

# THINK DIFFERENTLY TO GET DIFFERENTIATED RESULTS

## Quarterly Investment Update

### Executive Summary

August kicked off with Japan's largest equity drop since Black Monday about 40 years ago, seemingly triggered by an unexpected rate hike by the Bank of Japan and the unwinding of the Japanese Yen carry trade. This sharp move spilled over globally, rattling markets like the S&P 500. As it turns out, this eventful period happened over a short period of the first 3 trading days in August. Subsequently, markets rebounded strongly over the rest of the month to erase the losses and more. If anything, the turbulent month reminds investors to be aware of the interconnected risks across global markets and to ensure that they have a portfolio that is prepared for multiple scenarios.

We are now nearing multiple crossroads that have the potential to influence market direction and create fresh bouts of volatility: In September, the Fed is widely expected to cut interest rates now that the battle with inflation looks to be won. In November, we have the US election which now still looks too early to call. On top of that, markets are watching each data point like a hawk to determine how the current growth slowdown will evolve – will growth rebound into the ideal soft-landing scenario, or continue to deteriorate such that we fall into a painful recession?

The best strategy in this environment is to prepare, not predict. Our focus on higher-quality, large-cap sectors like Healthcare has strengthened our portfolio to better able to withstand unexpected shocks. This has resulted in better performance over the past month, which puts us in a good position to navigate markets in the coming weeks and months.

For fixed-income investors, the upcoming Fed rate cuts also present an opportune time to lock in current higher yields for longer. As rates fall, the supply of high-income opportunities may diminish, making now an opportune time to consider the broad range of higher-yielding opportunities still available to investors today.

While the Fed's green light for rate cuts is encouraging, what matters is if economic growth can continue to hold up. Today, concerns of slower growth are being balanced by supportive fundamentals in the form of the resilient US consumer and corporate earnings. We remain cautiously optimistic (while watching out for risks!), focusing on quality investments that are less reliant on strong economic growth and can capture 'higher quality' gains as we head into the final months of 2024.



## MARKET REVIEW

### **A financial earthquake ...**

August started with a bang as a financial “earthquake” hit Japan. Japanese equities saw their largest drop since Black Monday about 40 years ago. During the shakeout, investors saw their positions decline in a sea of red.

### **... impacting interconnected markets**

Unlike real-world earthquakes, these were not isolated in a particular region. On the other side of the world, even seemingly unrelated investments such as the S&P 500 and Nvidia suffered losses, creating a mini panic for investors who were not expecting their positions to drop like that. To the relief of many, the tremors subsided as suddenly as they happened.

Market commentators put the Japan equity sell-off down to the Bank of Japan raising interest rates just a few days before. This, together with market consensus that US interest rates would be cut, was enough to trigger a partial unwinding of the JPY carry trade. In a matter of weeks, the JPY strengthened over 10% against the USD (your holiday in Japan just got more expensive).

What has currency got to do with equity markets? In the case of Japan, a lot. It is no coincidence that the run-up in Japanese equities over the past two years came together with JPY weakening (there’s a well-established relationship between the two). The sudden strengthening of the JPY was a surprise, but it should not be a surprise that Japan equities tanked at the same time.

**Common risk amid seemingly different markets.** The carry trade was not just in Japan. Globally, it seemed like a no-brainer to borrow cheaply in JPY and invest in higher-yielding currencies like the USD. For those who wanted more, borrowing in Yen and investing in US equities including Nvidia made perfect sense. Across the world, what looked like very different investments were levered to the same risk.

This is not an issue for those who recognize the common risks and can take the volatility. The fortunate thing is this episode was brief and relatively painless. But it should serve as a wake-up call for investors to reflect if they

are taking the appropriate risk in their portfolio that their tolerance can bear.

### **The expected volatility is happening**

We have mentioned before that one should expect more volatility amid the late-stage economic cycle. And this is exactly what has been happening. Market participants are not just latching on but also highly sensitive to every data point. The early August sell-off was on the heels of weaker-than-expected employment data (specifically job openings) at the end of July.

This week, markets are waiting with anticipation for the latest employment data release such as the nonfarm payrolls on 6<sup>th</sup> September. Any data that is weaker than expected (and expectations are high) would invariably lead to more volatility. Trying to speculate on each of these data releases is impractical. What is more sustainable is to see how these data points collectively inform us of where we are in the market cycle.

### **Interest rate cuts a foregone conclusion ...**

Which leads us to one man that the media has been focused on, and his actions: The Fed Chair Jerome Powell. The Fed has been trying to be data-dependent; they too are watching the labour market data to guide their monetary policy.

It looks like they have seen enough. At the Jackson Hole meeting in August, the Fed Chair effectively signalled that they would be cutting rates in September. This means that rate cuts are pretty much a foregone conclusion.

### **... but not so the economy and markets.**

While lower rates are generally positive for risk assets, the market trajectory is far from a foregone conclusion. The Fed continues to manage a delicate balancing act. Cut too early and risk losing the war on inflation. Cut too late and risk triggering recession that will see markets decline. We need to remind ourselves that the Fed’s mandate is managing inflation and the labour market, not financial markets. What’s key is to make sure our portfolios are prepared for whichever scenario we find ourselves in.



# FUNDAMENTAL SUPPORT

Global equities recorded gains of 2.6% in August 2024. The monthly gain is not particularly interesting on its own, but it masks a sharp intra-month decline experienced earlier in the month.

Equity Markets	Aug 1-5	Aug: 1-30
US	-6.1%	2.4%
Europe	-4.6%	3.9%
Japan	-16.8%	-0.2%
Emerging Markets	-6.3%	1.6%

Source: Bloomberg. Total Return in USD.

After a relatively smooth journey in the first half of 2024, we've undoubtedly arrived at the part of the journey that comes with more twists and turns.

The past months' decline and subsequent strong rebound tell us the following:

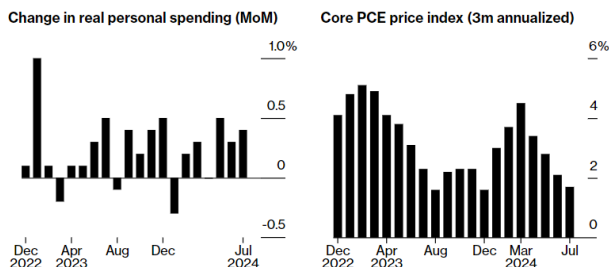
1. As the inflation battle looks to be won, concerns about the state of the economy and upcoming US elections are increasingly coming to the forefront of investors' minds - investors should expect bouts of volatility to resurface in the coming weeks and months.
2. While the sharp declines over Aug 1-5 reflected concerns of a recession, the subsequent rebound also shows that such concerns are overblown (for now).

Make no mistake; the growth environment is slowing, as evidenced by further cooling in labour demand and continued weakness in manufacturing activity in August. Now is a crucial time to be selective, **but opportunities exist to make money, even in today's late-cycle environment.**

There continue to be reasons for the economy to chug along. For one, the average US consumer has continued to spend. This bears watching closely as consumer spending represents about two-thirds of the country's GDP. While the lingering impact of high interest rates and their [dwindling pandemic-era savings](#) should eventually weigh more heavily on spending power, this has not been the case so far.

## US Consumer Spending Picks Up as Inflation Trend Softens

Underlying inflation over the past three months posts smallest advance of year



Alongside cooling inflation, we've observed continued willingness by the US consumer to spend as shown in the above charts. This is consistent with the resilient retail sales data that was reported in the past month.

Meanwhile, there has also been a broadening of recovery across equity markets beyond a narrow group of stocks i.e. Magnificent 7. Our positions in higher quality large-cap equities have benefitted - close to 80% of US large-cap companies have beaten earnings expectations despite the slower growth environment. We are cautiously optimistic that continued earnings growth is supportive for markets.

In all, markets are balancing concerns of slower growth with still supportive fundamentals in the form of resilient US consumer and corporate earnings.

What we are looking out for is any signs of a full-blown recession that would trigger meaningful declines and would prompt us to make further adjustments to our portfolios. Until then, fundamentals remain supportive for more gains towards the end of the year.



**Base case:  
What to  
position for**



**Watch closely and  
prepare for  
unexpected shocks**



# NEARING CROSSROADS

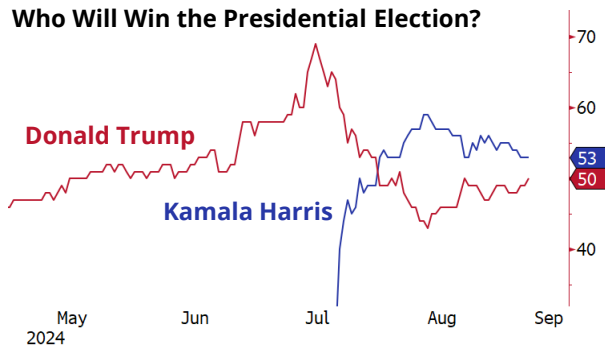
'Crossroad' can be used to describe a major market event with the potential to drive market movements in the near term. They can influence market direction or create volatility and uncertainty for investors.

Though markets have recovered quickly over the past month, we are nearing a series of market crossroads with the potential to trigger fresh bouts of volatility:

- Fed rate cut (September – expected)
- US election (November)
- Growth slowdown (or something more?)

**US Election:** Although elections have taken a backseat to growth concerns, they are likely to regain attention as we approach November. Beyond the usual speculation on policy rhetoric and potential market 'winners or losers', one thing is clear: markets dislike uncertainty. Latest prediction markets (PredictIt) inform us that the presidential race remains too close to call:

### Who Will Win the Presidential Election?



Source: PredictIt. Probability % of winning the election.

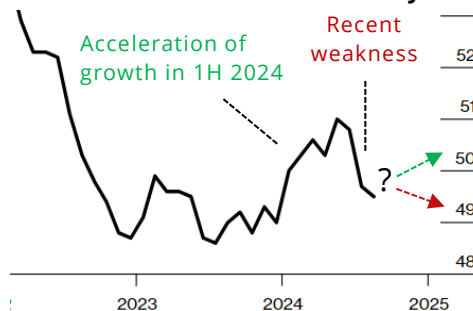
Our focus on higher-quality positions is expected to weather any upcoming shocks better, especially as election-related uncertainties unfold. Additionally, the reduction of China exposures since the start of the year has also further enhanced our portfolio's resilience in the event of a likely 'hardening' stance against China.

**The Fed has given the green light for a September rate cut.** Fed Chair Jerome Powell's confidence in the (cooling) inflation outlook and acknowledgement of recent weakness in labour market data has increased the likelihood of interest rate cuts starting in September.

*'The balance of the risks to our two mandates [inflation, employment] has changed.'* Notably, the Fed's recent comments indicate a shift in focus to managing labour market risks going forward, where it was more squarely on inflation before. This hints at a Fed that will be more proactive in cutting rates to support the economy on further signs of weakness.

**The change in Fed's focus means re-aligning our strategy playbook for what's to come.** The green light for lower rates would give us more reason to revisit economically-sensitive opportunities like small-caps once more, but we are not jumping the gun just yet. Such opportunities require not only rate cuts but also more sustainable growth to do well – the missing ingredient that we are now looking out for.

### Recent Weakness in Economic Activity



Source: Bloomberg as of 5/9/2024. PMI Manufacturing.

**Fed's green light, but look both ways.** With all the discussion on crossroads, markets are ultimately driven by fundamentals in the medium to long-term. Historically, rate cuts have been positive for equities when growth can continue to hold up. In the current slower growth environment, we are positioned in more resilient market segments such as Healthcare which are less reliant on strong economic growth and can help us to capture 'higher quality' gains as shown in the table below. This has benefitted our portfolios and put us in a good position to navigate the weeks and months ahead.

Equity Markets	Aug 1-5	Aug: 1-30
Global	-6.4%	2.6%
Healthcare	-2.3%	5.5%
Small-caps	-9.5%	-1.5%

Source: Bloomberg. Total Return in USD.

# LOCKING IN INCOME

## Rate cuts mean fewer yield opportunities

Given that interest rates are pretty much certain to be lower in the coming months (with the Fed cutting in September), it means that bond yields will be lower going forward.

To put it another way: there will soon be fewer higher-yielding bonds out there for yield-hungry investors to invest in. Just two months ago, the US government was issuing bonds at 4.625% coupon. Last week, the US was issuing bonds at a 3.750% coupon\*. The supply of higher-yielding Treasuries is already shrinking before the Fed cuts rates.

## Locking in income amid rate cuts

There are things that an income investor can do today to preserve a higher level of income on their holdings. The most practical way is to re-allocate from short-dated segments like Money Market Funds (where the return potential will reduce alongside interest rates), into fixed income segments with higher yields and the potential for price appreciation when interest rates decline.

The re-allocation to lock in higher income for longer seems like a low-hanging fruit, but reality indicates otherwise as shown in the chart below. There are a few interesting findings about Money Market Fund (MMF) investors in the last few rate cut cycle:

- MMF investors are slow to respond to interest rate cuts.
- They continued to buy into MMFs even as their return potential reduced.
- They reduced MMFs only when interest rates bottomed.

The data suggests that there is room for MMF investors to optimize and secure a higher higher-income level for a longer, rather than being at the mercy of the Fed.

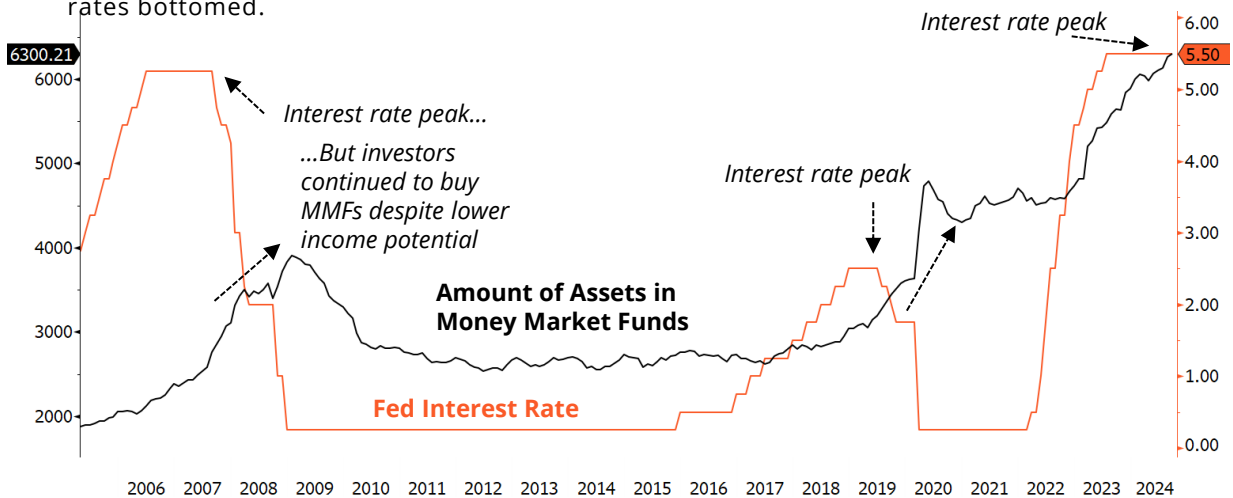
## Locking in higher income

If one wants to lock in income, why not lock in *higher* income today? The table shows that, even amid a shrinking supply of income opportunities, there are still higher income opportunities to meet the needs of various investors.

Bond Market	Yield
Investment Grade	4.25%
High Yield	7.23%
EM High Yield	8.93%

That said, it is probably not a good idea just to invest in the market with the highest yield – not before considering the ‘right’ segment that is commensurate with your risk tolerance and time horizon. It is equally important to assess their fundamentals and valuations particularly as markets approach key crossroads as discussed earlier. In such a dynamic environment, actively-managed strategies offer the potential to adjust to evolving risks and opportunities.

Source: Bloomberg as at 6 Sep 2024. Investment grade: Bloomberg US Agg. High yield: Bloomberg US Corporate High Yield Bond Index, Emerging market high yield: Bloomberg Emerging Markets High Yield Total Return Index. \*Bloomberg. US Treasury 2 year bonds.



Source: Bloomberg as at 4 Sep 2024. Orange: Fed Funds Rate. Black: ICI Money Market Funds Assets  
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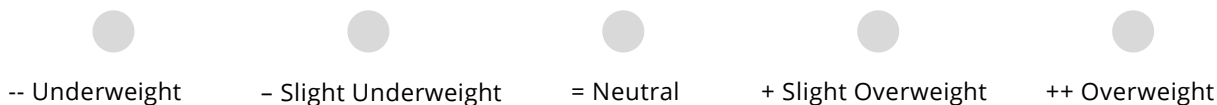
# HOW ARE WE POSITIONED?

Equity (Green)    Bonds (Blue)

Key Themes	
<p><b>Positioning for Growth</b></p> <p>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.</p>	<p><b>US equities</b></p> <p><b>Europe equities</b></p>
<p><b>Emerging Opportunities</b></p> <p>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.</p>	<p><b>Emerging Market and Vietnam equities</b></p>
<p><b>Late Cycle Stability</b></p> <p>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.</p>	<p><b>Healthcare equities</b></p> <p><b>Government Bonds</b></p>
<p><b>Capturing High Yields</b></p> <p>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.</p>	<p><b>Asian High-Yield bonds</b></p> <p><b>Emerging Market bonds</b></p>



# ASSET ALLOCATION STRATEGY



## 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	2.57	16.34	9.36	8.91
United States	2.43	19.52	12.96	10.65
Europe	3.83	12.68	6.09	7.36
Japan	-0.02	11.74	6.60	5.05
Asia Pacific ex Japan	2.34	11.19	3.90	7.83
Emerging Markets	1.64	9.80	2.93	7.62

Equity Markets	MTD	YTD	10Y	20Y
Australia	4.12	8.65	5.98	9.93
Brazil	6.47	-12.94	-1.29	5.82
China "A"	-1.51	-0.54	4.32	8.82
China "H"	3.89	13.39	-1.92	5.37
Hong Kong	4.10	9.39	0.27	5.29
India	0.71	14.36	9.74	13.01
Indonesia	10.85	7.58	3.79	12.29
Korea	-1.07	-2.03	1.81	7.32
Malaysia	9.86	25.39	-0.71	6.77
Singapore	4.20	12.59	3.95	7.80
Taiwan	3.35	21.39	12.21	11.30
Thailand	8.13	-0.92	1.07	8.81
Vietnam	4.18	12.05	7.93	9.10

Equity Sectors	MTD	YTD	10Y	20Y
Gold	2.44	24.61	5.09	3.30
Energy	-1.70	11.35	3.41	8.14
Technology	1.46	24.44	19.82	14.34
Healthcare	5.52	18.05	9.88	10.10
Financials	4.51	22.57	11.42	5.62

Fixed Income	MTD	YTD	10Y	20Y
Global Aggregate	2.37	1.86	0.12	2.43
Global Aggregate (H)	1.10	3.19	2.18	3.44
High Yield	1.63	6.09	4.17	6.47
Asia	1.34	4.37	3.06	3.21
Emerging Markets	2.10	6.29	2.84	5.81

Note: (H) Currency Hedged

Currencies	MTD	YTD	10Y	20Y
SGD/USD	2.24	1.04	-0.45	1.36
EUR/USD	2.05	0.08	-1.71	-0.49
JPY/USD	2.61	-3.51	-3.34	-1.45

Commodities	MTD	YTD	10Y	20Y
Gold	2.28	21.35	6.88	9.47
Oil	-5.60	2.65	-2.62	2.83

As of 31 August 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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