Monthly Investment Update
May 2019

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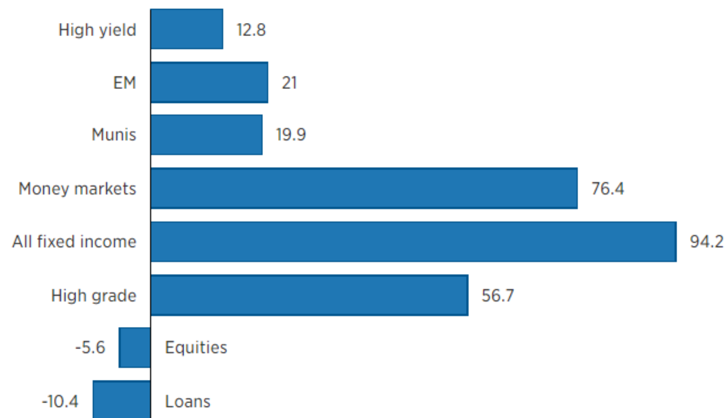
Market Review: Fixed Income

An article on CNBC wrote that "investors who suffered the worst December since the Great Depression seemed still reluctant to throw themselves back in even though stocks have fully made back the steep losses." On 30th April, the Wall Street Journal reported that "Stocks Are Off to Their Best Four-Month Start in Decades" but investors have been missing out as Q1 saw large buying into money market funds (refer to figure below).

We were able to participate in the strong gains this year, not because we are passively invested, but our asset allocation process did not indicate the need to go to cash.



Source: www.cnbc.com/2019/03/29/investors-shun-stock-funds-as-market-has-best-start-since-1998.html

Accommodative central banks underscored gains in April as equity markets rallied and safe fixed income markets languished. Consequently, unhedged investment-grade bonds declined 0.30%, while currency-hedged investment grade bonds which we hold as a better safe haven position gained 0.06%.

The EUR had a flat month but that masked a general downtrend that reflects the negative interest rate environment imposed by the ECB (European Central Bank).

High yield fixed income participated in April's market gains. US high yield had the strongest gains with contribution from coupon income and improvement in credit spreads. Asia high yield returns (+0.42%) came from coupon gains but less from credit spreads which tightened mainly in Q1 and stabilised in April. Despite this, Asian high yield is one of the best performing credit segments this year.

It's often said that diversification is one of the free lunches in investments, which is something we enjoy in our diversified portfolios. But, "hungry" as we are, we go for more "cheap" lunches through our tactical asset allocation (TAA). This is in the form of investing in opportunities with better risk/reward, which is akin to similar reward with less undesired risk, or more reward with similar risk. This is illustrated in the "Search for Yield" section.

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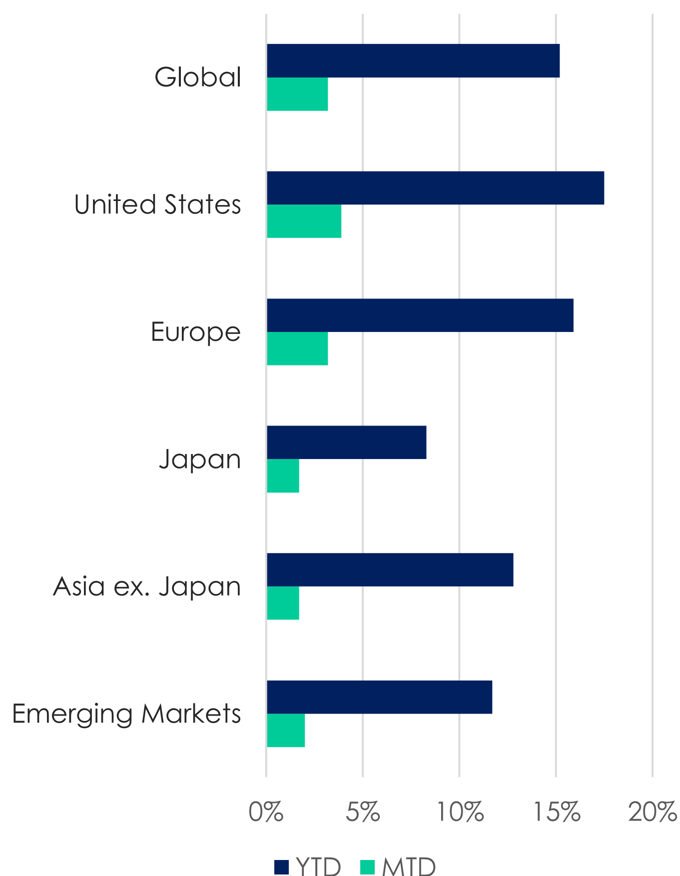
Market Review: Equities

Regional Equity Performance



Returns in index currency terms as of 30 Apr 2019
Source: Bloomberg

Equity markets continued to gain in April on the back of more accommodative central bank policies. The past month also marked the start of the US earnings reporting season, which introduced some volatility as investors reacted to a slew of new information.

US equities had another good month as corporate earnings were by and large positive relative to less optimistic consensus. Companies like Facebook (+16%), and Twitter (+21%) saw their shares pop on strong revenue numbers. In contrast, companies that reported weaker numbers were punished – Google's (Alphabet) initial gain of 10% reduced to 2% when the company reported weaker than expected revenue. Healthcare was one of the worst performers across sectors, driven by concerns over potential policy headwinds. A portfolio strategy came in helpful in avoiding large losses here: the strong momentum of tech in our allocation to US large-growth companies more than made up for the healthcare weakness.

European equities performed well despite mixed economic data, presumably due to expectations of a potential rebound in economic activity. Against this backdrop, economically-sensitive financials (+7.8%) rose alongside the high-growth tech sector (8.7%). We continue to pay close attention to the risk drivers in Europe for opportunities that may present themselves in the coming months.

Japanese equities rose modestly in April, though still not enough to catch up to the YTD performance in the other major markets. Returns continued to be dispersed across sectors, with tech posting strong gains, and healthcare and utilities at the bottom. The coming month will be important, as it is when many Japanese companies are due to report their Q1 earnings

Returns in the Asia ex. Japan indices were largely driven by China, though Singapore (+5.8%) was a standout performer following better-than-expected bank earnings. China A-shares (+1.1%), where we are still overweight, extended its YTD performance to 30%.

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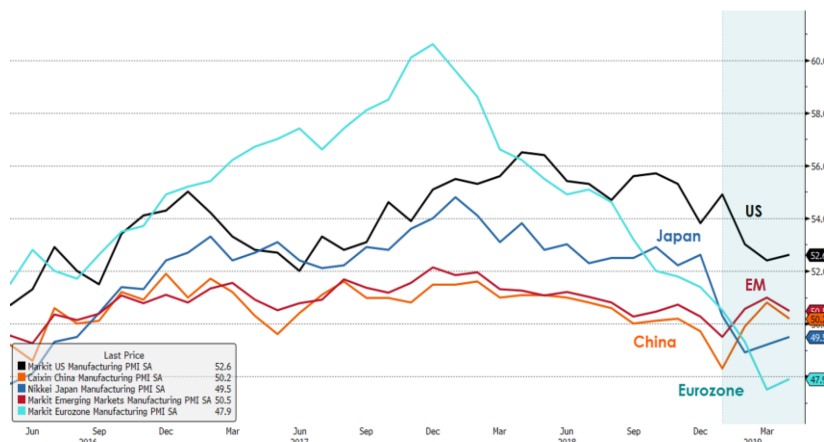
Key Themes: Slowing Growth

Signs of global slowdown bottoming out?



Comparing P/E: Some markets are cheaper than others

Source: Bloomberg

Growth has slowed considerably since early 2018. This has led to increased fears of an impending recession, and ensuing uncertainty around asset prices. Which then prompts the question: if growth is slowing, how do we invest?

The strong performance in risk-assets YTD can be construed as expectations of growth slowdown bottoming i.e. It's not the end of the world. It is fair to say that fundamentals need to come through for asset prices to move even higher from here, especially as valuations have gone up since the start of the year. The good news is there are early signs of growth slowdown bottoming out: the latest Q1 GDP growth and PMI manufacturing numbers were not as bad as what markets were expecting.

Our allocations to large-growth companies in US and Europe have done well YTD, outperforming the MSCI All-Country Equity Index by a few percentage points. In a slower growth environment, our strategy was to invest in the most resilient markets at attractive valuations. With less attractive valuations today, and with a potential rebound in growth over the coming months, we may soon re-allocate into markets with a better risk/reward proposition.

We also prefer markets that are more attractively valued. Going into 2019, we proposed that China 'A' and Japan were two markets with an attractive risk/reward profile - at that time their P/E ratios were well below their historical averages. It turns out that it only took the first few months of 2019 to vindicate our China 'A' (+30%) overweight in our portfolios. Even after such strong gains the China 'A' market is not expensive. In fact, valuations (measured in P/E) today are still slightly below their 10-year average, which may imply potential for further gains. Performance in Japan has been more lacklustre so far, though the market continues to offers both attractive valuations, as well as supportive corporate fundamentals.

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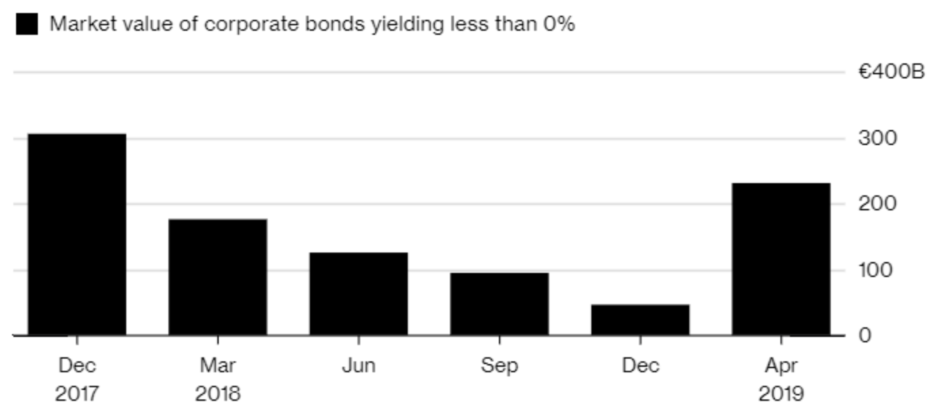
Key Themes: Central bank on hold

The Fed has decided to be more responsive and nimble in using interest rates to influence economic growth. Hence with less signs of the economy overheating, it held back on tightening measures for the time being. However, major central banks are also clear that they want a more normalised interest rate environment after years of QE.

Consequently, we expect rates to be more volatile as the Fed tries to respond to economic numbers (at the risk of flip-flopping), and market participants in turn try to predict Fed moves. Rather than making such short term predictions, we position the portfolios based on the state of the market relative to the current economic cycle, and the medium term policy bias of the central banks.



Source: Bloomberg

Would you pay someone to borrow your money?

That is happening in Europe: LVMH, the global luxury brand, issued EUR 300m in 2-year maturity bonds which yield investors -0.13%.

Sovereign bonds: A major conundrum facing many bond investors is how to invest in an environment of low rates. USD investors are in less of a predicament, aided by a recovering US economy and the Fed's policies to raise interest rates since 2016. The situation is more tricky in Europe as investors are confronted with negative returns on their bond investments (refer to figure) as the Eurozone tries to dig itself out of a slowdown.

Given that the major central banks are all holding interest rates steady, there is less upward pressure on the Euro which is still at negative rates. We maintain exposure to currency-hedged sovereign bonds for multiple benefits: The EUR is expected to decline during market stress which means hedging the EUR provides the desired flight to quality returns from investment grade bonds without currency downside. Furthermore, current interest rate levels mean that one actually gets paid to hedge the EUR. For similar reasons, we maintain the currency-hedged exposures to European equities.

Short duration: Gains from investments come when markets have not priced in expectations. Markets have started to price in rate cuts, whereas the Fed is of the bias to raise rates when it can. This resulted in yields rising (and interest rate volatility) when the Fed chair was deemed to be of the view that inflation may come back. Given the central bank's bias to hike rates, we look to add duration when more of the policy headwind dissipates.

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Key Themes: Search for yield

Asian High Yield, US & EM short duration provides attractive yields

	2 Jan 2018	3 May 2019
Asia HY	5.6%	**7.0%**
US HY short dur. bonds	5.7%	**5.8%**
US HY bonds	5.5%	6.1%
EM short dur. bonds	4.0%	**4.9%**
EM bonds	4.5%	5.3%

Much more attractive than what bank deposits offer today

SGD 1Y deposit	2.0%
USD 1Y deposit	2.8%

Source: Bloomberg

With interest rates not expected to move up or down dramatically, the search for yield focuses on segments delivering sustainable coupon income with fundamentals that can ride out the late stage growth cycle.

US High Yield: The US high yield short duration market has been an area where we have enjoyed the cheap lunch of similar reward for less undesired risk. For yields of about 6%, the average maturity of normal and short duration markets are about 6 and 3 years respectively. As we expect more volatility in the current phase of the market, lenders in the real economy that issue shorter maturity loans get more visibility on the ability of the borrowers to repay.

EM bonds: EM hard currency bonds offer higher yield to EM local currency bonds, without taking on currency risk. Proponents of local currency bonds argue that emerging economies increasingly issue in local vs hard currency, and that holders of local currency bonds are long term investors as opposed to fickle external hard currency lenders. That could be true if one's base currency was the local currency, else a local currency bond investor would have to bear the currency risk, as seen where local currency bonds are -3% vs +3% for hard currency bonds for the whole of volatile 2018 through to April 2019. We will get into local currency bonds when the tailwinds for better risk/reward exist.

Asian High Yield: Structural Asian credit fundamentals have not changed much over the years but the market was overbought and at unattractive valuations. This was until Q4 last year where valuations and sentiment improved, which prompted us to enter the market. Evidently, Asian high yield is one of the best performing fixed income segments this year. Sentiment continues to be positive, supported by strong inflows into Asian high yield funds. Nevertheless, the segment offers one of the highest yields across major fixed income markets, with credit spreads holding steady. This means room for appreciation due to valuation re-rating, and high coupon income even if that does not happen.

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Key Themes: How are we positioned?

Slowing Growth	Central Bank on Hold	Search for Yield
US Large-Growth equities	Short duration fixed income	Asian High-yield bonds
Europe Large-Growth equities	Currency-hedged European equity	Emerging market short duration bonds
Japan equities		
China 'A' equities		

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Asset Allocation Strategy

Equity Regional	--	-	=	+	++	Allocation strategy
United States		X				Large cap growth to capture late business cycle growth, and where large caps are more resilient to rising financing and wage costs. Underweight driven by higher valuations relative to other markets
Europe		X				Slight underweight as economic activity is slowing meaningfully, and as valuations have trended up.
Japan				X		Slight overweight as economy is supported by corporate reforms, and equities at attractive valuations.
Asia Pacific ex Japan				X		Slight overweight to China 'A' as valuations are attractive and supported by earnings growth.
Emerging Markets			X			Weaker-stable USD may help to support equities in the region.

Fixed Income	--	-	=	+	++	Allocation strategy
Sovereign			X			Focus on currency-hedged global government bonds to buffer portfolio volatility during periods of stress.
Investment Grade	X					Maintaining no exposure as low incremental yield and long duration exposure are less attractive than other segments.
High Yield			X			Maintain short duration which provides better yield to broad market with less sensitivity to interest rate changes.
Asia				X		One of the most attractive yields across major fixed income markets backed by policy support and sentiment.
Emerging Market Debt				X		Range-bound USD eases downward pressure on EMD which adds to portfolio diversification.

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

Current Previous

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Market Index Returns

Equity Regional	MTD	YTD
Global	3.2%	15.2%
United States	3.9%	17.5%
Europe	3.2%	15.9%
Japan	1.7%	8.3%
Asia Pacific ex Japan	1.7%	12.8%
Emerging Markets	2.0%	11.7%

Fixed Income	MTD	YTD
Global Aggregate	-0.3%	1.9%
High Yield	1.5%	9.6%
Asia	0.3%	5.0%
Emerging Market Debt	0.4%	5.9%

Currencies	MTD	YTD
USD/SGD	0.4%	-0.2%
EUR/SGD	0.4%	-2.3%
JPY/SGD	-0.2%	-1.8%

Commodity	MTD	YTD
Gold	-0.7%	0.1%
Oil (WTI Crude)	6.3%	40.7%

Equity Markets	MTD	YTD
Australia	2.3%	12.0%
Brazil	1.0%	9.6%
China “A”	1.1%	30.0%
China “H”	1.4%	14.0%
Hong Kong	2.2%	14.9%
India	0.9%	8.2%
Indonesia	-0.2%	4.2%
Korea	2.9%	8.0%
Malaysia	-0.1%	-2.9%
Russia	2.5%	8.0%
Singapore	5.8%	10.8%
Taiwan	3.1%	12.8%
Thailand	2.1%	7.0%

Equity Sectors	MTD	YTD
Gold	-6.8%	-0.7%
Energy	0.0%	15.4%
Technology	6.3%	26.8%
Healthcare	-2.6%	4.8%
Financials	8.8%	17.4%

Returns in index currency terms as of 30 Apr 2019. Source: Bloomberg

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