JANUARY 2023

KNOCK, KNOCK.
A DECADE OF POSSIBILITIES.

Foreword

Happy new year! This is the time of the year when social media is abuzz with why “2022 was a year to forget” for a multitude of reasons ranging from health to personal relationships. Investors are also keen to forget 2022. For some, their portfolios were dented as both equities and bonds declined. Others saw fortunes evaporate as the reversal of years of QE brought about the unravelling of investment fads.

I recall in a prior conversation “Bitcoin? We knew about it 400 years ago. They were called tulips.” Hence, fads are not a modern problem; over the centuries investors have been lured by get-rich-quick schemes time and again. However, the pace at which information and market noise travels today certainly compounds the problem.

In this commentary, instead of just pontificating about “this year’s outlook” and adding to the gaggle of market commentators, we have included some lessons which I have internalized from experiencing different events over the years. They may not sound as exciting as “10 best places to invest in 2023!”, but they have a much longer shelf life, helping one to manage themselves in order to navigate markets for the next decade, which as we explain later, will be quite different from the last. Hopefully, these will provide some shortcuts so that you do not have to learn everything on your own time and capital.

Alvin Goh

Chief Investment Officer

Finexis Asset Management

Monthly Investment Update

Executive Summary

December's performance mirrored tough market conditions in 2022. Both equities and bonds experienced significant declines, causing many investors to lose confidence in their portfolios. Even the popular 60/40 (equity/bond) portfolio was deemed "dead". However, those who held alternative investments had better weathered the storm as alternatives outperformed - our portfolios benefitted from allocating to trend-following. As we move into 2023, investors should brace for further volatility as global economies soften, by positioning both offensively and defensively in areas of equities and bonds that are attractively priced.

We have strategically invested in Europe, US Small-caps, and China equities, much like how a football team carefully places key players on the field. Despite facing some challenges in 2022, they are expected to become our strongest players in driving strong performance due to their attractive valuations. Having said that, any successful football team must have strong players to play defence - we continue to deploy Healthcare and Biotech 'players' as they tend to be more resilient during market downturns while still offering the potential to participate in up markets.

Predictions about an upcoming recession or market downturn may not be reliable and provide false comfort at best. The current economic environment is marked by uncertainty and less supportive monetary policies, which makes it more challenging for investors. Therefore, instead of relying on predictions, investors need to ensure that they are well-prepared for the challenges ahead. It is also worth noting that markets have delivered strong returns after large declines, and the current market conditions (with valuations returning to more realistic levels) present good buying opportunities for the long-term investor.

One would also recall, a few months ago, many investors rushed to put their money into fixed deposits offering 2.7% return for 24 months. Today, they are offering around 4% and those who invested earlier missed out on higher returns. However, unknown to many there are opportunities to achieve even higher yields and returns. For example, Asian high-yield bonds returned over 17% in Q4 2022 (6.76% in December alone). Investors who followed our recommendation to invest in these bonds would be sitting on double-digit gains. This is why it is important to look beyond the crowd and consider a wide range of options to achieve better returns.

MARKET REVIEW

December's performance echoed what happened in 2022. In what was an "annus horribilis" for the typical investor, **equities and bonds, the common building blocks of many portfolios, both dropped**.

While this was not the first time equities and bonds dropped together, this was the largest concurrent drop ever. Investors had never seen conservative risk portfolios drop as much as aggressive portfolios, altering their perception towards investments. At the start of 2022, no one would have predicted such an outcome. But we were prepared.

Many found there was nowhere to hide, even proclaiming the death of the 60/40 equity/bond portfolio. For them, 2022 was a year to forget. But we would not want to forget. Because we have experienced and learnt from prior episodes, we made the call earlier to avoid developed market government bonds with "return-free risk", and it shows in the performance.

As we know the pain when it seems there is nowhere to hide**,** we structure our portfolios to include **alternative exposures that move differently from conventional asset classes**.

In December, as well as 2022, global equities and bonds were down, while alternatives were positive. This is why our portfolios were less affected and outperformed when many portfolios were hurting. This means investors feel less pain on the downside and can stay invested so that they can participate in the subsequent upside.

Performance	Dec 2022	2022
Global equities	-3.60%	-17.69%
Global bonds	-0.98%	-11.04%
Alternatives	0.71%	17.80%

It is important to emphasize **that not all alternatives are the same**. Commonly offered alternatives such as equity long/short, event-driven, and private market strategies were negative in the face of market and economic headwinds. Whereas trend following benefitted from such adverse environments. When stocks and bonds are both down, our alternatives are truly alternative, providing much needed diversification.

For our investors who do not have access to alternatives, don't fret. They have also avoided much of the government bond carnage last year, and are positioned for meaningful upside, as we elaborate in the "search for yield" section.

Investors who emerged from 2022 relatively unscathed should **position for the upside while preparing for further volatility**. How? With the recent World Cup, we would be remiss not to use a football analogy: ensure your portfolio is balanced with players up front and at the back. And try not to be distracted by the fans a.k.a market noise.

Why have players up front after taking a bruising from last year? Global economies are normalizing from a post-covid boom. This transition started last year, when major central banks sought to combat inflation and prevent economies from overheating. The consequence is that some degree of slowdown is very likely.

Equity markets have already priced in slowdowns, and certain markets are even pricing in recessions, offering compelling risk-reward. In short, while an economic slowdown is ahead of us, **investors are better off taking some offense now.**

Having said that, investors are well-served by maintaining a back line to cushion volatility amid such economic phase transitions.

We had warned against and positioned for rising interest rates. The pace of rate hikes last year meant that bond markets have meaningfully normalized, and are no longer "return-free risk". While others are reviewing on hindsight and questioning the 60/40 portfolio, now is the time to **reconsider bonds to provide both income and safety**.

Before last year, over a decade of QE and low interest rates saw investors caught up in all manner of speculative investments amid proclamations of "this time is different". History does not repeat itself, but it rhymes. For investors who took a big hit and even permanent capital loss from the fads of yesteryear, repair your portfolios. If you need help with that, do get in touch.

Source: Bloomberg, Global equities: MSCI All Country World index, Global bonds: Bloomberg Global Aggregate index, Alternatives: Winton Trend Fund as at 30/12/2022

POSITIONING FOR RECOVERY

We will go out on a limb to say that **2022 was a gift for long-term investors**. How can this be when major markets are down double-digits last year?

For one, markets have tended to deliver particularly strong returns after a large decline. It can be tough to watch your portfolio take a hit but staying invested ultimately leads to better outcomes - history is on our side on this one. In fact, you can do better than just staying invested; by buying additional units at lower prices and compounding higher returns over the long investment horizon.

Some have taken the other option: selling to avoid further pain; but this ensures that they lock in last year's declines and more importantly risk losing out on the subsequent strong rebound.

Last year's decline was also a gift as it took a lot of the froth and speculation out of markets. In general, this reduces the risk of a bubble and clears the runway for a more enduring bull market going forward. This has two important implications:

1. **Valuations are back to more realistic levels** more in line with fundamentals (see below chart). Today's valuations are now below their 10-year average, a far cry from the extreme levels seen during the post-covid rebound. Lower valuations mean higher future returns for investors.
2. **During times of market euphoria, investors risk getting caught up in the hype** and make decisions based on short-term price movements - remember the cryptocurrency or *meme* stock frenzy? Market declines are a good way to remind long-term investors to stay disciplined and focus on investment fundamentals and valuations that can reliably compound long-term returns.

With this in mind (and continuing from the earlier football analogy), we have deployed strong players to score more goals:

Our **European** 'player' had a shaky start due to the Russia-Ukraine invasion, but favourable risk/reward still prevailed – it emerged as one of the most resilient markets in 2022. Improving economic sentiment means there is room for further outperformance.

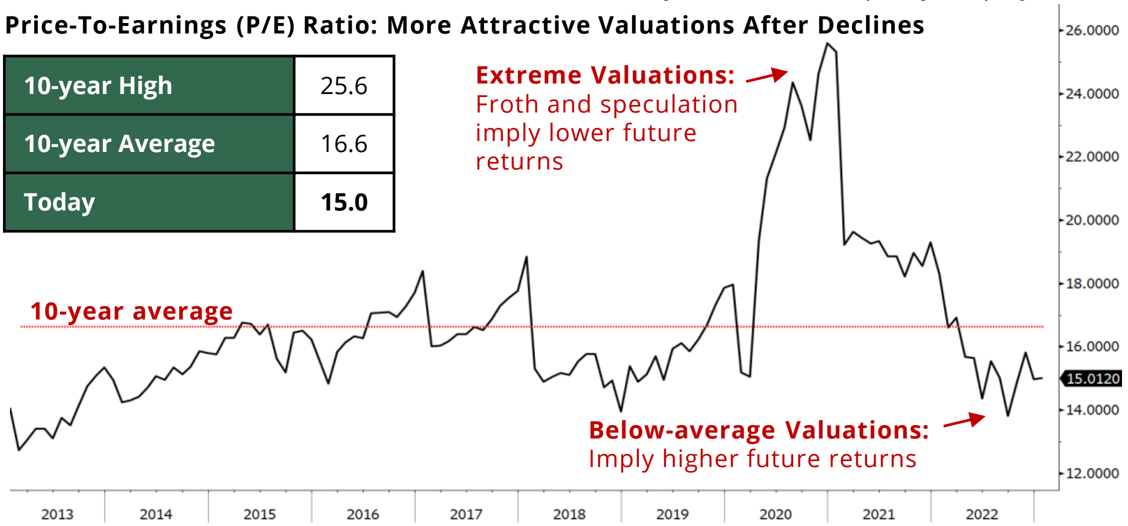
US small-cap has been warming up; holding up well against large 'blue-chip' stocks in last year's declines. Going forward, their attractive valuation is expected to help them do much better when markets recover.

China was a laggard in 2022 but has recently been showing signs of revival. We are closely monitoring the pivot away from covid-zero; which may be the final catalyst for an overall better 2023 season.

In short, there are now attractive investment opportunities even amid a slowdown...of course, you still need to pick your players well.

Price-To-Earnings (P/E) Ratio: More Attractive Valuations After Declines

10-year High	25.6
10-year Average	16.6
Today	**15.0**



Source: Bloomberg. Global equities: ACWI. 10-year data as of 4 Jan 2023.

STABILITY AMID VUCA

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

A recent article on Bloomberg was titled 'the most-anticipated downturn ever'[1]; which may cause some anxiety amongst investors. But read further and you will find that the article also mentioned that it also 'could be the mildest recession in history'.

How to handle seemingly contradicting views? This brings to mind a joke: Economics is the only field in which two people can share a Nobel Prize for saying the complete opposite.

The reality is that there are multiple potential scenarios at any point in time, each with its own likelihood of happening. Which is why we know that predictions are a futile exercise and refrain from them. We remind readers that while it can be comforting to hear someone make a convincing economic prediction, it is at best false comfort. It is more practical to prepare rather than predict.

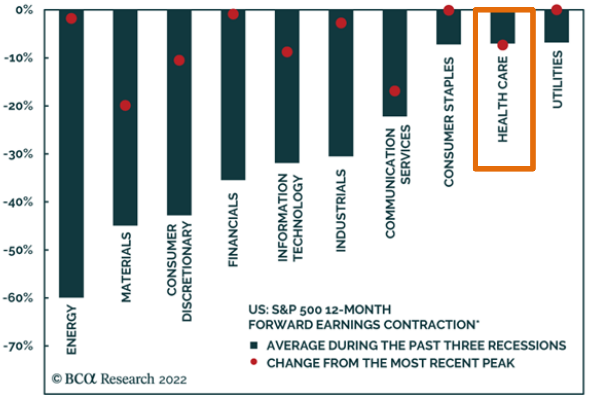
While we are of the view that today is a much better starting point for long-term investors, we also acknowledge that the world today is fraught with uncertainties. That is why we have the stability theme to cater for these multiple scenarios.

Investors who started investing sometime in the past decade would likely say that they had a relatively smooth investing journey overall; with some even feeling that equities were rising almost non-stop apart from a few scares that lasted at most a few months. It turns out that they were lucky (or unlucky) to be part of the longest US bull market in history – totaling 131 months starting from March 2009.

The past decade of low inflation and low interest rates was where one could make decent investment return without much turbulence (or competence). That environment has passed and taken some reckless investors along with it. Today's environment, with less accommodative monetary policy, is much more challenging. Which suits us fine because we see such environments gifting us even more opportunities.

Hence, **investors should be taking the time to review their portfolios to ensure that they are well-prepared for the decade ahead.**

Earnings Decline In A Recession... Some More Than Others



* SOURCE: REFINITIV/IBES.

Today, our **stability theme consists of diversified Healthcare and Biotech exposures that are more resilient during declines while still being able to participate in up markets.** They did just that in 2022, outperforming global equities by more than 10% and benefitting our portfolios.

This is due to the Healthcare sector's defensive profile, where earnings are largely driven by healthcare spending that is hard for consumers to compromise on. Indeed, we have observed earnings for the Healthcare sector being one of the most resilient in past recessions for this reason (see above chart).

When it comes down to it, all of this – diversifying into Healthcare, or paying attention to fundamentals and valuations - is to make sure that our investors avoid large declines where they can.

This is important as large declines are particularly hard to recover from. **While a 20% decline requires a 25% gain to recover from the initial loss, a 50% decline requires a 100% gain to recoup.** Some of us can probably think of a stock or fund that has declined by even more than 50% in the past year alone – how much do they need to gain just to recover?

[1]Bloomberg article 'The Most-Anticipated Downturn Ever'

SEARCH FOR YIELD

Recall a few months ago when there were long queues to put money into deposits. It was when deposit rates had risen, prompting savers to lock in their cash for 24 months to get a 2.7% return.
[Banks in Singapore raise fixed deposit rates as demand surges for safe returns - CNA (channelnewsasia.com)]

Today, savers can get around 4% on deposits, so those who rushed to lock in their cash earlier have missed out on higher returns.
[Best Fixed Deposit Rate Singapore (22 Dec 2022): UOB, OCBC, DBS, Maybank & More (seedly.sg)]

For many, this search for yield can be an exciting process; uncovering better deals from one bank to another. But is their search thorough enough? Is the cash working hard enough amid an inflationary environment?

The table shows the performance of various fixed income investments in recent months.

Performance	Dec 2022	Q4 2022 return
Money market fund	0.34%	0.88%
Global investment grade	-1.18%	0.99%
US high yield	-0.88%	4.57%
Asian High Yield	6.76%	17.29%

Money market funds returned 0.88% in Q4, which is substantially higher than the 0% a year ago in Q4 2021. But it's not just cash returns that have increased; other fixed income markets such as high yield are generating even stronger returns. This reminds us that higher-yielding markets return more than lower-yielding ones.

How can one know where the higher-yielding markets are? Actually, "search for yield" may be a misnomer as higher yields are hiding in plain sight. The table shows the long-term and current yields for various fixed income investments.

Yield	Long term average yield	Current yield
Global investment grade	3.11%	3.73%
US High Yield	8.35%	8.98%
Asian High Yield	10.57%	14.19%

With a bit of internet research, one would be able to find yield data across fixed income markets. Of course, if one prefers not to do the research, there are investment managers such as us who research and highlight where the higher-yielding markets are. With the resources available to today's investors, the search for yield is not that difficult.

The following shows that higher-yielding markets provide higher total return over time.

Long term performance	Total return	=	Income return	+	Price return
Money market fund	**67%**		67%		0%
Global investment grade	**195%**		206%		-12%
Asian High Yield	**322%**		379%		-57%

*Source: Bloomberg. Global investment grade: Bloomberg Global Agg Index Hedged, Money market fund: Vanguard Federal Money Market Fund, Asian high yield: ICE BofA Asian Dollar High Yield Corporate Constrained Index from 31/12/1996 to 30/12/2022

Who would not want a return of 322% from high yield compared to a return of 67% from money markets? Just as savers know to queue for banks offering higher rates, investors can get a "free lunch" by investing in higher-yielding markets. Then why is it difficult for investors to get the higher return from higher-yielding markets? The catch is they need to keep the lunch in their stomachs.

We can see why many do not get the higher return from high yield when we look into what makes up the total return for bonds; namely income and price return. The table above shows that for money market funds, all the total return comes from income, and savers do not experience any price volatility. As we move into investment-grade bonds, which provide higher yield and return, investors will experience some price volatility. High-yield markets with even higher returns have more price volatility, but the fact remains the that **majority of bond returns come from income over time**.

Except that when investors are experiencing volatility, it is natural to get caught up in the moment and lose their lunches. Which is why investors must remember: higher-yielding markets provide higher returns, it's just that price volatility throws people off course.

This same price volatility also creates opportunities. In Q3, we were encouraging those with dry powder to invest in Asian high yield. Those who did so would be sitting on double-digit gains in a year where others are seeing double-digit losses.

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	Government Bonds	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.

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.

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 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 to focus on return from credit while limiting exposure to emerging market currencies and interest rate risk.

MARKET INDEX RETURNS

Equity Regional	MTD	YTD	10Y	20Y
Global	-3.91	-17.96	8.56	8.64
United States	-5.77	-18.13	12.55	9.79
Europe	0.41	-15.22	5.65	7.57
Japan	1.52	-14.28	6.06	5.61
Asia Pacific ex Japan	-0.49	-17.48	3.55	9.03
Emerging Markets	-1.51	-19.94	1.77	9.04

Fixed Income	MTD	YTD	10Y	20Y
Global Aggregate	0.54	-16.25	-0.44	2.72
Global Aggregate (H)	-1.18	-11.22	1.70	3.22
High Yield	-0.88	-11.88	3.47	7.28
Asia	1.32	-11.21	2.23	4.94
Emerging Markets	0.85	-15.26	1.71	6.55

Note: (H) Currency Hedged

Equity Markets	MTD	YTD	10Y	20Y
Australia	-1.64	-5.84	5.62	11.45
Brazil	-3.09	10.13	-3.56	9.83
China “A”	3.46	-26.14	5.58	9.29
China “H”	5.26	-15.68	-1.66	9.79
Hong Kong	6.46	-12.61	2.07	7.49
India	-4.98	-4.73	9.00	14.11
Indonesia	-1.92	-1.59	2.09	14.65
Korea	-5.52	-28.65	1.16	8.14
Malaysia	1.59	-6.22	-1.52	7.34
Russia	-15.00	-35.67	0.95	9.95
Singapore	1.09	9.06	2.94	8.80
Taiwan	-4.57	-26.90	9.55	10.51
Thailand	3.92	-0.44	3.74	13.27

Currencies	MTD	YTD	10Y	20Y
SGD/USD	1.63	0.67	-0.92	1.30
EUR/USD	2.87	-5.85	-2.07	0.10
JPY/USD	5.30	-12.20	-4.05	-0.49

Commodities	MTD	YTD	10Y	20Y
Gold	3.14	-0.28	0.85	8.63
Energy	-0.36	6.71	-1.34	4.84

As of 31 Dec 2022. Source: Bloomberg. ***Total return in USD****.*
10 and 20 year returns are annualized.

Equity Sectors	MTD	YTD	10Y	20Y
Gold	1.12	-8.63	-3.52	1.65
Energy	-2.99	65.43	5.93	9.68
Technology	-8.00	-30.60	16.60	12.18
Healthcare	-1.15	-4.97	12.59	10.00
Financials	-5.27	-10.57	12.11	5.56

"In investing, what is comfortable is rarely profitable.“

Rob Arnott

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