JUN 2024

THINK DIFFERENTLY
TO GET DIFFERENTIATED RESULTS

Monthly Investment Update

Executive Summary

Investors have experienced a tumultuous journey over the past year, marked by fluctuating Fed rate expectations (from 6 cuts, 2 cuts, 6 cuts, to 1.5 cuts today!). Consequently, markets were volatile: in April, markets dipped due to inflation concerns. In May, we saw markets rally driven by improved growth expectations alongside a slight decline in rates. The emotional roller coaster of investing will always be there, but by understanding the strategy and portfolio well, investors can be more confident to hold through challenging periods and enjoy the rewards at the end of the investing journey.

Despite short-term volatility, markets generally trend upwards over time due to persistent fundamental drivers. It is crucial for investors to know which drivers matter for their investment to avoid getting caught off guard when things don't turn out as expected. Investing in the S&P 500 relies on continued strong earnings, though its concentration in a few large-cap stocks warrants close monitoring. Recovery markets like US Small-caps and Europe offer dual drivers of both attractive valuations and earnings growth potential but may undergo more volatility and require more patience to play out. Staying adaptable and understanding the key drivers behind your portfolio is essential for investing success.

One big question for income investors is how long the *high*-income environment will last. As tempting as it is to forecast short-term interest rate moves, this is difficult to do reliably as evidenced by forecasters getting it wrong so far this year. Rather than trying to time for an even higher interest rate and income environment, it may be better to lock in the current high-income today when bond yields are at multi-year highs. There is also the additional benefit of potential capital appreciation if interest rates decline in the future. By focusing on what you can control today income investors can set themselves up for a more predictable income stream going forward.

Finexis Asset Management

MARKET REVIEW

One cannot blame investors for feeling like they are going through a nauseating journey. After all, Mr. Market has been particularly schizophrenic in the past 12 months, Fed expectations have swung from 6 (interest rate) cuts to 2 cuts, back to 6 cuts, and then 1.5 cuts as shown in the chart below.

While this may sound like it only relates to economists, such roller coaster swings have affected investors who have been watching their investments month in and month out.

In April, markets were down due to renewed jitters that the war on inflation was not won. Alongside that, interest rates rose 0.2%*. In May, markets rallied due to improving growth expectations and interest rates declined marginally. Let's put this in context for a moment: such moves are nothing compared to the 5% rate rise in 2022 which was easier to be positioned for (but one needed to be patient).

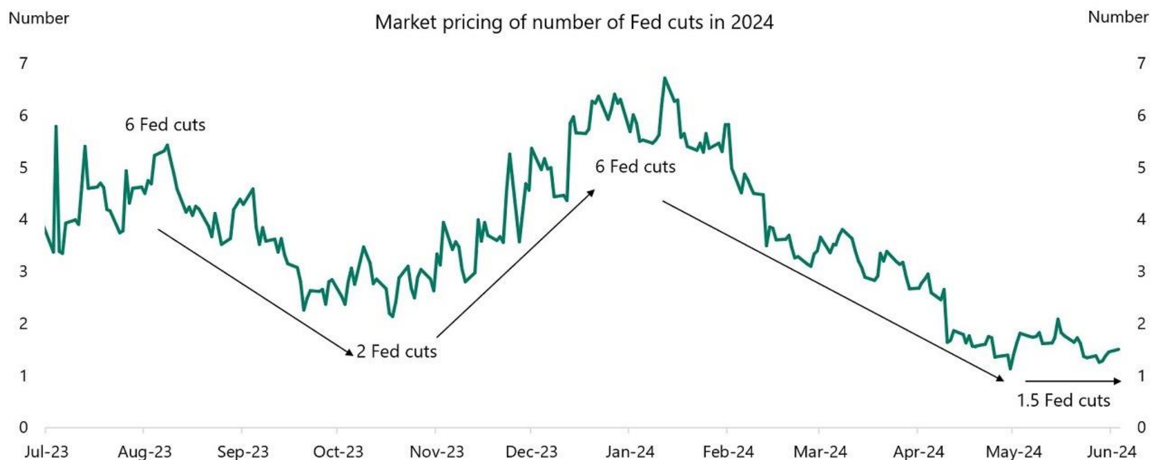
Still, one might look at the down-up-down chart below and feel that these were opportunities for good managers to capture. Facts tell us otherwise. An index of macro hedge funds that tracks the performance of macro managers (the experts who watch markets day in and day out) was down 5% in 2023. Conversely, anyone just sitting on any equity, fixed income, or multi-asset portfolio would have made some money. This shows how too much activity does not always translate to better outcomes.

Like it or not, the emotional roller coaster will always be there. It is especially so now that on any given day (including weekends) some market is trading, and investors are fed a deluge from whichever media and social media they open their screen to. But just like one can choose not to ride the roller coaster in a theme park, investors can do the same.

There are real reasons for these. First, when presented with something moving (investment P&L), it is human nature to be drawn to it, and want to act on it. Of course, one can try to reconcile the short-term drivers which is easier said than done. This means being able to distinguish what we know and do not know. Even professionals are learning as they go along.

What can one do then? As challenging as it is, as Warren Buffett said, 'put in the drawer and ignore it'. We advocate for an additional step: **understanding your investment strategy and portfolio well and having the discipline to stick to it. By doing so, investors can navigate the emotional roller coaster of investing with greater confidence and better outcomes.**

*Source: Bloomberg. Interest rates: US 12-month bond yields, Macro: Credit Suisse Global Macro Index



*Source: Bloomberg, Apollo.

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KNOW WHAT YOU OWN WELL

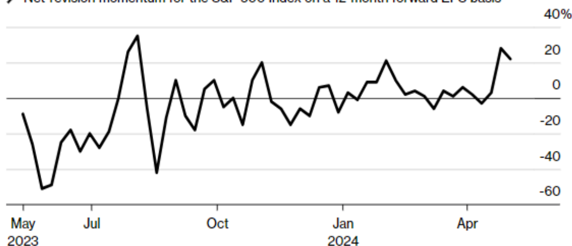
Despite the see-saw in short-term economic and market expectations, seasoned investors recognize that markets trend upwards over time. This force is akin to gravity, anchoring the market's upward trajectory. More specifically, this long-term growth in markets is propelled by persistent fundamental or valuation drivers.

Rather than greed or fear (or hope?), prudent investing means that the choice of investment should reflect the view that one or more of these fundamental market drivers will play out over your investment time horizon. How does this apply to different market segments today?

Investing in the popular S&P 500 means taking the view that strong earnings will continue, given that (higher) valuations are less helpful here. Investors can point towards better margins and positive earnings revisions for these large-caps stocks as reasons to be optimistic. Of course, given historic weighting to a few stocks in the S&P 500 ([Nvidia and Five Tech Giants Now Command 30% of the S&P 500 Index]), investors need to also watch closely for any meaningful developments in these names and adjust accordingly.

Profit Revisions for S&P 500 Firms Hit Fresh 2024 Highs

Net-revision momentum for the S&P 500 Index on a 12-month forward EPS basis



Source: Bloomberg Intelligence

We have invested in recovery markets like US Small-caps and Europe which can benefit from both better valuations and expectations of better earnings growth as economies recover – these positions offer 'pent-up' return potential but may come with more volatility. Some positions have worked out in a timelier manner, while others still require more time to play out fully.

Euro-Zone Activity Hits One-Year High as Recovery Gains Pace

▪ Euro-area composite PMI at 52.3 in May; economist saw 52

Our allocation to Europe has been timely, as fundamentals have inflected positively since the start of the year alongside a more accommodating central bank (ECB is expected to cut interest rates ahead of the Fed in June) supporting equity markets. Indeed, Europe declined less in April's broad market sell-off and gained more in May when markets rebounded.

US small-caps similarly rebounded strongly in April, though it has been a more volatile journey over the prior few months. Valuations remain attractive at decade-lows versus large-caps, though the expected stronger earnings growth could take a longer time to play out more convincingly.

While prospects for current recovery positions remain attractive, it is also essential for us to remain adaptable to changing market conditions. The stronger positive earnings revision of the S&P 500 and its underlying large-cap stocks may warrant a closer look, alongside the fact that the average stock in the S&P 500 is at more reasonable valuations compared to the top few stocks in the index as shown in the following chart. We are currently watching out for opportunities to capitalize on this positive momentum while managing the risks – watch this space.

Valuations: Price to Earnings

Source: Bloomberg. Forward est. P/E

Today, with global economies and corporate earnings continuing to grow, and (especially) if interest rates moderate, the environment is conducive for equity markets to go up – but it is important to know what is driving your portfolio so that you have the confidence to stay in the position when fundamentals remain intact, or to adjust when the environment changes.

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EMERGING OPPORTUNITIES

Investors who saw that China 'A' equities were flat in May while global equities rallied might question its proposition as an Emerging Opportunity. But they only have to step back a bit further to see that the emergence may be happening: China 'A' equities rallied over 11% in the prior months while global equities had more muted gains. It is exactly this manner with which China markets move differently with other markets that provides real diversification value.

	Feb-Apr	May
China 'A' Equities	+11.1%	-0.4%
Global Equities	+3.7%	4.1%

Counterintuitive as it may seem, pauses in market rallies do not signal the end of the rally. As Goldman Sachs noted, even with the correction, China has outperformed global equities by 10% during the latest recovery*.

Skeptics might point to geopolitical risks such as cross-strait tensions and debates on "overcapacity". One has to look much further back in history to see what lies ahead. Over a century ago, the British empire lost its status as global industrial powerhouse to a rapidly industrializing United States that was more populous and more productive. With its overcapacity, the US went on to export to the world its products, brands, and culture, with the side effect of being a global superpower.

To be clear, China needs to execute well if it is to emerge at the top. What is frustrating is that China is executing on a multi-year (if not multi-decade) strategy that does not align with the horizons of many investors.

Our thesis on China does not need it to execute well and be a global superpower. The Chinese economy is 65% the size of the US economy, while the market cap of Chinese stocks is 16% that of US stocks. Without going into technicalities, clearly there is at least still room for China equities to go up further even on a shorter time horizon.

*Source: Goldman Sachs Portfolio Strategy Research 29/05/2024

The other Emerging Opportunity is Vietnam equities. Truth be told, despite the positive attributes of growth at the right price, it was not an easy decision to call when we introduced the position earlier in the year.

In many ways, we were lucky that Vietnam equities rallied considerably as soon as we introduced the position. There was an equally likely chance for Vietnam markets to go down in the short term if there was any bad news that came out then.

But imagine how distressing if that actually happened, especially as China markets also rallied during that period. Such is the noise and volatility that investors need to drown out if they expect to be able to harvest the returns that equity markets have to offer.

Investors' mettle were indeed tested in recent months. Vietnam sold off in April from the double whammy of global risk-off and news of political resignations in the country. In the throes of the decline, it was natural to question the wisdom of having any exposure to Vietnam at all.

Before one could worry much longer, Vietnam equities recovered. For anyone who had the courage to load up, they would have netted impressive gains in a matter of weeks. We do not expect to capture such moves, nor do we know anyone who can do so reliably. We know enough to know what we do not know.

So what do we know about Vietnam?
There are short term risks such as rate hikes that can temper the market. But this is amid the backdrop of an economy that is recovering on many fronts. The cyclical real estate market looks like it has bottomed out. Consumer and business confidence is growing as seen from improvements in credit growth. Accordingly, robust corporate earnings growth is expected, which provides the fuel for stocks to appreciate.

These are the factors that influence the market weighing machine to generate returns for investors as opposed to the voting machine that distracts them.

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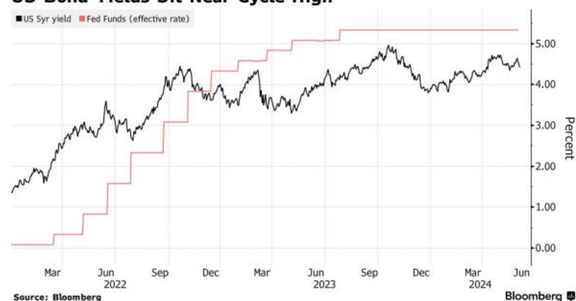
SHOPPING FOR INCOME

This month, we try to address some questions facing income investors in a more relatable way.

How long will the high-income environment last?
Unlike a timed-sale on Shopee or Lazada, there is no obvious countdown timer for markets. Anyone who tells you definitely 'when' is either bluffing you or themselves. As we saw in the review section, both sides of the speculative community betting that the high-income environment would last or not last have gotten it wrong.

If we can't tell when, what can I do?
Ever had that experience where you bought a discounted item online, only to see a further price drop after that? The response might be "Argh! I should have waited just a bit longer". But how would one have known that there would be a further price drop? The opposite result of prices rising could easily happen as well. So long as one was satisfied with the price they paid for what they wanted, there would be less frustration.

It is the same for income investors today. The chart below shows US government bond yields are at multi-year highs, and the same can be said for most other bond markets including high yield. With yields holding at these levels (albeit with quite a bit of volatility), **does it make more sense to try to angle for that marginal improvement that may not happen, or to lock in yields that one is comfortable with?**



Some investors may ask "What if yields go up even more?". As with the example of the further price drop, yields going up is not a given. It matters more than you are comfortable with the type of income investment they are in, and be able to hold.

There is one additional benefit for income investors who lock in current yields compared to someone who locked in a good price for an item on Shopee. If you bought something on Shopee and the price of the item went up, you probably would not sell it at a higher price.

If yields go down (as they are widely expected to eventually), income investments will experience *capital appreciation* i.e. prices go up. Even though income return is and should be the main focus for income investors, at least they have the option of selling at a higher price, or choose to continue to enjoy the yield that they locked in.

High or lower income?
There are many income offerings out there but we can broadly group them into high-income and lower-income. How high is high income? In general, being able to get 3% more than money-market or fixed deposit can be considered high income. One might wonder 'wouldn't everyone take higher income?' especially if it was a simple matter of choosing an investment?

Markets have a pretty effective way of determining which investors get higher or lower income. Like a jigging sorting machine, markets use volatility to separate high and lower-income investors. Rather than go through that process of being "sorted" by the markets, let's do some pre-qualifying.

High income: Investors take more risk, primarily more interest rate and/or credit risk. Expect to experience high volatility and heightened emotional stress when bad news abounds. If you have the patience to sit through prolonged periods of uncertainty, you will most likely be able to get the high income at the end of the day.

Lower income: Investors who do not like the roller coaster journey related to changes in interest rates and market cycles will find lower income options such as money market funds a comfortable place. The flip side is when yields drop, their income is not locked in.

Note: Any mention of Shopee/Lazada is not an endorsement or investment recommendation.

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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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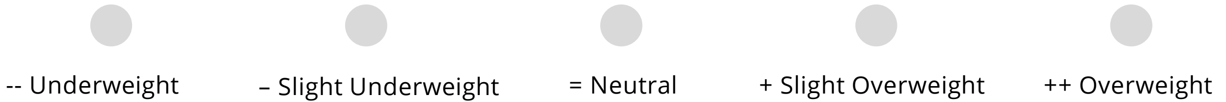
ASSET ALLOCATION STRATEGY



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	4.12	9.11	8.98	8.53
United States	4.96	11.30	12.68	10.20
Europe	5.17	8.60	5.30	7.11
Japan	1.25	6.10	6.48	4.76
Asia Pacific ex Japan	1.89	4.44	3.86	7.59
Emerging Markets	0.59	3.50	3.03	7.45

Equity Markets	MTD	YTD	10Y	20Y
Australia	3.46	0.81	5.62	9.69
Brazil	-4.01	-15.63	0.19	6.86
China “A”	-0.46	2.67	5.92	8.27
China “H”	2.15	11.05	-1.14	5.25
Hong Kong	2.54	7.25	0.93	5.49
India	-0.26	2.71	9.47	12.84
Indonesia	-2.65	-7.01	2.81	11.74
Korea	-2.01	-6.88	1.72	7.11
Malaysia	2.76	9.11	-1.88	6.18
Russia	-2.96	4.86	5.08	7.88
Singapore	3.52	3.22	3.31	7.62
Taiwan	4.17	11.62	12.07	10.69
Thailand	-0.28	-9.80	1.46	8.06
Vietnam	4.32	7.21	8.91	8.42

Equity Sectors	MTD	YTD	10Y	20Y
Gold	5.98	13.89	5.98	2.83
Energy	-0.39	12.38	3.90	8.59
Technology	8.67	15.14	19.74	13.29
Healthcare	2.73	6.25	9.32	9.39
Financials	3.16	11.15	10.89	5.19

Fixed Income	MTD	YTD	10Y	20Y
Global Aggregate	1.31	-3.30	-0.37	2.29
Global Aggregate (H)	0.88	-0.73	1.97	3.36
High Yield	1.11	1.42	3.83	6.53
Asia	1.56	0.24	2.81	3.00
Emerging Markets	1.72	1.58	2.52	5.99

Note: (H) Currency Hedged

Currencies	MTD	YTD	10Y	20Y
SGD/USD	1.07	-2.28	-0.75	1.15
EUR/USD	1.71	-1.73	-2.26	-0.58
JPY/USD	0.32	-10.34	-4.26	-1.80

Commodities	MTD	YTD	10Y	20Y
Gold	1.80	12.81	6.42	9.27
Oil	-6.03	7.45	-2.84	3.34

As of 31 May 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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