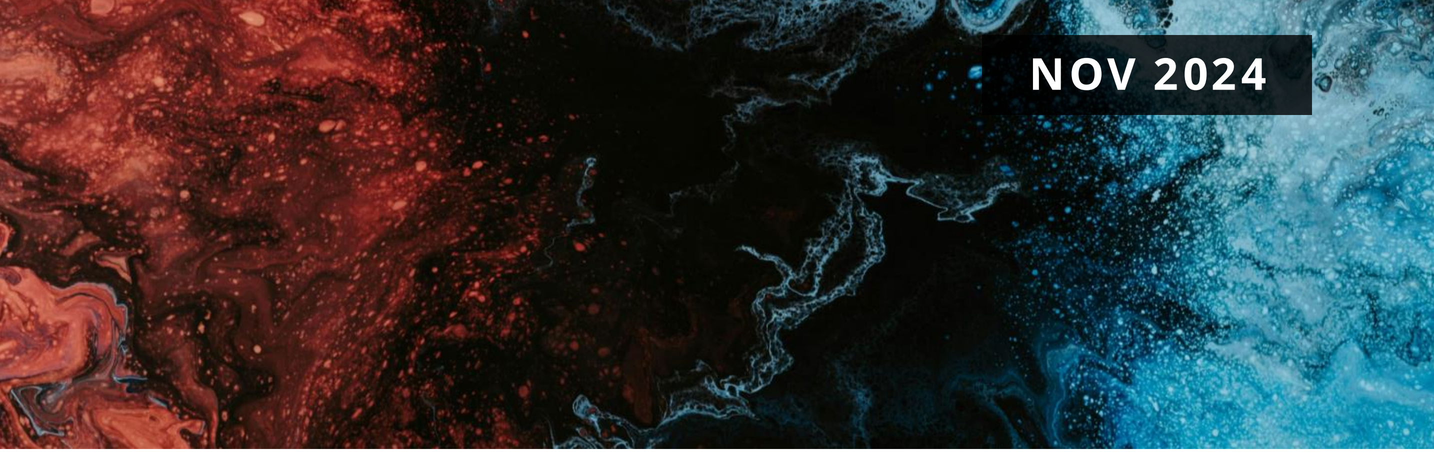

THINK DIFFERENTLY

TO GET DIFFERENTIATED RESULTS

Monthly Investment Update

Executive Summary

October saw a reversal of September's rally, reflecting the ongoing challenges of investing in a late-stage economic cycle. The past month has been a case of "good news is bad news" as resilient economic data raised concerns that the Fed might cut interest rates less aggressively than previously expected.

Markets are now facing a series of critical crossroads: late-cycle economic pressures, uncertain interest rate policies, and the recent US election. **With Trump's latest victory (just as we are writing this commentary!) one major uncertainty looks to be out of the way though volatility may remain for a while longer as markets digest the implications of his win**. Initial reactions have been largely positive for markets, fueled by expectations of pro-business policies like tax cuts and lighter regulations. The Republicans have also won control of the Senate, making it easier for policies to be implemented (both good and bad). Beyond the initial positive sentiment, the longer-term outlook will depend on how these policies unfold, especially if trade tensions escalate or inflation picks up due to Trump's policies – either one could trigger fresh anxieties for markets down the road.

Trump's win also has implications for international markets. China, in particular, may experience near-term weakness in expectations of Trump's hard stance on China – he has previously threatened steep tariffs on Chinese exports into the country. Yet this may also mask interesting opportunities beneath the surface. Should China's policymakers respond with stronger stimulus measures in response to the US election outcome, particularly in fiscal policy, we could see a tactical opportunity in Emerging Markets and China. We will be looking towards China's National People's Congress in anticipation of any signs of such support.

Ultimately, markets are driven by economic fundamentals more than election rhetoric. While it's important to consider how policies might impact the economy, the broader economic trajectory remains a priority. At present, the economy continues to show resilience with a soft-landing scenario the current base case, supporting further gains in both equity and fixed-income markets. We remain positioned to capture this growth while staying alert for any signs of economic slowdown, ready to shift to a more defensive stance if needed to manage volatility.

MARKET REVIEW

Investors who watch markets month in month out can find it nauseating if they are not used to it. Markets see-sawed as they were up in September (exemplified by the strong rally in China markets) and then retracing in October.

As uncomfortable as it is, this is part of the investing journey. The good news is those who sit through it can benefit from capital gains in equity markets. There are also more comfortable paths for investors such as those who prefer income over capital gains.

Good news is bad news
October saw a reversal across markets which put a temporary pause on prevailing trends. While it is not surprising to see a pullback in China markets after overshooting in September, the reversals were not just about China.

In the US, it was a case of good news is bad news. As counterintuitive as it may seem, good fundamentals led to more volatility. Data releases indicating a more resilient economy also caused some concerns that there could be fewer (and a slower pace) of rate cuts than previously expected.

Markets at crossroads
Markets are indeed at important crossroads, figuring out which way to turn. While it is easy to pin it on the US elections, the broader dynamic is that this is typical of late-stage economies during which markets are a lot more sensitive to changes in economic data. If anyone assured you that it will be a hard, soft, or no landing, applaud them for their confidence but leave it at that. The reality is that the situation is so dynamic that each data release does not provide a definitive conclusion, but an incremental insight into the big puzzle of where economies are headed.

Steaming ahead, but watch for meaningful signs of slowdown
Some market commentators may argue for investors to head to the exits in light of the late-stage economy as a recession is a matter of when not if. While we do not ignore this eventuality, it is a fine line between being too early and being wrong. In fact, those who took money off the table would have missed out on recent gains as the economy continues to be chugging along. As such, we remain invested while watching for meaningful signs of slowdown to adjust exposures.

Markets are facing a series of critical crossroads

Interest-rate policies

Late-cycle economies

US elections

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ELECTION UNCERTAINTIES

Unsurprisingly, the election of the world's largest economy has gotten investors contemplating the potential implications for their investment portfolios. This comes amid a tightly contested election between the two presidential candidates – Donald Trump and Kamala Harris. As of writing (6 Nov SGT), Trump has just beaten Harris to win the US presidency for a second time – removing a source of market uncertainty, but volatility is likely to remain as markets digest the implications of his win.

Markets have continued to grind higher over the past few months seemingly brushing off any election concerns. But we would also caution against assuming it will be smooth sailing ahead, given the backdrop of late-cycle economies and high valuations across markets globally.

The path ahead will be determined by the path of the economy rather than election outcomes. One of our favourite illustrations is the simple chart below which shows markets going up over time regardless of who is in the white house (shown at the bottom of this page). *'Over nearly 100 years of US presidential terms, stocks have consistently marched upwards'* illustrating the market's ability to go up as economies and companies grow. Of course, we know that markets do not go up in a straight line: investors encounter frequent light scratches, occasional bruises, and a hard knock (>20% declines) once every few years.

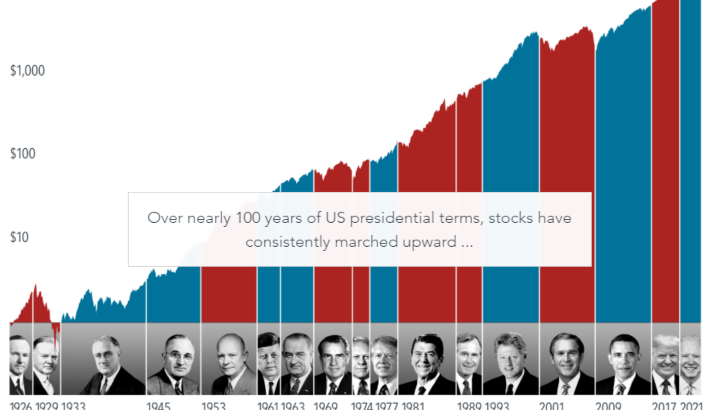
Looking back to history, market returns post-election can often be explained by the economic backdrop at the time rather than who ends up winning the election. Take for instance the election in 2020 or 2000.

<u>2020 election</u>: The last election took place against the backdrop of the COVID-19 pandemic. The pandemic and consequent recession dominated market sentiment. Notably, by the time the election came along in November 2020, there was good news from Pfizer on the effectiveness of covid-vaccines, which led markets to price in a recovery in the following months.

<u>2000 election</u>: A good example of a prolonged contested election; with a mere 327 votes separating George W. Bush and Al Gore. Unsurprisingly, markets were volatile. But this was also due to challenges in the economy – this period saw the popping of the 2000 dotcom bubble which caused a lot of pain for investors.

These are just two examples which show how the economy matters more for markets than election rhetoric which may cause short-term volatility but often nothing more. Today, the economy is chugging along with corporate earnings continuing to be supportive for further gains in the coming months.

Of course, it is worth assessing how certain policies could affect fundamentals. Trump's victory and likely republican sweep means that his pro-business policies are more likely to be implemented i.e. tax cuts and lighter regulations which could act as a tailwind for corporate earnings – this could be another source of optimism for markets in the near term. On the other hand, investors need to balance their optimism with the risk of global trade instability if Trump actively engages in trade tariffs, or if his policies lead to a resurgence in inflation.



Source: Dimensional

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CLEARER PATH TO SOFT LANDING?

Markets have made it past the historically weak September to October period without much fanfare. Even with the uncertainties that usually accompany the weeks leading up to the US election, markets seemed less interested this time compared to previous elections despite the race being so tight.

As discussed earlier, one reason is that the election coincided with the late-stage economic cycle which would matter more for markets than political rhetoric.

Hard, soft, or no landing?
Economic fundamentals ultimately assert themselves when it comes to the trajectory of markets.

The tricky thing is this is a highly dynamic situation. Just not too long ago, it was a toss-up between hard or soft landing as it was not clear if economies could handle the implications of interest rate hikes: the labour market was cooling quickly, and recession indicators like the 'Sahm rule' pointed towards an imminent recession. On the other hand, corporate earnings were still growing alongside resilient consumer data (we had discussed this back in our August commentary).

Rather than overreacting to one or two bad data points, we maintained a well-balanced positioning in our portfolios and benefitted from the higher-quality market recovery since then.

Base case: soft-landing supports upside
Indeed, the current data is pointing towards a base case soft landing in the US. The economy grew 2.8% in the third quarter of 2024, supported by consumption and employment data that have largely remained resilient. The outsized 0.5% rate cut by the Fed in September is another factor that has been supportive for markets (in this backdrop we are reminded of the phrase 'don't fight the Fed').

If the soft-landing narrative continues to gain momentum, expect risk assets such as equities to continue to do well. Fixed-income credit markets will also perform driven by coupons rather than capital gains. Either way, capital growth or income investors are expected to benefit – we continue to be positioned for further gains until our indicators tell us otherwise.

Watching out for deterioration in the data
The downside scenario is where the economy disappoints, with a confluence of data indicating a more protracted slowdown. This is a scenario that markets are not pricing in just yet. Should the data start to indicate a higher probability of a hard landing (recession!), we will make further portfolio adjustments to mitigate the downside – this is a lower probability scenario as of today.

Opportunities and shifts in markets
Our portfolios have been diversified across 'risk-on' equities complemented by more defensive healthcare. With continued supportive data, we expect to re-allocate from defensive to more 'risk-on' segments in the US.

At the same time, we are also looking out for tactical opportunities outside of the US. For instance, China may have left a bad taste in investors' mouths in the past two years but it may finally be 苦尽甘来 (in short; the hard times could soon be behind us).

While a Trump victory can cause near-term volatility and weakness in Chinese markets, there is also the possibility of more forceful stimulus out of China considering this election outcome. The ongoing National People's Congress is one to watch – indications of more meaningful stimulus on the fiscal side would be favourable for Emerging Market and China equities to do well. This can trigger a fresh round of buying into China assets and a potential capital rotation within Emerging Markets as investors warm up to the China story i.e. re-allocations from 'China plus one' markets like India or Vietnam back to China. We are watching closely how the situation develops and look to adjust portfolios accordingly.

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FINDING THE RIGHT INCOME

Income portfolios were more resilient during choppy equity markets.
While income markets were up less in September, they were also more resilient in October; providing a more comfortable investing journey for income investors. This is why it is important for investors to determine a suitable investment that matches *both* their objective and risk tolerance.

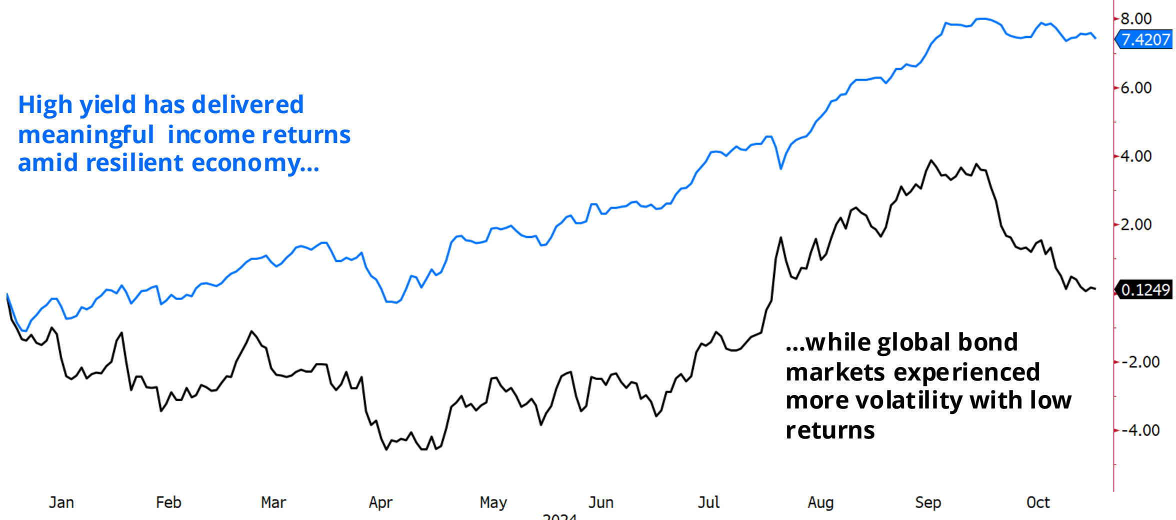
However, not all income investors had a comfortable journey. Those with heavier exposures to government bonds are probably rethinking their decision as the 'Global Aggregate' bond market (heavy in government bonds and investment grade) is barely up this year compared to 7.4% for high yield. Furthermore, the global aggregate has been more volatile, declining in October as rates markets reversed, while high-yield markets held up.

Not all income strategies are the same
Even if a little bird told us at the start of the year this was how markets would perform in Q4, we would not be surprised. The yield for the global aggregate was 3.5% at the start of the year, so being up low single digits at this time would be in line. High-yield markets with yields of 7.6% are also on track amid a backdrop of a resilient economy. With economies in late-stage and markets at crossroads, **picking the right bonds can continue to generate meaningful income returns.**

Where income investors should expect to extract returns
In the current environment, most returns are expected to be from income rather than capital appreciation. The chase for income has led to bond markets enjoying capital appreciation which has benefitted investors. However, this means less room for capital appreciation going forward. Hence, most of the return ahead will be coming from income. For investors seeking higher income, there are opportunities in higher-yielding markets, such as in Emerging Markets and Asia.

Return and risk are both sides of the coin.
It would be irresponsible to only talk about return and not the risk. High-income investors are rewarded with higher income because they are being compensated for taking high-yield risk. In the current environment of resilient economies, high-yield markets have continued to deliver.

The risk is a change in economic regime where we see a more meaningful slowdown. Markets will likely experience volatility and declines in this case. As we maintain diversified exposures in our income portfolios, we are confident that there would not be any material permanent capital loss in the portfolios. Furthermore, we remain alert to indicators that can inform us of the appropriate level of high-yield exposures to help mitigate the ensuing volatility.



Source: Bloomberg. Global bonds: Bloomberg Global Agg Index, High yield: Bloomberg US Corporate High Yield Bond Index

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HOW ARE WE POSITIONED?

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

Key Themes	Allocation
Positioning for Growth With the end of the rate tightening cycle and economies continuing to grow; there is a window of opportunity for capital appreciation in equity markets. Maintain a preference for higher-quality segments that offer growth potential while being more resilient in the event of slowdown.	**US 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.	**Emerging Market equities** (e.g. China, India, Vietnam)
Late Cycle Stability The effects of high interest rates are still working its way through the economy. 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 figure 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

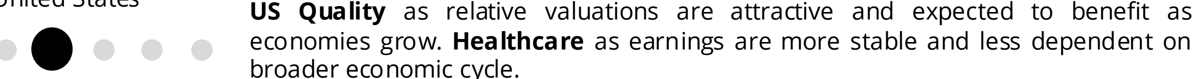
United States

US Quality as relative valuations are attractive and expected to benefit as economies grow. **Healthcare** as earnings are more stable and less dependent on broader economic cycle.

Europe

Europe's pro-cyclical industrial base to benefit from economic growth so long as severe recession is not on the cards.

Japan



Maintaining no exposure as continued Japanese equity performance needs JPY to weaken further whereas both BoJ and Fed policies point to a stronger JPY.

Asia Pacific ex Japan

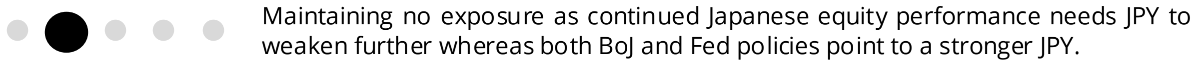
Recent stimulus measures announced by the Chinese government provides better tailwinds for Asia to catch-up. Participate in Asia and China via broader exposure to Emerging Market.

Emerging Markets

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

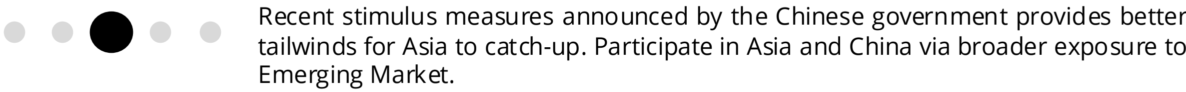
Fixed Income

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	-2.21	16.45	9.64	8.67
United States	-0.92	20.96	12.99	10.57
Europe	-5.70	6.86	6.17	6.67
Japan	-4.18	7.65	6.47	4.90
Asia Pacific ex Japan	-4.97	13.98	4.66	7.57
Emerging Markets	-4.32	12.11	3.82	7.30

Equity Markets	MTD	YTD	10Y	20Y
Australia	-6.59	7.58	6.62	9.19
Brazil	-7.37	-18.80	0.13	5.24
China "A"	-4.37	16.39	5.18	9.71
China "H"	-3.33	31.46	-0.29	5.85
Hong Kong	-3.92	24.81	1.86	5.86
India	-6.05	10.12	8.97	12.16
Indonesia	-2.66	5.24	3.96	11.27
Korea	-5.85	-8.79	2.17	6.59
Malaysia	-8.39	19.98	-0.70	6.28
Singapore	-3.62	15.03	4.62	7.61
Taiwan	1.54	24.39	13.26	11.39
Thailand	-3.18	8.10	1.98	9.17
Vietnam	-4.54	9.16	8.24	8.95

Equity Sectors	MTD	YTD	10Y	20Y
Gold	1.42	30.26	10.12	3.29
Energy	0.79	9.22	4.33	7.56
Technology	-1.27	25.57	19.92	13.95
Healthcare	-4.80	9.07	8.70	9.76
Financials	2.69	25.17	11.37	5.75

Fixed Income	MTD	YTD	10Y	20Y
Global Aggregate	-3.35	0.12	0.23	2.16
Global Aggregate (H)	-1.35	2.97	2.12	3.37
High Yield	-0.70	6.93	4.36	6.29
Asia	-1.48	4.26	3.01	3.21
Emerging Markets	-1.37	6.68	2.91	5.66

Note: (H) Currency Hedged

Currencies	MTD	YTD	10Y	20Y
SGD/USD	-2.63	0.04	-0.25	1.16
EUR/USD	-2.25	-1.40	-1.39	-0.81
JPY/USD	-5.52	-7.22	-2.98	-1.80

Commodities	MTD	YTD	10Y	20Y
Gold	4.15	33.01	8.87	9.73
Oil	1.60	-3.34	-1.50	1.47

*As of 30 Oct 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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