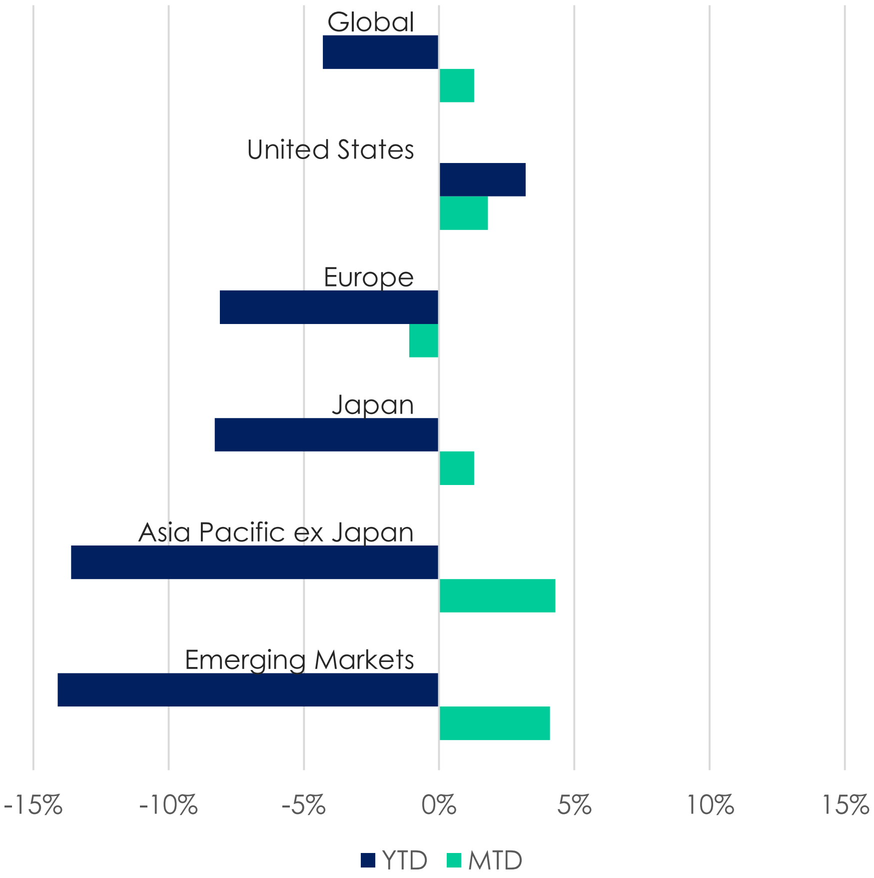
Monthly Investment Update
December 2018

finexis

Market Review: Equities

Regional Equity Performance



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

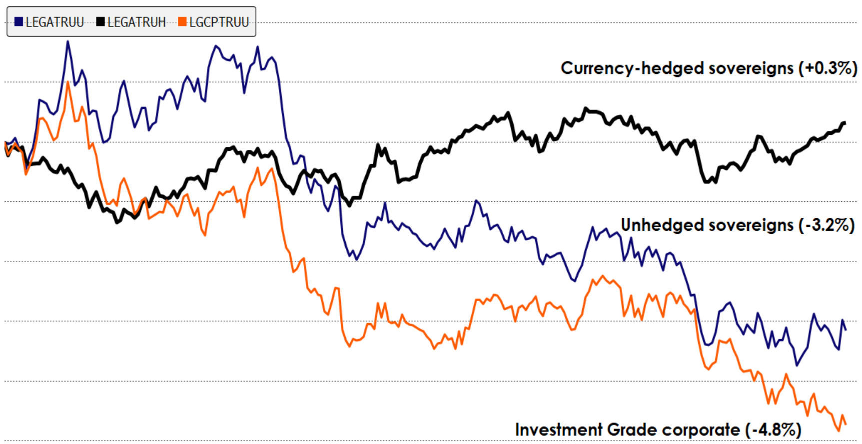
Equity markets recovered some of October's losses, even as concerns over a global growth slowdown continue to mount. Notably, the biggest losers in the year, emerging markets, had the strongest gains over the past month, as they also recovered off a lower base (in terms of valuations) relative to developed markets. While we do not proclaim smooth sailing from here on, it is fair to say that markets are already pricing in much of investors' concerns today. Risk-assets were also supported by remarks made by the Fed chairman, to which markets interpreted as the US central bank taking a more accommodative monetary policy stance.

The dispersion of performance across sectors may reflect more risk-averse behaviour recently. Across most of the major markets, defensive sectors (utilities, consumer staples, healthcare) shone, while sectors more geared to the economy (consumer discretionary, energy) lagged behind in the past month. Our earlier decision to reduce exposure to European equities benefitted, as the region was the only one out of the major markets to post declines in November - political risks alongside a softening economy continue to be headwinds for Europe.

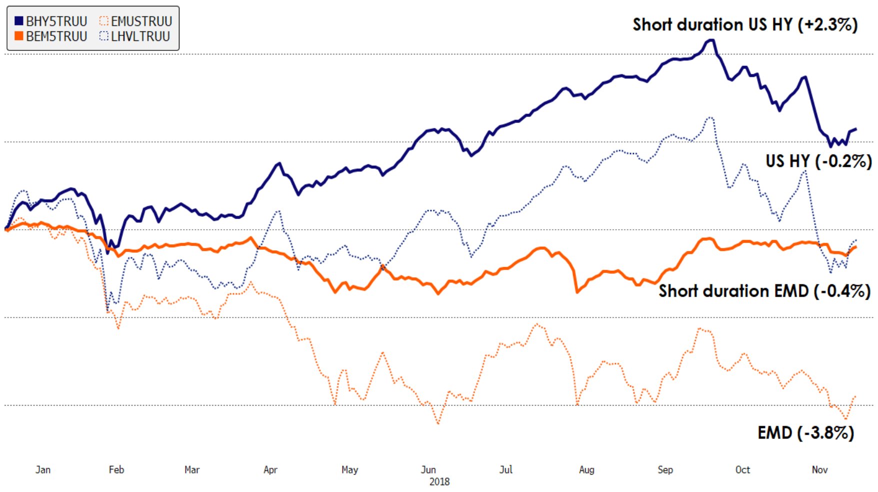
Asia and emerging market (EM) indices rebounded strongly, contributing to our portfolio performance. China equities (a meaningful part of the Asia and EM indices) surged close to 5% over the past month leading up to the highly anticipated meeting between the US and China presidents.

Market Review: Fixed Income

Currency-hedged sovereign bonds resilient under stress



Short duration debt outperformed for both US high yield and EMD



Source: Bloomberg

Managing portfolios is like mixing ingredients with the right balance in order to prepare tasty dishes. Too much spice may create unbearable pain, too little spice will result in the dish being too bland. Our portfolios consist of two major types of "ingredients": spicy risk assets such as equities to provide the upside gains, and safe haven components such as sovereign bonds to mitigate the downside in times of market volatility. Every once in a while, the spicy and safe parts of the portfolio can both be profitable, which was what happened in November.

Global economies are in the late stage of the business cycle. Encouraging signs continue to come from strong corporate earnings, as reflected in November's bounce in equity markets. However, markets are also particularly sensitive to credit tightening that can derail growth. Credit concerns came to the fore in November as investors worried about companies' ability to sustain debt amid rising rates and maturing economic growth.

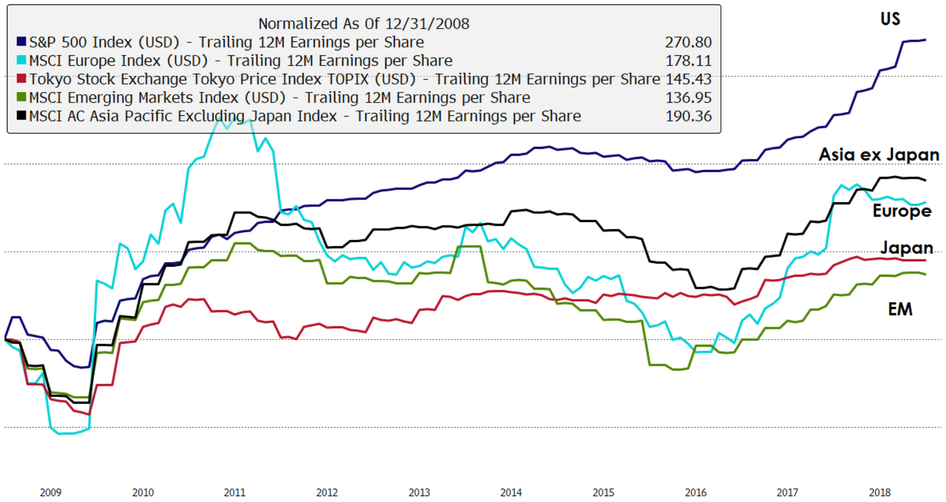
US high yield bonds came under pressure amid the risk-off sentiment and falling oil prices. We had cut the overweight position previously on high valuation and this proved to be timely. Our specific exposure to short duration high yield bonds also mitigated downside losses. Emerging market debt (EMD) was caught in the tussle between emerging market equity rebound and credit concerns, ending the month slightly negative. Nevertheless, our exposure to short duration EM debt ended the month slightly positive.

It would be nice (but not realistic) to report outperformance in all parts of the portfolio. Our overweight position in Asian high yield bonds detracted (the underlying fund declined 0.12%) as spreads widened in line with credit concerns. This mitigating of the downside is aided by the focus on valuation, with a high running yield of 9% compensating for the spread widening.

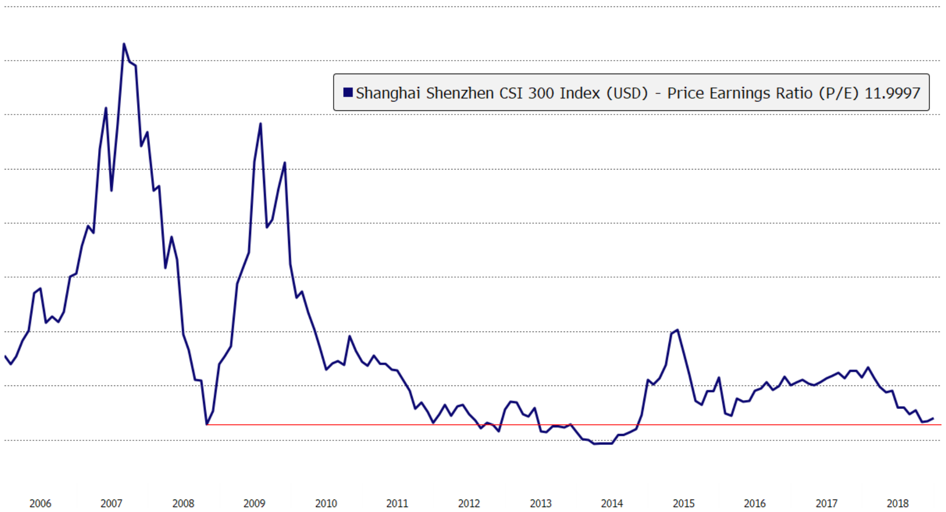
Our safe haven exposure to currency-hedged sovereign bonds paid off amid the risk-off environment in credit markets. Dovish statements on interest rate policy from Fed Chairman Powell gave an additional boost to sovereign bonds.

Key Themes: Late-stage growth

Earnings have held up so far



China 'A' valuations are close to historical lows



Source: Bloomberg

It is increasingly looking like we will be entering 2019 without the optimism around the markets a year ago. Back then, the world was thought to have entered a synchronised growth environment that would propel risk assets much higher. Since then, we observed growth stalling for a few economies, while others like the US have continued to chug along. Our active approach is to be more selective in allocating to areas of growth, reducing exposure to areas with declining growth and unfavourable valuation, while being exposed to growth markets that present better value after their price declines.

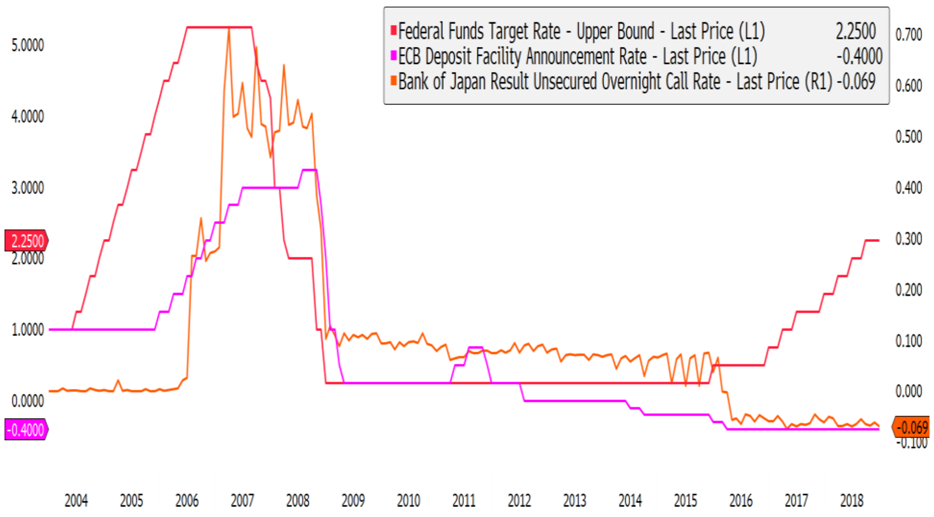
While investor sentiment has taken a turn for the worse, what has not changed is that corporate earnings in the US have continued to grow alongside a fairly robust economy; and in particular for the large-growth companies that we have allocated to. In contrast, other economies are showing more meaningful signs of a slowdown. We had earlier reduced our exposure to Europe, where declining economic activity poses a headwind for already weakening corporate earnings. While growth in Japan has moderated, we maintain our exposures on attractive valuations and evidence of structural improvements in the economy.

The risk of a China slowdown is balanced by attractive valuations. For most part of the year, markets have been quick to price-in the weakening of economic and business conditions, as well as any developments around the trade tensions. Consequently, China 'A' valuations are near historical lows, compelling for investors who like good risk/reward. We are monitoring for easing in credit conditions as a catalyst for a more sustainable rally and outperformance. In the meantime, we expect heightened volatility as investor sentiment continues to remain weak.

Key Themes: Central bank tightening

Central banks continue to act on their mandate to achieve balanced growth with managed inflation, and at the same time avoid undesired outcomes of speculative investments due to abundance of liquidity. Historically low levels of interest rates mean that central banks want to hike rates. However, global growth is less synchronised now compared to 2017. Moderating growth momentum in the US could lead to the Fed slowing the pace of tightening in 2019. Signs of slowdown in the Eurozone mean that the ECB will be more measured in hiking interest rates.

Japan and Europe to follow US to hike interest rates?



Source: Bloomberg

Short duration: Fixed income investing amid a rate hike cycle is like paddling upstream. Focusing on short duration effectively reduces the speed of the current, while risk-adjusted yields in high yield and emerging market bonds provide extra propulsion against the current. This decision has been positive as short duration bonds have outperformed long duration bonds in 2018. As interest rates are still on the rise, it is prudent to maintain short duration exposure.

Financials: Conventional wisdom is that rising interest rates are beneficial for banks, whose business model rely on higher interest rates to earn higher profits. While this has mostly played out in supporting bank earnings and fundamentals, concerns over a slowdown in growth have led to financial stocks underperforming. One could protest that markets are not reflecting financial sector fundamentals. We maintain our exposure as valuations are attractive, but look to revise the view where fundamentals shift e.g. increasing evidence of recession.

Sovereign bonds: 2018 has been an eventful year where many spicy asset classes saw volatility and losses, and a good illustration of how safe haven assets can mitigate the downside. Currency-hedged sovereign bonds are one of the few global asset classes that are positive year to date. With global trade friction, volatility in oil prices, uneven growth path among countries, and rising interest rates, we expect financial markets to be challenged from time to time. Hence, maintaining appropriate exposure to currency-hedged government bonds is prudent from a portfolio standpoint.

Key Themes: Search for yield

Higher yields today compared to the start of the year

	31 Dec 2017	30 Nov 2018
Asia HY	5.6%	9.2%
US HY short duration	5.7%	7.1%
EM short duration	4.0%	5.8%

Much more attractive than what bank deposits offer today

SGD 1Y deposit	2.1%
USD 1Y deposit	3.1%

Source: Bloomberg

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. To avoid permanent capital loss, we are cautious on products which offer yields not backed by strong fundamentals. We take a more measured approach to search for yield on a risk-adjusted basis.

US High Yield: The favourable fundamentals remain intact as default rates are low. The near-term driver is oil prices which declined 35% since October, resulting in over-valued high yield markets selling off. Oil prices could stage a short-term technical rebound but the supply glut remains a risk. However, high yield spreads indicate increasingly favourable valuations; we are watching developments in energy markets to potentially increase allocations to high yield.

EM bonds: With more dovish statements from Fed Chairman Powell on interest rate policy, downward pressure on emerging market bonds has been reduced. Favourable fundamentals are generally intact. We maintain our overweight positions in short duration EM debt which offers a balanced mix of yield while being more insulated from currency and interest rate risk.

Asian High Yield: Yields above 9% backed by long term fundamentals bolster the case for Asian high yield. To avoid catching a falling knife, we are monitoring risks such as the pace of economic growth in China, the real estate sector, refinancing risk, and sentiment.

Investment grade (IG) corporate bonds continued to underperform in November and for the year. Valuations have improved after the sell-off, but not yet near levels that would compensate for the long duration exposure, and lack of safe-haven attributes of government bonds. We will re-engage IG corporate bonds in due course, but not just yet.

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		

Asset Allocation Strategy

Equity Regional	--	-	=	+	++	Allocation strategy
United States		■				Large cap growth to capture late business cycle 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		■				Slight underweight as valuations are on the higher end, and as economic activity continues to moderate.
Japan				■		Slight overweight as economy is supported by structural growth arising from corporate reforms, and equities at attractive valuations.
Asia Pacific ex Japan				■		Maintaining exposure to China 'A' as valuations are attractive and supported by earnings growth.
Emerging Markets			■			Earnings are expected to slow, and valuations are de-rating from high levels.

Fixed Income	--	-	=	+	++	Allocation strategy
Sovereign			■			Focus on hedged global government bonds to buffer portfolio volatility during periods of stress.
Investment Grade	■					Maintaining no exposure as slightly improved valuations do not compensate for low incremental yield and long duration exposure.
High Yield			■			Sentiment is poor due to credit concerns, though valuations have become more attractive. Maintain short duration to mitigate rate hike impact.
Asia				■		Valuations have improved significantly after being overvalued from 2017, with attractive absolute yields. Maintain short duration to mitigate rate hike impact.
Emerging Market Debt				■		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**

Market Index Returns

Equity Regional	MTD	YTD
Global	1.3%	-4.3%
United States	1.8%	3.2%
Europe	-1.1%	-8.1%
Japan	1.3%	-8.3%
Asia Pacific ex Japan	4.3%	-13.6%
Emerging Markets	4.1%	-14.1%

Fixed Income	MTD	YTD
Global Aggregate	0.3%	-3.2%
High Yield	-0.7%	-0.2%
Asia	0.5%	-1.9%
Emerging Market Debt	-0.2%	-3.8%

Currencies	MTD	YTD
USD/SGD	-1.0%	2.7%
EUR/SGD	-1.2%	-3.2%
JPY/SGD	-1.3%	1.9%

Commodity	MTD	YTD
Gold	0.6%	-6.2%
Oil (WTI Crude)	-22.0%	-15.7%

Equity Countries	MTD	YTD
Australia	-2.8%	-6.6%
Brazil	2.4%	17.1%
China “A”	0.6%	-21.3%
China “H”	4.8%	-9.3%
Hong Kong	6.1%	-11.4%
India	5.1%	6.3%
Indonesia	3.8%	-4.7%
Korea	3.3%	-15.0%
Malaysia	-1.7%	-6.5%
Russia	1.7%	13.4%
Singapore	3.3%	-8.4%
Taiwan	0.9%	-7.1%
Thailand	-1.6%	-6.4%

Equity Sectors	MTD	YTD
Gold	1.2%	-17.4%
Energy	-2.2%	-8.8%
Technology	-2.1%	5.0%
Healthcare	5.3%	9.9%
Financials	2.6%	-3.6%

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

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