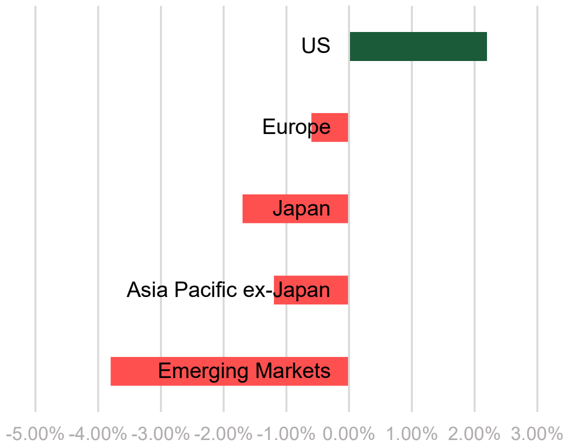
Monthly Commentary

All data as at 31 May 2018 June 2018

EQUITY REVIEW

Global Equity Return: -0.2% (USD)

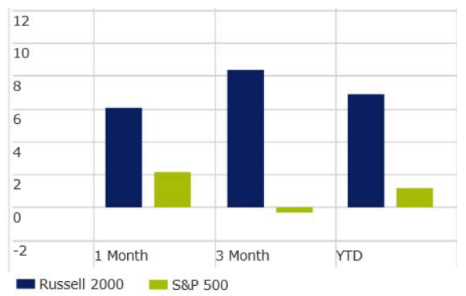


Source: Bloomberg

United States 2.2% (USD)

Amidst trade rhetoric and a strengthening dollar, we benefited from the outperformance of small-caps over the S&P 500 (6% vs 2.4%). The financial sector disappointed, as investors grapple over a murkier growth outlook. Growthier tech stocks continued to lead the way, while volatile energy names gave back earlier gains as oil prices fell towards the end of the month.

Small handily beat large in the US this year



Source: Morningstar Direct

Asia Pacific ex Japan -1.2% (USD)

Emerging Markets -3.8% (USD)

A stronger dollar, together with the ongoing rhetoric between US-China-North Korea affected sentiment in Asia. Healthcare was the top performing sector, gaining 4.7%. In contrast, the Industrials and Telecom sectors were down 3.1% and 5.6%, respectively.

Emerging markets bore the brunt of a stronger dollar. While oil prices rallied most of the month, markets were focused on countries' fiscal position, resulting in currency weakness. Measured in USD, Brazil's IBOV index was down more than 16% as the Real weakened. In this environment, Russia and China were one of the few exceptions, perhaps cushioned by their relatively stronger fiscal position. Sentiment was further affected later in the month as oil declined on expectations that the OPEC nations may boost oil production.

Europe -0.6% (EUR)

Political risks re-emerged from Italy in the past few weeks, sending the region's financial stocks tumbling. Unsurprisingly, Italy was the worst performer of the bloc. Tech stocks remained resilient, as investors continued to favour the high growth sector. The euro weakened on increased political risks and as growth moderated from their prior blistering pace.

Japan -1.7% (JPY)

The Japanese yen – a safe haven currency – rose towards the end of the month as equities declined. While returns of Japan's Topix Index was roughly flat, we observed large dispersion in performance across sectors. The defensive consumer staples sector rose 2.3%, while the more volatile energy sector fell by more than 6%.

FIXED INCOME REVIEW

Sovereign

In the first half of May, ten-year treasury bonds declined with yields rising to 3.1% on encouraging economic numbers as US nominal GDP growth hit 4.8% year-on-year. In the second half of the month, major market sovereign bonds bounced and rallied to close the month positive as investors flocked to safe haven assets particularly the USD. Our position in currency-hedged global bonds benefitted consequently (refer to figure below).

In Europe, most bond markets gained in local currency terms. However, Italian government bonds sold off on fears of unsustainable government debt and potential exit from the single currency bloc, putting pressure on the EUR. In echoes of the Eurozone crisis, the PIIGS markets (perhaps more politically correct GIPS) such as Spain, Portugal and Greece, were also affected.

Currency-hedged bonds rally as riskier assets sold off

Source: Morningstar Direct

Investment Grade

Within the investment grade segment, corporate bonds underperformed. The historically tight spreads (rich valuations) amid a rising interest rate environment offers a relatively poor risk/reward proposition, which prompted us to reduce exposure to this segment early on. Mirroring fears in sovereign bonds, Italian and Spanish bank bonds sold-off.

High Yield (HY)

High yield bonds continued to demonstrate resilience amid the fixed income sell-off. The broader high yield markets were flat through the month, with small gains in healthcare and energy offsetting losses in other sectors.

Our position in short duration high yield stood out with steady gains. Short duration high yield issuers saw gains in all sectors except in retail.

Asian bonds

Asian hard-currency bonds were subject to the whipsaw similar to global bonds but closed the month flat, as the safe haven nature of the USD asserted itself. Significant detractors were sovereign issuers such as Philippines and Indonesia with longer duration exposures. Philippine government bonds sold off as its central bank, the Banko Sentral ng Pilipinas, was poised to hike rates to tackle inflation.

Emerging Markets Debt (EMD)

Investors in emerging market bonds experienced wide divergence, depending on whether one was invested in hard or local currency bonds. Turkish hard currency bonds dropped 5%, whereas local currency bonds tanked 18% in USD terms. A trifecta of high inflation, worsening budget deficit, and policy uncertainty were the key culprits. There was some relief towards the end of the month as Turkey was clearer on its interest rate regime. Argentine hard currency bonds fell 4%, while the peso tanked 18% as the government hiked rates to defend the currency and negotiate a credit line from the IMF (International Monetary Fund).

Consequently, short duration EMD (where we are positioned) was the most resilient, followed closely by hard currency EMD, while local currency bonds had outsized losses.

OUTLOOK AND STRATEGY

Not surprisingly, volatility continued to be a prominent feature of the market. The VIX 'fear' index jumped towards the end of the month, as markets were once again spooked by the ongoing trade rhetoric, as well as the political drama unfolding in Italy.

Equity

In the **US**, our small-cap growth bias continued to be supported by a strengthening dollar and a rally in tech stocks. Being more exposed to the stronger domestic recovery in the US, small-caps are inherently more insulated to trade fears or currency effects. Year-to-date, small has outperformed large by about 5% (Russell 2000 vs S&P 500). We employed a similar strategy for our financials allocation – rising interest rates, strong earnings, and attractive valuations underpinned our initial investment thesis. More recently, key risks have emerged that we are paying close attention to: financials are especially sensitive to concerns over future growth (a flattening yield curve somewhat indicative of these concerns), and potential contagion risks that may arise from the political drama in Italy.

Fears that **Europe** would experience slower growth were reflected in a weaker euro. Euro area Purchasing Manager's Index (PMI) eased in May, though still reflecting a healthy pace of growth. Furthermore, latest data has shown a meaningful pick-up in inflation. As the European Central Bank (ECB) takes into account inflation to guide their interest rate policy, a higher inflationary environment should support the euro.

The improved earnings and business outlook of **Japanese** corporates are encouraging, though the country's equity markets have not been rewarding for investors in this volatile environment. We continue to review this segment, especially as valuations become more attractive, and where monetary policy under the Bank of Japan (BoJ) remains extremely accommodative.

Trade rhetoric has continued to affect sentiment in **Asia Pacific ex-Japan**. We are maintain a constructive view on equities in the region, at the same time being mindful of the developments around the proposed US-North Korea meeting in Singapore and the ongoing trade negotiations. Games played in the political arena can be hard to predict and has contributed to volatility. Our strategy emphasizes on identifying attractive risk-to-reward opportunities in the region, while continuing to monitor the situation closely.

Equity valuations have become more attractive in the **Emerging markets**, as corporate earnings continue to grow. That said, the region is at risk of contagion from the unwinding of debt in Argentina and Turkey. A strengthening USD and higher borrowing costs would also put pressure on the ability to refinance existing dollar debt. Oil prices retreated sharply from their highs above $70/bbl (WTI) on plans by Russia and Saudi Arabia to increase oil production, consequently hurting oil producers in the region. Interestingly, metal prices have remained firm near support levels as we continue to observe a healthy pace of global growth.

Fixed income

Boom & bust are necessary parts of economic and market cycles. The current boom cycle is extended as growth continues to outpace interest rates. It is typically during the bust where safe haven assets are appreciated.

Sovereign bonds have had a traditional role as a safe haven asset. Other safe haven assets include currencies e.g. USD, JPY, and gold; each having its own risk/reward proposition.

We manage our investments from a portfolio approach; understanding how they may overlap and interact (whether there is correlation or lack of).

In fixed income, the exposure to short duration, major market sovereigns, USD & JPY are intended to mitigate the adverse effects of a downturn in risk assets.

The portfolios are positioned for rate hikes, while not over compromising on return opportunities. We are monitoring for adverse risk factors such as short-term funding cost and recession that portend market stress or capitulation.

Investment grade (IG) corporate credit spreads continue to rise due to the sell-off in February but remain less attractive relative to other fixed income segments. Investors are not sufficiently compensated for taking the duration and credit risk in corporate bonds. With economic growth, general corporate fundamentals are sound but rich bond valuations provide little room for upside. Alternatively, the portfolio is benefitting from the economic growth via its equity exposures. The response of corporate bonds throughout May's fixed income volatility validates our underweight.

The fundamental tailwinds for **High Yield (HY)** are tied to corporate health and commodity prices. Default rates remain low, while yield and spread levels remain attractive. We are watching out for headwinds such as rising default rates and adverse spread movements that may negate our thesis.

Asian bonds

It's said that "this time is different" are the four most dangerous words in investing. Proponents and detractors of Asian bonds have good reason to be in a stalemate. Proponents justify that Asian issuers have better fundamentals and balance sheets than before, and more Asian-based investors are holders of Asian bonds. Sceptics will point to China Energy Reserve and Chemical (CERC), a state-linked company, which defaulted after failing to repay its dollar bond just three days after doing a $150m issuance. While isolated, this may prove to be a canary in the coal mine.

Given the general tightening in credit conditions, we focus on corporate issuers with strong balance sheets and short duration, such that they are more insulated from macro headwinds. We also monitor bond markets increasing defaults and signs of stress that may be building up in equity markets.

EM bonds

While EM inflationary pressures were benign, we were running short duration to mitigate general tightening among major central banks. As inflationary pressures start to build up, coupled with currency weakness, the case for reduced duration is stronger.

We stick to our FVT process as it helps to improve the odds of being right on the opportunity, right on the environment, and right on the P&L. While the fundamental proposition was always there for EM currencies, we had not previously identified sufficient risk/reward in local currencies; perhaps the recent sell-off will improve the proposition.

There is also a foreboding reminder of previous crises that began with stresses in EM fixed income. As recent events provide potential opportunity, we are monitoring for signs of increasing stress and capitulation. Regardless, we will steer the portfolio in the best interest of our investors.

MARKET PERFORMANCE

Regional Equity	MTD	YTD
Global	-0.2%	-0.8%
US	2.2%	1.2%
Europe	-0.6%	-1.6%
Japan	-1.7%	-3.9%
Asia Pacific ex-Japan	-1.2%	-1.3%
Emerging Markets	-3.8%	-3.3%

Fixed Income	MTD	YTD
Global Aggregate	-0.8%	-1.0%
High Yield	-0.1%	-0.7%
Asia	0.0%	-1.9%
Emerging Market Debt	-0.7%	-3.2%

Currencies	MTD	YTD
USD/SGD	0.9%	0.1%
EUR/SGD	-2.3%	-2.6%
JPY/SGD	1.4%	3.6%

Commodity	MTD	YTD
Gold	-1.3%	-0.3%
WTI Crude	-2.2%	11.0%

Source: Bloomberg. All returns in index currency terms.

Country	MTD	YTD
Australia	0.5%	-0.9%
Brazil	-10.9%	0.5%
China "A"	1.2%	-5.7%
China "H"	-2.9%	2.3%
Hong Kong	-1.1%	1.8%
India	0.5%	3.7%
Indonesia	-0.2%	-5.9%
Korea	-3.7%	-1.8%
Malaysia	-6.9%	-3.1%
Russia	-0.2%	9.2%
Singapore	-5.1%	0.7%
Taiwan	2.0%	2.2%
Thailand	-3.0%	-1.5%

Sector	MTD	YTD
Gold equity	0.1%	-3.8%
Energy equity	2.5%	4.7%
Technology	6.1%	9.5%
Healthcare equity	0.2%	-0.7%
Financial equity	-1.1%	-3.0%

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