FEBRUARY 2023

Monthly Investment Update

Executive Summary

2023 started with robust market performance. The S&P 500 rose 6.28%, while US small caps, where we are in, gained 9.75%. However, not everyone reaped the benefits. Those who let emotions of greed and fear drive their investment decisions would have missed out on these gains, possibly buying into richly valued areas, and selling during market downturns. To be successful in investing, investors need an objective approach for making informed buy and sell decisions. Almost every market has its own cycle of greed and fear that presents opportunities, but the key to capturing these returns is having an established process for knowing when to buy and sell.

Investors' risk-on appetite was largely fueled by positive developments regarding the reopening of China, favorable energy price trends, and anticipation of a slowing pace of rate hikes. This has led many investors to wonder which market segments are likely to perform well in the future. It is expected that China will perform well as it moves beyond its zero-covid policy and may surpass the S&P 500 in terms of performance. Additionally, US small caps are expected to perform better than their large cap counterpart. Both China and small caps equities are part of our recovery theme.

For many investors, the desire to find an investment that guarantees returns is understandable, but in reality, none exists. As mentioned above, successful investing requires more than just knowing when or what to invest in, it also requires managing risk and an understanding of human emotions. Ensuring a sufficient margin of safety and favourable risk/reward can help investors achieve higher than average market returns, while understanding the emotions of greed and fear can steer investors away from the pitfalls of emotional investing. This is why our portfolios are diversified for stability in the form of defensive healthcare to manage any potential overreaction going forward.

One would recall news articles declaring Asian High Yield (AHY) "uninvestable" due to reports of distress in China's property market and sharp decrease in investment values. As a result of their concerns about further declines, some investors sold their holdings. Ironically, AHY rebounded and rose by 40%, leaving many to doubt the reliability of these news sources. In reality, the news outlets simply report current events and do not provide enough information or context to make sound investment decisions. That is why it is important not to base investment decisions on them. What is next for AHY? While no one can predict the future, history shows that this rally may only be the start of multi-year gains.

MARKET REVIEW

If 2022 ended badly for most market participants, 2023 started with a bang, with the biggest January gains in 4 years. The S&P 500 rose 6.28%, while US small caps where we are in gained 9.75%.

As mentioned in our previous commentary, our strategies had a good end to 2022, with true diversification providing resilience, while setting up the portfolios for strong recovery. This potential manifested in January, with our **recovery themes delivering above-market return.**

We achieved this not because we "predicted and were nimble". In fact, our portfolios were pretty much unchanged from a year ago. We just made sure to structure the portfolio so that each position had a role to play. Think of it as defense holding the fort when under siege, and offense going on the attack after the siege.

Not all investors are enjoying the good start to 2023. Why? Because they responded to the most effective call to action in markets. Investors who were **triggered by greed to buy past winners** such as the S&P or growth strategies would endure a painful reality as markets declined last year, ultimately **selling when triggered by fear**. Ironically in investing, **the most effective call to action is the worst**. Unfortunately, this is not unique to the S&P. Just about every other market has such cycles. Investors who recognize this can see these greed-fear cycles as opportunities.

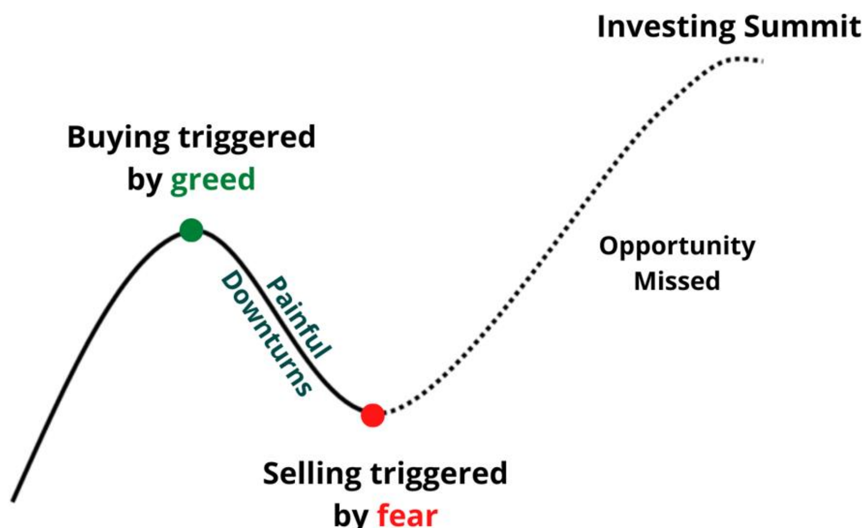
How can one not succumb to greed and fear?

First is to establish and stick to a process. So that when fear is maximum and selling pressure is everywhere, **one has objective measures to say "buy"**. However, having a process set up but not taking action will not make any impact. The ability to take action against knee jerk response requires deliberate practice.

If one spent 3 hours a day, every day of the year for 10 years, they are supposed to clock the 10,000 hours of deliberate practice to become an expert*. We spend much more time than that, studying data and charts, keeping records, understanding and upgrading. By **continuously conditioning ourselves to internalize the market cycles** can we improve the odds of not being caught up in this greed and fear.

It is a long journey of ups and downs to the investing summit. Anyone who thinks they have a shortcut or a rocket ship will invariably end up not completing the journey. In the following pages, we elaborate on our themes that were formed as we saw opportunities during the recent greed-fear cycles, themes that will help our investors reach the investing summit in due course.

*https://www.amazon.com/Outliers-Story-Success-Malcolm-Gladwell/dp/0316017930



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POSITIONING FOR RECOVERY

Our **recovery positions demonstrated their potential in January**, providing meaningful above-market return. When major asset classes were under siege last year, our stability positions played defense. This allowed our recovery positions to stay in the game, and shine as market pressures eased off this year.

In the flash of an eye, investor sentiment has swung from negative to positive as good news continued to hit the headlines. First with the re-opening of China, followed by trends in energy prices boosting the outlook for energy importing countries such as Europe. Additionally, markets are now anticipating a slowing in rate hikes, further fueling the positive sentiment. These have boosted the risk-on attitude of market participants and contributed yet another could-have, should-have moment for those who missed out on the rally.

Is there anything wrong with these investors? No, they were just responding to natural human instinct, taking flight in the face of fear. **Fear drove them to make hasty decisions, and greed cause them to take unnecessary risk.**

Amidst this rebound, the mindset of investors will also shift towards "which segments of the market are likely to do better?"

With China poised to play a significant role in driving economic recovery due to the ending of its zero-covid policy, Chinese equities have been building on the gains made in December. How likely can this outperformance persist?

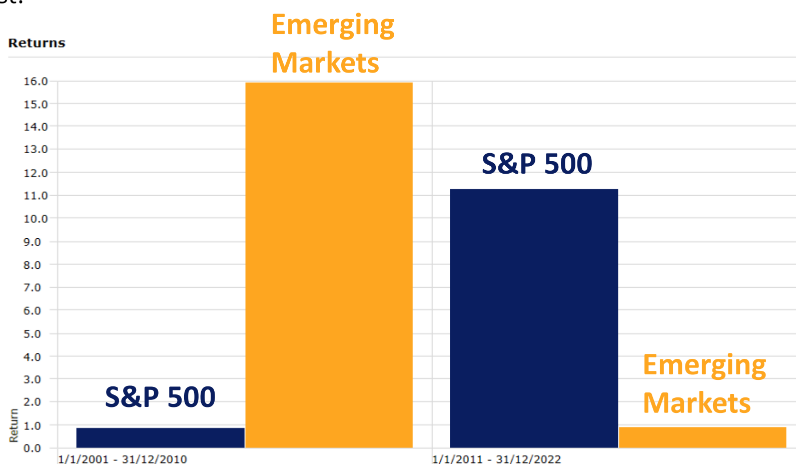
The fact is it has happened before. The chart below shows that emerging markets with meaningful China exposure outperformed S&P from 2001 to 2010. In the recent years from 2011 to 2022, a combination of Fed cheap money and macro pressures in China allowed the S&P to outperform. **If we agree that those days are over, the next phase of performance leadership should be driven by China and Emerging markets.**

"Why shouldn't we bet everything on China?", one might ask. While investing everything into one segment might look like high conviction, to us that demonstrates

- At best, a lack of awareness of the need for diversification. "You can't read about a panic, you have to experience it" An all-in investor would not have gone through enough to internalize the importance of diversification;
- At worst, lazy investing. Sometimes conviction happens when there is a lack of choice. This can come from not being aware or not being open to other opportunities. Either way, such traits do not bode well for the investment journey.

Ask anyone who was all-in on China, and they will tell you any high conviction melted away in recent years. That is why we have **US small caps to provide a different source of recovery potential.**

The positions we have been accumulating since last year have positioned us for the recovery ahead. By maintaining a long-term perspective and stay invested, we continue to work towards our ascent to the summit.



Will Emerging markets or S&P 500 outperform in the next phase?

Source: Morningstar

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STABILITY AMID VUCA

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

Blackstone's chairman once said that "there are no brave old people in finance".

What he meant was that being too brave while ignoring risks is a surefire way to get destroyed early in their careers. Similarly, anyone who thinks that they have found an investment that is a *sure-thing* should take a step back to ensure that they are not taking undue risks that can derail their investment journey. At the end of the day, they may end up being right; but is there enough holding power to reach the destination?

Cheap can get cheaper.
Our long-time investors would know that we focus on investments with attractive valuations that provide a good margin-of-safety (as such investments do better in the long-term). While we take great care to invest only when the risk/reward is in our favour, such investments do take time to unlock their full value. Furthermore, the opportunity to acquire investments at good value usually coincides with bad news and volatility. For instance, we continued to hold our positions in undervalued European equities amid the Russia-Ukraine invasion and the ensuing energy crisis early last year. Investors experienced large price swings, but ultimately benefitted from the subsequent strong rebound.

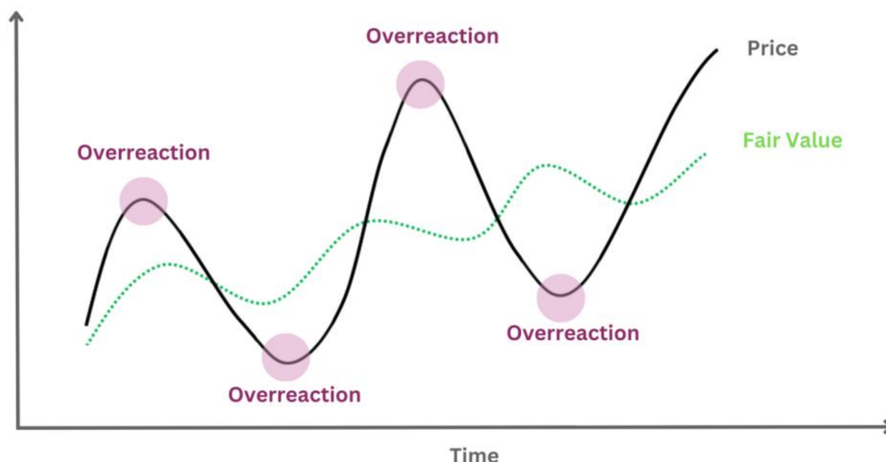
Volatility can cause investors to lose faith, especially when prices overreact further to the downside. At this point, investors feel the most uncomfortable, but need to recognize that this is when it is the most attractive from an investment standpoint.

Overreaction is a natural behavior of market participants, occurring when investments get excessively sold-off due to emotional rather than fundamental reasons. While there are no good ways to determine by how much and how long markets will overreact, we can prepare for it.

Diversifying into Stability in the form of Defensive Healthcare equities is one practical way to manage potential overreaction going forward. Even as recent market gains have given investors more optimism, ominous clouds continue to loom in the form of slowing economies and potential recessions – such concerns can just as quickly dominate the market narrative as they went away (did they really go away or was markets too pessimistic before?). In volatile markets, Healthcare equities can help to:

- Cushion downside volatility, so that our investors are better set-up to stay for the rewarding long-game.
- Provide capital to acquire discounted assets. In periods of volatility, we look to re-allocate defensive Healthcare positions into investments with strong rebound potential as we identify them.

The journey to the destination is fraught with volatility, uncertainty, complexity, and ambiguity. Our stability theme's purpose is to cushion the impact of VUCA, so that investors can stay in the game.



Source: Finexis Asset Management

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4 minute read · October 31, 2022 8:38 PM GMT+8 · Last Updated 3 months ago

Asia bond funds dump China in favour of cash after high-yield rout

While there are select bonds that have upside, China high yield as an asset class is currently "uninvestable", she said.

We were sent this article* last year. As readers know, we have meaningful exposure to Asian high yield, having added after the China property sector experienced stresses earlier.

"Why are we still investing here?" "Is there hope?" These were questions being asked. It was hard, if not near impossible, to put up any convincing argument to invest in Asian high yield. Any study showing the return opportunity and margin of safety was overwhelmed by facts such as the following:

- Asian high yield markets by then had experienced a peak to trough decline of 50%. ("If it dropped so much, something must be wrong.")
- Any development had a negative connotation: Property companies being nationalized, property sales being stalled because of zero covid.

With the article stating that some experts in Asian bonds were calling the market uninvestable, it really seemed like the final nail in the coffin. Indeed, it was the **final nail in the coffin…for those who capitulated**. After this news article was published, Asian high yield markets bottomed and rallied [1]40%.

This is yet another example of that **effective call to action that works against the interests of investors**; fear triggering one to sell at the bottom. The article is a "4 minute read". For anyone who capitulated after reading it, this would likely be one of the most expensive 4 minutes they had.

To reach a higher summit (level of wealth), an investor needs to fight that natural Fear and Greed impulse that is counterproductive to investing outcomes.

*https://www.reuters.com/markets/asia/asia-bond-funds-dump-china-favour-cash-after-high-yield-rout-2022-10-31/

Some readers might have mixed feelings about news reports now. "Why didn't the news report say that most declines are followed by recoveries?" "Is it a conspiracy to make retail investors sell so others can buy at low prices?" The truth is simpler.

The fact is the newswires are doing their job, which is to report current affairs. When something happens, reporters need to get the article out asap (especially with today's internet media), and with as much brevity as possible. When a market has a big drop, it is their job to report that. **No one should expect such articles to contain research on past market cycles, and the implications for investors**. If anything, a more sensational report probably gets more eyeballs.

At this point, let us provide some other facts, facts we feel are more helpful to investors.

[2]Fact #1: A $100 invested in Asian high yield would have returned $454 compared to $301 invested in a global bond index fund.

Fact #2: An investor would have gone through 50% peak to trough decline in Asian high yield, yet still emerge with the returns above.

Perhaps one question today is "After the 40% rally, should I sell?"

Fact #3: Asian high yield markets have had 40% gains before. Such gains were only a small part of the subsequent multi-year gains for investors who were able to tolerate the volatility.

[1]Source: Bloomberg. Global bond index: Bloomberg Global Agg Index Hedged, Asian high yield: ICE BofA Asian Dollar High Yield Corporate Constrained Index from 31/10/2022 to 31/01/2023

[2]Source: Bloomberg. Global bond index: Bloomberg Global Agg Index Hedged, Asian high yield from 31/12/1996 to 31/01/2023

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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	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.

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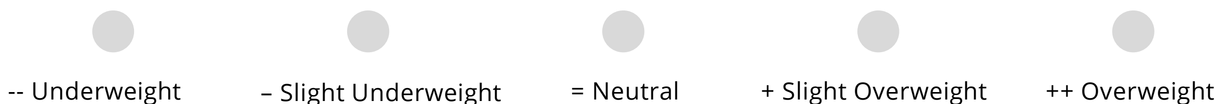
ASSET ALLOCATION STRATEGY



-- 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.

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.

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MARKET INDEX RETURNS

Equity Regional	MTD	YTD	10Y	20Y
Global	7.20	7.20	8.83	9.18
United States	6.28	6.28	12.67	10.27
Europe	8.30	8.30	5.89	8.28
Japan	5.07	5.07	6.27	6.08
Asia Pacific ex Japan	8.63	8.63	4.14	9.42
Emerging Markets	7.90	7.90	2.42	9.49

Equity Markets	MTD	YTD	10Y	20Y
Australia	9.81	9.81	6.04	11.80
Brazil	7.35	7.35	-2.96	10.32
China “A”	9.65	9.65	5.86	9.30
China “H”	10.22	10.22	-1.27	9.87
Hong Kong	9.90	9.90	2.57	8.03
India	-0.96	-0.96	8.34	14.25
Indonesia	3.25	3.25	2.17	15.32
Korea	11.07	11.07	2.67	8.96
Malaysia	2.66	2.66	-0.72	7.33
Russia	7.75	7.75	1.11	10.54
Singapore	5.49	5.49	3.26	9.31
Taiwan	10.44	10.44	10.62	10.39
Thailand	5.76	5.76	3.47	13.30

Equity Sectors	MTD	YTD	10Y	20Y
Gold	11.39	11.39	-1.41	2.20
Energy	2.81	2.81	5.45	9.97
Technology	10.09	10.09	17.47	12.80
Healthcare	-0.61	-0.61	11.74	10.03
Financials	6.86	6.86	12.21	6.00

Fixed Income	MTD	YTD	10Y	20Y
Global Aggregate	3.28	3.28	-0.03	2.83
Global Aggregate (H)	2.30	2.30	1.98	3.31
High Yield	4.04	4.04	3.79	7.18
Asia	3.40	3.40	2.61	5.09
Emerging Markets	3.20	3.20	2.09	6.62

Note: (H) Currency Hedged

Currencies	MTD	YTD	10Y	20Y
SGD/USD	1.96	1.96	-0.60	1.41
EUR/USD	1.48	1.48	-2.21	0.04
JPY/USD	0.79	0.79	-3.43	-0.41

Commodities	MTD	YTD	10Y	20Y
Gold	5.72	5.72	1.49	8.63
Energy	-1.73	-1.73	-2.10	4.37

As of 31 Jan 2023. Source: Bloomberg. ***Total return in USD****.*
10 and 20 year returns are annualized.

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

Rob Arnott

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