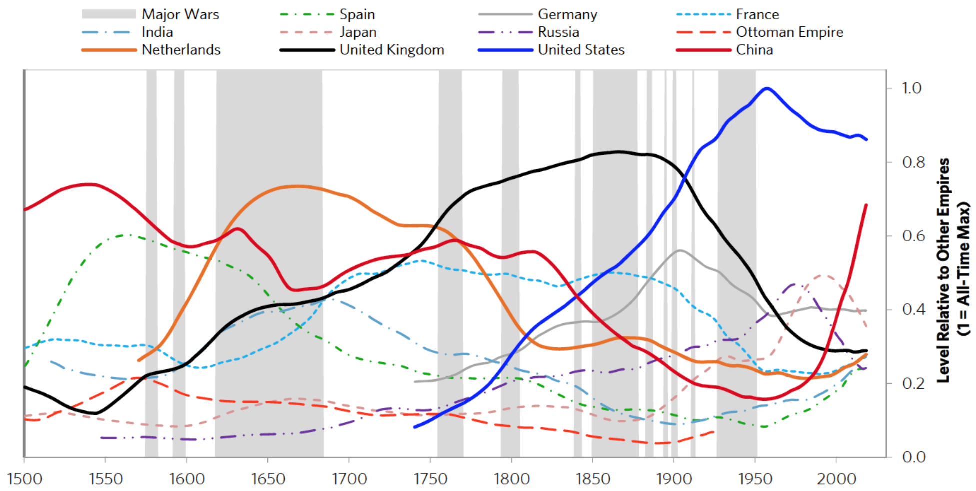
Investment Update
November 2020

finexis
ASSET MANAGEMENT
汇信资产管理有限公司

Market Review

Most of us grew up knowing the USA as a global superpower. Students of history will know that this was not always the case. In fact, **the rise and fall of empires is as certain as death and taxes**. The chart below shows how the US rose and peaked after the 1950s as the Chinese dragon rose from its slumber. Certainly, this inflection in global leadership is not the best signal for investing (imagine the opportunity cost of not investing in the US markets from 1950!)

Rough Estimates of Relative Standing of Great Empires



Source: https://www.linkedin.com/pulse/chapter-6-big-cycle-china-its-currency-ray-dalio/

This election is less about being able to predict who the winner is. An America where tourists, students, migrants do not feel safe is one that has ostensibly lost its appeal and ability to attract human capital. Is this a uniquely American trait? Not so, time and again, civilizations became more insular and xenophobic when the incumbents feel threatened in bad times, or feel their success did not require imported human capital. Even Singapore, as a microcosm of the world, struggles with this tension.

If the current state of affairs is a catalyst for the decline of American exceptionalism, perhaps **now is a better time to diversify meaningfully into other markets rather than look back at how well the US has done.**

Global equity markets declined 2.5% in October, while global investment grade bonds were flat. Looking into equities, developed market equities were –3%; what might seem like a surprise is that emerging market equities were +2%. While we do not want to read too much into a single month performance, we will gladly take the benefits of diversification as they come along. Perhaps as more of such bifurcation occurs, EM will really come into its own, and not be the tail that is wagged by the dog.

In fixed income, global investment grade bonds were flat, and credit markets were down albeit less than equities. Are bonds not delivering on their proposition if they were not up when equities were down? There is a sure way to get profits when equities are down: to invest in negatively correlated assets. However, negative correlation means going in the opposite direction, which entails a negative return expectation (hard for most people to accept).

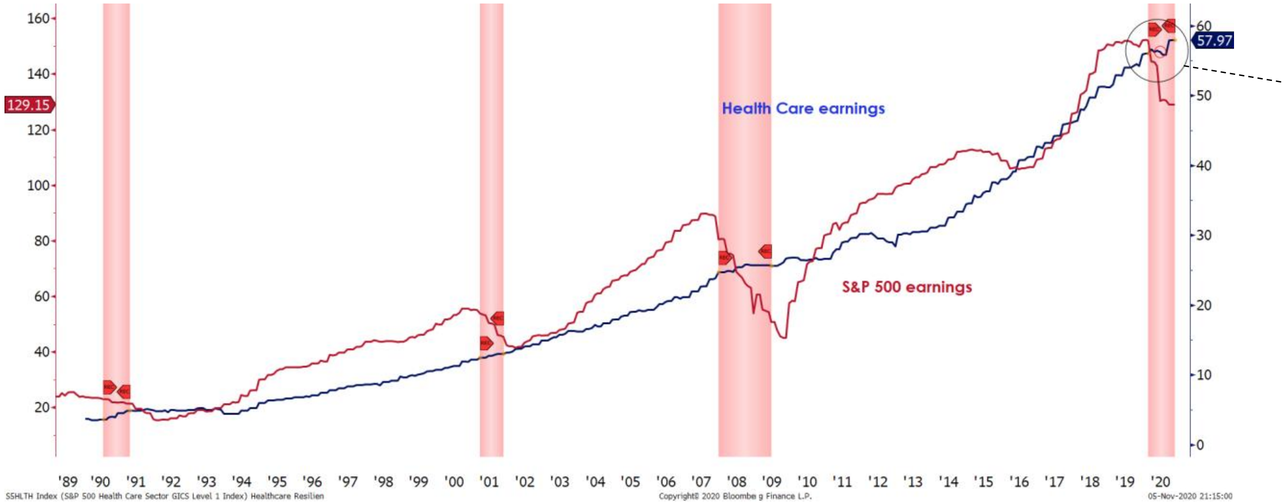
If you recall last month's segment on correlation, one should expect a portfolio diversifier to have low correlation, not negative correlation. In any case, the equity decline of 2.5% last month is not the kind of drop where one should expect the "shield" to kick in.

References

Global equities: MSCI All Country World Index, Global investment grade bonds: Bloomberg Barclays Global Aggregate Index, Developed market equities: MSCI World developed markets, Emerging market equities: MSCI Emerging Markets Index.

Key Themes: Resilience Amid Downturn

We've said before that our portfolios are currently well positioned to navigate the challenging environment we find ourselves in today. This includes the outcome of the US election, which is still being finalised at time of writing. This is particularly true for our resilient US Quality Growth and Healthcare equity segments, where earnings are underpinned by secular tailwinds that are expected to continue no matter Trump or Biden. To reinforce this point, we can take a look at how healthcare earnings have performed vs the broader US market since 1989:



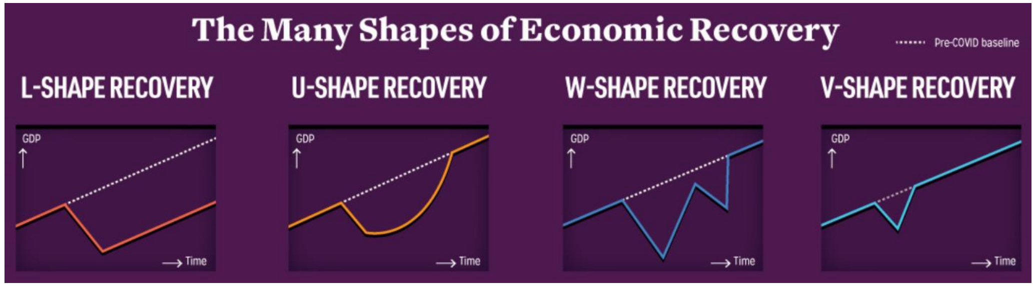
Source Bloomberg

Healthcare earnings have held up in 2020 despite a recession and pandemic, continuing with their long-term trend of being more resilient. Stable earnings growth is an attractive feature to have especially during periods of economic uncertainty, as these companies are less prone to disappointment and subsequent outsized declines. We also like that we do not need to pay a premium over the market, which makes this an attractive proposition for us.

A prudent investment strategy not only focuses on the upside, but also takes care to protect against outsized losses. That is why we allocate to areas we identify as being more resilient and with supportive fundamentals. We believe this is a much more enduring strategy than trying to chase performance, which is understandably hard not to do especially when everyone else seem to be doing so *and* getting much higher returns. **To be a successful investor, one would need to have a well-thought out strategy, and also the discipline (and courage) to stick to it.** Take Stan Druckenmiller's (one of the legendary investors) personal experience during the 2000 tech bubble as a reminder and cautionary tale for all of us:

"I bought $6 billion worth of tech stocks, and in six weeks I had lost $3 billion in that one play. You asked me what I learned. I didn't learn anything. I already knew that I wasn't supposed to do that. I was just an emotional basket case and I couldn't help myself. So maybe I learned not to do it again, but I already knew that." Source: https://theirrelevantinvestor.com/2018/05/16/druckenmillers-big-mistake/

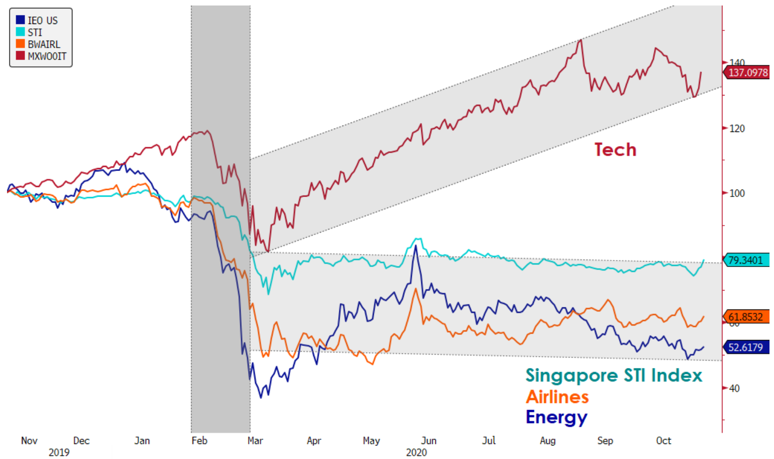
Key Themes: Positioning For Recovery



Source: https://www.visualcapitalist.com/shapes-of-recovery-when-will-the-global-economy-bounce-back

Do you know your ABCs? Of course, here we are referring to the ABCs of an economic recovery which may be used by economists to describe the shape (and path) of the recovery. The common ones are L, U, W, and V as illustrated above. But there is a more unusual shape that we think is a better representation of what we are experiencing today: the K.

The K-shape more accurately represents the bifurcated recovery we have observed so far:



Do you see the K? On K's upper arm, industries like technology have recovered strongly. On the lower-arm, we see segments that have not yet recovered – airlines, energy explorers, and even Singapore's STI Index. It may come as a surprise that Singapore's stock market is in the same camp as energy exploration companies on the other side of the planet. Indeed, the lower-K markets have all similarly struggled amid the pandemic restrictions and subsequent uneven recovery we've gone through. Likewise, they are expected to perform when we get a broad-based economic recovery.

One could see how we could just as likely invest into any one of these markets as a recovery play. Why did we choose to invest in energy? The short answer is that we expect higher upside return here when the recovery play pans out (it helps that valuations are at historical lows).

China 'A' equities, our other recovery play, has so far worked out very well for us. Being ahead on the recovery curve, China offers a glimpse to what a potential recovery could look like. A recent IMF report showed that China will be the only major economy to grow in 2020, underscoring the strength of their economy.

We mentioned early on that the timing of recovery is hard to pin down. Additional central bank stimulus, fiscal support, or potential vaccine approvals are expected to accelerate the recovery timeline, but there is still large uncertainty. The benefit of our approach is that we are able to sit tight by investing into differentiated positions across the recovery curve.

References Tech: MSCI World Tech Index, Singapore: Straits Times Index, Airlines: Bloomberg World Airlines Index, Energy: U.S. Oil & Gas Exploration & Production ETF. Source: Bloomberg

Key Themes: Search for Yield

In our Q4 outlook presentation, we discussed how JP Morgan was starting to charge fees on some of their deposit accounts, and wondered aloud when low interest rates would start to hit home. Today there were notifications that deposit rates at a local bank were being reduced to near zero. We imagine many depositors getting the same notification. We have been highlighting the low rate environment for some time. Indeed, if low rates were not sufficient to prompt a change in behavior before, zero would certainly be a key catalyst (at least from a psychological standpoint). **Faced with 0% interest, a depositor will invariably ask "how can I get more?"**

An answer is the search for yield, which is an established theme in our portfolio. While the answer is straightforward, the execution is less so.

We are not alone in the search for yield. Flush with liquidity and low interest rates, banks and fixed income investors have been lending more and more to borrowers in a quest to get more on their capital. **With more money chasing less opportunities, borrowers actually had more bargaining power**, and there have been situations where lenders relaxed on certain conditions that they normally would have imposed. The implications are that **creditors may not get the same kind of protection as they would in the event of default by the borrower, resulting in losses beyond what they might have seen before.**

That is why we don't just look at where the highest yields are. There are risks underlying whatever opportunity is available. There are certain risks we are prepared to take, and others that we are not. Some opportunities offer higher yield because they are inherently levered. **Blowups do not happen when there is leverage; they happen when there is unwinding of leverage.** Today, the leverage is in place; we are just mindful not to be standing right in front of an unwind situation. Other opportunities offer higher yield simply because they contain bad risk that is not worth taking. If you come across an opportunity that promises high returns such as more than 10% a month, be sure to look underneath the hood and see what the risk is. Accordingly, some parts of our yield portfolio may not look that exciting, but addressing the likelihood of permanent capital loss is crucial for long term compounding.

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 declines, 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	-2.41%	-2.41%	-0.66%
United States	-2.66%	-2.66%	2.76%
Europe	-5.09%	-5.09%	-15.63%
Japan	-2.84%	-2.84%	-6.22%
Asia Pacific ex Japan	2.41%	2.41%	5.59%
Emerging Markets	2.08%	2.08%	1.13%

Fixed Income	MTD	QTD	YTD
Global Aggregate (Unhedged)	0.10%	0.10%	5.82%
Global Aggregate (Hedged)	0.01%	0.01%	4.66%
High Yield	0.35%	0.35%	0.26%
Asia	-0.14%	-0.14%	4.34%
Emerging Market Debt	-0.12%	-0.12%	1.81%

Currencies	MTD	QTD	YTD
USD/SGD	0.07%	0.07%	1.52%
EUR/SGD	-0.56%	-0.56%	5.46%
JPY/SGD	-0.78%	-0.78%	-3.64%

Commodity	MTD	QTD	YTD
Gold	-0.37%	-0.37%	23.83%
Oil (WTI Crude)	-11.01%	-11.01%	-41.39%

Equity Markets	MTD	QTD	YTD
Australia	1.94%	1.94%	-8.40%
Brazil	-0.69%	-0.69%	-18.76%
China "A"	2.38%	2.38%	16.96%
China "H"	3.89%	3.89%	-9.16%
Hong Kong	2.79%	2.79%	-11.78%
India	4.25%	4.25%	-2.83%
Indonesia	5.34%	5.34%	-16.46%
Korea	-2.61%	-2.61%	3.76%
Malaysia	-2.37%	-2.37%	-5.23%
Russia	-5.83%	-5.83%	-6.54%
Singapore	-1.57%	-1.57%	-21.90%
Taiwan	0.25%	0.25%	8.01%
Thailand	-3.39%	-3.39%	-22.01%

Equity Sectors	MTD	QTD	YTD
Gold	-4.20%	-4.20%	28.08%
Energy	-4.69%	-4.69%	-52.50%
Technology	-5.18%	-5.18%	20.02%
Healthcare	-4.93%	-4.93%	-0.17%
Financials	-1.05%	-1.05%	-22.55%

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

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