Monthly Investment Update
June 2019

Market Review: Fixed Income

Investors were greeted with the first down month this year as equity markets sold off. Inevitably, the popular adage "sell in May and go away" comes to mind. In fact, this was reinforced in a media report that "sell in May works". What was problematic with the report is that it used a single down month of May 2019 to justify the headline.

Source: Bloomberg

So does selling in May really work for investors? Over the last 30 years, an investor in the S&P 500 would have actually made money in May, with average gains of 1.44% (as shown in table below).

May has also seen largest gains and losses of +9.75% and -7.99% respectively. What should one do after the recent month's decline of 6.35%? The largest May loss of -7.99% in the last 30 years was in 2010. Few people will remember 2010 as the S&P closed the year +15%. Hence, it is possible that 2019 will be a year of strong returns. We prefer to invest in accordance with our FVT (Fundamental, Valuation, Technical) framework rather than rely on observations that are not robust.

Amid a risk-off month, unhedged sovereign bonds rallied 1.7%, while **currency-hedged sovereign bonds** which we hold as a better safe haven position gained 1.8%.

Our **defensive posturing in currencies** generally benefitted. The EUR (which we hedged) continued its string of losses for the year, driven by weak economic fundamentals and accommodative ECB (European Central Bank) trying to stimulate the economy with negative interest rates.

Fixed income generally offset losses in equities, demonstrating the effects of diversification. Investment grade and emerging market bonds were positive. US high yield markets were the worst performing in fixed income (-1.48%) which was mitigated by our exposure to short duration (-0.89%). Asia high yield was flat as gains from coupon were offset by rise in credit spreads.

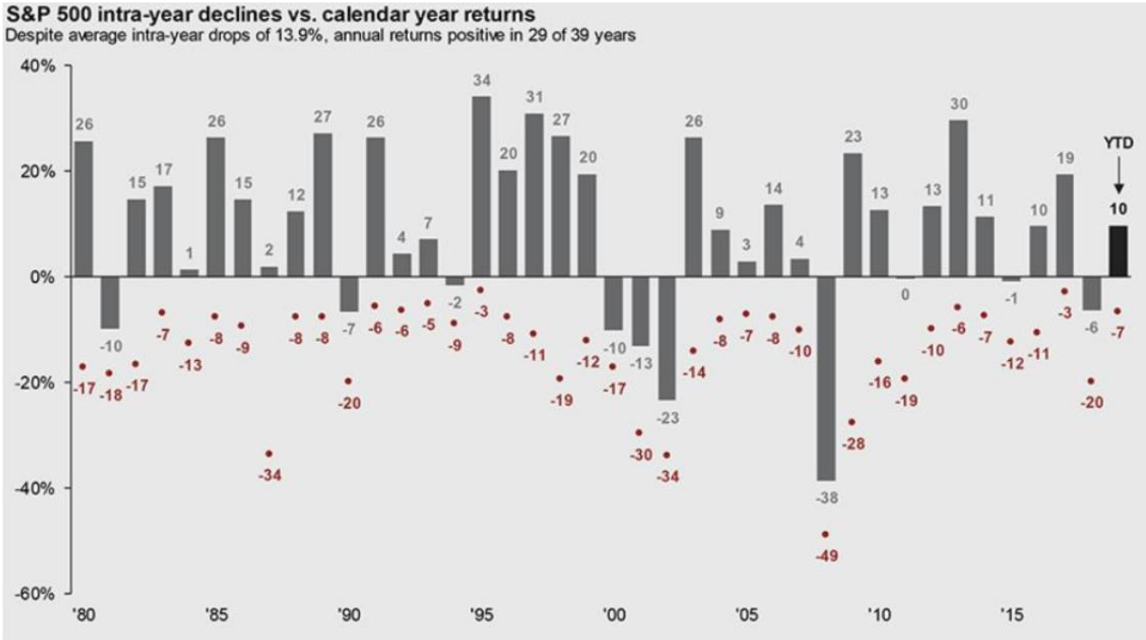
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
30 Yr Trailing High(2019)	7.32	7.21	9.78	9.57	9.75	5.55	9.03	6.21	8.92	10.93	7.67	11.44
30 Yr Trailing Avg(2019)	.44	.39	1.48	1.77	1.44	-.29	1.36	-.50	-.20	1.36	1.80	1.50
30 Yr Trailing Low(2019)	-8.43	-10.65	-6.34	-6.06	-7.99	-8.43	-7.80	-14.46	-10.87	-16.79	-7.88	-9.03
2019	8.01	3.21	1.94	4.05	-6.35							

Market Review: Equities

What seemed like meaningful progress towards a US-China trade deal took a turn for the worse in May, roiling equity markets. Asia and EM equities led declines, while developed markets did slightly better. With all the negative headlines that have been coming out, it is useful to remember that global equities are still up a respectable 8% YTD. Past history tells us that even as larger intra-year declines are common, markets are more often than not still positive for the year.

Large-growth US equities were down 6.3%, with tech stocks (a meaningful component of growth indices today) contributing to most of the negative performance. In uncertain environments the more defensive utilities or health care sectors held up better, as their more predictable businesses become more sought after. Conversely, the more economically-sensitive sectors (which we have avoided) underperformed; with the energy (-11.7%), materials (-8.5%), and financial (-7.4%) sectors all experiencing large declines.

Despite average intra-year drops of 13.9%, annual returns have been mostly positive



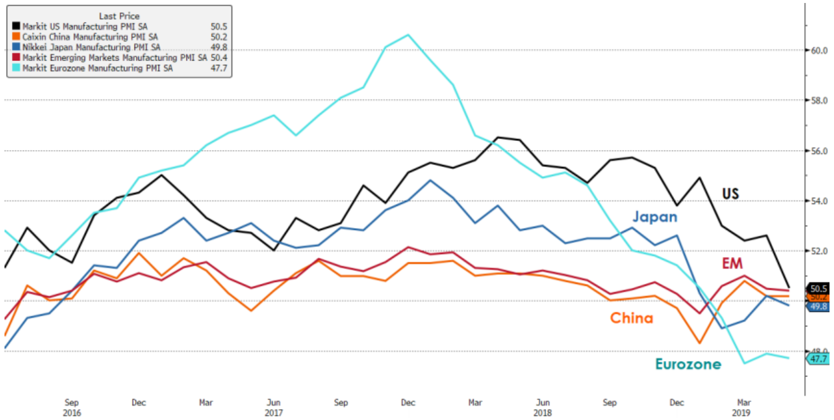
Source: J.P. Morgan Asset Management

We observed similar dynamics in **Europe and Japan**, which fell 5.7% and 6.5% respectively. Cyclical sectors (energy, materials, etc.) experienced larger losses compared to the more defensive segments (real estate, healthcare, etc.). May's economic data remained relatively weaker in Europe and Japan, which added on to the poor sentiment.

Emerging markets and Asia fell more than 7% in May, a large part due to China which is the largest component of the index. Despite the US-China trade-conflict, the domestic China 'A' market (where we are overweight) performed more or less in-line with other major markets, and remains the best performing equity market this year with 20.6%. This is in contrast to the last round of trade tariffs in June 2018, when China 'A' underperformed by a large margin. India was one of the standout performer in Asia, gaining 1.7% on optimism that PM Modi would adopt policies to support the Indian economy.

Key Themes: Slowing Growth

Global economic activity has remained weak



Our Growth-bias has continued to benefit YTD

Source: Bloomberg

It is often said that 'all correlations go to one a crisis'. In other words, there are not many places to hide when markets sell-off. This may be true observing the performance of major equity markets over the past month, and during other periods of decline. **Our strategy of 'using the right tool for the job' allows us navigate markets more effectively:** for our multi-asset portfolios, we allocate to different asset-classes or strategies that may perform in different market environments. Likewise, within equities we identify sectors or styles that are expected to give us better outcomes in a slower growth environment.

Our allocations to large-growth companies in US and Europe have done well, outperforming global equities YTD. In a slower growth environment, our strategy was to invest in segments with the most resilient earnings without overpaying. Conversely, investors focused primarily on value would have had a tough time YTD (and for the most part of the last decade); underperforming on the way up, and also on the way down. With the right economic and market environment, value styles will get their time to shine again, though we do not yet think we have all the ingredients for this to happen today.

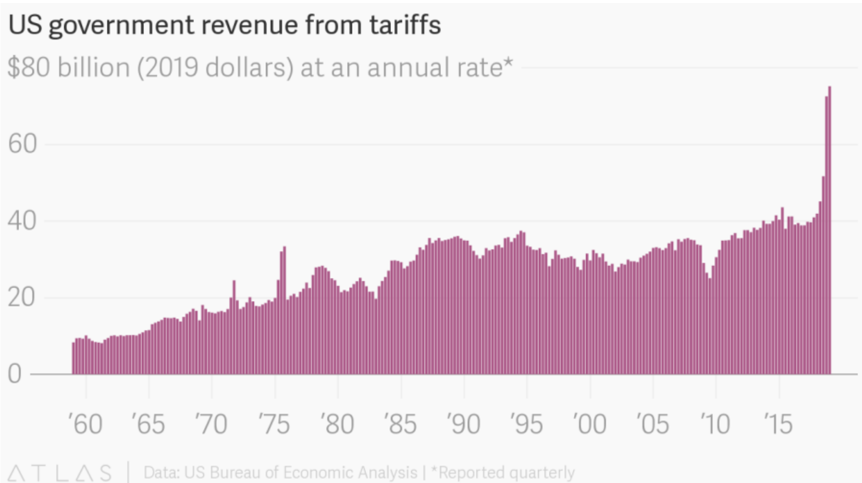
We applied the same process for investing in China 'A' equities, and was rewarded with strong performance YTD. Even after May's sell-off China 'A' is up more than 20% YTD. Today, valuations are still well below their historical averages, and further supported by earnings growth. Nevertheless, we pay close attention to developments around the US-China conflict and the potential market impact. The Chinese government is also expected to unveil more stimulus to support their economy.

Our allocation to Japan was expected to outperform with attractive valuations, and on growth picking up. However, growth has remained lacklustre, and profit margins deteriorating. If the growth dynamics capitulate even further, our thesis would be derailed and we may look to adjust our positions accordingly.

Key Themes: Central bank on hold

It is a tough time to be a central banker. Structurally, the major central banks want higher, normalised interest rates after years of QE (quantitative easing). However, they are loathe to be the ones guilty of murdering one of the longest economic expansions on record. With recent softening of economic numbers, markets are expecting (and pricing in) interest rate declines.

A lot of concerns have been voiced about the trade war, arguably amplified by media coverage. As many debate about the extent and ramifications of the trade tensions on markets, what is apparent from the tariffs is a sharp increase in US government revenue (which the US president is not shy to tweet about). While the increase in tariff-driven revenue to $80 billion is significant, it is a smaller part of total US tax revenue of over $2 trillion. So are the tariffs as impactful as the (social) media make them out to be?



A potential downside is the spectre of stagflation: Tariffs slowing growth and consumption while contributing to inflation, compounded by a policy misstep in raising interest rates. To be clear, this is not our central case but our role is to contemplate and manage various outcomes as they become more probable.

Consequently, expect interest rate and equity markets to be more volatile as market participants try to predict and respond to 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 how the portfolios responds to market stress.

Sovereign bonds: Our sovereign bond exposure has a clear purpose; to reduce portfolio volatility arising from down markets without costing too much (analogous to an insurance policy that pays out without incurring too high a premium). A currency-hedged sovereign bond exposure is expected to deliver on this proposition as US bonds tend to be a flight to quality investment and offer higher yield compared to Euro-denominated bonds where the ECB is finding difficulty getting out of a negative rate regime.

Short duration: Short duration exposures serve to reduce interest rate risk. Short duration has been an obvious position to take, and benefitted when central banks were hiking. In the current environment where what is clear is higher interest rate volatility rather than the direction of interest rates, one can choose to take a bet on interest rate direction or choose not to. We take the latter option. Is it because we are not smart enough, or not working hard enough? Sometimes, it is better to not take a view when there is more noise than information. Furthermore, our short duration exposures reduce the downside in stressed markets substantially without giving up much upside.

Key Themes: Search for yield

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

	2 Jan 2018	31 May 2019
Asia HY	5.6%	**7.1%**
US HY short dur. bonds	5.7%	**6.3%**
US HY bonds	5.5%	6.5%
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	2.7%

Source: Bloomberg

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 similar yields of over 6%, short duration markets provide similar return with less interest rate risk. With the recent sell-off, we may get an opportunity to re-enter as valuations become more attractive.

EM bonds: A significant part of risk in bond investing is actually not in bonds but the underlying currencies. For example, currency risk makes up 74% and 84% of the total risk in unhedged global investment grade and local currency emerging market bonds. Our investment process also takes into account such currency risk. We have not been able to crystallise a thesis for outright exposure to EM local currency bonds, which has served us well; local currency bonds have underperformed hard currency bonds across most time windows over the last 10 years. Issuers of hard and local currency bonds share similar fundamentals. EM hard currency bonds offer higher yield to EM local currency bonds, without taking on currency risk. There are dynamics that are shifting in favour of local currency bonds, such as greater issuance, and more long-term local investors. As these effects assert themselves on the market, local currency bonds will provide better risk/reward.

Asian High Yield: Asian high yield is geared to the Chinese market, particularly the real estate sector. An event that worried investors was the Chinese government's first seizure of a bank in two decades. This primarily affected smaller banks with exposure to weak borrowers. Asian high yield markets, however, were resilient as their exposure is more to large firms that have access to funding. Currently, the yields are one of the most attractive segments globally but we are watching for signs of deterioration such as a slowing economy, and broader-based funding issues that would derail our thesis.

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		

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. Underweight driven by higher valuations relative to other markets
Europe		■				Slight underweight as economic activity is slowing meaningfully, and as valuations have trended up.
Japan				■		Slight overweight as economy is supported by corporate reforms, and equities at attractive valuations.
Asia Pacific ex Japan				■		Slight overweight to China 'A' as valuations are attractive and supported by earnings growth.
Emerging Markets			■			Weaker-stable USD may help to support equities in the region.
Fixed Income	**--**	**-**	**=**	**+**	**++**	**Allocation strategy**
Sovereign			■			Focus on currency-hedged global government bonds to buffer portfolio volatility during periods of stress.
Investment Grade	■					Maintaining no exposure as low incremental yield and long duration exposure are less attractive than other segments.
High Yield			■			Maintain short duration which provides better yield to broad market with less sensitivity to interest rate changes.
Asia				■		One of the most attractive yields across major fixed income markets backed by policy support and sentiment.
Emerging Market Debt				■		Range-bound USD eases downward pressure on EMD which adds to portfolio diversification.

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

Current **Previous**

Market Index Returns

Equity Regional	MTD	YTD
Global	-6.2%	8.0%
United States	-6.6%	9.8%
Europe	-5.7%	9.3%
Japan	-6.5%	1.2%
Asia Pacific ex Japan	-7.4%	4.5%
Emerging Markets	-7.5%	3.3%

Fixed Income	MTD	YTD
Global Aggregate	1.4%	3.3%
High Yield	-1.5%	8.0%
Asia	1.0%	6.1%
Emerging Market Debt	0.6%	6.5%

Currencies	MTD	YTD
USD/SGD	1.0%	0.9%
EUR/SGD	0.6%	-1.8%
JPY/SGD	3.9%	2.0%

Commodity	MTD	YTD
Gold	1.7%	1.8%
Oil (WTI Crude)	-16.3%	17.8%

Equity Markets	MTD	YTD
Australia	1.1%	13.3%
Brazil	0.7%	10.4%
China "A"	-7.2%	20.6%
China "H"	-10.0%	2.6%
Hong Kong	-9.4%	4.1%
India	1.7%	10.1%
Indonesia	-3.8%	0.2%
Korea	-7.3%	0.0%
Malaysia	0.5%	-2.4%
Russia	4.1%	12.5%
Singapore	-8.3%	1.6%
Taiwan	-4.3%	7.9%
Thailand	-3.2%	3.6%

Equity Sectors	MTD	YTD
Gold	3.1%	2.3%
Energy	-11.7%	1.9%
Technology	-8.6%	15.9%
Healthcare	-2.6%	2.0%
Financials	-7.4%	8.8%

Price Returns, index currency terms as of 31 May 2019. Source: Bloomberg

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