Investment Update

May 2021

finexis
ASSET MANAGEMENT
汇信资产管理有限公司

Market Review

The Old Faithful geyser in Yellowstone National Park draws crowds for its eruptions where scalding hot spring water is blasted over 40m high. It is also popular because its eruptions are regular (every 68 minutes) and predictable (give or take 10 minutes). https://www.nps.gov/yell/planyourvisit/geyser-activity.htm

Markets have their own version of Old Faithful: the VIX fear gauge that blasts volatility 40 points into the markets. **The VIX typically rises when there is fear in the markets**. This has happened in prior recessions (areas shaded in red); and just like the Old Faithful geyser that erupts on cue, **the VIX "erupted" during the recent recession**. These eruptions also tend to be accompanied by market declines. Markets do mimic real life in that they also need to blow off steam.

VIX CBOE Volatility Index, Source: Bloomberg

We also see that there can be "**aftershocks**"; subsequent spikes after the main eruption. Unfortunately, the VIX eruptions are nowhere as predictable as Old Faithful. Just as the covid resurgence is reminding us not to be complacent on safety measures, we need to **continue to invest with a properly structured and diversified portfolio, without complacency**.

April was relatively uneventful compared to the previous month. **Global equity markets were up 4.4% as the VIX hit new lows** since last year's market crash. This is not a surprise as the fear gauge tends to drop during a post-recessionary recovery, which is what we are going through now.

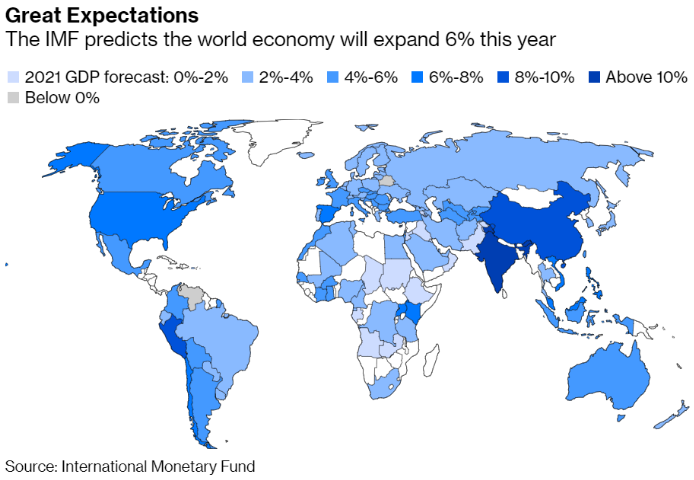
Looking under the hood, equity markets were bifurcated. Recovery plays such as energy, small caps, and Europe took their foot off the pedal, with gains around 2%. Emerging market gains were in-line with other recovery themes. While these geographical markets were more muted, the commodity sector had outsized gains as commodity prices raced toward record highs, reflecting confidence in the economic recovery.

On the other side of the spectrum, the healthcare sector gained 4%, perhaps related to renewed concerns on covid. Large cap tech, which has been lagging this year, received a shot in the arm with gains of 5%. **All in, the early recovery themes of energy and small caps are the better performing markets this year.**

There was some respite in the bond sell-off as global investment grade bonds stemmed their losses. Hedged global bonds were marginally positive, while unhedged global bonds had gains of 1.3%, driven by currencies such as the Euro. **High yield and emerging credit did well** among major fixed income markets, benefitting our targeted exposures. In a low rate world, the strategy of focusing on extracting fixed income return from credit risk as opposed to taking interest rate risk has been paying off.

References: Global equities: MSCI All Country World Index, Global investment grade bonds: Bloomberg Barclays Global Aggregate Index, Energy equity: MSCI ACWI Energy Sector Index and Dow Jones U.S. Select Oil Exploration & Productions Index, Small cap: Russell 2000 Index, Europe: EURO STOXX 50 Index, High yield: Bloomberg Barclays US High Yield 350mn Cash Pay 0-5 Yr 2% Capped Bond Index, Bloomberg Barclays Asia USD High Yield Bond Index

Key Themes: Positioning For Recovery



By and large, the world economy looks to be on track to emerge out of the covid-recession - the International Monetary Fund (IMF) recently upgraded their global growth forecast to 6% this year, faster than previously thought. Perhaps more important for investors is that growth is expected to be choppy and uneven across regions as shown on the graphic above, which is why investors need to be selective in what they invest into.

Even as recovery is the most likely scenario over the coming quarters, we should not expect the journey to be smooth sailing from here on. Already, the unfortunate resurgence of covid-19 cases around developing markets such as India have hampered their recovery. Closer to home, we have also seen bouts of covid cases even as the vaccination campaign is underway. It is plausible that such obstacles and roadblocks may weigh on investor sentiment.

This is to say that investors need to be prudent playing the recovery. Our diversified portfolios are designed to withstand speed bumps, so that we can focus on capturing the broader recovery theme that we have better clarity on. Which is why we also invest into differentiated recovery segments:

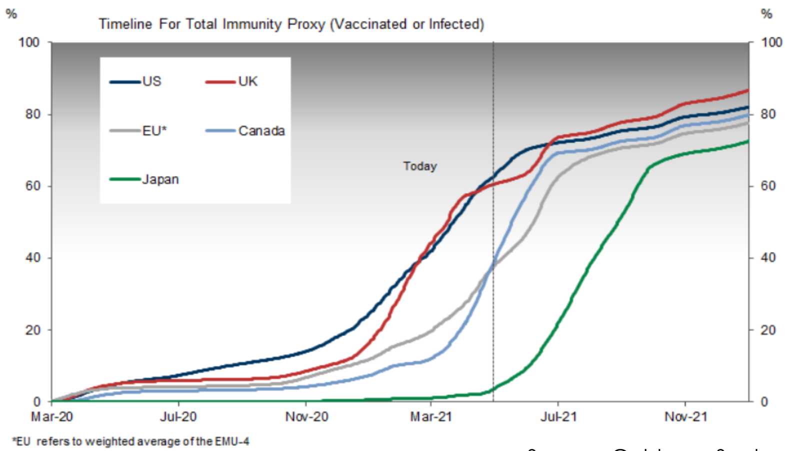
US small-caps: Potential for earnings acceleration alongside a strong recovery, with an attractive valuation discount to US large-caps.

China 'A': Economy in later stage of recovery, with expectations of more robust earnings growth. Valuation more reasonable than the US.

Emerging Markets: Benefits from both domestic and global recovery drivers, and valuations similarly more attractive vs developed markets

Europe: Laggard recovery play with further upside. Europe is set to catch-up in the coming months if the vaccination trajectory is any indication:

% of population with immunity (based on infections & vaccinations)



Source: Goldman Sachs

Key Themes: Stability Amid *VUCA*

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

The largest US Healthcare ETF by assets saw outflows of approximately $1.7 billion over the first three month of the year. For most investors, stability is never a priority when volatility (or fear) is low and markets are trending up, which is also what the flow data seems to suggest.

As recovery optimism rose over the past few months, we wondered if a few earnings misses would quickly cast doubt on the market recovery. There are reasons to be cautious as markets are counting on a surge in corporate earnings to justify the rich market valuations today. We have also seen that the path to eradicating covid-19 is no easy task even with vaccines, and could affect businesses if it becomes more widespread. Going by the strong Q1 earnings season that is current underway, are such concerns unwarranted?

1Q Earnings Season Summary as of April 29, 2021

Source: Goldman Sachs

		Earnings		
	No. of Companies Reported	**Positive**	**Negative**	**In Line**
US S&P 500	302/500	69%	6%	25%

With the majority of companies reporting strong earnings, should we expect all investments to react positively to the happy news? Actually no, stocks can drop even if they exceed earnings expectations. For example, Tesla's Q1 EPS exceeded market expectations by more than 15%, but the stock dropped 4.5% the day after. It does not mean that Tesla is a bad company, it's just that the stock was pricing in so much good news that even additional good news is not helpful. https://www.barrons.com/articles/teslas-earnings-ticked-all-the-boxes-big-questions-remain-51619469933

This asymmetric response to earnings beats also applies to the rest of the market:

Median Performance vs S&P 500 following Earnings beat

Sector	Return
Comm Svcs	3.05%
Healthcare	3.01%
Staples	1.51%
Materials	1.30%
Discretionary	1.08%
Industrials	1.00%
Energy	0.74%
Real Estate	-0.30%
Utilities	-0.91%
Financials	-1.16%
Technology	-2.33%
S&P 500	0.20%

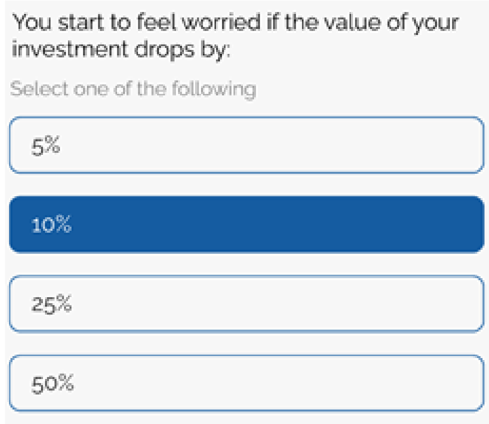
Source: Goldman Sachs

Indeed, Goldman Sachs found that **earnings beats in Healthcare have been rewarded more than most other parts of the market**, which could indicate investors 'positioning'. To put it more simply, Healthcare, being less crowded and with more reasonable expectations is offering a better risk/reward for investors. Putting it another way, **if you were right** in forecasting that Technology stocks would exceed earnings expectations, **you would still not make money.**

We maintain a Healthcare allocation as it continues to play a useful role in our portfolios as part of the 'Stability' theme. Their more reasonable valuations, coupled with a more stable earnings profile regardless of economic growth makes Healthcare a defensive sector and a useful portfolio diversifier in a VUCA environment.

Key Themes: Search for Yield

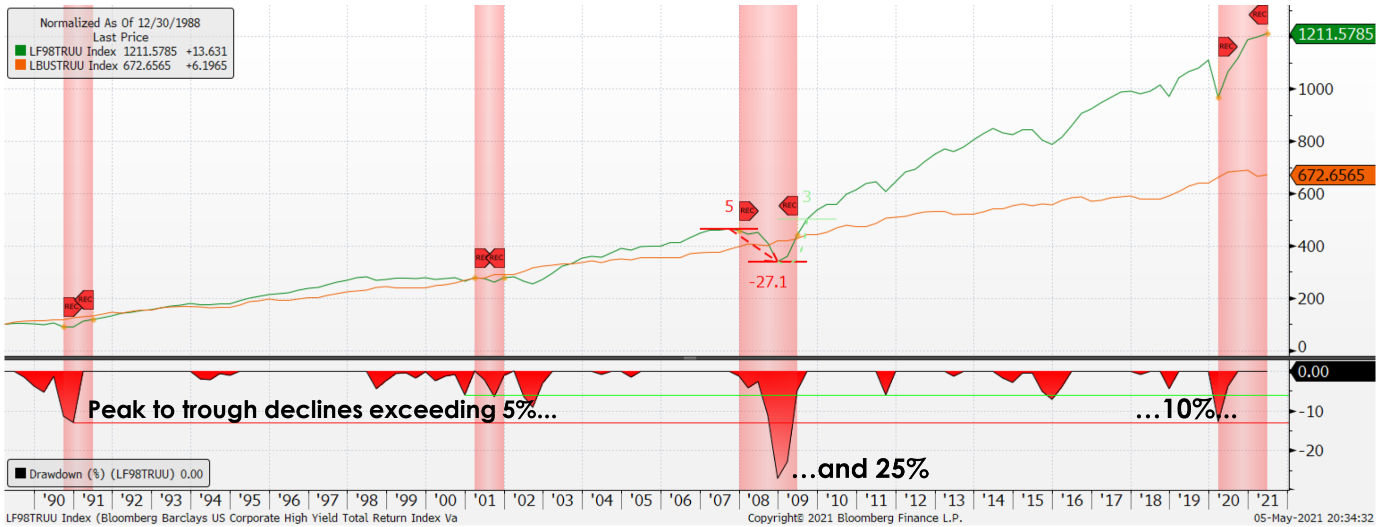
How would you respond to the question on the right? Most will likely choose 10%; after all who likes losing money? But the reality is that risk-averse investors will certainly forego gains as **risk and reward are two sides of the same coin**.



Consider two investors: one invested in Investment grade bonds and the other, High yield bonds. After 32 years, the high yield investor's initial $100 would be $1,211, nearly double that of the investment grade bond investor's $672. At this point, it would seem a no-brainer to choose high yield bonds.

But high yield bonds are not without volatility. For starters, an investor in high yield bonds who responded 5%, 10%, even 25% to the question will experience worry during the peak to trough declines shown in the chart below. Hence, **one needs to be mentally prepared for the volatility while pursuing higher return**; and definitely cannot assume that the path to higher yield is a straight line.

It is inevitable that investors will compare notes. Sure, **the high yield investor should end up with greater wealth** over the long term. But there will also be periods of underperformance in between, such as the 4.5 year stretch from 1998-2002. To some investors such underperformance can be unbearable as it is amid challenging conditions such as recessions. To rub salt in the wound, the investment grade investor is likely not to see much losses during the same period. However, the investment grade investor cannot complain when their ending wealth is much less. **Investing is as much about managing psychology as it is about technique**.



How can we have the confidence to stay the course when our high yield investments are underperforming? We do that by having the right expectation of the inherent behaviour of various asset classes. Hence, **we continue to invest in high yield and emerging market bonds in the search for yield.**

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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
Emerging Market equities		Emerging Market Short Duration bonds
US Small-cap equities		
Europe equities		

Asset Allocation Strategy

Equity: Regions	--	-	=	+	++	Allocation strategy
United States		■				**Healthcare** as earnings are more stable and less dependent on broader economic cycle. **Small-caps** as relative valuations attractive and are expected to benefit as economies recover.
Europe			■			Relative valuations are attractive, and expected to benefit as economies recover.
Japan		0%				Maintaining no exposure as they are less attractive compared to other opportunities.
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
Global			■			Focus on currency-hedged government bonds and unconstrained credit 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	4.41%	4.41%	9.29%
United States	5.34%	5.34%	11.83%
Europe	2.36%	2.36%	11.01%
Japan	-2.85%	-2.85%	6.11%
Asia Pacific ex Japan	2.82%	2.82%	5.62%
Emerging Markets	2.50%	2.50%	4.79%

Fixed Income	MTD	QTD	YTD
Global Aggregate (Unhedged)	1.26%	1.26%	-3.25%
Global Aggregate (Hedged)	0.26%	0.26%	-2.21%
High Yield	0.99%	0.99%	1.56%
Asia	0.25%	0.25%	-0.92%
Emerging Market Debt	1.33%	1.33%	-2.20%

Currencies	MTD	QTD	YTD
USD/SGD	-1.04%	-1.04%	0.66%
EUR/SGD	1.41%	1.41%	-0.92%
JPY/SGD	-1.27%	-1.27%	5.87%

Commodity	MTD	QTD	YTD
Gold	3.60%	3.60%	-6.81%
Oil (WTI Crude)	7.47%	7.47%	31.04%

Equity Markets	MTD	QTD	YTD
Australia	3.48%	3.48%	8.29%
Brazil	1.94%	1.94%	-0.10%
China “A”	1.59%	1.59%	-1.58%
China “H”	-1.22%	-1.22%	0.93%
Hong Kong	1.30%	1.30%	5.92%
India	-1.45%	-1.45%	2.35%
Indonesia	0.71%	0.71%	1.01%
Korea	2.82%	2.82%	9.67%
Malaysia	1.85%	1.85%	-0.25%
Russia	0.10%	0.10%	7.94%
Singapore	2.00%	2.00%	13.99%
Taiwan	6.96%	6.96%	19.46%
Thailand	0.22%	0.22%	10.72%

Equity Sectors	MTD	QTD	YTD
Gold	6.24%	6.24%	-4.43%
Energy	0.46%	0.46%	29.87%
Technology	5.44%	5.44%	6.72%
Healthcare	3.74%	3.74%	4.00%
Financials	6.41%	6.41%	22.75%

Total return in index currency terms as of 30 April 2021.
Source: Bloomberg

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