INVESTMENT INSIGHT APR 2022

Investment Services Department

Altruist Financial Group Limited
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THE TRIO OF WAR, VIRUS AND ACCELERATED INFLATION

2022 Q1 MARKET HIGHLIGHTS

- *The Russian invasion of Ukraine accelerated global inflationary pressure*
- *The U.S. treasury yield curve inverted*
- *Slowdown of economic activities in China due to the outbreak of Omicron variant*

Shortly before dawn on 24 February, the Russian President, Vladimir Putin, shocked the world by an invasion of Ukraine and kicked off the biggest ground war in Europe since the Second World War. The invasion by the Russian troops seems to be a "Black Swan" event, however, it was long predicted by the Western World even though the Russian side repeatedly denied. The Russia-Ukraine war has already caused severe destruction and mounting casualties. Also, it has triggered the biggest refugee crisis in Europe in recent decades.

Since the first day of the Russian invasion, most of the western countries have implemented unprecedented sanctions against Russia, the Russian stock market fell sharply as much as 40% in one day and has also been suspended from trading for about a month while the Russian Ruble also tumbled to a historical low. Although Russia accounts for only around 2-3% of the world economy, as a country with rich natural resources, Russia is the major global supplier of oil, natural gas, precious metals, minerals and agricultural products. The sanctions against Russia has intensified the supply

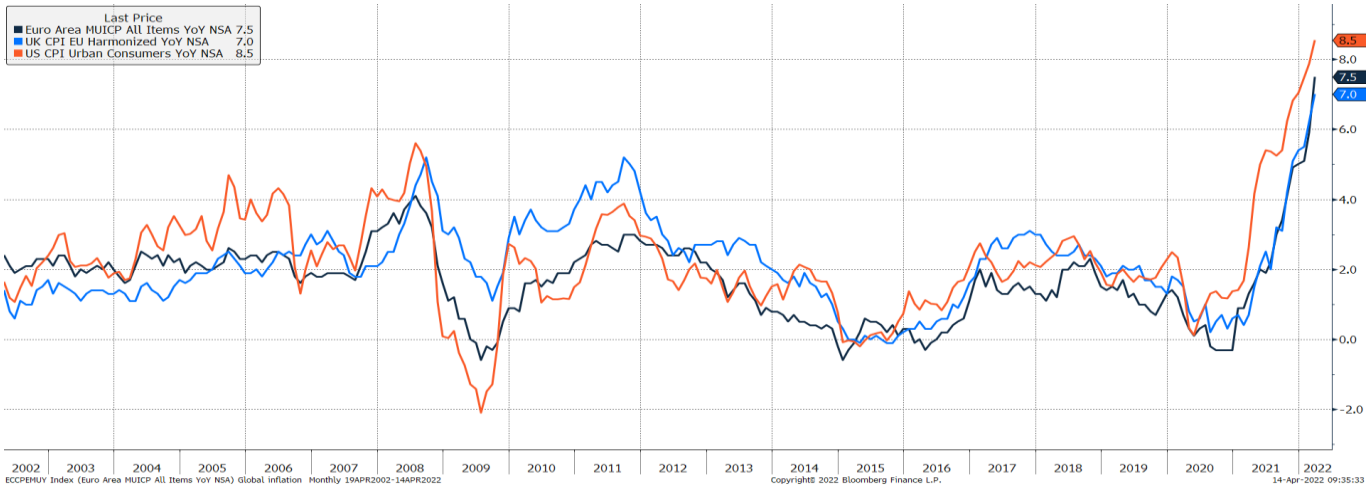
chain disruption, stimulated the surge of commodity price and heightened global inflationary pressure further.

EXHIBIT 1: The Bloomberg Commodity Spot Index rallied about 25% in the 1st quarter of 2022

Source: Bloomberg (as at 31/03/2022)

Apart from the European Central Bank, most of the global major central banks have started monetary policy normalization to fight against the heightened inflation and the U.S. Federal Reserve ("Fed") has already started lifting interest rate during its meeting in March. According to many different studies, the Fed may move forward with a more aggressive, quicker rate hike and will send financing costs higher. For example, the U.S. 30-year fixed mortgage rate has rocketed above 5%, which was the highest in the past 10 years. In addition, the Fed also plans to begin reducing its USD 9 trillion balance sheet in the coming months. The prompt and vigorous reversal of monetary policy may bring more uncertainties amid the current complicated global economic and political situation.

EXHIBIT 2: Global inflationary pressure accelerated due to the Russian- Ukraine Crisis



Source: Bloomberg (as at 31/03/2022)

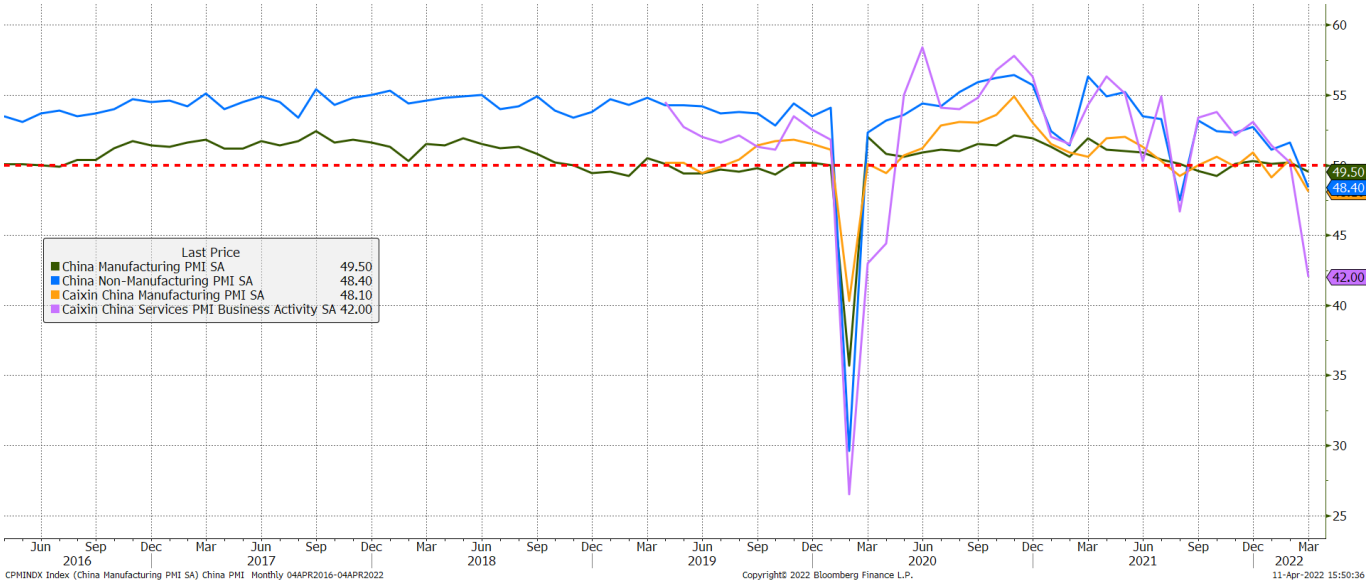
Due to the Fed's hawkish stance, the yields of short-term treasury have risen significantly. The overall U.S. treasury yield curve flattened and at the end of March, the yield of the 2-year treasury was even higher than the 10-year's and the yield curve inversion phenomenon happened. Inverted yield curves are unusual since a longer-term debt should carry greater risk and provide higher interest return. When such phenomenon occurs, it may reflect the change of investors' risk perception. Historically, when the U.S. yield curve inverts, economic recession always follows in the coming one or two year. The last time that happened was in 2019 and the U.S. economy coincidentally entered into recession due to Covid-19 pandemic in next year.

EXHIBIT 3: The spread between the 2-year and 10-year treasury yield turned to negative at the end of 1st quarter 2022

Source: Bloomberg (as at 31/03/2022)

The negative impact of Covid-19 towards the U.S. and Europe economies is diminishing since most of the western countries have chosen "living with the virus" policy and most of the restriction measures have been eased due to the high vaccination coverage. On the contrary, with the outbreak of Omicron variant in China, two most of the important business hubs, Shenzhen and Shanghai, recently have been under lockdown. Omicron variant is highly transmissible and if the spread of the virus cannot be controlled, more restrictive measures may be imposed due to the "Dynamic Zero" policy of China, the country's normal economic activities may be affected and ultimately, it may bring downside pressure to the global economy as well.

EXHIBIT 4: China's official and Caixin PMI fell into contraction zone in March 2022



Source: Bloomberg (as at 31/03/2022)

TABLE 1: Global Stock Markets Performance

	2022 Q1 Return		2021 Full Year Return	
Indexes	**Local Currency**	**USD**	**Local Currency**	**USD**
S&P 500	-4.60%	-4.60%	28.68%	28.68%
Nasdaq Composite	-8.94%	-8.94%	22.21%	22.21%
STOXX Europe 600	-5.87%	-8.39%	25.82%	17.19%
DAX	9.25%	-11.12%	15.79%	6.61%
CAC 40	-6.94%	-8.86%	31.88%	22.83%
Nikkei 225	-2.58%	-7.70%	6.62%	-4.42%
Hong Kong Hang Seng	-5.99%	-6.08%	-11.84%	-12.33%
Hang Seng China Enterprises	-8.63%	-9.02%	-21.25%	-21.69%
Shanghai Stock Exchange Composite	-10.65%	-10.02%	7.05%	9.93%
Shanghai Shenzhen CSI 300	-14.53%	-13.92%	-3.51%	-0.91%
Singapore Straits Times	9.57%	9.02%	13.55%	11.34%
Korea KOSPI	-7.39%	-9.13%	4.15%	-4.79%

Taiwan TWSE	-2.69%	-5.93%	26.92%	28.85%
India SENSEX	0.71%	-1.17%	23.23%	20.84%
Indonesia JCI	8.36%	7.69%	12.46%	10.65%
Thailand SET	3.19%	3.38%	17.70%	5.81%
Russia RTS	-35.67%	-35.67%	21.73%	21.73%
Brazil IBOV	14.48%	34.53%	-11.93%	-18.10%
S&P Pan Arab Composite	15.00%	15.00%	32.66%	32.66%
MSCI World	-5.04%	-5.04%	22.38%	22.38%

Source: Bloomberg (as at 31/03/2022)

TABLE 2: Major Currencies Performance (In terms of USD)

	Change in 2022 Q1	Change in 2021
Currencies	**In terms of USD**	
Euro	-2.66%	-6.93%
British Pound	-2.91%	-1.01%
Japanese Yen	-5.44%	-10.28%
Hong Kong Dollar	-0.41%	-0.56%
Chinese Renminbi (CNY)	0.25%	2.69%
Australian Dollar	3.02%	-5.60%
New Zealand Dollar	1.77%	-4.98%
Singapore Dollar	-0.41%	-1.99%
South Korean Won	-1.90%	-8.63%
Taiwanese Dollar	-3.30%	2.25%
Indian Rupee	-1.91%	-1.71%
Indonesian Rupiah	-0.81%	-1.42%
Thai Baht	0.45%	-10.34%
Russian Ruble	-7.45%	-1.51%
Brazilian Real	17.59%	-6.77%

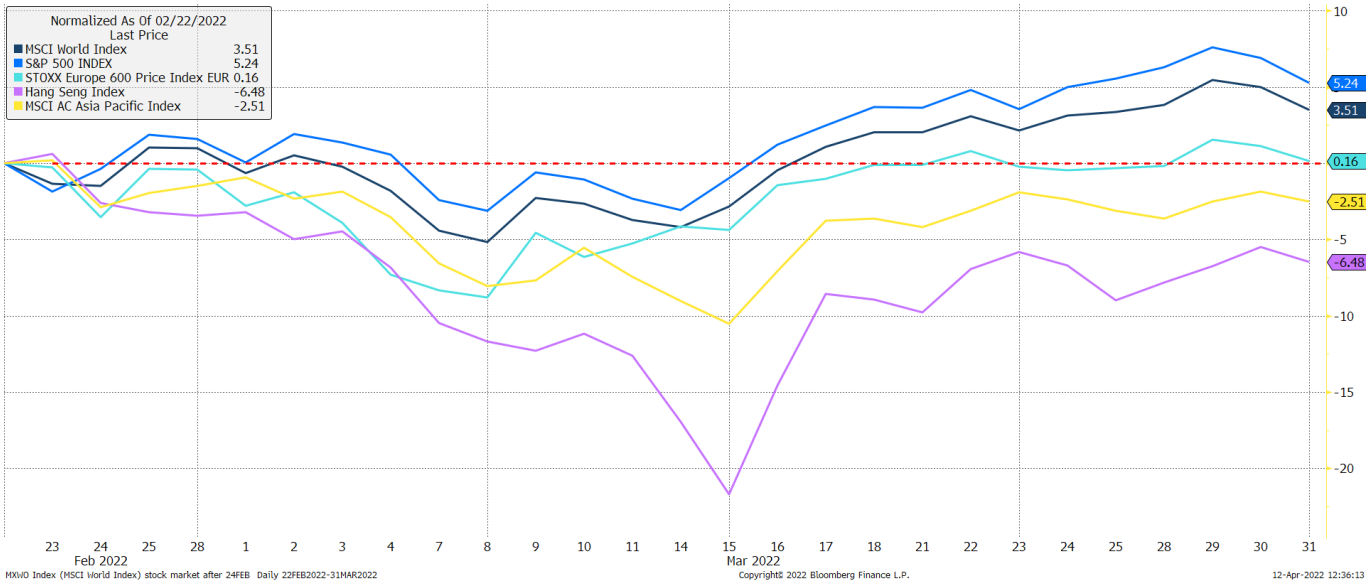
Source: Bloomberg (as at 31/03/2022)

THE STOCK MARKET

The Russian invasion of Ukraine immediately brought volatility to the global stock markets. The Russia stock market has fallen as much as 40% in one day, the stock exchange has been suspended for trading for a month and foreign investors are still banned from selling Russian stocks right now.

"Buy on the sound of cannons, sell on the sound of trumpets." At the end of March, most of the major stock markets in the developed world have already rebounded and recovered the loss since the Russian invasion started.

EXHIBIT 5: Stock markets rebounded after the Russian invasion of Ukraine



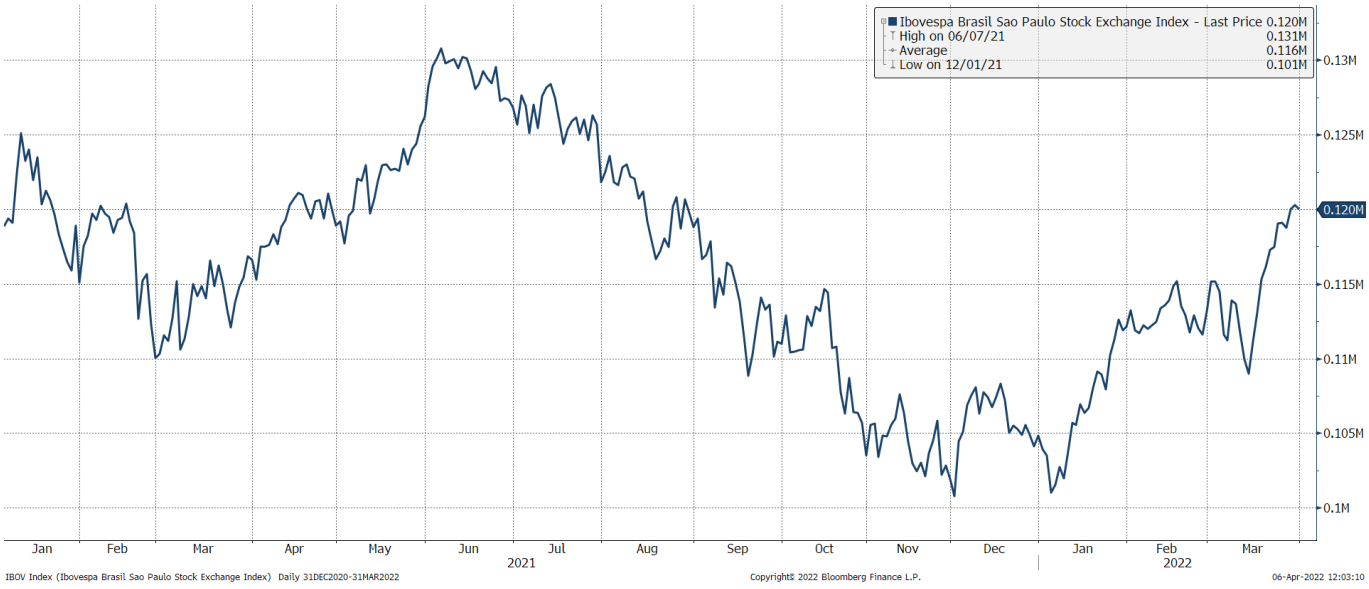
Source: Bloomberg (as at 31/03/2022)

It is always believed that the impact of war or geopolitical crisis towards stock markets is always short -lived, however, the western world has brought a wide range of sanctions toward the exports of Russian commodities in the current crisis. As a result, commodity prices are skyrocketing, and it seems that the rising commodity price cycle may go on. Global inflation accelerates, and the stance of global major central banks is crucial to the stock markets. If the U.S. Fed speeds up its monetary tightening, it may dry up market liquidity, which will be unfavorable to risky assets, especially to those growth stocks.

On the other hand, other countries with rich natural resources may benefit from the recent crisis and Brazil is one of them. The Brazilian stock market was among the worst-performing stock markets in

2021, however, due to the reason of low market valuation, surging commodities price, and strong foreign inflow, the Bovespa Index has already gained over 30% in terms of USD this year. Looking ahead, the country faces risks including sluggish local economy and surging interest rate across the globe, and market volatility is expected to pick up ahead of the October presidential election, but the broad range of commodities rally may still support the market.

EXHIBIT 6: The Brazilian stock market rallied after the market slump last year



Source: Bloomberg (as at 31/03/2022)

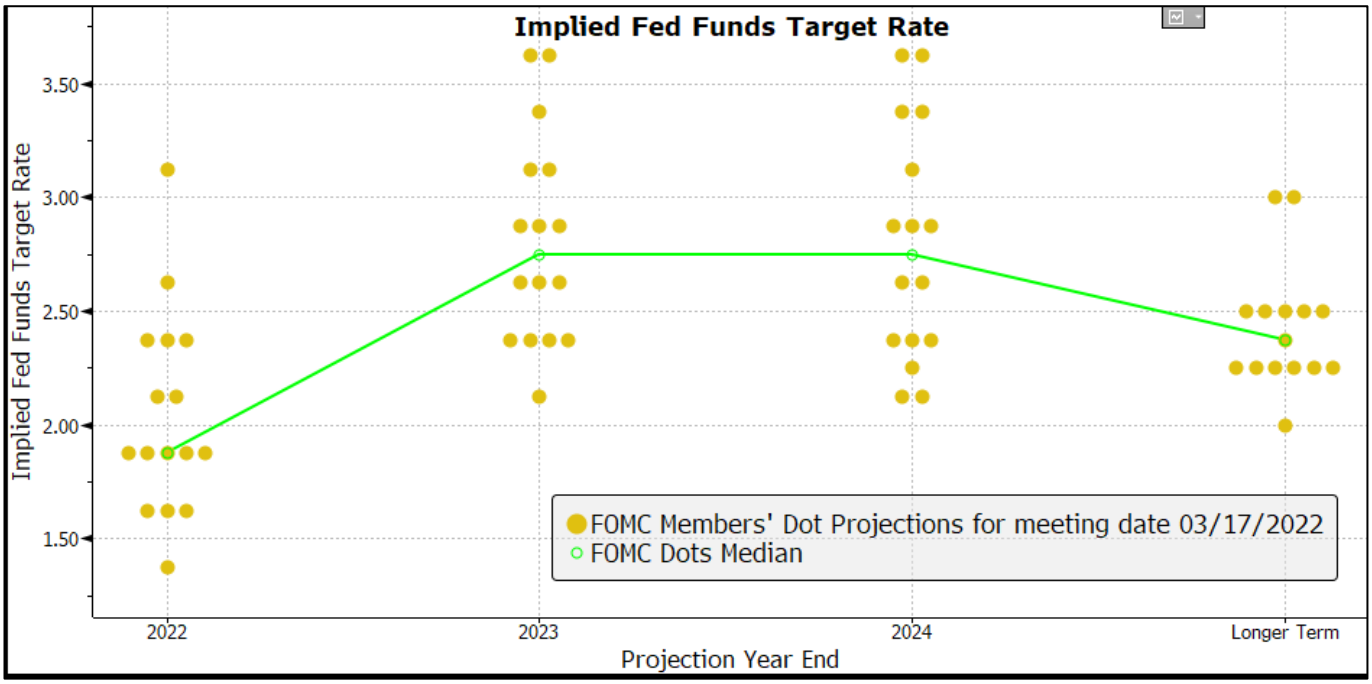
The poor market sentiment of Hong Kong and China stock markets extended in the first quarter of 2022. In early February, the Hang Seng Index has climbed to about 25000 level, however, with the outbreak of Omicron variant, the Russian invasion of Ukraine and also, the threat of delisting of U.S. listed Chinese companies, the Hang Seng Index plunged over 6500 points to 18200 level in about 1-month time, which was almost at the lowest in the past 10 years.

In Asean region, Hong Kong's long-term competitor, Singapore, is sheltered from the recent geopolitical crisis and Sino-US relationship. Besides, as Singapore starts to lift Covid restrictions, economic activities gradually resume normal and its attractiveness to global talents also increases. Not surprisingly, the Straits Times Index posted over 9% return in the first quarter in 2022 and has been the best performing Asian stock index this year so far.

FIXED INCOME

According to the recent projection from the Federal Open Markets Committee ("FOMC") members in their recent meeting in March, it is expected that the Fed will have 6 more rate hikes this year and the projected fed fund rate median are 1.9% and 2.8% at the end of 2022 and 2023 respectively. Besides, the latest FOMC meeting minutes also indicated that the Fed officials have reached consensus on the timing and size of balance sheet reduction, likely reducing $95 billion a month and starting in May. The pace of balance sheet reduction is radical, and it is almost the 2 times of the last balanced reduction cycle happened between 2017 and 2019.

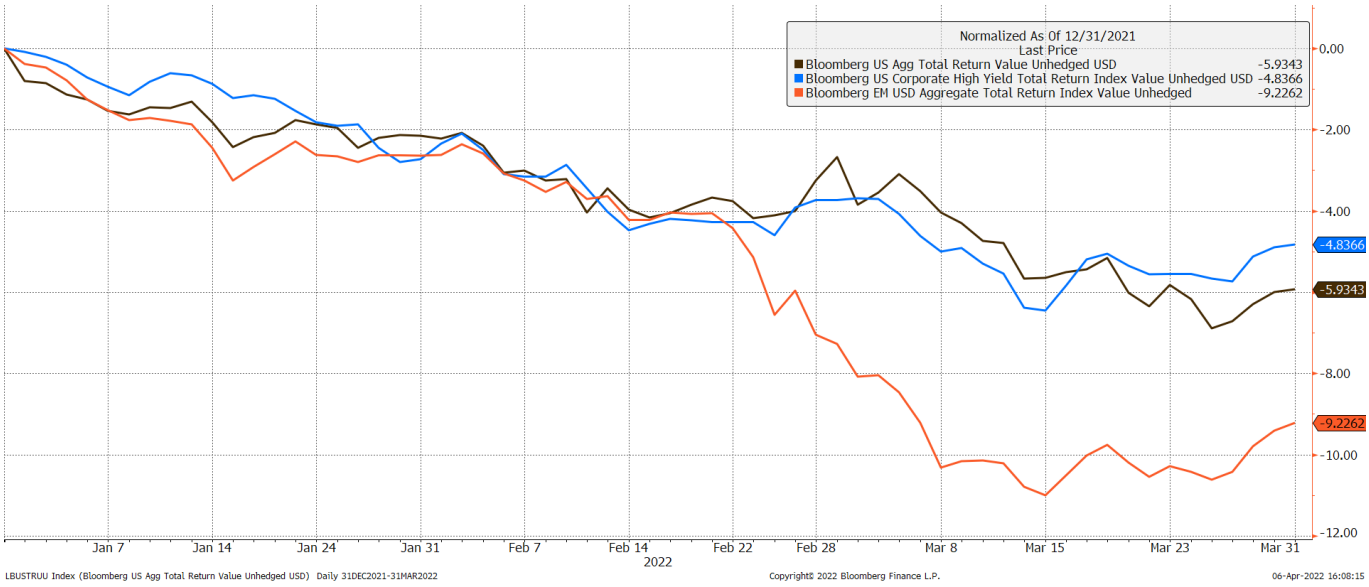
EXHIBIT 7: FOMC member's latest Dot Projection



Source: Bloomberg (as at 31/03/2022)

Most of the fixed income asset classes posted negative return in the 1st quarter of 2022. Even though geopolitical crisis happened in Russia and Ukraine, high quality fixed income cannot attract money inflow. Faster interest rate hike and earlier than expected monetary policy normalization path triggered bond sell-off and sharp rise of short-to-medium treasury bond yields. The Bloomberg U.S. Aggregate Bond Index which comprises Treasuries, investment grade corporate and mortgage-backed bonds was down around 6% this year, on track for the third worst quarter since 1976.

EXHIBIT 8: Different fixed income classes posted negative return in the 1st quarter of 2022



Source: Bloomberg (as at 31/03/2022)

CONCLUSION AND RECOMMENDATION

Looking ahead, it is believed that the combination of the Russian – Ukraine war, Omicron epidemic in China and the Fed's vigorous monetary policy reversal towards the accelerated global inflationary pressure will have enormous impacts towards global economic growth and add further volatility to the investment markets.

For equity, ***cyclical and valuable stocks*** are still preferable in the current market cycle. As mentioned in the previous Market Insight in January, financial sector always outperforms the general market during monetary policy tightening cycle as financial institutions like, banks and insurance companies can earn higher net interest income.

In the long run, the ***sustainable energy equities*** sector may benefit from the recent Russian-Ukraine war. The crisis indirectly encourages the world, especially those European countries, to reduce the dependence of traditional energy and increase the demand of clean energy, like Wind, solar, etc and also energy-saving technology.

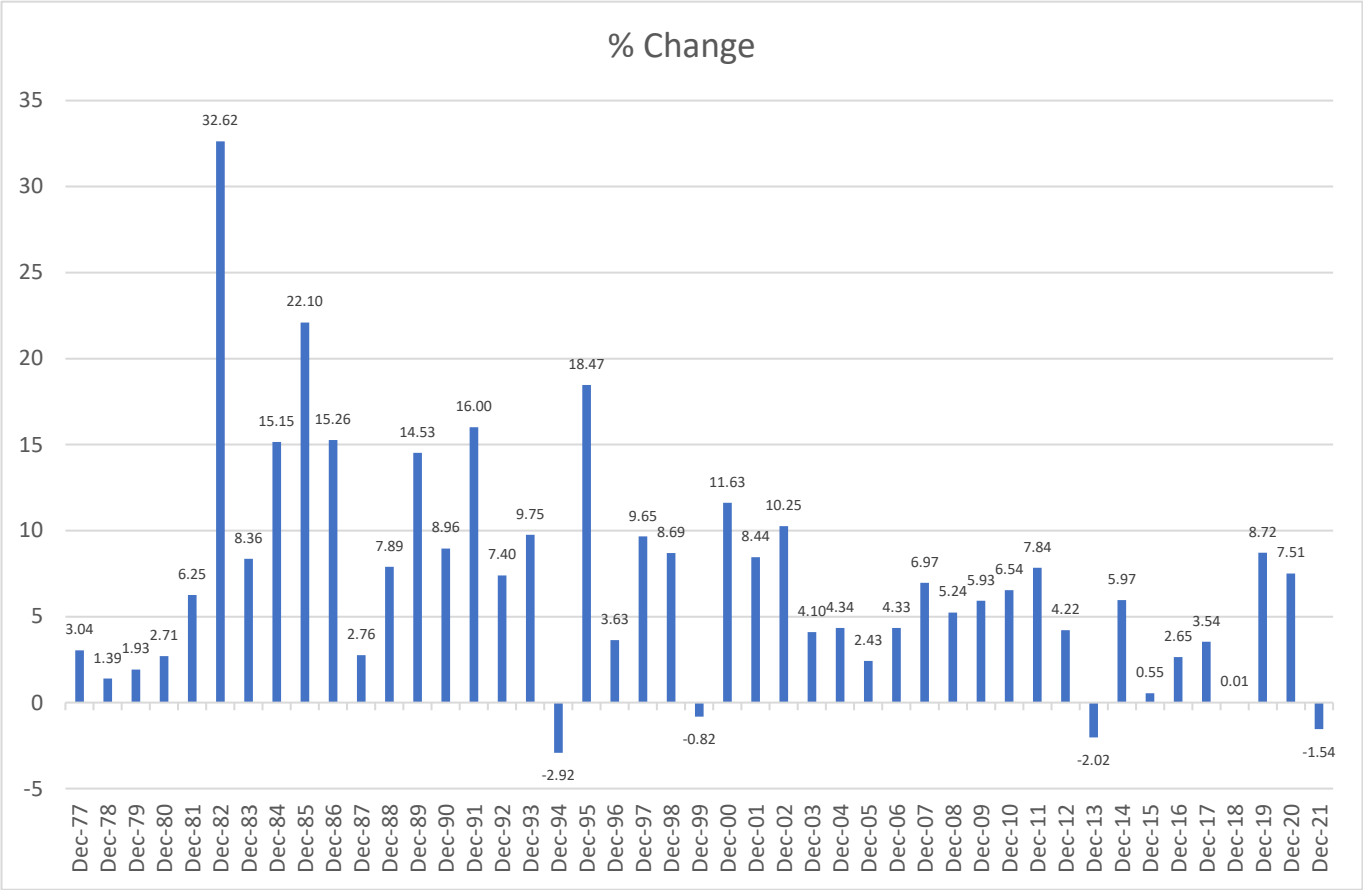
Geographically, it is believed that the ***U.S. market*** is more resilient as the U.S. economy still maintain better growth and it is relatively less sensitive to the rising commodities price. Although the hawkish stance of the Fed will bring downside risk, it may offer investors a long-term investment opportunity during market correction.

In terms of stock market valuation, the ***Hong Kong and China markets*** are attractive. The Hang Seng Index is currently traded at a deep discount, the Price-to-Earnings ratio is at around 8 times while the Price-to-book ratio is also below 1. Unlike other global major central banks, the People's Bank of China currently is adopting a loosening monetary policy and more easing is expected to come in order to boost up the economy and strengthen the country's financial stability. Although there are still many uncertainties surrounding the Hong Kong and China markets which include the deteriorating Sino-U.S. relationship, the worries of economic slowdown in China due to the outbreak of Omicron variant, regulatory crackdown and the brain drain problem in Hong Kong, etc. , investors may still consider their medium-to-long term investment opportunities due to the reason of relatively low valuation and abundant market liquidity.

For ***fixed income***, negative annual returns for U.S. high quality bonds are rare. Since its inception, the Bloomberg U.S. Aggregate Bond Index has only ended a year with a negative return at four times. It recorded 1.54% and 5.93% loss in 2021 and the 1st quarter of this year respectively. The recent sell-

off of fixed income may have priced in the Fed's coming contractionary monetary policy to a certain extent and current higher bond yield can provide a more attractive reinvestment return, it is believed that fixed income can still offer portfolio diversification in medium-to-long term.

EXHIBIT 9: Annual performance of Bloomberg U.S. Aggregate Bond Index



Source: Bloomberg (as at 31/03/2022)

The rest of 2022 will not be easy for most of the investors as there are many different market uncertainties. To be more conservative, holding more cash and waiting for discount buying opportunities may be a good alternative.

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