Covenant Capital

16 Raffles Quay, #41-02
Hong Leong Building, Singapore 048581

Tel/Fax +65 6819 0860
Web covenant-capital.com

The Navigator

July 26

World in Motion

By Edward Lim, CFA

In the 1980s, the image of English football was characterised by one word, hooliganism. The nadir of English football came in 1985 when English football fans (sadly it was my team) attacked Juventus fans in Heysel Stadium, Belgium, which led to a tragic human crush that killed 39 people and injured over 600 spectators. All English clubs were subsequently banned for 6 years from competing in all European club competitions.

The 1990 World Cup was the first time the English fans travelled to Europe and into Italy, and the situation was a powder keg. The English team arrived in Italy carrying the heavy baggage of a tarnished reputation. Yet, against all odds, that summer became a turning point where the team completely rehabilitated its image, capturing the world's imagination and kicking off a brand-new, modernized era for what a combination of football and capitalism could do. And they even advanced to the semi-finals only to be knocked out by West Germany during a dramatic penalty shootout. They did it by changing the narrative entirely and it was best captured in their theme song "World in Motion" by New Order. Instead of relying on aggressive and old-school football tactics, the song and the team embraced a fresh, creative energy that proved you can successfully reinvent both style of play and image.

Today, global markets are navigating their own ungainly transition: strained political alliances, fractured trade relationships, and a technological revolution that is as exhilarating as it is destabilising. The lesson from Italia '90 is not merely that reputations can be rehabilitated. It is that when the old playbook no longer works, survival depends on adaptation rather than the retention of outdated strategies. In this quarter's Navigator, we explore what this multitude of changes means for future investment opportunities.

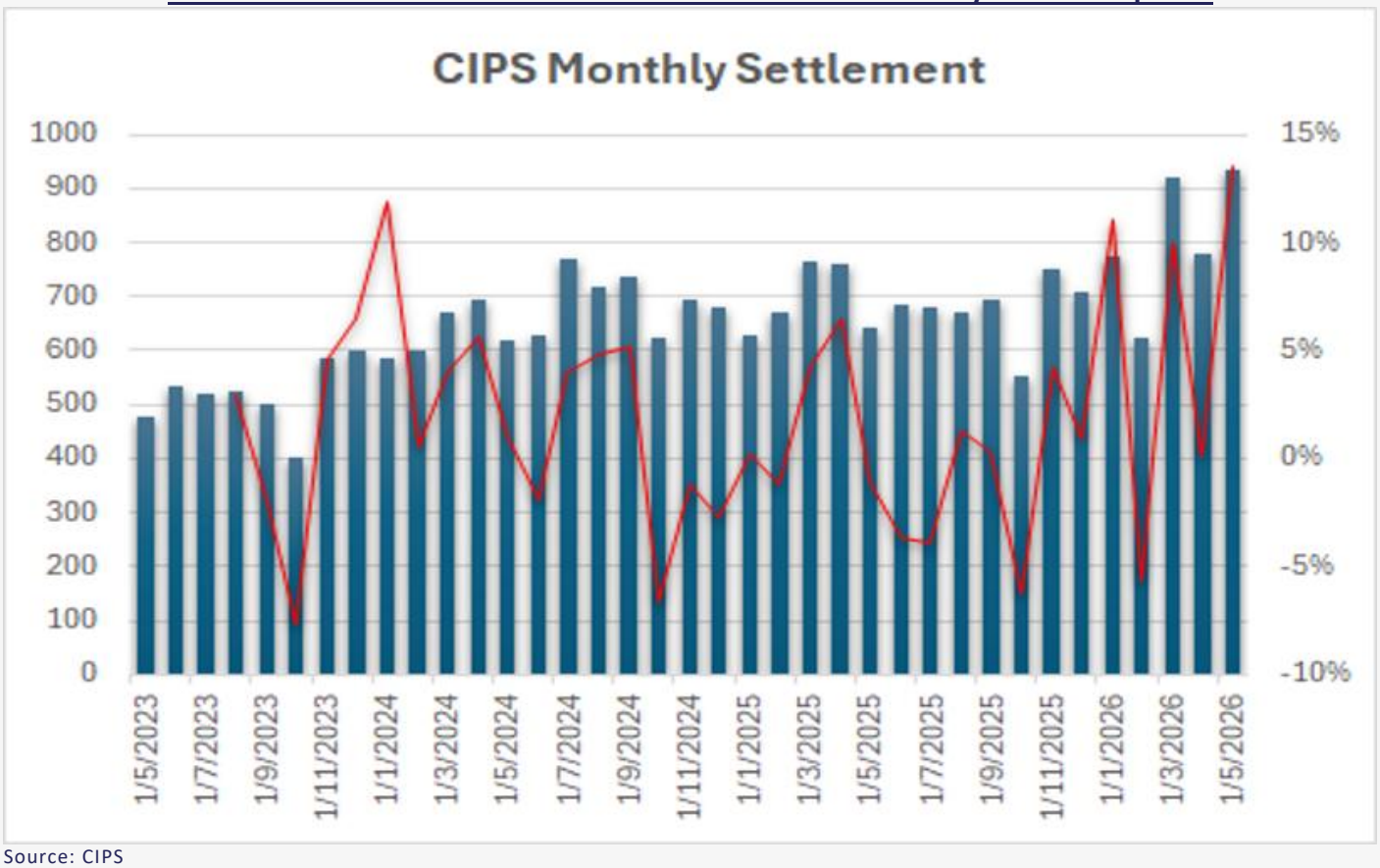
We are witnessing the global order being rewritten in real time. The old order of a unipolar and multi-lateral world underwritten by US financial, technological, ideological, and security largess is no longer the organizing principle. Instead, we are now moving towards a multi-polar world, each jostling for their relevance on the world stage while wrestling with increasingly febrile domestic undercurrents. The advent of generative AI in the last few years is expected to bring about exciting new opportunities as well as profound changes in many existing business models and potentially a re-writing of social contracts. If not managed properly, AI will further exacerbate the schism between the haves and have-nots.

As we have mused in 2020 Navigator - The Four Horsemen of the Apocalypse how the Covid pandemic has exposed the fallacies of an inter-dependent and cooperative world of supply chain, the once-unthinkable closure of the Strait of Hormuz by Iran has now extended those fault lines from medical and food supplies to energy. **The need to onshore key capabilities especially in critical resources, key industries, and securing one's sovereign AI, has become sine qua non to not only one's survival but also to its dominance.** We have identified a few tenets of a multi-polar world and navigate through their investment implications.

1) **Energy security implications:** Regardless of whatever resolutions the US, Iran, and rest of GCC can eke out in the end, this episode has redrawn the terms of trades of oil security for every country, especially in Asia.

A) **During this crisis, we saw a tectonic shift of trading oil outside of the USD.** As evidenced in China's Cross-Border Interbank System (CIPS), China's rival platform to SWIFT, the de facto global cross-border payment system, saw a significant jump in transactions. The value of transactions from Mar-May has jumped 25% since the start of the war when compared to the previous three months. While RMB 2.6trn transaction value still represents a small percentage of global flows, if you include other currencies like Rupees, Dirhams and Euro, the war has accelerated the use of non-USD in settlement of critical resources – a trend precipitated when the US unilaterally shut Russia out of the international payment system back in 2022.

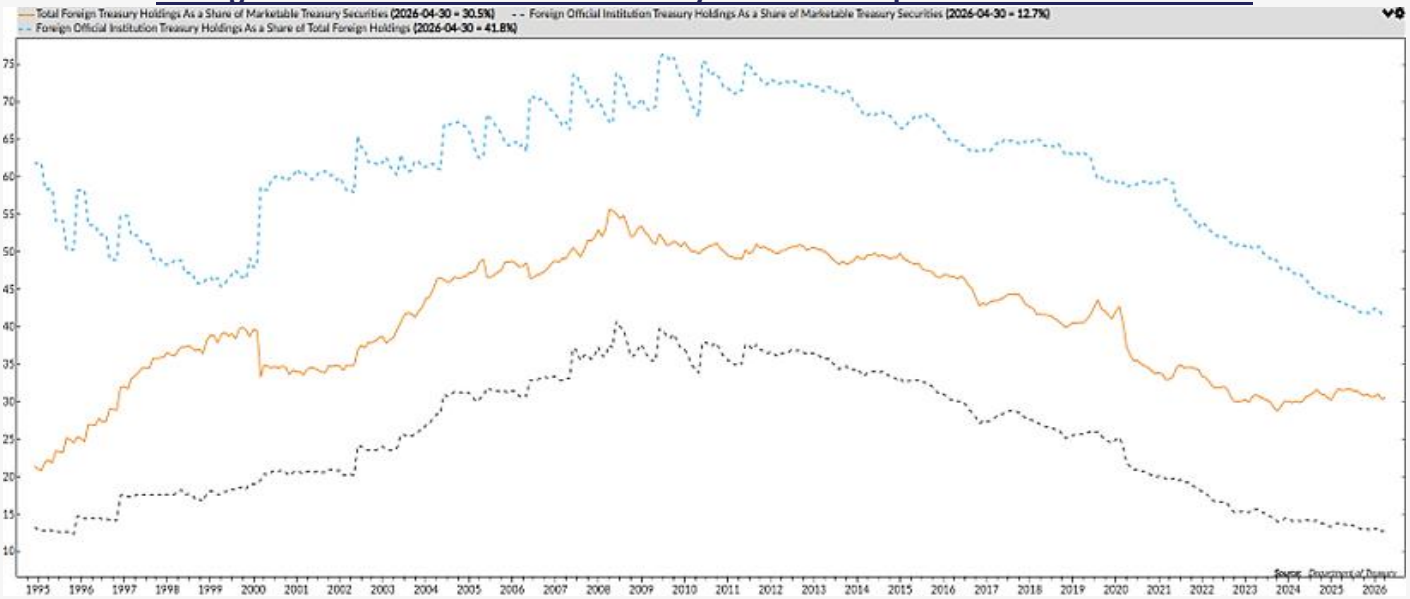
Transactions on China-backed international settlement system has spiked



Source: CIPS

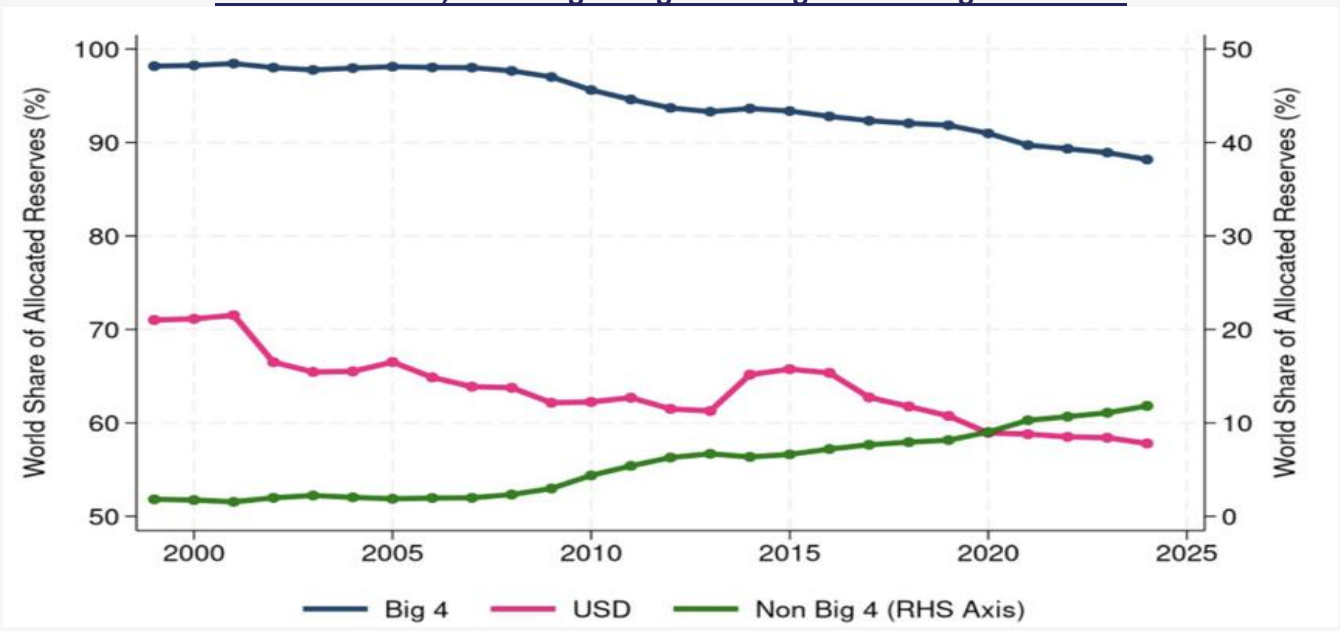
If you overlay that with the continuation of the sale of US Treasury holdings by foreign official entities, the erosion of the USD's exorbitant privilege is already in motion. Based on IMF data, USD share of global foreign reserves has fallen from more than 70% in 2000 to less than 60% and in its place, RMB has risen from less than 1% to almost 10%. While the USD is now inexpensive relative to other majors on a Purchasing Power Parity basis when compared to the start of 2025 (it is 3 to 5% cheaper than the GBP and Euro), we note since the de-pegging of the USD from Gold in 1971, there has been times the USD has traded more than 10% lower than the implied fundamental value. **Expect the USD to weaken further and domestic buyers better step in, otherwise US yields will have to rise.**

Foreign official holders of US Treasury continue to pare down US Treasuries



Source: US Treasury

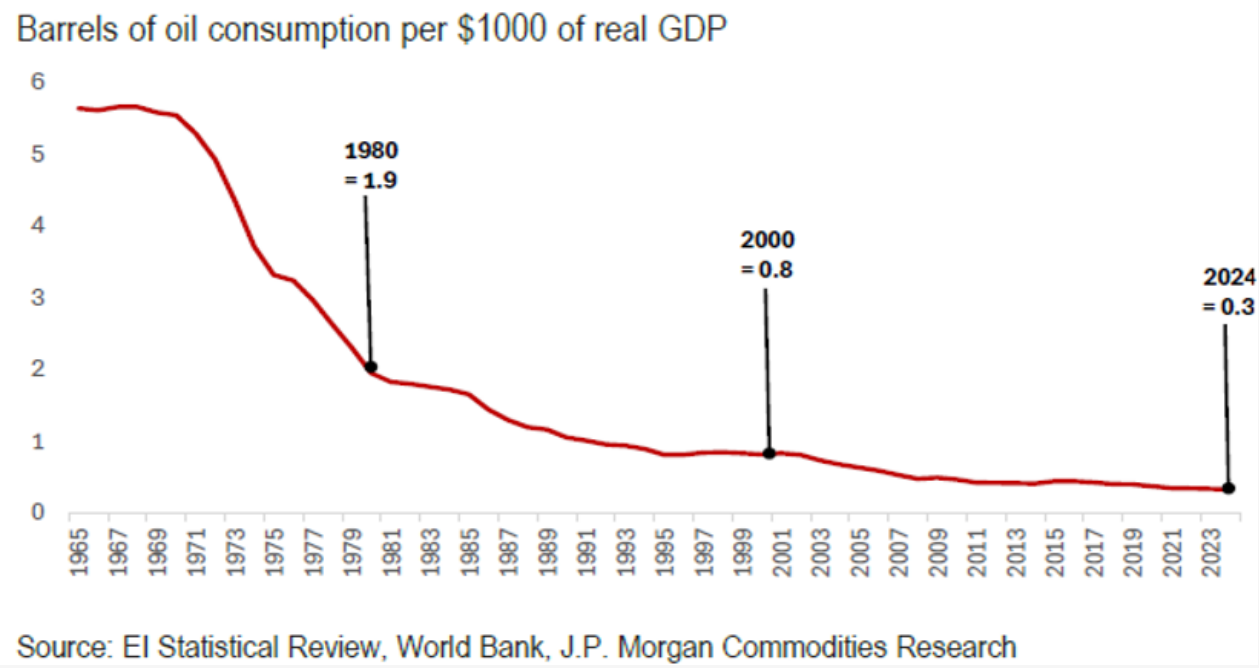
Where USD lost, RMB is gaining as % of global foreign reserves



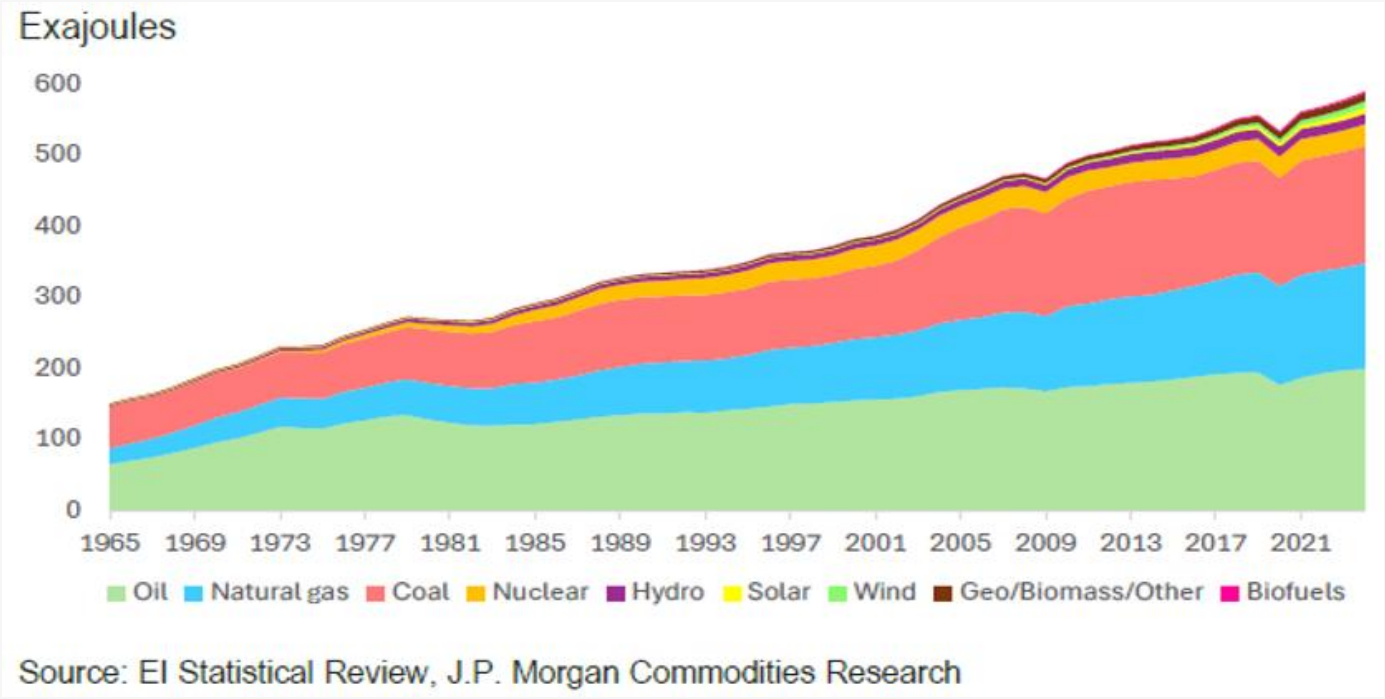
Source: IMF

B) **Overblown oil risk and the renaissance of renewable energy.** At the start of the war, some oil experts speculated that oil price will temporarily spike above $140 and stay above $100 for a prolonged period, having modelled their views against the 1970s Arab oil embargo and Russia-Ukraine analogue. We disagree with the 1970s analogue just as we did during the second Russia-Ukraine war in 2022 arguing oil intensity have fallen dramatically and non-fossil fuel, including renewables and nuclear, now represent a larger share of energy mix.

Oil intensity has fallen more than 90% since 1970s



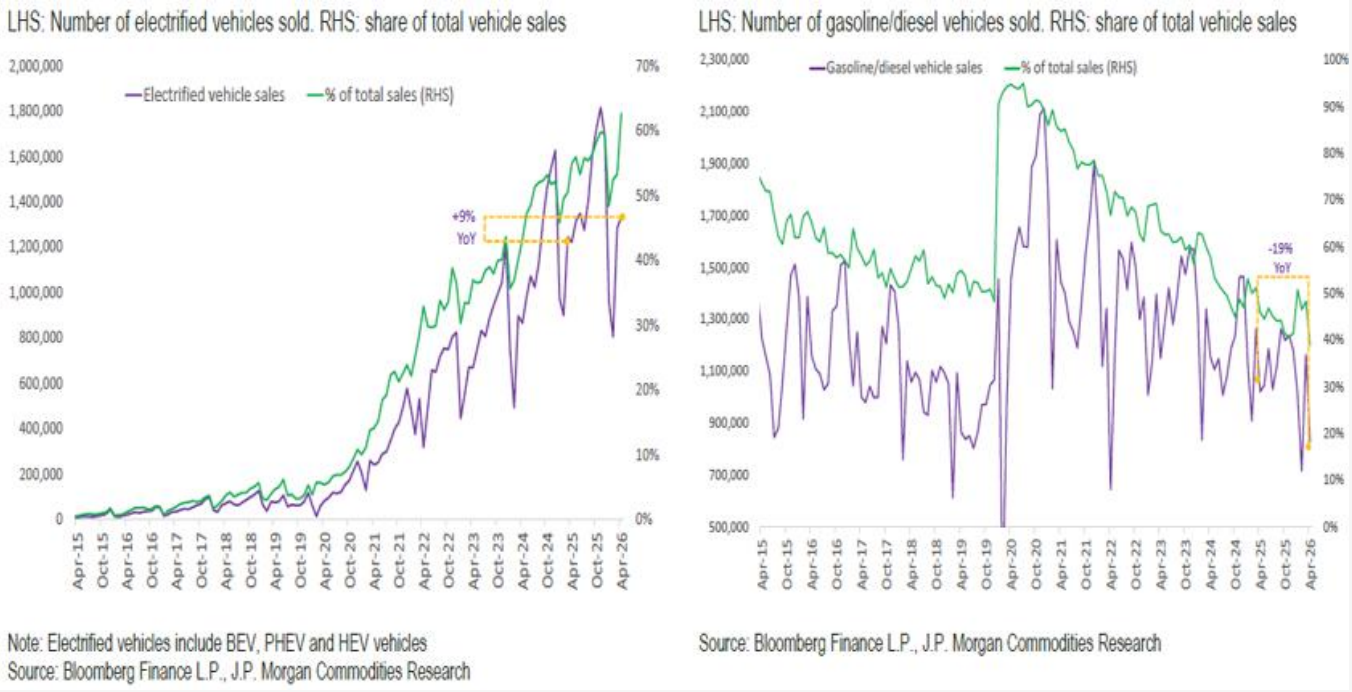
and Oil and Gas fuel has fallen from 75% of energy source in '70s to 50%



A further lesson is that a combination of surging non-GCC oil exports - particularly from the US, which has increased exports by 50% - alongside coordinated stockpile releases and increased throughput from alternative routes such as Saudi Arabia's East-West and the UAE's Fujairah pipelines, **has capped the surge in oil prices.** Crude averaged $92/bbl during this period, rather than sustaining the $100-plus levels initially expected by many oil analysts.

More importantly, **the shock accelerated systematic substitution and demand destruction**, with no country exemplifying this better than China. Already 6 out of 10 cars sold in China are EV cars. Immediately post-war, China EV sales saw a fillip of +9% yoy while conversely gasoline/diesel vehicles saw an accelerated decline of -19% yoy and now accounts for less than 30% of total vehicles sold during this period. We do not think this is just a China phenomenon. Global EV car market share since the Hormuz shock has increased 3.4pp to 27% of new car sales. During China's last major national holiday, we also saw a significant switch from air travel to trains and cars as jet fuel spiked more than other transport fuels. This illustrates consumers are adaptive to alternative modes of transport and will switch to suit their budgetary needs.

Drivers are apt at changing drivetrains to suit their needs

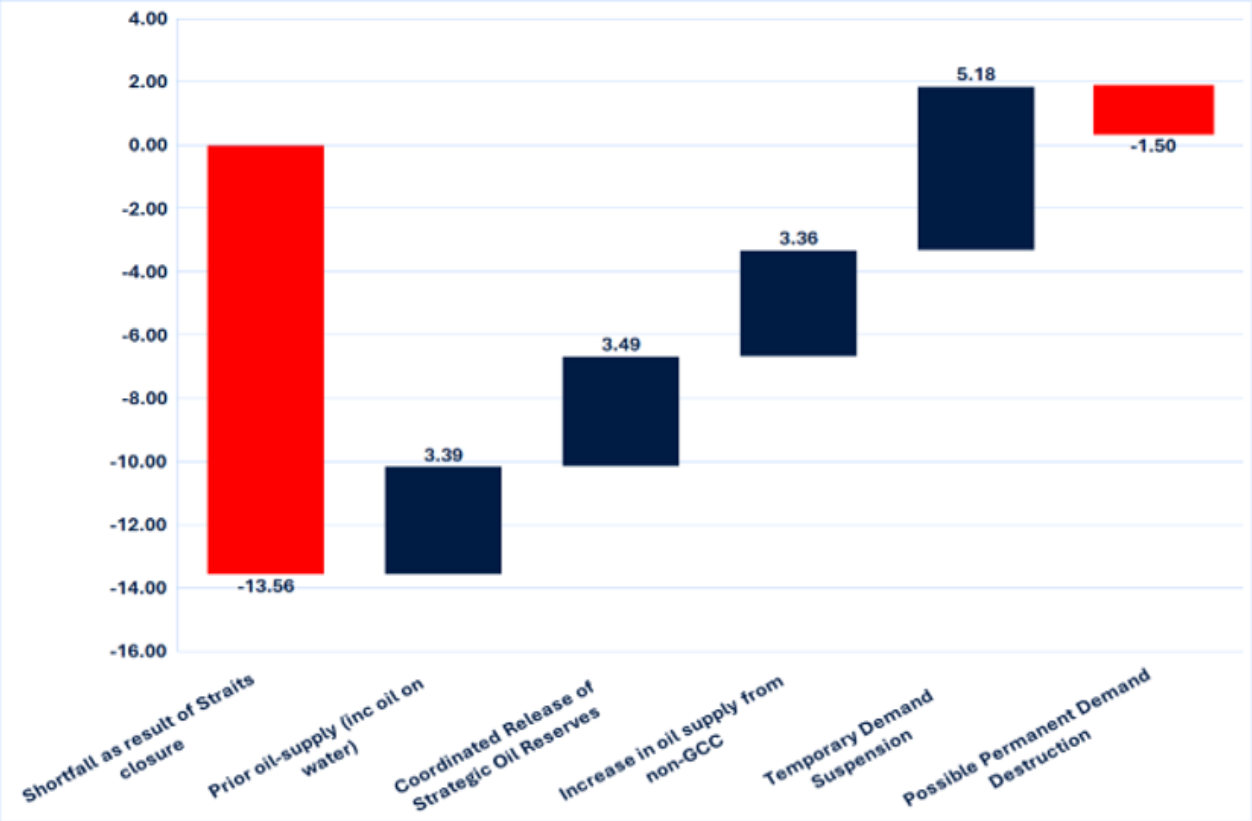


Note: Electrified vehicles include BEV, PHEV and HEV vehicles
Source: Bloomberg Finance L.P., J.P. Morgan Commodities Research

Source: Bloomberg Finance L.P., J.P. Morgan Commodities Research

JPM estimates of the 6.68 mn b/d of demand destruction that has happened globally, about 1 to 1.5 mn b/d could be permanently destroyed through a combination of drivetrain substitution from ICE to EV, efficiency gains and material substitutions in manufacturing, and slow steaming and route optimization in shipping.

Latest Oil Calculus: Not as severe as initially feared

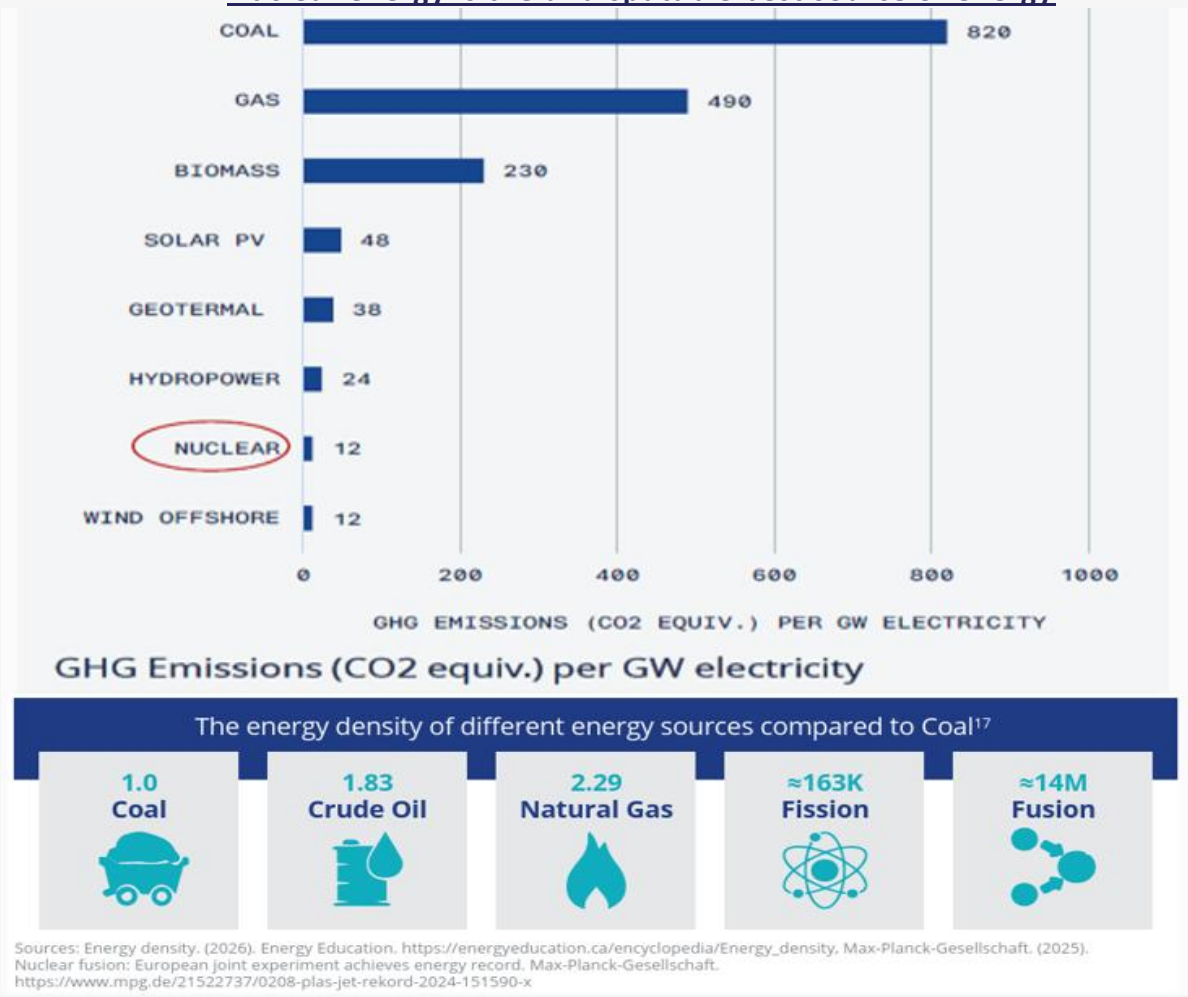


Source: IMF

The more consequential lesson from the two recent oil crises is that energy security can no longer be taken for granted. The founding member of Singapore, Lee Kuan Yew, was once asked why Singapore liked to impose an assortment of fines. He replied human nature is such that without financial repercussions, one cannot institute behavioural changes. The rising sea tide, raging wildfires, and scorching temperature did not sustain climate investment. For most, these issues are someone else's existential concerns, and in the current moment, they are mere short-duration discomforts until one becomes a casualty of it. It took an obvious military error by the US-Israel and an abhorrent brazen act of Iran in shutting the strait to trigger the renaissance of investment in clean energy.

Of all the clean energy, the one we are most excited about is nuclear energy. Nuclear reactors are installed within one's sovereign territory. They provide baseload availability, can be modulated, and are not subject to weather conditions. Nuclear produces larger energy density than any other sources and is also the second most environmentally friendly source after wind.

Nuclear energy is the undisputable best source of energy



The Trump administration understands AI supremacy requires power supremacy, and it has been instrumental in jumpstarting this industry.

AI supremacy = Power supremacy and Trump knows it

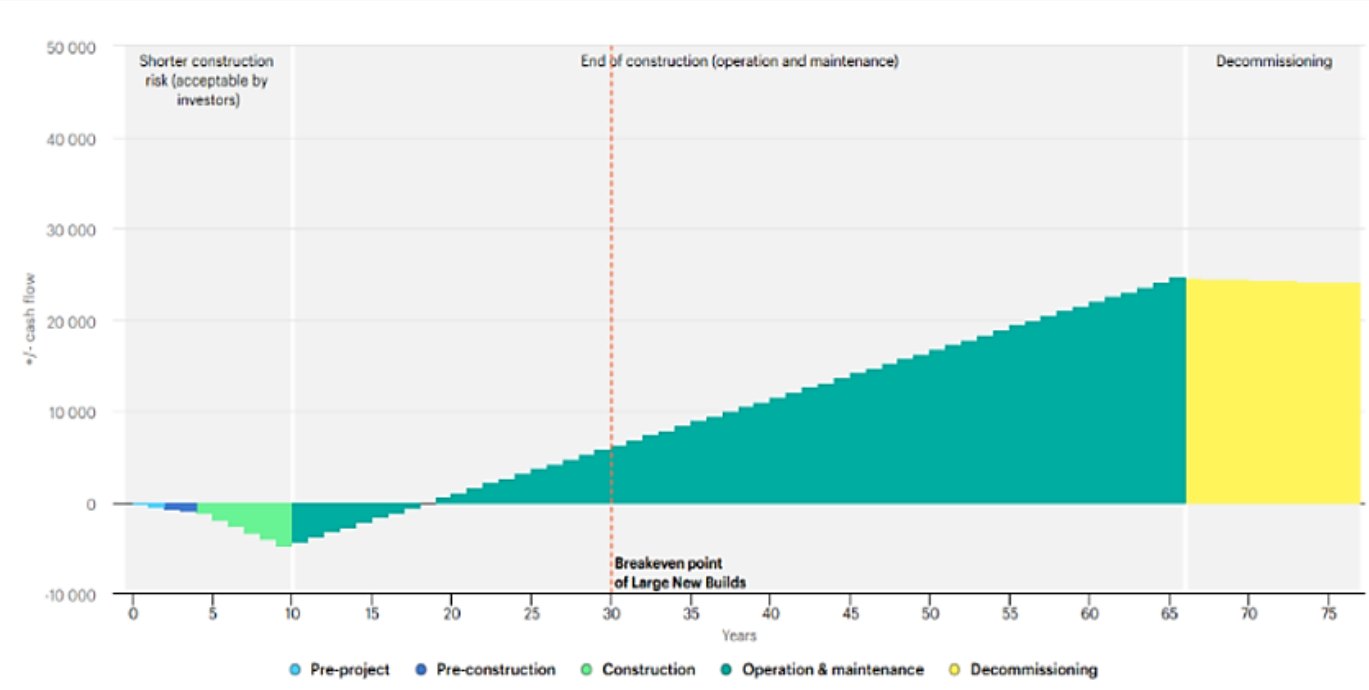
Reinvigorating Nuclear Industrial Base	Deploying Advanced Nuclear Technologies for National Security	Ordering the Reform of Nuclear Regulatory Commission	Reforming Nuclear Reactor Testing at Department of Energy
Makes broad actions to revitalize the US nuclear supply chain, including a specific focus on nuclear fuel	Prioritizes deployment of nuclear reactors at locations with national security interests, including AI data centers	Reforms activities at the Nuclear Regulatory Commission and targets 400 GW of new nuclear by 2050 (100 GW today)	Directs Department of US Energy (DOE) to accelerate testing and deployment of advanced nuclear reactors
Makes transformational actions to leverage US government fuel stockpiles and accelerate nuclear fuel recycling to supply early US nuclear projects	Allocates US government fuel supplies and accelerates nuclear fuel recycling for facilities at national security locations	Mandates 18-month review deadlines, for new reactors, caps Nuclear Regulatory Commission licensing fees, and directs modernization of nuclear related regulations	Launches a pilot program that targets three operational advanced reactors by July 2026

Source: White House

Technological improvements in mainstay fission technology using non-water coolant such as molten salt, gas or liquid metal have ushered improvements in fuel usage, less nuclear waste and are generally safer than water coolant reactors. Advocates of thorium instead of uranium reactors are being developed again. The benefit of Thorium reactor is it is significantly safer as they can be turned off in the event of an emergency, has a much shorter life, better energy production density than uranium reactors. And unlike uranium, thorium is less useful for weaponization.

There have been several groundbreaking constructions of small modular fission reactor (SMRs) in China, Sweden, UK, and USA. Because **SMRs are modular in design, they reduce construction costs and time to market significantly allowing cashflow breakeven by the 15th year; 10 years faster than large reactors.**

The significance of SMR roll out is economics: Half the time to breakeven



Source: IEA

Investment in the holy grail of all energy sources, fusion technology, is also gathering pace. According to Fusion Industry Association, there has been a considerable increase in fusion technology investment. Total public-private sector investments in fusion technology amounted to $10bn in 2025 and year-to-date, it has already surpassed $10bn whereas the cumulative investment from 2020 to 2024 was only $7bn. There are significant milestones to watch out for.

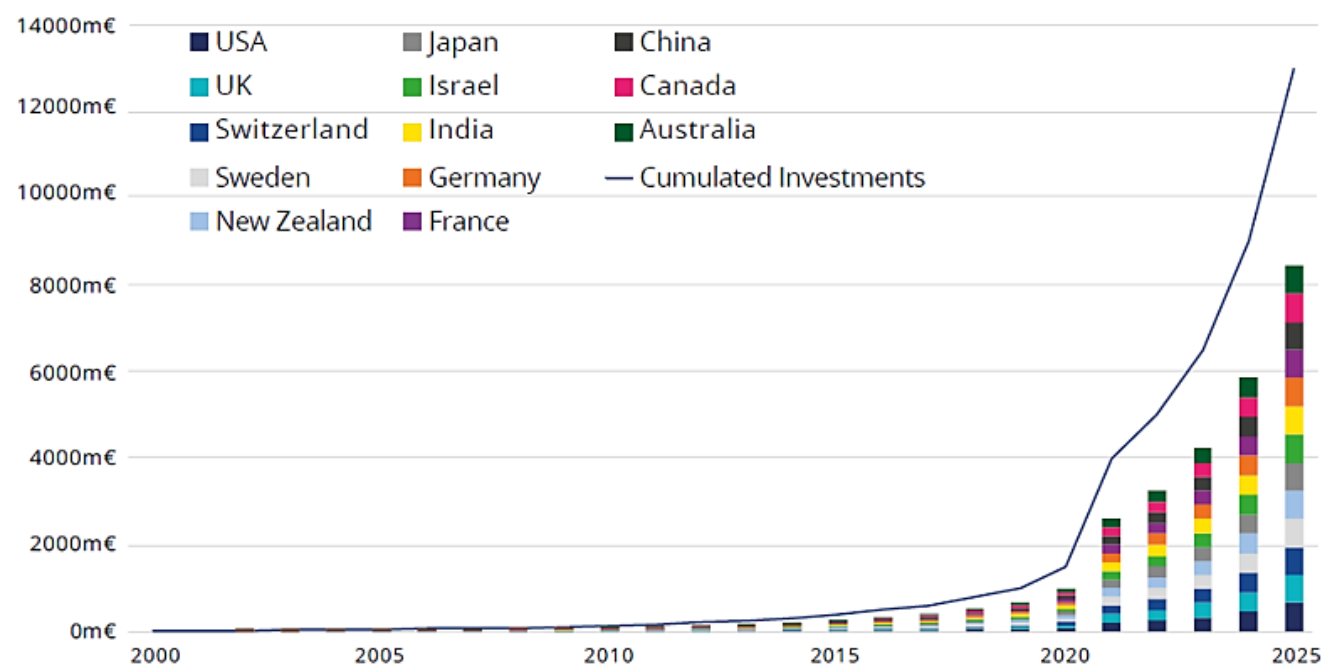
(1) The US led project by CFS called SPARC. SPARC is slated to demonstrate its ability to generate “net energy” ie create more energy than it consumes by early 2027. CFS hopes to commercialise by early 2030.

(2) France's ITER project called Tokamak hopes to demonstrate net energy creation early 2030 and commercialise by 2039.

(3) But it is China again, that is leading the pack. Its project called CRAFT is 1.3x larger than the Tokamak and just a few weeks ago, it has passed the final test demonstrating net energy creation at 100mn Celsius temperature. With this development, they will be moving to Phase 1 of commercialisation and hope to produce energy by 2035.

Going long nuclear energy and shorting oil will be a multi-year trade.

Significant pick up in investment in nuclear fusion technology



Source: Fusion for Energy. (2025). Global investment in the private fusion sector: F4E Observatory 2025. https://fusionforenergy.europa.eu/wp-content/uploads/2025/11/F4E_Observatory_2025_digital.pdf

2) **Re-industrialization means higher capex:** Catalysed by what happened after covid and compounded by the oil crisis of Russia-Ukraine and the Hormuz crisis, many governments have launched their own initiatives to reindustrialize and to onshore or friend shore key industries. But we **will focus on the sovereign AI and the defense industries.**

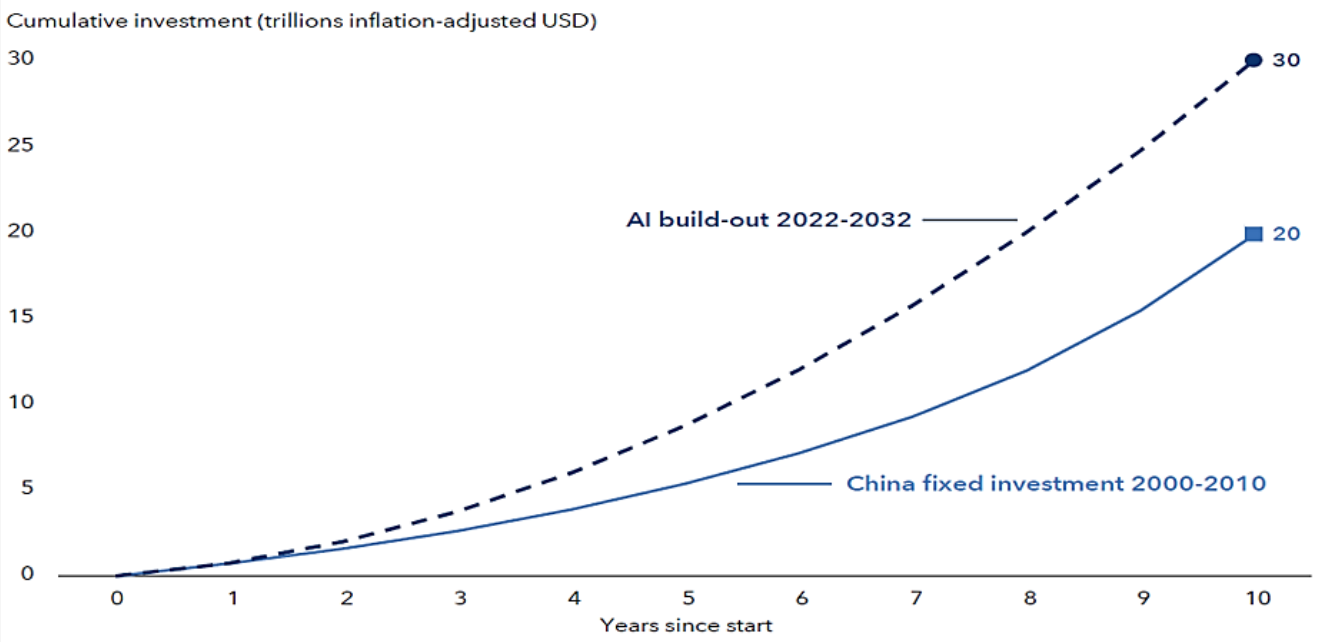
Jensen Huang coined the term "AI factories" and in many senses, today's most important factories do not look like a steel mill or an automotive plant. They sit in vast tract of land, in windowless and temperature-controlled buildings, filled with servers, drawing vast amounts of electricity and turning data into economic output. Sovereign AI is not merely a technology policy; it is re-industrialisation by another name. In an era where productivity, security and economic competitiveness are increasingly shaped by compute, data and models, nations are treating AI infrastructure as the backbone of a new industrial base.

The plethora of announcements by various governments on investing in their own AI is just mind boggling. The US Stargate consortium intends to invest US$500bn over four years and explicitly frames the project as supporting America's "re-industrialization" and national security. Across the Pacific, China is preparing a US$295bn, five-year plan to build a nationwide AI data-centre network. There is an additional of USD200bn devoted in deploying their semiconductor self-sufficiency and applications in robotics and quantum computing/ Europe, which has often been bogged down with regulation, is now responding with capital. The European Commission's InvestAI aims to mobilise €200bn, including a €20bn fund for up to five AI gigafactories.

But it is Japan and South Korea's announcements in the past few weeks that is a sticker shock. Japan has unveiled a 14-year investment roadmap targeting more than US$2.0tn across 17 strategic sectors. US$600bn is earmarked for AI and chips, US$65bn earmarked for physical AI investment in robotics and autonomous systems and another US$420bn for semiconductor development and mass production. South Korea's announcement framed the plan around a "triple axis" of semiconductors, physical AI, and data centres. The investment in chip component is over US$576bn helmed by Samsung Electronics and SK Hynix to build four new chip fabrication plants in the southwest, plus US$52bn for a chip-packaging cluster near Seoul. It also targets a build out of data centre to the tune of $360bn by 2029 with an initial 8.4GW of AI data-centre capacity planned by SK, GS and Naver and the rising to US$1 trillion by 2035.

Capital Group estimates this AI buildout will be comparable to China's modernisation push in the early 2000s, which was the largest industrial boom in modern history. After joining WTO, China invested a cumulative amount of $20 trn, they estimate AI build out into 2032 will gross over $30trn.

Capital Group estimate AI investment will be as large as China modernisation boom



Source: IEA

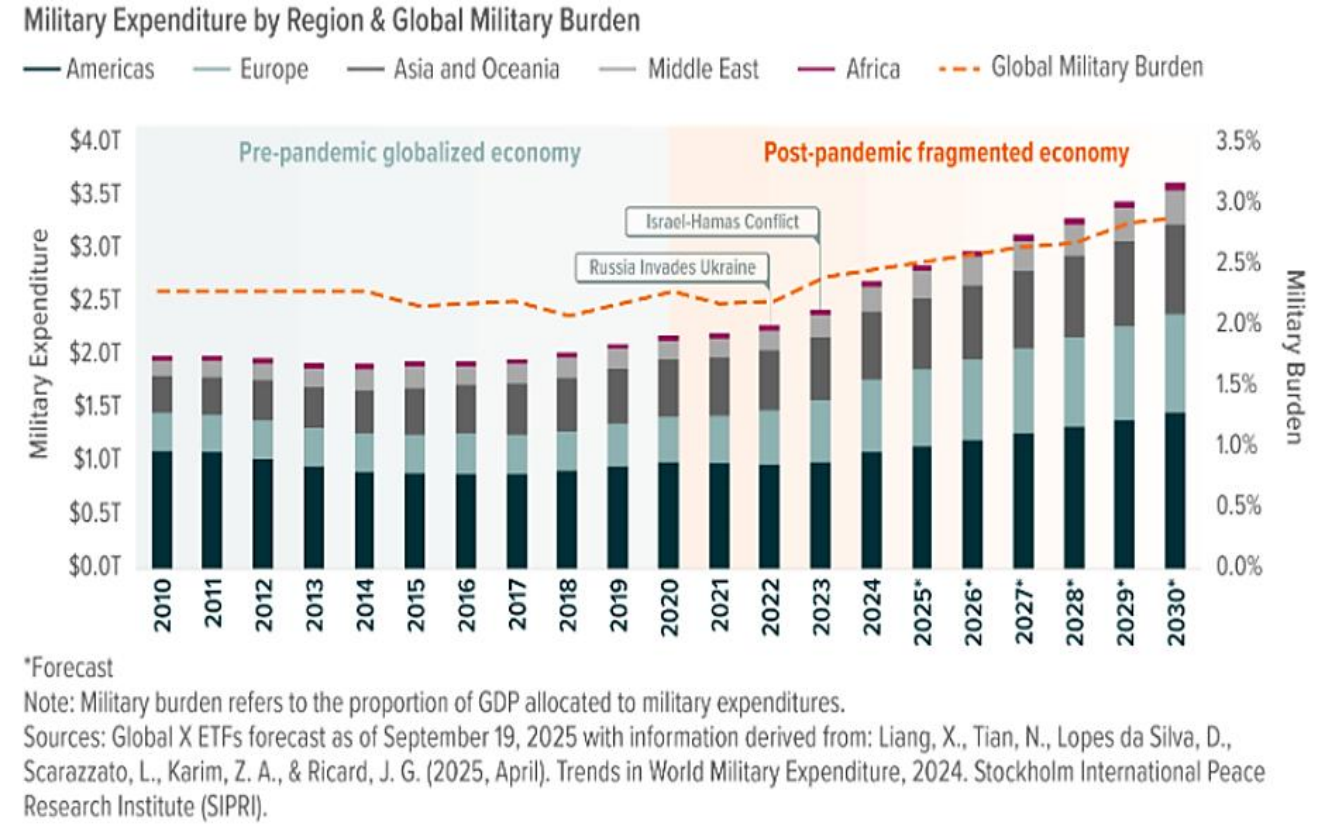
All of these announced initiatives signal a shift of view that AI is no longer viewed as a software layer, but as a foundational production system akin to building manufacturing capability, having the ability to develop downstream industrial and military applications, and to drive productivity gains especially for developed economies that is rapidly ageing. Critically, it is about retaining agency over their sovereign data and models too. **Prefer infrastructure AI plays and we have some concerns of the rapid commoditization of frontier models.**

Through Trump's bellicose behaviour**, all 32 NATO members have met the 2% GDP pa of defense spending target for the first time in 2025, with European allies and Canada increasing spending by 20% to $574 billion.** Germany plans to more than double defense outlays to €162 billion by 2029, targeting 3.5% of GDP. NATO is now discussing a new 5% GDP target by 2032. It is worth noting Europe's GDP growth has only been 1% in the last many decades, this increase in military spend is no insignificant change relative to their growth prospect. Many unconfirmed reports suggest that the critical US munitions are at a threshold of its operational requirement and will require accelerated replenishment, which could take two to three years, hence the recent activation of Defense Production Act in June.

What has happened in Iran has merely demonstrated US is equally quick to enter a war and exit with none of its strategic objectives achieved and yet wrought an unimaginable geopolitical crisis in the Middle East and energy shock to the world. All the US allies in the Pacific are astounded by US unilateralism and will surely be taken aback that despite all the pomp and ceremony, lavish gifts and the perceived security blanket that the web of US military bases in the GCC has adopted, Trump is willing to engender an Israeli hegemon in the region and leaving their region more fragile than before.

Facing an increasingly assertive China and an unreliable partner in the US, Japan has departed from its pacifist stance of over 80 years by increasing its spending from its historical less than 1% to 3.5% of GDP for the foreseeable years. South Korea too has been pressured by Trump to increase their spending, and it is expected to move to 3.5% of GDP in the near-term and 5% possibly. Taiwan has just increased their defense spending to 3.5% of GDP for the first time in 25 years. **Buy defense and industrial complexes.**

Call it as it is: A $3.6trn Arms Race till 2030



*Forecast
Note: Military burden refers to the proportion of GDP allocated to military expenditures.
Sources: Global X ETFs forecast as of September 19, 2025 with information derived from: Liang, X., Tian, N., Lopes da Silva, D., Scarazzato, L., Karim, Z. A., & Ricard, J. G. (2025, April). Trends in World Military Expenditure, 2024. Stockholm International Peace Research Institute (SIPRI).

In 1914, in the opening hours of the war, Britain severed Germany's undersea cables to impede their communications. Today that communication layer is migrating from the seabed and terrestrial to Low Earth orbit (LEO).

What is LEO?

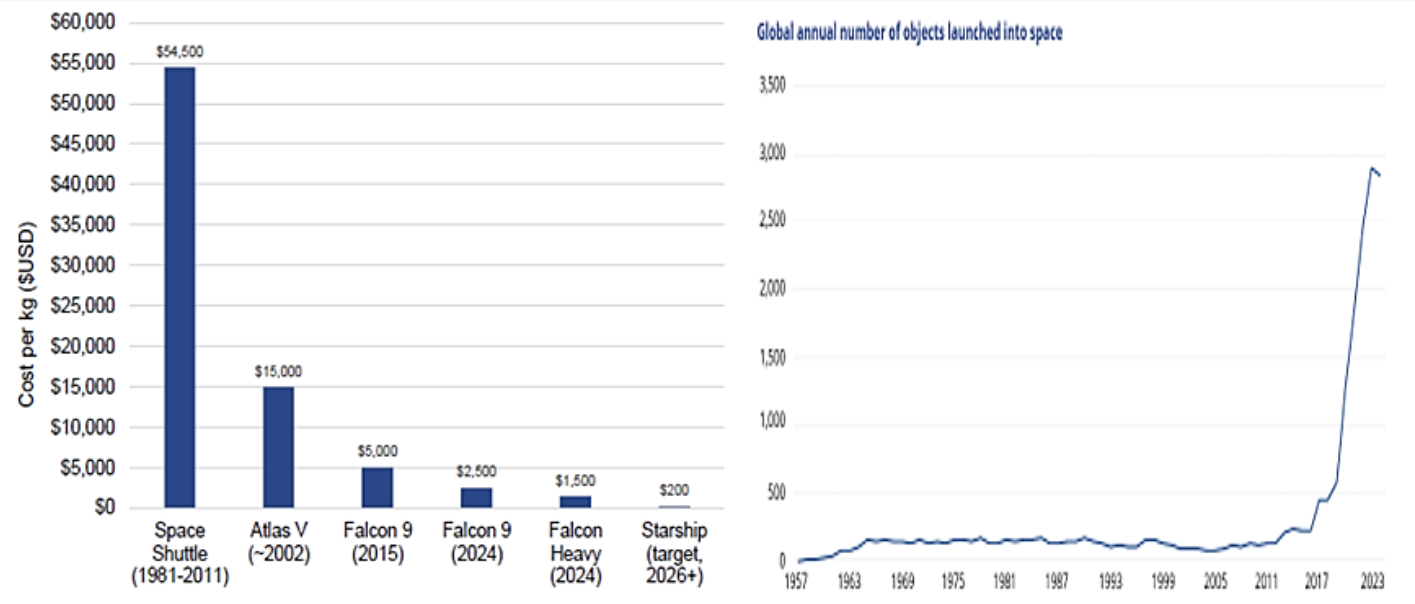
New-generation LEO satellites versus traditional satellites: advantages and disadvantages

Feature	LEO Satellites	GEO Satellites
Altitude	160–2,000 km	35,786 km
Round-trip Latency	Low (20–50 ms)	High (around 500 ms)
Coverage	Regional (via constellations)	Regional (spot beam)
Constellation Size # units	Large (hundreds to thousands)	Small (typically <10)
Deployment Cost	High	Moderate to high
Data Transfer Rates	High	High
Reliability	Depends on constellation management	Generally reliable
Best for	Both phone and internet	Primarily internet
Advantages	▪ Low latency ▪ High data rates ▪ Less atmospheric interference	▪ Wide coverage ▪ Stable signal strength ▪ Fewer satellites needed
Disadvantages	▪ High deployment cost ▪ Requires large constellation ▪ Possible signal interference	▪ High latency ▪ Limited coverage ▪ Weaker signal at high latitudes[7]

Source: VanEck

Two trends are converging that is making LEO the new frontier for science and for warfare. First, the economics of launching satellites in space is compounding fast. Reusable rockets have cut the cost of orbit to less than $200 per kg in a brief period of two and a half years, chiefly due to SpaceX's reusable rockets technological feat. Second, this has led to connectivity expanding. JP Morgan estimates the coverage of LEO communication in 2025 was over nine million subscribers across 155-plus countries and that will double by the end of 2026. The undisputed leader in LEO is Starlink which controls three-quarters of active satellites. This single operator is already an omnipresent geopolitical asset for any military. In the early days of the second Russia-Ukraine war when Ukraine land-based communications were compromised, it was Elon's Starlink that helped Ukraine coordinate their military responses and it is still now their dominant communication protocol.

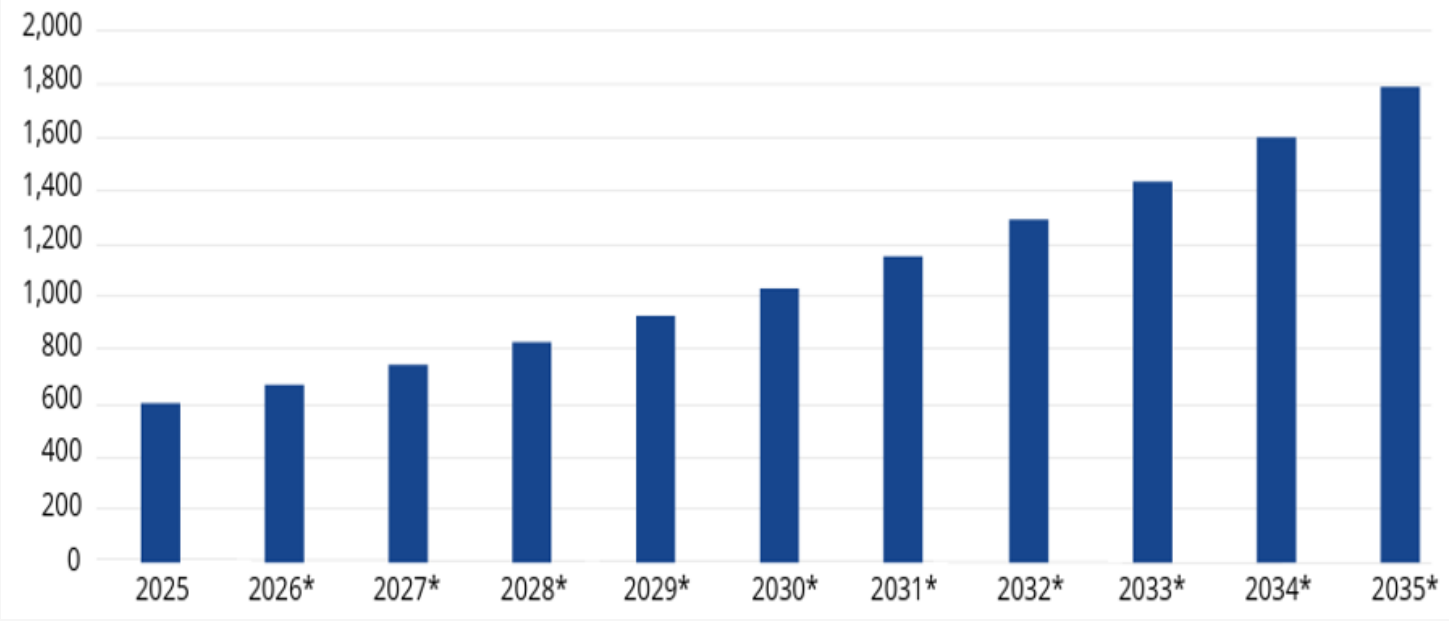
Cost of launching into space has fallen enabling better connectivity



Source: JP Morgan and VanEck

LEO has now become the newest missile-defence layer. Of the $137 billion spent on space in 2025, defence took the majority for the first time ($73.5 billion versus $63.7 billion civil). According to the CBO, President Trump's Golden Dome is expected to cost $1.2trn over the next twenty years. Every single country has either reorganised its military structures or created a new agency to achieve supremacy in space. **Buy Space, not just SpaceX.**

The total TAM of LEO could increase to $1.8 trn by 2035



Source: Bloomberg

Space Force(S) – Mel Brooks would be proud

Reorganizing space forces for a clearer focus

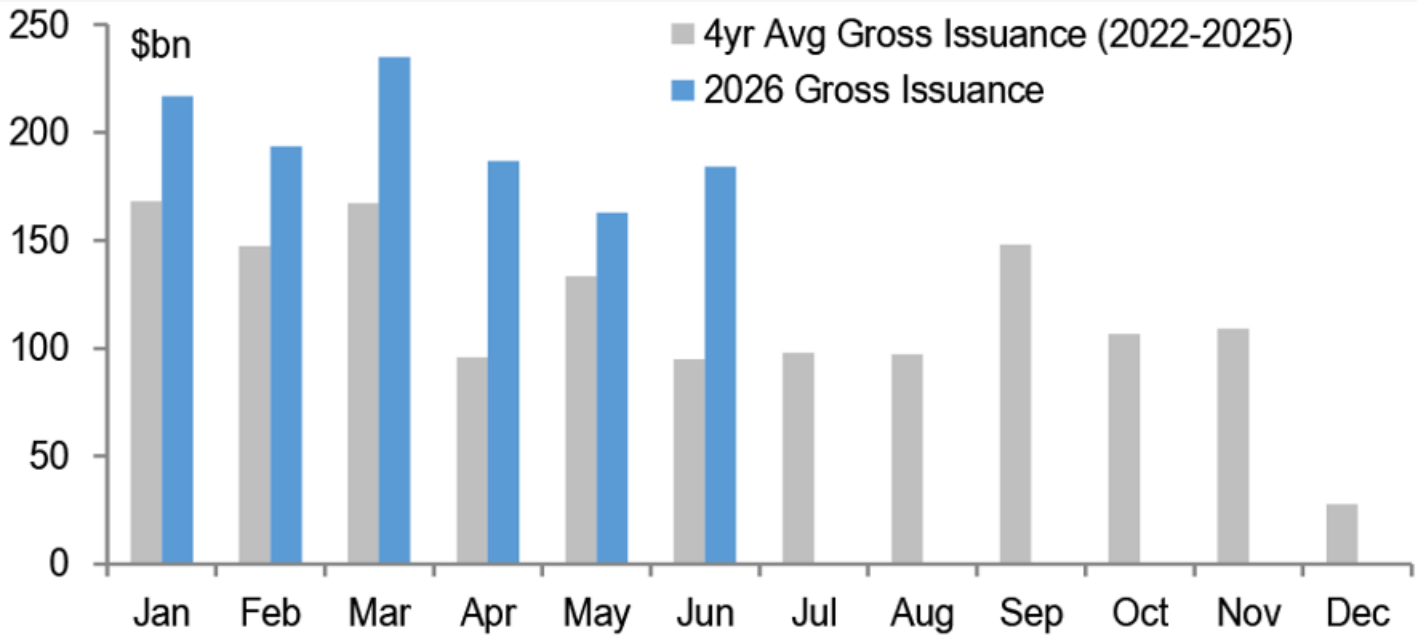
Year	Country	Organization / Unit	Objectives
2015	Russia	**Aerospace Forces (VKS)** – includes **Space Forces**	Consolidated air and space under one military structure.
2015	China	**PLA Strategic Support Force (PLASSF)**	Integrates space, cyber, and electronic warfare under military command.
2019	USA	**United States Space Force** (independent military branch)	First country to create a fully independent space service branch to defend U.S. space interests and support military operations.
2019	France	**Space Command** (under French Air and Space Force)	To elevate space to a strategic military domain and strengthen France's defense capabilities in space.
2019	India	**Defence Space Agency (DSA)**	Coordinates defense space operations with the Indian Space Research Organisation (ISRO) and the Indian armed forces.
2020	Japan	**Space Operations Squadron (JASDF)**	Part of Japan Air Self-Defense Force; expanded into a larger space unit.
2021	Germany	**Space Command Center** (German Air Force)	Focused on space surveillance and traffic management.
2021	United Kingdom	**UK Space Command** (under Royal Air Force)	Centralized command for SATCOM and missile warning.
2022	Australia	**Defense Space Command** (Joint Capabilities Group)	Focused on integration across branches.
2022	Canada	**3 Canadian Space Division** (Royal Canadian Air Force)	National-level military space division.

Source: McKinsey

3) **Capex will be large for the foreseeable future as many nations reconfigure their trade and industry, and security pacts in this multi-polar world. Demand for financing will be ratcheted higher whilst elevated level of government debt also risk of crowding out. All of this can snowball to push yields higher for longer.**

As of mid-point of the year, the high-grade debt issuance in the US is now at a record of $1trn (of which $350bn are AI/Data Centre related issuance) and is up 27% yoy and that is off three consecutive years of record issuances. JP Morgan estimates a gross supply of $1.92 trn will be issued in 2026 and even after netting maturities, it would still be a $412bn increase in supply or 2.8x higher than already a record year in 2025!

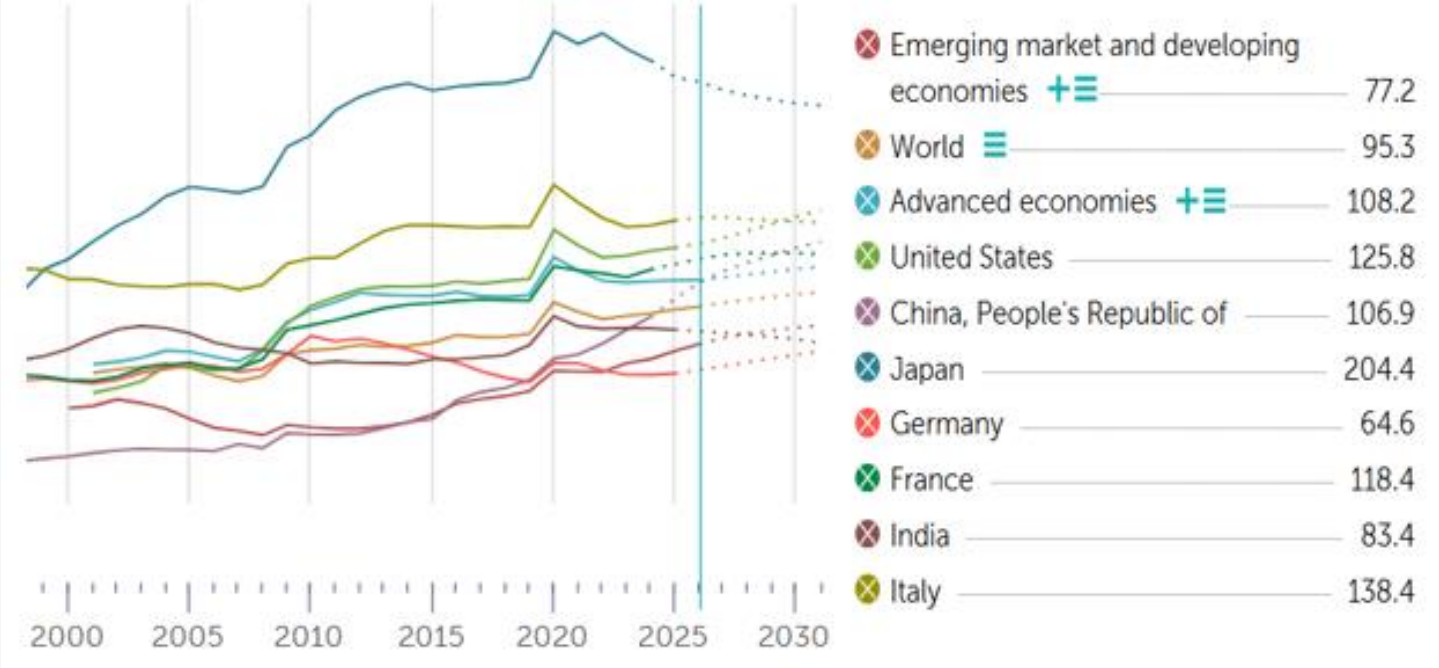
Record investment-grade issuance on the back of 3 consecutive years of records



Source: JP Morgan

We wrote back in 2024, Now I Know When I Must Retire, "An aging demographics, the end of neoliberal economics, the rise of state-sponsored enterprises, the ascendance of the vox populi, and the emergence of a new world order" has translated to "the greatest transfer of debt from the consumer and the corporate sectors to the government". Since then, public debt continues to rise as % of GDP in almost all developed countries and is projected by IMF to remain elevated for years to come. Empirically, IMF data shows when a country runs Debt/GDP above 100%, future growth prospects are impinged.

Public Debt to GDP for Developed Economies is at post WWII high or higher

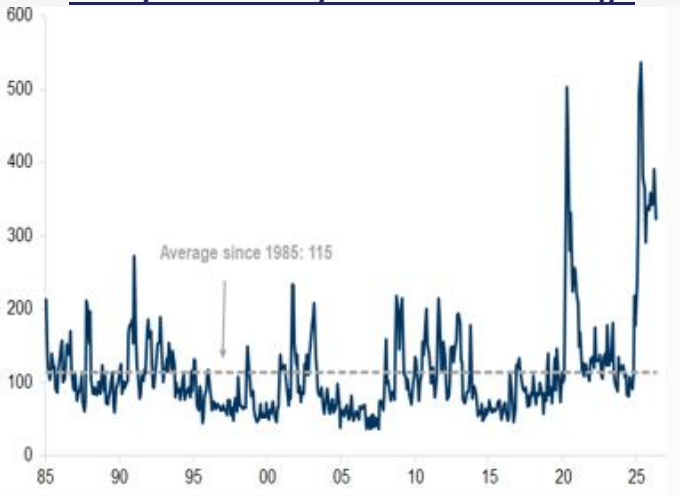


Source: IMF

If you combine the increase in corporate debt issuance and bloated public debt, **yields will remain high for longer.** And if it does, it will **make economies more vulnerable to moves in yields** as it curtails policy flexibility. It **also makes asset prices more vulnerable** since the longer-dated end of the sovereign yield curve underpins a company's cost of financing and an investor's discounting mechanism for all assets.

30-year yields have skyrocketed post Covid

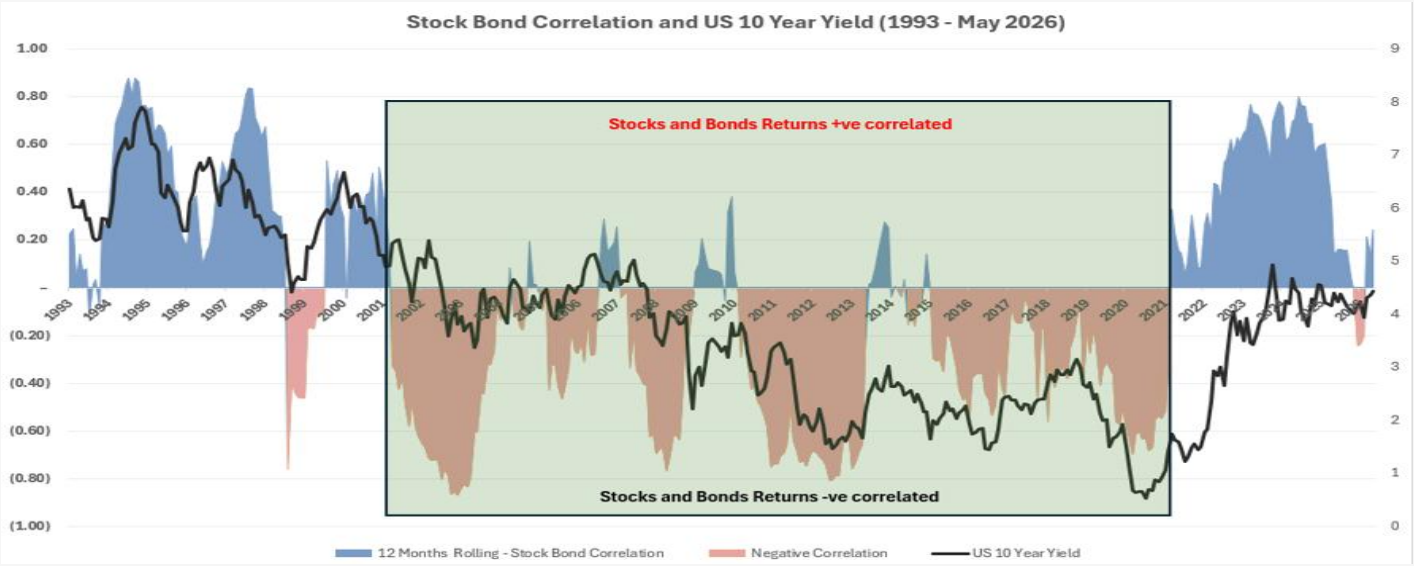
Policy uncertainty is multi-decade high



Source: Goldman Sachs

The most material and deleterious implication of a rising higher yield is it will challenge the 60/40 stocks/bond portfolio. Many of us have been schooled with the concept that bonds offer diversification to equities. But as shown in the chart below, the world is in motion. Yes, that adage has held true since the dot-com bust of 2001 until 2020 as stock and bond returns have been negatively correlated with only a few episodical convergences. But during that period, we have also seen yields on a downward trend driven by easy and unorthodox monetary policy (average yield was 3%), tepid inflation (average inflation was 2.0%) and with an embedded Fed's put whenever equity vacillates; the late "Alan Greenspan's Put".

World in Motion: Stock and Bonds Returns are Converging Again



Source: Bloomberg

Prior to 2001, stock and bond have generally been positively correlated. Incidentally during that period, yields averaged 6.0% and inflation at 3.9% were higher as well. **From 2021 onwards, after a 20-year hiatus, their returns have converged again.** Post 2021, yields have started to climb out of the crazy world of ZIRP as the Fed and many other central banks begun their policy normalization in earnest. Inflation has been volatile but have trended higher averaging 4.5% driven by both structural and cyclical factors like ageing demographics, de-globalization, and the end of goods deflation from China. Furthermore, term premium of bond, compressed for two decades, have started to expand due to burgeoning indebtedness as investors priced in higher risk premium.

If stocks and bond returns are correlated to the upside, this would not be an issue. **But what we are seeing is the frequency of both stocks and bonds generating negative returns has increased materially whenever they converge in the recent times.** In the low inflation-low yields of 2001-2020, there were six occasions or 7.5% of the time stocks and bonds both fell on a quarterly basis; the figure is 10% if we use monthly performances. **But from 2021 onwards, the frequency of negative outcomes has tripled to 23% based on a quarterly basis and more than doubled if based on a monthly performance.** Whenever stock and bonds converge and had negative returns, the average declines in 2001-2020 were 3.1% and 1.3% based on quarterly and monthly data respectively. However, in recent periods, the average declines in equities and bonds have more than doubled to 6.6% and 4.3% on quarterly and monthly basis. **There is a need to find better alternative to bonds as a diversifier to equities, cue in alternatives particularly semi-liquid hedge funds.**

More frequent convergence of stocks and bonds return with -ve outcomes since 2021

2021 - Present (Higher yield-Higher inflation New Norm)	Based on quarterly performance	2001 - 2020 (Low yield-Low Inflation era)	Based on quarterly performance
Frequency of Equities and Bonds (#) Negative Returns	5	Frequency of Equities and Bonds (#) Negative Returns	6
Frequency of Equities and Bonds (%) Negative Returns	22.7%	Frequency of Equities and Bonds (%) Negative Returns	7.5%
Average Negative Returns - Equities	(6.6%)	Average Negative Returns - Equities	(3.1%)
Average Negative Returns - Bonds	(4.3%)	Average Negative Returns - Bonds	(1.3%)

More frequent convergence of stocks and bonds with negative outcomes since 2021

2021 - Present (Higher yield-Higher inflation New Norm)	Based on monthly performance	2001 - 2020 (Low yield-Low Inflation era)	Based on monthly performance
Frequency of Equities and Bonds Negative Returns	17	Frequency of Equities and Bonds (#) Negative Returns	23
Frequency of Equities and Bonds (%) Negative Returns	26.2%	Frequency of Equities and Bonds (%) Negative Returns	9.6%
Average Negative Returns - Equities	(4.3%)	Average Negative Returns - Equities	(3.8%)
Average Negative Returns - Bonds	(2.4%)	Average Negative Returns - Bonds	(1.1%)

Source: Bloomberg

Asset Allocation Strategy

In our 2nd quarter Navigator aptly titled, Regime Change, we downgraded global growth and upgraded inflation outlook due to the ongoing war. Even as we expect global growth to be below potential, we ascribe a low probability of a recession or stagflation. Inflation will spike and stay higher for longer but have argued the Fed has never tightened due to supply shocks since their dual mandate was codified in 1977. Nonetheless, in a **stable growth but rising inflation macro regime, empirically Equity returns fall to mid-single digit, Credit returns do not outpace Short-Term Treasuries, while Gold and Commodities tend to be stronger performers. Hedge funds made solid returns and when risk adjusted, it is the 2nd best performing asset class after short-term treasuries.**

Expected lower equities returns, Prefer hedge funds and T-Bills

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**
Difference in 2 regimes	-9.3	0.1	16.3	25.7	2.6	2.3

Source: NDR

Our latest macro-clock remains in this regime of "Stable Growth but Rising Inflation." Nowcasting model points to a below potential growth of 3.0%, 0.2ppt lower than 3 months ago with weaker reading across many countries. The downgrade to medium term consensus GDP forecast for 2026 and 2027 is unchanged for Developed Economies while Emerging Economies have slightly improved due to India, Brazil, and several oil-producing countries.

Growth is below potential, but downgrade has stabilised

	Nowcaster GDP Growth (Annualised)	Change from 3mths Ago
Global	**3.0**	-0.2
Developed Markets	**2.0**	-0.1
Emerging Markets	**3.9**	-0.2
US	**2.8**	0.1
China	**4.4**	0.1
Euro Area	1.0	-0.2
Germany	-0.8	0.0
France	0.9	-0.1
Japan	1.4	-0.6
UK	-0.6	-0.7
India	7.6	0.4
Brazil	2.1	-1.5

Source: Goldman Sachs Nowcaster and Bloomberg Consensus

	GDP Forecast by Consensus		Change from 2Q26publication	
	2026(F)	2027 (F)	Change 2026(F)	Change 2027(F)
Global	**3.1**	**3.1**	**0.1**	**0.0**
Developed Markets	**1.8**	**1.8**	**0.0**	**0.0**
Emerging Markets	**4.6**	**4.6**	**0.2**	**0.5**
US	**2.1**	**2.1**	**-0.2**	**0.1**
China	**4.6**	**4.4**	**0.0**	**0.0**
Euro Area	0.6	1.2	-0.8	-0.1
Germany	0.6	1.1	-0.3	-0.1
France	0.6	0.9	-0.4	-0.1
Japan	0.6	0.8	-0.2	-0.1
UK	1.0	1.1	0.1	-0.1
India	7.7	7.7	0.2	1.2
Brazil	2.3	2.3	0.5	0.5

Source: Bloomberg

Inflation has been revised higher for both years across all regions for 2026 and 2027, but inflation is expected to peak in 2026. Because of rising and sticky inflation, central banks' policy rates have increased for most key regions. As oil prices have retraced below $75, this fragile truce provides policy flexibility going into second half of the year after more than 35% of global central banks have raised their policy rates in the last 3 months.

Higher inflation = Higher Policy Rates; but recent oil respite provides policy flexibility

	Inflation Forecast by Consensus		Change from 2Q26publication	
	2026(F)	2027 (F)	Change 2026(F)	Change 2027(F)
Global	**4.3**	**3.7**	**0.3**	**0.4**
Developed Markets	**3.6**	**2.8**	**0.0**	**0.1**
Emerging Markets	**3.5**	**3.1**	**0.2**	**0.2**
US	**3.4**	**2.5**	**0.1**	**0.1**
China	**1.2**	**1.1**	**0.2**	**0.0**
Euro Area	2.0	2.1	**-0.8**	**0.0**
Germany	2.9	2.2	**0.6**	**0.2**
France	2.7	2.3	**0.5**	**0.5**
Japan	2.3	1.9	**0.3**	**-0.1**
UK	3.2	2.5	**0.0**	**0.1**
India	2.0	5.0	**-2.6**	**1.0**
Brazil	4.7	4.0	**0.8**	**0.4**

Source: Bloomberg

	Consensus Central Bank Rate Forecast 2026 (F)	Change from 2Q26publication
Developed Markets	3.92	0.21
Emerging Markets	5.53	0.16
US	3.74	0.28
China	2.95	0.17
Euro Area	2.47	0.13
Japan	1.14	0.00
UK	3.86	0.01
India	5.54	0.03
Brazil	13.38	0.38

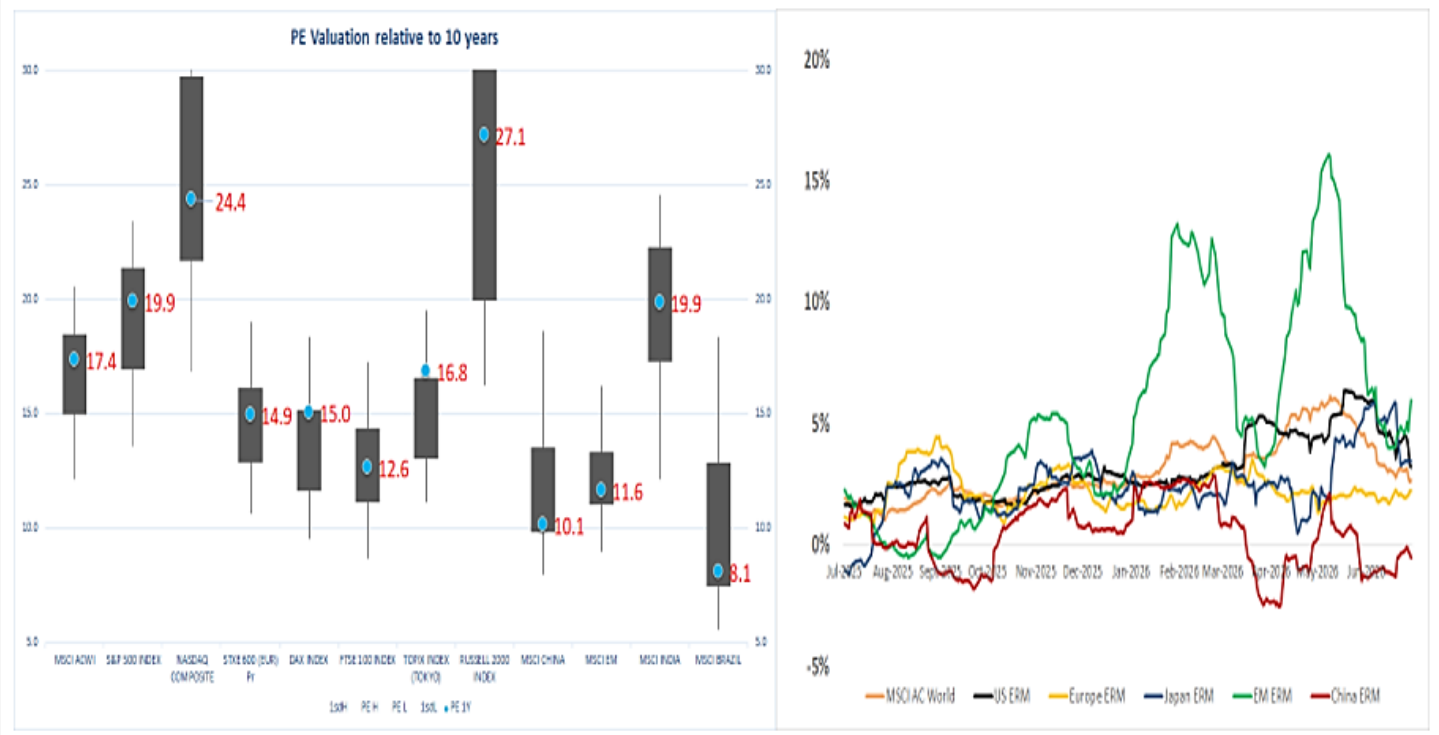
Source: Bloomberg

Alternatives: The biggest beneficiary of the resumption of equity- bond correlation is semi-liquid hedge funds. Our approach towards investing in hedge funds is via a combination of more than a dozen managers that invest across equities, FX, rates, credit, deployed across equity long/short, macro, relative-value, and event strategies, and across the globe. This global oriented multi-manager, multi-asset, multi-strategy approach enables us to generate returns that are not correlated to bonds, and with much lower correlation and beta to broader equities. Speak to your wealth manager to find out more about fund of hedge fund (GARP).

Since 2021 when correlation re-converges, there were 17 occasions when both equities and bonds generated negative returns. During those episodes, equities averaged a negative return of -4.3% with the largest monthly decline was -9.2%. Bonds fell -2.4% on average and endured the steepest decline of -4.7%. GARP on the other hand had fewer negative monthly returns in the period when both equities and bonds were down with 9 such episodes. The average decline was inconsequential at -0.70% with a much smaller down of only -1.6%. That is a demonstrable conclusion that our fund of hedge funds is an effective return enhancer and risk diversifier.

Equities: Neutral. Forward PE multiple for US market has derated by 4 ppt since the peak in Oct last year to 19-20x, which we believe is a fair multiple. The downgrade in multiple is not unusual and is in line with where the macro regime is and that of a late-stage bull cycle. But because of material upgrade in EPS from 15% at the start of the year to 27% currently, S&P500 has been able to return 8% so far. Unless we have a favourable shift in macro-regime either on growth or the interplay with inflation-policy rates, we believe the next 6-12 months return will still be governed by the pace of earnings upgrades particularly in the AI plays and hopefully the broadening of EPS upgrades from other non-tech sectors as well. For now, earnings revision momentum continues across all major regions except China. From a country perspective, we retain our preference for the US over all other markets. It is important to reiterate what we said at the start of the year that flash crash of more than -15% can happen even without a recession in a mature bull.

Valuations are fair valued and ERM remains supportive of equities

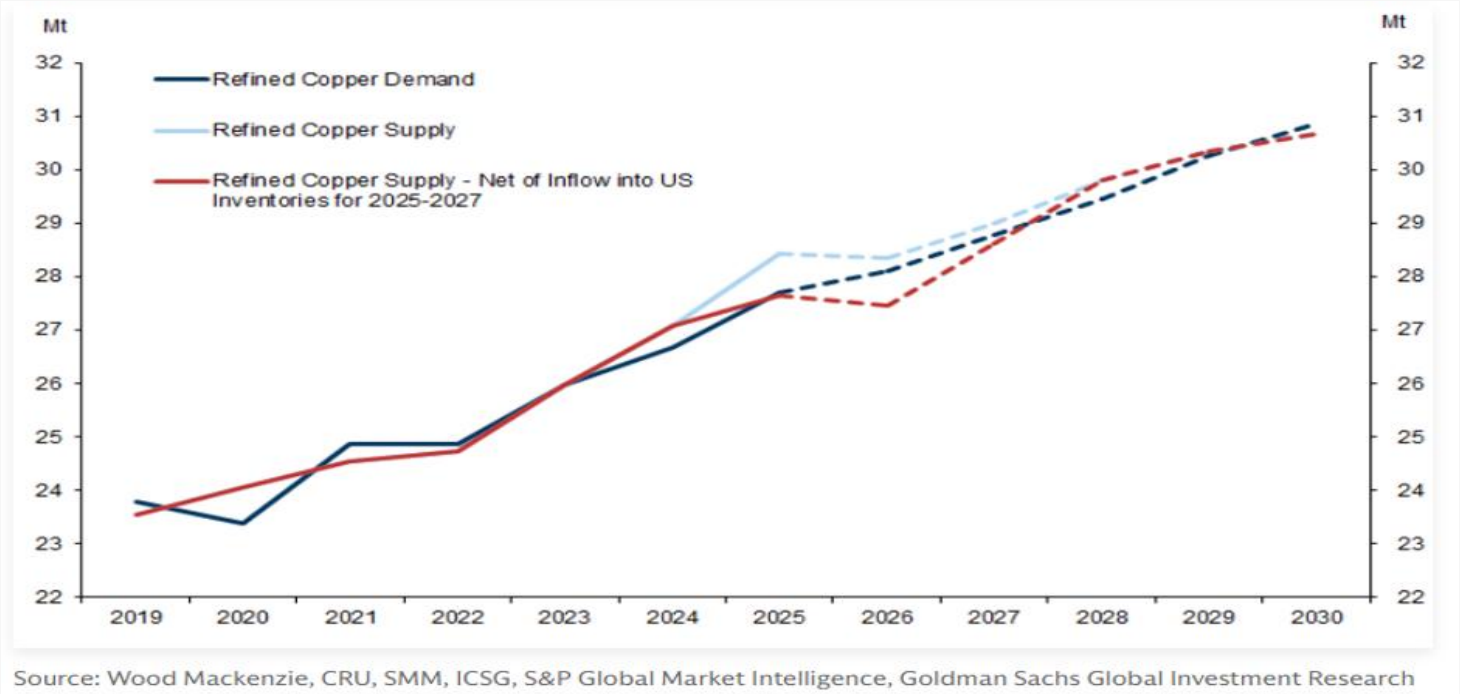


Source: Bloomberg

Fixed Income: Underweight. Our longer-term view of structurally elevated yields limits scope of capital appreciation in bonds; owning bonds here is less about capital appreciation and more about locking in income. While we are not advocating wholesale abandonment of bonds in a 60/40 portfolio as we enter a new correlation regime, it warrants holding a much lower weight in a multi-asset portfolio than history would suggest. We dispute market's narrative that the next move by Fed is to raise rates. Growth in US labour market is slowing and is highly concentrated in only two sectors, even as monthly data is choppy. AI will lead to both destruction and displacement just as we have witnessed in the jobless recovery era of the early '90s when enterprise and consumer PC penetration increased. Contrary to market, we believe the next move for Fed is to cut rates although the cuts will likely be shallow. Staying in shorter duration investment grade bond and selectively in EM credits due to higher carry and also EM countries have been more disciplined than their developed counterparts in fiscal and monetary austerity.

Commodities: The global initiatives we listed above are bullish for metals. From increased penetration of EV cars to further investment into renewable power generation which requires further grid investment, to larger defense spending and growing competition to win the AI race are highly supportive of copper, lithium, and aluminium demand. **We prefer copper as it is easily accessible via ETF.** Copper demand is expected to be anchored by grid and power infrastructure driving 60% of copper demand into 2030. Defense and electrification of transportation system are additional impetuses. On the supply side, growth remains lethargic from challenges in mining deeper and extracting lower yielding ore. Operating cost of mines have also increased for many. Copper is expected to be in undersupply until 2028. We have been disciplined selling Gold in the last 12 months, our position in gold is immaterial now, so are our bitcoin exposures both of which were hurt by rising yields and the exit of fast money accumulated in the preceding 12 months.

Copper to remain under-supplied until 2028



Source: Wood Mackenzie, CRU, SMM, ICSG, S&P Global Market Intelligence, Goldman Sachs Global Investment Research

Cash: Holding more Short-term treasuries than Cash in this current macro set-up.

Featured Picture/Quote:

I may be a Liverpool fan, but I recognise talent, grit and yet light-heartedness.

Edward Lim, CFA

Chief Investment Officer

edwardlim@covenant-capital.com

Risk Disclosure

Investors should consider this report as only a single factor in making their investment decision. Covenant Capital ("CC") may not have taken any steps to ensure that the securities or financial instruments referred to in this report are suitable for any particular investor. CC will not treat recipients as its customers by their receiving the report. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about such investments or investment services. Nothing in this report constitutes investment, legal, accounting, or tax advice or a representation that any investment or strategy is suitable or appropriate to your circumstances or otherwise constitutes a personal recommendation to you. The price, value of, and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. The value of securities and financial instruments is affected by changes in a spot or forward interest and exchange rates, economic indicators, the financial standing of any issuer or reference issuer, etc., that may have a positive or adverse effect on the income from or the price of such securities or financial instruments. By purchasing securities or financial instruments, you may incur above the principal as a result of fluctuations in market prices or other financial indices, etc. Investors in securities such as ADRs, the values of which are influenced by currency volatility, effectively assume this risk.