Hamon Investment

Quarterly Strategy

2Q 2022

Market Review

It was yet another difficult quarter for the markets after a tough start to the year, with worries of a global recession and inflation moving higher in many major economies during the quarter. Russia's ongoing invasion in Ukraine continued to put a strain on global food supply chains, as well as on energy prices. Both equity and bond markets were under pressure, and developed markets saw some of the worst market performance for the first half in over 50 years. Markets across Asia were also sold down, with the exception of the Hong Kong/China markets, which saw a slight recovery in June as Covid lockdowns were lifted, and performed well relative to peers in the region. The S&P 500 and Euro Stoxx fell 16.45% and 16.26% over the second quarter, while the MSCI Asia Ex-Japan index fell 9%.

The US dollar strengthened against most currencies, with the USD index gaining 6.48% in the second quarter alone. The Euro fell to a 20-year low, reaching near parity with the US dollar, weighed down by prospects of an energy crisis, and lag in the US central bank in raising rates. The Japanese yen depreciated by 11.52% to 135 levels during the period, as the Bank of Japan continued their dovish stance by keeping its short term interest rate around 0% and controlling its 10-year bond yield below 0.25%.

After the first interest rate hike in March, the US Fed raised interest rates twice over the quarter, first by 0.5% at the beginning of May, and then by a further 0.75% in June, the largest hike since 1994, to fight the worsening inflation situation. With CPI at 9.1% in June YoY, the Fed signaled that they were determined to get inflation under control, and that there would further rate hikes to come. Even so, the task of bringing inflation down without triggering a recession would be challenging, especially as it is now estimated that interest rates will have to be raised to around 3.8% by next year to combat inflation. While unemployment remains low and wage growth strong, consumer sentiment has fallen sharply. CPI may come down a bit next month, as gas prices should fall slightly, but there is the risk of gas prices shooting up again.

The second quarter saw further steep declines in the Eurozone markets, as the war in Ukraine continued and concerns grew over potential gas shortages. Higher inflation is also dampening consumer confidence, with the European Central Bank (ECB) poised to raise interest rates in July and likely in September as well. Concerns over the higher cost of living and possibility of a recession saw the European Commission's consumer confidence reading fall to -23.6 in June, the lowest level since the early stages of the pandemic in April 2020. An estimate from Eurostat signaled inflation at 8.6% in June, up from 8.1% in May, with energy the biggest contributor to the rise.

In Asia, most markets also fell, with the exception of the China/Hong Kong markets. Investor sentiment turned increasingly downbeat amid concerns that rising global inflation and ongoing supply chain problems, accentuated by the war in Ukraine, could lead to a global recession.

South Korea was the worst-performing market in the MSCI Asia ex Japan index in the quarter, with the Kospi Index down 20.28% in 2Q. Financials, technology and energy stocks were hit particularly badly, on fears of a global recession. The Taiwanese market also dropped, with the TWSE down 19.35%, on fears that rising inflation and global supply chain problems would weaken demand for tech. India's Nifty 50 index also lost 13.11%, as Indian stocks declined on global volatility, rising inflation, and soaring energy prices, which weakened investor sentiment.

In ASEAN, the Philippine, Malaysian, Thai, and Singaporean markets all recorded sharp declines in the quarter, falling 19.43%, 13.01%, 12.82%, and 11.26% respectively, mirroring the share price falls seen in global markets, while declines in Indonesia were relatively less severe, down 5.99%.

The Hong Kong/China markets performed well relative to regional peers, with the MSCI China Index up 3.41%, and the Hang Seng Index up 0.71%. Covid-19 lockdown measures in China began to be relaxed, and the Chinese government also loosened their tight grip on regulations regarding internet stocks. This, alongside government data that showed improving factory activity in China in June, led to a broad-based market rebound as investor sentiment was boosted.

Hamon Investment
1001, 10th floor, Standard Chartered Bank Building
4-4A Des Voeux Road Central, Hong Kong
Tel: (852) 2526 4268 • Fax: (852) 2526 7277
Website: www.hamon.com.hk • Email: enquiry@hamon.com.hk

Hamon Investment

Quarterly Strategy

2Q 2022

Market Review (cont'd)

On the bond side, bonds continued to be sold off sharply, with yields markedly higher amid still elevated inflation data, hawkish central banks and rising interest rates. The US 10-year bond yield rose from 2.35% to 2.97% and the two-year yield from 2.33% to 2.93%. Corporate bonds suffered in the broad bond market sell-off, underperforming government bonds as spreads widened. With growing concerns over the economic outlook, high yield credit was particularly hard hit.

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 risk of a global recession, we expect global markets will remain volatile in the near term. These fears, plus inflation worries should continue to impact the markets. We believe the China/HK markets will continue to outperform the region and see inflows in the near term, especially given better sentiment from both onshore and offshore investors due to easing concerns on regulatory risks for internet stocks, fine-tuning of their Covid policy, good liquidity, and uncertain global economy. However, the Taiwan and Korean markets may continue to underperform until the overhang of global recession worries and demand for consumer tech products, such as smartphones and PCs, improves.

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/EV/renewable energy related 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 and high quality IG bond

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

Hamon Investment
1001, 10th floor, Standard Chartered Bank Building
4-4A Des Voeux Road Central, Hong Kong
Tel: (852) 2526 4268 • Fax: (852) 2526 7277
Website: www.hamon.com.hk • Email: enquiry@hamon.com.hk