THINK DIFFERENTLY
TO GET DIFFERENTIATED RESULTS

Monthly Investment Update

Executive Summary

Following what appeared to be a brief rally in July, markets fell further in August. Investors who focused solely on bad news may have given up, expecting even more pain, because losses appear to be the only natural outcome in the current weak environment. However, investing requires patience and the ability to seize opportunities during a market downturn – this is what many successful long-term investors subscribe to.

Are economies heading into a recession? It certainly seems to be the case given how quickly central banks around the world are raising interest rates. But it is not a given that markets will decline further - nobody knows for sure where markets will end up. Selling simply because markets have experienced a slump can do more harm than good. For instance, it can mean foregoing the opportunity to earn higher expected returns in the future. Rather than sell on fear and uncertainty, investors would be better off holding on to their investments knowing that it is fundamentally sound.

A recession may appear to be frightening for investors, but it would pay to know that equities delivered positive returns on average over previous recessions. As aforementioned, investors would be better off staying invested - time in the market is far more important than market timing. This is also why it is prudent to diversify appropriately, as we did with ”recovery" (e.g. US small-cap) and "stability" (e.g. Healthcare) positions, in order to be prepared for both scenarios i.e. recovery or recession.

On the other hand, bond investors who have been invested saw how rising interest rates have negatively affected bond returns. As a result, many have cut their losses or even switched to riskier investments; these activities cause more harm than good because they would miss out on better days ahead as interest rates normalize, or unnecessarily expose themselves to greater risks than they can bear. Nonetheless, rising rates have also created opportunities for cash investments and other high-yielding bonds, which now offer more attractive yields.

MARKET REVIEW

As at the end of August, global equity markets are down 18%^, having recovered from intra-year lows of -22%. While markets are off their bottoms, investors are worried.

Because of what they have experienced this year, investors' minds are focused on looking for bad news that might cause further declines. In fact, losses seem to be the only thing they see, and is becoming their only takeaway for investing. While one cannot deny the pain, this picture of investing is myopic.

Just like many other things in life, one needs to zoom out and see the big picture. This big picture is shown in the chart below. Investments do not go up in a straight line. In fact, the journey to investment wealth entails going through periods of interim volatility and losses, as we are going through this year.

Capitulation

Despite this established long term behavior, each time markets drop investors cannot help but think of selling. Why? Because selling is an easy way to relieve the stress of holding on to a currently painful position.

Billionaire investor Howard Marks said "when you look at the chart for something that's gone up and to the right for 20 years, think about all the times a holder would have had to convince himself not to sell." **We are at one of these times.**

^Source: Bloomberg. Global equity markets: MSCI World, 31/8/2022 year to date.

Snapping up bargains

"The time is right to snap up "bargains" in financial markets following a widespread sell-off"*

What is a widespread sell-off? One can get an idea by referring to the performance table at the end of this commentary. When the major segments across equities and bonds are down together, it is fair to say we are in the midst of a widespread sell-off. In times like these, investors who think like Howard Marks are happily buying assets at more than 20% below their recent prices.

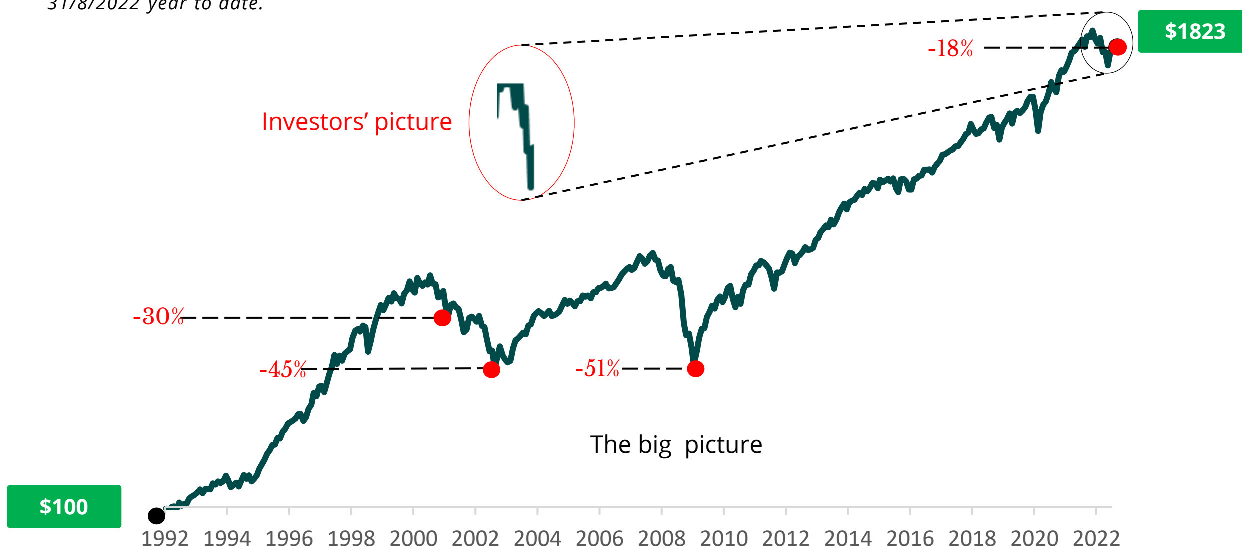
"I'll buy when markets bottom"

Imagine if markets actually dropped 50%, and someone (e.g. a friend, an investment manager, a little bird) told you it was the bottom and you should buy. Are you more likely to buy, or reply "Let's wait and see. Something must be really wrong for markets to drop so much"?

Markets may not decline further this time round, which is why Howard Marks said "waiting for the bottom is a terrible idea," And if assets get cheaper than current valuations he'll buy more.*

For those who really sold their investments recently, at least they can thank the bargain hunters for relieving them of the pain.

*https://www.ft.com/content/a3f14c51-0b1c-416e-84db-0fa0fc842f1f



Source: Bloomberg. Equity market return based on S&P 500.

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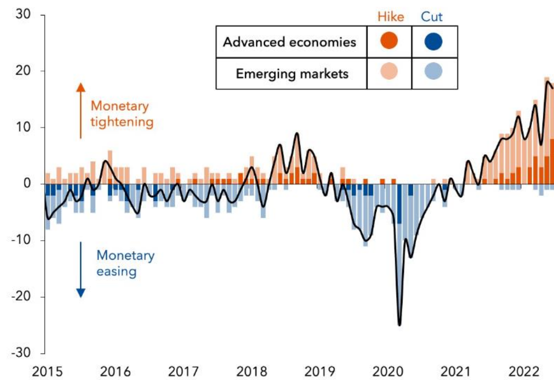
POSITIONING FOR RECOVERY

Will global central banks lead the economy into a recession? Going by ongoing measures taken to combat higher inflation, it does feel like we are heading in that direction.



Source: IMF and Bloomberg

In the recent Fed speech in Jackson Hole, Fed Chair Jerome Powell cautioned for higher interest rates 'for some time', and to expect 'some pain' to the economy – markets sold off sharply in response, presumably spooked by the 'hawkish' tone. A news headline read 'Hopes for Fed Pivot Have Faded, Sapping Stocks' Momentum', as the Fed emphasized fighting inflation as their top priority.

Naturally, many investors will be tempted to act on such headline news; perhaps by exiting positions in order to avoid further losses on their investments. As investors (not traders!), it is helpful to remind ourselves why this is usually not a good idea:

1. Prices could very likely go up instead of going down as expected, causing the investor to miss out on gains and even buy in at higher prices.

2. Even if you are right; you still need to decide when to get back in – the odds are not in our favour to be able to time both the exit and re-entry consistently.

3. If you had decided that the investment was attractive before, any shorter-term declines will only make it even more desirable. Exiting today means giving up the higher expected returns in the future.

No one really knows for sure where markets will end up in the near-term. But what about the impact of rising interest rates? It turns out that things are similarly not so simple; as studies have shown that equities have also tended to rise during past rate hike cycles[1].

What we know for sure is that such trading activities incur costs (trading cost, opportunity cost, etc.) that eat into a long-term investor's compounding. The more effective way to invest is to hold through the noise while making sure that long-term fundamentals are intact.

We have maintained our recovery positions with this in mind, ensuring our portfolios retain strong recovery potential and higher long-term expected returns. Practically, we do so by focusing on the key ingredients that make up long-term investment returns such as good fundamentals and valuations.

Position	Fundamental, Valuation, Technical	YTD %
	Reference: Global Equity	-17.5%
EM & China A	Emerging Market and China equities offer attractive valuations relative to developed markets with higher growth potential. China is currently embarking on a range of accommodative policies to support the economy and markets, in contrast to the tightening stance taken elsewhere.	*EM:* -17.3% *China*: -22.3%
US Small-cap	Valuations already pricing in the risk of recession. Year-to-date performance resilient vs large-caps despite being perceived as much 'riskier'. The position is expected to do well when markets rebound.	-17.2%
Europe Value	Maintain current neutral allocation with a focus on undervalued segments that offer a larger margin of safety. We are monitoring developments with respect to slowing activity and higher inflation, which needs to be balanced with attractive valuations and still resilient corporate earnings.	-16.5%

Source: Bloomberg, returns in USD as of 31/8/2022. [1]Forbes Advisor 'How Does The Stock Market Perform When Interest Rates Rise?

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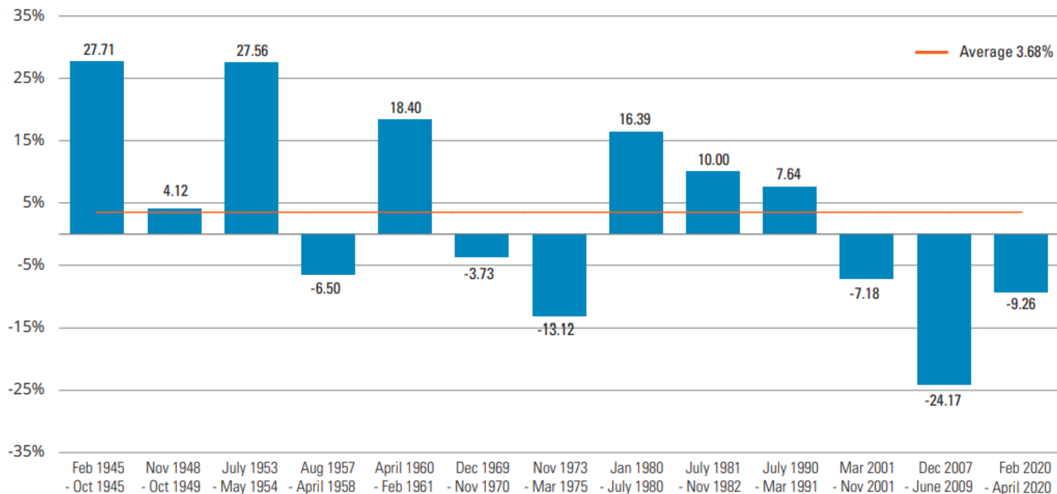
STABILITY AMID VUCA

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

Equities Have Managed To Record Positive Returns Even During Recessions



Past performance does not guarantee future results. Indices are unmanaged and not available for direct investment. For illustrative purposes only. Data sources: Morningstar, Ned Davis Research, and Hartford Funds, 3/22.

Investors are aware that recessions are bad as they tend to coincide with painful bear market declines (20%+ decline). What is perhaps less well known is that **equities have actually posted positive returns during past recessions, on average,** as shown on the above chart.

The phrase 'the economy is not the stock market' comes to mind. Financial markets are forward-looking machines, which means that they care more about the future rather than what has happened today. Consequently, markets may post gains over a recession, and decline in a time of economic expansion.

As such it is incredibly difficult for anyone to reliably predict the market's next move. Even if you knew exactly when a recession would happen, it is impossible to know exactly when to enter or exit to maximize profits. We showed last month how missing just a few of the market's best days can have devastating repercussions for long-term returns – **in the end, time in the market is far more important than trying to time the market.**

Rather than try to 'guess' where markets will be in the next day/month/year, we focus our efforts on managing the Known Unknowns i.e. we know markets will peak and bottom, but do not claim to know exactly when they will happen.

We do so by focusing on things we can control: by avoiding overheated areas, focusing on margin of safety, and ensuring that our portfolios are diversified in case things don't play out the way we expect them to (as they so often do when it comes to investing).

In today's *VUCA* environment, we complement 'recovery' positions (covered in the previous section) with 'stability' positions in the form of Healthcare and Quality Value. As mentioned before, these market segments consist of profitable companies that are more resilient to the ebb and flow of the economy.

We can look to history for clues on how 'stability' positions are expected to fare in recessionary periods. In such challenging periods, stock prices experience declines as earnings deteriorate – it is fair to say that companies with the worst earnings declines are expected to see their stock prices falling the most, and vice versa. On aggregate, earnings for global equities fell by more than 20% over the past 3 recessions (2001, 2007, 2020). In contrast, Healthcare earnings held up much better; never falling by more than 10%. Accordingly, they also outperform in recessions, as expected of the more defensive position. Diversifying into such differentiated positions allows investors to look forward to the subsequent recovery with peace of mind today.

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SEARCH FOR YIELD

The US Fed raised rates from 0.25% to 2.5% this year. This meant that the classical and most common bond investment; long dated investment grade bonds are down an unprecedented 15.5% this year. Recall that bond prices fall as interest rates go up, and longer dated bonds are more sensitive to changes in interest rates.

While unprecedented, this was not unexpected. When interest rates were near 0% over the past few years, we cautioned against sticking to the classical approach for bonds. **Our portfolio were able to mitigate the impact of rising rates by**

- Focusing on short duration so as to reduce the negative price impact of rising rates.
- Focusing on high yielding bonds that provide meaningful return with volatility, instead of classical bonds providing little return, with volatility.
- Allocating to alternatives that actually benefitted from rising interest rates.

Some who experienced the unprecedented volatility in their bond investments decided to take one of the following two actions.

1. Cut their losses: Simply put, this is capitulation. Cutting losses leads to buying high and selling low, the exact opposite of what an investor should do.
2. Shift to a more aggressive risk profile because "bonds have not done their "job". For those who do not have the requisite risk tolerance for higher equity exposure, this is jumping out of the frying pan into the fire.

The storm is usually the worst before it ends. **Investors who are able to sit through the volatility will be greeted with a much better climate for bond investing.** Professionally, this is what we call a normalisation of interest rates that is long overdue. The Fed hiking interest rates has created a nice reset to the bond market.

Pragmatically, this means while the process was painful for existing bond investors, the gloomy conditions for bonds have significantly dissipated. After over a decade of getting next to nothing on their deposits, investors are now able to get about 3% return on their savings. Accordingly, we have seen a rush by investors to take advantage of higher cash returns. Is that the best option?

With cash return at 3%, should one just park their assets in cash to get the yield they need? There are reasons why they should not.

- Recall that an investor gets the lowest return from their cash investments. We do not know how long 3% rates will last. Even if these lasted for another decade, the average cash return for investors over the past and next decade would be about 1.5%; which is not able to beat long term inflation, forget getting extra return to build wealth.

- Recall that other bond investments provide a higher return on top of the base cash returns. With the "reset", what used to be not worth the risk is now looking a lot more attractive. For most of last year, investors were getting just over 1.5% yield from investment grade corporate bonds while taking on meaningful corporate credit risk. These same bonds are now yielding 4.5%; the highest since the post-GFC recovery, and higher than the long term average.

With higher interest rates, the search for yield has not ended. In fact, it has gotten more interesting as more opportunities open up.

This does not mean that one should avoid cash investments altogether. A suitable allocation to cash acts as:

- The portion that can be liquidated for those that need capital on short notice (i.e. short investment horizon) that is also not subject to volatility.
- Part of a barbell approach that complements a significantly higher yielding position e.g. Asian high yield, that is subject to greater volatility, and requires time to realise its return potential.

By separating their portfolios into two buckets: one focused on liquidity and capital preservation to meet short term spending needs, the other focused on long term higher return compounding to grow wealth, investors can have the best of both worlds.

**Source: Bloomberg. Long dated investment grade bonds: Bloomberg Global Aggregate, 31/8/2022 year to date.*

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HOW ARE WE POSITIONED?

Positioning for Recovery	Stability Amid VUCA	Search for Yield
China 'A' Equities	Healthcare Equities	Asian High-Yield Bonds
Emerging Markets Equities	Quality Value	Emerging Markets Short Duration Bonds
US Small-Cap Equities		
Europe Equities		

The 'Positioning for Recovery' positions are expected to do well as the economy and markets gradually work through current shorter-term volatility, while the complementary Stability and Yield positions provide effective diversification to the rest of the portfolios.

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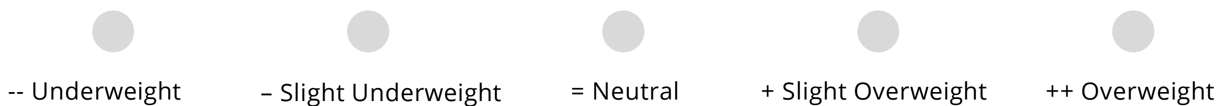
ASSET ALLOCATION STRATEGY



-- Underweight – Slight Underweight = Neutral + Slight Overweight ++ Overweight

Equity: Regions

United States

US Small-caps as relative valuations are attractive and expected to benefit as economies recover. **Healthcare** as earnings are more stable and less dependent on broader economic cycle. **Quality Value** as valuations are 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

Maintaining no exposure as they are less attractive compared to other opportunities

Asia Pacific ex Japan

Maintain **China 'A'** slight overweight as deleveraging cycle has taken its course, with credit conditions expected to improve.

Emerging Markets

Neutral as valuations are attractive relative to developed markets, but where earnings tend to be less resilient

Fixed Income

Global

Focus on currency-hedged government bonds and unconstrained credit to buffer portfolio volatility during periods of stress.

Investment Grade Corporate

Maintaining no exposure as low incremental yield and long duration credit exposure are less attractive than other segments

US High Yield

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 Markets Debt

Hard currency short duration focus as a more defensive credit investment amid low rates.

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MARKET INDEX RETURNS

Equity Regional	MTD	YTD	10Y	20Y
Global	-3.64	-17.47	9.30	8.45
United States	-4.08	-16.15	13.06	9.73
Europe	-5.03	-12.42	8.08	6.62
Japan	1.20	-0.06	12.82	5.71
Asia Pacific ex Japan	-0.19	-15.80	4.97	8.89
Emerging Markets	0.45	-17.31	3.28	9.14

Equity Markets	MTD	YTD	10Y	20Y
Australia	1.37	-2.77	10.82	10.08
Brazil	6.16	4.48	6.74	12.50
China "A"	-1.96	-15.79	8.65	7.43
China "H"	-0.23	-14.23	0.69	10.14
Hong Kong	-0.78	-12.47	3.77	7.13
India	3.59	3.32	14.59	17.50
Indonesia	3.39	11.59	8.21	17.90
Korea	0.84	-16.59	4.48	8.23
Malaysia	1.37	-1.62	2.46	7.63
Russia	8.41	-35.02	11.02	15.27
Singapore	1.71	6.79	4.26	6.67
Taiwan	1.17	-13.70	11.29	9.82
Thailand	4.52	1.05	6.16	11.83

Equity Sectors	MTD	YTD	10Y	20Y
Gold	-8.78	-25.11	-5.62	0.65
Energy	2.83	48.52	4.84	8.95
Technology	-5.90	-25.10	17.26	12.53
Healthcare	-6.00	-12.67	12.16	9.46
Financials	-2.01	-14.62	12.62	5.04

Fixed Income	MTD	YTD	10Y	20Y
Global Aggregate	-3.95	-15.55	-0.28	3.02
Global Aggregate (H)	-2.61	-9.17	2.06	3.48
High Yield	-2.96	-11.84	3.97	7.60
Asia	-0.45	-10.83	2.64	5.15
Emerging Markets	-0.54	-15.85	2.13	7.02

Note: (H) Currency Hedged

Currencies	MTD	YTD	10Y	20Y
USD/SGD	1.20	3.57	1.14	-1.12
EUR/SGD	-0.44	-8.44	-1.10	-1.00
JPY/SGD	-2.98	-14.18	-4.49	-1.90

Commodities	MTD	YTD	10Y	20Y
Gold	-3.11	-6.46	0.11	8.87
Energy	-9.20	19.07	-0.74	5.80

*As of **31 Aug 2022**. Source: Bloomberg. Total return in index local currency terms. 10 and 20 year returns are annualized.*

"The most important quality for an investor is temperament, not intellect."

Warren Buffet

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