THINK DIFFERENTLY

TO GET DIFFERENTIATED RESULTS

Monthly Investment Update

Executive Summary

November witnessed a significant rally in the markets, practically making a full year's return in a single month. Almost predictably, but no less surprising every time it happens, markets bottomed just as the fear gauge was flashing ‘extreme fear’. It's moments like these that would make any investor wonder - what if we had the foresight to dive in at October's close? But for most people, this is very difficult to do especially when markets are volatile. The next best option is to focus on the long-term goals and be rewarded as markets go up over time.

This year’s volatility has no doubt been triggered by a departure from the 'easy money' era of 2009-2021. Indeed, investors will have to recalibrate for a world where interest rates promise to linger on the higher side – by exploring beyond the popular market indices or strategies that did well amid the previous broad-based growth environment to find tomorrow’s winners.

The market's response to the Federal Reserve signaling an end to rate hikes was overwhelmingly positive, with equities and bonds rallying. Our recovery positions, in particular Emerging Market and US small-caps equities, danced to this upbeat tune. This is consistent with past periods of Fed pauses, where markets tend to be positive in the 6 and 12 months after the final interest rate hike.

In fact, now is a good time as any to invest. But in this late stage of the economic cycle, where a soft landing seems within grasp, let's not be lulled into complacency. The markets may yet throw us curveballs - be it a resurgence of inflation or the lagging impact of high interest rates on the economy and businesses that would trigger fresh bouts of volatility. In such an environment, it continues to pay having a portfolio that can help us stay invested through the volatility and capitalize on the long-term market uptrend.

For fixed income investors, the higher interest rate environment currently offers a spectrum of yield opportunities: from risk-free returns to high-income options with varying degrees of market volatility. While cash is now offering better than before, it will still be a challenge to outpace inflation over time. For those who are willing to venture beyond ‘risk-free’, higher yielding markets such as in Emerging Market bonds present attractive returns. As we head into the end of the year, we wish everyone a happy holiday and a prosperous investing journey!

MARKET REVIEW

Markets were up big in November, practically making the equivalent of one year's return in a single month.

The first thing that comes to mind would be "If only one could have invested at the end of October?" Perhaps the more appropriate question is "If only we could find someone to invest in October when markets were down?" Indeed, the sentiment at the end of October was downbeat, which is to be expected for the typical investor. It would be a tall order to expect one to add at the end of October, but at least we did not see many investors jump off and miss out on November's rebound.

One of the chief culprits for this immense volatility is the exit from the era of easy money that lasted from 2009 to 2021. In market terms, these 12 years was a small phase, but for many in the current generation of investors (as indicated by Howard Marks in his latest memo) "this time it really might be different".

For starters, investors have to get used to higher for longer: Average **interest rates will be higher in the next decade compared to the past decade**. Central bankers have little desire to repeat sustained quantitative easing which saw asset inflation exceed actual productivity gains, making the rich richer, with many others not benefitting as much, and in fact suffering disproportionately from high inflation in recent years.

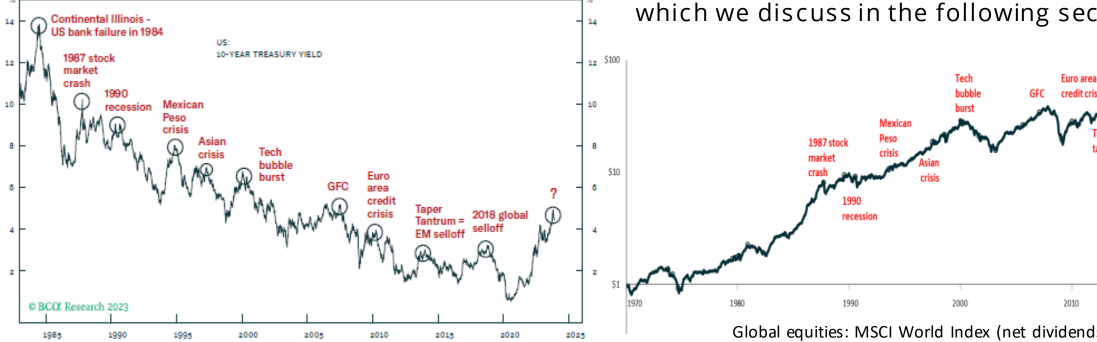
Nevertheless, the path to steering global economies back on track will not be smooth. The chart on the left shows how rising interest rates have tended to "break" things. This sounds scary but the chart on the right shows that markets still go up despite things getting broken along the way. The challenge is investors are most compelled to jump off when things break, so when markets resume their upward trajectory, those investors get left behind. Our job is to help investors stay on track.

Apart from the immense volatility, what else should investors who continue this journey of compounding expect going forward?

Lower overall economic growth: With no obvious global growth driver, broad-based economic growth is expected to moderate in the context of higher capital costs. **This does not mean that there are no opportunities**, there continue to be segments of the market that will still benefit in a low growth world. It also means that investors have to look past the popular market indices that did extremely well amid the previous broad-based growth to find tomorrow's winners.

Lower valuation for risk assets: This is something that is anchored in valuation theory, but highly evident in markets. Parts of the market that are more sensitive to interest rates such as real estate sold off as interest rates rose. When rates were near zero, real estate could fetch a (higher) valuation by providing a yield of 3%. But with rates much higher now, no investor would want take real estate risk to earn the same 3%, which is why a lower valuation is required to make it worth investors' while to hold such assets.

Central bank rate hikes continue to have a domino effect. Where the pain has been felt has been in bond markets, commercial real estate (CRE), and parts of private equity. Where it remains to be seen is in private credit, and companies with low return on capital. While these present some areas of risk, there are also more opportunities today which we discuss in the following sections.



Global equities: MSCI World Index (net dividends) 1970–2021

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POSITIONING FOR RECOVERY

Scenario 1		Scenario 2
• Inflation peaks • Less concern about higher rates • Mild US recession 'soft landing' → **Market recovers?**		• Fed overdoes tightening in face of higher inflationary environment • US recession 'hard landing' → **Market crisis?**

What happened in November? To put it simply: the tug-of-war between the two economic 1. soft and 2. hard-landing scenarios inched a step closer towards 'soft' on indications that the Fed is done with their rate hike cycle.

4:06 p.m. ET, November 1, 2023

Dow closes 220 points higher as Fed holds rates steady

Market reaction to the pause was dramatic, with both equity and bonds rallying strongly in the immediate aftermath and throughout the rest of the month.

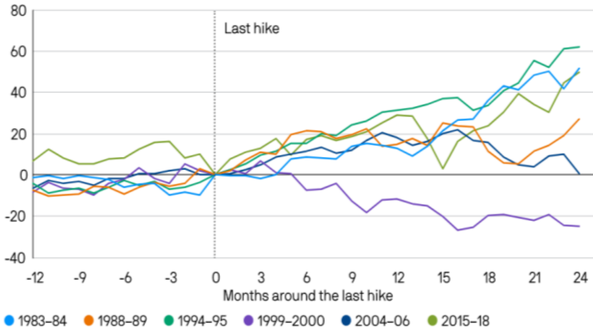
Most of our recovery positions benefitted, as expected in such a scenario. Emerging Market equities rallied strongly, and US small-caps doing even better (our best performing US small-cap fund was up about 18% in a month - double the market return!). But even after the strong rally, we expect more upside for our equity holdings. This contrasts with other segments of the markets that are more richly valued and hence more limited upside potential. i.e. certain mega-cap tech stocks.

China was the notable exception, as their performance lagged other major markets meaningfully on downbeat sentiment despite bottoming fundamentals and continued policy support. Clearly, there is a good opportunity for long-term investors here on the back of attractive valuations and extreme pessimism amongst investors, but the situation remains hard to call in the short-term. With better news flow and sentiment, a quick turnaround should not be so surprising given the current setup. Already, we have seen more investors dipping their toes into the beaten-up market[1]. Nevertheless, we are monitoring the situation closely and will update accordingly.

[1]Bloomberg: Fidelity, Invesco Prep for Revival in China

In any case, markets are convinced that the Fed is done with the current rate hike cycle. Importantly, inflation has continued to moderate, leaving room for the Fed to pause barring any unforeseen circumstances. If this is the base case, how should we expect markets to fare now that the aggressive Fed rate hike cycle is behind us? Understandably, higher interest rates have tightened financial conditions for both individuals and businesses, so it would make sense that a reversal (or at least a pause!) should be taken positively.

What can we learn from history? Since 1984, equity returns have typically been positive in the 6-12 months after the Fed's final rate hike. There was one exception in the early 2000s, where, despite the Fed pause (and subsequent rate cuts), equities fell meaningfully as the now infamous tech bubble eventually burst.



Source: J.P. Morgan Asset Management

What should the takeaway be? Now is a good time as any to invest, but keep in mind that there is a difference between a *rate pause* and a *rate cut*. The fact is that interest rates remain much higher than at any time in the past decade, and investors will need to be selective to invest in areas with good fundamentals and valuations to grow their wealth more sustainably going forward.

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LATE CYCLE STABILITY

With the likely end of the Fed interest rate hike cycle and increased evidence of a soft landing in the economy, investors on the sidelines risk missing out on potential strong gains in markets.

That said, we remind investors not to expect only smooth sailing from here on. In fact, expect bouts of volatility as markets continue to make their way upward. In this section, we discuss two key risks that remain front and center today:

1. Resurgence of Inflation. Today, market participants are expecting lower inflation and lower rates as the base case. While this is the most likely outcome, it also means that markets may react negatively on any ‘bad surprise’ on inflation.’

> **Jerome Powell’s Federal Reserve is still on pause when it comes to rate hikes - *for now*.’**

2. Higher interest rates have yet to fully make their way through the economy. We reiterate that a Fed pause is not the same as a Fed cut. Unless we see a meaningful reduction in rates, the impact of higher interest rates will likely continue to have a domino effect on the economy in the coming months and quarters.

> **“It is very unlikely that the most aggressive monetary cycle in 40 years does not eventually trigger recession.”**
> **BCA Research**

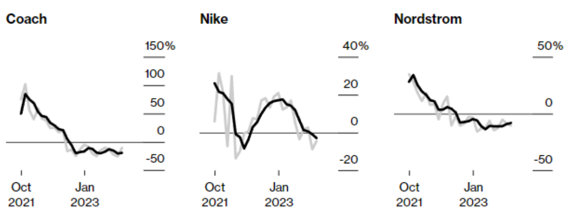
While the past month shows the soft-landing scenario is increasingly the consensus market view, the risks outlined above hint at how the narrative can change just as quickly. The common thread is that a prolonged higher interest rate environment would hurt the economy and eventually corporate earnings.

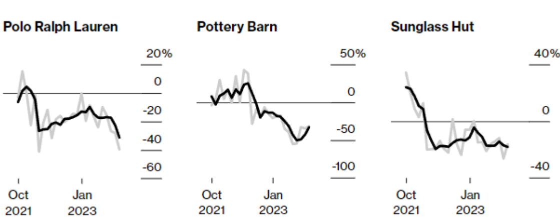
Already, we have seen continued signs of cooling in the economy. For one, labour markets have continued to moderate, with US job openings falling to their lowest level in more than two years in October. There have also been signs that the almighty US consumer is starting to crack as indicated in the following graph:

Brands Catering to Upper Middle Class Are Struggling

Change in consumer spending (YoY) for selected high-end retail brands, 3-month rolling averages.

YoY sales, 3-month rolling average / YoY sales, observed





Source: Bloomberg Second Measure

The above shows that Americans have been curtailing their spending ahead of the holiday shopping season. According to Bloomberg, ‘a group of retailers that cater to the upper middle class — including Apple, Coach and Nordstrom — saw its biggest sales drop in two years’[1].

This is worth monitoring closely. While some cooling of demand is precisely what the Fed hopes to achieve i.e. a soft landing (mild recession) scenario, any more meaningful deterioration will bring the ‘hard landing (deep recession)’ crowd back in droves. Continuing with the tug-of-war analogy; we do not rule out the ‘hard landing’ narrative resurfacing once more before the final score is settled.

The implication for investors is that portfolios will need to be robust enough to participate in market gains while being resilient enough to take a few bumps and bruises along the way. This is what the stability theme is for; so that our investors have the holding power during such breaks and are not compelled to dump their investments at the worst points.

[1] Bloomberg: Is the US Headed for a Recession? Look at What Richer Americans Do on Black Friday

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CAPTURING HIGH YIELDS

Choose where "yield" want to be
This may be a little tongue-in-cheek, but it does reflect the wide range of opportunities in the current environment: There is a yield investment for just about every type of investor:

Risk-free return
We are not going back to the era of cheap money anytime soon, which is actually a good thing. For a long while when money was cheap, the search for yield was not easy. Even cash was not safe: in a cheap money environment, cash was a *return-free* risk that gave little value with a lot of volatility, as investors experienced last year. Today, that has changed; **cash has regained its role as risk-free return, offering low single-digit returns.**

As much as cash can preserve its value, what is being preserved is face value. With Singapore inflation at 4.70%*, cash returns are barely keeping pace. And many will find that the prices of their meals and lifestyle activities have risen more than the official inflation rate.

High income with market volatility
High rates have led many to dash for cash in their bid to get some fixed income. Yet there are a small number of investors who are seeing yield opportunities that are providing much more than cash.

In the same memo, Howard Marks mentioned that "thanks to the changes over the last year and a half, investors today can get equity-like returns from credit investments." We agree, and we see this globally.

*Source: Singapore Dept of Statistics as at Oct 2023

Emerging market high-yield bonds are yielding more than 10%. While EM bond markets have seen their fair share of volatility in recent years, it is fair to say that the worst is over and investors have more upside than downside to look forward to. For example, in the 1-year ending Nov 2023, EM HY markets returned over 10% compared to 2.6% for the popular investment grade index.

Last month, we mentioned that developed market corporate bonds are more attractive than when interest rates were low. But don't just jump blindly into DM high yield.

There is still risk in the form of higher defaults when lower-quality companies need to refinance the cheap debt they took on. This was the kind of debt that does not figure well in our analysis: poor valuation plus poor fundamentals, and we expect some pain here in the impending future.

Hence, we are focusing efforts on specific opportunities that provide high yields while being mitigated by a potential wave of defaults. Watch this space.

High income with little market volatility
Alternative income markets are not new; they just tend to be under most investors' radars. Today, one can get over 10% in alternative income, for example in insurance-linked markets. Furthermore, this is achieved without needing to take the risk of illiquid or private markets.

The table below summarizes the range of yield opportunities investors can choose from today based on their preferences and risk tolerance.

EM HY: Bloomberg Emerging Markets High Yield Total Return Index, Investment grade: Bloomberg Global Aggregate

Type of Yield Investments	Pros	Cons
Risk-free return e.g. treasury bills, money market funds	Low single digit return with confidence in getting money back	Certainty in compromise of purchasing power
High income with market volatility e.g. high yield bonds	High income of 5-8% over risk-free providing meaningful purchasing power	Sit through market volatility and potential default losses
High income with little market volatility e.g. alternative income	>10% income from specialist markets that are less impacted by market volatility	Limited capacity, not easily accessible to investors

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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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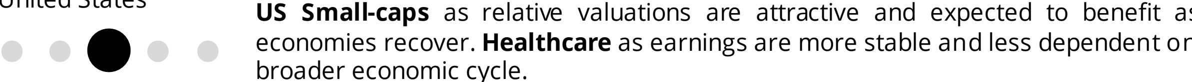
ASSET ALLOCATION STRATEGY

-- Underweight – Slight Underweight = Neutral + Slight Overweight ++ Overweight

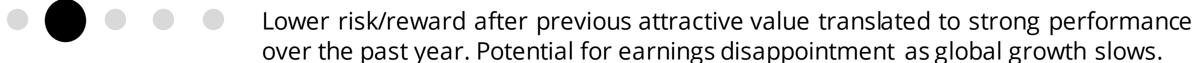
Equity: Regions

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	9.28	17.16	8.19	8.22
United States	9.13	20.79	11.80	9.72
Europe	9.83	14.19	4.79	6.90
Japan	7.73	13.63	5.04	4.92
Asia Pacific ex Japan	7.44	2.59	3.34	7.42
Emerging Markets	8.01	6.01	2.49	7.36

Equity Markets	MTD	YTD	10Y	20Y
Australia	9.61	2.93	5.30	9.57
Brazil	15.30	24.62	1.41	6.87
China "A"	0.37	-10.58	4.26	8.49
China "H"	0.15	-9.57	-3.05	5.46
Hong Kong	0.04	-10.70	0.04	5.14
India	4.82	10.65	10.62	12.00
Indonesia	7.46	7.07	4.82	12.46
Korea	15.67	10.80	2.00	7.51
Malaysia	3.01	-4.55	-2.41	5.92
Russia	2.35	25.64	3.74	8.37
Singapore	3.16	-0.60	2.86	7.35
Taiwan	12.88	25.30	10.96	10.12
Thailand	2.39	-16.37	2.22	8.30

Equity Sectors	MTD	YTD	10Y	20Y
Gold	11.29	9.33	4.71	2.11
Energy	-1.00	-1.34	3.77	9.07
Technology	13.69	47.33	18.63	12.26
Healthcare	5.77	-0.18	9.19	9.31
Financials	10.92	6.40	9.66	4.71

Fixed Income	MTD	YTD	10Y	20Y
Global Aggregate	5.04	1.50	-0.09	2.35
Global Aggregate (H)	3.44	3.83	2.04	3.30
High Yield	4.77	9.50	3.81	6.32
Asia	3.91	4.12	2.97	2.83
Emerging Markets	5.30	4.69	2.64	5.68

Note: (H) Currency Hedged

Currencies	MTD	YTD	10Y	20Y
SGD/USD	2.42	0.17	-0.63	1.28
EUR/USD	2.96	1.71	-2.19	-0.48
JPY/USD	2.35	-11.52	-3.63	-1.50

Commodities	MTD	YTD	10Y	20Y
Gold	2.65	11.64	4.97	8.50
Oil	-6.25	-5.36	-1.97	4.68

*As of 30 Nov 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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