Investment Update

September 2021

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ASSET MANAGEMENT
汇信资产管理有限公司

Market Review

It was a forest of green in August compared to the sea of red in July. **It is times like this where we are reminded not to allow market volatility to throw us off the path to our investment goals.**

Our portfolios have given back some of their outperformance in the recent months. The combination of resurgent Delta-variant scares and China policy action put a dent in our recovery positions in small caps and China. What should we do when we encounter such choppiness during the investing voyage? Do we dump assets overboard or jump ship altogether? Or do we hold fast so that the assets can realize their value in due course?

At times like this, we remind investors that investing is not riskless. **If things were so certain, there would be no money to be made.** Those who have ridden through our China 'A' and energy positions would know what it takes. They should also expect more of that going forward as economies transition from recession to recovery to expansion. Small caps have benefitted from the recovery and are expected to do better with continued expansion; just be ready for volatility as investors tussle with ongoing news flow. Transitions in life are never that smooth to begin with, what more markets?

If you were the owner of a company, what would you do it you had these two employees? Who would you retain?

	Employee #1	Employee #2
Revenue generation	$300,000	$150,000
Salary	$500,000	$100,000

The answer would seem obvious: employee #2 for the positive return on investment; but when it comes to markets, investors don't seem to use the same logic.

Last month we discussed how much more investors would be rewarded by investing in emerging markets (EM) vs developed markets (DM) simply as a buy & hold proposition. However, the volatility of EM and uncomfortable periods of underperformance prevent many investors from doing so.

Why do we think now is a better time to have some EM assets in a portfolio?

First, where secular growth was always prevalent, EM economies today are more diversified and not reliant on certain business models e.g. being Factory to the World. Emerging markets are also exporting services, and fueled by domestic demand.

Second, we do not just invest in anything that has higher revenue. Here, we see how much investors are paying for the US and China as two "employees".

	USA	China
GDP USD/billion	20,893	14,722
Market cap USD/billion	51,929	12,136
Market cap/GDP	249%	82%

Source: *Bloomberg GDP US Annual, World Bank China GDP as at 31 Dec 2020, China Market Cap USD as at 2 Sep 2021*

The market cap to GDP ratio is actually a valuation metric known as the Buffett indicator. Think of it as how much you are paying to get a dollar of revenue. At current levels, which offers a better reward going forward?

Discipline in investing is what makes the difference to achieving long term goals. Paying attention to valuation (the V in our FVT) is an objective and sustainable way for us to invest in stories but not get carried away by promises.

Key Themes: Positioning For Recovery

Global markets continued on their recovery trajectory through August, despite the spectre of the COVID-19 pandemic looming large once more in the form of the delta and delta plus variants**.** However, it's not all good news - consumer confidence took a beating. Within the US, airline travel, restaurant visits and hospitality bookings all reported month on month softening. These data-points may be undesirable, but they are certainly not unanticipated**. The road to recovery was always expected to have several speed bumps along the way.**

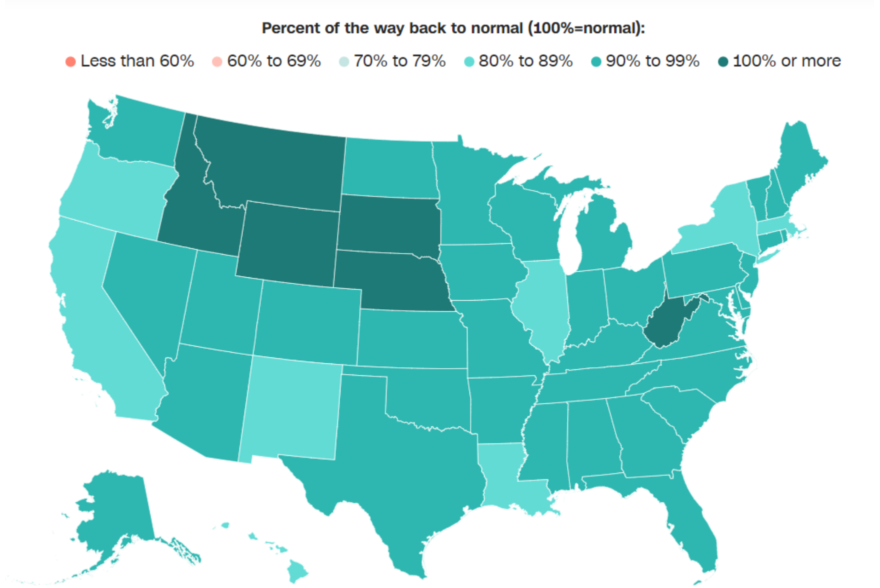
It is important to understand that the recent negative news are only speed bumps and not the application of the emergency break, which would send growth into a grinding halt. **If the recent news constitute only speed bumps, then our positioning for recovery is still valid and should continue to be in play**. The recent data becomes merely a short term event to be ridden out. There are good reasons to think that the economic softening is only a speed bump:

(1) global vaccination rates are increasing,

(2) while the number of cases is increasing rapidly in some parts of the globe, it is accompanied by a less than proportionate rise in death rates,

These considerations place a floor on how much the economy will soften, preventing a return to peak deterioration in 2020 and reducing the odds of economies falling back into recession in the near term.

Moreover, while the total number of COVID-19 cases increased over the month, US jobs data indicates that unemployment has continued to improve. In fact, as reported by the US Bureau of Labour Statistics, the unemployment rate for August was 5.2%, the lowest since the recession in March 2020. **This indicates that the economic recovery can continue marching on despite rising case numbers. This is also a reminder to focus on data points that are more relevant and not be distracted by headlines.**



In fact, the back to normal index created by Moody's and CNNAnalytics above, shows that in spite of the current tricky COVID-situation, the US is already 93% recovered. (with 100% meaning that the economy has reached its pre-pandemic levels). All in all, we continue to maintain positions that can ride on the broader economic recovery and which hold up to scrutiny via our FVT process: At the current time, this includes equity positions in US-small-caps, China 'A', Emerging market, Europe and Quality Value.

We highlight European equities in particular, which has benefitted from such recovery - the region is making a comeback in the vaccination race after a sluggish start. Momentum is also building up on the back of strong second quarter earnings reports. Furthermore, the ECB has strengthened its forward guidance substantially in one respect: it is pushing out the expected date of its first rate hike by two years to 2025. This commitment to winding down government support gradually will play a part in securing a conducive macro-environment for companies to flourish.

Key Themes: Stability Amid *VUCA*

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

In the month of August, **VUCA** reared its ugly head through three forms: **(1) rising inflation rates (2) the possibility of government asset purchases winding down** [the first step in a gradual process of tapering government support] and **(3) the seemingly endless litany of regulations announced by the Chinese state government.**

Countries across the globe are emerging from varying states of lockdown and this has resulted in a sharp run up of their respective economies as well as their inflation rates. At the 2021 Jackson Hole symposium, Jerome Powell reported that the United States, over the 12 months through July, saw measures of headline and core PCE (Personal Consumption Expenditure) inflation reaching heights of 4.2% and 3.6% respectively. These numbers are well above the US Fed's 2% long run objective. Eurostat numbers show that inflation across Europe is moving in tandem with the US; the eurozone's harmonized index of consumer prices rose by a decade high of 3% over a year earlier. There are some reasons to believe that high inflation rates are temporary. However, if we were to discount them, then we can expect rapidly increasing inflation to induce expectations of lower earnings growth, driving stock prices down.

Eurozone inflation hits decade-high

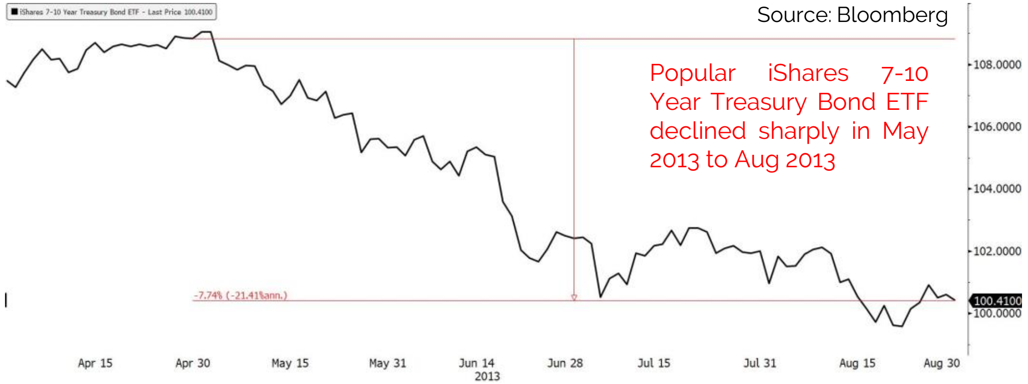
Harmonised index of consumer prices (annual % change)

Source: Financial Times

The European Central Bank this year raised its inflation target to 2 per cent; it previously targeted "below but close to 2 per cent"

The imminent winding down of asset purchases has its roots in rising inflation. To quote Fed Chair Jerome Powell ad verbatim, "My view is that the substantial further progress test has been met for inflation". This means that inflation targets have been met. As a result, one might see a reduction in the pace of asset purchases as early as the end of this year. A similar uptick in inflation across the Atlantic has likewise prompted investors to believe that the ECB might wind down its emergency bond-buying programme as soon as this month. The VUCA theme here is manifested through the fear of the 2013 "taper tantrum" occurring once more, driving bond prices into markedly despondent levels.

Source: Bloomberg



Finally, it is anyone's guess which industry will next fall within the crosshairs of the Chinese regulators. Industries as disparate as gaming and private education have been bound together by the rope of the state's social agenda and forced to walk the plank together.

In view of ongoing VUCA conditions, it is important to diversify our positions so that we cover all our bases and are not caught off guard. The current keystone to our diversification policy is our position in healthcare equities, which has done well amidst recent volatility. Healthcare is relatively resilient in inflationary environments (as demonstrated in our June commentary). It is also defined by stable and growing earnings which adds a defensive element to our portfolio should the recovery take longer than expected to play out.

Key Themes: Search for Yield

A friend used to say investing in bonds is risky; one clips coupons that are fraction of the principle while running the risk of losing the bulk of their principle if the borrower defaults. This is coming from someone who started his career in fixed income and is now a CEO of an asset management company offering bond products. Clearly, despite the risk, there is something worthwhile to invest in bonds.

This risk came to the forefront in August as fears grew that Evergrande, China's largest property developer, could not pay back its debt. Indeed, that is the fear of any lender; "what if my borrower misses payments on their loan?", "what if I can only get back a part of my principal?" Accordingly, there was a fire sale of Evergrande bonds. Today. Evergrande bonds are giving triple digit yields, which can be a nightmare or a dream, depending on how you look at it.

危机 is Chinese for crisis. How apt that danger and opportunity go hand in hand. Indeed these crises in bond markets are the ones that create opportunity in today's yield starved world. We need to be alert to these opportunities because they are the ones that can make a difference in the search for yield. What can we do to invest and get our target return, yet manage the risks?

First, diversify. When investing in bonds, no matter investment grade or high yield, it is inevitable that episodic and recurring fears will arise. **Diversify so that you can sleep at night** when things like Evergrande happen, and maintain composure because your portfolio is still robust despite some choppiness. But, diversification is not enough, we still need to find attractive opportunities.

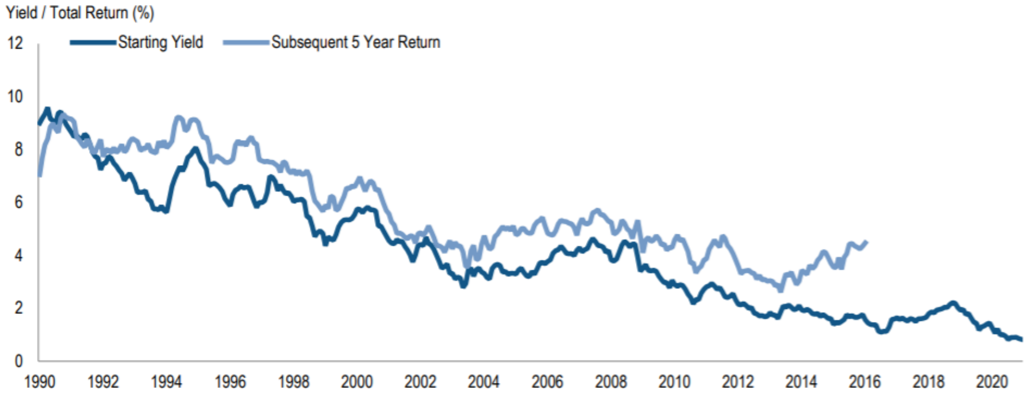
Second, one has to invest in areas with higher return to begin with. This is actually not that difficult; how you set up your portfolio influences the return you get. The chart shows that one's investment return is highly related to the starting yield. This chart from 1990 shows that this relationship is true before and after QE. Today, investment grade and Asia high yield are yielding 1.1% and 9.2%* respectively; which would you invest in for a higher future return? **Perhaps this is as close to a crystal ball as one can get.**

How do we manage the risks in bond investing in today's world? The same way we do even when rates were higher. But that is not done by sticking to the same kinds of bonds. The same way for us means leveraging on our **FVT process to constantly search out fixed income markets that offer that balance of risk and return e.g. Asia HY.** When return does not compensate for the risk, we allocate to other segments of the fixed income market, continuously setting up our portfolio for higher return while managing the risks.

*Source: Bloomberg. IG: Bloomberg Global Aggregate Index, Asia HY: Bloomberg Asia USD High Yield Bond Index

EXHIBIT 1: STARTING YIELDS ARE OFTEN A GOOD PREDICTOR OF FUTURE FIXED INCOME RETURNS

Bloomberg Barclays Global Aggregate Starting Yield and Subsequent 5 Year Return



Source: FactSet. Based on monthly data from January 1990 to December 2020.

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		
Quality Value		

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Asset Allocation Strategy

Equity: Regions	--	-	=	+	++	Allocation strategy
United States			■			**US Small-caps** as relative valuations attractive and are expected to benefit as economies recover. **Healthcare** as earnings are more stable and less dependent on broader economic cycle. **Quality Value** as valuations attractive, and expected to benefit as economies recover. Quality bias to avoid potential 'value traps'
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				■		Maintain **China 'A'** slight overweight as relative valuations continue to be reasonable, and supported by a recovering 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 valuations.
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 amid low rates.

Notes: - - Underweight - Slight Underweight = Neutral + Slight Overweight + + Overweight

Current Previous

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Market Index Returns

Equity Regional	MTD	QTD	YTD
Global	2.54%	3.27%	16.24%
United States	3.04%	5.49%	21.57%
Europe	2.22%	4.36%	20.83%
Japan	3.16%	0.91%	9.90%
Asia Pacific ex Japan	2.18%	-4.58%	1.95%
Emerging Markets	2.63%	-4.24%	2.92%

Fixed Income	MTD	QTD	YTD
Global Aggregate (Unhedged)	-0.42%	0.91%	-2.33%
Global Aggregate (Hedged)	-0.20%	1.04%	-0.49%
High Yield	0.54%	0.81%	3.85%
Asia	0.93%	0.69%	0.64%
Emerging Market Debt	0.97%	1.14%	0.53%

Currencies	MTD	QTD	YTD
USD/SGD	-0.70%	-0.04%	1.72%
EUR/SGD	-1.21%	-0.44%	-1.64%
JPY/SGD	0.27%	-0.98%	6.56%

Commodity	MTD	QTD	YTD
Gold	-0.03%	2.46%	-4.46%
Oil (WTI Crude)	-7.37%	-6.76%	41.18%

Equity Markets	MTD	QTD	YTD
Australia	2.69%	3.82%	17.84%
Brazil	-2.48%	-6.33%	-0.20%
China “A”	0.14%	-7.18%	-6.24%
China “H”	-0.30%	-13.05%	-12.47%
Hong Kong	-0.05%	-9.63%	-2.92%
India	9.47%	9.87%	21.50%
Indonesia	1.41%	2.97%	4.65%
Korea	-0.10%	-2.95%	11.72%
Malaysia	7.20%	4.56%	0.62%
Russia	3.91%	3.80%	23.98%
Singapore	-2.41%	-1.25%	10.44%
Taiwan	2.26%	0.17%	21.28%
Thailand	8.20%	3.81%	15.70%

Equity Sectors	MTD	QTD	YTD
Gold	-6.65%	-3.77%	-9.16%
Energy	-2.88%	-11.07%	26.60%
Technology	3.80%	7.47%	21.11%
Healthcare	2.68%	6.43%	16.07%
Financials	5.00%	4.37%	29.94%

Total return in local currency terms as of **31 August 2021**
Source: Bloomberg

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