Investment Playbook Weekly Update

August 12th – August 16th 2024

GLOBAL Private Banking INNOVATION AWARDS 2024
BEST FAMILY OFFICE – UNITED ARAB EMIRATES

GLOBAL Private Banking INNOVATION AWARDS 2024
BEST FAMILY OFFICE – MIDDLE EAST

2023 ASIAN PRIVATE BANKER 13th AWARDS FOR DISTINCTION
BEST INDEPENDENT WEALTH MANAGER ASIA PACIFIC

2023 ASIAN PRIVATE BANKER 13th AWARDS FOR DISTINCTION
HIGHLY COMMENDED INDEPENDENT WEALTH MANAGER INDIA

PRIVATE BANKING AWARDS 2023 ASIAMONEY
RISING STAR, SINGAPORE

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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Charts of the week

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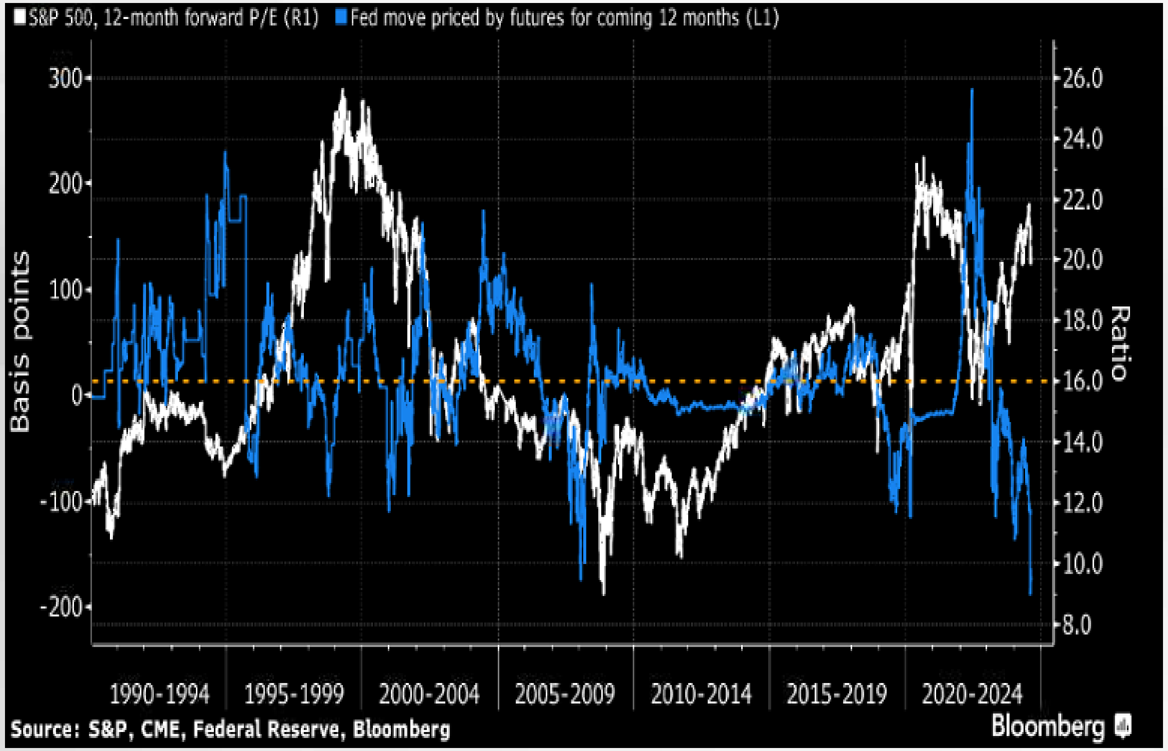
When Two Worlds Collide

Bonds Price For A Recession Equities Just Are Not Seeing



- In 2008 when bonds were (rightly) positioning for a recession, equities valuations had already dropped to below long-term averages. If bonds are again picking the economic cycle correctly, that means stocks are facing a lot more pain.
- But if equities are right to price for robust earnings, then bonds are the asset class headed for trouble. The bear case for Treasuries is enhanced by both the strong recent pushback from Fed speakers, and the fact that traders have been forced to flip-flop on pricing for steep rate cuts so many times this cycle already.
- With geopolitical and US political turmoil also brewing, these competing scenarios signal plenty more volatility to come, in at least some part of the market.

Source: Bloomberg, August 2024

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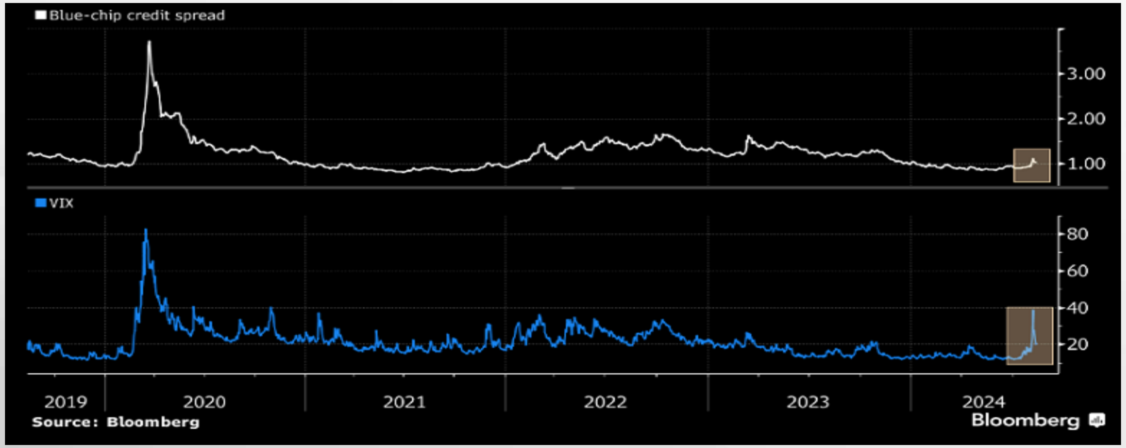
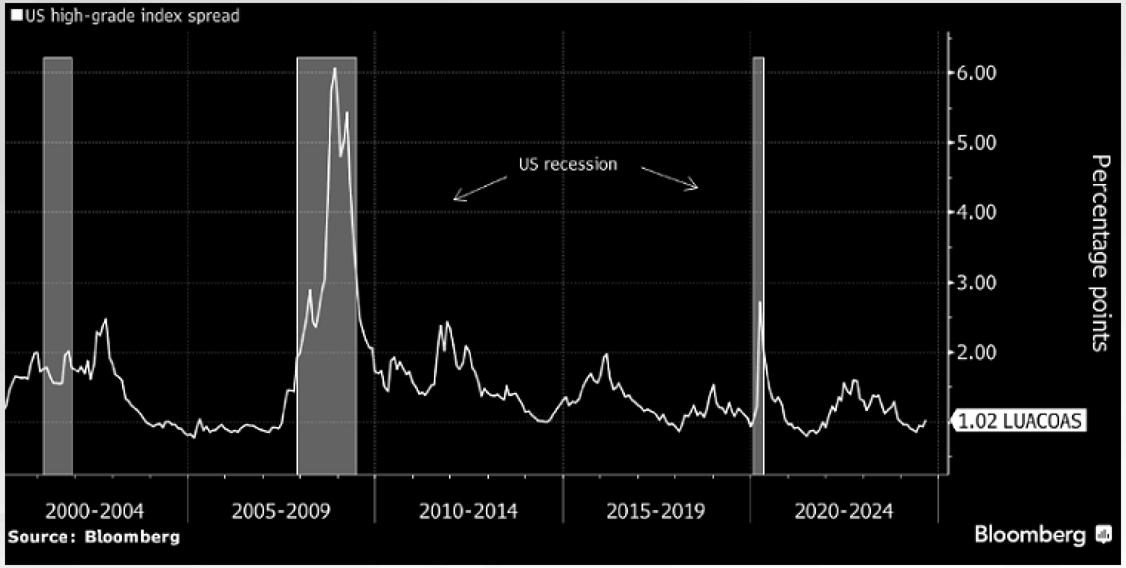
Credit Spreads Widen But Not Enough(1/2)

Average Spread At 103 bps Is Relatively Low





- Last week's significant market volatility caused the VIX, commonly referred to as the stock market's "fear gauge," to briefly reach its highest level since the onset of the pandemic in March 2020. Concurrently, the average blue-chip credit spread widened to the broadest level since November, though it remains significantly below historical norms and far from levels indicative of severe economic stress.

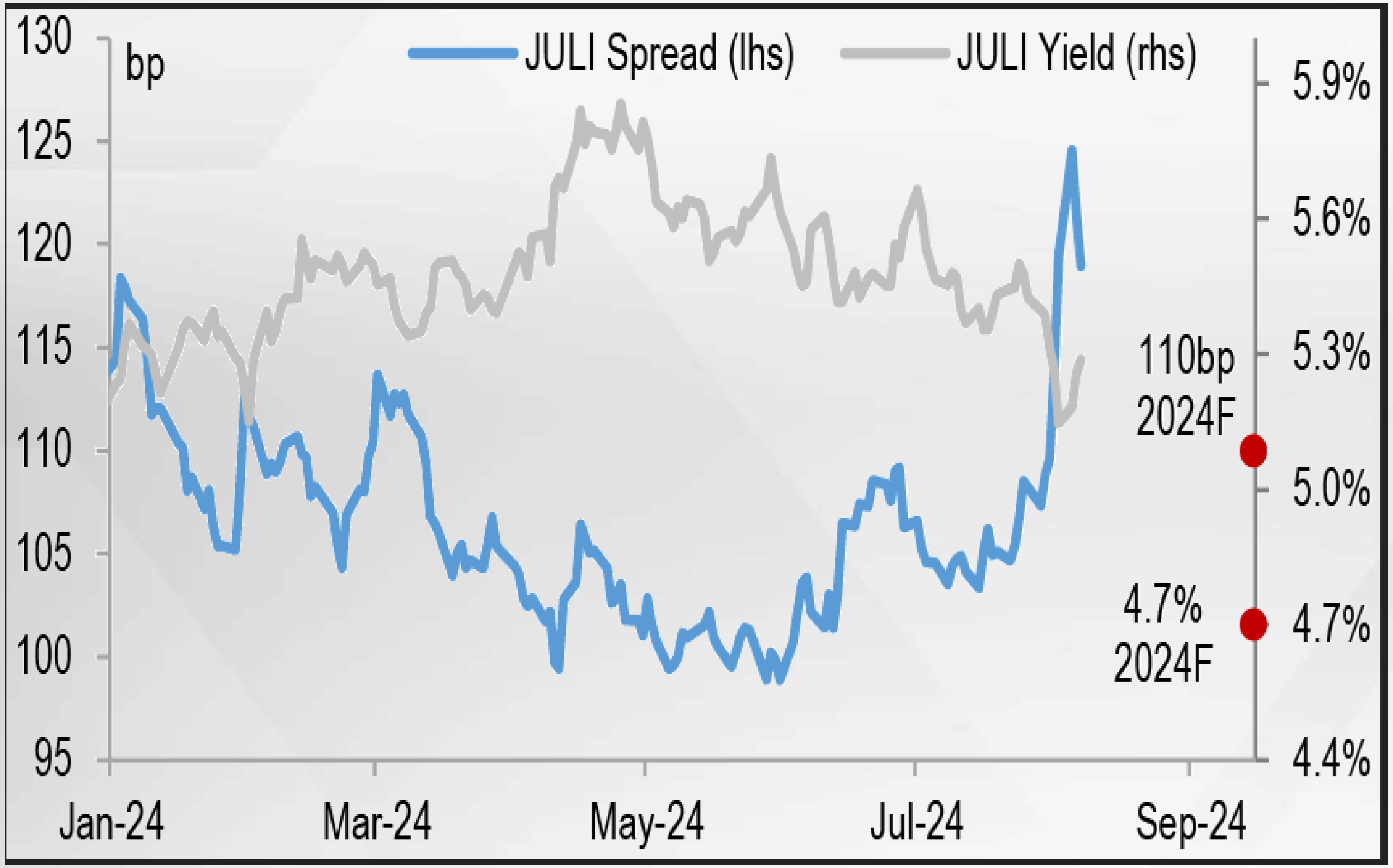
- Although risk indicators have moderated sharply since last week, the underlying discussion about which metric is more reliable persists. The debate focuses on whether the recent softness in U.S. economic data signals the start of a deeper downturn, and whether the Federal Reserve has been slow to respond.

- Despite this, the likelihood of a recession has increased, leading some bond investors to view current credit spreads as unusually low. Bottom line: stick to quality bonds as a foundation of your core portforlio.

Source: Bloomberg, August 2024

Spread widening but not a worry yet(2/2).

Despite widening spreads are still below historical averages.



- Weaker economic and earnings data reported last week has changed the landscape of economic risks leading to spreads widening. The JULI (JP Morgan US High Grade Index) touched 125 bps before retracing.
- Lower yields is the likely driver of widening spreads as there has been no change in the default/downgrade probabilities yet.
- Investor interest on new issues remained strong at wider spreads.
- However, if weaker economic prints persist, then investor perspective might alter.

Source: JP Morgan, August 2024

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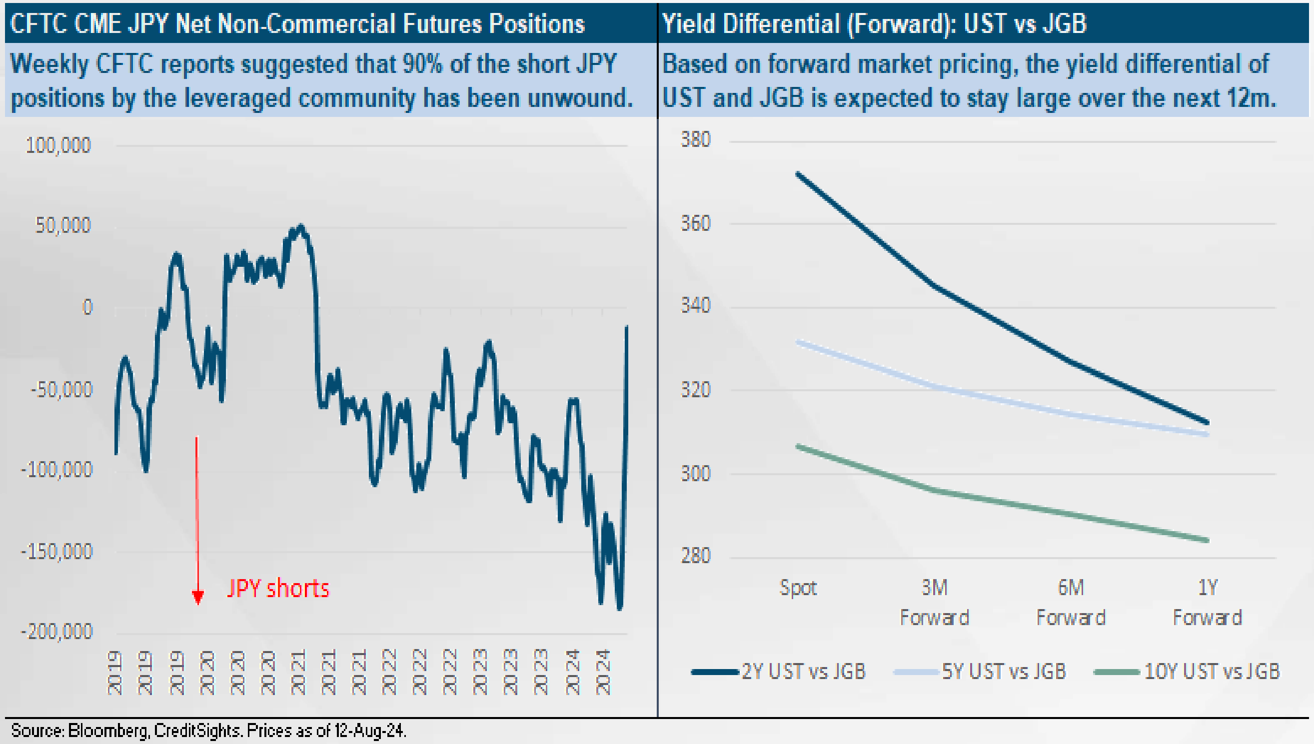
Unwinding of JPY carry trade and US Treasuries

Impact of carry trade unwinding on Treasury yields are expected to be minimal.

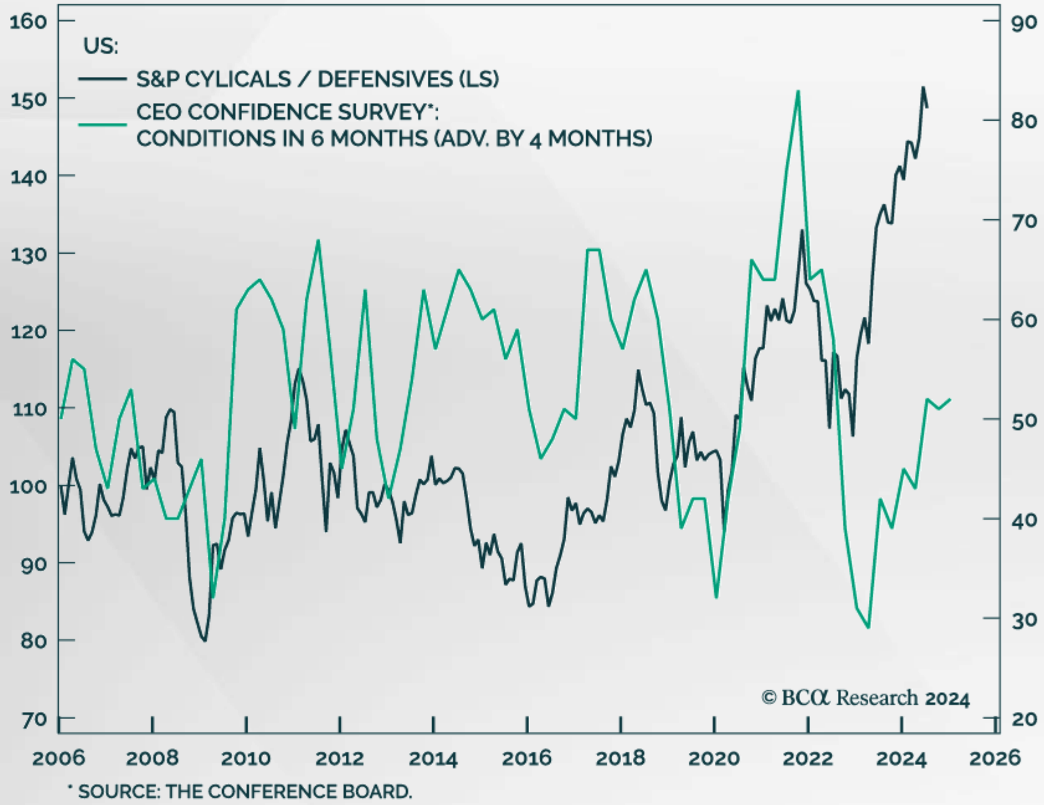


- Chart on the right suggests that 90% of the leveraged shorts via futures on JPY have been unwound .
- Large yield differential likely to persist in near future suggesting that US treasuries might see limited impact from the unwinding.

Source: CreditSights, August 2024

CEOs more cautious, but still see no recession

Share of CEOs expecting a recession declined to 30% in Q3 from a high of 84% in 2023



- The Conference Board's CEO Confidence measure (RHS) fell to 52 in Q3, down from 54, marking its lowest point this year. Despite this decline, the reading remains above 50, suggesting that optimism still outweighs pessimism among CEOs.

- CEO confidence has typically been a leading indicator of the performance of cyclicals versus defensives, and is likely to continue to raise earnings expectations, which are already overly optimistic, thus making equities vulnerable to disappointment.

- Therefore, a defensive investment stance is advisable, especially considering the disparity between large company CEOs' views and broader employment indicators, such as the hiring intention component from the NFIB (National Federation of Independent Business) survey, which is currently in a downtrend.

Source: BCA, August 2024

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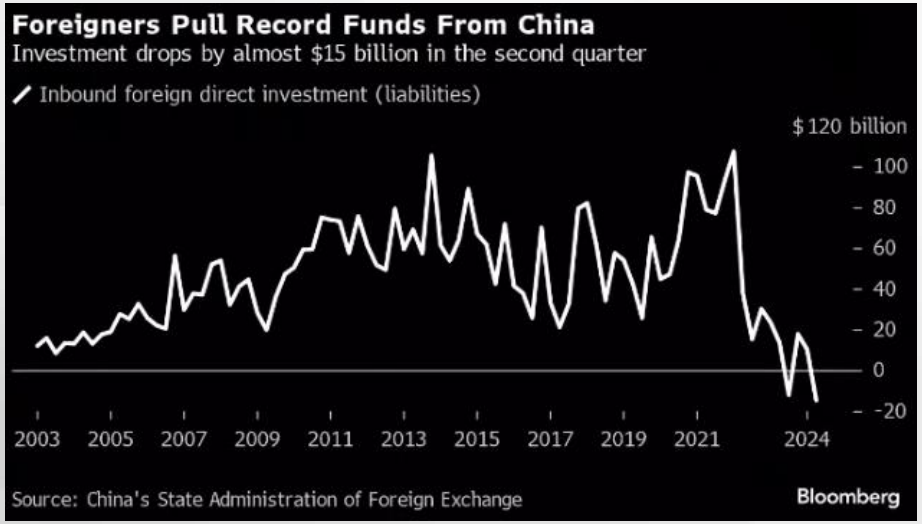
China – The biggest value trap of all

Foreign investors continue to shun Chinese assets and investments into the country

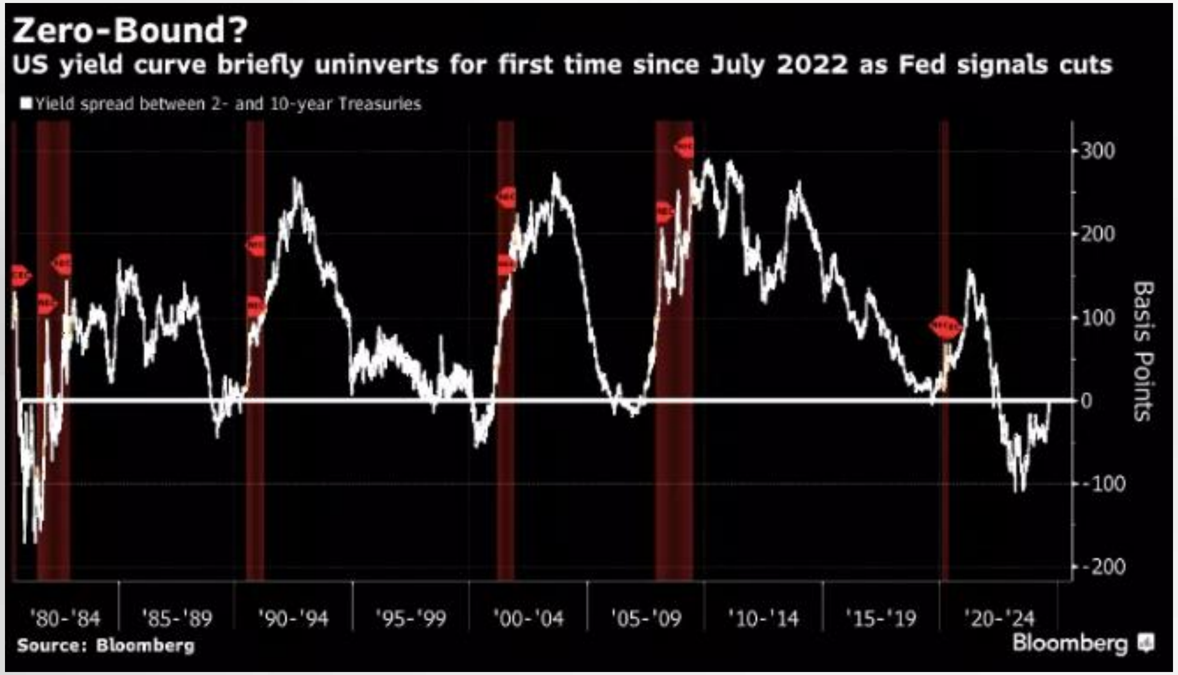


- China’s direct investment liabilities in its balance of payments dropped almost $15 billion in the April-June period, marking only the second time this figure has turned negative, according to data from the State Administration of Foreign Exchange released Friday. It was down about $5 billion for the first six months.
- Should the decline continue for the rest of the year, it would be the first annual net outflow since at least 1990, when comparable data begins.
- Foreign investment into China has slumped in recent years after hitting a record $344 billion in 2021. The slowdown in the economy and rising geopolitical tensions has led some companies to reduce their exposure, and the rapid shift to electric vehicles in China also caught foreign car firms off guard, prompting some to withdraw or scale back their investments.
- This further adds to China’s economic woes, where domestic consumption continues to be subdued, culminating in sluggish economic growth.

Source: Bloomberg, August 2024

Yield Curve un-inversion

While the yield curve inversion is often touted as an indicator of an upcoming recession, it's the un-inversion that investors should really worry about



- While yield curve inversion is routinely sited as a leading indicator of a recession, it has not been good in predicting exactly when will the recession start. As seen this time around, the yield curve has now been inverted since July, 2022 and yet there isn't a recession in sight.
- Having said that, a metric that has historically been a better predictor of a recession has been the un-inversion of the yield curve, which usually happens due to the shorter end coming off sharply due to expectations of impending rate cuts, which usually tend to be quite rapid and associated with a recessionary economic environment.
- Considering what we have seen over the past 2 weeks, we think that this is yet another indicator that is flashing the red light and begs to question the viability of further outperformance being delivered by risk assets.

Source: Bloomberg, August 2024

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Concentration Will Quickly Become Problematic

The "Mag. 7" currently represent a third of the S&P 500 and could double their share in five years

Magnificent 7: Playing the Trend Forward

	2019	2024	2029 (Projected)
Net Income	$170B	$545B	$1,749B
Market Capitalization	$5,152B	$15,771B	$48,279B
Avg. Weighting in S&P 500	2.6%	4.7%	9.8%
Total Weighting in S&P 500	18.5%	33.0%	68.7%

The growing concentration among top companies in the S&P 500 is becoming increasingly problematic. During the dot-com bubble, giants like Microsoft, General Electric, Cisco, Intel, and Walmart made up 18% of the index—a large but manageable share, especially since they spanned different industries.

In 2024, however, the top five companies—Amazon, Apple, Alphabet, Nvidia, and Microsoft—are all tech and now represent over 30% of the index, nearly double the peak concentration during the dot-com bubble.

Even more concerning, Callodine Capital projects that, based on current earnings trends, the "Magnificent 7" could account for as much as 68.7% of the index by 2029.

Source: Bloomberg, Callodine Capital, August 2024

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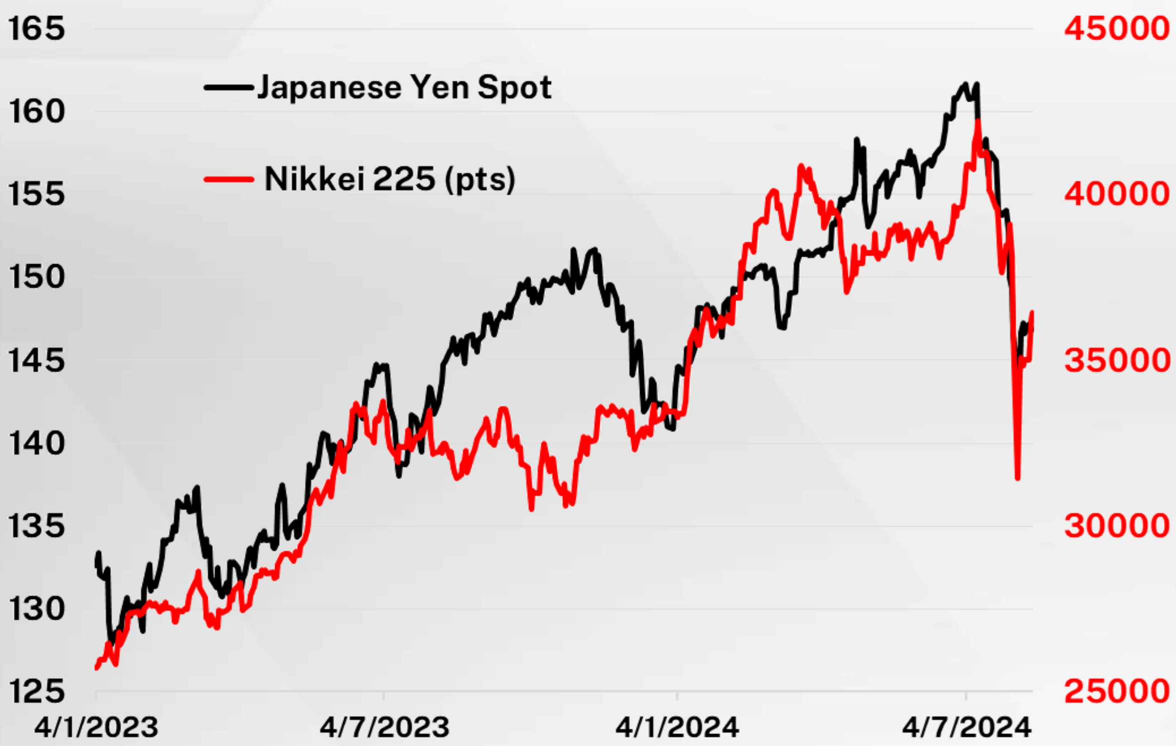
Currency Vs. Fundamentals

Japanese Gains Under Scrutiny: Governance Reforms or Currency Depreciation?



Over the past two years, corporate governance reforms have been credited with boosting Japanese stocks by improving transparency, enhancing shareholder value, and increasing management accountability.

However, a closer look at the Nikkei 225 index alongside the performance of the Japanese yen suggests that much of the stock market's positive performance has been driven by a weaker yen rather than fundamental improvements. This became particularly evident during the recent market selloff when the yen appreciated by 10.8%, leading to a 20% drop in Japanese stocks. This highlights the sensitivity of the market to currency fluctuations, with the weaker yen propping up stock valuations more than underlying corporate strength.

Source: Bloomberg, August 2024

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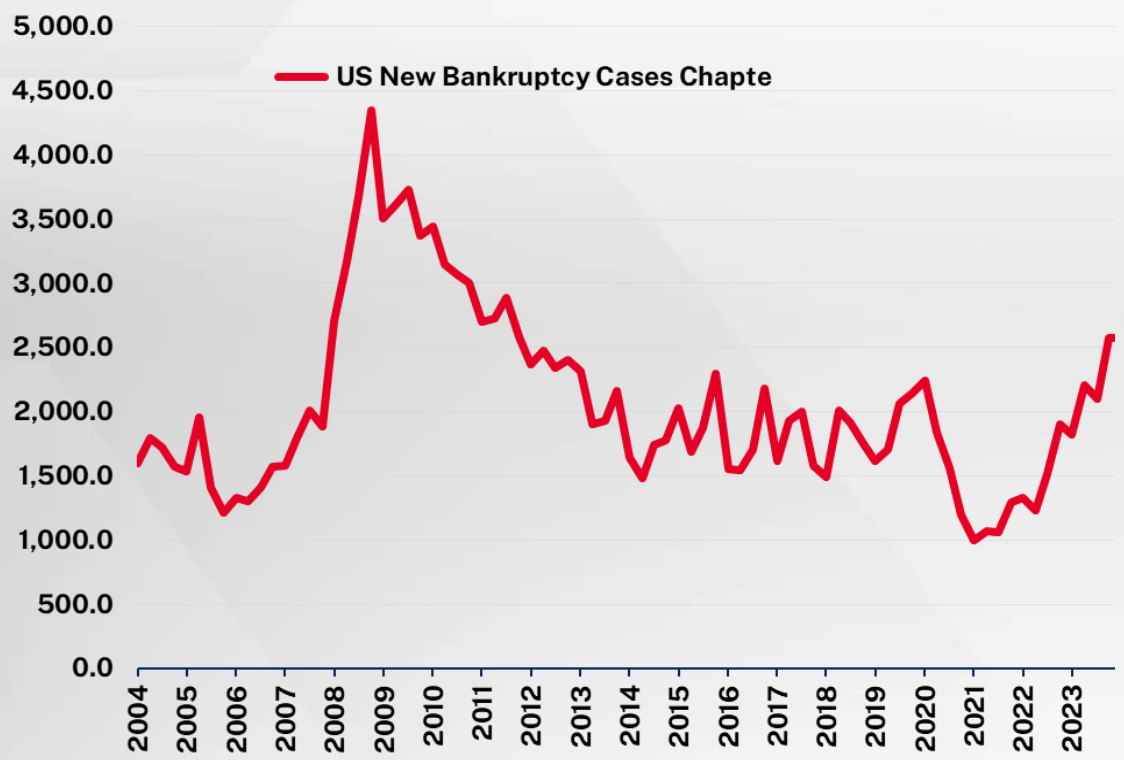
Chapter 11 Filings Surge to Decade-High Levels

Corporate Distress Peaks: Record-High Bankruptcy Filings Reflect Growing Economic Pressures



The number of U.S. companies filing for Chapter 11 bankruptcy has reached 2,576 as of the end of June 2024, marking the highest level since 2012. This figure surpasses anything seen over the past decade and is significantly higher than the levels recorded during the pre-financial crisis period of 2004-2007.

What makes this figure even more concerning is that it represents only the first half of 2024, meaning the year-end total could be much higher if this pace continues. While Chapter 11 filings are a normal part of a capitalist system, allowing companies to reorganize under financial distress, the current volume is notably elevated. This rapid acceleration is alarming and reflects the growing pressures faced by businesses, from rising interest rates to tighter financial conditions.

Source: Bloomberg, August 2024

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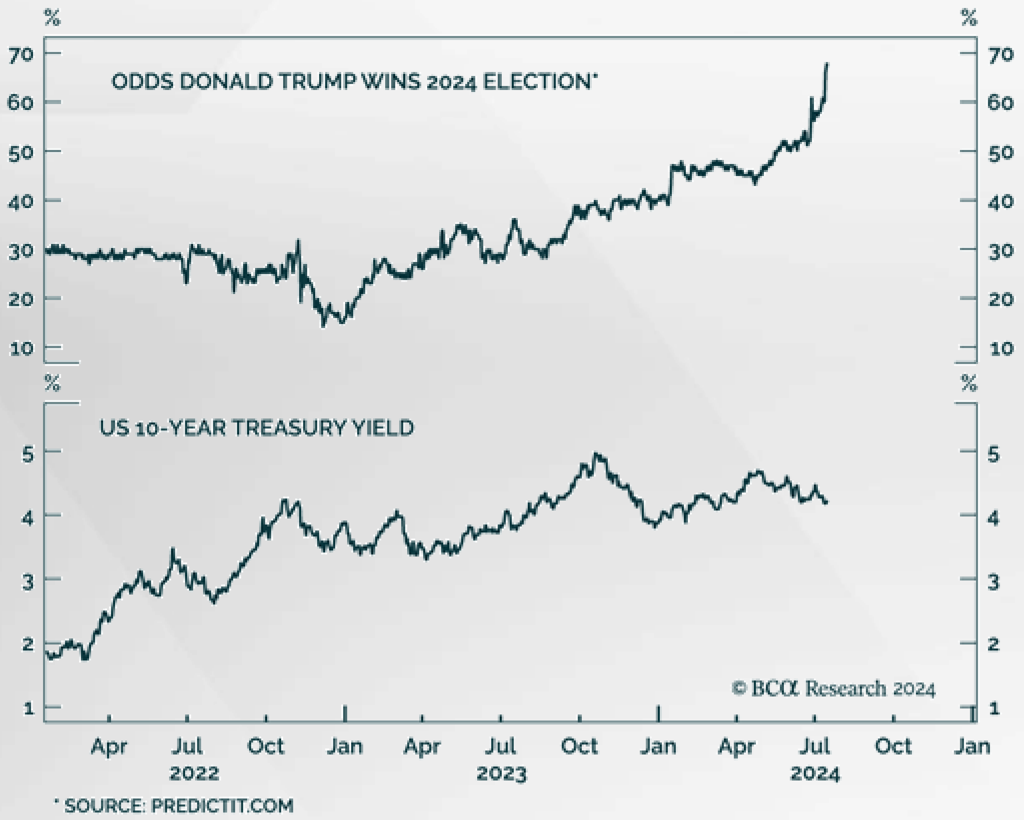
US Election Odds And The Bond Market

US Bond Yields More Likely To Be Lower On A 6-12 Month Horizon



- On Monday morning (15 July), markets reacted to the attempted assassination of Donald Trump. The betting odds that Trump will win the presidency in November rose to 67% (from 60% on Friday) and the 10Y UST yield increased by 4 basis points.
- The market narrative is that a second Trump presidency will be bearish for bonds due to hawkish trade policy, immigration restrictions, and tax cuts. This could lead to higher long-term bond yields if Trump's election odds continue to rise.
- The potential bond-bearishness of a Trump presidency must be weighed against slowing economic growth, falling inflation, and limits on further fiscal easing.
- When looking at all these factors together, according to BCA, it seems more likely that US bond yields will be lower on a 6-12-month investment horizon.

Source: BCA, July 2024

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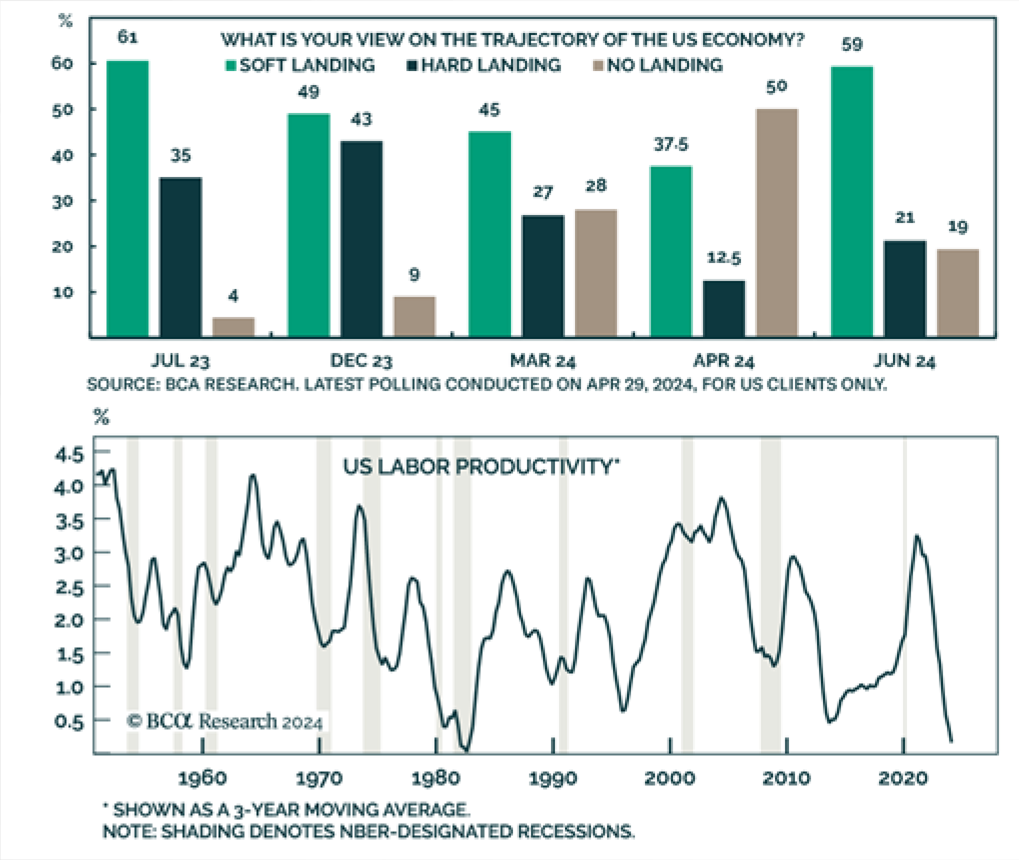
Is A Soft Landing Possible And Probable?

Not Unless There Is A Resurgence Of Productivity Which Is Not Likely To Be Soon



- According to BCA Research, the market is overestimating the odds of a soft landing. This number has been bolstered since the April poll by a slew of disappointing economic data and soft inflation prints.
- However, despite recent deceleration, disinflation, and a still-low unemployment rate, a soft landing is not a likely outcome. As an economic slowdown that leads to a recession will initially look like a desired cooling until it overshoots to the downside. A soft landing is easy to achieve but hard to maintain.
- The long and variable lags that took a long time to weigh on the US economy will be equally difficult to undo unless the Fed pursues a very aggressive easing campaign, which is unlikely as it is still dogged by inflation concerns. The only realistic path to a soft landing is a resurgence of productivity and AI will not have a major impact on productivity for several years.

Source: BCA, July 2024

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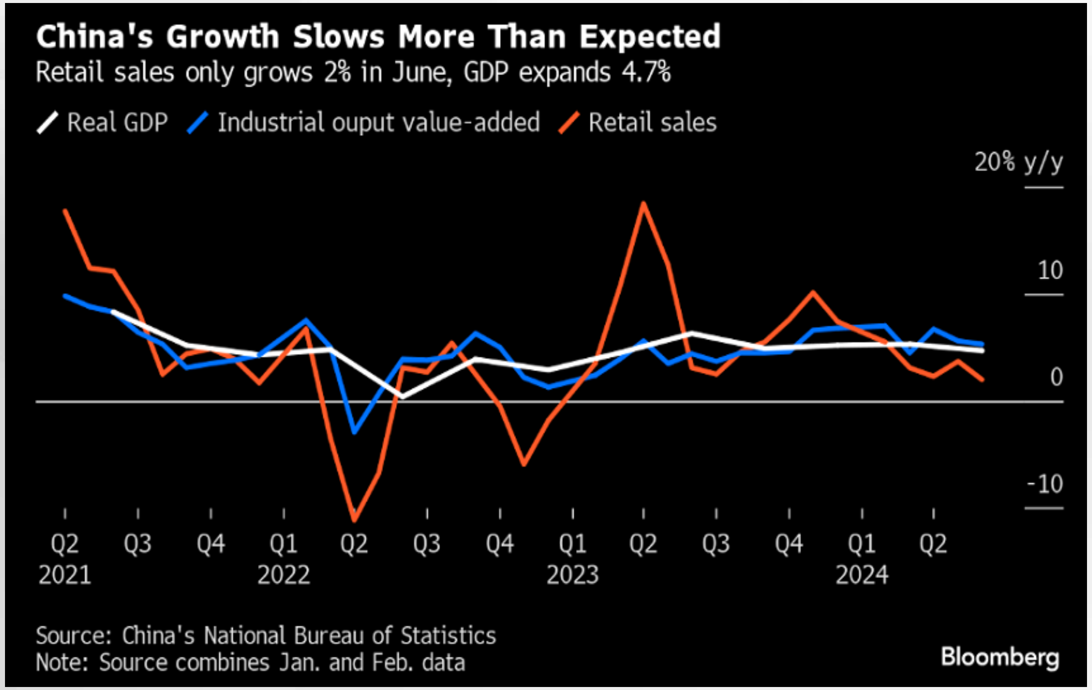
China’s Economy Slows Unexpectedly

GDP Expansion Slowest In Five Quarters As Demand Struggles



- The economy slowed more than expected, with second-quarter GDP rising 4.7% (consensus 5.1%), the weakest pace in five quarters.
- The data offers more evidence of an uneven recovery, with industrial output climbing 5.3% in June to top estimates, and retail sales growing a much weaker-than-expected 2%.
- Home prices extended their declines in June, showing that the real estate sector continues to struggle despite the rescue package unveiled in May. Property sales and investment continued to shrink in the first half.
- Investors are pinning their hopes on the Third Plenum meeting, scheduled to run 15-18 July, to deliver policy support and bolster sentiment.

 Source: Bloomberg, July 2024

LC Views - Summary

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LC Views Summary (1/3)

Sub-Asset	Recommended Positioning
Rates	• Treasury yields tumbled after benign jobs data stoked recession fears with markets anticipating that the Federal Reserve will be forced to cut interest rates aggressively than estimated to save the economy from sinking into recession. Most rates slid to their lowest since March, with those on two-year debt — more sensitive than longer maturities to changes in the Fed's policy outlook — sinking as much as 25 basis points on 2nd Aug to 3.88%. The odds of a 50 bps September rate cut is back into the fray after the data. The 10-year Treasury yield, which peaked above 5% last year after 11 Fed rate increases, fell sharply to lows of 3.7893% the same day. Treasury yield curve saw sharp steepening with 2s10s touch –ve 1bp intraday that day before normalizing at present levels of –ve 8bps (at the time of writing this). CPI data also pointed to a slowing goods inflation while there was a modest acceleration in the services. However, the overall print being as expected and continuing its downward trajectory is likely to keep the Fed in path of cutting in its Sept FOMC. The quantum of cut however would most likely depend on the jobs data expected in early Sept (for Aug) in our opinion. • Fed Chair Jerome Powell hinted at downside risks to labor market and "implicitly" indicated Sept rate cut . During the Q&A session Powell mentioned " zero to several rate cuts" as well leading to markets anticipating almost 100 bps of cuts in 2024. The Fed has a dual mandate of seeking full employment and price stability in the US economy.
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. We recommend a duration (in IG credits) of 5-10Y and advise against increasing duration beyond 10 years in corporate credits as the risk-reward does not favor ultra-long ends. However, on a tactical play, we recommend allocating a small position up to 5% of portfolio in iShares 20+ Year Treasury Bond ETF (TLT US) as the Fed is on the brink of an easing cycle. 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.

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LC Views Summary (2/3)

Sub-Asset	Recommended Positioning
Equities	• The equity markets bounced back this week, bringing back a sense of calm after an extremely volatile week for the markets. Market participants cheered a softer than expected PPI & CPI print which should allow the Fed to start its rate cutting campaign in September which the markets think will be supportive for risk assets. We are however slightly more skeptical of this stance being taken by the equity markets, given our understanding of how equity markets tend to start correcting only once the Fed has gotten going on its rate cutting spree and historically, they have been unable to manufacture a soft landing every time real interest rates have been maintained at such high levels for so long. • We continue to believe that valuations in the market are expensive in context of their own historical average, with the S&P 500 one-year forward P/E ratio at 22.4x and the Tech sector (S5INFT) at 31.7x and in case of any further disappointment on the macro-economic front, there is room for significant downward P/E re-rating which can lead to a steep correction in the equity markets. Additionally, we have also seen the end of the 'Great Rotation' it seems given the sharp drawdown seen in the Russell 2000 Index, which is down by about 10% from the highs seen during the last week of July. We believe that this was most definitely yet another false start for the small caps as we had expected and the retail investor frenzy in the small cap markets has also died down, with investors pulling out of the IWM ETF (iShares Russell 200 ETF) at one of the fastest rates on record. • Almost all of the S&P 500 constituents (458/500) have reported numbers for the 2^{nd} quarter and here's how they have stacked up till now : Sales have grown by 5.0% YoY while earnings have increased by 8.8% on a YoY basis. Till now about 79% of the companies have surpassed analyst estimates delivering a positive earnings surprise of about 4.1%, which is quite a bit lower than the mid-single digit earnings surprise that we usually see. • Overall, we recommend being long equities, especially Tech after the recent drawdown while hedging using index level put options to insulate the direct equity holdings against any sudden drop in the markets. Additionally, investors can also take advantage of further gains in equities by opportunistically selling out of positions that seem over stretched / expensive from a valuation perspective.

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LC Views Summary (3/3)

Sub-Asset	Recommended Positioning
Currencies	• We anticipate continued currency volatility throughout 2024, exemplified by the Japanese Yen, which plummeted to its lowest level against the USD (158) since 1990. With global recessionary risks looming, the USD may see short-term strengthening from a tactical perspective. While exposure to JPY, EUR, and GBP could be gradually increased to capitalize on recent lows, implementing such a strategy now may be premature. Additionally, we suggest incorporating active managers, particularly Macro funds, to capitalize on opportunities arising from heightened volatility in both currencies and interest rates.
Commodities	• 2024 promises to be an intriguing year for commodities. Our structural bullish outlook on Gold, driven by factors such as diversification benefits, inflation hedging, geopolitical risks, and the de-dollarization trend, has proven positive thus far with a 15% increase. Similarly, Oil is expected to remain highly speculative, as evidenced by a 20% surge over Q1 2024, followed by a 15% correction in Q2. While recessionary concerns may dampen demand, production cuts by OPEC+ members and already low oil inventories are likely to support prices in the near term. We recommend allocating up to 5% of assets to one or two managers to capitalize on commodity trends.
Real Estate	• 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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