Investment Playbook Weekly Update

29th May – 2nd June 2023

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Charts of the week

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Chinese Stocks In Bear Market

China stock gauge slumps 20% from 2023 Peak as pessimism abounds



Source: Bloomberg, May 2023

- The Hang Seng China Enterprises Index, a crucial indicator of Chinese stocks, is poised to enter a bear market due to a combination of factors, including a sluggish economic recovery and escalating tensions with the US.
- The index is now 20% below its 2023's peak (January 27th), which is the definition of a bear market. This significant decline deals a blow to investors (including us) who had been hopeful for a revival following China's reopening. In light of the lackluster economic recovery and modest earnings, some China bulls are expressing frustration and reducing portfolio allocations.

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The Fabulous 7

7 stocks accounts for 95% of the S&P 500 performance so far in 2023

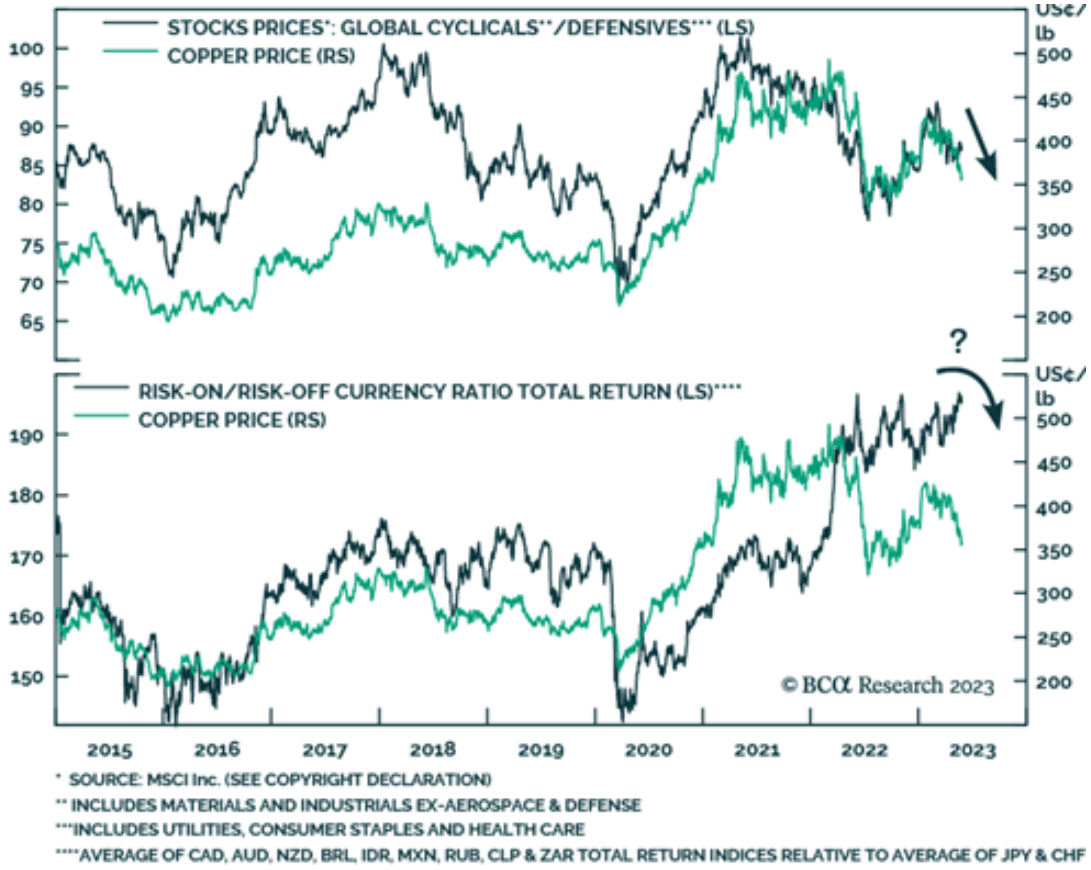
Name	Market Cap. as of 31st Dec. 2022	Market Cap. as of 26th May 2023	Difference	Performance	Index Weight
Apple Inc	2,037,688,481,382	2,759,286,191,860	721,597,710,478	35.4%	7.4%
Microsoft Corp	1,774,844,050,515	2,475,199,458,842	700,355,408,327	39.5%	6.6%
Alphabet Inc	1,123,922,800,723	1,587,351,470,000	463,428,669,277	41.2%	4.2%
Amazon.com Inc	861,869,709,792	1,232,371,081,466	370,501,371,674	43.0%	3.3%
NVIDIA Corp	360,903,810,338	961,966,200,000	601,062,389,662	166.5%	2.6%
Meta Platforms Inc	308,399,172,972	671,538,302,189	363,139,129,218	117.7%	1.8%
Tesla Inc	390,419,539,797	612,253,145,824	221,833,606,027	56.8%	1.6%
			3,441,918,284,662	**57.2%**	**27.6%**
S&P 500 Index	33,498,108,420,000	36,580,706,669,601	**3,606,330,784,703**	**9.5%**	**100%**

Source: Lighthouse Canton, May 2023

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Dr. Copper's Warning

Discouraging economic data releases from China has further contributed to the sell-off



- Copper's range of applications across various economic sectors has established it as a dependable indicator of economic conditions. The recent trend of declining copper prices in May has been a cause for concern, continuing the downtrend that originated in January. In fact, prices have now reached levels not witnessed since before the conclusion of China's zero-Covid policy.

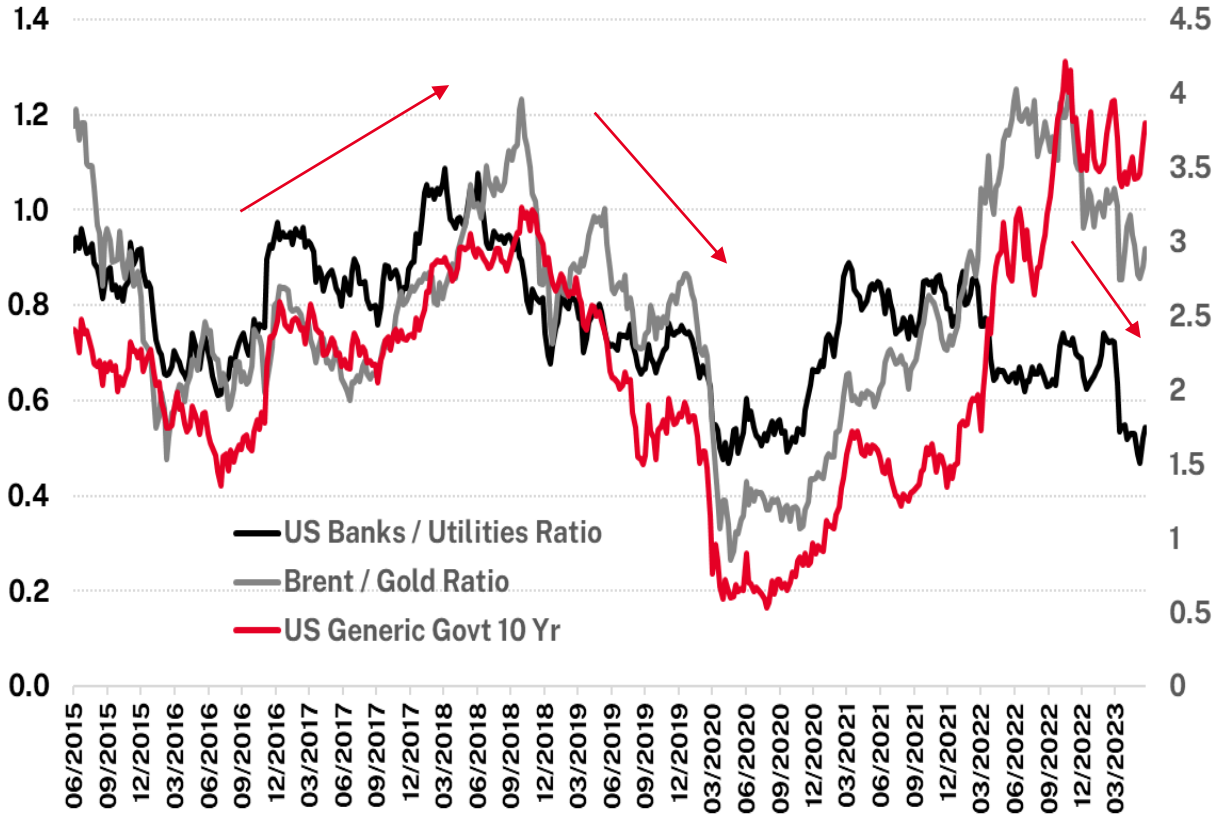
- Given that China represents more than half of the global copper consumption, the state of Chinese construction and manufacturing activities significantly influences the dynamics of the copper market.

Source: BCA Research, May 2023

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Growth Outlook Drives 10y Yields

Trajectories of Banks/Utilities and Brent/Gold ratios are crucial to ascertain direction of 10 year yields



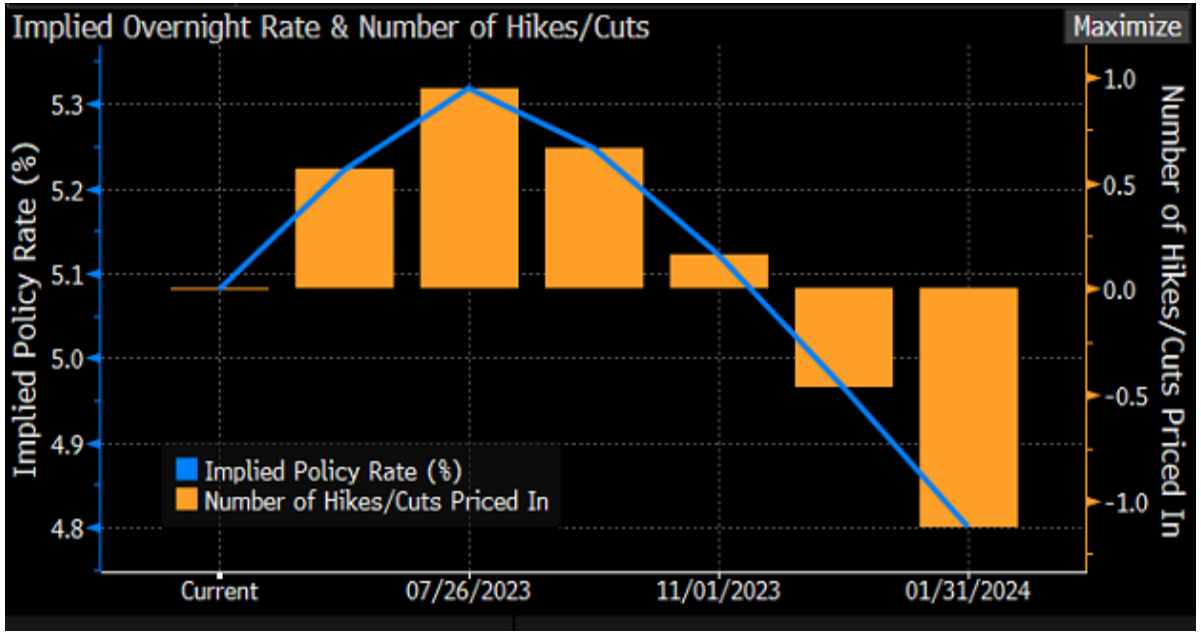
- Typically, when banks outperform utility, yields go up and vice versa.
- This relationship holds true for when oil vs gold.
- When the cycle is strong, oil and banks tend to do well compared to their defensive counterparts
- As the economic outlook continues to deteriorate, we continue to hold the view that these cyclical indicators will continue to remain weak, which should translate into lower long-term yields.
- Consequently, having a longer duration continues to be our recommended positioning for bond portfolios

Source: Lighthouse Canton, May 2023

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Markets factoring in an additional rate hike in US.

Probability of another rate hike by July spiked .



- Stronger than consensus economic data prints last week raised rate hike probability to 100% by July 2023.
- The US Treasury yield curve while maintained the inversion but shifted up with 10Y UST yield spiking to 3.82 levels from 3.40 in about a week .
- This provides us with an opportunity to add longer duration names in the portfolio.
- AT1s , especially the ones with call dates in 2024 witnessed some drawdowns (for e.g., JB AT1) as fears of an extension reignited. Refinancing costs increase with another hike and that further reduces the probability of a call as extension will make more economic sense to the issuer.

Source: Lighthouse Canton, May 2023

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LC Views - Summary

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LC Views Summary (1/2)

Sub-Asset	Recommended Positioning
Rates	• Post May FOMC, the Fed had hiked by 25bps as widely anticipated. Last week's slew of stronger than expected economic data prints have spiked the probability of another rate hike in June /July (~95% probability). Meanwhile bank lending standards have tightened further on back of banking stresses, with headline CPI at 4.9% and core CPI at 5.5% nowhere near the Fed's long-term average of 2%. The Fed will likely be challenged with balancing inflationary risks and containing any further deterioration to financial stability. We feel policy rates have likely peaked and markets are expecting cuts to start materializing early next year – this makes longer duration positioning more favorable.
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	• 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. Equity valuations do not appear compelling once adjusted for the shortfall in corporate earnings, and equities do not seem attractive relative to bonds when using a 3-year Z-score Bond-Yield to Earnings-Yield ratio. The S&P 500 posted a 3.6% drop in earnings and a modest 4.2% growth in sales, with Q1 earnings having mostly wrapped up. We expect earnings to continue deteriorating on the back of tighter credit conditions and declining consumer spending and contrary to the consensus estimates, do not expect a strong rebound in earnings in the back half of the year. Consequently, we maintain our bearish 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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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)

Balrama Premises Co-Op
Society LTD
Office no. 606-607, 6th
Floor,
BKC Bandra East
Mumbai 400051

Phone: +91 9650473961

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