

LC Investment Playbook Weekly Update

April 29, 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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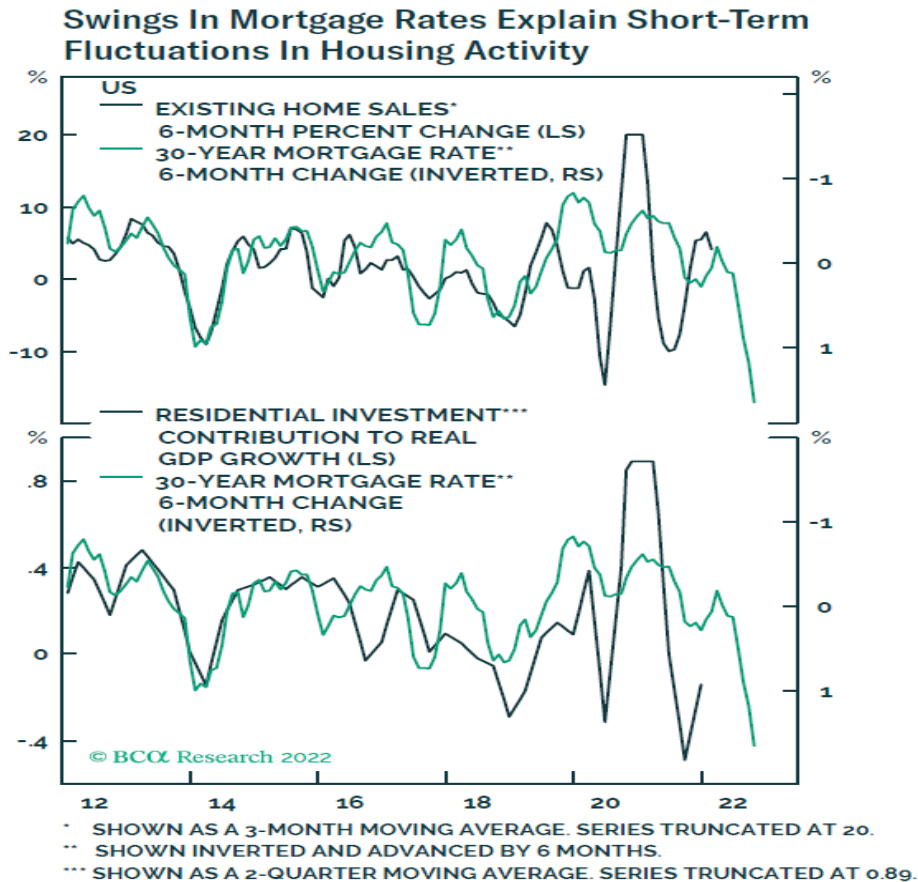
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Macro Highlights



Housing is Key to Fed's Hawkish Limit

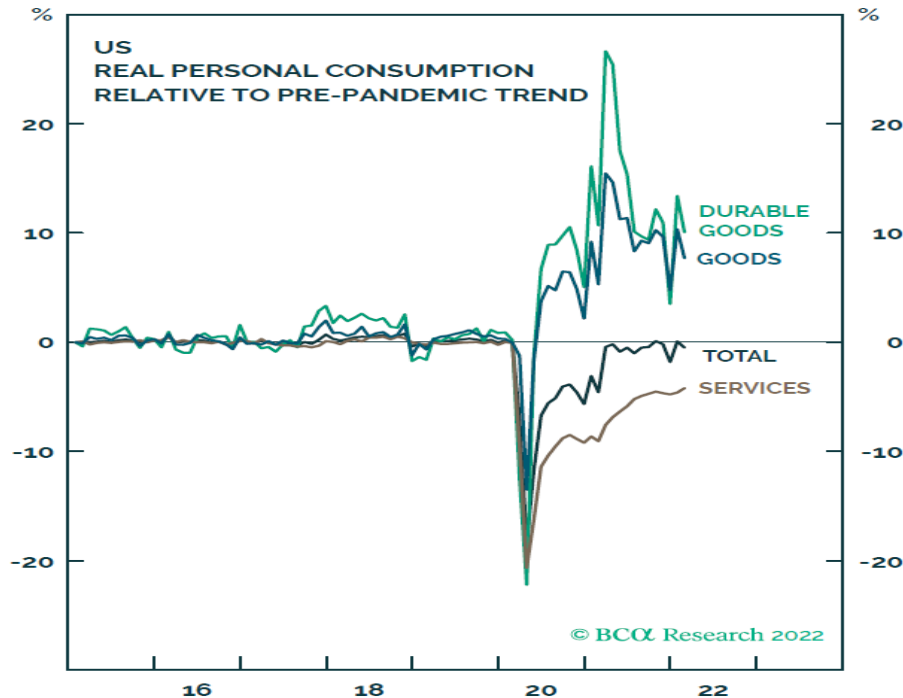


Source: National Bureau of Economic Research, BCA, 18th Apr 2022

- According to a 2007 research paper published by the NBER, 65% of weakness leading up to recessions are driven by the consumer side, and not business. Prior to commencement of recession, the first item to soften and the first to turn back up is residential investment, followed by consumer durables, consumer nondurables and then services.
- The Fed therefore, would be cognizant in ensuring the degree of hawkishness does not jeopardize housing activity in the US. The US housing market has started to cool, but remains in reasonably good shape despite rising rates. It supported by rising incomes and near record low home vacancies. Furthermore, changes in mortgage have not reached crippling levels, yet.

Service Inflation Could Catch Up

Spending On Services Remains Well Below The Pre-Pandemic Trend, While Spending On Goods Is Above It



NOTE: ALL SERIES REBASED TO JAN. 2015 = 0%.

Source: BCA, 22nd April 2022

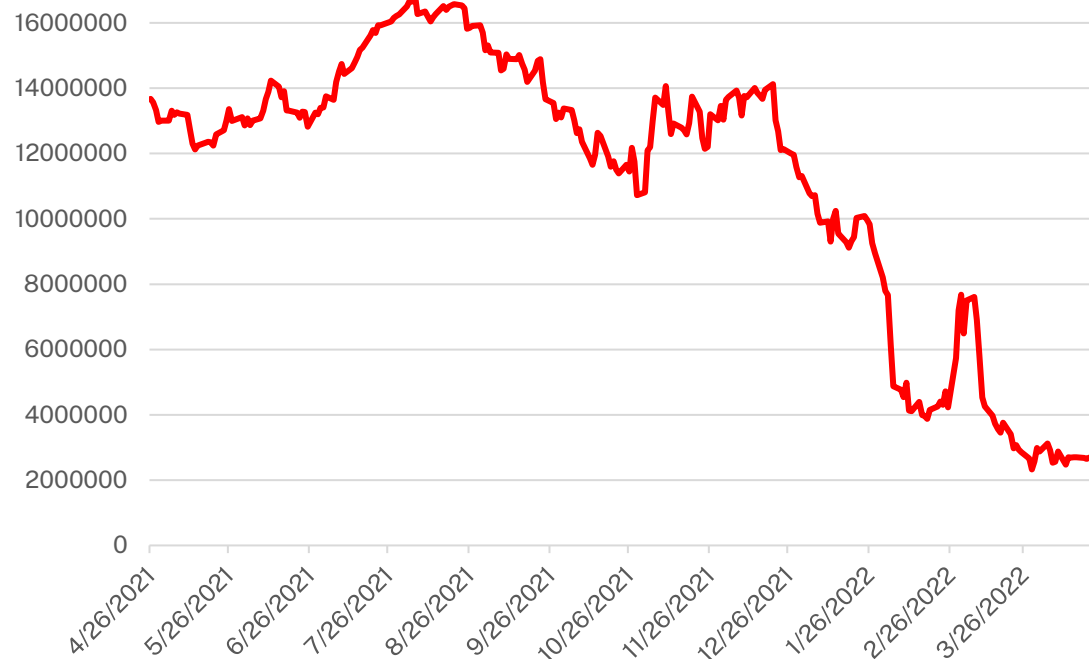
- As pandemic disruptions continue to abate and assuming a stabilization in Ukraine, BCA foresees another leg room up in inflation somewhere towards the end of 2023. Goods inflation has started to peak and could trend lower this year due to base effect and reopening. This may create a temporary breather in monetary tightening and briefly support equity and bond prices.
- However, as real yields continue to rise on back of QT, so will real incomes. This is likely to increase consumer spending, especially in the services sector. As a result, labor costs could be pushed higher amidst an already tight labor market. Should this materialize, the Fed may be forced to re-calibrate their hawkish stance and this might be bearish for stocks and bonds alike.

Fixed Income Highlights

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Global -ve Yielding Debt

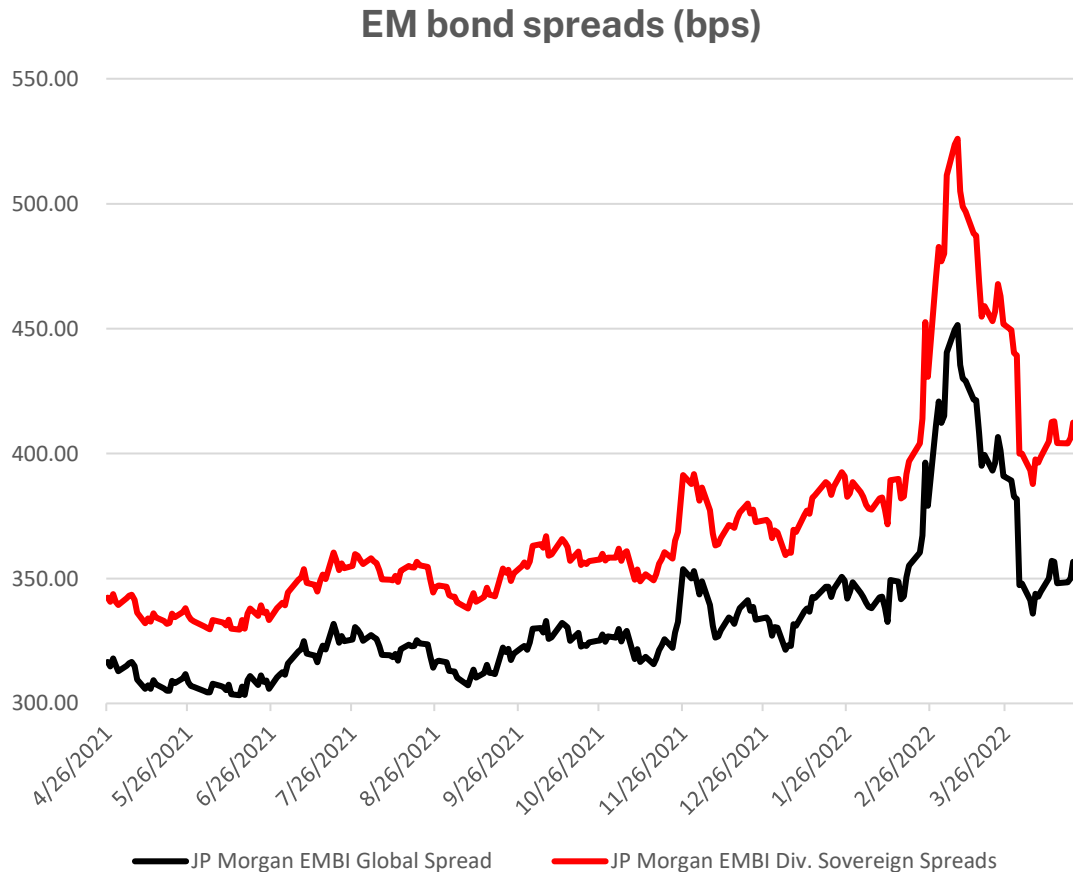
Bloomberg Gl. Agg. Negative Yielding Debt Mkt.
Value (In US\$ MM)



Source: Lighthouse Canton & Bloomberg 24th Apr 2022

- The total value of global negative yielding debt fell from highs of US\$ 16T (approx.) to slightly above US\$ 2T. This highlights the impact of hawkish central bankers on bond yields across the globe.
- While higher yields are obviously not good news for borrowers, negative yields (borrowers get paid to borrow!) are an economic nonsense and we consider the normalization as a step in the right direction.

EM Bond Spreads



Source: Lighthouse Canton, Bloomberg dt. 24th Apr 2022

- EM bond spreads have started widening again post its lows in early April . Excludes Russia since March 31st 2022.
- Risks remain higher in EM sovereign debt space as is explained by higher spreads in the graph left. EMBI Div. Sov spreads are at 419.45 bps as of last close compared to 362.92 bps in blended index (EMBI Global Spread).
- Likely a result of higher energy prices and food shortages arising out of the Russia-Ukraine conflict. EM countries are facing this owing to them being net importers of energy. Sri Lanka default is a case in point. Advise caution and thorough credit selection before investing in EM and HY securities.

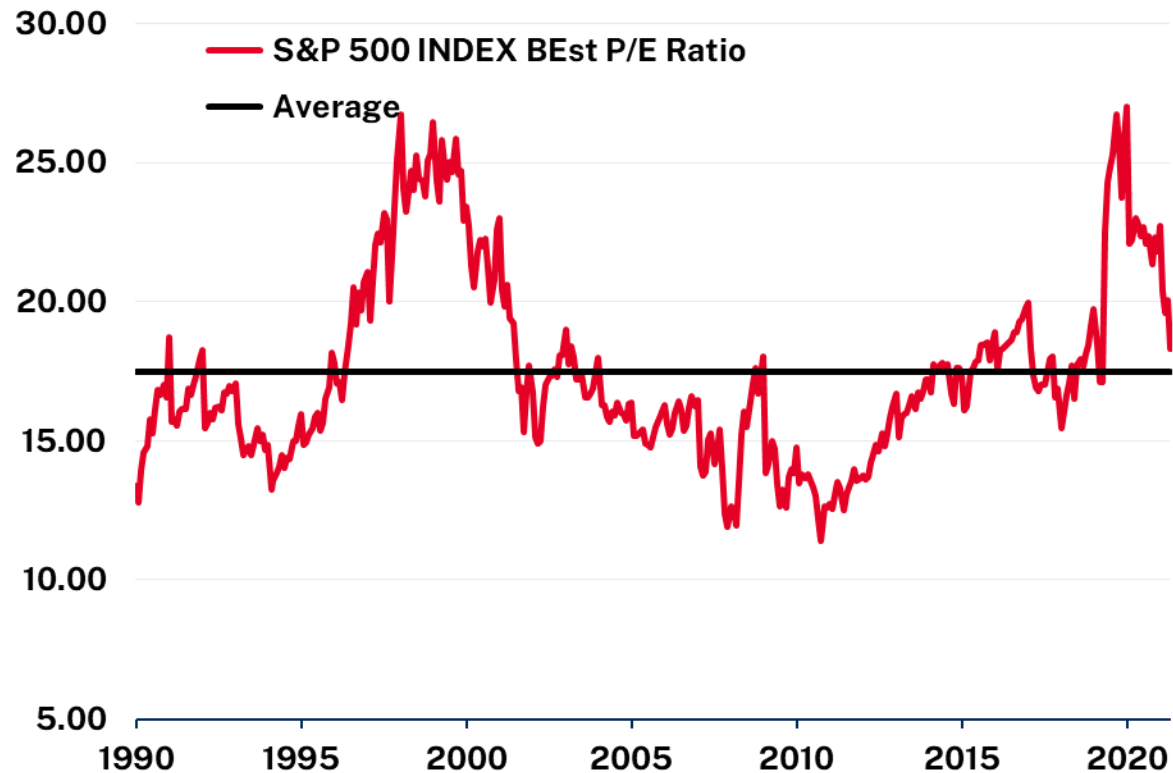
Fixed Income – Executive Summary

- **The 10Y US Treasury yield fell sharply on back of flows to safer haven.** This is largely on back of expectations of slowdown (as evidenced in the consumer confidence data and new home sales) in the US economy and the impact lockdowns in China is expected to have on global economies.
- **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.
- **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.

Equity Highlights

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S&P 500 Valuation



Source: Bloomberg April 27th, 2022

- The Bloomberg Estimates Price/Earnings Ratio has fallen to 18.3x and is now valued just 1 point above its long term average of 17.48x
- 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.

How attractive are equities?

Index	EV / EBITDA	Average*	Diff.	31-Dec-19	26-Apr-22	Diff.
S&P 500	14.60	11.12	31%	3230	4175	29.2%
Nifty 50	13.76	11.45	20%	12168	17200	41.4%
Euro Stoxx 50	9.12	8.6	6%	3745	3721	-0.6%
Nikkei 225	8.87	9.5	-7%	23656	26700	12.9%
Hang Seng	8.82	10.25	-14%	28189	19934	-29.3%

Average* period 31/12/1999 – 26/04/2022

Source: Bloomberg April 27th, 2022

- Despite its recent weakness, the S&P 500 Index is still trading 29% above its pre-pandemic level (31st Dec. 2019), a far cry from a market capitulation.
- The EV/EBITDA Multiple also indicate that the S&P 500 Index is expensive as per historical standards, as well as for the Nifty Index (Indian Equities).
- European and Japanese equities look fairly priced, while Hong Kong listed equities look cheap by historical standards, highlighting the current headwinds (regulation, lockdowns, slowing growth).

Q1 Earnings: downsides twice as large as upsides

Leaders	Sector	% Chg 1M	Laggards	Sector	% Chg 1M
Twitter Inc	Communication Services	28.70%	Netflix Inc	Health Care	-46.93%
Nielsen Holdings Plc	Industrials	18.09%	Nvidia Corp	Information Technology	-32.15%
Lamb Weston Holdings Inc	Consumer Staples	16.01%	Advanced Micro Devices	Information Technology	-28.84%
Kimberly-Clark Corp	Consumer Staples	15.71%	Solaredge Technologies Inc	Information Technology	-27.00%
Ross Stores Inc	Consumer Discretionary	14.20%	Generac Holdings Inc	Industrials	-26.44%
United Airlines Holdings Inc	Industrials	13.15%	Paypal Holdings Inc	Information Technology	-26.42%
Constellation Energy	Utilities	11.43%	Marketaxess Holdings Inc	Financials	-25.88%
Sherwin-Williams Co/The	Materials	10.67%	Match Group Inc	Communication Services	-25.55%
Dollar General Corp	Consumer Discretionary	10.62%	State Street Corp	Financials	-25.19%
Delta Air Lines Inc	Industrials	10.52%	Schwab (Charles) Corp	Financials	-24.98%
American Airlines Group Inc	Industrials	10.35%	Etsy Inc	Consumer Discretionary	-24.34%
Philip Morris International	Consumer Staples	9.97%	Paramount Global-Class B	Communication Services	-23.67%
Monster Beverage Corp	Consumer Staples	9.61%	Freeport-Mcmoran Inc	Materials	-22.63%
Kellogg Co	Consumer Staples	8.66%	Zions Bancorp Na	Financials	-21.45%
Sysco Corp	Consumer Staples	8.33%	Enphase Energy Inc	Information Technology	-20.63%

Source: Bloomberg April 27th, 2022

Equities – Executive Summary (1/2)

- 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. Financial conditions are tightening.
 - b. The war in Ukraine is ongoing and continues to pose risks to European energy supplies and global commodity prices.
 - c. Surging prices threaten to dent both corporate profit margins and consumers' purchasing power.
 - d. The COVID-19 outbreak in China is negative for both domestic economic activity and global supply chains.

The S&P 500 slid below 4200 points, just a hair above its March 8 low. Technology stocks are the worst-performing S&P 500 sector so far this year, followed by cyclical sectors such as financials and industrials. 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.** That being said, even after its recent weakness, the S&P 500 Index still remains 29% above its pre-pandemic level (31st Dec. 2019) , a far cry from a market capitulation.

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. Moreover, the ECB continued to tighten monetary policies to tame inflation. European benchmarks have already discounted a significant portion of the negative news and are now trading at their long-term average (EV/EBITDA Multiple).
- **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.**
- **With prolonged Covid lockdown in major cities like Shanghai, market sentiments remain depressed for Chinese Equities.** While the PBoC is likely to remain accommodative **we continue to apply a higher equity risk premium (7) to account for the renewed uncertainties around the tech crackdown, covid-related lockdowns, the real estate sector restructuring as well as slowing GDP growth.**

Currencies & Commodities



CNY slipped to six months low



Source: Bloomberg April 27th, 2022

- The yuan slipped to its weakest level in six months, pressured by concern surrounding China's growth outlook and a surge in U.S. Treasury yields.
- The decline comes as a growing number of traders fear the world's second-largest economy is becoming snarled in lockdowns -- igniting fresh chaos to global supply chains.
- China moved to limit the drop in the yuan by cutting the amount of money that banks need to have in reserve for their foreign currency holdings.

G10: EUR & JPY at 5Y lows

Country	Currency	Last	Min 5Y	Max 5Y	(last-Min)/ (Max-Min)
USA	USD	102.259	88.593	102.817	96%
Sweden	SEK	9.7941	7.841	10.4167	76%
Canada	CAD	1.2788	1.2035	1.4511	70%
Australia	AUD	0.718	0.5743	0.811	61%
New Zealand	NZD	0.6583	0.5672	0.752	49%
Swiss	CHF	0.9629	0.8784	1.0204	40%
UK	GBP	1.2595	1.1485	1.4339	39%
Norway	NOK	9.2169	7.6428	11.8023	38%
Japan	JPY	127.75	102.36	128.91	4%
Europe	EUR	1.0653	1.0638	1.251	1%

Source: Bloomberg April 27th, 2022

- The Federal Reserve is set to tighten policy more aggressively than other developed world central banks, and the resulting rate differentials attract currency flows that push the dollar up. The extreme case is Japan, where an apparently ironclad commitment to “yield curve control” — holding long-term government bond yields near zero — dooms the yen to depreciation.
- The euro tumbled to its lowest level against the dollar since April 2017 amid concerns for growth and threats to energy supplies from Russia.

Currencies & Commodities – Executive Summary

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 (1.06) 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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