MAY 2023

THINK DIFFERENTLY

TO GET DIFFERENTIATED RESULTS

Monthly Investment Update

Executive Summary

Concerns from March continued into April, with First Republic Bank surpassing Silicon Valley Bank as the second-largest bank failure in the United States. Contrary to popular opinion, the root cause of these failures was not rising interest rates but poor risk management during a period of historically low interest rates. For investors, they offer important lessons to avoid painful losses in their portfolios – by ensuring diversification and evaluating the fundamentals and valuations of investment opportunities over chasing performance. While these failures shocked many, they are a normal part of markets. Investors should use such opportunities to accumulate good assets at attractive prices.

Investors often consider the S&P 500 to be the best market, but investing in the S&P 600, which includes 600 small-sized companies in the US, may provide even better returns. While the volatility of small-cap stocks can be uncomfortable for some investors, history has shown that investors who can withstand short-term price swings are eventually rewarded with higher returns. Today, small-caps are experiencing a larger discount to large-caps than they have in over a decade, making it a particularly attractive investment opportunity. For those seeking returns outside of the US, China proves to be a promising market with attractive valuations that could provide better future returns.

As markets adapt to tighter financial conditions, investors should expect volatility to persist. As aforementioned, while such conditions may present investment opportunities, investors must take a discerning approach to avoid incurring permanent capital losses. The 2020 pandemic rally serves as a cautionary tale as many investments that appeared promising ultimately crashed, underscoring the importance of evaluating investment fundamentals and valuations to distinguish between good and bad investments. In a VUCA environment, maintaining portfolio stability is crucial to weathering market ups and downs, as demonstrated by the outperformance of defensive healthcare equities over the past month.

On a similar note, while higher interest rates have seemingly shocked markets, they have reset bond markets, paving the way for less downside risk for bonds and a better opportunity to invest in the asset class. That said, investors should ensure that they are well compensated for taking risks i.e. Investment Grade Corporates are not so attractive today. On the other hand, those seeking higher yields to beat inflation should turn to Asian High Yield (AHY) bonds (offering 14% yield). Though more volatile, independent, patient, and courageous investors can realize such attractive returns over time.

Finexis Asset Management

MARKET REVIEW

"Only when the tide goes out do you discover who's been swimming naked"

When the tide was high for many years and masking a lot of bad behaviour, these classical words of wisdom seemed more like an old wives' tale. When the Fed started draining liquidity last year, the tide started receding. Slowly but surely, those who thrived on liquidity would find themselves exposed.

Concerns from March flowed into April, with First Republic Bank surpassing Silicon Valley Bank as the second-largest US bank failure.
https://www.bloomberg.com/news/articles/2023-05-01/first-republic-ranks-as-second-largest-ever-us-bank-failure

How did this happen?
Before we go and blame the Fed for making banks fail, let's be clear: while rising rates are painful, they are the catalyst not the reason for the bank failures.

Instead of managing risk tighter in an era of low interest rates, these banks went the other way and banked (pun intended) on strategies that flourished on cheap money.

Douglas Diamond, who won the Nobel prize for his work on the fragility of the banking system, found that "SVB deployed just about every bad policy on both the asset and liabilities sides of its balance sheet"
https://fortune.com/2023/03/15/economist-douglas-diamond-silicon-valley-bank-collapse

First Republic grew faster than other banks by handing out interest-only mortgages at rock-bottom rates; essentially low-yielding assets whose value had been severely dented since the rate hikes. Those who have been following us will see that this is the potent mix we have been warning against. First Republic's recipe for growth ultimately contributed to its collapse.
https://www.bloomberg.com/news/articles/2023-05-01/first-republic-s-history-of-jumbo-mortgages-led-bank-to-failure-sale

Will there be more? The fact that larger, better risk-managed banks had bidding wars for the assets show that these are cases of mismanagement rather than toxic assets. If there are more mismanaged banks, it is better to flush them out now.

How to avoid such permanent capital loss?
This week, Charlie Munger said that things might not be as bad as 2008 but it is not ending yet. The withdrawal of liquidity will not be painless; investors should expect to see more bad news going forward.

Some may ask "Aren't the professionals able to predict these failures?" The fact is, failures are part and parcel of markets and also critical for capitalism to succeed. And just as rocket scientists cannot predict explosions, professionals cannot predict failures. Nevertheless, one can mitigate the risk of failures by:

1. **Being skeptical**: Post-covid, the failed banks and segments such as tech disruptors outperformed equity markets massively. Seeing such performance, more were jumping on board, few were asking questions. Anytime you see an investment rise at an extraordinary pace, ask: Where is the growth coming from? How much risk is being taken? How concentrated is this investment?
2. **Checking their portfolios**: At the end of 2020 when bonds were still "return-free risk", we reminded investors to check their portfolios for liquidity and leverage. Eventually, the bond rout happened in 2022, not 2021, which shows that even if the storm is late, it will never miss the season.
3. **Being less naked**: Fundamentals and valuation provide clothing for investors. Companies that saw massive drops in share prices tended to have weak balance sheets (e.g. the failed banks) or no profits (e.g. tech disruptors). Furthermore, their valuations were unattractive as investors chased prices up as they bought into self-fulfilling but unsustainable trends.

Doing the above will provide a margin of safety; if things become challenging, and more failures unfold, one does not get hurt so badly. In such an environment, instead of fighting fire, it might be one of the best times to sharpen your knives, accumulate good assets and get ahead of the rest.

The information contained herein: (1) is proprietary to Finexis Asset Management and/or its content providers; (2) may not be copied or reproduced; and (3) is not warranted to be accurate, complete or timely. Neither Finexis Asset Management nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

POSITIONING FOR RECOVERY

"The S&P 500 is the best market in the world." After a decade of exceptionally strong returns, many investors have unsurprisingly arrived at this conclusion. It also helps that the S&P 500 had Warren Buffett's stamp of approval.

What if there are ways for investors to beat the best market in the world? In fact, you may not even need any state-of-the-art system or superior insights to do so. Here's one way:

Invest in the **S&P ~~500~~ 600**.

What's the S&P 600? In contrast to the S&P 500 which represents the largest 500 companies listed in the US, the S&P 600 consists of 600 small-sized companies in the US. By simply investing in the S&P 600, a long-term investor would have done much better than the S&P 500:

Market	20 Year Total Returns
S&P 500	576.0%
S&P 600	642.6%

It makes sense that small-cap companies would outperform as they have more room to grow than those that have already grown to become the largest companies in the world (these companies were also small-caps once).

Of course, the journey is not an easy one. **Small-caps often experience higher short-term volatility in their prices, which can make many investors uncomfortable.**

We are once again in another volatile period, with the banking crisis causing large price swings in recent weeks. Consequently, small-caps gave back strong gains from the start of the year. We can also see that a broad-based recovery has not happened. **It is not just small-caps – only a handful of stocks have contributed to the strong returns of the US S&P 500 year-to-date.**

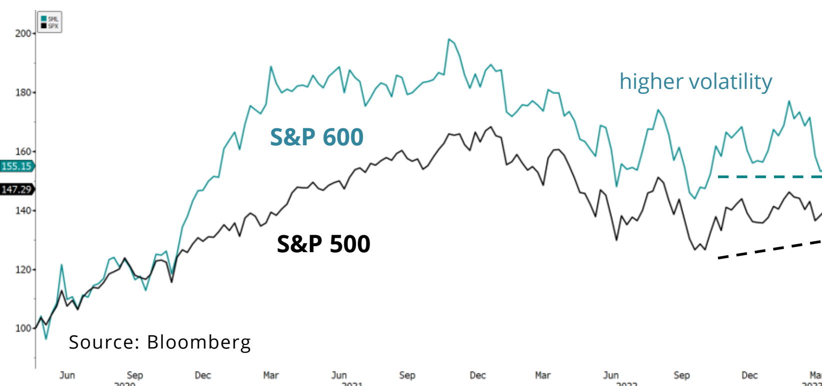
History shows that investors who can withstand these temporary 'shocks' are eventually rewarded with higher returns. This is especially so with small-caps' current largest discount to large-caps in over a decade.

China's recovery potential: This week, Charlie Munger said "It's gotten very tough to have anything like the returns that were obtained in the past,". He was referring to how US markets had low interest rates, and low equity valuations during his investing career. Investors who only focus on the US will wish they had a time machine to travel back to a more conducive environment.

More pragmatically, **there is another place now with low interest rates and low valuations that do not require a time machine: China.** Indeed, JPMorgan noted that "investors will soon run out of reasons to avoid holding Chinese stocks, with low multiples and better earnings driving prices higher...The evidence is already there. The remaining bit is time."

Market	USA	China
Interest rates	5.34%	2.41%
Equity valuation	4.04x	1.71x

Source: Bloomberg as at 4/5/2023. Interest rates: 3-month USD Libor, CNY Shibor. Equity valuation: Price/Book for S&P 500 & CSI 300.



Broad-based recovery has not yet happened

S&P 500 gains supported by a few mega-cap stocks. Sustainable?

The information contained herein: (1) is proprietary to Finexis Asset Management and/or its content providers; (2) may not be copied or reproduced; and (3) is not warranted to be accurate, complete or timely. Neither Finexis Asset Management nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

STABILITY AMID VUCA

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

Rising interest rates is the catalyst but not the reason for the market turmoil. Post the 2020 'covid-crash', the subsequent wave of liquidity and speculative bets on the future made it hard to distinguish the good investments from the bad. Now that the tide is receding, markets are likely to once again move back to their *true fair value*.

How to determine, and why is this important?

Focus on Fundamentals…

Like First Republic Bank which grew (recklessly?) on interest-only mortgages at rock-bottom rates, other businesses similarly thrived in periods of abundant liquidity but are now struggling in a higher interest environment.

…and don't forget about Valuations.

How much are you paying for an investment? Valuation is one of, if not the most important thing to consider when it comes to investing. This is for good reason: they tell us if we are getting a good deal or not. Overpay and you'll likely be disappointed, even if the fundamentals are good. Even after the past year's decline, certain market segments continue to trade at rich valuations compared to history. For example; the S&P 500 continues to be overvalued by most measures:

Valuation Measure	Latest	25-year avg.	Std. dev. Over/undervalued
P/E	17.81x	16.80x	0.30
CAPE	29.82x	27.89x	0.30
Div. Yield	1.74%	1.99%	0.74
P/B	3.57x	3.10x	0.58
P/CF	13.25x	11.21x	0.93

Source: J.P. Morgan Asset Management as of 31/3/2023

(one more reason why investors should not just invest in the 'best market in the world')

Naturally, investors should be more discerning in this environment. Rather than investing based on strong past performance, fundamental and valuation metrics can help investors to identify where the future outperformers will be, while also avoiding any landmines along the way.

If it seems like we've observed more occurrence of 'land mines' exploding n the past year or so, it must be that rising interest rates is the pressure that triggered the explosion. As interest rates rose, many investments have declined sharply, with a few even experiencing permanent capital loss:

Examples of investments that went to the moon and back	Peak-to-trough decline
Silicon Valley Bank	-99.9%
First Republic Bank	-98.4%
Meme stocks	-68.5%
Tech disruptors	-74.7%

Source: Bloomberg from 1/1/2021 to 30/4/2023. Meme stocks: Solactive Roundhill Meme Stock Index, Tech disruptors: GS Non-profitable Tech Index

While much of the froth is now out of the system, economies and markets are still adjusting to the new normal. This has a few implications for investors:

- Higher volatility. This was one of our key views going into 2022 and which continues to remain true for 2023. Expect larger price swings as major economies transition from slowdown → recession → recovery.

- The best opportunities will present themselves. As they say, 'Buy when there's blood in the streets.' Today, we are excited about the prospects for our 'Recovery' positions as discussed in the previous section. This is the time for long-term investors to set themselves up well for the eventual recovery.

- Be cautiously optimistic. We remain in a *VUCA* environment as the withdrawal of liquidity means that we are likely to get more bad news from time to time. Against this backdrop, ensure that your portfolios have effective diversifiers. This is why 'Stability' is one of our key themes today. Our preferred defensive position, Healthcare equities, outperformed in April (+3.52%) as volatility continued.

The information contained herein: (1) is proprietary to Finexis Asset Management and/or its content providers; (2) may not be copied or reproduced; and (3) is not warranted to be accurate, complete or timely. Neither Finexis Asset Management nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

SEARCH FOR YIELD

Instead of blaming the Fed, prudent investors should thank them for taking the froth out of the bond markets. The series of Fed hikes has essentially provided a reset to the bond markets. This reset has two main implications.

1. Less downside risk

For years, we warned of the poor risk-reward in bonds, even putting out a comic to try to convince investors of the "return-free risk". The series of rate hikes and corresponding bond market declines that have happened mean that most of the downside risk has passed i.e. there is less downside risk going forward. (Which also means we have to retire our comic.)

Every reset does involve some pain, as we saw from the significant bond market declines last year. Investors have two choices now:

1. Bail out of bonds after last year's horrendous performance; or
2. **Recognize that bonds have transitioned away from "return-free risk"**

We are in the latter camp.

2. Better opportunity set

With cash now giving mid-single digits, should investors be content with parking their assets in cash? The answer is no.

In the years before rate hikes normalized bond markets, the opportunity set was far from great. Negative-yielding bonds hit a record high, which meant that investors were paying to lend others money. We refused to be in that camp and stayed away from negative yielding bonds. This reduced our opportunity set but we did not mind as it helped us avoid the unprecedented declines in low-yielding bonds last year.

https://www.bloomberg.com/news/articles/2020-12-11/world-s-negative-yield-debt-pile-at-18-trillion-for-first-time

Those days of negative-yielding bonds are now gone. That is why after years of shunning flat or negative-yielding government bonds, we have allocated back to these flight to quality assets while getting some yield at the same time. How about those who want to have higher yield that beats inflation?

https://www.bloomberg.com/news/articles/2023-01-05/world-says-goodbye-to-negative-yielding-debt-as-boj-shift-bites

Where's the higher yield?

At the beginning of 2021, investment grade (IG) bonds were yielding 1.12%. They are currently yielding 4.35%. The proposition seems great: Get 4.35% by lending to blue chip companies such as JP Morgan and Microsoft. It almost seems like a no-brainer to load up on IG; but there is more than meets the eye.

The chart below from Goldman Sachs shows that IG bonds are offering the lowest ever extra yield compared to Treasury bills. Meaning anyone getting into IG today is getting a similar return to T-bills but with extra credit risk. To that we say, no thanks.

Exhibit 3 : Today's meager 18bp of yield pickup offered by the USD IG bond index over the 3-month Treasury bill is the thinnest on record

Source: ICE-BAML, Goldman Sachs Global Investment Research

On the other hand, Asian High Yield is on the other end of the spectrum, offering 14% yield, or 9.43% over T-bills. This is actually the no-brainer option for investors who want a higher yield. Yet, not everyone can realize the return from this opportunity as they also need:

1. **Independence**: AHY is not a popular choice as it has seen declines in recent years due to concerns about the Chinese property market. Investors wanting to capture the opportunity need to do things differently from the crowd.
2. **Patience**: Investing independently does not mean instant gratification. The restructuring in AHY is happening, and investors need to let the recovery process play out.
3. **Courage**: Howard Marks said to outperform, one needs to dare to be different, be wrong, and look wrong. Even where AHY is right in the long run, it will look wrong in the short run.

*Source: Bloomberg as at 28/4/2023. Investment grade bond: Bloomberg USAgg Index, Asian High Yield: ICE BofA Asian Dollar High Yield Corporate Constrained Index

The information contained herein: (1) is proprietary to Finexis Asset Management and/or its content providers; (2) may not be copied or reproduced; and (3) is not warranted to be accurate, complete or timely. Neither Finexis Asset Management nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

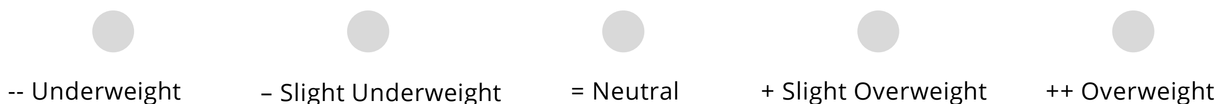
HOW ARE WE POSITIONED?

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.

The information contained herein: (1) is proprietary to Finexis Asset Management and/or its content providers; (2) may not be copied or reproduced; and (3) is not warranted to be accurate, complete or timely. Neither Finexis Asset Management nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

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.

The information contained herein: (1) is proprietary to Finexis Asset Management and/or its content providers; (2) may not be copied or reproduced; and (3) is not warranted to be accurate, complete or timely. Neither Finexis Asset Management nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

MARKET INDEX RETURNS

Equity Regional	MTD	YTD	10Y	20Y
Global	1.48	9.04	8.50	8.92
United States	1.56	9.16	12.19	10.01
Europe	4.14	14.75	6.35	8.14
Japan	0.20	5.92	4.68	6.22
Asia Pacific ex Japan	-1.69	2.34	3.33	9.08
Emerging Markets	-1.12	2.85	2.17	9.10

Equity Markets	MTD	YTD	10Y	20Y
Australia	0.61	2.80	4.59	10.89
Brazil	3.85	0.60	-2.87	8.16
China "A"	-1.12	3.94	6.19	8.86
China "H"	-3.77	-0.60	-1.25	9.09
Hong Kong	-2.44	0.37	2.04	7.76
India	4.12	1.84	8.91	14.87
Indonesia	4.28	8.79	1.44	14.62
Korea	-1.59	5.75	2.36	8.86
Malaysia	-1.40	-4.77	-2.30	7.15
Russia	4.16	12.07	2.92	9.62
Singapore	0.94	2.46	2.57	9.27
Taiwan	-2.59	10.47	10.26	11.49
Thailand	-4.52	-5.64	1.12	12.42

Equity Sectors	MTD	YTD	10Y	20Y
Gold	3.63	17.43	2.26	2.47
Energy	3.30	-1.56	4.83	9.58
Technology	-0.13	21.03	18.10	12.83
Healthcare	3.52	2.05	10.86	9.87
Financials	3.18	-2.56	10.31	5.09

Fixed Income	MTD	YTD	10Y	20Y
Global Aggregate	0.44	3.46	-0.03	2.69
Global Aggregate (H)	0.51	3.43	1.87	3.29
High Yield	0.93	4.77	3.50	6.61
Asia	0.85	3.74	2.65	2.81
Emerging Markets	0.39	2.55	1.91	6.03

Note: (H) Currency Hedged

Currencies	MTD	YTD	10Y	20Y
SGD/USD	-0.27	0.39	-0.80	1.44
EUR/USD	1.66	2.93	-1.77	-0.07
JPY/USD	-2.52	-3.80	-3.30	-0.68

Commodities	MTD	YTD	10Y	20Y
Gold	1.05	9.10	3.03	9.26
Energy	1.47	-4.34	-1.95	5.60

As of 30 Apr 2023. Source: Bloomberg. ***Total return in USD****.*
10 and 20 year returns are annualized.

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

Rob Arnott

The information contained herein: (1) is proprietary to Finexis Asset Management and/or its content providers; (2) may not be copied or reproduced; and (3) is not warranted to be accurate, complete or timely. Neither Finexis Asset Management nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

DISCLAIMER

To the best of its knowledge and belief, Finexis Asset Management Pte. Ltd. (Finexis Asset Management) considers the information contained in this material as accurate only as at the date of publication. All information and opinions in this material are subject to change without notice. No representation or warranty is given, whether express or implied, on the accuracy, adequacy or completeness of information provided in the material or by third parties. The materials on this material could include technical inaccuracies or typographical errors, and could become inaccurate as a result of subsequent developments. Finexis Asset Management undertakes no obligation to maintain updates of this material.

Neither Finexis Asset Management nor its affiliates and their respective shareholders, directors, officers and employees assume any liabilities in respect of any errors or omissions in this material, or any and all responsibility for any direct or consequential loss or damage of any kind resulting directly or indirectly from the use of this material. Unless otherwise agreed with Finexis Asset Management, any use, disclosure, reproduction, modification or distribution of the contents of this material, or any part thereof, is strictly prohibited. Finexis Asset Management expressly disclaims any liability, whether in contract, tort, strict liability or otherwise, for any direct, indirect, incidental, consequential, punitive or special damages arising out of, or in any way connected with, your access to or use of this material.

This material is not an advertisement and is not intended for public use or distribution. This material has been prepared for the purpose of providing general information only without taking account of any particular investor's objectives, financial situation or needs and does not amount to an investment recommendation.

The information contained in this material does not constitute financial, investment, legal, accounting, tax or other professional advice or a solicitation for investment in funds managed by Finexis Asset Management, nor does it constitute an offer for sale of interests issued by funds that are managed or advised by Finexis Asset Management. Any offer can only be made by the relevant offering documents, together with the relevant subscription agreement, all of which must be read and understood in their entirety, and only in jurisdictions where such an offer is in compliance with relevant laws and regulatory requirements.

Simulations, past and projected performance may not necessarily be indicative of future results. While there is an opportunity for gain, any investor is at risk of loss of 100% of its investment when investing in funds managed or advised by Finexis Asset Management.

The information on this material is not intended for persons located or resident in jurisdictions where the distribution of such information is restricted or unauthorized. No action has been taken to authorize, register or qualify any of the Finexis Asset Management funds or otherwise permit a public offering of any Finexis Asset Management fund in any jurisdiction, or to permit the distribution of information in relation to any of the Finexis Asset Management fund in any jurisdiction.

The information contained herein: (1) is proprietary to Finexis Asset Management and/or its content providers; (2) may not be copied or reproduced; and (3) is not warranted to be accurate, complete or timely. Neither Finexis Asset Management nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.