Quarterly Investment Outlook
Third Quarter 2018

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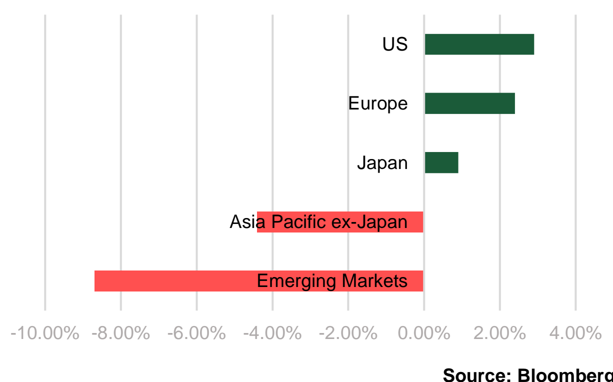
EQUITY REVIEW

What was initially politlcal drama between US and China trade relations has deteriorated into a risky game of chicken. The clash has intensified tensions between the US and her allies, and tit-for-tat tariffs threaten to derail the global recovery. Sentiment took a hit as we observed a more risk adverse market in the past quarter. Developing markets underperformed the developed markets, with the former bearing the additional burden of a stronger dollar. That said, growth fundamentals are still largely intact on aggregate, even if they are a little shaky. The risk factors relating to the ongoing trade skirmish, as well as central bank policy tightening, are hanging in balance and we expect volatility to remain at elevated levels.

Global Equities -0.1% (QTD, USD)



Source: Bloomberg

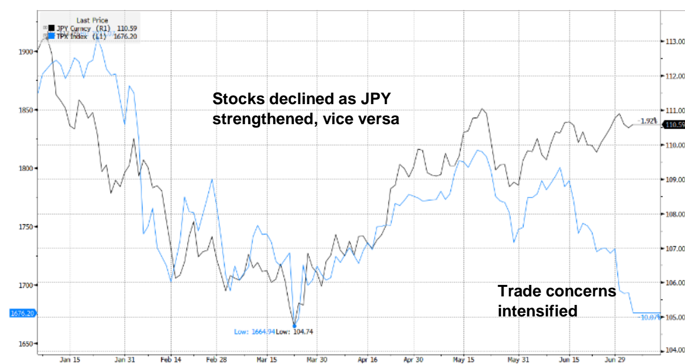
United States 2.9% (QTD, USD)

Small-caps outperformed the broader S&P 500 index in Q2 (7.7% vs 3.4%) as trade tensions intensified, benefitting our small-growth bias. Tech stocks continued their strong uptrend, making new highs in June. The energy sector saw the largest gains as oil prices rose more than 10% over the quarter. Financials declined as concerns mount over future growth prospects.

Europe 2.4% (QTD, EUR)

Energy stocks emerged the star performer in Q2 as oil prices rallied. European financials saw outsized declines, as the region saw political risks alongside US-China trade tensions. Year-to-date, Commerzbank and Deutsche Bank are down -33% and -40% respectively. European auto makers also declined meaningfully as the Trump administration threatened to slap tariffs on European vehicles.

Japan stocks driven less by currency movements in the past month



Source: Bloomberg

Japan 0.9% (QTD, JPY)

Japan managed to eke out small gains in Q2 even as it declined meaningfully towards the end of June. The historical inverse relationship between the country's equity and currency (JPY) diminished in June; as investors turned their focus to the trade conflict.

Asia Pacific ex Japan -4.4% (QTD, USD)
Emerging Markets -8.7% (QTD, USD)

Asia saw broad-based declines as the region's export-driven economies were perceived to be more at risk of a trade induced slowdown. Weakness in the economically-dependent industrials sector (down 7% in Q2) was reflective of this. In contrast, the more defensive utilities and consumer staples experienced the least drawdown consistent with the risk-off environment.

China A-shares saw outsized declines being in the epicentre of the trade skirmish. Consistent with fears of a trade induced slowdown, the industrial and materials sectors declined the most.

Similarly, the emerging markets experienced a steep decline with losses exacerbated by a stronger dollar. The Brazilian Real and Turkish Lira each fell more than 15% against USD in Q2, emerging the region's main detractors. Commodities have been more volatile amidst a murkier outlook – the Bloomberg Commodities Index is essentially flat for the quarter. Oil is one exception, as prices made new highs for the year and providing some support for the commodity-driven economies. Russia, a major oil producer, is up about 1% in local currency terms.

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FIXED INCOME REVIEW

Similar to equities, the backdrop for fixed income reflected higher dispersion between the emerging markets (EM) and developed markets (DM). EM bonds were hurt by the risk off sentiment triggered by fears of escalating trade tensions, while DM bonds remained relatively unscathed.

Sovereign bonds fell sharply in the first half of Q2 when concerns around US-China were more muted. Italian bonds sold off over fears of unsustainable government debt and a potential exit from the single currency bloc. Political instability also put downward pressure on peripheral bonds such as in Spain, Portugal and Greece. Subsequent risk-off sentiment saw sovereign bonds staging a strong rally as EM equities declined, providing some support when our riskier positions detracted. US treasuries – being the ultimate safe haven – outperformed.

Investment Grade (IG) bonds continue to fall as credit spreads (the premium required for holding a lower credit quality bond vs a sovereign equivalent) widened from historically tight levels (rich valuations). IG bonds, conventionally deemed to be safer, did not provide much protection. This benefitted our underweight position.

Asian bonds corrected the most among the EM bonds, given that the US-China trade tensions could have an outsized impact on the relatively trade-dependent region. Coupled with weaker than expected economic data out of China, this contributed to the negative sentiment. Additionally, a stronger dollar acted as a headwind for EM and Asia companies it would make existing borrowings harder to refinance.

Emerging Market (EM) debt declined across the board. Weaker growth expectations out of China dampened commodity prices, affecting the commodity-dependent economies. Consequently, we saw bonds of the commodity-dependent Latin America (Latam) bloc coming under pressure. Bonds from Eastern Europe, Middle East and Africa did relatively better as they could be perceived to be more insulated to trade concerns.

High Yield (HY) bonds held up better as higher coupon managed to offset the widening of spreads. Within the high yield segment, emerging market bonds underperformed developed markets, which ended the quarter in positive territory. Continued strong earnings growth, and low default rates were positive factors for high yield debt in the US.

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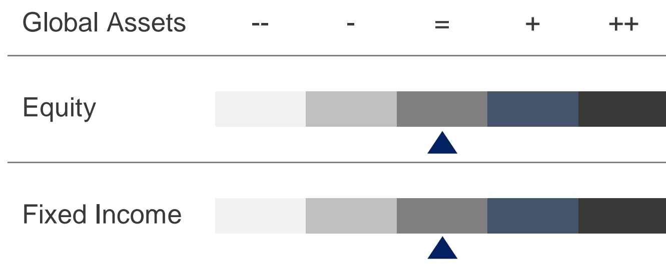
OUTLOOK AND ASSET ALLOCATION STRATEGY



Note:
--: Underweight | -: Slight Underweight | =: Neutral | +: Slight Overweight | ++: Overweight

Equity: Neutral

As the first round of tariffs are implemented, we focus on positioning for the more challenging road ahead, rather than trying to predict an outcome that we cannot control. Additionally, the US Fed has been steadfast in continuing to hike interest rates amidst low unemployment and gradual inflation.

While global economic growth has moderated, we are still now able to identify markets where valuations are more attractive, and forms the basis for our neutral equity exposure.

Fixed Income: Neutral

The underlying dynamics of the fixed income markets have become more multi-faceted. On one hand, the tightening of monetary policy by the Fed and ECB would lead to higher interest rates, and pressuring bond prices. On the other hand, the escalating trade tensions may derail the global growth story and push sovereign bond prices up.

Our strategy of identifying favourable risk/reward segments of the market guides our allocating to the high yield (HY) and EM bond markets, but with a shorter duration to reduce risks from rising interest rates. At the same time, we maintain a meaningful allocation to safe-haven sovereigns to protect our portfolio against a risk-off scenario.

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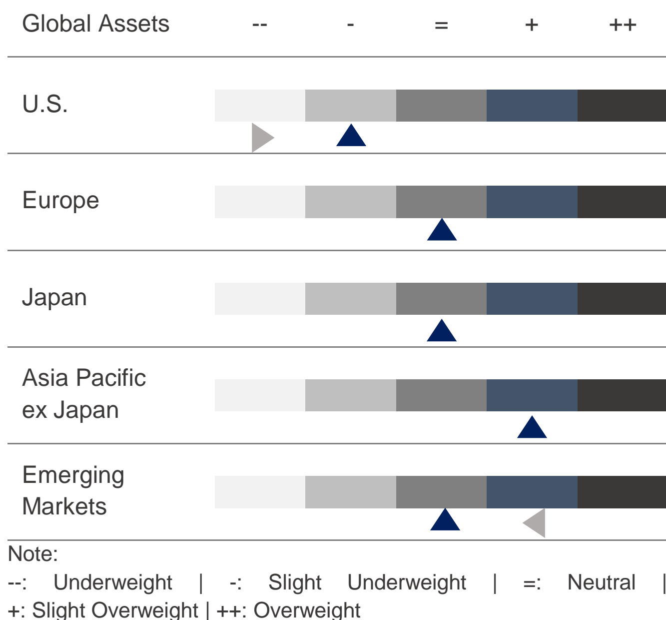
EQUITIES



United States: Slight Underweight

The ongoing trade skirmish has been a major catalyst for small-cap outperformance in the US. Being less exposed to the overseas market, they are perceived to be more insulated to potential tariffs. Though their stretched valuations may imply smaller gains going forward, **we are inclined to increase our exposure to US small-caps, where revenue has continued to grow encouragingly.** Furthermore, the macro-environment is favourable for companies that are more sensitive to the domestic recovery.

The financial sector continues to be attractively valued on a historical basis and relative to other sectors. US banks have also recently passed a rigorous stress-test by the Fed, vindicating their sound fundamentals. Interest rates have also continued to increase gradually, which should be a net positive. For these reasons are maintaining our financials exposure.

Japan: Neutral

Valuations have become even more attractive after the recent sell off. In general, revenue has also continued to trend upwards steadily. While these are positive factors, we have not yet seen a convincing catalyst for us to want to overweight the country relative to other segments, and therefore maintain our neutral exposure to Japanese stocks.

Europe: Neutral

A moderation in growth (though still in positive region), coupled with political risks around Germany and Italy has dampened sentiment for European risk assets. The more economically-sensitive banks underperformed, especially as the ECB announced that it would only raise rates towards the end of 2019 (higher interest rates are generally more favourable for banks).

We maintain our neutral exposure while continuing to monitor the prevalent risk factors.

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Asia Pacific ex Japan: Slight Overweight

A trade war would negatively impact the region, given that China is a meaningful part of Asia. While fundamentals have not yet deteriorated significantly, sentiment has undeniably took a hit. Though China A shares have undergone a particularly deep correction, valuations are now at attractive levels and should help to limit the downside.

We maintain our slight overweight exposure on a valuation standpoint.

Emerging Markets: Neutral

While EM fundamentals have not yet deteriorated significantly, the equity markets are beginning to price in the effect of potential trade tariffs and a slowdown in the growth of global exports. Furthermore, other headwinds have been gradually building up; a stronger dollar is generally less positive for the region, while commodities – that was supposed to support the resource-dependent economies – may be susceptible to a trade-induced slowdown. Perhaps more importantly, emerging market valuations are less attractive relative compared to China A, for instance.

We slightly reduce our emerging markets exposure to neutral in view of these headwinds.

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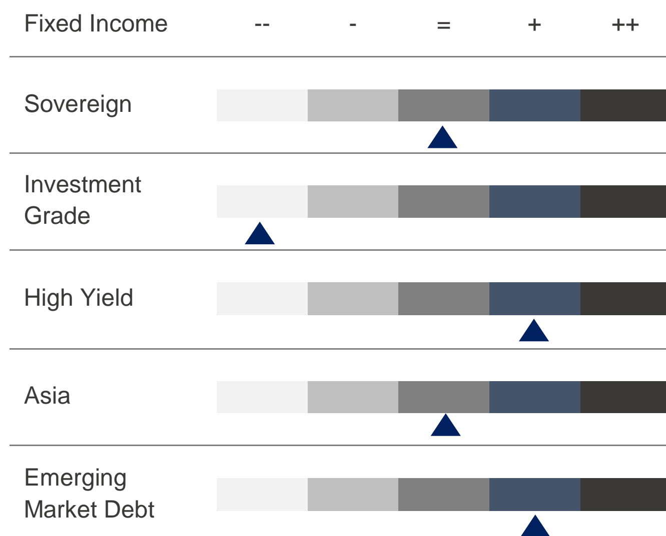
FIXED INCOME



Note:
--: Underweight | -: Slight Underweight | =: Neutral | +: Slight Overweight | ++: Overweight

Investment Grade: Underweight

Investment grade bonds are likely to underperform in most scenarios. Spreads between IG bonds and sovereign bonds are tight from a historical perspective. In the likely scenario that interest rates continue their upwards trend, the tight spreads would not be able to compensate for the negative impact from higher rates. Likewise, IG bonds would not provide much protection in a risk-off scenario as evident in the last couple of months. **We bring the allocation to Investment Grade bonds to zero**.

Sovereign: Neutral

While we are not oblivious to rising interest rates in the US and Europe (which would put downward pressure on bond prices), the risks present in the markets today justifies our meaningful exposure to the safe-haven asset. In event of a risk-off event such as a full-blown trade war, sovereign bonds (especially treasuries) would perform when other risky assets decline. **We slightly increase our allocation to sovereigns to hedge against a more uncertain market environment.**

High Yield: Slight Overweight (Short duration)

Continued strong earnings, and still low corporate default rates have continued to be encouraging for the high yield segment. Though high yield spreads have widened in the recent risk-off markets, this has been relatively contained. We continue to maintain our slight overweight to shorter duration high yield bonds which offers relatively high coupon, while being less sensitive to interest rate increases.

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Asia: Neutral (Short duration)

Asian bonds are subjected to higher uncertainty after the recent round of tariffs by US and China (early July). The region could be more exposed to contagion risks that may present themselves from the trade tariffs. Wider spreads plus cheaper currencies are presenting us with better investment opportunities. That said, we note that liquidity and flows have been less positive, and there remains further downside risks.

We maintain a neutral allocation to Asian bonds, but now targeting the shorter duration part of the market to mitigate interest rate risks.

EM: Slight Overweight (Short Duration)

EM bonds have suffered large sell-offs in the last few months. Besides the negative impact from rising interest rates and widening credit spreads, EM bonds have also been impacted by the latest threat of tariffs. That said, our shorter duration bias has experienced less volatility, whilst still offering relatively high coupons. We continue to maintain our slight overweight to EM debt.

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RETURNS AS AT 30 JUNE 2018

Regional Equity	MTD	QTD	YTD
Global	-0.7%	-0.1%	-1.5%
US	0.5%	2.9%	1.7%
Europe	-0.8%	2.4%	-2.4%
Japan	-0.9%	0.9%	-4.8%
Asia Pacific ex-Japan	-4.1%	-4.4%	-5.4%
Emerging Markets	-4.6%	-8.7%	-7.7%

Fixed Income	MTD	QTD	YTD
Global Aggregate	-0.4%	-2.8%	-1.5%
High Yield	0.4%	0.9%	-0.3%
Asia	-0.5%	-1.2%	-2.4%
Emerging Market Debt	-0.7%	-2.4%	-3.8%

Currencies	MTD	QTD	YTD
USD/SGD	1.9%	3.9%	2.0%
EUR/SGD	1.8%	-1.5%	-0.8%
JPY/SGD	0.1%	-0.3%	3.8%

Commodity	MTD	QTD	YTD
Gold	-3.5%	-5.4%	-3.8%
WTI Crude	10.6%	14.2%	22.7%

Country	MTD	QTD	YTD
Australia	3.0%	7.6%	2.1%
Brazil	-5.2%	-14.8%	-4.8%
China “A”	-7.7%	-9.9%	-12.9%
China “H”	-7.6%	-7.7%	-5.4%
Hong Kong	-5.0%	-3.8%	-3.2%
India	0.3%	7.4%	4.0%
Indonesia	-3.1%	-6.3%	-8.8%
Korea	-4.0%	-4.9%	-5.7%
Malaysia	-2.8%	-9.2%	-5.9%
Russia	-0.3%	1.1%	8.8%
Singapore	-4.7%	-4.6%	-3.9%
Taiwan	-0.3%	-0.8%	1.8%
Thailand	-7.6%	-10.2%	-9.0%

Sector	MTD	QTD	YTD
Gold equity	-0.3%	1.6%	-4.1%
Energy equity	0.6%	12.7%	5.3%
Technology	-0.5%	5.6%	8.9%
Healthcare equity	1.3%	2.4%	0.6%
Financial equity	-2.0%	-3.6%	-4.9%

Source: Bloomberg
All returns in index currency terms.

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