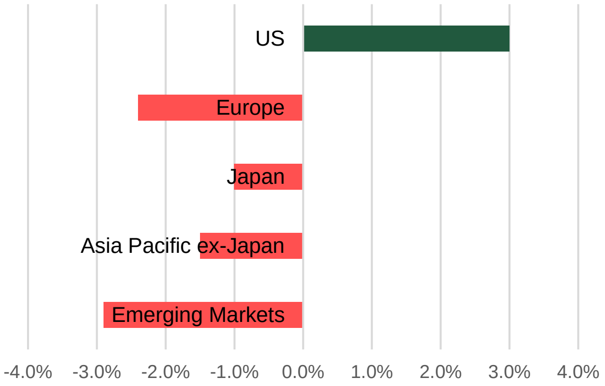
Monthly Commentary

All data as at 31 August 2018 September 2018

EQUITY REVIEW

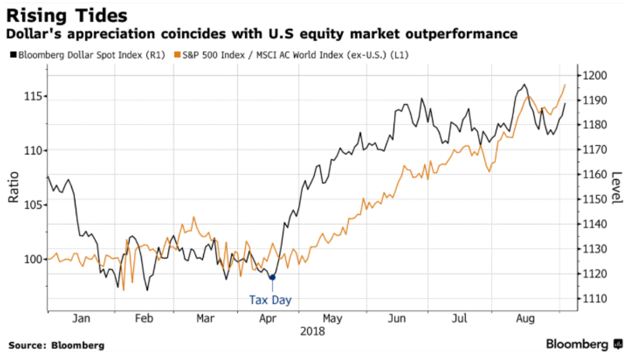
Global Equity 0.6% (USD)



Source: Bloomberg

United States 3.0% (USD)

US stocks ended the month at record highs, driven by relatively strong economy and corporate earnings. The tech and healthcare sectors drove most of these gains, while energy and materials lagged. Small-cap stocks extended their dominance year-to-date, being perceived to be less exposed to the global trade tensions. Dollar strength has been a major theme impacting global equity, fixed income and commodity markets.



Asia Pacific ex Japan -1.5% (USD)

Emerging Markets -2.9% (USD)

Equity returns continue to be dispersed across the Asian countries. While the technology sector was a main driver of performance for South Korea and Taiwan, tech stocks contributed to most of the losses in China – Alibaba, Baidu, and Tencent were all down meaningfully.

Emerging market equities came under renewed pressure the past month, as Turkey and Argentina faced a currency crisis. Both the Turkish Lira and the Argentina Peso fell more than 20% against the USD in a matter of days. Brazil and South Africa emerged the main detractor to the emerging market index, falling 11.4% and 8.7% when measured in USD terms, respectively.

Commodities saw broad declines in August as trade tensions begin to affect demand. Industrial metals fell with copper trading near 52-week lows. Crude oil prices were marginally higher, supported by supply concerns stemming from Venezuela and Iran.

Europe -2.4% (EUR)

Cyclical sectors led declines in Europe – energy, materials, and financials were meaningfully lower over the month. European banks were under pressure as markets fret about their exposures to stressed Turkish or Italian assets. The technology sector was the sole performer in August, as investors continue to reward companies with high-growth prospects.

Japan -1.0% (JPY)

Tech and healthcare stocks led the way in Japan, echoing the broader pattern around stock markets globally. The Japanese Yen gained marginally as investors grappled with uncertainty caused by protracted trade tensions.

FIXED INCOME REVIEW

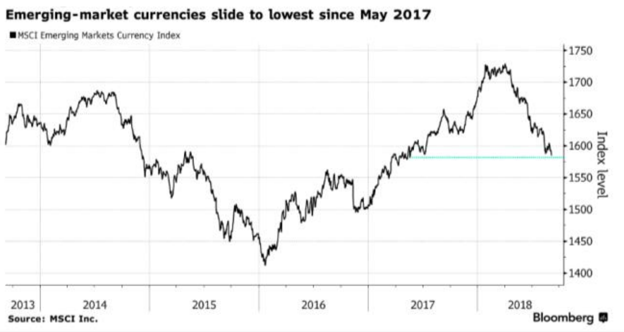
Sovereign

Major-market sovereign bonds rallied, led by the US, as risk aversion rose in Emerging Markets (EM), benefitting our overweight in currency-hedged investment grade bonds. Trump stepped up his pressure on trade issues with China, and commented that the Fed should not be aggressively hiking interest rates.

A confluence of idiosyncratic risks from markets including Argentina, Venezuela, South Africa, Russia and Turkey, were relatively contained, but contributed to market uncertainty. These put downward pressure on EM equities, debt and currencies, as investors sought refuge in sovereign bonds.

Investment Grade

Gains in Investment Grade (IG) bonds were driven by sovereign bonds. Credit spreads in corporate bonds continued to widen from stretched levels in February, reflecting weakness in overpriced assets during periods of concern. Year to date, corporate bonds have underperformed, benefitting our underweight in the segment.



High Yield (HY)

High Yield (HY) bonds performed the best among the major fixed income segments, contributing to our overweight position. US high yield debt, which represents a large part of our exposures, performed well on strong corporate earnings and demand from investors. The three major sources of returns for investors in fixed income: coupon, tightening of yields and credit spreads, all contributed.

Asian bonds

After being sold down in the first half of the year, USD-denominated Asian bonds were more robust amid the volatility in August. While there are concerns of contagion, the market has been signalling that near-term impact on Asian economies could be limited. Continued inflow from real money investors managed to offset outflows from leveraged investors and corporates.

Emerging Markets Debt (EMD)

EMD came under pressure in August, with the most pain felt in currencies. In addition to the tweets by Trump which eroded sentiment, idiosyncratic domestic events further added to the selling pressure.

Venezuela, the oil-rich but cash-poor nation, devalued its currency by around 96% in a radical attempt to end a prolonged period of economic turmoil and hyperinflation. The Turkish Lira was under tremendous selling pressure as the market is not convinced that the central bank and the government are able to contain the skyrocketing inflation and stabilise the ailing banking sector. Brazil also came under pressure with heightened geopolitical risks from impending presidential election. Correction in commodities prices also added to the woes in EMD.

While our EMD overweight detracted, our positions in short duration significantly mitigated the downside. There has been large dispersion in the EMD complex, with short duration down 1.3% YTD, while EM local currency bonds are down 11.7%.

OUTLOOK AND STRATEGY

August was another positive month for tech stocks, as investors continue to favour high-growth sectors over economically-sensitive ones amid global trade tensions. Trump's trade rhetoric and sanctions has led to a bifurcation of performance between the US and the rest of the world, with developing countries suffering the most the past month.

Equities

US equities continued to be resilient alongside a robust domestic economy, even as markets elsewhere were more tumultuous. Q2 GDP was most recently revised upwards to 4.3 percent, with corporate earnings broadly chugging along. Earlier this year, we increased our exposure to US small-growth (from the emerging markets) on robust corporate fundamentals, even as we acknowledged valuations were on the high end. This decision has benefitted us greatly since then, with the small-growth index returning about twice the broader S&P 500 index (18.2% vs 9.8%) year-to-date. That said, we pay particular attention to any potential slowdown in fundamentals, especially as valuations are increasingly unattractive relative to other markets which have corrected significantly.

Amidst the on-going global trade tensions, **Europe equities** have also suffered from political woes out of Italy. Italy's current populist government has proposed to increase spending, and which has led to political tensions over the upcoming budget proposal in October – Italian equities fell alongside bonds in response. As a whole, the intertwined financial sector was the main detractor the past month, as markets worry about any exposure to stressed assets; such as Italian or Turkish bonds.

Investors have continued to shun **Japanese** equities even as corporate earnings have remained steady, and where valuations have become even more attractive after the sell-off over the past few months. An on-going concern is the pull-back of support from the Bank of Japan (BoJ), though this is likely to be some time away. We continue to watch out for any catalyst that would prompt us to review our neutral allocation.

Asia continues to be dragged down by China, as it faces the brunt of Trump's tariffs. We had earlier maintained our allocation to China 'A' shares based on attractive valuations, and where fundamentals had not deteriorated sharply. While this largely remains true today, we expect volatility to remain elevated until there is better clarity on the trade situation. We are watching out for a meaningful deterioration in corporate fundamentals, and market conditions that would prompt us to review our thesis.

Performance across the **emerging markets** were more dispersed recently. A stronger dollar, coupled with trade tensions, have brought scrutiny on countries with high levels of external debt – Argentina, Turkey, Brazil, and South Africa are a few examples. On the other hand, South Korea and Taiwan have been more resilient as a result of their healthier fiscal position. The sell-off may present opportunities for active allocation where negative sentiment goes ahead of true fundamentals.

Fixed income

As pockets of stress start to emerge, we are seeing higher volatility among the various segments in fixed income. Central bank tightening is expected to contribute volatility as markets position for weakness in sovereign bonds but flock back to them in times of stress. The Fed is expected to continue to raise rates into 2019. After the European Central Bank (ECB) completes winding down its QE program by 2018, it is expected to start raising rates in middle of 2019. Idiosyncratic risks in EM markets with weak fundamentals, e.g. Turkey, Venezuela, may persist for a while. Our allocation to **sovereign bonds** is to provide insurance to the portfolio if downside persists in the risky asset classes. Sovereign bonds typically perform well in a risk-off environment.

We maintain our underweight in **Investment Grade (IG)** corporate bonds. The incremental coupon over sovereign bonds is insufficient to compensate for the credit risk. The tight credit spreads are not sufficient to cushion the price loss if interest rates were to rise further. Markets seem to be agreeing as credit spreads continue to widen, rendering investment grade corporate bonds as a poor option for a flight to quality asset. In a risk-on environment, other bond segments with more room for spreads to tighten (less over-valued), would offer better risk-adjusted returns than IG bonds.

The growth cycle continues to support a robust US economy, with corporates reporting favourable earnings. This trend is likely to continue into 2019, and **High Yield bonds** are expected to outperform in this environment. At the same time, default rates remain at low levels, reflecting the ability of high yield borrowers to service their debt. Similar to EMD and Asian bonds, we maintain a short duration bias in light of central bank tightening.

Emerging market debt (EMD) came under pressure in August. So far, these have been limited to certain EM countries with weak economic fundamentals and fiscal mismanagement. Collectively, they are also not significant drivers of emerging markets relative to the major economies. Fundamentals generally remain favourable in major EM countries. Opinions are divided as to whether these will escalate into a contagion for emerging markets; certain quarters maintain that "this time is different". On the other hand, we are reminded of how prior EM crises have started from relatively innocuous stresses.

Having cut our Emerging Market equity overweight earlier, our portfolios are in a better position to manage the current uncertainty. With the recent sell-off, certain pockets of opportunity are presenting themselves, which we look to capture if the situation does not deteriorate.

After being sold down for most of the year, **Asian bonds** continued to recover in August as valuations were less stretched than before. Unlike EM economies in other regions, fundamentals in Asian countries remain strong. Despite a slowdown in the Chinese economy, balance of payments is constructive for most Asian countries. Recent credit tightening policies by the Chinese authorities, while creating pain for certain weak and levered companies, is good for credit markets in the longer term. We maintain our exposure to Asian debt markets via short duration bonds to dampen volatility and reduce interest rate risks.

MARKET PERFORMANCE

Regional Equity	MTD	YTD
Global	0.6%	1.9%
US	3.0%	8.5%
Europe	-2.4%	-1.8%
Japan	-1.0%	-4.5%
Asia Pacific ex-Japan	-1.5%	-6.1%
Emerging Markets	-2.9%	-8.8%

Fixed Income	MTD	YTD
Global Aggregate	0.1%	-1.5%
High Yield	0.8%	1.7%
Asia	0.5%	-1.2%
Emerging Market Debt	-1.3%	-3.6%

Currencies	MTD	YTD
USD/SGD	0.8%	2.7%
EUR/SGD	0.0%	-0.8%
JPY/SGD	1.3%	3.9%

Commodity	MTD	YTD
Gold	-1.9%	-7.8%
WTI Crude	1.5%	15.5%

Country	MTD	YTD
Australia	0.6%	4.2%
Brazil	-3.2%	0.4%
China “A”	-5.2%	-17.3%
China “H”	-1.4%	-7.1%
Hong Kong	-2.4%	-6.8%
India	2.8%	13.5%
Indonesia	1.4%	-5.3%
Korea	1.2%	-5.9%
Malaysia	2.0%	1.3%
Russia	1.1%	11.2%
Singapore	-3.2%	-5.6%
Taiwan	0.1%	4.0%
Thailand	1.2%	-1.8%

Sector	MTD	YTD
Gold equity	-12.5%	-19.8%
Energy equity	-3.8%	2.7%
Technology	6.4%	18.1%
Healthcare equity	2.8%	9.7%
Financial equity	1.2%	1.2%

Source: Bloomberg. All returns in index currency terms.

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