Investment Playbook Weekly Update

7 October, 2022

LIGHTHOUSE CANTON



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Macro & Fixed Income

1

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Macro – Executive Summary (1/2)

		3Q22	Market Expectations (1Q23)	Δ*	Market Expectations (3Q23)	Δ*	LC Views
US	Real GDP Growth (YoY)1	1.8%	0.6%	-	0.8%	+	▪ As expected, the Fed delivered a 75bp rate hike in the last FOMC, bringing the fed funds rate to a range of 3% to 3.25%. The updated Summary of Economic Projections (SEP) shows downwards revisions to economic growth estimates and upwards revisions to unemployment rate and inflation forecasts. Real GDP growth is now expected to be 1.2% in Q4 2023, while unemployment is projected to increase to 4.4%. ▪ FOMC members shifted up their projected policy path quite significantly. The fed funds rate is now expected to peak at 4.6% in 2023 (up from 3.8% in June) before moving down to 3.9% in 2024 (0.5pp higher than June estimate). Bottom line is, **we do not think the fed is going to pivot any time in the next 12 months.**
	Inflation (YoY)[2]	8.3%	5.8%	-	3.1%	-	
	Unemployment (YoY)[3]	3.7%	3.9%	+	4.3%	+	
	Probability of Recession[4]				50.0%		
	Policy Rate[5]	3.3%	4.5%	+	4.4%	-	
EU	Real GDP Growth (YoY)[6]	4.1%	0.1%	-	0.1%	NC	▪ On September 8th, the ECB raised the deposit rate by 75bps to 0.75%, the highest level since 2011. ▪ The revised economic projections include an increase to the inflation forecasts with an average inflation rate of 8.1% this year and a decrease to the GDP growth forecasts from 2.1% to 0.9% in 2023. ▪ **We think risk of policy error is high and the possibility for upside rate surprises should not be underestimated.**
	Inflation (YoY)[7]	10.0%	7.7%	-	4.7%	-	
	Unemployment (YoY)[8]	6.0%	7.1%	+	7.1%		
	Probability of Recession[9]				72.5%		
	Policy Rate[10]	0.7%	2.6%	+	3.0%	+	
UK	Real GDP Growth (YoY)[11]	4.4%	-0.6%	-	-0.3%	+	▪ We are in line with the market view that **Bank of England may continue to raise interest rates aggressively with at least 6 more rates hikes** of 25 bps each over the next 12 months.
	Inflation (YoY)[12]	9.9%	9.9%	-	5.2%	-	
	Unemployment (YoY)[13]	3.6%	4.3%	+	4.6%	+	
	Probability of Recession[14]				60.0%		
	Policy Rate[15]	2.3%	5.6%	+	5.8%	+	

**Change from previous period column*

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Macro – Executive Summary (2/2)

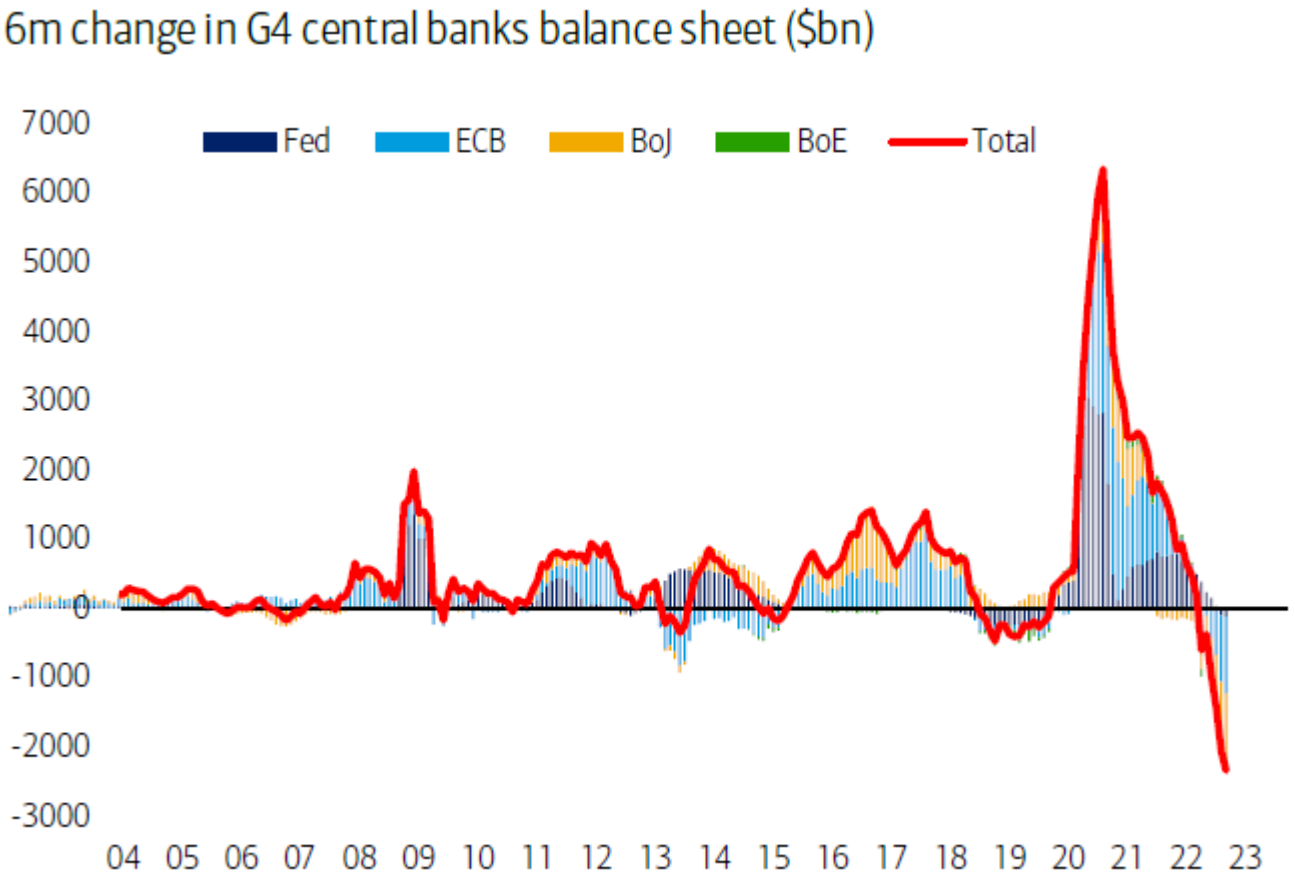
		3Q22	Market Expectations (1Q23)	Δ*	Market Expectations (3Q23)	Δ*	LC Views
China	Real GDP Growth (YoY)[16]	0.4%	3.5%	+	5.0%	+	▪ The main economic risk for China is deflation and the continuation of underwhelming economic growth. Core and service consumer price inflation are both below 1% and property prices are deflating. Falling prices amid high debt levels is a recipe for debt deflation. - BCA (15 Aug) ▪ **We think policy easing is a matter of when not if. This is difficult to predict as the CCP is unlikely to take any dramatic policy action leading up to the National Congress on 16 October**. Any meaningful support is likely to come in only after the event and even then, timing of new policy implementation remains uncertain.
	Inflation (YoY)[17]	2.5%	2.8%	+	2.2%	-	
	Unemployment (YoY)[18]	4.0%	4.0%	+	4.0%	-	
	Probability of Recession[19]				20.0%		
	Policy Rate[20]	4.4%	4.4%	+	3.7%	-	
India	Real GDP Growth (YoY)[21]	13.5%	4.3%	-	6.7%	+	• On 30th Sept 2022, Monetary Policy Committee (MPC) decided to increase the policy rates by 50 bps to 5.90%. • Going ahead, further policy tightening is warranted, as inflation for first three quarters of 2022-2023 is expected to be above upper tolerance band of 6%. We expect terminal rates 6.25% to 6.5% likely to be achieved by year end. • On the demand side of India's economy, urban consumption is being lifted by discretionary spending ahead of the festive season and rural demand is gradually improving. Investment demand is also gaining traction as reflected by rising imports and domestic production of capital goods, steel consumption and cement production. • Headwinds from geopolitical tensions, tightening of global financial condition and slowing external demand pose downside risks for FY23 GDP estimates.
	Inflation (YoY)[22]	7.0%	6.0%	-	5.2%	-	
	Unemployment (YoY)						
	Probability of Recession[23]				0.0%		
	Policy Rate[24]	5.9%	6.0%	+	6.1%	+	

**Change from previous period column*

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Liquidity Pullback at Rapid Pace

G4 Central Banks' balance sheet -$3.1tn in the past 7 months

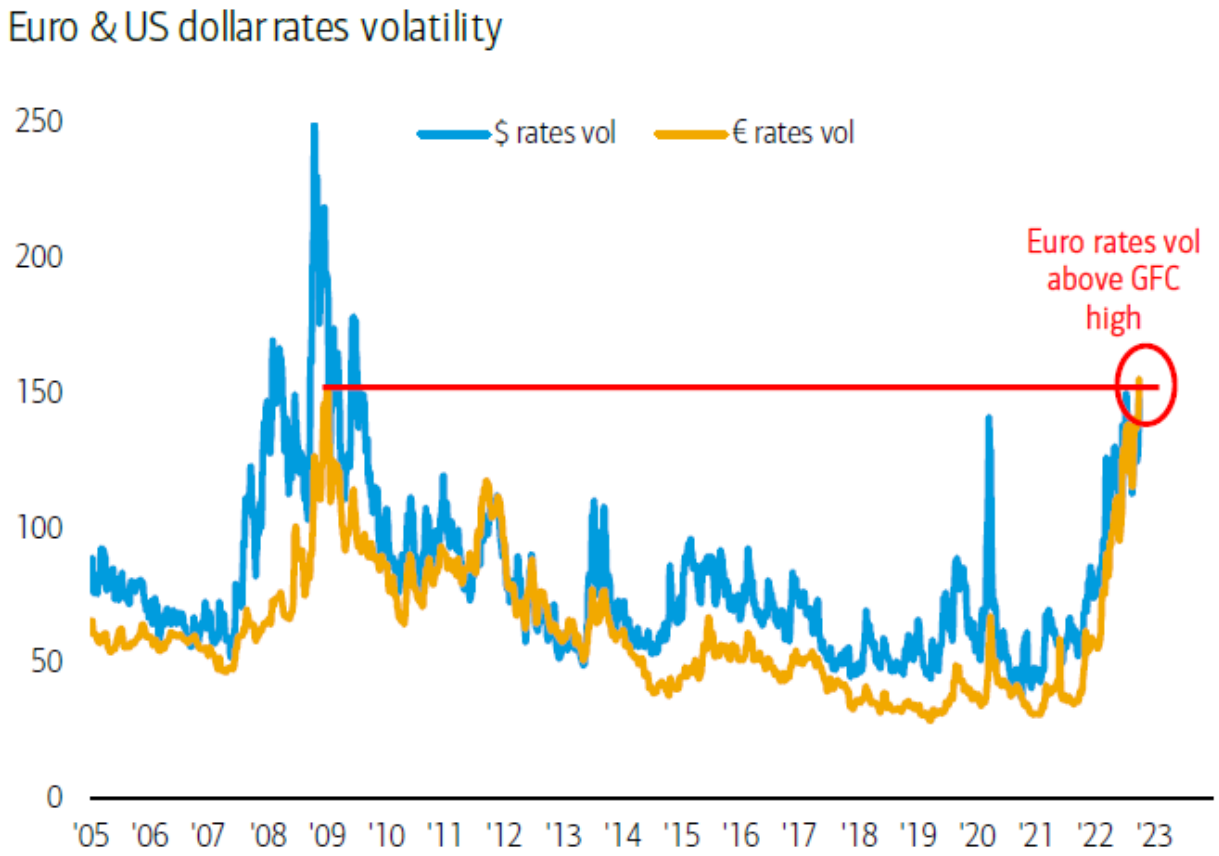


Source: BofA, October 2022

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Euro Rates Volatility Above GFC Highs

Surge in DM rates volatility reflects rapidly growing fear in markets

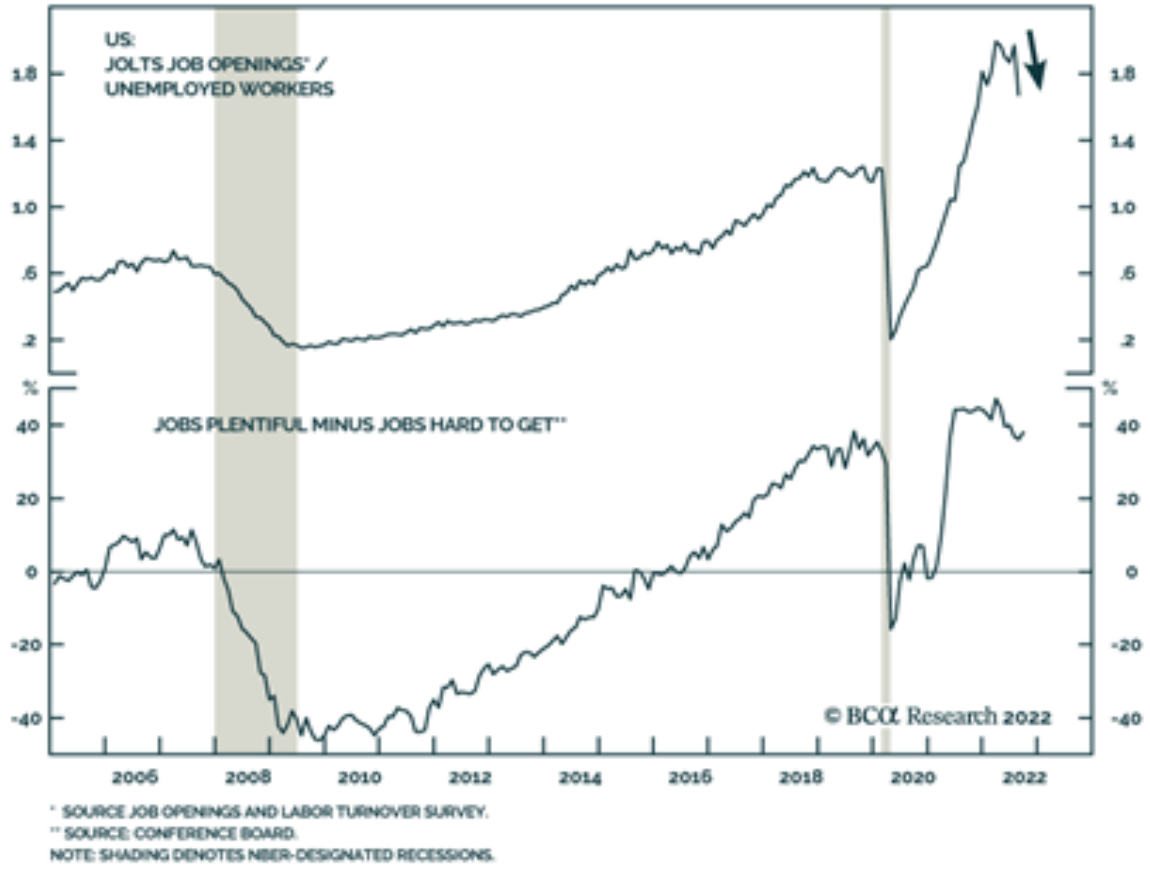


Source: BofA, October 2022

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US Job Openings Plummet In August

the number of job openings decreased to 10.1 million in August from 11.2 million in July



Source: BCA, October 2022

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Macro – Executive Summary (Sources)

1) "GDP US Chained 2012 Dollars YoY SAAR ", GDP CYOY Index, Source: Bureau of Economic Analysis. Forecast data derived from "GDP US Chained 2012 Dollars NSA", GDNSCHWN Index, Source: Bureau of Economic Analysis.
2) "US CPI Urban Consumers YoY NSA", CPI YOY Index, Source: Bureau of Labour Statistics. Forecast data derived from "US CPI Urban Consumers NSA", CPURNSA Index, Source: Bureau of Labour Statistics.
3) "U-3 US Unemployment Rate Total in Labor Force Seasonally Adjusted", USURTOT Index, Source: Bureau of Labour Statistics.
4) "United States Recession Probability Forecast", ECRPUS 1Y Index, Source: Bloomberg.
5) "Federal Funds Target Rate - Upper Bound", FDTR Index, Source: Federal Reserve.
6) "Euro Area Gross Domestic Product Chained 2010 Prices YoY", Source: Eurostat. Forecast data derived from "European Union Gross Domestic Product Chained 2010 Prices ", ENGKEU27 Index, Source: Eurostat.
7) "Euro Area MUICP All Items YoY NSA »", ECCPEMUY Index, Source: Eurostat. Forecast data derived from "Eurostat European Union HICP All Items NSA", CPALEU Index, Source: Eurostat.
8) "Eurostat Unemployment EU SA", UMRT27 Index, Source: Eurostat.
9) "Eurozone Recession Probability Forecast ", ECRPEU 1Y Index, Source: Bloomberg.
10) "ESTR Volume Weighted Trimmed Mean Rate", ESTRON Index, Source: European Central Bank.
11) "UK GDP Chained GDP at Market Prices YoY ", UKGRABIY Index, Source: UK Office for National Statistics. Forecast data derived from "UK GDP Chained GDP at Market Prices", UKGRABMI Index, Source: UK Office for National Statistics.
12) "UK CPI EU Harmonized YoY NSA", UKRPCJYR Index, Source: UK Office for National Statistics. Forecast data derived from "UK CPI EU Harmonized NSA", UKRPCHVJ Index, Source: UK Office for National Statistics.
13) "UK Unemployment ILO Unemployment Rate SA", UKUEILOR Index, Source: UK Office for National Statistics.
14) "United Kingdom Recession Probability Forecast", ECRPGB 1Y Index, Source: Bloomberg.
15) "UK Bank of England Official Bank Rate", UKBRBASE Index, Source: Bank of England.
16) "China GDP Constant Price YoY SA", CNGDPYOY Index ,Source: National Bureau of Statistics of China. Forecast data derived from "China GDP Constant Price", CNGDGDP Index , Source: National Bureau of Statistics of China.
17) "China CPI YoY", CNCPIYOY Index,Source: National Bureau of Statistics of China. Forecast data derived from "China CPI YoY", CNCPIYOY Index, Source: National Bureau of Statistics of China.
18) "China Qtrly Registered Unemployment Rate in Urban", CNUERATE Index, Source: National Bureau of Statistics of China.
19) "China Recession Probability Forecast", ECRPCN 1Y Index, Source: Bloomberg.
20) "China 1 Year Benchmark Lending Rates" , CHLR12M Index, Source: The People's Bank of China.
21) "GDP Growth Annual % India", GDPGAIND Index, World Bank Group. Forecast data derived from "India Qtr Real GDP By Expenditure Cons 2011-12 Prices ", IGQREGDP Index, Source: Central Statistics Office India.
22) "India CPI Combined YoY", INFUTOTY Index, Source: Central Statistics Office India. Forecast data derived from "India CPI Combined", INFUTOT Index, Source: Central Statistics Office India.
23) "India Recession Probability Forecast", ECRPIN 1Y Index, Source: Bloomberg.
24) "Reserve Bank of India Repurchase Rate Policy Announcement", INRPYLDP Index, Source: Reserve Bank of India.

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Fixed Income

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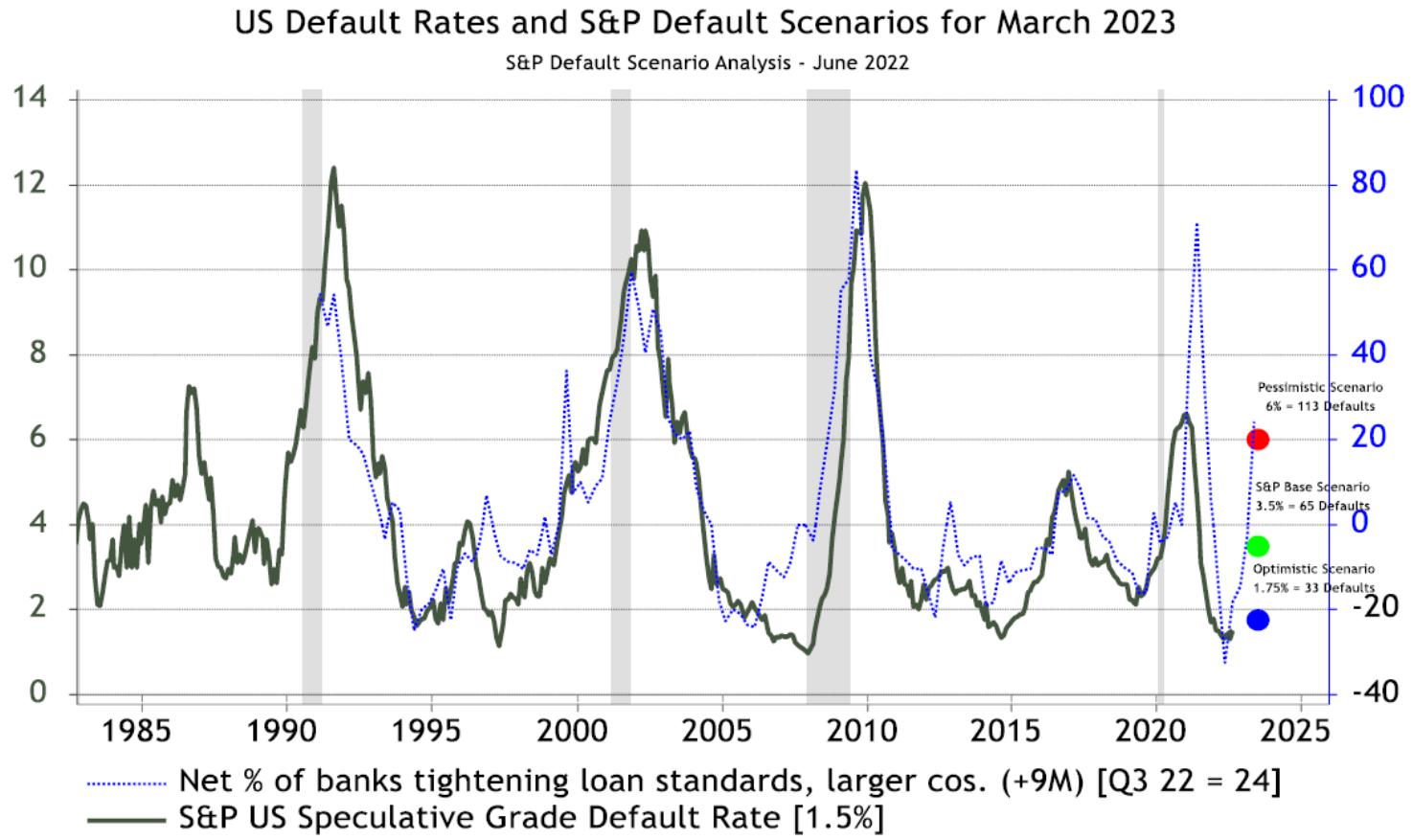
Fixed Income – Overview

	Sub-Asset	Region	IC Outlook (2Q23)	IC Comments	Recommended Positioning
Long Term Rates	10Y Rate	US	↑	▪ Despite potential downward pressure on long term rates as a result of recessionary fears, we broadly agree that there is further room for longer term rates to move higher if the Fed maintains its resolve in combating inflation. ▪ Fed balance sheet roll off likely to add further upward pressure on long end of yield curve.	▪ We think now is a good time to start adding fixed income exposures as yields are admittedly starting to look attractive. That said, this should be done progressively as rates are expected to trend higher in the near term. ▪ We are **selectively bullish on bonds in US IG credit**. with duration < 3 over a 12 months horizon. ▪ **Avoid EU names, PERPs, Cocos, High Yield and long Duration** (>3) bonds for the moment. ▪ **Add Distressed managers** to benefit from dislocations and mispricing.
		EU	↑	• Like the US, Europe's long-term rates are likely to trend higher given the ECB's acceleration in the pace of hikes and firm resolve to tame inflation.	
Credit	IG Spread (bps)	US	↔	• Global Corporate bonds are likely to face headwinds up until 1H23. • Policy rates in 1H23 are expected to rise across DM, while corporate spreads should widen on back of a global economic slowdown and higher refinancing rates, with HY to be the most heavily impacted.	
		EU	↑		
	HY Spread (bps)	US	↑		
		EU	↑		

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Avoid HY as Default Rates Are Likely to Soar

We reiterate our cautious stance on US HY given higher default risks

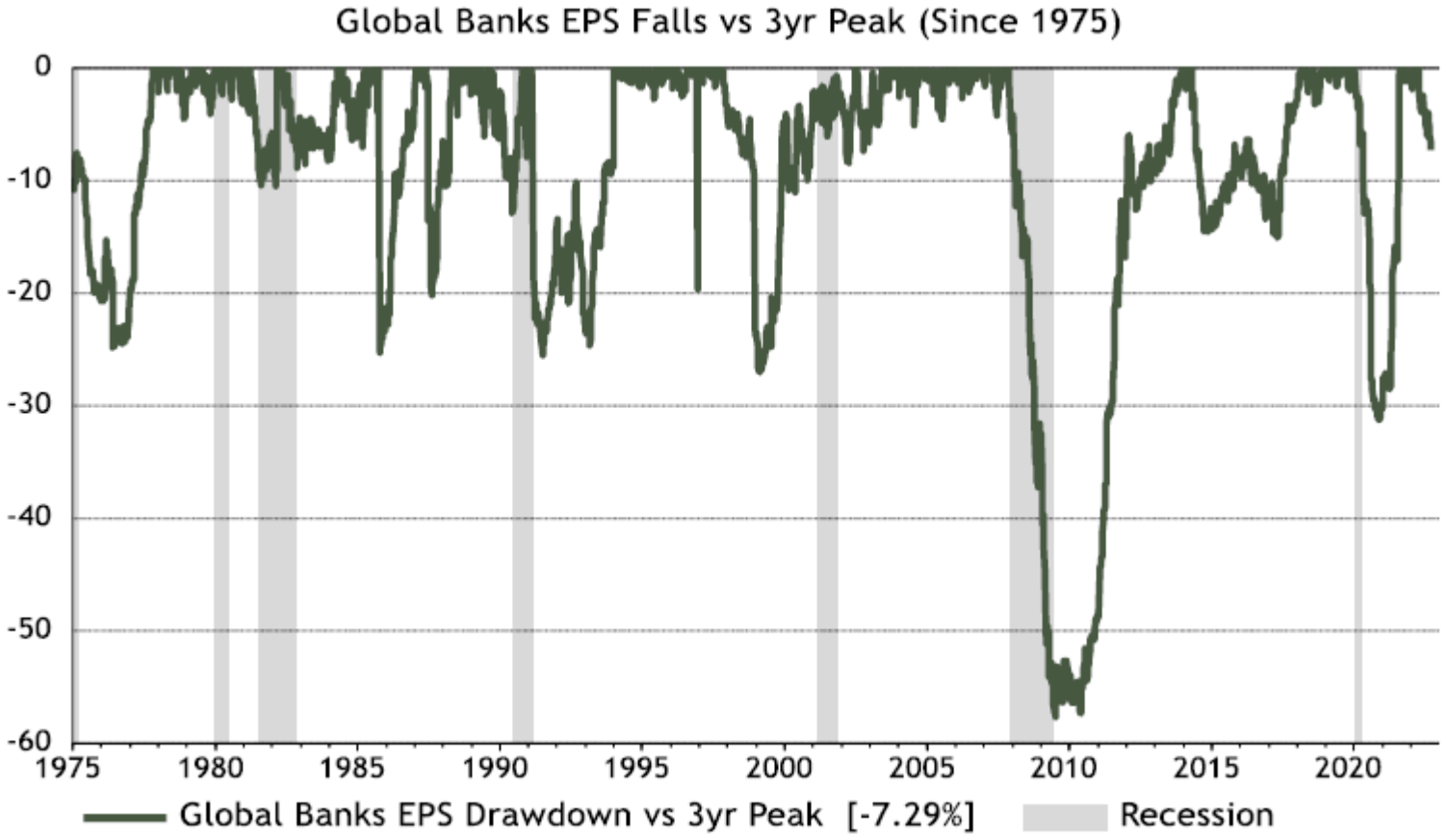


Source: ASR, October 2022

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Bank Earnings Likely to be Challenged

The average drawdown for global banks' earnings in a recession is ~20-30% (excluding GFC)



Source: ASR, October 2022

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Equities Highlights

3

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Equities – Overview (1/2)

Region	IC Outlook (2Q23)	IC Comments	Recommended Positioning
US (S&P 500)	↓	▪ Analysts have been downgrading their S&P 500 earnings expectations for the past three months. ▪ We hold a bearish view on US equities over the next 6-12 months given that interest rates are expected to continue rising and economic growth, while not collapsing, is softening. ▪ Moreover, US Equities are likely to continue to be negatively correlated with long-term rates and are exposed to any hawkish comments from the FED.	▪ Earnings are coming under pressure as evidenced by the earnings reported by Nike and Car Max over the past few weeks. We expect negative EPS growth through 2023 in either a mild-recession or soft-landing scenario. ▪ We **do not think it is time to increase beta on portfolios** yet and recommend a cautious stance in terms of positioning. ▪ Consider adding **Long/Short managers** who can take bi-directional bets and who should benefit from current dispersion. ▪ There are some good quality companies which we have on our list that appear oversold with high implied volatility – making them good candidates for **FCNs/ELNs structure**. This is a good way to maintain a defensive stance while benefiting from high carry from coupons. **Do not** go beyond 6M in maturity.
EU (STOXX 600)	↓	▪ We think EU is in a precarious situation as it is likely to already be in recession. Elevated gas prices and energy rationing efforts would keep a lid on any growth prospects, and we anticipate corporate earnings pressure to intensify into 1H23. ▪ Despite the bleak economic situation, the consensus STOXX 600 earnings growth expectations is at >10%, a fairly optimistic scenario in our opinion. We expect more earnings misses to materialize over the next 12 months. ▪ According to Deutsche Bank, investors have redeemed $83 billion from European equities in the past 6 months.	

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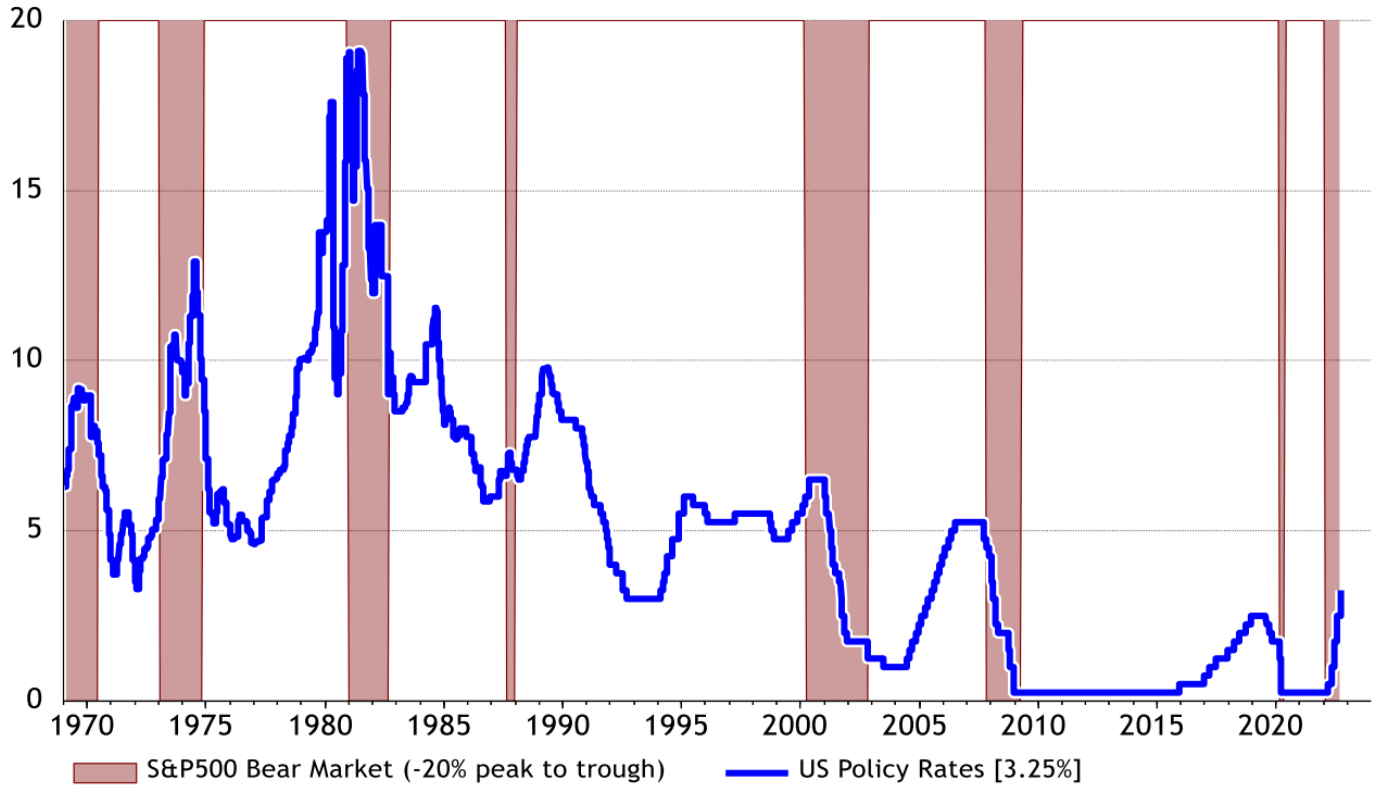
Equities – Overview (2/2)

Region	IC Outlook (2Q23)	IC Comments	Recommended Positioning
China (CSI 300)	↔	▪ We reckon that Chinese valuations are attractive, but equities are likely to stay undervalued as growth is expected to slow down with Zero Covid Policy placing a lid on economic activity and profit outlook. ▪ A preliminary deal between the US SEC and China PCAOB has been reached allowing American accounting regulators to inspect the audit records of Chinese companies listed in New York. However, because of the structural nature of the US-China geopolitical rivalry, the road to success will be long and full of obstacles. ▪ We think markets are likely to trend sideways. Supportive policies and relaxations to ZCP would be key recipes to an eventual tailwind for market sentiments. Visibility remains very low on this front.	▪ Investors should **continue to remain invested in low beta long short managers** (FengHe, Luxence, UBS O'Connor China L/S) for now. Indeed, w**e do not recommend taking on full beta risk just yet**. ▪ For direct stocks, we **prefer bottom-up picks with strong earnings** this year and clear growth trends ahead.
India (NIFTY 50)	↔	▪ Indian equities continue to outperform global equity markets on the back of strong economic growth expectations and inflation prints not getting out of hand. ▪ Valuations are however expensive, with the Nifty trading at close to 21 times earnings, which is more than its historical average of 18.6 times earnings. ▪ Despite the sanguine view on the region, we think aggressive monetary policy actions and even more aggressive communication from Advanced economies and a strong dollar, serve as key risk factors to any meaningful upside to Indian equities.	▪ We recommend a **cautious and staggered approach** when it comes to allocating to Indian equities, as we await further clarity with respect to how the global macro situation unfolds and whether Indian corporate earnings can hold up in an increasingly tougher macro environment and a more restrictive monetary stance being taken by the central bank.

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Not Time to be Bullish on Equities Yet

Bear Markets Only End <u>After</u> the Fed Has Cut Rates Aggressively.

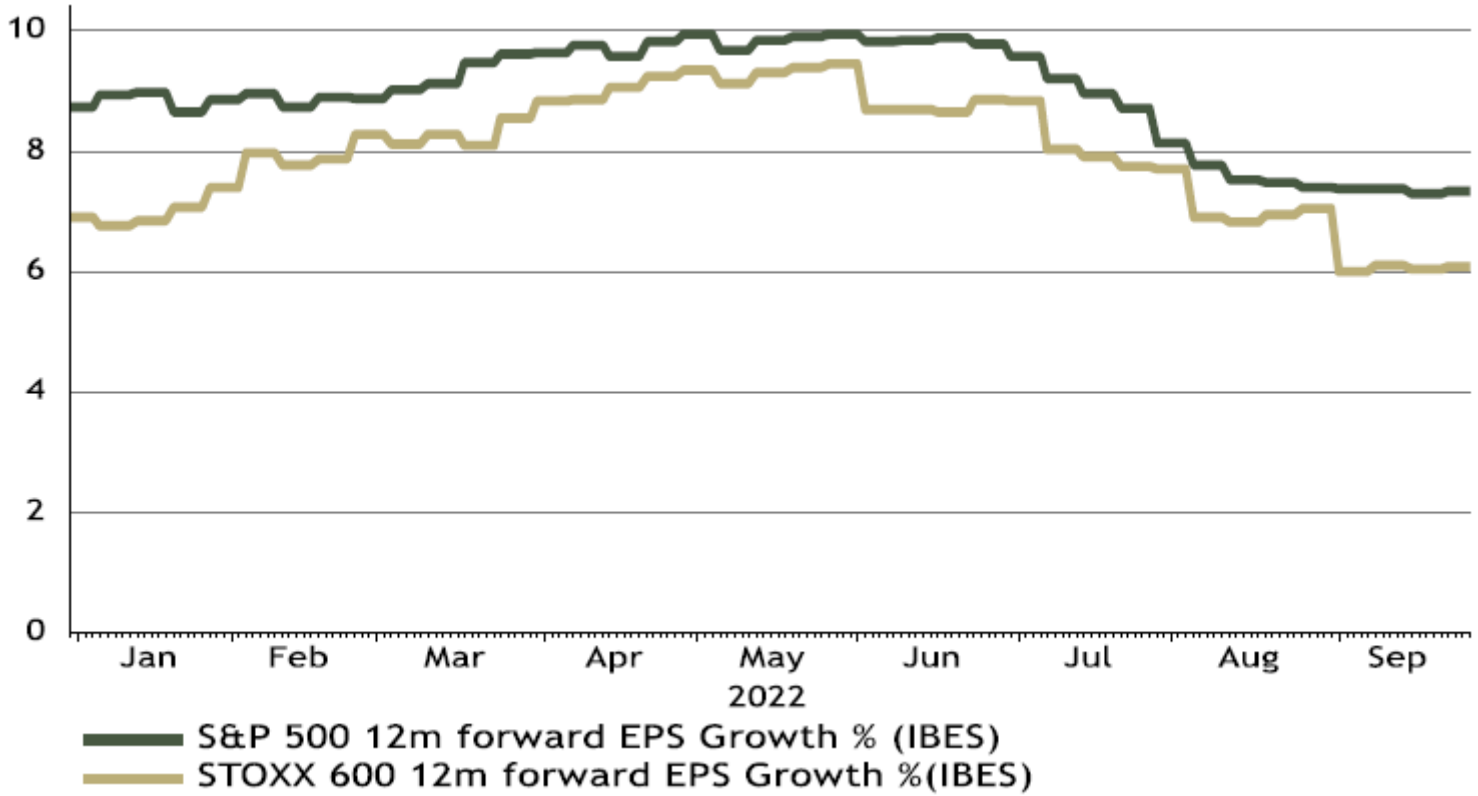


Source: ASR, October 2022

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EPS Growth Estimates Have Hardly Moved

Earnings expectations in US and EU still look very optimistic and vulnerable with recession looming

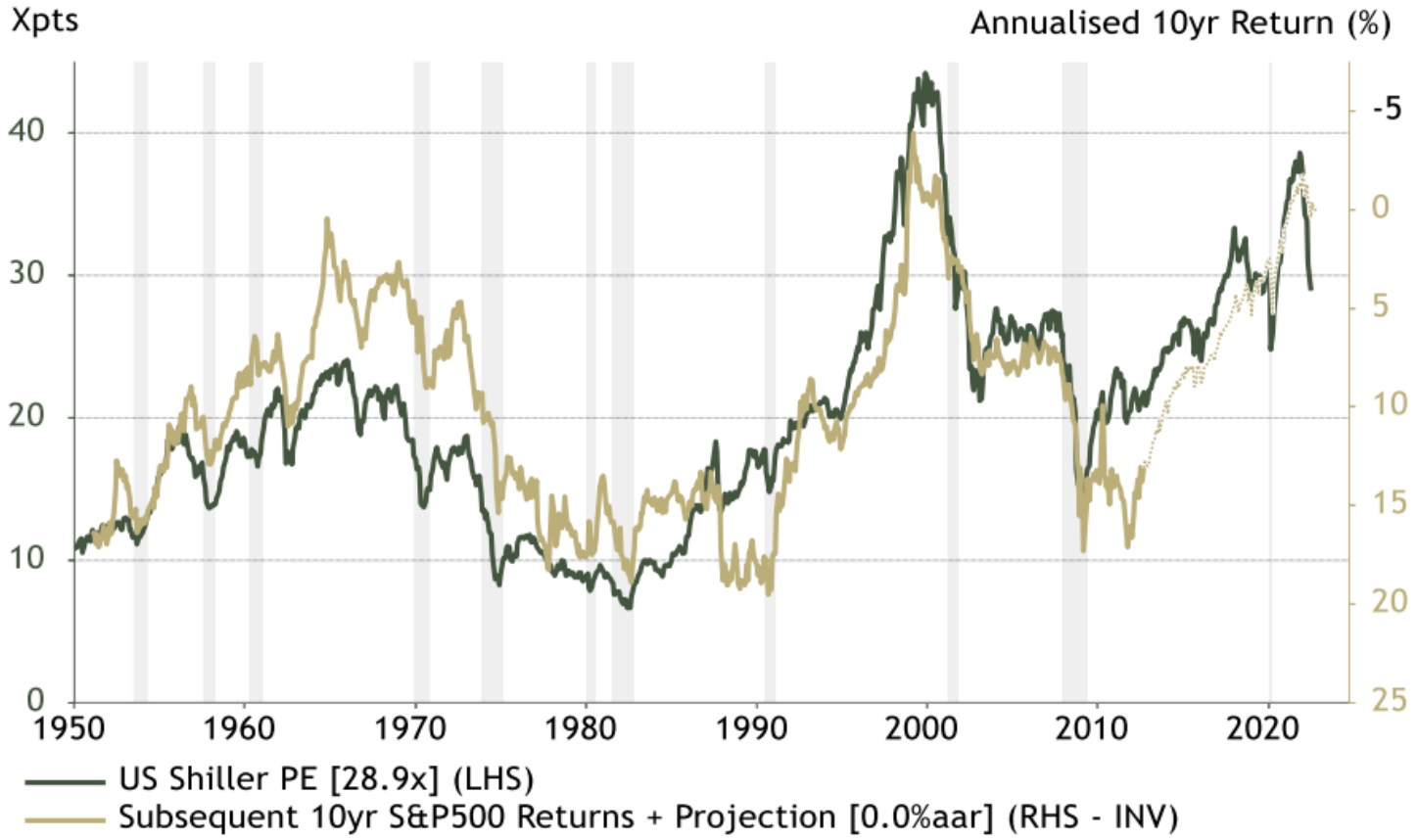


Source: ASR, October 2022

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Equities Are Still Expensive (Another POV)

Relationship of Shiller PE and subsequent 10yr S&P500 returns suggests <5% returns in next 10 years

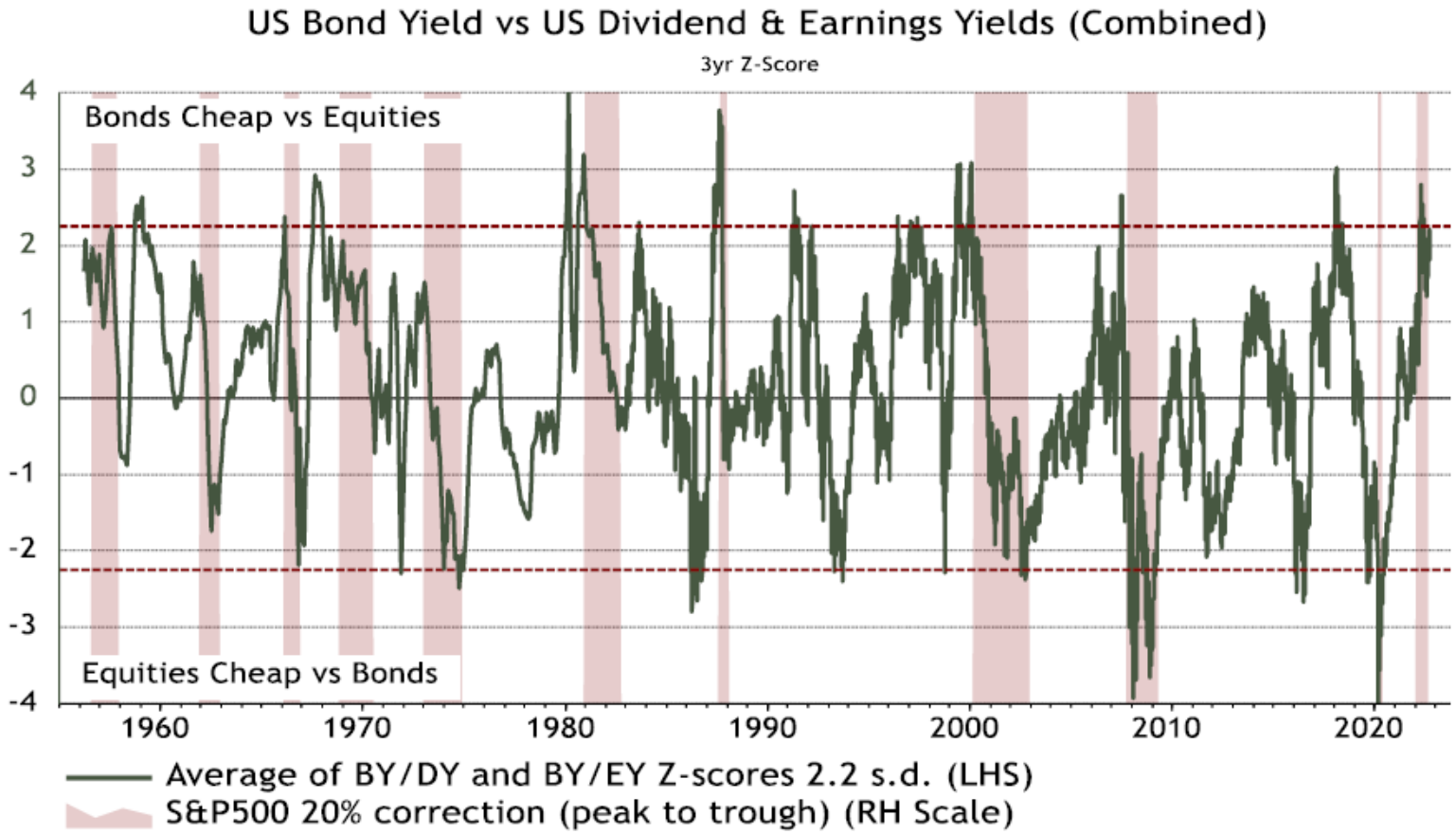


Source: ASR, October 2022

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Bonds are still more attractive than Equities

We are starting to increase allocations to bonds given more attractive yields and more equity downside



Source: ASR, October 2022

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China stocks valuations hit record lows

Hang Seng China Enterprises Index falls to GFC level; price-to-book ratio hits a historical low of 0.6x

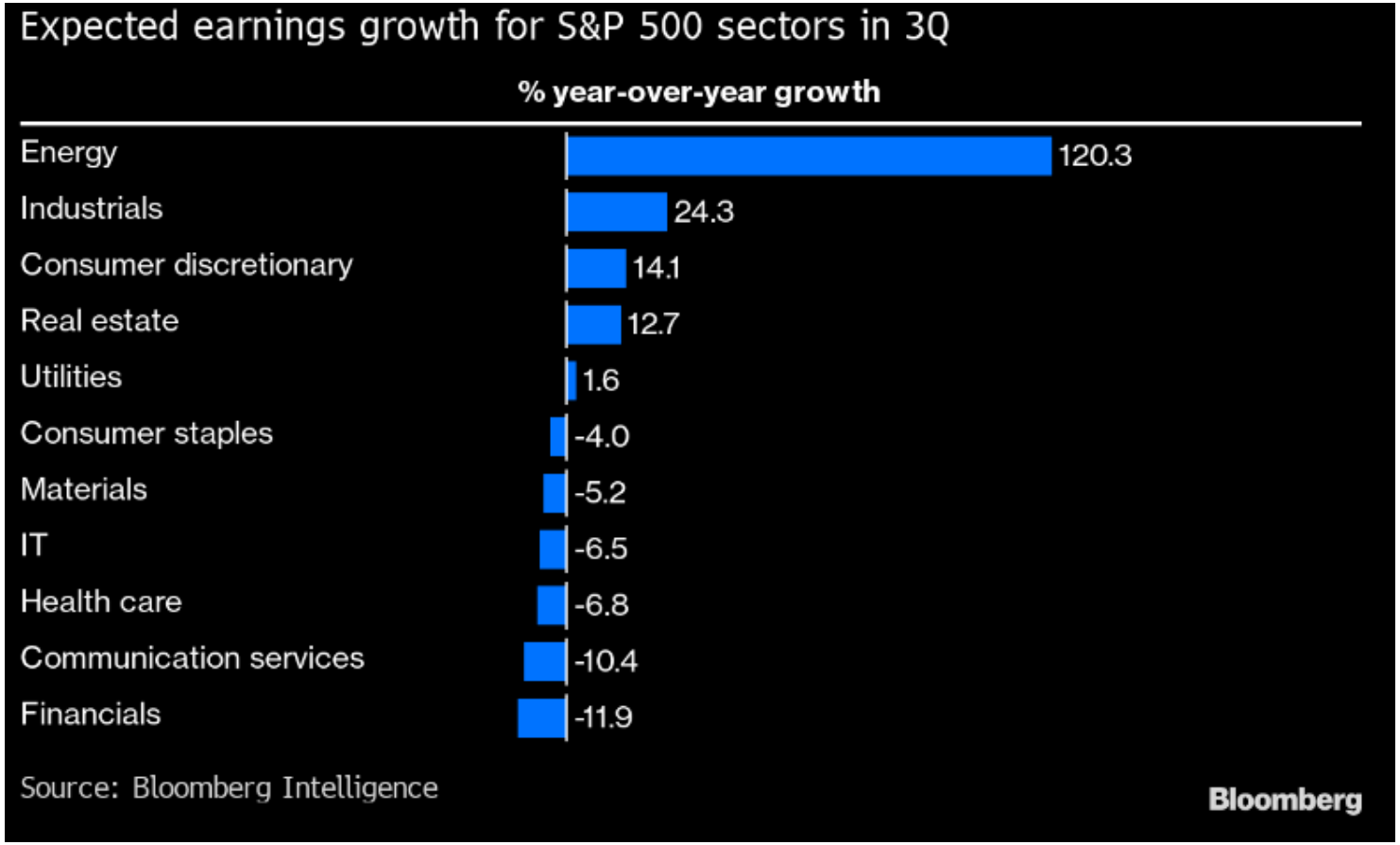


Source: Bloomberg, October 2022

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S&P 500 Q3 earnings expectations

Analysts expect an aggregate earnings growth of 2.9% for the quarter, with much of it coming from energy companies



Source: Bloomberg, October 2022

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Forex, Commodities & Alternatives

4

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Commodities – Overview

	Sub-Asset	IC Outlook (2Q23)	IC Comments	Recommended Positioning
Commodities	**Gold**	↔	▪ There are two opposite forces for Gold. ▪ On the one hand, gold is likely to face near term headwinds on back of higher rates (which is an opportunity cost for gold holders) and a strong dollar. ▪ On the other hand, increasing holdings of gold in global central bank reserves points to a de-dollarization trend which could act as tailwinds for the yellow metal.	▪ We believe that **some exposure to gold makes sense** as a means to hedge longer term inflation and geopolitical shocks. ▪ As it is difficult and extremely tricky to time and trade the yellow metal, our **recommended way to gain exposure is via external managers** (Delbrook - gold equities, Drakewood - gold futures/options)
	Oil	↔ / ↓	▪ Oil demand should likely deteriorate on back of higher recession risks globally. ▪ On the flipside, OPEC to lower production by 2mm b/d starting in November, marking the largest cut since 2020. ▪ We think risks are skewed more to the downside given the historically large drawdowns (>40%) which oil faces during recessions. That being said, The production cuts could help minimize the extent of these drawdowns.	-

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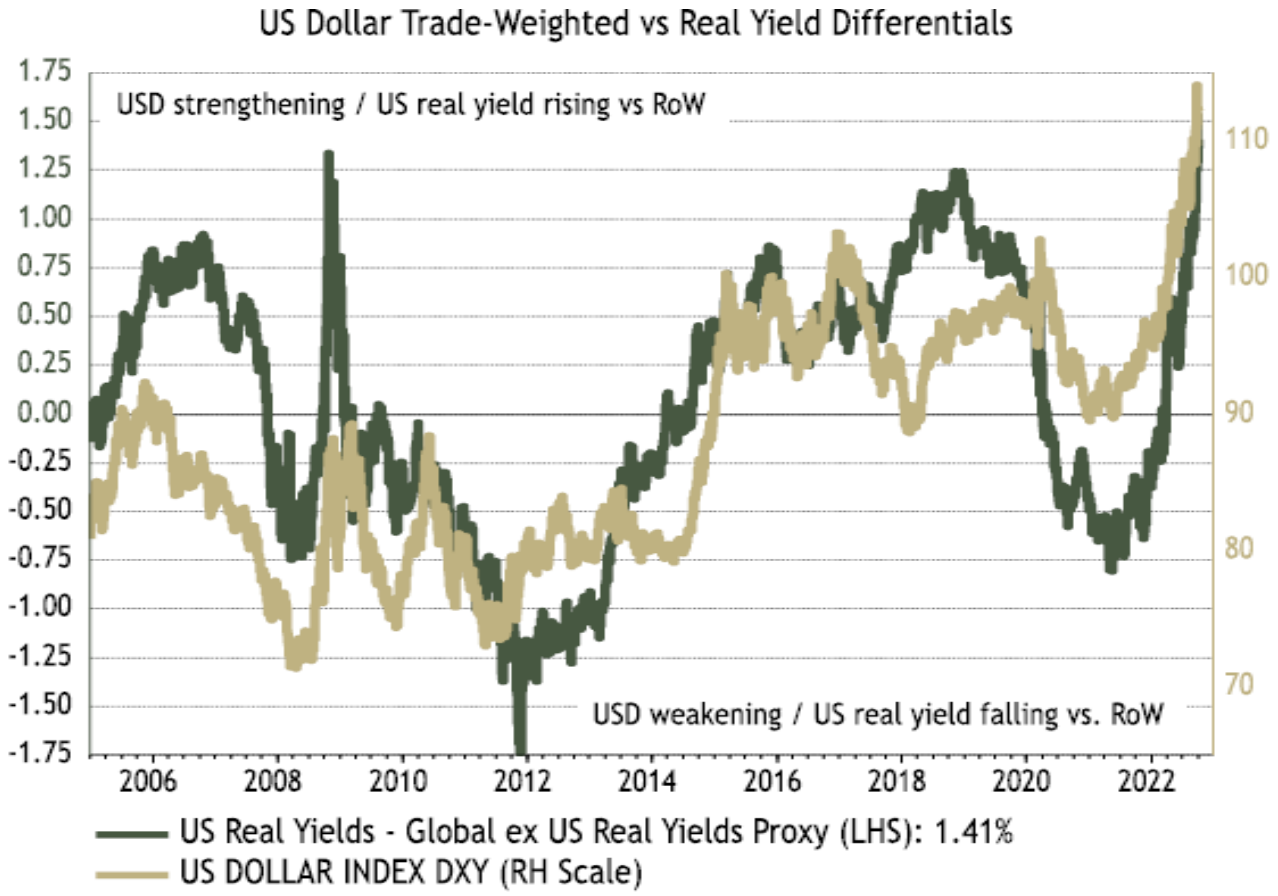
Forex – Overview

	Sub-Asset	IC Outlook (2Q23)	IC Comments	Recommended Positioning
FX	USD	↔/↑	▪ A stronger dollar is the global transmission policy of the Federal Reserve's rate policy, that policy is tightening fast, and it is uncertain where it will stop. We anticipate the dollar to maintain its strength throughout 22 as recessionary fears accelerate.	• With another 75 bps & 50 bps rates hike expected by the Fed respectively in November and December, **we expect the US dollar to remain strong until the end of the year. Any risk-off sentiment is also likely to be favorable for the USD in the short term.** • However, **bleaker growth outlook in other regions as well as a hawkish fed will continue to support current levels.** • Both BOE and ECB are now expected to hike rates further to narrow the interest rate differential with the USD and support their currencies. • Despite its strength, **longer term investors may consider gradually adding DM currency exposures** (EUR or GBP) as they are looking cheap versus the dollar.
	EUR	↔	▪ The EUR continues to remain below parity (Vs USD) because of adverse news flow: I. The German Ifo Business Climate Index weakened further in September, sliding from 88.6 to 84.3, below expectations of a milder deterioration. II. Italy's right-wing coalition led by Giorgia Meloni secured 44% of the vote in Sunday's general election. Italian government bond yields rose 21bps on Monday following the announcement of the right-wing victory.	
	GBP	↔	▪ Sterling collapsed to an all-time low in intra-day trading on September 26th. The weakness follows UK Chancellor Kwasi Kwarteng's mini-budget announcement and comments that more tax cuts are coming. ▪ The Bank of England will ultimately tighten monetary policy more aggressively in order to combat inflationary pressures stemming from the looser fiscal stance.	
	CNY	↓	▪ The PBOC is very supportive and has started decreasing interest rates. Policymakers will ultimately continue to ease domestic policy to reflate the economy and the PBoC will probably cut rates further. The implication is that the CNY – which has already depreciated by 11% so far this year – is likely to continue weakening. ▪ Given that the Chinese economy faces deflationary pressures, authorities in Beijing do not have an incentive to pursue a stronger yuan.	
	JPY	↔	▪ The JPY is unlikely to rebound as the rates differential increases with other central banks.	

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Dollar to Remain Strong With Hawkish Fed

Dollar's strength will only peak when interest rates differential with ROW starts to narrow

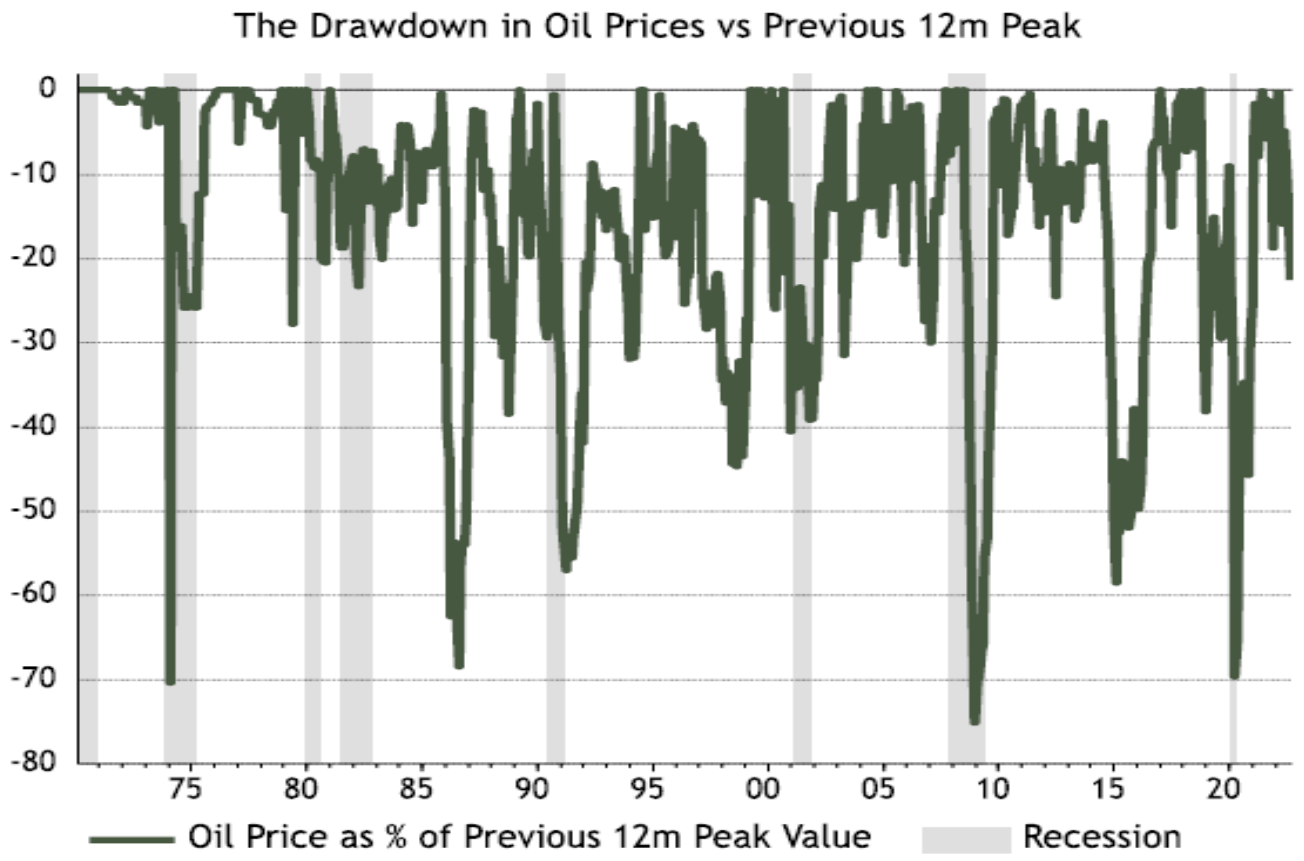


Source: ASR, September 2022

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Oil Prices Could Struggle In a Recession

Historically, oil has corrected more than 40% in every recession.



Source: ASR, September 2022

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