Hamon Investment

Quarterly Strategy

1Q 2023

Market Review

Continuing last quarter's rally, the global equity markets surprised on the upside over the quarter, as global growth was stronger than expected, with the rebound in US, European and China PMI. Lower energy and oil prices, alongside the reopening of China after harsh Covid lockdown policies benefitted global sentiment. The World Developed index gained 7.25%, while the MSCI Asia Ex-Japan index rose 4.09%

The geopolitical backdrop remains challenging, as the war in Ukraine continued with no potential resolution in the near-term, and tensions were renewed between the US and China. Headline inflation continued to ease over the quarter, on the back of low energy prices, but core inflation, which excludes food and fuel prices, generally remained stickier, forcing global central banks to tighten monetary policy further.

The collapse of Silicon Valley Bank (SVB) in March, the second largest banking failure in US history, followed by issues with Credit Suisse, led to a major sell-off in the US and European financial sectors. The labour market in the US remains resilient as February non-farm payrolls were stronger than expected. Average hourly earnings rose by just 0.2% MoM, and 4.6% YoY, which shows that wage pressures are gradually decelerating. February CPI figures showed that headline inflation fell to 6.0% YoY, an eighth consecutive monthly decline and now much lower than its 8.9% peak in June. Inflation is now dominated by an increase in rent and housing, which accounts for 70% of the increase in prices. Given the cooler inflation data and the turmoil surrounding SVB, the Federal Open Market Committee voted unanimously to raise the fed fund rate by just 25 bps in March to a target range of 4.75%-5.00%.

In the Eurozone, despite rapidly rising interest rates and the turmoil in the banking sector in March, economic activity surprised on the upside throughout the quarter, on the back of falling energy prices and the resilience of services activity. Composite PMI for March rose to a 10-month high of 54.1, which was well above expectations. This strong momentum was almost entirely driven by the service sector, while the manufacturing sector continued to struggle as shown by the drop in the manufacturing PMI to 47.1 in March. Headline CPI continued to decrease in Q1, from 9.2% YoY in December to 8.5% in February, while core inflation increased from 5.2% to 5.6% over the same period. The Euro STOXX gained 15.42% over the quarter, one of the better performing markets globally. With growth more resilient than expected and core inflation still high, the European Central Bank (ECB) increased its deposit rate by 50bps in March, despite the banking turmoil caused by the collapse of SVB in the US and the subsequent issues for Credit Suisse in Europe. The ECB now expects higher growth and lower inflation this year, while there may be chances of future rate hikes, depending on upcoming data.

The China market continued its momentum from the end of last year and into the first month of 2023, boosted by the earlier and faster than expected reopening of China. After three years, mainland China re-opened its borders and ended a requirement for incoming travelers to quarantine, dismantling the final pillar of their zero-Covid policy. While there was a broad selloff in February, it was expected profit-selling, especially as the market had rallied over 45% at one point. Nevertheless, strong PMI numbers in March of 56.4, and contract sales for top 100 property develops growing 29% YoY shows the continued recovery in the Chinese economy. The MSCI China gained 4.71% over the quarter, while the Hang Seng index rose 2.49%.

In North Asia, while guidance was generally weaker, the strong 4Q results from Taiwan's TSMC signaled that the semiconductor sector would be nearing its bottom in the first half of the year. Taiwan and Korea subsequently saw US$5.14 bn and US$7.90 billion inflow into the market over the first quarter. This was despite the surprise move by Berkshire Hathaway to sell the majority of its holdings in TSMC, which dampened market sentiment. With the introduction of ChatGPT by OpenAI, the adoption of AI across different industries will be sped up, boosting semiconductor consumption. This would benefit both Korea and Taiwan. The Taiwan TWSE gained 13.13% over the first quarter, while the Korean Kospi rose 7.27%.

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Market Review (cont'd)

The bond market had been quite bumpy over the first quarter of the year. US 10 year bond yields moved up from 3.88 % to 4.05%, as increasing evidence of stubborn inflation added to expectations that US Fed will continue to hike rates. The failure of the US regional banks and Credit Suisse, however, worried the markets over fears of a global market recession and the US 10year bond yield fell back to 3.47%.

US Investment grade bonds were up 2.96% over the month, while US High Yield bond was up 3.73%. Asian Investment Grade bonds were up 2.64%, while Asian High Yield bonds were up 2.02%

Outlook & Strategy

Looking ahead, we continue to be positive towards the HK/China markets, given China's strong PMI numbers, the gradually recovering property market, and low inflation, with CPI remaining at 1% YoY. We remain focused in the internet-related, technology, property, and domestic consumption-related sectors. We are more cautious toward the US market, as the recent failures of regional US banks raised concerns on the stability of its banking systems. Given such a sharp rise of interest rate in past 13 months, we believe financial instability will remain an overhang on the market for the rest of the year. While the bond market may be volatile, we are positive on the high quality investment grade bond market due to a possible global recession.

We focus on four key areas in our portfolios:

i. Hardware technology companies with strong pricing power and which are expected to be recovering from the cyclical bottom very soon;
ii. China reopening and recovery from Covid: Internet/technology, Property, Domestic consumption;
iii. Global recession beneficiary areas, such as gold and related stocks;
iv. Dividend yield play companies;
v. Long duration and high quality IG bonds, and Asian High Yield bonds

Our core positions are in consumer internet/AI stocks, such as Tencent and Meituan; financial stocks such as AIA and Berkshire Hathaway; dividend yield play companies, such as CNOOC; and technology stocks such as Apple and Microsoft

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