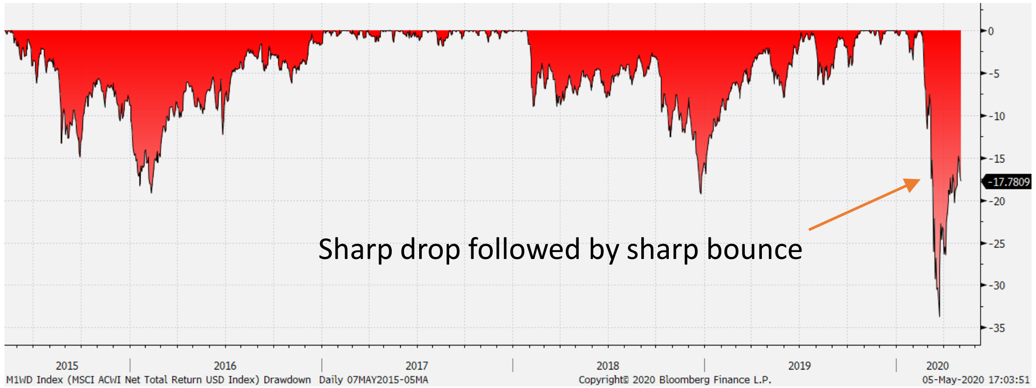
Investment Update
May 2020

finexis
ASSET MANAGEMENT
汇信资产管理有限公司

Market Review

If March was the horrifying drop from the top of the roller coaster, April was the bounce. While March was the worst month for global equities since October 2008, April's gain of 10.6% was the best month since April 2009. Global markets seem to be bouncing as rapidly as they tanked.



Source: Bloomberg, MSCI World drawdown and recovery since 2015

The Barclays unhedged global aggregate index, a commonly-used yardstick for "safe" bonds is 1.63% April YTD, compared to our "safer" choice of hedged global aggregate which is up 3.09% YTD. **The core part of our "shield" investments continues to work.**

From a market standpoint, April will be monumental in that the world saw oil prices not only break historic lows, not only go to $0, but went negative in a big way to -$40. Did energy equities, which tend to be driven by oil prices, go to $0 as well? For details on our energy position, please refer to our update*.

*https://webcms.finexisam.com/assets/publication/monthly/FAM_Updates_20200421.pdf

Our portfolios participated in the bounce, with the multi-asset balanced and aggressive portfolios returning between 4.3% to 8.2% in April. Amid a strong equity bounce, the resilient positions were not shabby, with quality growth and healthcare outperforming global equities. Our "recovery" play equities were mixed, with energy equities being a standout compared to other equity markets while China 'A' was broadly in line with global equities.

Our yield investments had gains between 3-4% in April, which might seem impressive for fixed income. **At the same time, these positions have yet to realize their value**, which we discuss in detail in the section "Search for Yield".

As risk assets recovered, trend-following gave back its earlier gains. Despite this, trend-following has the best absolute returns YTD among strategies in the portfolios. **This is part and parcel of having truly differentiated parts of a portfolio, each plays a role under different conditions.**

Lately, newspapers seem to be dominated by covid-19 coverage. Even what little business, sports, lifestyle and entertainment coverage is covid-19 related. There are demoralising stories of economic slowdowns, and individuals being called out for bad behaviour. There are also uplifting situations of transformation, renewal, and recuperation.

Think of it as the world's way of restoring some balance for a more sustainable future. If emissions are reduced, and animals can reclaim part of their environment, it may not be such a bad thing. Environmentalists might even think that the oil price crash was a fitting way for dirty energy to be part of restoring nature's balance. For us, it is the markets' ongoing mechanism to relieve some hot air.

Market Review

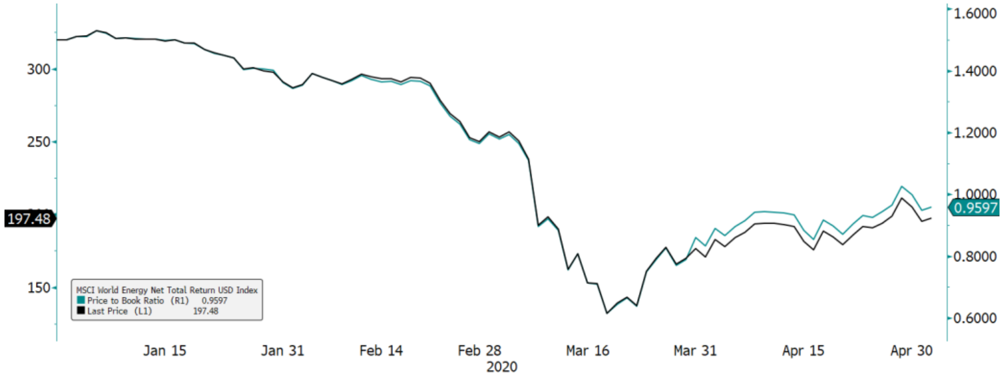
Some people are puzzled by the dichotomy between market prices and the economy. Global equities have rebounded more than 20% since the lows in March, even as economies and businesses have been impacted by covid-19 restrictions. Amazon's Jeff Bezos even called the current crisis 'the hardest time we've ever faced'.

Similarly, energy equities have rebounded despite demand falling off the cliff, and oil prices going into negative territory. As the figure on the top-right shows, our recent allocation to energy benefitted over the past month as prices (black line) rose strongly alongside valuations (green) bouncing off their historical lows.

Proponents of efficient markets may point towards the gradual resumption of economic activity in China (bottom-right chart) or central bank stimulus, to make the case that markets are pricing in green shoots of recovery. If this is indeed the case, then forward-looking markets may be looking beyond the large declines in economic and corporate data expected to be reported over the coming quarters, towards expectations that global activity will recover alongside the gradual easing of lockdown restrictions.

In reality, it is hard to forecast how the path of recovery will look like. Economies may very well rebound towards the end of the year, though it can also take much longer. We do not think it is prudent to bet the farm on either outcomes, which is why our portfolios are positioned not only for 'Resilience Amid Downturn', but also for eventual 'Recovery', which we discuss in the next section.

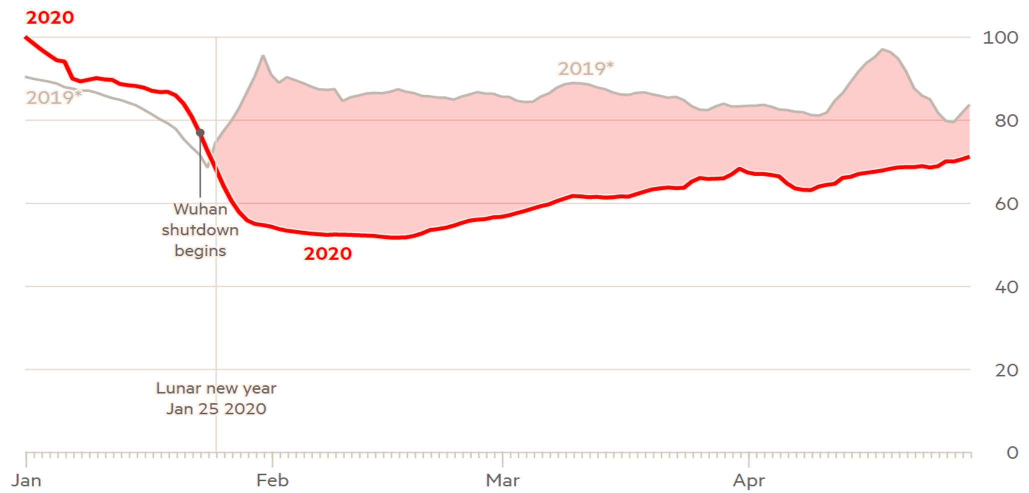
Energy equities gained in April as valuations (green) bounced off lows



Source: Bloomberg, MSCI World Energy Index price and price-to-book.

China's economy has been showing signs of life

FT China Economic Activity Index (Jan 1 2020 = 100), last updated Apr 29



*2019 values at same number of days before/after the lunar new year
Sources: WIND; EntGroup; FT research

Key Themes: Resilience Amid Downturn

Is the bounce from March lows a bear rally or the beginning of a new bull market? Anyone who can confidently declare either binary outcome has either done so much homework, or is disingenuous to themselves and their investors. While we cannot accurately predict what markets will do, we can structure the portfolios to be prepared through opportunities that offer better risk-reward in either scenarios. That is why resilience is an important theme in our portfolios alongside the recovery theme.

While bonds have been more resilient among asset classes, we also see signs that simply buying bonds may not be as effective as before due to low interest rates. The figure below shows unhedged global aggregate bonds (blue) and global equities (green) during the recent sell-off and recovery. Can one easily differentiate between equity and "safe" bonds?

Source: Bloomberg, MSCI World and Bloomberg Barclays Global Aggregate

With that in mind, we coupled our **hedged "shield" bonds** with steepeners which are less dependent on the general direction of bond markets to do well. We expect these to have significant upside; more importantly, we expect them to do so differently from other parts of the portfolio. **The portfolios continue to be truly diversified by deploying into strategies that benefit from bullish, range-bound, and bearish markets.**

Have we changed how we invest?

Do unprecedented times warrant unprecedented responses? That seems to be the order of the day based on what we hear from governments, organisations, even parents. While seemingly unprecedented, history does not repeat itself but it rhymes. Human memory is short, and that can lead to judgment based on limited information. We make up for that by being students of history.

Does our FVT process need to be overhauled to cope with a changing world? Are we arrogant or fail to recognize the need to adapt? Ironically, we seem to be lacking a catchy one-liner pitch that makes it a challenge to describe us. That is the consequence of having an adaptive approach; one that is able to adapt but at the same time, hard to define in certain times.

But our adaptive FVT processes allows us go beyond single opportunities such as China 'A' equities, US high yield, or Gold. Our process is robust enough to assess such wide-ranging opportunities rather than be wedded to one regardless of how the risks or rewards change. Our PPP (philosophy, portfolio, performance) process also means that we look past the product labels and understand the underlying risks and reward. **This does not mean that our portfolios will always outperform, but it allows us to invest with confidence.**

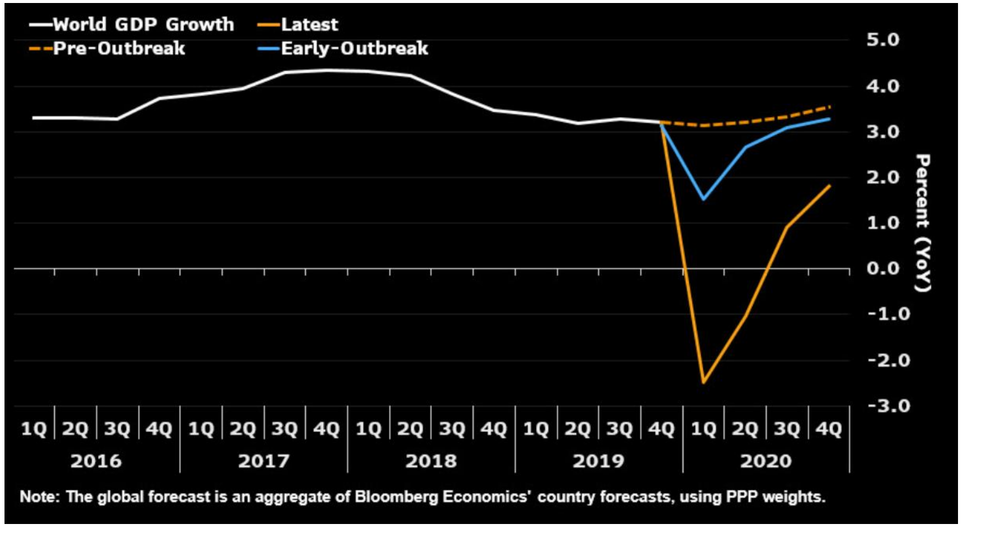
Key Themes: Resilience Amid Downturn

Why resilient equities?

With economic activity grinding to a halt, even viable business models get stressed. Expect also to see bankruptcies as businesses that seemed strong in good times reveal their weaker fundamentals or poor financial discipline when the tide goes out. As mentioned before, the timing and shape of economic recovery is highly uncertain, and challenges remain even as central banks have reacted quickly to try and soften the economic blow.

We invested into US Quality Growth and Healthcare back in 2019 when global growth slowed, and subsequently benefitted as businesses with higher earnings predictability proved to be more resilient. These allocations have also continued to been more resilient than the broader markets as economies are being disrupted by covid-19. Going forward, we continue to favour these investments as a way to manage risks in our portfolios, and also to provide more certainty amidst an uncertain environment.

Timing and shape of recovery is highly uncertain



Source: Bloomberg

US Large-cap Quality Growth equities are well placed to tide through the current economic disruption. The 'Growth' in Quality Growth refers to businesses or industries that usually grow faster than the broader economy. **While not immune to economic slowdowns, growth companies tend to be not so highly sensitive to the economy as other more cyclical businesses.** More importantly for us, larger 'Quality' companies tend to have low debt, stronger earnings, and overall healthier balance sheets; which make them more resilient in a prolonged downturn.

Healthcare continues to be one of our preferred sectors in an economic slowdown. **While healthcare earnings are also expected to decline as a result of current disruptions, it is expected to be much less severe and more temporary than the broader market.** Additionally, even as healthcare has been one of the best performing sectors YTD and have benefitted our overweight, current valuations are still reasonable relative to the broader market.

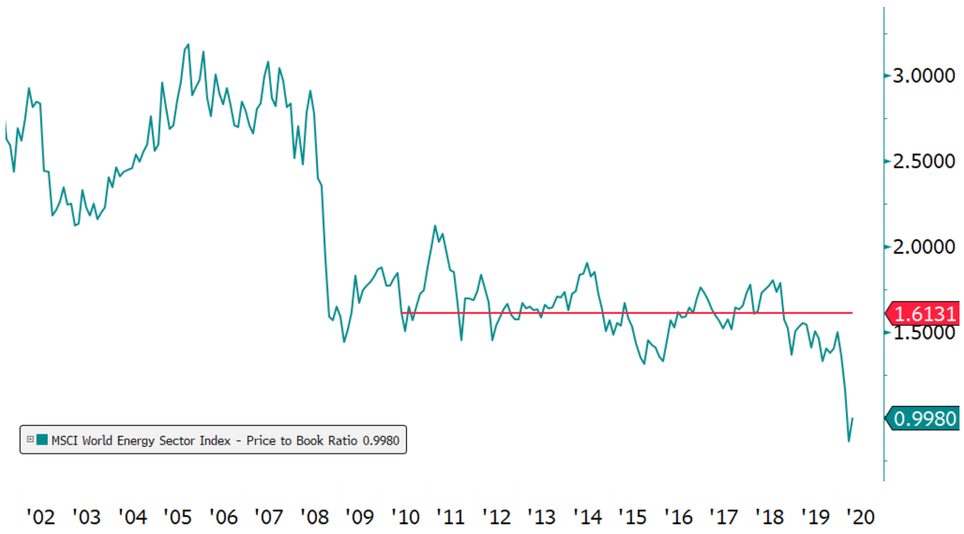
Key Themes: Positioning For Recovery

Our FVT investment framework boils down to identifying areas that are priced cheaply, with good and/or improving fundamentals. Opportunities do show up routinely as part of the process, though compelling ones are less frequent, or are easy to benefit from quickly - the most undervalued areas tend to take a while to be recognised by the market.

Recall that our allocations to **China 'A' equities** did poorly in 2018 amidst the US-China trade tensions. **It was indeed uncomfortable to invest when markets are volatile in the short-term, but we took comfort in their low valuations and earnings growth profile to invest over a longer-time horizon**. Indeed, we benefited as China 'A' proceeded to become one of the best performing markets in 2019, and also year-to-date. We continue to maintain our overweight as valuations are still around their historical average, and as we are encouraged by the gradual resumption of the Chinese economic activity as shown earlier.

We received more than a few questions after we invested into **Energy equities** early April. With headlines like 'Oil Prices Fall Below $0!', or 'Oil Demand Drops by Record' making the front page of news websites over the past month, investors were understandably concerned. Isn't the energy sector a risky investment today? While investors can expect continued price volatility over the coming weeks, this does not mean it is a high risk investment. Our approach here is the same as our other investments, which is to be positioned where there is an asymmetric payoff i.e. bigger gains, smaller losses. **By being patient and only biting after oil prices plunged by 66%, and energy equities by 51% in Q1 2020, we were able to invest at very attractive levels** - valuations of energy equities continue to be below their historical lows today (refer to chart on the right). Consequently, we expect to do well as oil adjusts back to higher long-term prices. That said, we also do not rule out the possibility of low oil prices for longer; which is why we favour the larger, better capitalised energy companies that will be more able to survive a prolonged downturn.

Energy Equities: Current Price-to-Book 0.99 vs 10-year average of 1.6



Key Themes: Search for Yield

Yield of major credit markets

	4 May 2020	31 Mar 2020	28 Feb 2020
Asia HY	10.5%	11.9%	6.6%
US HY short dur. bonds	9.6%	12.7%	6.9%
US HY bonds	7.7%	8.7%	6.2%
EM short dur. bonds	8.6%	8.1%	5.0%
EM bonds	7.1%	7.2%	4.8%
Global investment grade corporate	2.4%	3.0%	1.9%

As bank deposit rates continue to drop

	4 May 2020	31 Mar 2020	28 Feb 2020
SGD 1Y deposit	0.68%	0.75%	1.30%
USD 1Y deposit	0.68%	0.92%	1.35%

Source: Bloomberg

The "regular" table above has been updated to show how yields changed over the past three months. While credits sold off in March as reflected by a rise in yields, buyers started coming in to take advantage of better prices in April. On the other hand, savings rates kept decreasing over the three months.

Why do we continue the search for yield in these times? It is precisely in these times where meaningful opportunities for yield surface. Generally, higher yield is better provided an investor is comfortable with the associated risks. Conversely, low yields are unattractive if they are bundled with risks that investors are not being compensated for. An example of an unattractive investment is the pool of negative yielding debt that has been growing over the years. Please refer to our November 2019 commentary* on why investing in negative yielding debt may seem helpful in the short run, but is bad in the long run. **Essentially, one is paying to take risk rather than being paid to take risk.**

So who invests in these unattractive opportunities? Plenty. As the Asia-Pacific head of UBS Global Wealth Management's CIO office noted*, governments "obligate captive pools of capital like pension funds, banks and insurers to hold" bonds with suppressed yields. We and our investors are not obligated to follow suit. Some readers might note that Asian and emerging market yields rose more than other segments from February to March. The clear implication is that these markets dropped more, meaning **our portfolios would dip more than a passive multi-asset portfolio** comprised of global bond and equity indices. We would rather take short term pain for long term gain, instead of the opposite.

*https://webcms.finexisam.com/assets/publication/monthly/FAM_Commentary_201911.pdf

*https://www.straitstimes.com/business/invest/investing-in-a-post-covid-world

Key Themes: Search for Yield

Fixed Income market	Yield %	Years to double
Cash USD	0.04	1733.21
SGD 1Y deposit	0.68	103.03
Investment grade corporate	2.39	29.35
EMD Short duration	8.55	8.45
US High yield	7.69	9.36
Asian high yield	10.47	6.96

Source: Bloomberg as at 5 May 2020

Investment grade corporate bonds recovered faster in April compared to Asian high yield and Emerging market debt. **But is investment grade corporate better?**

Another way of looking at yield is the time it takes for an investment to double. The table above shows that **Asian high yield would take 7 years to double**, while investment grade corporate bonds need 29 years. Clearly, investment grade risk is different from high yield, but investors are sufficiently compensated for high yield risk in a diversified portfolio with sword and shield. Similarly, **emerging market short duration bonds check the boxes on our FVT process** leading us to be constructive on these credit segments.

Why have our portfolios not recovered as much in the past month? The table on the previous page shows that while Asian high yield and Emerging market debt have started to recover, they lagged investment grade corporate which has rallied quickly back to unattractive valuations. We expect our different positions to take turns to realise their value, and certainly not on short order. But with our higher yielding positions, **we are being paid to wait for a positive outcome**, rather than paying to wait for a negative outcome. This is why we expect a stronger recovery in the future.

Invariably, there will be comparisons between our portfolios to other multi-asset offerings. Not all multi-asset offerings are the same. We encourage investors to do their own PPP; and they might see some portfolios behaving like obligated investors holding suppressed yields. Such market-like portfolios would have dropped less and bounced more in the past months. For the investor with a long-term mindset, would you rather target higher returns with a bit more excitement when opportunities arise, or be lulled into a false sense of safety and sacrifice long term performance?

Key Themes: How Are We Positioned?

Resilience Amid Downturn	Positioning for Recovery	Search for Yield
US Quality Growth equities	China 'A' equities	Asian High-yield bonds
Health Care equities	Energy	Emerging Market Short Duration bonds
Currency-hedged Government securities		

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Asset Allocation Strategy

Equity: Regions	--	-	=	+	++	Allocation strategy
United States						**Large-cap Quality Growth** have stronger balance sheets and are more resilient in an economic slowdown. **Healthcare sector** as earnings are less dependent on broader economic cycle. **Energy** where valuations are compelling and providing a margin of safety for investors. *Overweight in US as a result of allocations to Global Healthcare and Energy, which are US-heavy.*
Europe	0%					Maintaining no exposure as economic activity declines, and as valuations are not attractive.
Japan	0%					Re-allocated to energy equities which has better risk/reward.
Asia Pacific ex Japan						**China 'A'** overweight as valuations continue to be attractive and earnings expected to be more resilient.
Emerging Markets						Neutral as valuations attractive relative to developed markets, but where earnings have declined.

Fixed Income	--	-	=	+	++	Allocation strategy
Government						Focus on currency-hedged global government fixed income to buffer portfolio volatility during periods of stress.
Investment Grade Corporate	0%					Maintaining no exposure as low incremental yield and long duration credit exposure are less attractive than other segments.
US High Yield	0%					Maintaining no exposure due to relative poorer fundamentals.
Asia						Attractive yield across major fixed income markets with room for capital appreciation and better fundamentals.
Emerging Market Debt						Hard currency short duration focus as a more defensive credit investment for a recessionary environment.

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

Current Previous

Market Index Returns

Equity Regional	MTD	QTD	YTD
Global	10.78%	10.78%	-12.78%
United States	12.82%	12.82%	-9.30%
Europe	6.74%	6.74%	-17.30%
Japan	4.35%	4.35%	-13.96%
Asia Pacific ex Japan	9.82%	9.82%	-12.83%
Emerging Markets	9.18%	9.18%	-16.55%

Fixed Income	MTD	QTD	YTD
Global Aggregate (Unhedged)	1.96%	1.96%	1.63%
Global Aggregate (Hedged)	1.62%	1.62%	3.09%
High Yield	4.21%	4.21%	-8.63%
Asia	1.55%	1.55%	-1.38%
Emerging Market Debt	2.60%	2.60%	-7.13%

Currencies	MTD	QTD	YTD
USD/SGD	-0.85%	-0.85%	4.76%
EUR/SGD	-1.51%	-1.51%	2.39%
JPY/SGD	-0.33%	-0.33%	-1.32%

Commodity	MTD	QTD	YTD
Gold	6.93%	6.93%	11.15%
Oil (WTI Crude)	-8.01%	-8.01%	-69.15%

Equity Markets	MTD	QTD	YTD
Australia	8.79%	8.79%	-16.01%
Brazil	10.25%	10.25%	-30.39%
China "A"	6.17%	6.17%	-4.47%
China "H"	4.65%	4.65%	-10.09%
Hong Kong	4.43%	4.43%	-12.40%
India	14.42%	14.42%	-18.02%
Indonesia	4.31%	4.31%	-24.29%
Korea	11.03%	11.03%	-11.18%
Malaysia	4.87%	4.87%	-9.95%
Russia	5.65%	5.65%	-12.71%
Singapore	5.79%	5.79%	-18.09%
Taiwan	13.26%	13.26%	-8.11%
Thailand	16.85%	16.85%	-15.81%

Equity Sectors	MTD	QTD	YTD
Gold	38.64%	38.64%	10.90%
Energy	29.66%	29.66%	-36.54%
Technology	13.52%	13.52%	-1.63%
Healthcare	11.49%	11.49%	-1.83%
Financials	9.34%	9.34%	-26.02%

Total return in index currency terms as of 30 Apr 2020. Source: Bloomberg

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