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SPECIAL UPDATE: WRITTEN 3/7/2022

Ukraine, Seeds of Change, and the Law of Unintended Consequences

Seemingly unimaginable events have unfolded in Ukraine. We are overwhelmed by the scale of unnecessary human suffering and tragedy, and we feel it necessary to point out that misguided energy policy may have helped set the stage.

Our most recent Advisor newsletter featured a guest perspective which addressed the energy crisis in Europe (*The ZCM Advisor, Page 7 included with this letter*). Current events compel us to offer this special update.

Germany's dependency on Russia as a source of natural gas may have contributed to Putin's calculus before invading Ukraine. Three policy decisions by the government of Germany may have created this unusual and regrettable circumstance.

1. Beginning in 2005, then-Chancellor Gerhard Schroder supported Gazprom's proposed Nord Stream 1 pipeline, which offered the Russian government an alternative to transporting gas through the pipeline network that runs through Ukraine. This eliminated a form of economic alignment between Germany and Ukraine, and also eliminated an incentive for Germany to protect Ukraine's sovereignty;
2. In 2000, Schroder's government launched the Energeiwende, a policy that encouraged rapid growth of renewable sources of energy by offering subsidies that eventually increased its share of energy production to 25% of Germany's total; and
3. Angela Merkel's administration committed to eliminating nuclear generation from Germany's energy mix by 2022, which increased the country's reliance on Russian natural gas. It also committed to eliminating coal-fueled generation by 2030.

Over time, the combination of these policies made the German economy dependent on Russian natural gas and significantly reduced the country's incentive to align itself with the Ukrainian government during Russia's threat to its sovereignty. And now, Germany is considering a fourth energy policy decision to unwind the tragic impacts of these three previous policies and extend

the operation of its nuclear plants and, ironically, its coal plants so that the country can reduce its reliance on Russian gas.

In our view, Germany's energy policy was driven in part by an aspiration to lead on climate change, and in part by political necessity. In short, the policy plan was thin, not thick, and lacks economic, political, and environmental sustainability. As current events evidence, the need for Thickness, which considers the long-term implication of climate related actions, is rather apparent.

In collaboration with the University of Wisconsin Nelson Institute for Environmental Studies, a group of students are assisting us in identifying thick electric utilities in the US. ZCM Sustainability strategies will further evaluate investment in these utilities to help accelerate our country's energy transition to low/zero carbon. We'll report back later this year when the results are in.

In closing, thank you for your kind attention. Please reach out with additional thoughts on this matter.

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4Q 2021

The Advisor

EXECUTIVE SUMMARY

- Real gross domestic product (RGDP) is estimated to have reaccelerated to an annual rate between 5.5% and 7.5% in the fourth quarter of 2021, supported by impressive holiday spending, after growing at only 2.3% in the third quarter.
- COVID-19 variants are making economic forecasting increasingly difficult, but recent variants appear to be less harmful and government authorities are more cautious about imposing strict measures and mandating closedowns.
- Inflation has surged as pent-up demand translated into a stronger economic reopening, while supply bottlenecks and labor shortages have created pricing pressures.
- A record number of job openings underscores a shortage and/or mismatch of labor, especially in service industries.
- A $1.2 Trillion infrastructure package was passed, but the Congress failed to pass the Build Back Better program and will likely push for a smaller, more widely agreeable version in 2022.
- The Fed abandoned its “transitory” view on inflation and has scheduled cessation of its bond purchases by March. Interest rate hikes are expected over the balance of the year.
- Equities currently trade at relatively high historical valuations with prices supported by growing earnings without significant multiple expansion. We remain cautiously optimistic on the outlook for equities in early 2022 but are concerned over slowing earnings growth and the prospects of rising interest rates.

ECONOMIC REVIEW

Published:
January 13, 2022

Economic growth strengthened in the fourth quarter, despite the spread of the Delta and Omicron variants of COVID-19.The Omicron variant pushed cases to the highest levels in nearly a year as it spread rapidly, but symptoms appear to be less severe than previous strains.

Congress and the Biden administration were able to stave off default on its debt and pass a $1.2 trillion infrastructure package, but the closely-balanced, highly-divided Congress could not move the administration’s Build Back Better bill forward. The child tax credit of up to $300 per child expired at the end of December with more than 30 million households receiving their last payment as the last of the COVID-19 economic impact payments expired.

Consumer confidence benefitted from rising incomes and a strong jobs market. Resignations have reached historic rates as workers are taking higher compensated jobs elsewhere and are assessing their options in a post-pandemic economy.

Optimism is somewhat tempered by the uncertainty around increasing cases of COVID-19 and rising concerns over inflation. Brisk demand for goods, supply chain disruptions, temporary shortages and a rebound in travel have pushed 12-month inflation rates to the highest readings in decades with inflation rates often exceeding wage gains.

The FOMC met in early November and announced it would begin scaling back its $120 billion of monthly bond purchases and set a June target for cessation of the program. In mid-December, elevated inflationary pressures and a rapidly strengthening labor market, prompted the Fed to accelerate its cessation rate and now has an expected March 2022 completion date. Many foreign Central Banks also began to reduce bond purchases and/or raise interest rates to combat rising inflation, despite the ongoing threat from new COVID-19 variants.

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MACRO SUMMARY

GDP

- Real GDP increased at an annual rate of 2.3% annual rate in the third quarter of 2021 and second quarter Real GDP increased 6.7%.
- The deceleration in third quarter RGDP was driven by a slowdown in consumer spending, as goods purchased went down and growth in services spending decelerated.
- Real GDP for the fourth quarter of 2021 is forecast to have grown at a rate of between 5.5% - 7.5%, supported by strong holiday spending.

Employment

- In December, the economy added 199K jobs, below the consensus estimate of 450K, while the prior two months were revised up by 141K.
- The unemployment rate fell from 4.2% to 3.9%. In February 2020, before the pandemic, the unemployment rate was 3.5%.
- The economy continues to add jobs, but the December report was probably less robust than policymakers would like. The rising Omicron variant case count could put the positive momentum in job creation on hold for the first part of 2022.

Housing

- The median existing home price was $353,900 in November, up 13.9% over the previous year and fueled by a low 2.1 months of inventory.
- Sales of previously owned homes in November rose 1.9% from October to 6.46 million units, according to the National Association of Realtors. Sales likely increased due to the strengthening job market and concerns over higher mortgage rates in 2022. Median national rental rates soared over the first half of the past year before cooling down by year end; nevertheless, median rents increased 17.8% over 2021.

Consumer

- The Conference Board reports its Consumer Confidence Index increased in December and was revised upward in November. The Index now stands at 115.8 (1985=100), up from November's revised 111.9.
- The survey reflected consumers' plans to increase purchases of homes, autos, appliances, and vacations over the coming six months.
- Concerns about inflation began to abate in December after hitting a 13-year high in November.

Business

- December's ISM Manufacturing Index of 58.7 was the 19th consecutive month of growth, but missed the consensus estimate of 60.3 and was down from November's 61.1 reading.
- Demand expanded with new orders growing, customer inventories remaining at low levels, and persistently high order backlogs. Supplier deliveries, inventories, and imports continue to constrain production, with heightened supply chain disruptions deliveries deferred into 2022.
- The ISM Services Index fell 7.1 points in December to 62.0 far below the 66.7 consensus estimate. The Prices component reached its third-highest reading ever as respondents cited continued supply chain and labor challenges.

The Fed

- The Fed indicated in early November that it would begin winding down its bond buying program with a target to end it completely in June.
- At its mid-December meeting, the Fed decided to double the rate of reduction in its bond purchases to effectively end the program in March and set the stage for increasing interest rates.
- The median projection for the appropriate level of the federal funds rate is 0.9% at the end of 2022, which is about 0.50% higher than projected in September.

Inflation

- Inflation increased to a 39-year high of 6.8% on an annualized basis in December up from the 2% level prevailing before the pandemic.
- The Producer Price index rose 9.6% over the November reading. This is the largest advance since the measure was first introduced in November 2010.
- The Personal Consumption Expenditure (PCE) index increased 5.7% since last November, while the core measure increased at a 4.7% annual rate.

Commodities

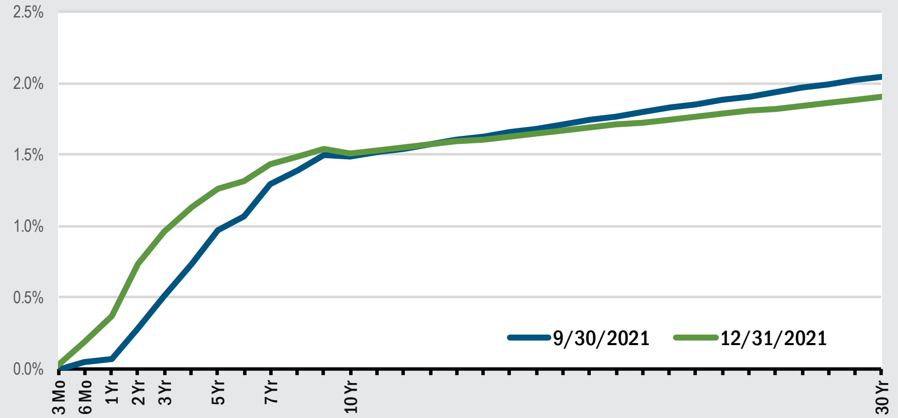
- The U.S. dollar index rose 1.5% during the fourth quarter and should remain strong from support of the continued strengthening of the U.S. economy and move to higher interest rates relative to other countries.
- West Texas Intermediate oil prices rose sharply in October on expectations of a global reopening but pulled backed as the Omicron variant clouded the economic outlook and produced only a 0.2% gain in the fourth quarter.

MACRO SUMMARY

Yield Curve

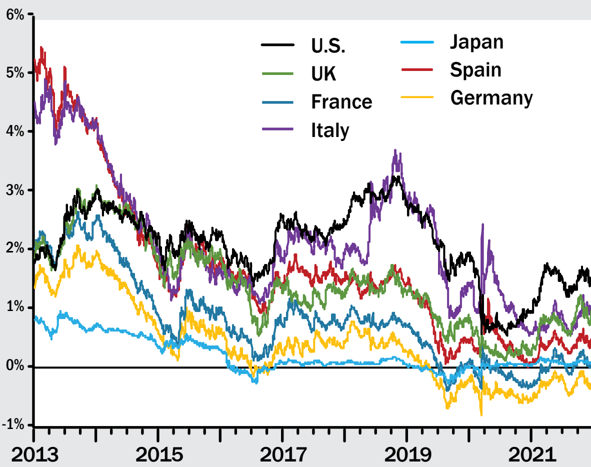
As of 12/31/2021, Source: Bloomberg

	9/30/2021	12/31/2021
3 Month	0.03%	0.03%
6 Month	0.05%	0.19%
1 Year	0.07%	0.38%
2 Year	0.28%	0.73%
3 Year	0.51%	0.96%
5 Year	0.97%	1.26%
7 Year	1.29%	1.44%
10 Year	1.49%	1.51%
30 Year	2.05%	1.90%



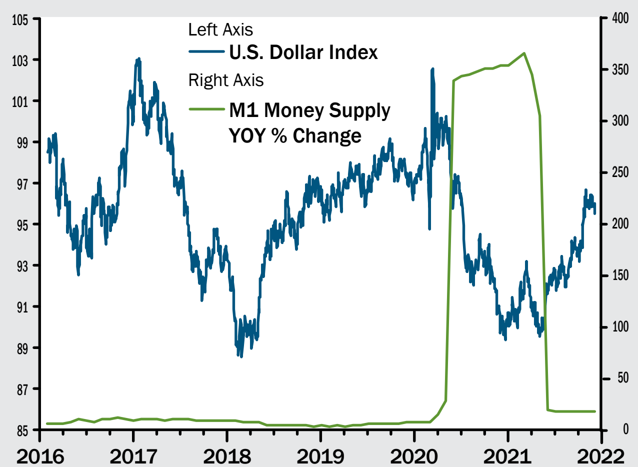
10-Year Sovereign Yields

As of 12/31/2021, Source: Bloomberg



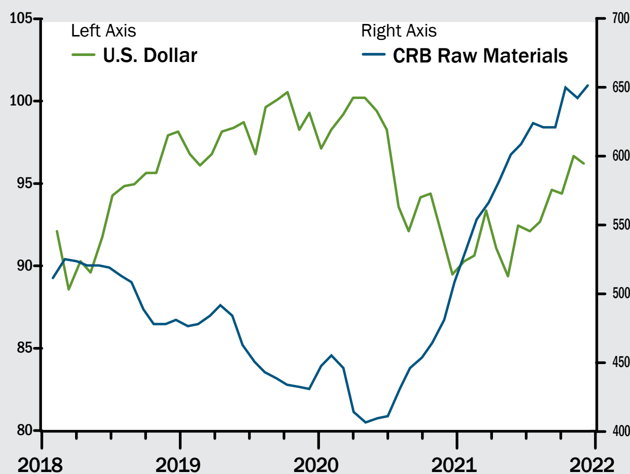
Money Supply vs U.S. Dollar

As of 12/31/2021, Source: Bloomberg



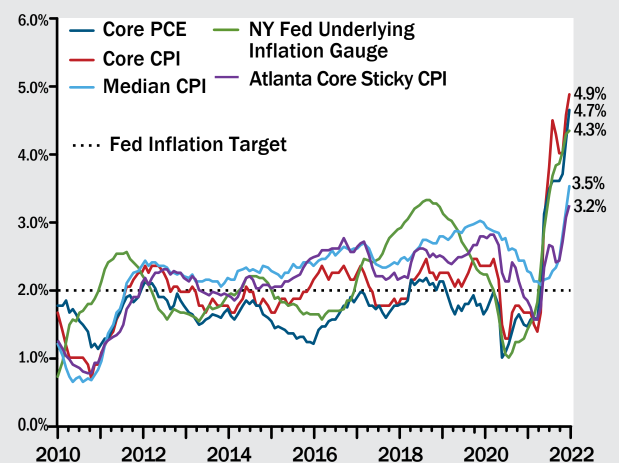
U.S. Dollar vs Raw Materials

As of 12/31/2021, Source: Bloomberg



Inflation Data (YOY percent change)

As of 12/31/2021, Source: Bloomberg



ECONOMIC OUTLOOK

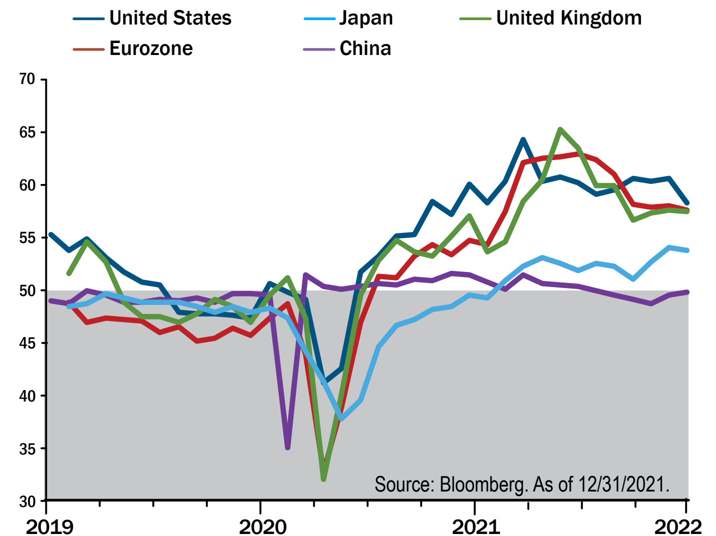
A winter surge in COVID-19 cases driven by the Omicron variant is prompting economists to downgrade U.S. and global growth expectations in the early part of 2022 as businesses struggle with absenteeism and consumers stay home to avoid getting sick. However, government authorities have been more cautious about taking strict measures and mandating the closedowns that led to economic hardship during the initial onset of the virus. COVID-19 stimulus relief programs have expired with no plans for additional relief in 2022. Congress is expected to work toward scaled down social spending and climate packages that it can pass before the November midterm elections.

High levels of job creation were a cornerstone of 2021's robust economic growth and can provide a strong underpinning for continued elevated demand by consumers in 2022. This is despite headwinds from a potentially prolonged pandemic, elevated inflation and supply shortages. However, the pace of labor market gains could potentially slow due to the uncertainty posed by the virus, especially in restaurants, hotels and other venues where people gather.

Business surveys cite strong ongoing demand, with some respondents noting a peak in supply chain disruptions and pricing pressures, while lead times improve and inventories grow. Economic growth rates are expected to taper off in 2022 as monetary policies begin to tighten without continued fiscal stimulus.

The Federal Reserve's recent monetary policy pivot showed a much greater concern for the potential of inflation to staying high and set the stage for a series of interest rate increases beginning in the spring. Many global central banks are expected to continue to pivot away from historically easy monetary policies as inflationary pressures mount and economies reopen.

Global Purchasing Managers' Index (PMI)



FIXED INCOME COMMENTARY

MARKET REVIEW

The fourth quarter opened with persistent inflation concerns and policymakers beginning to look to reduce economic stimulus. In November, the Fed announced they would start to taper the pace of asset purchases only to double the pace a few weeks later as CPI spiked, with the Fed's median Summary of Economic Projections signaling three rate hikes in 2022.

The Fed became more hawkish on inflation and Fed Chairman Jerome Powell pivoted to a more aggressive posture as a significant cloud came from the Omicron COVID-19. The markets ricocheted between Fed tightening and the pandemic as inflation alarms were sounding. Risky assets were able to ride over the whipsaws until the final days of November when the S&P 500 fell 4% and investment grade corporate spreads gapped 6bps in an already weak month.

December started under the gloom of the Omicron variant and its rapid transmission rate. The markets were determined to look past another pandemic wave with the 10-year U.S. Treasury rate moving to the high end of the four-week range, while investment grade credit recovered the spread widening of late November.

During the quarter, the yield on the 10-year U.S. Treasury rose only 2bps to 1.51%, 10-year inflation breakeven rates rose a dramatic 21bps to 2.59% and the 10-year TIPS rate dropped 24bps to -1.10%. The shift in 10-year breakeven rates reflecting the concerns about that inflation, while the drop in 10-year real rates seem indicate doubt that it would be smooth sailing for global growth.

The fourth quarter was defined by a bear flattener as the inflation scare left its imprint. Fed Funds Futures at the beginning of the quarter were showing little prospect of Fed tightening in 2022, only to price close to 75bps by the December 2022 meeting. The 2-year/30-year U.S. Treasury yield curve flattened by 37bps to 117bps, while the 2-year/10-year yield curve flattened 43bps to 78bps.

Curve positioning was important as the 2-year Index lost 53bps but the 30-year Index gained 4.70%. TIPS continued to outperform nominal treasuries with the U.S. TIPS Index returning 2.36% for the quarter and a staggering 5.96% for the year, while the U.S. Treasury Index returned a paltry 18bps for the quarter and was down 2.32% for the year.

The U.S. Credit Index started the quarter at an OAS of +80bps and stayed within a 3bps range until November 12th. The credit market drifted wider as the Fed became more hawkish and new issue volume remained heavy in front of the November FOMC meeting. Spreads moved quickly wider as the Omicron variant began to spread rapidly. Spreads peaked at an OAS of +95bps and moved tighter in December as credit shrugged off the pandemic concerns, ending the year 4bps tighter. The U.S. Credit Index ended the quarter with an excess return of -24bps. Longer credit underperformed (-0.54%) versus intermediate issues (-0.05%). Single-A issuers underperformed (-0.32%) triple-Bs (-0.17%). Most sectors had a negative excess return with Chemicals (0.17%) and Autos (0.15%) the few notable exceptions. Sovereigns continued their rollercoaster ride outperforming (0.83%) during the quarter after a strong December (2.16%).

Agency MBS never really recovered after posting one of the worst single months in two years during November (-0.46%). The Fixed Rate Index was down 26bps of excess return for the quarter. 30-year Conventional and GNMAs overall performed in-line. 30-year Conventional 1.5% was the only 30-year coupon to earn a positive excess return (0.01) while Fed sponsored 2.0% (-0.01%) surprisingly outperformed higher coupons with the taper on the horizon. Further out the coupon stack, 30-year Conventional 3.0% (-0.62%), 4.5% (-0.69%) and 5.0% (-0.63) underperformed, while 3.5% (-0.19) was third best performer for the quarter. 15-year MBS was the star performer adding positive excess return (0.02%-0.04%) as banks continue to add to an already rich sector.

ABS struggled in the fourth quarter with tight spreads and a heavy new issue calendar. The ABS Index had an excess return of -0.12% with Auto issues (-0.07%) outperforming credit cards (-0.21%). Autos benefited from a push by investors into subprime, lower quality tranches and less on-the-run issuers as they looked or additional spread.

CMBS underperformed in the fourth quarter with other credit sectors widening approximately 7bps overall. Non-Agency (-0.12%) outperformed Agency (-0.24%) driven by strong performance of triple-B tranches (0.79%). Agency CMBS struggled with tight valuations with longer maturities underperforming with the CMBS 8.5+ year Index down 0.65%.

FIXED INCOME COMMENTARY (CONTINUED)

OUTLOOK

- We expect GDP growth to remain strong based on continued solid demand, a restocking of inventories, business investment, and a rebound in services.
- The unemployment rate is expected to continue to fall and move back to pre-pandemic levels as excess savings accumulated during the pandemic are exhausted.
- Inflation will drive monetary policy as the Fed seems satisfied that employment is on the path to full recovery. We expect inflation to remain stubbornly high but to moderate in the second half of 2022 as shortages of materials and workers are alleviated. We will monitor for wage inflation and pandemic disruptions.
- With Powell's pivot, we now expect the taper to end in March and rate liftoff at the June meeting with likely two additional hikes before year end. The frequency of hikes will depend on inflation momentum.
- We expect the yield curve to continue to flatten but at a less aggressive rate considering 2-year/10-year is already at 78bps. Historically, after the first rate hike, the 2-year/10-year curve flattens an average of 80bps over the the following 12 months.
- We do not expect 10-year and 30-year yields to move much higher with a range of 1.75% to 2.25% by year end. This is based on the view of a neutral rate not much above 2.00%, inflation in the second half moderating, inflation expectations falling, and real rates moving higher.
- Economic uncertainty remains high as the Omicron variant and other potential variants are still a threat and must be watched. Domestically, we don't expect this to affect growth as the economy has learned to adapt.

POSITIONING

- We remain at 90% of the benchmark duration with an underweight to 5-year and shorter maturities. We will look for an opportunity to add duration by adding longer maturities as rates reach the lower bound of our range.
- We expect a challenging year for the U.S. Mortgage-Backed Securities (MBS) Index. We remain underweight Agency MBS. This is based on the Fed's taper, strong net supply, currently tight valuations, and rising loan sizes.
- We continue to underweight lower, heavily Fed-supported coupons and GNMAs overall as we believe prepayments will remain higher than conventional issues and 15-year agency pass-throughs due to current historic tight valuations of this sector.
- Across the coupon stack, we continue to overweight seasoned higher conventional coupons as we expect these issues to outperform in a rising rate environment.
- We remain overweight to U.S. investment grade corporate credit as spreads have recently lagged and current valuations are well positioned for tightening. We expect credit to outperform early in 2022 due favorable seasonals but look to take advantage of any strength to reduce weight.
- U.S. credit spreads should trade in a wider range as markets normalize, but are expected to be supported by strong fundamentals, higher U.S. Treasury yields, moderating inflation trends and strong technical factors. Rising volatility will require more position adjusting as spreads are tight.
- We continue to favor longer maturity, higher beta, cyclical, and re-opening BBB issuers. Security selection will remain extremely important as there is little room in spreads. We see greater M&A activity next year and favor those credits that are deleveraging.
- ABS valuations continue to be relatively tight. However, strong investor demand and a sanguine credit outlook should keep spreads in a tight range. We remain overweight the sector favoring lower quality issues given the strength of the consumer and lower overall volatility.
- We believe current CMBS valuations look mostly fair with improving property fundamentals and stabilizing loans. We favor high quality single asset, single borrower exposure and will continue to look for opportunities in the non-agency CMBS space to increase our overweight.

Fixed Income Market Performance Overview

	Fourth Quarter 2021		2021 Year-to-Date	
	Total Return	Excess Return	Total Return	Excess Return
U.S. Treasury 2-Year	-0.53	-	-0.57	-
U.S. Treasury 10-Year	0.67	-	-3.60	-
U.S. Treasury 30-Year	4.70	-	-4.62	-
U.S. TIPS 10-Year	2.72	-	6.02	-
Bloomberg U.S. Aggregate	0.01	-0.15	-1.54	0.32
U.S. Credit	0.22	-0.24	-1.08	1.51
Bloomberg U.S. Intermediate Credit	-0.55	-0.05	-1.03	0.79
U.S. Long Credit	1.52	-0.54	-1.18	2.81
U.S. High Yield Corporate	0.71	1.06	5.28	6.63
MBS	-0.37	-0.26	-1.04	-0.68
ABS	0.57	-0.12	-0.34	0.31
CMBS	-0.64	-0.17	-1.16	1.05
S&P 500	9.75	-	28.68	-
AA	0.39	-0.31	-1.26	1.33
A	0.15	-0.32	-1.82	0.82
BBB	0.33	-0.17	-0.40	2.29
BB	0.75	1.03	4.61	6.24
B	0.84	1.27	4.85	5.92
CCC	0.54	0.98	8.59	9.52

Chart axis: -12 -9 -6 -3 0 3 6 9 12

Source: Bloomberg. As of 12/31/2021.

EQUITY MARKET COMMENTARY

MARKET COMMENTARY

Equity market prices advanced steadily upward in the first half of the fourth quarter as Delta variant risks began to abate, interest rates remained rangebound and the economy resumed its reopening. The rally faltered in November as the Omicron variant emerged accompanied by worries that higher inflation would lead to rising interest rates. A year-end rally saw many of the major indices reached historically high levels, as investors' angst over the virus and interest rates gave way to a more sanguine outlook. Larger, growth-oriented indices outperformed smaller capitalization issues with a value bias in the fourth quarter.

- Shares of larger capitalization companies displaying better profitability and strong price momentum outperformed smaller companies with higher earnings variability and higher volatility, as the uncertainties over COVID-19 dampened investors' appetite for higher risk.
- S&P 500 Index operating earnings are estimated to have increased 14% YOY in 4Q'21, after increasing 9% YOY in 3Q'21.
- Companies in the S&P 500 Index reported an 80% level of earnings "beats" in 3Q'21, well above the 72% 10-year average.
- Market volatility spiked in late November on concerns over the Omicron virus and rising interest rates but waned in late December.
- Energy, Financials, and Real Estate sector stocks enjoyed strong upward 2021 earnings revisions in 4Q'21, while earnings expectations for Industrials, Consumer Discretionary, Materials and Utilities sectors moderated.

MARKET OUTLOOK

- Currently elevated equity valuation levels may reflect the negative real interest rate environment and strong earnings growth from a reopening economy. Interest rates are expected to rise in 2022, while forward earnings growth rates will likely moderate.
- History suggests that stocks can advance in face of initial short-term interest rate hikes and moderating earnings growth, with prices historically peaking in advance of an earnings pinnacle.
- Relative performance between growth and value equity styles has been driven by the changing outlook for interest rates and the reopening of the global economy, a trend we expect to continue in 2022.
- The economic expansion remains on track, but we expect equities will have difficulty maintaining the strong performance achieved since the current advance began in March 2020.
- Companies' operating margins are likely to come under continued pressure as surging input and transportation costs combine with rising wages to impact comparisons.
- Globalization is now in retreat as tariffs, supply chain, and logistic pressures are forcing business to shift production back "home" to reduce supply chains uncertainties.
- Companies are expected to pour even more cash into share buybacks and dividends increases in the coming year.
- Companies have been delivering a high rate of earnings "beats" since the disappointing 1Q'20 quarter, but this favorable trend may come under pressure as revenue gains moderate and contracting margins pressure future earnings growth.
- Congressional gridlock delayed/blocked the passage of further fiscal stimulus, but the prospects for high earner individual and corporate tax rate legislation remains uncertain.
- Abundant liquidity and easy borrowing conditions supportive of investor and business use of excessive financial leverage might introduce increased volatility into near term equity price behavior.

Equity Market Performance Overview

	Historic Annual Periods					Recent Quarters				2021	Trailing Periods	
	2016	2017	2018	2019	2020	Q121	Q221	Q321	Q421	YTD	3-Year	5-Year
DOMESTIC EQUITIES												
LARGE CAP CORE (S&P 500 Index)	11.96	21.83	-4.38	31.49	18.40	6.17	8.55	0.58	11.03	28.71	26.07	18.40
LARGE CAP GROWTH (Russell 1000 Growth Index)	7.07	30.22	-1.52	36.39	38.49	0.94	1.93	1.16	11.64	27.59	34.08	25.32
LARGE CAP VALUE (Russell 1000 Value Index)	17.34	13.66	-8.27	26.54	2.80	11.26	5.21	-0.78	7.77	25.16	17.64	11.16
SMALL CAP CORE (Russell 2000 Index)	21.31	14.65	-11.02	25.52	17.47	12.70	4.29	-4.36	2.14	14.81	19.18	11.55
SMALL CAP GROWTH (Russell 2000 Growth Index)	11.32	22.17	-9.31	28.48	34.63	4.88	-0.36	-1.60	0.01	2.83	21.12	14.49
SMALL CAP VALUE (Russell 2000 Value Index)	31.74	7.84	-12.86	22.39	4.63	21.17	2.20	-0.74	4.36	28.27	17.94	9.04

Source: Bloomberg & Factset. As of 12/31/2021. Periods greater than 1 year are annualized.

GUEST PERSPECTIVE

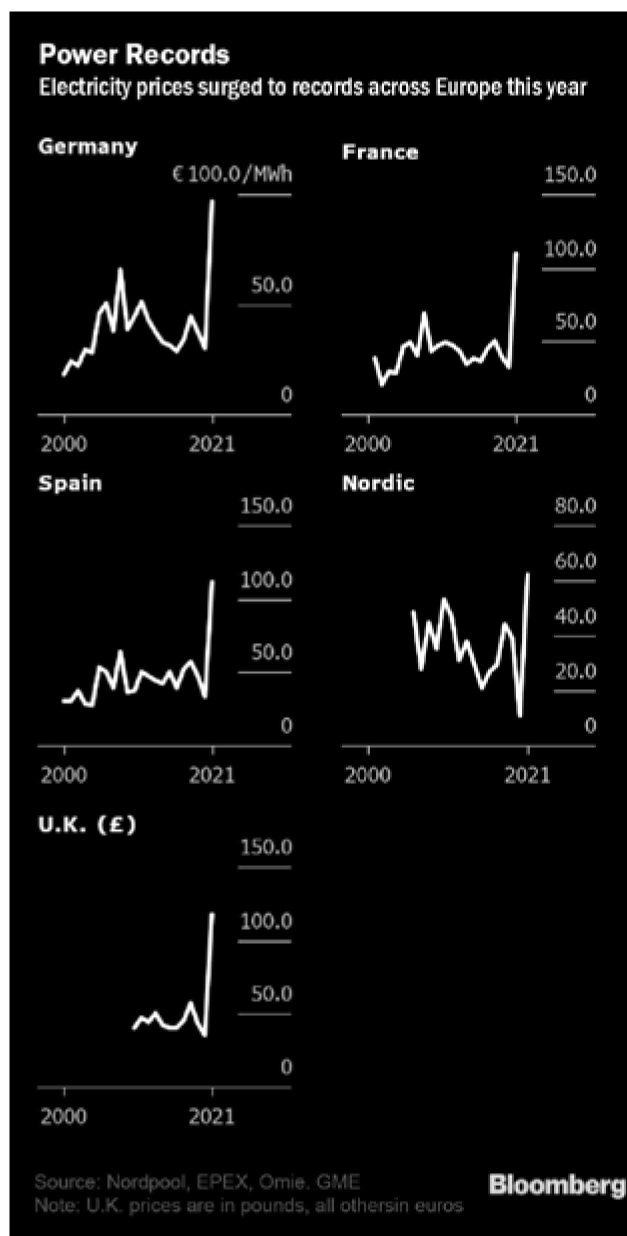
Europe's Electricity Crisis: Energy, Inflation, and the Transition

Europe is facing its worst energy crisis in decades, with record high gas prices and record high power prices. The immediate cause for the spikes was an unexpected shutdown in some of the French nuclear fleet, and lower output from wind in Germany and Northern UK. The trend is likely to fuel further inflation and hamper growth in the region. To date, over 20 power retailers in the UK filed for bankruptcy. European governments rolled out a slew of policy measures aimed at lowering household electricity bills such as price caps, vouchers, suspension of VAT/taxes, subsidies, and clawing back power generation profits. Still, Italians are expected to face a 55% increase in household electricity bills in 1Q'22,[1] even after taking into account the EUR 8 billion spent since July by the government to curb price hikes.

The European electricity crisis originated as a gas crisis. Growth in global gas demand, low European gas storage (less than 80% full vs 96% last year),[2] and supply disruptions led to a 250% year-to-date rise in European gas prices with prices peaking at over 800% last month.[3] As global gas markets became further integrated, Europe succumbed to the effects of China's spike in demand, South America's drought-induced demand for imported natural gas, production outages in Norway, and Russia's fluctuating levels of supplies. Coal also saw surging prices thanks to its own supply disruptions and emergency gas to coal switching. To make matters worse, European renewable output was lower than usual. France unexpectedly shut down 10% of its grid in December and plans to shut another 20% in January for nuclear plant maintenance.[4] As a result, France, a major regional exporter of electricity, will be forced to purchase power in the market alongside its neighbors at elevated prices. Finally, Germany is pushing ahead with its well telegraphed but poorly timed shut down of half its nuclear fleet this year.[5] European power prices surged over the last few months, peaking at over EUR 400/MWh compared to a 3-year average of EUR 60/MWh. Last week, gas prices and power prices came down from these unprecedented highs as LNG shipments were diverted to Europe. However, prices remain elevated, and fears of supply risk and volatility persist as Europe heads into the coldest part of the year.

The crisis is playing out against the backdrop of Europe's longer term energy transition plan. Ironically, the crisis increased Europe's use of coal and oil generators. Fossil fuels will continue to play a critical role in the energy transition despite potentially slowing demand and investment, especially because fossil fuels, unlike electricity, can be easily stored. Power prices are likely to remain volatile as Europe relies more on intermittent sources of renewable energy while also pushing towards greater electrification. Away from the near-term confluence of destabilizing factors, over time, we expect investment in storage solutions and long-distance transmission lines to integrate electricity markets will help increase reliability.

Written January 4, 2022



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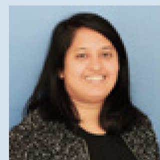

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GIA Partners, LLC
Director and Portfolio Manager

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1) https://www.reuters.com/business/energy/italy-retail-power-bills-rise-55-next-quarter-regulator-2021-12-30/
2) https://agsi.gie.eu/#/historical/eu
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Chart) Bloomberg, https://blinks.bloomberg.com/news/stories/R4XIBADWX2PX

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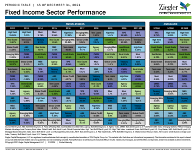

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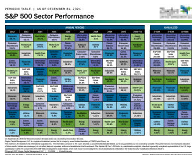

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