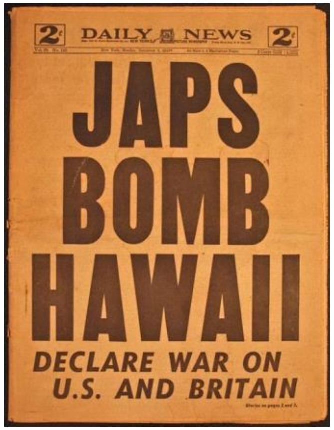
Investment Update
June 2020

Finexis
ASSET MANAGEMENT
汇信资产管理有限公司

Market Review

We started the year with Covid-19, followed by global lockdowns, a swift and widespread market crash, unprecedented negative oil prices, record unemployment, bankruptcies of long-standing companies, and now protests from America spreading to global major cities. What could be worse than all that has happened in the past few months?



This was a headline from 8th December 1941 during World War II. Imagine if a large scale war was to break out today? The economy would take multiple hits as people truly worry about lives vs livelihoods. But even in a world war, markets did not go to zero. During World War II, the maximum peak-to-trough decline of the S&P 500 index was -39%.

How can it be that markets don't go to zero during such extreme stress? Markets tend to price in investors' expectations of future economic value. So unless there is no future, it is hard for a market to go to zero. Of course, this is not true for individual companies where their stock prices can indeed go to zero if they cease to be a going concern.

While covid-19 will be detrimental to the economy, it is not as bad as a world war in terms of economic and psychological impact, so one should not be overly pessimistic on their investments unless they were excessively concentrated or levered.

With markets continuing to rally off the lows in March, albeit not as strong as April, our multi-asset balanced and aggressive portfolios returned between 2.4% to 2.7% in May. It was the resilient equities' (quality growth) turn to shine in May after the recovery equities (energy & emerging markets) drove performance in April. This is why **it is important to have differentiated ideas in a portfolio as even sound ideas can have periods of underperformance due to the fickleness of the market.**

In fixed income, the shield portion comprising government bonds was generally flat amid broader market gains. This is expected as in light of current low interest rates, the expected returns for developed market government bonds are minimal, primarily serving as a defensive asset during stress. As we know, **one needs a shield to defend but cannot win a battle just with shields.**

Our yield investments (Asian high yield and emerging market debt) continued to power on from April with gains between 3-13% in May. Recall in last month's commentary that these positions had yet to realize their value, causing temporary underperformance, with the value realization process continuing in May.

Amid the rally, trend-following detracted as it continued to run a short bias. It is at such times when questions are asked about alternatives. We then have to remember that they are in the portfolio precisely because they dance to a different tune. If the recent gains turn out to be a bear rally and a prolonged bear market takes hold, trend following is expected to profit while the other strategies take a hit.

Key Themes: Resilience Amid Downturn

With the world seemingly in disarray, we continue to take comfort in resilient equities to provide more certainty in our portfolios. We have mentioned before how companies with weaker fundamentals or poor financial discipline have gone bankrupt as a result of the pandemic. Many business models that were viable before are also being challenged – think of F&B businesses having to transition online or risk going belly up. Unsurprisingly, companies finding themselves in such a precarious position have seen their stock prices plunging. In the case of Hertz, the 102 year-old car rental company that recently filed for bankruptcy, investors have lost more than 90% year-to-date.

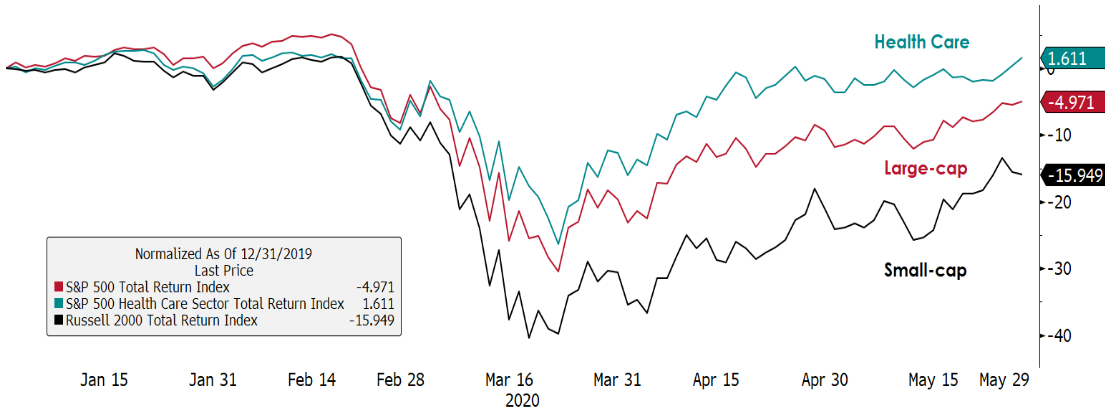
In our portfolios, resilient equities come in the form of **US Large-cap Quality Growth**, and **Healthcare**. While these companies are not immune to slowdowns, they tend to grow faster than the broader economy, with earnings expected to be less volatile compared to cyclical businesses or industries. Additionally, our bias to large-quality indicates a preference for businesses with lower debt, stronger earnings, and overall healthier balance sheets; which make them more resilient in a prolonged downturn. Let us take a look at how the different markets have performed this year:

Reported Sales & Earnings Growth (Q1 2020)

Market	Sales Growth	Earnings Growth
Large-caps (US S&P 500)	+0.89%	-7.66%
US Healthcare Sector	+10.12%	+7.27%
Small-caps (Russell 2000)	-1.14%	-44.66%

Source: Bloomberg. Sales & Earnings Growth for period 16/2/2020 to 15/5/2020. Data extracted on 5/6/2020.

Performance (Year-to-date)



In the top-left table, we see that smaller businesses experienced outsized declines in sales and earnings growth in Q1, when covid-19 measures were first implemented. In contrast, large companies as represented by the S&P 500 fared much better. Healthcare even managed to report the strongest growth of any sector. **In such an uncertain environment, relative strength in fundamentals have translated into relative outperformance year-to-date** as shown in the top-right chart.

Key Themes: Positioning For Recovery

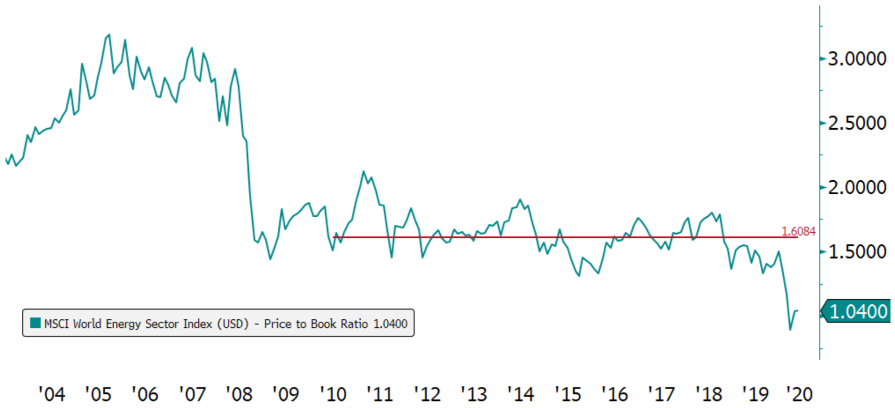
With all the gloomy news, why should investors even think about recovery? Anyone who claims that markets will reward investors may be seen as living on a planet without covid-19. Yet, amid the gloom, markets have rallied strongly over the past two months, seemingly divorced from fundamentals. Can this happen? Earlier, we noted that even during World War II, markets did not go to zero. Another point to note is that markets bottomed in 1941, four years before the war ended in 1945. As the war escalated in 1942, few would have realized that the market had already bottomed before.

We are not saying that markets will rally indefinitely; there will still be ups and downs that will cause nervousness and fear. There will also be bad events and news that will feed that fear. What is important is not to let the fear result in action that can harm the investment e.g. chase the high and sell the low. Our FVT process guides us to make investment decisions by focusing on fundamentally good investments that get beaten up during stress, that we know will reward us nicely over time.

Indeed, it was mostly doom and gloom when we initiated exposures to **energy equities** in early April. Oil prices even fell below $0 for a short time after we invested. Looking through an 'FVT' lens, **we took comfort in the fact that we had invested at attractive valuations, and that oil prices would be supported as supply eventually adjusted to demand.** In short, we determined that the potential upside for investing was much larger than the downside.

Even so, we are still surprised at how quickly market sentiment has improved in the short span of a few weeks. Indeed, short-term oil prices rallied strongly in the past month, with the International Energy Agency (IEA) even saying that the oil market may rebalance more quickly than previously thought. That said, even as valuations continue to be below their long-term levels, we do not presume that it will only be smooth sailing from here on given that many uncertainties remain.

Energy Equities still undervalued despite strong rally



Source: Bloomberg

We keep our overweight to **China 'A' equities** as it continues to offer access to a high growth market without overpaying. As one of the first countries to ease covid-19 measures, we are encouraged by the gradual resumption of economic activity. In fact, life seems to have returned to some semblance of normality in China; with local air travel rebounding to more than 50% of level seen in 2019, and Shanghai Disneyland even managing to reopen in May. **The resumption of activity, coupled with attractive valuations and accommodative policies put the odds in our favour for China 'A' equities to continue to do well.**

Key Themes: Search for Yield

Yield of major credit markets

	29 May 2020
Asia HY	9.3%
US HY short dur. bonds	8.1%
US HY bonds	6.6%
EM short dur. bonds	5.0%
EM bonds	5.1%
Global investment grade corporate	2.1%

As bank deposit rates continue to drop

	29 May 2020	31 Dec 2019
SGD 1Y deposit	0.94%	1.35%
USD 1Y deposit	0.52%	2.01%

Source: Bloomberg

Last month we spoke of deposit rates dropping while yield opportunities became more attractive. Recently, the issue of declining rates struck close to home. As background, the 1-month Singapore interbank offered rate (Sibor) used for mortgages had declined meaningfully to 0.25% from 1.75% at the start of the year, which meant that floating mortgage rates would drop as well, reducing interest costs for home owners. While this is good news for home owners, it might not be good news for depositors searching for better interest rates. Recall that a bank's business model is borrowing capital at lower cost (your deposit) and lending it at higher rate (your mortgage) to cover overheads and make a profit. If you are maintaining your deposits to earn interest while paying interest on your mortgage, you will realise that you cannot use deposit interest to cover borrowing costs.

Proper yield investments address this by getting a higher return on one's investable cash. The yield table above shows that returns from credit markets surpass mortgage rates. This means that a credit investor is expected to be able to fund their mortgage interest payments (and perhaps more). Note that this benefit comes with taking on additional risk but is worth taking so long as the risks are assessed as appropriate.

Nevertheless, yield investments alone are insufficient to cope with the challenges facing investors today. Abundant liquidity has resulted in a rich get richer situation as liquidity finds its way into financial assets. Ironically but pragmatically, taking "more risk" via equities for capital appreciation is a better way to manage asset price inflation. This is why we pair yield investments with equities in our multi-asset portfolios.

Key Themes: How Are We Positioned?

Resilience Amid Downturn	Positioning for Recovery	Search for Yield
US Quality Growth equities	China 'A' equities	Asian High-yield bonds
Health Care equities	Energy	Emerging Market Short Duration bonds
Currency-hedged Government securities		

Asset Allocation Strategy

Equity: Regions	--	-	=	+	++	Allocation strategy
United States					■	**Large-cap Quality Growth** have stronger balance sheets and are more resilient in an economic slowdown. **Healthcare sector** as earnings are less dependent on broader economic cycle. **Energy** where valuations are compelling and providing a margin of safety for investors. *Overweight in US as a result of allocations to Global Healthcare and Energy, which are US-heavy.*
Europe	0%					Maintaining no exposure as economic activity declines, and as valuations are not attractive.
Japan	0%					Re-allocated to energy equities which has better risk/reward.
Asia Pacific ex Japan					■	**China 'A'** overweight as valuations continue to be attractive and earnings expected to be more resilient.
Emerging Markets			■			Neutral as valuations attractive relative to developed markets, but where earnings have declined.

Fixed Income	--	-	=	+	++	Allocation strategy
Government			■			Focus on currency-hedged global government fixed income 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

Market Index Returns

Equity Regional	MTD	QTD	YTD
Global	4.41%	15.66%	-8.93%
United States	4.76%	18.19%	-4.98%
Europe	3.50%	10.48%	-14.40%
Japan	6.82%	11.46%	-8.01%
Asia Pacific ex Japan	-0.30%	9.49%	-13.10%
Emerging Markets	0.79%	10.04%	-15.89%

Fixed Income	MTD	QTD	YTD
Global Aggregate (Unhedged)	0.44%	2.41%	2.08%
Global Aggregate (Hedged)	0.28%	1.91%	3.38%
High Yield	4.58%	8.98%	-4.45%
Asia	2.09%	3.67%	0.68%
Emerging Market Debt	4.61%	7.33%	-2.85%

Currencies	MTD	QTD	YTD
USD/SGD	0.26%	-0.60%	5.02%
EUR/SGD	1.53%	0.00%	3.96%
JPY/SGD	0.61%	0.27%	-0.72%

Commodity	MTD	QTD	YTD
Gold	2.60%	9.71%	14.04%
Oil (WTI Crude)	88.38%	73.29%	-41.88%

Equity Markets	MTD	QTD	YTD
Australia	4.39%	13.57%	-12.31%
Brazil	8.57%	19.70%	-24.42%
China "A"	-0.87%	5.24%	-5.30%
China "H"	-4.16%	0.30%	-13.83%
Hong Kong	-6.31%	-2.16%	-17.92%
India	-3.74%	10.14%	-21.08%
Indonesia	0.89%	5.23%	-23.62%
Korea	4.21%	15.71%	-7.42%
Malaysia	4.80%	9.90%	-5.63%
Russia	3.87%	9.74%	-9.33%
Singapore	-3.29%	2.32%	-20.79%
Taiwan	-0.45%	12.75%	-8.53%
Thailand	3.40%	20.83%	-12.95%

Equity Sectors	MTD	QTD	YTD
Gold	5.62%	46.43%	17.13%
Energy	0.67%	30.52%	-36.12%
Technology	7.53%	22.07%	5.78%
Healthcare	3.87%	15.80%	1.96%
Financials	2.43%	11.99%	-24.22%

Total return in index currency terms as of 31 May 2020. Source: Bloomberg

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