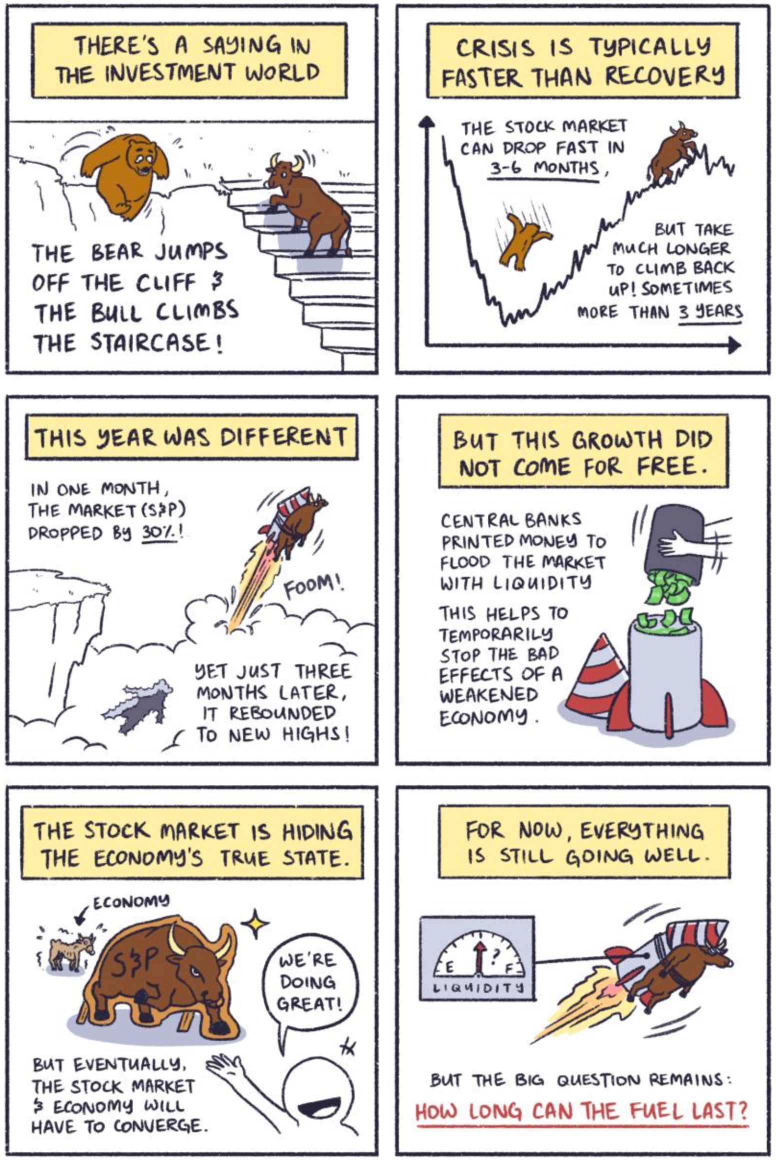
Investment Update
September 2020

finexis
ASSET MANAGEMENT
汇信资产管理有限公司

Market Review



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Global equity markets rose 6.16% in August, while global investment grade bonds were flat at -0.15%. After five straight months of strong market gains, it would not be surprising if the media paid less attention to “recession” and “bear market”. So we came up with our own graphic media to try to explain market cycles, and in particular what happened this year.

Indeed, everything is still going well, which has benefitted investors. In fact, the more aggressive and undiversified one was, the more likely they had a higher return this year (provided they held on through the large and swift drop in Q1).

Our multi-asset balanced and aggressive portfolios returned between 2.06% to 4.28% in August, reflecting our more diversified approach which we believe is more in tune with our investors. **We do not shy away from taking risk; it’s just that we recognise that risk is a double-edged sword and invest appropriately.** Why? In the case of the rocket analogy, real-life rockets carry enough fuel to blast out of the Earth’s atmosphere so that gravity does not pull them back crashing down even when they run out of fuel. **However, when it comes to investments, gravity will always assert itself.**

The first week of September has seen equity markets decline e.g. Tesla was down 18% in three days. Is this an air pocket before another run up, or the beginning of a dot.com like crash? **Only time can tell**.

In fixed income, the shield portion comprising government bonds was flat. This is probably a good indication of what to expect longer term: flat returns from government bonds. Hence, their main purpose in a portfolio today would be to mitigate losses of the sword positions during market stress. However, even this proposition is being challenged as we saw government bonds also dropping with equities during the Q1 sell-off.

Yield markets as proxied by Asian high yield and emerging market debt indices returned between 0.84-2.13%. In general, our positions did better than their respective indices. In some ways, market dynamics in August reflect what we expect of our investments going forward i.e. for our active positions to contribute (just not in every month).

Key Themes: Resilience Amid Downturn

Every downturn has some common elements. There tends to be an epicentre whose excess was a contributing factor to the recession, and for which the impact is the largest in terms of business failure and jobs lost. Just think of how past crises are called e.g. dot.com crisis, Great Financial Crisis, and you have a sense as to where the biggest boom-bust was. Outside of these epicentres, other industries are not spared as economic activity declined, and more people found themselves out of a job if they are part of a cost-cutting exercise. Even if one did not lose their job, they had to tighten the purse strings. But by and large, the impact on other industries was fairly proportionate.

Today's crisis is rather unique in terms of how the impact has not been proportionate. Businesses that were otherwise humming along found themselves to be collateral damage as the pandemic drastically changed our behaviours and day-to-day routines. Think of airlines and hotels where demand has practically evaporated whereas in prior recessions they would have suffered but to a similar extent as the broader economy. If we were to name this crisis for where the job losses are, it might be called the 'Hospitality Recession' as we continue to see airlines and hotels shutting down.

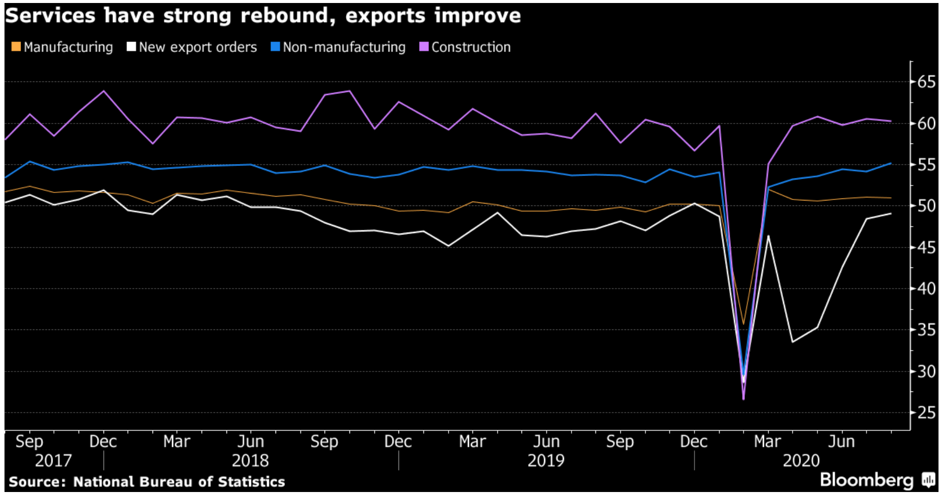
There have also been beneficiaries of a covid-world, such as businesses that help to facilitate 'work-from-home' arrangements. Zoom, which is now ubiquitous with virtual meetings, is one company that has benefitted tremendously. To say that their earnings have been resilient is an understatement: Q2 revenue jumped more than four times from the year before as their services were in high demand over the past few months.

In our portfolios, resilient allocations come in the form of Large US Quality Growth, and Healthcare equities. Both of these positions have done well year-to-date; as they were more resilient during market declines in March, and also participated strongly in subsequent gains. Though not completely immune to the economic slowdowns, we have showed before that earnings growth for these companies have held up better than the broader market this year. Earnings growth for these markets are underpinned by secular tailwinds that precede (and will last long after) Covid-19. e.g. healthcare stocks benefitting from increased spending and ageing demographics globally.

We do not think that the economy is necessarily out of the woods just yet, and we continue to count on these segments to be able to provide more resilient earnings and returns if things turn for the worse.

Key Themes: Positioning For Recovery

China's economy on the path to recovery (above 50 = Expansion)



How do we position for recovery when markets have seemingly already run ahead of an economic recovery? Take for instance tech stocks (we use 'tech' loosely here), which have already experienced strong gains over the past few months, but where valuations are now stretched to say the least. Do we chase performance and hope that we can get out before the music stops? Ironically, some of these high-flyers may even do poorly if economies open earlier than anticipated - analysts from Goldman Sachs recently said that a Covid-19 vaccine approval could 'support traditional cyclicals…and challenging tech leadership'. As investors with a global view, we are able to be selective in investing into markets that may offer higher future expected returns, and with lower downside risks:

Energy equities declined modestly in August as demand concerns remained on investors minds. Our energy allocation benefitted when we first allocated earlier in the year but has detracted more recently. Interestingly, oil prices have recovered strongly as expected (in April, we thought that $20 oil was too low), but equities have not yet reacted positively. Such large divergence is uncommon but tends to converge with time. Improving fundamentals in the form of ongoing rebalancing in the oil market, coupled with historic low valuations improves the odds that equities can play catch-up going forward. We also have a preference for energy companies with healthier balance sheets that can survive a prolonged downturn, which means that we can remain invested even as economies do not fully re-open so quickly. Till then, energy equities retain a high recovery potential on the back of higher oil prices with vaccine approvals as a possible catalyst for unlocking this value.

China 'A' equities rose close to 3% over the past month, extending July's strong performance. Our overweight here has been driven primarily by the attractiveness of a high-growth market that continues to be reasonably valued - a mix that is increasingly scarce today. China has also made positive strides in containing the virus, and their domestic economy has been recovering close to pre-covid levels. Though demand is still patchy in certain sectors, the range of economic indicators that we monitor were broadly positive in August as shown on the top-right chart. Going forward, we expect earnings to continue to be supported by accommodative government policies and as economic activity picks up.

Key Themes: Search for Yield

Yield of major credit markets

	31 Aug 2020
Asia HY	6.8%
US HY short dur. bonds	5.9%
US HY bonds	5.1%
EM short dur. bonds	3.8%
EM bonds	4.1%

As bank deposit rates remain low

	31 Aug 2020
SGD 1Y deposit	0.81%
USD 1Y deposit	0.40%

Source: Bloomberg

An editorial* in the Straits Times titled "Fed sets the stage for more asset price inflation" discussed how the Fed is shifting how it operates going forward, with the result being lower interest rates for longer. The major implications from this are: **no ammunition left to cut rates further if things get worse, and continued liquidity in the system leading to (as the title states) "more asset price inflation".**

The first implication challenges what many have assumed to be a principal tenet of investing; that bonds are good diversifiers during market stress. This has been preached in school and applied in practice by finance professionals. For many, they may not realize it but the world has changed. Central banks used to cut rates to get economies out of crises. With interest rates at current low levels, further rate cuts by central banks have may not be so effective. That is why we are looking beyond bonds to provide effective diversification.

The second implication of asset price inflation is perhaps easier to address: Combat asset price inflation by owning the very assets that are being inflated! The question is how do we decide which assets to invest in? Liquidity in financial markets is fleeting and fickle especially for markets which have no other fundamental or valuation support. Hence we focus our opportunities for capital gains by assessing their fundamentals and valuations. These may not provide instant gratification especially when compared with markets that have run up but are more sustainable longer term.

Our yield investments are one of the themes to address a low rate world because we expect yield returns to be in the mid single digits (and more with capital appreciation by investing at lower valuations). Importantly, they also serve to **provide returns when equities are not firing as strongly like in the recent months, or when equity markets get choppy in the event of increased uncertainty post-recovery**.

Perhaps the Fed is caught in between a rock and a hard place, which means they have little room to manoeuvre except maintain low rates. We don't like to have little room to manoeuvre when we see a potential train wreck on the horizon, which is why we search for additional tools to manage difficult markets.

*https://www.straitstimes.com/opinion/fed-sets-the-stage-for-more-asset-price-inflation-0

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 equities	Emerging Market Short Duration bonds
Currency-hedged Government securities	Emerging Market equities	

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** 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 remains lacklustre, and as valuations are less attractive compared to other opportunities.
Japan	0%					
Asia Pacific ex Japan						**China 'A'** overweight as valuations continue to be reasonable 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	6.16%	11.82%	5.14%
United States	7.19%	13.23%	9.74%
Europe	3.08%	2.14%	-9.86%
Japan	8.19%	3.85%	-4.64%
Asia Pacific ex Japan	3.88%	12.15%	5.48%
Emerging Markets	2.24%	11.45%	0.67%

Fixed Income	MTD	QTD	YTD
Global Aggregate (Unhedged)	-0.15%	3.03%	6.11%
Global Aggregate (Hedged)	-0.72%	0.36%	4.27%
High Yield	0.79%	5.77%	1.09%
Asia	0.44%	2.61%	5.04%
Emerging Market Debt	0.54%	3.68%	3.24%

Currencies	MTD	QTD	YTD
USD/SGD	-1.03%	-2.39%	1.07%
EUR/SGD	0.28%	3.72%	7.60%
JPY/SGD	0.08%	-1.87%	-2.49%

Commodity	MTD	QTD	YTD
Gold	-0.41%	10.49%	29.69%
Oil (WTI Crude)	5.81%	8.51%	-30.22%

Equity Markets	MTD	QTD	YTD
Australia	3.04%	3.57%	-6.83%
Brazil	-3.44%	4.54%	-14.07%
China "A"	2.75%	16.69%	19.87%
China "H"	-0.27%	3.97%	-7.33%
Hong Kong	2.54%	4.08%	-8.27%
India	2.83%	11.20%	-5.45%
Indonesia	1.90%	7.16%	-14.75%
Korea	3.41%	10.33%	6.33%
Malaysia	-4.82%	1.71%	-2.01%
Russia	1.97%	10.77%	1.21%
Singapore	1.05%	-1.00%	-18.56%
Taiwan	-0.04%	10.69%	8.12%
Thailand	-0.90%	-1.64%	-14.60%

Equity Sectors	MTD	QTD	YTD
Gold	-1.64%	15.72%	44.19%
Energy	-2.05%	-7.29%	-41.62%
Technology	10.52%	16.95%	32.61%
Healthcare	1.94%	6.04%	6.59%
Financials	4.13%	7.79%	-18.74%

Total return in index currency terms as of 31 August 2020. Source: Bloomberg

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