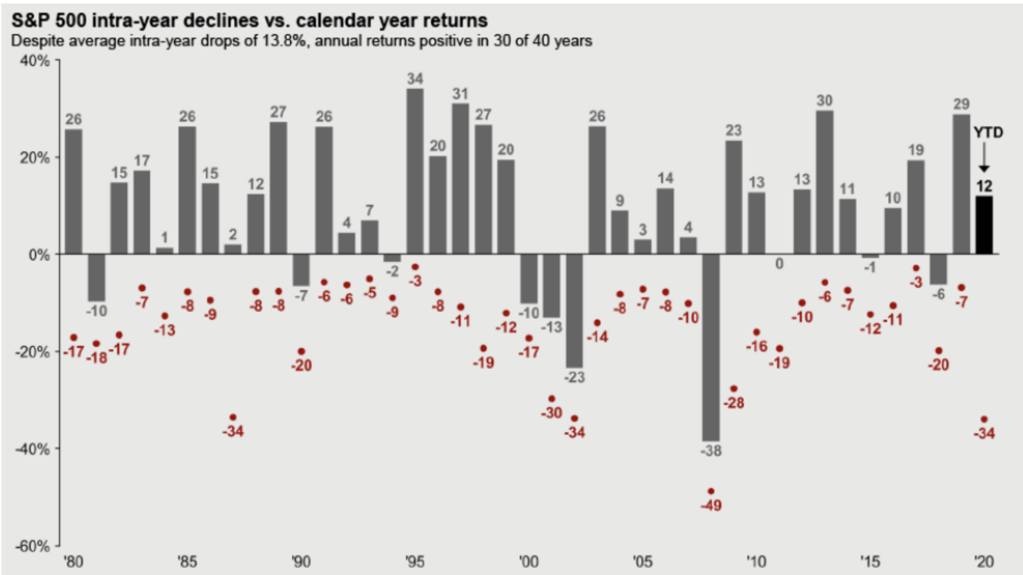
Investment Update
December 2020

finexis
ASSET MANAGEMENT
汇信资产管理有限公司

Market Review

Global equity markets rose 12.4% in November. If that does not raise any eyebrows, **this was the best month in 45 years**, with the Dow Jones index crossing 30,000 points for the first time. For those who were waiting on the sidelines due to US elections, they certainly missed out.

Others were also waiting on the sidelines due to what happened throughout this year. With a world rattled by covid deaths and markets experiencing a perfect storm in Q1, no one would have guessed that 2020 would have one of the best months in history. But history tells us something else more important; even though there are intra-year declines, the year-end returns tend to end up higher. Reading it in a more practical way: **one needs to take on interim losses in order to enjoy the gains they target.**



Source: JP Morgan Asset Management Guide to the Markets as of 30 Nov 2020

If November was a resurgent tide that lifted all boats, then bonds also benefitted. Unhedged global investment grade bonds were up 1.8%, perhaps reflecting their characteristic increasingly as a risky rather than defensive asset. Recall that unhedged global investment grade bonds fell and rose with equity markets during the sell-off earlier this year.

On the credit front, high yield markets rose about 3% depending on region. It is in such months like November where credit investments are able to provide return from capital appreciation on top of coupon.

Alas, the November tide did not lift all boats as gold prices were down 5.4%. Actually, this is to be expected as gold continues to retain its characteristic as a safe haven, which tends to get sold off when risk appetite is high.

2020 has seen its fair share of unprecedented events. The large moves in markets this year also look unprecedented. The daily volatility of the MSCI World index this year is 1.8% compared to 0.8% in the prior 10 years from 2009 to 2019. However, this 10-year period saw depressed levels of volatility. So what we are currently experiencing is probably a reversion back to higher levels of volatility that were more commonplace before. To the uninitiated, welcome to what should be more normalised market volatility.

Yes, we are experiencing events that create volatility and uncertainty, yet these are what create opportunity.

References

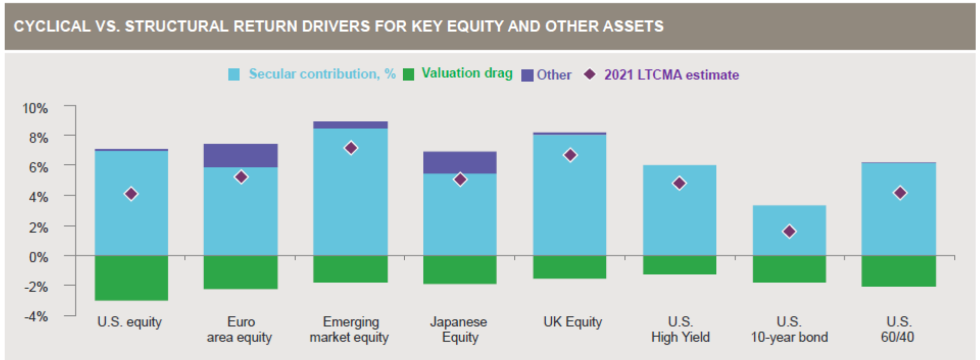
Global equities: MSCI All Country World Index, Global investment grade bonds: Bloomberg Barclays Global Aggregate Index, High yield: Bloomberg Barclays High Yield Total Return Index, Bloomberg Barclays Asia USD High Yield Index.

Key Themes: Resilience Amid Downturn

We first introduced the resilience theme in 2019, and subsequently allocated to Healthcare and Quality Growth equities which continue to make up our resilient equity holdings to this day. Our portfolios turned progressively more defensive over 2019 as we observed economic indicators deteriorating, and benefitted during the bouts of market volatility since then. Resilient equities also served us well earlier this year, when markets experienced one of the most ferocious declines in recent memory.

Financial markets have rallied strongly since March's sell-off, making new highs even as the world grapples with covid-19. We always ask ourselves; what's next? If a recovery is truly underway, is there still a role for resilient equities in our portfolios?

Elevated valuations are a challenge to returns across public markets



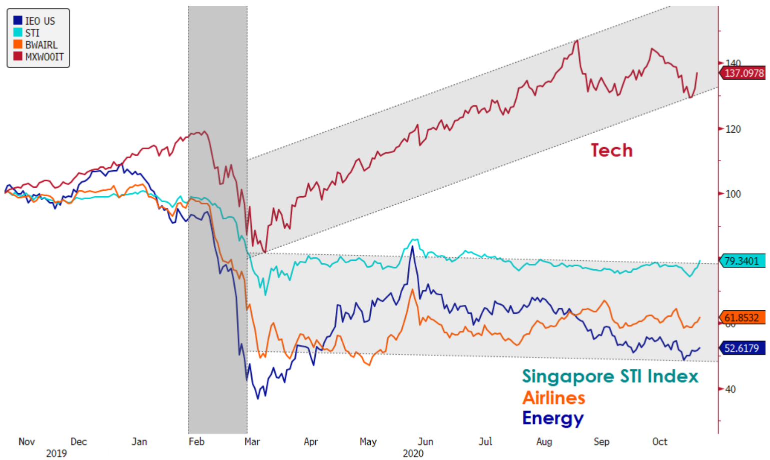
Source: J.P. Morgan Asset Management 2021 Long-Term Capital Market Assumptions

For now, we believe that resilient equities will continue to play an important role as part of a diversified portfolio, especially in the backdrop of 1. historically high valuations, and 2. as recovery is likely to be uneven and *k-shaped* (we covered the shapes of economic recovery in last month's update). In general, high valuations means that investors have a lower margin of safety, and can expect lower long-term returns as shown in the chart.

Passive investors, in particular, should re-evaluate their portfolios or risk being unprepared for lower returns and potentially larger drawdowns going forward. This is one advantage of our more flexible approach; to be able to utilise our FVT process to invest into areas with higher expected returns and better risk/reward. Healthcare and Quality Growth stocks - with their more stable earnings growth profile - is a good complement to the portfolio's recovery plays (which we cover in the next section), and provide overall diversification for our portfolio. That said, even resilient markets can also become less attractive as valuations become overly stretched, at which point we expect to re-allocate into more favourable parts of the market.

Key Themes: Positioning For Recovery

Last month, we said that the ‘K-shape’ is a good representation of the uneven recovery we have observed so far – where tech has recovered strongly, but where other segments such as Singapore's STI, airlines, and energy has lagged. Recall the following chart:



One month can make a big difference:

	QTD Returns (30 Oct 2020)	QTD Returns (30 Nov 2020)
Tech	-5.13%	6.83%
Singapore STI	-1.57%	14.34%
Airlines	-0.68%	25.37%
Energy	-4.76%	26.74%

Source: FAM & Bloomberg. Reference indices: MSCI World Information Technology Index, Straits Times Index, Bloomberg World Airlines Index, DJ US Select Oil Exploration & Production Index, Shanghai Shenzhen CSI 300 Index. All returns shown in local currency terms.

We did not have a crystal ball to tell us when the recovery will happen, but know from history that the market ‘voting machine’ will eventually give way to the ‘weighing machine’ over the long-run. **The past month is a reminder that chasing performance can be a dangerous game**, as you are likely to have missed the strong run up and may be getting in right as it is about to go off the cliff. Just like how you would not drive by just looking in the rear-view mirror, successful investing means looking ahead and steering clear of any impending danger.

In the end, positive vaccine developments ended up being the catalyst for recovery markets to catch up. In the past month, our energy overweight surged while previously ‘resilient’ tech lagged, vindicating our diversified approach. **We are cautiously optimistic that a more sustained economic recovery may be underway.** Despite a fresh wave of covid-19 cases, the world is looking like it is slowly but surely adjusting to a new normal. Green shoots have also emerged across the economic indicators that we monitor; such as improvements in manufacturing activity and jobless claims.

To be clear, we do not think it is going to be smooth sailing from here on. We also do not want to invest in anything and everything ‘cheap’ and hope for a recovery. How many of you have gone to the cinema since covid-19? In fact, Warner Bros. just announced that all its major movies in 2021 will debut online and in cinemas simultaneously, raising serious questions about the future of the industry. Our approach ensures that we invest only where fundamentals are sound and when valuations are in our favor.

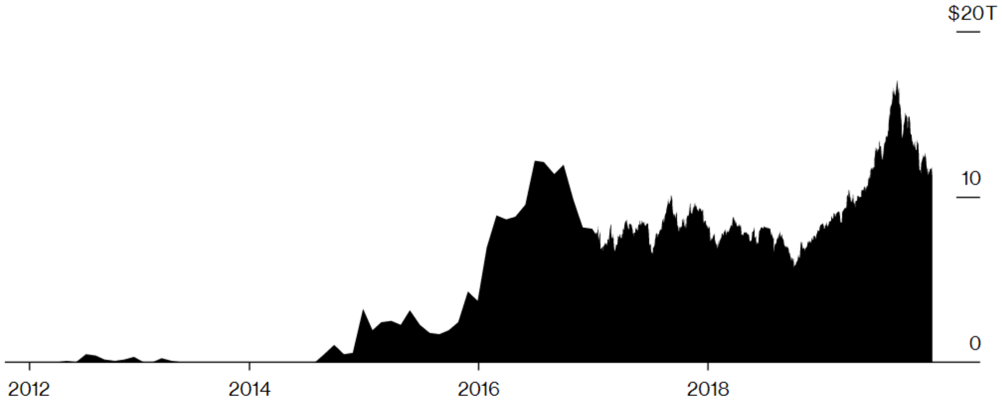
Key Themes: Search for Yield

Amid the record breaking gains and new market highs, we cannot ignore the unprecedented challenges investors are facing: that of low rates.

We have been cautioning on low rates for quite some time, and started positioning our portfolios to mitigate the risk of low rates since 2016. These include **avoiding investment grade bonds which already had low or negative yields** which we were not prepared to accept as investors.

This was not always a smooth path as other market participants were going "down the curve" together with low rates. In 2019, we highlighted that investors were paying companies to borrow money by investing in negative yielding bonds, in effect supporting those unattractive bonds.

Market Value of Negative-Yielding Bonds in the Bloomberg Barclays Global-Aggregate Index



Data: Compiled by Bloomberg

Source: https://www.bloomberg.com/graphics/negative-yield-bonds

Today, there are still portfolios out there that continue to invest in such bonds as these bonds are index constituents. By virtue of their investment objective, passive funds (which have been growing in popularity) continue to invest in negative yielding bonds. We are not opponents of passive funds, we just avoid those when their objective is to invest in areas with poor FVT. There are also non-passive funds that have constraints such that they cannot invest in higher yielding opportunities even if they wanted to. This group is significant as they can be comprised of large and influential investors such as pensions and insurers.

Of late, our chorus has gotten louder as more investment managers wake up to the reality of low rates. To drive home the message, some have reports to indicate that interest rates are at 5000 year lows. **We are part of the group that is saying "I do not pay to lend money. That's not fixed-income investing, that's fixed-loss investing."*** In the search for yield, we continue invest in Asia and Emerging market high yield though developed market high yield markets are starting to look interesting as well.

*https://www.bloomberg.com/news/articles/2019-10-16/jpmorgan-veteran-refuses-to-buy-insane-negative-yield-bonds

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	12.36%	9.66%	11.63%
United States	10.95%	8.00%	14.01%
Europe	13.86%	8.07%	-3.94%
Japan	11.12%	7.97%	4.29%
Asia Pacific ex Japan	9.12%	11.75%	15.22%
Emerging Markets	9.25%	11.52%	10.49%

Fixed Income	MTD	QTD	YTD
Global Aggregate (Unhedged)	1.82%	1.92%	7.75%
Global Aggregate (Hedged)	0.57%	0.58%	5.26%
High Yield	3.84%	4.20%	4.11%
Asia	1.39%	1.25%	5.79%
Emerging Market Debt	3.07%	2.94%	4.93%

Currencies	MTD	QTD	YTD
USD/SGD	-1.82%	-1.74%	-0.32%
EUR/SGD	0.55%	-0.01%	6.04%
JPY/SGD	-0.33%	-1.11%	-3.96%

Commodity	MTD	QTD	YTD
Gold	-5.42%	-5.77%	17.11%
Oil (WTI Crude)	26.68%	12.73%	-25.75%

Equity Markets	MTD	QTD	YTD
Australia	10.31%	12.44%	1.04%
Brazil	15.90%	15.11%	-5.84%
China "A"	5.70%	8.21%	23.63%
China "H"	8.06%	12.26%	-1.84%
Hong Kong	9.38%	12.43%	-3.51%
India	11.45%	16.19%	8.30%
Indonesia	9.46%	15.30%	-8.55%
Korea	14.30%	11.32%	18.61%
Malaysia	6.67%	4.13%	1.09%
Russia	15.52%	8.78%	7.96%
Singapore	16.17%	14.34%	-9.28%
Taiwan	9.38%	9.65%	18.14%
Thailand	17.98%	13.98%	-7.99%

Equity Sectors	MTD	QTD	YTD
Gold	-7.65%	-11.53%	18.28%
Energy	26.57%	20.63%	-39.88%
Technology	12.47%	6.65%	34.98%
Healthcare	8.85%	3.48%	8.66%
Financials	16.75%	15.53%	-9.57%

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

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