Quarterly Strategy

1Q 2022

Market Review

Russia's invasion of Ukraine in late February shocked the world, creating a cascade of events that impacted the markets. Equity markets fell, while bond yields rose. Commodity prices soared, especially as Russia is a producer of some key commodities such as oil, gas, and wheat. This led to a surge in inflation, as well as supply chain disruption, especially in the Eurozone, who are more reliant on Russian oil and gas. The S&P 500 was down 4.95%, while the NASDAQ dropped 9.10% and the Euro STOXX fell 11.63%.

US Fed raised interest rates in March, for the first time since 2018, by 25 bps and Fed Chair Powell signaled that there would be further and more aggressive interest rate rises for the rest of 2022. This triggered a large selloff in the US bond market in March, the worst drop in over 40 years, and the S&P 500 has also de-rated from 22x to 18x 2022 forward PE. While US unemployment rates dropped to 3.6% in March and wages continued to rise, they have yet to match the rate of headline inflation, with US CPI hitting 7.9% in February.

While Europe saw a surge in prices, which led to consumer confidence falling, European institutions are discussing the launch of an energy and defense fund and a new issuance of European bonds, which could be critical to cushioning sharply rising energy costs. PMI figures also remained in expansionary territory at 54.5, showing strong resilience. In response to rising inflation, the ECB outlined plans to end bond purchases by the end of September. ECB President Christine Lagarde indicated that a first interest rate rise could potentially come this year, saying rates would rise after asset purchases had concluded. Data showed annual Eurozone inflation at 7.5% in March, up from 5.9% in February.

In Asia, most markets also fell, with the exception of selective ASEAN markets. In China, worries of potential sanctions due to the Russia-Ukraine conflict, geopolitical tension delisting risk of Chinese ADRs, and further regulatory risk in internet stocks affected the market, with the MSCI China down 25% at one point. Pressure alleviated slightly after the Vice Premier's speech and the Chinese government showed willingness to address and solve the market's concerns. Nevertheless, renewed Covid-19 outbreaks were seen in Hong Kong and China, with cases reaching their highest level in more than two years, despite pursuing one of the world's strictest virus elimination policies. In China, a total lockdown in major cities was enacted, which further disrupted supply chains. The city of Shanghai, China's financial capital with a population of 25 million people, went into a partial lockdown at the end of the quarter in a bid to curb a surge in Omicron Covid-19 cases, prompting fears that other parts of the country could also go into lockdown. The Hang Seng Index and MSCI China index dropped 6.41% and 14.19% respectively over the period.

The Taiwan and South Korean markets were also sharply lower in the first three months of 2022 as the Covid-19 pandemic continues to affect economic activity, with the TWSE down 6.12%, and the KOSPI down 9.13%. The Indian market fared slightly better, down 1.24%, as the RBI maintained interest rates and oil prices stabilized towards the end of the quarter.

However, there were pockets of growth such as in Singapore, Indonesia, and Thailand which achieved solid gains, as well as Malaysia and the Philippines, which performed better relative to regional peers. The Singaporean, Indonesian, and Thai markets were up 8.57%, 6.79% and 2.46% respectively, while the Malaysian and Philippine markets were flat over the quarter. Following mostly net outflows since 2019, foreign funds flowed back into ASEAN markets over the quarter, switching from Hong Kong. Indonesia saw inflow of US$1.2 billion in February alone, the most since April 2019. Driving this renewed interest was a surge in commodity prices, a positive for key producing countries like Indonesia and Malaysia, coupled with the sparse economic links between Southeast Asia and Russia and Ukraine. The Singaporean market performed well on easing of Covid-19 measures, while banks continued to outperform on the interest rate hike cycle.

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HAMON INVESTMENT

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Outlook & Strategy

With expectations of rising interest rates in the US, the ongoing war in Ukraine, uncertainty from the impacts of sanctions on Russia, and high energy and commodity prices, we expect global markets will remain volatile in the short term. These fears, plus inflation worries should continue to impact the markets. We remain cautious on the overall Chinese economy, given the resurgence of Covid in China. We will monitor and wait for a clearer sign and further data before we make more aggressive changes to our portfolios. However, we continue to look for good entry points, especially in stable growth companies with higher yields.

We focus on four key areas in our portfolios:

(i) Companies with strong pricing power to protect margins, stable earnings visibility and good operating cash flow amidst rising inflation and rates environment, such as financials, semiconductor, and energy sectors;
(ii) Beneficiaries of policy tailwinds, especially infrastructure-related companies in China;
(iii) Seven core sustainability themes with structural growth opportunities in the areas of: digitization & technology, de-carbonization, green energy, sustainable finance, sustainable production, environmental protection, and health & society;
(iv) Short duration IG bond and selective China high yield bond

Our core tech positions are in consumer internet/AI stocks, such as Tencent, Apple, and Microsoft; property service stock, such as Yuexiu services; financial stocks such as AIA, HSBC, DBS Holdings, and Berkshire Hathaway; dividend yield play companies, like China Mobile, China Merchant Port, CNOOC; and hardware technology stocks such as TSMC, E-ink.

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