Investment Playbook Weekly Update

4th November 2022

LIGHTHOUSE CANTON

GLOBAL Private Banking INNOVATION AWARDS 2022

OUTSTANDING DIGITAL TRANSFORMATION IN COVID 19 BY A FAMILY OFFICE

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Macro & Fixed Income

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Macro – Executive Summary (1/2)

		Nov 22	Market Expectations (1Q23)	Δ*	Market Expectations (3Q23)	Δ*	LC Views
US	Real GDP Growth (YoY)1	1.8%	0.4%	-	0.2%	-	▪ In 3Q22, the US achieved an annualized QoQ GDP growth of 2.6%, beating expectations. However, the main contributor was oil and gas exports to Europe. The risk of a recession persists. ▪ In the November's FOMC meeting, the Fed hiked another 75 bps. Powell's statements were more hawkish than expected, e.g. "We may ultimately move to higher levels than we thought in the September meeting,"… "It's premature to discuss pausing, still ways to go." ▪ FOMC members shifted up their projected policy path quite significantly. The fed funds rate is now expected to peak at 5.0% in 2023 (up from 3.8% in June). Nomura even suggested 5.5%.. Bottom line is, **we do not think the fed is going to pivot any time in the next 12 months.**
	Inflation (YoY)[2]	8.2%	5.9%	-	3.6%	-	
	Unemployment (YoY)[3]	3.5%	3.9%	+	4.4%	+	
	Probability of Recession[4]				60.0%		
	Policy Rate[5]	4.0%	5.1%	+	5.1%	+	
EU	Real GDP Growth (YoY)[6]	2.1%	0.0%	-	-0.2%	-	▪ Oct 27th saw the ECB hiking by 75 bps. Ms. Lagarde reiterated that further rates hikes will be as appropriate to bring inflation down to target levels. However, markets take the commentary from ECB to be dovish. ▪ The revised economic projections include an increase to the inflation forecasts with an average inflation rate of 8.1% this year and a decrease to the GDP growth forecasts from 2.1% to 0.9% in 2023. ▪ **We think probability of a pivot by ECB is higher that their US counterparts.**
	Inflation (YoY)[7]	10.7%	8.1%	-	5.0%	-	
	Unemployment (YoY)[8]	6.0%	7.1%	+	7.2%	+	
	Probability of Recession[9]				80.0%		
	Policy Rate[10]	1.4%	2.6%	+	3.0%	+	
UK	Real GDP Growth (YoY)[11]	4.4%	-0.5%	-	-0.5%		▪ We are in line with the market view that **Bank of England may continue to raise interest rates aggressively** over the next 12 months. ▪ The BOE **raised rates by 75 bps** on Thursday, their largest hike in over 30 years.
	Inflation (YoY)[12]	10.1%	9.7%	-	5.2%	-	
	Unemployment (YoY)[13]	3.5%	4.2%	+	4.6%	+	
	Probability of Recession[14]				80.0%		
	Policy Rate[15]	3.0%	4.5%	+	4.7%	+	

**Change from previous period column*

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Macro – Executive Summary (2/2)

		Nov 22	Market Expectations (1Q23)	Δ*	Market Expectations (3Q23)	Δ*	LC Views
China	**Real GDP Growth (YoY)**[16]	3.9%	3.5%	-	4.7%	+	▪ The main economic risk for China is deflation and the continuation of underwhelming economic growth. Core and service consumer price inflation are both below 1% and property prices are deflating. Falling prices amid high debt levels is a recipe for debt deflation. - BCA (15 Aug) ▪ In the Global Financial Leaders' Investment Summit in Hong Kong, vice-chair of CSRC and governor of PBoC both tried to boost confidence of international investors. However, the strict **zero covid policy remains the key concern, which is likely to keep consumer confidence at depressed levels and reduce the efficacy of any policy support.**
	Inflation (YoY)[17]	2.8%	2.8%	**NC**	2.3%	**NC**	
	Unemployment (YoY)[18]	4.0%	4.0%	+	4.0%		
	Probability of Recession[19]				17.5%		
	Policy Rate[20]	4.4%	4.4%	+	3.7%	-	
India	**Real GDP Growth (YoY)**[21]	13.5%	4.4%	-	6.5%	+	▪ On 30th Sept 2022, Monetary Policy Committee (MPC) decided to increase the policy rates by 50 bps to 5.90%. ▪ Going ahead, further policy tightening is warranted, as inflation for first three quarters of 2022-2023 is expected to be above upper tolerance band of 6%. We expect terminal rates 6.25% to 6.5% likely to be achieved by year end. ▪ On the demand side of India’s economy, urban consumption is being lifted by discretionary spending ahead of the festive season and rural demand is gradually improving. Investment demand is also gaining traction as reflected by rising imports and domestic production of capital goods, steel consumption and cement production. ▪ Headwinds from geopolitical tensions, tightening of global financial condition and slowing external demand pose downside risks for FY23 GDP estimates.
	Inflation (YoY)[22]	7.4%	6.1%	-	5.3%	-	
	Unemployment (YoY)						
	Probability of Recession[23]				0.0%		
	Policy Rate[24]	5.9%	6.6%	+	6.6%	+	

**Change from previous period column*

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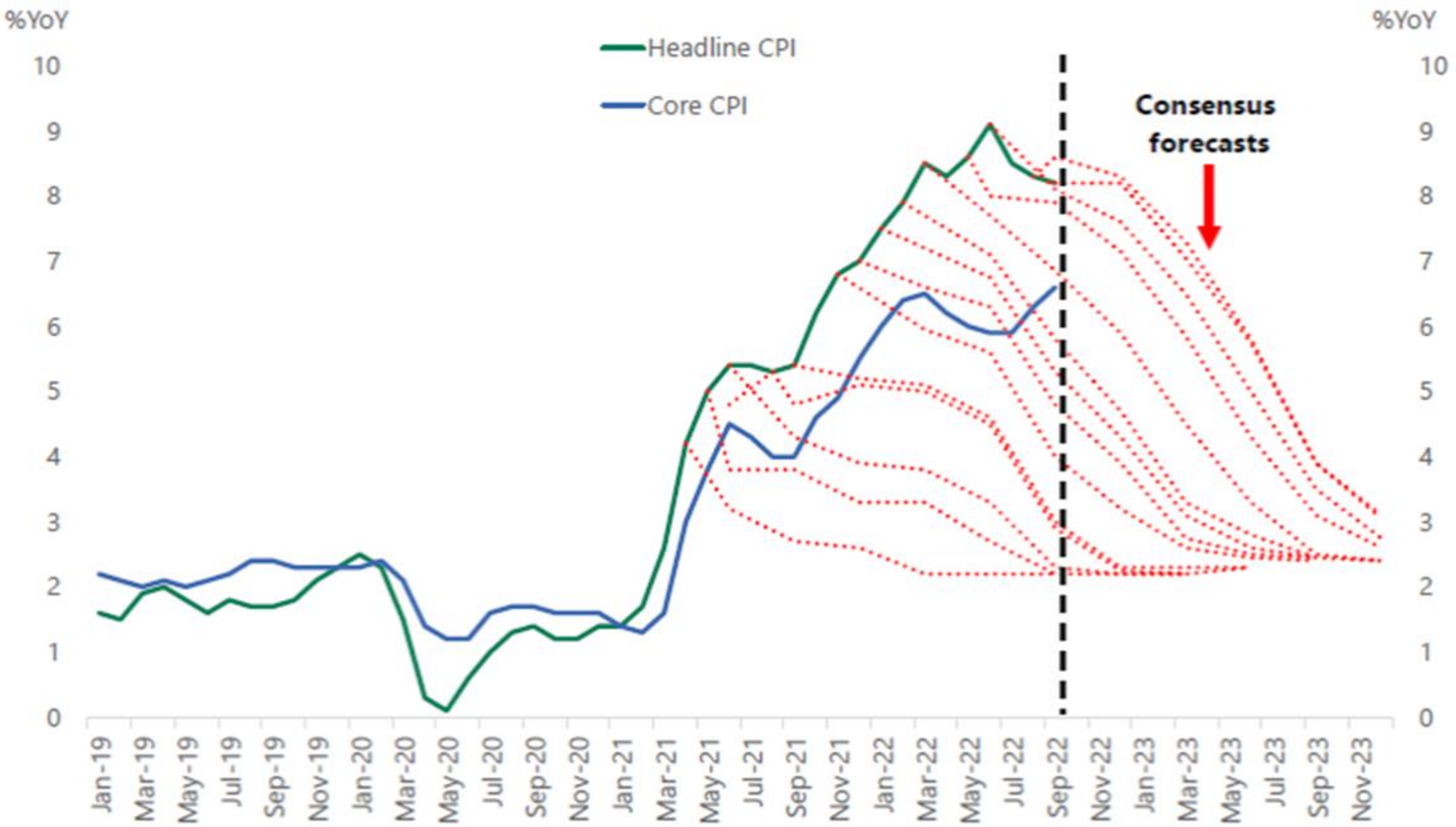
Inflation Might Be Stickier Than Expected

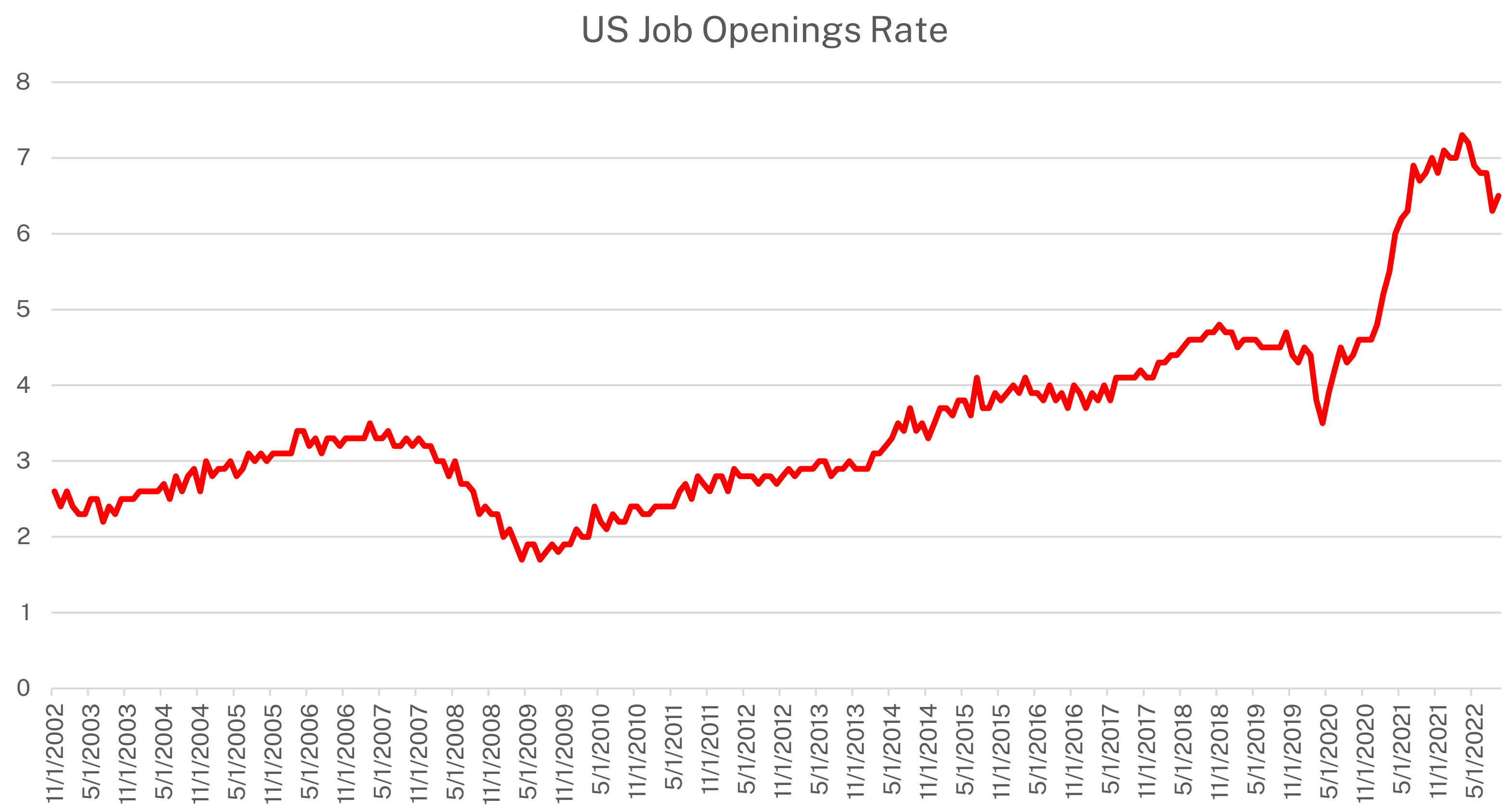
The consensus has been systematically wrong about inflation coming down



Source: Cleveland Fed / Apollo, November 2022

US Labour Market- Still very tight (1/2)

US Job Openings Rate is dipping but is still very high at 6.5%



Source: Bloomberg, November 2022

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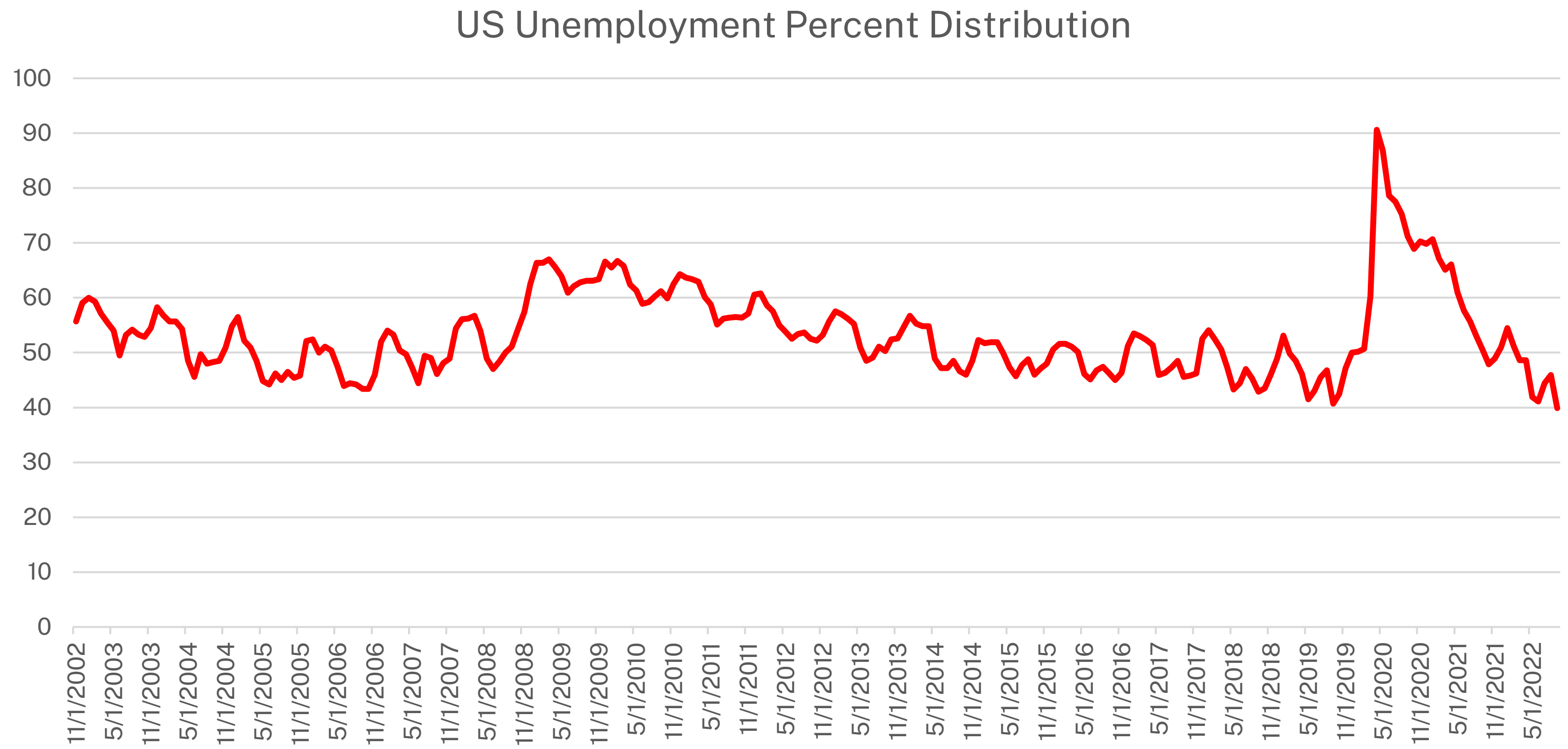
US Labour Market- Still very tight (2/2)

Unemployed to Total population (39%). Ratio of job vacancies to unemployed persons at 1.86



Source: Bloomberg, November 2022

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Macro – Executive Summary (Sources)

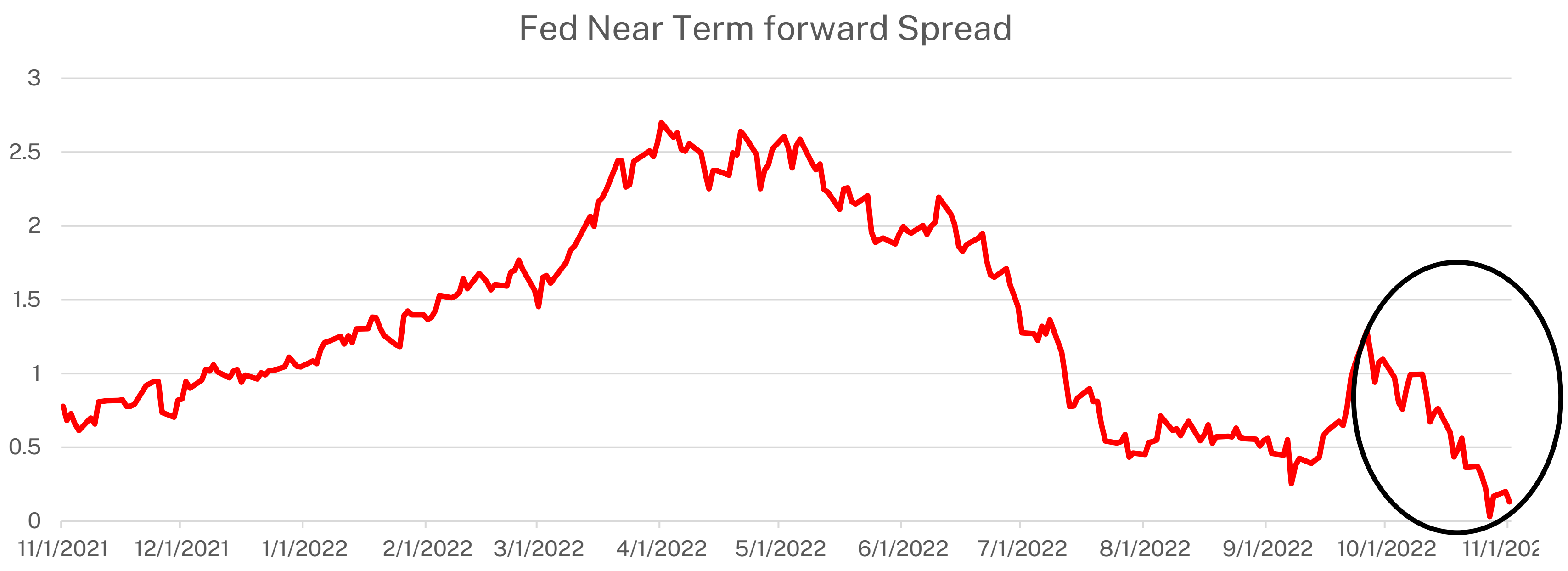
1) “GDP US Chained 2012 Dollars YoY SAAR ”, GDP CYOY Index, Source: Bureau of Economic Analysis. Forecast data derived from “GDP US Chained 2012 Dollars NSA”, GDNSCHWN Index, Source: Bureau of Economic Analysis.
2) “US CPI Urban Consumers YoY NSA”, CPI YOY Index, Source: Bureau of Labour Statistics. Forecast data derived from “US CPI Urban Consumers NSA”, CPURNSA Index, Source: Bureau of Labour Statistics.
3) “U-3 US Unemployment Rate Total in Labor Force Seasonally Adjusted”, USURTOT Index, Source: Bureau of Labour Statistics.
4) “United States Recession Probability Forecast”, ECRPUS 1Y Index, Source: Bloomberg.
5) “Federal Funds Target Rate - Upper Bound”, FDTR Index, Source: Federal Reserve.
6) “Euro Area Gross Domestic Product Chained 2010 Prices YoY”, Source: Eurostat. Forecast data derived from “European Union Gross Domestic Product Chained 2010 Prices ”, ENGKEU27 Index, Source: Eurostat.
7) “Euro Area MUICP All Items YoY NSA »”, ECCPEMUY Index, Source: Eurostat. Forecast data derived from “Eurostat European Union HICP All Items NSA”, CPALEU Index, Source: Eurostat.
8) “Eurostat Unemployment EU SA”, UMRT27 Index, Source: Eurostat.
9) “Eurozone Recession Probability Forecast ”, ECRPEU 1Y Index, Source: Bloomberg.
10) “ESTR Volume Weighted Trimmed Mean Rate”, ESTRON Index, Source: European Central Bank.
11) “UK GDP Chained GDP at Market Prices YoY ”, UKGRABIY Index, Source: UK Office for National Statistics. Forecast data derived from “UK GDP Chained GDP at Market Prices”, UKGRABMI Index, Source: UK Office for National Statistics.
12) “UK CPI EU Harmonized YoY NSA”, UKRPCJYR Index, Source: UK Office for National Statistics. Forecast data derived from “UK CPI EU Harmonized NSA”, UKRPCHVJ Index, Source: UK Office for National Statistics.
13) “UK Unemployment ILO Unemployment Rate SA”, UKUEILOR Index, Source: UK Office for National Statistics.
14) “United Kingdom Recession Probability Forecast”, ECRPGB 1Y Index, Source: Bloomberg.
15) “UK Bank of England Official Bank Rate”, UKBRBASE Index, Source: Bank of England.
16) “China GDP Constant Price YoY SA”, CNGDPYOY Index ,Source: National Bureau of Statistics of China. Forecast data derived from “China GDP Constant Price”, CNGDGDP Index , Source: National Bureau of Statistics of China.
17) “China CPI YoY”, CNCPIYOY Index,Source: National Bureau of Statistics of China. Forecast data derived from “China CPI YoY”, CNCPIYOY Index, Source: National Bureau of Statistics of China.
18) “China Qtrly Registered Unemployment Rate in Urban”, CNUERATE Index, Source: National Bureau of Statistics of China.
19) “China Recession Probability Forecast”, ECRPCN 1Y Index, Source: Bloomberg.
20) “China 1 Year Benchmark Lending Rates” , CHLR12M Index, Source: The People's Bank of China.
21) “GDP Growth Annual % India”, GDPGAIND Index, World Bank Group. Forecast data derived from “India Qtr Real GDP By Expenditure Cons 2011-12 Prices ”, IGQREGDP Index, Source: Central Statistics Office India.
22) “India CPI Combined YoY”, INFUTOTY Index, Source: Central Statistics Office India. Forecast data derived from “India CPI Combined”, INFUTOT Index, Source: Central Statistics Office India.
23) “India Recession Probability Forecast”, ECRPIN 1Y Index, Source: Bloomberg.
24) “Reserve Bank of India Repurchase Rate Policy Announcement”, INRPYLDP Index, Source: Reserve Bank of India.

Fixed Income

2

Near term spreads close to inversion.

Fed's preferred gauge of recession (3M implied 18 months fwd. – 3M spot) is close to inversion.



Source: Bloomberg, November 2022

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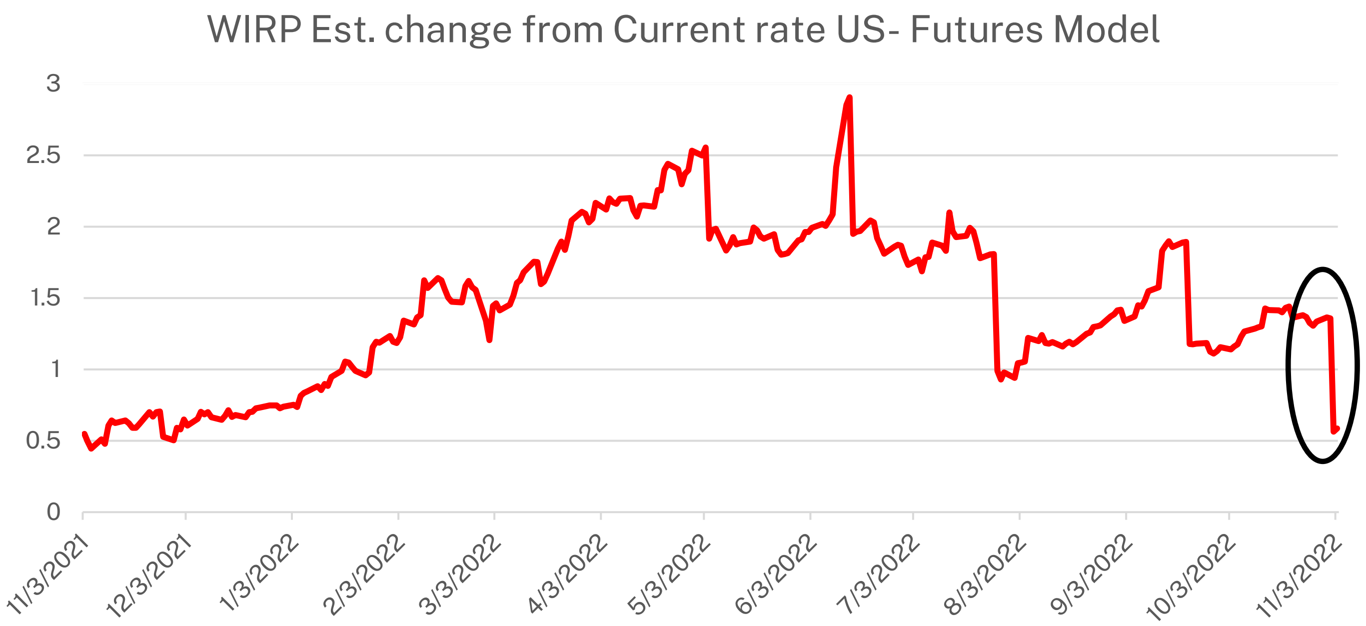
50 bps or 75 bps in Dec?

Markets currently pricing in a 50-bps hike in Dec. CPI and NFP data sets to determine the quantum.



Source: Bloomberg, November 2022

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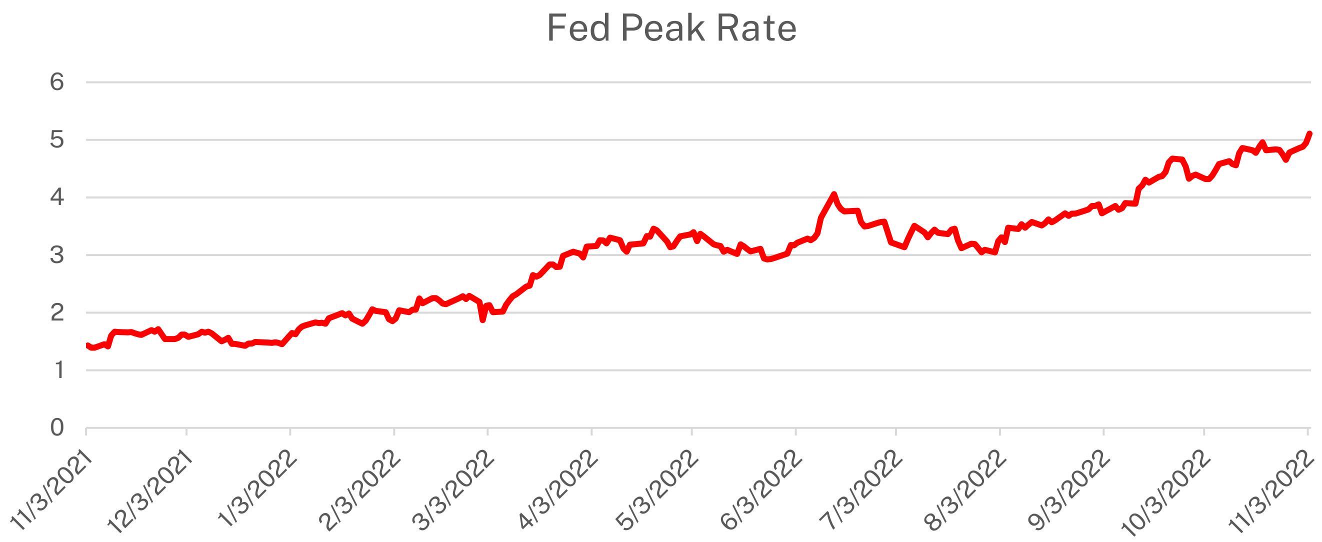
Up, up and away-Fed Peak rate estimate

Market estimates of Fed's peak rate ever increasing. Currently 5.11% from 4.9% prior.



Source: Bloomberg, November 2022

Fixed Income – Overview

	Sub-Asset	Region	IC Outlook (2Q23)	IC Comments	Recommended Positioning
Long Term Rates	**10Y Rate**	**US**	↑	▪ Despite potential downward pressure on long term rates as a result of recessionary fears, we agree that there is further room for longer term rates to move higher as the Fed maintains its resolve in combating inflation. If anything, yesterday's FOMC meeting confirmed higher rates for longer. ▪ Fed balance sheet roll off likely to add further upward pressure on long end of yield curve.	▪ We think now is a good time to start adding fixed income exposure as yields are admittedly starting to look attractive. That said, this should be done progressively as rates are expected to trend higher in the near term. ▪ We are **bullish on bonds in US IG credit**. with duration < 3 over a 12 months horizon. ▪ **Avoid EU names, PERPs, Cocos, High Yield and long Duration** (>3) bonds for the moment. ▪ **Add Distressed managers** to benefit from dislocations and mispricing.
		EU	↑	• Like the US, Europe's long-term rates are likely to trend higher given the ECB's acceleration in the pace of hikes and firm resolve to tame inflation.	
Credit	**IG Spread (bps)**	**US**	↔	• Global Corporate bonds are likely to face headwinds up until 1H23. • Policy rates in 1H23 are expected to rise across DM, while corporate spreads should widen on back of a global economic slowdown and higher refinancing rates, with HY to be the most heavily impacted.	
		EU	↑		
	HY Spread (bps)	**US**	↑		
		EU	↑		

Equities Highlights

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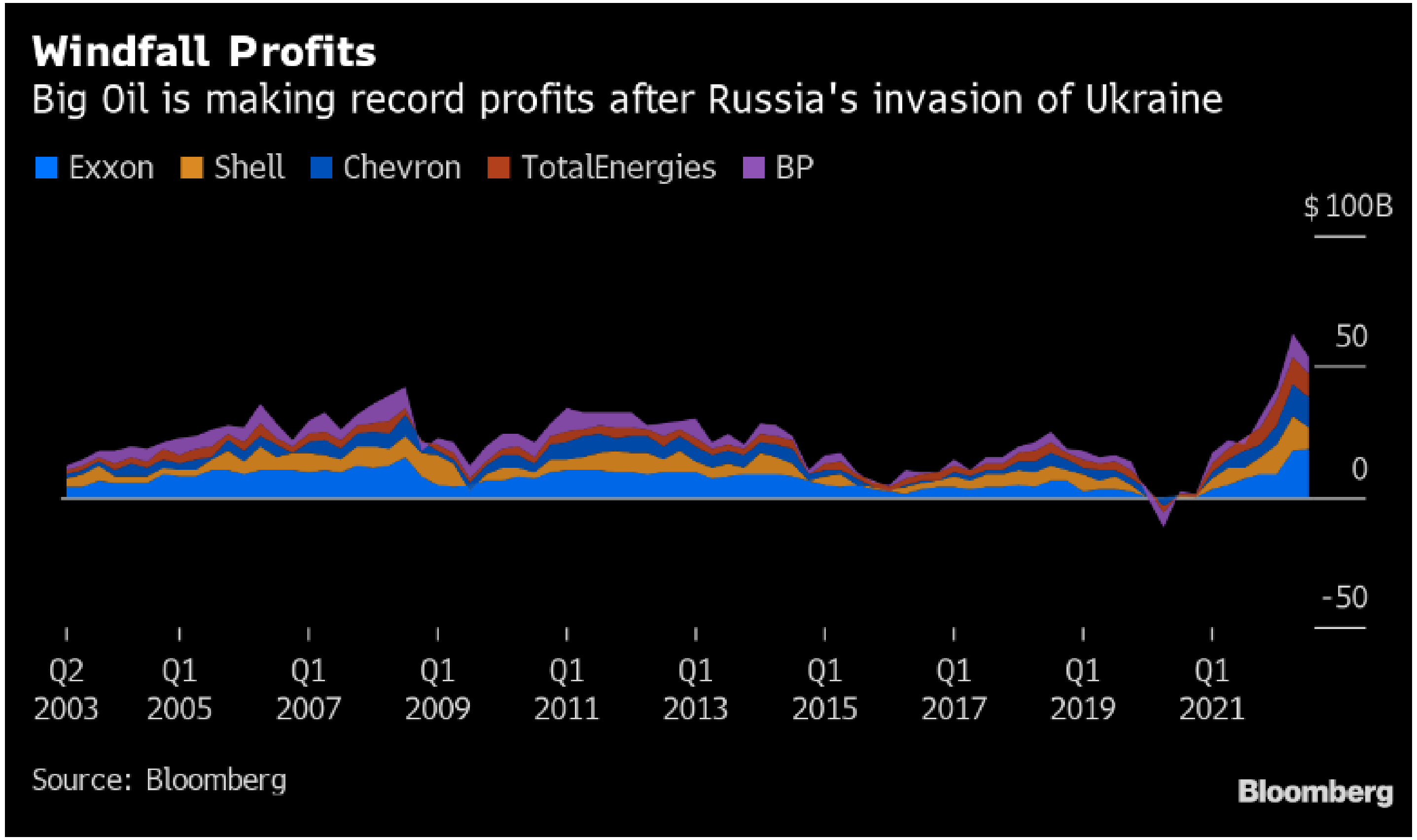
Oil firms and windfall taxes

President Biden, announced his intentions to levy a windfall tax on oil companies this week



Source: Bloomberg, October 2022

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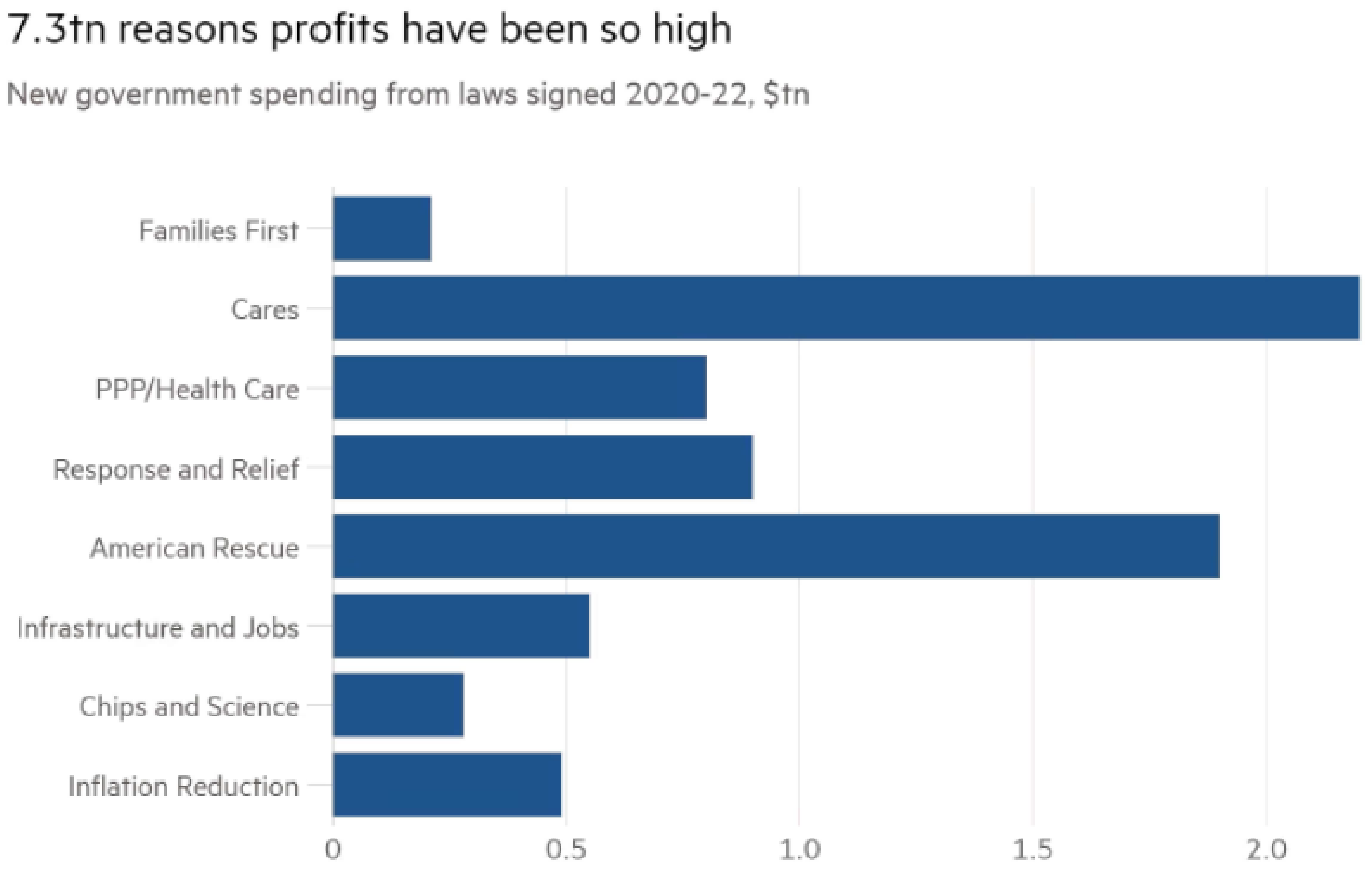
More Earnings Downgrade likely after Midterm

New spending plans will become less likely to be passed under a divided US government.



Source: Financial Times, November 2022

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Considerable slowdown in PE deal-making

Higher financing costs and potentially lower returns might be the new reality

Source: Bloomberg, October 2022

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Equities – Overview (1/2)

<table>
<tr><th>Region</th><th>IC Outlook (2Q23)</th><th>IC Comments</th><th>Recommended Positioning</th></tr>
<tr><td>US (S&P 500)</td><td>↓</td><td>Analysts have been downgrading their S&P 500 earnings expectations for the past three months but are still way too optimistic. Forward earnings growth has fallen to 6.6% – still a far cry from the typical 15%-to-20% decline in a recession.
We hold a bearish view on US equities over the next 6-12 months given that interest rates are expected to continue rising and economic growth, while not collapsing, is softening.
Moreover, US Equities are likely to continue to be negatively correlated with long-term rates and are exposed to any hawkish comments from the FED.</td><td rowspan="2">Investors seemed to be worried about missing a rally caused by a Fed pivot and on Wednesday any such hopes were dashed, with the Fed delivering yet another 75bps hike and Chairman Powell issuing statements that were considered pretty hawkish by the street, causing the S&P 500 to drop 2.5%.
Around 65% of S&P 500 companies have reported earnings, with more than two thirds of them beating earnings and revenue expectations. While revenue growth has been broad based with YoY growth in all 11 sectors, the earnings picture is not as positive, with 6 out of the 11 sectors registering a YoY degrowth.
We do not think it is time to increase beta on portfolios yet and recommend a cautious stance in terms of positioning as we continue to believe that earnings expectations are overly optimistic, especially those for 2023.
Consider adding Long/Short managers who can take bi-directional bets and who should benefit from current dispersion.
There are some good quality companies which we have on our list that appear oversold with high implied volatility – making them good candidates for FCNs/ELN structures. This is a good way to maintain a defensive stance while benefiting from high carry from coupons. <u>Do not</u> go beyond 6M in maturity.</td></tr>
<tr><td>EU (STOXX 600)</td><td>↓</td><td>We think EU is in a precarious situation as it is likely to already be in recession. Elevated gas prices and energy rationing efforts would keep a lid on any growth prospects, and we anticipate corporate earnings pressure to intensify into 1H23.
Despite the bleak economic situation, the consensus STOXX 600 earnings growth expectations is at >10%, a fairly optimistic scenario in our opinion. We expect more earnings misses to materialize over the next 12 months.
According to Deutsche Bank, investors have redeemed $83 billion from European equities in the past 6 months.</td></tr>
</table>

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Equities – Overview (2/2)

Region	IC Outlook (2Q23)	IC Comments	Recommended Positioning
China (CSI 300)	↔/↓	▪ We reckon that Chinese valuations are attractive, but equities are likely to stay undervalued as growth is expected to slow down with Zero Covid Policy (ZCP) placing a lid on economic activity and profit outlook. ▪ We think Chinese stocks are likely to trade sideways. Supportive policies and relaxations to ZCP would be key recipes to an eventual tailwind for market sentiments. Visibility remains very low on this front.	▪ In the short term, the Chinese markets will be primarily driven by policies. As the party congress meeting reemphasized CCP's commitments to zero Covid, consumer confidence and investor sentiments will likely remain depressed. ▪ Investors should **continue to remain invested in low beta long short managers** (FengHe, Luxence, UBS O'Connor China L/S) for now. Indeed, we **do not recommend taking on full beta risk just yet**.
India (NIFTY 50)	↔	▪ Indian equities continue to outperform global equity markets on the back of strong economic growth expectations and inflation prints not getting out of hand. ▪ Valuations are however expensive, with the Nifty trading at close to 22 times earnings, which is more than its historical average of 18.6 times earnings. ▪ Despite the sanguine view on the region, we think aggressive monetary policy actions and even more aggressive communication from Advanced economies and a strong dollar, serve as key risk factors to any meaningful upside to Indian equities.	▪ We recommend a **cautious and staggered approach** when it comes to allocating to Indian equities, as we await further clarity with respect to how the global macro situation unfolds and whether Indian corporate earnings can hold up in an increasingly tougher macro environment and a more restrictive monetary stance being taken by the central bank.

Forex, Commodities & Alternatives

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Commodities – Overview

	Sub-Asset	IC Outlook (2Q23)	IC Comments	Recommended Positioning
Commodities	Gold	↔	▪ There are two opposite forces for Gold. ▪ On the one hand, gold is likely to face near term headwinds on back of higher rates (which is an opportunity cost for gold holders) and a strong dollar. ▪ On the other hand, increasing holdings of gold in global central bank reserves points to a de-dollarization trend which could act as tailwinds for the yellow metal.	▪ We believe that **some exposure to gold makes sense** as a means to hedge longer term inflation and geopolitical shocks. ▪ As it is difficult and extremely tricky to time and trade the yellow metal, our **recommended way to gain exposure is via external managers** (Delbrook - gold equities, Drakewood - gold futures/options)
	Oil	↔ / ↓	▪ Oil demand should likely deteriorate on back of higher recession risks globally. ▪ On the flipside, OPEC to lower production by 2mm b/d starting in November, marking the largest cut since 2020. ▪ We think risks are skewed more to the downside given the historically large drawdowns (>40%) which oil faces during recessions. The OPEC production cuts will temporarilly help minimize the extent of these drawdowns.	-

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Forex – Overview

	Sub-Asset	IC Outlook (2Q23)	IC Comments	Recommended Positioning
FX	USD	↔/↑	▪ A stronger dollar is the global transmission policy of the Federal Reserve's rate policy, that policy is tightening fast, and it is uncertain where it will stop. We anticipate the dollar to maintain its strength throughout 22 as recessionary fears accelerate.	• With the 75bps rate hike in the November FOMC meeting and another 50bps expected in December, **we expect the US dollar to remain strong until the end of the year. Any risk-off sentiment is also likely to be favorable for the USD in the short term.** • However, **bleaker growth outlook in other regions as well as a hawkish fed will continue to support current levels.** • Both BOE and ECB are now expected to hike rates further to narrow the interest rate differential with the USD and support their currencies. **Longer term investors may consider gradually adding DM currency exposures** (EUR, GBP) as they are looking cheap versus the dollar.
	EUR	↔	▪ The EUR continues to remain below parity (Vs USD) because of adverse news flow: I. The German Ifo Business Climate Index weakened further in September, sliding from 88.6 to 84.3, below expectations of a milder deterioration. II. Italy's right-wing coalition led by Giorgia Meloni secured 44% of the vote in Sunday's general election. Italian government bond yields rose 21bps on Monday following the announcement of the right-wing victory.	
	GBP	↔/↑	▪ The 2/30y Gilt curve remains extremely steep and is a reflection of entrenched inflation and fiscal fears. ▪ BOE is likely to be pressured to flatten the curve by way of 1) aggressive hikes (real rates too low vs UK inflation which is at 6%+), and 2) buying long end papers to keep liquidity neutral ▪ Together with some fiscal loosening on the horizon, this should set the GBP for an eventual rebound from very depressed levels	
	CNY	↓	▪ The PBOC is very supportive and has started decreasing interest rates. Policymakers will ultimately continue to ease domestic policy to reflate the economy and the PBoC will probably cut rates further. The implication is that the CNY – which has already depreciated by 11% so far this year – is likely to continue weakening. ▪ Given that the Chinese economy faces deflationary pressures, authorities in Beijing do not have an incentive to pursue a stronger yuan.	
	JPY	↔	▪ The JPY is unlikely to rebound in the near term as the rates differential increases with other central banks, owing to the BoJ's YCC policy ▪ That said, it currently looks extremely cheap relative to its longer-term PPP fair value.	

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