

LC Investment Playbook Weekly Update

May 9 – May 13, 2022

**LIGHTHOUSE
CANTON**



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

lighthouse-canton.com

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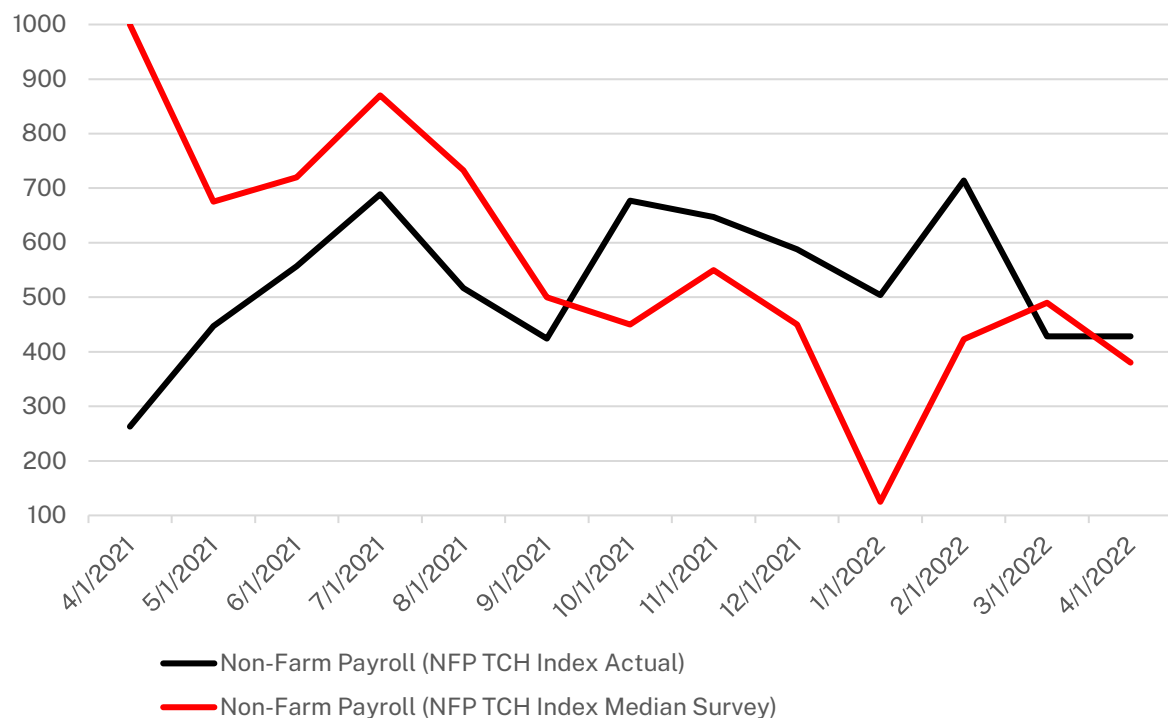
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Macro Highlights



US Labour Market- Mixed signals

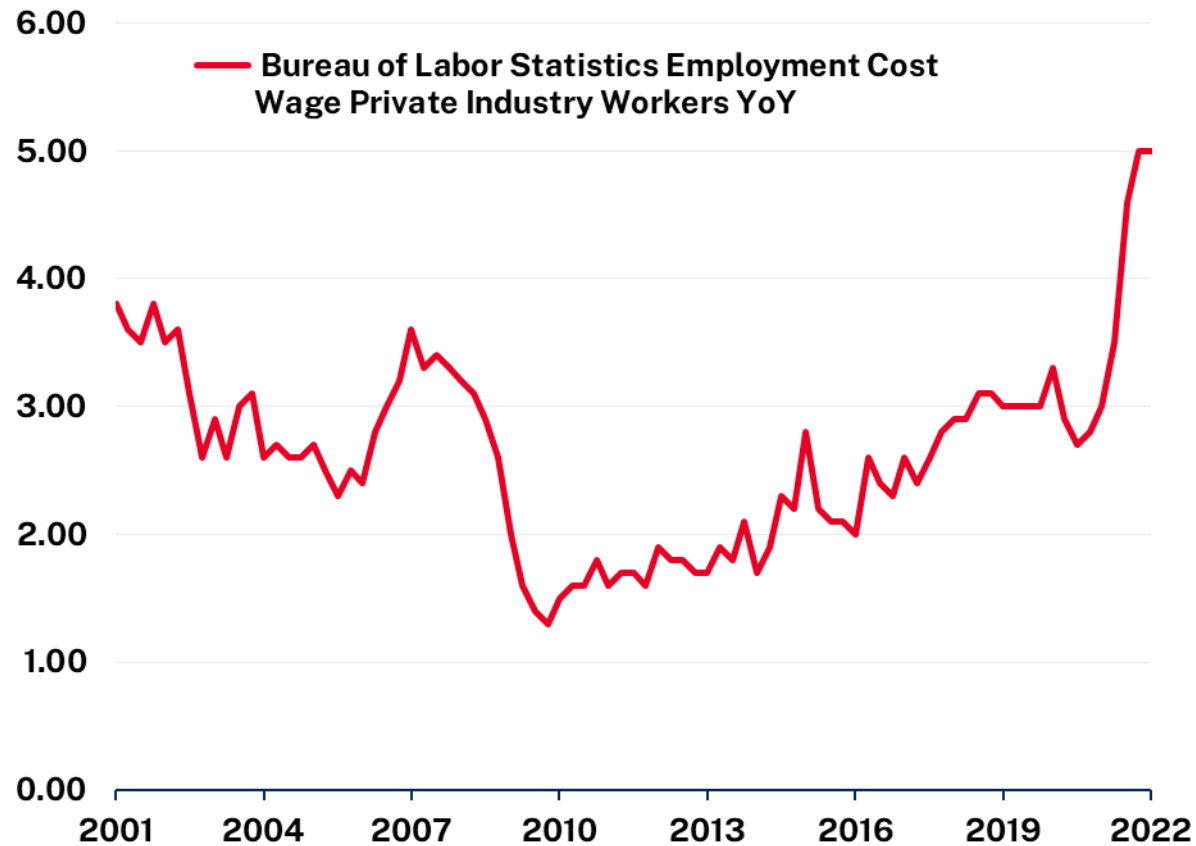
Non-Farm Payroll (monthly '000)



Source: BLS, Bloomberg and Lighthouse Canton dt 08th May 2022

- Headline nonfarm payrolls increased by 428k in April (vs 428k in March), above the consensus of 380k. Negative revisions - a rare occurrence during the pandemic - showed that hiring was 39k weaker in the previous two months combined than previously thought.
- Painting a drastically different picture, the participation rate edged down to 62.2% (vs. 62.4% in March). The Unemployment rate maintained at 3.6%, above the consensus (3.5%).

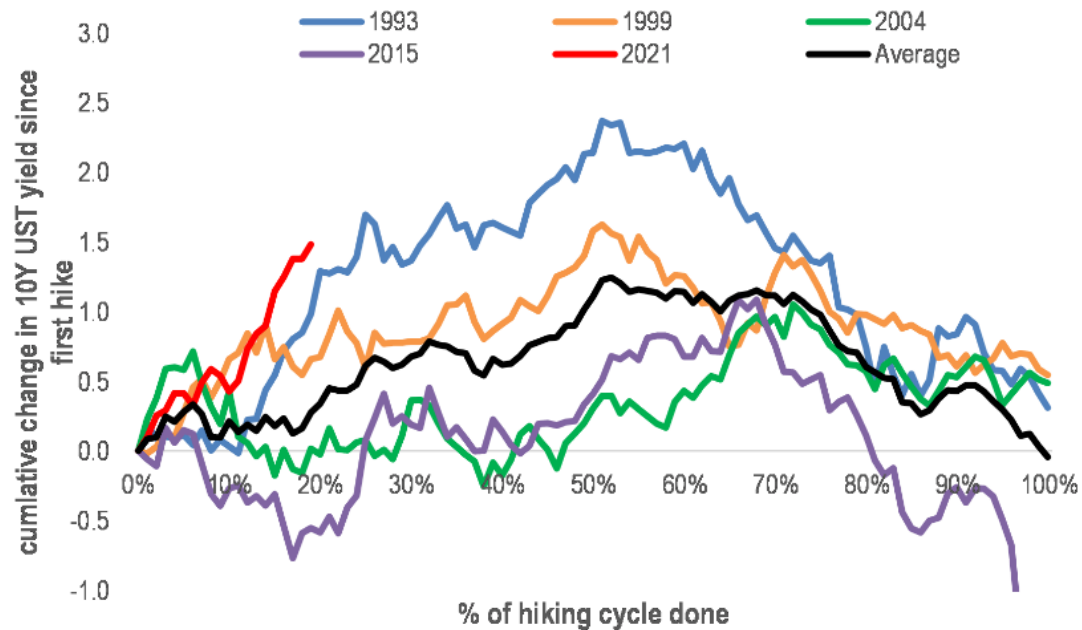
The workers rise up



Source: FT.com, Bloomberg 4th May 2022

- The employment cost index, an inclusive measure of labor costs has risen to 5% for Q1 2022, its highest level since its start (Q1 2001).
- We foresee corporates margins to be under pressure especially for the companies unable to pass these additional costs to their customers.

Tightening unlikely to be fully priced in...



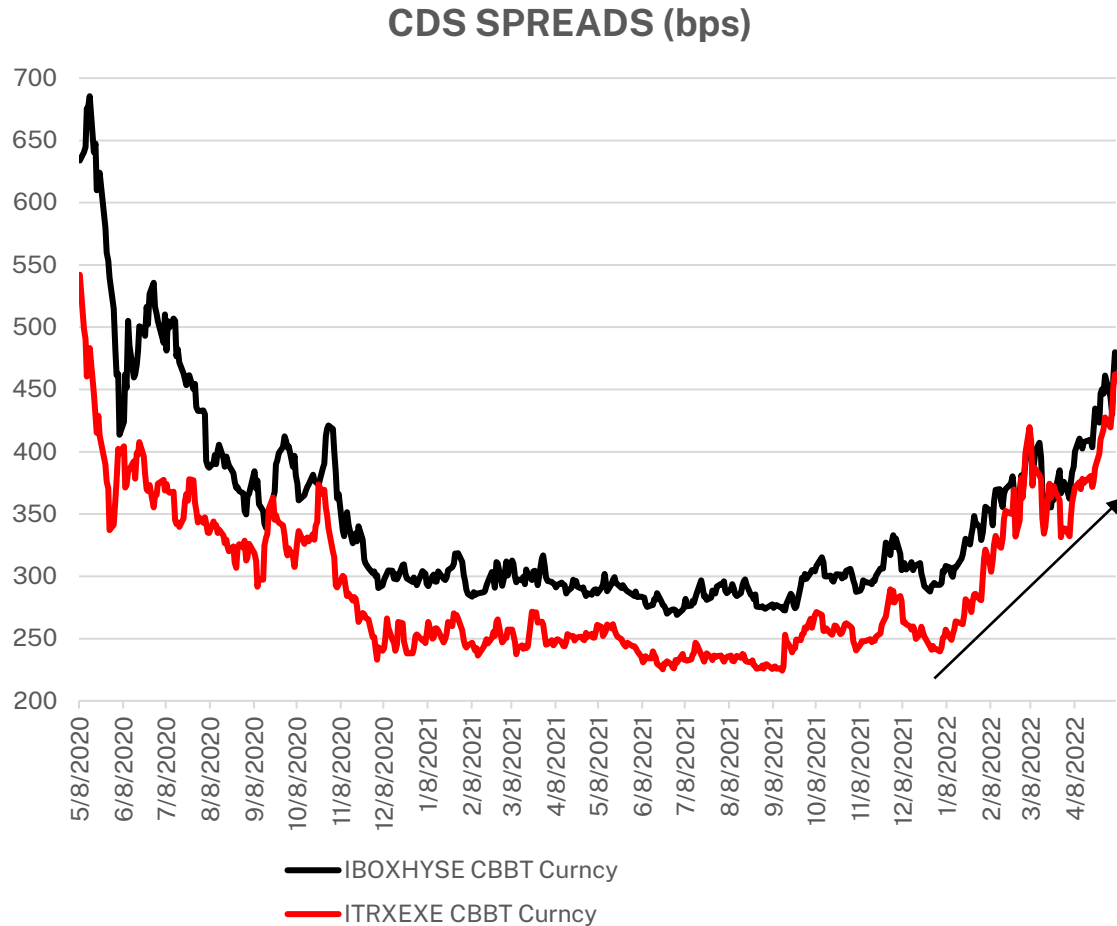
Source: JPM. 4th May 2022

- According to JP Morgan, 10Y UST yields do not peak until the hiking cycle is 50% - 75% done.
- As the fed has not started balance sheet roll off (begins June 1), we share similar views that the recent up move in UST yields are likely to be at its infancy.
- This means equity and credit markets are likely to remain vulnerable for the year, or at least until inflation starts to peak.

Fixed Income Highlights

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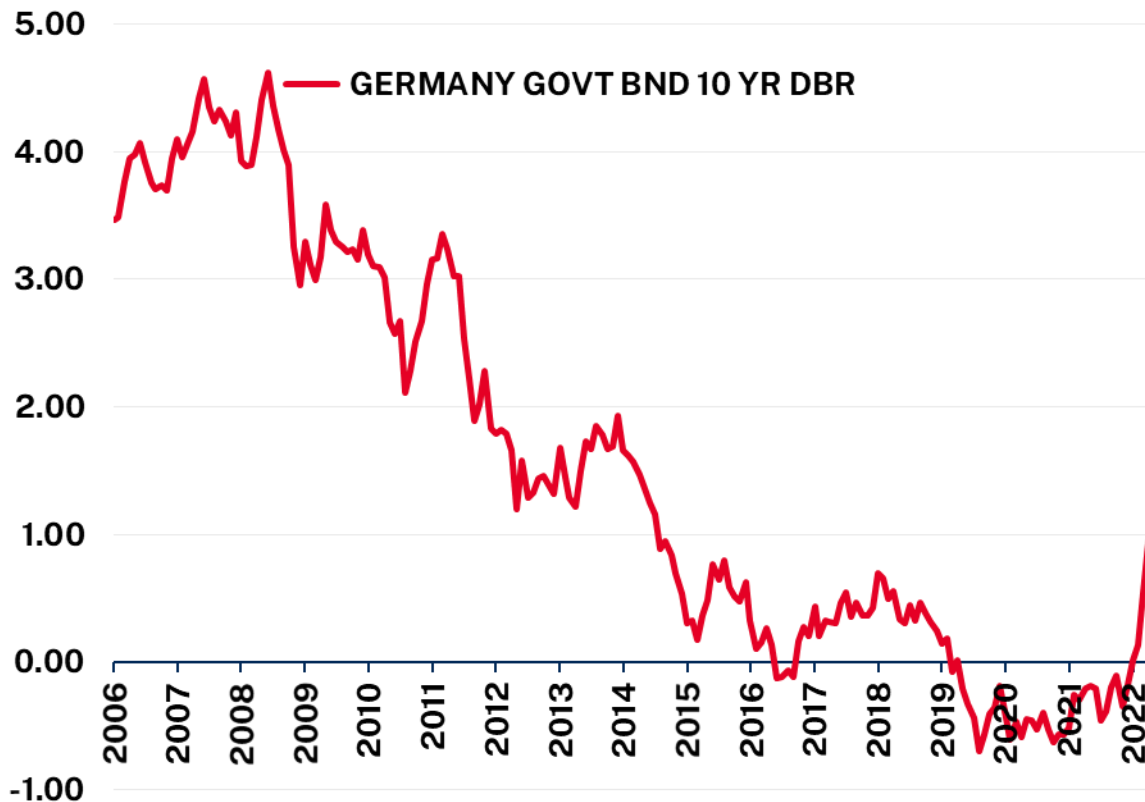
Fear of Stagflation



Source: Lighthouse Canton & Bloomberg dt.08th May 2022

- In North America, the Markit CDX North America High Yield Index, a key measure of corporate credit risk, climbed to 475 bps, its highest level in two years.
- The pain is global. A risk gauge on Europe's junk companies (the Markit iTraxx Europe Crossover index) also rose to the highest since late May 2020.
- The war in Ukraine and China's Covid lockdowns are set to hurt global economic growth while at the same time stoking inflationary pressures. A stagflation environment is particularly painful for credit investors because accelerating consumer price pressures eat into returns, while any economic downturn increases default risks for weaker borrowers.

Germany's 10-year Bund Yield at 1%



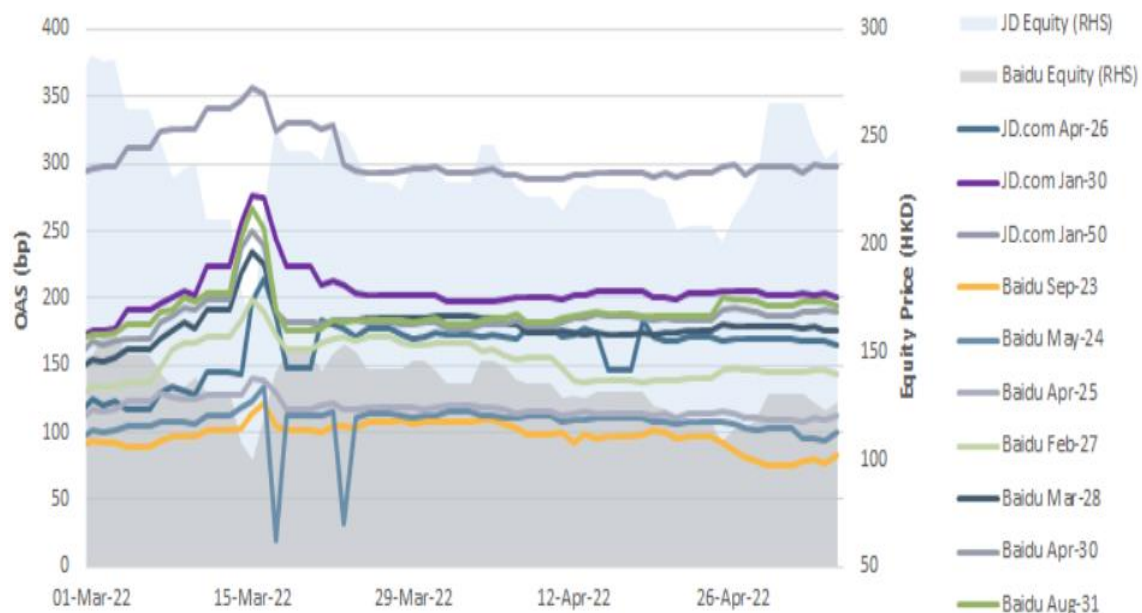
Source: FT.com, Bloomberg 9th May 2022

- Sovereign debt yields climbed in Europe, mimicking US rates. Germany's 10-year Bund yield, which started the year below zero, exceeded 1 per cent for the first time in seven years in European morning trading before settling to 0.96 per cent.
- The UK equivalent crossed 2 per cent briefly before trimming some of its gains to trade at 1.96 per cent. The shake-out in bond markets came after the Reserve Bank of Australia raised interest rates for the first time in more than a decade on Tuesday, increasing borrowing costs by a higher than anticipated 0.25 percentage points and citing inflation that had "picked up more quickly, and to a higher level, than was expected".

Delisting risks fully priced in for Chinese \$bond

JD and Baidu: Bond Spreads and Equity Price Movement

JD 2026 and 2030 tightened 2-4 bp overnight despite its inclusion to the HFCAA list



Source: CreditSights, 5th May 2022

- In early May, the US Securities and Exchange Commission (SEC) added 88 more US-listed Chinese firms to an enlarged provisional list of companies that could be forced to delist from US exchanges, including JD.com and Baidu.
- However, unlike the equity market, the bond market reactions have been quite muted. The bond market seems to have already fully priced in the delisting risks.
- Dollar bonds of Chinese companies are primarily not listed on US exchanges. The companies with dual listing in Hong Kong or onshore can still tap domestic and international capitals should they be forced to delist. The potential delisting would unlikely have material negative impacts on the credit profiles of these companies.

Fixed Income – Executive Summary

- **The 10Y US Treasury yield fell sharply this week from 3.20% on May 9th to 2.82% on May 12th. Such a large move (50 bps in just 3 days) is unconventional and largely explained by renewed fears of an economic slowdown**, as evidenced in the consumer confidence data and new home sales in the US. The fact that China and Europe are also showing signs of weakness has not helped. Indeed, a stagflation environment globally is particularly painful for credit investors because inflation reduces the expected returns, while the economic downturn increases the risk of default for the weaker borrowers.

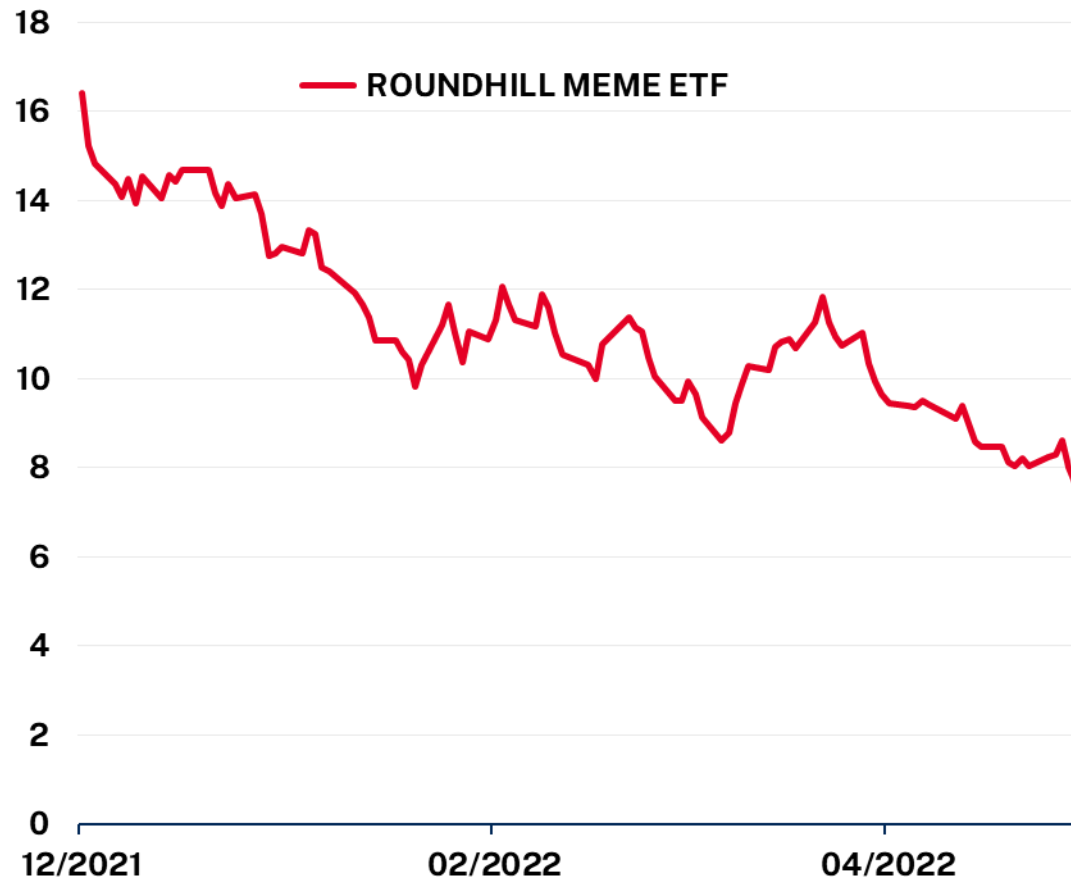
In case you missed it

- **ECB President Christine Lagarde mentioned that the rate hikes could come “some time after” the Asset Purchase Program ends.** This leads to possible hike(s) perhaps in Q4 of this year. **Core CPI came in at 2.9% against expectations of 3% and prior reading of 3%.** The ECB is likely to watch this (Core CPI prints) very closely before deciding on hikes although the APP will end as planned.
- **A Confederation of British Industry survey depicted a poor April for retailers in UK.** The squeeze is being felt as energy bills and taxes rose sharply handing households the biggest drop in their real incomes since 1950s.

Equity Highlights

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Retail investors get washed out



Source: Bloomberg 9th May 2022

- Amateur investors who jumped in when the lockdowns began have now given back all of their once-prodigious gains, according to an estimate by Morgan Stanley.
- Day trader favorite AMC is down 78% since June 2021 and Peloton is off 90% from the record. GameStop is one-third of its value since January 2021.
- Roundhill MEME ETF is an exchange-traded fund that seeks to track the performance of the Solactive Roundhill Meme Stock Index (the "Index").

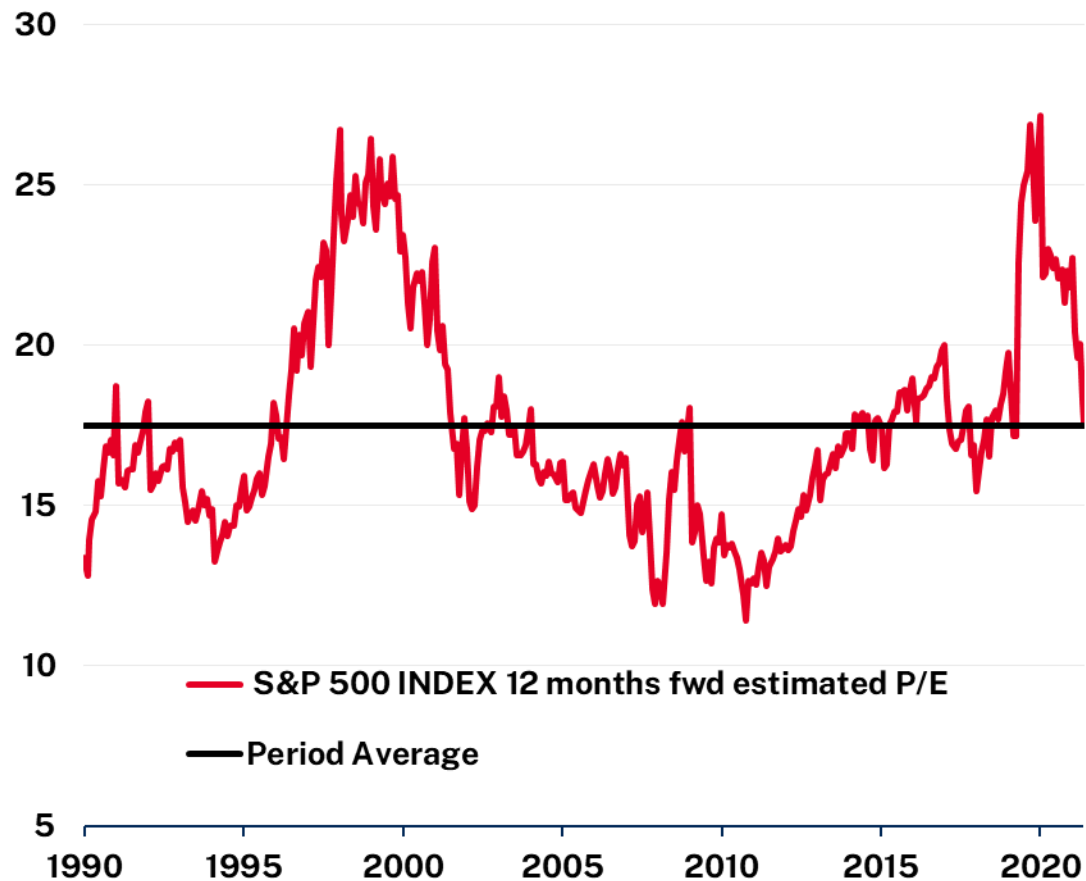
Spac index lost half its value



Source: Bloomberg 9th May 2022

- Goldman is pulling out of working with most blank-check firms it took public, spooked by new liability guidelines from regulators. The bank, which was the second-biggest underwriter of such vehicles last year, has been telling sponsors it'll be ending its involvement, throwing into doubt the fate of billions that have already been raised for blank-check firms. Goldman will also pause new U.S. SPAC issuance for now, and BofA scaled back work with some SPACs.
- The IPOX SPAC Index, which is a benchmark for the performance of a broad universe of Special Purpose Acquisition Vehicles (SPACs) is now down 48% from its peak.

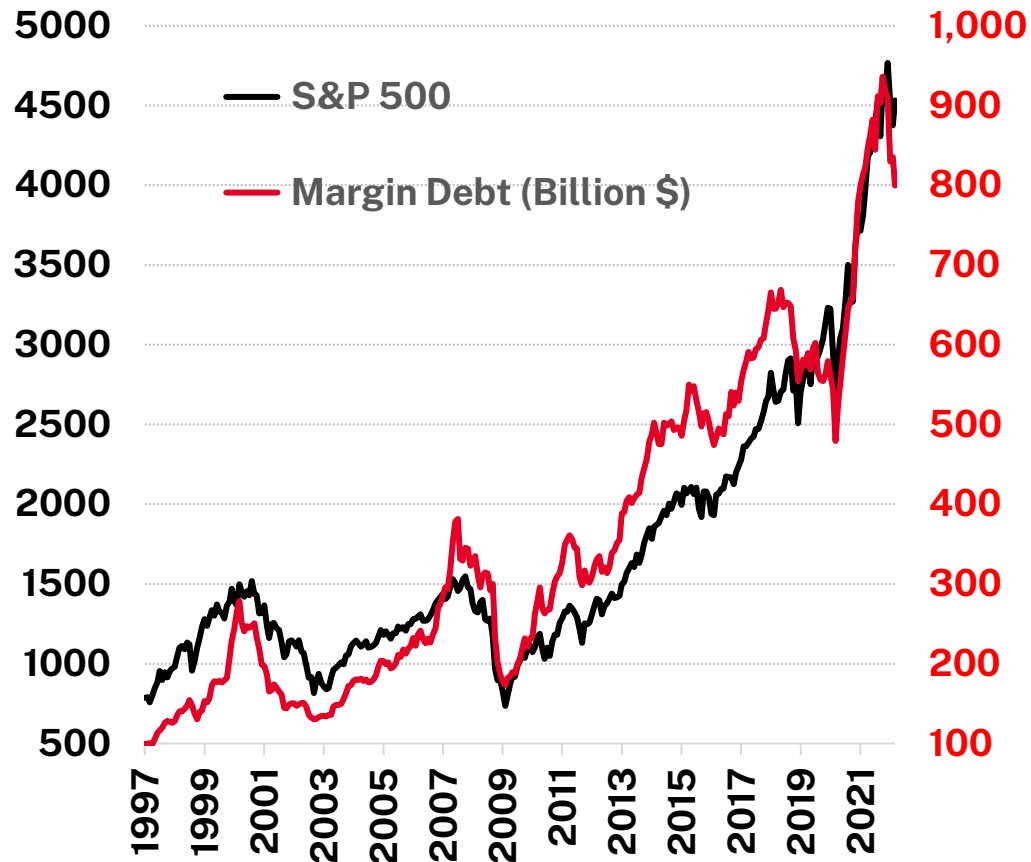
US Equities are fairly priced



Source: Bloomberg 9th May 2022

- The 12-month forward Price / Earnings ratio (source Bloomberg) is back to 17.5x, its long-term average, over the period 1990-2022. While US equities (S&P 500) are no longer considered “expensive”, it would be a mistake to consider them “cheap” at 17.5x forward P/E.
- We remain cautious on equities globally, in a context of reduced visibility. Indeed, higher Real Yields, lower corporate margins or tighter financial conditions can all potentially impact equity valuations in the coming months.

Shrinking margin debt



Source: FINRA and NYSE

- Margin debt has come off from its highs of \$935 billion in October 2021 to \$800 billion in March 2022. Representing a 14.4% drop.
- Slowing growth rates and significant drops in margin debt have long been associated with the market peaking out and early signs of a prospective correction.
- In 2000 and in 2007, the S&P hit its own peak just a few months after margin debt peaked. Similarly, once margin debt hit its lowest point in 2009 following the recession, the S&P hit bottom just one month later.

Equities – Executive Summary (1/2)

- We remain cautious as far as equities are concerned. There is no scarcity of reasons for investors to be concerned about the global growth backdrop:
 - a. Major central banks have started to hike interest rates aggressively at a time of elevated uncertainty.
 - b. Financial conditions are shifting from quantitative easing to quantitative tightening.
 - c. The war in Ukraine is ongoing and continues to pose risks to energy supplies and global commodity prices.
 - d. Surging prices threaten to dent both corporate profit margins and consumers' purchasing power.
 - e. The COVID-19 outbreak in China is negative for both domestic economic activity and global supply chains.
 - f. Higher food prices lead to social unrest.

The S&P 500 slid below 4000 points and is now -17% YTD, as of May 11th (Nasdaq 100 -27% YTD). Market participants are responding to the economic slowdown and the lower liquidity that the Fed is determined to cause. Markets do not see a recession, but they are bracing for a slowdown.

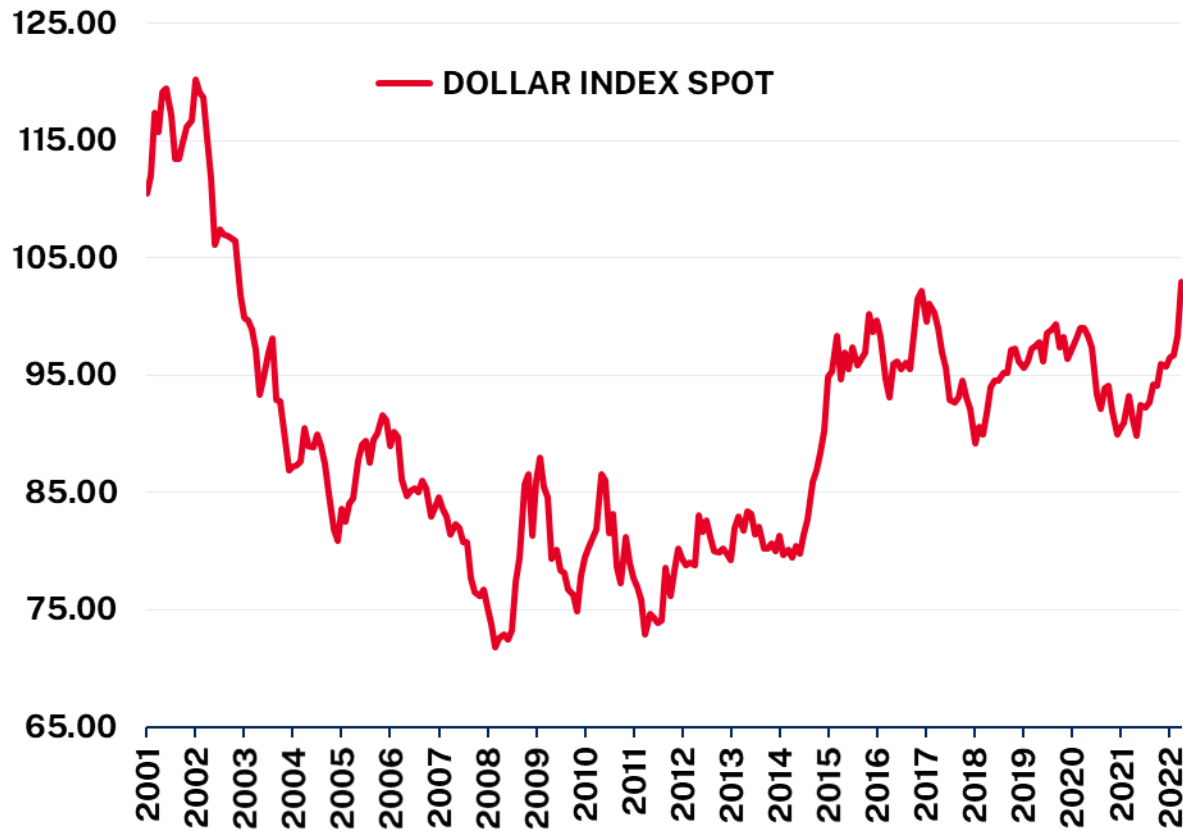
Equities – Executive Summary (2/2)

- We expect European equities to remain depressed as long as the situation in Ukraine does not improve. The lose/lose situation is unlikely to be solved quickly.
- **The ongoing issues of increase in commodity prices and supply side disruptions post two challenges for Indian equities a) margin compression for companies and b) lower consumption for households. We believe government spending and exports would be the primary drivers for the Indian GDP this year. Since valuation metrics (P/E multiple, EV/EBITDA Multiple) remain above their long term average, we expect Indian equities to remain flat but volatile this year.**
- Xi Jinping’s renewed commitment to zero-Covid rattles markets in China. While the PBoC is likely to remain accommodative, Tech stocks and the renminbi slip as Beijing refuses to change course despite economic pain. Over the weekend, Premier Li Keqiang painted a grim picture of the labor market, calling it “complex and grave”. We continue to apply a higher equity risk premium (7 Vs 5) to account for the renewed uncertainties around crackdowns, lockdowns, the real estate sector as well as slowing GDP growth.

Currencies & Commodities



USD at a 20Y peak

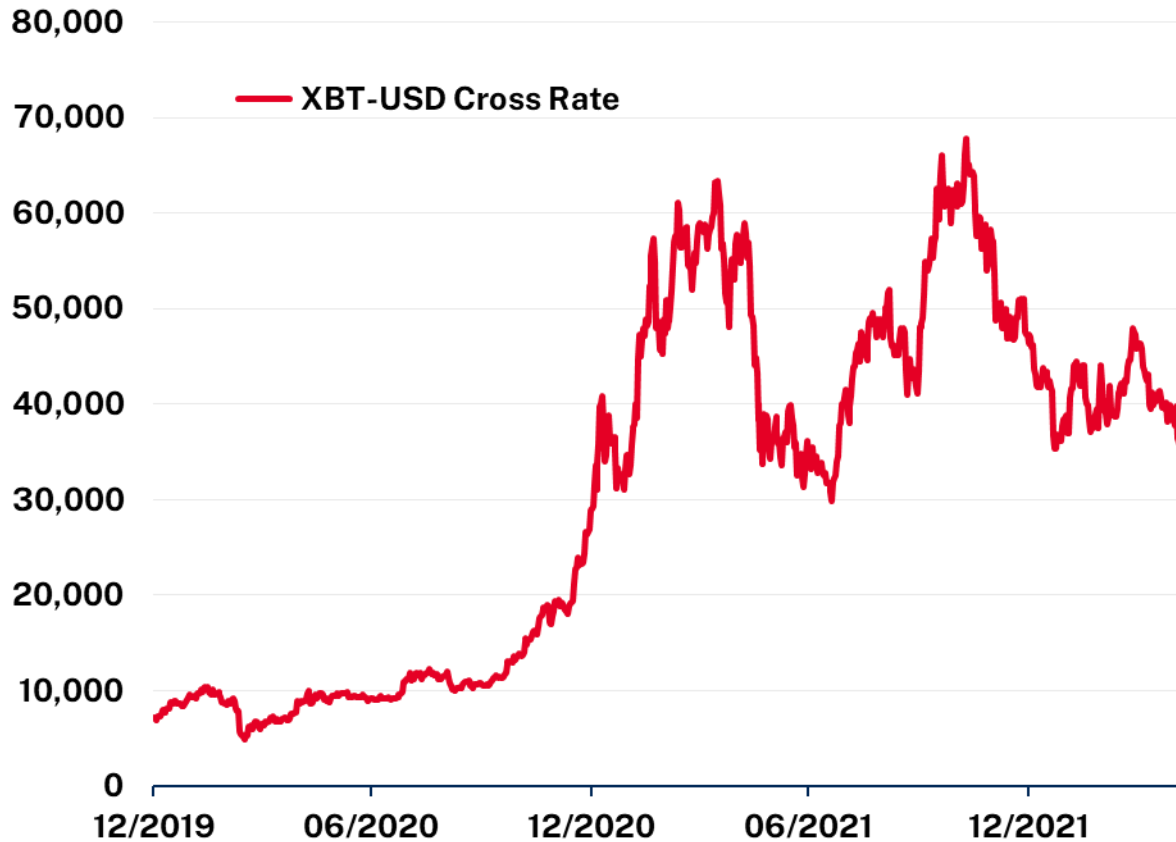


Source: Bloomberg 4th May 2022

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- The dollar index, which measures the US currency against six others, hit a 20-year high last week highlighting the strength of the US economy or more precisely the weakness of others (Europe, Japan and China especially).
- The widening interest-rates differential amongst Central Banks, as well as the Ukrainian war has also been detrimental for the Yen and the EUR respectively.
- New lockdowns in China, when most of the world now live covid-free, has put the CNY under renewed pressure.

Bitcoin at half its peak



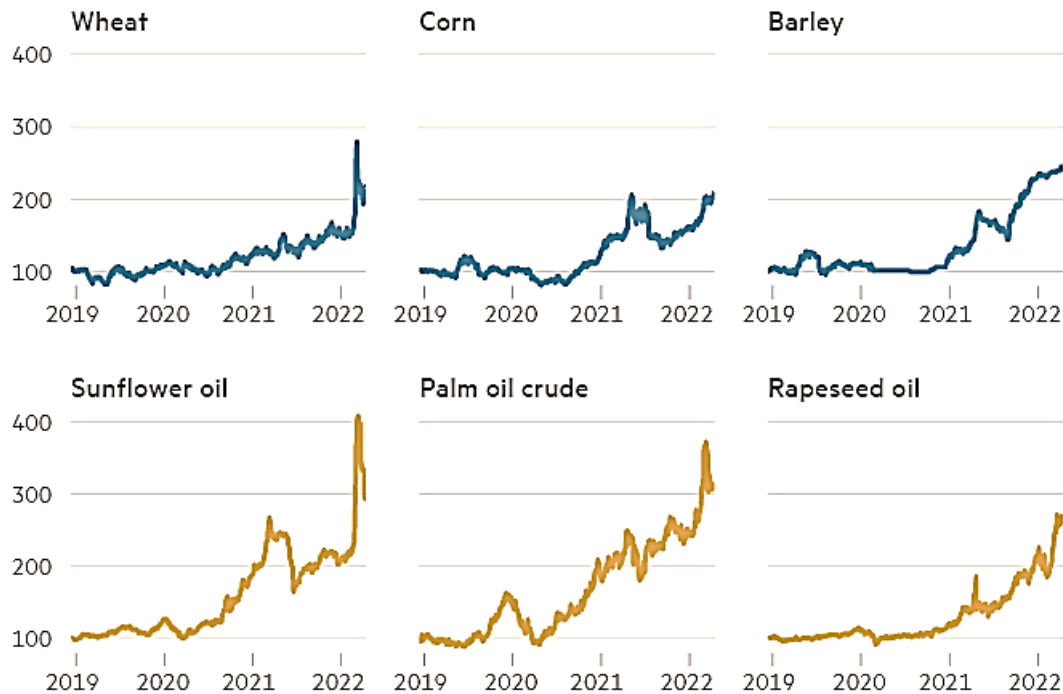
Source: Bloomberg 10th May 2022

- Bitcoin fell as much as 5 per cent to around \$32,630 on Monday 9th and is now 56 per cent below its peak reached in November last year.
- The top 500 digital assets have also tumbled 50 per cent in that time. Cryptocurrencies have shed \$1.6tn in market value since then (Source: FT.com) with interest rate rises sending investors fleeing from the riskiest corners of global financial markets.

Fall of a major food grain exporter

Key agricultural commodities have risen in price as a result of the war

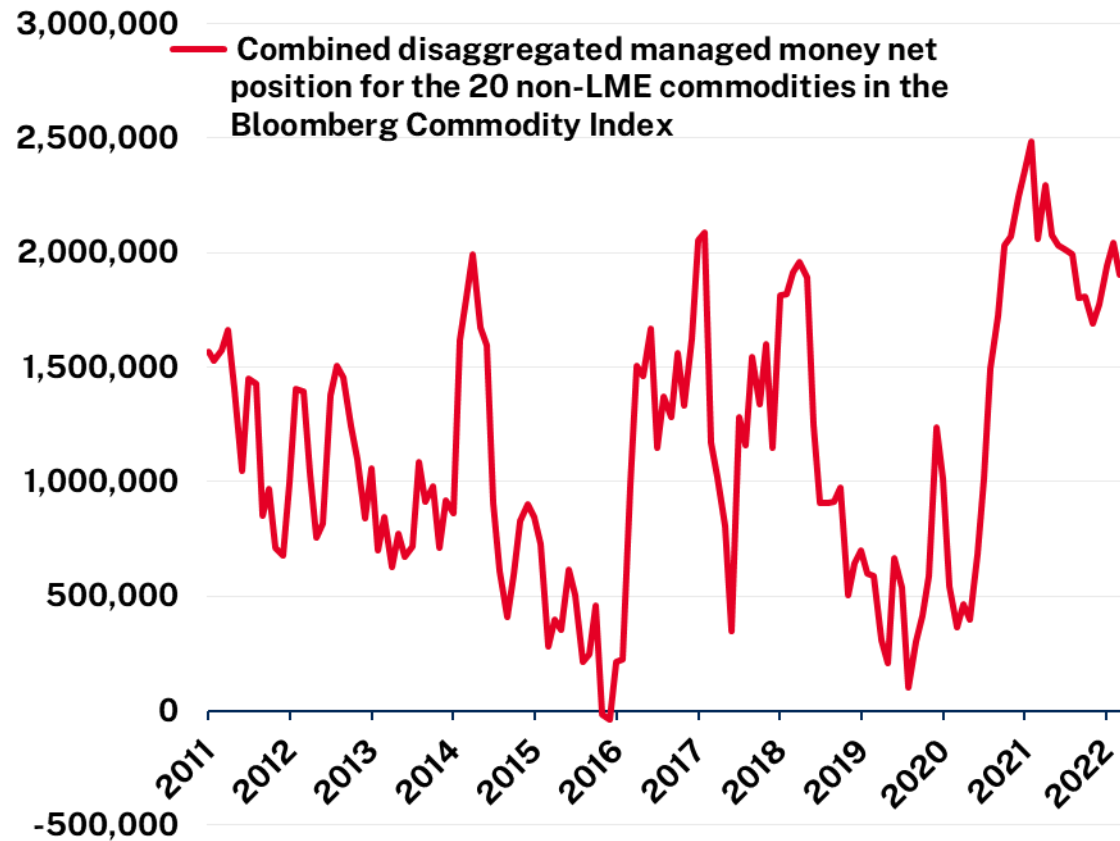
Rebased



Source: Refinitiv

- Ukraine accounted for approximately 8% of global wheat exports, 13% of corn flows and more than one third of the sunflower oil trade. Before the Russian invasion, Ukraine exported 90% of its agricultural products through ports on the Black sea. Russian territorial gains in the south-east have since blocked access to these crucial sea routes.
- Ukrainian road and railway infrastructure could have served as possible substitutes for shipping, but are heavily compromised due to the war and not equipped to handle the given scale of goods to be transported respectively.

Funds slashed bets on commodities



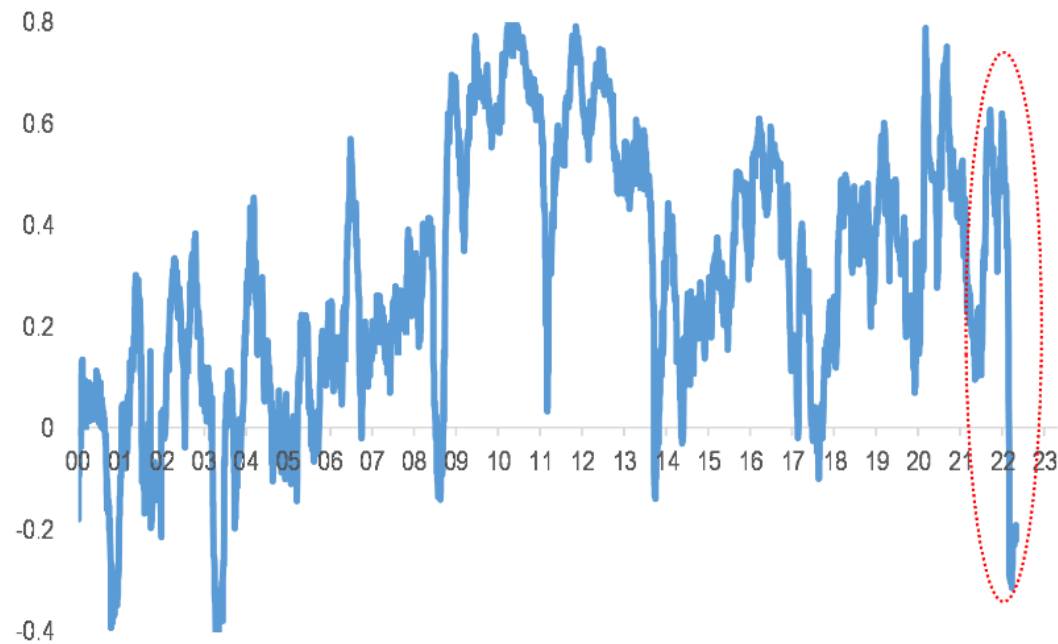
Source: Bloomberg 9th May 2022

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- Hedge funds slashed bullish bets on commodities to the smallest since December, according to CFTC data compiled by Bloomberg, as the biggest increase in U.S. interest rates in 22 years prompted recession fears.
- Investors clipped wagers on higher prices for grains, precious metals and natural gas, and flipped to a net-bearish position in copper.

Commodities provide diversification to traditional portfolios

66d rolling correlation between 60/40 and Commodities



Source: JPM. 4th May 2022

- Correlation between commodities and traditional portfolios have turned negative and remain near historic lows. This increases the diversification benefits the asset class brings.
- Commodities have provided hedging properties against inflation and geopolitical risk which are key right now.
- Investors should consider having commodity exposure as part of their core portfolios given inflation is likely to remain elevated and energy transition to provide structural tailwinds for the asset class.

Currencies & Commodities – Executive Summary

In case you missed it

Commodities

- **Commodities are likely to remain highly speculative throughout 2022 on the back of an extremely fluid geopolitical environment.** We recommend outsourcing the trading of commodities to well established managers with strong risk-management culture and have the ability to take non-directional views

Forex

- According to BCA Research, **the dollar has tended to decline 3-to-6 months after the Fed starts hiking interest rates.** This has been true since the mid-1990s and the average decline after six months has been 5.3%.
- **The EUR (1.04) and JPY (128) trade respectively at a 5-year and 20-year low.** The EUR has been weak on back of geopolitical uncertainty which has stalled the pace monetary tightening and the JPY tumbled sharply over the last 2 months as investors priced in further monetary policy divergence from other major central banks.
- **The PBOC is trying to strike the balance between controlling the CNY downside move and supporting growth.** The Yuan pared its biggest loss since 2015 after China took measures to bolster its currency. We remain supportive of the CNY on the long-term, keeping in mind that further weaknesses are likely in the coming quarters on back of lockdowns.

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