LC Investment Playbook Weekly Update

1 April, 2022

LIGHTHOUSE CANTON



Disclaimer

The contents of this document are confidential and are meant for the intended recipient only. If you are not the intended recipient, please delete all copies of this document and notify the sender immediately.

This document, provided as a general commentary, is for informational purposes only and is not to be construed as an offer to sell or solicit an offer to buy any financial instruments in any jurisdiction. This does not constitute any form of regulated financial advice, and your independent financial advisor should be consulted prior to taking any investment decision(s).

This document is based on information from sources which are reliable but has not been independently verified by Lighthouse Canton Pte Ltd and its subsidiaries ("LC"). LC has taken the reasonable steps to verify the contents of this document and accept no liability for any loss arising from the use of any information contained herein. Please also note that past performances are not indicative of future performance.

Information contained herein are those of the author(s) and does not represent the views held by other parties. LC is also under no obligation to update you on any changes made to this document.

This document is prepared by Lighthouse Canton Pte Ltd and its subsidiary, Lighthouse Canton Capital (DIFC) Pte Ltd, which are regulated by Monetary Authority of Singapore (“MAS”) and Dubai Financial Services Authority (“DFSA”) respectively. MAS and DFSA has no responsibility for reviewing, verifying and approving the contents of this document and/or other associated documents. The contents of this document may not be reproduced or referenced, either in part or in full, without prior written permission from LC.

This document is confidential and is only intended for Accredited Investors and/or Professional Clients, as defined by MAS and DFSA.

LIGHTHOUSE CANTON

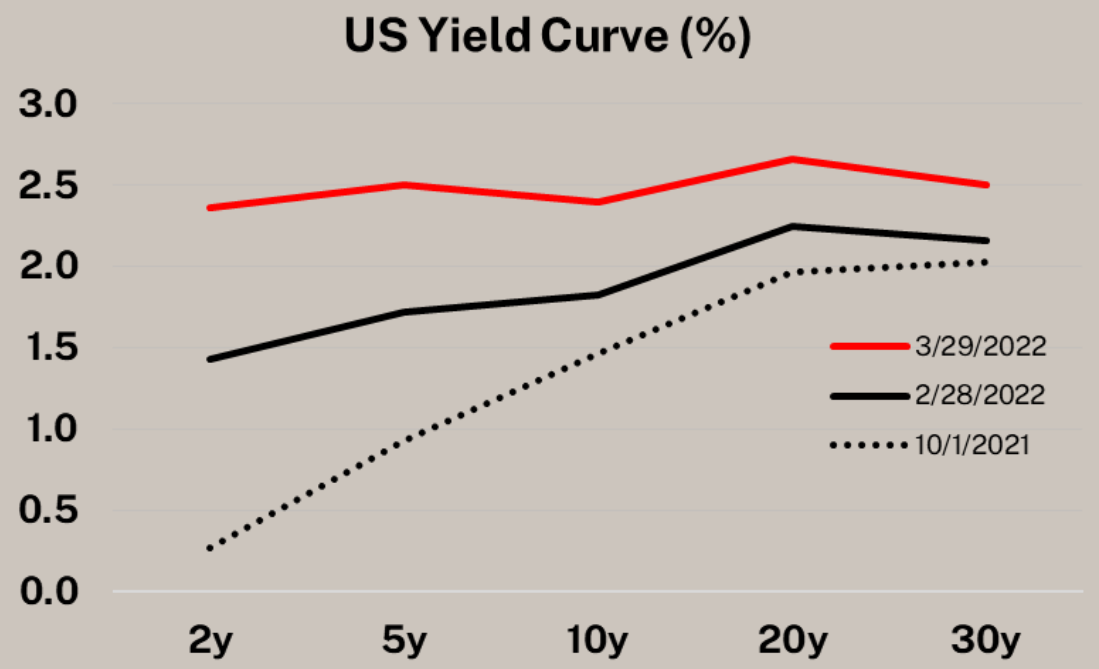
Fixed Income

1

LIGHTHOUSE CANTON

The US Yield Curve is now flat

- Over the last 6 months, the 2y Treasury has risen by a whopping 215 basis points, to 2.40 per cent, leaving the 10/2 yield curve near inversion.
- More interestingly, a closer look at the US yield Curve shows multiple dislocations with the 5y/10y as well as the 20y/30y being already inverted, whereas the 2y/5y and the 10y/20y are still upward slopping.
- **Since the US Yield Curve is not entirely downward sloping, a recession in the US is not the base-case scenario.**

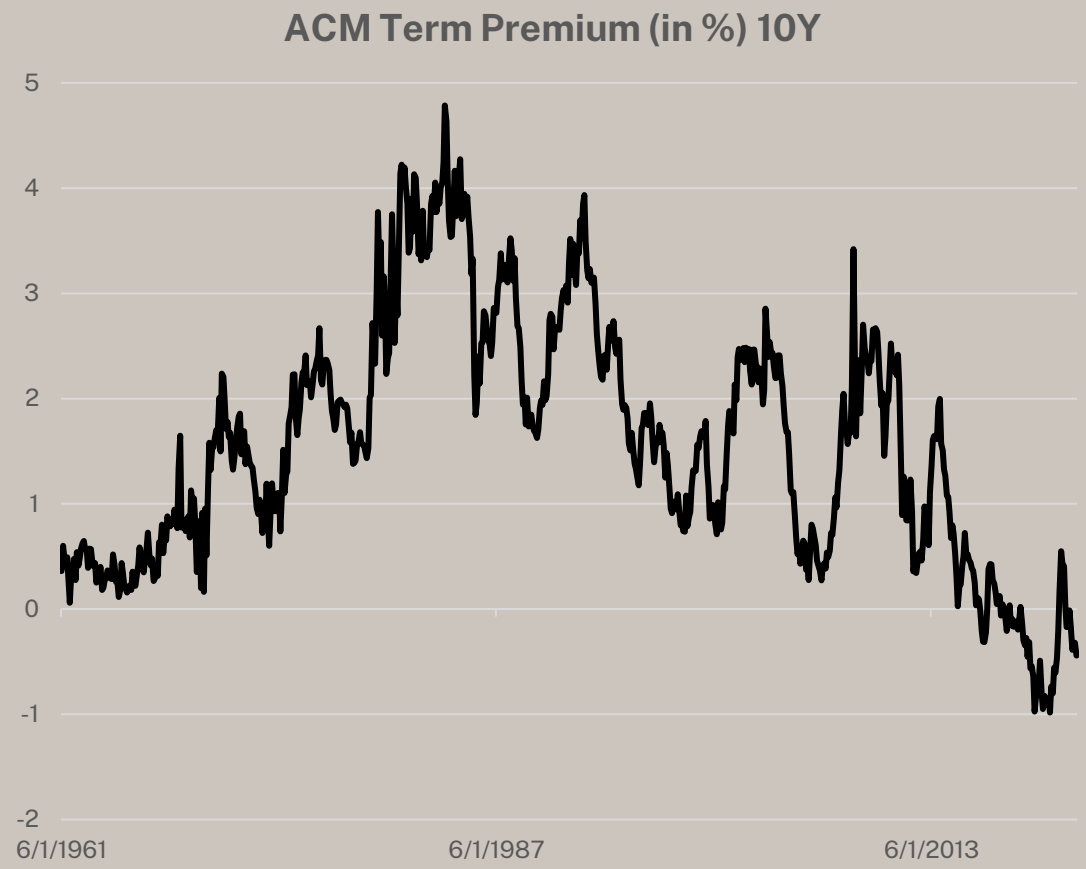


Source: Bloomberg, March 29th 2022

LIGHTHOUSE CANTON

Term Premium is key

- Long bond yields are made up of two parts: 1) **the sum of projected short-term rates** and 2) **a premium to compensate investors for locking up their money**. This latter part, called the “term premium”, has been squeezed out by Central Banks quantitative easing.
- The Fed has deliberately driven down the long end of the yield curve with its asset buying program. Consequently, the long end of the US yield curve is heavily distorted, with a term premium now into negative territory.
- **Such a distortion should be understood before gauging whether the recent inversion of the 2-year/10-year Treasury slope is a lead indicator of a looming US recession.**



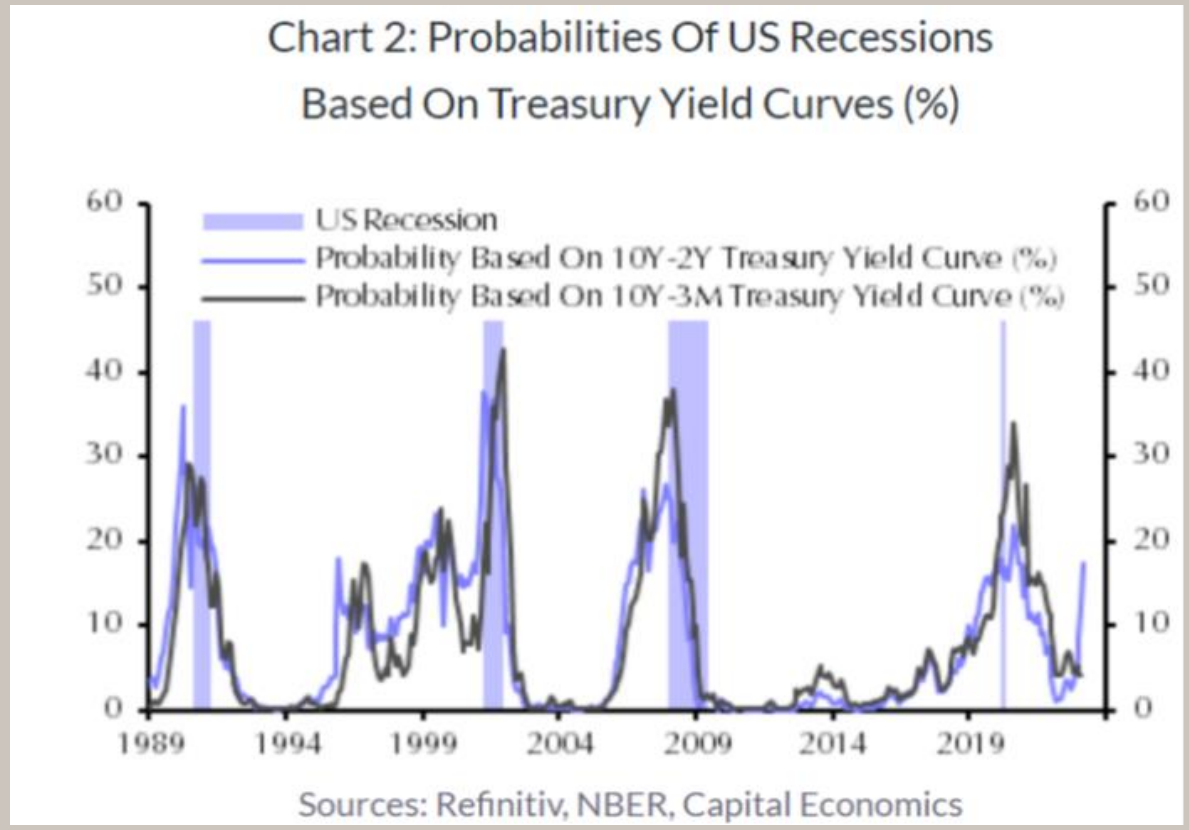
Source: Bloomberg, Lighthouse Canton 30th Mar 2022

LIGHTHOUSE CANTON

Inverted Yield Curve – which segment to look at?

According to BCA Research, since 1969:

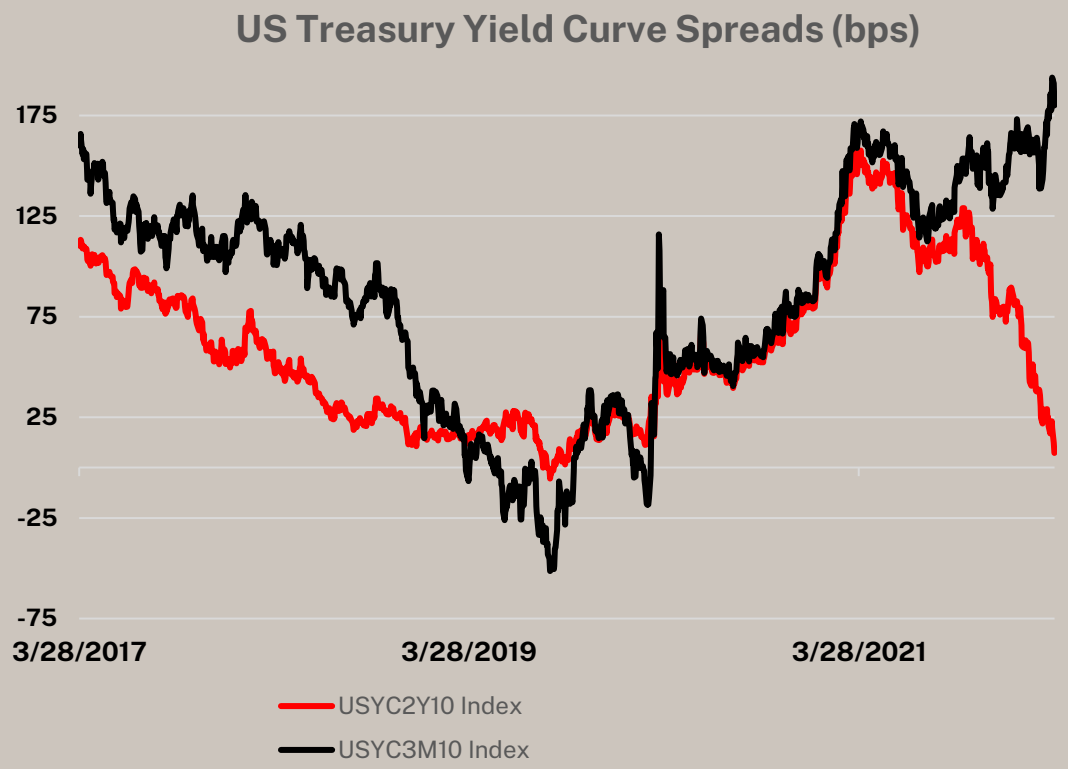
- The 2-year/10-year Treasury slope has on average inverted 15.9 months before the start of the next recession and 10.5 months before the S&P 500 peaked. **This slope briefly inverted in intraday trading on March 29th.**
- The 3-month/10-year Treasury slope inverted on average 11 months before a recession and six months before the S&P 500 peaked. **That slope is currently elevated.**



LIGHTHOUSE CANTON

A Tale of Two Tenors

- **The Fed will keep raising rates as long as inflation remains elevated** even if the economy stalls.
- And what about that yield curve and inversions? Powell dismissed the significance of readings for anything beyond two-year maturities.
- **The Fed itself is looking at the difference between three-month bill rates and 10-year yields, which is about the widest since March 2017.**



Source: Bloomberg, Lighthouse Canton March 29th 2022

LIGHTHOUSE CANTON

Fixed Income – Executive Summary

- **The Fed kicked off its tightening cycle with a 25-bps hike and signaled six more increases this year. What followed suit was a distorted US Treasury yield curve. 10Y yields are trading lower to 3Y, 5Y and 7Y levels, signifying an inversion whereas 2s10s inverted briefly on March 29th. The 2s30s has flattened to a meager 15 bps spread. Whether these indicate a recession ahead remains to be seen.**

- **The UK Core CPI Year-on-Year (YoY) printed 5.2% against a consensus survey of 5%.**

- **4-decade low unemployment numbers at 7%, improved labor force participation and modest wage growth** will force policymakers at the ECB to be more hawkish going forward. The Russia-Ukraine crisis is not helping.

- On March 29th, the **BoJ** intervened with unlimited buying of 10Y Japanese treasuries at 0.25% policy rate ceiling, to prevent yields from raising further.

LIGHTHOUSE CANTON

Equities

2

LIGHTHOUSE CANTON

Yield Curve Inversion & US Equity markets

- According to BCA Research, stocks have consistently performed better while the yield curve is flattening than they have when it is steepening.
- Investors should remain overweight equities on a 6-to-12 month horizon and monitor the 3-month/10-year Treasury slope as well as the 3-month/3-month, 18 months forward slope for a signal to reduce equity exposure on a cyclical basis.
- **An asset allocator who reduced equity exposure upon receiving advance notice of recessions would have generated significant alpha**, according to BCA Research.

Sector Performance Before & After Yield Curve Inversion

Sector	-12Mos	-6Mos	-3Mos (sorted)	+3Mos	+6Mos	+12Mos
TECH	32.5%	19.5%	12.0%	-2.4%	4.0%	3.4%
UTL	13.3%	2.5%	6.0%	5.4%	14.3%	20.7%
S&P 500	12.8%	12.6%	5.8%	3.2%	6.9%	8.2%
IND	4.4%	1.3%	1.5%	9.6%	7.4%	11.6%
CD	1.7%	4.4%	1.3%	2.4%	-1.6%	15.8%
MAT	0.4%	2.0%	0.8%	4.4%	-2.2%	13.8%
COMM	7.2%	6.8%	0.0%	-0.3%	-0.5%	8.8%
ENE	4.0%	-5.9%	-1.0%	9.8%	4.2%	-0.3%
HC	-2.3%	-2.7%	-1.0%	8.1%	9.8%	20.4%
FIN	-1.1%	1.3%	-2.7%	12.0%	14.3%	14.8%
CS	-1.6%	-1.7%	-2.8%	5.3%	5.5%	19.1%

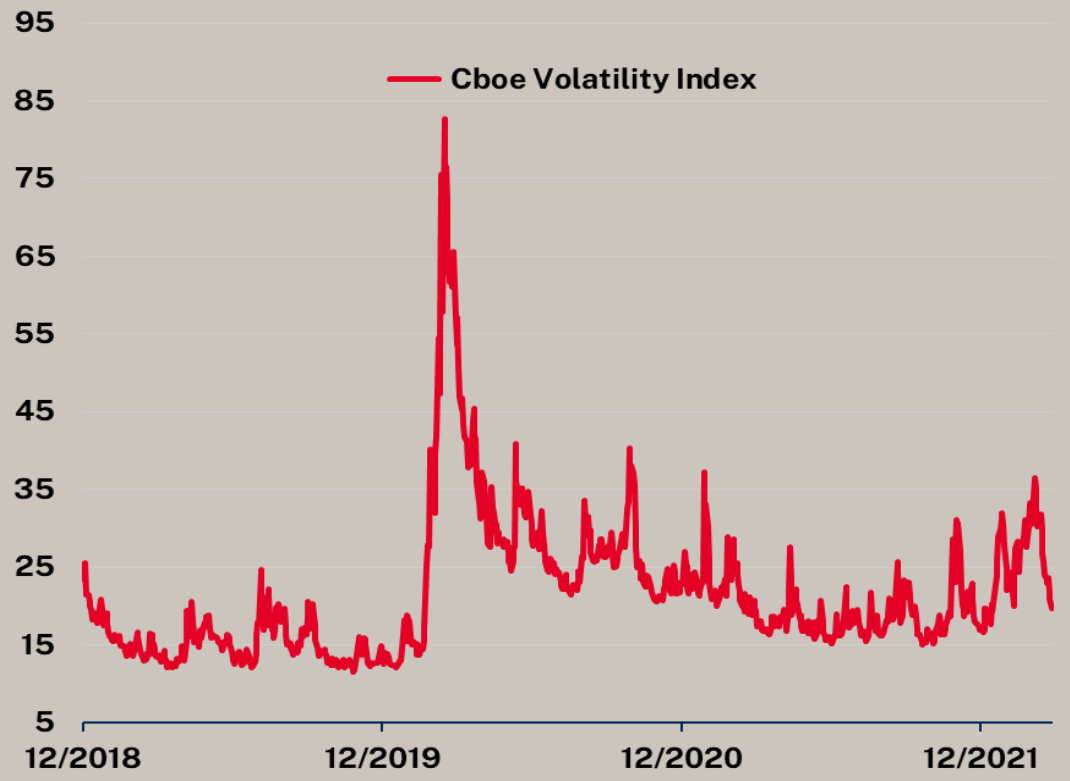
Source: Strategas, March 2022

LIGHTHOUSE CANTON

The Fear Index is receding

- US stocks have rallied respectably over the last two weeks, illustrating that stocks pickers are ruling out a recession for the moment in the US.

- Indeed, there has been little relationship between Fed policy direction and stock performance in the past. While tightening hurts equities valuations, they generally happen when the economy is strong, i.e. at periods when earnings are rising.



Source: Bloomberg, March 29th 2022

LIGHTHOUSE CANTON

US Equities Might Not Have Bottomed Out

- According to a research published by BCA, the factors mentioned in the table on the right are key to assessing a rebound in this cycle.
- While many of the factors seem to have normalized and seem reasonably priced in by markets, other important factors like economic growth and earnings growth expectations continue to remain optimistic despite the deteriorating macro backdrop.
- This could mean that US equity markets may still have room to correct further as these expectations start to normalize eventually.

Factors	Indications
Monetary tightening	Remains elusive and uncertain.
Economic Growth expectations	Investors remain optimistic despite monetary tightening, falling PMIs and soaring energy costs.
Earnings growth expectations	Earnings growth expectations over the next 12 months (9%) continue to look optimistic. Room for disappointment and downgrades.
Energy Prices	Oil prices have started to stabilize.
Technicals	Sentiment indicators indicate oversold conditions in US equities
Valuations	Valuations look fairly priced
Black Swans	Drag of Russia-Ukraine crisis not fully priced in, while China's pledge to be more investor friendly is positive.

Source: BCA, March 21st 2022

LIGHTHOUSE CANTON

US – China Geopolitical Risk

- Geo-political risk circumventing China's stance on Russia should not be underestimated. While implications for China is difficult to predict any escalation in tension between the US and China could spark another wave of sell-offs for Chinese ADRs (listed abroad).

Ticker	Name	Market cap (USD mn)	Foreign ownership %*
BIDU US	Baidu Inc - Spon Adr	52,512	94.4%
YUMC US	Yum China Holdings Inc	18,437	86.7%
291 HK	China Resources Beer Holding	19,311	71.5%
2269 HK	Wuxi Biologics Cayman Inc	25,469	70.0%
TCOM US	Trip.Com Group Ltd-Adr	14,878	69.0%
2020 HK	Anta Sports Products Ltd	34,550	68.2%
2318 HK	Ping An Insurance Group Co-H	123,184	67.8%
2319 HK	China Mengniu Dairy Co	21,712	60.2%
2382 HK	Sunny Optical Tech	19,692	59.5%
BGNE US	Beigene Ltd-Adr	20,622	57.8%
2688 HK	Enn Energy Holdings Ltd	13,974	56.3%
2331 HK	Li Ning Co Ltd	19,372	55.2%
HTHT US	Huazhu Group Ltd-Adr	10,894	53.2%
386 HK	China Petroleum & Chemical-H	72,095	52.5%
700 HK	Tencent Holdings Ltd	450,713	49.7%
9988 HK	Alibaba Group Holding Ltd	251,527	48.8%
1211 HK	Byd Co Ltd-H	93,082	48.2%
2899 HK	Zijin Mining Group Co Ltd-H	40,359	47.2%
3968 HK	China Merchants Bank-H	170,784	47.1%
1093 HK	Cspc Pharmaceutical Group Lt	12,635	40.8%
1288 HK	Agricultural Bank Of China-H	158,508	40.1%
857 HK	Petrochina Co Ltd-H	139,270	38.2%
960 HK	Longfor Group Holdings Ltd	26,219	38.0%
NIO US	Nio Inc - Adr	31,294	36.7%
XPEV US	Xpeng Inc - Adr	23,560	35.4%
968 HK	Xinyi Solar Holdings Ltd	15,963	34.8%
ZTO US	Zto Express Cayman Inc-Adr	21,662	34.5%
6690 HK	Haier Smart Home Co Ltd-H	30,490	34.4%
992 HK	Lenovo Group Ltd	11,610	31.9%
3690 HK	Meituan-Class B	109,865	30.7%
2313 HK	Shenzhou International Group	18,780	30.6%

* Note: data may be less accurate, because 1) many institutions are registered in Cayman Island or BVI, instead of their true origin, and 2) on average, 36% of outstanding shares are not disclosed, thus not accounted for in the ownership data.

Source: BofA, March 17th 2022

Equities – Executive Summary

- We expect US equities to remain extremely volatile throughout the year, in a context of quantitative tightening and interest rate hikes on the one hand and speculators “buying the dip” on the other hand. **Should economic growth forecasts and earnings growth estimates be downgraded later this year, then global equities are likely to correct during the second semester.** A risk to U.S. equities will emerge if the Fed attempts to hike interest rates in a way that will also push up real yields.

- We recommend reducing or completely steering clear from European equities (and HY credits) for the time being. Indeed, bond markets are now pricing in an economic slowdown in Europe and the quantitative tightening, announced by the ECB to tackle inflation, does not bode so well for European equities in the coming weeks.

- The announcement by Liu He (China’s Vice Premier) that Authorities would take “measures to support the economy and financial markets” suggests that policymakers are concerned about the recent market rout. We believe beaten-down Chinese stocks offer a good entry point for long-term investors**. Since China’s regulatory clampdown is not over yet and that ADRs still face the risk of being delisted (from US exchanges), a higher equity risk premium and lower multiples are justified for Chinese stocks.**

Currencies & Commodities

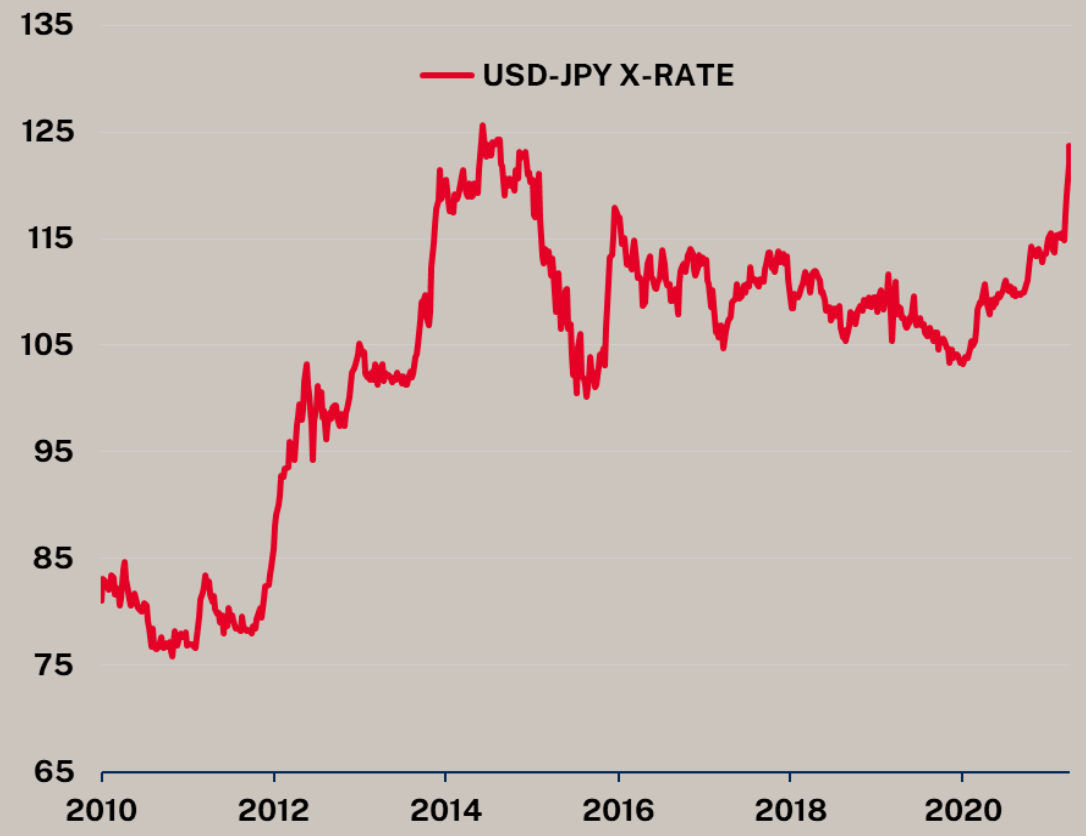
4

LIGHTHOUSE CANTON

JPY at a 7y low

- Investors are moving out of the yen. In just three weeks, the yen has weakened 8 per cent against the dollar, to a seven-year low.

- BoJ dovishness is behind yen weakness. On Monday, the central bank offered to purchase an unlimited amount of 10-year JGBs at 0.25% for the first four days of this week to defend its yield curve control target. Meanwhile, government bond yields of other developed markets are climbing rapidly as DM central banks adopt a more hawkish stance to temper elevated inflation.



Source: Bloomberg, March 29th 2022

LIGHTHOUSE CANTON

Currencies & Commodities – Executive Summary

In case you missed it:

- **Gold will remain volatile**. On one hand, a stronger USD and raising rates are making Gold less attractive. On the other hand, geopolitical instability is positive for the metal. With no correlation to US Equities (0.09 between 03/2016 and 03/2022, monthly observations), we consider gold as a good portfolio diversifier rather than a hedge.

- As the Chinese economy becomes the world largest, **we remain supportive of the CNY for all investors with a long-term view**. Reports showing that Saudis are considering selling Oil to China in Yuan is also representative of the international shift in favor of the Chinese currency.

- **Below 1.10, the Euro start looking attractive for institutional investors**, with a long-term horizon (5-10Y). For investors with a shorter investment horizon, we recommend waiting for the EUR/USD to trade closer to 1.05 before adding European equities.

- **Commodities are likely to remain highly speculative throughout 2022**. We recommend outsourcing the trading of commodities to well establish managers with strong risk-management culture.

LIGHTHOUSE CANTON

LIGHTHOUSE CANTON

Singapore

Lighthouse Canton Pte Ltd

16 Collyer Quay
#11-02
Income at Raffles
Singapore 049318
Phone: +65 67130570

Dubai

Lighthouse Canton Capital DIFC Pte Ltd

The Exchange
Gate Village 11, Unit 204
Dubai International
Financial Centre
PO Box 507026
Dubai, UAE
Phone: +971 45 861500

India

LC Capital India Private Limited

First Floor, Aloft hotel,
Asset no. 5B, Hospitality
District, Aerocity
New Delhi, 110037 (India)

H9 EFC,12th Floor
Parinee Crescenzo,
G Block BKC
Mumbai 400051

Phone: +91 9650473961

info@lighthouse-canton.com
service@lighthouse-canton.in
Lighthouse Canton