INSIGHTS INTO WHAT MAY LIE AHEAD

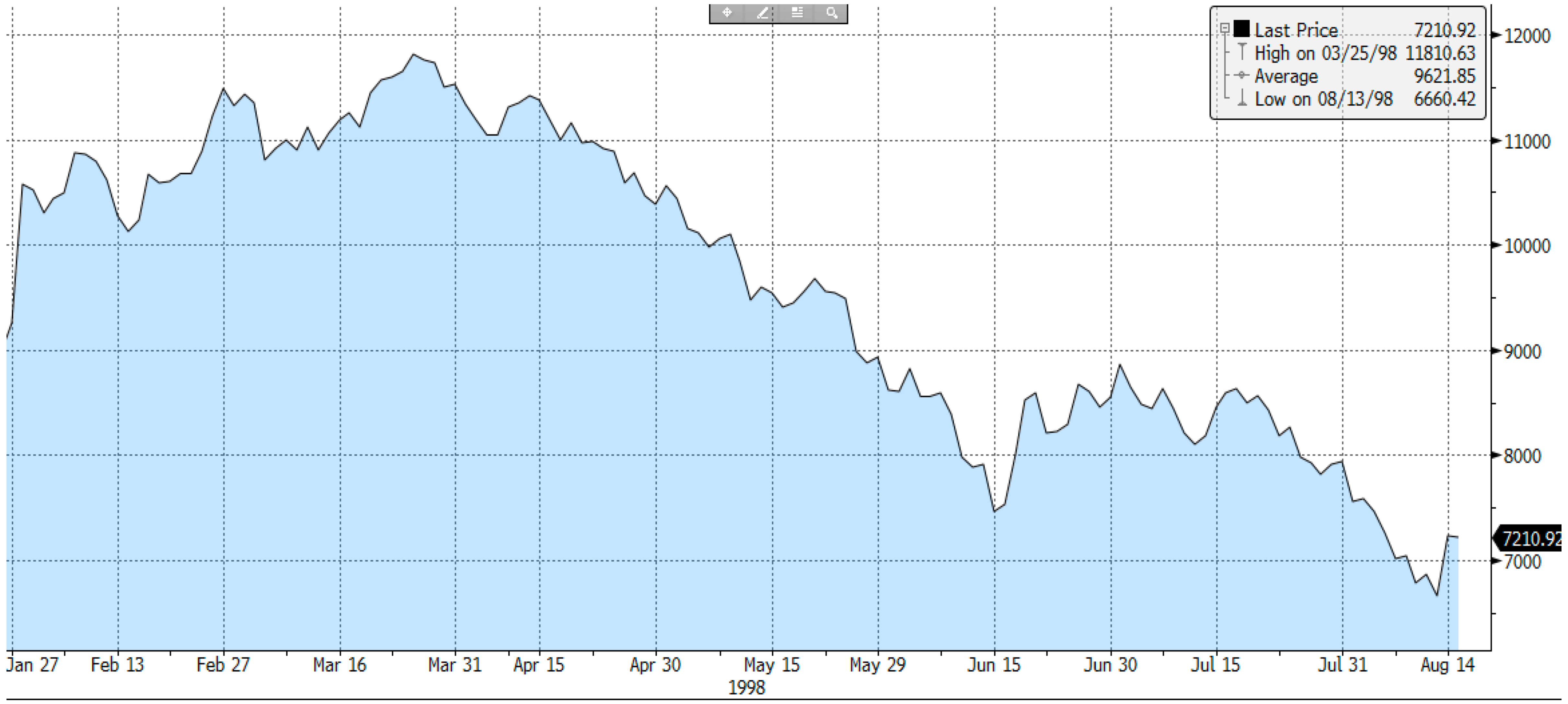
Global Macro and Market Update

For CFA Society Kuwait

November 2022

إدارة الأصول
Asset Management
RASAMEEL

My initiation into asset management…….



Significant market selloffs of the time

Hong Kong banks recovered better than others

HSI 1997-2000

Lessons:

- **Be aware of financial contagion - a crisis can spread rapidly**
- **Bottom-up research critical – not all stocks are the same**

Russia was a buy of a lifetime

Lessons:

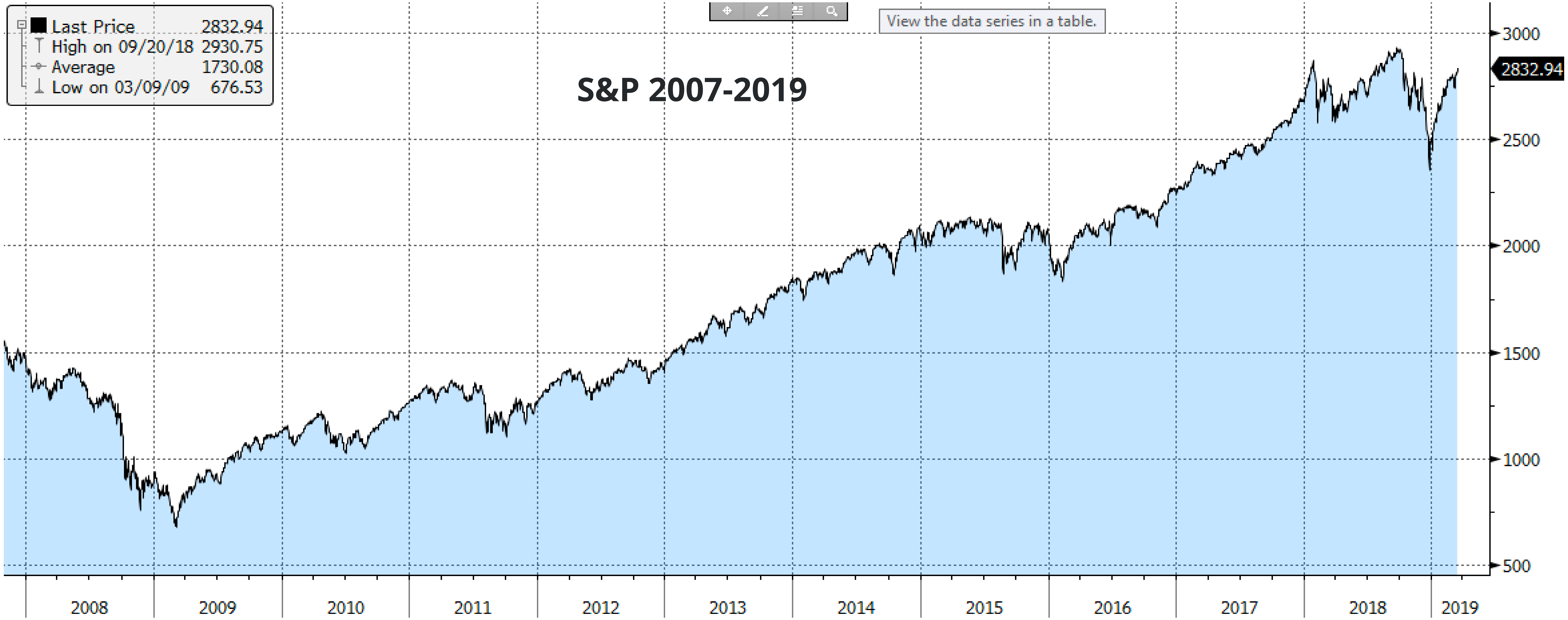
- Portfolio managers disown markets at their lows – opportunity in unloved markets
- Opportunity knocks when upside risk predominates – but many fail to see it

Technology bust was severe

Lessons:

- Markets are inefficient and driven by sentiment and psychology
- Market miss-pricing can last longer than you can stay solvent – in case of shorts in '99
- Markets can break lower – and higher - for no clear reason
- Markets can remain unloved for lengthy periods

GFC was followed by a massive rally in equities



Lessons:

- If something seems too good to be true – high yield on AAA credit – then it probably isn't
- Don't underestimate the innovation of the financial markets
- Correlations can go to 1 and everything can get sold down as investors search for liquidity
- Don't underestimate the power of the Central Bank to reverse market direction

2020 reinforced the power of governments

Lessons:

- **Don't underestimate the power of the central banks and the government combined to turn market direction**

25 years and many lessons later

- Be aware of financial contagion - a crisis can spread rapidly
- Bottom-up research critical – not all stocks are the same
- Portfolio managers disown markets at their lows
- Opportunity knocks when risk predominates – but many fail to see it
- Markets are inefficient and driven by sentiment and phychology
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- Markets can break lower –and higher - for no clear reason
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- ....markets rebound

Today's market will rhyme with prior cycle

What is different in today market:

- Government Debt levels to GDP at much higher levels
- Central Bank balance sheets are significantly larger
- May be at the end of a 40yr era of falling yields ????
- Central banks and Governments more powerful than ever

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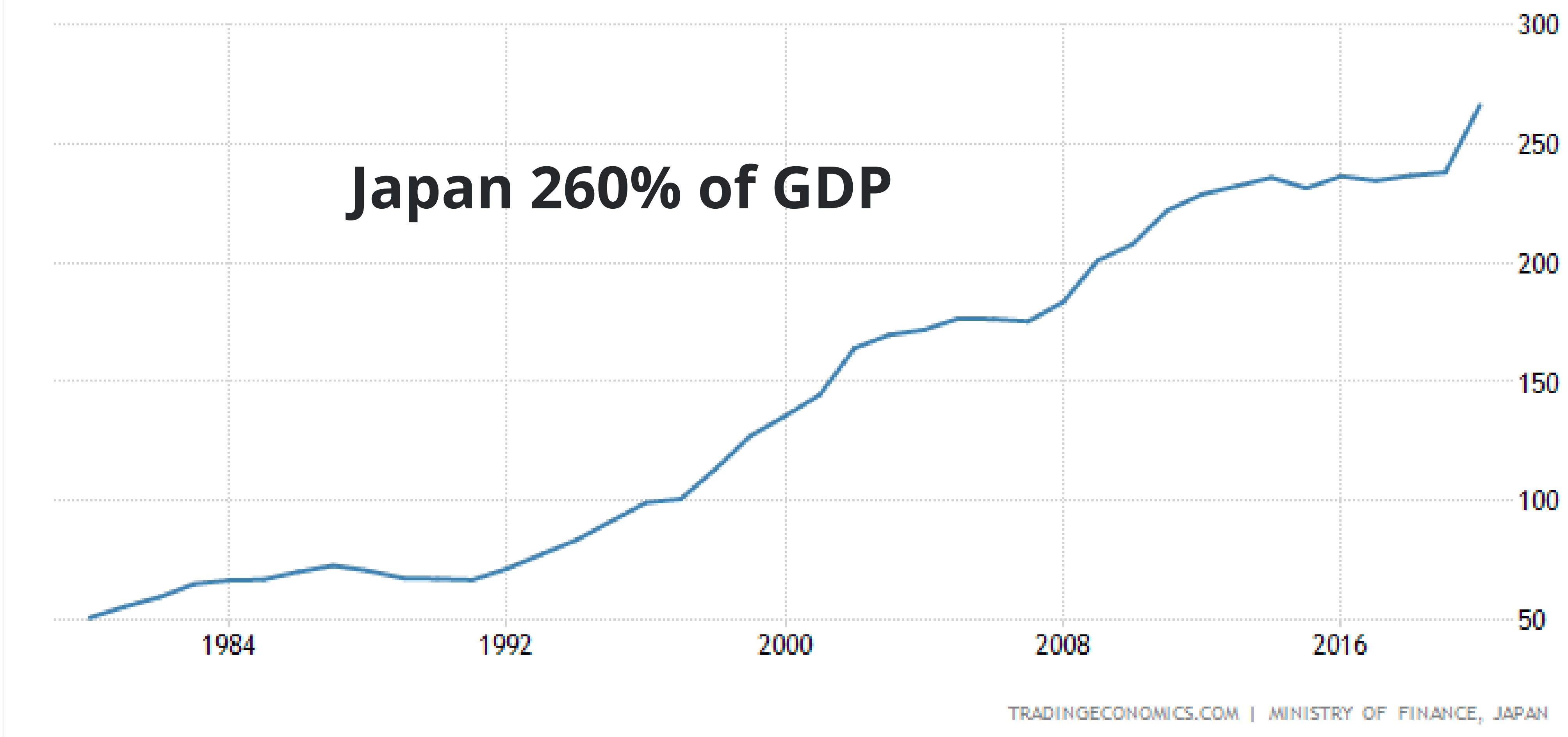
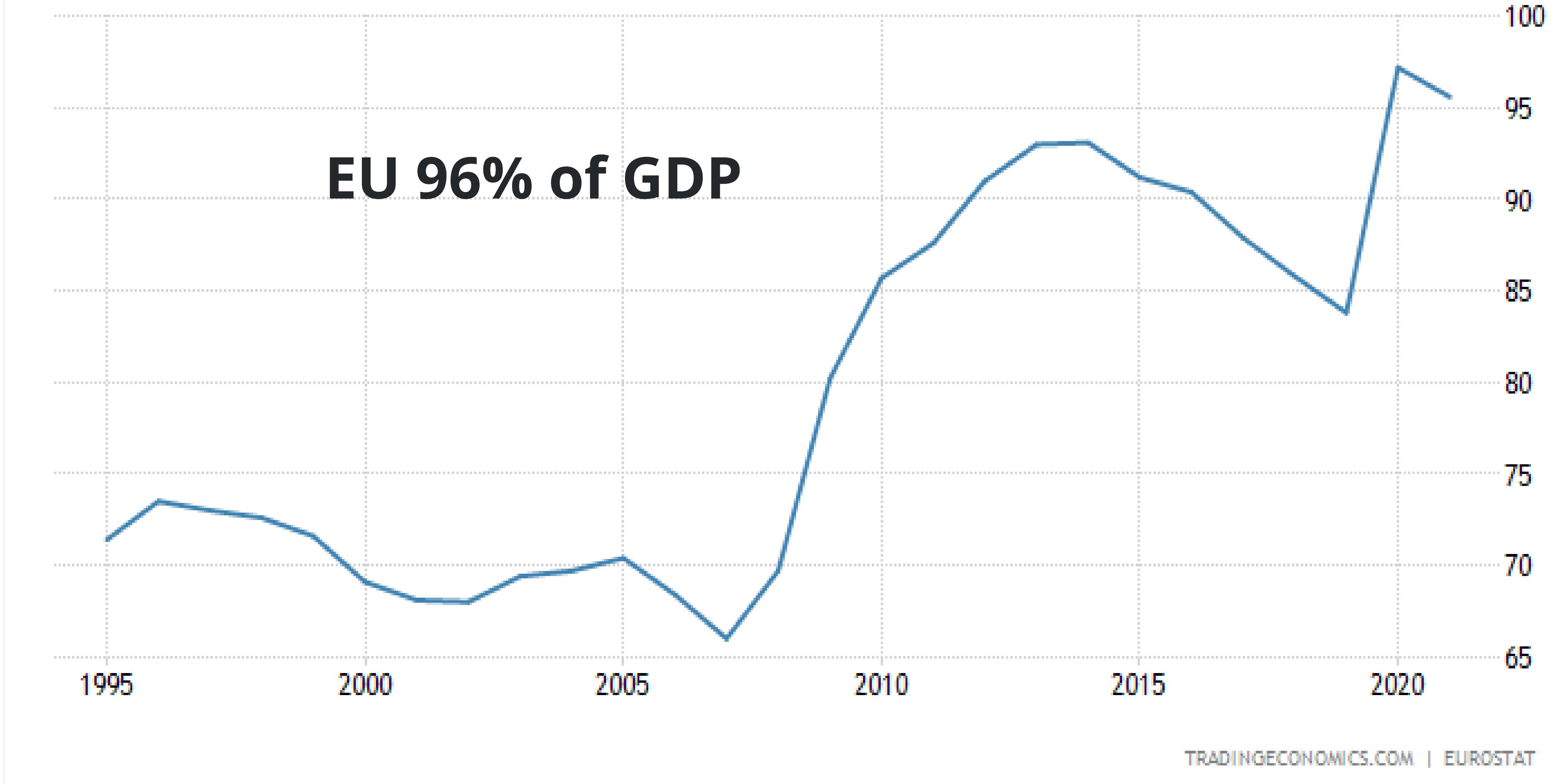
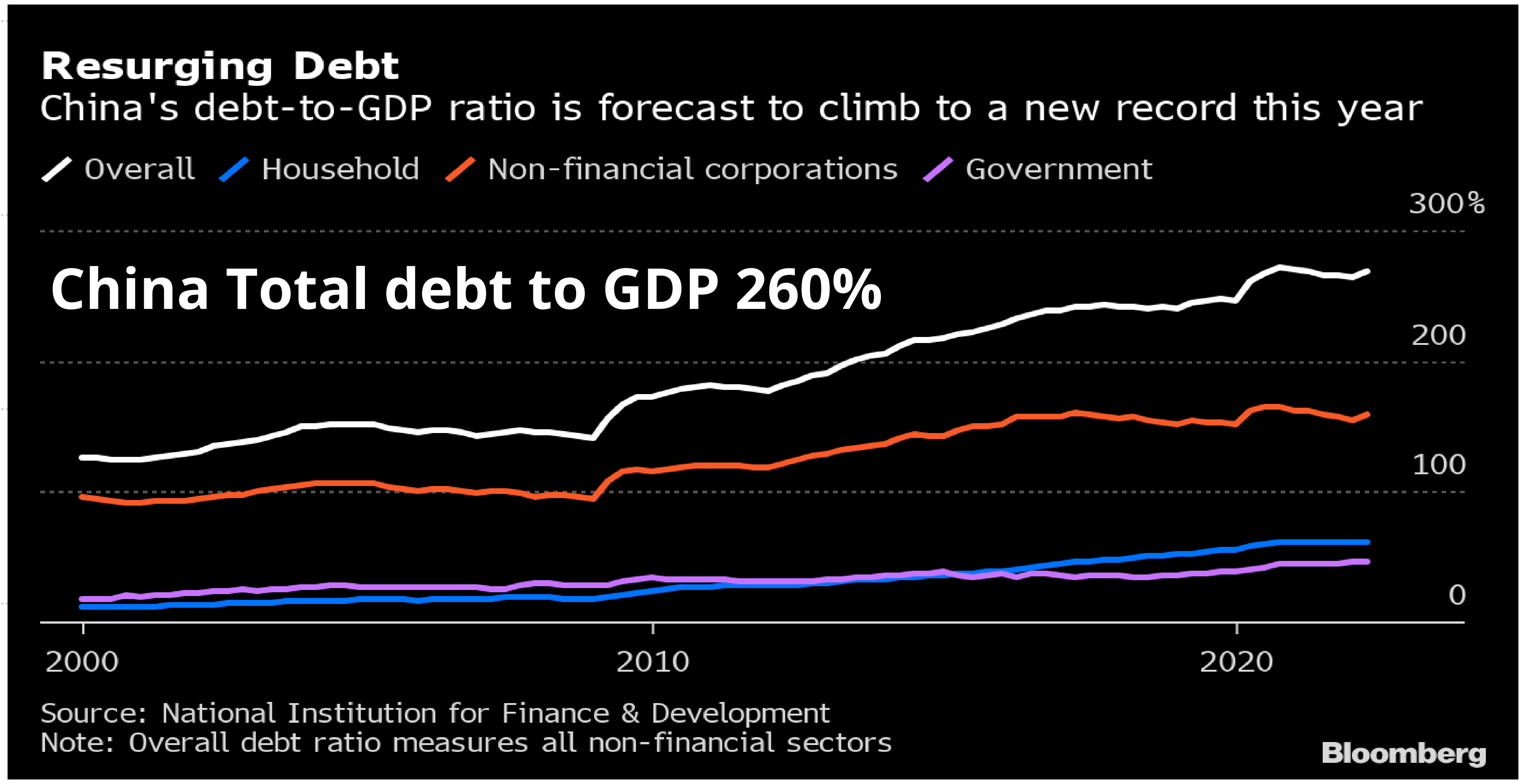
Government debt



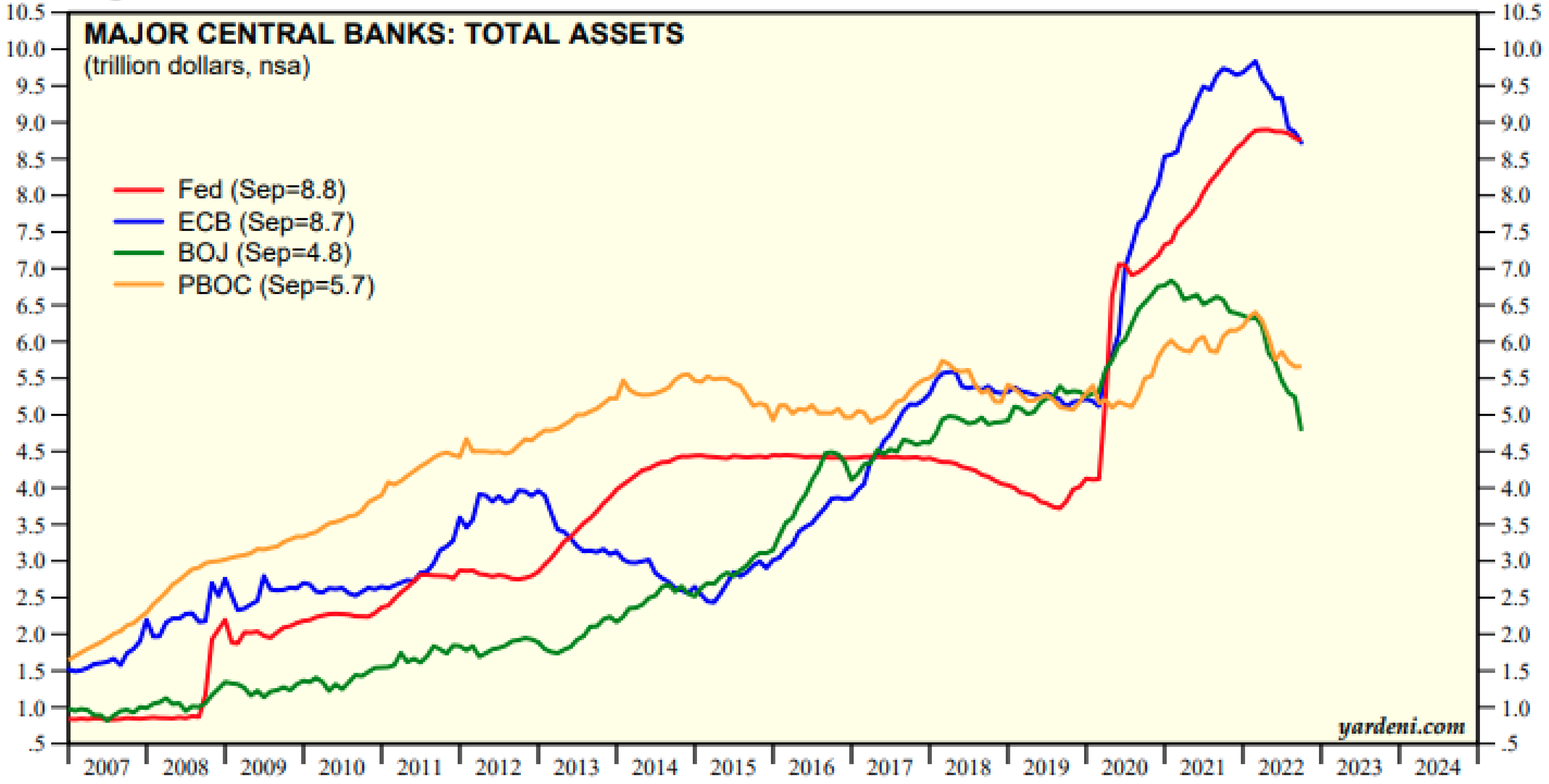




Central Bank Balance sheets

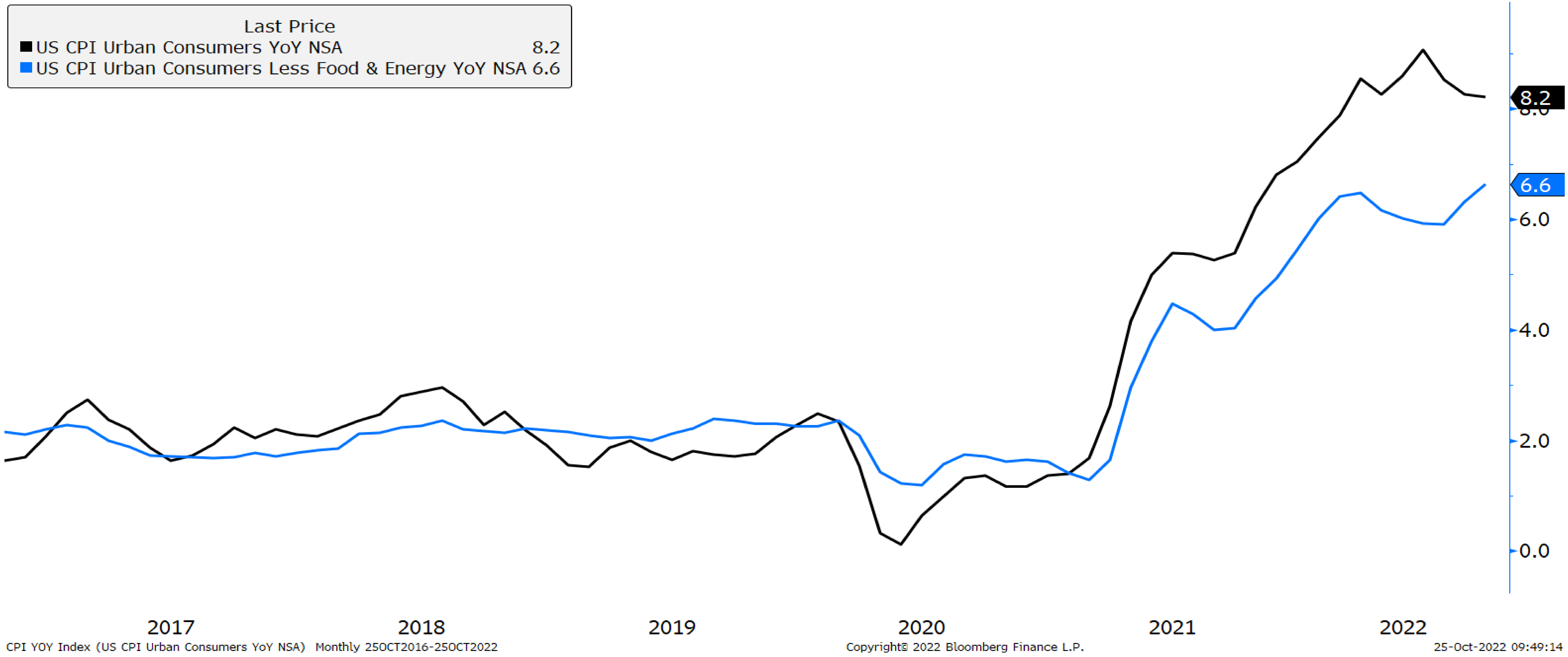
Total Assets of Major Central Banks

Figure 1.

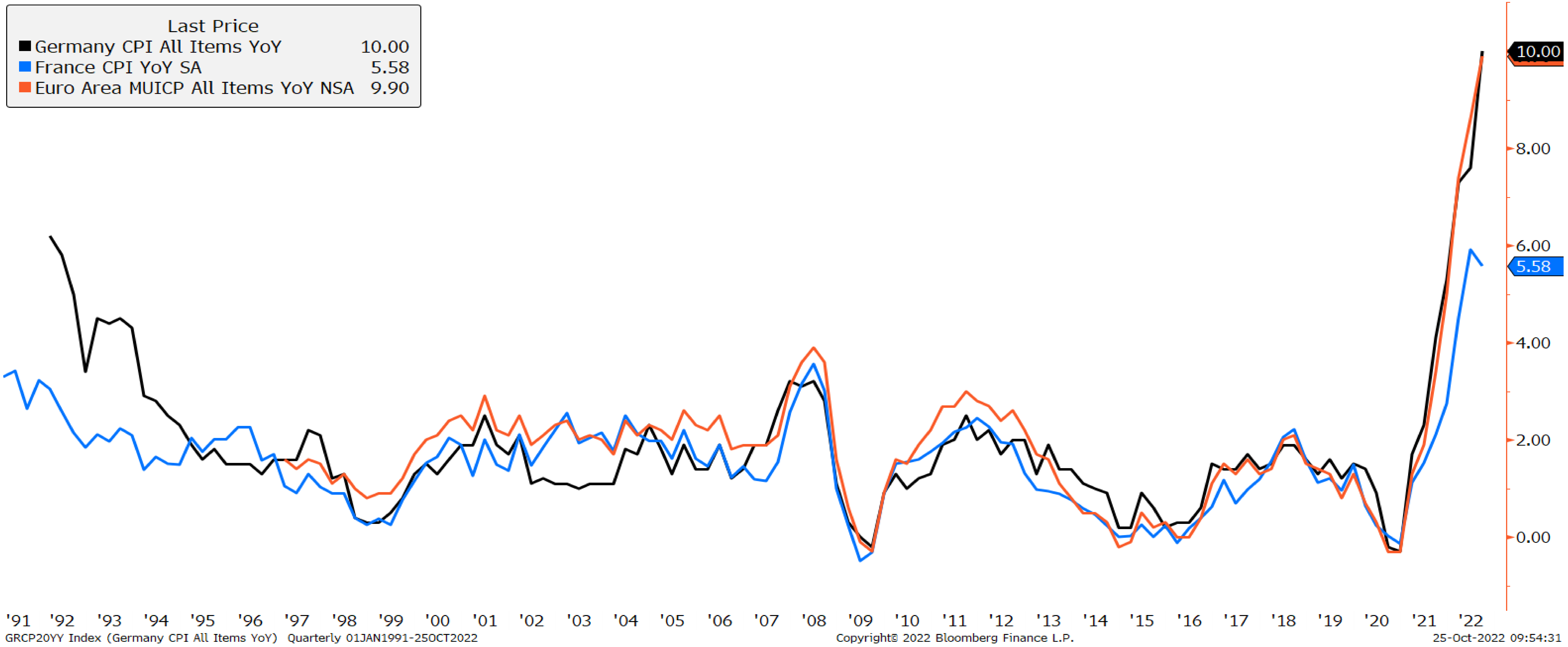


Source: Haver Analytics.

Higher than expected US CPI (Headline & Core) yet again rattled investors

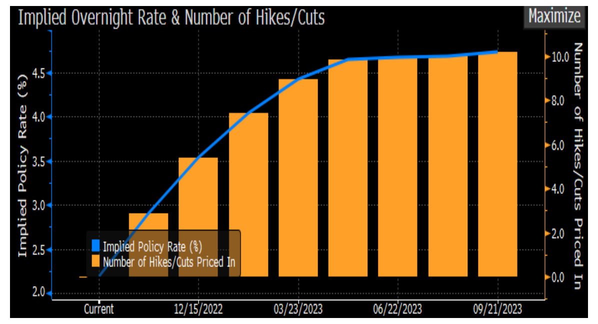


Higher than expected EU CPI (Headline & Core) also rattled investors

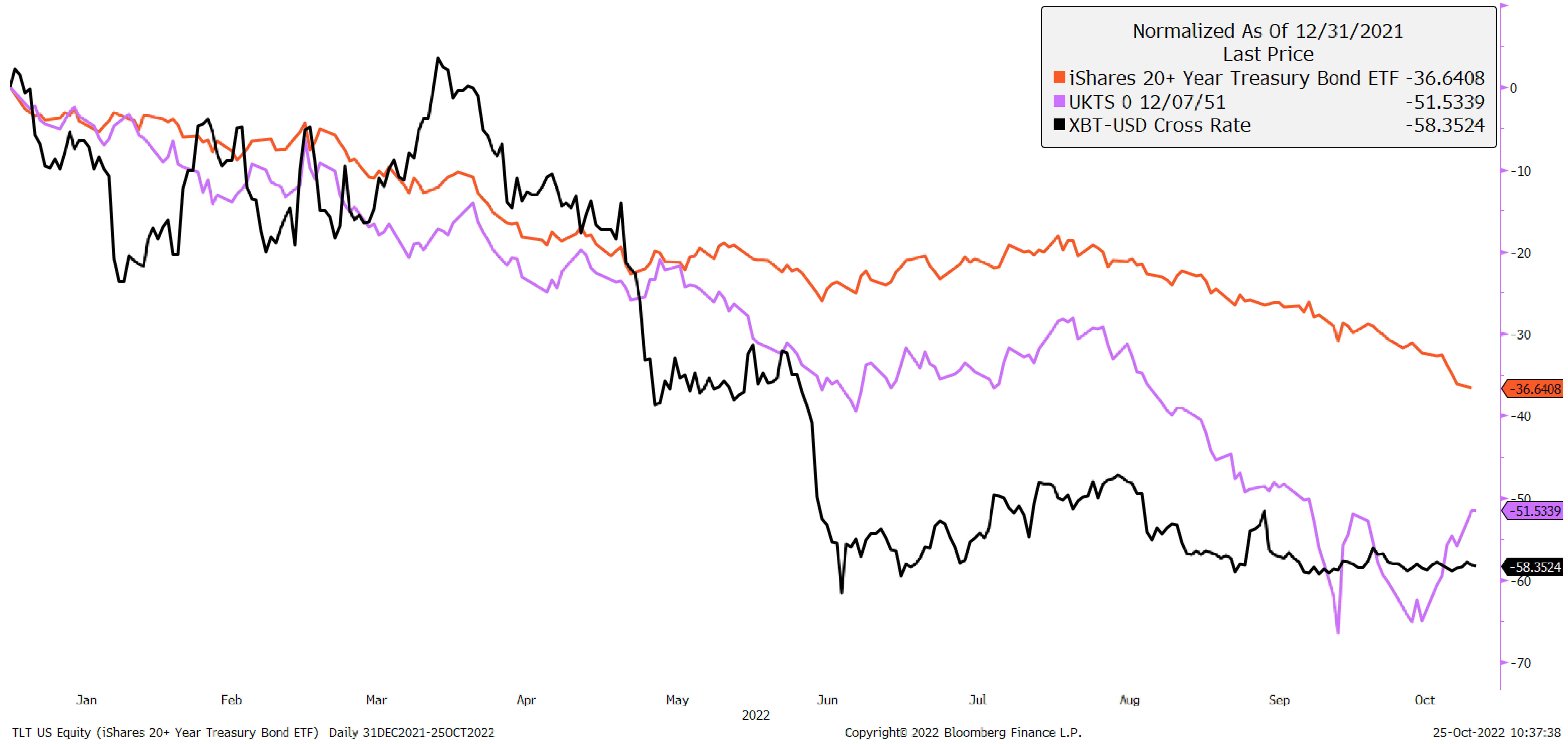


Terminal CB rates have moved higher

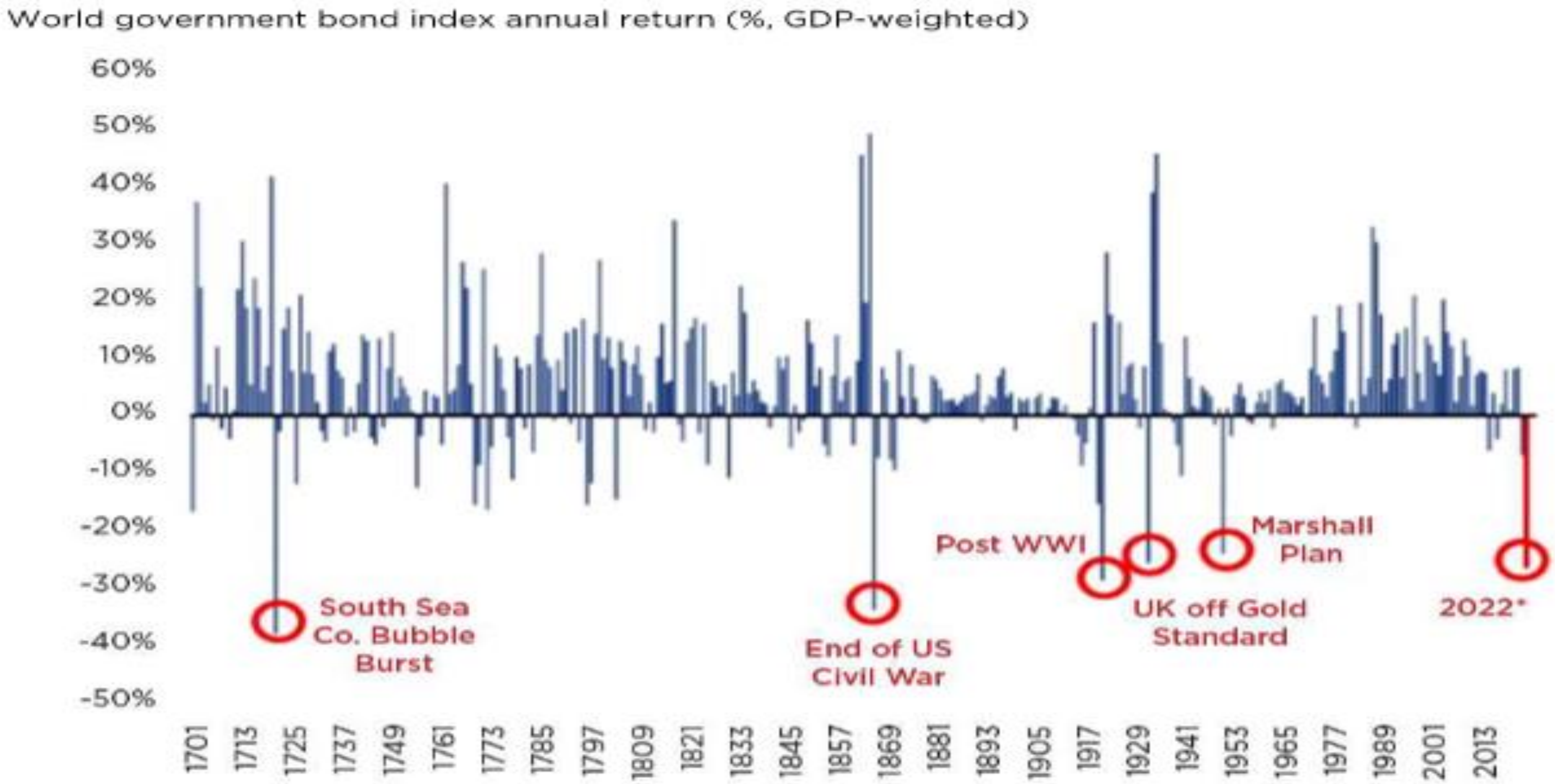
Put these graphics in



Bond market under unprecedented pressure

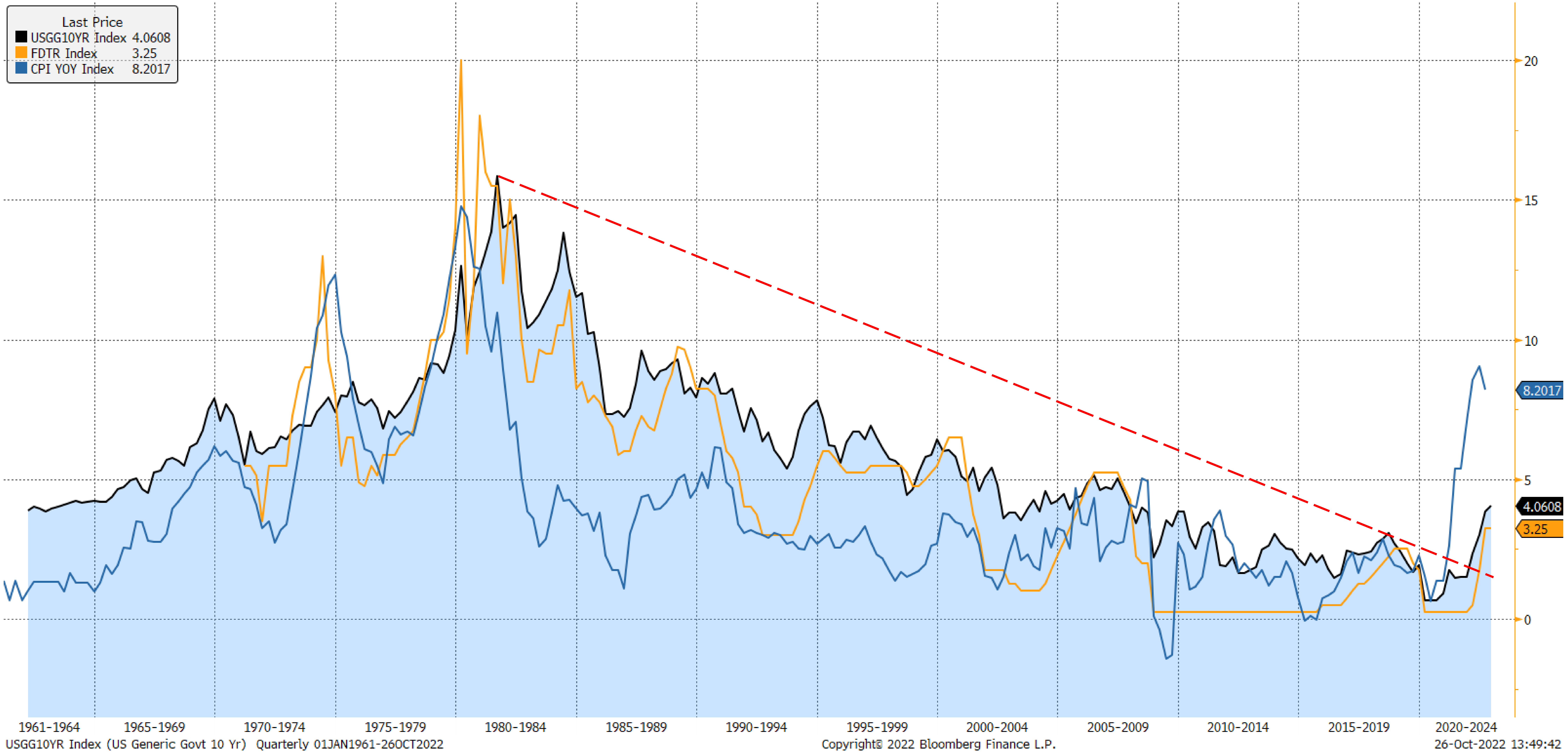


Long Bonds = Pain Trade of 2022
Offered zero hedge for equities



Source: *BofA Global Investment Strategy, GFD Finaeon. 2022 annualized as of end of September.*

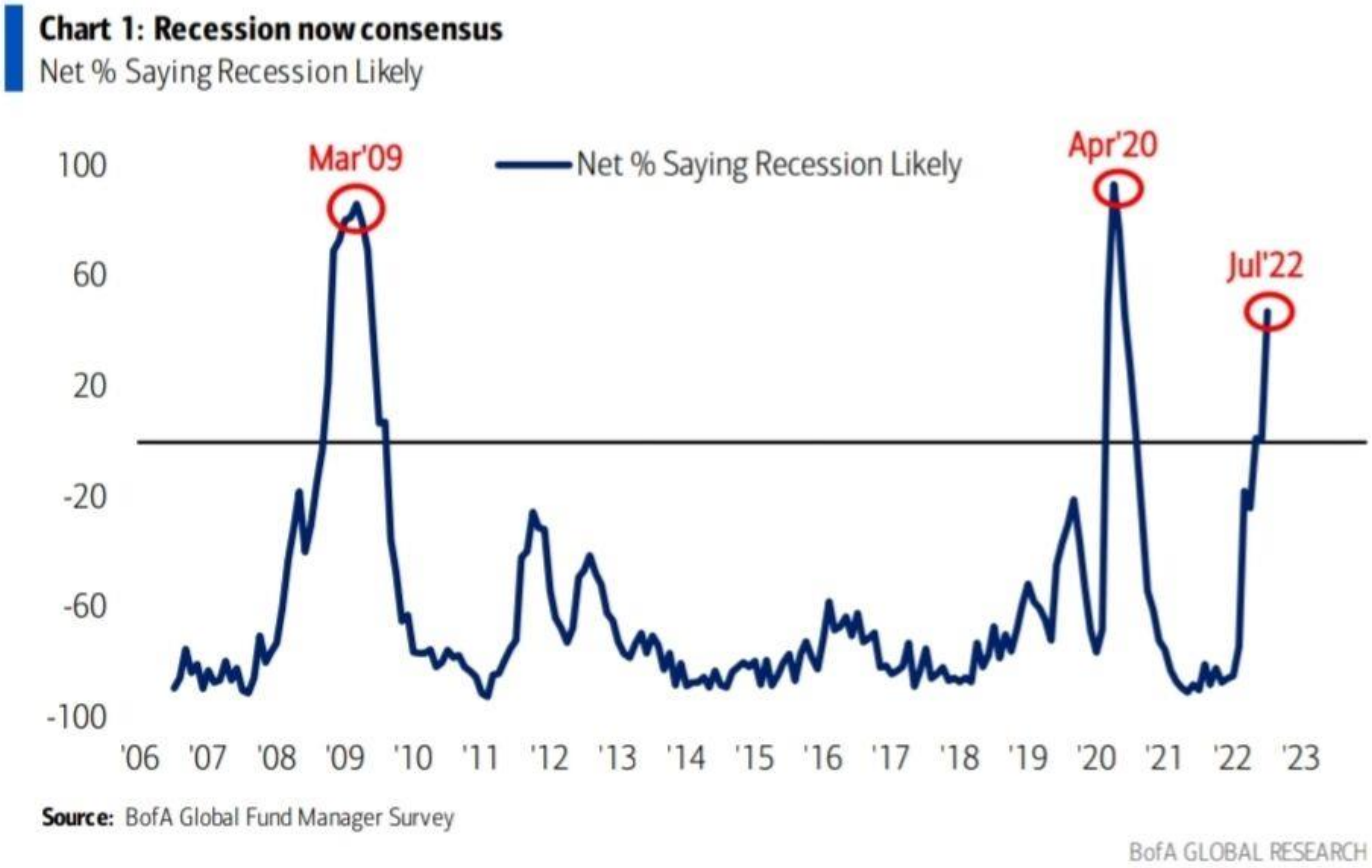
Are we at a turning point in inflation and yields?



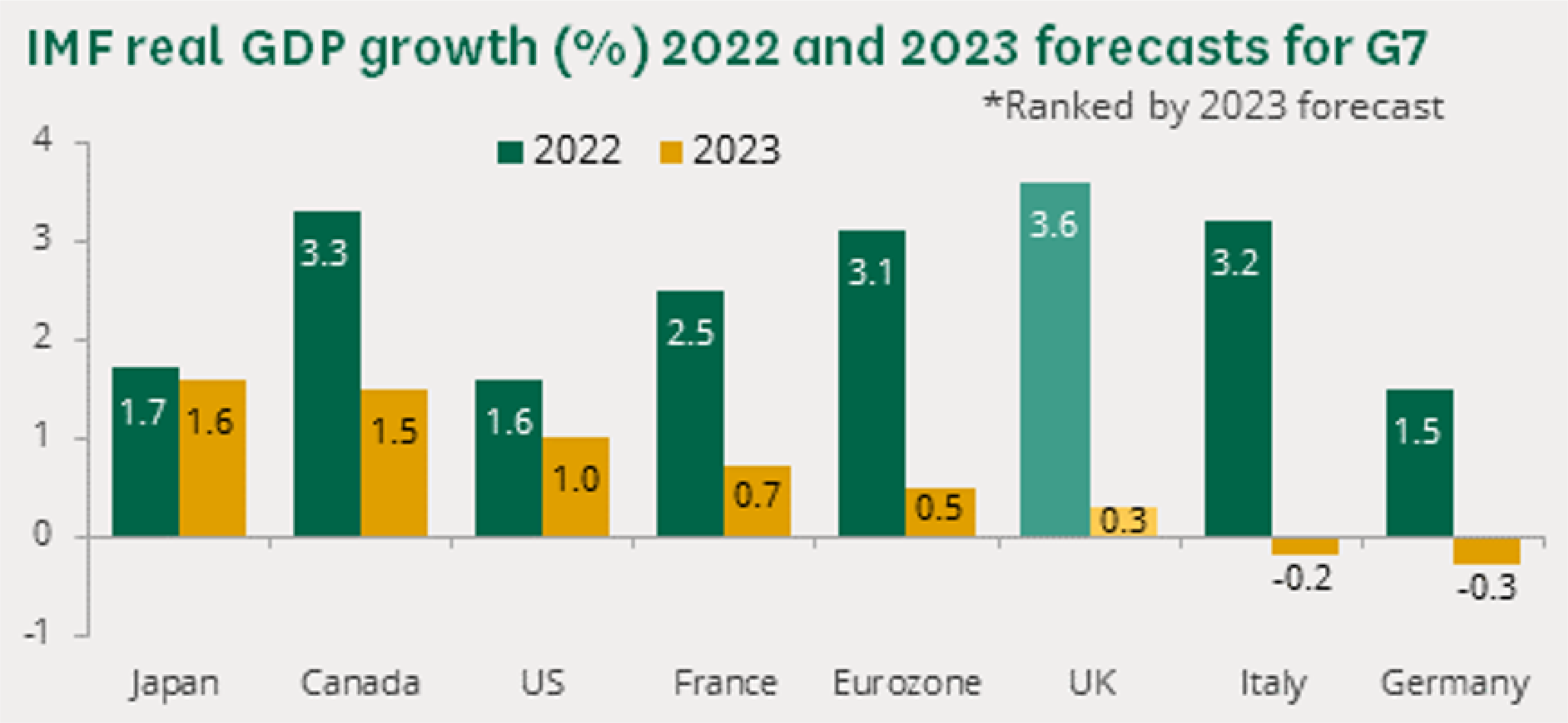
FX market turmoil with USD continuing to strengthen

Chart of DXY for the last 50 yrs or so

Recession is now consensus



Economic forecasts have declined



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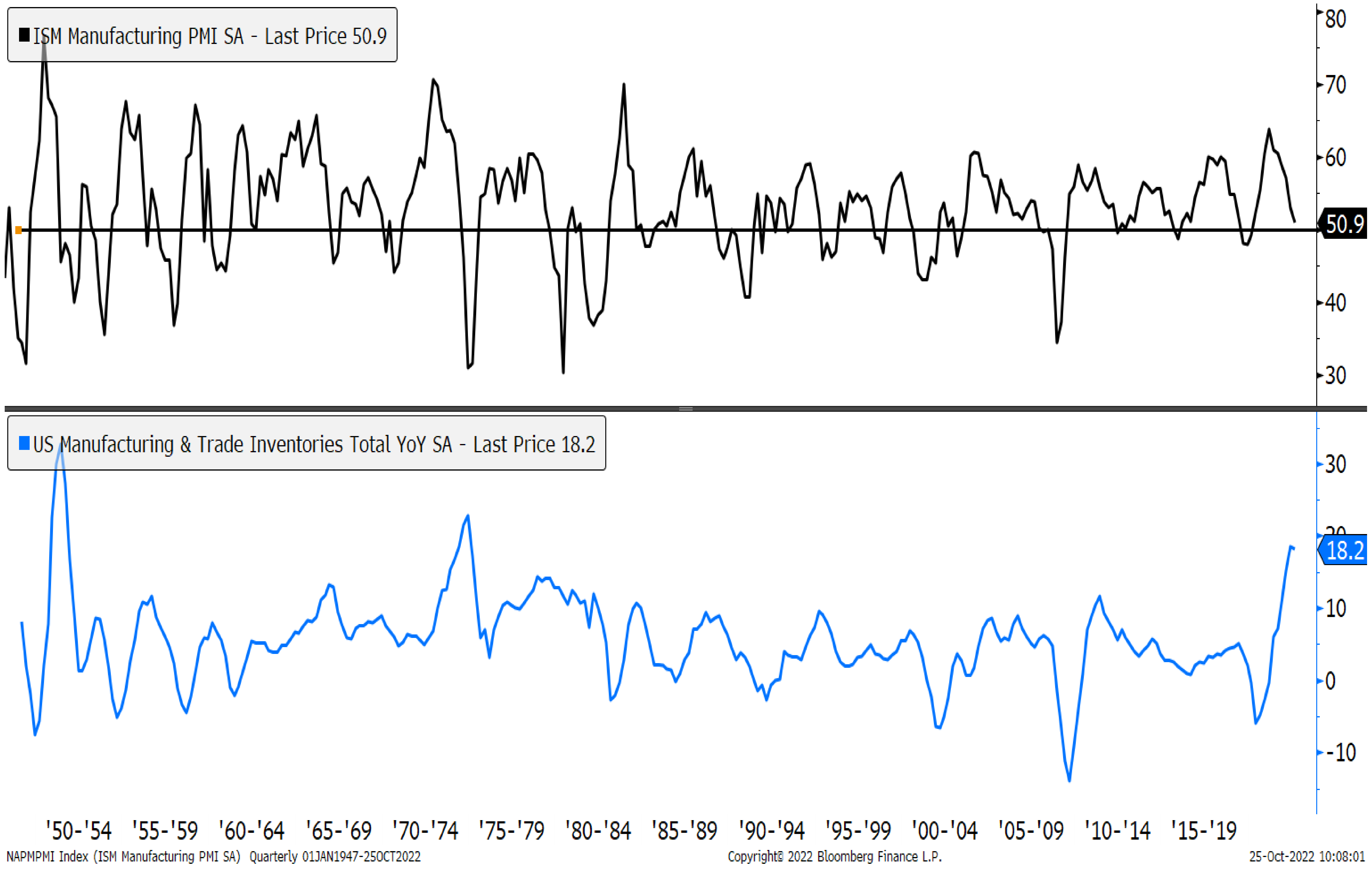
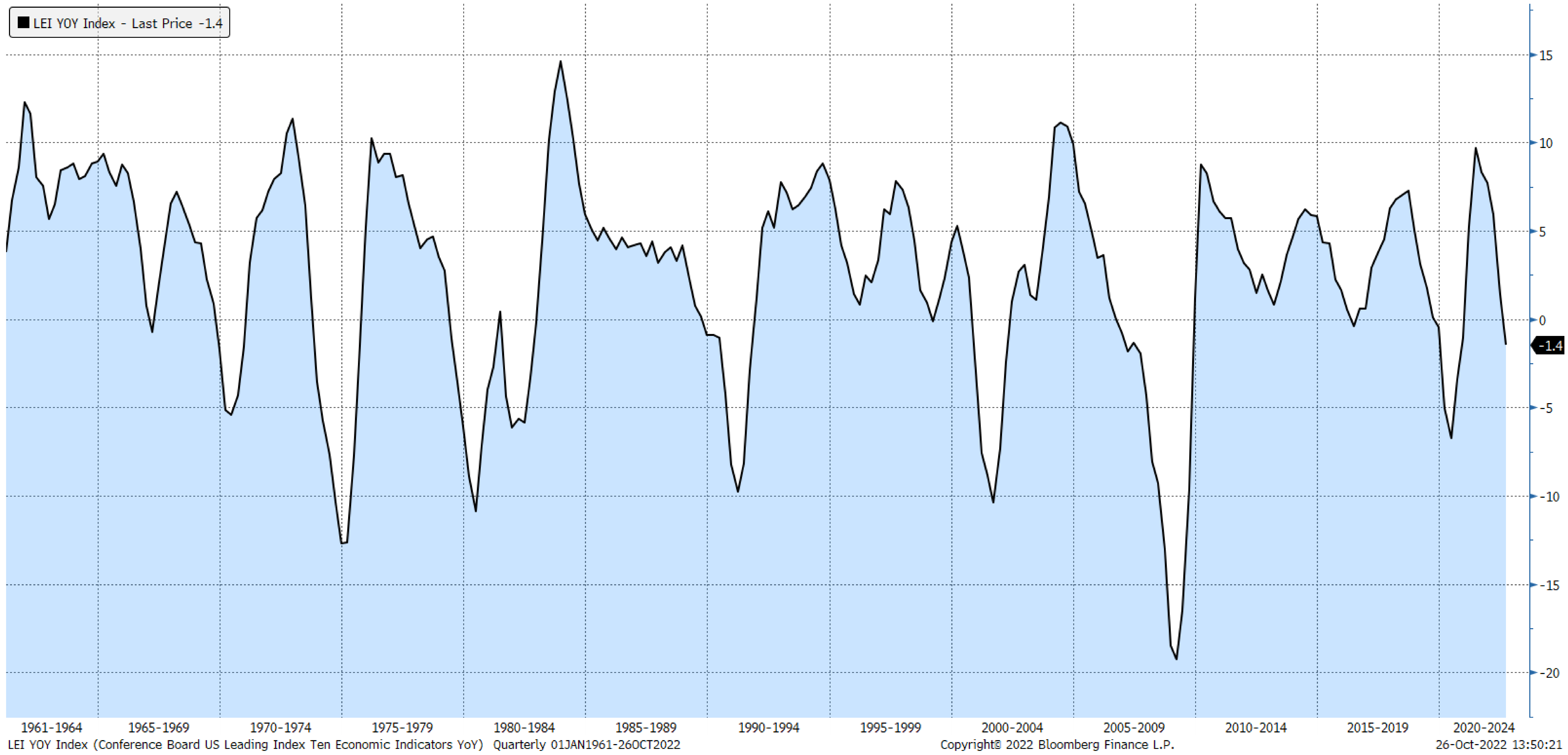
Economic Data in US continues to weaken, and we expect it to weaken further in 2H22 and 2023



ISM weakening

Manufacturing and Trade Inventory building up

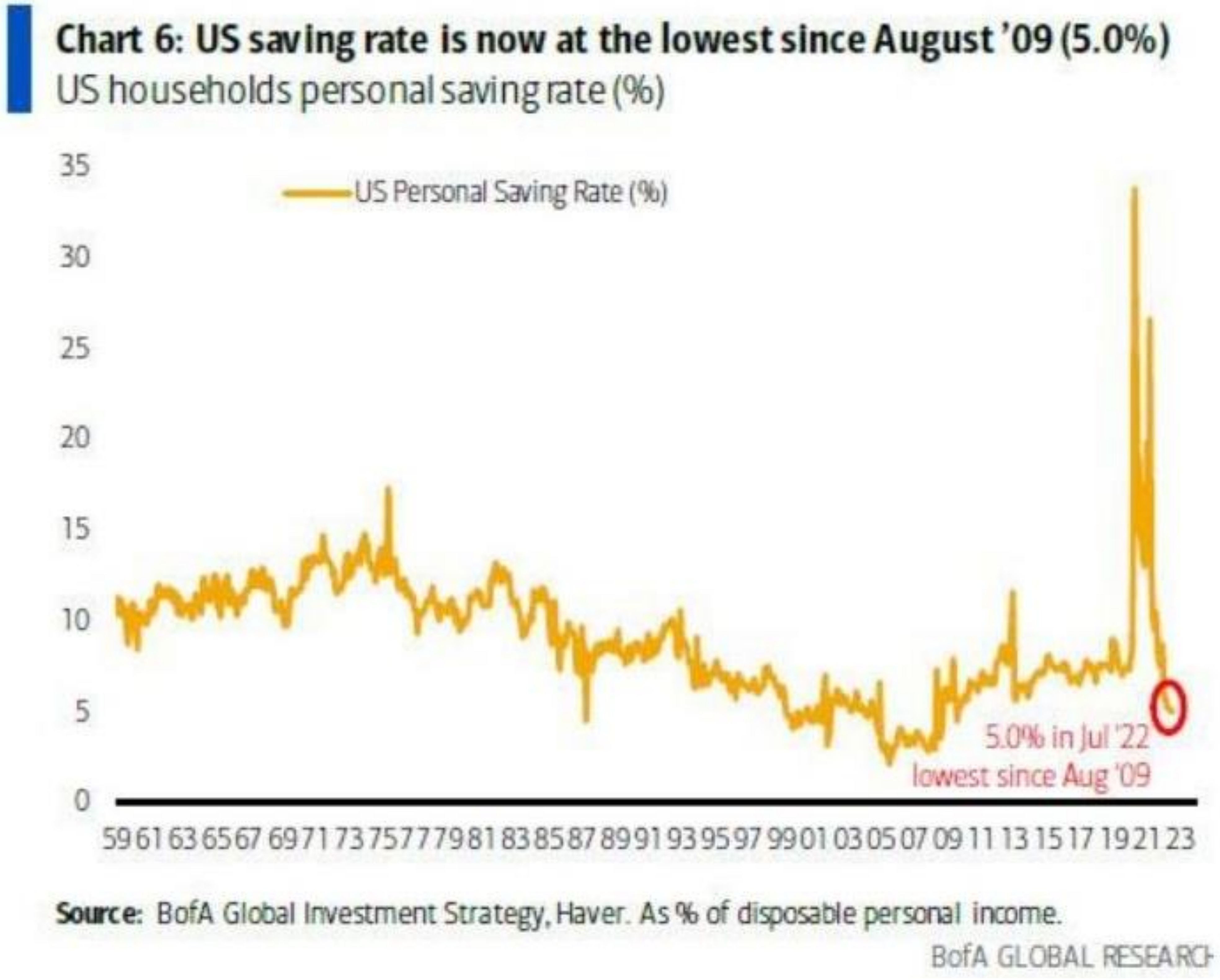
Conference board leading economic index

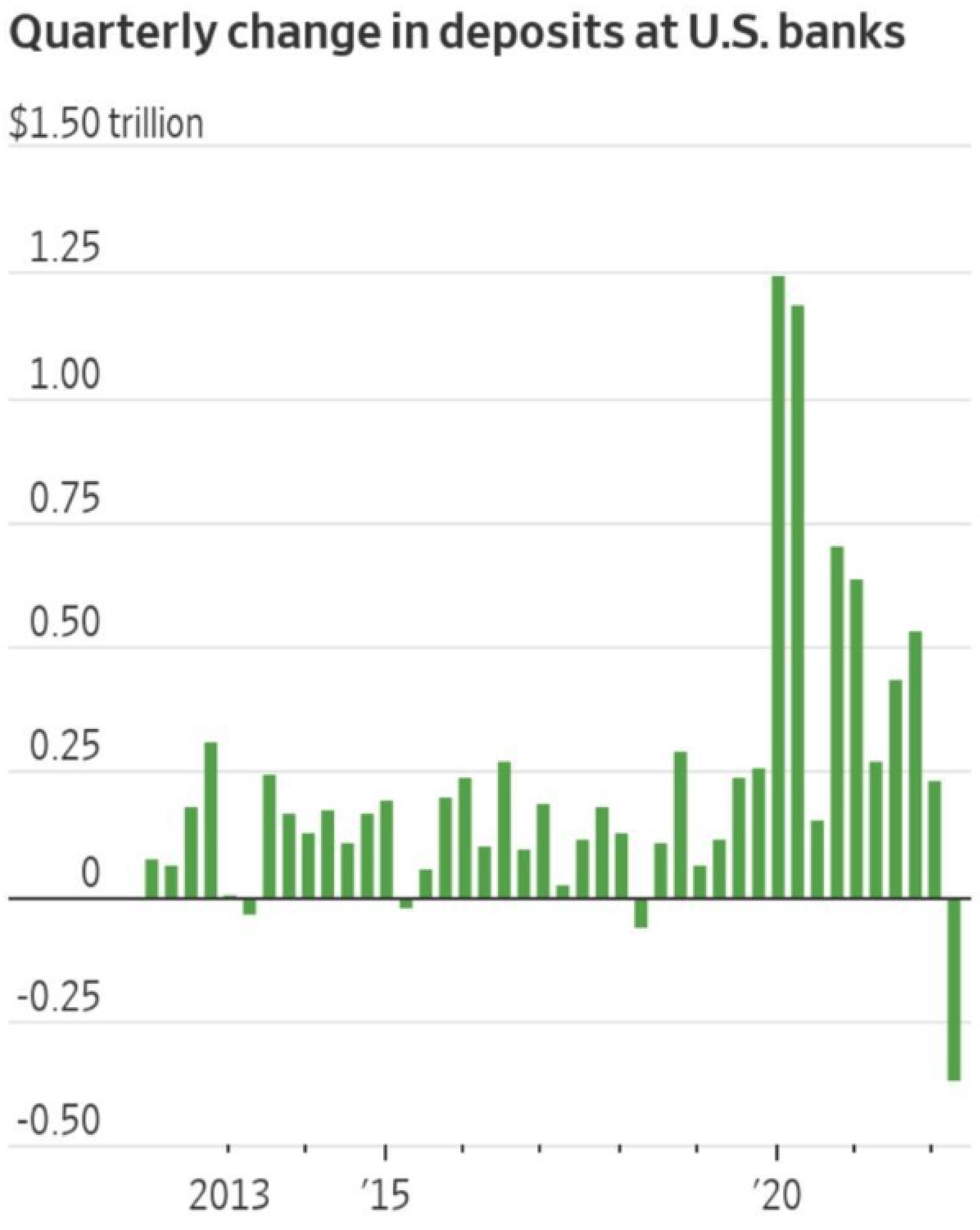


Economic Data in EU continues to weaken, and we expect it to weaken further in 2H22 and 2023

PMI weakening

Stimulus driven high savings are evaporating in this current high inflation environment

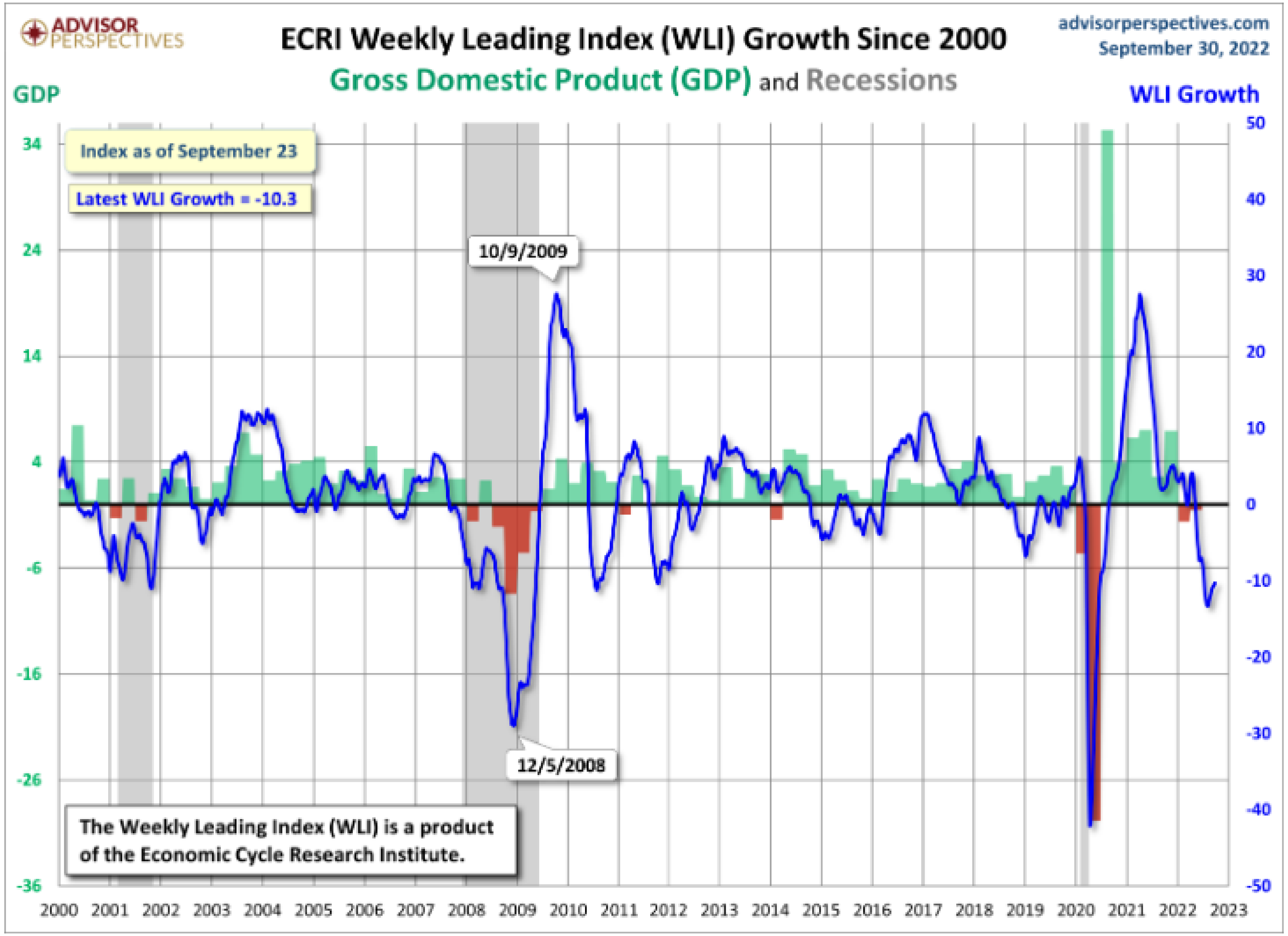




Source: Federal Deposit Insurance Corp.

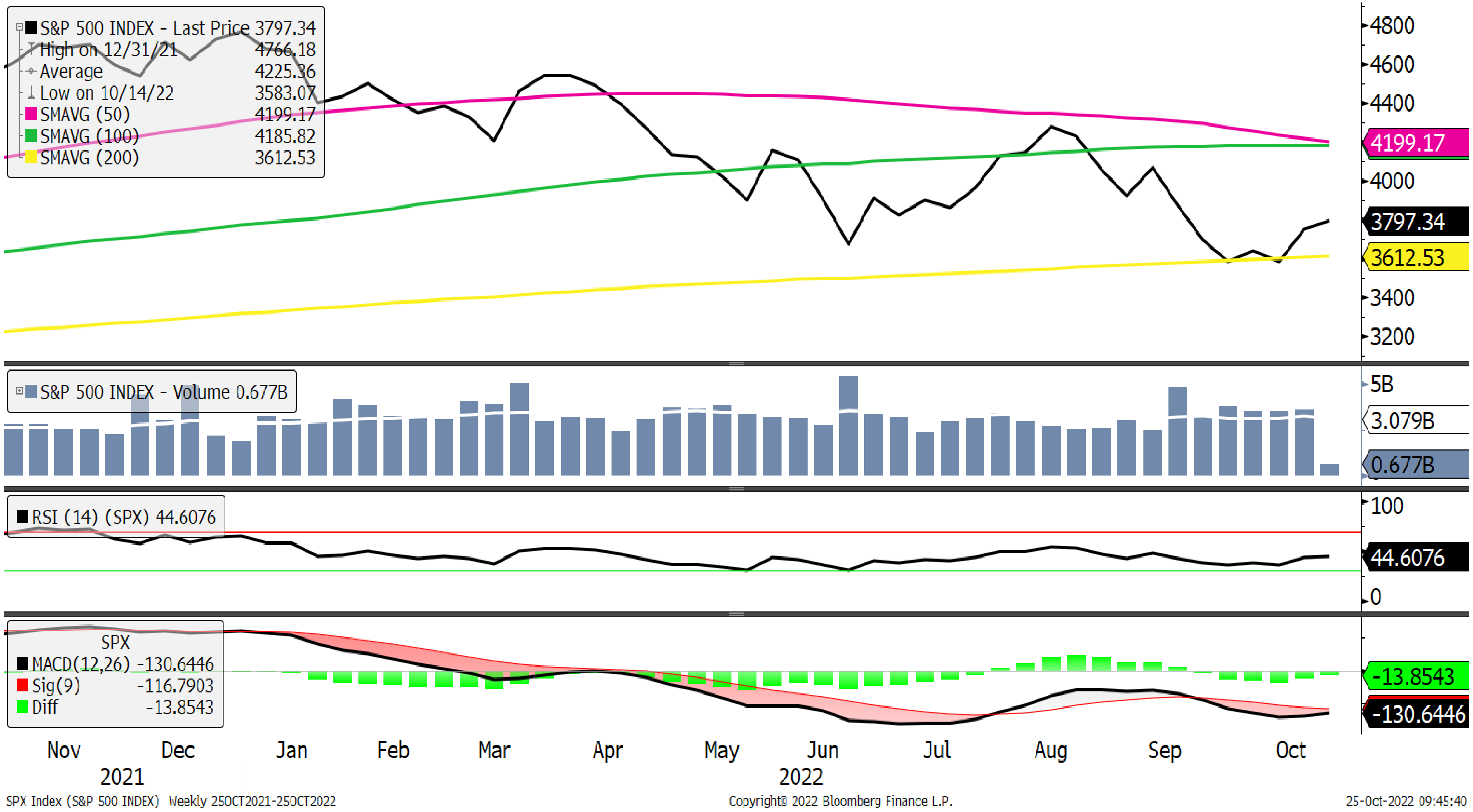
2-10 curve inversion – Deeply inverted

ECRI Leading indicator



So, what does the future hold for the main asset classes?????

The S&P 500 found support at its 200wma



Can expect a bounce at these levels Before falling lower?

In prior bear markets, the 200dma historically serves as resistance

Update following my comments in report

Average bear market = 30% in S&P
S&P down 25% as at end Sept

S&P 500 Bear Markets Since 1950

Peak	Trough	%Decline	# of Days	Breakeven	# of Days	Years
7/15/1957	10/22/1957	-20.7%	99	9/16/1958	329	0.9
12/12/1961	6/26/1962	-28.0%	196	9/3/1963	434	1.2
2/9/1966	10/7/1966	-22.2%	240	5/4/1967	209	0.6
11/29/1968	5/26/1970	-36.1%	543	3/6/1972	650	1.8
1/11/1973	10/3/1974	-48.2%	630	7/17/1980	2114	5.8
9/21/1976	3/6/1978	-19.4%	531	8/15/1979	527	1.4
11/28/1980	8/12/1982	-27.1%	622	11/3/1982	83	0.2
8/25/1987	12/4/1987	-33.5%	101	7/26/1989	600	1.6
7/16/1990	10/11/1990	-19.9%	87	2/13/1991	125	0.3
7/17/1998	8/31/1998	-19.3%	45	11/23/1998	84	0.2
3/24/2000	10/9/2002	-49.1%	929	5/30/2007	1694	4.6
10/9/2007	3/9/2009	-56.8%	517	3/28/2013	1480	4.1
4/29/2011	10/3/2011	-19.4%	157	2/24/2012	144	0.4
9/20/2018	12/24/2018	-19.8%	95	4/23/2019	120	0.3
2/19/2020	3/23/2020	-33.9%	33	8/18/2020	181	0.5
Averages		-30.2%	338		603	1.7

Equity Risk/Reward at least at the index level remains unattractive in our view

Equity risk/reward should negative earnings revisions accelerate

Severity of 2023 recession	Upside/Downside		2022 EPS Cut- Consensus $223 EPS as on 10/10/2022					
	Spot SPX - 3588		-15%	-10%	-5%	0%	5%	10%
	Spot Fwd PE - 15x		189.6	200.7	211.9	223.0	234.2	245.3
	2023 EPS Cut	10%	-18.1%	-13.3%	-8.5%	-3.7%	1.2%	6.0%
Mild	2023 EPS Cut	5%	-20.8%	-16.1%	-11.4%	-6.8%	-2.1%	2.6%
Mild	2023 EPS Cut	0%	-23.4%	-18.9%	-14.4%	-9.9%	-5.4%	-0.9%
Severe	2023 EPS Cut	-5%	-26.0%	-21.7%	-17.3%	-13.0%	-8.6%	-4.3%
Severe	2023 EPS Cut	-10%	-28.7%	-24.5%	-20.3%	-16.1%	-11.9%	-7.7%
Like '02 & '08	2023 EPS Cut	-15%	-31.3%	-27.3%	-23.2%	-19.2%	-15.2%	-11.1%

		S&P 500 2022 Target (Spot - 3588 on 10/10/2022)					
	2023 EPS Growth	-15%	-10%	-5%	0%	5%	10%
	2023 EPS	189.6	200.7	211.85	223	234.15	245.3
Fwd PE Ratio	15.5	2938	3111	3284	3457	3629	3802
Fwd PE Ratio	15.0	2843	3011	3178	3345	3512	3680
Fwd PE Ratio	14.5	2748	2910	3072	3234	3395	3557
Fwd PE Ratio	14.0	2654	2810	2966	3122	3278	3434
Fwd PE Ratio	13.5	2559	2709	2860	3011	3161	3312
Fwd PE Ratio	13.0	2464	2609	2754	2899	3044	3189
Fwd PE Ratio	12.5	2369	2509	2648	2788	2927	3066

Note - The above analysis is based on the assumption of 2022 EPS meeting the current consensus of $223

If the S&P multiple falls to 15x and earnings growth falls by 5% for 2023 this would equate to an S&P of 3178 (11% downside from its current level).

Similarly, if we have a 10% fall off in earnings for 2023 and the market multiple falls to 13, this would equate to an S&P of 2609 (27% downside from its current level).

This is not a forecast, just a reflection of where the S&P could go based on its sensitivities to valuation multiple and earnings.

S&P has sold off but is not at cheap levels yet

S&P 500 valuation measures

S&P 500 Index: Forward P/E ratio

Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	15.15x	16.84x	-0.50
CAPE	Shiller's P/E	27.15x	27.97x	-0.13
Div. Yield	Dividend yield	1.90%	1.99%	0.26
P/B	Price to book	3.18x	3.10x	0.10
P/CF	Price to cash flow	11.51x	11.18x	0.15
EY Spread	EY minus Baa yield	0.57%	0.24%	-0.17

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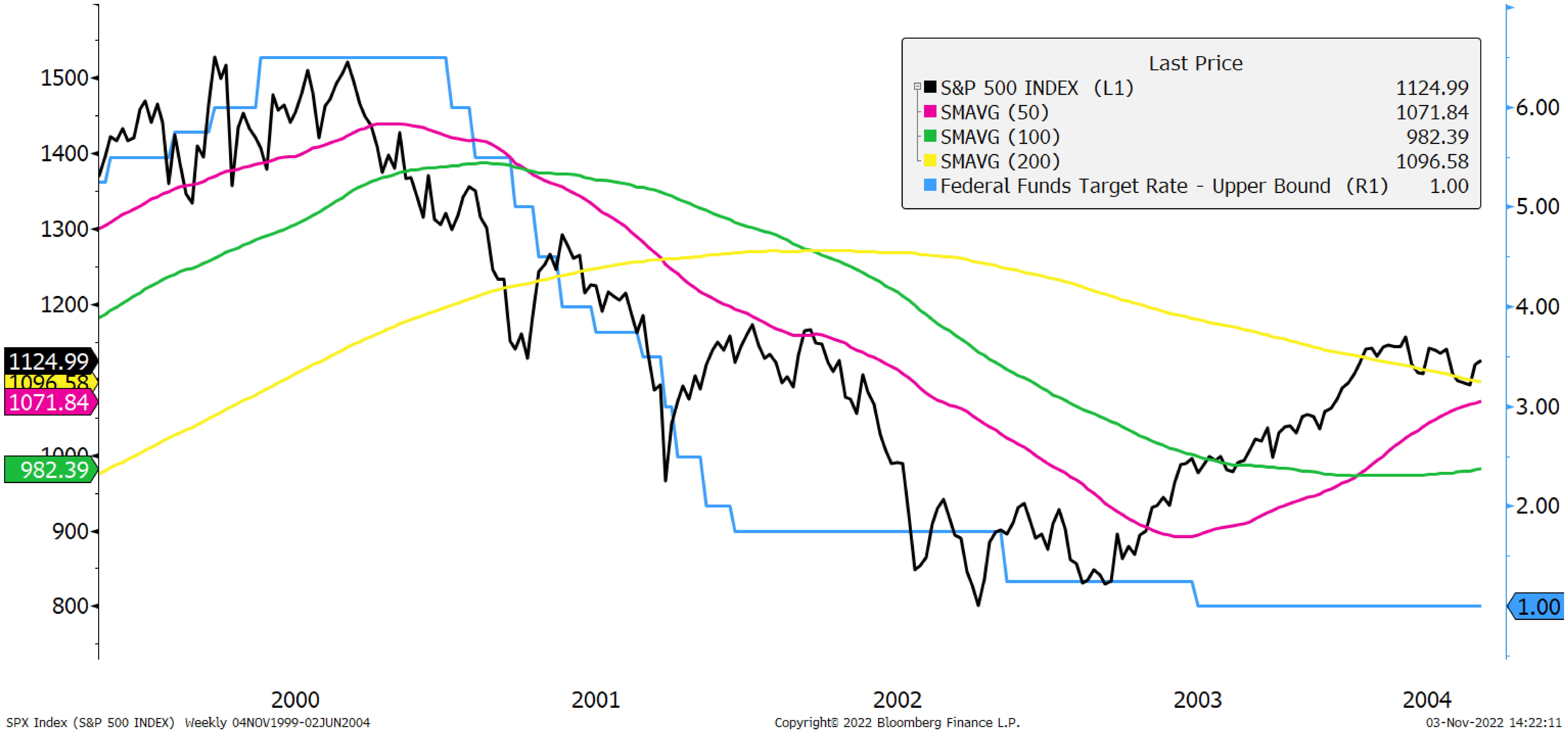
Equities may not rally on pivot if slowdown entrenched



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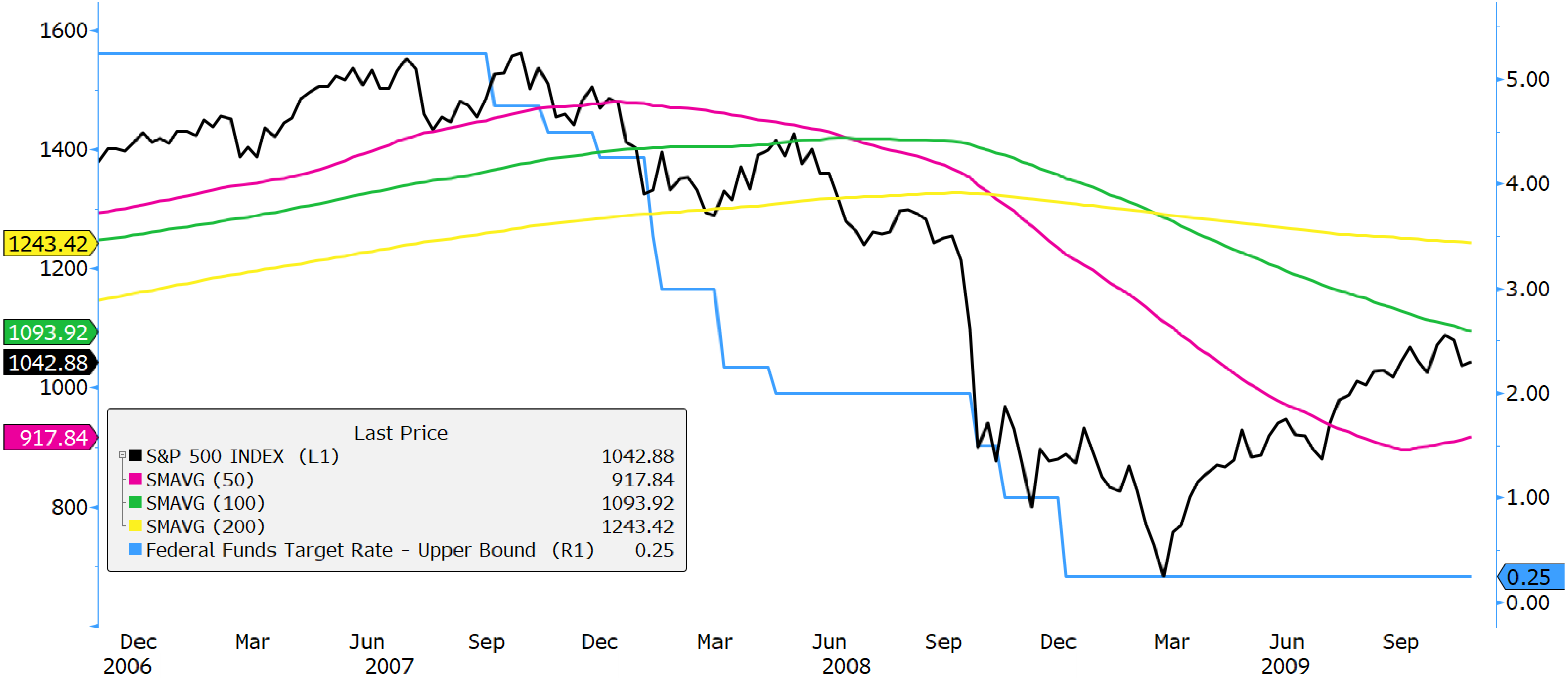

SPX Index (S&P 500 INDEX) Weekly 04NOV2006-02NOV2009

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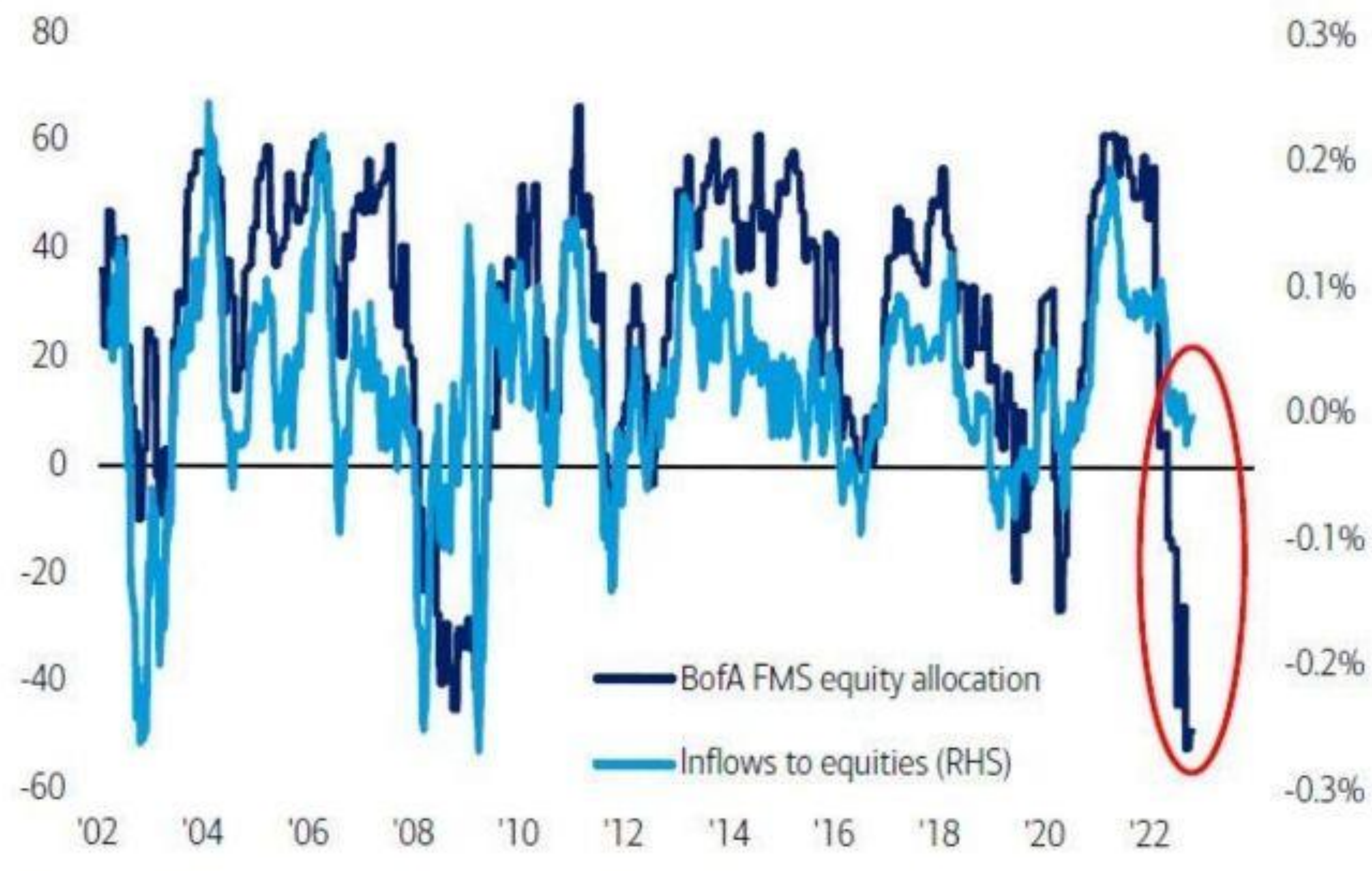
No Capitulation in Equities "yet"

EPS revisions key before capitulation

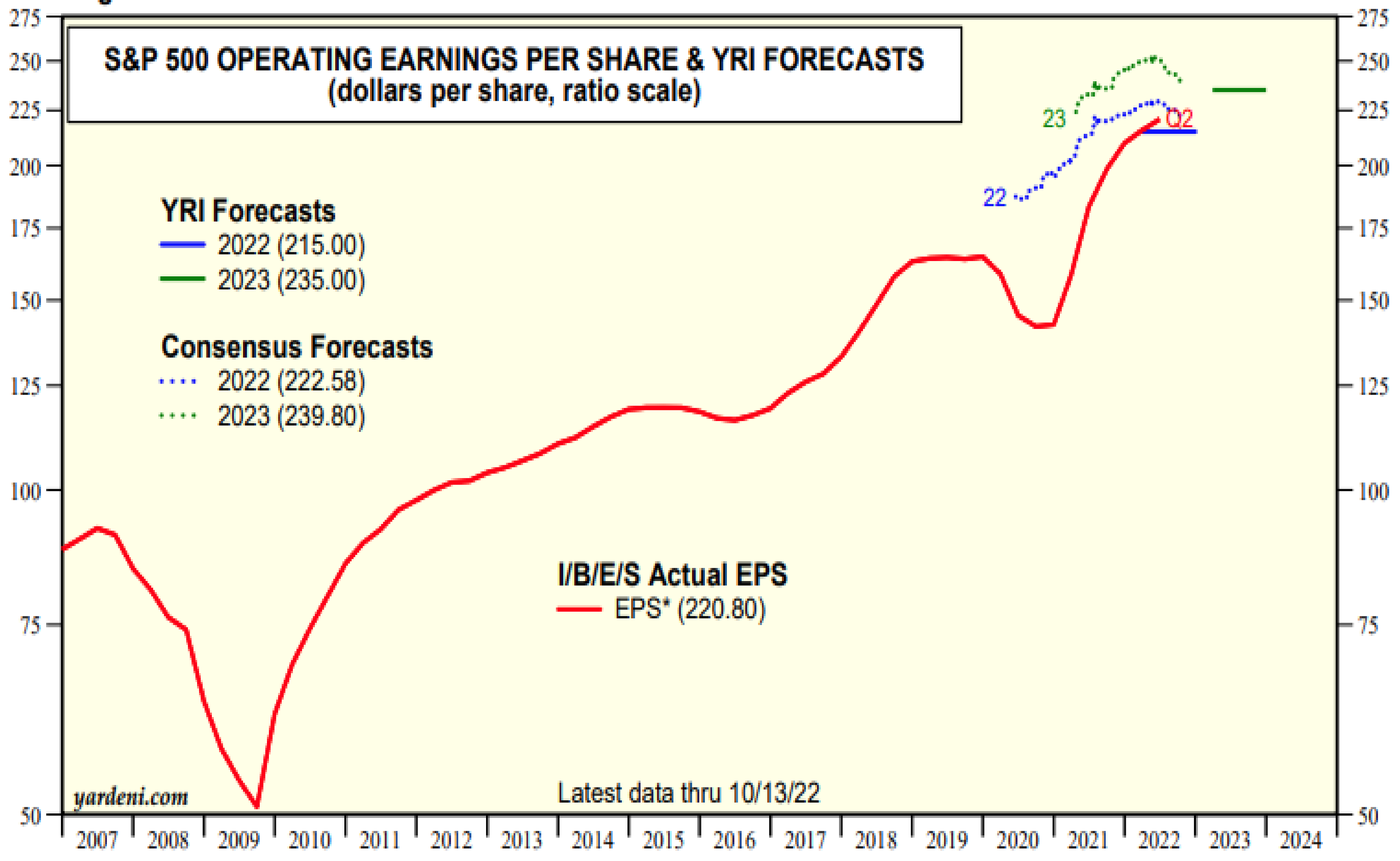
Chart 5: Big BofA FMS equity UW yet no final capitulation equity flows
FMS net % OW equities vs Inflows to equities (12wk MA % of AUM)



Source: BofA Global Investment Strategy, Bloomberg.

BofA GLOBAL RESEARCH

Figure 2.



* Four-quarter trailing sum of operating earnings per share.
Source: I/B/E/S data by Refinitiv.

Late Cycle dynamics at play – hence like Healthcare and Cash

S&P 500 sector excess price return relative to the S&P 500 Index

Position of economic cycle (ISM Manufacturing Index)	S&P 500 Materials	S&P 500 Industrials	S&P 500 Consumer discretionary	S&P 500 Financials	S&P 500 Information technology	S&P 500 Energy	S&P 500 Health care	S&P 500 Consumer staples	S&P 500 Utilities	S&P 500 Real estate
Early cycle	0.760%	0.144%	0.964%	0.513%	1.659%	-1.464%	-1.020%	-0.554%	-1.433%	-1.243%
	0.110%	0.142%	0.027%	0.682%	-0.533%	0.516%	0.119%	-0.206%	-0.439%	0.603%
Mid cycle	0.301%	0.131%	0.120%	-0.100%	1.477%	-0.133%	-0.504%	-0.643%	-1.371%	-0.349%
	-0.509%	0.340%	-0.075%	-0.452%	0.692%	-0.213%	-0.184%	-0.285%	1.280%	0.562%
Late cycle	-0.666%	-0.140%	0.249%	-0.014%	0.515%	-0.042%	0.620%	0.314%	0.152%	0.486%
	-0.276%	-0.095%	-0.095%	-0.490%	-0.818%	0.317%	1.524%	1.440%	0.267%	-0.539%

Fed Cycle - Dec 2015 - Dec 2018

	3M	6M	1Yr
Start	01/01/2019	01/01/2019	01/01/2019
End	01/04/2019	30/06/2019	01/01/2020
S&P 500 ENERGY INDEX	18.0%	13.1%	11.8%
S&P 500 MATERIALS INDEX	11.9%	17.3%	24.6%
S&P 500 INDUSTRIALS IDX	19.6%	21.4%	29.3%
S&P 500 CONS DISCRET IDX	17.1%	21.8%	27.9%
S&P 500 CONS STAPLES IDX	11.8%	16.2%	27.6%
S&P 500 HEALTH CARE IDX	6.8%	8.1%	20.8%
S&P 500 FINANCIALS INDEX	11.2%	17.2%	32.1%
S&P 500 INFO TECH INDEX	21.5%	27.1%	50.3%
S&P 500 UTILITIES INDEX	10.1%	14.7%	26.3%
S&P 500 COMM SVC	15.6%	19.1%	32.7%
S&P 500 REAL ESTATE IDX	17.2%	20.4%	29.0%
S&P 600 SMALLCAP INDEX	13.0%	13.7%	22.7%
S&P 400 MIDCAP INDEX	16.1%	18.0%	26.2%
MSCI US LARGE	14.8%	18.3%	31.8%
S&P 500 Value	13.7%	16.7%	31.9%
S&P 500 Growth	16.1%	20.2%	31.1%

Fed Cycle - June 2004 - June 2006

	3M	6M	1Yr
Start	01/07/2006	01/07/2006	01/07/2006
End	29/09/2006	28/12/2006	01/07/2007
S&P 500 ENERGY INDEX	-1.7%	10.3%	28.0%
S&P 500 MATERIALS INDEX	-0.6%	11.3%	29.1%
S&P 500 INDUSTRIALS IDX	-0.1%	6.4%	17.4%
S&P 500 CONS DISCRET IDX	5.0%	16.2%	19.1%
S&P 500 CONS STAPLES IDX	5.7%	9.9%	14.8%
S&P 500 HEALTH CARE IDX	10.2%	12.1%	18.6%
S&P 500 FINANCIALS INDEX	8.0%	16.3%	14.7%
S&P 500 INFO TECH INDEX	8.5%	15.4%	25.9%
S&P 500 UTILITIES INDEX	6.1%	16.0%	26.1%
S&P 500 COMM SVC	10.6%	19.8%	38.8%
S&P 500 REAL ESTATE IDX	9.7%	21.5%	11.7%
S&P 600 SMALLCAP INDEX	-0.9%	7.8%	16.0%
S&P 400 MIDCAP INDEX	-1.1%	6.6%	18.5%
MSCI US LARGE	5.7%	12.7%	18.5%
S&P 500 Value	5.3%	13.9%	21.7%
S&P 500 Growth	6.1%	12.5%	19.4%

Healthcare, Consumer Staples, Utilities and Real Estate do well late in the cycle

Technology, Consumer Discretionary, Communication and Materials have delivered good returns everytime the Fed paused rate hikes

Energy should also perform better than the market

Goldman Sachs

Sector share of S&P 500 *equity cap* since 1975

Tech accounted for 33% of S&P 500 equity capitalization at bubble peak in 2000

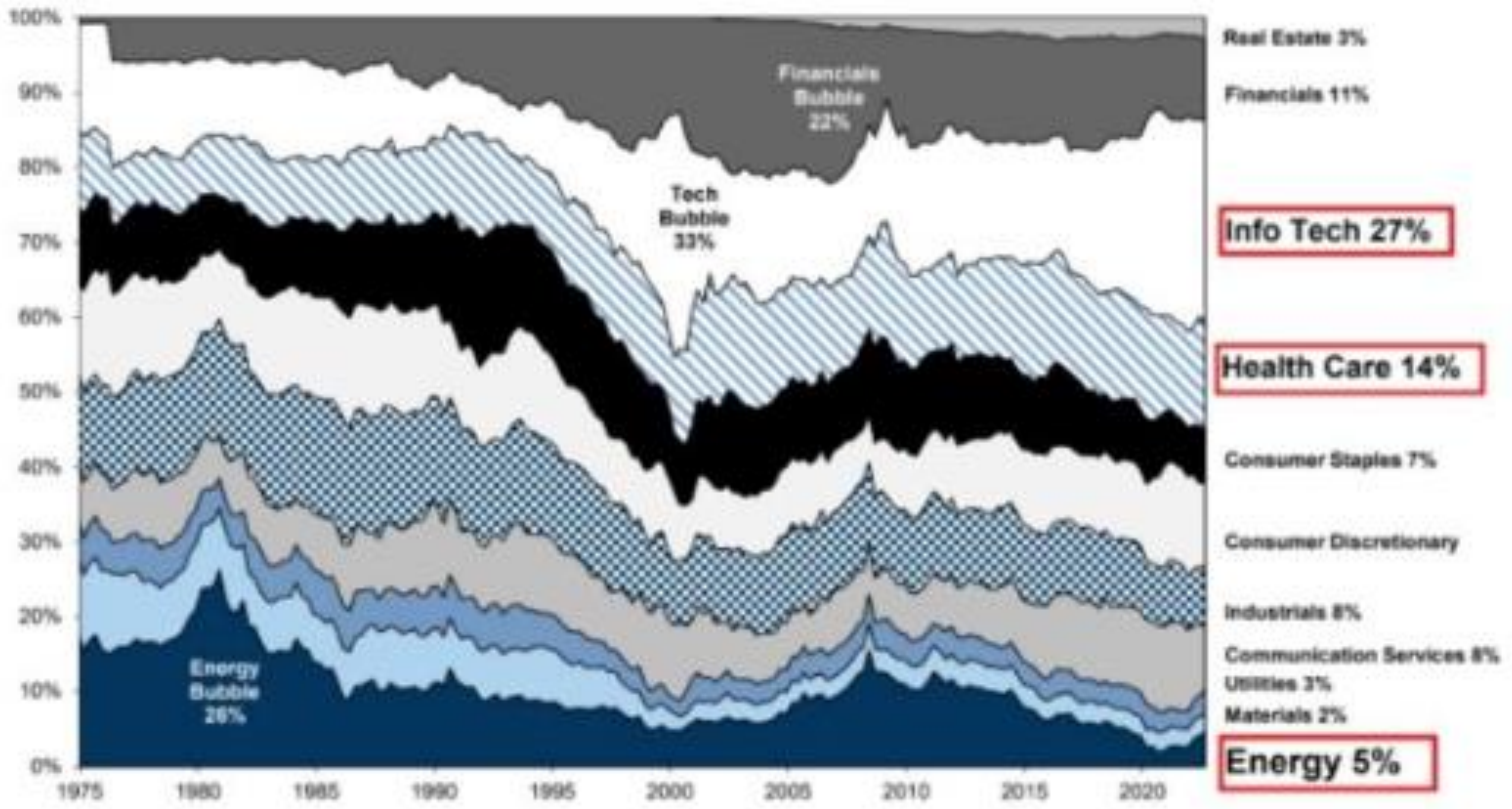
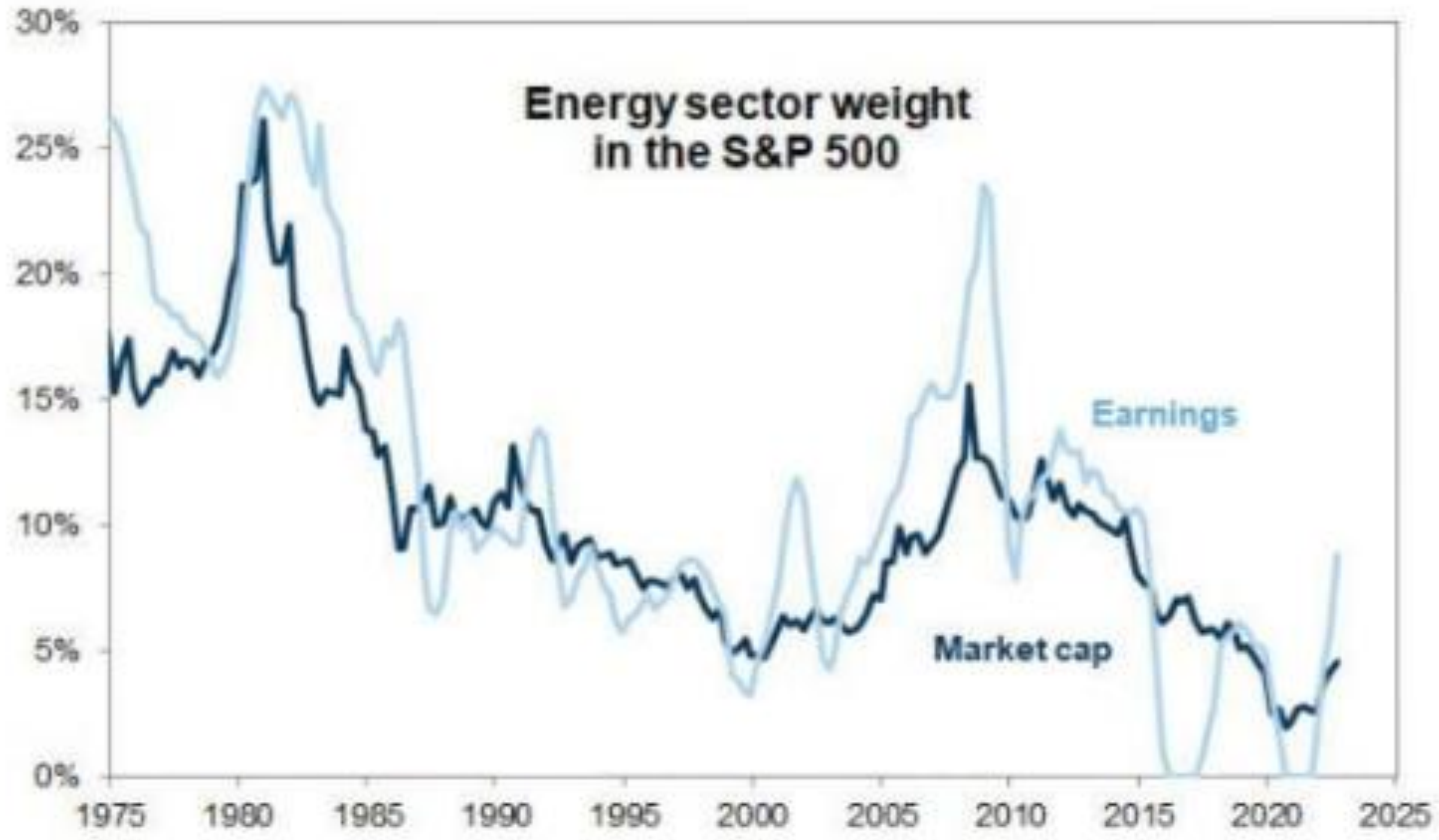


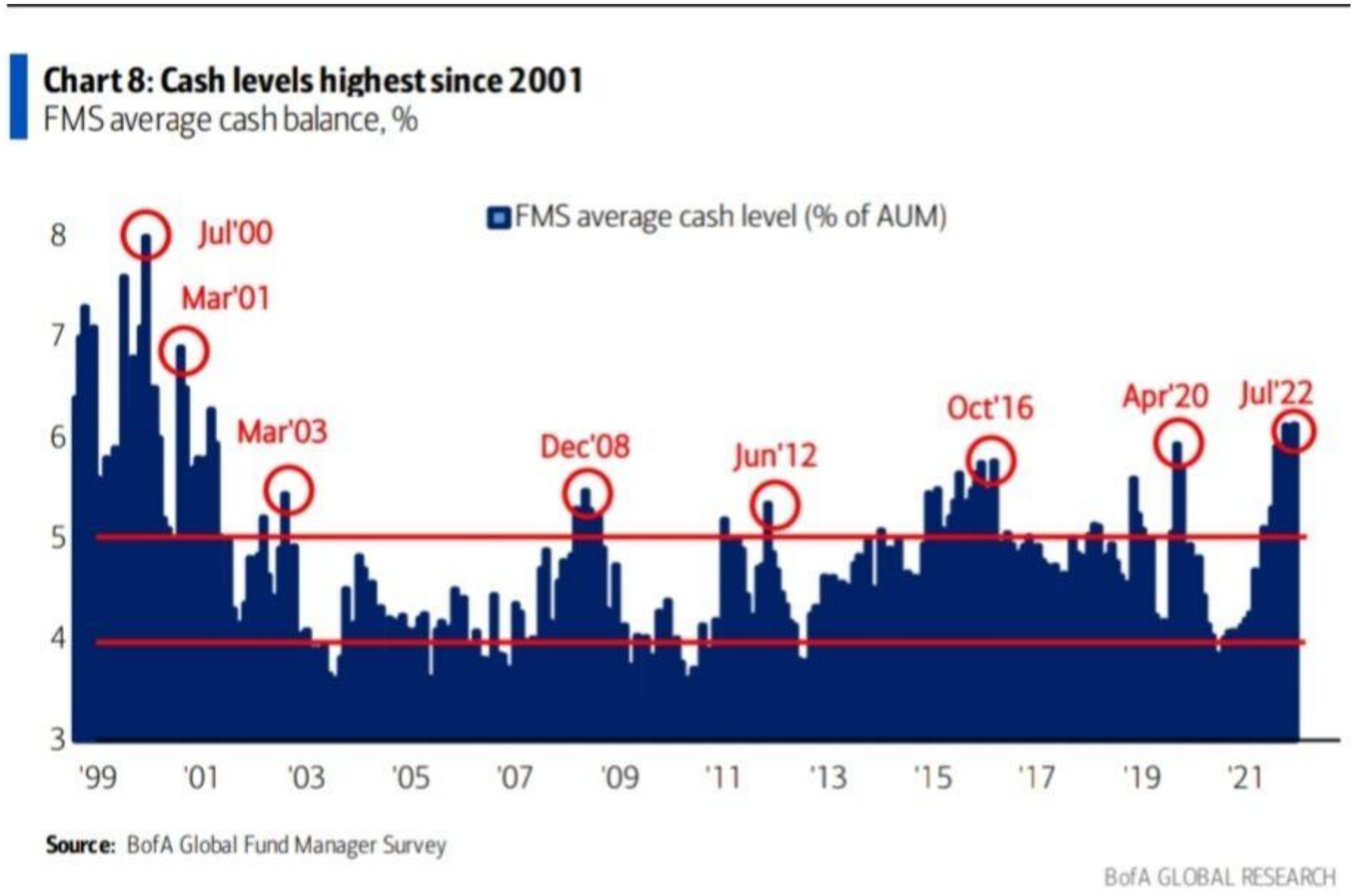
Exhibit 1: With confidence in durability of commodity prices prices, we see potential for Energy market-cap weighting within S&P 500 to further increase

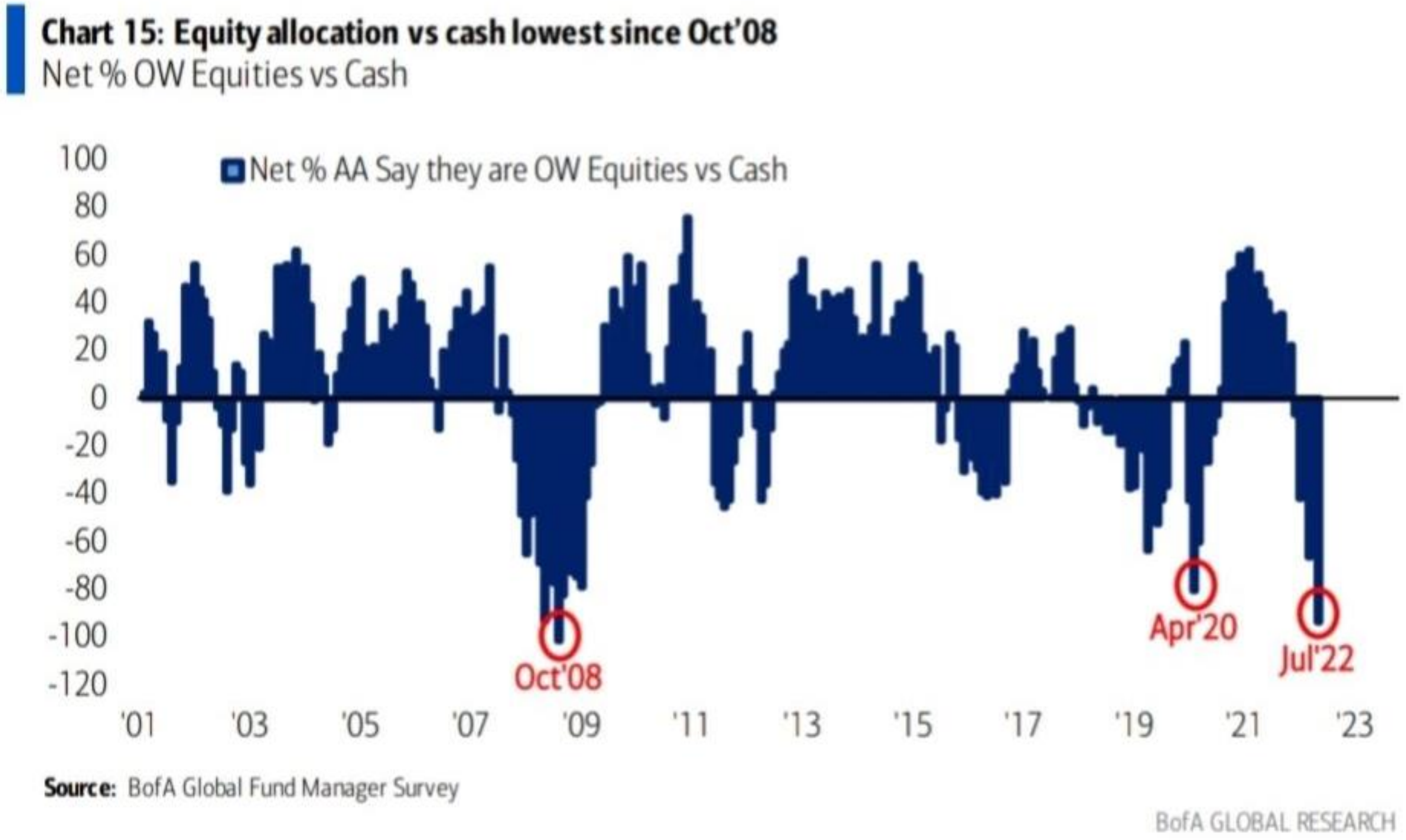
Energy sector earnings and market-cap weighting within S&P 500



Source: Goldman Sachs Global Investment Research

Like others we are also overweight cash





We continue to prefer USD over other currencies… At least for the moment

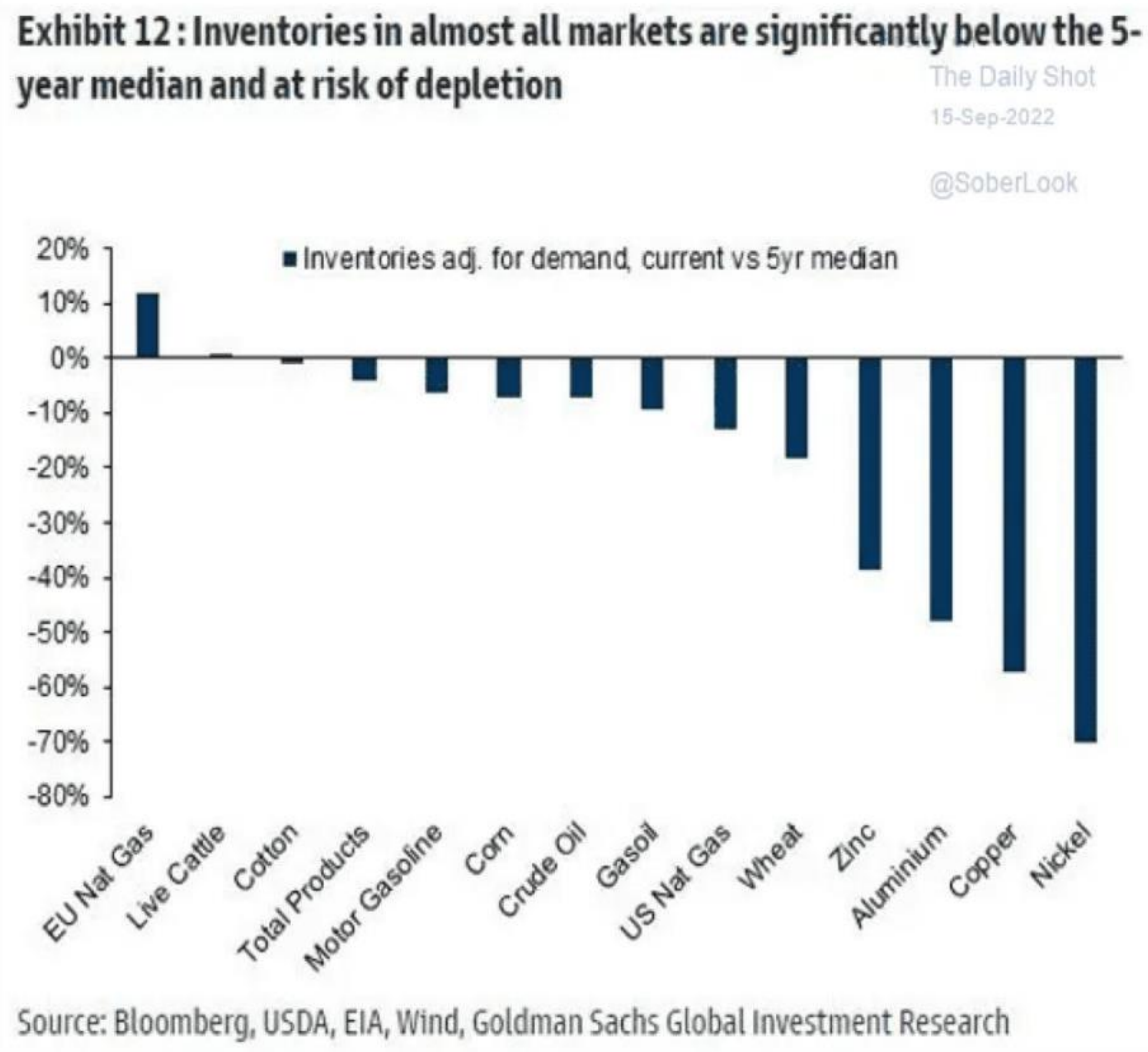
UPDATE

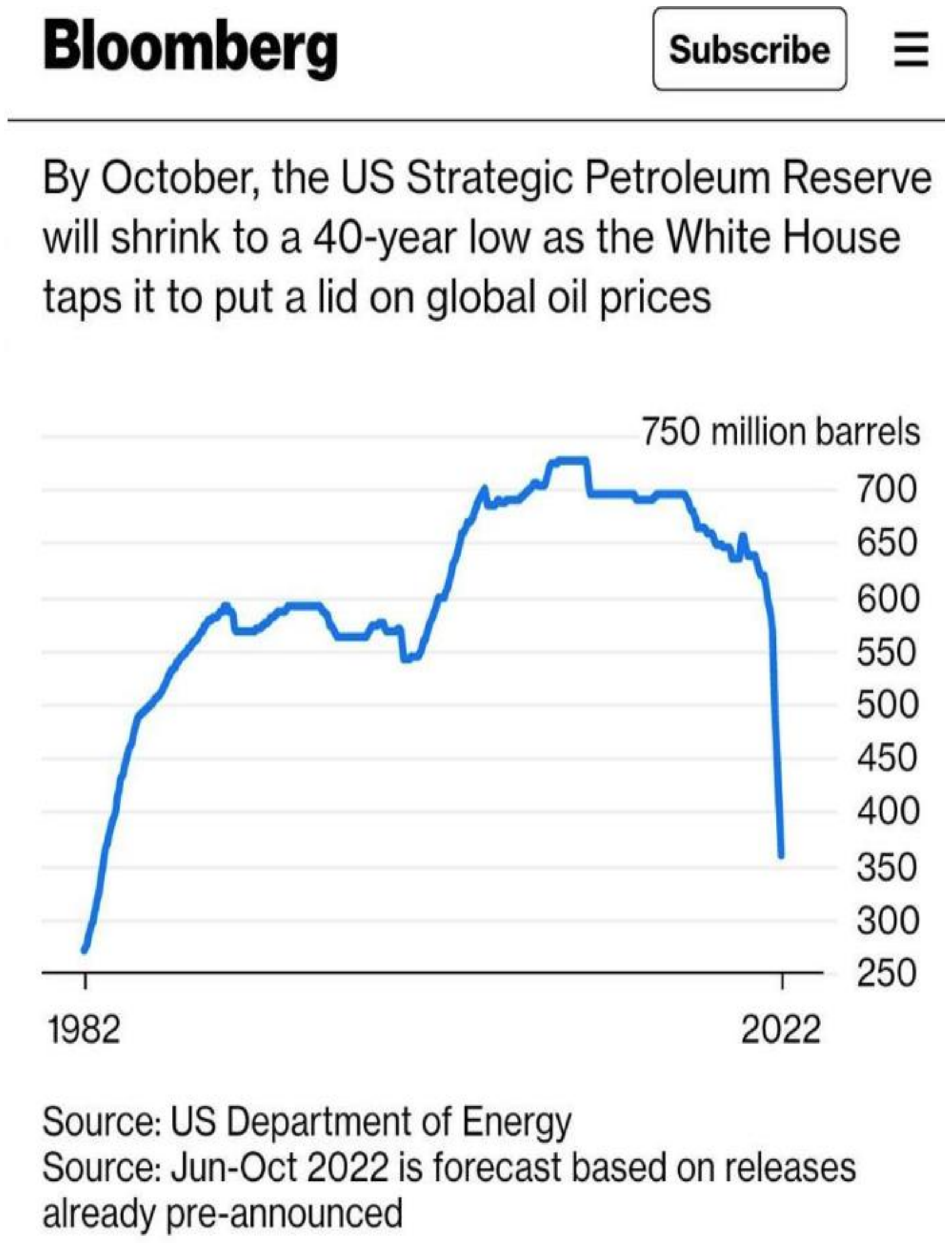
We expect the USD to continue to strengthen, and significantly so if we see a flight from risk assets. We are not there yet. But soon.

When will the USD peak? When there is maximum pain and something breaks. At that point there will be a step shift at the Fed and the dollar will be driven lower. Gold should move higher on dollar weakness and the furthering of QE policies.

Commodities inventories meanwhile continue to shrink

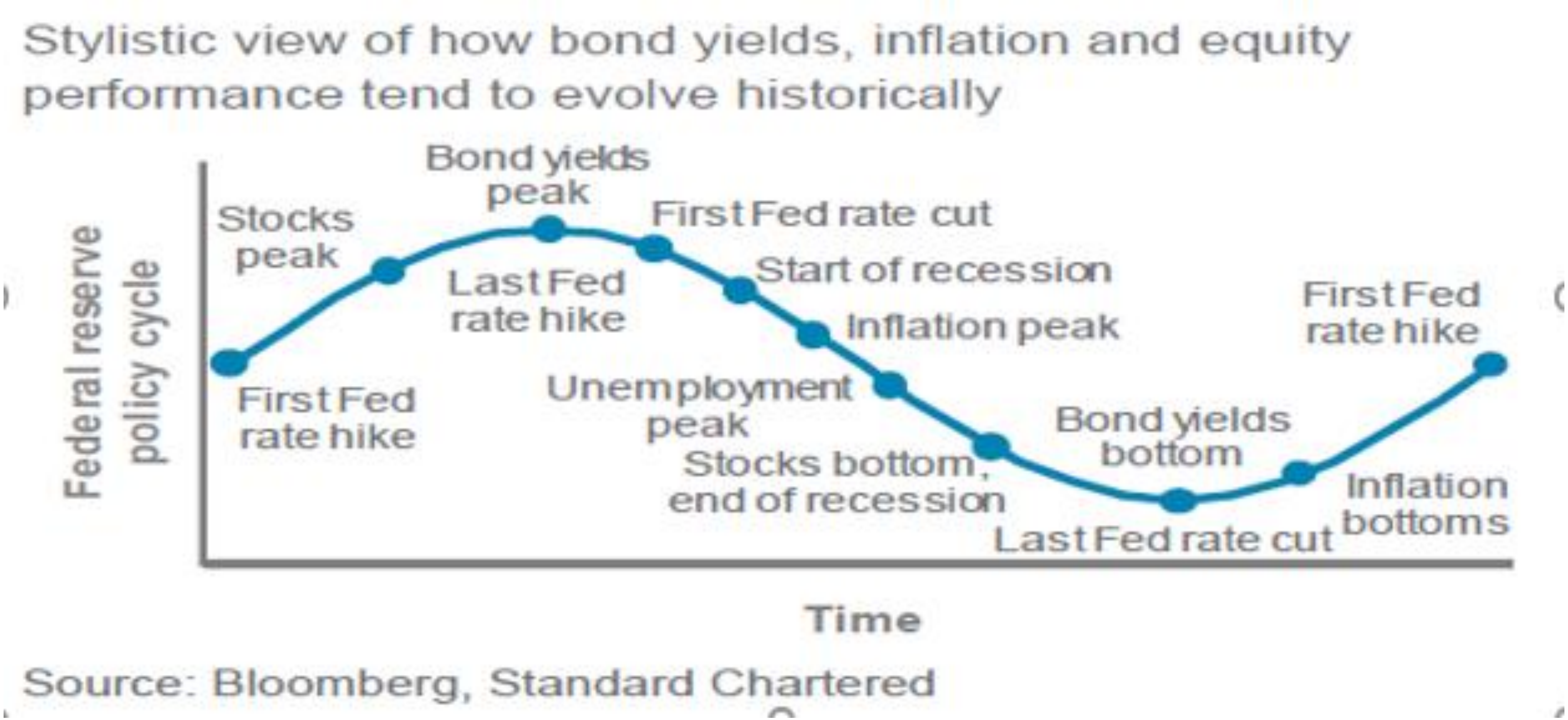
Short term we are underweight economically sensitive materials; longer term we are very optimistic



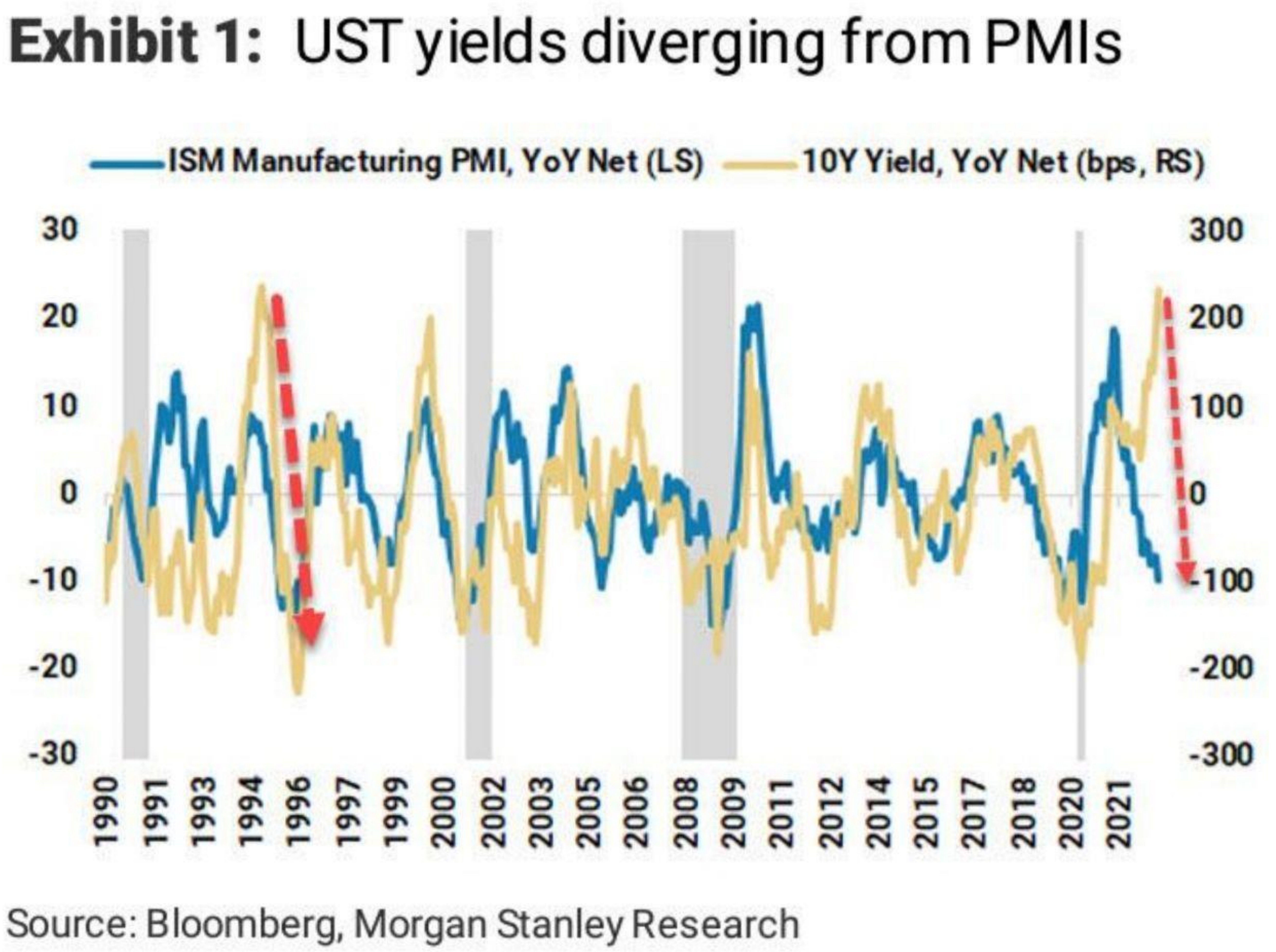


Refilling of the SPR and the roll out out of Climate Change Policies will drive commodity demand higher

Yields peak usually towards end of rate hike cycle



Long Bonds the trade to be in 2023?
…bonds need to price in higher inflation for longer

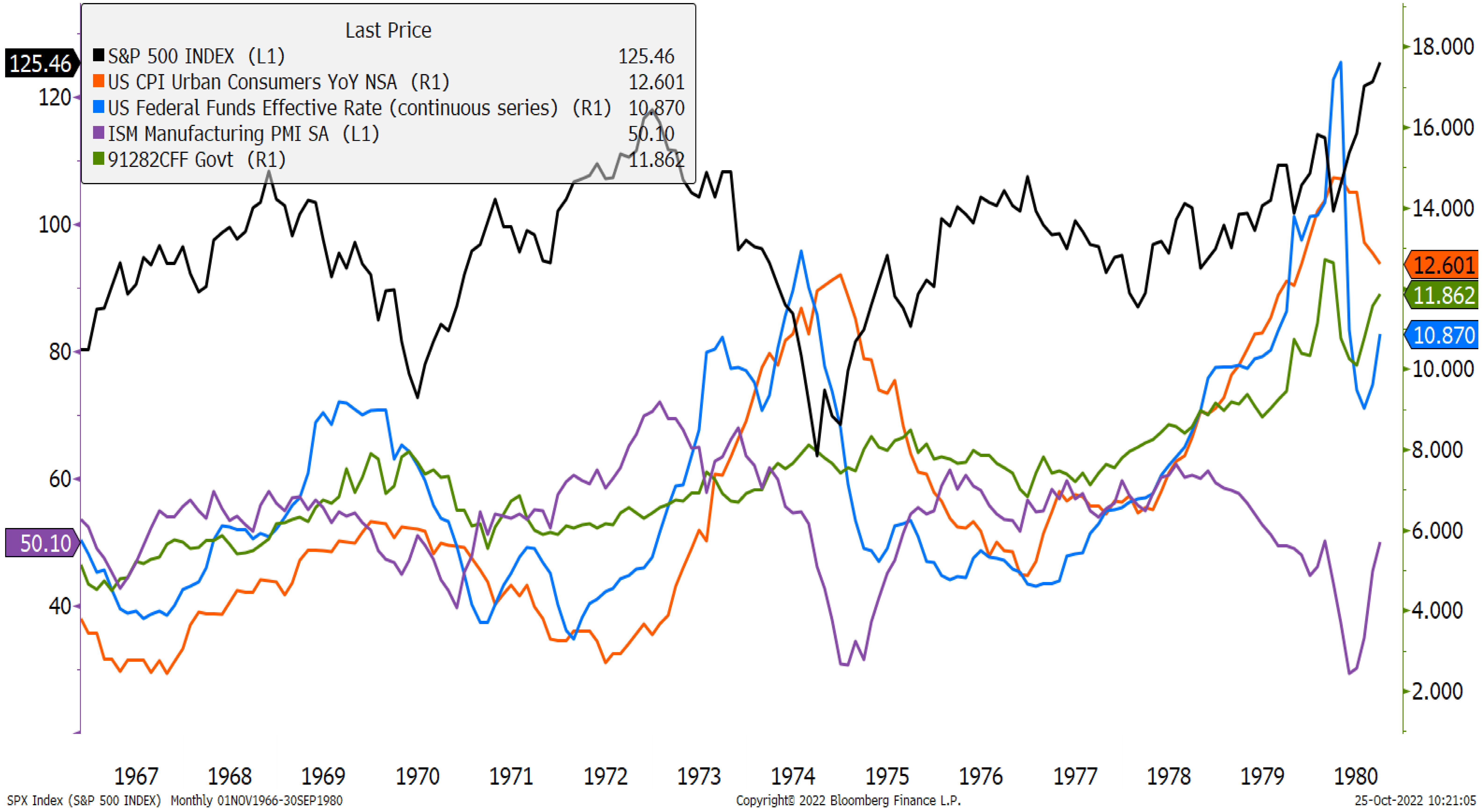


Bonds are looking increasingly interesting from a pure yield point of view.

But where will inflation level off?

1970-1980 may be best historical comparison

Lets layer this chart

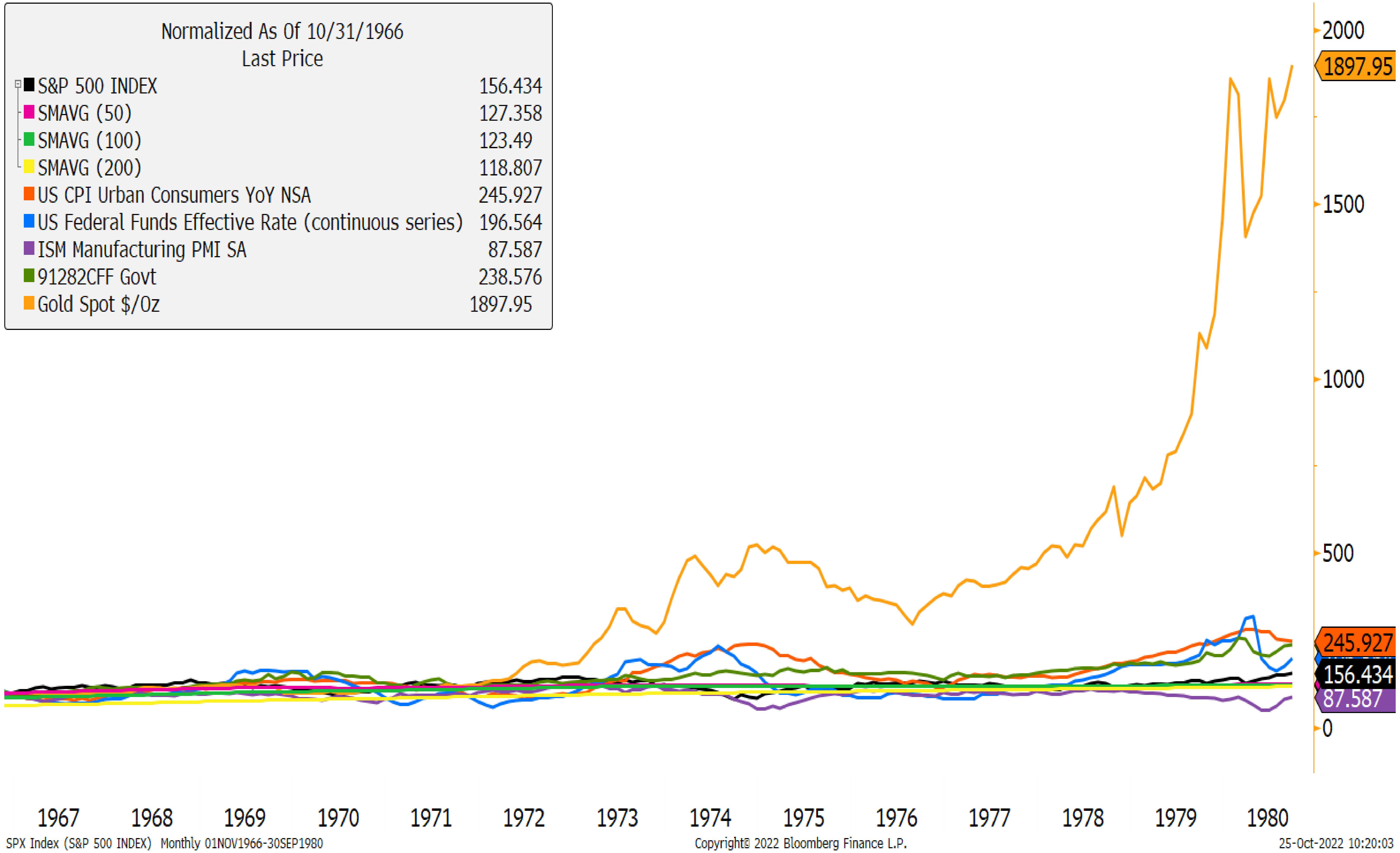


Inflation in the US ramped all the way up to around 12% in 1974, the Fed raised to 13% and the economy fell off a cliff. '73 to'74 the S&P fell around 47% peak to trough.

It was way worse back then in terms of inflation levels. Debt levels today though are far higher.

The higher inflation and rates collapsed the economy and the market. In time though the market reallocated to inflation hedging assets – shifting out of bonds and cash and into Equities and Gold.

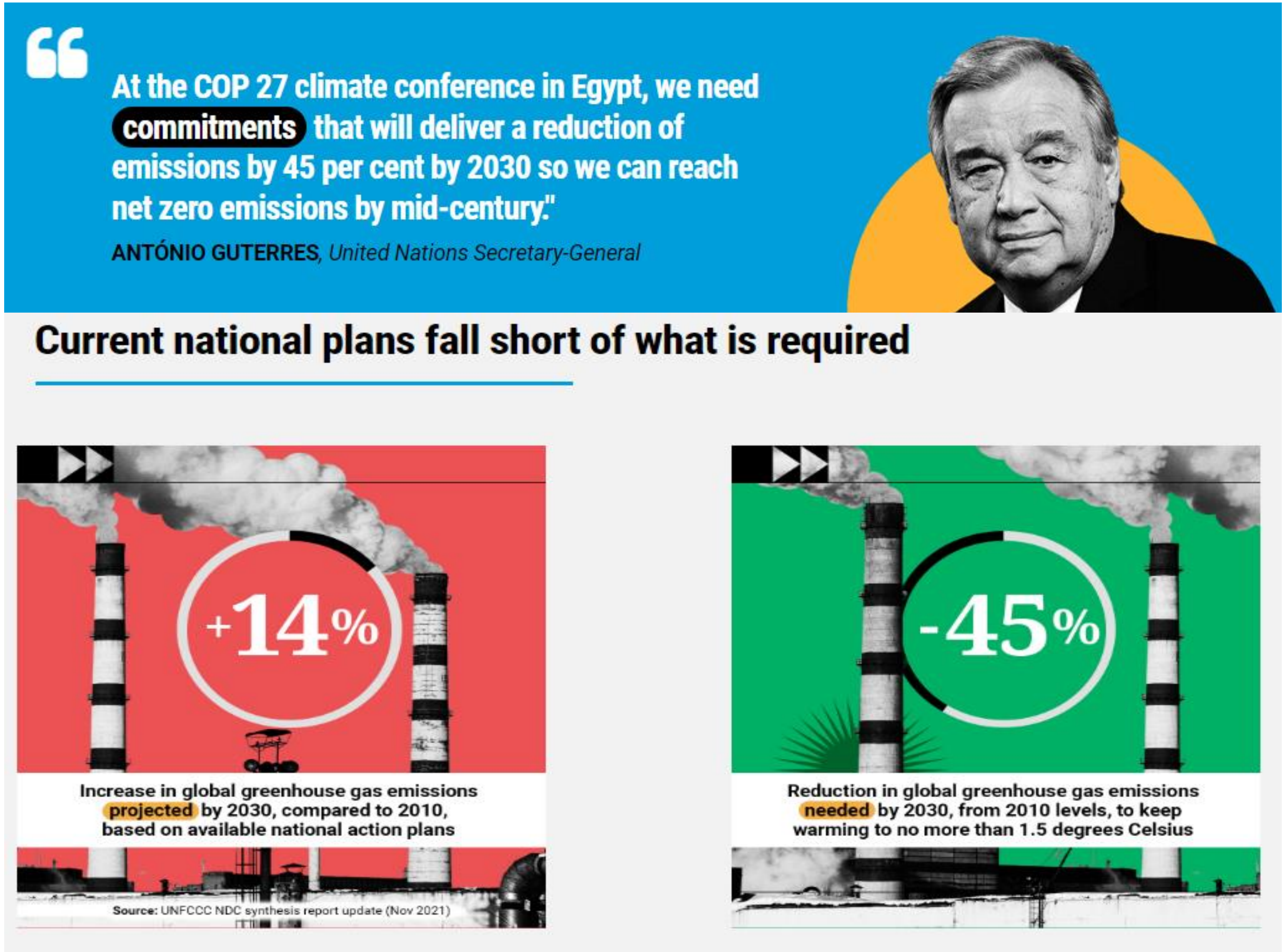
Gold a massive beneficiary of the inflation in late ’70s



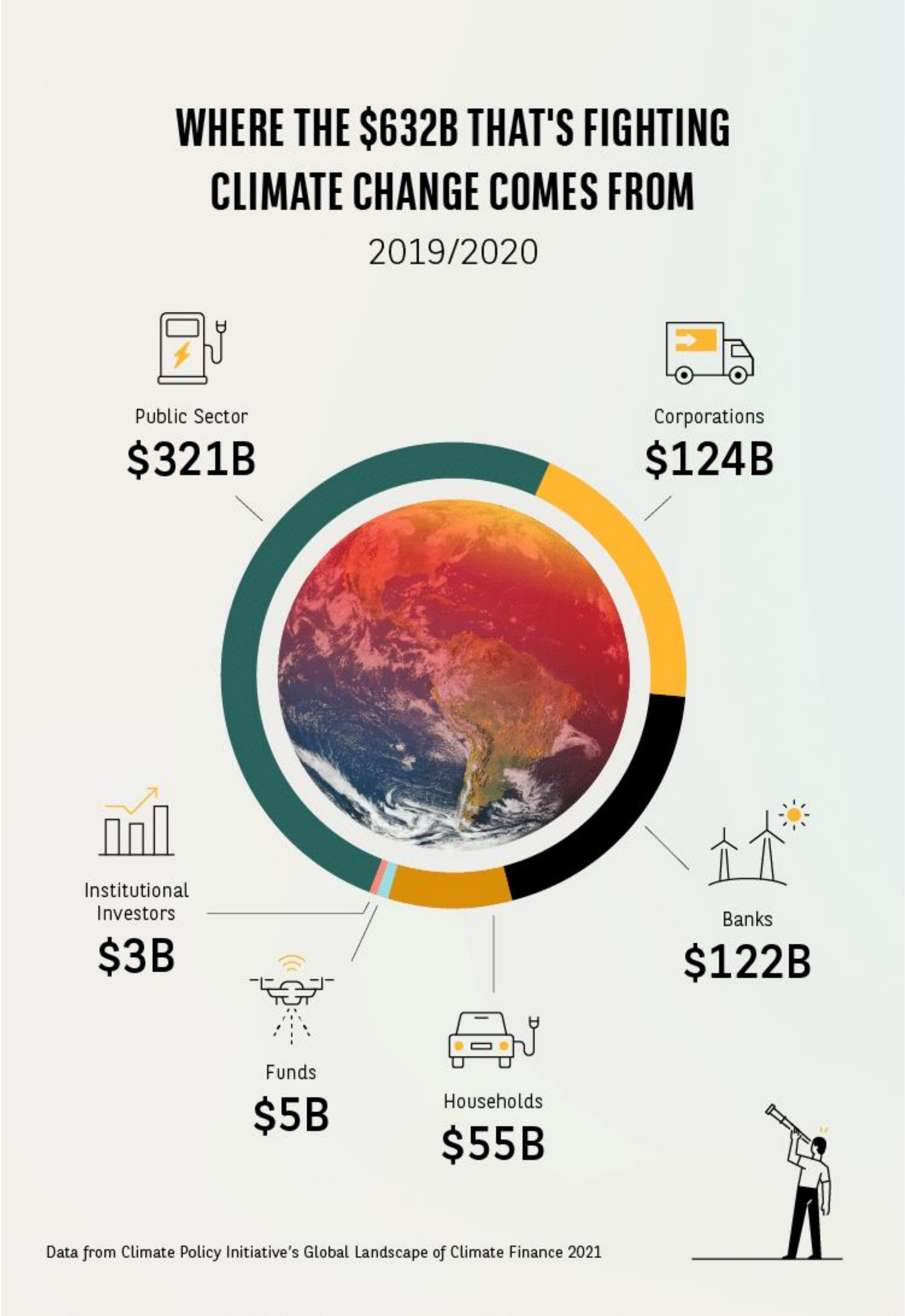
Gold rallied from ’71 (off the Gold peg) and from ’76 to ’80 as investors sought a hedge against inflation.

Can’t expect same magnitude but, if inflation does trend like the ’75-80 period and become more entrenched, then gold will follow a similar pattern.

Climate change policies to drive future economic growth?



Whether you believe in it or not, one should expect Trillions of USD to flow into the space

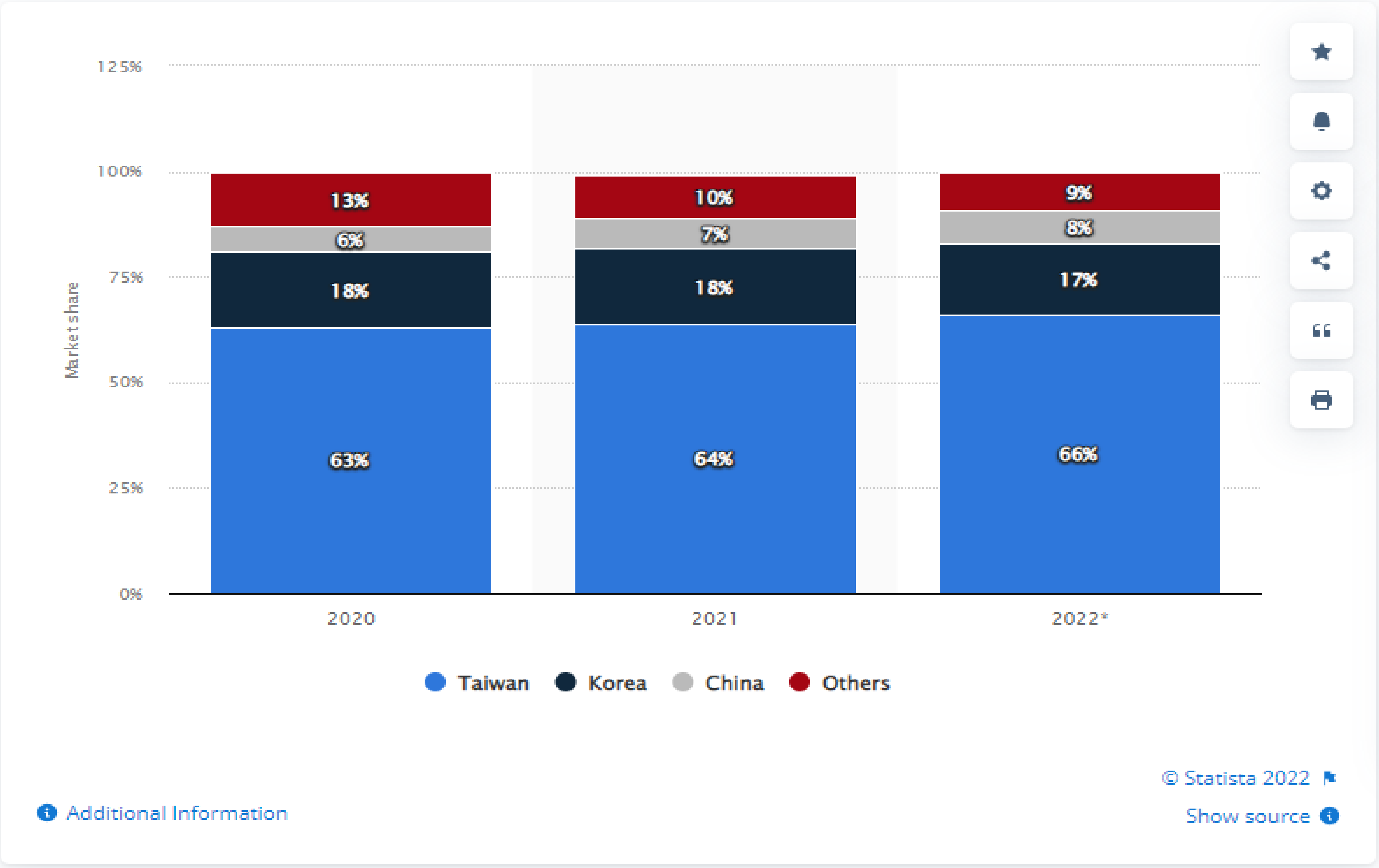


‘Clean Energies’ likely inflationary ….and dirty

Need a good chart for this

Build back Better at Home

Semiconductor foundries revenue share worldwide from 2020



China's hegemony in rare earths production worldwide

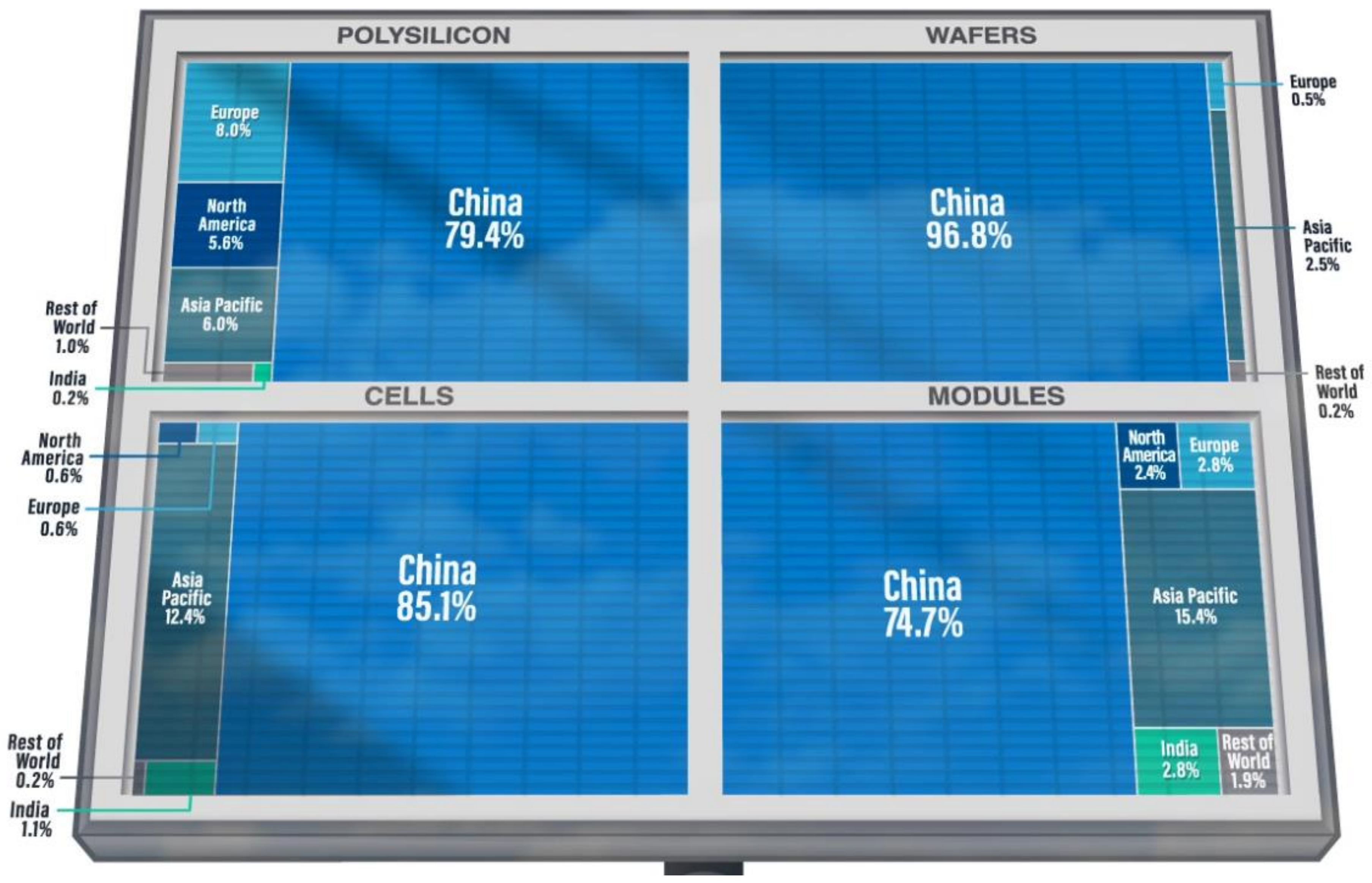
Production as share of global output by country, 2021

Country	Production share (%)
China	60.6%
US	15.5%
Myanmar	9.4%
Australia	7.9%
Thailand	2.9%
Madagascar	1.2%
India	1.1%
Russia	1%
Brazil	0.2%
Vietnam	0.1%
Burundi	0%
Rest of world	0.1%

Source: Statista

INVESTMENT MONITOR

Share of Manufacturing Capacity by Country/Region in 2021



Outlook for asset classes over next few months

- **Bonds:** Yields becoming attractive……nor far off a good opportunity to add to mid to long duration

Bonds will do well as slowdown priced in by markets and inflation tapers off

- **Equities:** Too early to add……but will offer excellent upside once this ‘recalibration’ is complete

If we have higher inflation for longer, should rotate from Cash, to Bonds to Real assets

- **Gold: watch for USD weakness ….not far off if DXY starts to peak**

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