

Investment Playbook Weekly Update

11th – 15th September 2023

**LIGHTHOUSE
CANTON**



OUTSTANDING DIGITAL
TRANSFORMATION IN COVID
19 BY A FAMILY OFFICE

BEST FAMILY OFFICE –
MIDDLE EAST

BEST FAMILY OFFICE –
UNITED ARAB EMIRATES

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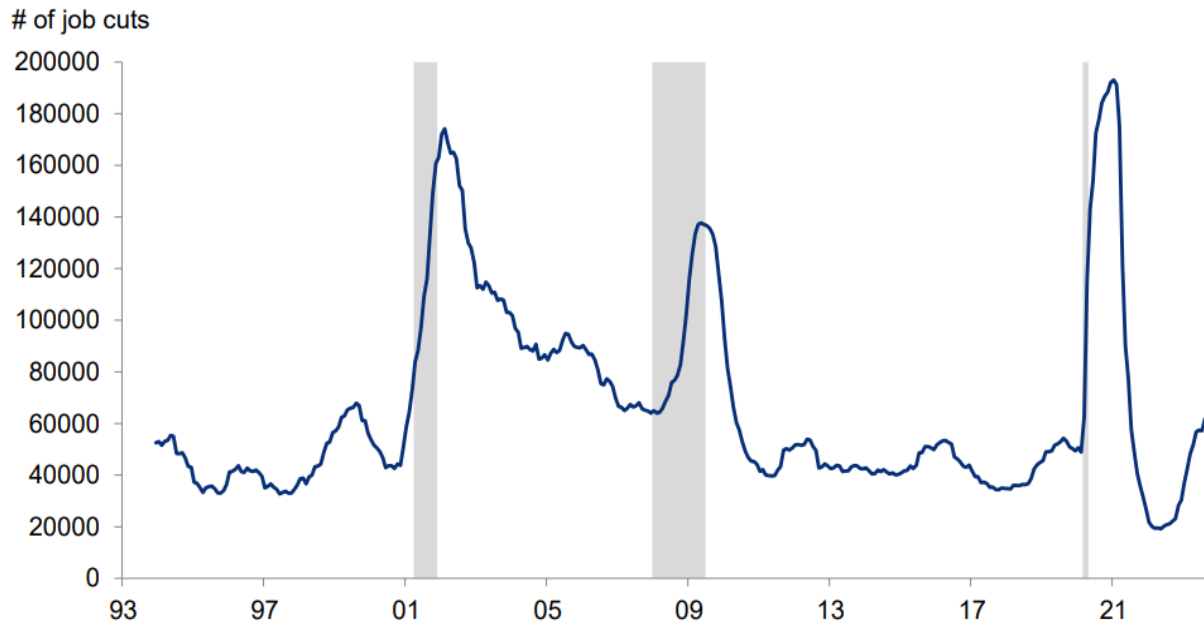
Charts of the week

1

US Employment Softening

Job Cuts Over Last 12 Months Up to Highest Level since GFC

Challenger, Gray & Christmas: Announced Job Cuts, Total (Number) 12-month Moving Average

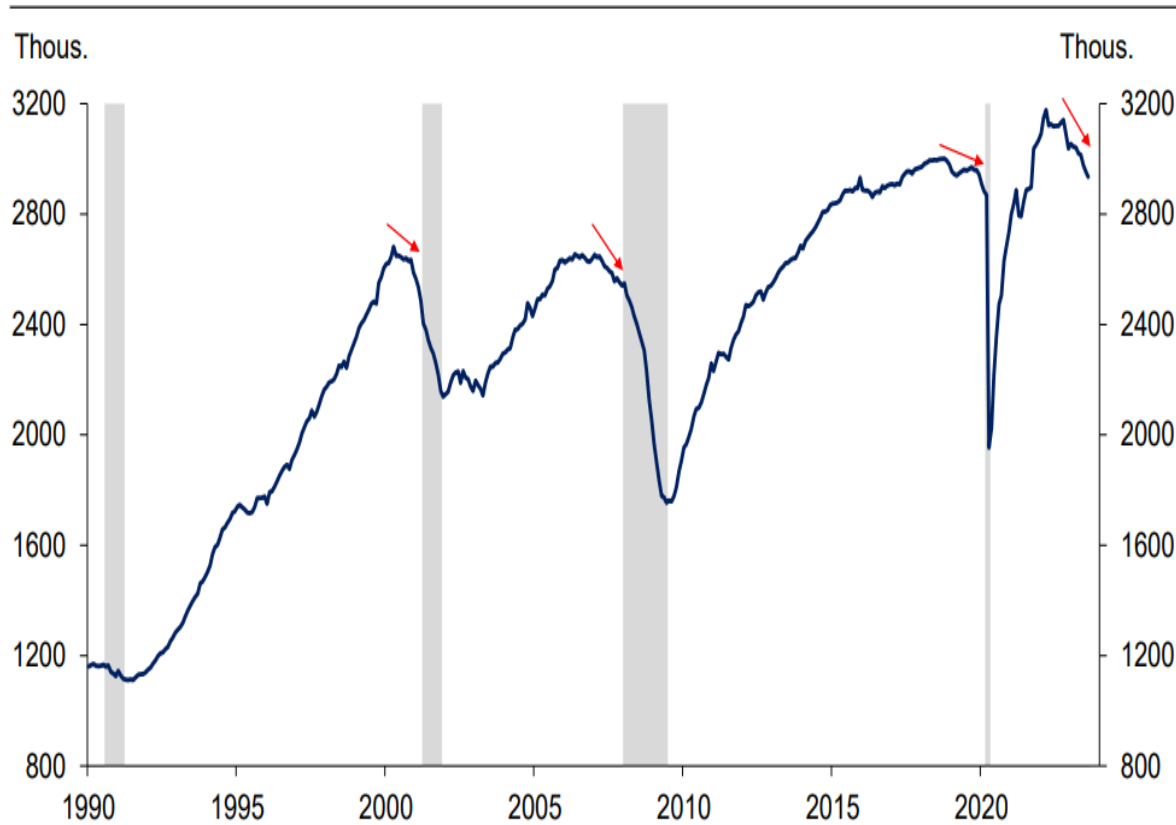


- Rising job cuts is a common trend seen in the past recessions and currently we are at level close to that seen at the onset of the GFC.

US Employment Softening

Payrolls in the Temporary Help Services Category are Already Falling

All Employees: Temporary Help Services

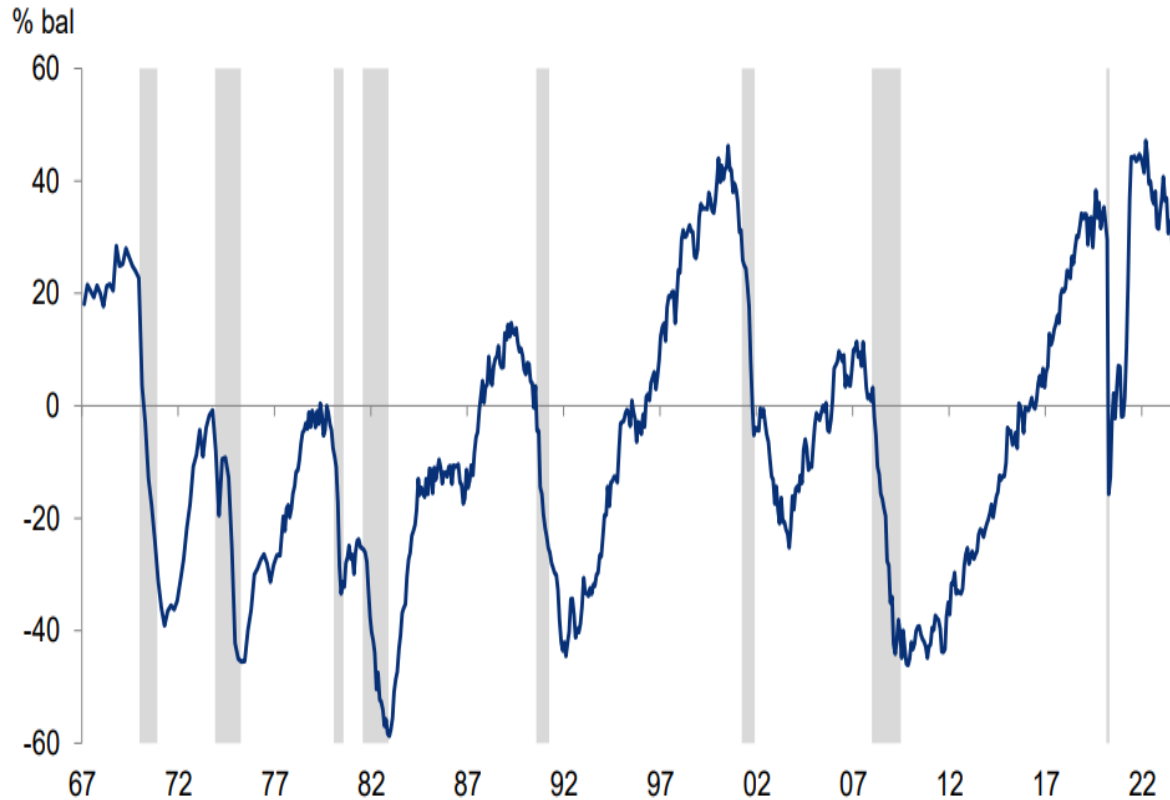


- Payrolls in the Temporary Help Services tend to lead the cycle historically and they are already falling.

US Employment Softening

Labor Market Differential Between Jobs “Plentiful” and “Hard to Get” Has Fallen

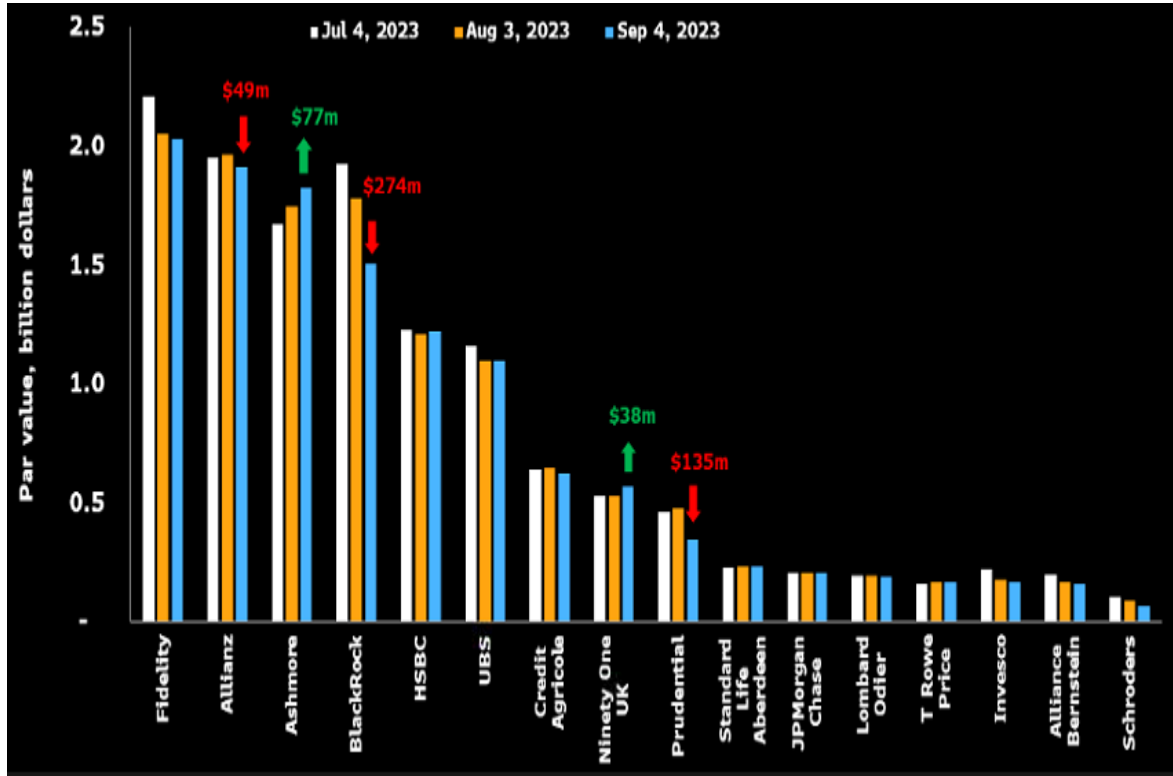
Labor Market Differential between jobs “plentiful” and “hard to get”



- Difference between those saying that US jobs were “plentiful” and “hard to get” has fallen noticeably in recent months; similar to what we normally see ahead of recessions.

China Junk Holders Cut Stake

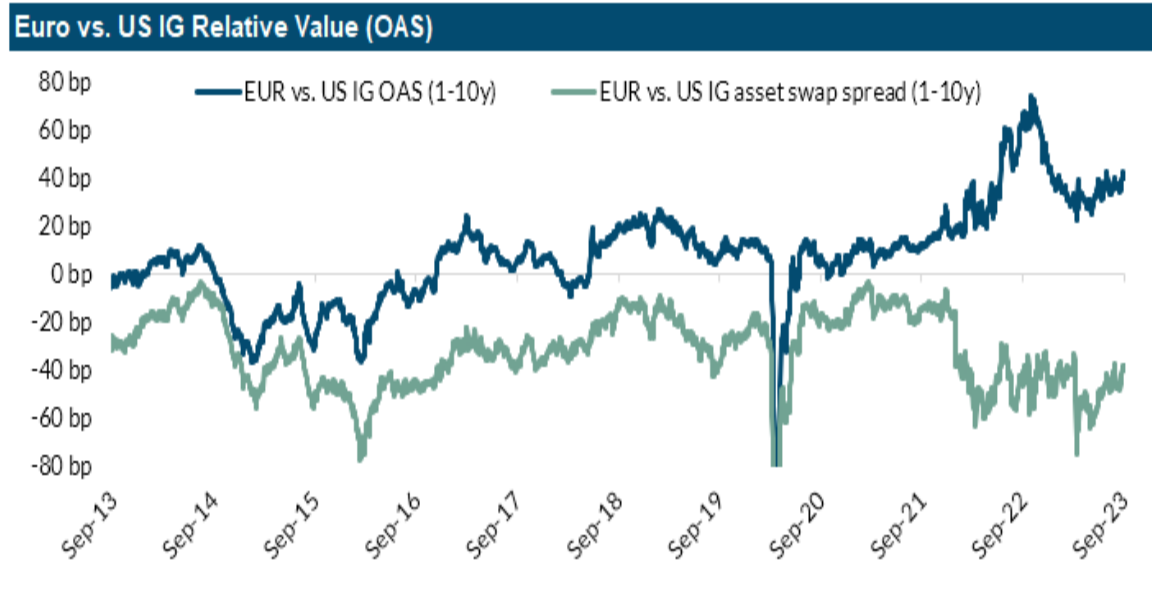
Selling Pressure Builds



- Major funds are still slashing stakes in China junk bonds from real estate sector, providing little respite to bond spreads. Chinese property-bond spreads could stay under pressure as the country's growth slows, even after a price rebound due to the recent property stimulus.
- BlackRock, one of the largest holders of China dollar junk bonds from the real-estate sector, has cut its stake for seven straight months and was the largest seller over the past month at \$274 million in terms of par value. Prudential and Allianz led other sellers, while Ashmore and Ninety One UK added positions.

Relative Value: Euro IG vs US IG

EUR IG looks cheap on a historical basis

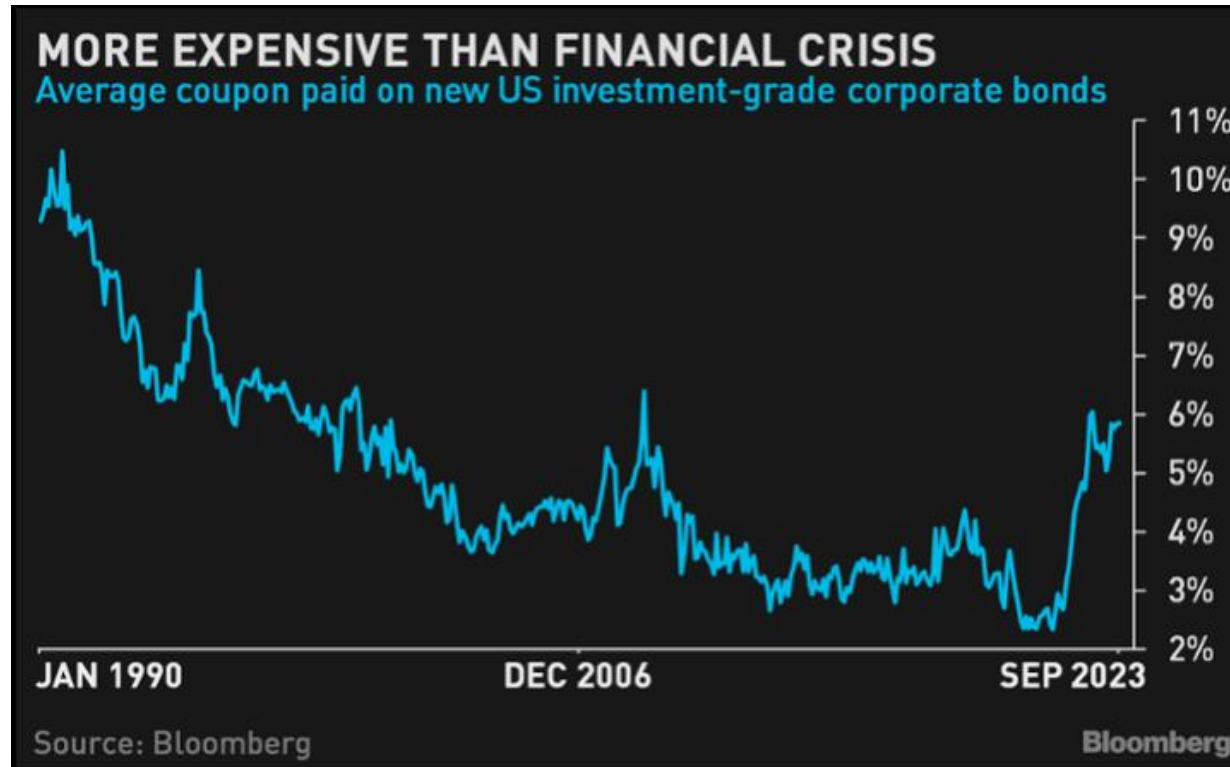


Source: CreditSights, ICE Indices

- EUR IG credit looks cheap relative to US IG on a historical basis. Current spread differential stood at 40bps relative to 10 bps of 10Y historical average.
- The enhanced spread is pricing in the relative vulnerability of EU economies.

Corporate Margins Could Drop Due to Increased Borrowing Costs

As average coupons on new us IG corporate increase, margins predicted to drop from 10.5% to 7.5%

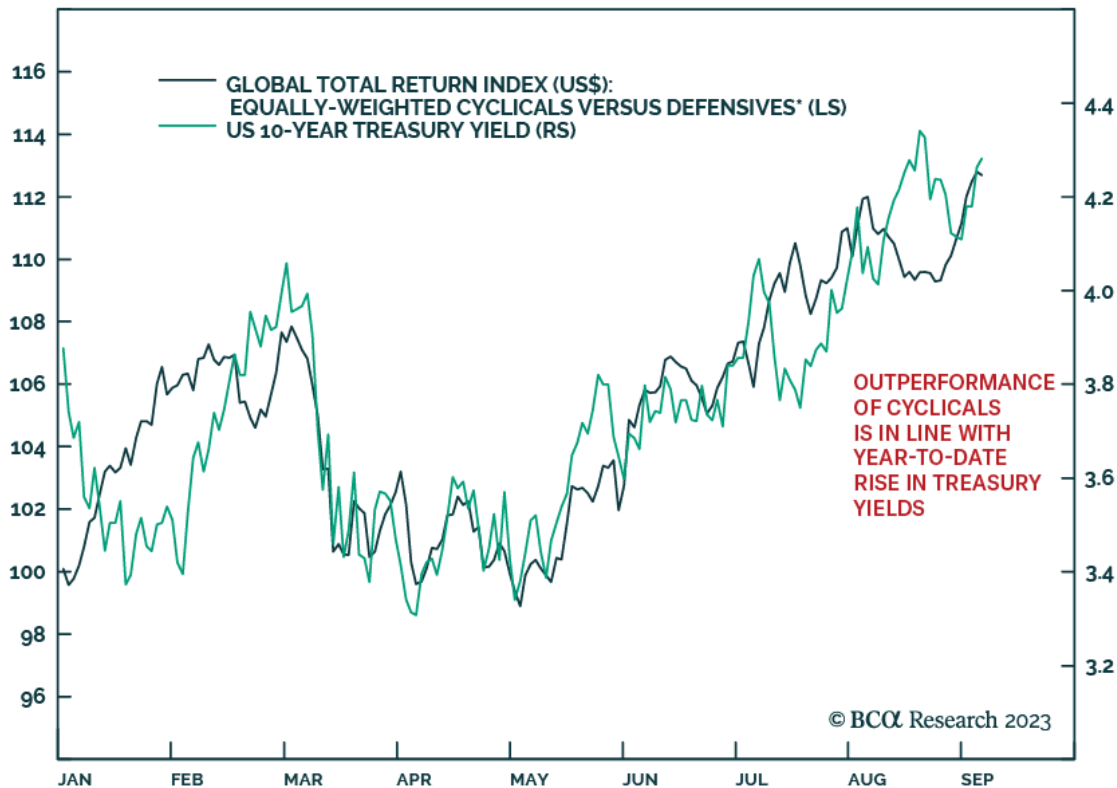


- In recent months, US companies faced higher borrowing costs than during most of the financial crisis. Last week marked a record for global corporate issuance, with the US seeing its busiest day in over three years. Corporate treasurers hurried to borrow after Labor Day and before the US CPI release due to recent bond selling pressures. They anticipate higher inflation might increase yields. Bloomberg predicts corporate margins might drop from 10.5% to 7.5% due to tighter monetary policy, affecting profits. Equity investors should note this since 75% of S&P 500 companies have bonds in Bloomberg's US Corporate Index, making up 85% of the S&P 500's weight.

Source: BCA Research, August 2023

Strong Correlation Between Global Cyclical Index & 10Y Yield

However, in a “Hard-Landing/Recession” Scenario, Defensive Sectors are Preferred



CYCLICAL SECTORS DEFINED AS ENERGY, MATERIALS, INDUSTRIALS, CONSUMER DISCRETIONARY, AND FINANCIALS.
DEFENSIVE SECTORS DEFINED AS CONSUMER STAPLES, HEALTH CARE, TELECOM SERVICES, AND UTILITIES.
* SOURCE: MSCI INC. AND BCA CALCULATIONS; SHOWN REBASED TO DEC 30 2022 = 100.

- Since the beginning of the year, the equally-weighted global cyclical index has outperformed equally-weighted defensives by about 13%. This relative performance has been extremely positively correlated with 10Y UST yield.
- One reason is rising long-maturity yields, at this stage of the business cycle, suggest that investors expect US economic growth to justify higher interest rates or less interest rate cuts than what was previously expected, which equity investors take to be fundamentally bullish for cyclical sensitive industries.
- Another reason is that on average defensive sectors tend to have higher dividend yields than that of the cyclical sectors, and that yield is eroded with as government bond yields rise.

Source: BCA Research, September 2023

LC Views - Summary

2

LC Views Summary (1/2)

| Sub-Asset | Recommended Positioning |
|-----------------|--|
| Rates | <ul style="list-style-type: none">Headline CPI jumped 0.6% in August as rising commodity prices pushed the headline reading higher. The big driver of rising headline CPI was gasoline prices, which were up 10.6% on the month. Food prices rose modestly, matching July's 0.2% MoM increase. Core CPI rose a touch more than expected at 0.3% MoM (0.2% consensus), but matched the consensus call for a 4.3% YoY increase (4.7% prior month). This is the fifth consecutive monthly decline and also the slowest rate since September 2021. The latest data would likely make a case for another pause for the FOMC in September but provides little clarity into Fed action beyond this. Fed policy still remains very much data driven. |
| Credit | <ul style="list-style-type: none">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. We advise against increasing duration beyond 10 years as the risk-reward does not favor ultra-long ends. 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 | <ul style="list-style-type: none">There are two potential scenarios for the global economy. First, higher interest rates could further suppress global economic growth, leading to margin compression and possibly slower growth. Alternatively, if the economy demonstrates robustness (for instance, the Atlanta Fed GDP Now is a remarkable 5.8%!), Central Bankers would be compelled to continue raising rates to align inflation with the 2% target. In either scenario, equities are poised for challenges.The valuation of equities currently appears expensive:<ul style="list-style-type: none">Historically speaking, with a forward P/E ratio at 19x, investors might find limited opportunities for substantial returns in the forthcoming 12 months.Even more pertinently, when compared to bonds and cash, equities seem less appealing. To illustrate, the disparity between the yield of 3-month US Treasuries and the S&P 500's dividend yield has expanded to a significant 400 basis points. Such pronounced differentials were last witnessed in 2000 and 2007, both instances that preceded major equity downturns.Considering the uncertain trajectory for equities over the next year, coupled with their elevated valuations and their comparative disadvantage against cash and bonds, our recommendation is to underweight equities in portfolios. |

LC Views Summary (2/2)

| Sub-Asset | Recommended Positioning |
|-------------|---|
| Currencies | <ul style="list-style-type: none"> 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 | <ul style="list-style-type: none"> 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 | <ul style="list-style-type: none"> 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. |

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