MAY 2024

THINK DIFFERENTLY

TO GET DIFFERENTIATED RESULTS

Monthly Investment Update

Executive Summary

April saw large swings in the market after a strong Q1 when equities rallied as confidence grew in the economy's resilience. Stickier-than-expected inflation data triggered fresh concerns that the Federal Reserve may hold or even raise interest rates - this sparked a quick retracement in equities, emphasizing how interest rates continue to drive financial markets in the near term.

Despite inflation, it is important to remember that households remain in good shape with real wage growth positive. In short, the economy remains resilient at least for now. This provides abundant opportunities for global investors as diverse markets offer exciting potential.

Over the past month, the "voting machine" of short-term market sentiment overshadowed the "weighing machine" of corporate earnings. As we see from the earnings season, US corporates have generally exceeded expectations. The positive earnings trajectory, along with improved macro indicators provide good support for markets to continue rising.

Interestingly, China equities have quietly risen over the past few months; catching up to global markets despite ongoing interest rate fears. Although geopolitical concerns persist, strong policy support and improving factory activity indicate more gains are likely ahead. What's clear is that the distinctive growth drivers of Emerging Opportunities provide good diversification and resilience to our portfolios.

For fixed-income investors: it has been better to focus on income, and not on interest rate decisions. Investors betting on rates have struggled, as investment-grade bonds fell by 1.6% while high-yield markets gained 2.0%. Ironically, 'higher quality' Investment-grade bonds come with higher interest rate risks and offer lower yields, making higher-yield bonds an attractive proposition today.

Amid the continued tug-of-war between high-interest rates and resilient fundamentals, investors who focus on the key drivers of returns while ensuring careful risk management can enjoy better returns at the end of the day.

MARKET REVIEW

After a relatively stable Q1 which saw equities climb as investors got more confident about the economy's resilience, April saw a bout of volatility in a case of "good news is bad".

Stronger-than-expected inflation data released in April caused renewed jitters that not only would the Fed not cut rates as soon as expected, but they may even hike rates. To put things in context, this was not a case of inflation spiking but more of inflation holding and not coming down as fast as expected.

This led to 12-month bond yields rising a rather tame 0.2% but this was a good enough reason for markets to sell down equities which rallied in Q1. The right-most shaded area in the chart shows the higher volatility and retracement in equity markets during April. What is important to note is that:

- Such bouts of volatility are not uncommon, with two similar episodes in just the past year
- Equities tend to rise after these periods of higher volatility

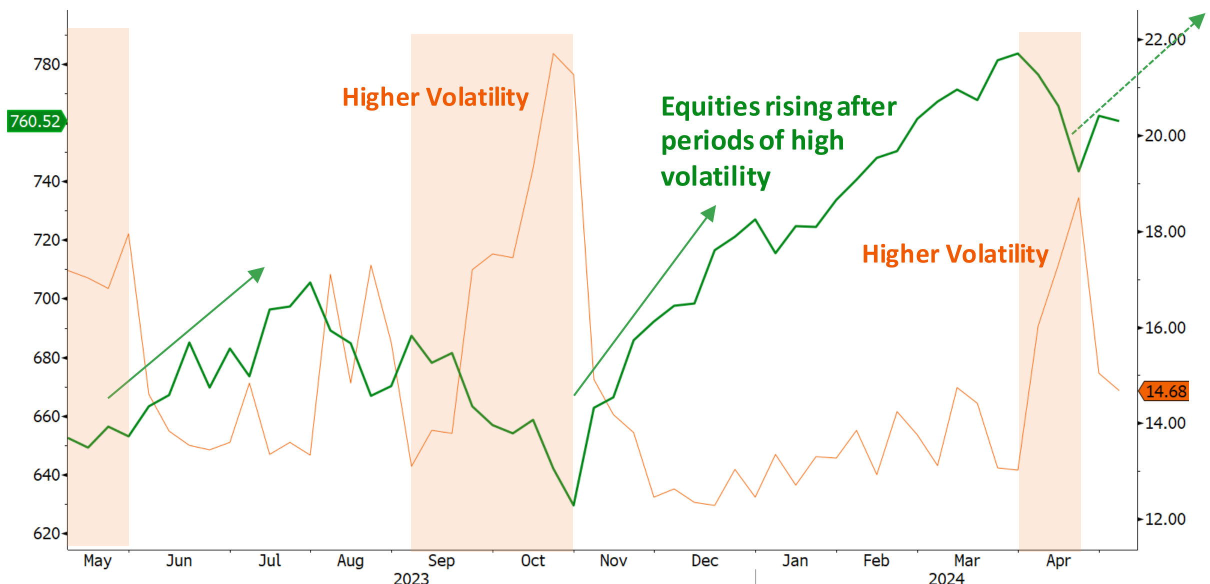
Indeed, interest rates have been the main driver of volatility for financial markets. As we discuss in the following section, this year has been a horrible experience for those trying to navigate the ebb and flow of interest rates.

It is important not to look at inflation data in isolation. Inflation is persistent because the economy is resilient. With demand outstripping supply, prices must go up.

We could go on discussing about how economic indicators e.g. PMI manufacturing, LEI (Leading Economic Index) are showing positive signs that the economy can withstand persistent inflation, but let's look at what matters to the man on the street: their bottom line.

Despite inflation in recent years, wages have risen more than inflation itself i.e. real wage growth is positive. This shows that households are fundamentally in good shape despite complaints about rising prices. (Isn't it human nature to complain about higher prices while keeping quiet about one's wage increases?)

Even though markets are at all-time highs, the asset allocation landscape is more exciting than ever for flexible global investors. A wide dispersion across markets means there are abundant opportunities as sentiment and growth expectations continue to improve…for those to know where to look.



Source: Bloomberg. US Average Hourly Earnings All Employees Total Private SA, US CPI Urban Consumers NSA

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HIGH RATES MEET BETTER EARNINGS

On May 1st, the US Federal Reserve kept interest rates unchanged at 5.25% to 5.50% for the sixth straight meeting, as widely expected by markets. Over the past month, what seemed like stickier inflation led to renewed fears that interest rates will stay higher for longer (or go even higher), triggering fresh bouts of volatility in April.

As many investors got used to markets going up in almost a straight line since the end of October 2023, the recent declines unsurprisingly caused some anxiety.

In times like this, it is useful to revisit the below chart and remind ourselves that markets do not go up in a straight line. We can see from the chart (current drawdown of -5%) that April's declines are well within the 'normal' range of volatility investors should expect, and that markets tend to consolidate before making new highs.

"In the short run, the market is a voting machine but in the long run, it is a weighing machine." *Investors should position for the more predictable weighing machine that results in positive yearly returns, rather than the fickle voting machine that causes the intra-year declines.* This is why an important theme for 2024 is the recovery of corporate earnings. We've said before that this year will be a 'show me the numbers' market, and in the past month, we saw further evidence of recovering fundamentals.

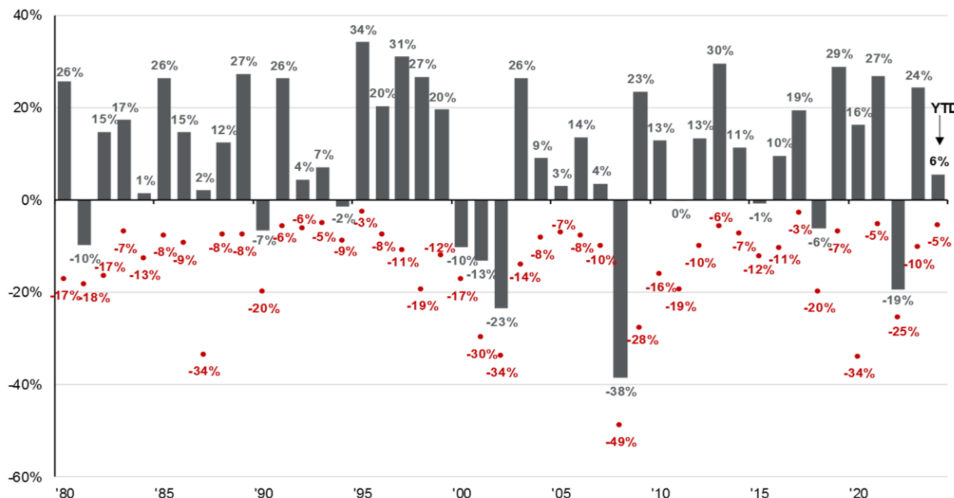
As the US earnings season gets underway, we have seen companies generally reporting better-than-expected earnings growth. While financial news headlines prefer to cover tech earnings more extensively, there were clear improvements across the various segments of the market.

For instance, the Healthcare sector saw more than 90% of reported companies topping estimates – one of the best beat-rate across sectors. All in all, improving macro trends (e.g. improving PMI activity) have been supportive of earnings growth. The positive trends are expected to continue to be supportive for equities in 2024, and we maintain allocations to markets like small-caps that stand to benefit in this environment.

Euro-Zone Speeds Out of Recession But Inflation Proves Sticky

- Region's top economies all beat estimates for first quarter
- Inflation unchanged at 2.4% in April — matching expectations

It is not a coincidence that Europe equities outperformed in April's sell-off (-1.87% vs Global equities -3.26%). Jitters from earlier in the year gradually dissipated as leading indicators pick up. As the European economies stabilize, and with a central bank (ECB) that is keener than the Fed to get their rate cut cycle going, earnings estimates of European corporates have also steadily crept upwards reflecting the more positive outlook. Performance is expected to follow.



Source: J.P. Morgan Asset Management

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EMERGING OPPORTUNITIES

It took more than a while, but we may already be on the way to a durable recovery in China equities. As opposed to the widespread enthusiasm for Chinese equities at the start of 2023 on expectations of a covid re-opening recovery (which eventually failed to materialize), the current rally got moving without much fanfare.

Since the bottom in January, Chinese equities have posted strong performance, quickly catching up to the performance of global equities. It is said that the strongest performance sometimes comes when no one is paying attention, and this looks to be another one of those cases.

	Jan	Feb-Apr
China 'A' Equities	-7.1%	+11.1%
Global Equities	+1.2%	+3.7%

Source: Bloomberg. CSI 300, ACWI

Importantly, the strong performance over Feb-Apr 2024 occurred over a period where fears of higher US interest rates drove the volatile performance of other major markets. This is the clear benefit of diversification and highlighting the distinctive growth drivers of our Emerging Opportunities positions.

Unsurprisingly, we are starting to see interest in China picking up after the strong performance, such as the recent upgrade of China to 'overweight' by UBS bank.

That said, we are likely still far from the FOMO (fear of missing out) territory. According to Goldman Sachs, China allocations in fund portfolios remain at historical lows. To put it simply, **most investors are still under-invested today which gives another reason for our China positions to run even further when more money comes in.**

What other factors have been driving the performance and is it likely to continue? Besides valuations which are still low historically, there has been continued strong policy support with state-backed ETF purchases and measures to strengthen the economy and market.

Economic activity has also been improving, with factory activity continuing to be in expansionary territory in April.

Yes, the fundamentals are slowly but surely improving, but at the same time, the coast is still far from clear. Corporate earnings growth is still a mixed picture, and geopolitical tensions continue to linger.

The coast is never clear, especially at the early stage of the recovery. But at least there is a path forward, as recovery in the economy is expected to trickle down to improvements in corporate fundamentals. In the meantime, we invest where there is good valuation and fundamentals, and maintain good portfolio diversification while doing so.

The other Emerging Opportunity is Vietnam equities, which experienced a volatile April alongside other major markets.

In recent months, there has been news of the resignation of two prominent political figures; Vietnam's President (a largely ceremonial position) in March, and the Chairman of the National Assembly in April, which may have caused some worry for investors. Our checks with local experts indicate little cause for concern; in fact, the resignations are part of the Vietnamese ruling party's commitment to addressing corruption even at the highest level. Nevertheless, we are keeping a close watch on developments here and provide updates where there are meaningful developments.

As mentioned earlier, we similarly positioned for the 'market weighing machine' here:

According to Dragon Capital (a local asset manager in Vietnam), in Q1 2024 "Vietnam's GDP recorded the fastest Q1 growth of the last five years, foreign direct investment increased by 13.4% year-on-year, and exports expanded by 17% from Q1 2023", showing how Vietnam has differentiated itself from other emerging economies and established itself as a key beneficiary of the China Plus One strategy.

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FOCUS ON INCOME NOT RATES

We've mentioned that the environment has become more conducive for bond investors after the era of easy money. That's provided one is focused on the right source of returns.

Investors generally got what they wanted if they focused on extracting income in a higher-yield environment. However, if they were focused on trying to bet on where interest rates would go, this year would have been horrible.

For example, global high-yield markets are up 2.0% year to date while global investment grade bonds are down -1.6%. It sounds counterintuitive that investment grade bonds would do worse than high yield bonds but as always, it is key to look under the hood to figure out the what risk one is taking.

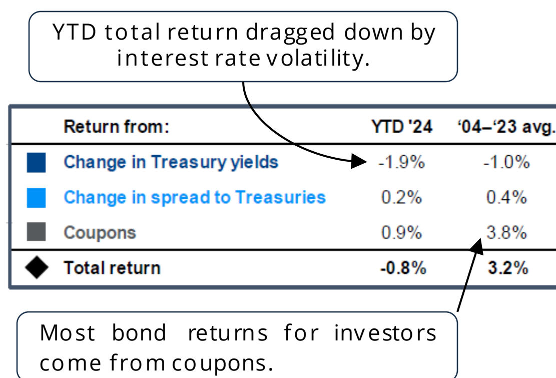
Investment grade bonds tend to have longer maturities as investors are much more willing to lend for longer periods to "higher quality" companies. Similarly, these investment-grade companies don't need to give investors much income as the risk is perceived to be lower. The table shows that IG investors should expect lower income while taking more interest rate (duration) risk compared to high-yield investors.

Bond market	Yield	Duration
Investment Grade	4.06%	6.60
Global High Yield	8.46%	4.08

Source: Bloomberg. Investment Grade: Bloomberg Global Aggregate Corporate Index, Global High Yield: Bloomberg Global High Yield Index, as of 30/04/24.

Bond markets have been the most sensitive to economic surprises than they have ever been since the global financial crisis. That is why interest rate-sensitive bond markets such as treasuries and investment grade bonds have been flip-flopping with every update on inflation data.

Here we need to remind ourselves that the main source of return for bonds is from the coupon instead of changes in interest rates as shown in this study by JP Morgan:



Return from:	YTD '24	'04–'23 avg.
Change in Treasury yields	-1.9%	-1.0%
Change in spread to Treasuries	0.2%	0.4%
Coupons	0.9%	3.8%
Total return	**-0.8%**	**3.2%**

Unfortunately, the media is not helping investors by preferring to print reports about central banks and their interest rate policies. After all, a journalist gets more eyeballs from discussing prominent players in finance than relatively boring coupons.

For the same amount invested, an investor can choose to get lower from investment grade bonds or higher return from high yield bonds. Of course, the "price" of this higher return comes in the form of being subject to more volatility. After all, volatility is a market mechanism to allocate higher returns to those who can stomach volatility from those who cannot.

We continue to harvest the higher income available in select high-yield bond markets while monitoring for potential risks developing that may prompt us to take some money off the table.

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HOW ARE WE POSITIONED?

Equity (Green) **Bonds (Blue)**

Key Themes	
Positioning for Recovery With the end of the rate tightening cycle and soft-landing as the current base case; there is a good window of opportunity for undervalued markets to lead the recovery. Maintain a preference for higher quality segments that still offers strong recovery potential.	**US small-cap equities** **Europe equities**
Emerging Opportunities Financial markets operate in cycles. The end of the easy money era means looking beyond popular markets that did well during the previous broad-based growth to find tomorrow's winners. Focus on high-growth markets driven by their own distinctive economic trajectories and coupled with attractive valuations.	**China 'A' equities** **Emerging Market and Vietnam equities**
Late Cycle Stability With interest rates remaining at higher levels compared to the past decade, there continue to be signs that economies and businesses are adjusting to the new regime. e.g. tight labour markets and slower growth.	**Healthcare equities** **Government Bonds**
Capturing High Yields The combination of high interest rates with the end of the Fed interest rate tightening cycle means that bonds should place prominently on investors radars. Position in higher yielding markets that can provide a good buffer to their higher volatility profile.	**Asian High-Yield bonds** **Emerging Market bonds**

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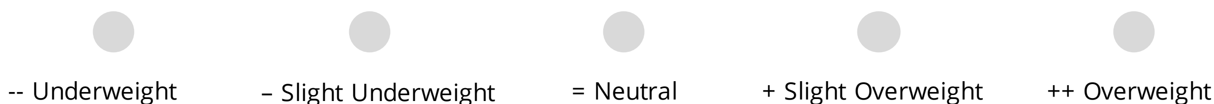
ASSET ALLOCATION STRATEGY



-- 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

Europe's pro-cyclical industrial base to benefit from economic recovery as it becomes clearer a severe recession is not on the cards.

Japan

Maintaining no exposure as they are less attractive compared to other opportunities. Valuations have also become less attractive, with the prospect of a stronger JPY posing a risk to Japanese equities.

Asia Pacific ex Japan

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

Emerging Markets

Preference for high-growth markets at attractive valuations i.e. Vietnam

Fixed Income

Global

Focus on currency-hedged government bonds to buffer portfolio volatility during periods of stress.

Investment Grade Corporate

Maintaining no exposure as we run a barbell strategy combining defensive government bonds and high income credit.

US High Yield

Maintaining no exposure due to relative poorer valuations and risk of defaults as economies remain late-cycle.

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	-3.26	4.79	8.78	8.36
United States	-4.08	6.04	12.39	10.00
Europe	-1.87	3.26	4.89	6.93
Japan	-4.78	4.67	6.73	4.53
Asia Pacific ex Japan	0.42	2.51	3.99	7.39
Emerging Markets	0.43	2.89	3.33	7.31

Equity Markets	MTD	YTD	10Y	20Y
Australia	-3.39	-2.56	5.39	9.56
Brazil	-5.06	-12.10	0.51	6.67
China "A"	1.75	3.14	6.01	8.15
China "H"	8.12	8.71	-0.83	5.49
Hong Kong	7.52	4.60	1.22	5.52
India	1.01	2.96	10.56	11.80
Indonesia	-3.09	-4.48	3.13	11.17
Korea	-4.71	-4.98	2.22	6.90
Malaysia	1.75	6.17	-1.96	5.89
Russia	3.02	8.06	6.60	7.83
Singapore	1.95	-0.29	3.11	7.28
Taiwan	-1.26	7.15	12.02	10.34
Thailand	-2.24	-9.54	1.37	7.95
Vietnam	-7.79	2.77	8.24	7.92

Equity Sectors	MTD	YTD	10Y	20Y
Gold	6.11	7.46	4.60	2.53
Energy	-0.76	12.82	4.09	8.65
Technology	-5.70	5.95	19.17	13.00
Healthcare	-3.93	3.43	9.25	9.26
Financials	-4.18	7.75	10.71	5.13

Fixed Income	MTD	YTD	10Y	20Y
Global Aggregate	-2.52	-4.55	-0.44	2.25
Global Aggregate (H)	-1.61	-1.60	1.97	3.30
High Yield	-0.96	0.30	3.81	6.39
Asia	-1.57	-1.30	2.84	2.93
Emerging Markets	-1.65	-0.14	2.61	5.84

Note: (H) Currency Hedged

Currencies	MTD	YTD	10Y	20Y
SGD/USD	-1.19	-3.31	-0.85	1.11
EUR/USD	-1.15	-3.38	-2.59	-0.58
JPY/USD	-4.09	-10.62	-4.25	-1.77

Commodities	MTD	YTD	10Y	20Y
Gold	2.53	10.82	5.88	9.29
Oil	-1.49	14.35	-1.95	4.00

As of 30 Apr 2024. 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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