



10 investment  
themes for 2022



# 10 investment themes for 2022



**Jody Jonsson**

is an equity portfolio manager with 33 years of experience.\* She is president of Capital Research and Management Company<sup>SM</sup> and a manager for New Perspective Fund<sup>®</sup>



**Martin Romo**

is an equity portfolio manager with 30 years of experience. He is president of Capital Research Company<sup>SM</sup> and a manager for The Growth Fund of America<sup>®</sup> and The Investment Company of America<sup>®</sup>

Investors are facing new risks and a market in transition. From the conflict in Ukraine to high inflation and rising interest rates, the future seems as uncertain as ever. And as central banks reduce stimulus, we are likely to see a shift in market leadership, along with sustained volatility.

In these uncertain times, we believe it's important to step back and consider the long-term trends that are driving companies and markets. That's why we asked our investment team to highlight 10 themes they are closely following today.

Some of these are within industries under pressure or facing near-term headwinds. But we invest in companies, not industries. It's our job to analyze individual businesses, meet with management and invest in a select group we believe are most likely to prosper in the years ahead.

We hope this report helps put the current environment in perspective and provides some reassurance that the future still looks positive for long-term investors.

\*Years of experience for all investment professionals are as of December 31, 2021.



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# 1. Pricing power



## Diana Wagner

is an equity portfolio manager with 25 years of experience. She is a manager for Washington Mutual Investors Fund<sup>SM</sup>

I believe inflation will linger in the months ahead, making it one of the biggest risks investors face in 2022. That's why I am focused on uncovering companies with pricing power that can protect their profit margins by passing those costs along to customers.

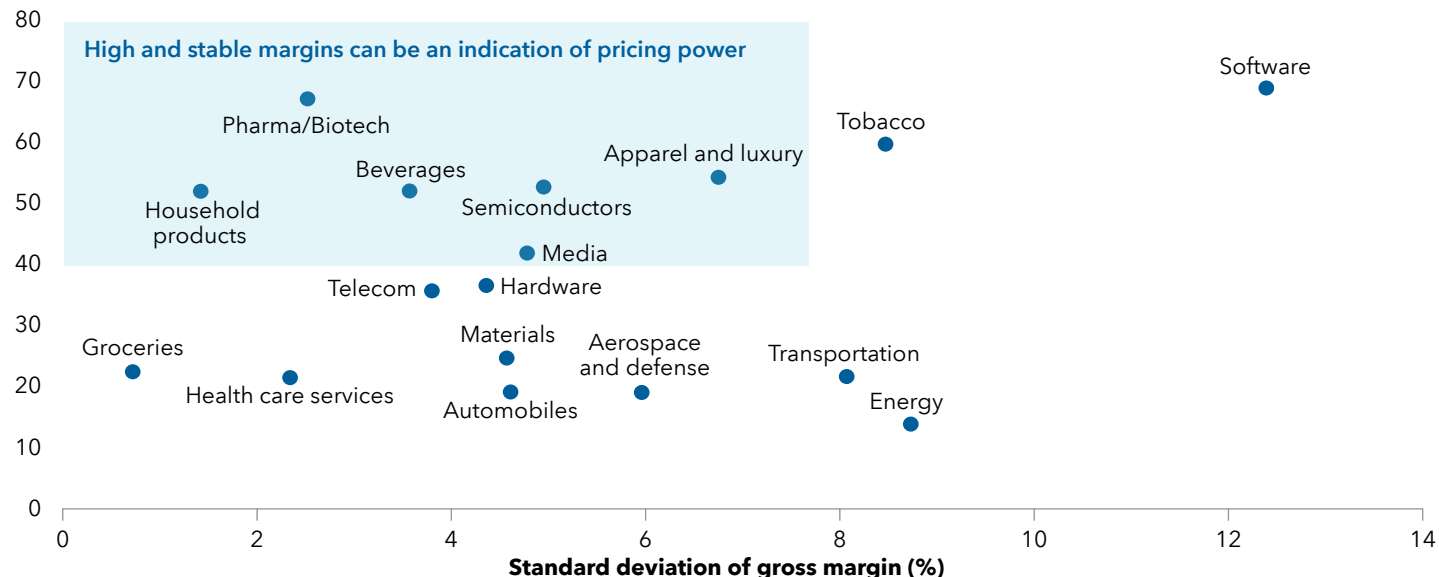
Companies with pricing power potential include consumer businesses with strong brand recognition, like beverage makers Keurig Dr Pepper and Coca-Cola; companies in the fast-growing video games segment, like Microsoft and Tencent; and companies providing essential services, like Pfizer and UnitedHealth.

Semiconductor companies with proprietary chip designs, like Broadcom, or Dutch chip-equipment maker ASML, could also raise their prices in an inflationary environment.

With slowing growth, rising inflation and conflicts overseas, 2022 is off to a rough start. But I'm optimistic that an active portfolio of select companies with strong pricing power may help investors thrive in the year ahead.

## Some industries have a greater potential for pricing power

### Average gross margin (%)



Sources: Capital Group, FactSet, MSCI. Reflects select industries within the MSCI World Index. Average and standard deviation of gross margins are calculated for the five-year period ending 12/31/21. Average gross margin is net sales less the cost of goods sold and is shown as a percentage of net sales. Standard deviation is a common measure of variation that tells how a statistic has varied from the mean over time. A lower number signifies lower volatility.



## 2. Tech trifecta



**Mark Casey**  
is an equity portfolio manager with 21 years of experience. He is a manager for The Growth Fund of America.

Semiconductors, cloud computing and software – what I call the tech trifecta – are three industries I’m following closely this year.




If pricing power is a key to fighting inflation, then the semiconductor industry is in a strong position. Supply chain disruptions have chip prices skyrocketing, pressuring manufacturers that increasingly depend on them. Anyone who tried to find a PlayStation 5 last Christmas knows what I mean.

Even in the wake of supply chain issues, I see no end to the world’s appetite for semiconductors. Today a new car uses as many as 3,000 chips, and that number is growing with each new model.

Semiconductors are the backbone cloud technology companies use to power their business. I believe we are still in the early innings of the cloud transition. For example, makers of CPUs, like Advanced Micro Devices; DRAM chipmaker Samsung; and ST Microelectronics, which develops microcontrollers, could all see demand multiply for years.

If chips are the backbone of the cloud, then software is the brains. Today, software is driving advancements not only in e-commerce and finance but also health care, education, transportation, construction and agriculture. Software-as-a-service (SaaS) companies enable other companies to grow and innovate at a

### Demand for semiconductors is soaring, along with prices

	 High-end smartphone	 Automobile	 Data center server
Value of chip content per unit (USD)			
2015	\$100	\$310	\$1,620
2020	\$170	\$460	\$2,810
2025 (estimated)	\$275	\$690	\$5,600

Sources: Capital Group, Applied Materials. As of 6/16/21.

lower cost than ever before. Examples include Shopify, the maker of e-commerce tools; HubSpot, a sales and marketing platform; and Paycom, a payroll and human resources provider.

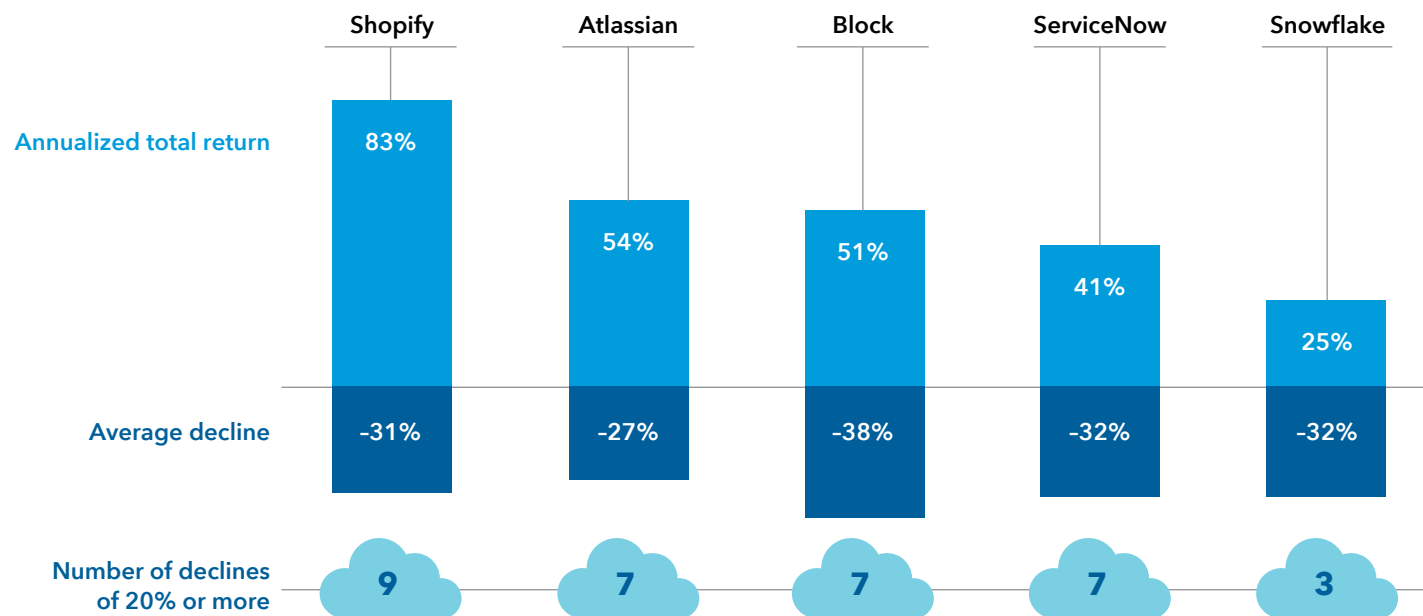
Legacy software giants are also shifting to the cloud. Microsoft, for example, has made the transformation with its Office software and its cloud infrastructure service Azure. A more alarming development is the need for new cybersecurity services offered by companies like Okta and Zscaler to defeat escalating online threats.

For many of these businesses it's been a tough year in the market. Rising inflation and expectations that the Federal Reserve will soon

increase interest rates hit their stocks harder than most. That's because higher rates reduce the current value of the much higher earnings such businesses expect to generate in the future.

Investors might wonder if many of these companies have grown too far, too fast. My job is to look past today's volatility to understand fundamental growth dynamics that can drive long-term returns. For example, investors in Shopify would have experienced nine declines worse than 20% between its IPO in 2015 and the end of 2021. But if they held throughout that period would have realized a return on investment of approximately 50x.

### Cloud software companies have been resilient despite frequent volatility



Sources: Capital Group, Morningstar. Examples used are the five largest companies within the BVP Nasdaq Emerging Cloud Index, which tracks the performance of companies providing cloud-based software and services, excluding those that had an IPO date prior to 2010. Number of declines, average decline and annualized returns are calculated from company IPO date through 12/31/21. Average decline calculated based on all declines of at least 20%. Returns are in USD.

### 3. Dividend comeback



**Caroline Randall**  
is an equity portfolio manager with 24 years of experience. She is a manager for Capital Income Builder®

Companies are shifting from dividend zeros to dividend heroes.

Particularly in Europe, companies suspended dividends during the pandemic primarily due to political or regulatory pressure, but now many of them have surplus capital to redeploy as regular and catch-up dividends.

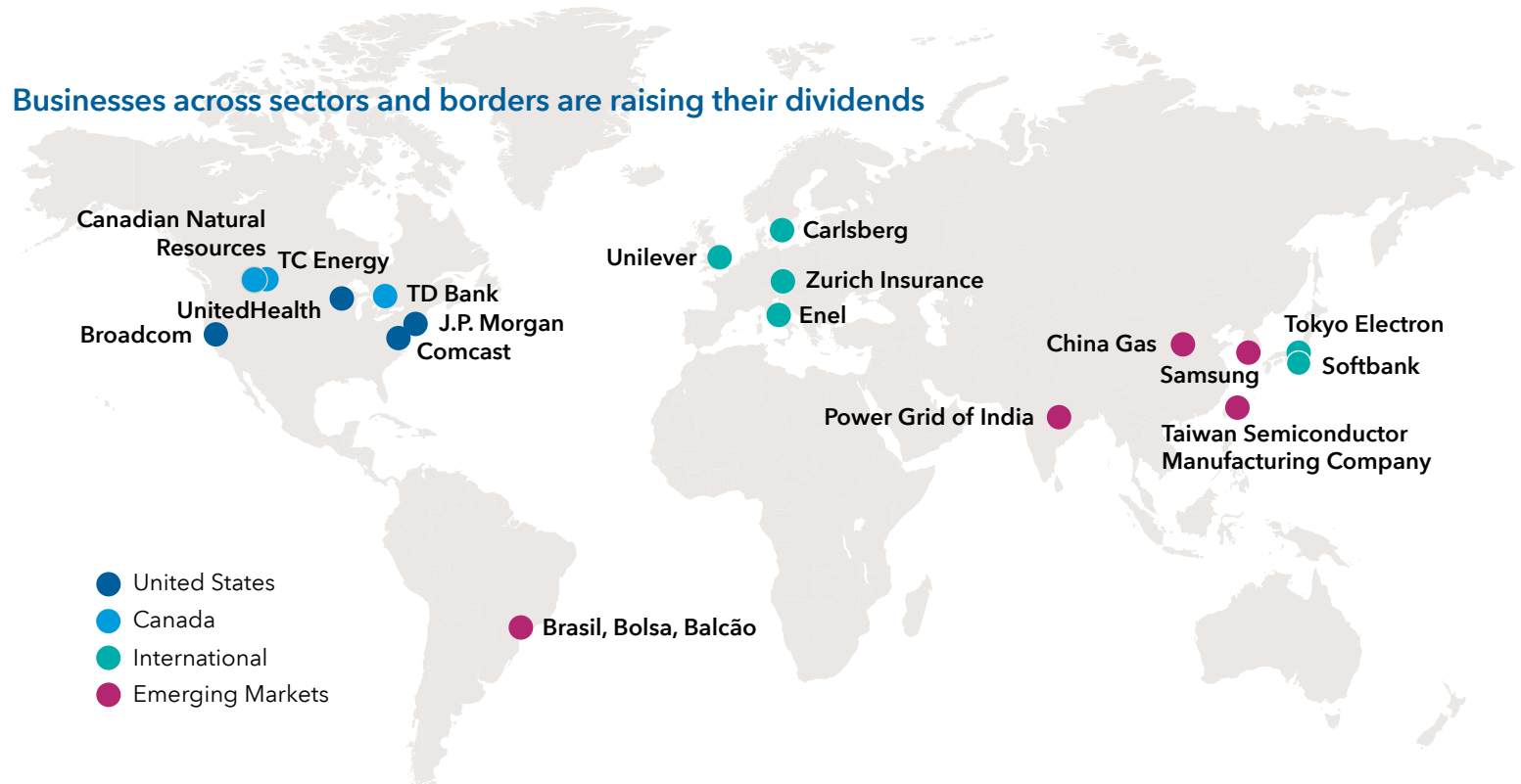
You might think the search for dividend income starts with companies that pay the highest yields. While these companies can be sound investments, a high dividend yield can also be a warning sign and potentially unsustainable.

Our research shows that since 2007, the highest yielding quintile of stocks had the lowest overall returns. We found the sweet spot

to be the next bucket of dividend payers, those that yielded closer to 3%. This group included companies with more stable balance sheets and attractive dividend growth prospects.

This year, I'm focused on companies with strong underlying earnings growth that have demonstrated a commitment to raising their dividends over time. Increasing dividend payouts can be a signal of management's confidence in future earnings growth. Dividend growers historically have tended to generate greater returns than other dividend strategies, while also keeping up with the broader market. Dividend growth can also offer a measure of resilience against inflation and interest rate hikes.

#### Businesses across sectors and borders are raising their dividends



Sources: Capital Group, Refinitiv Datastream. Represents examples of companies that have raised their dividends during the two-year period from 12/31/19-12/31/21.

## 4. Health care innovation



### Rich Wolf

is an equity portfolio manager with 25 years of experience. He also has research responsibilities for U.S. medical technology companies and is a manager for The New Economy Fund®

Life-changing drugs are being developed and approved faster than ever. The COVID-19 mRNA vaccines from Pfizer and Moderna provide a powerful affirmation of the global nature of innovation.

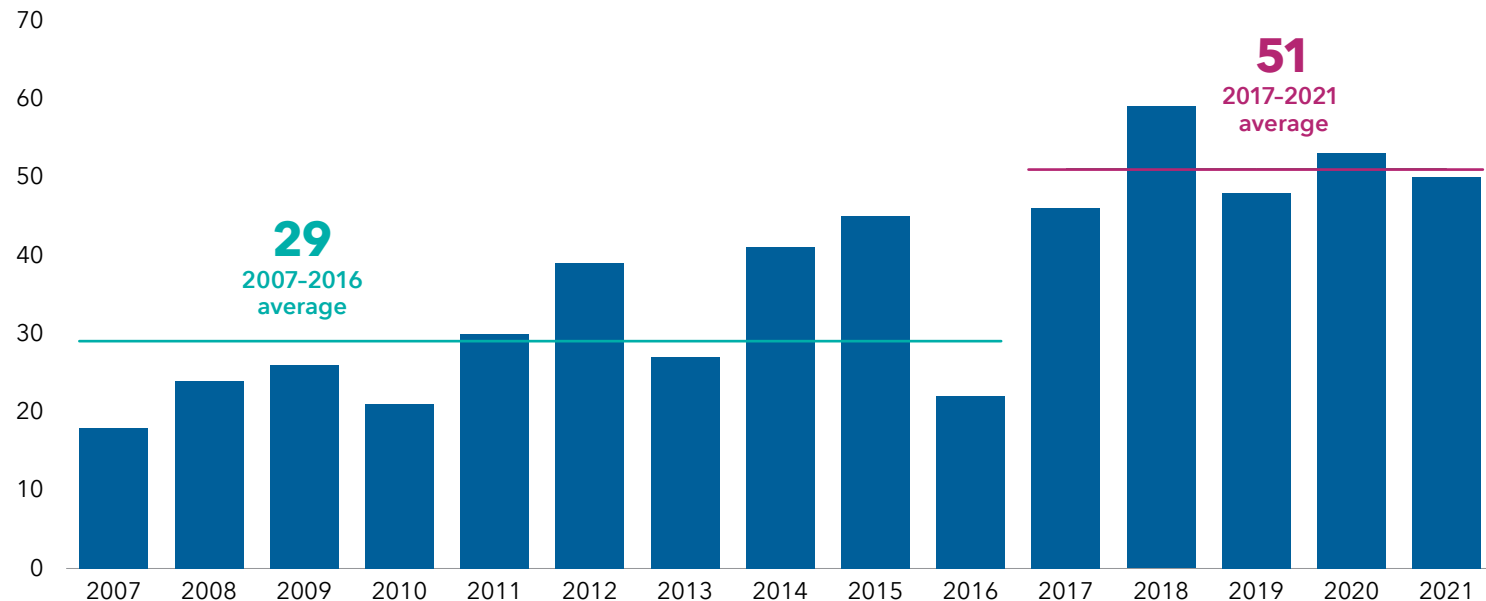
Will that breakneck speed continue in 2022? With recent advancements in genomic and proteomic analysis and the launch of many new modalities of drugs, I believe it will. Today we have new therapies designed to engineer how the body recognizes and treats disease itself that have the potential to extend lives and generate billions of dollars in revenue for companies able to develop them successfully.

But it's not just drug discovery that excites me. A massive wave of innovation from health technology companies has led to improved diagnostics – both in the lab and at home. For example, Dexcom's continuous glucose monitor allows diabetics to continuously check their glucose levels and integrate that information directly to an insulin pump.

Companies like Exact Sciences and Illumina have developed liquid biopsy blood tests and genomic technologies that enable early detection of cancer and help in the research of complex diseases. In addition, as the technology improves, remote patient monitoring and home diagnostics are becoming part of the continuum of care.

### New drugs are coming to market faster than ever

#### Novel drugs approved by the FDA



Source: Food and Drug Administration. As of 12/31/21.

## 5. Transportation transformation



**Kaitlyn Murphy** is an equity analyst who covers U.S. chemicals and automobile & components manufacturers and railroads for the U.S. and Canada. She has 17 years of investment experience.

Ladies and gentlemen, start your batteries.

The adoption curve of electric vehicles (EVs) has steepened thanks in large part to government incentives and tighter emissions standards for gas-burning cars, particularly in China and Europe. The price of batteries, which can account for a third of a vehicle's cost, has also plunged. EV makers are now appealing to more consumers by introducing models with lower prices, better performance and longer range.

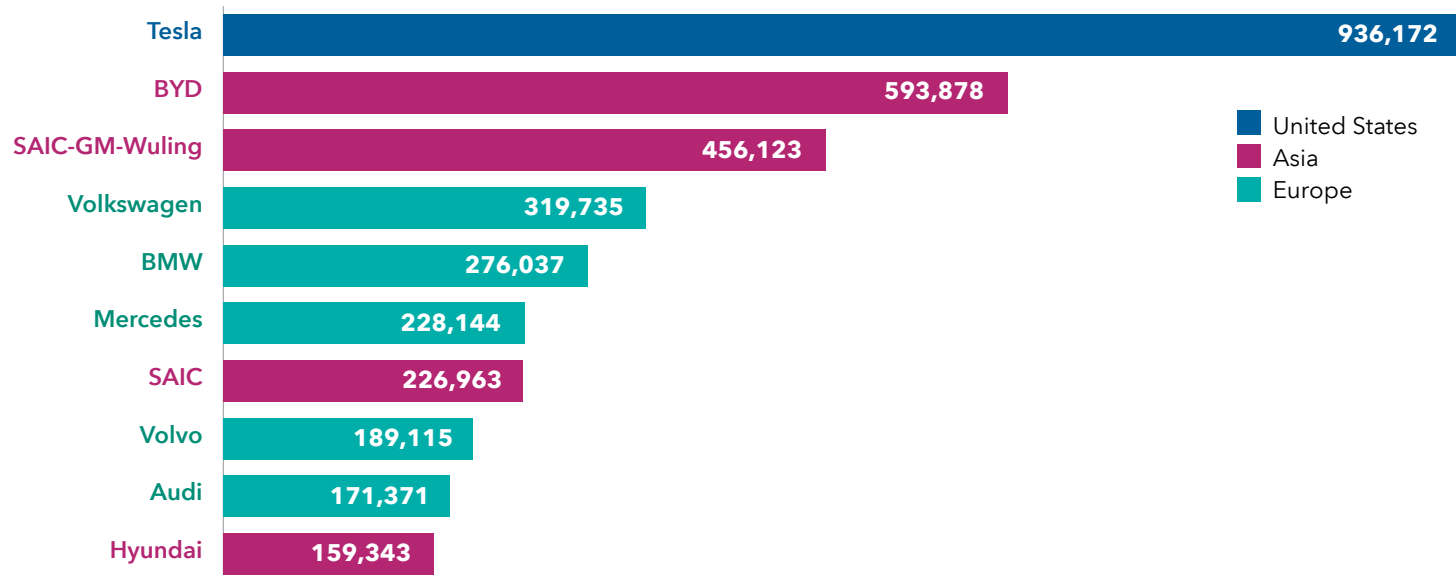
Although EVs are on the threshold of profitability, some will likely get there sooner than others. Tesla has been a clear leader, having briefly surpassed a market cap of \$1 trillion in 2021. Companies

quick to embrace structural change and rapidly adapt have a better chance of success over the long term, whether they are industry titans or startups. Innovative manufacturers can also differentiate themselves with their use of software, which allows for vehicles that can learn and improve, become safer and introduce more services over time.

Many believe the level of disruption in transportation will make it difficult for incumbents to survive, but don't count them out. At General Motors, CEO Mary Bara is disrupting the company from within. In addition to its pledge to go all-electric by 2035, the company has invested heavily in Cruise, its self-driving unit. We believe it could be one of the future leaders.

### Tesla has raced ahead of global competition in EV sales

Global plug-in electric vehicle sales in 2021 (units)



Sources: CleanTechnica, EV-Volumes.com, Statista. Estimates as of January 2022. SAIC-GM-Wuling is a joint venture based in China.



**Drew Macklis** is an equity investment analyst who covers U.S. semiconductors, autos and mobility technology. He has five years of investment experience.



One of the coolest parts of our job as investors in the broader mobility space has been test-riding autonomous vehicles. Even after more than a dozen such rides, we still feel a rush whenever we get to see a driverless car or truck in action. It's a truly surreal experience.

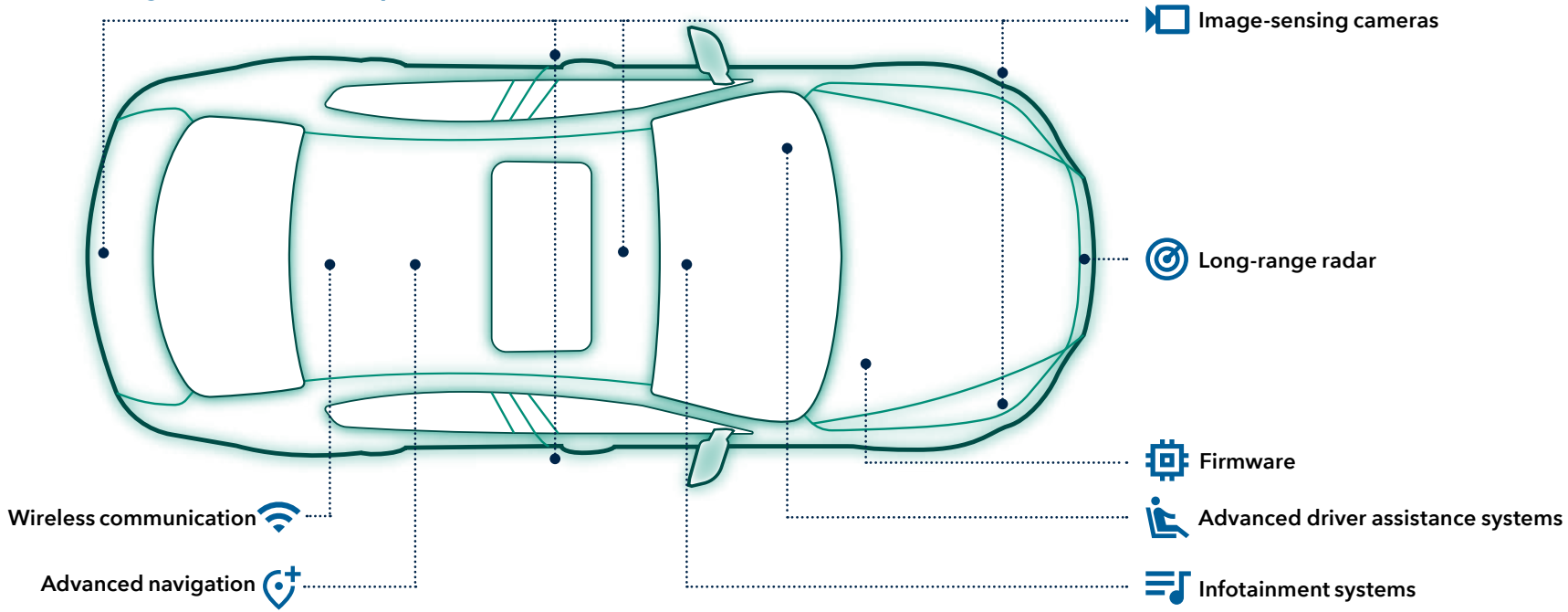
We're in the very early stages of the autonomous vehicle industry, but the market doesn't seem to fully appreciate the progress that has already been made. Alphabet's Waymo operates a fully functional robotaxi service in Arizona open to the public. General Motors' Cruise intends to launch their fully driverless robotaxi service in San Francisco before the end of this year. Since many of these autonomous companies are divisions within or majority

owned by larger corporations, they provide breakout optionality to the parent company's stock if they succeed.

The opportunity for commercial vehicles is also vast. Adoption will take time, but the technology has already shown great promise. This past December, for example, self-driving truck startup TuSimple completed an industry first: an 80-mile autonomous truck ride on public roads with no human in the cab and zero interventions required.

We believe we could be at the dawn of a decade-long move toward vehicle automation with profound implications for many aspects of the economy. But right now we are just at the starting line, so investors should be prepared for bumps along the road.

## Self-driving cars will be computers on wheels



Source: Capital Group.

## 6. China challenges and opportunities



**Winnie Kwan**  
is an equity portfolio manager with 25 years of experience. She is a manager for New World Fund®

Risks to investing in China have risen due to macro and regulatory issues. Investors need to tread carefully with sectors such as property, education and gaming. However, I believe there are still compelling long-term, secular growth trends that make the country an attractive market on a stock-by-stock basis.

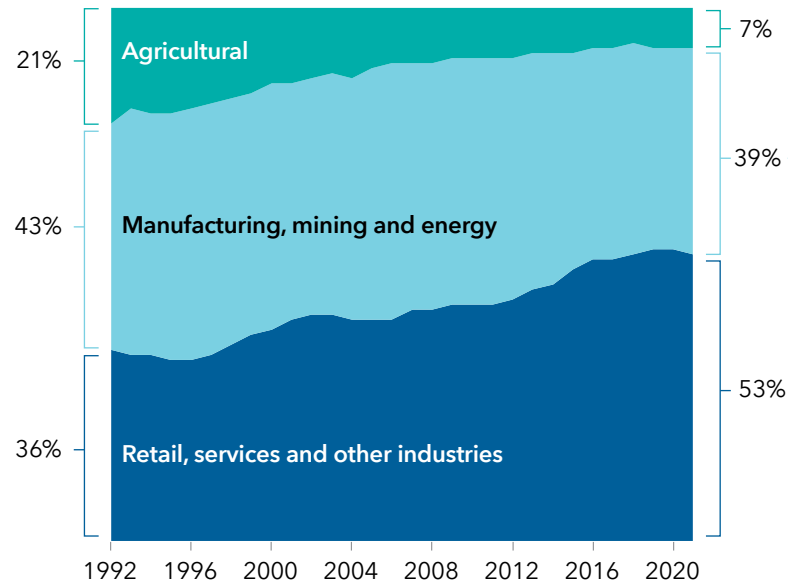
For example, China is positioned to dominate the global manufacturing supply chain for EVs and decarbonization solutions such as solar. Chinese manufacturers are producing high value-add parts at scale, including servo motors, electric drive trains and thermo management systems. A fast-growing home market for EVs is supportive of the supply chain development. China is already a dominating force in solar panel manufacturing, and it is increasingly leading in specific components such as inverters.

Automation is another growth area, driven by manufacturing upgrades and an aging population. Japanese and European companies have historically dominated production of precision parts and components in automation, but Chinese manufacturers are rapidly taking share.

Localization and import substitution continue to be big trends, not only in capital goods but in health care and medical technology equipment. At the same time, contract development and manufacturing organizations have become a sweet spot. These companies are partnering with multinationals on drug development, testing and manufacturing, often at lower prices and higher efficiency.

### China has moved up the manufacturing value chain

**Contribution to China GDP, by industry**



Estimate of global production from China (%)				
1990's	2000's	2010's	2020's	
88%	53%	60%	40%	50%
Toys	Personal computers	Smart phones	Solar inverters	EV batteries

Sources: Capital Group, company filings, Euromonitor, National Bureau of Statistics of China, Refinitiv Datastream, SNE Research. Manufacturing examples and share of global production are based on estimates as of May 2021. The relative share of the three industries depicted are as of 12/31/21, and are classified according to National Bureau of Statistics of China's "Three Industry Division Regulations."

## 7. Media disruption



**Martin Romo** is an equity portfolio manager with 30 years of experience. He is president of Capital Research Company<sup>SM</sup> and a manager for The Investment Company of America<sup>®</sup>

This January, three blockbuster deals announced over a matter of days highlighted the swift change of pace in the industry.

If all three are finalized – Microsoft’s bid for gaming giant Activision Blizzard among them – it would amount to more than \$90 billion in M&A activity centered on video games, the fastest-growing segment of the media sector.

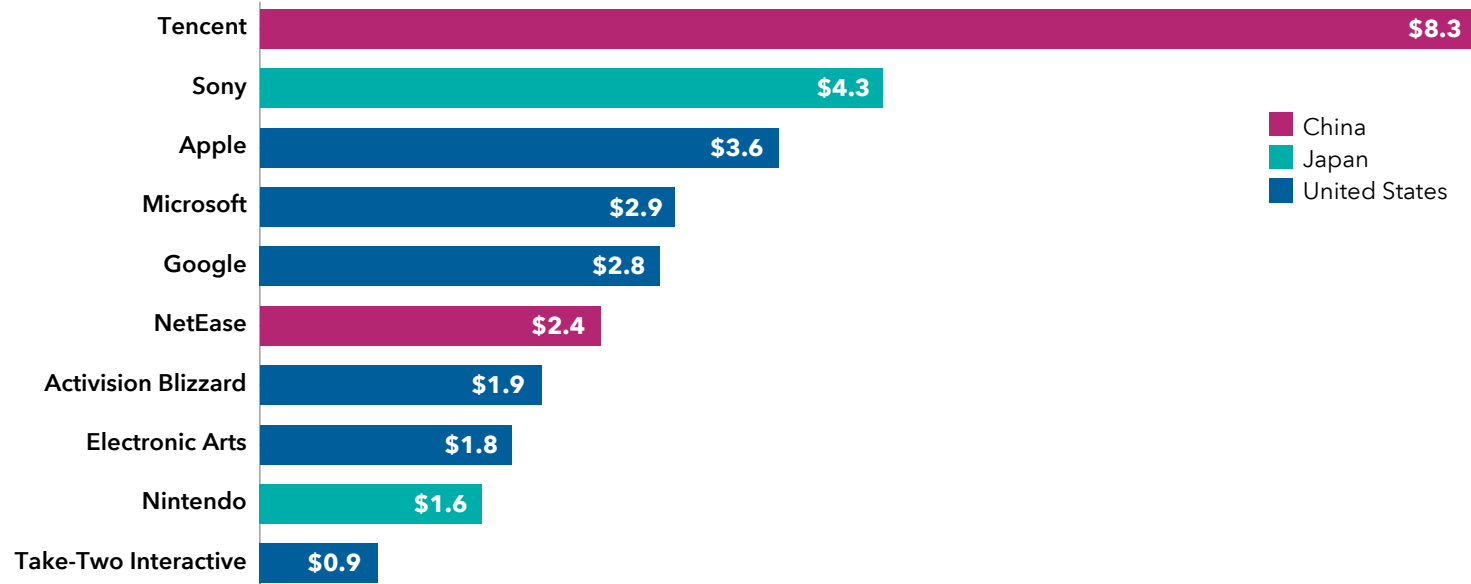
Driven in part by a pandemic-era gaming boom, the media landscape is fundamentally transforming the way people communicate and entertain themselves. That makes interactive games all the more valuable to the likes of Microsoft, Sony and many others.

It’s a testament to how powerful and alluring video games have become. The \$200 billion gaming industry provides compelling entertainment at a reasonable cost, and it’s already surpassed the movie industry in terms of annual gross revenue. Fundamentally, I think that growth is likely to continue and even accelerate in the years ahead.

The disruption also extends to other segments of the media and entertainment world. Netflix, the clear leader in streaming video with over 200 million subscribers, is encountering fierce competition from Amazon and Apple, as well as old guard companies like Disney. The biggest threat to Netflix’s dominance may be Disney+, whose deep library of intellectual property-driven content has helped it attract 130 million subscribers in just three years.

### Gaming’s global appeal fuels industry leaders in China, Japan and the U.S.

Top 10 global companies ranked by quarterly gaming revenue (USD billions)



Sources: Capital Group, Newzoo. Quarterly revenue figures are estimates by research firm Newzoo, as of September 30, 2021.



## 8. Future of financials



**Emme Kozloff** is an equity investment analyst covering global capital market infrastructure providers and U.S. and European discount brokers. She has 30 years of investment experience.

Today the financials sector encompasses a broader set of opportunities than traditional banks and insurers. Among these are exchanges, data providers and asset managers. Financial exchanges that focus on equity trading may even benefit from increased volume during volatile markets.

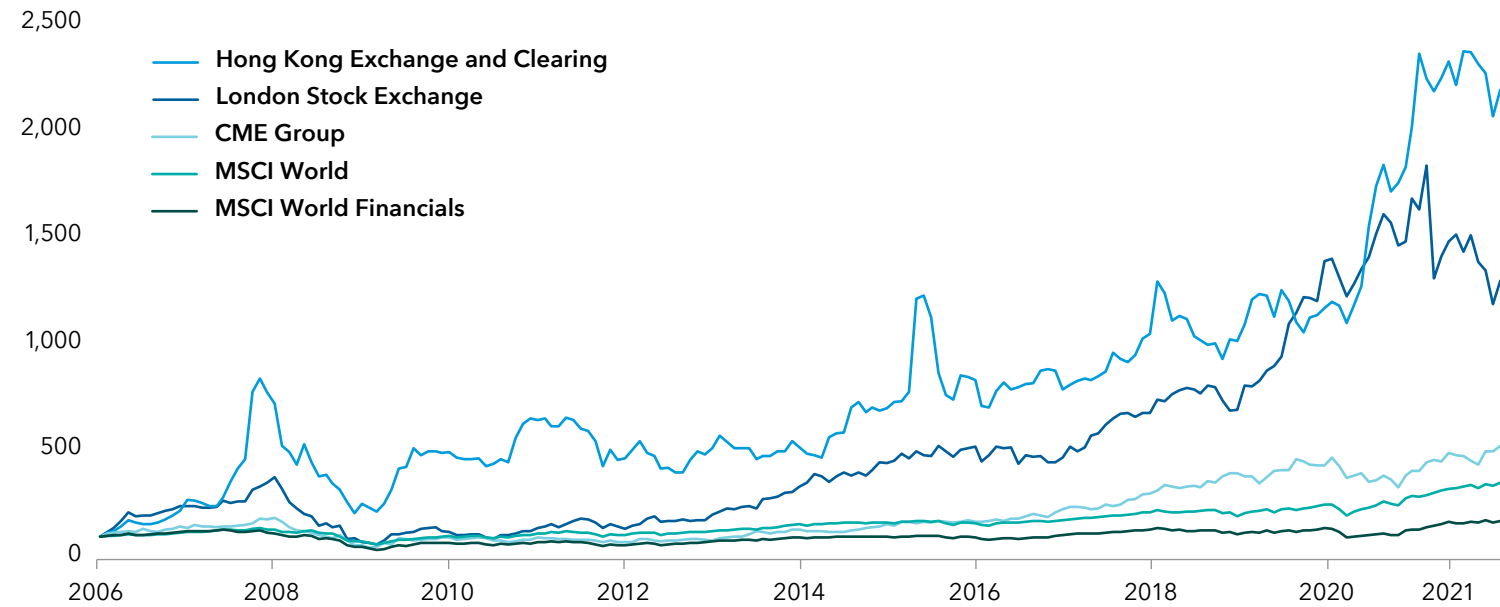
I believe several trends will drive growth in financial exchanges. One is the modernization of fixed income trading, which is moving out of the horse-and-buggy era. As fixed income – by far the largest asset class in the world with over \$100 trillion in assets – moves to digital trading, exchanges like Tradeweb could see their sales volumes soar.

Another driver of growth is the voracious appetite for data analytics. London Stock Exchange, known primarily for its equity exchanges, and Standard & Poor's, known largely as a ratings agency and index creator, have built robust analytics offerings. Likewise, only a third of NASDAQ's revenue comes from trading with much of the rest coming from its data services segment. I don't think the market fully appreciates how diversified many of these companies are.

To invest successfully in financials, it can help to look really closely at each of these companies to understand what assets they own and where those offerings fit into the business cycle.

### Financial exchanges have outpaced the broader market

#### Total return (rebased to 100)



Sources: MSCI, RIMES. Returns rebased to 100 on 12/31/05 and are in USD. As of 12/31/21.

## 9. ESG everywhere



**Rob Lovelace** is an equity portfolio manager with 36 years of experience. He is vice chair and president of The Capital Group Companies, Inc.,<sup>SM</sup> and is a manager for New Perspective Fund.

Environmental, social and governance investing, or ESG, is everywhere, and it's only going to get more important.




At Capital Group, we have fully integrated ESG principles into our investment process, and it's a part of every investment decision we make. We don't think of ESG as just an exclusion process. We think of it as identifying companies that are doing the right thing and supporting those in transition, such as oil companies shifting toward clean energy.

This effort extends far beyond the energy sector. For example, buildings pump more carbon dioxide into the atmosphere than the entire transport industry. One of the most effective ways to

reduce greenhouse gas emissions is to improve air conditioning and heating efficiency. Regulations that require the replacement of older systems with more energy-efficient products in Europe and elsewhere could underpin a long-term tailwind for HVAC companies like Daikin and Carrier.

I understand there is some trepidation about how our industry will implement ESG concepts. People are worried about new government regulations, additional rules or expanded disclosure requirements. But I would say: This is important. While there's a lot to learn, I believe we should approach it with a sense of optimism and enthusiasm.

### Many global industrial companies have made sustainability a priority

<p><b>DAIKIN</b> HVAC manufacturer</p> 	<p><b>\$66.4B</b> Market cap</p> <p><b>JAPAN</b></p> <p><b>1924</b> Founded</p>	<p><b>CARRIER</b> HVAC manufacturer</p> 	<p><b>\$47.1B</b> Market cap</p> <p><b>USA</b></p> <p><b>1915</b> Founded</p>	<p><b>NIBE</b> Heating technology</p> 	<p><b>\$30.5B</b> Market cap</p> <p><b>SWEDEN</b></p> <p><b>1952</b> Founded</p>
<ul style="list-style-type: none"> <li>• Aims to achieve carbon neutral operations by 2050</li> <li>• 98% of sales mix is categorized as "environmentally conscious," up from 83% in 2017</li> <li>• Reduced greenhouse gas emissions by 31% from 2016-2020</li> </ul>		<ul style="list-style-type: none"> <li>• Aims to achieve carbon neutral operations by 2030</li> <li>• Reduced hazardous waste production by 23% from 2015-2020</li> <li>• Reduced greenhouse gas emissions by 17% from 2015-2020</li> </ul>		<ul style="list-style-type: none"> <li>• Aims to achieve six global sustainability goals by 2030, including a 40% reduction of energy use</li> <li>• Increased Climate Solutions segment sales by 87% from 2016-2020</li> <li>• Committed to the UN Global Compact to share sustainability principles across subsidiaries, partners and suppliers</li> </ul>	

Sources: Capital Group, company reports, Refinitiv Datastream. Company market cap is in USD as of 12/31/21.

## 10. Flexible fixed income



**Damien McCann**

is a fixed income portfolio manager with 22 years of experience. He is a manager for American Funds Multi-Sector Income Fund<sup>SM</sup>

Inflation is running hot – and that’s cooling bond returns. Speculation about the Federal Reserve’s path and pace of interest rate hikes has pressured bond prices.

The good news? High inflation is partially a response to extraordinary consumer demand. The economy is doing well. People have jobs and cash – and they want to spend it. What’s more, many companies have strong balance sheets and are positioned for growth.

In my mind, this means there are solid investment opportunities in corporate bonds. The post-pandemic economy may benefit casinos and cruise lines as demand returns. Energy prices have jumped, which could help both midstream and exploration and production companies. On the other hand, I think that rising labor

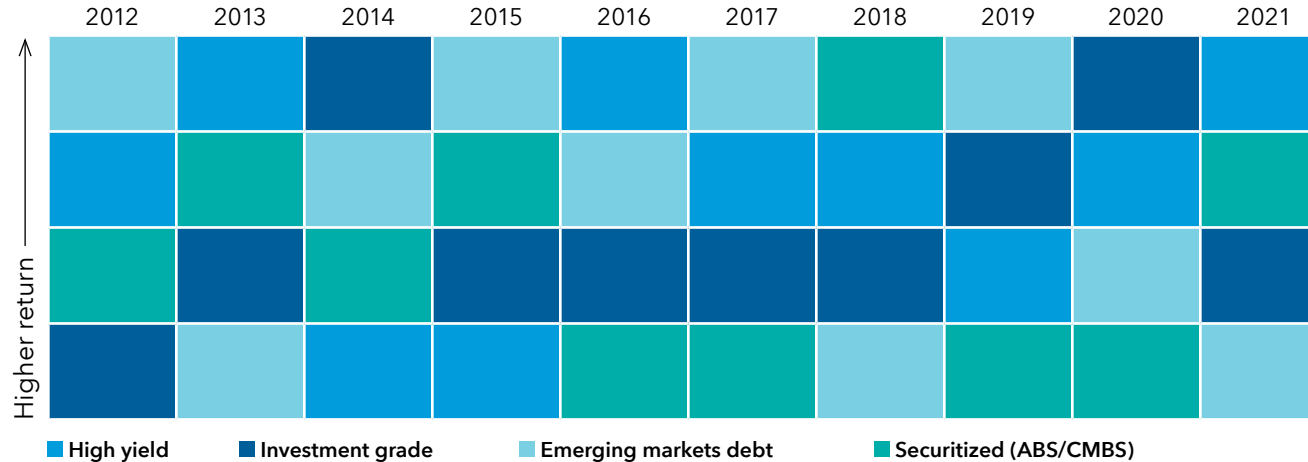
costs and shortages could crimp growth for consumer-oriented retail companies. Restaurants may also feel the pinch.

The relative value between higher income bond sectors such as investment grade (rated BBB/Baa and above), high yield, emerging markets and securitized debt is always changing. I’m focused on identifying which of these offer the most attractive opportunities for income-seeking investors. Recently, the underlying strength in the economy and the shorter interest duration in high yield and securitized debt have made those sectors more attractive.

I take a flexible, diversified approach to allocating among these different sectors based on market conditions and investment insights. This could help create a more resilient income and return stream for investors.

### No sector has consistently posted the highest return each year

Annual returns of higher income sectors



Source: Morningstar. As of 12/31/21. Sectors represented by Bloomberg U.S. Corporate High Yield 2% Issuer Capped Index, Bloomberg U.S. Corporate Investment Grade Index, J.P. Morgan Emerging Markets Bond Index (EMBI) Global Diversified and 80% Bloomberg CMBS Ex AAA Index /20% Bloomberg ABS Ex AAA Index, respectively. Bond ratings, which typically range from AAA/Aaa (highest) to D (lowest), are assigned by credit rating agencies such as Standard & Poor’s, Moody’s and/or Fitch, as an indication of an issuer’s creditworthiness. If agency ratings differ, the security will be considered to have received the highest of those ratings, consistent with the fund’s investment policies.



# Keeping 2022 volatility in perspective



**Jody Jonsson**

Today's challenging environment is causing more market volatility than we've seen since the onset of the pandemic. Against a backdrop of slowing growth and high inflation, the tragic war in Ukraine adds a new series of risks and unknowns.

However, history has shown that markets have powered through past periods of geopolitical market shocks. It's important to remember that investors can still find opportunity in the midst of chaos – be it war, inflation, or recession. There are still many

companies that are thriving and innovating, so that's where we focus most of our time and energy.

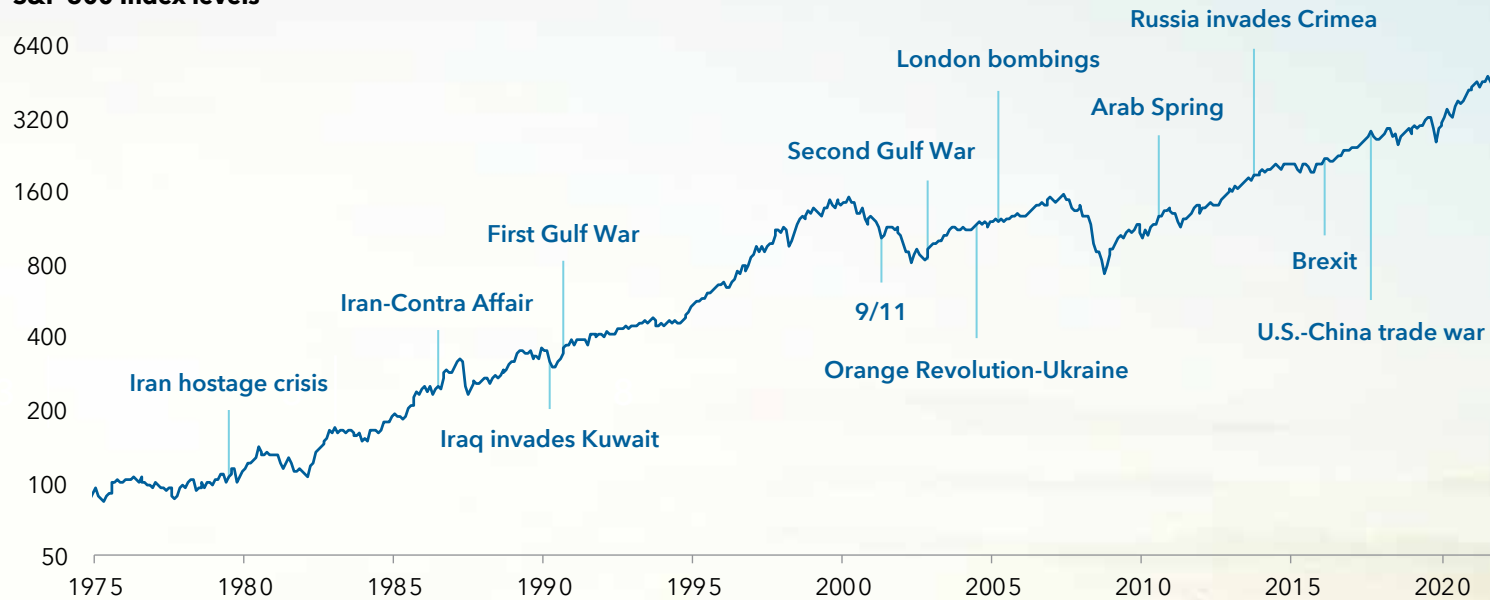
Our primary message for investors is to stay committed to your long-term investment goals. Don't be disoriented by moments of crisis. Remember that markets over the long term have been resilient and have powered through many challenges. Now is the time to evaluate your portfolio, stay focused on your path and try not to let external events derail your objectives.



**Martin Romo**

## Equity markets have historically powered through geopolitical events

### S&P 500 Index levels



Sources: Capital Group, Refinitiv Datastream, Standard & Poor's. Index levels reflect price returns, and do not include the impact of dividends. Chart shown on logarithmic scale. As of 2/28/22. Standard & Poor's 500 Composite Index is a market capitalization-weighted index based on the results of approximately 500 widely held common stocks.

# 10 investment themes for 2022

1. Pricing power
2. Tech trifecta
3. Dividend comeback
4. Health care innovation
5. Transportation transformation
6. China challenges and opportunities
7. Media disruption
8. Future of financials
9. ESG everywhere
10. Flexible fixed income

## Voted #1 for thought leadership\*



2019



2020



2021



\*Source: Fund Intelligence, February 20, 2020. FUSE Research survey of nearly 600 advisors identifying the “most-read thought leaders.” Marketing Support: The Advisor View, June 2020. FUSE Research survey of more than 700 advisors identifying the “most-read thought leaders.” Marketing Support: The Advisor View, July 2021. FUSE Research survey of 720 financial advisors identifying the “most-read asset manager thought leaders.”

**Investors should carefully consider investment objectives, risks, charges and expenses. This and other important information is contained in the fund prospectuses and summary prospectuses, which can be obtained from a financial professional and should be read carefully before investing.**

Investing outside the United States involves risks, such as currency fluctuations, periods of illiquidity and price volatility, as more fully described in the prospectus. These risks may be heightened in connection with investments in developing countries. Small-company stocks entail additional risks, and they can fluctuate in price more than larger company stocks.

The return of principal for bond funds and for funds with significant underlying bond holdings is not guaranteed. Fund shares are subject to the same interest rate, inflation and credit risks associated with the underlying bond holdings. Lower rated bonds are subject to greater fluctuations in value and risk of loss of income and principal than higher rated bonds.

Bloomberg U.S. Corporate Investment Grade Index represents the universe of investment-grade, publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity and quality requirements. Bloomberg U.S. Corporate High Yield 2% Issuer Capped Index covers the universe of fixed-rate, non-investment-grade debt. The index limits the maximum exposure of any one issuer to 2%. The Bloomberg CMBS Ex AAA Index tracks investment-grade commercial mortgage-backed securities excluding AAA-rated securities. The Bloomberg ABS Ex AAA Index tracks investment-grade asset-backed securities excluding AAA-rated securities.

JP Morgan Emerging Markets Bond Index (EMBI) Global Diversified Index is a uniquely weighted emerging markets debt benchmark that tracks total returns for U.S. dollar-denominated bonds issued by emerging markets sovereign and quasi-sovereign entities.

MSCI World Index is a free float-adjusted market capitalization-weighted index designed to measure equity market results of developed markets. The index consists of more than 20 developed market country indexes, including the United States. MSCI World Financials is a subcomponent of the MSCI World Index and only contains companies within the financial sector.

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