Investment Playbook Weekly Update

31st July to 4th August 2023

LIGHTHOUSE CANTON

2022 ASIAN PRIVATE BANKER AWARDS FOR DISTINCTION
BEST INDEPENDENT WEALTH MANAGER ASIA PACIFIC

PRIVATE BANKING AWARDS 2023 ASIAMONEY
RISING STAR, SINGAPORE

2021 ASIAN PRIVATE BANKER AWARDS FOR DISTINCTION
BEST INDEPENDENT WEALTH MANAGER WEALTH PLANNING SERVICES

GLOBAL Private Banking INNOVATION AWARDS 2022

2021 ASIAN PRIVATE BANKER AWARDS FOR DISTINCTION
BEST INDEPENDENT WEALTH MANAGER INVESTMENT ADVISORY

OUTSTANDING DIGITAL TRANSFORMATION IN COVID 19 BY A FAMILY OFFICE

BEST FAMILY OFFICE – MIDDLE EAST

BEST FAMILY OFFICE – UNITED ARAB EMIRATES

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Charts of the week

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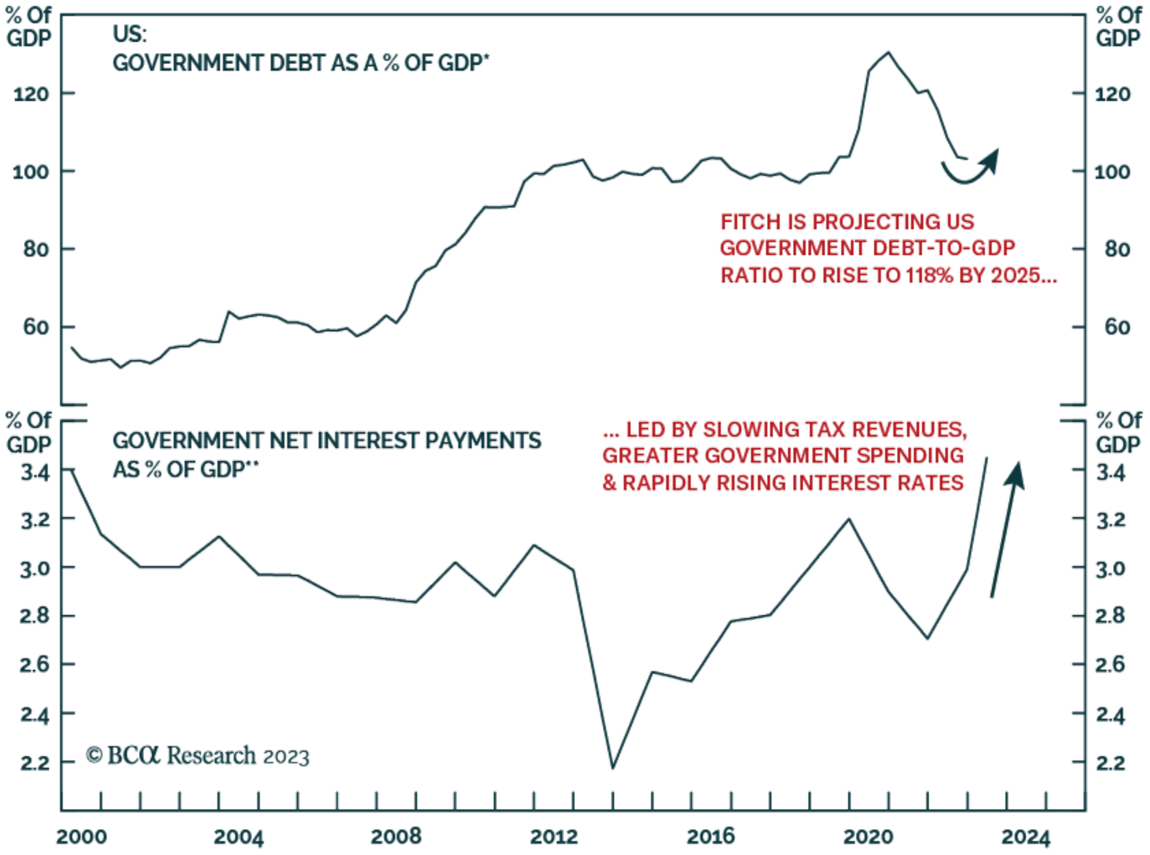
Fitch US Downgrade: AA+ Is The New AAA

Investors will Learn to Live with the US No Longer being a AAA country



* SOURCE: BIS.
** SOURCE: OECD.
NOTE: ALL SERIES REFER TO GENERAL GOVERNMENT DEBT WHICH INCLUDES FEDERAL, STATE AND LOCAL DEBT.

Source: BCA, August 2023

- Fitch lowered US credit rating from AAA to AA+ on 1 August, bringing down to the same level as that of S&P (which downgraded the US 12 years ago).
- Primary reason was an erosion in confidence over US fiscal governance in the aftermath of the US debt ceiling showdown. Fitch also projected the general government debt-to-GDP ratio to rise from 112.9% this year to 118.4% in 2025, as well as a rise in its net interest payments-to-GDP ratio.
- However, BCA does not expect the bond market reaction to the downgrade to extend much. The bigger drivers of US Treasury yields in the near term will continue to be the pace of US inflation and economic growth, and what it means for Fed policy and inflation expectations.

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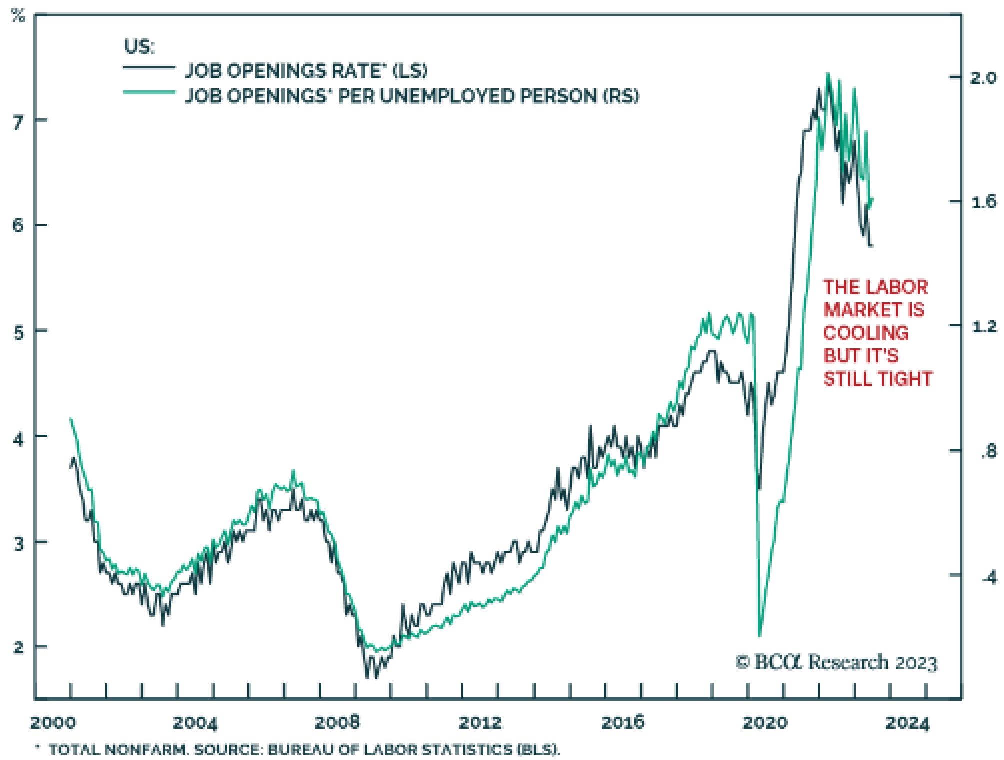
July Jobs Data Still Point to Tight Labor Market

Strong employment growth and continued elevated job openings could deter premature dovish pivot



Source: BCA, August 2023

- The ADP Jobs Report for July showed a significant increase in private employment, surpassing expectations with a rise of 324,000 jobs, the second-highest reading in a year.
- The service-producing sector contributed the most to the job gains, with an increase of 303,000 jobs across various industries, except for a decrease in manufacturing employment. Leisure & hospitality remained the primary source of job creation.
- Despite a decline in job openings, employment conditions remain tight, with 1.61 job openings for every unemployed person, and layoffs have decreased for three consecutive months.

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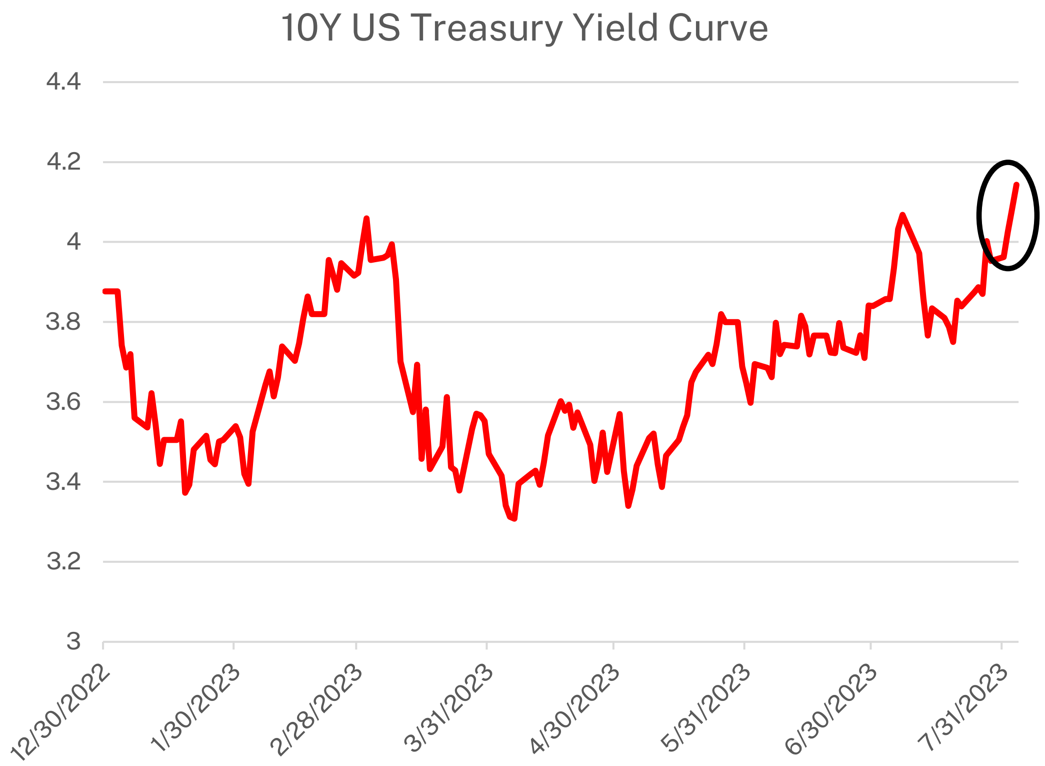
10Y Yield Back Above 4% and at YTD High

Treasury auctions, BoJ and strong labor market data have been key drivers of the move up this week

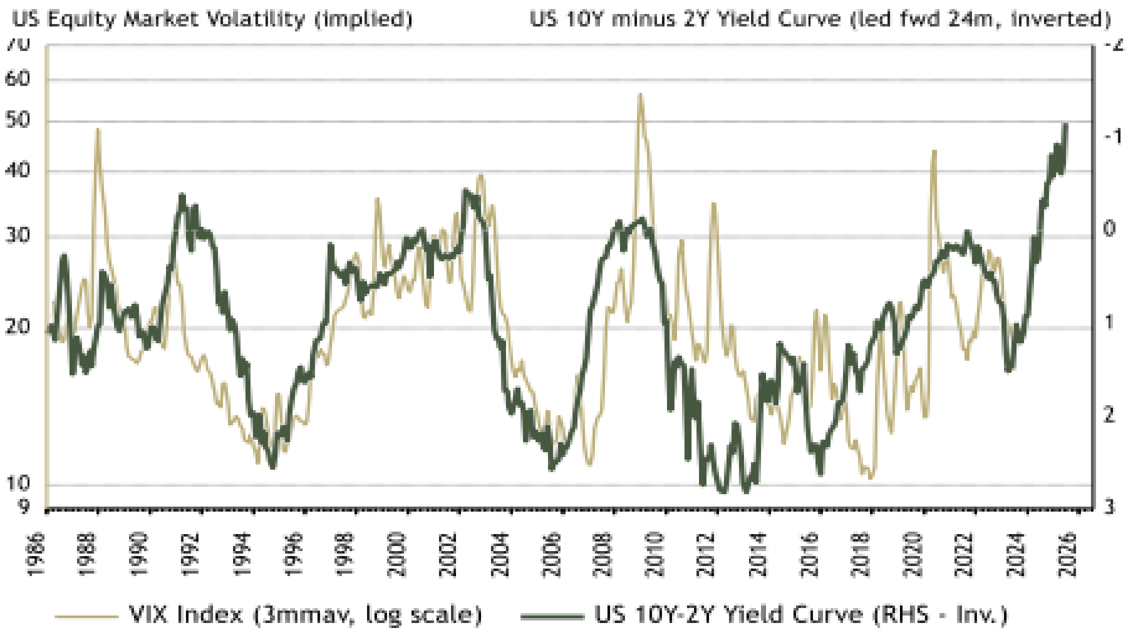


Source: Bloomberg, August 2023

- The 10- year yields have crept up from its regional bank crisis lows this year.
- Auction program also termed as Treasury Refunding, announced on 2nd August surprised on the upside, both on size of the auctions as well as nominal coupons. That put upward pressure on the yield and has been the key driver this week.
- Tight ADP jobs data added fuel to fire.
- BoJ's flexibility on the YCC (Yield Curve Control) increased the opportunity cost of holding US Treasuries thereby spiking up yields.
- While core inflation has trended lower YTD, the persistent tightness of the labor market will likely keep rate cuts at bay and put upward pressure on yields.

The US Yield Curve Leads The VIX by 24-30 Months

Volatility expected to surge in the coming quarters for US Equities



Source: ASR, August 2023

- According to research conducted by Absolute Strategy Research, there is a significant correlation between the US yield curve and the VIX index, with the yield curve tending to lead the VIX by approximately 24 to 30 months. Currently, the 30-day implied volatility stands at a remarkably low level of 13, historically uncommon for US equities, which indicates a prevailing sense of complacency among equity investors rather than an abundance of optimistic opportunities.
- If historical patterns hold true, the current state of the US yield curve, which is the most inverted since the 1980s at -86 bps, suggests that we could expect a sharp spike in the VIX index, potentially reaching levels above 40 within the next two years.

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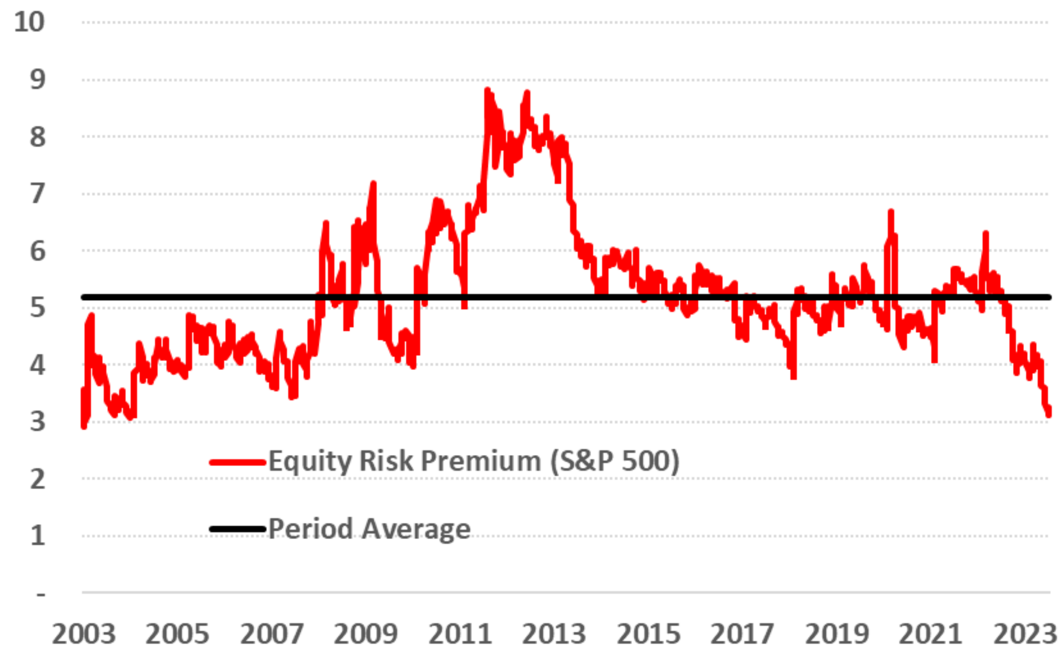
The S&P 500 Equity Risk Premium Reaches 3%

Equities investors are less compensated for the risk they take



Source: Lighthouse Canton, August 2023

- The Equity Risk Premium (ERP) for the S&P 500 index, which is determined by the difference between the expected S&P 500 earnings yield (currently at 4.70%) and the US Real Rates (10-year government bonds minus expected inflation, currently at 1.68%), has recently reached its lowest level in the past two decades. This ERP decline indicates that equities are currently failing to adequately compensate investors for the risk they face.
- Investors should be cautious in such a market environment, as the diminishing Equity Risk Premium suggests that the potential returns from equities may not be as attractive as they have been in the past.

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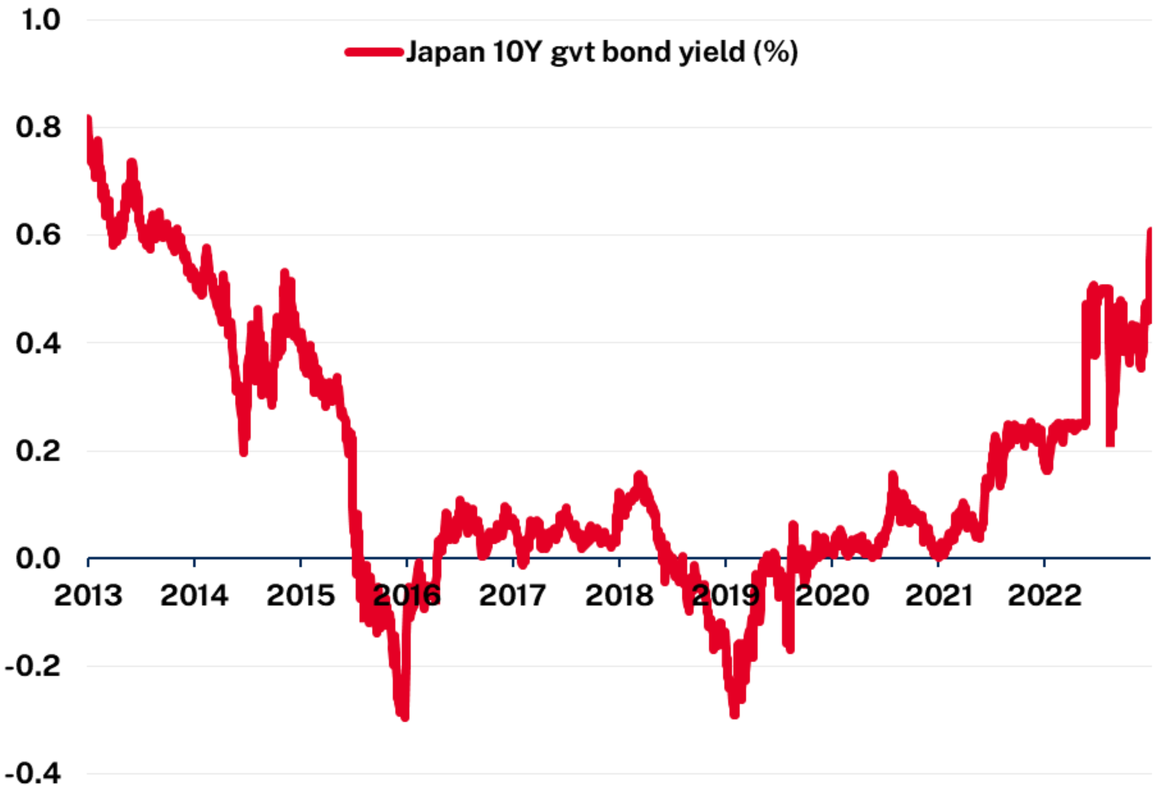
BOJ Commits To "Greater Flexibility"

Muted But Not Deteriorating Sharply



Source: BCA, August 2023

- On July 28th, the Bank of Japan announced an important tweak to its yield curve control (YCC) program. Although it maintained the 0.5% cap on 10-year bond yields, it indicated that it would manage the program with "greater flexibility" such that the 0.5% level is a reference, rather than a strict ceiling.
- The BOJ will tolerate higher yields on 10-year bonds until 1%, indicating a step closer to the end of the yield curve control.
- The yield on 10-year Japanese government bonds jumped on Friday 28th and ended the day at the highest level in nearly 9 years.

LC Views - Summary

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LC Views Summary (1/2)

Sub-Asset	Recommended Positioning
Rates	• The Federal Reserve hiked 25bps in July FOMC as widely expected. The lack of substantive changes to the policy statement suggests most officials still want to keep the door open to another rate hike. But Chair Powell's somewhat dovish performance at the news conference suggests a willingness to skip a hike at the September meeting, provided inflation data continue to be soft. He indicated that real rates are well above neutral and already restrictive, several times characterized June's soft CPI report as "better" than expected, said credit conditions are tight and getting tighter. Market participants are now pricing in a very low probability of a rate hike in September and 5 rate cuts next year. However, we urge against complacency as Powell continued to stress the Fed's determination to bring inflation back to the 2% target. Hence, we would not rule out another rate hike this year.
Credit	• We continue to favor investment grade bonds to build a strong foundation for the portfolio and seek to compliment the latter with selective high yield bonds for yield enhancement. While we recommend to allocate a larger portion of the portfolio in short duration bonds due to the elevated yields, we are actively extending duration (in IG credits) into the 5-10Y space with the spike in treasury yields. Due to the challenging economic outlook ahead, we see further opportunity in special situations bond funds, which could provide asymmetric returns in a prolonged distressed and disruptive credit market.
Equities	• Having maintained a cautious perspective year to date has been an unpleasant experience, however, we are not yet ready to fully embrace the market frenzy on the back of elevated valuations and slowing earnings. Till date, 365 of the 498 companies in the S&P500 have reported Q2 numbers, which have translated into a YoY earnings drop of 7.4%, which seems to be slightly better than the 9% fall in earnings expected by wall street. This week, equity markets were also impacted by Fitch's decision to downgrade US Sovereign debt from AAA to AA+ leading to some risk off sentiment coming back into the markets. Further, the treasury refunding program came in with bond auction sizes that were larger than expected and nominal coupons which were higher than expected, which caused a spike in yields, which inherently tends to affect stocks (higher discount rates used for valuation purposes as well as re-allocation from equities to bonds). We would also like to mention that the last time US 10-year yields reached 4.1%, the S&P 500 was trading at 3,600 – about 900 points below current levels. Consequently, we maintain our cautious outlook on equities for the next six months and recommend (in order of preference) Long/Short managers, options (FCNs or Puts), and quality stocks.

LC Views Summary (2/2)

Sub-Asset	Recommended Positioning
Currencies	• **Currencies** are expected to remain volatile throughout 2023. Given higher recessionary risks, the USD may strengthen over a short-term tactical horizon but for longer term investors, we continue to hold the view for a bearish USD. Exposure to JPY, EUR and GBP could be increased over time to benefit from the recent lows and a peak in dollar's strength driven by peak policy rates. We also recommend adding active managers (Macro funds) to monetize opportunities in currencies and rates.
Commodities	• Our long-term view for a bearish USD is likely to be supportive for Gold. We also like the yellow metal for structural reasons: diversification benefit, inflation hedge, geopolitical risk and de-dollarization trend. • Oil is likely to remain highly speculative this year as witnessed in March. On one hand, recessionary fears should temper demand. On the other hand, the production cut by OPEC+ members and already low oil inventories will support prices in the near term.
Real Estate	• Tightening financial conditions have started to cause sharp repricing in property prices globally and threaten rental growth rates. The risk of further correction in real estate prices should not be underestimated. There will be opportunities to pick good REITs cheaper next year. • With the recent banking turmoil, Commercial Real Estate exposure is increasingly at risk given the large exposures the smaller banks have to the sub-sector. Clients holding on to any related exposures should consider removing them.

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