



Current allocation

We are neutral equities, overweight Europe and underweight the US, underweight fixed income with an underweight in high yield and with a long gold position.

What we did this year

1. In July we sold the Axa inflation linked product, as it no longer provided protection from rising inflation. The product has since fallen 12%
2. In August, we reduced the 3% overweight in equities, due to portfolio market drift, (fixed income underperformed during the rally from the June lows), back to neutral, we sold the Allianz Animal Health fund, as the sector's growth trajectory collided with valuation, and Europe exposure. The fund has lost 19% since then
3. No active purchases were made

In view of the increased likelihood of a binary outcome for financial markets - just look at the huge volatility in all asset classes over the last ten days - we decided to render the portfolios more asymmetric, and take advantage of the cheapness of upside options, (calls' volatility is 10% lower than puts): we are therefore reducing the equity allocation to 45%, (from 49% for a balanced portfolio), by reducing an equal amount of US and European equities, and replacing it with S&P500 calls, 10% out of the money, maturing in January 2023, with an equivalent delta to the amount of sold equities. Thus, we are cushioning the downside while keeping exposure to the upside.

Fed hawkishness has left several equity sectors and regions outside of the US oversold and approaching deep-value. Inflation has once again been the key focus, and markets are likely to remain volatile until the next CPI release in mid-October. We see many encouraging signs on inflation, with, amongst them, declining gasoline prices and declining prices of core goods. Housing is definitely cooling also, while global positioning is extremely depressed. Central banks will act to avoid a deep recession. China is likely to address its economy more vigorously during/after its upcoming congress. Recent UK government announcements, (it already backtracked on some of them), also contributed to global volatility.



Macro: The US will thus either avoid or have a shallow recession

Inflation: data points to lower inflation in the months ahead

- Recent macro data including from China has been better, for example China's PPI index sank to 2.3%, off the 13.5% high from last October
- Commodities including agriculture are back to pre-war levels
- US gasoline prices are back to pre-war levels
- Leading indicators on rent and shelter are falling as 30-year mortgage rates are approaching 7%, more than three times the average spread to US treasuries, (1%)
- Supply chains are easing, and US congestion is now back to January 2021 levels
- Shipping costs on average are back to late 2020 levels

Consumer confidence

- Various indicators show consumer US consumer confidence is increasing as inflation expectations 1 year out are now at around 2% on average
- The all-important US consumer is healthy: its balance sheet has never been so good, jobs are plentiful, and confidence is rising again

Financial conditions

- Central banks like the BOE and the Fed will avoid pushing the housing market into a crisis, and will act in case of need: Bank of England intervened to calm the market and restarted buying long-term Gilts
- The Fed might 'pivot' sooner, stop raising rates or else act to soothe an illiquid treasury and repo market

Valuations

- Valuations, outside the US and particularly in Europe, are approaching deep-value, depression levels. For the Eurozone forward PEs are at the same as at the deepest point of the covid crisis, and in-line with the European debt crisis in 2011-2012: we have a very large underweight in the US
- Earnings estimates, particularly for some 'growth' sectors, particularly in the US, still have to come down to realistic levels

Politics

- With US consumer confidence rising, so are Biden's approval ratings and those of the democrats ahead of the November mid-term elections: they are now likely to keep the senate, compared to disastrous polls before the summer
- The political pressure from the White House on the central bank might therefore diminish



Fiscal policy

- The EU and the single states are full steam ahead in addressing the energy crisis, both in terms of supply, as well as in fiscal aid or price caps to help its citizens and businesses. Governments' balance sheet repair will be left for the next generation.
- The Euros 700 billion post-covid stimulus fiscal plan from the EU, via, for example, the European Recovery fund, is now in its distribution phase and gathering steam
- The USA Build Back Better plan: a comprehensive medium term investment plan that includes, amongst other items, 213 billion usd for building and retrofitting more than 2 million homes, 40 billion to improve public housing, 111 billion for infrastructure, such as modernizing wastewater systems, universal school for 3-year-olds and improved medical access for the elderly

Market positioning

- Market positioning is extremely depressed, while we observe some short-covering by hedge funds: asset managers have even less equities than during the 2020 first lockdown, net shorts by hedge funds are at the same historical low level as in June 2020, and retail investor bearishness is far below the level observed in March 2020
- Our own contrarian indicator has moved into oversold levels

Risks

Central banks

- Policy mistake pushes economies into deep recession -
- And sparks a housing market crisis

Geopolitics

- The Ukraine war spirals out of control
- China-Taiwan tensions move towards a conflict

Energy

- Russia completely shuts down gas supply to Europe
- A very harsh winter materializes in Europe

Government policy

- China continues its Zero Covid Policy
- The UK becomes a European economic pariah and loses control of its financial markets, with contagion affecting world markets
- Cracks emerge in European energy solidarity



Catalysts

Central Banks

- A clear confirmation that central banks are not behind the curve, and further confirmation that peak inflation is behind us: markets typically bottom around 6 months before the bottom in the economy and earnings' revisions
- Peak central bank hawkishness and a Fed pivot similar to 2019
- Financial conditions in China are extremely tight, despite rate reductions and monetary injections. Expect more vigorous action to ease them, thus reactivating the economy

Geopolitics

- The tide appears to be turning in the Russian media regarding the war and there are now some critics openly expressing themselves: unprecedented until recently. Political opposition is rising.
- A harsh winter in Ukraine 'freezes' the conflict, and gives time for the opponents to either stop or possibly remove Putin
- China removes its Zero Covid Policy after its October congress, (Hong Kong is already opening up, maybe a precursor on a smaller scale)

The government bond market has always been the key market for the future direction of other markets, such as equities. It has been the supertanker that needs 1 mile to make a U-turn. What is happening now, even in US Treasuries and the US repo market, is not normal, with extreme intraday volatility and illiquidity. We need more stable bond markets, and we believe central banks/treasuries will address this soon.



This document has been prepared by Sunline Pte Ltd. It is not intended for distribution, publication, or use in any jurisdiction where such distribution, publication, or use would be unlawful, nor is it aimed at any person or entity to whom it would be unlawful to address such a document.

This document is provided for information purposes only and does not constitute an offer or a recommendation to purchase or sell any security. It contains the opinions of Sunline Pte Ltd, as at the date of issue. These opinions do not take into account individual investor circumstances, objectives, or needs. No representation is made that any investment or strategy is suitable or appropriate to individual circumstances or that any investment or strategy constitutes a personal recommendation to any investor. Each investor must make his/her own independent decisions regarding any securities or financial instruments mentioned herein. Before entering into any transaction, an investor should consider carefully the suitability of a transaction to his/her particular circumstances and, where necessary, obtain independent professional advice in respect of risks, as well as any legal, regulatory, credit, tax, and accounting consequences.

The information and analysis contained herein are based on sources believed to be reliable. However Sunline Pte Ltd does not guarantee the timeliness, accuracy, or completeness of the information contained in this document, nor does it accept any liability for any loss or damage resulting from its use. All information and opinions as well as the prices indicated may change without notice. This document may contain articles from other financial sources. These sources are always mentioned when included.

Past performance is no guarantee of current or future returns, and the investor may receive back less than he invested. The value of any investment in a currency other than the base currency of a portfolio is subject to foreign exchange rate risk. These rates may fluctuate and adversely affect the value of the investment when it is realized and converted back into the investor's base currency. The liquidity of an investment is subject to supply and demand. Some products may not have a well-established secondary market or in extreme market conditions may be difficult to value, resulting in price volatility and making it difficult to obtain a price to dispose of the asset.

This document has been issued in Singapore by Sunline Pte Ltd. Neither this document nor any copy thereof may be sent, taken into, or distributed in the United States or given to any US person.