Investment Playbook Weekly Update

5th to 9th June 2023

LIGHTHOUSE CANTON



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Weekly Spotlight

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Equity Spotlight: British American Tobacco PLC

At a Glance

Ticker	BATS LN EQUITY
Exchange	London
Sector	Consumer Staples
Industry	Tobacco
Listed Currency	GBp
Mkt Cap (m)	58,100
Country Risk	GB
Beta	0.72
3M implied Vol.	19%

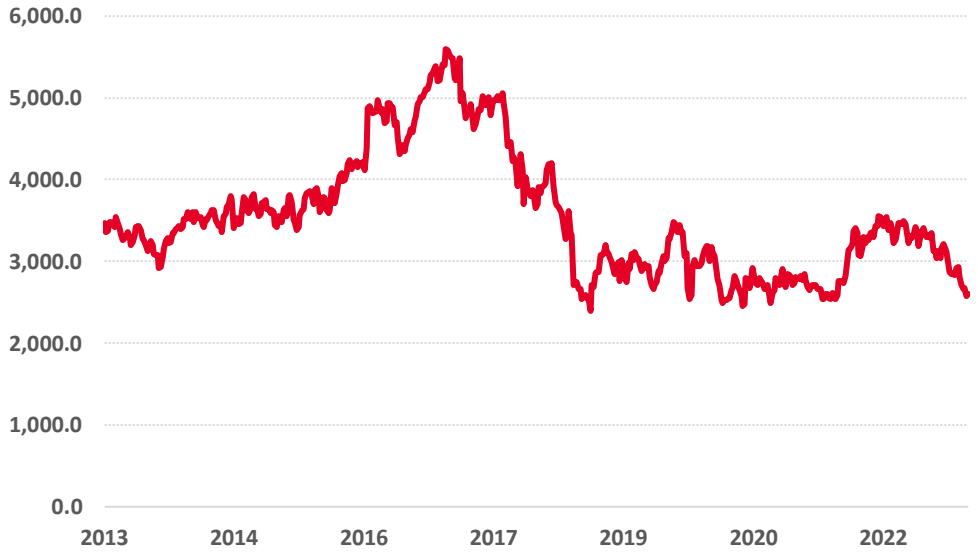
Profitability

Return on Capital	6.9%
Return on Equity	9.4%

Sales Growth

YoY	8%
CAGR 3Y	2%

Share Price



Valuation

Price / Sales	2.1
P / E (fwd)	

Yield

Dvd	9.3%
1 / PE Ratio	

Source: Bloomberg

Date: 08/06/23

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LC Target Price	3,315.0
Current Price	2,598.0
% Upside	28%

Analysts

Buy	16
Hold	4
Sell	0
Target Price (Avg)	3,698.3
% Upside	42%

Risk Consideration

Product Risk Rating	5
Shorts (% float)	
CDS	1.1%
Price Change 3M	-17.7%
Price Change 1Y	-27.2%

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Equity Spotlight: Investment Rationale

- **Issuer Description:** British American Tobacco P.L.C. operates as a holding company for a group of companies that manufactures, markets, and sells cigarettes and other tobacco products including cigars and roll-your-own tobacco.

- **Investment Rationale :**

  We see British American Tobacco as a very high-quality company, generating significant cashflow (FCF margin of 30% & FCF conversion of 60%) and managing to operate with healthy operating margins to the tune of 45%.

  While we do not expect the company to deliver significant growth in the coming years, we see the stock as a value stock at this point in time, post the 21% slump seen in the stock price this year. The stock currently also trades with a dividend yield in excess of 9% and a free cashflow yield of 14.4%, which we think is extremely attractive and makes it a great option for income oriented and defensive investors.

  Another aspect that makes us bullish about the business is the strong traction seen its non-combustibles segment, which has been growing at a CAGR of 33% over the last 4 years and its leading global market share in the vapor products industry, courtesy to its Vuse product.

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Fund Spotlight: SCOR ILS Funds - Atropos Catbond

FUND INFO

Asset Type	Fixed Income	**Fund AUM (m)**	1005
Investment Geography	Global	**Inception Date**	Jul-13
Strategy	Insurance Linked Securities		
Currency	USD		

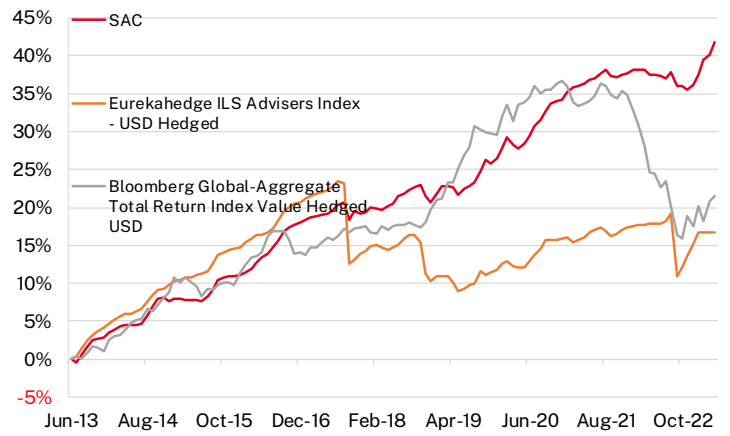
PERFORMANCE STATISTICS

	SAC	Eurekahedge ILS Advisers Index - USD Hedged	Bloomberg Global-Aggregate Total Return Index Value Hedged USD
Annualized Return	3.53%	1.63%	1.96%
Annualized Volatility	1.90%	4.17%	3.56%
Annual Sharpe Ratio (Rf)*	0.80	-0.09	-0.01
Annual Sortino Ratio (vs Rf)*	1.22	-0.09	-0.01
Max Drawdown	1.93%	11.80%	15.23%
Correlation to Global Equities	0.17	0.19	0.32
Correlation to Global IG	0.18	0.24	1.00
Correlation to Global HY	0.27	0.21	0.45

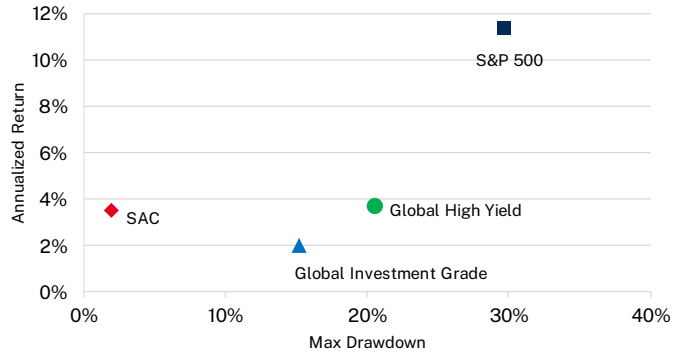
ANNUAL PERFORMANCES

2023 Return	3.00%	1.32%	2.90%
2022 Return	-1.15%	-1.77%	-12.88%
2021 Return	2.56%	1.18%	-1.39%
2020 Return	6.21%	3.69%	5.58%
2019 Return	4.77%	1.43%	8.22%

HISTORICAL CUMULATIVE RETURNS



RETURN VS MAX DRAWDOWN SINCE FUND INCEPTION



STRATEGY SUMMARY

- The fund is an absolute return fund dedicated to Insurance-Linked Securities ("ILS").
- It invests in natural catastrophe bonds through a buy and hold approach. These are extreme insurance risk products that insure against low frequency but high severity events (e.g. earthquakes, hurricanes, typhoons, etc.)
- Performance objectives:
  - Annual expected return: USD Cash + 400 to 500 bps
  - Expected volatility: < 3%
  - Target portfolio expected loss: 1.5%-2.5%
  - Investment horizon: 3 years minimum.
- The portfolio is mostly focused in US, Europe and Japan but places critical emphasis on multiple sources of diversification to minimize tail risk on fund.
- The fund does not invest in life settlements, secondary exposures or fund sponsored issuances and avoids exposures to perils linked to global warming (wildfires / flood).

More about Catbonds and the ILS market

- Floating rate debt instruments where the investor receives insurance payment in the form of coupons from the issuer.
- In the event of a peril, the principal would be use to pay the issuer to cover the losses incurred from the peril.

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Fund Spotlight: Investment Rationale

- The fund has garnered strong performance momentum this year, benefiting from higher rates and historically cheap spreads following a rate hardening cycle. **As of end May 2023, the fund has returned ~6%, annualizing at ~15%.**

- Portfolio currently **yields >11%** via a diversified portfolio of catbonds which are **floating rate securities.**

- Effectively, we are potentially looking at **HY like returns** with **IG like volatility**.

- The portfolio **coupon carry amounts to 5.5% with >600bps of spread above benchmark rates** compensating for peril risk which is uncorrelated with financial markets

- With a modelled expected loss of 1.5%, **current spreads overcompensates for peril risk by a factor of >3x**

- As we do not anticipate a rate cut anytime soon and with Catbond spreads currently trading at historic wides, we believe it is a good time to add some exposure to this asset class as a form of **yield enhancer** and **portfolio diversifier**.

- As an icing on the cake, the **fund is weekly liquid**.

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Charts of the week

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Valuations are Overall Expensive

Not just The Top of the Market



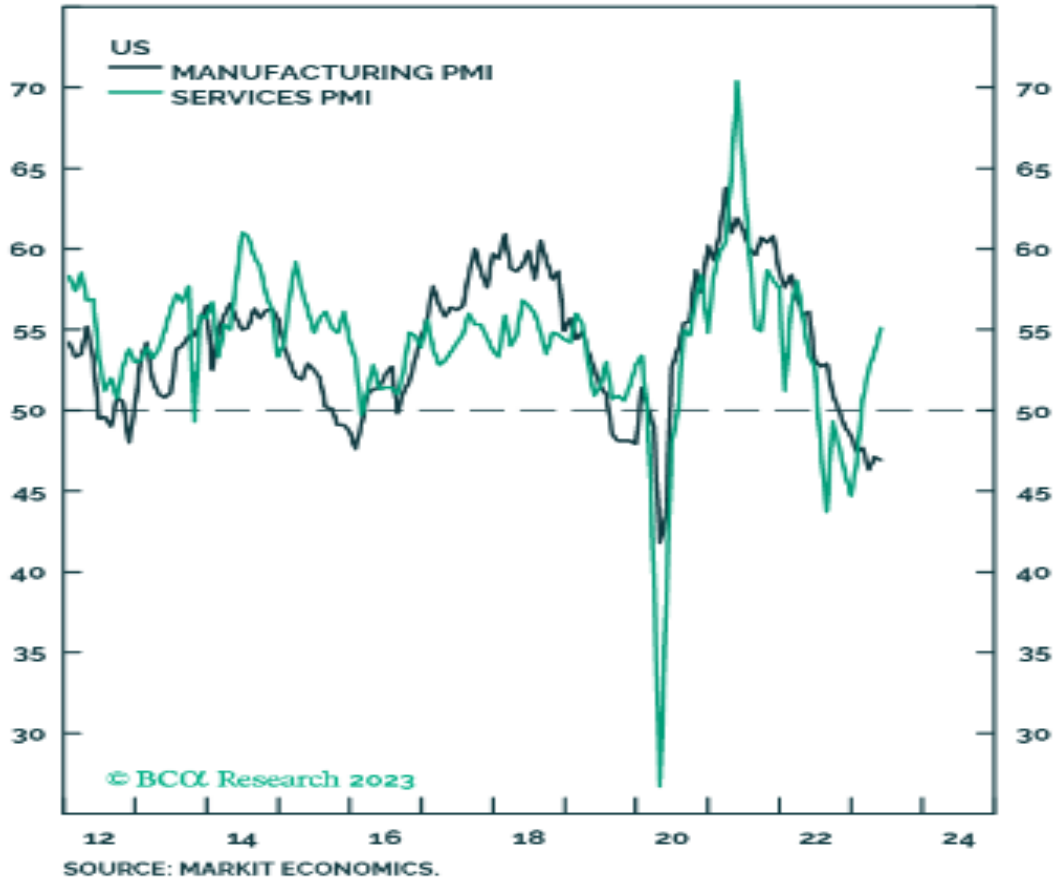
- A popular market narrative has been that only the 'top crust" is expensive. While the top quartile is indeed expensive, trading at 33.5x forward earnings, the second quartile is expensive too, trading at 20.9x. The bottom quartiles are outright cheap, trading at 13.9x and 9.1x, which is consistent with history.
- In other words, while the top quartile of the stocks is unusually expensive, the rest of the S&P 500 is either not cheap or not unusually cheap.

Source: S&P Global and BCA, June 2023

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Dual Track, Bifurcated Economy

Manufacturing in Recession; Services Expansionary



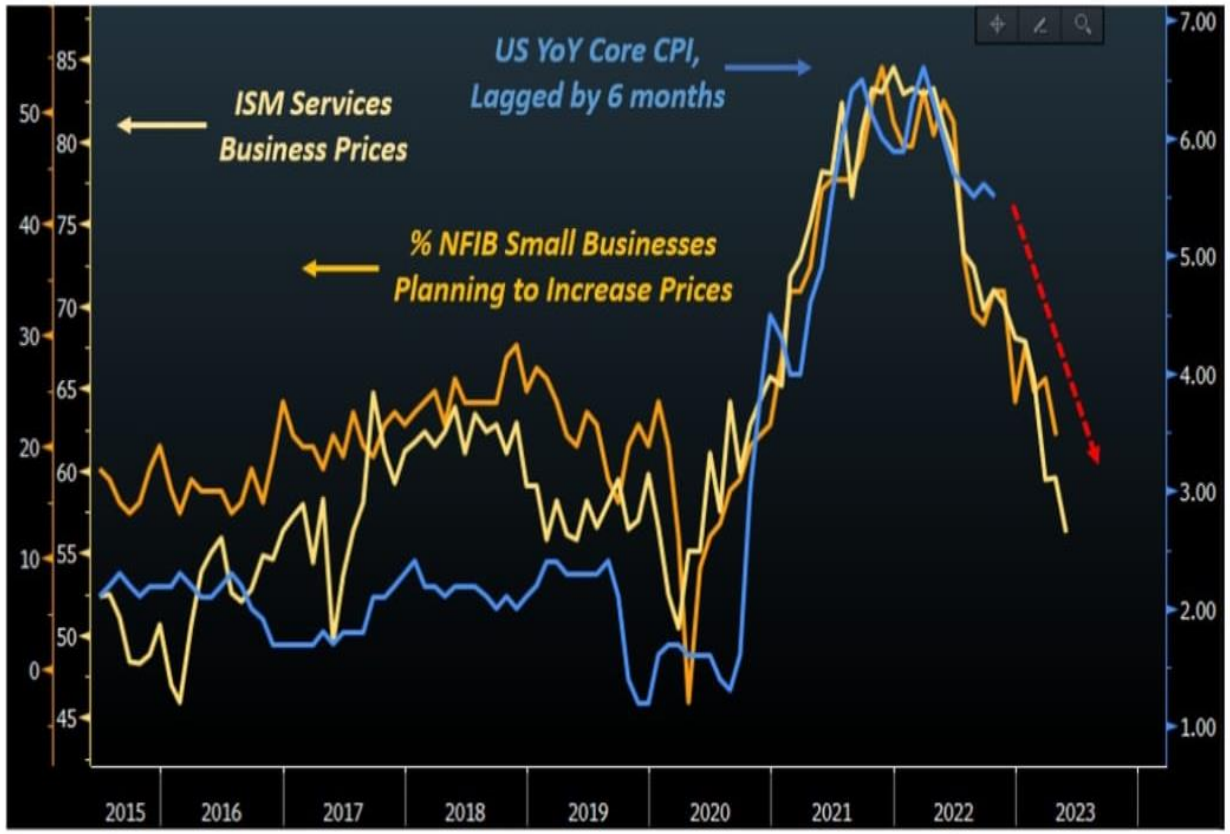
- The key drivers include strong sales and earnings growth of consumer services companies. However, we agree with BCA that the current trend is unsustainable and services are likely to eventually "catch down" to the demand for goods.
- Weakening demand, high wages and increasing cost of capital are likely to weaken the labor market which currently remains stubbornly tight. This should likely materialize through weaker earnings in the services sector.

Source: BCA, June 2023

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Lead Indicators Suggest 3% Inflation By Year-End

Core CPI expect to drop sharply by year-end



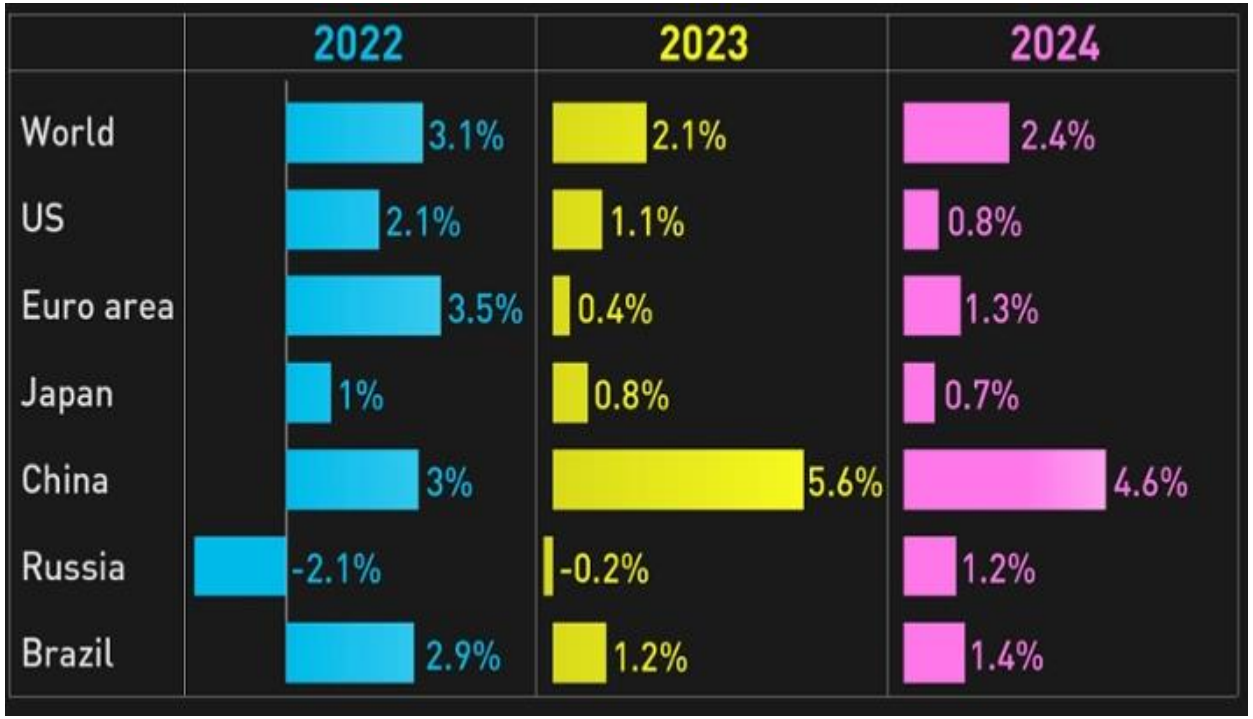
Source: Themacrocompass.com, Bloomberg, June 2023

- Based on ISM Services and NFIB Small Businesses, the US Core CPI is expected to drop significantly by year-end to 3% (from 5.5% as of April 30th).
- ISM (Institute for Supply Management) is an organization that provides monthly reports on economic indicators, including the ISM Services Index. This index measures the non-manufacturing sector's business activity and economic health.
- NFIB (National Federation of Independent Business) is a prominent organization that offers insights into small businesses. It provides data and reports on various aspects affecting small businesses, such as economic trends, business sentiment, and policy issues.

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Global GDP To Remain Soft In 2024

World Bank Expects Sluggish Growth To Last Into 2024



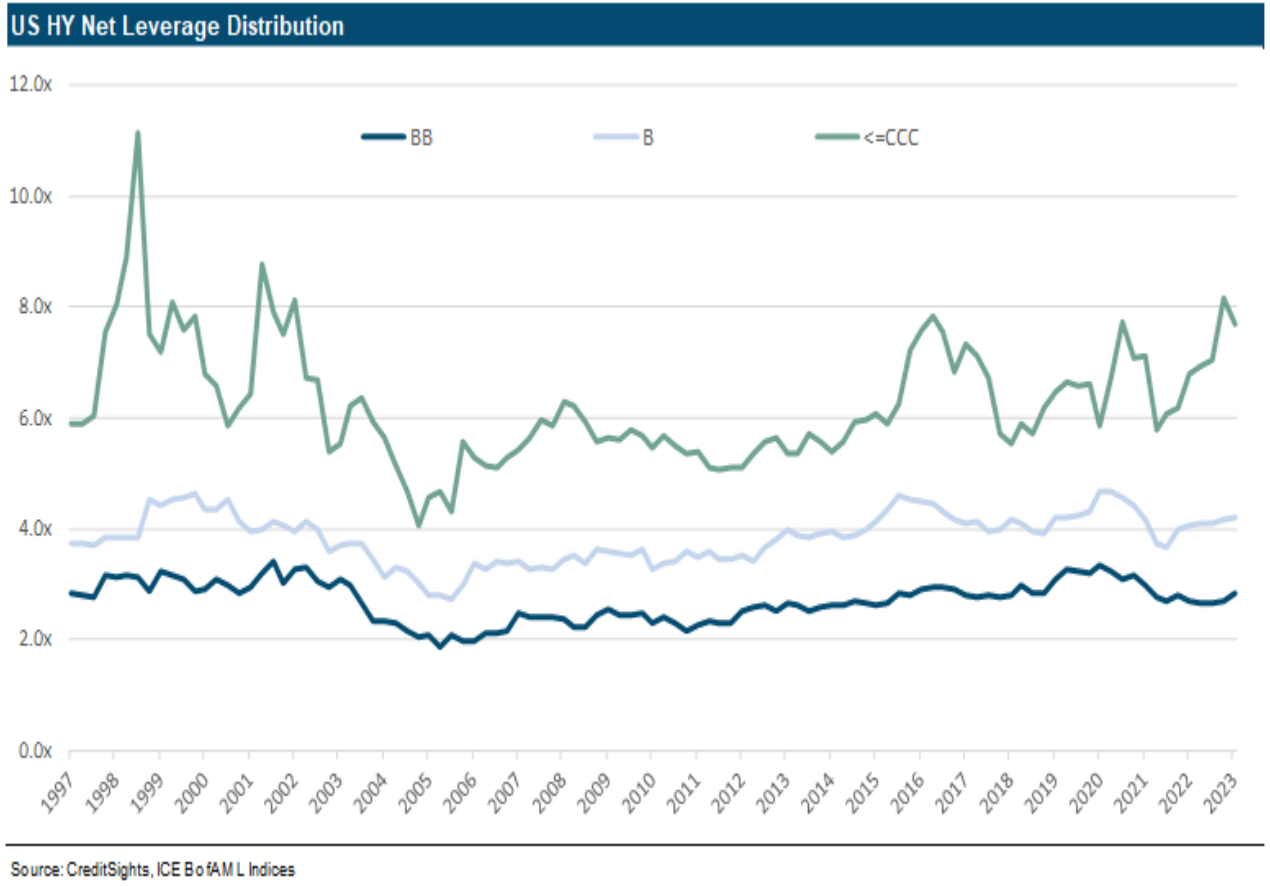
- The World Bank cut its 2024 world GDP forecast to 2.4% from 2.7%, calling the situation "precarious." The possibility of further rate hikes and more bank turmoil keeps expectations tilted down, with the outlook for developing nations especially grim. The report noted that China's reopening after the end of Covid is beginning to lose momentum.

Source: Bloomberg, June 2023

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US HY Leverage status (1Q23)

Net Leverage levels situation is stable except for CCC. EBITDA Margins are the wild card



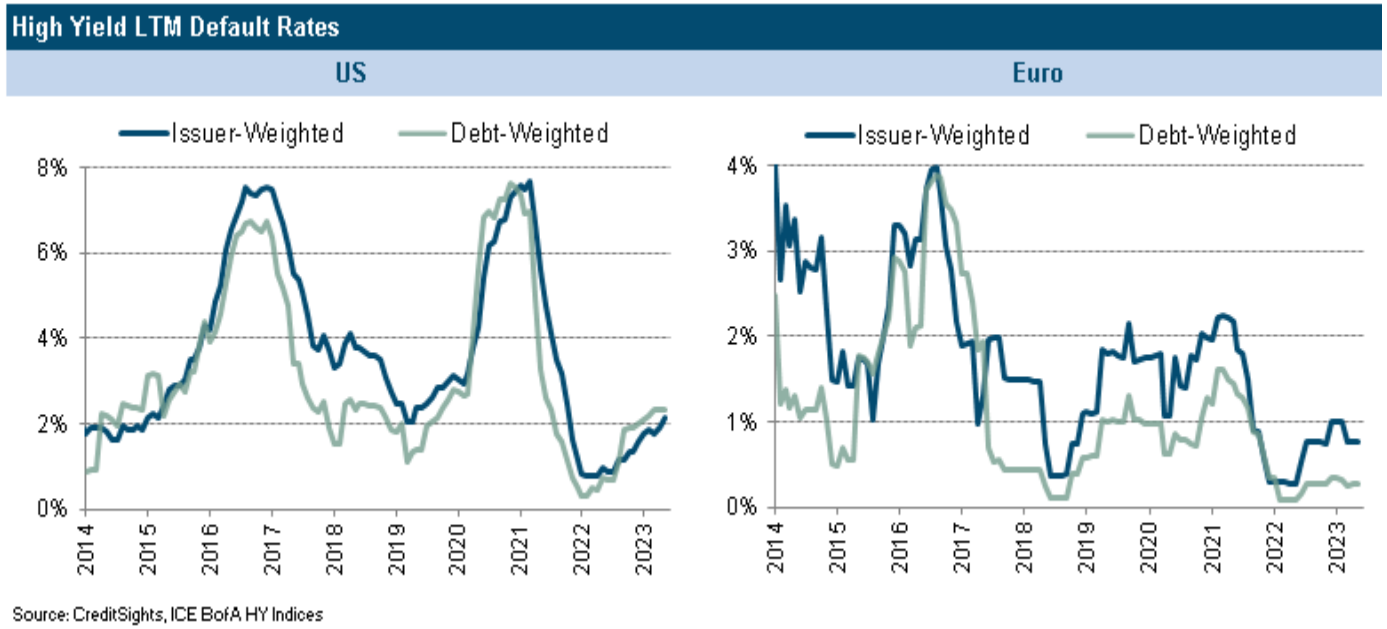
- Across the HY market median net-leverage increased incrementally to 3.57x from 3.53x.
- CCC saw a spike in their net leverage levels post pandemic and now looks to recede from their recent 8x level high.
- EBITDA margins however could play spoil sport. Sectors in this segment to avoid would be Utility, Leisure, Media and Healthcare.

Source: CreditSights, June 2023

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US & Euro HY Default rates

Default rates higher in US relative to their EU peers.



- US HY default rates (both issuer weighted, and debt weighted) inched up to around 2.2%-2.3%.
- US HY distress ratio stood at 12.1% compared to 13.5% post GFC average. The number is same for EU HY issuers as well.

Source: CreditSights, June 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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