

Investment Playbook Weekly Update

17th March, 2023

**LIGHTHOUSE
CANTON**


2022
ASIAN PRIVATE BANKER
AWARDS FOR DISTINCTION

BEST INDEPENDENT WEALTH MANAGER
ASIA PACIFIC


2021
ASIAN PRIVATE BANKER
AWARDS FOR DISTINCTION

BEST INDEPENDENT WEALTH MANAGER
WEALTH PLANNING SERVICES


2021
ASIAN PRIVATE BANKER
AWARDS FOR DISTINCTION

BEST INDEPENDENT WEALTH MANAGER
INVESTMENT ADVISORY

GLOBAL
**Private
Banking**
INNOVATION
AWARDS 2022

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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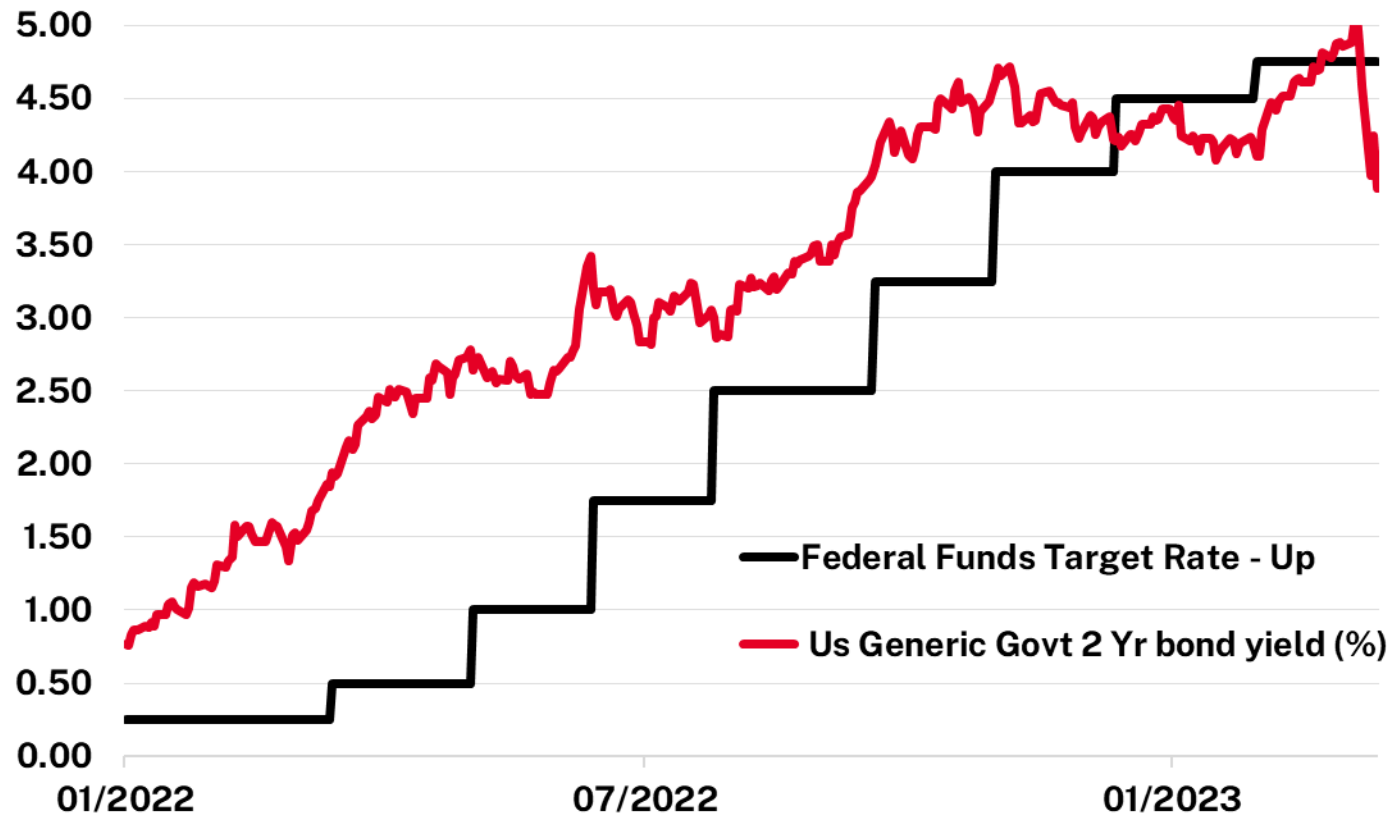
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Charts of the week

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Investors Are Expecting Fed to Cut Rates

The yield on 2Y US Treasuries has dropped significantly since SVB's failure

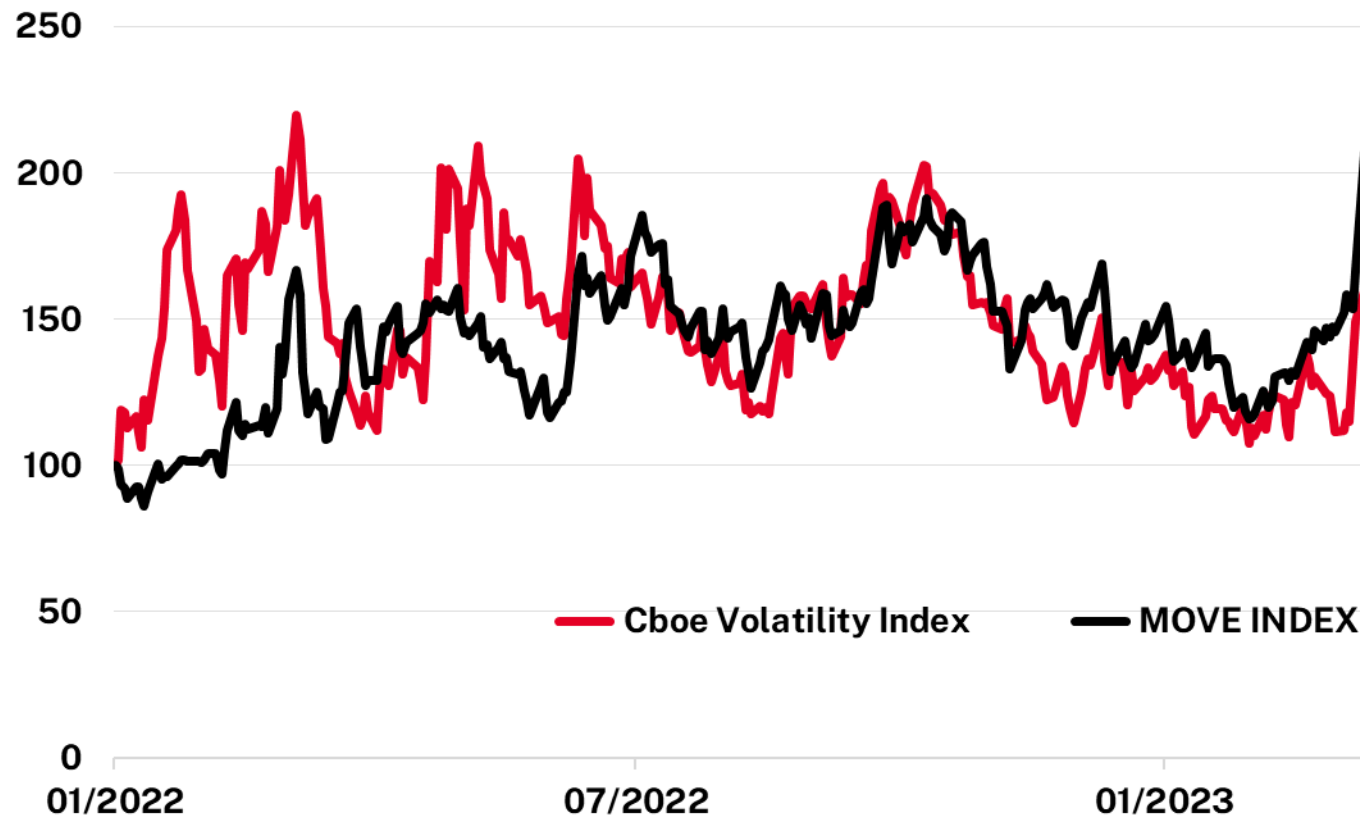


Source: Bloomberg, March 2023

- US Treasuries have rallied sharply on the expectation that the Fed will halt rate hikes in response to the collapse of Silicon Valley Bank. The 2-year yield has lost 110bps over the last 2 weeks and now trades below 4%, as investors have raised bets on rate cuts later this year.
- The SVB fallout has raised the Fed's attention to financial stability risks stemming from the 450 bps of rate increases delivered over the past year.

Bond Volatility Surges

The MOVE has surged more than double the magnitude of the VIX over the week.



Source: Bloomberg, March 2023

**Cboe Volatility Index - 30-day expected volatility of the U.S. stock market, derived from S&P 500 Index call and put options*

**MOVE Index - measures Treasury rate volatility through options pricing*

- This reflects the uncertainty markets have pertaining to the Fed's policy direction as a result of the stresses manifesting in the US Regional Banking Sector.
- Inflationary uncertainties prevail, further adding to volatility we are seeing with rates.
- Our slow and cautious approach to extending duration remains warranted, while the heightened volatility should create alpha opportunities for macro managers in the near term.

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US CPI: Still Sticky

Shelter cost increasing leading to stronger Core Services Inflation

Consumer Price Index Heat Map (MoM% Change)														
	Weight	Feb '22	Mar '22	Apr '22	May '22	June '22	Jul '22	Aug '22	Sep '22	Oct '22	Nov '22	Dec '22	Jan '23	Feb '23
Headline CPI	100%	0.7%	1.0%	0.4%	0.9%	1.2%	0.0%	0.2%	0.4%	0.5%	0.2%	0.1%	0.5%	0.4%
Shelter	34%	0.6%	0.5%	0.5%	0.6%	0.6%	0.6%	0.7%	0.7%	0.7%	0.6%	0.8%	0.7%	0.8%
Food	14%	1.0%	0.9%	0.8%	1.1%	1.0%	1.1%	0.8%	0.8%	0.7%	0.6%	0.4%	0.5%	0.4%
Medical Services	7%	0.1%	0.6%	0.5%	0.4%	0.7%	0.4%	0.7%	0.8%	-0.4%	-0.5%	0.3%	-0.7%	-0.7%
Vehicles & Parts	8%	-0.1%	-1.7%	0.0%	1.2%	0.5%	-0.1%	0.4%	-0.2%	-0.5%	-0.7%	-0.6%	-0.7%	-0.9%
Educ./Comm. Svcs	5%	0.1%	-0.1%	0.2%	0.2%	0.1%	0.0%	0.2%	0.2%	0.2%	1.0%	0.3%	0.5%	0.2%
Energy	7%	2.7%	0.2%	-1.0%	3.4%	6.9%	-4.7%	-3.9%	-1.7%	1.7%	-1.4%	-3.1%	2.0%	-0.6%
Transportation Svcs	6%	1.1%	2.1%	2.2%	1.6%	1.8%	-0.4%	1.0%	1.9%	0.6%	0.3%	0.6%	0.9%	1.1%
Recreation Services	3%	0.6%	0.4%	0.3%	0.5%	0.3%	0.5%	0.0%	0.2%	0.8%	0.9%	0.3%	0.7%	1.2%
HH Furnishings/Supplies	4%	0.8%	0.9%	0.6%	0.2%	0.6%	0.6%	0.9%	0.5%	0.0%	0.4%	0.3%	0.5%	0.8%
Apparel	3%	0.6%	0.3%	-0.1%	0.4%	0.7%	-0.1%	0.3%	0.0%	-0.2%	0.1%	0.2%	0.8%	0.8%
Recreation Goods	2%	0.8%	0.0%	0.5%	0.1%	0.4%	0.1%	0.6%	-0.1%	0.8%	-0.3%	0.1%	0.1%	0.4%
Medical Goods	1%	0.3%	0.2%	0.1%	0.3%	0.4%	0.6%	0.2%	-0.1%	0.0%	0.2%	0.1%	1.1%	0.1%
Core (Ex Food & Energy)	79%	0.5%	0.3%	0.5%	0.6%	0.6%	0.3%	0.6%	0.6%	0.3%	0.3%	0.4%	0.4%	0.5%
Core Services	58%	0.5%	0.6%	0.6%	0.6%	0.6%	0.4%	0.6%	0.8%	0.5%	0.5%	0.6%	0.5%	0.6%
Core Goods	21%	0.3%	-0.4%	0.1%	0.6%	0.6%	0.1%	0.4%	0.0%	-0.1%	-0.2%	-0.1%	0.1%	0.0%

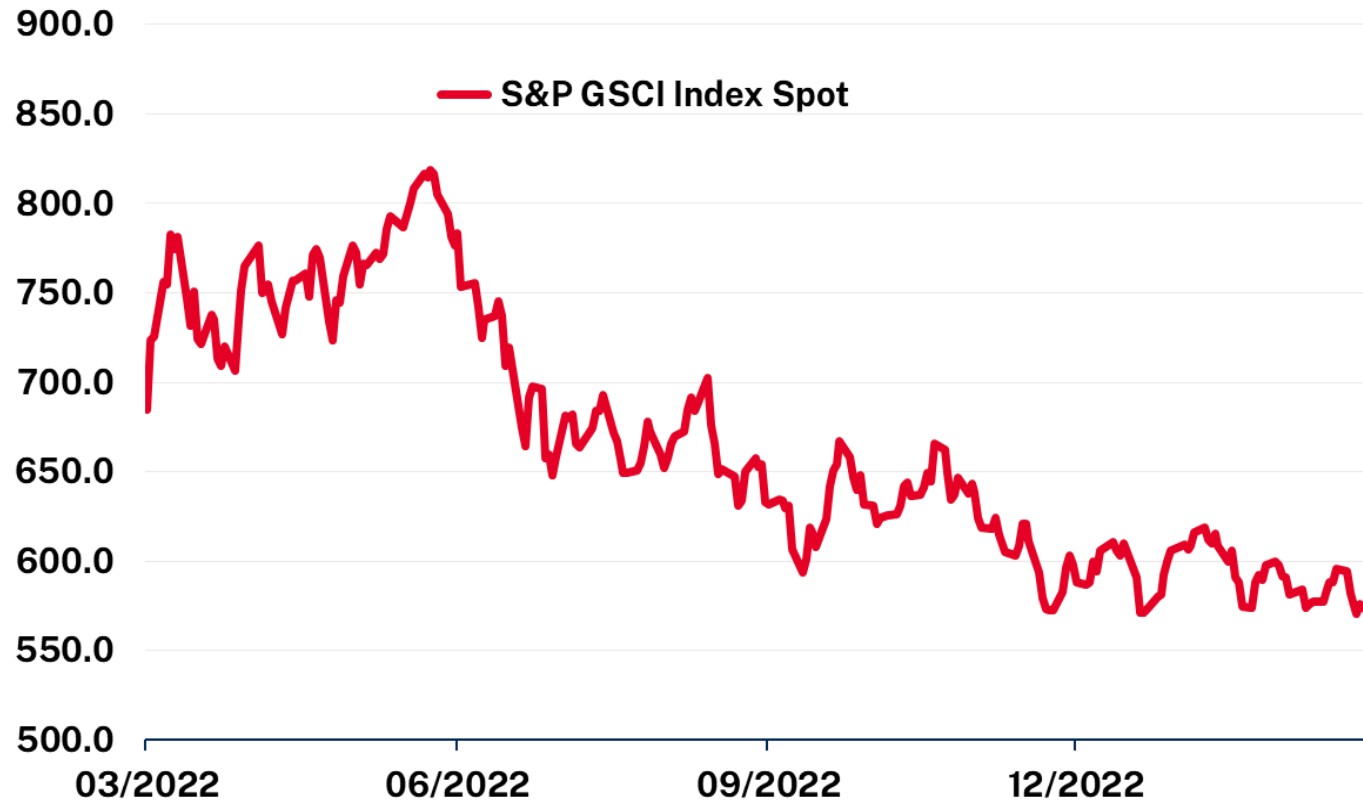
Note: Shows select MoM price change per CPI category, sorted by weight in the headline index.
 Category labels abbreviated from official titles. Seasonally Adjusted. Intra-category color scheme.
 Source: CreditSights, BLS

Source: CreditSights, BLS. March 2023

- Fed has a dangerous minefield to navigate. Stickier inflation as indicated in the chart most likely will force the Fed's hand in March 2023 FOMC.
- Owners' Equivalent Rent Index, a component in determining Shelter cost rose to a 2 decade high of 8% YoY NSA.

Commodities: Gloomy Picture

Commodity prices are not pointing to a strong economy globally



Source: Bloomberg, March 2023

- The S&P GSCI® index is down -11% YTD and -21% over the last 12 months.
- The S&P GSCI® index is widely recognized as a leading measure of general price movements and inflation in the world economy. It provides investors with a reliable and publicly available benchmark for investment performance in the commodity markets.

Fed Historically Cut Before Each Market Bottom

If history is any guide, the bottom will be seen only after the Fed start decreasing rates



- Based on historical trends, investors in equities should exercise patience and await the Federal Reserve's decision to reduce interest rates before anticipating a possible bottom in the US equity market. This pattern has occurred consistently during the past seven bear markets.

Source: Bloomberg, BofA Global Research, March 2023

LC Views - Summary

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LC Views Summary (1/2)

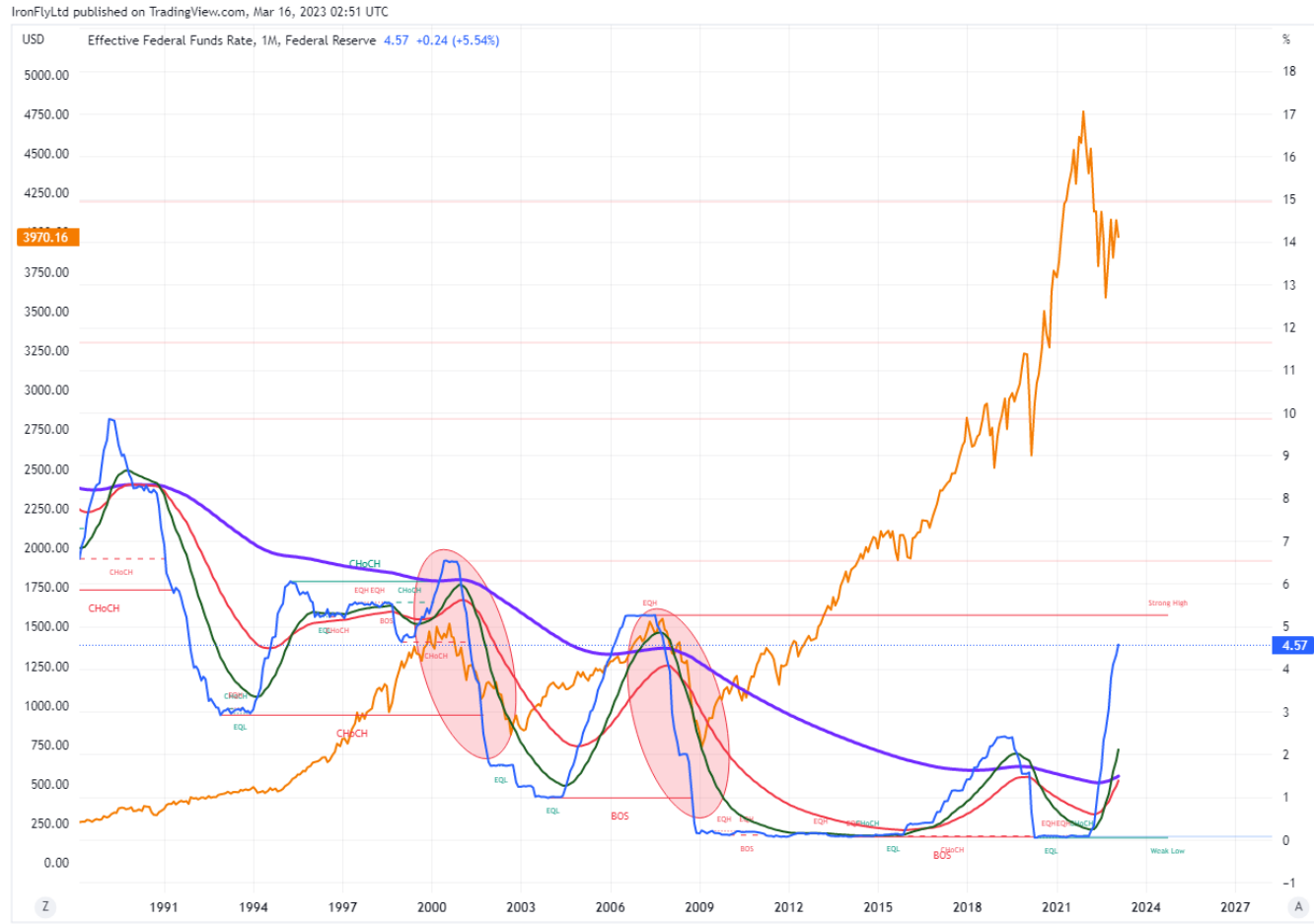
Sub-Asset	Recommended Positioning
Rates	It is unlikely that SVB will snowball into a new financial disaster. However, even if the fallout from SVB seems contained, the Fed is now constrained. Eventually, financial stability will prevail over an excessively hawkish monetary policy. In fact, fixed income investors have quickly adjusted their views. The policy-sensitive two-year yield has plummeted more than 100 basis points from 5.08% on March 9th to 4.0% on March 13th, representing the biggest drop in the 2Y Treasury Yield since the early 1980s. Significant cuts are now priced in, which would bring the fed funds rate to 3.9% by year-end. On March 10th, the year-end rate was 4.9%. We anticipate volatility to remain reasonably high across risky assets in 2023 and reiterate our views to keep a significant allocation to liquid alternative strategies and bonds which present low correlation to equities and / or thrive during periods of stress.
Credit	Corporate bonds now command attractive yields, and the portfolio should have a larger allocation to the asset class. Short Duration (<3) Investment Grade bonds are attractive and should be part of any portfolio. We recommend being selective with High Yield bonds and recommend adding duration gradually as 10Y US Treasury yield get above 4%. We also recommend adding distressed managers who benefit from markets dislocations and mispricing. We expect Fed rates in the U.S. to peak in Q2 2023 at 5.0%-5.25%, but contrary to what is implied by fixed income investors, we do not believe that the Fed will have to aggressively cut rates this year.
Equities	Jitters from the US banking system have reverberated throughout global equities, resulting in an 8% correction in US equities from their peak in 2023. Consequently, the S&P 500 index remains flat for the year, with a year-to-date increase of merely 0.42% as of March 13th. The projected depth of this year's profit slump has been intensifying, and historical precedents suggest that valuations will continue to decrease. Indeed, equity valuations do not appear especially 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-Earnings-Yield ratio. According to ASR Research, "US Equities look poised to return the same as Bonds over a 10-year period but with greater volatility." As we highlighted in our Weekly Update two weeks ago, the Equity Risk Premium (the excess return required by an investor to hold equities over the risk-free rate) has dropped to 4% over the last six months, compared to its 25-year average of 5.3%. This indicates that equity investors may be exceedingly complacent and excessively optimistic. Therefore, we maintain a 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.

LC Views Summary (2/2)

Sub-Asset	Recommended Positioning
Currencies	• Currencies are expected to remain volatile throughout 2023. We recommend adding active managers (Macro funds) to monetize opportunities in currencies and rates. Exposure to JPY, EUR and GBP could be increased over time to benefit from the recent lows.
Commodities	• The recent SVB saga has created a tactical tailwind for Gold which tends to be a beneficiary of panic and falling yields. • We like Gold for several other structural reasons: diversification benefit, inflation hedge, geopolitical risk and de-dollarization trend. • Oil is likely to remain highly speculative. On one hand, the slowdown of the economic activity globally, (recessionary fears) should reduce demand progressively in 2023. On the other hand, the lack of capex spending during covid as well as the possibility for OPEC to reduce production will inevitably support prices in the long run.
Real Estate	• Real Estate represents a good hedge against inflation, with its steady income, often linked to inflation. 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.

LC Views Summary – Technical Analysis

S&P declines when the Fed starts to cut



- Intuitively, and especially with the experience of 2022, one would expect an eventual FED rate cutting cycle to be positive for equities.
- However, history suggests otherwise – S&P declines when the FED starts cutting.
- The FED response, either in response to recession or an economic crisis (as distinct from a pandemic), is what drives equities down with the market bottoming with a lag after the FED starts to cut.

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