Investment Update
Q4 2020

finexis
ASSET MANAGEMENT
汇信资产管理有限公司

Market Review

Markets were down in September! After five straight months of strong gains, should that be a surprise? If it was not a surprise, why didn't we see it coming?

Yes, a retracement is a matter of when not if. The tricky reality is it's really hard to tell when. Imagine if you sold in 2017 after five months of gains, you would have missed out on another nine straight months of gains. Indeed, the saying "take the good with the bad" is apt when it comes to investing.

https://www.bloomberg.com/news/articles/2020-09-17/stock-market-did-options-trading-fuel-the-market-s-wild-rally

However there are other realities we have to deal with.

Reality #1: Investors take **joy** whenever markets go **up** even when such gains are unjustified.

Reality #2: Investors suffer immense **pain** whenever markets go **down**, even when such declines are part of inherent volatility.

Why do these happen? Just like there are ups and downs in life, why are we seemingly incapable of accepting the volatility of markets? The answer is simple: **we are human**. We are humans with emotions and cognitive biases.

Global equity markets declined 3.37% in September, while global investment grade bonds were also down 0.36%.

In fixed income, the shield portion comprising hedged government bonds was up 0.37%, compared to losses for unhedged bonds. Losses in unhedged bonds was driven primarily by strengthening of the USD, bucking the trend of dollar weakness in the prior three months. Who is right; the dollar bull or bear? Or is the recent weakness and strength merely reflecting typical behavior of the USD in risk-on and risk-off environments?

Our yield investments (Asian high yield and emerging market debt) also declined between 0.55-1.96% in September. If credit markets go down at the same time as equities, what is the point of diversifying? We explore further in the "Search for Yield" section.

The September sell-off started with a growth stock scare, exemplified with headlines such as "US stocks see 3rd-biggest outflow in history as investors flee tech". Before September, growth has been the best place to be in, with plenty of upside and less downside. Investors will recall that we have been running growth-centric investments over the past few years, and continue to do so, except that we switched to quality growth last year in the event of an economic slowdown. US growth equities were down 4.75% while quality growth declined less than 2%. If this is a taste of things to come when growth stocks unravel, **quality growth looks like a better place to be in going forward**.

Global equities: MSCI All Country World Index, Global investment grade bonds: Bloomberg Barclays Global Aggregate Index, Asian high yield: Bloomberg Barclays Asia USD High Yield Bond Index, Emerging market debt: Bloomberg Barclays EM USD Aggregate 1-5 Year Total Return Index.

Key Themes: Resilience Amid Downturn

There are two four letter words to describe the rally this year: FOMO and YOLO. **FOMO**, or the **fear of missing out**, has been part and parcel of investing, having fuelled speculative investments such as the South Sea Bubble in 1720, and numerous stock market bubbles since. **YOLO** entered popular culture from 2011 and has become part of investing vernacular as investors go all in on a huge bet cos "**you only live once**!"

A study by Stanford in 2007 (before the 2008 Global Financial Crisis) revealed that investors feel it makes perfect sense to chase risky investments so that they are not the only one to miss out on the next big thing. The cognitive dissonance works both ways; if everyone loses their money together when the bubble bursts, one does not feel so bad compared to if they lost alone.

So how does this relate to resilience amid downturn? Downturns tend to follow after markets go through exuberance that propel stock prices well past fair value. This pattern repeats itself time after time; some of us may remember how the Nasdaq took off during the dotcom era. Incidentally, the FT compared Tesla's strong rally this year to the South Sea Company 300 years ago. Are we calling a bubble in Tesla? Certainly not, but we tend to shy away after a stock goes up like a rocket. Does that mean we hide in cash? That's also not feasible. What we do is to allocate to areas we identify as being more resilient.

As mentioned in the previous page, **we maintain exposure to growth stocks, specifically in the quality space. We are also diversified into healthcare.** As a reminder, earnings for our resilient equities are underpinned by secular tailwinds that precede and will last long after covid-19. Nevertheless, this diversification has hurt us this year as pure growth rallied strongly and we indeed "missed out".

But we will continue to run diversified portfolios. As the Head of South East Asia at HSBC Global Asset Management echoed, the recent tech rout is a good reminder of the importance of diversification. Indeed we only live once, which is why we intend for our investments to outlast us, rather than have all our eggs in one basket break at the same time.

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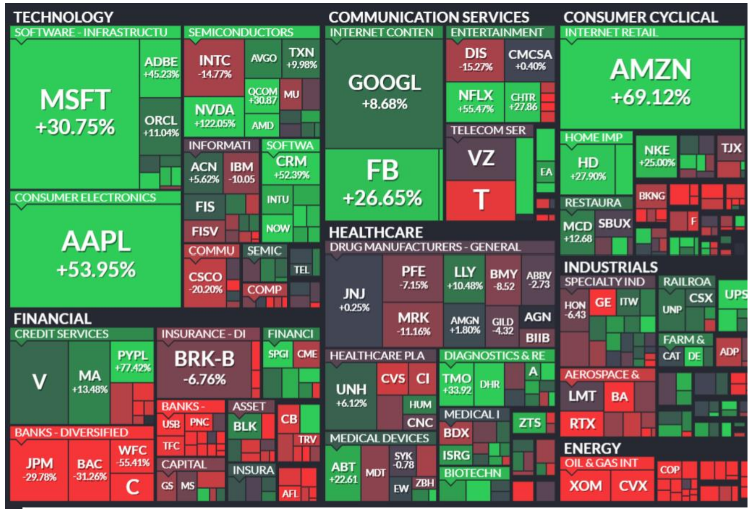
https://www.marketwatch.com/story/the-millennials-looking-to-get-rich-or-die-tryin-off-one-of-wall-streets-riskiest-oil-plays-2016-03-30
https://ftalphaville.ft.com/2020/02/04/1580828388000/Tesla-is-nuts--when-s-the-crash-/

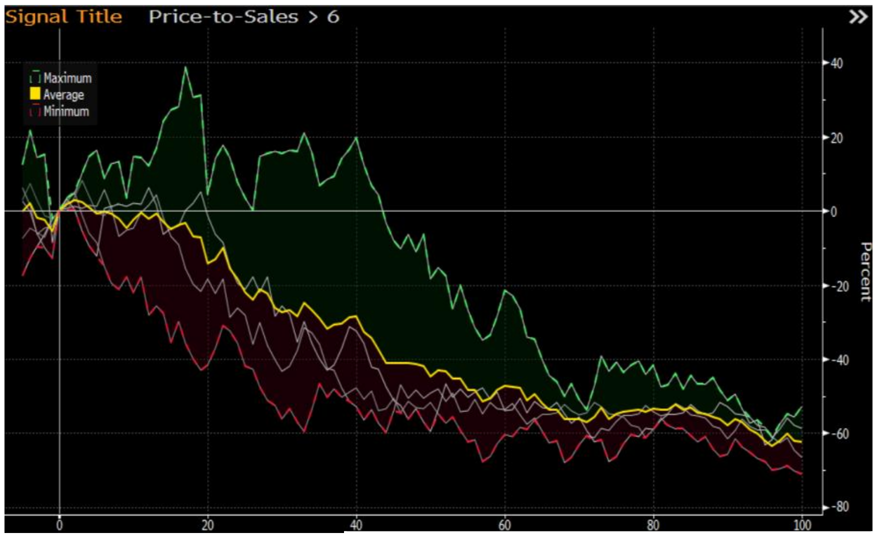
Key Themes: Positioning For Recovery



Heat map shows YTD performance of S&P 500 sectors. As of 2/10/2020
Source: finviz.com

Last month, we talked about how today's crisis is unique in terms of how disproportionate the impact has been on certain parts of the economy. One only need look at the year-to-date market performance to determine which industries were hit (or benefitted) the most in the pandemic. A few tech-related names feature prominently in green on the right-side heat map, reflecting their strong YTD performance. Unsurprisingly, we see that Financials, Aerospace, and Energy - sectors that saw outsized negative impact - have lagged. Some of our eagle-eyed readers may have also noticed that Warren Buffet's Berkshire Hathaway 'BRK-B' is part of the red team.

While we have some exposures to 'resilient' tech-related businesses through our Quality-Growth position, we have so far held back on allocating more to perceived beneficiaries of the pandemic largely due to their high valuations. Take for instance the US technology sector, which has not been this expensive (on a price-to-sales basis) since the dotcom crisis. Let's take a look at **how investors would have fared if they had invested when price-to-sales is above 6 (6.2 today):**



Source Bloomberg

The chart shows how an investor would have lost money 100% of the time in the subsequent 100 weeks. While this time may indeed be different, we do not like to invest with such odds as sky-high expectations tend to be pulled down by gravity. This is why our recovery theme consists of areas with better risk/reward. **China 'A'** remains one of the few high-growth markets at still reasonable valuations, and where earnings are expected to be more resilient as China's economic activity continues to rebound from the low levels earlier this year. **Energy equities** has not performed as well over the past quarter, as fresh lock-down fears and demand concerns continued to dominate headlines. That said, **we know from history that investing at such attractive levels of valuations tend to be profitable**, especially as the oil market has continued with their rebalancing process. For now, we maintain our allocation as energy equities retain a high recovery potential with vaccine approvals as a possible catalyst for unlocking this value.

Key Themes: Search for Yield

Credit markets were down together with equities. Is this a surprise? It should not be. Generally, credit markets are correlated to equities i.e. they tend to move in the same direction, particularly when there are large moves in equities. If that's the case, **what is the point of investing in credit? The benefit comes in when equities are range-bound or going nowhere.** In such environments, credit market returns tend to be driven by the coupon. Hence, credit investments add returns to a multi-asset portfolio when equities are not doing much.

I tried searching "correlation in layman terms", unfortunately, nothing really helpful came up (try it yourself to see what results pop up). Searching "correlation" images yielded the image below from of all places Math Is Fun. Do check out their website to see if the example on ice cream sales and temperature helps.

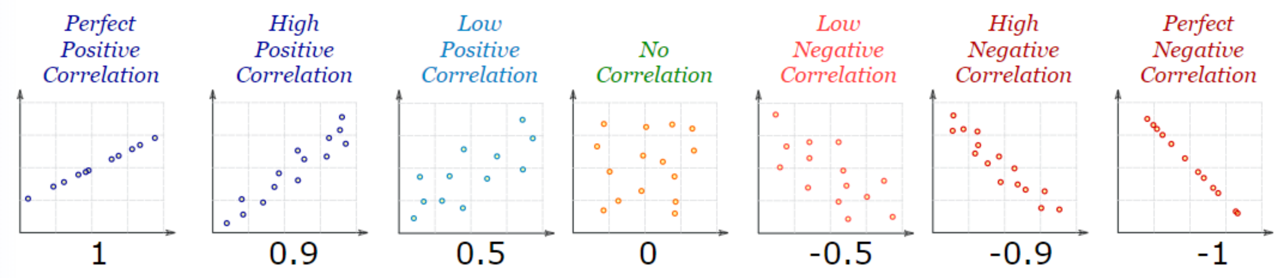


Figure 1: Correlation examples. Source: https://www.mathsisfun.com/data/correlation.html

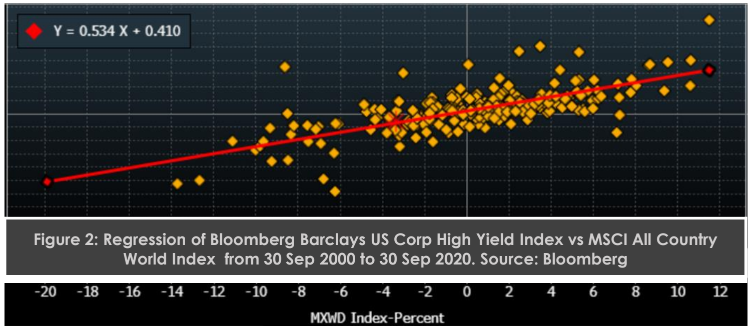


Figure 2: Regression of Bloomberg Barclays US Corp High Yield Index vs MSCI All Country World Index from 30 Sep 2000 to 30 Sep 2020. Source: Bloomberg

Figure 2 shows the relationship between high yield bonds and global equities. That is the real-world version of the Math is Fun illustration, reflecting low to high positive correlation across market environments.

What does all this mean to the investor? Figure 3 illustrates the diversification benefit of credit investing: Credit markets can be up when equities are down. It is important to note that these are periods where equity declines are smaller, or caught in what we call range-bound environments. Hence **credit markets contribute to a portfolio when equities do not a.k.a diversification.**

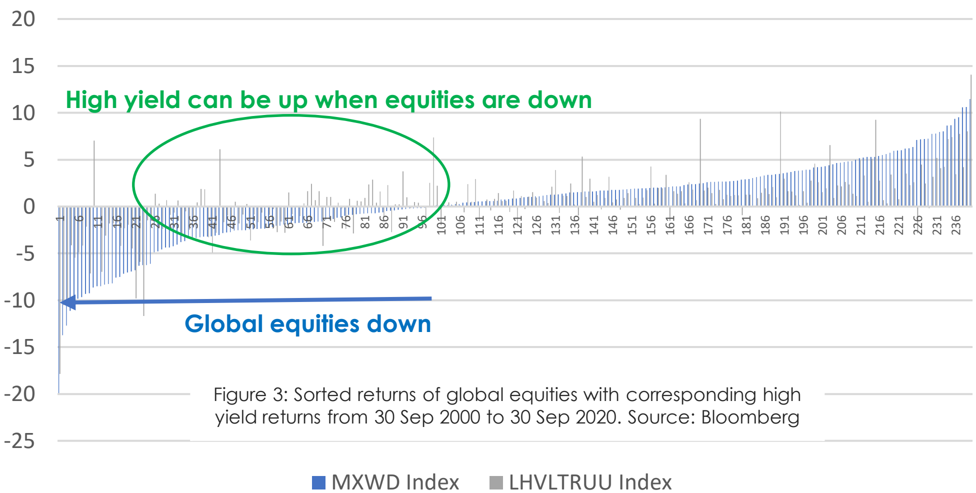


Figure 3: Sorted returns of global equities with corresponding high yield returns from 30 Sep 2000 to 30 Sep 2020. Source: Bloomberg

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 equities	Emerging Market Short Duration bonds
Currency-hedged Government securities	Emerging Market equities	

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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** 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 less attractive compared to other opportunities.
Japan	0%					
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	-3.20%	8.24%	1.78%
United States	-3.80%	8.93%	5.57%
Europe	-1.39%	0.72%	-11.11%
Japan	1.13%	5.02%	-3.57%
Asia Pacific ex Japan	-2.28%	9.59%	3.08%
Emerging Markets	-1.62%	9.65%	-0.96%

Fixed Income	MTD	QTD	YTD
Global Aggregate (Unhedged)	-0.36%	2.66%	5.72%
Global Aggregate (Hedged)	0.37%	0.73%	4.65%
High Yield	-1.16%	4.54%	-0.08%
Asia	-0.53%	2.07%	4.48%
Emerging Market Debt	-1.26%	2.37%	1.93%

Currencies	MTD	QTD	YTD
USD/SGD	0.37%	-2.02%	1.45%
EUR/SGD	-1.44%	2.23%	6.05%
JPY/SGD	-0.41%	-2.27%	-2.88%

Commodity	MTD	QTD	YTD
Gold	-4.17%	5.89%	24.29%
Oil (WTI Crude)	-5.61%	2.42%	-34.13%

Equity Markets	MTD	QTD	YTD
Australia	-3.55%	-0.11%	-10.14%
Brazil	-4.80%	-0.48%	-18.20%
China "A"	-4.69%	11.22%	14.25%
China "H"	-5.65%	-1.90%	-12.56%
Hong Kong	-6.44%	-2.62%	-14.18%
India	-1.42%	9.62%	-6.79%
Indonesia	-6.97%	-0.31%	-20.69%
Korea	0.07%	10.41%	6.38%
Malaysia	-0.94%	0.76%	-2.92%
Russia	-1.94%	8.62%	-0.76%
Singapore	-2.57%	-3.54%	-20.65%
Taiwan	-0.35%	10.31%	7.75%
Thailand	-5.47%	-7.02%	-19.27%

Equity Sectors	MTD	QTD	YTD
Gold	-7.28%	7.29%	33.70%
Energy	-14.64%	-20.86%	-50.16%
Technology	-4.56%	11.63%	26.57%
Healthcare	-1.49%	4.46%	5.01%
Financials	-3.67%	3.84%	-21.73%

Total return in index currency terms as of 30 September 2020.
Source: Bloomberg

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