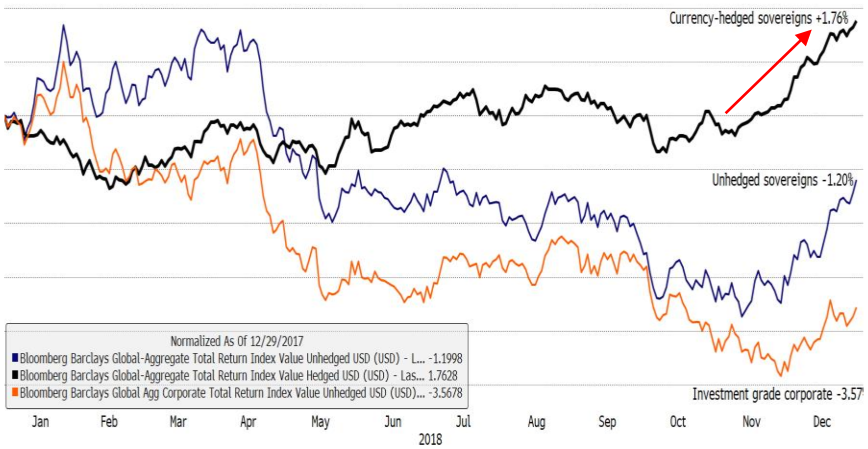
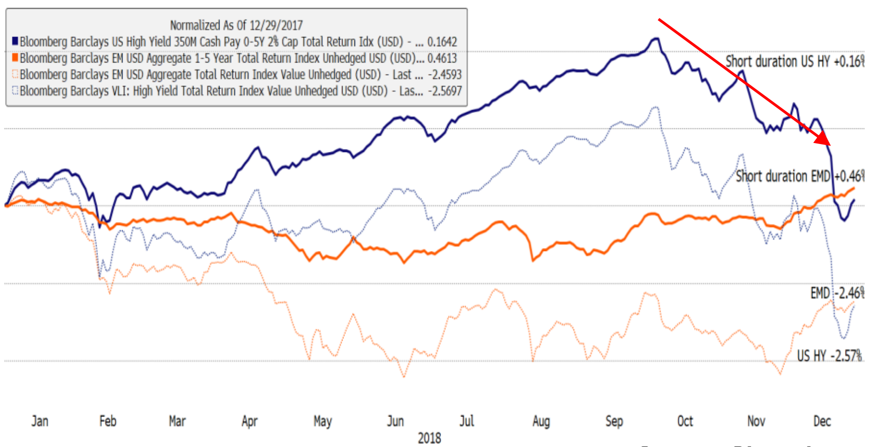
Quarterly Investment Update
Q1 2019

Market Review: Fixed Income

Currency-hedged sovereign bonds resilient under stress



Short duration debt outperformed for both US high yield and EMD



Source: Bloomberg

2018 will be remembered as one where investors had nowhere to hide. Only twice in the last 30 years have both equities and bonds had negative returns. Currency-hedged sovereign bonds (our long-standing position) were pretty much the only major segment that was positive for the year. The silver lining for investors is that it is unlikely (though statistically possible) that both asset classes will be negative in 2019.

Our portfolio approach to investments (recall the mix of spicy and safe-haven ingredients) paid off as Q4's volatility continued into December. The top-left chart show sovereign bonds bucking the prevailing downtrend as investors sought safe-havens in December. Conversely, US high yield bonds continued the quarter's declines as oil prices fell, echoing concerns of a softening economy. Taking off the US high yield overweight in early October proved timely (as indicated in the bottom-left chart). We benefitted from the rotation out of US high yield to Asian high yield as it was the best performing credit segment in December.

For the quarter and the year (even December in the case of high yield), our short duration positions outperformed. While the portfolios have benefitted from the short duration positioning, we do not hold winners just because they have outperformed. Our forward-looking process is such that we adjust allocations when prevailing conditions change. We respond to changes in the wind, not when the boats have veered drastically off-course.

Going forward, expect more volatility as we near inflection points in the economic and monetary policy cycles. With the increased likelihood of change in economic growth trajectory and central banks changing tack, expect adjustments to the duration and credit positioning as catalysts present themselves.

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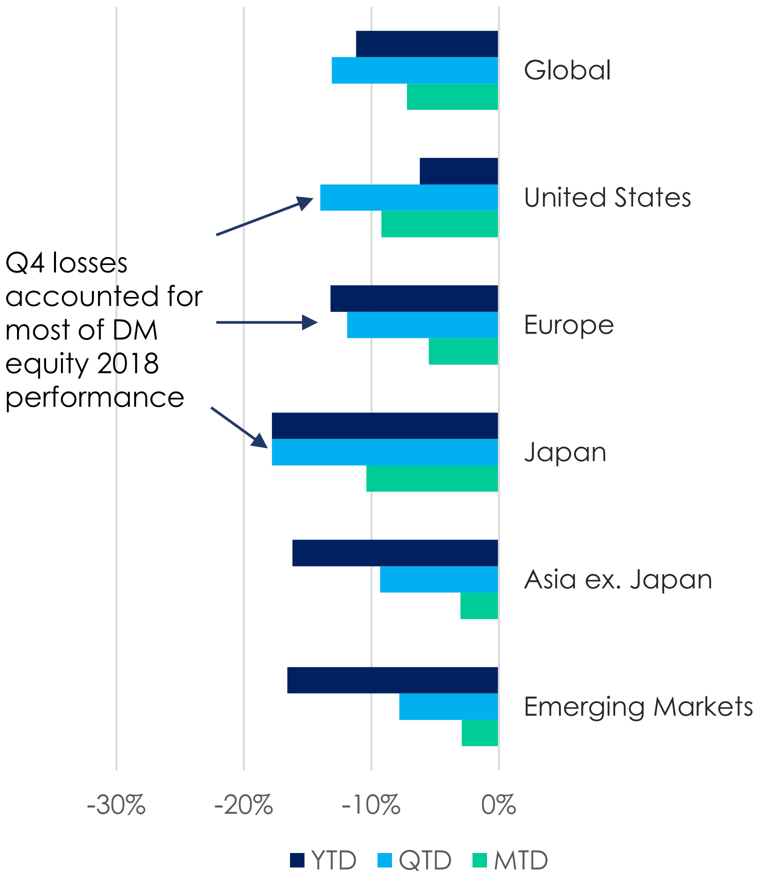
Market Review: Equities

Regional Equity Performance



Returns in index currency terms as of 31 Dec 2018.
Source: Bloomberg

Hopes of a year-end 'Santa Rally' were dashed as developed markets led global equities sharply lower in December. By and large, developed market equities played catch-down to developing markets which started declining earlier in the year, and hurting global portfolios that are usually US biased. Conversely, the meaningful outperformance of Asia (where we have a slight overweight) in December helped to prevent larger losses in our portfolios.

US equities sold off across the board in Q4, with sectors like energy and tech detracting meaningfully. As sentiment continued to deteriorate, investors were quick to price in lower levels of future earnings. Despite the recent sell-off, our US growth bias had benefited us greatly in 2018 – the S&P 500 Growth Index is flat for the year. Our downside was also mitigated via the shift from US small-cap to large-cap growth in early Q4, when we were concerned about the ability of smaller companies' to thrive in a less accommodative environment.

Our financials position underperformed in 2018, alongside the softening growth environment. Though US bank fundamentals remained robust, the prospect of lower loan demand and lower long-term interest rates have presented clearer headwinds for this sector (we expand on this in the Key Themes section).

Japan equities were additionally challenged by a stronger currency. The Japanese Yen gained 3.6% in Q4, exacerbating equity declines – historically, we see that a stronger JPY is negative for equity returns. The good thing is that we have been taking currency-unhedged positions, which meant that we were able to offset some losses through the stronger Yen.

Developing markets such as Asia ex. Japan and Emerging Markets (EM) fared better recently, as they had already corrected meaningfully before. A more stable USD in Q4 was also more positive, as opposed to a stronger dollar being a headwind for EM stocks.

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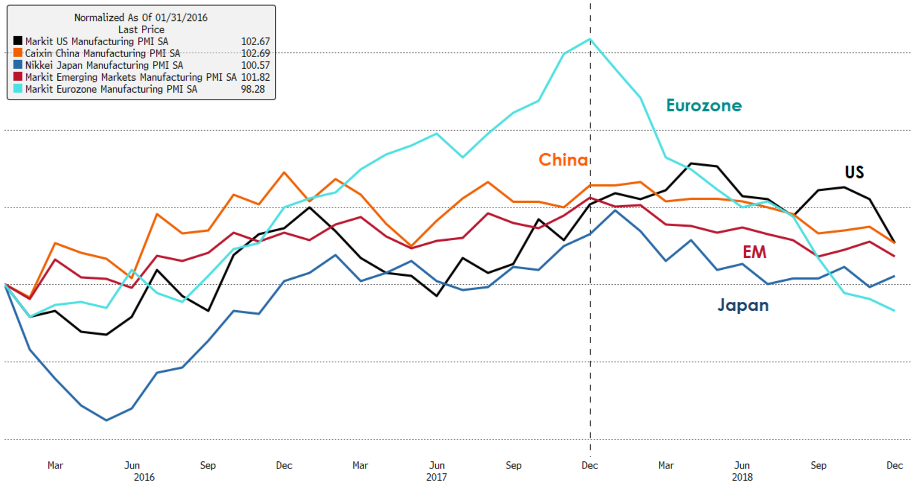
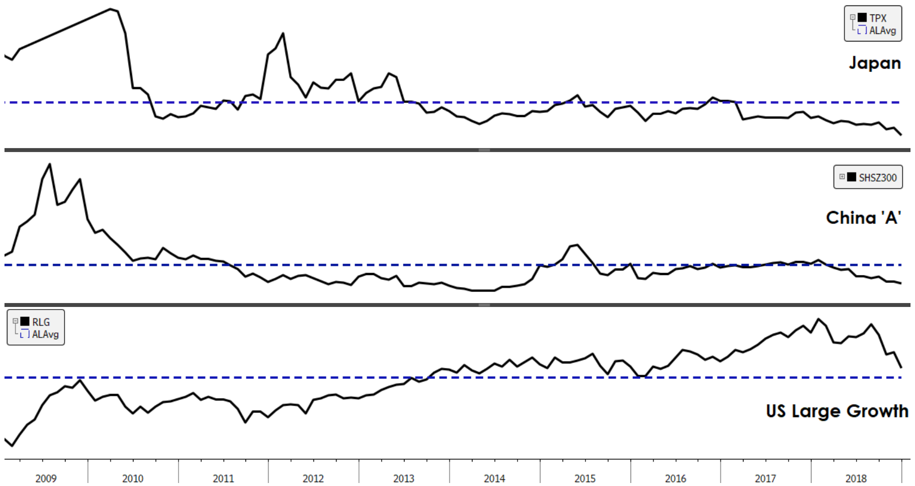
Key Themes: Peak growth

Manufacturing PMI indicates slowdown in growth over 2018



Reasonably priced: P/E ratios mostly below their 10 year average



Source: Bloomberg

We enter the new year with an environment vastly different from just one year ago. At the end of 2017, there was immense optimism that the synchronized growth environment would propel risk assets much higher. Since then, global growth have slowed considerably, with recent numbers even pointing towards a contraction for a few economies. Which then prompts the question: if growth has peaked, how should we invest in such an environment?

More recently, even the resilient US economy is showing signs of weaker growth; presumably affected by the ongoing trade uncertainty and generally slower growth globally. Despite this, we are still inclined to maintain our US large-growth allocation as there is a strong case versus the other segments: US large-growth companies have low debt, stronger earnings, and overall healthier balance sheet. These characteristics make them more resilient in a slowdown, or in a less accommodative environment. In contrast, reduced economic activity has clearer negative implications for our financials position, which would need a stronger economy to thrive.

It's not all doom and gloom, however, as valuations have become quite attractive in some markets. While price declines has been particularly meaningful in China 'A' over 2018, or even in Japan more recently, their P/E ratios are now well below their 10 year average. The same goes for the US large growth segment, whose P/E is back to their long term levels. While it is true that 'cheap can get cheaper', we will be going into 2019 with a better risk/reward proposition, especially when actual earnings are not yet reflecting the meaningful slowdown that markets are pricing in today.

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Key Themes: Central bank tightening

Historically low levels of interest rates mean that central banks want to hike rates. However, the Fed's Quantitative Tightening looks increasingly to be curtailed as the combination of peak cycle effects, fading fiscal stimulus, and trade friction reduce the risk of the economy overheating.

In the Euro area, the ECB will only contemplate hiking interest rates when growth momentum picks up and this will not likely to happen in the first half of 2019 given signs of slowdown in the Eurozone.

Odds of further US rate hikes have diminished significantly

Date	Probability of a Fed interest rate hike on 30th Jan 2019
30/09/2018	72.40%
31/10/2018	74.50%
30/11/2018	79.20%
14/12/2018	73.50%
18/12/2018	69.60%
19/12/2018	2.10%

Source: Bloomberg

Short duration: Fixed income investing amid a rate hike cycle is like paddling upstream. The speed of the current is expected to moderate as the Fed reduces the pace of rate hikes in light of mounting evidence of peak growth. Having said that, central banks have a tendency to over-tighten. Hence we maintain the short duration exposure while watching for catalysts to add duration. Meanwhile, risk-adjusted yields in high yield and emerging market bonds contribute returns to the portfolio.

Financials: Banks, whose business model rely on higher long-term interest rates to earn higher profits, are thought to be able to thrive when the economy was more robust at the start of 2017. However, market and economic uncertainty means that long-term rates have remained stubbornly low today, even as short-term rates have continued to be pushed up by the Fed the past year. A slower growth environment would also make it more challenging for the banks to grow their business, as there would be a lower demand for loans. **These factors present clear headwinds for our financials allocation, prompting us to reduce our exposure.**

Sovereign bonds: If 2018 caught investors by surprise, 2019 will not be a surprise in terms of the heightened uncertainty arising from inflection of prevailing trends. Further risk can come from global trade friction, volatility in oil prices, even economies slipping into recession. As we navigate the credit markets, we maintain exposure to currency-hedged sovereign bonds as an anchor for the portfolio

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Key Themes: Search for yield

Higher yields today compared to the start of 2018

	31 Dec 2017	31 Dec 2018
Asia HY	5.6%	9.0%
US HY short duration	5.7%	8.2%
EM short duration	4.0%	5.6%

Much more attractive than bank deposits today

SGD 1Y deposit	2.1%
USD 1Y deposit	3.0%

Source: Bloomberg

2018 marked the 10th anniversary of the Global Financial Crisis, triggered by the collapse of Lehman Brothers. In the past 10 years, easy monetary policies have suppressed bond yields and supported asset prices. Even as rates rise, investors' need for incremental yield to earn higher returns remain relevant. Our credit selection has been working out thus far. With the macro environment getting less supportive of risky assets, we continue to focus on fundamentals and valuations to extract yield on a risk-adjusted basis.

US High Yield: Low default rates serve to prevent the high yield market from going into a tailspin. With market declines over the quarter, yields have risen to 8%, levels not seen since early 2016 as oil prices recovered from a low of $26/barrel. Despite the improved valuation in high yield, we hold off on adding exposure due to heightened uncertainty on oil prices and economic growth driving energy demand. There will be a time to add back to high yield, but not just yet.

EM bonds: More dovish statements from the Fed have dampened USD strength, and reduced downward pressure on emerging market bonds. We maintain our overweight positions in short duration EM debt which offers comparable yield to the broad index 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. Our entry point into Asian high yield has been favourable so far as markets have held steady. A key risk to this position will be further deterioration in the Chinese economy affecting the ability of corporate borrowers in the real estate and industrial sectors to repay or refinance, triggering a chain reaction of defaults.

Investment grade (IG) corporate bonds continued to underperform in December and for the year, demonstrating the lack of safe-haven property without providing sufficient incremental yield. Demand for corporate bonds is expected to reduce as central banks ease off on their bond purchase programs. We expect IG bond valuations to improve thereafter, but maintain the underweight while other segments provide better risk-adjusted yield.

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Key Themes: How are we positioned?

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

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Asset Allocation Strategy

Equity Regional	--	-	=	+	++	Allocation strategy
United States	Current	Previous				Large cap growth to capture late business cycle growth, and where large caps are more resilient to rising financing and wage costs. **Reduce exposure to financials on slower growth and lower long-term rates.**
Europe		Current				Slight underweight as valuations are on the higher end, and as economic activity continues to moderate.
Japan				Current		Slight overweight as economy is supported by structural growth arising from corporate reforms, and equities at attractive valuations.
Asia Pacific ex Japan				Current		Slight overweight 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			Previous	Current		Focus on hedged global government bonds to buffer portfolio volatility during periods of stress.
Investment Grade	Current					Maintaining no exposure as slightly improved valuations do not compensate for low incremental yield and long duration exposure.
High Yield			Current			Sentiment is poor due to credit concerns, though valuations have become more attractive. Maintain short duration to mitigate rate hike impact.
Asia				Current		Valuations have improved significantly after being overvalued from 2017, with attractive absolute yields. 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	-7.2%	-13.1%	-11.2%
United States	-9.2%	-14.0%	-6.2%
Europe	-5.5%	-11.9%	-13.2%
Japan	-10.4%	-17.8%	-17.8%
Asia Pacific ex Japan	-3.0%	-9.3%	-16.2%
Emerging Markets	-2.9%	-7.8%	-16.6%

Fixed Income	MTD	QTD	YTD
Global Aggregate	2.0%	1.2%	-1.2%
High Yield	-2.3%	-4.7%	-2.6%
Asia	1.3%	0.8%	-0.6%
Emerging Market Debt	1.4%	-0.2%	-2.5%

Currencies	MTD	QTD	YTD
USD/SGD	-0.7%	-0.3%	2.0%
EUR/SGD	0.6%	-1.5%	-2.6%
JPY/SGD	2.8%	3.4%	4.8%

Commodity	MTD	QTD	YTD
Gold	4.9%	7.5%	-1.6%
Oil (WTI Crude)	-10.8%	-38.0%	-24.8%

Equity Markets	MTD	QTD	YTD
Australia	-0.4%	-9.0%	-6.9%
Brazil	-1.8%	10.8%	15.0%
China “A”	-5.1%	-12.5%	-25.3%
China “H”	-4.7%	-8.1%	-13.5%
Hong Kong	-2.5%	-7.0%	-13.6%
India	-0.3%	-0.4%	5.9%
Indonesia	2.3%	3.6%	-2.5%
Korea	-2.7%	-12.9%	-17.3%
Malaysia	0.6%	-5.7%	-5.9%
Russia	-1.4%	-4.7%	11.8%
Singapore	-1.6%	-5.8%	-9.8%
Taiwan	-1.6%	-11.6%	-8.6%
Thailand	-4.7%	-11.0%	-10.8%

Equity Sectors	MTD	QTD	YTD
Gold	10.8%	14.3%	-8.5%
Energy	-12.8%	-24.4%	-20.5%
Technology	-8.1%	-17.9%	-3.5%
Healthcare	-8.1%	-9.7%	1.0%
Financials	-11.4%	-13.6%	-14.7%

Returns in index currency terms as of 31 Dec 2018. Source: Bloomberg

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