Monthly Investment Update
November 2019

finexis
ASSET MANAGEMENT
汇信资产管理有限公司

Market Review: Fixed Income

If September was a risk rally favoring risky equities over safe bonds, October was a period where the tide lifted all boats including safe bonds. Here you can imagine swords and shields both being used as offensive weapons.

Bonds have had a remarkable year, returning high single digits despite modest expectations of low single digit returns at the start of the year. Recall that last year 2018 was one of two years out of the past 30 where both equities and bonds were down, and 2019 is reverse of that where both asset classes were up significantly. **Hence it pays to be invested so long as the portfolio risk suits the tolerance of the investor.**

Date	Unhedged bonds	Hedged bonds
10/31/19	7.03%	8.57%
12/31/18	-1.20%	1.76%
12/29/17	7.39%	3.04%
12/30/16	2.09%	3.95%
12/31/15	-3.15%	1.02%
12/31/14	0.59%	7.59%
12/31/13	-2.60%	-0.14%
12/31/12	4.32%	5.72%
12/30/11	5.64%	5.40%
12/31/10	5.54%	4.61%

Source: Bloomberg, Year to date returns of Bloomberg Barclays Global Aggregate Bond Index Unhedged and Hedged from 31/12/2010 to 31/10/2019.

Furthermore, the portfolios' currency-hedged bond exposures were positive when unhedged bonds were down in 2018, and continue to outperform in 2019 when unhedged bonds have strong gains. That is not to say that hedged-bonds outperform all the time, but we managed to improve the odds by following the FVT (Fundamental, Valuation, Technical) process.

What was unforeseen in fixed income this year was the rally in government bonds driven by decline in interest rates. If we had taken more aggressive credit exposures, the portfolios would have done better. But with full hindsight and some view towards the future, we would still have been more conservatively positioned given the more uncertain state of economies this year.

At the start of the year, we expected most of the returns to come from coupon rather than spread compression, which did play out. **Asian high yield was the best performing major credit segment in October and this year.** Coupons returns were significant, with small bouts of price appreciation in September and October. Asian investment-grade credit, which we do not have exposure to, had gains that were more lacklustre.

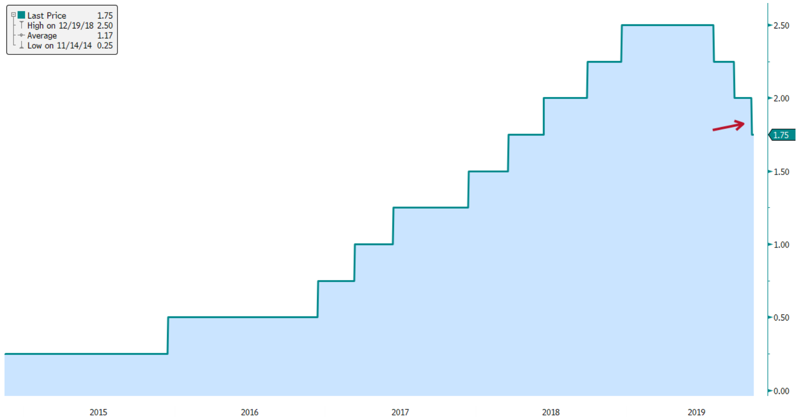
Short duration emerging market bonds have lagged the most this year, turning in mid-single digit returns. Indeed, most of their returns have come from coupon rather than price appreciation. Emerging markets have also been dogged by issues in Latin American markets such as Argentina and Venezuela.

While we are constructive on emerging markets, we are mindful that investors have scars of previous crises that stemmed from emerging market stresses. There are also proponents of emerging markets that say "this time is different"; **we prefer to invest using our philosophy and process to be objective about global opportunities and threats.**

Market Review: Equities

Source: Bloomberg

US Central Bank cut interest rates for the third time this year

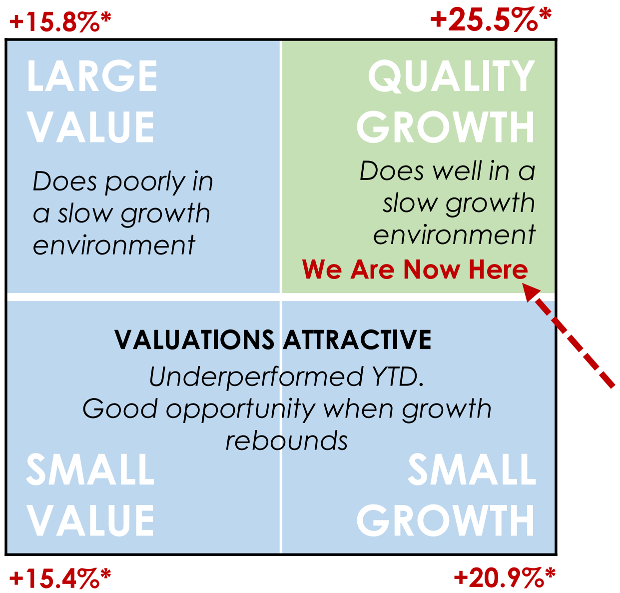


Equities continued to build on positive momentum in October, leading to positive gains across our portfolios. Recently, there were a few reasons to be slightly more optimistic despite a slowing growth environment: **1.** accommodative central banks (In October, the Fed delivered its third interest rate cut in 2019), **2.** the easing of trade-tensions between US-China (the two countries are once again back at the negotiating table), and an overall **3.** better-than-expected earnings season in the US so far (earnings were *not as bad* as people feared it would be).

Area of Interest	Market Observations
US Large-Growth (bias to quality)	US equities saw modest gains as companies reported their Q3 earnings results. By and large, earnings were not as bad as people were expecting in a slowing environment. Consequently, companies that reported better-than-expected earnings were rewarded with a higher share price. **Our preferred US Large-Growth segment outperformed as the Technology and Healthcare sectors (two of the largest components in growth-indices today) gained strongly over the past month.**
Healthcare	**Healthcare emerged the top performing sector in October, gaining close to 5% on the back of strong earning reports.** When we re-allocated from Europe equities into Healthcare in July, our assessment was that Healthcare's more attractive valuation and resilient earnings growth profile made it an attractive investment for investors. Indeed, Healthcare Q3 earnings continued to edge higher as the earnings of the broader US market saw slight declines.
Japan	We do not expect all of our investment decisions to work out at the very moment we decide to invest. Some, such as our China 'A' exposures, generated positive outcomes very quickly. Others, like our Japan overweight, may take awhile longer. Nevertheless, **our patience in Japanese equities was finally rewarded as it emerged one of the top-performers over the past two months (+11.3%).** While we are pleased with the recent outperformance, we are mindful that more sustainable returns in Japan – being a more cyclical economy - are only likely to materialize when global growth improves more meaningfully.
Asia Pacific ex. Japan Emerging Markets 'EM'	Asia and Emerging Market equities gained strongly in October on the back of improved sentiment and risk-appetite. As tensions between China-US eased, China (as a large part of Asia and EM) emerged the key contributor of returns in the region. A weaker dollar, which is an important ingredient for Emerging Markets, also helped over the past month.

Key Themes: Slowing Growth

Where is the next opportunity?



Recent market performance (adding on to the strong YTD gains across our portfolios) have vindicated our earlier decision to stay invested even as some economic indicators have moderated (manifested as economic slowdowns in newspaper headlines). While we remain invested in the markets, we are also on high alert for a more meaningful deterioration in economic data that would lead to a much less happy outcome – in the form of a global recession, which is likely to be accompanied by a bear market (declines of more than 20%). **Today, we have a few fundamental indicators such as the *yield curve* flashing warning signs, but when we assess the markets across our combination of Fundamental, Valuation and Technical 'FVT' inputs, they are still telling us to keep the door open to risk-assets moving higher for potentially some time longer.**

US quality-growth companies are well positioned for a slowing growth environment. Quality businesses have low debt, stronger earnings, and overall healthier balance sheets; which make them more resilient in a slowdown. Put it another way, we would expect the earnings of a group of quality-growth stocks to still be able to grow amidst a slowing environment, whereas economically-sensitive businesses would find it more of a struggle - the year-to-date returns shown on the left-side illustration reflects this dynamic well (25.5% vs 15.8%).

**Year-to-date returns of the respective MSCI World Style Indices in USD as of 31 Oct 2019. Includes: Large Value, Large Growth, Small Value, Small Growth indices.*

We have always said 'prepare, don't predict'. For us, this means knowing which markets to get into in different environments. As growth slowed YTD, we progressively turned more defensive in our positioning, preferring markets that are more resilient or with supportive valuations. There are two potential scenarios going forward: **1. If there are clearer signs of a recession, we would further increase exposures to safe assets to protect against sharp declines. 2. If accommodative policies lead to a resurgence in global growth, we are prepared to deploy to segments of the market that may benefit tremendously (see above graph).** Japan equities are expected to do particularly well when growth rebounds. Even though growth is still lacking, we maintain a slight overweight on attractive valuations and favourable risk/reward. Already, Japan is one of our best performers over the past two months (+11.3%).

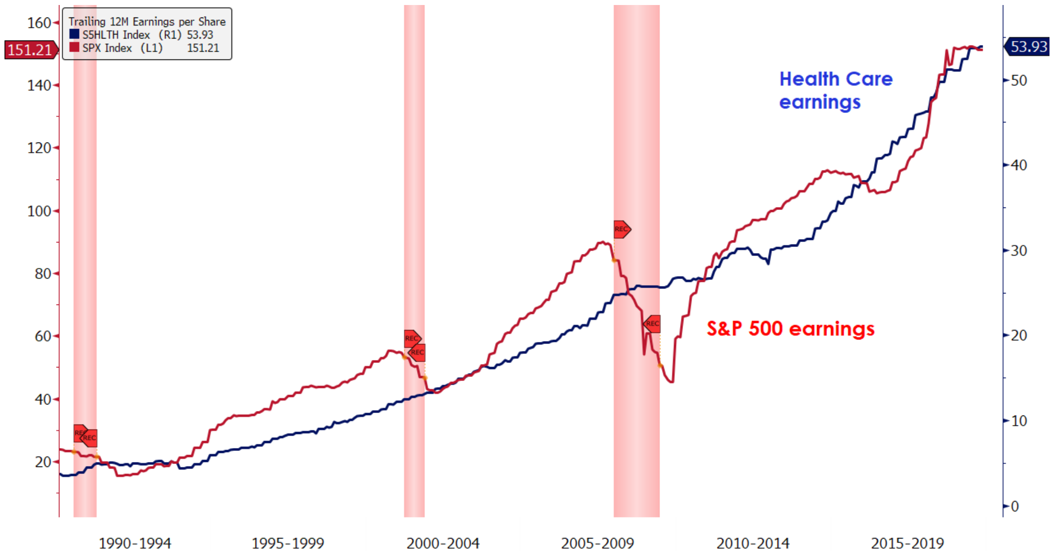
China 'A' equities continue to offer an interesting proposition, providing access to a high growth market without overpaying – valuations are currently attractive below their historical averages. Even with all the uncertainties of the US-China trade tensions, China 'A' is one of the top performing markets YTD (+32%), and a meaningful return contributor for our portfolios. The Chinese government is also expected to embark on policies that will support the economy and markets.

Key Themes: Slowing Growth

Earlier in July, we re-allocated our European equity exposures (effectively bringing holdings to zero) into the Global Healthcare sector, where earnings are generally less correlated to the broader economic cycle i.e. During recessions, Healthcare earnings are resilient whereas earnings for the broader market decline. Healthcare valuations are also broadly in line with historical average, which means that we are not overpaying to be invested here.

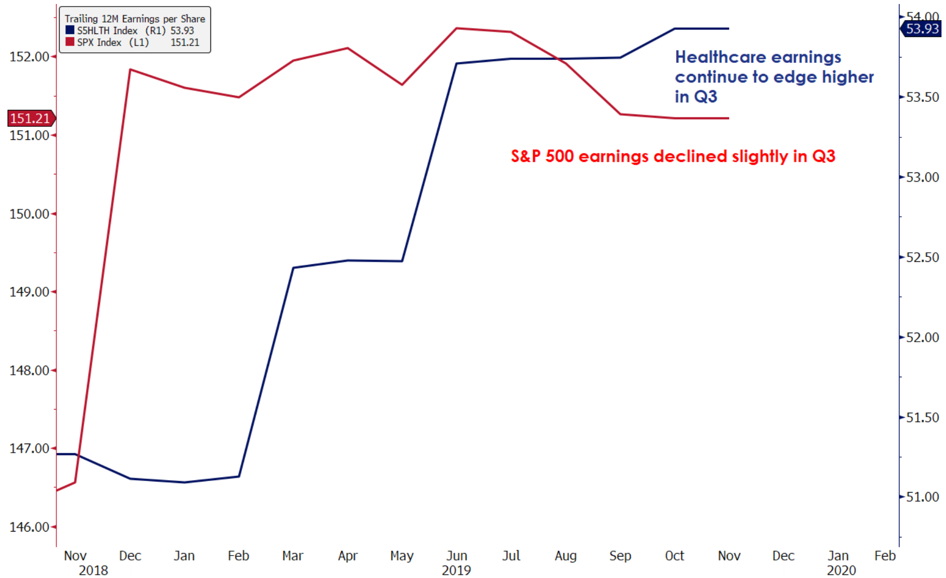
While we do not have a crystal ball to predict accurately what markets would do next, we utilise our 'FVT' process to form expectations of how different markets are likely to perform across different environments. Put into practice, we can use these FVT inputs (e.g. Bottom left-graph: forming an expectation that Healthcare earnings are more resilient in an economic downturn), to predict how a particular market would perform in the future (e.g. Bottom right-graph: Healthcare earnings were indeed more resilient vs the broader market in Q3 2019 as growth slowed) – our special crystal ball helps us to improve the odds of making a right investment.

Healthcare earnings are more resilient in an economic downturn



Shaded areas indicate recessionary periods.

Taking a closer look over the past few months…
Healthcare earnings were similarly resilient in the current slowdown



Source: Bloomberg

Key Themes: Central Bank Policy

Very often, investors look towards the professionals for expert advice. For fixed income markets, one common "view" goes something like this: "we expect <insert a number> rate hikes/cuts in the next six months". Now, this would seem particularly sagacious given the commentator's ability to tell the audience with confidence the future actions of central bankers. Very often, this crystal-ball "insight" is based on what markets have already priced-in i.e. even if that forecast is true, there is little money to be made; and if the forecast is not true, a lot can be lost. **We prefer to take positions on what is not yet priced-in, as the profit is high if we get it right, and losses mitigated if we are wrong.**

Our investment themes complement each other. As a consequence of slowing economic growth, central banks are running low interest rate monetary policies to stimulate business investment and consumer spending. Such investment and spending in turn keep the economies humming along. The undesirable effect is that investors in fixed income assets get low returns on their capital (which is what the central bankers intended).

By and by, investors are feeling the pain of negative rates. Last week, the Swiss National Bank defended its negative rate policy, telling an audience of pension trustees it would not be in the pensions' interest to abolish negative rates. Consequently, Swiss pension managers (and pensioners) either have to accept negative returns on cash or rethink their asset allocation strategies.

SGD-centric investors may not have to deal with negative returns on cash, but also face diminishing returns. Like other central banks, the MAS (Monetary Authority of Singapore) is also taking an easing path by reducing the Singdollar appreciation rate 'slightly' to make Singapore's exports more competitive, making SGD assets worth less vs the dollar.

Sovereign bonds: The good thing is our asset allocation process is flexible enough not to be caught in the negative rate conundrum or SGD home-bias. Currently, the safe-end of our portfolio barbell in currency-hedged bonds is where we expect modest returns while serving as a flight to quality asset.

The universe of negative yielding bonds is dominated by EUR issuers. Consequently, investors with loan facilities have been borrowing euros at low rates to invest in higher yielding opportunities. Leverage is a double-edged sword, and our investors who take on euro-denominated loans will be pleased to know that we have been managing the potential risk of a short squeeze in the euro currency.

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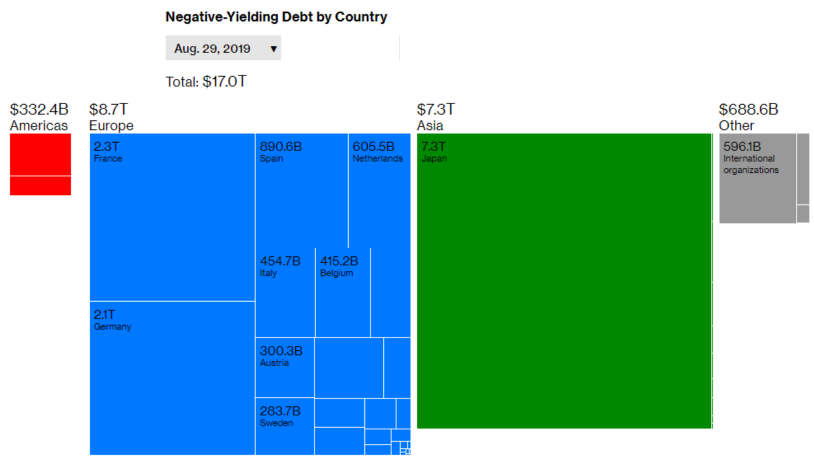

www.bloomberg.com/graphics/negative-yield-bonds/

Key Themes: Search for Yield

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

	31 Oct 2019
Asia HY	**6.7%**
US HY short dur. bonds	**5.8%**
US HY bonds	5.6%
EM short dur. bonds	**5.0%**
EM bonds	5.0%
Global investment grade corporate	2.2%

Much more attractive than what bank deposits offer today

SGD 1Y deposit	1.5%
USD 1Y deposit	2.0%

Source: Bloomberg

You might have heard the phrase "the whole is greater than the sum of the parts". This is attributed to the Greek philosopher Aristotle, but he probably did not have investing in his mind then. This phrase which represents synergy is how we invest using a portfolio approach, which means each position plays a role in making the portfolio better.

In an environment of low savings rates, the portfolios get higher returns from credit markets i.e. bonds issued by companies. The portfolios do not just take more risk but focus on areas where risk taking is expected to be compensated (yes, there are areas of the market where more risk may not mean more return).

In the face of slowing economic growth and higher uncertainty, investors in short duration bonds (generally, bonds that have shorter maturities) have greater visibility on the companies' earnings and credit risk over the next 1-3 years compared to 7-10 years. As bonds near their maturity, their prices converge to face value which means less expected volatility.

US High Yield: Short duration high yield bonds offer similar yields as their longer duration counterparts without taking too much interest rate risk. Default rates remain contained though we are more alert to signs of deterioration.

Asian High Yield and EM bonds: Markets have been able to digest some isolated stresses in Asia and Emerging markets; in fact investors have been buying on dips when valuations improved. At the beginning of the year, we mentioned that credit returns would be driven more by coupon than capital appreciation. Asian high yield has benefitted from high coupon and moderate spread compression which leaves more room for price appreciation. Emerging market bonds gains so far have been primarily from coupon and are at attractive valuations, which stand to benefit if sentiment improves.

Key Themes: How are we positioned?

Slowing Growth	Central Bank Policy	Search for Yield
US Quality Growth equities	Currency-hedged government securities	Asian High-yield bonds
Health Care equities	Short Duration credit	Emerging Market short duration bonds
Japan equities		
China 'A' equities		

Asset Allocation Strategy

Equity Region	--	-	=	+	++	Allocation strategy
United States			■			Large cap growth to capture late business cycle growth, and where large caps are more resilient to rising financing and wage costs. Health Care as earnings are less dependent on the broader economic cycle.
Europe	■					Maintaining no exposure as economic activity is slowing meaningfully, and as valuations are rich.
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			■			Maintain neutral allocation as valuations are at historical averages, and where earnings have moderated.
Fixed Income	**--**	**-**	**=**	**+**	**++**	**Allocation strategy**
Government			■			Focus on currency-hedged global government fixed income to buffer portfolio volatility during periods of stress.
Investment Grade Corporate	■					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 with room for capital appreciation.
Emerging Market Debt				■		Hard currency short duration focus as a more defensive credit investment for the late-stage economic cycle.

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

Current **Previous**

Market Index Returns

Equity Regional	MTD	QTD	YTD
Global	2.76%	2.76%	19.95%
United States	2.17%	2.17%	23.16%
Europe	1.06%	1.06%	21.59%
Japan	4.99%	4.99%	14.14%
Asia Pacific ex Japan	4.05%	4.05%	12.67%
Emerging Markets	4.23%	4.23%	10.66%

Fixed Income	MTD	QTD	YTD
Global Aggregate (Unhedged)	0.67%	0.67%	7.03%
High Yield	0.29%	0.29%	12.53%
Asia	0.58%	0.58%	10.09%
Emerging Market Debt	0.53%	0.53%	11.38%

Currencies	MTD	QTD	YTD
USD/SGD	-1.56%	-1.56%	-0.19%
EUR/SGD	0.74%	0.74%	-2.93%
JPY/SGD	-1.51%	-1.51%	1.29%

Commodity	MTD	QTD	YTD
Gold	2.75%	2.75%	17.97%
Oil (WTI Crude)	0.20%	0.20%	19.31%

Equity Markets	MTD	QTD	YTD
Australia	-0.35%	-0.35%	23.47%
Brazil	2.36%	2.36%	22.00%
China "A"	1.91%	1.91%	32.03%
China "H"	3.27%	3.27%	7.97%
Hong Kong	3.29%	3.29%	7.73%
India	3.90%	3.90%	12.51%
Indonesia	1.03%	1.03%	2.84%
Korea	0.99%	0.99%	2.72%
Malaysia	1.16%	1.16%	-2.56%
Russia	6.23%	6.23%	30.41%
Singapore	3.59%	3.59%	9.08%
Taiwan	4.91%	4.91%	21.71%
Thailand	-2.00%	-2.00%	5.38%

Equity Sectors	MTD	QTD	YTD
Gold	4.33%	4.33%	33.46%
Energy	-2.40%	-2.40%	0.61%
Technology	3.83%	3.83%	33.30%
Healthcare	4.94%	4.94%	12.32%
Financials	2.24%	2.24%	20.23%

Total return in index currency terms as of 31 Oct 2019. Source: Bloomberg

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