Quarterly Investment Outlook
Q4 2018

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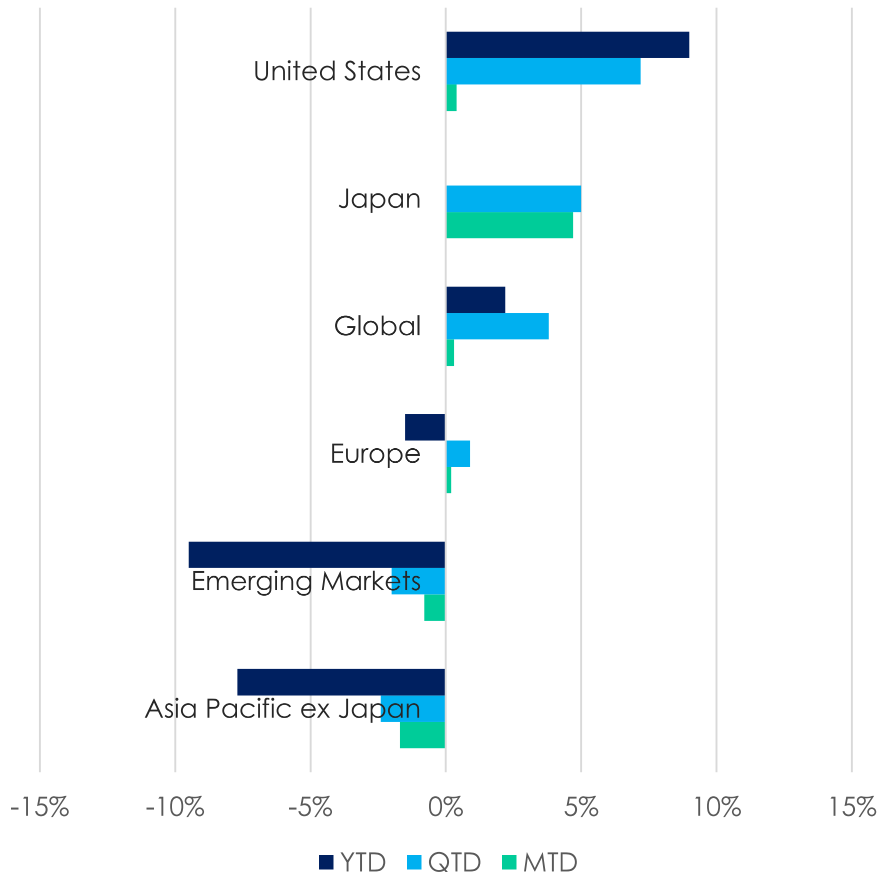
Market Review: Equities

Regional Equity Performance



Returns in index currency terms as of 30 Sep 2018. Source: Bloomberg

US equities have outperformed for most of the year, underpinned by robust economic data and strong corporate earnings. The high-growth tech sector continues to drive most of the returns. Familiar names like Apple +22%, Microsoft +16%, and Advanced Micro Devices +106% were up strongly in Q3. US small-cap stocks rallied strongly in the first half of the year, before turning down sharply towards the end of the quarter. Where our allocation to high-growth small-cap stocks had benefitted us for most of the year, we gave back a meaningful portion of this outperformance over the past month. Japan equities rallied strongly in September (+4.7%) after lagging other developed markets in the earlier part of the year.

Performance outside of the developed markets were less encouraging. China led declines in Asia amidst trade tensions and a deleveraging campaign, which may threaten China's growth story. While this position has detracted, current valuations have reached close to their historical lows. At this time, we are maintaining our active allocation, as long as corporate earnings continue to hold up. Emerging markets have also continued to be volatile. As the dollar strengthened, countries with weaker fundamentals were affected the most. Argentina and Turkey were two of the worst performers, as their currencies plunged and leading to a capital flights of sorts - both markets are down about 50% this year in USD terms, though they have stabilised more recently. Our earlier decision to reduce exposure to the emerging markets has helped to minimize losses in our portfolios.

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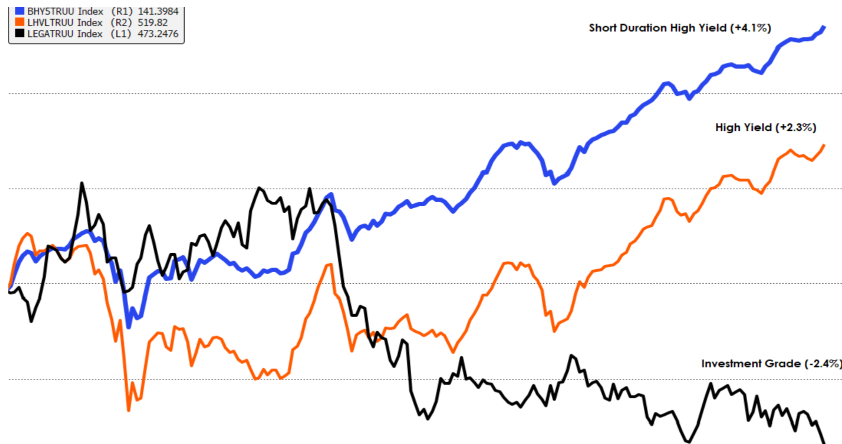
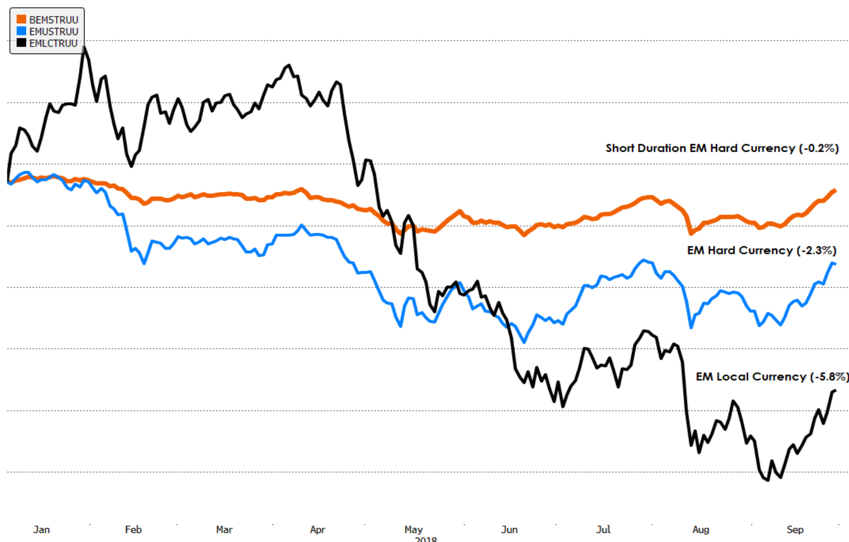
Market Review: Fixed Income

Short duration high yield bonds led the way in the US



Short duration hard-currency EM debt outperformed



Source: Bloomberg

High yield bonds have outperformed other fixed income segments this year, benefitting our active allocation there. Our specific exposure to short duration high yield gained 4.1% YTD, almost double that of broader high yield markets with 2/3 of the volatility. Investment Grade (IG) corporate bonds are down 2.4% YTD, reflecting the poor risk/reward that we have identified from mid-2017, and maintained underweight exposures since.

Emerging markets have been a cause of widespread concern, given headlines on trade wars, hyperinflation, currency devaluation etc. Performance in the Emerging market Debt (EMD) complex has been wide ranging; YTD hard currency bonds are down 2.3%, while local currency bonds are down 5.8%. Our specific exposure to short duration EMD has been resilient amid the challenges buffeting EM markets, with no losses for the year.

Sovereign bonds, which typically serve as flight to safety assets, are facing headwinds from central bank tightening. Recall that as rates go up, bond prices go down. Most segments of the investment grade bond complex comprising sovereign and corporate bonds are down around 3% YTD. Our exposure to hedged global investment grade bonds, focused on sovereigns, is flat YTD, which is a fair price to "pay" for flight to safety.

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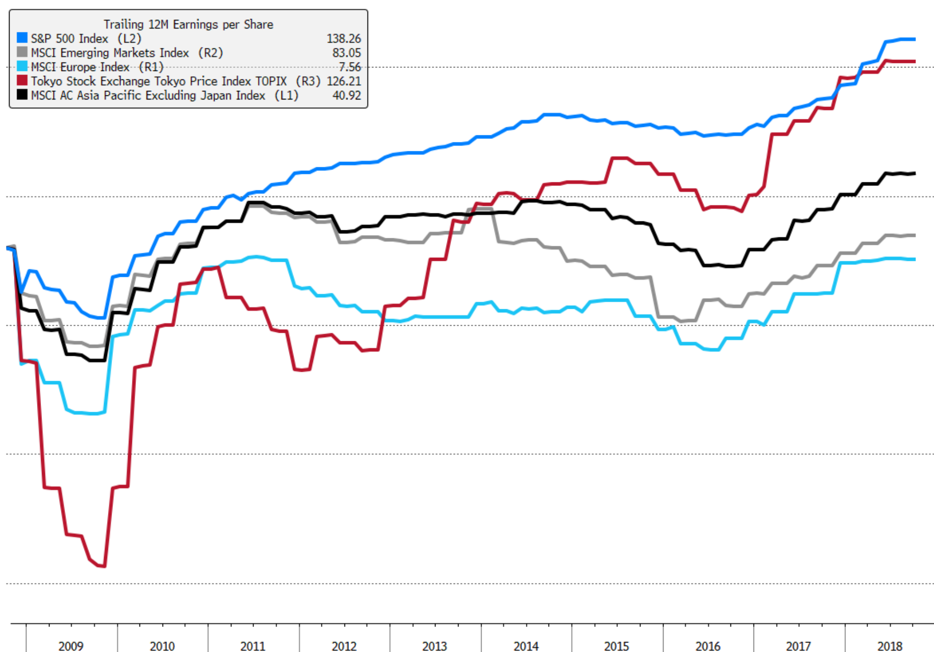
Key Themes: Riding on late-stage growth

Earnings are continuing to grow meaningfully today



Source: Bloomberg

Towards the end of 2017, a popular narrative was that the world has entered a synchronised growth environment that would propel risk assets much higher going forward. While it has not been the smooth ride that most investors were expecting, there are areas in the market which are exhibiting late-stage growth characteristics that may present us with interesting opportunities.

Corporate earnings and sales have continued to trend upwards strongly, with the US at the front of the pack. This effect is even stronger in the high-growth markets where we have a bias to: US small-growth, Europe growth and China 'A'. Recently, we are concerned about the ability of small businesses in the US to continue to grow at their blistering pace, especially when they face a less accommodative environment. Increasing borrowing costs arising from higher interest rates, and rising wage bills from historically low unemployment, do not bode well for the large debt burden that some of these companies have taken on. Large-caps, such as the big boys in the billion or *trillion* dollar club (hello, Apple and Amazon), generally have better access to financing and more capacity to adjust in a tighter environment. **Hence, we re-allocate our US exposure from the small-growth to the large-cap segment of the market.**

There is increasing evidence to suggest that Prime Minister Shinzo Abe's efforts to stimulate Japan's economy may be more sustainable. Earnings are robust, with profit margins hovering at their all-time-high. There is a further boost from corporate reforms as evident from increased dividend pay-outs. **Evidence of structural improvements in the economy, and where valuations are attractive prompts us to increase our allocation to Japan.**

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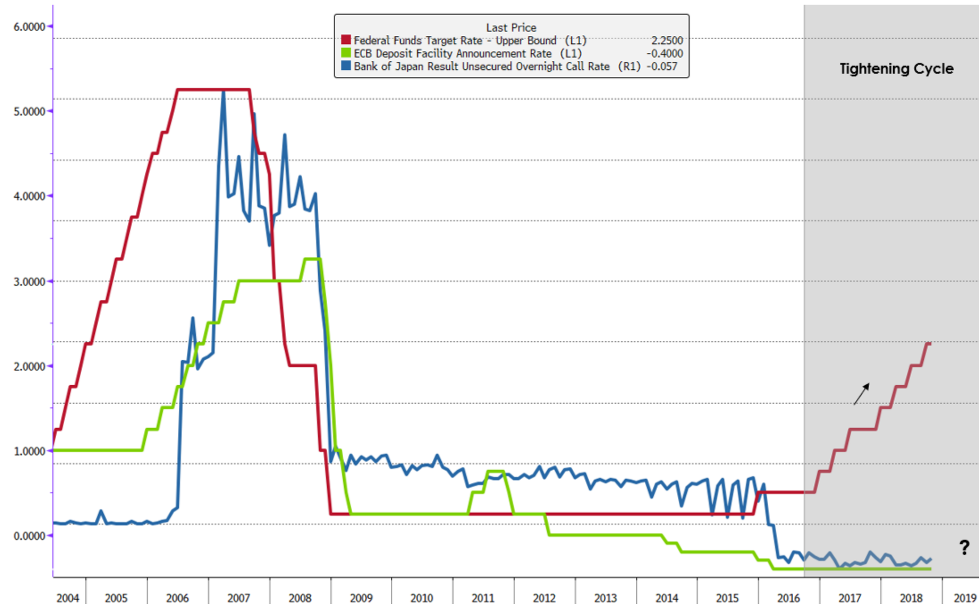
Key Themes: Central bank tightening

Japan and Europe to follow US to hike interest rates?



Source: Bloomberg

Central banks continue to act on their mandate to manage the undesirable aspects of growth, such as inflation and irresponsible investments fuelled by cheap money. The Fed continues its rate hike cycle, while the ECB and BoJ are biding their time to commence their own hikes as they seek signs of overheating in their respective economies.

Short duration: "Interest rates rise, bond prices go down"; this is one of the fundamental tenets in markets. Short duration bonds have less sensitivity to rate hikes than long duration bonds. To continue to earn coupon while mitigating interest rate risk, we reduce portfolio duration by focusing on short duration exposures in high yield and emerging market bonds.

Financials: The good thing about investing is there are always two sides to the coin. While rising rates present a challenge to bond investments (which have been mitigated through short duration), financial equities respond favourably to rising rates. A bank's business model is essentially borrowing at a lower rate and lending out at a higher rate to businesses and consumers. As interest rates rise in a growth environment, banks' earnings are expected to increase as they earn more interest income.

Does it make sense to hold sovereign bonds when there are headwinds in the form of central bank tightening? Just as everyone has insurance to cater to rainy days, or pay for airbags in their cars, sovereign bonds play an important role in buffering portfolio volatility during periods of stress. Like any consumer, we want our choice of "insurance" to be effective while limiting opportunity cost. We maintain our exposures to hedged global investment grade bonds as a more efficient exposure to manage portfolio volatility.

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Key Themes: Search for yield

Years of low rates post the 2008 crisis have resulted in cyclically lower rates of return for many assets. In such environments of low deposit rates and desire to beat inflation, investors are on the constant lookout for opportunities that offer an incremental return over cash. Sometimes, these efforts don't work out well; there are instances of investors losing their entire investment (and even their lives) after betting on opportunities promising high returns without understanding the risks. We take a more measured approach to the search for yield, while managing associated risks.

High yield: As US high yield bond markets have appreciated and contributed to the portfolios, they have become less attractive from a valuation standpoint. Unattractive valuations do not necessarily mean that markets will not continue to go up, but it is expected that any appreciation will be moderated. Hence it is more prudent to switch to other opportunities.

EM bonds: The long-term fundamentals for emerging markets are well-known, particularly as many of our investors are based in the region, and are able to live and breathe the opportunity. There are many ways to participate in the EM opportunity; from hard currency investment grade to local currency high yield bonds. We do not just buy into a story; assessing the benefit and risk is inherent in our process (and DNA).

We have not been enthused with Asian bonds for some time due to unattractive valuation. Being disciplined on valuation paid off as other investors who embraced Asian and local currency bonds have had to nurse losses most of this year. We prefer to be patient, waiting for an environment when the risk/reward is attractive. This has presented itself recently as Asian bonds have corrected to more attractive levels.

While "investment grade" reflects higher quality bonds, there can be sustained periods where high quality is unjustifiably expensive. As such, IG corporate bonds have limited upside potential, and lack the safe-haven attributes of government bonds. We do not like such poor odds, and believe our investors don't as well. Hence, we are funding our overweight allocation from the investment grade corporate segment.

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Key Themes: How are we positioned?

Late-stage growth	Central bank tightening	Search for yield
US Large-Growth equities	Financial equities	High-yield short-duration bonds
Europe Large-Growth equities	Short duration fixed income	Emerging market short-duration bonds
Japan equities		
China 'A' equities		

Volatility and interim mark-to-market losses are part and parcel of the journey in compounding wealth. Our tactical calls in recent years have played out well; we expect to be more right than wrong but we are never under the illusion that they will always work.

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Asset Allocation Strategy

Equity Regional	--	-	=	+	++	Allocation strategy
United States		Current				Large cap growth to capture late stage economic growth, and where large caps are more resilient to rising financing and wage costs. Financials to benefit from rising rates and increasing interest income.
Europe		Current	Previous ←			Reducing large cap growth as valuations are on the higher end.
Japan			Previous →	Current		Adding exposure as economy is supported by structural growth arising from corporate reforms, and equities at attractive valuations.
Asia Pacific ex Japan				Current		Maintaining exposure to China 'A' as valuations are attractive and supported by earnings growth.
Emerging Markets			Current			Earnings are expected to slow, and valuations are de-rating from high levels.

Fixed Income	--	-	=	+	++	Allocation strategy
Sovereign			Current			Focus on hedged global government bonds to buffer portfolio volatility during periods of stress.
Investment Grade	Current					Maintaining no exposure as Incremental yield does not sufficiently compensate for rich valuation.
High Yield			Current	Previous ←		Realising gains as valuations have become less attractive with recent outperformance. Maintain short duration to mitigate rate hike impact.
Asia			Previous →	Current		Adding exposure as valuations have improved significantly after being relatively overvalued from 2017. Maintain short duration to mitigate rate hike impact.
Emerging Market Debt				Current		Valuations continue to be attractive amid improving sentiment. Maintain short duration to mitigate rate hike impact.

Notes: - - Underweight - Slight Underweight = Neutral + Slight Overweight + + Overweight

Current | Previous

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Market Index Returns

Equity Regional	MTD	QTD	YTD
Global	0.3%	3.8%	2.2%
United States	0.4%	7.2%	9.0%
Europe	0.2%	0.9%	-1.5%
Japan	4.7%	5.0%	0.0%
Asia Pacific ex Japan	-1.7%	-2.4%	-7.7%
Emerging Markets	-0.8%	-2.0%	-9.5%

Fixed Income	MTD	QTD	YTD
Global Aggregate	-0.9%	-0.9%	-2.4%
High Yield	0.5%	2.6%	2.3%
Asia	-0.1%	1.1%	-1.3%
Emerging Market Debt	1.3%	1.6%	-2.3%

Currencies	MTD	QTD	YTD
USD/SGD	-0.4%	0.3%	2.3%
EUR/SGD	-0.3%	-0.4%	-1.2%
JPY/SGD	-2.5%	-2.3%	1.3%

Commodity	MTD	QTD	YTD
Gold	-0.7%	-4.8%	-8.5%
Oil (WTI Crude)	4.9%	-1.2%	21.2%

Equity Countries	MTD	QTD	YTD
Australia	-1.8%	0.2%	2.3%
Brazil	3.5%	9.0%	3.8%
China "A"	3.1%	-2.1%	-14.7%
China "H"	1.3%	-0.5%	-5.9%
Hong Kong	-0.4%	-4.0%	-7.1%
India	-6.3%	2.3%	6.4%
Indonesia	-0.7%	3.1%	-6.0%
Korea	0.9%	0.7%	-5.0%
Malaysia	-1.5%	6.0%	-0.2%
Russia	5.5%	7.8%	17.3%
Singapore	1.4%	-0.4%	-4.3%
Taiwan	-0.5%	1.6%	3.4%
Thailand	2.0%	10.1%	0.2%

Equity Sectors	MTD	QTD	YTD
Gold	-0.2%	-16.6%	-20.0%
Energy	2.4%	-0.1%	5.2%
Technology	-0.5%	7.9%	17.5%
Healthcare	1.9%	11.2%	11.8%
Financials	-2.4%	3.9%	-1.2%

Returns in index currency terms as of 30 Sep 2018. Source: Bloomberg

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