NOV 2023

THINK DIFFERENTLY

TO GET DIFFERENTIATED RESULTS

Monthly Investment Update

Executive Summary

Markets continued to be volatile due to the withdrawal of liquidity and rising interest rates, leading economic recovery to deferred but not derailed. The Federal Reserve's recent decision to pause rate hikes led to a market rally, signaling a potential shift in economic momentum. However, investors are cautioned to remain vigilant as the full effects of higher interest rates are still unfolding within the economy.

Investors who previously prospered in a low-interest environment must now reassess their strategies to determine if they can sustain success amidst higher rates. Even though cash has become a more appealing option, it is barely keeping up with inflation i.e. cash investors are not improving their purchasing power despite higher cash returns. In a high-rate environment, there are other investments that offer better returns for those with the risk tolerance.

The allure of markets with compelling narratives or recent success can often lead to a cycle of disappointment, characterized by buying high and selling low. The 'lost decade', exemplified by the S&P 500's stagnant returns from 2000 to 2009, is a recurring phenomenon in stock markets. Despite the current dominance of tech mega-caps, their lofty valuations may cap growth potential, whereas small-caps could gain traction if interest rates stabilize. Emerging markets, particularly in Asia, are showing signs of stabilization, presenting cautious yet promising investment opportunities.

To safeguard against extended market downturns, investors should focus on markets with solid fundamentals and attractive valuations, maintain investments during market lows to reduce average costs and accelerate portfolio recovery, allocate investments across a variety of asset classes and regions to mitigate risks and sustain growth, even in challenging periods.

On the macro front, projections of 3% for U.S. 10-year rates at the start of the year were upended as they climbed to nearly 5% by October. Investors seeking yield are now split between those seeking safety with modest returns, and those aiming to surpass inflation through higher-risk investments.

Credit fundamentals have improved, with Emerging markets becoming increasingly attractive due to their growth prospects and stability. China's shift towards high-tech industries and the favourable investment climates in Southeast Asia and India present compelling opportunities for credit investors. In the U.S., the combination of pressures on earnings and valuations for large-cap equities, the robust consumer market, and lack of a credit crunch indicate that bondholders might reap more benefits from corporate revenues than equity owners.

MARKET REVIEW

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

This is an often-used quote, but it is very relevant to the current times: The tide of liquidity that investors had been accustomed to started going out last year. More than a year on, the effect of rising interest rates is still percolating through markets, as we saw from the market volatility in October.

So why are markets still trying to find their feet this year?

The year got off to a good start with expectations of recovery driven by the Fed potentially ending its rate hikes, and China reopening. A few things happened to delay this recovery: High wage costs causing the Fed to continue to hike, and while China was the first major economy to expand this year it got dragged down as other economies continued to contract.

This impacted our portfolios in that the recovery themes were deferred, but not derailed. As we speak, the Fed's decision to hold rates steady on 2nd November brought confidence back to markets, with both equities and bonds rallying.

Nevertheless, investors need to be judicious as the flushing out process is still happening. This week WeWork, which was once valued at $47 billion filed for bankcruptcy. Not too long ago it was not just the darling of Wall Street but also to the man on the street.

That's what cheap money and abundant liquidity does to people. It makes them forget lessons from the past, or even declare "this time is different". But for many, times are indeed different.

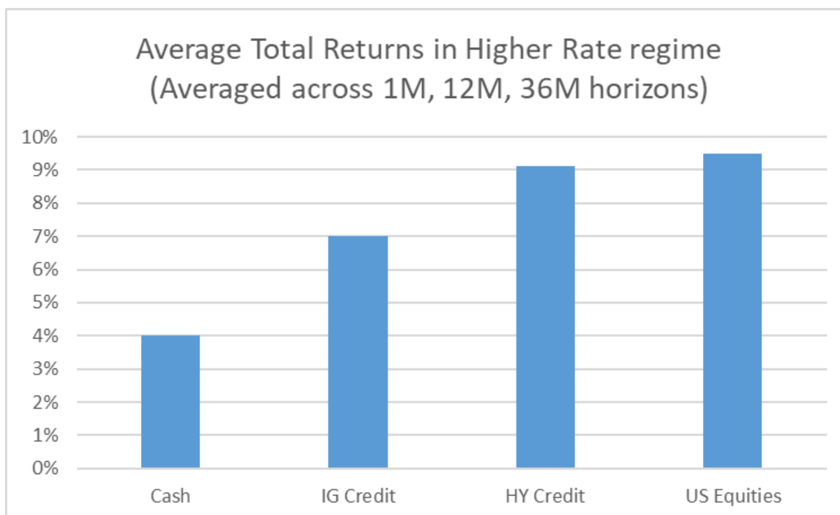
In the face of high interest rates, investors that have done well in recent years have to ask themselves

- Did I do well because of abundant liquidity?
- If yes, how do I adapt my investment to a regime of higher rates?

Which investments maintained their edge over cash in high rate environments?

The chart below shows returns for different assets in high interest rate regimes based on data spanning multiple market cycles. This is the closest an investor has to a crystal ball, as investing is really about navigating the future by understanding the past.

The chart shows that cash returns are higher than before, resulting in many shifting assets to cash. But with inflation at around 4%, cash returns are barely keeping up with rising prices. Cash investors are overlooking other investments that continue to provide higher return over cash in a high-rate environment. But not everyone has the risk tolerance to go all-in into any of these segments. Markets are fair, that is why not everyone is building their wealth at the same pace.



https://www.aqr.com/Insights/Research/Alternative-Thinking/Honey-the-Fed-Shrunk-the-Equity-Premium

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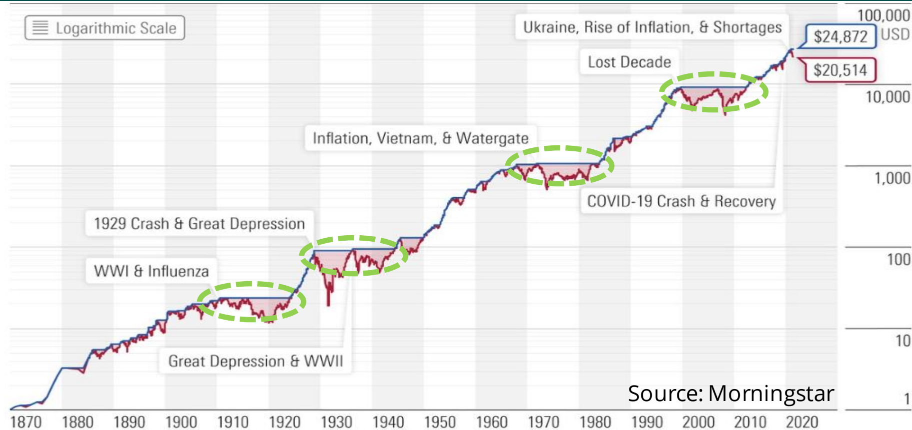
POSITIONING FOR RECOVERY



Source: Morningstar

How do investors know which is the right market to invest into? Often, people may choose the investment with the best or most exciting story. Or they may invest in what has done well recently, hoping that the prevailing trend will continue.

The issue with such an approach is that they are prone to disappointment when the exciting story or performance do not live up to the high expectations. The investor loses patience, choosing instead to find the next 'best' investment. In doing so, they risk missing out on the market's long-term return potential. Even worse, they may end up in a recurring doom-loop of always buying high, selling low.

Even if the investor has a long-term view and holding power, they can still end up disappointed: one of the worst outcomes is finding out that your portfolio had gone through a ***lost decade*** of practically 0% returns - after 10 years!

The term 'lost decade' is commonly used to refer to the period January 2000 to December 2009, when the US S&P 500 market delivered total returns of -9.1% (-0.95% annualized). Was that period just a one-off nightmare that investors shouldn't worry too much about?

Unfortunately, as we all know, nightmares tend to be recurring. A Morningstar study of the US market since 1870 led to an important insight: **"from time to time, stock markets go through long and deep periods of decline."** As the above chart shows, similar 'lost decades' have happened before (green circles), and are going to happen again in the future.

This observation is not unique to the S&P 500. Any single market or segment can experience long and deep periods of declines, which is why **it is important to invest looking ahead of us rather than by using the rear-view mirror.** By doing so, investors can better mitigate such risks.

Today, the rear-view mirror is showing strong performance in 'tech mega-caps' year-to-date, overshadowing other investments, including our recovery positions. What's ahead of us? Road signposts are critical when driving on roads with sharp twists and turns. Similarly, we look to our fundamental and valuation signposts to guide us in our journey ahead:

US small-caps: What do most lost decades have in common? Answer: High valuations. Today, valuations for the 'Magnificent 7' group of stocks (the current poster-child for mega-caps) are at 6.4x price-to-sales. This means that investors are paying up to *7.6 times* more than what small-cap equities are valued at. The stretched valuations makes it more challenging for mega-caps to continue with their outperformance. Small-caps, with their attractive valuations, could very well get a leg up especially when interest rates stabilize or come back down as the market expects.

Emerging Market & China: Fundamentals have clearly stabilized indicating that the worse is behind us. On the other hand, economic activity has not rebounded strongly; which is required for a sustained period of good performance. In the meantime, today's extreme pessimism sets the stage for a rebound, especially in the near-term – giving us some comfort in maintaining our current positioning, while actively looking out for better opportunities as they appear.

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LATE CYCLE STABILITY

Continuing from the previous section's discussion on lost decades, let us look at three things that an investor should do to protect themselves against the risk of a prolonged down market:

1. **Invest in markets with attractive valuations and fundamentals.** As highlighted in the previous month's investment update, these two investing ingredients have reliably shown to help long-term investors pick the 'right' markets that can grow given enough time. As hinted earlier, just by avoiding markets with extreme high valuations, an investor can reduce the risk of encountering a lost decade.
2. **Embark (and stick!) to a regular investing plan.** In a down market, the emotional fear of losing more money cause many investors to stop their regular investing when it is actually the best time to be investing even more. By regularly investing in a down market, investors lower their average cost of investment, and shortening the time taken for one to see gains in the portfolio.
3. **Diversification.** The 2000s were a painful period for any investor who had just invested in the S&P 500. But those who had diversified into other market opportunities would have still managed to compound strong performance over the same period as shown in the illustration below. Taking a diversified approach; whether across asset classes, geographies, or sectors, can help improve the odds for a successful investment outcome in the long-run.

Indeed, the 2000s was a particularly tumultuous period for investors. The 10-year period started with the bursting of the tech bubble in March 2000, and then ended with a bang (the bad kind) as the 2008 Great Financial Crisis unfolded. **Both crashes happened as the economy was in a late-cycle**; which is the part of the economic cycle we find ourselves in again today.

Of course, late-cycle does not mean that it will end badly for investors. Good opportunities could present themselves, and **there is still money to be made**. On 2nd November, the Fed hinted that the US central bank could be about done with their interest rate hikes; with markets reacting positively to the news. Some, like $2.3 trillion investment manager Capital Group, sees the Fed pause as a window of opportunity for people to get invested[1].

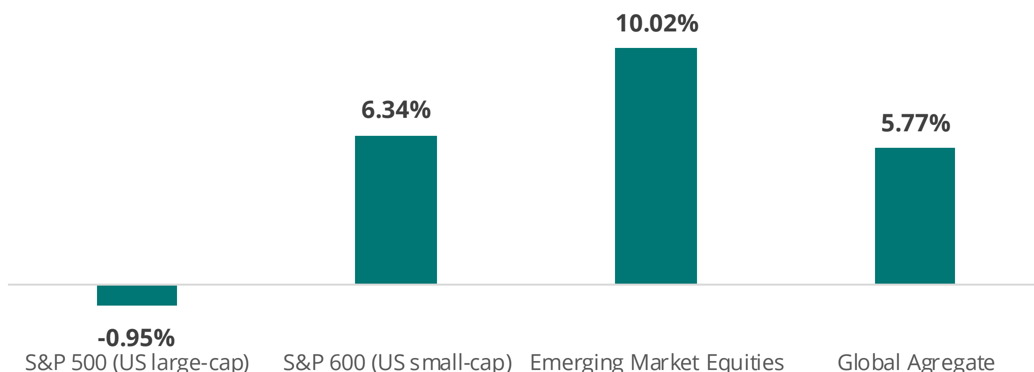
We are of similar view that markets will eventually recover and make new highs as they always do, but (in today's late-cycle environment) the journey is likely to undergo more twist and turns before reaching the destination. With our cautious optimism, we continue to maintain 'stabilizers' in the portfolio in the form of defensive Healthcare equities, and Government bonds that can help to buffer against large price swings.

While there is certainty in markets going from bottom left to top right, there is also certainty in the surprises they throw up during the journey. What an investor can do is to have a well-diversified portfolio that fits one's time horizon and risk tolerance.

[1] Capital Group Sees Window for Stock Buying on Fed Rate Signal

Diversification Can Mitigate the Risk of Lost Decades

Annualized Returns: Jan 2000 – Dec 2008



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CAPTURING HIGH YIELDS

Earlier in the year, all major investment banks and forecasters predicted that US 10-year rates would be at 3%. At the close of October, these rates were practically at 5%, levels few thought were possible.

Some investors have asked **"what if interest rates stay higher for longer?"** hinting at concerns of persistently high rates. The chart shows how the low interest rates that many have taken for granted in recent years are the exception rather than the norm. The recent rate hikes have only brought us to levels more consistent with the past 5000 years!

In this high-rate environment that is normal in the context of history, yet so alien to many, one needs to know what kind of yield investor they are.

Type 1: "I'm not looking for much"
High cash rates have led many to park their investments in deposits and money market funds, what we might call searching for yield in safe places. This is perfectly fine for those who are happy to let inflation take away what they are getting. In short, they are not getting returns after adjusting for inflation.

Type 2: "I want more purchasing power"
For those who want to beat inflation, higher cash rates also mean that investors willing to look beyond cash are being compensated more. The chart in the market review page shows that investors in IG and HY credit get meaningful return over cash provided they have the risk tolerance.

Higher yields for investors mean higher costs for borrowers. With money not as cheap as before, focusing on quality improves the odds of investors getting their return in the search for yield.

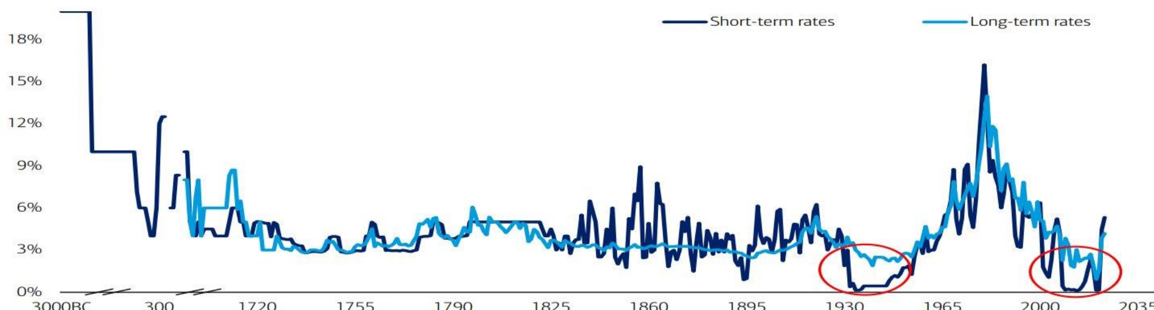
The search for yield has kept us in Emerging markets for some time due to the attractive yields available. While EM and Asia has seen its fair share of uncertainty, it now offers an interesting mix of growth with quality.

Asian high yield has evolved; secular growth with stable political and investment climate in South East Asia and India are driving the need for borrowers to finance, and in turn credit investors to get higher return.

China went through a painful transition; weaning itself away from low quality growth driven by real estate to new economy driven by high-tech high value-add industries. This emphasis on high quality growth is backed by strong fiscal position giving the central government plenty of room to act.

Outside of Emerging markets, the landscape is evolving, with rate hikes leading to opportunities in places that were not so attractive before.

While there is pressure on earnings and valuation in US large cap equities, the robust US consumer and no evidence of credit crunch mean that corporate revenues are more likely to flow to bond holders than equity owners. We are watching this space for potential opportunities.



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HOW ARE WE POSITIONED?

Positioning for Recovery	Late Cycle Stability	Capturing High Yields
China ‘A’ Equities	Healthcare Equities	Asian High-Yield Bonds
Emerging Markets Equities	Government Bonds	Emerging Market 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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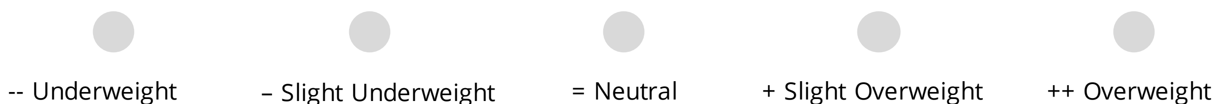
ASSET ALLOCATION STRATEGY



-- 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. Valuations have also become less attractive.

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 due to low incremental yield being 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 bias to focus on return from credit while limiting exposure to emerging market currencies.

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MARKET INDEX RETURNS

Equity Regional	MTD	YTD	10Y	20Y
Global	-2.99	7.20	7.39	7.82
United States	-2.10	10.68	11.16	9.29
Europe	-3.62	3.97	3.91	6.63
Japan	-4.34	5.44	4.37	4.33
Asia Pacific ex Japan	-4.08	-4.51	2.50	7.00
Emerging Markets	-3.88	-1.85	1.55	7.01

Equity Markets	MTD	YTD	10Y	20Y
Australia	-5.30	-6.09	3.82	9.10
Brazil	-3.58	8.08	-0.78	6.58
China "A"	-3.34	-10.91	4.51	8.62
China "H"	-4.60	-9.71	-2.34	5.41
Hong Kong	-3.84	-10.74	0.33	5.22
India	-3.06	5.57	9.81	11.84
Indonesia	-5.37	-0.36	3.03	11.99
Korea	-7.22	-4.24	0.67	6.74
Malaysia	-0.17	-7.34	-2.86	5.53
Russia	6.46	22.76	2.97	8.48
Singapore	-4.87	-3.64	2.32	7.16
Taiwan	-2.63	11.00	9.50	9.17
Thailand	-4.71	-18.32	1.19	8.24

Equity Sectors	MTD	YTD	10Y	20Y
Gold	4.16	-1.77	2.33	1.56
Energy	-5.97	-0.34	3.96	9.14
Technology	-0.83	29.59	17.54	11.59
Healthcare	-4.09	-5.62	9.00	9.14
Financials	-2.47	-4.08	9.01	4.16

Fixed Income	MTD	YTD	10Y	20Y
Global Aggregate	-1.20	-3.38	-0.66	2.17
Global Aggregate (H)	-0.71	0.38	1.68	3.14
High Yield	-1.22	4.52	3.36	6.14
Asia	-0.90	0.20	2.54	2.64
Emerging Markets	-1.48	-0.58	1.98	5.48

Note: (H) Currency Hedged

Currencies	MTD	YTD	10Y	20Y
SGD/USD	-0.25	-2.20	-0.98	1.20
EUR/USD	0.02	-1.21	-2.47	-0.46
JPY/USD	-1.52	-13.56	-4.24	-1.60

Commodities	MTD	YTD	10Y	20Y
Gold	7.32	8.76	4.13	8.55
Oil	-10.76	0.95	-1.72	5.25

As of 31 Oct 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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