Investment Playbook Weekly Update

7th to 11th August 2023

LIGHTHOUSE CANTON

2022 ASIAN PRIVATE BANKER AWARDS FOR DISTINCTION
BEST INDEPENDENT WEALTH MANAGER ASIA PACIFIC

PRIVATE BANKING AWARDS 2023 ASIAMONEY
RISING STAR, SINGAPORE

2021 ASIAN PRIVATE BANKER AWARDS FOR DISTINCTION
BEST INDEPENDENT WEALTH MANAGER WEALTH PLANNING SERVICES

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

2021 ASIAN PRIVATE BANKER AWARDS FOR DISTINCTION
BEST INDEPENDENT WEALTH MANAGER INVESTMENT ADVISORY

lighthouse-canton.com

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Charts of the week

1

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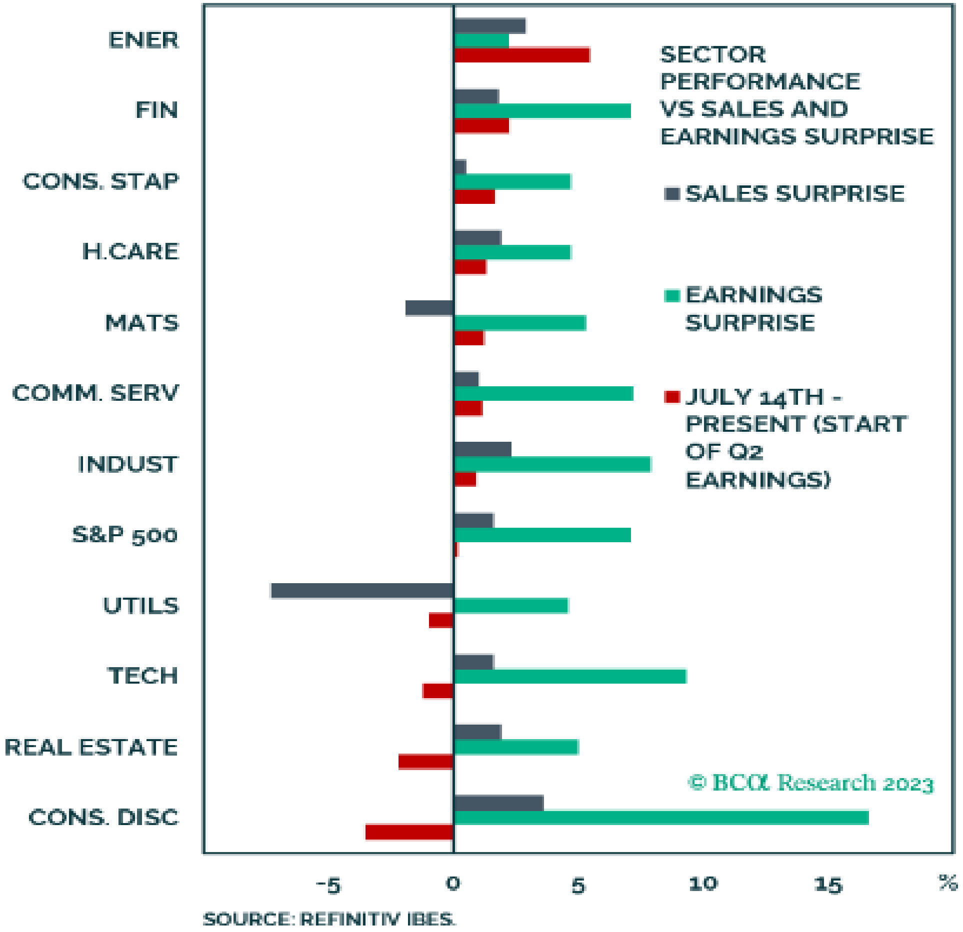
US Earnings: Good News Have Been Priced In

Broad earnings beat have failed to impress investors, with equity markets reacting tepidly



Source: BCA, August 2023

- With 80% of companies reporting earnings, 2Q23 S&P 500 earnings growth have clocked in an average growth of ~-8.25% vs expectations of ~-9% at the start of reporting season.
- Despite the broad-based beat, market reaction was rather muted, with S&P 500 posting a +0.2% price return from earnings beats and -0.7% from earnings misses.
- This suggests that expectations for surprises and misses have been widely priced in and nothing that companies told investors have moved the needle.

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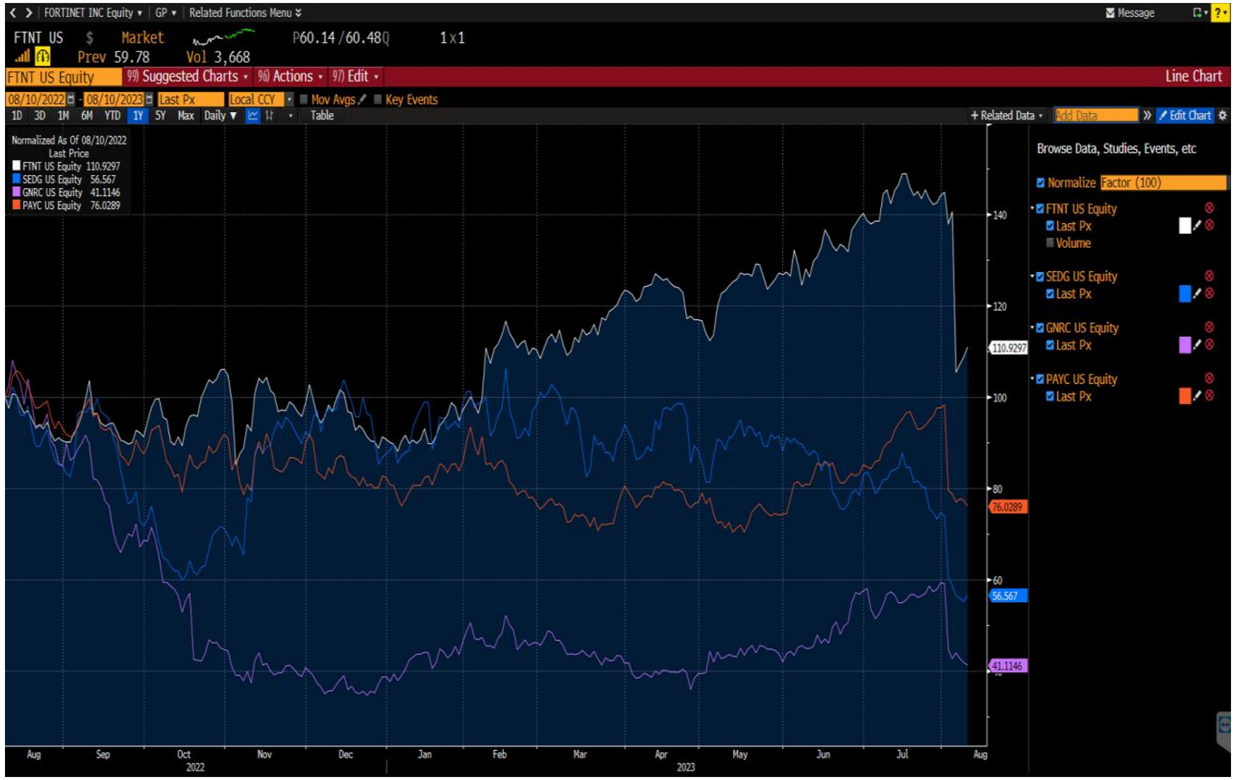
Richly valued stock + earnings miss / soft guidance = ⬇

Stocks priced to perfection have been held to a high standard & punished severely upon coming up short



- SaaS companies priced for significant future growth (for example Fortinet Inc. & Paycom Software Inc.), trading at well above 10x price to sales were punished brutally upon issuing soft guidance for H2 2023.
- Energy transformation stocks, which have been valued richly (> 40x TTM P/E) also cracked, post seeing a significant reduction in demand and guiding for subdued growth for the rest of the year.
- Markets always end up correcting past mistakes and hence it is important to stay disciplined when it comes to valuations.

Source: Bloomberg, August 2023

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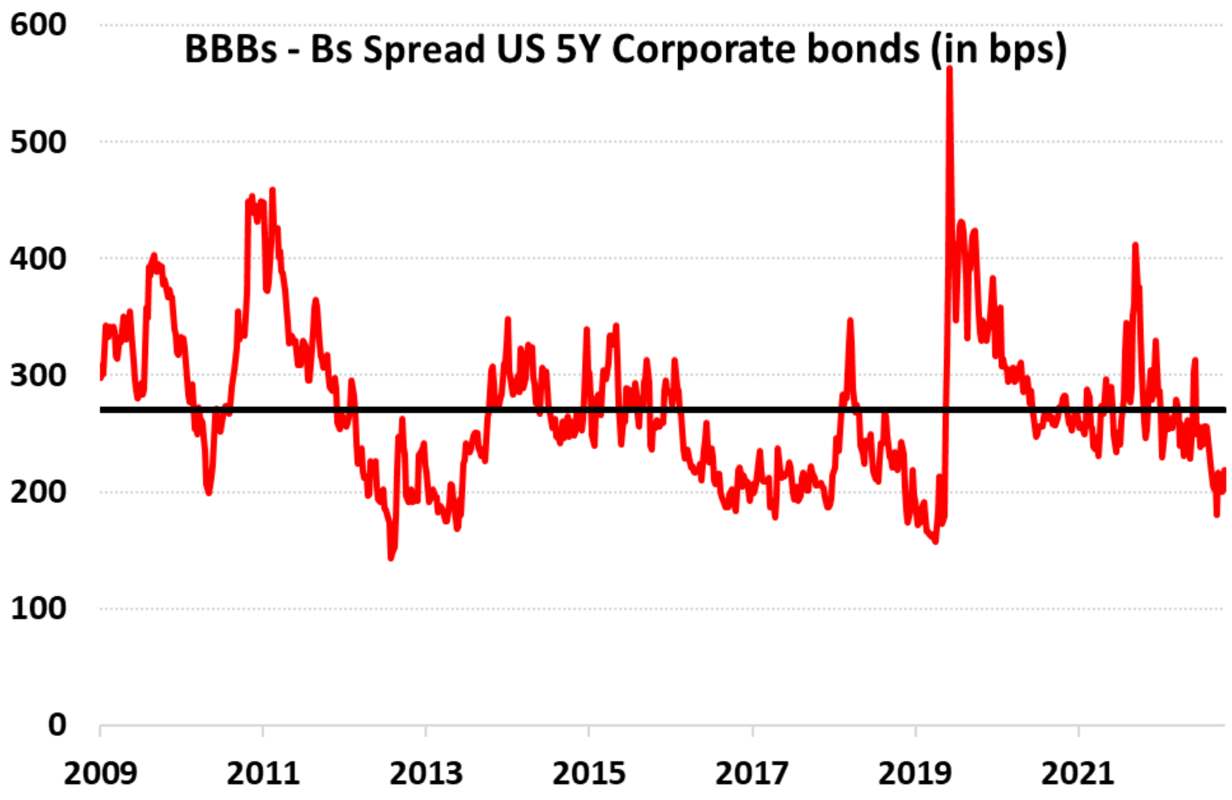
Credit Spreads Are Tight

The gap between junk and high-grade bonds does not incentivize taking excessive risks



Source: Lighthouse Canton, August 2023

- The gap between BBB and Bs ratings for US Corporate USD bonds with a 5-year maturity has narrowed to 218 basis points, which is 52 basis points below its historical average of 270 basis points. This reduction in spread highlights the compression in credit differentials and underscores the growing sense of investor complacency.
- A parallel trend is evident in equity valuations, which presently stand at elevated levels compared to historical norms. Given these circumstances, our recommendation leans towards overweighting cash positions for the time being and await more favourable entry points before adding bonds and equities.

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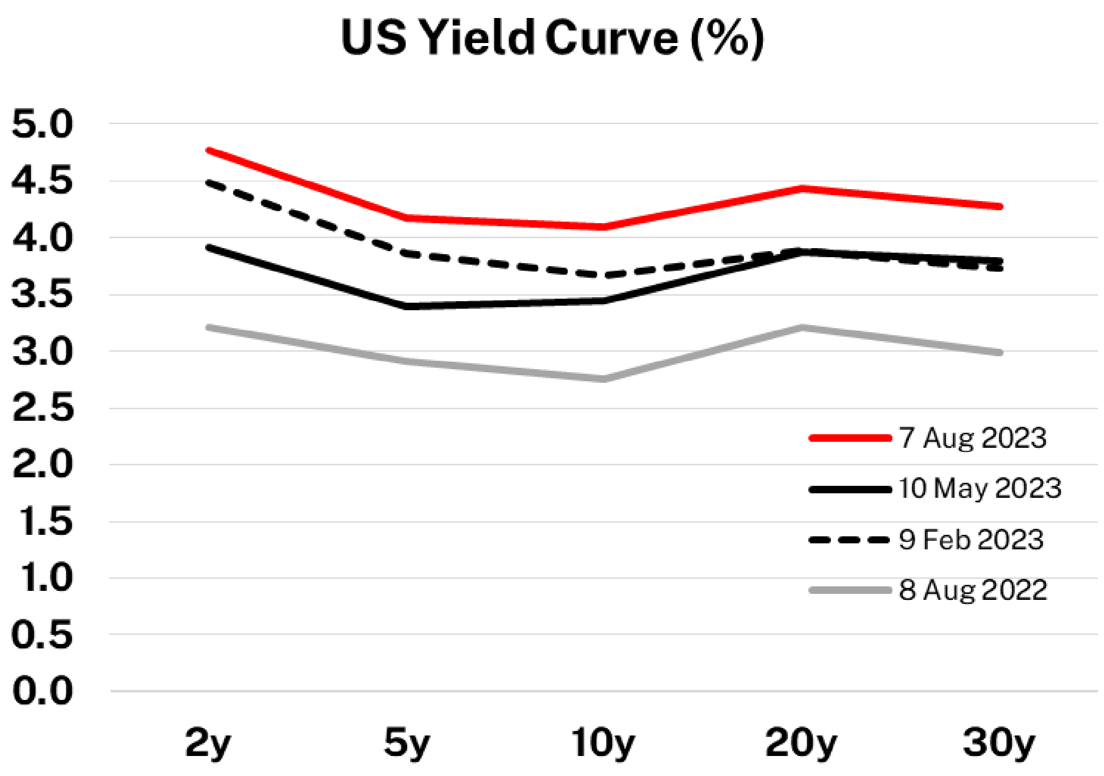
The Yield Curve Has Drifted 150 bps Higher

The US yield curve has not changed in shape but has shifted higher due to tighter monetary policies

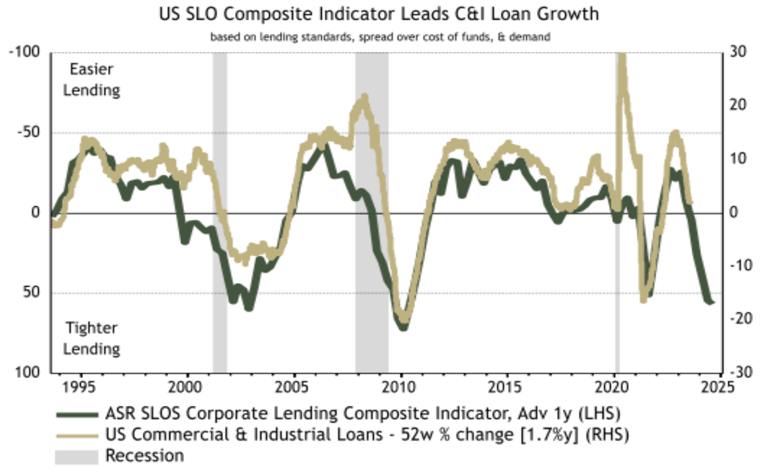


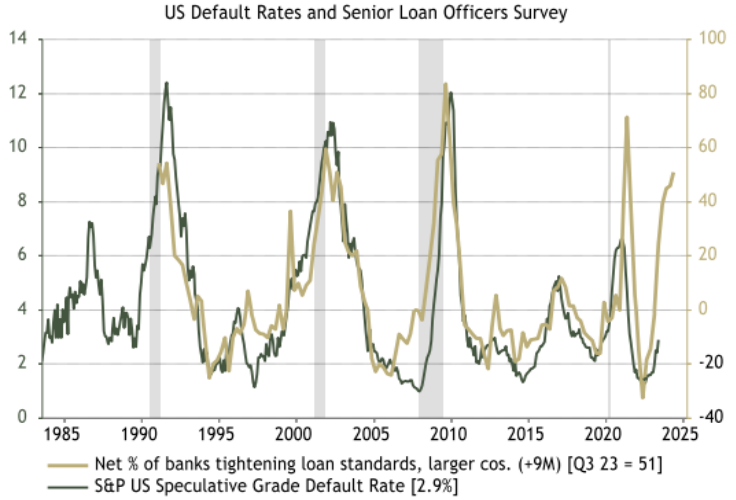
Source: Lighthouse Canton, August 2023

- The shape of the US Yield has barely changed over the past 12 months but has shifted higher by 150 bps. Interestingly, the yield on the 20-year maturity has consistently outpaced that of both the 10-year and 30-year maturities, primarily due to technical considerations.
- Indeed, private banks and asset managers, tend to concentrate on debts maturing within a 10-year timeframe. In contrast, institutional entities such as pension funds exhibit a preference for longer-term maturities. As a result, the demand for 20-year papers, being slightly less pronounced, has led to a marginal uptick in their yields compared to the other two maturity segments.

US SLO Survey Warns of Potential Credit Crunch

Expect Higher Default Rates and Rising Bankruptcies





Source: ASR, August 2023

- One reason why the market for risk assets has stayed stronger for longer is because Credit has continued to grow. But that could significantly change over the coming year, with the SLO Survey at levels consistent with a 10-15% contraction in C&I lending.
- On the lower chart, its shows that the SLO Survey has been a reliable leading indicator of the speculative default grade. Rating agencies are now upgrading their default projects and this chart shows a default rate as high as 8% a year from now.

LC Views - Summary

2

LC Views Summary (1/2)

Sub-Asset	Recommended Positioning
Rates	• The Federal Reserve hiked 25bps in July FOMC as widely expected. The lack of substantive changes to the policy statement suggests most officials still want to keep the door open to another rate hike. But Chair Powell's somewhat dovish performance at the news conference suggests a willingness to skip a hike at the September meeting, provided inflation data continue to be soft. He indicated that real rates are well above neutral and already restrictive, several times characterized June's soft CPI report as "better" than expected, said credit conditions are tight and getting tighter. Market participants are now pricing in a very low probability of a rate hike in September and 5 rate cuts next year. However, we urge against complacency as Powell continued to stress the Fed's determination to bring inflation back to the 2% target. Hence, we would not rule out another rate hike this year.
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 year to date has been an unpleasant experience, however, we are not yet ready to fully embrace the market frenzy on the back of elevated valuations and slowing earnings. Till date, 453 of the 498 companies in the S&P500 have reported Q2 numbers, which have translated into a YoY earnings drop of 8.24%, which seems to be slightly better than the 9% fall in earnings, expected by wall street. This week, equity markets were also impacted by Moody's decision to downgrade multiple US Banks leading to risk off sentiment continuing to linger in the markets post last week's US sovereign debt downgrade by Fitch. 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.

LIGHTHOUSE CANTON

Singapore

Lighthouse Canton Pte Ltd

16 Collyer Quay #11-02
Collyer Quay Centre
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