Investment Playbook Weekly Update

2 September, 2022

LIGHTHOUSE CANTON



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Macro

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Macro – Executive Summary

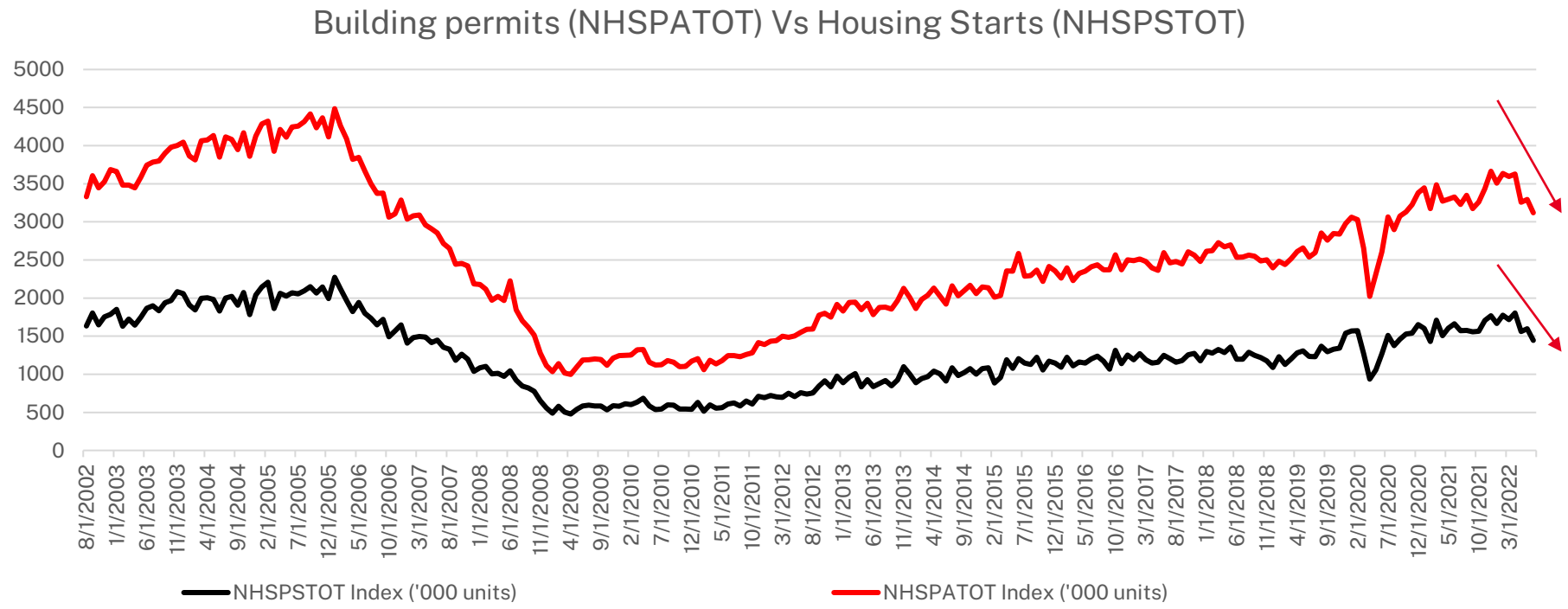
		Current Quarter	Market Expectations (3-6M)	Δ	Market Expectations (6-12M)	Δ	LC Views
US	Real GDP Growth (QoQ)	-0.6%	2.8%	+	2.31%	+	▪ Core inflation remains elevated and sticky, and benchmark real rates are still negative. Pressures from shelter costs are building. ▪ Guidance from Jackson Hole is loud and clear: the central bank is committed to ensuring that inflation returns to target. Consequently, we do not believe that the Fed will reverse its policy and start decreasing rates next year, as implied by the Futures market. ▪ We are broadly in line with market expectations for rate hikes. This coupled with higher recession probabilities (50%) increases stagflationary risks.
	Inflation (YoY)	8.5%	1.0%	-	2.91%	-	
	Unemployment (YoY)	3.5%	3.7%	+	3.95%	+	
	Probability of Recession				50.00%		
	Policy Rate	2.50%	3.8%	+	3.91%	+	
EU	Real GDP Growth (YoY)[6]	0.6%	1.0%	+	0.4%	-	▪ Inflationary risks continue to be on the upside but with the weak economic outlook, the ECB should keep its cautiously hawkish stance. Money markets fully priced in a percentage-point of tightening by the ECB's October meeting. ▪ Core inflation continues to climb higher which is putting the ECB increasingly behind the curve. ▪ We think risk of policy error is high and the possibility for upside rate surprises should not be underestimated.
	Inflation (YoY)	9.10%	1.8%	-	3.13%	-	
	Unemployment (YoY)	6.00%	6.9%	+	7.05%	+	
	Probability of Recession				55.00%		
	Policy Rate	-0.08%	1.59%	+	2.25%	+	
UK	Real GDP Growth (YoY)	2.90%	4.1%	+	-1.52%	-	▪ Investors expect Bank of England to continue to raise interest rates aggressively with at least 6 more rates hike of 25 bps each over the next 12 months.
	Inflation (YoY)	10.10%	5.7%	-	1.89%	-	
	Unemployment (YoY)	3.80%	4.0%	+	4.45%	+	
	Probability of Recession				60.00%		
	Policy Rate	1.75%	3.6%	+	4.35%	+	

Macro – Executive Summary

		Current Quarter	Market Expectations (3-6M)	Δ	Market Expectations (6-12M)	Δ	LC Views
China	Real GDP Growth (YoY)	-2.60%	15.9%	+	-11.82%	-	▪ Although policymakers have ramped up stimulus measures, poor housing market dynamics, weak domestic demand, an impending contraction in exports due to a strong dollar and the zero-covid policy will limit the effectiveness of these efforts. ▪ 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) ▪ The recent bailout funds that have been announced only account for 1.5-2% of last year's total financing for developers. The fragmented nature of China's property market also makes bailouts difficult to organize and implement. ▪ Recent attempts by the government to revive the housing market are likely to prove unsuccessful given poor household income growth. BCA highlights that there has been no recovery in the Chinese economy in past cycles, without a revival of the housing market.
	Inflation (YoY)	2.70%	1.6%	-	0.61%	-	
	Unemployment (YoY)	3.96%	4.0%	+	3.97%	+	
	Probability of Recession				20.00%		
	Policy Rate	4.35%	N.A.		3.65%	-	
India	Real GDP Growth (QoQ)	13.50%	9.10%	-	-1.61%	-	▪ Q1FY23 real GDP growth of 13.5% surprised on the downside. Compared to pre pandemic levels, growth was quite tepid, specially in the services sector. ▪ RBI is expected to hike rates in the next two policy meets by 35 bps to 60 bps and then pause to assess the impact on growth and inflation. The future policy direction will depend on the RBI's timeline to bring inflation down to its 4% target and prevailing growth conditions.
	Inflation (YoY)	6.71%	2.28%	-	2.46%	-	
	Unemployment (YoY)						
	Probability of Recession				0.00%		
	Policy Rate	5.40%	N.A.		N.A.		

Data points to low inventory (1/2)

Falling building permits and housing starts in US is likely to drive shelter costs (core inflation) higher

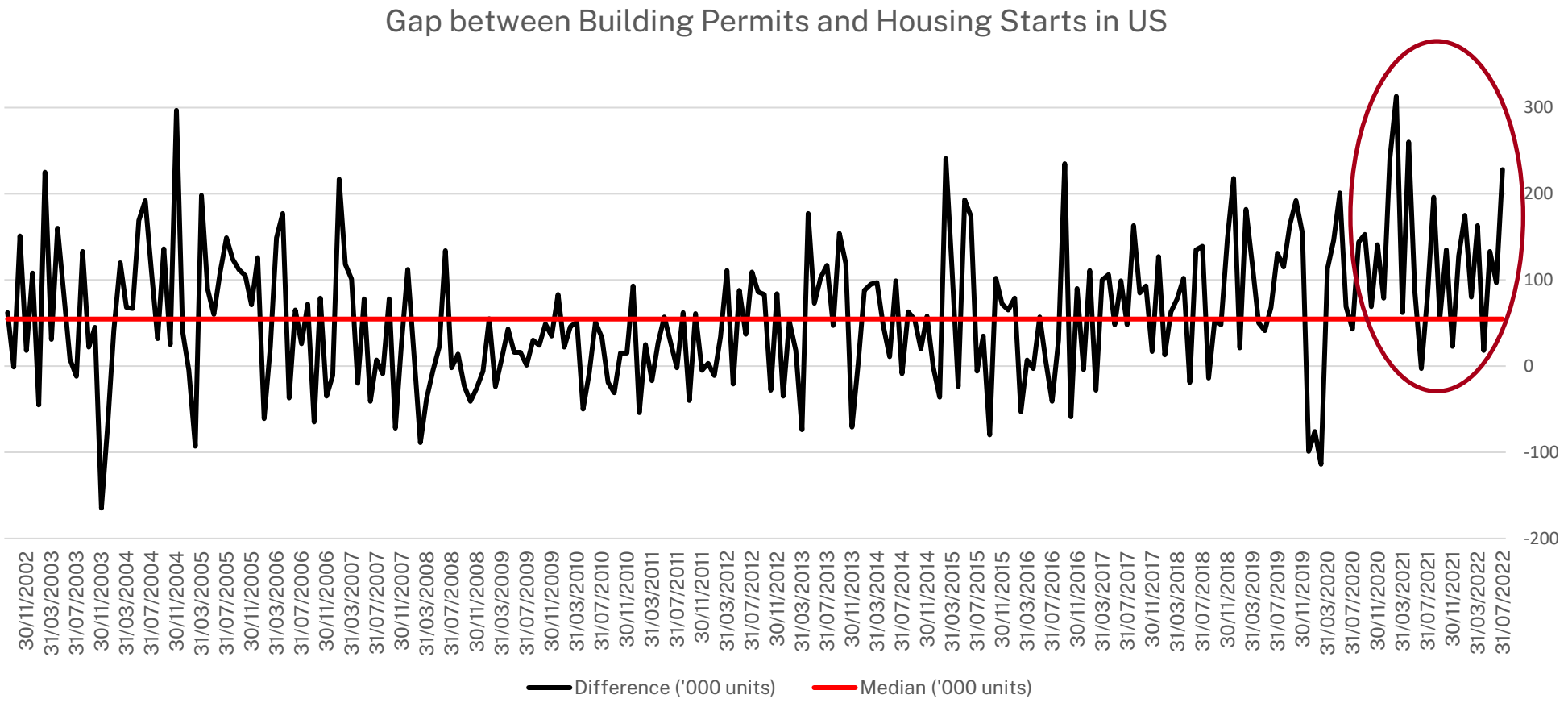


Source: Bloomberg, August 2022

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Data points to low inventory (2/2)

Gap is resulting in low inventory levels, thereby ensuring shelter costs remain sticky.

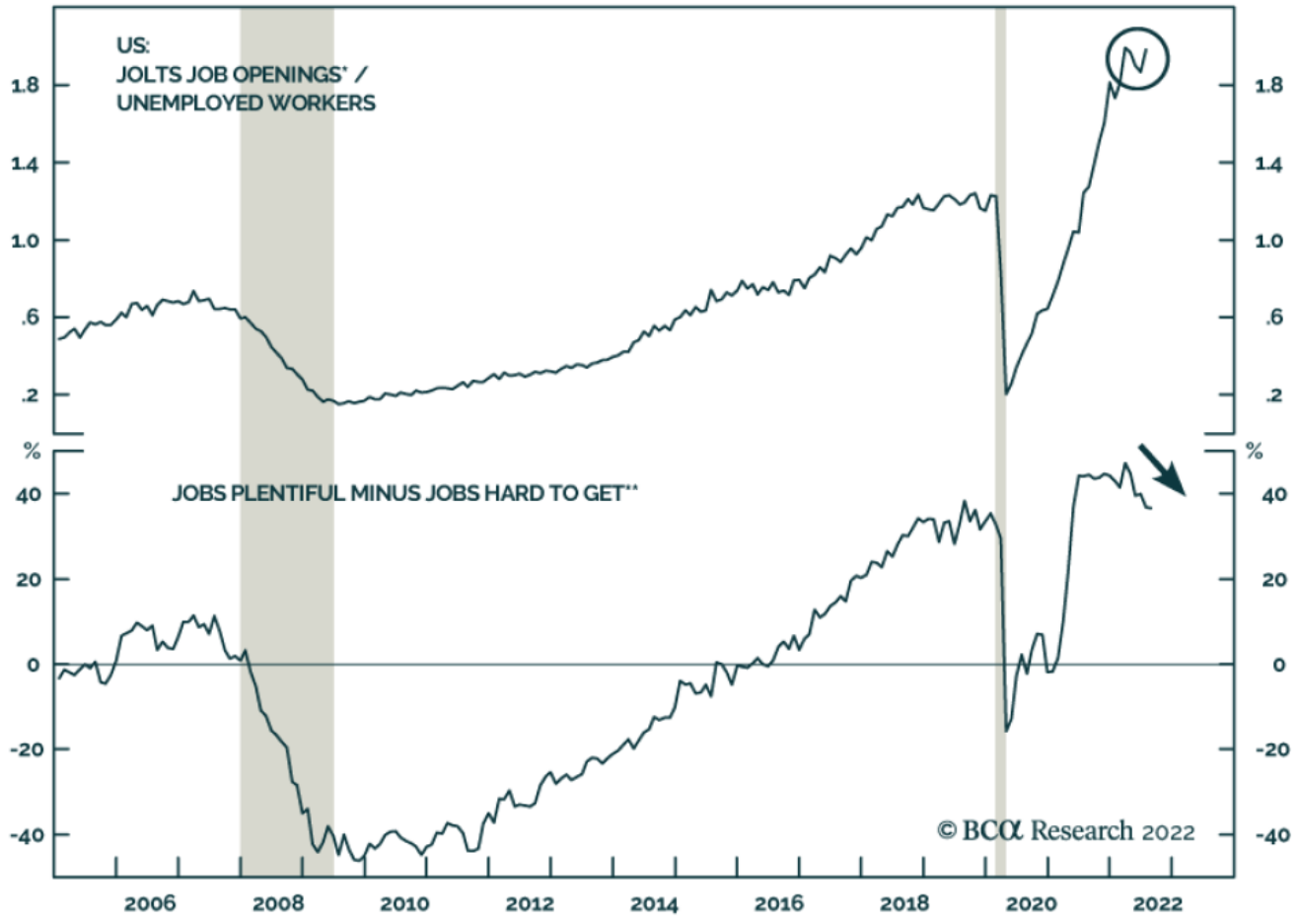


Source: Bloomberg, August 2022

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US Job Openings Surprised to the Upside

Inflation will likely stay elevated amidst the labor market tightness



Source: BCA, Aug 2022

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Macro – Executive Summary (List of Sources)

1) "GDP US Chained 2012 Dollars QoQ SAAR ", GDP CQOQ Index, Source: Bureau of Economic Analysis
2) "US CPI Urban Consumers YoY NSA", CPI YOY 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 QoQ", Source: Eurostat
7) "Euro Area MUICP All Items YoY NSA »", ECCPEMUY 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
12) "UK CPI EU Harmonized YoY NSA", UKRPCJYR 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 QoQ SA", CNGDPQOQ Index ,Source: National Bureau of Statistics of China
17) "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
22) "India CPI Combined YoY", INFUTOTY 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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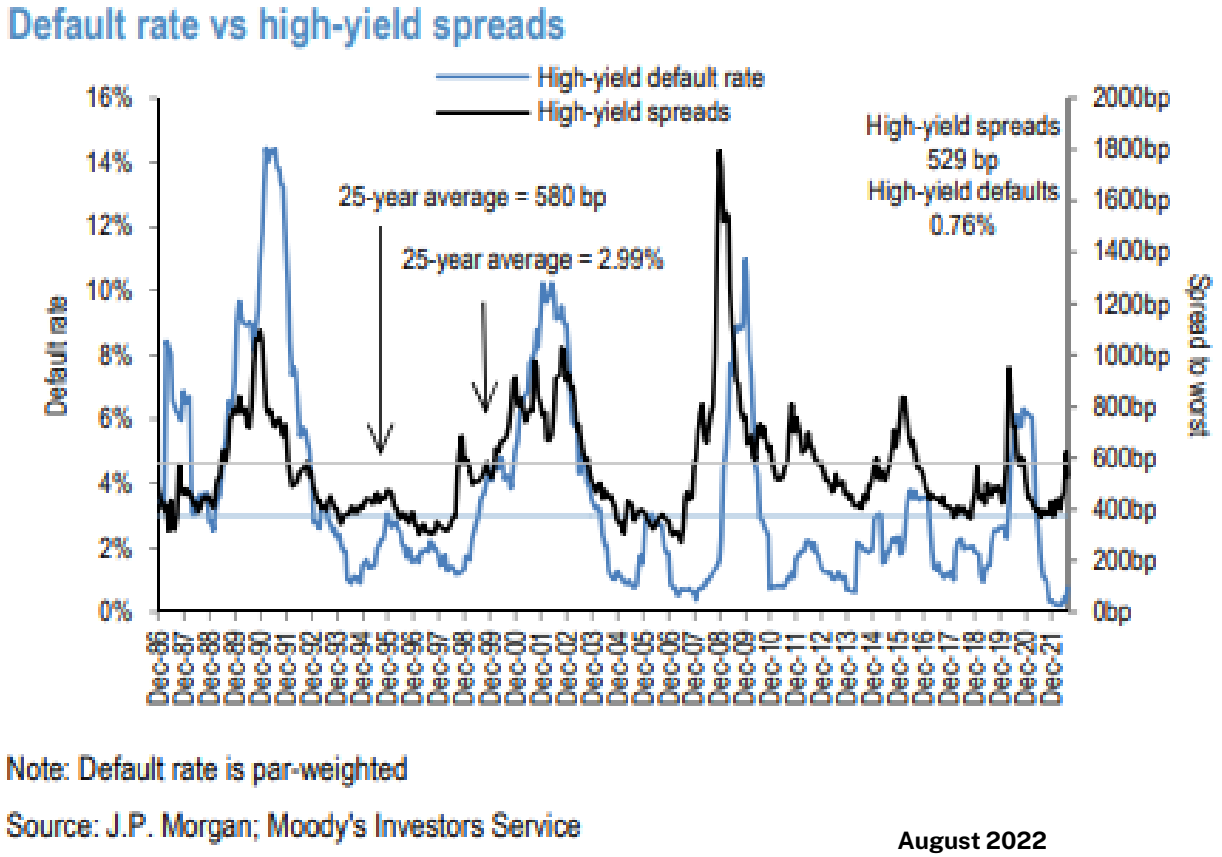
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Fixed Income – Overview

	Sub-Asset	Region	IC Outlook (1Q23-2Q23)	IC Comments	Recommended Positioning
Long Term Rates	10Y Rate	US	↑	▪ Long term rates are likely to trend sideways as stagflationary forces could intensify by 1H23 ▪ Fed balance sheet roll off likely to create upward pressure on long end of yield curve. ▪ Despite potential downward pressure on long term rates as a result of recessionary fears, we broadly agree with BCA's view that there is further room for longer term rates to move higher as long as the Fed maintains its resolve in combating inflation.	
		EU	↑	• Long term rates are likely to trend sideways as stagflationary forces could intensify by 1H23	
Credit	IG	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.	▪ While we are broadly bearish on bonds, there are pockets of opportunities we see on US IG credit. We suggest reallocating progressively to Investment Grade Bonds (Duration < 4) after September FOMC to lock in attractive risk adjusted carry. ▪ Avoid PERPs, Cocos, High Yield and long Duration (>5) bonds for the moment. ▪ Add Distressed managers to benefit from dislocations and mispricing.
		EU	↑		
	HY	US	↑		
		EU	↑		

Higher default rates already priced in

JPMorgan expects HY default rates to be at 1.75% in 2023, below implied spread expectations.



Note: Default rate is par-weighted

Source: J.P. Morgan; Moody's Investors Service

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Equities Highlights

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Equities – Overview

Region	IC Outlook (1Q23-2Q23)	IC Comments	Recommended Positioning
US (S&P 500)	↓	▪ We hold a bearish view on US equities over the next 6-12 months and think the June/July rally is unsustainable given that interest rates are expected to continue rising, valuations are above their long-term average and economic growth, while not collapsing, is softening. ▪ US Equities are likely to continue to be negatively correlated with longer term rates for the rest of the year and are exposed to any hawkish comments from the FED. ▪ Elevated volatility likely to create dispersion which is a very ripe environment for Long/Short Strategies	▪ Take advantage of recent market rebound to reduce equity positions and take a more defensive stance in anticipation of another potential leg down. ▪ Consider adding lower beta equity managers who can take bidirectional bets.
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. ▪ Sentiments should continue to remain dampened.	▪ Given more downside expected, we think it is still not a good time to be increasing exposure to European equities yet.

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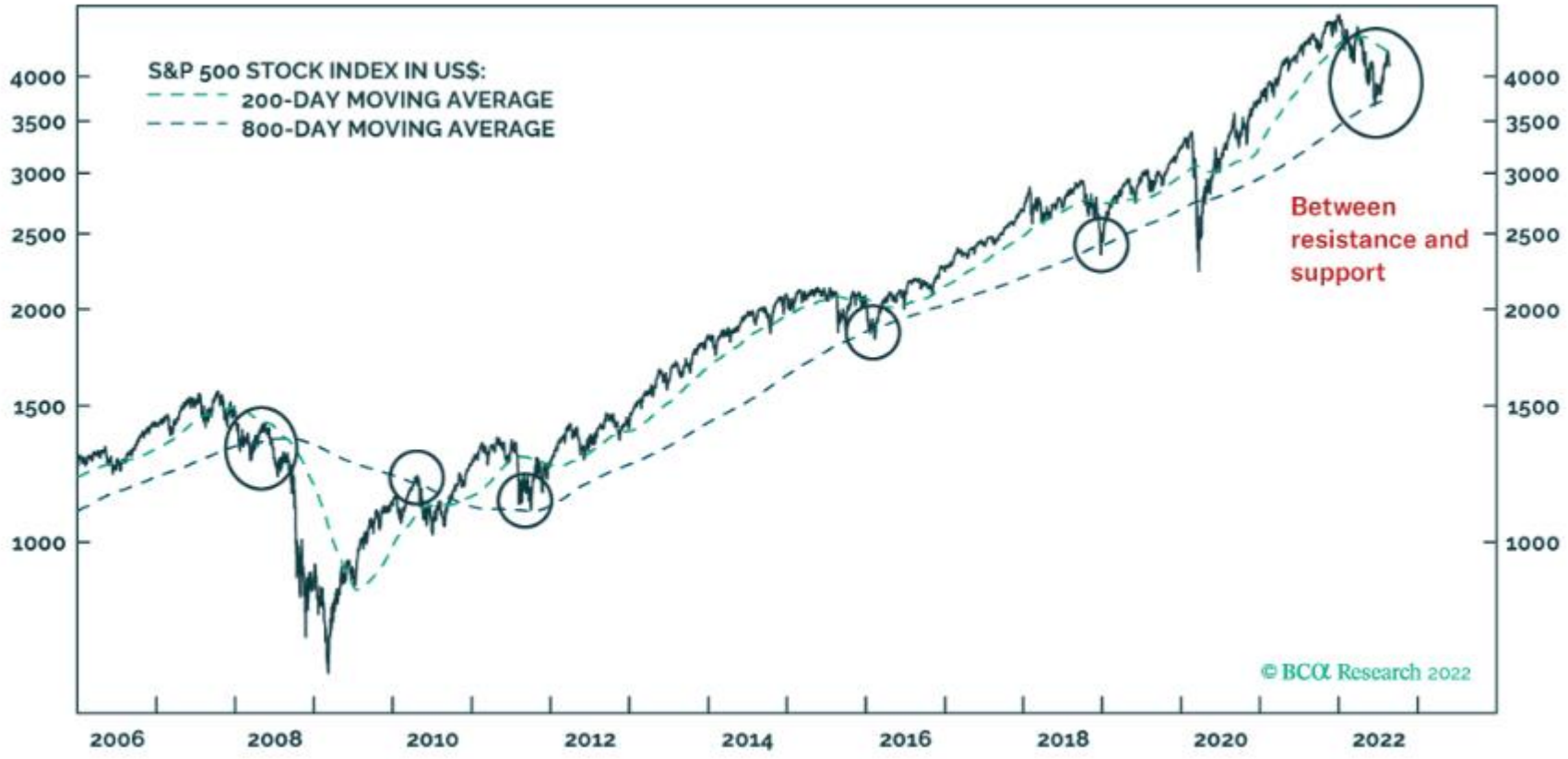
Equities – Overview

Region	IC Outlook (1Q23-2Q23)	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. We do not expect this to come anytime before 1H23.	▪ We do not recommend taking on full beta risk just yet. Investors should continue to remain invested in low beta long short managers (FengHe, Luxence) for now.
India (NIFTY 50)	↔	▪ India's economy seems to be holding up well despite higher oil prices. ▪ Recent correction in commodity markets (especially energy) and renewed FII buying has led to a strong rally in Indian equities (Nifty 50) In July and Aug 2022. ▪ Valuations on equities are slightly higher than their 20Y average but not at unrealistic levels. ▪ Despite the sanguine view on the region, we think a strong dollar serves as the biggest headwind 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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Volatile Market Driven by Economic Outlook

SP500 is stuck between technical resistance and support lines

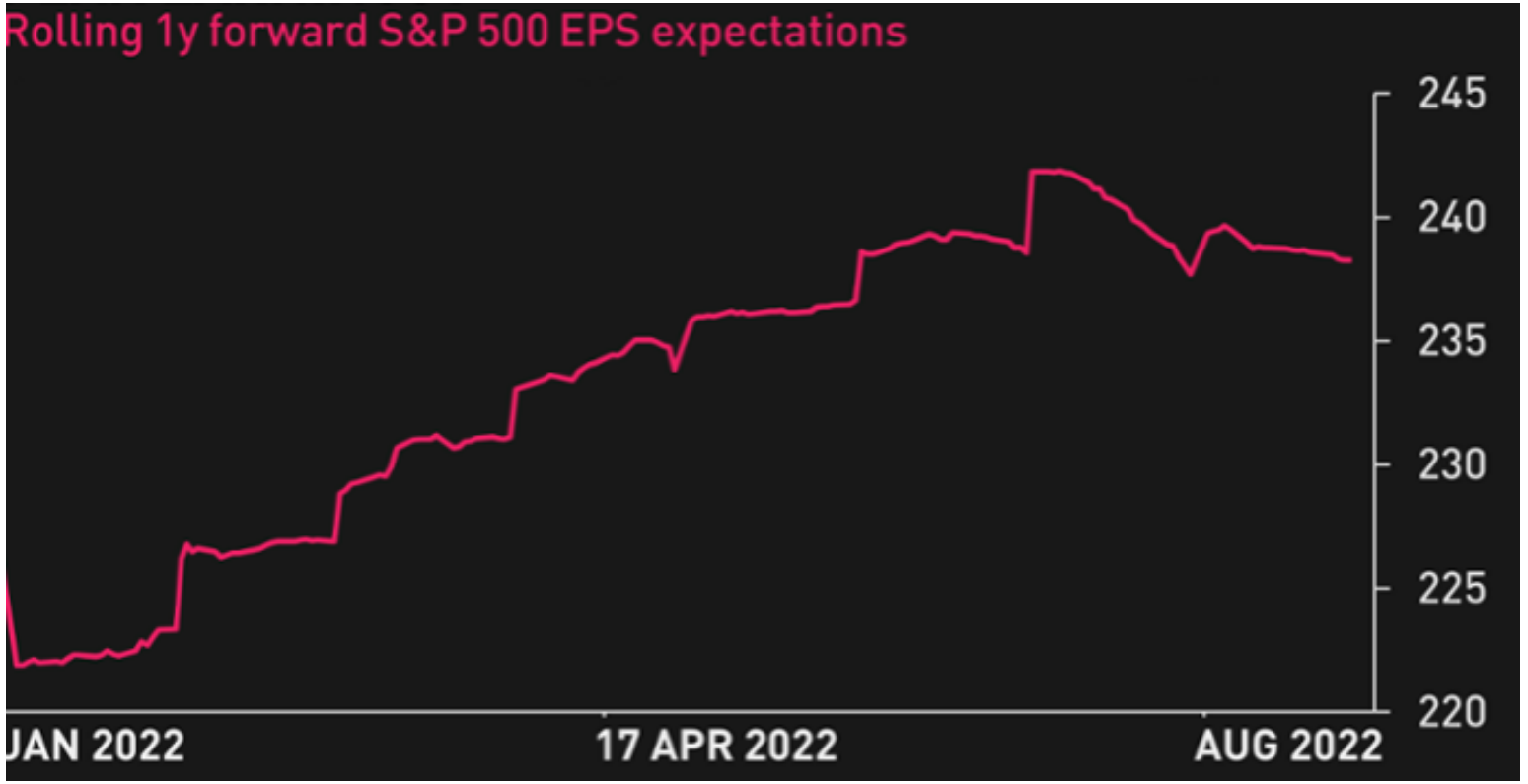


Source: BCA, Aug 2022

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Peak Earnings?

Rolling 1y forward EPS expectations have started to drop for US Equities (S&P 500 index)



Source: Bloomberg, August 2022

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Bear Market For US Equities

S&P 500's July rally was shorty lived and did not survive Jackson Hole's hawkish comments



Source: Bloomberg, August 2022

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Forex, Commodities & Alternatives

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Commodities – Overview

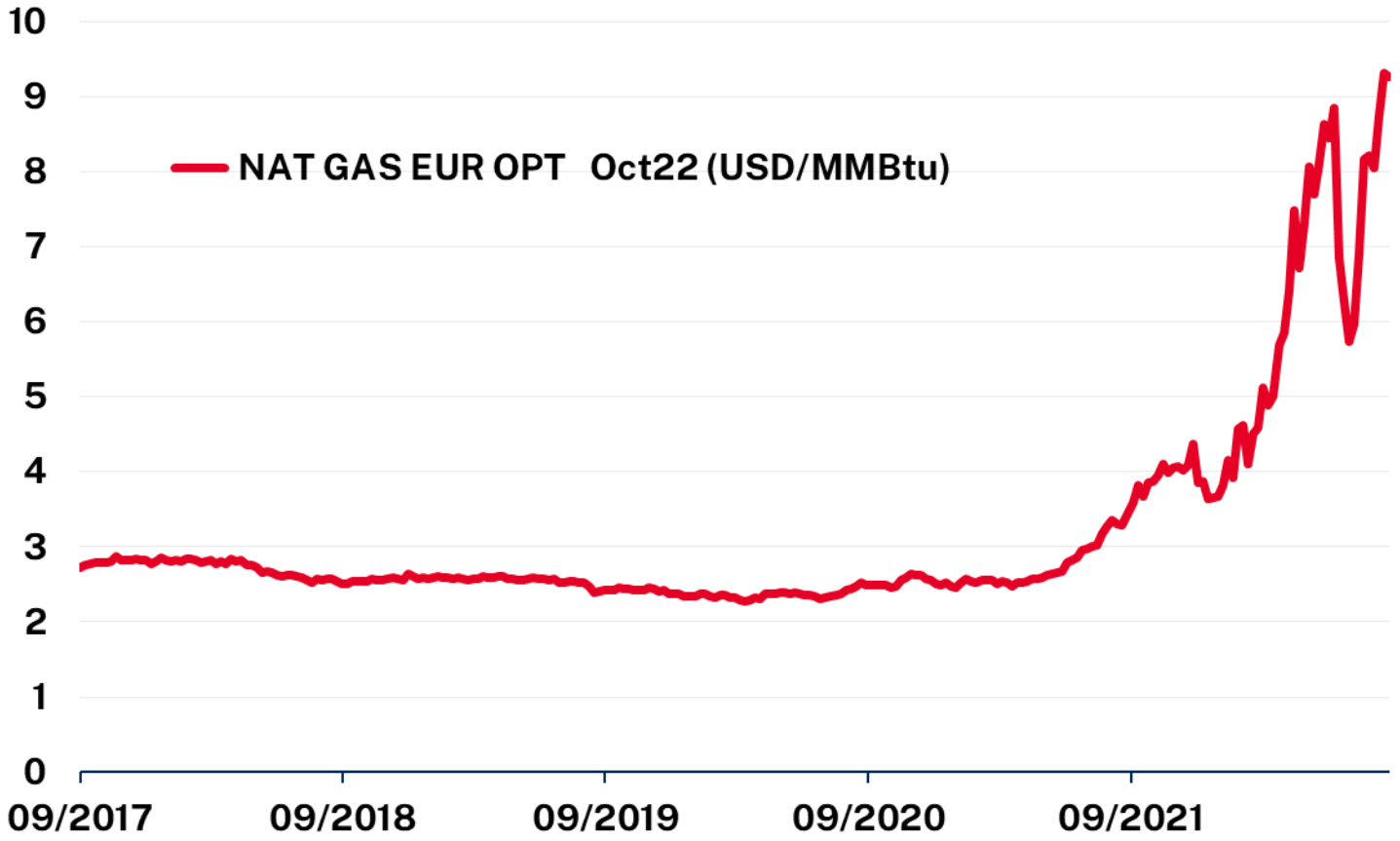
	Sub-Asset	IC Outlook (1Q23-2Q23)	IC Comments	Recommended Positioning
Commodities	Gold	↔	▪ There are two opposite forces for Gold :- • On the one hand, gold is likely to face near term headwinds on back of higher rates (which is an opportunity cost for gold holders) and a strong dollar. • On the other hand, increasing holdings of gold in global central bank reserves should act as tailwinds for the yellow metal.	▪ We believe that high inflation and high geopolitical risk does warrant an allocation to gold ▪ 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 should continue to remain volatile on back of higher recession risks globally. ▪ However, geopolitics remain a wild card which makes the near-term outlook uncertain. ▪ Supply side conditions remain fairly tight and inelastic, especially with OPEC exercising some restraint on production despite high oil prices.	- N.A.

Forex – Overview

	Sub-Asset	IC Outlook (1Q23-2Q23)	IC Comments	Recommended Positioning
FX	USD	↑	▪ We anticipate the dollar to maintain its strength throughout 22 as recessionary fears accelerate. ▪ This trend could reverse should the FED start reversing its monetary policy, which is very unlikely in the coming quarters.	• Big picture, we do believe the dollar's strength is overstretched. • However, recessionary fears as well as a hawkish fed will continue to underpin its strength. • Despite its strength, longer term investors may consider gradually adding DM currency exposures (EUR or GBP) as they are 1) trading at historically cheap valuations (EUR & GBP) versus the dollar, and 2) Sharper rate hikes in these economies are expected to narrow the interest rate differentials between the US.
	EUR	↔	▪ At 0.99 (Vs USD), the currency looks cheap by historical standard and could benefit from ECB starting increasing rates faster than anticipated and/or a termination of the Ukrainian war.	
	GBP	↑	▪ Inflation seems out of control in the UK. The BoE will have to act swiftly and aggressively increase rates to keep inflation below 10%.	
	CNY	↓	▪ The PBOC is very supportive and has started decreasing interest rates. The CNY is likely to be soft as long as the rates differential widens with other central banks ▪ Chinese export volume growth has come to a halt. Shrinking imports of inputs used for re-export (imports for processing trade) are pointing to an imminent contraction in the mainland's exports which does not bode well for the CNY. - BCA (Aug 15)	
	JPY	↓	▪ The JPY is unlikely to rebound as the rates differential increases with other central banks.	

European Natural Gas At Record High

European natural gas prices should remain elevated and volatile as winter-shortage risks persist

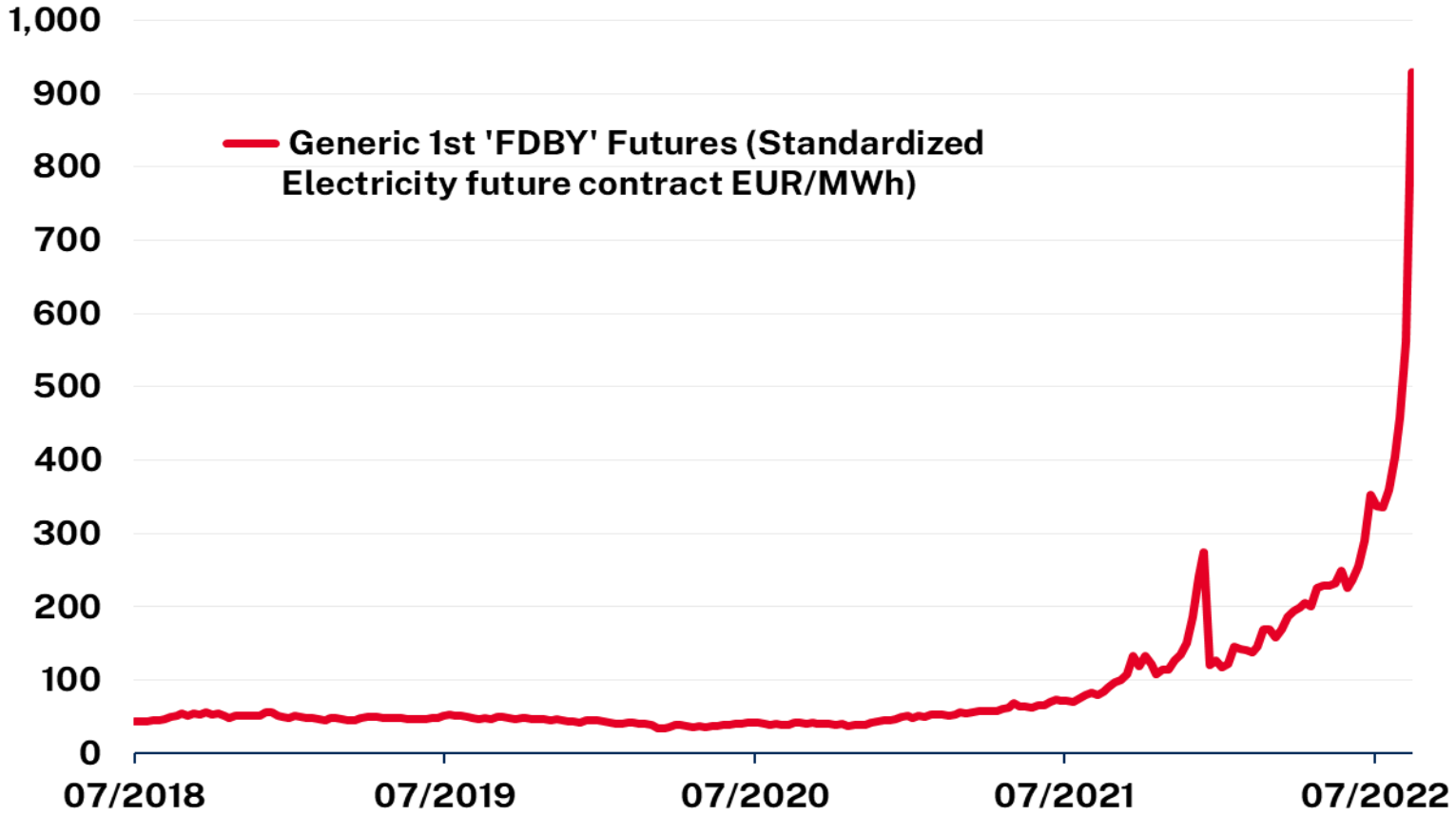


Source: Bloomberg, August 2022

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European Electricity At Record High

Utility bills will be significantly higher for European households in the coming quarters



Source: Bloomberg, August 2022

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