Monthly Investment Update
December 2019

finexis
ASSET MANAGEMENT
汇信资产管理有限公司

Market Review: Fixed Income

Recall that October was a period where the tide lifted all boats including safe bonds. November was a more "normal" risk rally environment where equities gained and bonds detracted.

This year has been a unique situation where equities and bonds both have had larger than expected gains. With the benefit of hindsight, we can see that 2019 has been a mirror image of a less-normal 2018 where both equities and bonds declined.

Finexis Asset Management has implemented the FVT (Fundamental, Valuation, Technical) framework since 2016, the year it started operations. Similar frameworks are used by firms such as JP Morgan Asset Management though each firm has its own style in practice.

From 2016 to 2018, we had a series of good runs where asset allocation calls generally worked out. As impressive as it seemed, we were aware that such streaks are not persistent, and cautioned on times when our calls would experience challenging environments. Indeed, we have had varied outcomes from our decisions this year.

At the start of the year, our FVT assessment led to a preference for USD-centric and short duration fixed income exposures. The **USD-centric view worked** with currency-hedged gains of about 2% in government bond investments as the Euro languished amid a soft European economy. Where our views and positions came under challenge were in short duration.

At the beginning of the year, few professionals would have staked their money on long duration government bonds gaining 6% by November. Consequently, this was a drag on our portfolios as **short duration did not participate as much** in the bond rally. But we have to remember why we have short duration exposures in the first place as interest rate direction was not clear at the beginning of the year and the current reward does not warrant the risk to go into longer duration bonds. Please continue to our section on central bank policy and search for yield for the adverse conditions facing bond investors, and how we are positioning the portfolios to cope with such conditions.

On the flip side, **Asian high yield did work out for us**. It continues to be one of the best performing major credit segment in November and this year. Asian high yield bonds do not carry much duration, but had **gains from high coupon** and moderate capital appreciation.

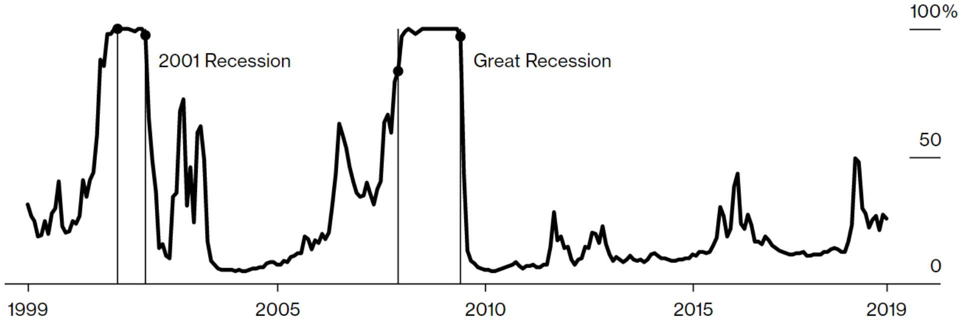
In this "abnormal" year for bonds, short duration emerging market bonds were perhaps the most normal with YTD returns of 6.7% compared to expectations of 5.6% at the start of the year. And this was due to some isolated stresses where protests have sprouted due to socio-economic and political issues. Consequently, investor concerns have risen. From a valuation standpoint, emerging market bonds have actually become more attractive. And yet, emerging market bonds are up this year. How can this be so? This is because emerging market bond gains from coupon have been able to offset capital "depreciation.

Market Review: Equities

Global equities recorded another positive month in November, setting 2019 up to be a bumper year for equities. This is especially notable given the elevated risk of recession observed in the beginning of the year. In general, risk appetite creeped back over Q4 driven by accommodative central bank policies, easing of trade tensions (markets are more or less expecting a partial trade deal to be struck between US and China in December), and dwindling recession risks. In the past month, developed market equities outperformed developing market equities, which lagged as a group.

Recession risks down to 26% from close to 50% at start of year

Probability of U.S. recession within 12 months

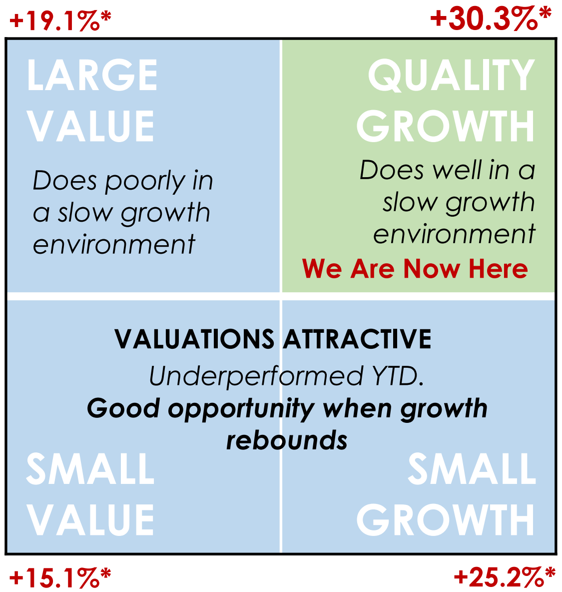


Source: Bloomberg Economics

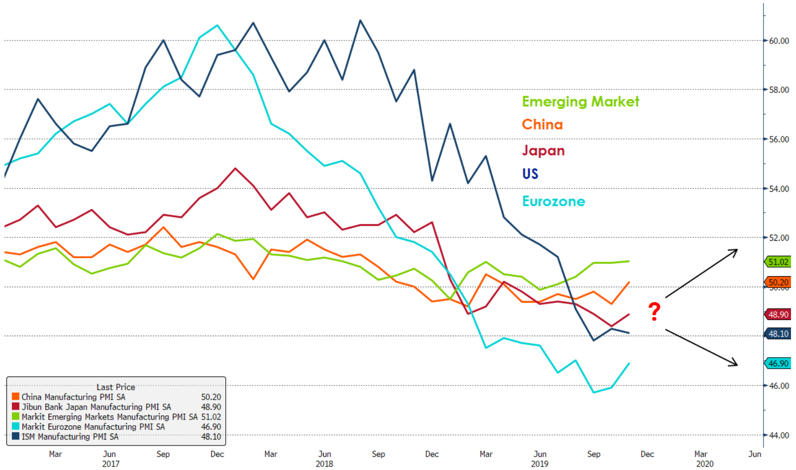
Area of Interest	Market Observations
US	Once again, US equities posted one of the strongest returns out of the major regions in November, maintaining its lead year-to-date (+27.6%). In particular, our preferred growth-segment saw strong returns driven by the Tech and Healthcare sectors. In contrast, the more defensive Real Estate and Utilities sectors (where we have no active exposures) posted negative returns of close to 2 percent.
Healthcare	**Healthcare continued to gain strongly in November (+4.8%), building on their positive momentum from the prior months.** In Q3, we observed Healthcare earnings continue to edge higher while earnings of the broader US market saw slight declines; which quickly vindicated our decision to allocate earlier in July. While we are pleased that the US Quality Growth and Healthcare segments have worked out well for us over the past few months, we are also on the look out for more interesting opportunities that may provide a more attractive risk/reward profile especially if we observe a growth resurgence.
Asia Pacific ex. Japan Emerging Markets 'EM'	Asia and Emerging Market equities underperformed the other major regions in November. Returns here were more dispersed across countries, and currency effects were a meaningful detractor in the past month. The dollar strengthened 1% against the Korean Won, 5% against the Brazilian Real, and a blistering 10% against the Chilean Peso (Chile's economy has been impacted by weeks of protest). We are currently paying close attention to the USD as we expect it to be a meaningful driver of returns for the region over the coming months.

Key Themes: Slowing Growth

Where is the next opportunity?



Some green shoots in manufacturing activity



We posed the following question to our investors at the beginning of 2019: 'If growth has peaked, how should we invest in such an environment'? It was about a year ago when growth started slowing considerably, prompting concerns that the multi-year uptrend in equities has come to an end. Our answer to the question came to us through our FVT (Fundamental, Valuation, Technical) framework; which told us to stay invested in markets where earnings were more resilient (such as US Quality Growth, and Healthcare), while avoiding areas that were most at risk of a slowdown (cyclical value sectors, or markets that were unjustifiably expensive). In a year where newspaper headlines were increasingly dominated by mentions of an 'economic slowdown' or 'recession risks', our portfolios saw positive year-to-date returns across the board.

As we come close to the end of 2019, we find ourselves asking another question: How does 2020 look like for markets and our portfolios?'. At the moment, there are two potential scenarios we see playing out: **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 growth, we are prepared to deploy into segments of the markets that may benefit tremendously (refer to graph on the left). **Over the next few months, we pay close attention to see if the scales would tip more clearly in favour of either a 1. further slowdown or 2. growth resurgence (Refer to bottom-left chart).**

As growth slowed YTD, we progressively turned more selective in our positioning, preferring markets that are more resilient or with supportive valuations. Going through our portfolio positions today, the US Quality Growth and Healthcare allocations are the most resilient in terms of being able to sustain their earnings growth in a slowdown, whereas more economically-sensitive areas i.e. value-stocks would find it more of a struggle – the year-to-date returns shown on the top left-side illustration reflects this dynamic well (+30.3% for the World Growth Index vs 15.1% for the World Small-Value index.

We also continue to favour our China 'A' and Japan equity exposures, both of which has attractive valuations, and has the potential for strong returns especially when growth rebounds.

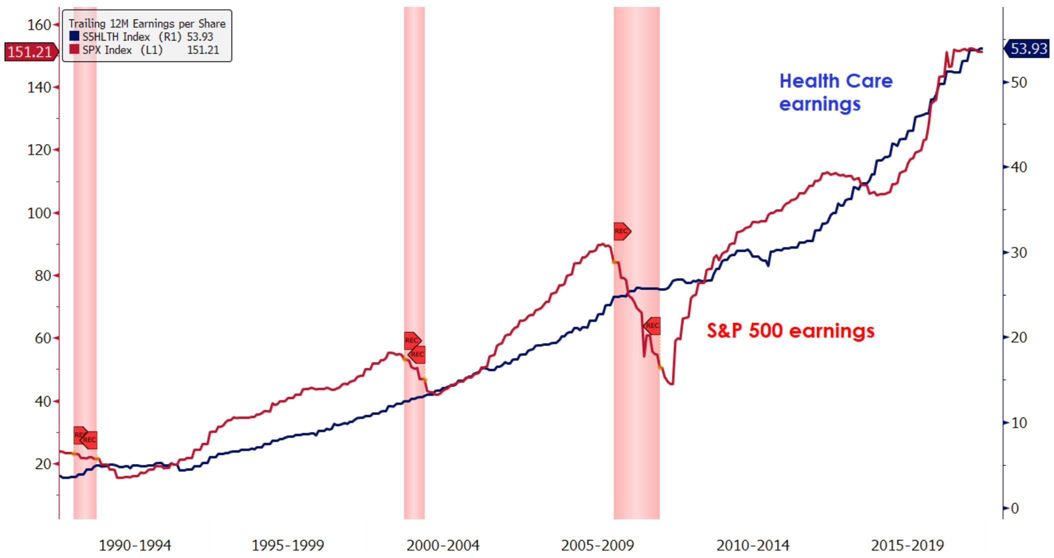
*Source: Bloomberg, Year-to-date returns MSCI World Large Value, Growth, Small Value, Growth indices. As of 29/11/2019

Key Themes: Slowing Growth

For us, the best kind of investment are those that can do well regardless of how the economy turns out. Put it simply, we want to have our cake and eat it too. Over the past few months Healthcare was such an investment for our portfolios - the sector held up well in volatile markets in August, and is also one of the best performing sectors in Q4 so far.

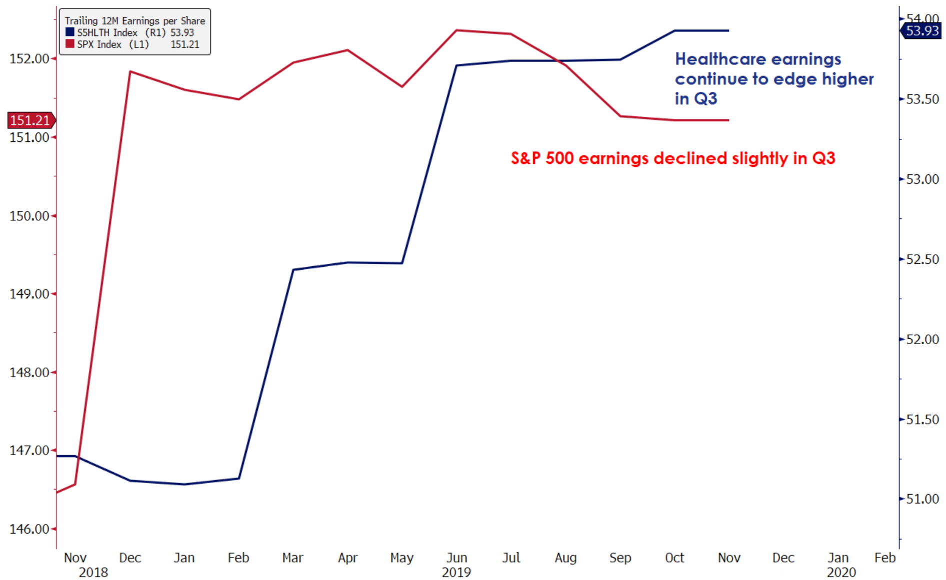
Earlier in July, we re-allocated our European equity exposures (effectively bringing holdings to zero) into the Global Healthcare sector, where earnings are generally less correlated to the broader economic cycle i.e. During recessions, Healthcare earnings are resilient whereas earnings for the broader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

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



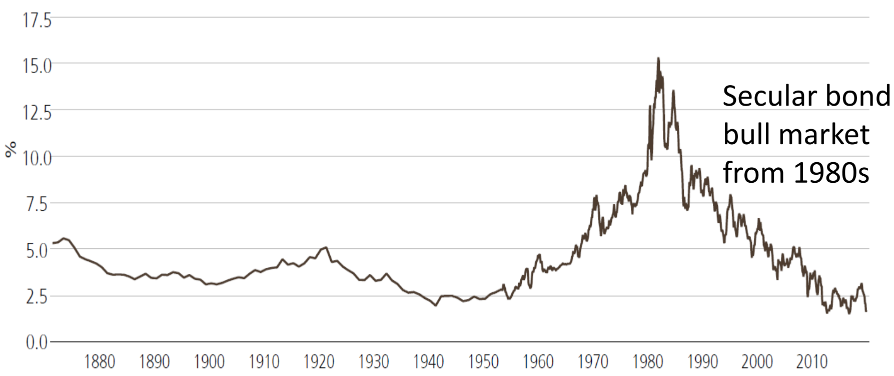
Source: Bloomberg

Key Themes: Central Bank Policy

In multi-asset investments, bonds have traditionally played the role of capital preservation and income generation, while equities are for growth and capital appreciation.

Indeed, bonds have provided returns with relatively low volatility while being a good diversifier to equity investments (a reliable shield to the sword). This was in the context of a secular bull market in bonds since the 1980s as shown in the chart below (bond prices rise as yields decline).

United States average monthly 10 year yield



Source: UBS Asset Management, Macrobond as of November 11, 2019

Looking at the long history of interest rates since 1880, would you bet on yields rising or falling more? Going forward, is it reasonable to expect the bond shield to continue to be as reliable?

It is known that sea waters recede before a tsunami, displaying rare sights and prompting people unaware of the danger to remain near the shore. Are the exceptional returns for bonds this year a similar situation?

We have been discussing the poor return prospects for government bond investors in light of a negative interest rate environment. **A secondary but non-trivial consequence is also the increased volatility posed by negative rates** as markets react strongly to positive and negative catalysts. Hence investors are faced with diminished return expectations and higher volatility; not attractive risk-reward in our minds.

In the face of this environment, the traditional investment construct is expected to be less robust. **We are focusing on moving the portfolio to being less dependent on macro-economic conditions** or broad market direction. We have begun to do this with healthcare sector exposures where earnings are expected to remain resilient during recessions. Other opportunities include those that do not rely on bonds yields to go down to be profitable, structural trends which are less affected by economic cycles, or generally strategies that are less correlated to broad markets.

We continue to **take risk in the portfolios to generate returns** but such risks are less subject to the Ambiguity in a VUCA(Volatility-Uncertainty-Complexity-Ambiguity)world. We use these to **complement the safe-end of our portfolio barbell of currency-hedged bonds** where we expect modest returns while serving as a flight to quality asset.

Key Themes: Search for Yield

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

	29 Nov 2019
Asia HY	**6.8%**
US HY short dur. bonds	**5.7%**
US HY bonds	5.5%
EM short dur. bonds	**5.2%**
EM bonds	5.1%
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

In an environment of low savings rates, **the portfolios get higher returns from credit markets** i.e. bonds issued by companies. High yield bond investors who effectively are creditors will be in a favourable position relative to equity investors who as shareholders are the last in the financial pecking order. Being last is good when economic conditions are favourable where companies generate ample profits and cash for shareholders, but not so great when economic conditions are uncertain. If uncertainty in economic outlook translates to range-bound equity markets with little capital appreciation, high yield bonds continue to provide coupon returns to investors.

US High Yield: Low interest rates since the financial crisis in 2008 have prompted US companies to take on more debt with the aim to grow their businesses. Recent media articles have highlighted the $10 trillion of debt that companies have since accumulated. These companies are generally able to service their debt so long as the economy continues to sustain their businesses. **One area of potential risk is the knock-on effects of economic slowdown** to increased defaults and impact on high yield bond prices. For now, default rates remain contained though we are more alert to signs of deterioration. We are positioned in short duration high yield bonds that offer similar yields as their longer duration counterparts, and are expected to be more resilient in the event of a downturn.

Asian High Yield and EM bonds: These segments are comprised of short duration bonds (generally, bonds that have shorter maturities) where investors have greater visibility on the companies' earnings and credit risk over the next 1-3 years compared to 7-10 years; greater visibility which is helpful in the face of slowing economic growth and higher uncertainty. Emerging market bond valuations are becoming increasingly attractive as investors felt the grip of fear from protests in Argentina, Chile, and Lebanon. We look to be greedy when others are fearful, and envisage greater opportunities in emerging market bonds.

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	2.49%	5.32%	22.95%
United States	3.63%	5.87%	27.63%
Europe	2.85%	3.94%	25.06%
Japan	1.95%	7.03%	16.44%
Asia Pacific ex Japan	0.46%	4.53%	13.19%
Emerging Markets	-0.13%	4.09%	10.51%

Fixed Income	MTD	QTD	YTD
Global Aggregate (Unhedged)	-0.76%	-0.10%	6.22%
High Yield	0.36%	0.64%	12.93%
Asia	0.10%	0.68%	10.21%
Emerging Market Debt	0.03%	0.56%	11.42%

Currencies	MTD	QTD	YTD
USD/SGD	0.54%	-1.03%	0.35%
EUR/SGD	-0.67%	0.07%	-3.58%
JPY/SGD	-0.83%	-2.32%	0.46%

Commodity	MTD	QTD	YTD
Gold	-3.24%	-0.57%	14.15%
Oil (WTI Crude)	1.83%	2.03%	21.49%

Equity Markets	MTD	QTD	YTD
Australia	3.47%	3.11%	27.75%
Brazil	0.95%	3.33%	23.15%
China "A"	-1.49%	0.40%	30.07%
China "H"	-2.20%	1.00%	5.60%
Hong Kong	-1.98%	1.25%	5.60%
India	1.66%	5.62%	14.37%
Indonesia	-3.45%	-2.46%	-0.71%
Korea	0.22%	1.21%	2.95%
Malaysia	-2.09%	-0.95%	-4.59%
Russia	1.43%	7.74%	32.27%
Singapore	-0.82%	2.74%	8.18%
Taiwan	1.16%	6.12%	23.12%
Thailand	-0.57%	-2.57%	4.78%

Equity Sectors	MTD	QTD	YTD
Gold	-3.46%	0.71%	28.83%
Energy	1.10%	-1.32%	1.72%
Technology	5.22%	9.24%	40.25%
Healthcare	4.61%	9.78%	17.50%
Financials	4.83%	7.18%	26.03%

Total return in index currency terms as of 29 Nov 2019. Source: Bloomberg

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