JUL 2024

THINK DIFFERENTLY
TO GET DIFFERENTIATED RESULTS

Quarterly Investment Update

Executive Summary

Looking back at the first half of 2024, global equity markets performed strongly, with US stocks surpassing expectations, accompanied by positive economic growth that led to inflationary pressures. Despite inflation moderating from its peak at 9%, the Fed's caution about rate cuts has created market volatility, challenging investors to navigate income opportunities amidst rate cut speculation.

Additionally, a market preference for mega-tech leaders has left segments like small caps and even large, prominent companies unfavored. Going into the second half of 2024, the case for a broadening rally and positive economic growth looks to provide opportunities for catch-up plays in segments like quality large-cap stocks and small caps.

Global economic activity has rebounded strongly in Developed Markets (DM) such as the US and Europe, and a similar trend is observed in Emerging Markets (EM) like China and Vietnam. While the Chinese economy has shown signs of revival, mixed fundamentals in the form of lingering weaknesses in the property market and potential trade tensions leading up to the US elections warrant a cautious stance on China 'A' shares.

That said, we remain exposed to China as an opportunistic play on the back of continued policy support through the broader EM bloc while being diversified into markets which offer bright economic prospects (i.e. India, Vietnam). Additionally, anticipated global monetary easing towards the end of the year is expected to provide further support to equity and credit markets worldwide.

Amidst the positive outlook, investors should remain vigilant for potential economic and market fluctuations ahead. Factors such as the Fed's interest rate policy and the upcoming US presidential election could reintroduce volatility. Moreover, corporate fundamentals, particularly as mega-cap tech earnings are anticipated to stabilize, will be crucial to monitor. A true diversification approach to portfolio holdings would bode well for both investors looking to generate income and capitalize on upcoming opportunities.

As we look forward to the remainder of 2024, it remains a promising period for seizing both high income and growth opportunities. Emphasizing higher quality portfolios capable of capturing upside while navigating potential market volatility will be key to achieving sustainable investment objectives.

Finexis Asset Management

MARKET REVIEW

Global equity markets had a strong first half, with US stocks outperforming even the most optimistic expectations. The economic growth trajectory is still positive which is expected to provide fundamental support for markets in the second half, but it may not be as easy as the first.

Most economies are in the late-stage growth phase. Resources tend to be tight in such phases as seen from high capacity utilization and a tight labour market. Strong demand and limited marginal supply lead to inflationary pressures which have been happening.

While inflation has come off the peak of 9% and moderated since, the Fed is trying to be proactive and data-dependent. This is being done with good intentions because the Fed would not cut too early and risk inflation staying high. It is now apparent that in the absence of overwhelming evidence of a recession, fear of a second wave of inflation makes the Fed reluctant to cut rates.

This means investors should expect more volatility in rates markets as market participants speculate not just on how many cuts, but also when and why central banks will change policy.

This volatility and uncertainty on interest rates mean that for those more exposed to fixed-income markets such as income investors, it makes sense to **focus on <u>income</u> opportunities in the credit markets rather than trying to time the next interest rate move**. For example, global bonds with longer duration which investors can use to time interest rate changes are flat while Asia High Yield is up 10% in the first half of the year.

<u>Why economic growth did not translate to performance in many segments in H1</u>

What happens in rates markets also has implications for equity investors. This reluctance to cut rates also means that expectations for segments that are positioned to benefit from lower rates such as small caps will have to be pushed out.

The challenging performance of small caps led to questions if higher cost of financing was causing smaller companies to lag.

This is not the case. In the large-cap space, entire consumer industries with names such as Nike, and Lululemon are down 30% this year*. These are companies with access to low-cost financing, yet these large companies are faring much worse. So, it is not only about the cost of financing per se.

What is clear is that we underestimated the markets' bias toward the mega-tech leaders vs everything else. With their recent positive earnings revisions, there are real reasons to be optimistic. **Given their recent run-up, we are watching closely the mega-cap group for better entry points for our investors.**

In the meantime, market dynamics are also slowly shifting. Where last year was all about the Magnificent 7, that narrow rally has been broadening out. So far that broadening has been seen in retailers and industrials. This broadening has been less obvious amid the splashy headlines focusing on the likes of AI and the poster child Nvidia.

But when we see how periods of concentrated outperformance are followed by catch-ups rather than catch-downs, **one opportunity going forward is in the catch-up stocks.** And this opportunity set is now not just in small caps but also in segments of quality large-cap stocks as well.

This is pertinent considering what investors are facing in the second half of 2024: A broadly positive environment for equity and bond investors, but one that will eventually give way to a slowdown. There is also an upcoming US election in November for investors to grapple with.

Accordingly, portfolio positioning should be about being able to capture growth while mitigating the risk of any unexpected shocks. '*Prepare, don't predict'.* **Maintaining an overall higher quality portfolio today allows us to face any near-term corrections with confidence and to accumulate assets with strong fundamentals at lower prices.**

*Source: Bloomberg. S&P 500 Apparel & Accessories Sub Industry, S&P 500 Footwear Sub Industry

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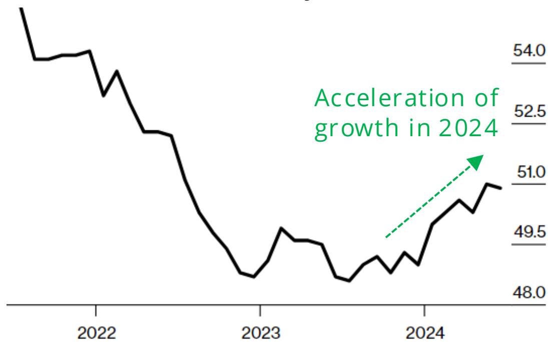
ECONOMIC GROWTH TO CONTINUE

We remain in a window of economic growth that is generally favourable for investors.

Global Economic Activity



Source: Bloomberg as of 1/7/2024. PMI Manufacturing.

After a tepid 2023, global economic activity re-accelerated from its lows (as shown on the above chart) driven by moderating inflation and improvements in consumer confidence.

We have observed economies like the US remaining resilient, while others like the Eurozone (which experienced a shallow contraction in 2023) rebounding**.** It is not just the Developed Markets that were contributing to the positive trend; Emerging Market economies have also seen improvements.

Vietnam, a key player in the global supply chain, has been recovering on multiple fronts i.e., consumption, manufacturing, exports, and Foreign Direct Investments (FDI) were positive. The country's GDP grew at 6.42% in the first half of 2024, making it one of Asia's fastest-growing economies.

China, whose economy and capital markets have disappointed investors, also had signs of revival. Export data was better than expected in both April and May suggesting a stabilizing economy, though other segments like property remained quite weak. The performance of China equities has perhaps also reflected this patchy recovery: they are currently experiencing a mini-correction over the past month after the strong rebound earlier in the year. While market corrections are common amid bull markets, we are watching closely to see how this one plays out.

Today, with continued mixed fundamentals in China, and likely increasing trade-tensions in the run-up to the US elections, we prefer to avoid outsized positions here. Instead, **the Emerging Market (EM) bloc is a better way for investors to participate in the multiple favourable trends that are underway.** China is a meaningful allocation within EM (~25% weight), but tilted towards 'H-shares' (Chinese companies listed on the Hong Kong stock exchange) which provides an opportunistic play on the back of continued policy support. In addition, other EM markets like India offer bright economic prospects and relative insulation from current geopolitical tensions. Lastly, promising up-and-coming markets like Vietnam continue to offer investors high growth at still reasonable valuations.

Indeed, current expectations are for growth to be maintained in the second half of the year which bodes well for equities and (fixed income) credits to perform. One important supportive factor is expectations of a more accommodative global monetary policy as we head towards the end of 2024.

Yes, markets have revised down their expectations for the Fed to cut just 1-2 times before the end of the year; far from the 6 cuts that were expected at the start of the year. Despite this, a delay in the Fed's rate cut will not hold back other global central banks from easing.

Current forecasts by Bloomberg Economics are for interest rates to be broadly lower globally by the end of 2024.

Already, we've seen the ECB cutting rates in June and more central banks are expected to follow. With the Fed also expected to follow suit before the end of the year, global equities and select recovery segments stand a good chance to do better in this environment.

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WATCH OUT FOR TWISTS & TURNS

The current phase of economic upswing that started beginning of the year has been akin to a relatively straight road. And as with any straight road, it will be followed with an eventual turn ahead.

As drivers of investment portfolios, we are watching out for changing road conditions, and ensuring our investment vehicles are configured optimally for the journey ahead.

The current base case: economic growth to remain positive in the second half of the year, though at the risk of some twists and turns as we head into 2025. Some market participants are already sounding the alarms on recession, citing data that show some softening. They are right but only partially: Just as winter follows summer, recessions follow late-stage growth. The *key difference is that economic cycles are not measured by time*. So investors risk not participating in further upside if they reduce speed too early. This is especially true for financial markets that have tended to reward investors who can ride through the twists and turns.

Base case: What to position for

Watch closely and prepare for unexpected shocks

While the odds of an imminent recession remain low at this juncture, we touch on a few key factors that we are monitoring that could prompt us to adjust our positioning… switching to winter tyres when conditions get slippery!

Corporate fundamentals will need to come through to support gains in the market. We will be watching the upcoming US earnings season to see if companies can continue with their strong showing: in Q1, 80% of companies beat their profit expectations. More importantly, as 'big-tech' earnings are expected to moderate from here on, the time is ripe for other sectors to take centre stage.

In other markets like China, where fundamentals have been more mixed, a more convincing upturn in earnings beyond the tech sector is needed for us to turn more bullish on the market. Investors will be on the lookout for further signs of government support that may come out of a key political meeting held on July 15-18 (Third Plenum). Though expectations are rightly conservative, any positive surprises could be a good catalyst for gains across EM and China.

US Elections: Historically, markets have been positive in election years. But there are good reasons why the upcoming election could end up a more unpredictable one; especially with the latest polls for President Biden and former President Trump showing a close contest. This year's election is amid the backdrop of deglobalization and tariffs - policies that will likely be in place regardless of who becomes president. There are also implications for other countries and markets: for one, the two candidates are expected to ramp up their rhetoric against China leading up to election day, and investors should be prepared for some volatility ahead.

Finally, all eyes are on the Fed's interest rate policy. The US central bank has the challenging job of ensuring inflation stays well-behaved while also avoiding an economic downturn. They have managed that so far, but it continues to be a delicate balancing act. While some recent signs of economic softening can be seen as positive as it would allow the Fed to cut rates earlier, it would be prudent to watch out for signs of any meaningful deterioration that could signal a sharp downturn.

Amid the base case of positive growth but one with potential twists and turns, our portfolios emphasize higher quality positions that can capture upside while being more resilient to potential market volatility ahead. This allows us to be positioned in segments of the market that are likely to catch up, and identifying better entry points into the mega-caps on pull-backs.

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FINDING TRULY DIVERSIFIED INCOME

The chart below shows the building blocks of many income portfolios; just look into any income fund factsheet and you will likely see exposures to at least one of them.

Our fixed income allocation has done well for us this year. Out of the income markets in the chart, Asia High Yield is the best-performing segment in the first half of this year with gains of 10.14% compared with US High Yield's 2.58% gain.

This may bring about concerns on US High Yield markets which look to be undershooting expectations. But if we look back at the last 18 months, both Asia and US high-yield markets have returned 16%. It's just that they took different paths to reach this number. Asia High Yield returns started the first half of 2023 slow and accelerated, while the US High Yield started strong and moderated.

It was challenging for investors to sit through a slow start in Asia High Yield last year just like it may be challenging when looking at US High Yield this year. That is why there is a certain degree of diversification available to many income investors to allow them to sit through the volatility that is inherent in their income accumulation journey.

Nevertheless, the diversification only works to a certain extent. As interest rates rose rapidly from Aug 2021 to Oct 2022, these income markets offered little to no diversification; they were all down double digits. It did not matter if they were government, investment grade, or high yield. While they might have behaved differently most times, they behaved the same when it really mattered; when investors' risk tolerances were tested.

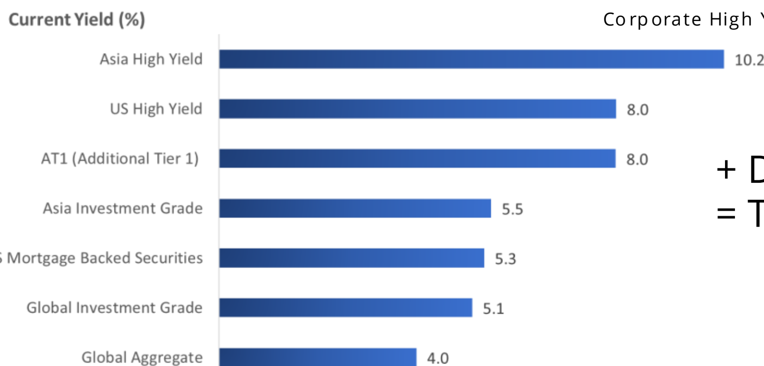
They declined together because just as these income sources derive their income primarily from economies, they are impacted by global factors such as inflation and markets.

Amid the ongoing macro economic uncertainty, the volatility arising from interest rates is at best a distraction, and at worst makes investors abandon their income accumulation journey. **Rather than try to time the next interest rate move, one should focus on clipping the coupons which has worked well and expected to continue.**

Even then, many investors will find that their income sources are tied in some way to the economy. A way to address this is to find true income diversification. And one way to do that is to find income sources that are different. As we saw from the chart below, different does not mean difference in name or even market, but truly different in substance. Only when there is a difference in substance can one expect a difference in outcomes. These are sources that do not depend on economies to derive their income. Examples are insurance-linked securities, asset-backed financing, and royalties.

Diversification is not just about the textbook benefits. It is crucial for investors to stay on their income accumulation journey. Remember that fixed income is not the same as fixed return; the journey to an income target comes with twists and turns. And the higher the desired income, the more volatility a typical income investor needs to go through. This is why it is important to get income from both conventional and different income sources.

Source: Bloomberg. Asia High Yield: Bloomberg Asia USD High Yield Bond Index, US High Yield: Bloomberg US Corporate High Yield Bond Index as at 30/6/2024.



+ Different income sources
= Truly Diversified Income

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HOW ARE WE POSITIONED?

Equity (Green) **Bonds (Blue)**

Key Themes	
Positioning for Growth With the end of the rate tightening cycle and economies continuing to grow; there is a window of opportunity for capital appreciation in equity markets. Maintain a preference for higher quality segments that offer growth potential while being more resilient in the event of slowdown.	**US equities** **Europe equities**
Emerging Opportunities Financial markets operate in cycles. The end of the easy money era means looking beyond popular markets that did well during the previous broad-based growth to find tomorrow's winners. Focus on high-growth markets driven by their own distinctive economic trajectories and coupled with attractive valuations.	**Emerging Market and Vietnam equities**
Late Cycle Stability With interest rates remaining at higher levels compared to the past decade, there continue to be signs that economies and businesses are adjusting to the new regime. e.g. tight labour markets and slower growth.	**Healthcare equities** **Government Bonds**
Capturing High Yields The combination of high interest rates with the end of the Fed interest rate tightening cycle means that bonds should figure prominently on investors radars. Position in higher yielding markets that can provide a good buffer to their higher volatility profile.	**Asian High-Yield bonds** **Emerging Market bonds**

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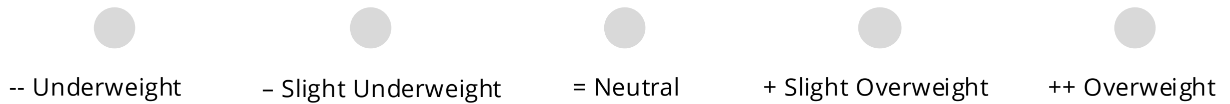
ASSET ALLOCATION STRATEGY



-- Underweight | – Slight Underweight | = Neutral | + Slight Overweight | ++ Overweight

Equity: Regions

United States

US Quality as relative valuations are attractive and expected to benefit as economies grow. **Healthcare** as earnings are more stable and less dependent on broader economic cycle.

Europe

Europe's pro-cyclical industrial base to benefit from economic growth so long as severe recession is not on the cards.

Japan

Maintaining no exposure as continued Japanese equity performance needs JPY to weaken further whereas both BoJ and Fed policies point to a stronger JPY.

Asia Pacific ex Japan

Tailwinds for China building up in the form of improving credit conditions and economic activity but confidence remains low. Participate in China via broader exposure to Asia.

Emerging Markets

Preference for high-growth markets at attractive valuations i.e. Vietnam.

Fixed Income

Global

Focus on currency-hedged government bonds to buffer portfolio volatility during periods of stress.

Investment Grade Corporate

Maintaining no exposure as we run a barbell strategy combining defensive government bonds and high income credit.

US High Yield

Maintaining no exposure due to relative poorer valuations and risk of defaults as economies remain late-cycle.

Asia

Attractive yield across major fixed income markets with room for capital appreciation and better fundamentals.

Emerging Markets Debt

Hard currency bias to focus on return from credit while limiting exposure to emerging market currencies.

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MARKET INDEX RETURNS

Equity Regional	MTD	YTD	10Y	20Y
Global	2.26	11.58	9.01	8.54
United States	3.59	15.29	12.84	10.28
Europe	-2.32	6.08	5.06	6.90
Japan	-0.87	5.18	5.80	4.49
Asia Pacific ex Japan	3.86	8.48	4.08	7.83
Emerging Markets	3.96	7.60	3.16	7.63

Equity Markets	MTD	YTD	10Y	20Y
Australia	1.52	2.34	5.81	9.77
Brazil	-4.56	-19.48	-0.78	6.09
China "A"	-2.86	-0.27	5.40	8.72
China "H"	0.31	11.39	-1.40	5.28
Hong Kong	-0.95	6.24	0.70	5.39
India	7.22	10.12	9.80	13.25
Indonesia	1.00	-6.09	3.07	11.83
Korea	6.52	-0.81	2.22	7.53
Malaysia	-0.41	8.67	-2.01	6.08
Russia	1.10	6.02	4.48	7.96
Singapore	-0.40	2.81	3.34	7.53
Taiwan	9.38	22.08	12.60	11.36
Thailand	-3.16	-12.65	0.52	7.88
Vietnam	-1.16	5.96	8.52	8.39

Equity Sectors	MTD	YTD	10Y	20Y
Gold	-3.71	9.67	3.87	2.64
Energy	-1.29	10.93	3.25	8.25
Technology	8.75	25.22	20.45	13.59
Healthcare	1.93	8.30	9.27	9.52
Financials	-0.89	10.16	10.53	5.12

Fixed Income	MTD	YTD	10Y	20Y
Global Aggregate	1.31	-3.30	-0.37	2.29
Global Aggregate (H)	0.88	-0.73	1.97	3.36
High Yield	1.11	1.42	3.83	6.53
Asia	1.56	0.24	2.81	3.00
Emerging Markets	1.72	1.58	2.52	5.99

Note: (H) Currency Hedged

Currencies	MTD	YTD	10Y	20Y
SGD/USD	-0.35	-2.63	-0.84	1.19
EUR/USD	-1.24	-2.95	-2.42	-0.65
JPY/USD	-2.22	-12.33	-4.52	-1.94

Commodities	MTD	YTD	10Y	20Y
Gold	-0.02	12.79	5.77	9.28
Oil	5.91	13.80	-2.53	4.02

As of 30 June 2024. Source: Bloomberg. ***Total return in USD.*** *10 and 20 year returns are annualized.*

"In investing, what is comfortable is rarely profitable."

Rob Arnott

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