

The Navigator

April 26

Regime Change

By Edward Lim, CFA

In my early days as a portfolio manager, I met a highly ranked Asia strategist. He had a large institutional following partly because he was the only Asian in a bulge-bracket firm as a regional strategist and his analysis was often data-backed rather than eloquent rhetorics of most of his Caucasian peers. I can still remember one of his punch lines “The most important quality of a good strategist is to stick to your views; eventually you will be right.” Unfortunately, as the CIO of the firm, I do not have that luxury. Strategists do not run portfolios; they just write and speaks well in front of an audience. When you are managing risk like several of my colleagues do, it is imperative to mark to market developments and adjust your portfolios accordingly if there is a need to.

We entered the year, [Bubblicious](#), with these bullish contours. First, we expect growth to remain resilient driven by accommodative fiscal policies, AI capex boom as well as fading effect of Liberation Day tariffs. We judge the recent weakness in the labour market as a low-hire, low-fire environment similar to what we have witnessed in the early 1990s when PC and enterprise adoption accelerated that entailed both job displacement and creation but was accompanied by higher productivity.

Second, on inflation, we acknowledged that inflation will not fall back to central bankers’ comfort level due to stubborn service inflation and nascent increase in goods inflation. However, it does not derail the view that most central banks will remain accommodative even as we disagree with market consensus then for further cuts by the Fed.

Third, while high valuation can put a constrain on the magnitude of upside returns in equities, we argued wide-spread earnings growth across regions and sectors and more importantly, positive earning revision momentum will underpin constructive return profiles across many asset classes favouring equities over bonds though.

But like any strategist, there must always be a hedge to the call, and we caution we are in a mature bull market now running into its fourth year. There have been several instances since 1945 when the market corrects more than -15% even in an absence of a recession. Such episodes are rarely born of fundamentals alone. They are often the inevitable consequence of complacency and hubris following extended rallies. We noted that 2026 could well prove to be such a year.

But this regime has changed all thanks to US and Israel waging a war against Iran. Not quite the regime change President Trump was hoping for, but the more deleterious change in macro-environment regime that moved away from the Recovery phase we have anchored at the start of the year where growth is rising, and inflation stabilises to several other less constructive paths. We marked to market these developments, and we believe we will **move into a macro regime of decelerating, but non-recessionary growth coupled with higher inflation, but not back to Covid levels.** We do not dismiss the worst-case scenario of stagflation and that would simply come from the failure to restore up to half of the flows from the Middle East by end of May.

As we have laid out in our flash Navigator published shortly after the war, [Dire Straits – Money for Nothing](#), there is enough oil inventory to sustain 2-3 months of the global economy needs. But what we did not realise, the same cannot be said of refined products, which have little excess inventory in part because there was no incentive to stockpile them given the continuous fall in prices prior to the war.

We refined our oil calculus. Before the war, the seven Gulf producers supplied 32.7mbd of molecules (25.4 mbd of crude, 2.8 mbd of condensate, 4.4 mbd of natural gas). As of writing, they have been forced to shut-in 12.3 mbd of production concentrated in 12.1 mbd of crude and condensate and 1.2mbd of natural gas. Assuming this is the peak of shut-in ie the war does not spill into a regional retaliation by the GCC, the total cuts in April would amount to 13 mbd. JP Morgan laid out the potential re-opening schedule in the table below. This underpins their oil price assumptions of \$100bbl on average in 2Q26, \$90/bbl in 3Q, and \$80/bbl in 4Q. There are two other important takeaways from their analysis.

First, it will take at least 4 months for the world to refill their operating requirement after taking into consideration the commercial inventories available in the system. Poignantly, the last of oil tankers leaving the straits before the war reaches their port of destinations this week. Thereafter, draws on inventories and shut-ins will have to happen. Second, this means the up shot in downstream refined products prices will accelerate even further in the coming weeks. Moreover, the downstream refined products will take even longer to replenish and hence we should expect higher for longer prices for likes of diesel, jet fuel as well as petrochemical, plastic resin, and fertilizers (in which LNG is 60-70% of production cost). **We are only at the beginning of cost-push inflation and demand destruction.** Granted these are working assumptions and it could very well take longer and acknowledged **there is non-linearity to the downside the longer the straits are constricted.** But we need to work with something.



Assuming the timeline to resume supply disruptions

Total oil and gas disrupted from Middle East	32.7 mbd	25.4 mbd in crude, 2.8 mbd in condensate and 4.4 mbd of Natural Gas	Spot: \$110/bbl
Total shut-in (As of end of March)	12.3 mbd		
First month of re-opening (Assume by May)	6.3 mbd restored	VLCCs takes 2 days to berth, load and depart and another 2 months to travel to respective docks affected by congestion	2Q26: Average \$100/bbl
Second-Third month of re-opening (Jun - Jul)	29.3 mbd	Assume Saudi fully recover since they have alternate routes and spare capacity UEA 95% recovery Qatar natural gas 60% recovery Iraq and Kuwait 80%	3Q26: \$90/bbl
UEA 95% recovery	31 mbd	Never fully recover because of damage to Qatar loading system as that would take years	4Q26: \$80/bbl

Source: JP Morgan

The feedback loop to higher oil prices obviously will be on growth and inflation dynamics. It is hard to be precise on their impact, but most economists have worked on the rule of thumb for every \$10 increase in oil, global growth could be shaved off by 0.2 ppt and inflation increase by 0.2ppt. We started the year with consensus global GDP growth of 3.0%, 2.0% for the US, and 4.5% for China. The price of oil assumption was for \$60/bbl for 2026, but oil has already averaged \$78/bbl in 1Q26 and using the forecast above, oil will average \$87/bbl for the full year. **Global GDP growth could therefore be reduced by 0.54ppt to 2.45%, which is below trend potential but not recessionary.** US and China will be downgraded by a lesser extent due to the former little dependence on Middle Eastern oil coupled with their recent OBBA tax cuts, while the latter derived nearly 30% of their energy needs from renewable sources and another 50% from coal.

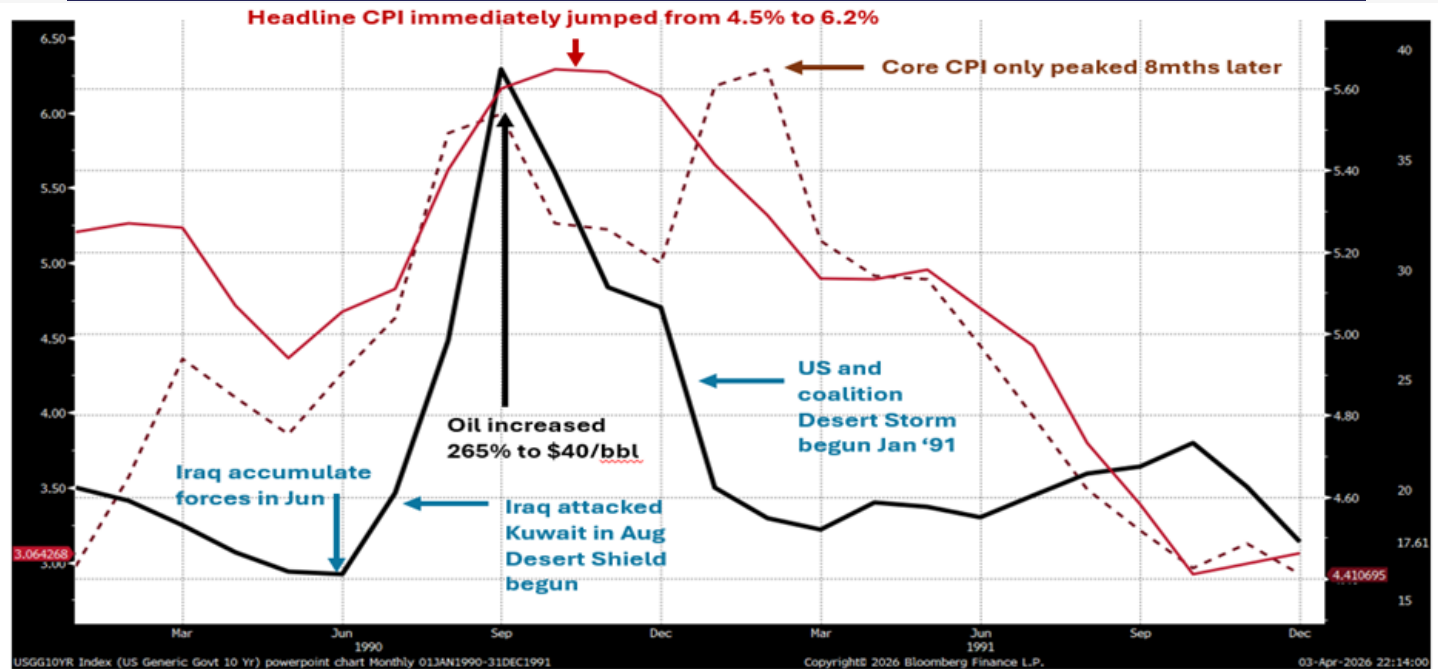
The inflation dynamics is more complex. We learned from the Ukraine-Russia war and the first Iraq war in 1990, the impact to headline inflation is almost immediate, while the inflation measure more relevant to monetary policy, core inflation, tends to be impacted with a lag of 2 to 3 months. None of these figures peaked until several months later after oil peaked. **We believe the 1990 Iraq war is a better analogue to understand inflation and commiserating impact on yields and policy responses** than the 2022 Ukraine-Russia invasion because inflation dynamic was complicated by post-Covid supply chain and labour shortage interruptions.

The 1990 Operation Desert Shield followed by Operation Desert Storm: Saddam Hussein started to accumulate his forces in June 1990 along the Kuwait borders. By August, Iraq invaded Kuwait and US with its coalition started their military build-up in Saudi Arabia to defend the kingdom. By Jan 1991, through the United Nations authorization, the US led a coalition of forces and embarked on Operation Desert Storm to drive the Iraqis out of Kuwait. The entire ground offensive took 1 month and 1 week to liberate Kuwait ending at the end of Feb 1991.



Starting from June 1990, oil price moved aggressively higher as the Iraqi military build-up escalated. Oil (Black line) moved from a low of \$15/bbl and increased by 265% to a high of \$40/bbl. It took 6 months later for oil to fall below \$20/bbl. The impact to headline inflation (Solid Red line) was immediate spiking from the low of 4.3% in May 1990 to peak at 6.2% by November. Core inflation (Dotted brown line) only started to move more aggressively in July to surpass 5% and only peaked in February of 1991. We believe the current crisis impact on oil and inflation trajectories will be similar with the exception that oil from Middle East will now command a risk premium over its fundamentals because unlike previous oil shocks, Iran has now weaponized the Straits.

1990 Iraq-Kuwait war: Oil spike, headline CPI jump immediately. Core peaked 8mths later

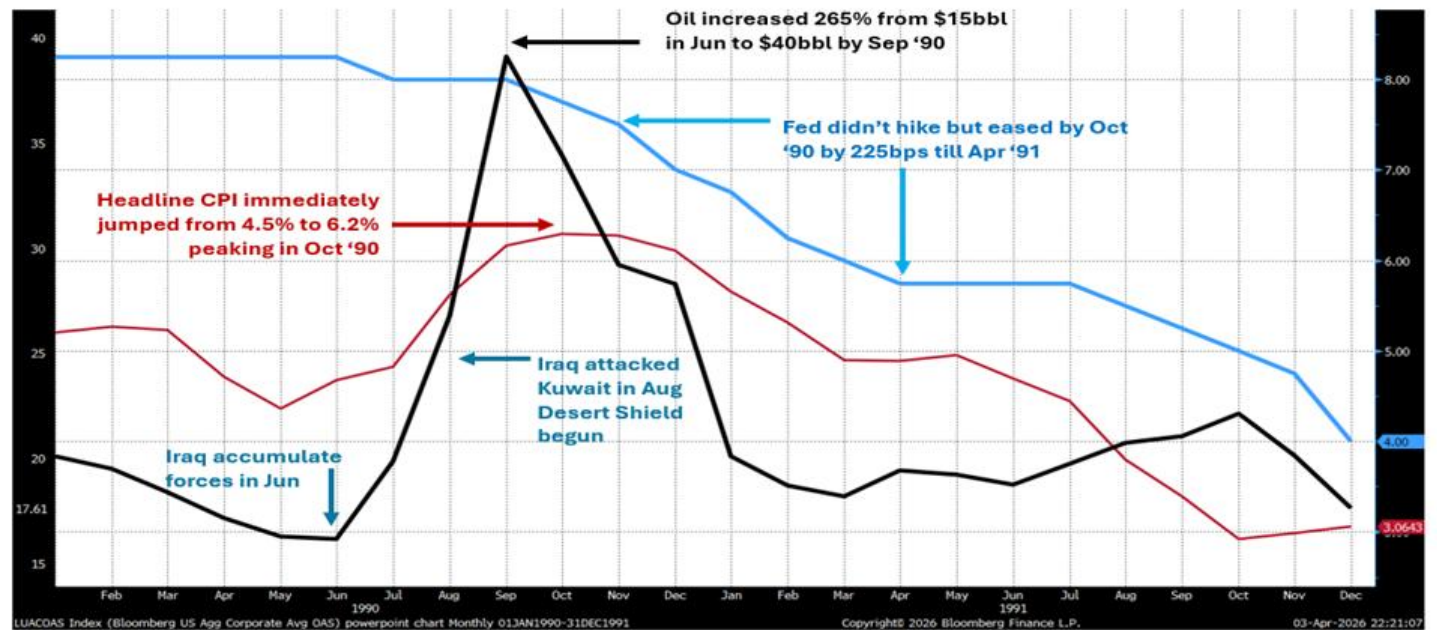


Source: Bloomberg

Prior to the Iraq-Kuwait conflict, the Fed was aggressively fighting inflation by tightening monetary conditions for much of 1986-1989 and only started to ease in late 1989 as the economy slumped bringing inflation down as well. It went into a wait-and-see pause mode in the first half of 1990 before the Iraq-Kuwait war upended the macro environment. **Post invasion, the Fed did demonstrate restraint of not reversing its prior course of easing followed by a pause by hiking even as inflation spikes were immediate and inflation readings were all above its targets.** Inflation prints did not peak until November for Headline CPI (Red line) and February for Core CPI. Instead, Fed re-assessed the balance of risk from the disruption in the oil market was tilted to growth downside and not inflationary pressure. By October 1990, it instituted a series of easing in monetary policies that did not stop till April of 1991 effectively lowering Fed Fund Effective rate (Blue line) from 8% to 5.75% (a 225bps easing).

Similarly, in this current episode, Fed easing cycle of 2024 came after a sharp hiking phase from 2022 to 2023. Prior to the US-Israel campaign against Iran, it has also paused and adopted a wait-and-see approach as it deliberates its dual mandate faced with sticky inflation versus a deteriorating labour market. We believe the **Fed will also show restraint from hiking even as supply-induced inflation shocks materialised**. Its toolbox is not designed to alleviate supply-shocks anyway. **We also believe the next path of their policy action will mimic the 1990 episode. A 25 to 50 bps cuts is in the offing by early second half of this year.** Noteworthy, we are again taking a contrarian view to the market on this issue which is pricing a hike.

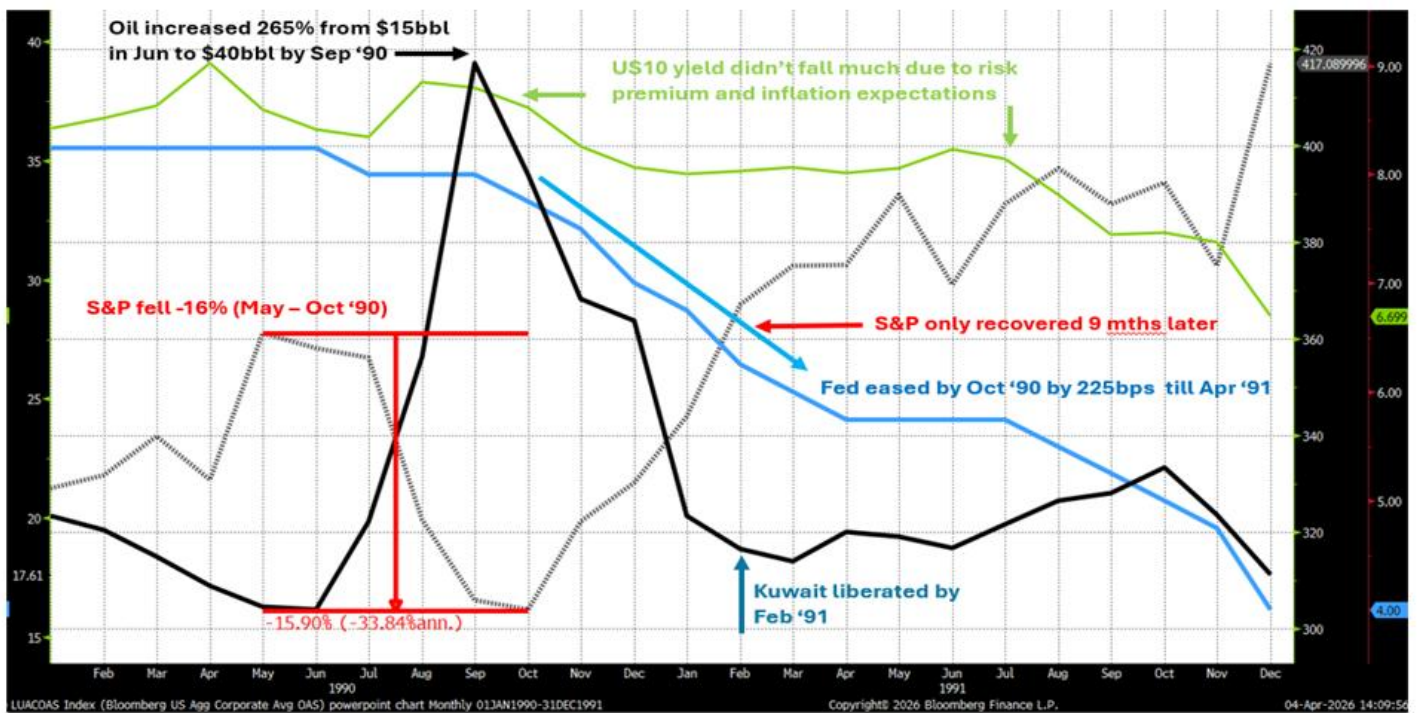
1990 Iraq-Kuwait war: Fed restrain from hiking at the onset, but cut aggressively after



Source: Bloomberg

What about the equity and the bond yields in 1990? As the Fed started to ease its policy rate by October 1990, US10 yields (Green line) did not move in tandem to cuts in Fed Fund Effective rate (Blue line) and stayed elevated at 8 to 8.50% before moving marginally lower below 8% for much of 1991. This was simply due to a build-up of higher inflation expectations initially and increase in risk premia thereafter (*Dear Treasury Secretary please remind your President what that means to your refinancing costs*). On the other hand, US 2-year yields declined by 1.30% from Jul 1990 to February 1991 in the same period. The S&P (Grey line) fell -16% from the peak in May (a month prior to Iraqi forces build-up) and only trough when the Fed started easing in October. It took nine months to recover from its peak when Kuwait was finally liberated in the end of February of 1991. **One important takeaway from this and including past oil crisis shocks is the equity market cares less who won the war but how the Fed and other central bankers react.**

1990 Iraq-Kuwait war: S&P trough when Fed start cutting and recovered when war was over



Asset Allocation Strategy

At Covenant Capital, we articulate our assumptions explicitly—even when they may ultimately prove imperfect. Investment without a framework is merely conjecture. We do not rely on conjectures. Our process is grounded in empirical data, historical precedents, and established economic theory as we attempt to interpret these evolving and difficult conditions. The question, then, is not what we think will happen, but what history and theories can reasonably teach us about what may come next.

As laid out, we believe the macro regime moves from rising growth and stable inflation to two paths, with **our base case as (1) Growth lower but at stable levels and higher inflation** or worst case (2) Growth declining and inflation rising. Our investment clock framework corroborates this base case. The Nowcaster GDP tracker is already signalling a move down in activity in countries and regions most sensitive to oil with China, Germany, India and the broader Euro Zone and Emerging Markets from levels published in last quarter Navigator. Latest consensus forecast has moved inflation higher in every major country so has their forecast for central banks' policy rates.



Early signs confirming we move to a lower but stable growth and higher inflation regime

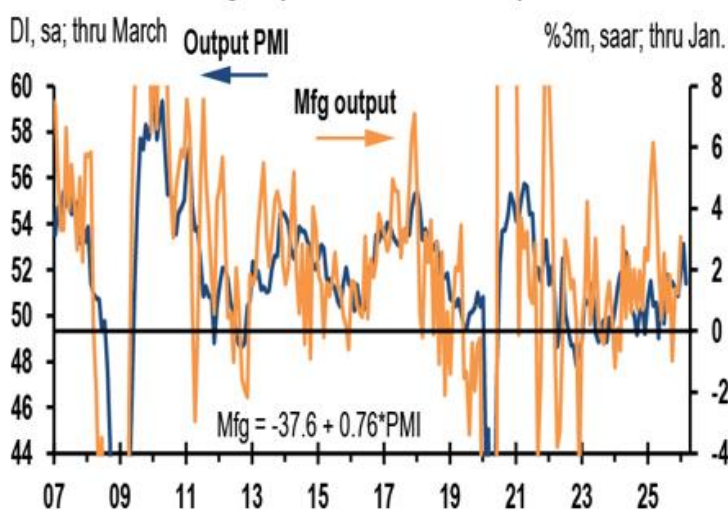
As of 30 Mar 2026	Nowcaster GDP Growth (Annualised)	Change from 1Q26 publication	Consensus Inflation Forecast 2026(F)	Change from 1Q26 publication	Consensus Central Bank Rate Forecast 2026 (F)	Change from 1Q26 publication
Global	3.0	0.4	3.6	0.4		
Developed Markets	1.9	0.4	3.2	0.4	3.49	0.19
Emerging Markets	3.9	-0.4	2.8	0.1	5.09	0.14
US	2.9	1.2	3.0	0.2	3.50	0.25
China	4.4	-0.7	0.9	0.1	2.86	0.06
Euro Area	0.7	-0.5	2.2	0.4	2.00	0.00
Germany	-0.5	-0.6	2.2	0.2		
France	1.0	0.0	1.5	1.5		
Japan	1.3	0.2	2.0	0.1	1.10	0.10
UK	0.2	0.2	2.7	0.2	3.25	0.00
India	7.3	-0.3	2.1	0.0	5.18	0.06
Brazil	1.5	0.9	4.0	0.0	12.3	0.3

Source: Goldman Sachs Nowcaster and Bloomberg Consensus

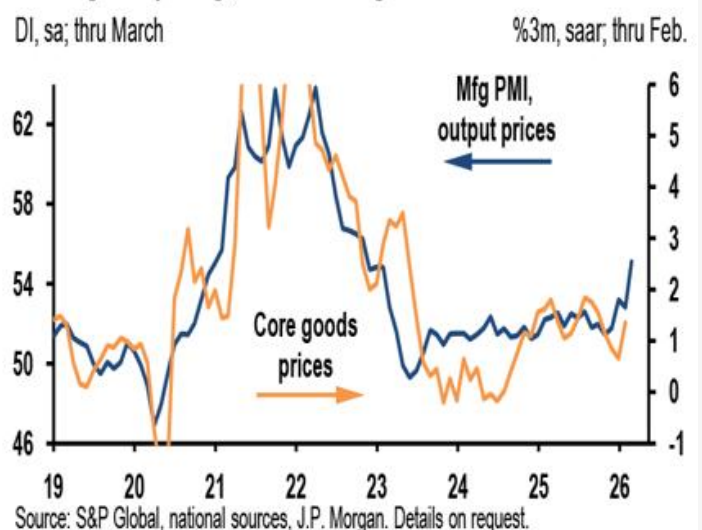
The latest **Global Manufacturing PMI in March** has reversed nearly all of its gain since December. The -1.7 pt fall **puts the global economy growing at sub-par growth of 1.5% annualised**. Under the hood, indicators such new orders, export orders and inventory accumulation are all pointing to a slowing economy. Moreover, survey respondents have also indicated output prices rising and can be seen across the globe.

PMI corroborates to lower growth and higher inflation in coming quarters

Global manufacturing output PMI and actual output



Global goods pricing, PMI and core goods



Based on NDR empirical studies from 1972 till 2025, as we move into a regime where growth forecast is downgraded but at stable level but with rising inflation, **equities return falls materially** from our start of the year regime of 16.1% pa to **6.8% pa**. Equities do not significantly outperform Bonds (3.8% pa) and bonds do not significantly outperform cash (4.9%). Gold and Commodities performed the best. On a volatility-adjusted basis, hedge funds not only perform the best but as standalone asset class, in this regime they perform the second best across all other regimes.

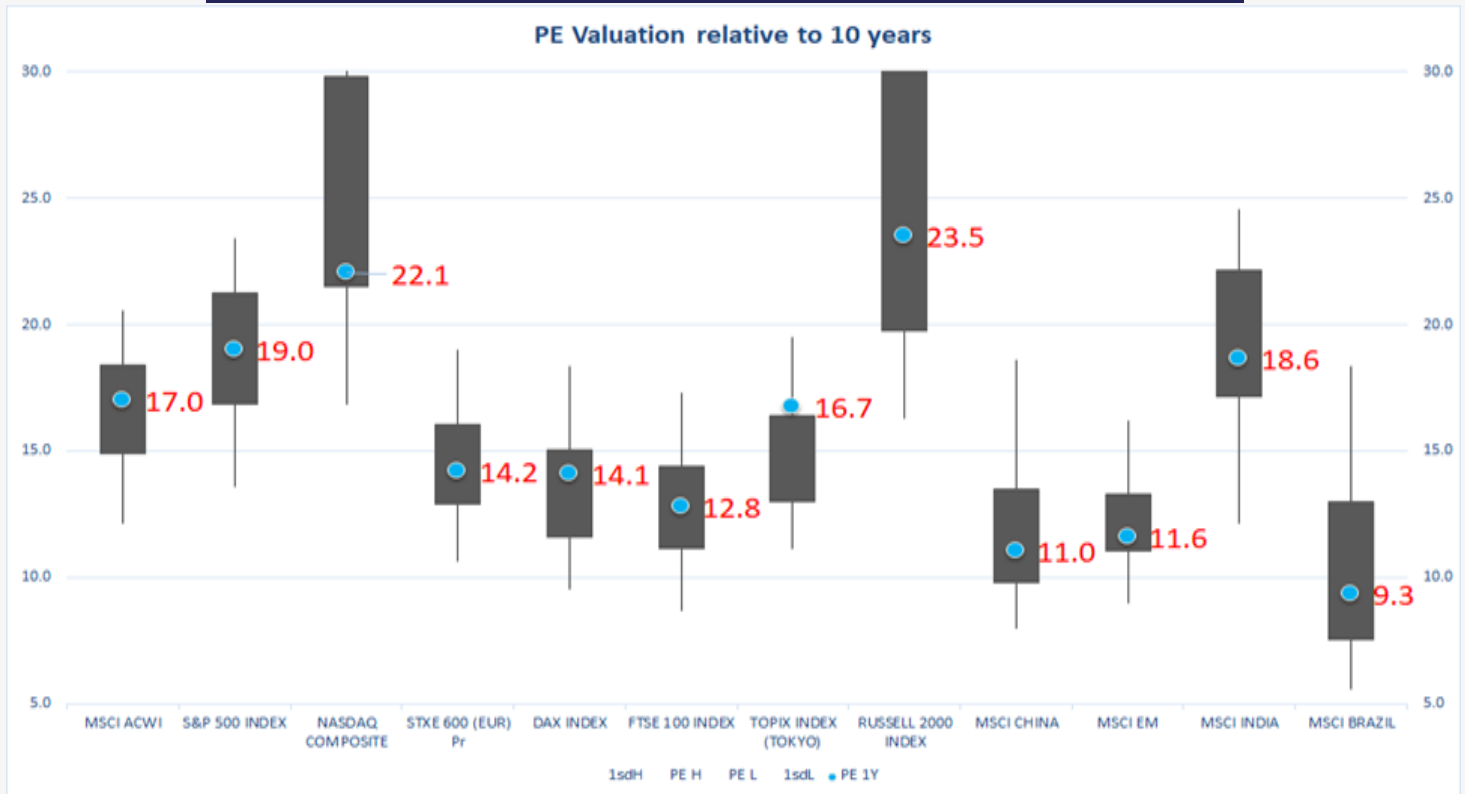
Annualised Returns across different macro regimes (1972 to 2025)

Returns (Annualised)	S&P 500	Bonds	Gold	Commodities	T-Bills	Hedge Funds
Start of year macro regime: Growth Rising, Inflation Stable	16.1	3.7	1.5	8.2	2.3	10.8
Current base-case macro regime: Growth Stable, Inflation Rising	6.8	3.8	17.8	33.9	4.9	13.1
Worst case macro regime: Growth declining, Inflation Rising	-3.2	4.7	30.2	19.8	7.1	12.9

Source: NDR and Bloomberg Finance. Note Hedge Funds = Barclays Hedge Fund Index (Top 50 Managed Futures index 1987-1996, CTA Index prior to 1987) (Analysis period: Dec 1979 to Jan 2026)

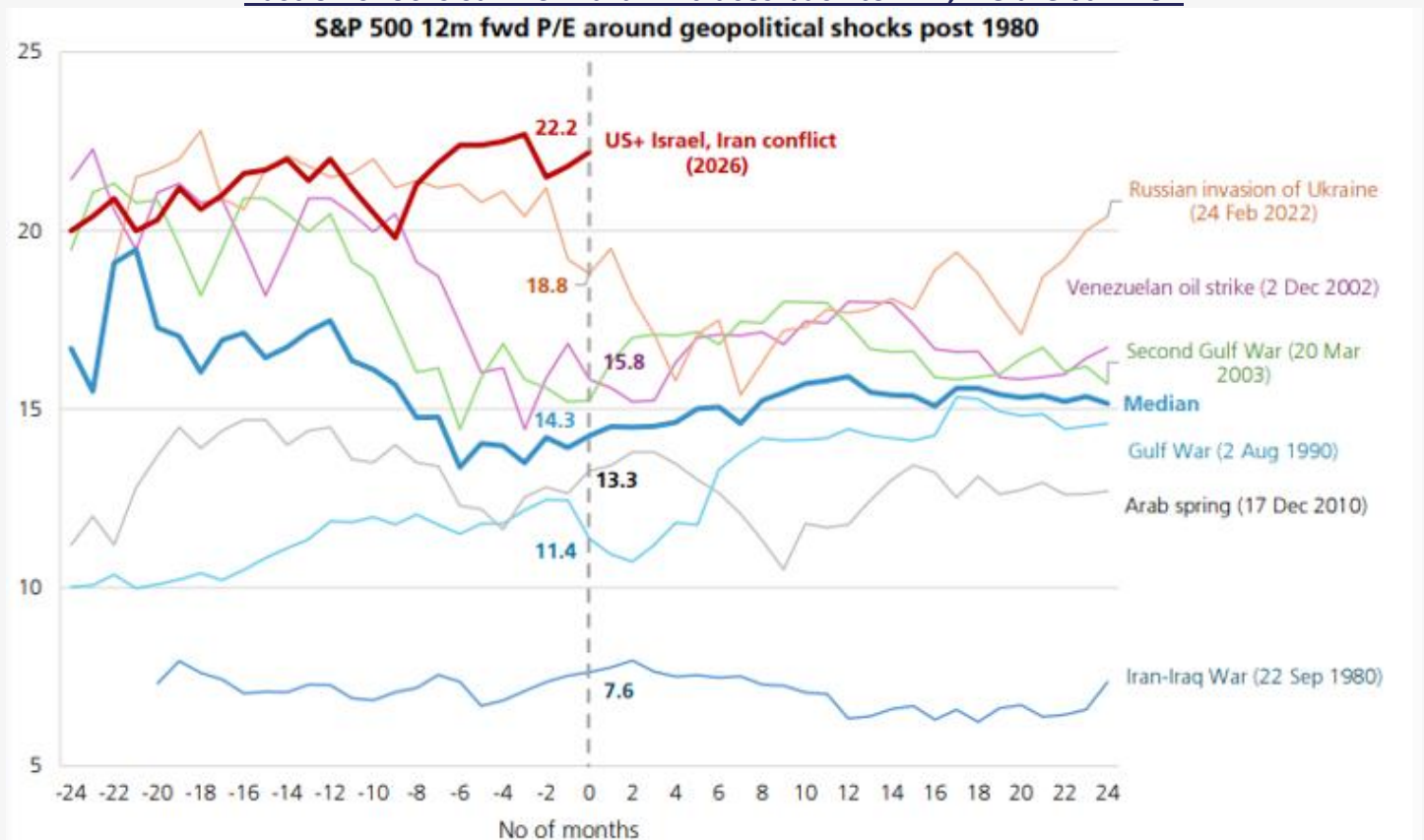
Equities Downgrade to Neutral: The downgrade in our macro views coupled with our views that the maximum impact of this current crisis has not fully run its course. GDP and earnings downgrades should ensue and inflation upgrades supports the downgrade of equities to Neutral. While we believe a relief rally can occur in the coming weeks because the market is oversold, we will be willing to reduce our equities further. Valuation has receded from its extreme expensive levels no doubt but an additional study from UBS Research shows that forward PE multiple typically corrects 6 ppt from the peak and bottoms at 14x forward PE in previous oil-shocks. The S&P is trading now at 18x having corrected from 22x. Amongst the key indices, NASDAQ looks attractive trading at close to its -1sd 10-year forward PE at 22x.

Valuation has receded from their highs but is not near trough valuation



Source: Bloomberg

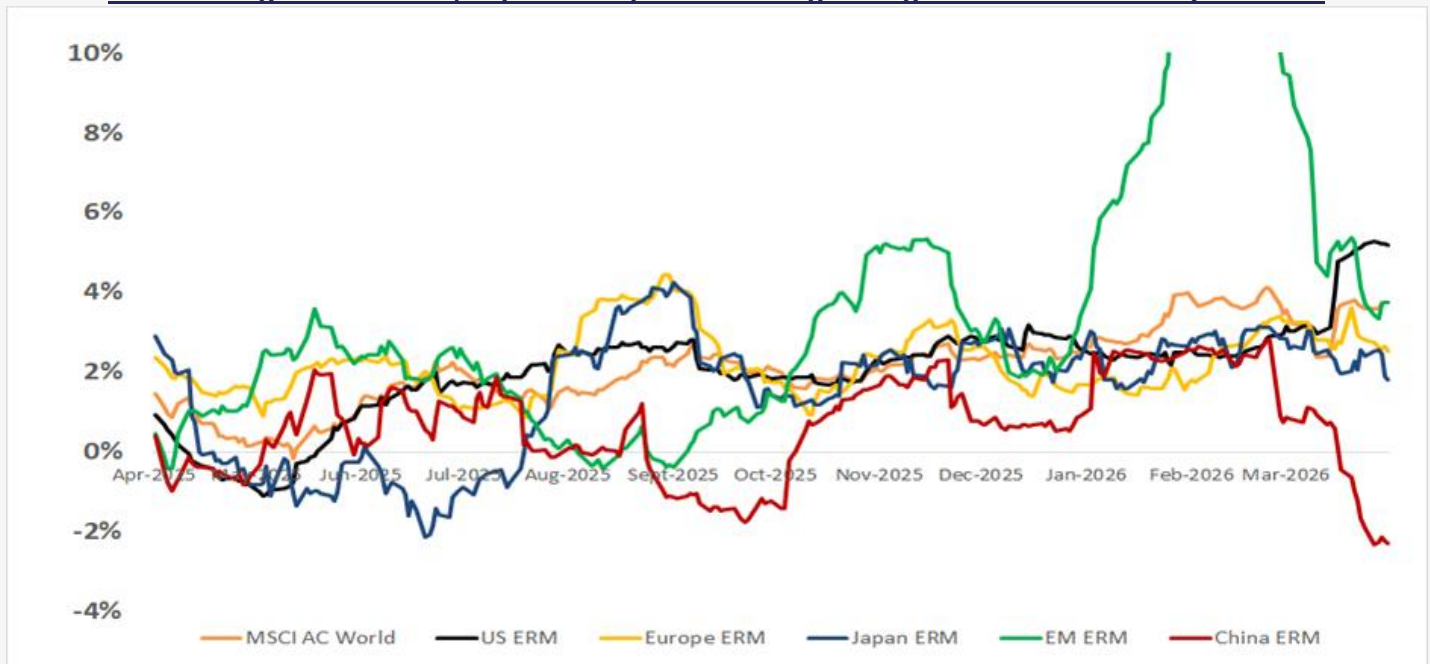
Past oil shocks saw forward PE traces back to 14x, we are still 18x



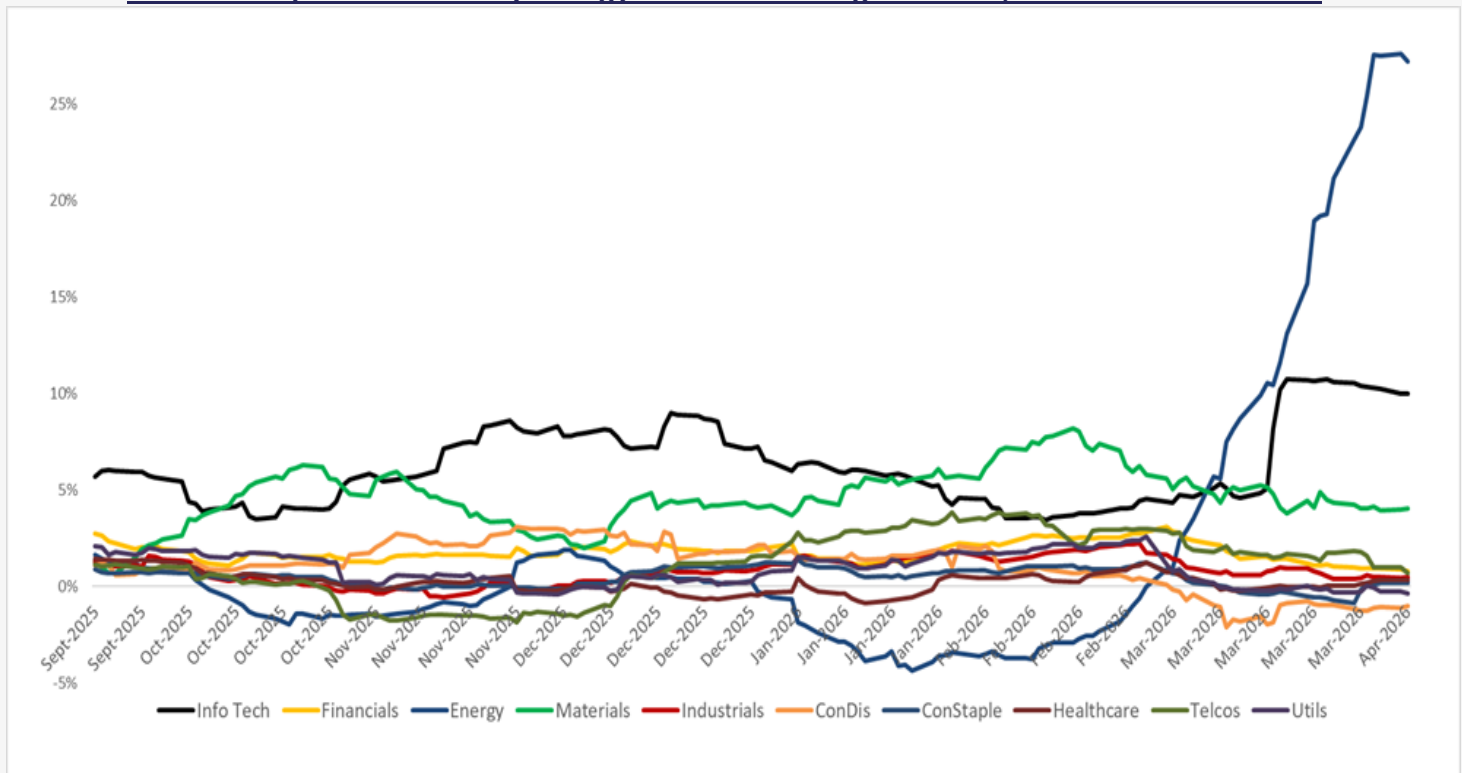
Source: Macrobond, UBS.

We are starting to see EPS revision momentum turned negative for every market with China EPS in negative revision zone, EM witnessing the biggest negative delta of change, and Europe and Japan likewise. Only the US is seeing upgrade driven narrowly by energy and tech sectors.

ERM rolling over for EM, Japan Europe and outright Negative in China. Only US isn't



Narrow scope of ERM: Only Energy and Tech seeing +ve ERM, rest are flat or down

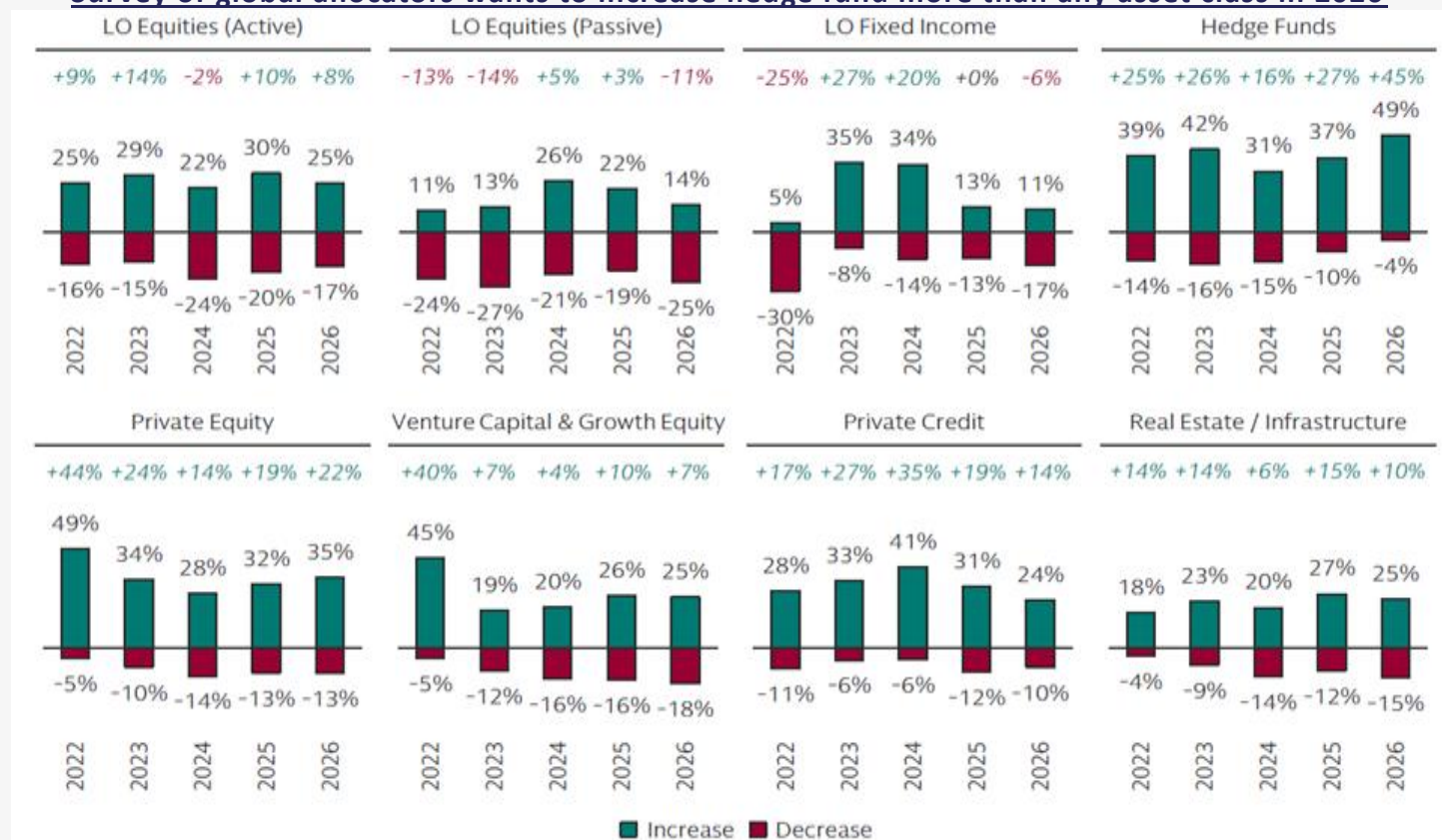


Source: Bloomberg Estimate

Fixed Income: Underweight. In the regime of lower but stable growth and rising inflation, the transmission mechanism to fixed income will be from an initial spike in the front end of the government bonds (2-year US Treasury has risen 47bps since the start of the war) more than the long-end of the curve (10-year +37bps) as investors price in inflationary risk and Fed hikes. But because recession is avoided, credit spreads should remain tight (investment-grade credit spread only rose 2bps, high-yield 20bps). **We do not believe there will be wholesale selling of investment-grade credit space as carry is still quite attractive there.** On the other hand, this spectre of rising commodities prices and the attendant move in Dollar have reduced the tailwind we were expecting at the start of the year of more easing in the emerging markets. We will be keeping our exposure in the short end of the investment grade credit but have **trimmed some of our EM debt exposure.** We do think chances have increased for a Fed cut in 2H26 and may move to extend duration in the later part of the year.

Alternatives: No change with 30% allocation to hedge funds. A recent survey by Goldman Sachs with responses from 317 global allocators accounting for \$1 trillion in assets in hedge funds showed hedge funds is the asset class they will likely increase in 2026 more than public equities and bond as well as other alternatives. The key reasons they have cited are (1) better risk adjusted performances than a traditional 60/40 portfolio (2) acts as better diversifier than bonds to equities (3) more consistent returns than private equity, private credit and venture capital and (4) Hedge funds are semi-liquid while the dearth of distribution from private equity and venture capital, and the mismatch duration of private credit's asset-liabilities are brewing concerns.

Survey of global allocators wants to increase hedge fund more than any asset class in 2026

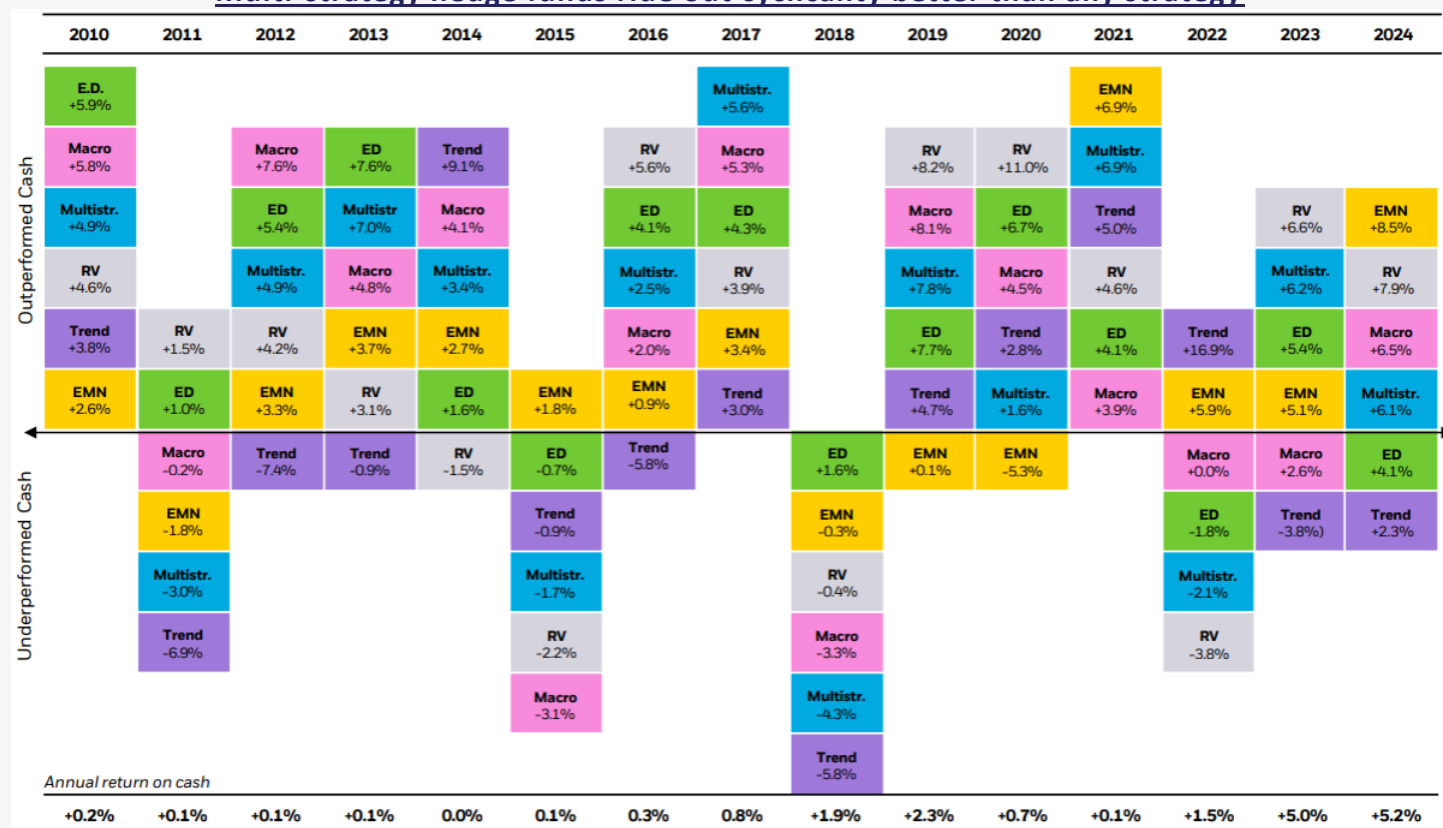


Source: Goldman Sachs



Our global, multi-manager and multi-strategy fund of hedge fund strategy is particularly suited to navigate this kind of macro regime. In fact, empirically, multi-strategy has consistently been the top few performers each year and has outperformed cash as well.

Multi-strategy hedge funds ride out cyclical better than any strategy



Source: Blackrock

Commodities: No change with Gold range bound and keeping a small percentage of Bitcoin. We have cautioned that meteoric rise in Gold in last two quarters was driven largely by fast money and the stickier buyer in the form of central bankers' purchases have abated. In fact, 2025 marks the lowest amount of gold central banks have purchased since 2022 and the first year, the Singapore government was net seller of gold. We were not surprised that gold has retraced sharply since it peaked in Dec at high \$5,400 per ounce to a recent low of \$4,200. We just witnessed the fastest ever reduction in gold futures contracted. Futures contracts outstanding for gold is still at elevated level compared to its longer-term history. In terms of flows in Gold ETF, we have seen \$3bn of outflows year-to-date but accounting only for 1.8% of the ETF assets. We will be a bigger buyer of gold below \$4,000 level. There are still too many specs in the system.



Gold price has fallen as speculative fast money unwound at the greatest pace on record



Source: Bloomberg

Cash: Keeping cash elevated until we can ascertain pass the fog of this war.

Featured Picture/Quote:

The other kind of kinder Terminator.

From Artemis II taken 4th April 2026.



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Risk Disclosure

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