Investment Update

November 2021

finexis
ASSET MANAGEMENT
汇信资产管理有限公司

Market Review

October saw equity markets recover from September's declines. Our equity themes more than made up their September drop as our US small cap and China 'A' positions staged a strong rebound. The rebound would have been stronger if not for more subdued gains in healthcare and Emerging markets.

On hindsight, wouldn't it be great if we had switched out of healthcare for more small cap? One must remember that we cannot predict such short term ups and downs, and should instead be able to identify noise that detracts from the investment thesis. We must also remember that healthcare is a differentiated theme to diversify the economic growth theme. Do not replace your midfielder with strikers just because your striker has scored a few goals.

Fixed income markets declined across the board, as sovereign bond markets tussled over inflation, while credit markets worried about China property as Evergrande played a game of chicken with creditors.

The prospect of interest rate hikes that has been looming in the background turned into reality as inflation forced global central banks' hands to unwind years of pumping liquidity into the system. This resulted in government bonds selling off while equities rallied. This in itself is not unexpected; governments tend to raise interest rates during periods of strong growth so that the growth does not go out of hand.

But in today's low yield environment where expected returns for government or investment grade bonds are already low, every decline makes it feel like a 1 step up, 2 steps down situation. This is why we do not favour such bond segments.

Market commentators do echo our view that investors today are between a rock (expensive bond markets) and hard place (expensive equity markets). However, many portfolios out there still only invest in these two segments due to the investment mandate or benchmark.

Last month, we discussed how alternatives have helped us address this dilemma, by providing an alternative source of return when bonds don't act as a cushion (Jan & Sep 2021). In October, alternatives continued to march to their own beat. At this point, we would caution readers from reallocating wholesale to alternatives when they see such returns.

Month	Global equities	Global investment grade bonds	Alternatives
Sep 2020	-3.23%	0.37%	-2.47%
Jan 2021	-0.45%	-0.88%	0.40%
Jun 2021	1.32%	0.49%	-1.33%
Sep 2021	-4.09%	-1.78%	0.69%
Oct 2021	5.13%	-0.24%	3.21%

As you can see, alternatives were down in June when both equities and bonds were up, and down in Sep last year with equities. The beauty of alternative strategies is that it does not behave like equities and bonds most of the time. But if investors assume the performance in certain months to be the whole picture, you will be disappointed. We would like to remind readers that alternatives are to provide a different return path to diversify so that investors have a smoother journey.

We prepare and structure our portfolios to avoid struggling with the futility of predicting the short term ups and downs of the market. **While good luck does not make a good company great, bad luck can destroy a company if it does not prepare for the worst.** The same applies to investments.

Source: *Bloomberg. Global equities: MSCI ACWI Index, Global Investment grade bonds: Bloomberg Global Aggregate Index, Alternatives: Winton Trend Fund.*

Key Themes: Positioning For Economic Growth

The economic malaise precipitated by the COVID-19 pandemic is slowly being brought under control via vaccinations and herd immunity. Investors across the globe are strategizing how best to ride this recovery. Despite the deliberation, the result for many has still been to adopt a strategy that tracks market benchmarks closely. We prefer not to go along with mainstream behaviours unquestioningly. **Instead, via our FVT process, we implement differentiated strategies that have the promise of long–term outperformance and a smoother journey.**

The medical aspect of the COVID-19 crisis is progressively being addressed. Global vaccination rates have significantly ramped up. 39% of the global population has been fully vaccinated while about half has been at least partially vaccinated (Our World In Data). Many countries are relaxing their COVID control regimes in this new "open to vaccinated individuals" phase of the crisis. The recovery is clearly real and has evolved into economic expansion as per our economic cycle analysis. Which prompts the question of how to invest in a manner that best rides this economic growth phase.

A popular strategy amongst investors is to have large exposures to the US, and the S&P 500 in particular. This mirrors a typical index fund that has more than half of its total exposure in the S&P 500. In contrast, our portfolios have avoided investing into the S&P 500, with all US exposures focused on small-caps. As another point of contrast, our Asia Pacific ex. Japan exposures are also meaningfully higher than index funds.

Our allocations beg the question – "why are our positions so different?" These are decisions that need to be substantiated convincingly. Thankfully, they are not differences for differences' sake. That would be an absurd way of investing. Our investments are different because our rigorous "FVT" process is leading us in that direction. It is designed to help avoid the pitfalls of simply following the herd. It is also our way of addressing the logic that in order to secure outperformance from the norm, we must do something different from the norm. It is okay to be different, as long as you are different in a good way. Moreover, if you seek outperformance, **being different makes a difference.**

The current outperformance of the S&P 500 compared to our positions seems to debunk the argument that we are different in a good way. After all, the S&P 500 has returned 24.03% YTD, while our positions have performed as such: (see right). In situations like this, it is important to reflect on Benjamin Graham's view that Mr. Market is prone to emotional swings in the short term.

	YTD
US Small Cap	17.18%
Healthcare	16.17%
Europe	22.40%
Asia Pacific ex. Japan	-0.45%
China A	-4.14%
Emerging Market	-0.14%

Source: Bloomberg, Returns in local currency terms

While our positions are underperforming, investors should refrain from exiting from these positions to chase the latest high-performer. After all, we are investing for future returns, not the past. Moreover, the underperformance is transient - opportunities with better FVT are expected to have higher future return in the long run. After all, **"in the short run, the market is like a voting machine but in the long run it's like a weighing machine."** For skeptics who need more than our word, please refer to the chart from Blackrock (see right) - over longer periods, our positions are expected to outpace the US-large caps (S&P 500). We are confident that our decision to stand out from the pack will pay off eventually.

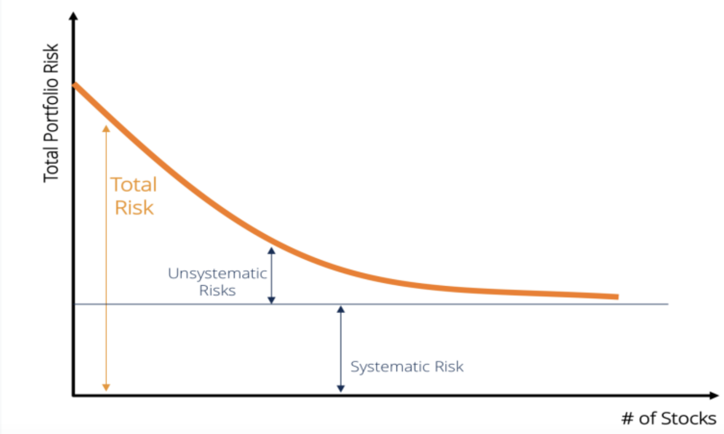
Asset	Return expectations (geometric, gross of fees)			
	5-year	10-year	15-year	20-year
Europe large cap equities	8.2%	8.2%	8.1%	8.1%
Global ex-U.S. large cap equities	7.4%	7.5%	7.5%	7.5%
China A shares	7.3%	7.1%	6.8%	6.5%
U.S. small cap equities	7.3%	7.6%	7.8%	7.9%
Emerging large cap equities	6.4%	7.1%	7.9%	8.3%
China-Broad market equities	6.2%	7.2%	8.3%	8.9%
U.S. large cap equities	6.0%	6.4%	6.7%	7.0%

Source: Blackrock Capital Market Assumptions August 2021

Key Themes: Stability Amid *VUCA*

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

Diversification is the solution to our need for portfolio stability. In spite of detractors against diversification, our view is that diversification is a useful tool that minimizes the odds of whole of portfolio draw-downs. We achieve this diversity in our portfolio by making investments into the health-care sector.



As seen in the stylized graph above, having more stocks is a means of weeding out unsystematic (company and industry related) risks and therefore reducing total portfolio risk. For example, should one have invested into a single stock, Evergrande, one would be down 84% this year. However, if one invested into a relevant diversified portfolio such as the Hang Seng China Enterprises Index, one would only be down 18%.

There are detractors who speak up against this portfolio tool, the most prominent of which would likely be Warren Buffett. According to him, "risk comes from not knowing what you are doing". This means that as long as we know what we are doing, we do not need to diversify. However, is it possible for one to fully know every aspect of what one is investing in? Take for example, the spillover of the Evergrande saga. Much of the Chinese government's deliberation as to the exact level of intervention that ought to occur is taking place behind closed doors.

Cut off by the cloak of secrecy, can an external spectator truly profess to have complete knowledge assess how bad the contagion effect will be? Indeed, we lack the hubris to take a "crystal ball mentality" wherein we are "all-in" behind a single view. We recognize human fallibility and uncertainty in investing and these truths make diversification imperative.

To elaborate further, consider the US Federal Reserve Chairman's flip-flopping on inflation. In September 2021, he proclaimed that inflation would be transitory. However, in early November, he is seen publicly describing inflation as being rapid and enduring. Investing is based on such imperfect knowledge. This requires preparation for different outcomes through diversification. Afterall, if we are only ever all-in with regard to portfolio positions, even being wrong ***once*** in a hundred times is sufficient for our entire portfolio to implode. With the falling off a cliff of single stocks like Evergrande at the back of our mind, we will stick to our guns and diversify.

Diversification can manifest in many ways. Common ways of diversification include diversifying across geographies and industries. We go further to diversify across risk drivers that drive performance. Because the gradual recovery from COVID-19 is a main driver for our positions, an unexpected new wave would undermine our entire portfolio. That is why we need to invest in an area with different drivers. That way, even in the event of a protracted COVID-19 pandemic, there will be components of our portfolio that remain stable.

Healthcare fits the bill of having different drivers, and even stands to benefit if covid rears its ugly head again. The sector is characterized by stable and growing earnings, relatively insulated from the vicissitudes of economic cycles. Instead, healthcare is being driven by other secular trends such as an aging global population. Therefore, even if the economy tanks once more, healthcare stocks will continue to do well as long as the aging population phenomenon persists. This makes healthcare a suitable diversifier from recovery themed stocks.

Key Themes: Search for Yield

Last month we discussed the current high return opportunity in the search for yield via Asian high yield bonds. As if on cue, credit markets declined which provided us a great opportunity to get exposure to the Asian high yield market that we have been eyeing for a while. To us, this represents a 2 steps up, 1 step down opportunity that offers better risk-reward in the search for yield.

This month we will discuss another VUCA that is recently in the headlines, but has been fairly evident to us for some time: that of rising rates. And instead of catering to readers' reward sensors with an opportunity for higher return, this will likely trigger their pain receptors in terms of potential losses.

We have been talking about the challenge of a low rate world in terms of future return for many conventional fixed income portfolios out there. For a long while, many investors were told that this was the new normal and that lower returns should be expected.

Investors responded by adding to long duration bonds in the search for yield. Recall in our June commentary that "ultra long bonds are back in force" due to "willingness among investors to look past risks for the sake of slightly higher yields."

Why is this risky? The subdued reward from long duration bonds, while not so painful in itself, can manifest into quite a bit of pain when interest rates rise. This is because bond prices drop when interest rates rise, and is particularly painful for long term bonds as they are more sensitive to changes to interest rates. All it takes is the Fed to raise rates by 1% for investors to see losses of 7.6% on an index fund*, and this is coming from something where the expected return is 1.2%. To us, such a choice represents poor risk-reward.

**Source: Based on Bloomberg Global Aggregate Index as at 5/11/2021.*

If we have been in a low rate world for so long, **why should interest rates rise?** The fact is they are. In recent months, central banks in Korea, Norway, New Zealand, and Singapore have tightened monetary policy to try to rein in excess growth and inflation. In the US, the question is no longer a matter of if but when.

Are the governments trying to burn investors by doing so? No, the tightening of monetary policy is an important lever for governments to prevent the economy from going into a tailspin. The question is are people positioning themselves for this, or investing based on past performance?

While we could not predict when rates would start rising, we structured our portfolios to be more resilient to such an eventuality by running short duration exposures.

Why is this relevant to you? Nevertheless, it is also likely that many readers still have meaningful exposure to long duration bonds elsewhere. This is because even if one was not compelled to take on more duration risk to get that slightly higher yield, many fixed income products tend to be benchmarked to long duration investments. The popularity of ETFs also funneled more money into index funds which made investment grade markets more expensive.

In the animal kingdom, there is safety in numbers. This does not apply as well in markets; where are you in the crowded room when people start rushing for the exits? Do review your entire portfolio, and see if you are going to end up taking losses when rates rise or are resilient to such an outcome.

While it may be not be a popular view now, we remain constructive on Asian high yield and see the current environment as conducive to accumulate assets that are attractive amid the deluge of bad news.

finexis ASSET MANAGEMENT 汇信资产管理有限公司

Key Themes: How Are We Positioned?

Positioning for Economic Growth	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		

finexis
ASSET MANAGEMENT
汇信资产管理有限公司

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

Market Index Returns

Equity Regional	MTD	QTD	YTD
Global	5.13%	5.13%	17.20%
United States	7.01%	7.01%	24.03%
Europe	4.71%	4.71%	22.40%
Japan	-1.43%	-1.43%	13.01%
Asia Pacific ex Japan	1.73%	1.73%	-0.45%
Emerging Markets	1.00%	1.00%	-0.14%

Fixed Income	MTD	QTD	YTD
Global Aggregate (Unhedged)	-0.24%	-0.24%	-4.29%
Global Aggregate (Hedged)	-0.26%	-0.26%	-1.69%
High Yield	-0.33%	-0.33%	3.44%
Asia	-1.13%	-1.13%	-1.93%
Emerging Market Debt	-0.42%	-0.42%	-1.55%

Currencies	MTD	QTD	YTD
USD/SGD	-0.66%	-0.66%	2.02%
EUR/SGD	-0.81%	-0.81%	-3.41%
JPY/SGD	2.39%	2.39%	10.36%

Commodity	MTD	QTD	YTD
Gold	1.50%	1.50%	-6.06%
Oil (WTI Crude)	11.38%	11.38%	72.24%

Equity Markets	MTD	QTD	YTD
Australia	-0.09%	-0.09%	15.93%
Brazil	-6.74%	-6.74%	-13.04%
China “A”	0.95%	0.95%	-4.14%
China “H”	2.70%	2.70%	-14.32%
Hong Kong	3.27%	3.27%	-4.46%
India	0.44%	0.44%	25.43%
Indonesia	4.89%	4.89%	12.34%
Korea	-3.20%	-3.20%	3.85%
Malaysia	1.74%	1.74%	-0.37%
Russia	1.56%	1.56%	32.26%
Singapore	3.63%	3.63%	15.66%
Taiwan	0.32%	0.32%	18.18%
Thailand	1.14%	1.14%	15.13%

Equity Sectors	MTD	QTD	YTD
Gold	7.88%	7.88%	-11.59%
Energy	10.36%	10.36%	57.93%
Technology	7.55%	7.55%	23.54%
Healthcare	4.24%	4.24%	16.17%
Financials	7.30%	7.30%	38.46%

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

Disclaimer

To the best of its knowledge and belief, Finexis Asset Management Pte. Ltd. (Finexis Asset Management) considers the information contained in this material as accurate only as at the date of publication. All information and opinions in this material are subject to change without notice. No representation or warranty is given, whether express or implied, on the accuracy, adequacy or completeness of information provided in the material or by third parties. The materials on this material could include technical inaccuracies or typographical errors, and could become inaccurate as a result of subsequent developments. Finexis Asset Management undertakes no obligation to maintain updates of this material.

Neither Finexis Asset Management nor its affiliates and their respective shareholders, directors, officers and employees assume any liabilities in respect of any errors or omissions in this material, or any and all responsibility for any direct or consequential loss or damage of any kind resulting directly or indirectly from the use of this material. Unless otherwise agreed with Finexis Asset Management, any use, disclosure, reproduction, modification or distribution of the contents of this material, or any part thereof, is strictly prohibited. Finexis Asset Management expressly disclaims any liability, whether in contract, tort, strict liability or otherwise, for any direct, indirect, incidental, consequential, punitive or special damages arising out of, or in any way connected with, your access to or use of this material.

This material is not an advertisement and is not intended for public use or distribution. This material has been prepared for the purpose of providing general information only without taking account of any particular investor's objectives, financial situation or needs and does not amount to an investment recommendation.

The information contained in this material does not constitute financial, investment, legal, accounting, tax or other professional advice or a solicitation for investment in funds managed by Finexis Asset Management, nor does it constitute an offer for sale of interests issued by funds that are managed or advised by Finexis Asset Management. Any offer can only be made by the relevant offering documents, together with the relevant subscription agreement, all of which must be read and understood in their entirety, and only in jurisdictions where such an offer is in compliance with relevant laws and regulatory requirements.

Simulations, past and projected performance may not necessarily be indicative of future results. While there is an opportunity for gain, any investor is at risk of loss of 100% of its investment when investing in funds managed or advised by Finexis Asset Management.

The information on this material is not intended for persons located or resident in jurisdictions where the distribution of such information is restricted or unauthorized. No action has been taken to authorize, register or qualify any of the Finexis Asset Management funds or otherwise permit a public offering of any Finexis Asset Management fund in any jurisdiction, or to permit the distribution of information in relation to any of the Finexis Asset Management fund in any jurisdiction.

finexis ASSET MANAGEMENT 汇信资产管理有限公司