Investment Playbook Weekly Update

19th to 23rd June 2023

LIGHTHOUSE CANTON



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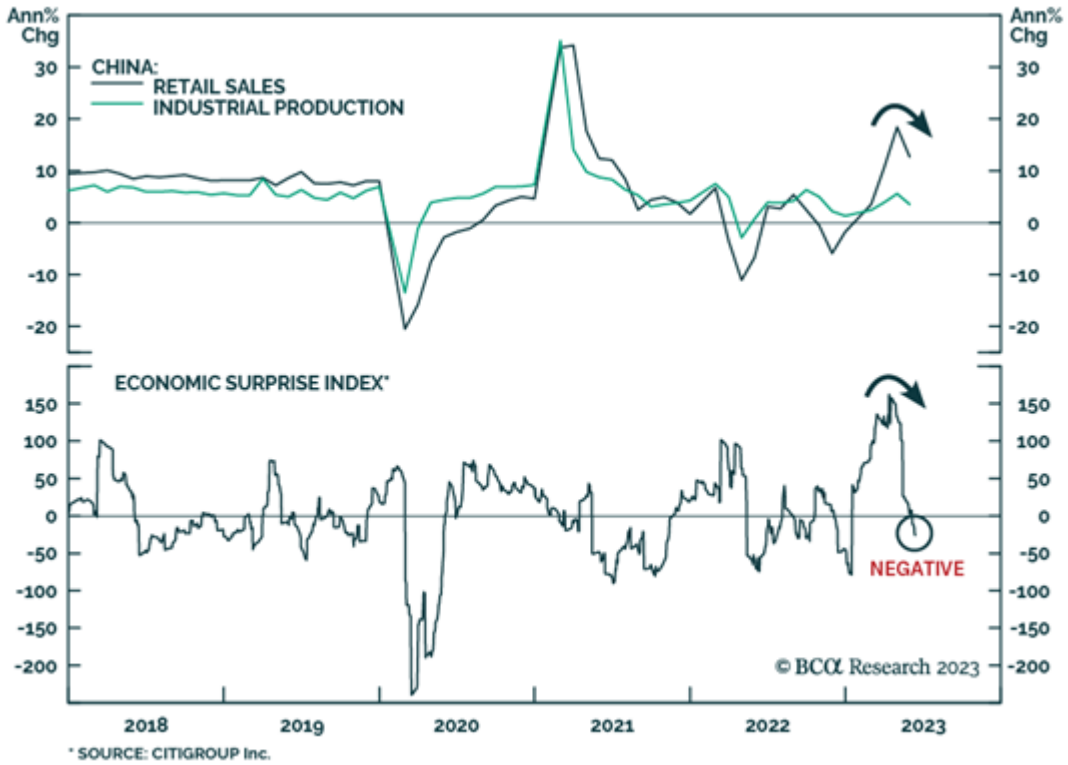
Charts of the week

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China's Recovery is Losing Momentum

More Chinese Data Disappointments



Source: BCA, June 2023

- China's economic data for May disappointed market expectations, particularly retail sales and industrial production, both decelerated YoY compared to April YoY figures. The data provide further evidence that China's recovery is losing momentum.
- Policymakers took steps last week to stimulate the economy by cutting its 1-yr medium-term lending facility and 7-day reverse repo; both by 10bps each.
- Despite the positive impact of the stimulus announcement on equities, investing in this sector continues to pose as a challenge and we suggest adding experienced fund managers who have consistently generated alpha returns.

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Discerning the Path of the Economy

Don’t Let Month-to-Month Data Distract From Recession Signal



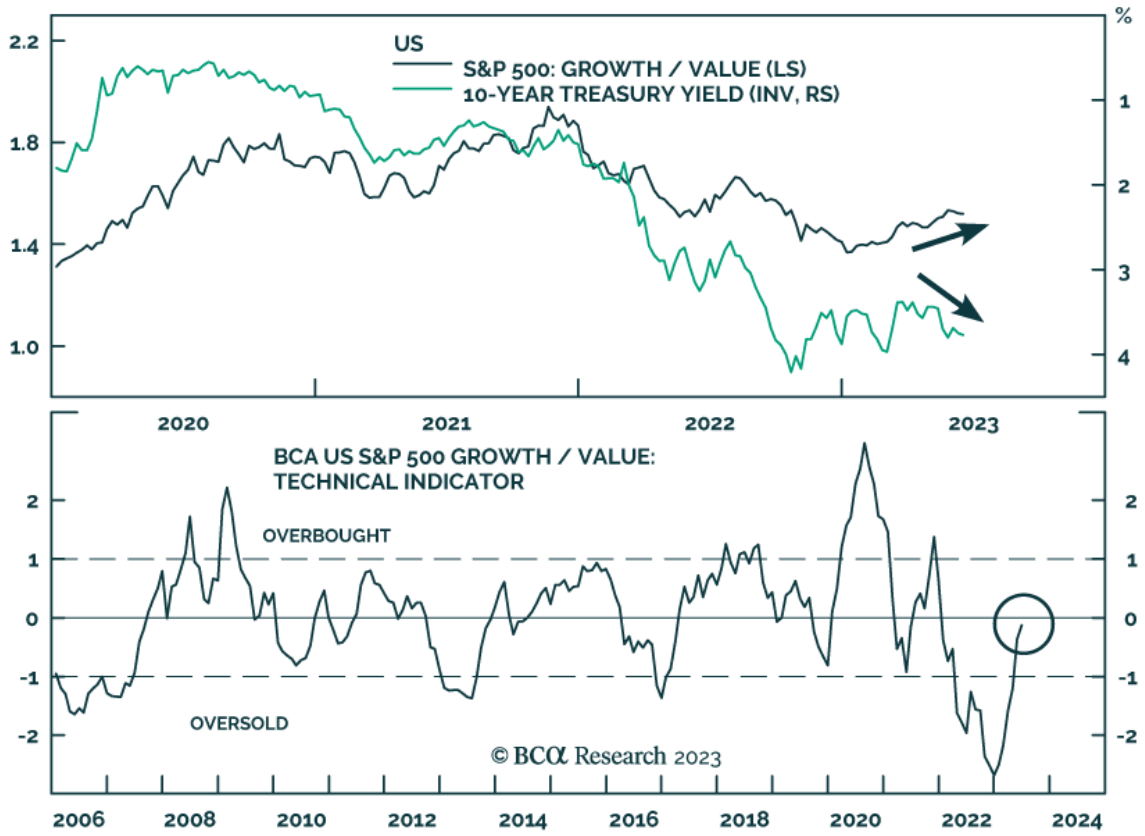
- The trends in retail sales, Fed regional surveys and claims are recessionary, adding to the case that after a pause the next move from the Fed will be a cut, rather than another hike, according to Bloomberg analysts.
- Monthly or weekly data are not helpful when trying to discern the path of the economy (referring to the increase in retail sales advance seen last week on MoM at +0.3%, which beat market expectations).
- The underlying picture that’s sending the ever-stronger recessionary signal, shows the number of states with deteriorating claims continues to rise, and is consistent with a near-term downturn.

Source: Bloomberg, June 2023

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Have Growth Stocks Overshot?

Growth stocks will be more exposed than Value to a sell-off



Source: FT.com, BCA, June 2023

Last year, the 10yr UST yield increased 231bps, which negatively impacted the performance of Growth stocks, which lost 22.7% vs. the Value index.

However, the usual relationship between rates and Growth/Value has recently been broken. Despite a 29bps increase in 10-year UST yield since the end of Q1, Growth index has gained 9.0% vs. 5.4% gain of Value stocks.

2 reasons are the frenzy in AI and Growth index started the year at extremely oversold levels relative to Value index.

Now, Growth stocks have already rallied ahead of any decline in bond yields and technicals are now back to neutral. If the enthusiasm around AI proves to be premature, Growth stocks will be more exposed than Value to a sell-off.

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For the First Time Ever, Yield is the same

Little to No Reward in Buying Equities





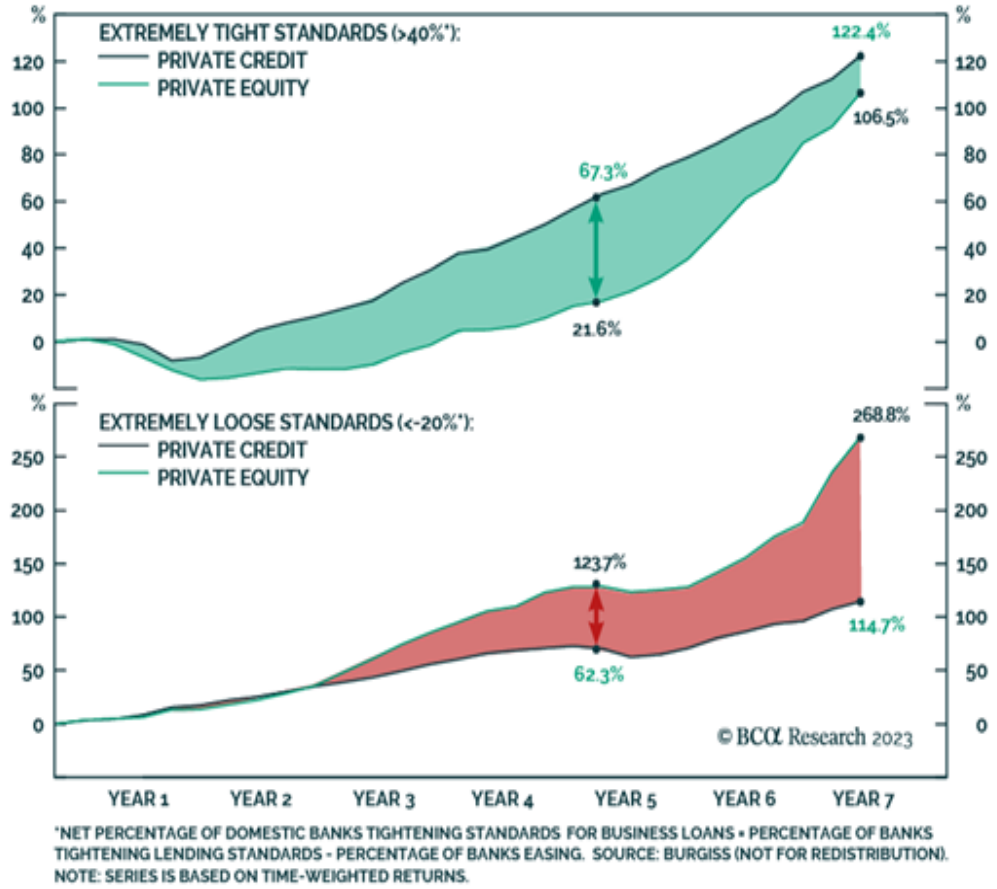
Source: Bloomberg, June 2023

- The outperformance of S&P, contributed mostly by 7 stocks, has driven S&P Index earnings yield to 4.76%. Much lower than the yields one could get from investment grade corporate bonds ETF (5.32%) and 3m UST (5.23%).
- Even if we compare it with equal weighted S&P index, the earnings yield at (5.57%) is only 25bps higher than that of IG bonds ETF and 34bps higher than that of 3m UST.
- On a risk-adjusted basis, equities are offering very little reward currently, hence, we recommend to be overweight in bonds.

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Times of Extreme Tightening Support Private Credit

Current Underperformance of Private Credit vs Private Equity unlikely to Persist



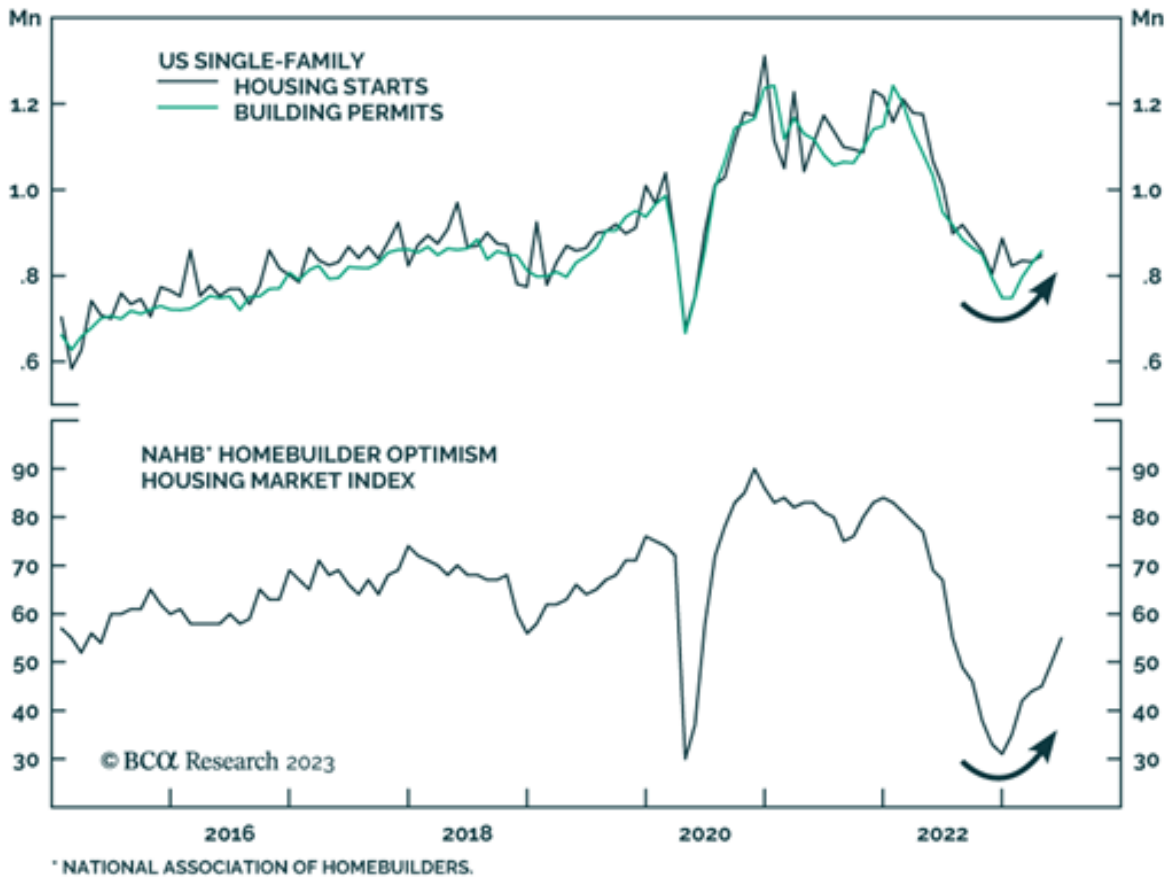
- According to BCA, the present moment in the business cycle appears to be favorable for Private Credit to Private Equity.
- In nearly all instances, except for the present one (Q1 2020 to Now), Private Credit has outperformed Private Equity over the subsequent five and seven years on an absolute basis. On average, during these occurrences, Private Credit has outperformed Private Equity by 40-50% over the next five years and 10-20% over the next seven years.

Source: BCA, June 2023

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Homebuilder Sentiment Continues to Improve

Strengthening of housing market could provide temporary short term support to decelerating economy



Source: BCA, June 2023

- NAHB Housing Market Index jumped above 50 to 55 in June for the first time in 11 months, beating expectations of 51.
- This follows a series of positive improvements in other housing metrics including housing starts and building permits.
- This could create positive wealth effect in terms of real income which strengthens the soft landing rhetoric and hence provide a tailwind for stocks over the short term.
- However, we continue to remain skeptical of the view that the US will be able to avert a recession in the next 12 months due to the Fed's aggressive tightening campaign and recommend investors to take a cautious and defensive in positioning for core portfolios.

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LC Views - Summary

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LC Views Summary (1/2)

Sub-Asset	Recommended Positioning
Rates	• The Federal Reserve is currently evaluating whether the rate hikes are complete or not. In order to avoid surprising investors soon, Powell emphasized that two rate hikes are still being considered. The revised Summary of Economic Projections indicates an increase in the median projection for the federal funds rate by the end of 2023, from 5.1% to 5.6%. This implies that there may be an additional 50 basis points of rate hikes this year. The Fed's assessment of the necessary extent of further tightening to bring inflation back to the 2% target will be guided by factors such as the cumulative tightening, the delayed impact of monetary policy on the economy and inflation, as well as economic and financial developments. According to the CME Fed Watch Tool, market participants currently assign a 60% probability of a rate hike in July, which is a significant increase compared to the 10% probability assigned just a month ago.
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 has been an unpleasant experience. Despite the lack of justification based on weak breadth, fear of missing out (FOMO), and the hype surrounding artificial intelligence, the remarkable price action cannot be disregarded. While we are not yet ready to fully embrace the market frenzy, we must reevaluate whether the S&P 500 (SPX) can successfully defend the 4325 level. Although investor sentiment towards equities has been improving, the earnings yield on equities remains significantly lower than that of bonds, indicating a worrisome level of complacency, particularly in a decelerating economy. US Equities (S&P 500 Index) have been surprisingly resilient so far in 2023, but 95% of the performance is explained by 7 technology stocks only. The path of least resistance for stocks seems to be on the upside for now, although the rise in valuations along with our view that a recession is looming, does call for cautiousness. 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.

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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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