Investment Update

June 2021

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Market Review

Inflation is the topic du jour, and rightfully so. Inflation concerns came to the fore in May, as reflected by Google Trends. And even if you were not an economist or investor, there is a chance inflation concerns have crept into your life amid the media barrage.

Before we get spooked by the spectre of inflation, let's step back and ask "is inflation a bad thing?" In its simplest form, inflation is rising prices, and typically measured as the price change from a year ago. What was the situation a year ago? Economies ground to a standstill amid mortal fears arising from covid, forcing a rapid recession. Consumption tanked, and producers responded by cutting back on inventory and new production.

A year later, as economies recover and demand recovers from a trough, producers have to ramp up production and demand more goods today instead of later. Hence, rising prices come hand-in-hand with economic growth. And if there is a recovery from the covid-driven economic malaise, we have to entertain the prospect not spectre of inflation. Furthermore, as e**conomies transit from recovery to growth, expect some of this to spill over to higher prices and market volatility.**

There is a kind of bad inflation, which is runaway inflation where prices rise so rapidly that they wreck havoc on economic progress and make societies hard to govern. This is not the scenario for most parts of the world.

Inflation concerns drove market performance in May. However these concerns did not mean markets declined. Markets were up in general but there was bifurcation between segments that would benefit and get affected by inflation.

On the equity front, the energy sector had outsized gains due to it providing a raw material that producers want more of today than later. Hard to imagine only last year, producers were actually paid to take delivery of crude oil.

What happens if you have to pay more for your cost of living? You either trade down or adjust your spending pattern to focus more on basic needs versus discretionary spending. Naturally, **the consumer discretionary sector was the biggest loser** in a month where inflation reared its head.

You also start thinking about value; "Is it worth paying for this?" This also manifested in markets as **global value stocks were up 3% while growth stocks were flat.** High growth segments such as technology declined as the market sold down stocks with elevated valuations that arose from optimistic expectations prior to inflation concerns.

Hedged global investment grade bonds recovered some of the losses from Q1, up 0.22%. This leaves global investment grade bonds about -2% for the year. Asian high yield and emerging market high yield were up 0.88% and 1.38% respectively, contributing to our yield strategies. Trend following has benefitted from inflation, latching on to trends in base metals and crops since the second half of last year, well before inflation became a broader concern.

References: Global value: MSCI AC World Value Index, Global growth: MSCI AC World Growth Index, Global investment grade bonds: Bloomberg Barclays Global Aggregate Index, Asian HY: Bloomberg Barclays Asia USD High Yield Bond Index, EM high yield: Bloomberg Barclays Emerging Markets High Yield Total Return Index

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Key Themes: Positioning For Recovery

It is useful for investors to have a good grasp of cycles, as it allows one to take advantage of ongoing opportunities in the market. Naturally**, we spend a lot of time trying to understand cycle dynamics, so that we can invest into segments of the market when they have the best chance of doing well.** Recall that there are four distinct phases in an economic cycle:

early (expansion) → mid → late → recession (contraction)

Since different parts of the market takes turn to perform, our goal is to capture more gains in the expansionary phase, and position more defensively as we get closer to a recession. For instance, our portfolios were previously invested into US large quality growth equities as economic activity slowed in 2019, and which was re-allocated to small-cap equities as the US economy recovered quickly out of recession. Of course, we try to navigate successfully through every market cycle, but the length of each cycle can vary (anywhere from a few weeks to a few years) and making it hard for our timing to be spot-on. By using our framework and process, however, we expect to tip the odds in our favour.

A navigator on ship uses a range of navigation instruments to determine their position at sea, and to chart the course to their destination quickly and safely.

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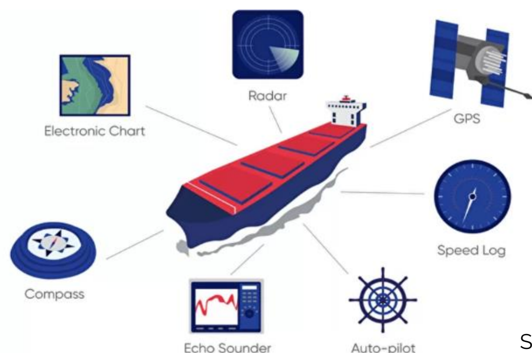


Source: https://marine-digital.com

Likewise, we have our own form of investing GPS codenamed 'FVT', which monitors a range of indicators to determine market conditions and portfolio allocations:

▼+266K

U.S. Employment

A measure of how tight the labor market is running in the world's biggest economy.

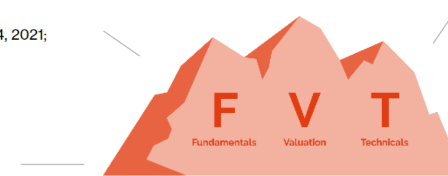
Updates monthly: Last June 4, 2021;

▲99.2

German Ifo

The leading indicator of health in the euro area's lynchpin economy, it is based on a survery of about 7,000 executives in German manufacturing, services, retail, wholesale and construction companies. The aim is to gauge their assessment of how the economy stands and their outlook for it.

Updates monthly: Last May 25, 2021;



▲56.0

Global PMI

IHS Markit and JPMorgan Chase's snapshot of the health of manufacturing around the world, based on surveys of multiple purchasing managers on their activity. A number above 50 signals expansion.

Updates monthly: Last June 1, 2021;

▼51.0Points

China Manufacturing PMI

China is the largest manufacturer of autos, smartphones and other goods the world over so this index provides a key insight into the heart of global production.

Updates monthly: Last May 31, 2021;

Source: Bloomberg, FAM. For illustrative purposes only

early (expansion) → mid → late → recession (contraction)

Similar to the positive signals shown above, many indicators are currently showing signs of a typical early-mid cycle expansion. As it became clear that recovery was taking hold, we have added into markets that are expected to thrive in such an environment: US small-caps, Europe, Emerging Markets, and China 'A'. These markets tend to benefit more as domestic and global growth accelerates, improving the odds of them doing well as we journey through this part of the cycle.

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Key Themes: Stability Amid *VUCA*

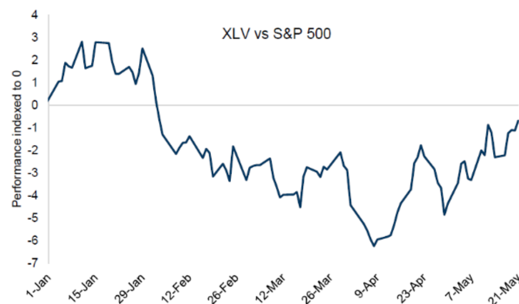
VUCA is used to describe environments with **Volatility**, **Uncertainty**, **Complexity**, and **Ambiguity**

Investors have become more emboldened to take risk as recovery becomes more likely, pushing markets once again to their all-time-highs. This is perhaps not unwarranted, given the positive economic and earnings outlook for the coming quarters.

On the other hand, we have observed certain investment themes being long in the tooth e.g. tech stocks which continued to underperform in May with a -1.2% decline. Last month, we also said that there were a group of stocks that declined even after reporting strong earnings, which was another sign that a lot of the good news is already priced in. **We can see that despite a clear path to economic recovery, we continue to operate within a VUCA environment. Which is why we emphasize on having different yet complementary positions in our portfolio to mitigate the risk of a single theme not playing out as we expect them to.**

In practice, this means balancing our recovery plays with investments that are less dependent on an economic recovery to do well: healthcare equities fit the bill. This has not been a popular investment when performance was lackluster compared to the broader markets at the start of the year. More recently, however, healthcare has 'quietly been closing its year-to-date underperformance gap':

Exhibit 1: Fighting back? The XLV has quietly been closing its ytd underperformance gap with the SPX since 1Q21 earnings .. this bears watching

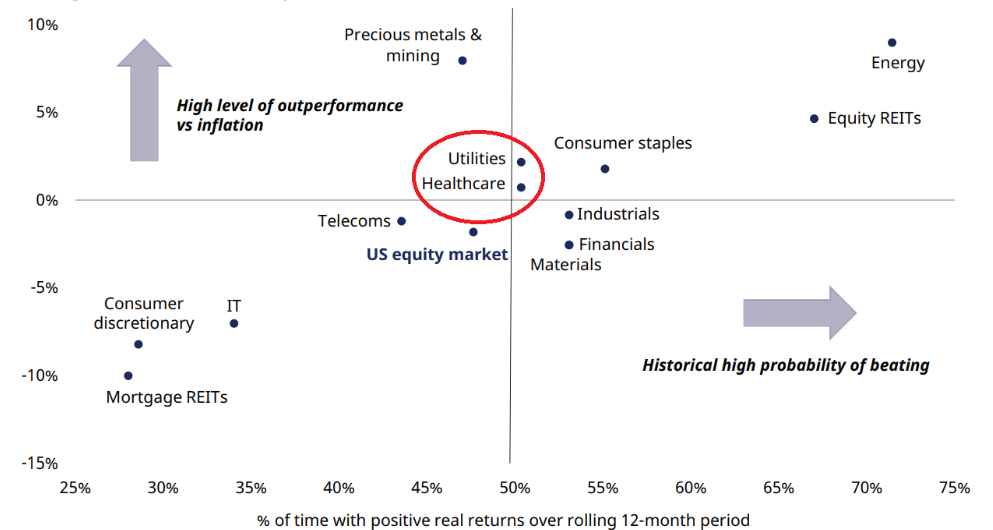


Source: Goldman Sachs

During the past month, everyone's favourite measure of fear - the VIX volatility index – briefly rose, which could have helped a more defensive sector like healthcare. But is it a surprise that healthcare outperformed even as inflationary concerns came to the fore? A recent study showed how different sectors have performed in previous inflationary periods:

US Equity Sector Performance in High (+3% on Average) and Rising Inflation Environments, 1973-2020

Average 12-month inflation-adjusted return, %



Source: Hartford Funds, Schroders

The above chart shows healthcare smack right in the middle. What does this mean? We've said before that healthcare is less dependent on economic activity to do well. **It turns out that healthcare may also be relatively resilient in inflationary environments, which is an added bonus for our stability position.**

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Key Themes: Search for Yield

"Ultra long bonds are back in force as rock-bottom rates create sweet spot"

This was from an article* in January where borrowers (mainly governments in this case) wanted to lock in low borrowing costs for 50 to 100 years due to "willingness among investors to look past risks for the sake of slightly higher yields".

The world of low or negative yielding debt is not a recent phenomena, as we have highlighted in the past years. There are also different ways to position oneself in such an environment. The article cites examples where some fund managers' search for yield took them further out on the maturity curve e.g. just lend to France for 50 years at 0.5% instead of -0.30% for 10 years and voila, instant positive yield!

Other managers were more vocal about the threat of low rates, citing "cash is trash"(Ray Dalio) or that bonds are "return-free risk"(GMO).

We belong to the latter cohort of investors that are less willing to invest in low yielding debt. Who would invest in something that is expected to pay back 0.5% for the next 50 years? But it was not an easy journey as our investments took time to shine. Many investors were willing to pay (rather than be paid) to lend out their money, and the wave of demand caused prices of otherwise low yielding bonds to rise further. This also had the effect of boosting major bond indices that are dominated by low yielding government and investment grade bonds. So while we were making money on our short duration yield investments, they did not seem to be better than investment grade bonds and indices at times. But the tide turned this year just as demand peaked.

The table shows how challenging it has been for fixed income investors this year. The major fixed income segments that comprise well-used bond indices (and hence many investors' portfolios) show that many bond investors have few places to make money from this year.

We've added a few more segments that we typically do not present. For those who chose to get extra yield through longer maturity bonds, the iShares 20+ Year Treasury Bond ETF, a popular long duration bond fund, is down 11.67% this year due to interest rate movements - just goes to show how important it is to consider not just credit rating and yield, but also bond duration. **We also show two segments we have exposure to based on our asset allocation process. Emerging market short duration and Asian high yield have continued to deliver returns from credit risk with limited interest rate risk.** Were we able to predict the interest rate driven sell-off this year? No, we just avoided areas that are expected to do badly if interest rates rise from historically low levels, and find better places to direct our clients' capital.

Fixed Income	31/5/21 YTD
Global Aggregate (Unhedged)	-2.35%
Global Aggregate (Hedged)	-2.00%
High Yield	1.80%
Asia	-0.40%
Emerging Market Debt	-1.30%
iShares 20+ Year Treasury Bond ETF	-11.67%
Asian High yield	2.77%
Emerging market short duration	1.12%

*https://www.reuters.com/world/americas/ultra-long-bonds-are-back-force-rock-bottom-rates-create-sweet-spot-2021-01-18/

References: Asian HY: Bloomberg Barclays Asia USD High Yield Bond Index, EM short duration: Bloomberg Barclays EM USD Aggregate 1-5 Year Total Return Index

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Key Themes: How Are We Positioned?

Positioning for Recovery	Stability Amid *VUCA*	Search for Yield
China 'A' equities	Health Care equities	Asian High-yield bonds
Emerging Market equities		Emerging Market Short Duration bonds
US Small-cap equities		
Europe equities		

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Asset Allocation Strategy

Equity: Regions	--	-	=	+	++	Allocation strategy
United States		■				**Healthcare** as earnings are more stable and less dependent on broader economic cycle. **Small-caps** as relative valuations attractive and are expected to benefit as economies recover.
Europe			■			Relative valuations are attractive, and expected to benefit as economies recover.
Japan		0%				Maintaining no exposure as they are less attractive compared to other opportunities.
Asia Pacific ex Japan					■	**China 'A'** overweight as valuations continue to be reasonable and supported by a stronger economy.
Emerging Markets			■			Neutral as valuations attractive relative to developed markets, but where earnings tend to be less resilient.
Fixed Income	**--**	**-**	**=**	**+**	**++**	**Allocation strategy**
Global			■			Focus on currency-hedged government bonds and unconstrained credit to buffer portfolio volatility during periods of stress.
Investment Grade Corporate	0%					Maintaining no exposure as low incremental yield and long duration credit exposure are less attractive than other segments.
US High Yield		0%				Maintaining no exposure due to relative poorer fundamentals.
Asia				■		Attractive yield across major fixed income markets with room for capital appreciation and better fundamentals.
Emerging Market Debt					■	Hard currency short duration focus as a more defensive credit investment for a recessionary environment.

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

Current Previous

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Market Index Returns

Equity Regional	MTD	QTD	YTD
Global	1.60%	6.08%	11.05%
United States	0.70%	6.07%	12.61%
Europe	2.71%	5.14%	14.02%
Japan	1.31%	-1.58%	7.61%
Asia Pacific ex Japan	1.46%	4.32%	7.16%
Emerging Markets	2.34%	4.90%	7.25%

Fixed Income	MTD	QTD	YTD
Global Aggregate (Unhedged)	0.94%	2.21%	-2.35%
Global Aggregate (Hedged)	0.22%	0.49%	-2.00%
High Yield	0.23%	1.22%	1.80%
Asia	0.53%	0.78%	-0.40%
Emerging Market Debt	0.92%	2.26%	-1.30%

Currencies	MTD	QTD	YTD
USD/SGD	-0.68%	-1.72%	-0.03%
EUR/SGD	1.03%	2.45%	0.09%
JPY/SGD	0.25%	-1.03%	6.13%

Commodity	MTD	QTD	YTD
Gold	7.79%	11.66%	0.45%
Oil (WTI Crude)	4.31%	12.10%	36.69%

Equity Markets	MTD	QTD	YTD
Australia	2.49%	6.06%	10.99%
Brazil	6.16%	8.22%	6.05%
China "A"	4.18%	5.83%	2.52%
China "H"	1.09%	-0.14%	2.04%
Hong Kong	2.09%	3.42%	8.13%
India	6.68%	5.13%	9.18%
Indonesia	-0.56%	0.12%	0.41%
Korea	1.78%	4.65%	11.64%
Malaysia	-0.53%	1.31%	-0.78%
Russia	6.86%	6.97%	15.35%
Singapore	-0.84%	1.15%	13.03%
Taiwan	-2.83%	3.93%	16.08%
Thailand	1.03%	1.25%	11.86%

Equity Sectors	MTD	QTD	YTD
Gold	14.31%	21.45%	9.25%
Energy	4.90%	5.39%	36.23%
Technology	-1.15%	4.23%	5.49%
Healthcare	1.89%	5.70%	5.97%
Financials	4.68%	11.39%	28.49%

Total return in local currency terms as of **31 May 2021**
Source: Bloomberg

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