Investment Update

December 2021

Market Review

Equities and bonds declined in November.

First, **one should not be too worried about down months.** Equity markets can have 6 down months in a year and still deliver double digit returns such as in 2010, 2007, and 1989. Indeed, down months and down years are part and parcel of investing. For those who are uncomfortable with down periods in their investments, they can either

1. Assess the investment over a longer period. As we explained in our Q1 2019 investor letter*, an investment will not show a loss if viewed on a 10-yearly horizon.

2. Stay in cash; as even bonds have down months. But one can be assured that their **purchasing power will erode over time with inflation by staying in cash.**

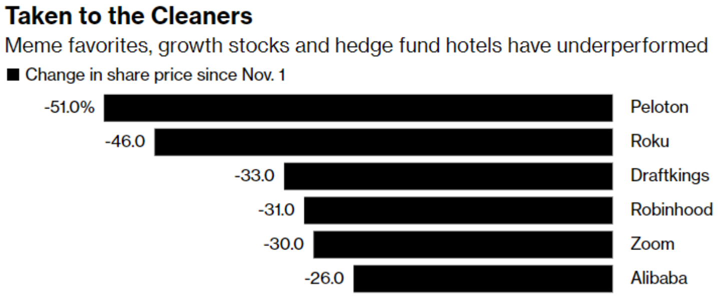
Second, this was only the third down month this year in an otherwise good year for equities. However, what might unsettle some investors is that **each time equities were down, investment grade bonds** that have historically been played the role of diversifier for equities **were also down**. For those investors who follow our commentary for the past 12 months, it should not be a surprise, we have been warning about the poor risk/reward for investment grade bonds after years of gains have made their valuations unsustainable.

Month	Global equities	Global investment grade bonds
Jan 2021	-0.45%	-0.88%
Sep 2021	-4.09%	-1.78%
Nov 2021	-2.38%	-0.29%
Year to date	**12.42%**	**-4.57%**

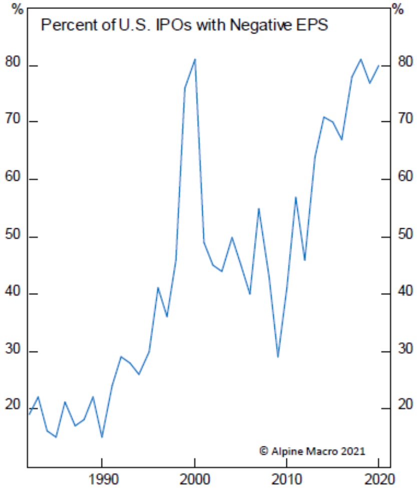
Source: Bloomberg. Global equities: MSCI ACWI Index, Global Investment grade bonds: Bloomberg Global Aggregate Index.

*https://www.finexisam.com/publication/investor%20letter/FAM_Investor%20Letter_201901.pdf

This brings us to the third point: **high valuations make an investment's prospects worse regardless if it is bonds or equities**. And the question is always "when" not "if". Beneath the surface, November's losses pale in comparison to what a few market darlings experienced. Peloton, a company without profits, tanked 51% in November, and is down 75% from its peak. Closer to home, Grab declined 20% on its first day as a listed company. Is this stocks going up and down, or are we seeing echoes of the dot.com bust? Only time will tell.



https://www.bloomberg.com/news/articles/2021-12-03/in-the-tarantino-market-the-hottest-stocks-are-getting-quietly-killed



Source: Warrington College of Business, University of Florida

To paraphrase Shakespeare's Hamlet, investors are asking themselves "to invest or not to invest". Many face this predicament because they are **accustomed to the binary choices of equity and fixed income**. Why are so many stuck with this mainstream fare? Is it because most product providers are mainstream (which is a fact of any business) or that the bulk of the investor market is mainstream? Whichever is the chicken or the egg, investors should ask themselves if they want to do anything about it. For investors who worry about a contagion of the meme and growth stock declines into their portfolios, they should seriously contemplate going into investments with greater margin of safety.

Key Themes: Positioning For Economic Growth

The COVID-19 pandemic is gradually being brought under control via vaccinations and herd immunity. However, the emergence of a novel variant named Omicron is threatening to give away progress made thus far. Since 26th November, the day when news of Omicron broke, markets have given up some gains. The S&P 500 has dropped 1.2% since, while the Straits Times Index has given back 2.0%.

From a medical perspective, Omicron poses a threat due to its fast-spreading nature. Experts estimate that Omicron can infect three to six times as many people as the Delta variant. Of course, this is not the entire picture because Omicron's other known traits include being "milder" and " less lethal" As per our discussion in last week's flash update, **one should not fall prey to the sensationalism and pay undue emphasis on the negatives**. This would be a classic case of amplifying the bad and understating the good. One should take an objective approach. On balance, once incorporating the positive elements, it would be inaccurate to claim that the economic recovery has been derailed. It merely means that the market should expect greater volatility, which is still within the ambit of the broader growth thesis.

If the economic growth thesis is still in play, how best should investors ride this wave? The response to this question, for many, has still been to adopt a strategy that tracks market benchmarks closely. In particular, many investors have put their money into the US S&P 500, or a global equity index fund that also has more than half of its total exposure in US equities.

In our case, we have opted for the path less trodden. **Of course, we do not invest differently for the sake of being different. Rather we invest according to our philosophy, based on the logic that should one aim to outperform, one must do something different and do it right.**

Afterall, when the entire community is placing their money on the same investment (e.g. S&P 500), the price is quickly bid up and the odds of outperformance quickly shifts away from our favour. Hence, rather than attempt to mirror the performance of benchmarks, we make investment decisions based on our FVT process, which helps unearth opportunities with strong fundamentals at good prices.

While we argue that the economic growth thesis is intact, the emergence of Omicron may still generate some anxiety and prompt a desire to exit markets, In that case, let us find our bearings from last year's market performance. From the first sell-off in February 2020 due to the COVID pandemic, It took only 6 months for the S&P 500 to return to its previous peak. What's more, the previous sell-off occurred when the world was unprepared and had no prior experience with COVID. This time, we are meeting the new variant from a position of relative strength and additional subject matter expertise. The aftermath of this new variant spreading might be more contained than in the previous case. In situations like this, one should steel oneself and hold on to their positions because such short-term challenge is part and parcel of investing. Patience is key, and eventually, over the long-run, investors will reap the sweet fruit of outperformance. Afterall, as per the words of Warren Buffet, "The stock market is a device to transfer money from the impatient to the patient".

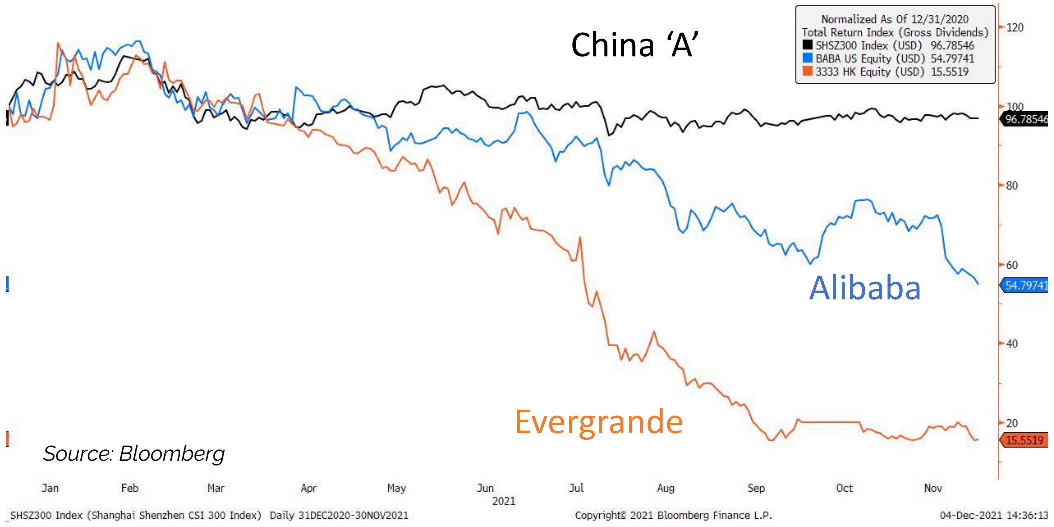
Key Themes: Stability Amid *VUCA*

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

"Not putting all of one's eggs in one basket" is perhaps one of the most well-known adages regarding investing and decision making in general, and for good reason. Afterall, who wouldn't want to minimize the risk of whole-of-portfolio implosions? Of course, there are detractors who claim that diversification is not necessary if one knows what one is doing. However, reality is such that we often operate under conditions of imperfect and incomplete knowledge. This means that we rarely meet the criterion of fully knowing what one is doing. This necessitates the practice of risk management via diversification.

Investors who have been following the global financial news would have seen the wisdom of this age-old percept in various instances. For instance, the recent plunge in Alibaba's share price due to regulatory fears demonstrates how falling share prices can come both sharply and swiftly. The huge uncertainty surrounding the Chinese Communist Party's interventionist strategies regarding its large corporations has resulted in Alibaba's share price cratering by more than 50% YTD. Of course, it is not sufficient to just diversify within the industry- the decimation of the entire private education sector in China is a poignant lesson that **diversification should not be taken with a flippant attitude and one should always commit to a version of diversification that is as robust as possible.**

Our commitment to a robust version of diversification is evident from the various "layers" of diversification present in our portfolios: (1) diversification across asset classes (equities, bonds and alternatives), (2) industries (finance, consumer goods, healthcare, etc) and (3) geographies (China, Europe, US, etc). Our pan-China approach towards obtaining an exposure to the China 'A' market has resulted in only a 5.63% YTD loss, as compared to an 84% YTD loss for the Evergrande single stock and a 50% YTD loss for the Alibaba single stock. We will continue to enjoy a much smoother ride and avoid stomach-turning volatility by being diversified. We are also able to stay invested and reap the better long-term expected returns arising from China's high growth and more attractive valuations.



Source: Bloomberg

Apart from incorporating the conventional forms of diversification into our portfolio construction, we go the extra mile by ensuring diversifying across drivers. Drivers refer to the factors that drive performance. If all our investments are driven by economic growth, a breaking of the growth thesis will have whole-of-portfolio repercussions, despite already diversifying across asset classes, industries and geographies. This is why we continue to have a significant position in healthcare equities. Unlike our other investments, healthcare is primarily driven by secular trends such as an aging global population. The sector enjoys stable and growing earnings, regardless of the general economic climate.

As a result, even in the event of a return to severe COVID-19 conditions, our portfolio will have positions that remain lucrative.

Key Themes: Search for Yield

Imagine you had an investment that was negative for the year. What would your gut tell you? Fight, Flight or Freeze?

Flight?

It is probably fair to say that most will take flight, because nobody likes pain, and interim losses inflict pain on investors. Most will likely justify their decision on the basis that the negative returns mean the investment is just bad. After all, if it's good, it should not be negative right? Or some decide it is better to just shoot first, and talk later. Surely they can fall back on the theory called efficient market hypothesis that states that asset prices reflect all available information? Invariably, many investors don't go back after taking flight.

Asian High Yield markets are down this year. How well does taking flight work out? Based on a study of Asia High Yield markets that spans the Asian crisis in 1997 to this year, the average return after a negative year is 19.8%. This is compared with the average annual buy and hold return of 8.7%. It seems that **taking flight is counterproductive despite what the impulse says.**

Freeze?

How about freezing, doing nothing? In the context of investing, that may not be a bad thing. In the case of Asian High Yield, a down year is typically followed by a positive year. Of course, we do not advocate doing nothing because of paralysis. One should assess the risk of permanent capital loss. Is the investment well diversified such that it can withstand even the impact of certain holdings being impaired? If the answer is affirmative, then the **investor should be in a position to enjoy above-average returns going forward**.

**Source: Bloomberg, ICE BofA Asian Dollar High Yield Index from 1997 to 2021.*

Fight?

Should one fight by adding more capital after an investment has declined? One might say "Why put good money after bad?", or "I logically know I should do it but I can't bring myself to do it."

When the price of a security drops, it generally gets into better valuation provided the risk of permanent capital loss is mitigated. The converse is true; when the price of a security rises, it generally gets into worse valuation unless the fundamentals have improved.

We added to our Asian High Yield exposures in mid October. These "reinforcements" went in amid tumultuous markets but also when valuations were attractive. Today, one would observe that Asian High Yield markets^ have had a peak to trough decline of 15% since May, and have not really moved up since October.

But because our reinforcements went in at low valuations, despite the ongoing uncertainty, they are not really taking losses. Even if markets declined further from here, our pain from these losses is much less compared to someone who bought near the top. For us, it is like falling from the first floor while they fell from much higher. This is the **margin of safety that comes from focusing on valuation; losses are mitigated which put one in a better position to hold on.**

Perhaps investing is like warfare. If one is not critically injured or flees out of fear during volatility, they can turn the tide of war and get that above-average return. Let others' fear be our opportunity.

^Source: Bloomberg Asia USD High Yield Bond Index

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		

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	-2.38%	2.63%	14.42%
United States	-0.70%	6.26%	23.17%
Europe	-2.50%	2.09%	19.34%
Japan	-3.64%	-5.01%	8.99%
Asia Pacific ex Japan	-4.27%	-2.61%	-4.70%
Emerging Markets	-4.07%	-3.12%	-4.21%

Fixed Income	MTD	QTD	YTD
Global Aggregate (Unhedged)	-0.29%	-0.53%	-4.57%
Global Aggregate (Hedged)	0.71%	0.45%	-0.99%
High Yield	-1.07%	-1.40%	2.33%
Asia	-0.06%	-1.20%	-2.00%
Emerging Market Debt	-1.07%	-1.48%	-2.60%

Currencies	MTD	QTD	YTD
USD/SGD	1.25%	0.58%	3.29%
EUR/SGD	-0.71%	-1.52%	-4.10%
JPY/SGD	-0.68%	1.69%	9.61%

Commodity	MTD	QTD	YTD
Gold	-0.50%	1.00%	-6.52%
Oil (WTI Crude)	-20.81%	-11.80%	36.40%

Equity Markets	MTD	QTD	YTD
Australia	-0.40%	-0.49%	15.47%
Brazil	-1.53%	-8.17%	-14.37%
China “A”	-1.55%	-0.62%	-5.63%
China “H”	-6.61%	-4.09%	-19.99%
Hong Kong	-7.42%	-4.39%	-11.56%
India	-3.78%	-3.36%	20.68%
Indonesia	-0.75%	4.11%	11.50%
Korea	-4.43%	-7.49%	-0.72%
Malaysia	-2.87%	-1.17%	-3.22%
Russia	-6.25%	-4.78%	23.95%
Singapore	-4.59%	-1.13%	10.35%
Taiwan	2.60%	2.93%	21.25%
Thailand	-3.26%	-2.15%	11.38%

Equity Sectors	MTD	QTD	YTD
Gold	0.32%	8.22%	-11.30%
Energy	-5.16%	4.67%	49.78%
Technology	2.66%	10.42%	26.83%
Healthcare	-3.54%	0.55%	12.06%
Financials	-5.68%	1.20%	30.59%

Total return in local currency terms as of **30 November 2021**
Source: Bloomberg

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