Investment Update
February 2021

ASSET MANAGEMENT
汇信资产管理有限公司

Market Review

"Undergraduate chalks up $100k in gains after putting in $20k of savings, tuition earnings."* We don't even have to tell you that this was about GameStop, a company few people knew about until recently.

In a matter of weeks, investors were treated to a roller coaster ride that went from $36 to $348 then to $54. Going by the date of the news article, the 500% gains were likely based on the closing price of $325 last Friday, just shy of the highest price. Since then, the price has declined to $54, which means the undergraduate is more or less at his buy price if he has not sold this week.

Source: Bloomberg. Price chart for GameStop Corporation for 6 months from 4/08/2020 to 4/02/2021.

For those who have been staring at this lost chance to make a fortune as well as score bragging rights, ask yourself: When would you have seen it coming? At what price would you have invested? At what price would you have taken profit or cut loss? Do you have a repeatable strategy to make money this way?

*https://www.straitstimes.com/business/companies-markets/undergrad-among-local-investors-betting-on-gamestop

Our process seeks to understand what drives a security's price. Going by how the stock plunged and bounced back when restrictions were imposed and eased, one key driver is liquidity. **Our wealth compounding strategy is not premised on profiting from liquidity and rapid boom/bust cycles.** So we were **able to observe from the sidelines as our themes played out independently.**

Global equity markets continued last year's momentum with strong gains of 3.7% in January. Oh wait, that was until the third week. After that, equity markets declined to finish the month –0.44%. So, there was quite a bit of volatility, but equities ended up going nowhere in the single month of January.

Energy exploration & production equities were also volatile, rising up to 18.8% before retracing to close the month with gains of 4.8%, outperforming the broad energy market. This was amid a backdrop of oil prices which broke past and held above the psychological $50 level.

Unhedged global investment grade bonds were down –0.88% in January, in part due to gains in the USD. Hedged investment grade bonds declined less as they benefitted from USD strength. Indeed, January was a month where markets took a pause after the strong gains from the past quarter.

Credit markets were steadier amid otherwise range-bound equity markets. Global high yield and emerging market bonds were positive with contribution from coupon return, demonstrating how they can complement a portfolio when equity markets are range-bound.

References: Global equities: MSCI All Country World Index, Global investment grade bonds: Bloomberg Barclays Global Aggregate Index, Oil: WTI Crude oil, Energy equity: Dow Jones U.S. Select Oil Exploration & Productions Total Return Index

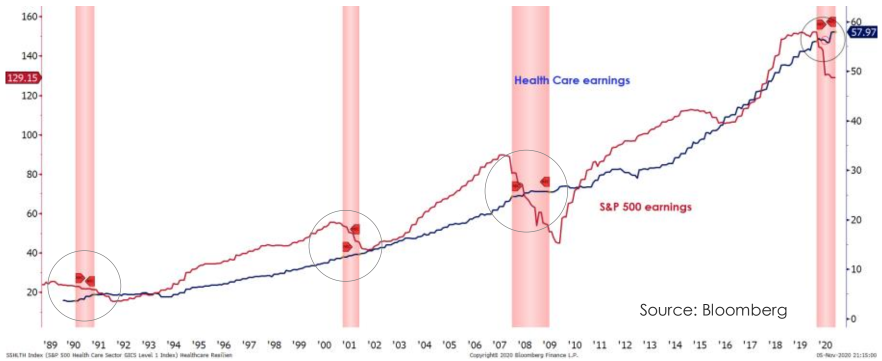
Key Themes: Stability Amid *VUCA*

VUCA is used to describe environments with **Volatility**, **Uncertainty**, **Complexity**, and **Ambiguity**

It is hard to argue that the blistering rise and fall of GameStop is not a sign of an over-exuberant market. We'd like to think of this as another reflection of VUCA – a world that is still rife with challenges while market valuations are stretched to say the least.

As mentioned earlier, our investment process seeks to 'understand relationships between securities and their drivers of returns'. **What was not said but even more important is that we are looking for *robust* drivers, so that we can be confident that the odds are in our favor when we invest.** The drivers behind the blistering rise in GameStop are more unpredictable, which makes any assessment of its risk/reward difficult.

This is why earnings are an important part of our FVT assessment, as it is one of the key fundamental driver of equity prices. Consequently, things get tricky for investors when earnings decline, as they usually do during periods of economic slowdown. In this regard, the stability in Healthcare earnings has made it a defensive segment relative to the broader markets:



Indeed, healthcare earnings continued to be resilient in 2020 despite a recession and pandemic, continuing with their long-term trend of being more stable than the broader markets.

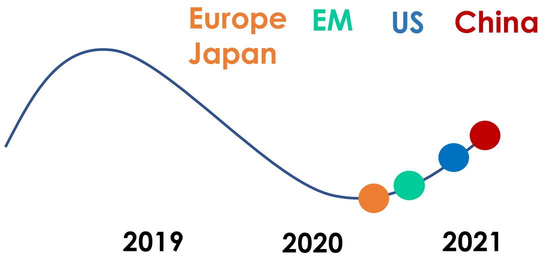
To help put things in perspective:

	Valuation (Forward 12M P/E)	EPS Growth (20Y Annualised)	Max EPS Drawdown (20 Years)
MSCI Healthcare Index	17.8	6.4	-7.7%
MSCI World Index	21.2	2.3	-67.6%

Source: Bloomberg, FAM. Valuation: Bloomberg Estimates Price/Earnings Ratio for the next 4 Quarters. Data retrieved 31/1/2021

In our view, this rare combination of steady, above average earnings growth at still attractive valuations makes for a compelling investment in a VUCA environment, and which is one reason why we further increased our Healthcare exposures in the prior month. The other reason is that it provides useful diversification for our recovery positions given that it is less dependent on a strong economic recovery to do well.

Key Themes: Positioning For Recovery

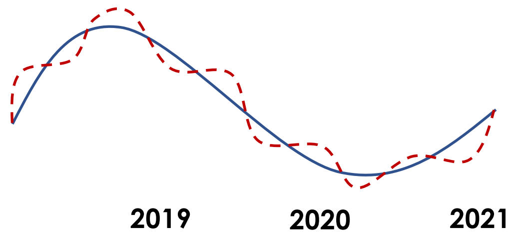


Early Cycle:
- Accommodative policy
- Activity rebounds
- Strong earnings growth

Source: Fidelity, FAM

Continuing on with the previous month's discussion on economic and market cycles; above is a stylized visualization showing the major economies at different parts of the cycle. Notice that our recovery positions are in place to benefit from early-mid cycle. **This is not a coincidence, but an outcome of our FVT process – the early cycle is usually when we expect to see strong economic and earnings growth.** Japan and Europe looks like it may soon join the party and may present interesting opportunities for us at a more appropriate time. For easy reference, we've summarized our views on each recovery segment in the table below.

We were asked recently if we thought the rally can continue. The short answer is that no rally can continue indefinitely without undergoing a correction. That said, barring an unexpected shock, this usually ends up as just noise or volatility (though we can't be sure about the more speculative areas of the market). **It is useful to visualize 'noise' as the red dotted line that periodically under and over-extends around the larger cycles (blue line) that we are positioned for**:



Our diversified portfolios are designed to withstand bouts of volatility so that we can focus on capturing longer trends that we have better clarity on. Similarly, our recovery positions are expected to do well as a broader economic recovery takes hold in 2021, even if we may hit a speed bump or two.

Recovery Basket	Outlook
China 'A'	As the only major economy to grow in 2020, China's GDP is projected to grow 8.1% in 2021 vs 5.1% for the US (IMF, Jan 2021 forecast). This is supportive for corporate earnings over the coming quarters. Valuations continue to be reasonable below historical highs.
US Small-caps	A vaccine-led recovery bodes well for small-caps as they tend to outperform during periods of accelerating growth. Small cap (Russell 2000) valuations are currently at a 28% discount to large-caps (S&P 500) vs an average premium of 2% over the past 20 years.
Emerging Market	Cyclical EM equities are expected to do well on the back of stimulus and a reviving global economy. Relative valuations attractive vs DM.
Energy	Energy equities have benefitted as oil prices broke past above $50. We are encouraged that tightening oil supply (supported by the OPEC oil cartel) has helped to offset uncertainties around the resurgence in virus cases. Oil demand is likely to be bumpy but is expected to recover alongside a rebound in economic activity. Relative valuations are compelling vs broader markets.

Key Themes: Search for Yield

Last month, we mentioned that yield investing can seem boring especially when some stock can rise xxx%. This seemed almost prescient as GME's rise of XXXX% whipped investors into a frenzy and saw new players enter the market for the first time. Elsewhere, broad equity markets were volatile and slightly down for the month. Following on from our sports analogy, equity markets were the strikers that ran up and down the field throughout January but did not deliver results. Credit markets are the midfielders who held their ground and delivered results while the strikers were working.

Imagine three parties came to you for a loan? Their profiles and borrowing terms are summarized on the right. Who would you lend to?

It seems obvious that one should lend to Borrower C as the interest return on the loan is the highest. Furthermore, it is in Asian property, an area with strong growth prospects.

Is there such a good deal where one can earn much more by just choosing who to lend to? Actually, there is, and it is what we are doing when choosing our yield investments. Table 1 is an extract from the yield comparison table we have been showing in our commentaries.

What's the catch?

	Borrower A	Borrower B	Borrower C
Profile	US government	Blue-chip businesses and banks	Asian property business
Loan amount	100	100	100
Interest Return after 1 year	28 cents	$1.30	$6.70

Table 1

Yield of major credit markets

	31 Dec 2020
Asia HY	6.7%
US HY short dur. bonds	4.2%
US HY bonds	4.0%
EM short dur. bonds	3.0%
EM bonds	3.5%
Global investment grade corporc	1.3%

As bank deposit rates remain low

	31 Dec 2020
SGD 1Y deposit	0.69%
USD 1Y deposit	0.28%

Source: Bloomberg.

Yes, there will be risks as one guns for greater reward. The key worries for a lender are that the borrower cannot meet interest payments, or lose their principal amount. Indeed, such risk is lower when lending to someone like the US government, but is the reward worth it? **The objective for an investor is to make a return <u>while</u> funding a borrower, not <u>just</u> fund a borrower.** When one lends to businesses, they will potentially encounter more borrowers defaulting on interest payments or even running away with the loan amount. But so long as one does so in **a diversified manner, you can benefit from the higher yield with manageable risk.**

Key Themes: How Are We Positioned?

Positioning for Recovery	**Stability Amid *VUCA***	**Search for Yield**
China 'A' equities	Health Care equities	Asian High-yield bonds
Energy equities		Emerging Market Short Duration bonds
Emerging Market equities		
US Small-caps		

Asset Allocation Strategy

Equity: Regions	--	-	=	+	++	Allocation strategy
United States						**Healthcare** as earnings are more stable and less dependent on broader economic cycle. **Energy** where valuations are attractive and are expected to benefit as economies recover. **Small-caps** as relative valuations attractive and are expected to benefit as economies recover. *Overweight in US as a result of allocations to Global Healthcare and Energy, which are US-heavy.*
Europe	0%					Maintaining no exposure as they are less attractive compared to other opportunities.
Japan	0%					
Asia Pacific ex Japan						**China 'A'** overweight as valuations continue to be reasonable and supported by a stronger economy.
Emerging Markets						Neutral as valuations attractive relative to developed markets, but where earnings tend to be less resilient.
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

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Market Index Returns

Equity Regional	MTD	QTD	YTD
Global	-0.44%	-0.44%	-0.44%
United States	-1.02%	-1.02%	-1.02%
Europe	-0.71%	-0.71%	-0.71%
Japan	0.23%	0.23%	0.23%
Asia Pacific ex Japan	3.51%	3.51%	3.51%
Emerging Markets	2.99%	2.99%	2.99%

Fixed Income	MTD	QTD	YTD
Global Aggregate (Unhedged)	-0.88%	-0.88%	-0.88%
Global Aggregate (Hedged)	-0.54%	-0.54%	-0.54%
High Yield	0.11%	0.11%	0.11%
Asia	-0.02%	-0.02%	-0.02%
Emerging Market Debt	-0.85%	-0.85%	-0.85%

Currencies	MTD	QTD	YTD
USD/SGD	0.52%	0.52%	0.52%
EUR/SGD	-0.12%	-0.12%	-0.12%
JPY/SGD	1.39%	1.39%	1.39%

Commodity	MTD	QTD	YTD
Gold	-2.67%	-2.67%	-2.67%
Oil (WTI Crude)	7.58%	7.58%	7.58%

Equity Markets	MTD	QTD	YTD
Australia	0.31%	0.31%	0.31%
Brazil	-3.32%	-3.32%	-3.32%
China "A"	2.70%	2.70%	2.70%
China "H"	4.38%	4.38%	4.38%
Hong Kong	3.87%	3.87%	3.87%
India	-3.05%	-3.05%	-3.05%
Indonesia	-1.95%	-1.95%	-1.95%
Korea	3.58%	3.58%	3.58%
Malaysia	-3.71%	-3.71%	-3.71%
Russia	-0.24%	-0.24%	-0.24%
Singapore	2.12%	2.12%	2.12%
Taiwan	2.75%	2.75%	2.75%
Thailand	1.24%	1.24%	1.24%

Equity Sectors	MTD	QTD	YTD
Gold	-3.82%	-3.82%	-3.82%
Energy	3.63%	3.63%	3.63%
Technology	-0.59%	-0.59%	-0.59%
Healthcare	1.00%	1.00%	1.00%
Financials	-1.93%	-1.93%	-1.93%

Total return in index currency terms as of 31 January 2021.
Source: Bloomberg

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