloomberg

Management ordering via rearview mirror

- When goods arrive, demand may have disappeared
- Atlanta Fed: Forecasts inventories to subtract 2.5 pts from Q2 GDP

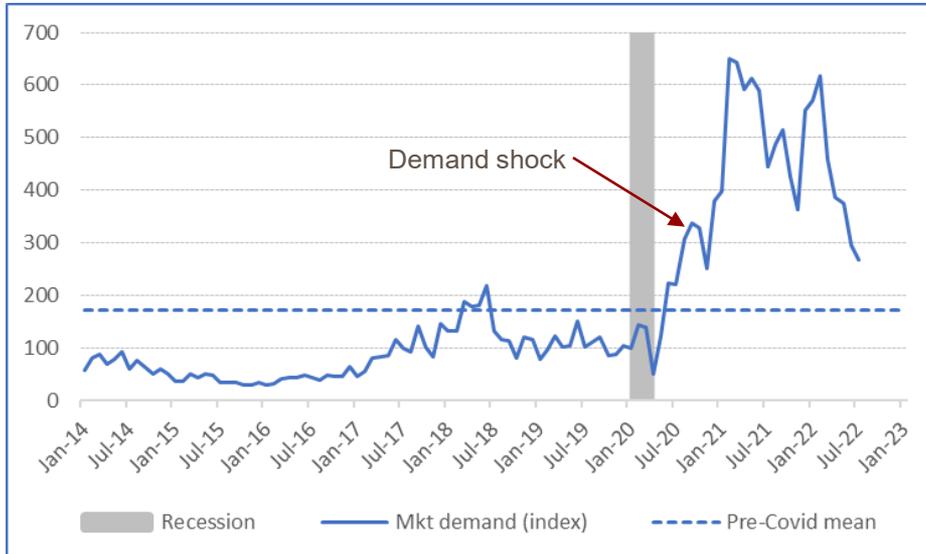
Autos will take a while to catch up



Source: NBER, Bloomberg

Labor Market: Tightest Since WWII

US trucking demand: 80% back to trend



Job openings: 11.2 mn

- Healthcare: 1.9 mn
- Leisure & hospitality: 1.6 mn
- Retail: 1.1 mn
- Education: 0.6 mn

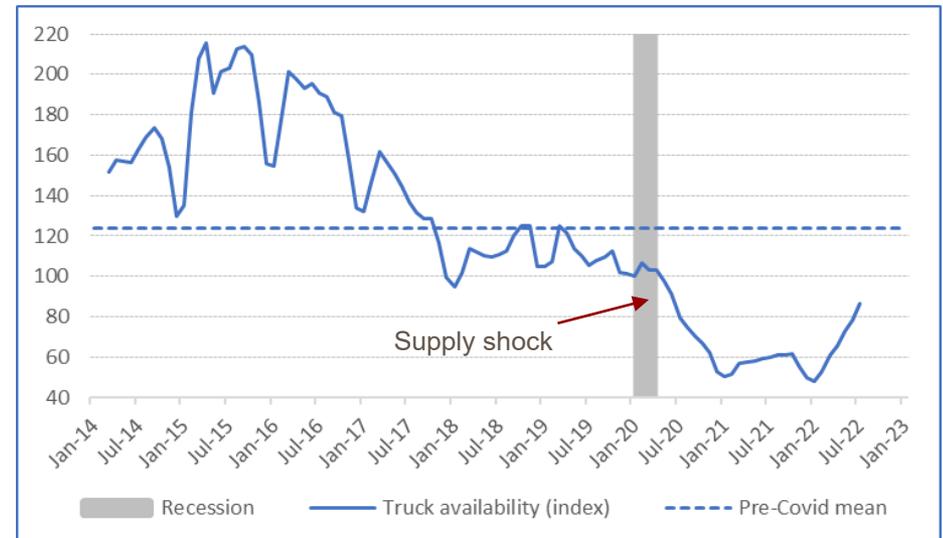
Available workers: 5.9 mn

Truckers disappeared: Just as demand soared

Source: NBER, Bloomberg

Lowest wage quartile

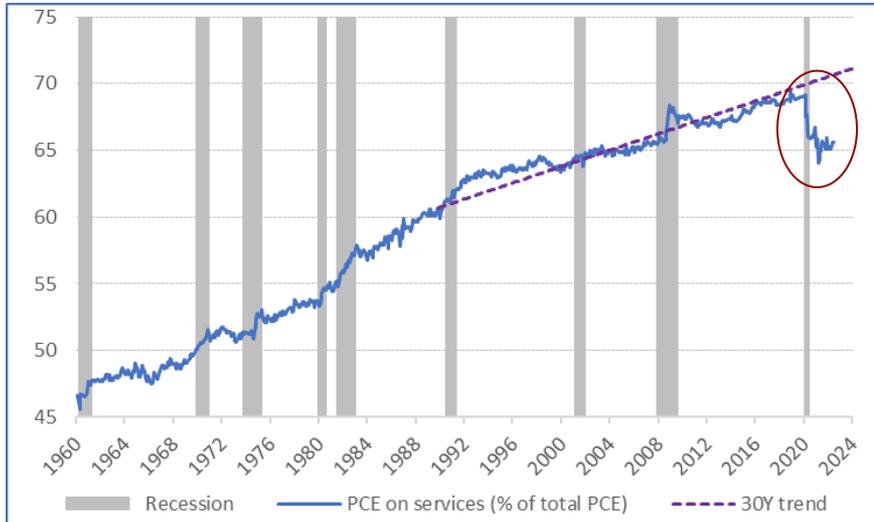
- Wages are up 7.0% yoy and rising
 - Highest wage quartile: 3.7% yoy



Source: NBER, Bloomberg

The Services Economy: 70% of PCE and Rising

Services as a % of Consumption



Source: NBER, Bloomberg

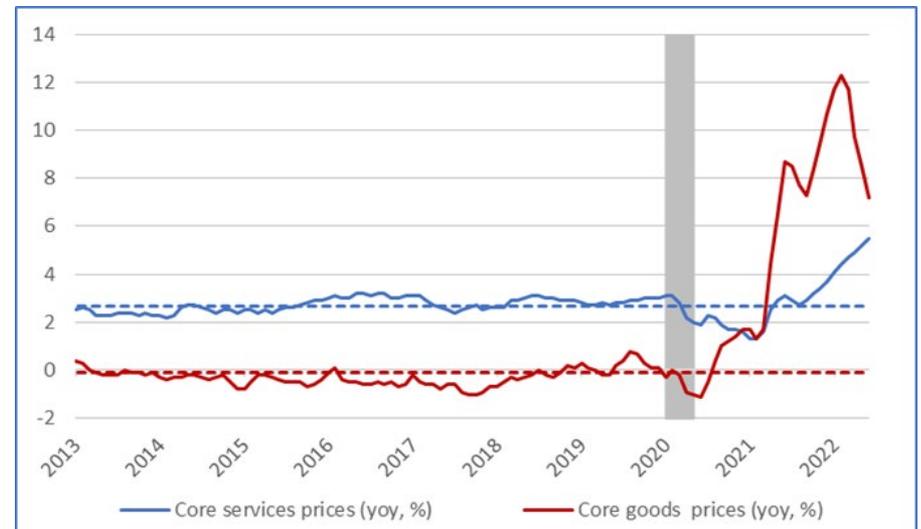
Our mental model is outdated

- We think too much about mfg goods
 - Stuff you can drop on your toe

Goods inflation

- Already halfway back to target

Services inflation: The bigger challenge



Source: Bloomberg

Services Inflation: Up 10 straight months

- More pervasive: 70% of consumption
- More persistent: Stickier, greater inertia
- More pernicious: Wage-price spiral

Watchlist

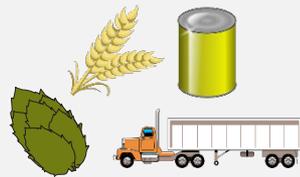
- Job openings
- Lowest quartile wages
- Rents

Same Profit, Lower Margins



Revenue
\$2/can

-



Costs
\$1/can

= GROSS MARGIN OF 50%



Revenue
\$2/can

FULL INCREASE IN COST PASSED TO CONSUMER



Revenue
\$3/can

-



Costs
\$2/can

= GROSS MARGIN OF 33%



Revenue
\$3/can

Ocean Freight Rates Remain Elevated

SHANGHAI SHIPPING EXCHANGE CHINA (EXPORT) CONTAINERIZED FREIGHT INDEX



Source: Bloomberg

Epoch Thought Leadership

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May. 25, 2022

Cryptocurrency: After the Fall

Apr 26, 2022

Analyzing the "S" in ESG



Reflation and the 3 Ds

Until recently, we had been living in a disinflationary environment that started in the 1980s. We believe three factors – Deglobalization, Demographics and Decarbonization – have led us to a secular reflationary environment. As a result, the next decade is going to look quite different than the 2010s, with critical implications for investors.



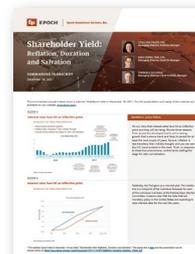
Greenflation: The Energy Transition Will Prove Inflationary

The transition to net-zero emissions (NZE) involves a fundamental change in the structure of the economy and will likely be messy. Further, inflation and nominal interest rates will probably be higher and more volatile. This has not yet been priced into markets.



China's "Common Prosperity": What Does it Mean for Investors?

China has launched a new policy framework, "Common Prosperity," which escalates government steering of the economy and features two critical initiatives: First, Beijing is taking action to tame the country's real estate obsession. Second, it has targeted a wide range of tech-related sectors. We examine the implications for investors.



Webcast - Shareholder Yield: Reflation, Duration and Salvation

Our portfolio managers discussed the uneven risks in equity portfolios based on sensitivity to rising interest rates and how stocks that provide dividends and other forms of shareholder yield can help mitigate those risks.



The Pandemic Accelerant Part II: Turbo-Charging the Digital Economy

The recent surge in start-ups and unicorns reflects the broadening of the digital revolution across industries. Although the digitization of the economy is still in early earnings, we expect digital platforms to represent the majority of market cap by 2025, with tech, health care and communications the most promising sectors.