Investment Playbook Weekly Update

8th – 12th January 2024

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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

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The Signal From US Equity Valuations And Technicals

BCA predicts US equities to decrease this year

S&P 500 TARGET

FORWARD P/E	FORWARD EPS GROWTH ESTIMATES: -10%	-5%	0%	5%	10%	15%
14	3091	3262	3434	3606	3778	3949
15	3312	3496	3680	3863	4047	4231
16	**3532**	3729	3925	4121	4317	4514
17	3753	**3962**	**4170**	4379	4587	4796
18	3974	4195	**4415**	**4636**	**4857**	**5078**
19	4195	4428	4661	4894	5127	5360
20	4415	4661	4906	5151	5397	5642

Source: BCA, January 2024

- The S&P 500's ascent to 4,750 points hinges on expectations of a 'soft landing' for the US economy, including an approximate 10% growth in US stock earnings and an 18x forward P/E ratio. Accordingly, we outline three scenarios for 2024:

- Scenario #1: A soft landing materializes, leading to equities moving sideways.

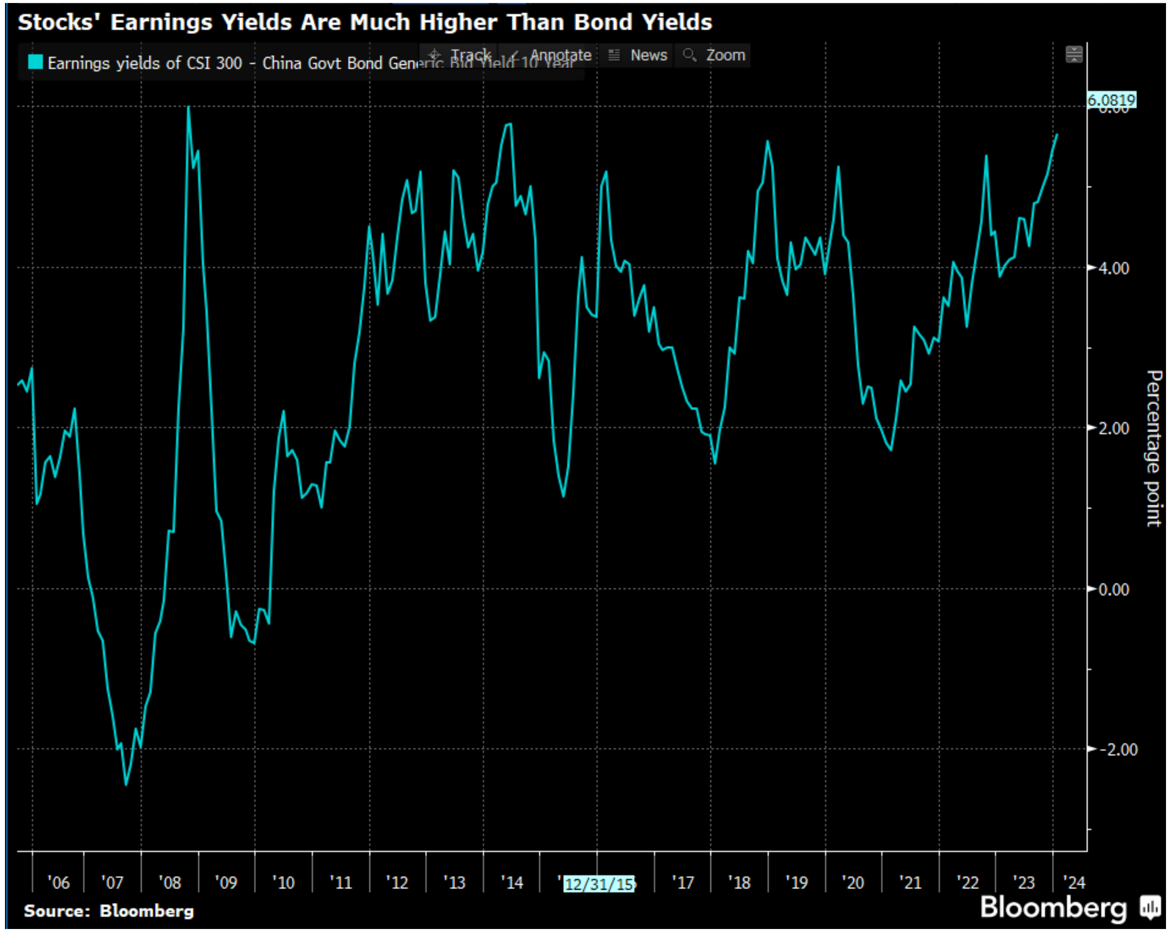
- Scenario #2: An increase in investor optimism ('Goldilocks scenario') drives US stocks higher.

- Scenario #3: Confirmation of a recession ('Retorquing' of Scenarios 1 & 2) prompts a market correction.

- Scenario #4: Inflation picks up and prompts a market correction.

Chinese Stocks Indicator Is Flashing Buy

The risk premium of Chinese stocks has reached a level that historically leads to spectacular returns



Source: Bloomberg, January 2024

- Chinese stocks may present a contrarian opportunity given the current negative sentiment towards China's economy and markets. Despite the CSI 300 Index dropping about 42% from its 2021 peak, the risk premium for Chinese stocks has reached levels historically associated with high returns.
- Meanwhile, China's bond market is rallying, with 10-year note yields at a low of 2.5%. The gap between the earnings yield of Chinese stocks and bond yields is unusually large, suggesting stocks are relatively cheap compared to bonds.
- This scenario, seen for the first time since 2005, indicates a potential for optimism in Chinese stocks amidst overall macroeconomic weakness.

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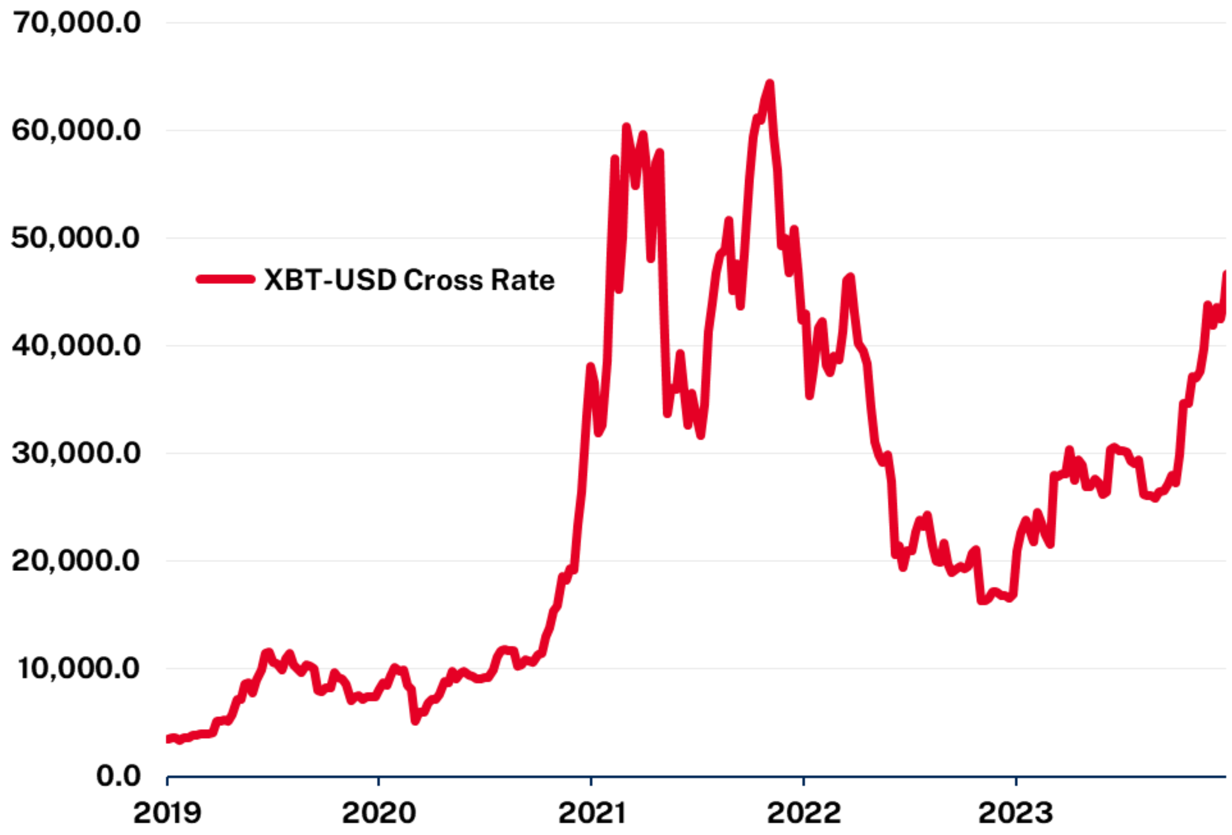
Time To Revisit Cryptos?

The SEC approval makes the asset class investible



- The SEC approved Bitcoin ETF proposals on an accelerated basis. The token traded near $46,000 as the news hit. It had surged to a 21-month high of more than $47,000 earlier in the week before whipsawing due to a false SEC announcement of the approval via Twitter/X.
- This regulatory advancement is likely to bolster confidence in an asset class that has largely struggled to gain widespread trust, particularly after facing significant setbacks in 2022.

Source: Bloomberg, January 2024

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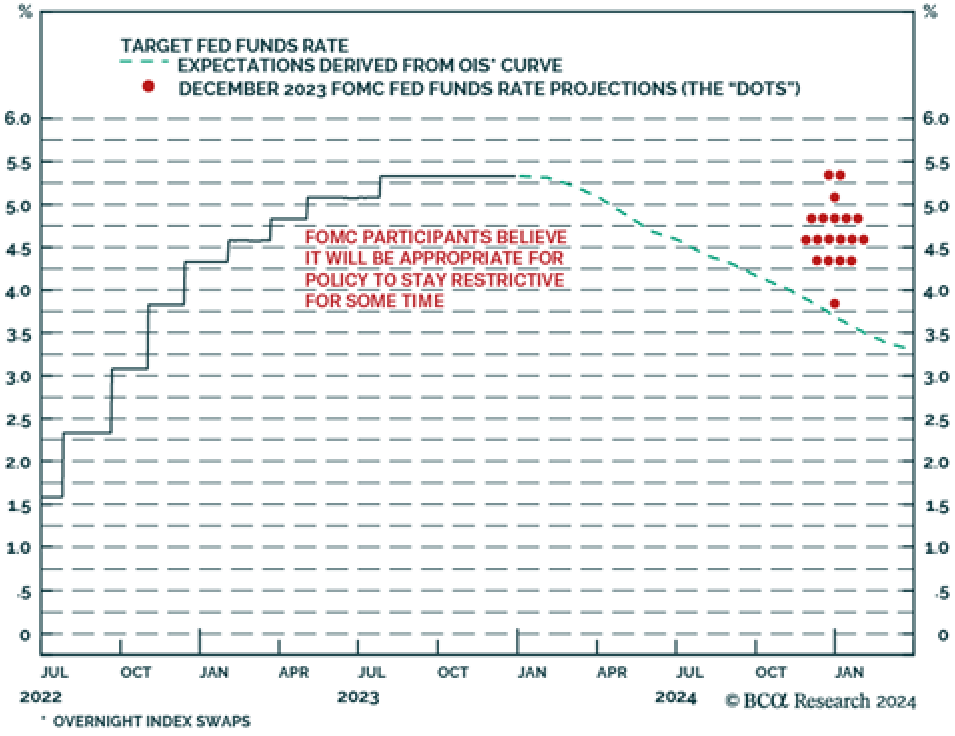
The Fed: Careful And Data-Dependent

Policymakers Believed That Monetary Policy Needs To Be Restrictive "For Some Time"



- Minutes from the Fed's December 12-13 FOMC meeting suggest that policymakers are more confident that inflation is on track to return to target. While they continued to note that inflation remains elevated and that they are highly attentive to inflation risks, they also acknowledged that it "had eased over the past year."
- On the growth front, FOMC members highlighted a slowdown in the pace of economic growth from the third quarter. And although the unemployment rate remains low, participants expect the tight labor market to continue cooling over the course of 2024 .
- Although BCA expects the Fed to deliver more rate cuts than are priced for 2024, they believe that the dovish surprise will only occur once the labor market deteriorates and the recession begins, likely in the second half of the year.

 Source: BCA, January 2024

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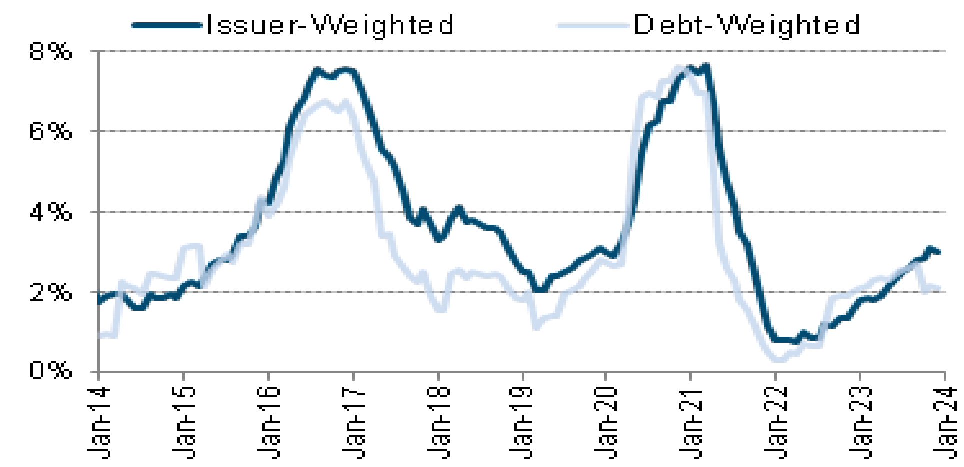
Default rates in US softening.

Resilient economy is most likely the cause

High Yield LTM Default Rates

US



Source: CreditSights, ICE BofA HY Indices

- US HY LTM default rate inched lower in December to 3% (issuer weighted) from 3.1% and 2.1% from 2.2% (debt weighted) .
- Automotive (10.5%) and Healthcare (9.8%) have the highest issuer weighted default rates .
- US HY distress ratio (bonds trading at an OAS of 1000 bps or higher) dipped to 8.8% from its Nov 2023 level of 10.1%. Post GFC average for the same is 13.3%.

 Source: CreditSights, January 2024

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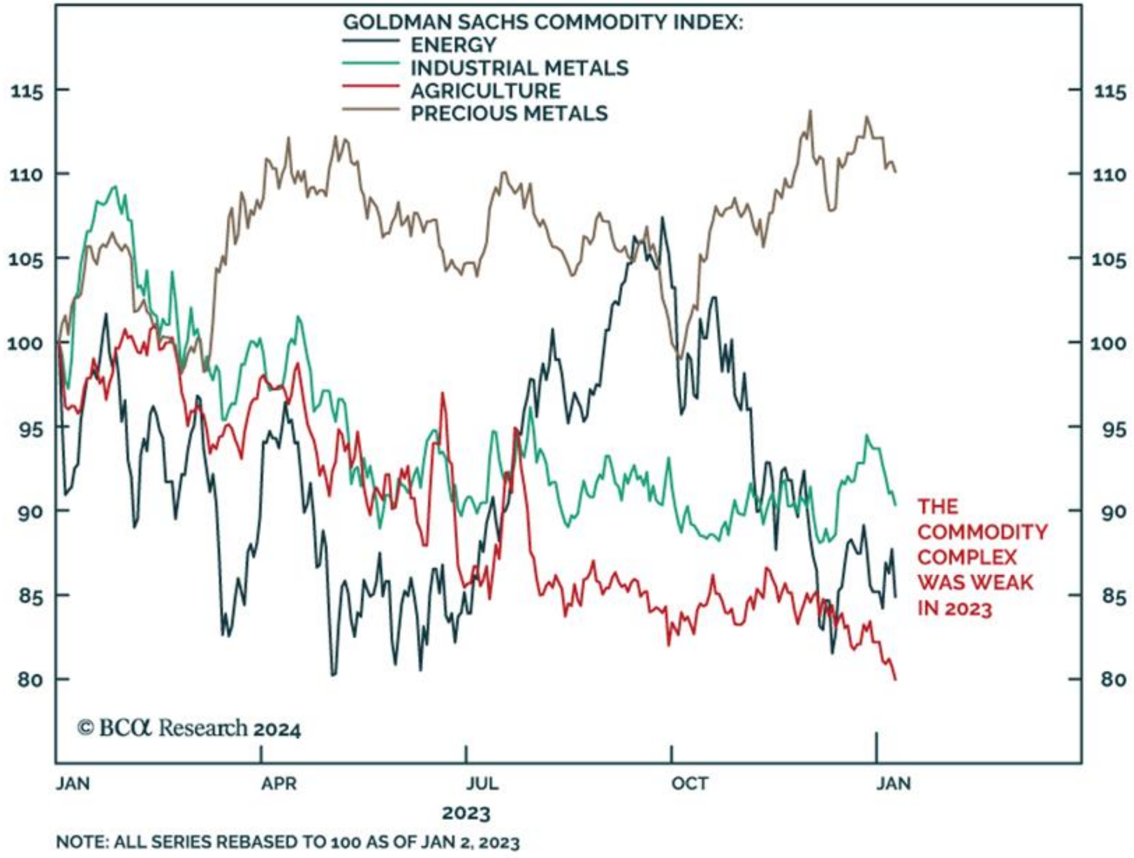
2023 Commodities in Review

Most Commodities Performed Poorly Except Gold, But Upside Limited



- The commodity complex performed exceptionally poorly last year. Industrial metals and crude oil were among the few major financial assets BCA track that posted negative z-scores in 2023.
- The weakness was broad-based with agricultural commodities (-17.8% in 2023) experiencing the most pronounced decline. The more cyclical commodities – energy and industrial metals – also weakened considerably last year.
- Precious metals bucked the trend, gaining 12% in 2023. This rally was driven by a 14.6% increase in gold prices amid a decline in Treasury yields and a subdued US dollar. Gold is now expensive, which will likely limit the gains.

 Source: BCA, January 2024

LC Views - Summary

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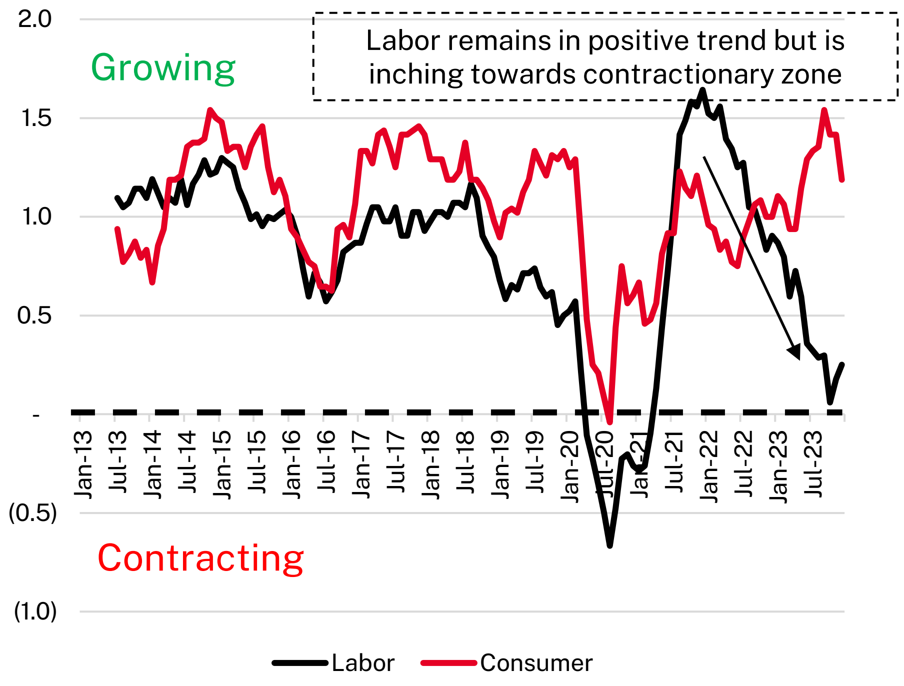
Macro Monitor

The case for a soft landing hinges weakly on the labor market and frothy growth expectations…

Equity Model Scores (as of Dec-23)		Current	1M Ago	3M Ago
Valuations	Weak (Decelerating)	1.77	↓	↑
Earnings	Moderate (Stable)	3.30	↑	↑
Economic	Moderate (Decelerating)	3.34	↑	↓
Mkt Signals	Weak (Decelerating)	2.60	↓	↑
LC Equity Score	Weak (Improving)	2.41	↓	↑

Score Legend	
1	Very Weak
2	Weak
3	Moderate
4	Strong
5	Very Strong

Rolling 6M Economic Sub-Component Scores



- We hold a cautious view on equities in the next 12 months.
- The earnings and economic cycle remain in a reasonably good shape thanks to healthy consumption – which is fueling the soft landing narrative.
- It is crucial to highlight that labor, which has held up consumption, has shown signs of deterioration and we remain cautious on the sustainability of the current cycle's strength.
- Valuations look expensive on most counts and technicals do not seem to seem to support a case to bullish equities either (at least for now)
- We therefore hold the view that the risk reward on equities is unattractive given the lack of margin of safety against any earnings miss on current 10% earnings growth expectations – which we remain skeptical about.
- A convincing rebound in labor maket trends may warrant a pivot from this view.

 Source: Lighthouse Canton, Dec 2024

Macro Monitor

Soft-landing unlikely to hold. We align with the consensus that rate cuts are likely to come this year.

Fixed Income Model Scores (as of 10-Jan-24)

LC Benchmark* Yield (%)	6.67			
LC Benchmark* Duration	4.81	**Current**	**Change**	**Implied**
Treasury Rate Expectations^	**Lower**	**3.95%**	**-50**	**3.45%**
IG Spread Expectations	**Wider**	**130**	**+24**	**153**
HY Spread Expectations	**Wider**	**422**	**+24**	**422**
Agg F.I. Score	**Moderate**	**3.57**		

**50% Gobal IG / 50% Global HY*

^Duration-Matched Treasury Rate of LC Benchmark

Score Legend	
1	Very Weak
2	Weak
3	Moderate
4	Strong
5	Very Strong

- Our fixed income team remains modestly constructive on fixed income this year.
- Given our cautious view on the economy this year, we would favor duration on a 12m horizon but prefer a staggered build up of duration due to potential technical pullback in long end rates.
- There is risk of spread widening, however, given that growth is likely to slow and default risks pick up in the face of higher rates.
- That said, we opine that current carry on credit is more than ample to offset any spread widening risk and falling rates will likely provide additional tail wind for the asset class for strong total returns overall.
- 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.
- Due to the higher expected credit dispersion, we see further opportunity in special situations bond funds, which could provide asymmetric returns in a prolonged distressed and disruptive credit market.

 Source: Lighthouse Canton, January 2024

LC Views Summary (1/3)

Sub-Asset	Recommended Positioning
Rates	• On Wednesday, the Federal Reserve held interest rates steady for a third meeting and gave its clearest signal yet that its aggressive hiking campaign is finished by forecasting a series of cuts next year. Officials decided unanimously to leave the target range for the benchmark federal funds rate at 5.25% to 5.5%, the highest since 2001. Policymakers penciled in no further interest-rate hikes in their projections for the first time since March 2021, based on the median estimate. • While Chair Jerome Powell said officials are prepared to hike again if price pressures return, he indicated policymakers are now turning their focus to when to cut rates as inflation continues its descent toward their 2% goal. Absent pushback on near-term rate cuts from the Fed chief, Treasuries surged and stocks jumped, while traders boosted bets on a March reduction to a near certainty. 2Y US Treasury yield plunged 31 bps and 10-year yield traded at 3.998% following the decision. • The timing of rate cuts will likely be dependent on how the labor market unfolds this year. Current trends seem to suggest weakness ahead and hence our bias is leaning towards cuts this year.
Credit	• Given our cautious view on the economy this year, we would favor duration on a 12m horizon but prefer a staggered build up of duration due to potential technical pullback in long end rates. • There is risk of spread widening, however, given that growth is likely to slow and default risks pick up in the face of higher rates. • That said, we opine that current carry on credit is more than ample to offset any spread widening risk and falling rates will likely provide additional tail wind for the asset class for strong total returns overall. • 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. • 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	• Equities have witnessed a remarkable resurgence in the closing two months of 2023, propelled by the plummeting interest rates. To illustrate this point, the yield on a 10-year US government bond, which stood at 5% on October 23rd, has now dipped to 4%. This substantial shift, a 100-basis-point drop over just two months, has been a pivotal factor behind the S&P 500 index's impressive 14% rebound since late October, and the VIX volatility index has plunged below 13, signalling a remarkable lack of anxiety among equity investors. • We hold the view that this resurgence may be transitory. The S&P 500's ascent to 4,750 points hinges on expectations of a 'soft landing' for the US economy, including an approximate 10% growth in US stock earnings and an 18x forward P/E ratio. Markets may be underestimating both upside risks to inflation and downside recessionary risks. Accordingly, we outline four scenarios for 2024:

LC Views Summary (2/3)

Sub-Asset	Recommended Positioning
Equities	• Scenario #1: A soft landing materializes, leading to equities moving sideways. • Scenario #2: An increase in investor optimism ('Goldilocks scenario') drives US stocks higher. • Scenario #3: Confirmation of a recession ('Retorquing' of Scenarios 1 & 2) prompts a market correction. • Scenario #4: Inflation picks up and prompts a market correction. • A decelerating labor market seems to suggest a softer global GDP growth outlook. The likelihood of a US recession, now pegged at 50%, may rise as the year progresses. Additionally, equities seem less appealing when compared to bonds and cash. The gap between the 3-month US Treasury yield and the S&P 500's dividend yield has widened to 400 basis points, a differential reminiscent of the years preceding the significant market downturns of 2000 and 2007. • Consequently, we lean towards the bearish camp in 2024. A convincing rebound in labor maket trends is needed (minimally) to pivot from this view.

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LC Views Summary (3/3)

Sub-Asset	Recommended Positioning
Currencies	• Currencies are expected to remain volatile throughout 2024. 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 prospect of rate cuts this year could present opportunities to pick good REITs which are trading cheap. • 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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