INVESTMENT STRATEGY
WEEKLY VIEW

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INVESTORS ARE STARTING TO CONSIDER HOW FAR THE FED WILL GO

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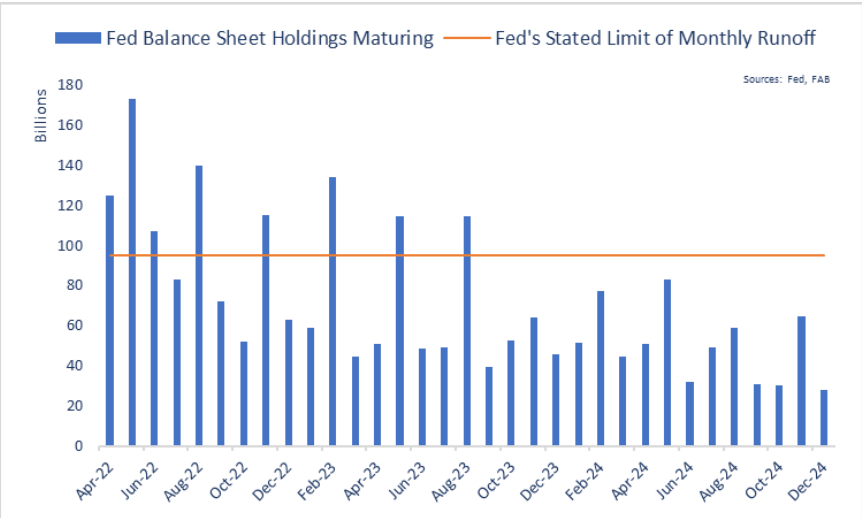
- Markets have started to price in a very significant slowdown in economic activity
- US inflation came in at 8.5% year-on-year, the highest since 1982
- The yield on 10-year US Treasuries breached 2.8% before retreating
- Investors will watch earnings reports for signs of a slowdown in profit growth

The Fed minutes have become the event to watch. The first quarter selloff, for one, began after the release of the details of the December meeting on January 5th. Then, it became clear that the Fed would get tough on inflation. That was also when governors first talked about reducing its balance sheet. Since the pandemic began, the Fed has bought US$4.8 trillion in bonds.

At the same time, the forward P/E ratio of the S&P 500 jumped to 23x from 18x at end-2019. The minutes of the March meeting suggested the Fed will stop reinvesting any bonds that mature starting next month. Markets reacted by pushing the S&P 500's P/E down to 19x. That, however, still depends on earnings growing as expected. Whether they will is the question, now.

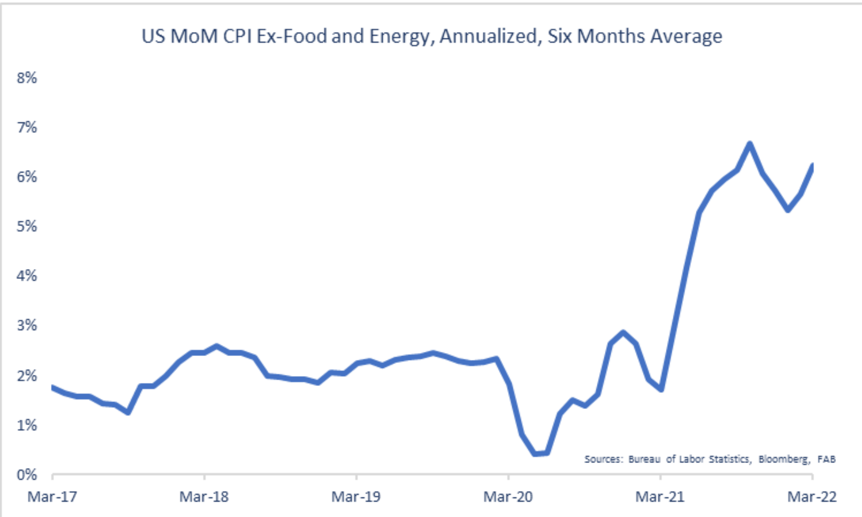
THE US$95 BILLION MONTHLY CAP SET BY THE FED COULD ACTUALLY BE DOVISH



- Last week, the minutes of the March Fed meeting said the FOMC favours not reinvesting up to US$60 billion of maturing bonds and coupons of Treasuries and US$35 billion of mortgage-backed securities.
- The cap means the Fed will reinvest part of some months' maturities.
- The minutes also suggested that the Fed will not run its entire balance sheet off, in line with its framework of having 'ample reserves' in the system.
- Yet, the liquidity drain could increase borrowing costs significantly.

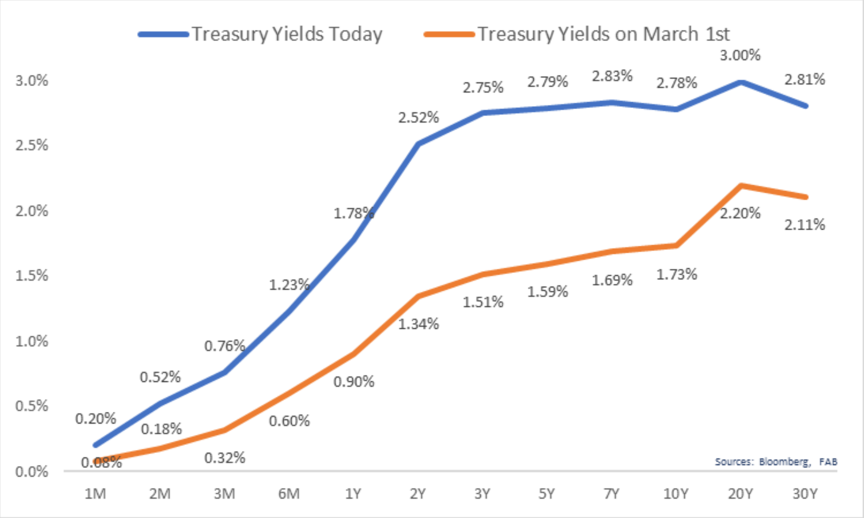
THE FED MAY KEEP HIKING AS LONG AS THE US INFLATION TREND REMAINS ELEVATED

- The year-on-year US CPI came in at 8.5% in March and the month-on-month increase at a high 0.3%.
- Inflation has reaccelerated recently as commodity prices spiked.
- Even when food and energy are excluded, consumer price increases are accelerating.
- The Fed is likely to hike rates by 50 basis points in its next meeting in May, and potentially by the same in June, to stem demand.
- The Fed might keep hiking rates until MoM inflation drops below 0.2%.



THE YIELD ON THE 10-YEAR US TREASURY BREACHED 2.8% AFTER THE FED MINUTES

- Bond markets are pricing a rapid rate hike schedule by the Fed and yields are spiking in response.
- The 10-year US Treasury yield is about to breach a long-term trendline that goes back to 1987.
- Momentum from hedging of new corporate bonds and the reallocation of investments by foreign investors could prompt a test of 3%.
- Treasury and Fed fund futures curves now indicate that bond markets expect long-term yields could go as high as 3.25% before retreating.

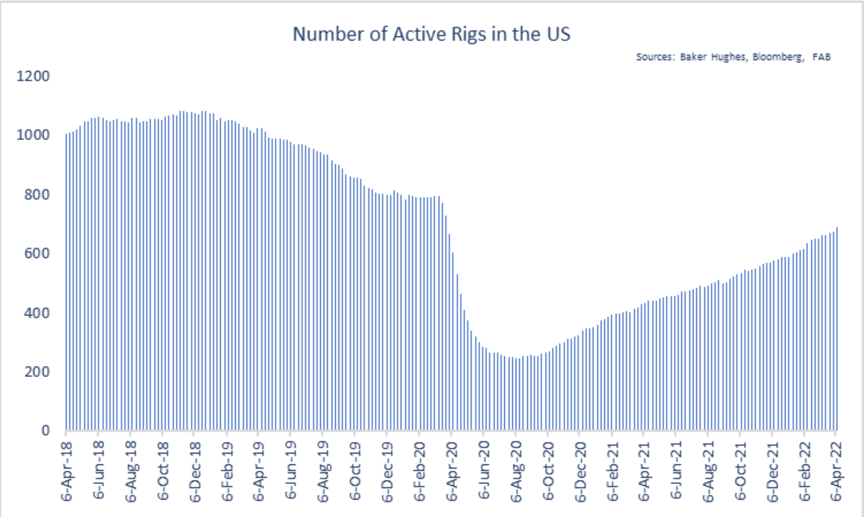


CHINESE COVID LOCKDOWNS ARE TAKING A TOLL ON THE COUNTRY'S ECONOMY

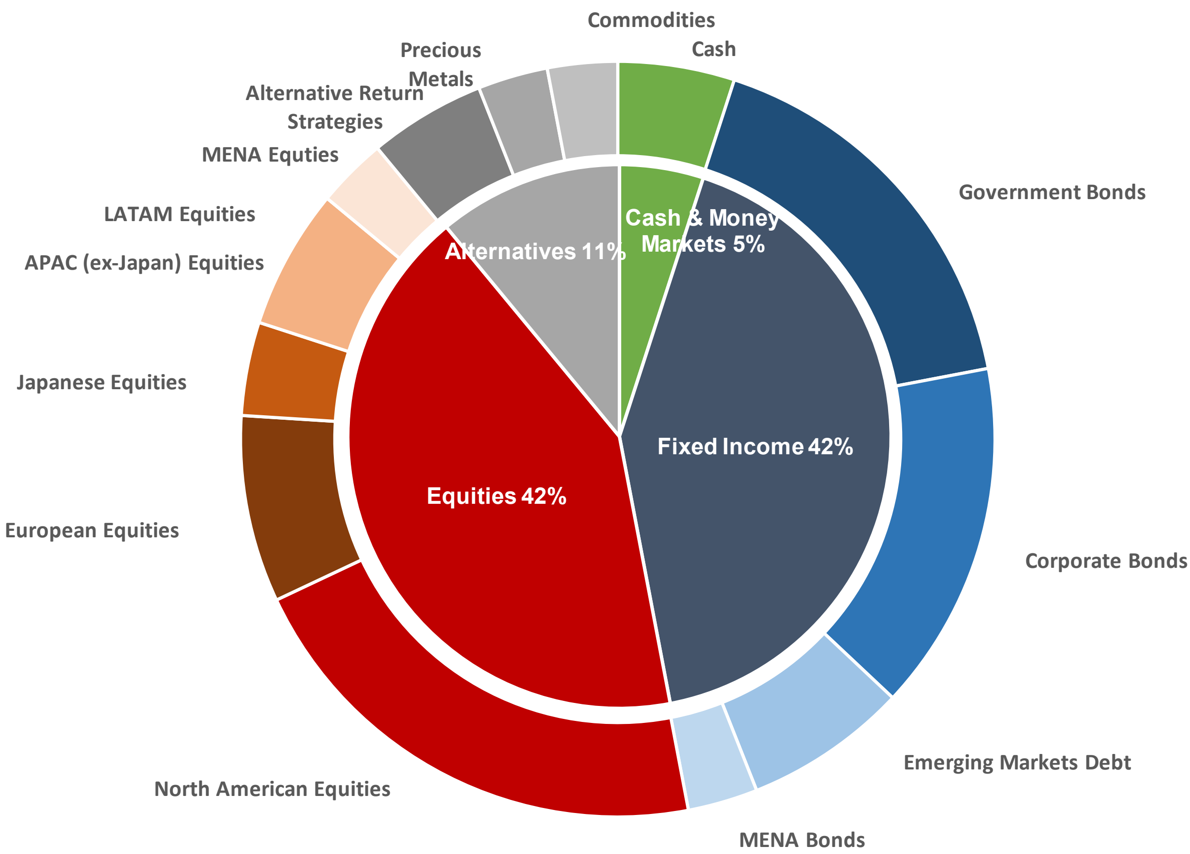
- Shanghai has been in a lockdown for weeks amid record Covid cases.
- This follows after Shenzhen and Hong Kong had been locked down earlier.
- The zero-Covid policy in the country is taking its toll as evidenced by the Caixin composite PMI, which came in last week at 43.9, the second lowest level in the history of the indicator.
- The Chinese and Hong Kong markets, which had started to stage a recovery, have been giving back recent gains.
- The Hong Kong Hang Seng index has fallen 25% in the past year.

OIL PRICES ARE DROPPING AMID DEMAND FEARS, BUT SUPPLY IS YET TO RISE MUCH

- Brent crude prices fell 4.18% on Monday, dropping below US$100/ barrel, but had recovered to US$104.64/barrel yesterday.
- Concerns about falling demand in China and potentially lower economic activity in the US have compounded with the release of strategic oil reserves from the US.
- However, strategic reserves will have to be replenished and supply has not increased significantly, so oil prices are likely to remain high throughout this year at least.



Asset Class	Positioning	Detail
Cash	Underweight	Putting cash to work in risk assets.
Fixed Income	Overweight	Keeping a slight overweight focused on EM dollar debt.
Equities	Overweight	Slightly overweight in Asia ex-Japan and US markets.
Alternatives	Underweight	However, reducing the underweight in hedge funds.



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