

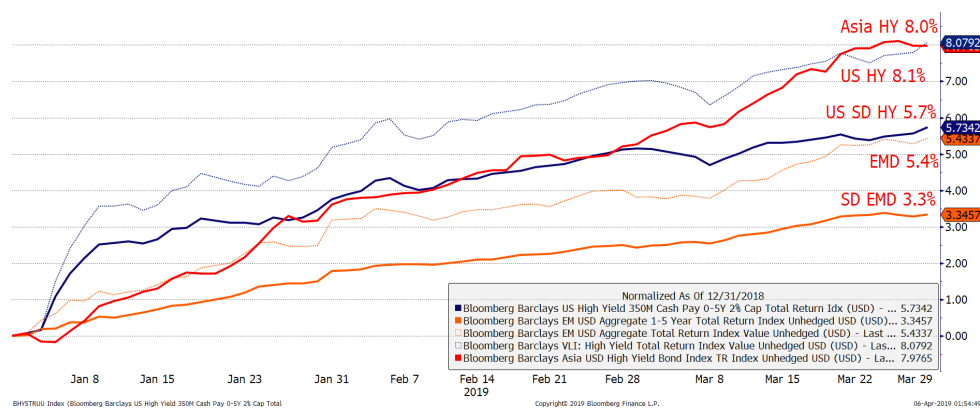


Quarterly Investment Update

Q2 2019

Market Review: Fixed Income

Headlines are shouting “Best quarter since 2009, 2010, 2016” for equities, loans, and commodities respectively. After a correction in Q4 2018 (“the worst since 2011”) which had many questioning the benefit of investing, most bond markets turned in a year’s gains in a quarter.



Source: Bloomberg

March had echoes of January where equities and government bonds rallied. For many investors who rode through V-shaped markets from Q4 2018 to Q1 2019, they have largely gotten back to the highs.

The March rally took its cue from the Fed decision to hold interest rates in order not to snuff out economic growth. This was read as a strong signal that the US central bank was departing from a policy of tightening that started in 2015.

Such a policy shift meant that the pre-existing pressure on long-duration bonds eased off, resulting in a bounce in sovereign bonds markets; akin to the lid being taken off a pressure cooker. Unhedged sovereign bonds anchored the rally across markets by gaining 1.25%. **Currency-hedged bonds which we hold as a better safe haven position gained 1.79%.**

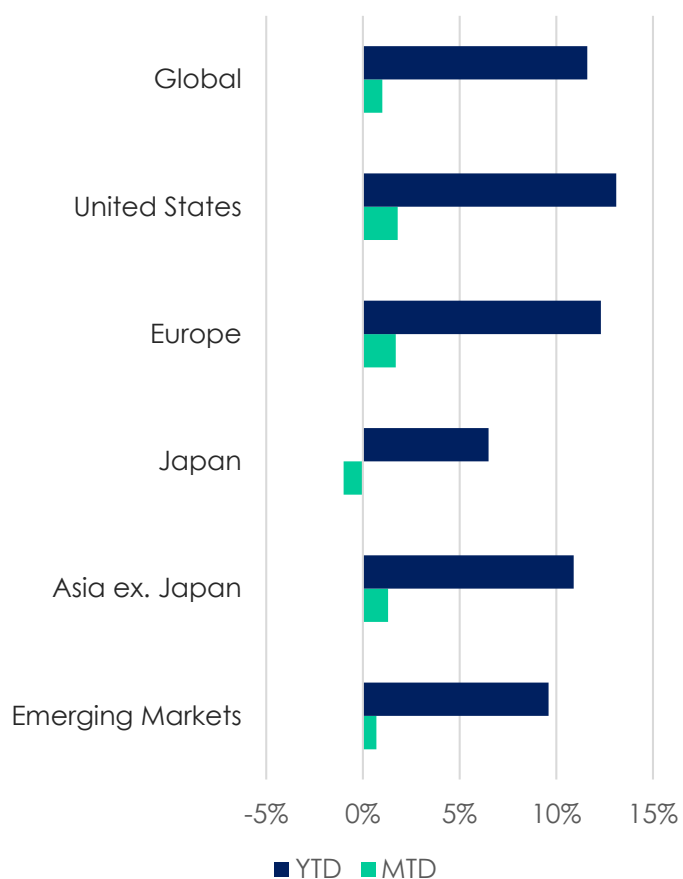
Among the major fixed income segments, Asian high yield had strongest gains with 2.64%, for YTD of 8.0%. This is a reminder that when we have allocated to markets that are sound fundamentally and at attractive valuations (with a dose of portfolio discipline), the reward will come. Short duration emerging market and high yield debt came in at 0.83% and 0.58% respectively.

Generally, each type of investment has its own “personality”. Investment grade bonds tend to be “safer”, are less volatile and consequently compound at a lower rate. High yield bonds are deemed riskier, are more volatile, and investors get rewarded for taking additional risk through higher compounding. Regardless, each investment needs its “personal space” (inherent volatility) as it travels from bottom left to top right.

Almost every portfolio manager will invariably say “it’s not about timing the market, it’s about time in the market”. We like to think of our philosophy as “it’s about time in the right market”. Apart from capturing the long term returns from each asset class, we have our strategy playbooks that guide us on asset allocation so that we are prepared to respond to what the markets throw at us.

Market Review: Equities

Regional Equity Performance



Returns in index currency terms as of 31 Mar 2019
Source: Bloomberg

US equities led developed markets in Q1, perhaps as investors were comforted by the dovish turn in Fed policy. After a volatile December, technology stocks once again emerged the top performer with a 19.9% gain through the first three months of 2019. **The large weighting of tech stocks in US growth indices meant that our allocation to US Large Growth performed exceptionally well in this environment.**

Markets are seldom (if ever) so straightforward. European equities gained a respectable 12.3% in Q1, even as economic activity continued to deteriorate sharply. Like in the US, the European Central Bank (ECB) remain committed to boosting Europe's struggling economy using all of the tools in their arsenal. We would be more interested in European equities with more convincing evidence of growth stabilising, particularly in segments with attractive valuations. In the meantime, we continue to assess the risk drivers for a case to be made here.

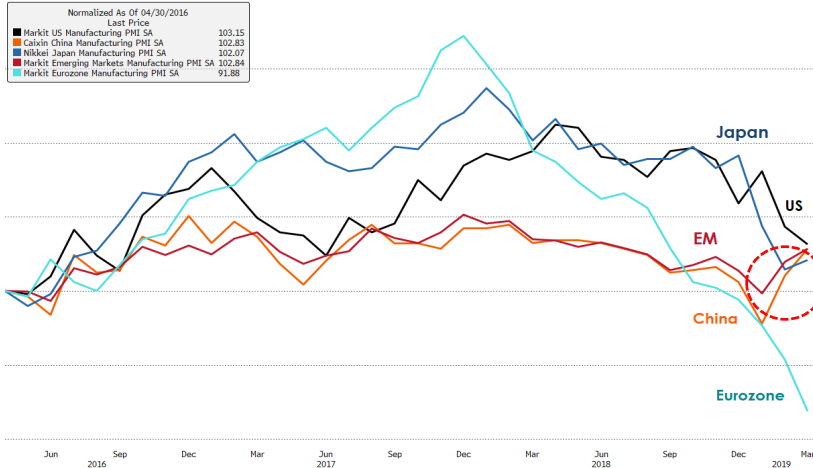
Japanese equities underperformed in the past quarter, with wide dispersion in performance across sectors. Tech stocks emerged the best performing sector, in line with the strong gains observed in global tech stocks. On the other end of the spectrum the consumer discretionary and financial sectors struggled to perform in Q1.

China 'A' gained a blistering 28.6% over Q1, easily trouncing gains in the other equity markets. Coming off historically low valuations in January, the domestic Chinese market gained strongly with the easing of trade concerns, as well as ongoing efforts by the Chinese government to stimulate the slowing economy.

Emerging markets benefitted from strong gains in China, which makes up a large part of the emerging market index. On the other hand, performance in other large EM countries were more modest: both India and South Korea saw only single digit gains. Additionally, the dollar has so far remained firm in Q1, despite calls for a weaker USD (which would benefit EM companies that borrow in USD).

Key Themes: Slowing Growth

Signs of global slowdown bottoming out?

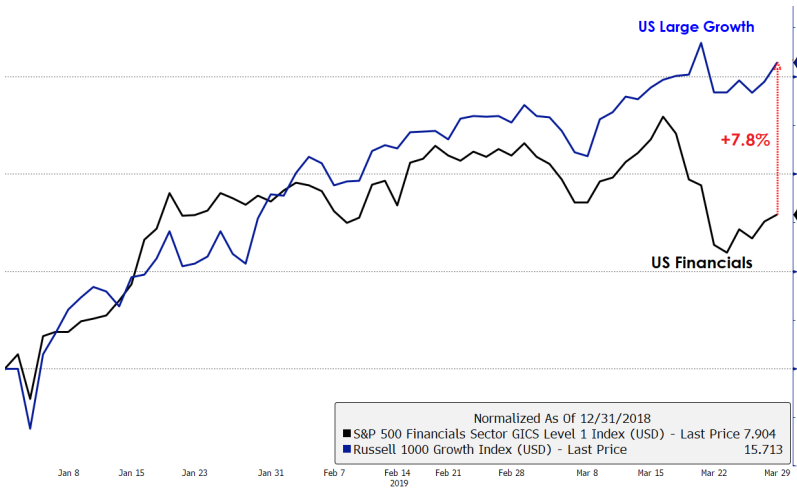


Growth has continued to slow YTD, keeping on with the downtrend in 2018. This has led to increased fears of an impending recession, and ensuing uncertainty around asset prices. Which then prompts the question: if growth is slowing, how do we invest?

The good news is there are recent signs of the growth slowdown bottoming out. Efforts by the Chinese government to stimulate the economy looks like it may be starting to bear fruit; with recent manufacturing numbers rebounding strongly in March. While we do not want to read too deeply into a few data points, it gives us more confidence that we are not spiralling into a recession.

Our portfolios have done well alongside the market rally year-to-date. While we could not have predicted such a positive performance YTD, **our strategy in this environment is to invest in the most resilient markets at attractive valuations. Conversely, we avoided investing in businesses that would suffer in a slowing growth environment.** Our investments in the US are a good case in point: in Q1 we maintained our allocation to US large growth companies that are supported by strong earnings growth, while exiting from US financial companies that would be more challenged by slowing growth – the former outperformed by almost 8% in Q1 alone.

US Large Growth companies outperformed financials in Q1



Source: Bloomberg

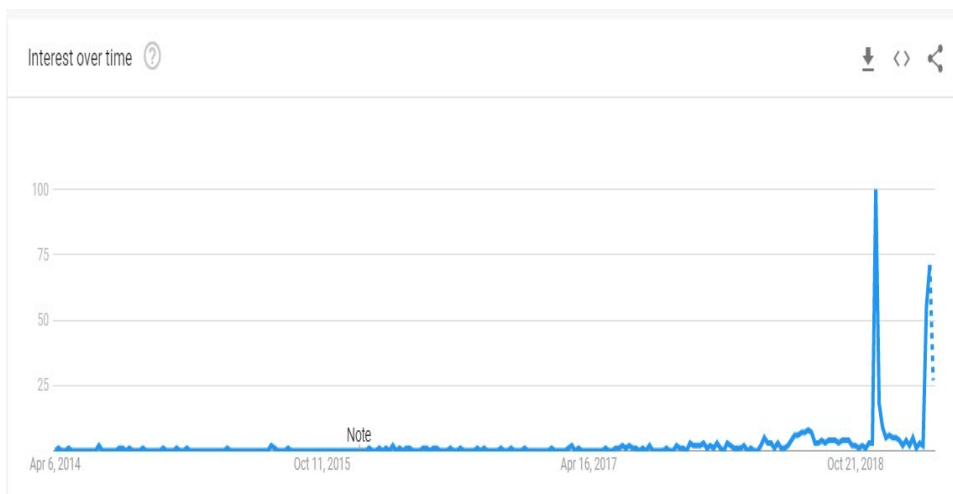
We also prefer markets that are more attractively valued. Going into 2019, we proposed that China 'A' and Japan were two markets with an attractive risk/reward profile - at that time their P/E ratios were well below their historical averages. It turns out that it only took the first three months of 2019 to vindicate our China 'A' (+28.6%) overweight in our portfolios. **Even after such strong gains the China 'A' market is not expensive.** In fact, valuations (measured in P/E) today are still slightly below their 10-year average, which may imply potential for further gains. Performance in Japan has been more lacklustre so far, though the market continues to offers both attractive valuations, as well as supportive corporate fundamentals.

Key Themes: Central bank on hold

Last month we touched on how bear markets are preceded by recessions, which in turn are preceded by yield curve inversions (it's not a yoga pose but similar concept). Inversion is an infrequent situation where you could get a higher interest on your 3-month fixed deposit compared to a 10-year fixed deposit (if it exists).

It turns out that "inversion" became the topic de jour in March as we can see from the chart below showing searches on Google. Accordingly, we have been inundated with research on the inversion phenomena. There are naysayers who claim that the inversion no longer precedes recessions due to a host of reasons, and that the Fed being on hold is a green light for risk assets to rally.

Google search interest for "yield curve inversion"



Source: Google Trends

Regardless of whether one is an optimist or pessimist, the good news is that even if the signal works, a recession is expected to be in 2020. Since 1978, market performance from an inversion until recession has ranged from +1% to +31%. Hence, we do not need to believe that "this time is different" in order to have positive expectation on market performance.

Sovereign bonds: The inversion was caused in part by a strong rally in government bonds that have benefitted the portfolios this quarter. **We take the opportunity to take profit on our existing overweight and re-allocate back to equities.** The remaining currency-hedged sovereign bond exposures provide coupon income and balance the riskier assets.

With growth moderating, global central banks are holding back on any tightening measures. There is less upward pressure on the Euro which is still at negative interest rates.

Given that the USD is expected to be more resilient than the Euro during stress, we switch our European equity exposures from currency-unhedged to hedged.

Short duration: We had a bias to short duration during the rate hike cycle. Should duration be increased once the central banks stop hiking? Fundamentally, there is a case to increase duration since the pressure from rate hikes is alleviated. But valuation tempers our enthusiasm to increase duration right now as markets have not priced-in any hike. That is, for a portfolio that increases duration now, if the Fed reduces rates, there is not much profit to be made; if there is a surprise hike, there stands quite a bit to lose. We are looking to add duration when the opportunity arises, but not just yet.

Key Themes: Search for yield

Asian High Yield, US & EM short duration provides attractive yields

	31 Dec 2017	4 Apr 2019
Asia HY	5.6%	7.0%
US HY short dur. bonds	5.7%	5.9%
US HY bonds	5.5%	6.2%
EM short dur. bonds	4.0%	4.8%
EM bonds	4.5%	5.3%

Much more attractive than what bank deposits offer today

SGD 1Y deposit	1.9%
USD 1Y deposit	2.8%

Source: Bloomberg

In another illustration of the inversion phenomena, you can refer to the deposit rates quoted in our recent commentaries. You will see that the 1-year deposit rates have come down quite a bit. This makes it more important to find attractive pockets of the market for yield.

US High Yield: In the previous slide, we discussed our preference to maintain short duration. Normally, a shorter duration investment means a reduction in the expected yield. The US high yield market continues to offer yield of 5.9% that is comparable with the broader market's 6.2%, yet with lower duration (less interest rate risk).

EM bonds: Emerging market bonds offer meaningful exposure to opportunities in Latin America and emerging Europe. They offer effective diversification and reduce total volatility in a portfolio. Investments include bonds issued by state-owned companies which offer additional yield while being backed by the respective governments. With the USD not expected to strengthen, emerging market borrowers are able to service their USD debt better, reducing the likelihood of defaults.

Asian High Yield: Asian high yield continued to outperform, gaining 8% YTD. Yet there is still ample upside opportunity from here as valuations are still attractive. Furthermore, China has been holding back on its financial deleveraging, resulting in easier credit and liquidity conditions. Sentiment also has turned for the better, which provides additional support for the thesis.

Key Themes: How are we positioned?

Slowing Growth	Central Bank on Hold	Search for Yield
US Large-Growth equities	Short duration fixed income	Asian High-yield bonds
Europe Large-Growth equities	Currency-hedged European equity	Emerging market short duration bonds
Japan equities		
China 'A' equities		

Asset Allocation Strategy

Equity Regional	--	-	=	+	++	Allocation strategy
United States	Q1 2019					Large cap growth to capture late business cycle growth, and where large caps are more resilient to rising financing and wage costs. Underweight driven by higher valuations relative to other markets
Europe						Slight underweight as economic activity is slowing meaningfully.
Japan						Slight overweight as economy is supported by corporate reforms, and equities at attractive valuations.
Asia Pacific ex Japan						Slight overweight to China 'A' as valuations are attractive and supported by earnings growth.
Emerging Markets						Earnings are expected to slow, though a weaker-stable USD may help to support equities in the region.
Fixed Income	--	-	=	+	++	Allocation strategy
Sovereign					Q1 2019	Focus on currency-hedged global government bonds to buffer portfolio volatility during periods of stress.
Investment Grade						Maintaining no exposure as low incremental yield and long duration exposure are less attractive than other segments.
High Yield						Maintain short duration which provides better yield to broad market with less sensitivity to interest rate changes.
Asia						One of the most attractive yields across major fixed income markets backed by policy support and sentiment.
Emerging Market Debt						Range-bound USD eases downward pressure on EMD which adds to portfolio diversification.

Notes: -- Underweight - Slight Underweight = Neutral + Slight Overweight ++ Overweight

Current

Previous

Market Index Returns

Equity Regional	MTD	QTD	YTD
Global	1.0%	11.6%	11.6%
United States	1.8%	13.1%	13.1%
Europe	1.7%	12.3%	12.3%
Japan	-1.0%	6.5%	6.5%
Asia Pacific ex Japan	1.3%	10.9%	10.9%
Emerging Markets	0.7%	9.6%	9.6%

Fixed Income	MTD	QTD	YTD
Global Aggregate	1.3%	2.2%	2.2%
High Yield	1.0%	8.1%	8.1%
Asia	2.0%	4.6%	4.6%
Emerging Market Debt	1.4%	5.4%	5.4%

Currencies	MTD	QTD	YTD
USD/SGD	0.3%	-0.5%	-0.5%
EUR/SGD	-1.1%	-2.7%	-2.7%
JPY/SGD	0.8%	-1.6%	-1.6%

Commodity	MTD	QTD	YTD
Gold	-1.6%	0.8%	0.8%
Oil (WTI Crude)	5.1%	32.4%	32.4%

Equity Markets	MTD	QTD	YTD
Australia	0.2%	9.5%	9.5%
Brazil	-0.2%	8.6%	8.6%
China "A"	5.5%	28.6%	28.6%
China "H"	0.1%	12.4%	12.4%
Hong Kong	1.5%	12.4%	12.4%
India	7.8%	7.2%	7.2%
Indonesia	0.4%	4.4%	4.4%
Korea	-2.5%	4.9%	4.9%
Malaysia	-3.8%	-2.8%	-2.8%
Russia	0.5%	5.4%	5.4%
Singapore	0.0%	4.7%	4.7%
Taiwan	2.4%	9.4%	9.4%
Thailand	-0.9%	4.8%	4.8%

Equity Sectors	MTD	QTD	YTD
Gold	0.7%	6.5%	6.5%
Energy	2.0%	15.4%	15.4%
Technology	4.2%	19.2%	19.2%
Healthcare	0.5%	7.6%	7.6%
Financials	-2.7%	7.9%	7.9%

Returns in index currency terms as of 31 Mar 2019. Source: Bloomberg

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