THINK DIFFERENTLY

TO GET DIFFERENTIATED RESULTS

Monthly Investment Update

Executive Summary

The unexpected failures of Silicon Valley Bank (SVB) and Credit Suisse (CS) in March sent shockwaves across markets, causing shareholders of SVB and bondholders of CS AT1 bonds to face the prospect of permanent capital loss. As a result, regional bank equities and the AT1 bond markets took the brunt of the sell-off amid widespread pain across markets. Although there were worries of a repeat of the 2007-2009 financial crisis, such a scenario is not the base case. These incidents remind us of the importance of diversification as a means of mitigating the impact of any single blow-up on the overall portfolio, as well as the need to prepare rather than predict.

Despite tough market conditions, our recovery positions have performed well. Specifically, our exposure to European equities paid off, outperforming both global equities and the S&P 500 despite multiple knee-jerk sell-offs in response to events such as the 2022 Russian-Ukrainian conflict and the more recent banking crisis. Today, we find ourselves in a good position to take profits while others are only beginning to show interest. We also remain optimistic about the future performance of our positions in US small-caps and China 'A' equities given time, as our European positions have demonstrated success with our Fundamentals, Valuation, and Technical (FVT) investment framework.

It's natural to seek shelter in cash during a Volatile, Uncertain, Complex, and Ambiguous (VUCA) environment. While this is not necessarily wrong, it may not be the best use of capital as inflation continues to eat away at their wealth - especially with today's high inflation. In uncertain periods, investors may also want to take sides based on where they predict markets will go. Unfortunately, markets are not so predictable; which is why we say to prepare rather than predict. To this extent, we have Healthcare positions that serve as an effective diversifier and good complement to our recovery positions during volatile periods.

While many believe that investing in the best-performing fund is the key to compounding wealth, this notion is far from true. In reality, the top-performing funds are just as likely, if not more likely, to experience a downturn than other investments. Conversely, a fund that has underperformed may have greater potential to yield better returns in the future. This is the case with Asia High Yield (AHY), which is often seen as a challenging investment but presents opportunities for high growth even after recent strong rallies. More importantly, China's embattled property sector remains on a path to positive restructuring, which bodes well for AHY.

MARKET REVIEW

March was notable for particularly bad news. Concerns about financial institutions came to the fore with the sudden failure of Silicon Valley Bank and Credit Suisse. As the drama unfolded, investors were asking themselves “Do I have any investment in either of them?”.

Whenever a blowup happens, there are typically two groups of asset managers:

1. Those who did not have exposure would fall over themselves proclaiming that they did not have exposure, perhaps implying that they were smart enough not to get involved with such blowups. But was it so easy to avoid? Blue-chip asset managers such as Blackrock, Franklin, and Pimco were among the biggest holders of SVB stock and Credit Suisse AT1 bonds.

2. Those who did have exposure had to first assess the damage. Some of our investors expressed concern when news emerged that Pimco, a popular manager, had losses to the tune of $340 million. Despite that, Pimco emerged unscathed because their portfolios were very diversified.

This goes to show that even if one held SVB or Credit Suisse AT1s, or any future blow-up, **so long as they are sufficiently diversified** (whether one is over-diversified is a discussion for another day), **they can live to fight another day.**

“Will it come back?”

As these securities sold down, both existing holders and certain non-holders seeking bargains would also ask, “Will it come back?”

The bad news is, at the single security level, sometimes they don’t come back. SVB is currently worth $57 million, a far cry from the $6 billion it was trading at last month. Credit Suisse did come back, albeit in a different form, as it was acquired by UBS.

The good news is, for every blowup, there are recoveries. And investors don’t have to look too far for those recoveries. 20th March will be remembered as the day Credit Suisse “left the building”. In the 11 days since, the AT1 market* has gained 11%, recovering more than half its recent declines.

*Source: Bloomberg. AT1: Credit Suisse Contingent Convertible Euro Total Return Index

Do recoveries also apply to the worst-performing markets? Citywire reviewed the worst-performing funds in 2022. The list was dominated by funds investing in Emerging Europe.

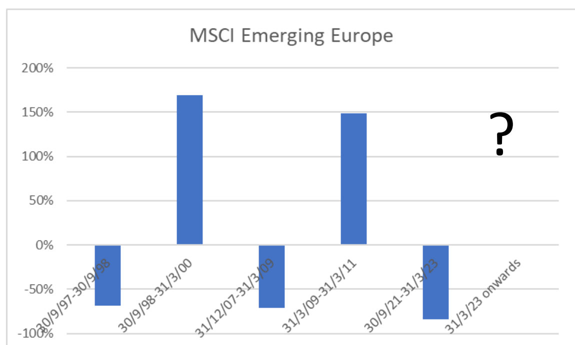
Worst-performing funds in 2022

Fund	Sector	Returns (YTD%)	5-year annualised returns (%)
Schroder ISF Emerging Europe	Specialist	-66.71	-13.51
BlackRock Global Funds - Emerging Europe	Specialist	-59.1	-11.59
Liontrust Russia	Specialist	-55.76	-5.64

https://citywire.com/wealth-manager/news/year-of-the-niche-2022-s-best-and-worst-performing-funds-and-trusts/a2404901

As we look at the headwinds facing Emerging European economies last year, one can appreciate why their markets were battered.

But this is not the first time Emerging Europe has experienced large declines. The chart shows large declines during the Russian debt default in the 90s, and the Global Financial crisis in the 2000s. After each drop, markets staged strong triple-digit rebounds. It is not a stretch of the imagination to see where Emerging Europe can go when the environment is more favourable.



Source: Bloomberg. Emerging Europe: MSCI Emerging Markets Eastern Europe USD from 30/9/97 to 31/3/2023.

Admittedly, Emerging Europe is a segment that might be too niche for many investors. But the fact that niche markets can and have recovered means that investors should be confident that the more established segments will also recover after down cycles.

In the following sections, we cover some of these opportunities that offer such recovery potential.

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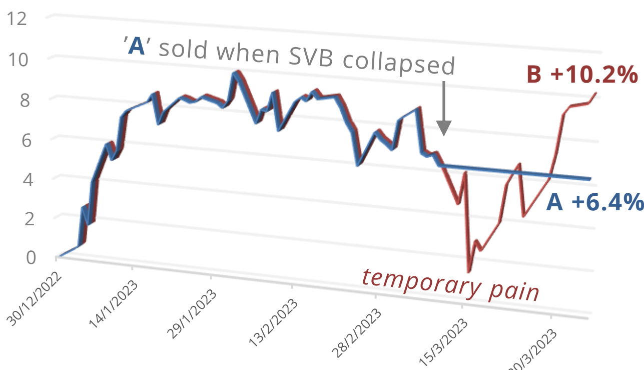
POSITIONING FOR RECOVERY

The recent 'banking crisis' has led to fresh waves of concern around the state of the global economy and market. Indeed, many investors are worried about a repeat of the 2008 Financial Crisis, which saw widespread contagion and indiscriminate selling across assets. In our recent updates, we shared that a 2008-style crisis is not our base case – the blow-ups were centered on businesses that had poor risk management, and regulators have also stepped in decisively. Do refer to our recent updates for further details: [1. Collapse of SVB], [2. Credit Suisse's Meltdown].

As the dust settles, what has been the impact? The good news is that markets have so far avoided a widespread contagion. Apart from regional bank equities which are down 24% this year (still better off than if you had concentrated positions in SVB), investors who stayed calm through the volatility have managed to 'come back' and are likely to have made some money in 2023.

Recent events did spotlight the effects of higher interest rates on the economy; leading speculators to prefer 'safer' investments. Amid this backdrop, **how are our economically-sensitive recovery positions doing?** Let us review:

Europe has emerged as the best-performing regional market and our top recovery position. Impressively, all of the losses from the initial knee-jerk sell-off in response to SVB's failure have been recovered. The initial knee-jerk sell-off is a common emotional reaction to 'bad news' as investors hope to avoid further pain without much consideration for longer-term implications. This can end up being costly for the investor. Consider the journey of two investors who invested in Europe this year:



Investor A exited after SVB collapsed, feeling comfortable that they had profits of +6.4%.

Investor B held through. The investor experienced temporary discomfort but ended up with a better outcome of +10.2%.

Some may recall a much earlier knee-jerk sell-off on 24 February 2022. This was in response to Russia's invasion of Ukraine. Since then, Europe has outperformed Global Equities by 7.9%, and the S&P 500 by 9.2%. Rather than reacting emotionally to headline news, sticking to fundamentals and valuations played out well for our investors. As a result, we are in a better position today to take some profits as others are only starting to get interested (with the strong gains likely behind them).

US small-caps have had a more challenging time than Europe equities this year. After a strong start to 2023, small-caps gave back the gains as the banking crisis triggered a fresh wave of risk aversion. Investors are fearful of an imminent recession – in the past month, we saw a knee-jerk rotation out of 'riskier' small-caps and into 'safe' mega-cap names. **Should we favour small-caps if we are heading into a recession?** The same lesson on avoiding knee-jerk reactions apply here. Schroders explained that in times of uncertainty, investors (over) prioritize short-term safety over the pursuit of long-term returns. This is **not sustainable as prices fall below their fair value – which is why such periods are good opportunities to position for the subsequent recovery.** Our latest assessment of small-cap valuations implies unusually high returns for the years ahead. Why risk missing out on such gains by timing the market? As long-term investors, time is on our side.

EM and China 'A' equities: For awhile, we've been cautiously optimistic on China 'A' which offered high growth potential at more reasonable valuations than developed markets. Despite the attractiveness, our smaller allocation was driven by weakness in the Chinese economy. We believe much of the pain is now behind us; with tailwinds steadily building up i.e. there has been a broad-based improvement in the leading indicators we track. Such periods have historically led to good outcomes, which is why we are finally adding to our positions and further enhancing our portfolio's overall risk/reward.

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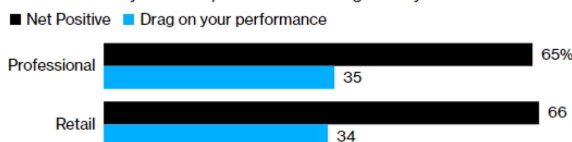
STABILITY AMID VUCA

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

Investors have a lot to grapple with in their minds today – the banking crisis, economic slowdown, recessions, and continued geopolitical tensions. It is no wonder that investors (both retail and professional) like to hold cash:



Source: Bloomberg MLIV Pulse survey on Feb 27- March 3 with 404 responses

About 2/3 of investors surveyed by Bloomberg prefer to hold cash this year! Perhaps it is not hard to see why. Amid today's uncertainties, cash deposits are offering returns of above 3% with seemingly no risk.

Is the remaining 1/3 oblivious? No. We'd like to think that the remaining group is focused on the bigger picture: that investing is the best to compound long-term wealth. Any decision that reduces the probability of achieving that outcome is risky.

Source: MVMoneyVisuals

Market timing
Chasing past performers
Over-concentration
...

For those of you who prefer to look at the data: **Since 1971, equities returned an average yearly return of 8.16% in periods where interest rates are above 3%.** This is comfortably higher than cash returns and also the best hope of preventing inflation from eating away at your wealth.

Unless you have upcoming expenses to pay for or are currently building up a sum of money for emergencies, we firmly believe that holding cash is a bad idea in the long-run.

Investors today fall into major two camps:

1. The optimist will tell you about innovation, Central Banks easing rates, earnings set to rise, and how battered stock prices are going to bounce back higher.

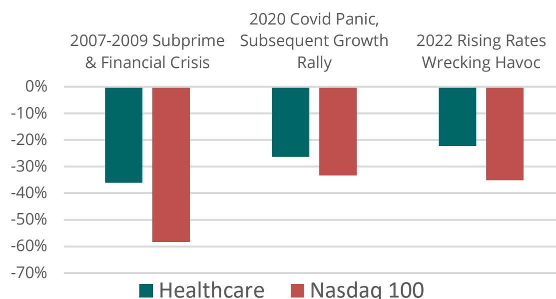
2. The pessimist will warn of consumer spending, inflation, and the long slow process of undoing the liquidity bubble caused by QE.

Clearly, investors prefer to have a high conviction view instead of entertaining multiple potential outcomes. Unfortunately, markets are never so binary, especially in the current environment where the likelihood of opposing outcomes are both high. That is why one should not position their portfolio for any single outcome that may be hard to recover from if things don't turn out as expected.

Prepare, don't predict. To this end, we maintain a core 'stability' theme in our portfolios consisting of defensive Healthcare equities. They act as a powerful diversifier as well as being highly complementary to our recovery positions.

How does Healthcare compare to 'Big Tech'? Some have proclaimed tech the new defensive play, after they performed strongly in the recent bank crisis. We are less confident, as such resilience has not been consistent in the past and with valuations less attractive today.

On the other hand, Healthcare's defensiveness is supported by secular trends such as aging demographics and enjoys resilient earnings regardless of the general economic climate. This is why they have had a long history of outperforming in down markets and will likely continue to do so going forward.



Source: Morningstar

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SEARCH FOR YIELD

What is the goal of the individual investor?

1. To compound wealth and increase purchasing power, or
2. Invest in the best performing funds

At first glance, these two goals don't seem to be a choice of one vs the other. In fact, **many believe that in order to compound their wealth, they have to invest in the best performing funds.**

This cannot be further from the truth.

The best performing funds have a real chance of swinging to the opposite end. In another review, Citywire found that

Our review of first-half fund performance: Previously top-performing funds run by the likes of Baillie Gifford crash to the bottom of the charts

the most high-octane and tech-tastic US fund managers have apparently done little better. Morgan Stanley's INVF US Growth fund lost 52.5% in the first half and Baillie Gifford American was down 49.1%. A Nikko European mirror of Cathie Wood's flagship ARK Innovation fund has more than halved, while T Rowe Price is another well-known growth investor being hit.

That has destroyed the medium-term track records of many funds.

https://citywire.com/funds-insider/news/fund-watch-the-winners-and-losers-in-a-torrid-year-so-far/a2392319

The funds mentioned are not bad per se; they are just inherently more volatile. The article says that many medium-term track records were destroyed. But in the process, it has **made their long-term full cycle track record more obvious**.

As we showed in last month's commentary, many investors choose and act based on medium term, partial cycle track records. **In trying to invest in the best, they end up deviating from their primary objective of compounding wealth.**

So should one do the opposite and look for the worst performing fund? There is some truth in it.

In the market review, we saw that markets, even niche ones, recover after a drop. The prospect is tantalizing; imagine capturing the swing from the bottom to the top of the chart.

But this is not easy to execute. One has to be able to bear with the solitude of investing in areas that many would shy away from.

Furthermore, they have to do additional work to be confident that they are not catching a falling knife.

Something else happened on 20th March that went relatively unnoticed amid all the attention on Credit Suisse; something that was a milestone for the Asian High Yield market. China Evergrande, the poster child for China's embattled property sector, announced that it had agreed on a debt restructuring plan with its creditors.

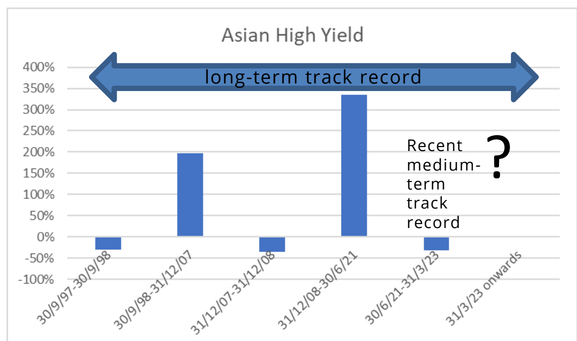
There are a few positives out of this.

- The agreement ended a deadlock that was affecting confidence in Evergrande's financing and operations.
- Because of its prominence, Evergrande also serves as a reference for other defaulted companies, paving the way for broader restructuring in the sector.

This restructuring is a welcome relief for investors in Asian High Yield, who have only felt pain and loss before. Indeed, the medium-term track record of Asian High Yield markets is horrible with crisis-like declines.

"Will it come back?"

AHY markets bottomed in Oct 2022, and have rallied around 30% since, but are still a long way from hitting a new high. The chart shows what happened after each decline. Evidently, AHY can and has recovered after each crisis.



Source: Bloomberg. AHY: ICE BofA Asian Dollar High Yield Corporate Constrained Index from 31/12/1996 to 31/03/2023.

Even as the recovery process gains momentum, investors need to be patient while they wait for the seeds that they have sown to bear fruit.

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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		

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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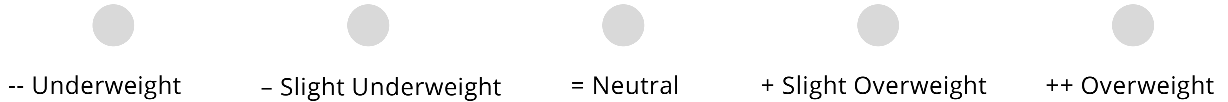
ASSET ALLOCATION STRATEGY



-- 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

Lower risk/reward after previous attractive value translated to strong performance over the past year. Potential for earnings disappointment as global growth slows.

Japan

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

Asia Pacific ex Japan

China 'A' overweight as deleveraging cycle has taken its course. Tailwinds steadily building up in the form of improving credit conditions and economic activity.

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	3.15	7.44	8.65	9.31
United States	3.67	7.48	12.23	10.36
Europe	2.29	10.19	6.39	8.62
Japan	3.90	5.65	5.54	6.21
Asia Pacific ex Japan	2.79	4.10	3.77	9.44
Emerging Markets	3.04	3.97	2.36	9.62

Equity Markets	MTD	YTD	10Y	20Y
Australia	-0.58	2.18	4.94	11.28
Brazil	0.07	-3.13	-3.24	9.32
China “A”	0.51	5.12	6.19	9.03
China “H”	5.88	3.30	-0.84	9.44
Hong Kong	3.48	2.88	2.50	7.98
India	0.67	-2.19	9.02	14.50
Indonesia	2.52	4.33	1.22	15.25
Korea	3.78	7.28	2.40	9.72
Malaysia	1.00	-3.42	-1.69	7.23
Russia	5.20	7.59	2.18	10.14
Singapore	1.39	1.50	2.78	9.26
Taiwan	2.85	13.41	10.92	11.39
Thailand	2.83	-1.17	1.90	12.94

Equity Sectors	MTD	YTD	10Y	20Y
Gold	18.68	13.31	-0.34	2.29
Energy	-0.21	-4.71	4.40	9.38
Technology	10.06	21.19	18.29	13.37
Healthcare	3.38	-1.42	10.92	9.97
Financials	-9.55	-5.56	10.27	5.53

Fixed Income	MTD	YTD	10Y	20Y
Global Aggregate	3.16	3.01	0.07	2.73
Global Aggregate (H)	2.22	2.90	1.93	3.29
High Yield	1.27	3.80	3.62	6.94
Asia	1.08	2.99	2.49	5.02
Emerging Markets	1.24	2.15	2.07	6.31

Note: (H) Currency Hedged

Currencies	MTD	YTD	10Y	20Y
SGD/USD	1.32	0.66	-0.70	1.42
EUR/USD	2.49	1.25	-1.66	-0.03
JPY/USD	2.49	-1.31	-3.38	-0.59

Commodities	MTD	YTD	10Y	20Y
Gold	7.79	7.96	2.11	9.22
Energy	-1.79	-5.72	-2.48	4.56

As of 31 Mar 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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