Investment Update
Q1 2020

ASSET MANAGEMENT
汇信资产管理有限公司

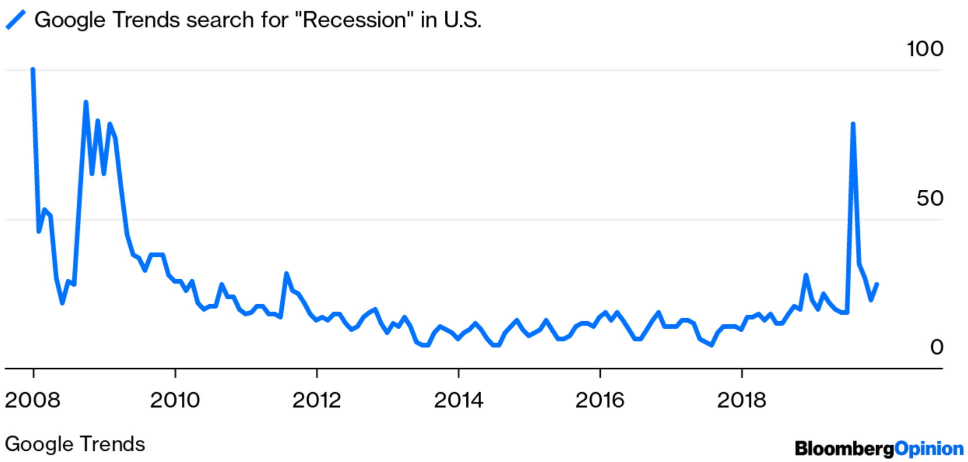
Market Review: Fixed Income

Markets staged a strong rally in December to close off an euphoric 2019. Yet, one would not have felt euphoric throughout 2019 unless they invested at the start of the year, and went off to a desert island ignoring what was happening around the world.

For most of 2019, it was reasonable to feel gloomy. There was an escalating trade war between the world's two greatest economies, yield curve inversion signaled potential recession, and protests were erupting across emerging markets. The European economy contracted while other major regions with slowing growth fought to avoid a similar fate.

Indeed, investment professionals were evaluating the likelihood of recession. Recession fears were also felt by the wider community, with Google Trends data showing interest in "recession" hitting a high unseen since the last crisis.

Recession fears spiked during the summer and have now evaporated



So, markets had strong gains in 2019 amid the negativity, but dropped in 2018 when things did not seem so bad. How can anyone invest properly with such a feedback loop?

Over the year, we positioned the portfolios more defensively, not because we saw imminent recession or bear market, but as a consequence of the late stage economic cycle. However, we did not cut risk and were able to participate in the market gains by getting exposure to risk we were comfortable with in the current environment. Arguably, it is easier to figure out what to invest in at various parts of the cycle as guided by our FVT (Fundamental, Valuation, Technical) process instead of trying to pick market tops.

Unhedged investment grade bonds closed the year with gains of 6.8% while our preferred currency-hedged bonds did 8.2% with lower volatility*. The USD-centric view has worked out for us the past two years, but we expect some volatility going forward as markets weigh the possibility of short-term strength in the Euro.

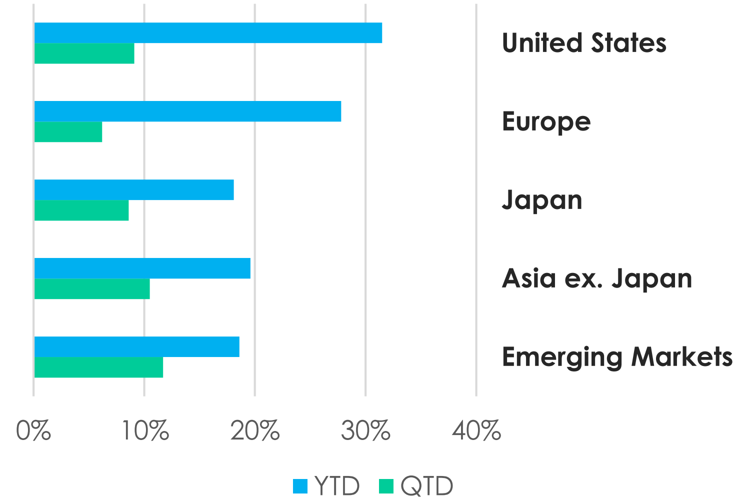
In credit markets, our overweight in Asian high yield paid off both from absolute and risk-adjusted standpoint. Asian high yield markets gained 13.8% for the year, edged out by US high yield markets which clocked in 15.3%. It is important to highlight that US high yield has higher duration so **Asian high yield was able to generate similar returns while taking less interest rate risk**.

It would be evident from recent commentary that our other short duration exposures lagged. Short duration US high yield and emerging markets returned 9.8% and 7.8% respectively. Ironically, these were the segments where the actual returns were closest to our expectations at the start of the year.

*Source: Bloomberg, Year-to-date returns Bloomberg Barclays Global Aggregate, Asia USD High Yield Bond, High Yield Total Return, US High Yield 350mn Cash Pay 0-5 Yr 2% Capped Bond, EM USD Aggregate 1-5 Year Total Return. As of 31/12/2019

Market Review: Equities

Source: Bloomberg as of 31/12/2019



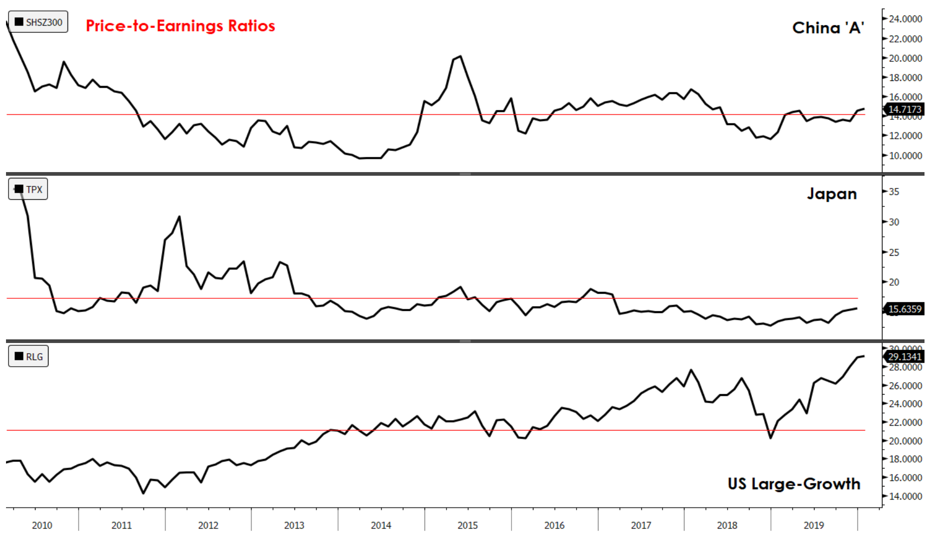
Equities capped off a strong year in December, delivering to investors what newspaper headlines commonly refer to as a 'Santa Claus rally'. The announcement of a widely-anticipated trade deal between US and China provided market participants an additional reason to cheer, even as some uncertainties on the trade deal remain. In general, risk taking returned to markets over Q4 2019 as recession risks subsided, with Asia and Emerging Markets catching up with Developed Market equities towards the end of the year.

Area of Interest	Market Observations
US	The US S&P 500 Index ended the year with strong gains of 9.1% in Q4, extending year-to-date gains to 31.5%. In the past quarter, the Tech and Healthcare sectors emerged the key contributors, and benefitting our overweight. For the most part of the year, US equities have been more resilient than their global peers in a slowing growth environment, though we are increasingly cautious about their relatively higher valuations going into the new year.
Europe	In contrast, European equities (where we have 0% exposure) underperformed with returns of 6.2% in Q4, and is also the weakest performance out of the major regions in Q4 2019. We had mentioned before that the upside for European equities may be capped given the *already* strong year-to-date performance despite a contracting European economy, so the recent weaker performance is more or less in line with these expectations.
Asia Pacific ex. Japan Emerging Markets 'EM'	Asia and Emerging Market equities, which had lagged meaningfully year-to-date, played catch-up towards the end of 2019 with strong gains of 5.7% and 7.4% in December. A large part of these gains were driven by China (as the largest component of EM and Asia), though a few EM countries such as Brazil (+10.4% QTD) and Russia (+12.8% QTD) also contributed strongly to performance. With a more convincing bottoming out of economic slowdown, we expect a weaker dollar to be supportive for the region's performance over the coming months.

Key Themes: Late-Cycle Extension

We posed the following question 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, while avoiding areas that were most at risk of a slowdown or unjustifiably expensive. In a year where newspaper headlines were increasingly dominated by mentions of an 'economic slowdown' or 'recession risks', our portfolios saw strong positive returns in 2019.

Valuations are much more attractive outside the US



Source: Bloomberg

As we enter the new year, we ask ourselves a similar question: What do markets look like in 2020?'. In the past year, governments and central banks around the world have embarked on policies to try and keep recession at bay. Barring any further deterioration in economic fundamentals, or meaningful breakdown in US-China trade relations, 2020 may see the fruits of these accommodative policies i.e. economic expansion to go on for awhile longer.

To be sure, we remain in the later-part of the economic cycle; one characterised by rich equity and bond valuations, and more frequent bouts of market volatility. In the meantime, we continue to favour **Quality-Growth and Healthcare stocks in the US** for their predictable and more durable earnings profile, while avoiding investments that are at the mercy of a growth rebound to do well. **For Q1 2020, we reduce our US equity allocations from neutral to slight underweight, reflecting the relatively rich valuations in the US compared to opportunities elsewhere.**

Subsequently, we further increase our allocation to China 'A' equities, which was one of our best performing positions for 2019. Despite a 37.5% gain in 2019, attractive valuations coupled with accommodative government policies and earnings growth continue to put the odds in our favour for this high-growth market to outperform. We also continue to maintain a slight overweight to Japan, which is one of the most attractively-valued markets today, and will do well especially if growth can pick up more convincingly over the coming months.

Key Themes: Central Bank Policy

It is the time of the year when everyone takes a shot at the crystal ball and prognosticate on where markets will go. Better still if the investment manager can confidently articulate an accurate forecast to demonstrate their "capabilities". We are not capable of making such predictions. What we seek to do is to understand the current environment, identify potential scenarios, and invest appropriately for such conditions.

At this stage of the economic cycle, there are two bifurcated scenarios:

1. Economies continue to slow and contract into a recession, increasing unemployment while denting corporate profits, and leading to a significant market decline.
2. Economic slowdown bottoms out and extends the late stage economic cycle, providing support for employment, corporate profitability, and markets.

For now, scenario 2 is the central case. Financial conditions are loose with supportive central banks suppressing interest rates. The economic barometer PMI (Purchasing Managers' Index) indicate at least that there is no worsening contraction, and recessionary conditions have abated.

Nevertheless, we are still in the late stages of the economic cycle, which invariably will be followed by contraction. We continue to take risk but focus on areas with favorable FVT.

Have markets already priced in this extension of the economic cycle? Indeed there are segments which have rallied and reflected a good part of this optimism. There are other segments such as emerging markets which are expected to participate in the next leg up, having already seen a basing of economic slowdown, and trading at attractive valuations.

Over the years, central banks have been driving interest rates lower and lower to sustain growth. As discussed in last month's commentary, the long term risk-reward for bonds is challenging with interest rates at lows since 1880s. The near time risk-reward is also challenging as investors are faced with negative return expectations in European and Japanese bonds. What is clear is more volatility in the bond markets as investors tussle with the headwinds above versus bonds' potential safe-haven properties.

How can we position the portfolio to cope with such conditions?

We maintain short duration primarily expressed through the credit exposures to be more defensive in a downturn, with tactical allocations to more attractive credit markets in the search for yield.

Focus on opportunities that are less dependent on macro-economic conditions or broad market direction. In fixed income, we have a game plan to implement positions that do not rely on bond markets to rally in order to be profitable. In equity, the healthcare sector which is expected to be resilient in the event of recession has done well even in the absence of recession. This was helped by the discipline of focusing on valuation. There are other resilient sectors but valuations are not as attractive; we look to catch such fish when conditions are more favourable.

Key Themes: Search for Yield

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

	31 Dec 2019
Asia HY	**6.6%**
US HY short dur. bonds	**5.1%**
US HY bonds	5.1%
EM short dur. bonds	**4.9%**
EM bonds	4.9%
Global investment grade corporate	2.2%

Much more attractive than what bank deposits offer today

SGD 1Y deposit	1.4%
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. Where uncertain economic conditions lead to range-bound equity markets with little capital appreciation, credit investors continue to benefit from coupon payments. We also maintain short duration on credit. Why this focus on short duration if taking long duration can lead to more gains as they did in 2019? In the event of deteriorating economic conditions and higher funding costs, there is higher visibility and ability for companies to meet their loan obligations. As a lender, we want to **balance the focus on extracting high yield against the risk of loss of principal**.

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. Based on the scenario of an extension of the late-stage cycle, US high yield issuers are expected to be able to service their debt with no material rise in defaults. However, current valuations are pricing in significantly optimistic outcomes, which leave little margin of safety. **This means that returns going forward are dependent on coupon returns, with a risk of price decline due to optimistic valuations.** **Hence, we reduce our exposures to US High Yield in Q1 2020.**

Asian High Yield and EM bonds: **With the reduction in US High Yield, we increase exposure to Emerging Market Debt.** One might ask, is there a difference between EMD yielding 4.9% vs 5.1% for US HY? We do not need to go into a discourse on the long term fundamentals of emerging markets, or the benefits of diversification. The 4.9% represents yields for investment grade emerging market bonds while 5.1% is for US "junk" bonds. Being able to get similar yield with higher credit rating, that seems like a nice trade-off. And within EMD, we prefer short duration for reasons of resilience mentioned above. What makes this segment more compelling is that it is at more attractive valuation than its long duration counterpart. Last month, we spoke about being greedy when others are fearful, and the opportunity has since presented itself.

Key Themes: How Are We Positioned?

Late-Cycle Extension	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 lags other regions, and as valuations are rich.
Japan						Slight overweight as economy is supported by corporate reforms, and equities at attractive valuations.
Asia Pacific ex Japan				→		Overweight to China 'A' as valuations are attractive and supported by earnings growth.
Emerging Markets						Neutral as valuations attractive relative to developed markets, but 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			←			Maintaining no exposure as there is an elevated risk of a price decline due to optimistic valuations.
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	3.54%	9.05%	27.30%
United States	3.01%	9.06%	31.48%
Europe	2.15%	6.17%	27.75%
Japan	1.44%	8.57%	18.11%
Asia Pacific ex Japan	5.67%	10.46%	19.61%
Emerging Markets	7.35%	11.74%	18.63%

Fixed Income	MTD	QTD	YTD
Global Aggregate (Unhedged)	0.58%	0.49%	6.84%
High Yield	2.08%	2.73%	15.28%
Asia	0.37%	1.05%	10.61%
Emerging Market Debt	1.52%	2.09%	13.11%

Currencies	MTD	QTD	YTD
USD/SGD	-1.59%	-2.61%	-1.25%
EUR/SGD	0.13%	0.20%	-3.45%
JPY/SGD	-0.86%	-3.17%	-0.41%

Commodity	MTD	QTD	YTD
Gold	3.64%	3.04%	18.31%
Oil (WTI Crude)	10.68%	12.93%	34.46%

Equity Markets	MTD	QTD	YTD
Australia	-2.16%	0.88%	24.99%
Brazil	6.85%	10.41%	31.58%
China "A"	7.01%	7.43%	39.19%
China "H"	8.43%	9.51%	14.50%
Hong Kong	7.02%	8.35%	13.01%
India	1.13%	6.81%	15.66%
Indonesia	4.91%	2.33%	4.17%
Korea	5.28%	6.55%	8.38%
Malaysia	1.85%	0.88%	-2.83%
Russia	4.67%	12.77%	38.45%
Singapore	1.11%	3.88%	9.38%
Taiwan	4.61%	11.01%	28.79%
Thailand	-0.48%	-3.04%	4.26%

Equity Sectors	MTD	QTD	YTD
Gold	9.36%	10.14%	40.89%
Energy	5.82%	4.42%	7.64%
Technology	4.10%	13.72%	46.00%
Healthcare	3.33%	13.43%	21.41%
Financials	2.49%	9.85%	29.17%

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

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