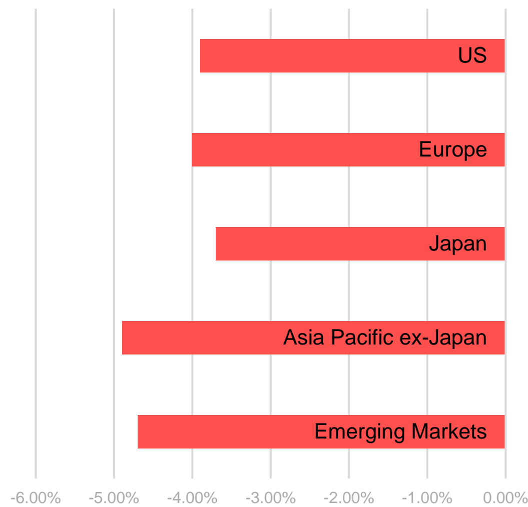
Monthly Commentary

All data as at 28 February 2018 March 2018

EQUITY MARKETS

Global Equity Return: -4.4%



Source: Bloomberg

United States -3.9% (USD)

Tech stocks were resilient as investors continue to favor the high-growth sector, ending the month marginally lower (-0.3%). Energy emerged the main detractor as oil prices pulled back from their recent highs. Oil and gas giant, Exxon Mobil, fell more than 13% on weaker than expected Q4 results. Growth outperformed value in the past month, as broadly reflected by the outperformance of tech relative to energy. Financials – where we are currently overweight - performed in line with the market.

Europe -4.0% (EUR)

The euro fell together with global equities, as safe haven currencies rose. The tech sector outperformed as a few companies posted strong earnings and outlook – Nokia rose more than 20% in February on better than expected Q4 earnings, for instance.

Asia Pacific ex Japan -4.9% (USD)

Emerging Markets -4.7% (USD)

Tech-related companies also remained in favour in Asia. Though the Information Technology sector weighed heavily on the market during their initial sell-off, they rebounded strongly as markets recovered from their lows. Large tech companies have continued to post strong earnings, underpinning their solid uptrend. Our growthier China A-shares exposure did well in January, but gave back these gains in the past month (-5.9%).

Within emerging markets, Russia stood out, holding above water with 0.3%. Standard & Poor's (S&P), a credit-rating agency, recently upgraded Russia to investment grade from junk rating, bolstering investors' confidence in the oil-exporting country. Commodities fell and subsequently recovered together with equity markets. Oil ended the month down more than 4%, even as tighter supply helped to provide some support to prices. Iron ore and other base metals saw demand return as the winter break comes to an end in China.

Japan -3.7% (JPY)

As the laggard in January's rally, Japan declined by less than the other regions over the past month. The negative equity-currency correlation made a reappearance as the yen – a safe haven currency – rose 2.3% against the dollar (and 3.3% against the Singapore dollar), benefitting foreign investors who were exposed to the local currency.

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FIXED INCOME

Sovereign bonds fell 0.68%, led by the US treasury market. Markets were spooked as US inflation indicators pointed towards higher inflation numbers; which would prompt the Fed to push up yields (and bond prices down). Consequently, 10-year US treasury yields rose to a 4-year high of 2.95% in February. Euro-area bonds actually gained on weaker than expected business surveys in Germany and France. All eyes are on US 10-year bond yields hitting the psychological threshold of 3% as markets become jittery on any hint of growth-induced inflation.

Asian bonds corrected in line with trends in the global bond markets. With the prospect of much higher yields in US treasuries, the entire complex of Asian bonds declined: from hard to local currency, sovereign to corporate, investment grade to high yield. India, which has the highest yields among the large Asian economies, saw ten-year yields continue to rise in February, reaching 7.8%, and pushing bond prices further down - the fear is that the government's expansionary policies may lead to higher inflation (especially now with higher oil prices), and wider deficits.

Emerging market debt broadly fell across the board with little distinction between the regions of emerging Asia, Latin America, Europe, and Africa. Again, this was driven by the rise in sovereign bond yields. An outlier was Russia where 10-year bonds gained 1.6% as its sovereign credit rating of BB+ was upgraded by one notch to BBB- by S&P – effectively an upgrade from junk to investment grade. EM bond funds saw strong outflows in the week ending 14th February, the largest since November 2016 which also saw EM bonds decline. The outflows proved to be temporary as the following week saw inflows return and bond prices recover.

Investment Grade (IG) bonds fell more than sovereign bonds as the risk of higher interest rates affected the sentiment in global bond markets. Investment grade credit spreads also widened; sufficient enough to attract some buying rather than cause greater concern.

High Yield (HY) bonds were also caught up in the fixed income volatility. Weaker sentiment in equities markets also affected the HY sector. Spreads widened from recent tight levels, effectively stalling the pace of spread tightening. This makes us look quite prescient in terms of closing the overweight in HY at the start of the year. This is not borne out of an innate ability to forecast, but founded on our analysis of headwinds and tailwinds across markets.

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OUTLOOK AND STRATEGY

After a long period of upward trending markets with little volatility, we got the market correction that everyone knew was coming, but not expecting. Technically, the sell-off has provided the market a psychological base for equities to move higher from. We are monitoring inflation risks closely. With synchronized growth observed globally, there is high demand for resources. In the US, we have seen low unemployment figures - hitting at a 17-year low of 4.1% in January 2018. More importantly, there have been signs of higher labour costs. Coupled with tax cuts, these could filter into the corporate and consumer sector and add inflationary pressures. While the Fed is still expected to gradually increase interest rates, they would not be hesitant to hasten the pace of monetary policy tightening if inflation were to spike up. We would expect volatility to go up in this scenario.

We have observed a decoupling between energy stocks and oil prices – energy sector stocks declined (MTD -11.3%) more than the market, even as oil prices have managed to hover above $60. Alongside financials, energy is a meaningful constituent of 'value', and a turnaround could finally lead to a recovery in value vs growth., particularly in the **US**. The recent slight steepening of the yield curve (where longer-term interest rates rise by more than short-term rates), and continued strong global growth should continue to benefit our financials exposure.

Where euro-unhedged investors gained in January, the past month saw the euro detracting from performance as safe-haven currencies gained. **Europe's** value stocks did not continue with their early outperformance at the start of the year, as financials declined with the market. Political risks may rise to the forefront as the Italian general election is due on the first week of March – which is one of the key political risks for the region in the near term.

Earnings growth in **Japan** has remained intact, even as we have seen higher levels of volatility and dispersion in stock price. Volatility in markets has so far not yet affected the country's economy activity. Moreover, the Bank of Japan (BoJ) has demonstrated a strong will in continuing to support the economy, which would also support the equities market. The yen has continued to function as a safe haven currency; as it has performed well during the bouts of market declines seen the past month. As the BoJ has announced its intention to start tapering sometime 2019, getting exposure to the safe haven currency may help manage the downside.

The outlook for **Asia ex Japan** remains favourable despite the pullback. Along with robust economic growth, China's role in globalisation and trade has grown in importance now that the US is taking a more protectionist stance and kicking off potentially a global trade war. February's initial sell-off was pervasive and technical; popular e-commerce company, Alibaba, fell in tandem with markets even as it reported an increase in revenue by more than 50% from a year ago. The subsequent recovery was not as homogeneous as we see the market being more discerning; potentially rotating from established positions into other areas with better risk/reward.

While equity markets and commodity prices have recovered from the lows, we expect volatility to remain elevated. As synchronized global growth moves into the latter stages of the economic cycle, volatile commodity prices reflect changes in supply and demand dynamics. For example, crude oil markets have established a backwardation profile for the first time since the decline of 2014, indicating stronger near term demand. Generally, strong global growth would translate into a favourable outlook for commodities, and also the resource-dependent **emerging markets.**

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Global fixed income markets are expected to exhibit higher volatility going forward compared to the last few years. Post 2008 financial crisis, the net effect of low inflation, low interest rates and QE led to the appreciation of assets with relatively low volatility. The Fed is expected to raise interest rates by at least another 75bps in 2018. Though the ECB and BoJ have not announced a concrete plan for when to start hiking interest rates, markets are speculating that they would have to do it sooner, rather than later, given the strong economic growth observed recently.

Our strategy for fixed income is to identify opportunities of favourable risk/reward for the portfolio, without losing touch with the defensive properties of fixed income assets. As we saw during the sell-off in February, fixed income either declined less or was positive viz a viz equities. In a low yielding environment with rising rates, we focus on allocating to segments of fixed income that are expected to contribute from coupon return and tightening spread. This has been achieved while maintaining lower duration exposures, mitigating the effects of rising yields. In some ways, the portfolios have been ready and waiting for the recent volatility.

We maintain our positions in the fixed income markets, for now. 10-year treasury yields tested the 3% level, a key psychological support level. With increasing short positions being accumulated by both speculative players and real money investors, sovereign bonds are in a consolidation phase in the near term.

Yields are expected to grind higher with the gradual tightening of monetary policies by major central banks. Higher interest rates would continue to bring about higher volatility in the riskier assets, such as non-sovereign bonds alongside equities. We therefore maintain a neutral stance in **sovereign bonds**, a safe haven asset class, to cushion potential downside in riskier fixed income classes.

Fundamentals remain constructive for corporate bonds with strong growth globally. That said, spreads (the difference in yields compared to government bonds) are not compelling in both the IG and HY segment. **Investment grade** spreads widened but remain tight from an absolute and relative standpoint, providing opportunity for perhaps short term trading. With spreads and coupon in IG offering little upside to mitigate the rise in bond yields, we keep the underweight stance in IG bonds.

Stable oil prices continue to be a supportive factor for **high yield** bonds. Higher coupon remains the main proposition while we mitigate the yield curve risk by running lower duration, and have dialled down exposures to neutral due to limited upside from spread compression.

Riding on the momentum globally, growth in Asia is expected to be strong, and supportive of **Asian fixed income**. High leverage built up in China is a concern. That said, the Chinese government is taking pro-active measures to deleverage, which could cause pain to weaker companies and investors in the short-term. We see this in the recent disposal of assets by companies such as Anbang and HNA which have been acquisitive globally in recent years. We are paying closer attention to Indian bonds, currently yielding 7.8%, and provide the highest yields among large Asian economies. We are closely monitoring the risk of higher inflation and widening fiscal deficit, which would exert further upward pressure on yields.

We remain constructive on **EM debt**. Stable and rising oil prices will improve trade numbers for exporters. Domestic growth is also picking up with muted inflationary pressure. EM credit spreads continue to indicate room for tightening. Notwithstanding favourable conditions, we keep duration short to help mitigate the risk of higher interest rates.

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MARKET PERFORMANCE

Regional Equity	MTD	YTD
Global	-4.4%	1.0%
US	-3.9%	1.5%
Europe	-4.0%	-2.5%
Japan	-3.7%	-2.7%
Asia Pacific ex-Japan	-4.9%	1.5%
Emerging Markets	-4.7%	3.2%

Fixed Income	MTD	YTD
Global Investment Grade	-0.9%	0.3%
High Yield	-0.9%	-0.6%
Asia	-0.7%	-1.2%
Emerging Market Debt	-1.4%	-1.5%

Currencies	MTD	YTD
USD/SGD	1.0%	-0.8%
EUR/SGD	-0.8%	0.6%
JPY/SGD	3.3%	4.7%

Commodity	MTD	YTD
Gold	-2.0%	1.2%
WTI Crude	-4.8%	2.0%

Source: Bloomberg. All returns in index currency terms.

Country	MTD	YTD
Australia	-0.4%	-0.8%
Brazil	0.5%	11.7%
China “A”	-5.9%	-0.2%
China “H”	-8.7%	5.7%
Hong Kong	-6.2%	3.1%
India	-5.0%	0.4%
Indonesia	-0.1%	3.8%
Korea	-5.4%	-1.6%
Malaysia	-0.7%	3.3%
Russia	0.3%	8.9%
Singapore	-0.5%	3.4%
Taiwan	-2.6%	1.6%
Thailand	0.2%	4.4%

Sector	MTD	YTD
Gold equity	-9.9%	-8.1%
Energy equity	-11.3%	-8.0%
Technology	-0.3%	7.1%
Healthcare equity	-4.7%	0.7%
Financial equity	-3.0%	3.2%

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