MARCH 2023

THINK DIFFERENTLY
TO GET DIFFERENTIATED RESULTS

Monthly Investment Update

Executive Summary

Human behaviour plays an important role in investing. It's common for investors to judge the quality of an investment based on its performance history; just like how we assess the quality of a product or service in our daily lives. However, relying solely on performance figures is harmful for making investment decisions. This was evident in 2022, as investors who stayed out of the market missed out on subsequent gains over the past few months. Though there was a slight retracement in February, global markets have started the year on a high note. Likewise, judging an investment product just on its performance may lead to disastrous results.

While it's true that a good story can help make an investment decision, it's important to remember that stories can also evoke a fleeting emotional response that is unpredictable. Just like performance figures, stories shouldn't be the sole determining factor when deciding whether an investment is worthwhile. For example, consider past news reports about the Chinese market: since October 2022, the narrative for China has evolved from pessimism to optimism to caution. However, over the same period, China 'A' equities have risen by double digits. We see that it's crucial to look beyond both performance and stories and consider other factors when making investment decisions.

Today, some investors remain concerned about the threat of higher interest rates, especially after seeing how it spiralled markets in 2022. While this is a natural concern, investors should be wary of over-extrapolating past conditions as they do not serve as a good predictor of the future state of things. Inflation may pose a challenge, but periods of unusually high inflation do not last forever. In times like these, it becomes clear that preparation is more important than prediction. To this end, we diversify across markets with attractive risk/reward (e.g. Healthcare as part of our stability-themed positions) to assure that our investors remain invested and emerge stronger than before.

As interest rates rise with inflation, we've seen many flocking to fixed deposits. However, to beat inflation, investors need to earn an even higher return than fixed deposits. This means going against our natural instincts to come out of the 'safety' of cash, in the search for higher-yielding investments. One such area that promises yields over inflation is Asian High Yield where we have benefited from their strong rally in recent months. We remain convinced of the potential for this market to deliver a strong performance as credit markets normalize.

MARKET REVIEW

Global equity and global bond markets retraced in February. Despite that, global equity and global bond markets are up 4.16% and almost flat at -0.15% respectively in 2023.

Any portfolio, even the conservative one, will have done better than fixed deposits, which returned 0.48% over the same period*. Which is why we say, **despite higher bank rates which are drawing many in, there are better opportunities available for those who remain invested.**

But if we wind back to the end of 2022; with major equity and bond markets down 10-20%, even 30% in the case of the Nasdaq, investors were questioning if investing was a good thing for them at all.

If they responded to that impulse, exited and moved into deposits, they would have lost out on the subsequent gains. This is hardly a surprise, because humans behave the same way for just about every other decision they make.

When you have a meal, buy a piece of clothing, or stay at a hotel, you will be able to determine how good or bad it is by assessing the taste, the stitching, and the furnishing. If we have a positive experience, we are more likely to assess a product or service as "good".

Because relying on 'performance experience' works, it is used by people day-in-day-out to simplify the process of deciding what is good for them.

*Source: Bloomberg from 31/12/2022 to 28/2/2023. Global equity: MSCI ACWI Index, US High Yield: Bloomberg Global Aggregate Index, fixed deposits: Singapore DBS Bank 6 Month Fixed Deposit

As useful as this approach is for many things in life, it does not apply to investing.

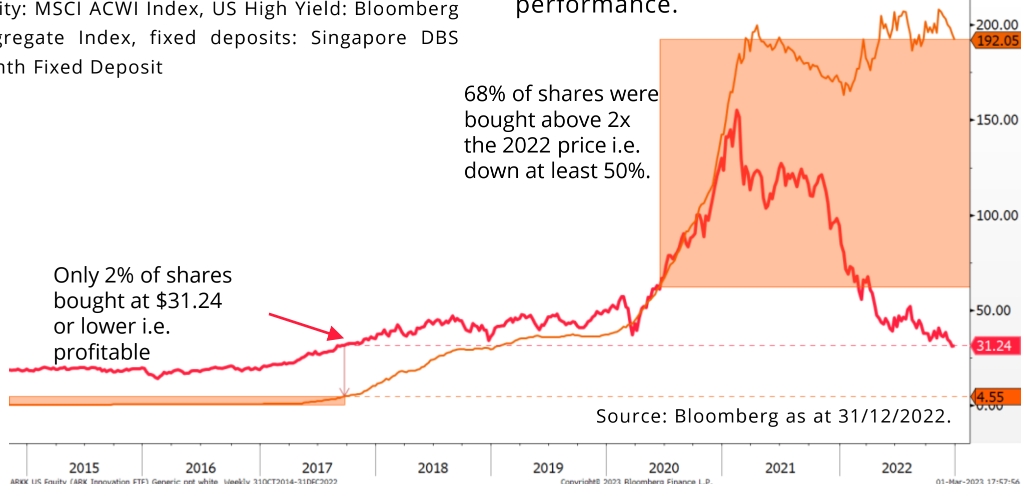
Take the case of a well-known innovation ETF. The fund price went from $18 at inception to $155 at its peak, an eye-popping 760% gain. Even after a subsequent decline of 80% at the end of last year, the fund has annualized 7% per annum since inception. **The NAV went up, but did investors' wealth go up?**

Here are some observations on investors' outcomes based on the fund's shares issued:

- Only 2% of the shares were bought below the 2022 end price i.e. profitable. The remaining 98% are underwater.
- 68% of shares were bought above $62 i.e. majority of shares are in negative compounding territory, with declines from 50-80%.

The way we use performance experience to decide what is good in just about every aspect of our lives does not apply to investing. "Buying the winner does not make one a winner". This is catchy but does not convey the downside of deciding based on performance experience. To put it bluntly, **using past performance to make investment decisions can be outright harmful.**

Does that mean we do not look at performance? We do, but we use it at the latter stages of our performance attribution analysis to validate any favourable fundamental or valuation attributes. We look at performance last, so that there is lasting performance.



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POSITIONING FOR RECOVERY

What makes a good investment? Is it the investment that has dropped the most, or one with strong gains in recent periods? Each one may appeal to certain groups of people with different personality types, but this would mean assessing what's 'good' based solely on performance – which as we mentioned earlier does not tell us whether an investment is good or not.

Does having a good story help with the decision to invest? Certainly. News of China's reopening has sparked a resurgence of interest among 'tourist' investors looking to invest in China over the past few weeks. The problem is that narratives can change as quickly as people's emotions (…or the sporadic weather we've had in Singapore over the past few weeks).

Oct 21, 2022 **Market:** **Emotion:**

China Market Revival Hopes in Tatters as Congress Disappoints

Dec 28, 2022 **Market:** **Emotion:**

The China trade is back on as Wall Street cheers the end of quarantine for international travelers

Feb 20, 2023 **Market:** **Emotion:**

Chinese reopening rally stalls as foreign investors cut purchases

As long-term investors, should we be making sell-and-buy decisions on stories that change on the whim of our emotions? Since the first article on October 21 (highlighted above), China 'A' equities are up 13.5%; twice that of the S&P 500's performance in USD. As Warren Buffet once said: 'if you cannot control your emotions, you cannot control your money'.

In the end, neither performance nor stories alone give investors the full picture to decide whether an investment is good. At best, they give false comfort. Instead, we've found that **through history, relying on Fundamental and Valuation factors is a far more reliable way to identify attractive investments.**

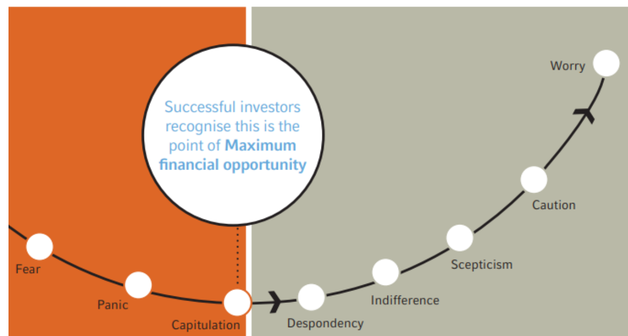
At the point of maximum pessimism last year, many investors chose to avoid China and Emerging Market (which has meaningful China exposures) investments altogether.

There were no shortage of concerns; from the unpredictable regulatory landscape to damaging covid-zero policies. That said, investors should embrace risk when they are sufficiently compensated - as investors capitulated, EM and China valuations and margin-of-safety became more attractive. Consequently, our investors managed to accumulate more units at lower prices and benefited from the subsequent rebound. Since then, the fundamental picture has also picked up on the back of China's reopening; giving us more signs that a durable rally may be underway.

Never put all your eggs into one basket, no matter how attractive the opportunity. This is why our recovery basket also consists of other positions that have contributed to our portfolio's positive performance.

US small-caps are up 8.1% year-to-date so far, besting S&P 500's 3.7%. This outperformance was not accompanied by stories that had captured investors' attention. Instead, this was possible on the back of attractive valuations and depressed sentiment. Similarly, Europe has outperformed over the past few months as previous negative sentiment around high energy prices and slowdown created the conditions required for them to stage a strong rebound as investors realized that they were overly pessimistic.

Recent performance shows that investors should not expect to do well by chasing after past winners or investing in exciting stories. On the contrary, when the story is overly positive or sentiment exuberant, it may be a sign that an investment is close to the top. This is not the situation we find ourselves in today. **Until then, we are happy to be climbing the wall of worry.**



Source: Russell Investments

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STABILITY AMID VUCA

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

Scenario 1	*Tug-of-war between Scenario 1 & 2?*	Scenario 2
• Inflation peaks • Less concern about higher rates • Mild US recession → **Market recovers?**		• Fed overdoes tightening in face of higher inflationary environment • US recession → **Market crisis?**

The astute CEO of a company looked out from his corner office and could see workers hustling and making deals. He scanned through the latest financial reports on his desk and saw that they had just achieved a record year of profit. By all measures, business was booming.

Despite the success, experience told him that things could not continue to get better forever. In response, he began to tighten their belts and prepared for more challenging times ahead.

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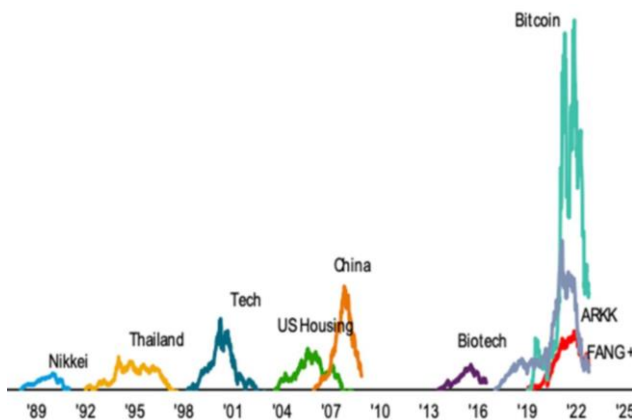
The above parable is a reminder that a good situation cannot be expected to last forever. Relating to our earlier discussion on 'Positioning For Recovery', this can also be reversed to explain how good opportunities can be found during the worst of times. Time after time, investors extrapolate what they see in the present. When times are bad, people expect things to get worse and for much longer. Likewise, when things are going well, they expect it to continue indefinitely. This is why we have asset bubbles. Of course, like the 'everything' bubble that ended in 2022, the 1990s dot-com boom, or the 2000s US housing bubble; **history is littered with reminders that markets go through a regular and somewhat predictable boom and bust cycle.**



Source: BofA Global Investment Strategy

2022's market decline helped to remove much of the froth from the most speculative parts of the market. That said, there are reasons to be cautious as parts of the market remain fragile amid a tightening environment. For instance, valuations for the popular S&P 500 are still not so attractive despite coming down from their highs, as fundamentals are at risk of deteriorating further i.e., sales growth continues to be unusually high even outside of a recession. In contrast, our preferred stability position via Healthcare equities is more reasonably valued, with fundamentals more resilient even amid a recession.

Our stability positions continue to play an important role in today's environment. While 2023 has so far been characterized by our 'Scenario 1' base case as illustrated above (benefitting our recovery positions), we do not expect this to be smooth sailing as economies adjust alongside the Fed's fight against inflation. In the past month, investors were concerned about the prospect of 'Scenario 2' playing out as Fed officials seemed to lean towards higher rates with certain inflation numbers coming out stickier than expected.

In times like this, it helps to zoom out and remember that periods of unusually high inflation do not last forever. This sentiment is echoed by Brian Moynihan, CEO of Bank of America. "We have to step back and realize these month-to-month data sets are going to bounce around a little bit..." says Moynihan. **"But the broad trend is inflation has peaked in some areas and not quite peaked in others, and that's good and that's also the intended outcome."**

In the meantime, sticking to a disciplined investment strategy can help investors reach their objectives. For us, this means continuing to invest and diversify across markets with attractive risk/reward - even as we expect bumps along the way, our investors can be assured to emerge stronger than before.

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SEARCH FOR YIELD

With cash returns so high, some investors are wondering if they should just park money in the bank instead of taking the risk to invest? Should one end the search for yield now that cash returns are higher?

Our answer is no.

Cash returns are currently high because central banks raise interest rates in response to inflation. The table below shows that when interest rates are high, inflation is also high.

Interest rates	3% or less	More than 3%
Average Inflation rate	2.29%	5.06%

During periods of higher interest rates, an **investor in deposits or money market funds would not beat inflation.** Not to mention that inflation can sometimes be much higher than cash returns, as we've seen in the past year.

How about those who want to beat inflation? The following shows that high-yield bonds provide meaningful returns in both low and higher interest rate regimes. More importantly, they provide a meaningful return during inflationary periods, **allowing investors to preserve their purchasing power and more.**

Interest rates	3% or less	More than 3%
US High Yield	8.67%	9.09%

Everyone will say they want to beat inflation. But it will not be easy because:

1. They have to avoid the herd instinct to park assets in cash.
2. They have to sit through a lot of volatility that is expected during regime shifts in economic and monetary policy cycles.

How to avoid herd instinct? There are three essential ingredients: objective analysis, experience, and personality. As for volatility, one of the places with the most volatility is also where the yields are.

Source: Bloomberg. Interest rates: Fed Funds Target Rate, Inflation rate: US CPI Urban Consumers YoY NSA from 01/01/1971 to 01/03/2023, US High Yield: Bloomberg US Corporate High Yield Bond Index from 29/7/1983 to 01/03/2023.

Just look at the Asian High Yield market last October. Then, the market was flooded with pessimism following a slew of bad news. Accordingly, there was immense volatility as markets were swinging up and down on every bit of news flow.

Volatility, Declining markets, Pessimism: **Everyone will hesitate, most will stay away.** As mentioned above, using performance experience to decide does not work when it comes to investments. Objective analysis needs to trump emotion.

We find objective analysis through our FVT framework, to effectively identify investment opportunities and guide our actions when managing portfolios.

As attractive as the opportunity is, it will not be instant gratification. The strong rally for Asian High Yield in recent months is only the beginning of a long recovery process.

Some components of this recovery include:

- Financing: Financing for high-yield issuers practically dried up, with the real estate sector most badly hit. Financing is coming back, with support from government-led programs.
- Property Transactions: Property purchases had ground to a halt for a variety of reasons including covid lockdowns and uncertainty that developers would finish construction. China's relaxation of covid controls and prioritizing of completion of construction is expected to pave the way for more transactions.
- Restructuring: Certain segments of the high-yield market are distressed, which is natural during any down cycle. Restructuring is a necessary process for creditors and debtors to make the best of the situation.

As the above start to gain pace, confidence among lenders is expected to lead to a normalizing of credit markets.

Of course, **investors who participate in this recovery process should expect to be handsomely rewarded for their ability to enter when others would not, and for their grit to hold when others fold.**

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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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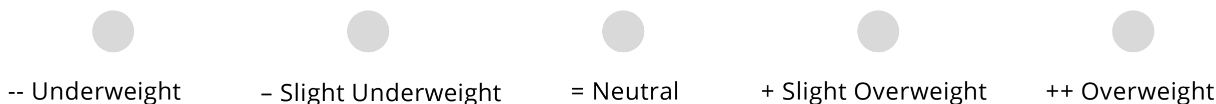
ASSET ALLOCATION STRATEGY



-- 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	Jan	YTD	10Y	20Y
Global	-2.83	4.16	8.51	9.12
United States	-2.45	3.68	12.24	10.22
Europe	-0.54	7.71	6.11	8.42
Japan	-3.23	1.68	5.65	5.84
Asia Pacific ex Japan	-6.76	1.28	3.32	9.21
Emerging Markets	-6.48	0.91	1.88	9.30

Equity Markets	MTD	YTD	10Y	20Y
Australia	-6.40	2.78	4.97	11.51
Brazil	-9.83	-3.20	-3.64	10.19
China “A”	-4.62	4.58	5.42	9.01
China “H”	-11.48	-2.44	-1.90	9.11
Hong Kong	-9.54	-0.58	1.85	7.57
India	-1.90	-2.84	8.92	14.07
Indonesia	-1.44	1.76	1.23	15.08
Korea	-6.93	3.37	1.67	8.86
Malaysia	-6.85	-4.37	-1.56	7.09
Russia	-5.08	2.28	1.18	9.64
Singapore	-5.10	0.11	2.75	9.10
Taiwan	-0.15	10.26	10.57	11.09
Thailand	-9.13	-3.89	1.97	12.88

Equity Sectors	MTD	YTD	10Y	20Y
Gold	-14.29	-4.53	-1.90	1.42
Energy	-7.12	-4.51	4.62	9.45
Technology	0.02	10.11	17.43	12.72
Healthcare	-4.06	-4.65	11.16	9.95
Financials	-2.30	4.41	11.81	6.04

Fixed Income	MTD	YTD	10Y	20Y
Global Aggregate	-3.32	-0.15	-0.27	2.59
Global Aggregate (H)	-1.60	0.67	1.76	3.18
High Yield	-1.49	2.50	3.59	7.02
Asia	-1.45	1.89	2.40	4.94
Emerging Markets	-2.23	0.90	1.89	6.34

Note: (H) Currency Hedged

Currencies	MTD	YTD	10Y	20Y
SGD/USD	-2.56	-0.66	-0.85	1.27
EUR/USD	-2.64	-1.21	-2.09	-0.11
JPY/USD	-4.46	-3.71	-3.79	-0.71

Commodities	MTD	YTD	10Y	20Y
Gold	-5.26	0.16	1.47	8.61
Energy	-2.31	-4.00	-1.76	3.79

As of 28 Feb 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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