Hamon Investment

Quarterly Strategy

3Q 2022

Market Review

After a strong rally for both bond and equity markets in July, the markets were sold off sharply again in August and September. Worries of a global recession and inflation continuing to move higher in many major economies dragged the markets down during the quarter. The rally in July was boosted by hopes of a soft landing for the markets, and interest rate cuts by the Fed in 2023 beginning to be priced in. However, the Fed and other central banks reiterated at the Jackson Hole summit that the top priority continues to be to fight inflation rather than support growth. This led to the sharp rise in bond yields and the sell off in the equity market in the second half of the quarter. The World Developed Market Index fell 10.54% over the third quarter of 2022, while the MSCI Asia Ex-Japan Index fell 13.83%.

Global central banks hiked policy rates, with 1.5% from the Fed, 1.25% from the European Central Bank and +1% from the Bank of England. Markets also began pricing in a much more aggressive path of future rate hikes, with rates now expected to rise to 4.5%, 3.5% and 5.75% by next year in the US, Europe, and UK respectively.

The US dollar continued to strengthen against most currencies, with the USD index gaining 7.15% in the third quarter. The Euro reached below parity with the US dollar at 0.98, continuing to be weighed down by the energy crisis and rising interest rates. The Japanese yen also depreciated sharply over the quarter to 144.74 levels, leading to the Japanese Ministry of Finance intervening in the foreign exchange market to stem the Japanese yen's depreciation. With the CNY nearing a low in 28 months of 7.30, the PBoC announced an increase to the FX risk reserve ratio from 0 to 20% in order to rebalance the currency supply demand. The yuan has fallen 11% YTD, which is the largest annual decline since 1994.

While global inflationary pressures moderated slightly, on the back of lower oil and food prices, core inflation remains high and well above most central bank targets. GDP data confirmed that the US economy is in a technical recession with GDP falling by 0.6% YoY in Q2 after a 1.6% contraction in Q1. However, other data was resilient, such as the strong job market, and rising wages.

The third quarter saw the Eurozone equity markets falling sharply amid the ongoing energy crisis, rising inflation, and worries on the economic growth outlook, as well as the continuing war in Ukraine. Annual inflation for the Eurozone was estimated at 10% in September, up from 9.1% in August. Energy costs continued to be the largest contributor to inflation. Nord Stream 1, the main pipeline supplying gas to Europe from Russia, was closed for maintenance in July. It came back temporarily before Russia shut it down again in early September. This put further pressure on power generators, many of whom will need to buy natural gas from higher cost sources, and intensified worries over potential energy shortages this winter. The news also sent the euro to a 20-year low versus the US dollar.

In Asia, equities were weaker in the third quarter, on investor concerns over rising inflation, higher interest rates and fears of a global slowdown. The ongoing tensions between the US, Chin,a and Taiwan also weighed on sentiment during the quarter.

China was the weakest market in the region, on concerns of ADR delisting, regulatory issues, and the "Covid zero" policy. This was despite data released in September which showed that Chinese factory activity unexpectedly expanded during August. The spread of Covid-19 throughout China also weakened sentiment, prompting fears of further lockdowns as the country continues to pursue a policy of zero-Covid. In Hong Kong, stocks fell as investors continued to sell riskier assets, for the safety of government bonds amid the threat of more interest rate hikes and economic recession. The Hang Seng Index and MSCI China Index fell 21.24% and 22.50% respectively over the quarter.

India was the best performer in the region, ending the quarter in positive territory, with the Nifty 50 Index up 5.06%, although concerns over the pace of interest rate hikes by the US Federal Reserve weakened sentiment towards the end of the quarter. PMI manufacturing data showed resilient manufacturing activity that did not seem affected by inflation or global growth slowdown.

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Market Review (cont'd)

The Taiwanese market saw continuous outflow, on the back of weakening exports and worsening geopolitical tension between China and Taiwan, due to the visit of US Congresswoman Nancy Pelosi to Taiwan earlier in August. Taiwan was down 15.19% over the quarter.

In the ASEAN region, the Indonesian, Singaporean, Thai, Malaysian and Philippine markets all recorded declines over the quarter, falling 0.27%, 2.36%, 5.42%, 8.26%, and 12.76% respectively. Indonesia continued to outperform its peers with continuous foreign inflow.

On the bond side, the hawkish position by the Fed and other developed market central banks triggered another round of government bond yield rises. The 10-year U.S. Treasury yield rose 64bps in September to 3.83%, and the 2-year yield rose 89bps to 4.28%, implying a further inversion of the yield curve. Higher risk-free rates across the developed world have dragged on corporate bond performance. U.S. investment-grade and high yield were down 5.1% and 4.1%, respectively.

Outlook & Strategy

Going into October, we expect the market will continue to be volatile, given the global macro uncertainties. However, we believe that because the Asia ex-Japan region has fallen so significantly, the region may start to outperform or be in-line with global markets. A few Asian markets, such as China, Taiwan, and Korea, are at or below the bottom range of their historical valuations. We still believe China will continue with relaxing fiscal and monetary policy to support the economy, and we continue to monitor for any changes in policy or supporting measures after the 20th Communist Party Congress. For the Taiwan and Korea market, these tech-centric markets have been beaten down significantly and are trading at around historically low valuations, where we see good opportunities.

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, technology, and energy sectors;
(ii) Beneficiaries of policy tailwinds, especially EV/renewable energy related names in China and Korea;
(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 and Apple; financial stocks such as AIA, DBS Holdings, and Berkshire Hathaway; renewable energy related stock such as Sungrow Power and Hanwha Solutions, 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