Quarterly Investment Strategy
Third Quarter 2019

A tipping point

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Investment Strategy

After a strong rally in the first quarter, markets faced a "fork in the road", and assessed if global growth could stabilise or run the risk of weakening further to more dangerous levels. In the early part of the second quarter, global growth data improved and signs were pointing toward the more attractive "fork". However, by May 2019, trade tensions between the US and China had escalated and global growth trends appeared to weaken further for both China and the US. While it is still possible that global trends stabilise over the course of the year, the level of uncertainties have increased and justifies further caution in our investment positioning.

We have trimmed our equity positioning to underweight from neutral and raised the fixed income allocation to overweight from neutral. A world of slower growth implies growing risks from rising interest rates and increased odds of interest rate cuts from central banks. With the uncertainties, income strategies look more attractive. We have also neutralised the positions in alternatives and commodities.

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Global Asset Allocation

Sector Allocation	View	Notes
Equities	–	**Rationale:** Growth continues to moderate and trade tensions have further added to uncertainties. **Risks:** There are upside risks to equities if global supply chains prove to be resilient and growth holds up well despite trade conflicts.
Fixed Income	+	**Rationale:** Markets are expecting interest rate cuts and the environment is benign for fixed income. In a quarter with many uncertainties, fixed income looks safer. **Risks:** Growth and inflation still have the potential to surprise markets but those risks seem quite remote at this stage.
Commodities	■	**Rationale:** Gold and precious metals provide a healthy hedge. However, other commodities may suffer as the growth outlook is called into question. **Risks:** USD strength could continue and put pressure on commodities.
Alternatives	■	**Rationale:** Equity and fixed income trends have been lacklustre which give alternatives room to achieve returns on lower volatility. **Risks:** Extreme market volatility and market movements outside of individual company performance.
Cash	–	**Rationale:** Cash outlook is stable in a questionable environment, but we prefer to direct the allocation weights to high quality bonds that we think will perform better. **Risks:** Cash rates are rising and market weakness could make it more attractive to overweight cash at some point.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

While we don't think the environment is pointing towards at a major downturn or crisis, we do think risks are rising. As uncertainties mount in a slower growth environment, we prefer to overweight fixed income as the asset class will be much better sheltered if the US-China trade tensions dent the growth outlook further. We underweight equities and shift the equity focus to developed markets over emerging markets with their high exposure to trade exports. We neutralise alternatives, commodities and underweight cash.

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Global Investment Strategy

A tipping point

There have been so many changing issues in 2019 which left many investors confused over the key the issues driving asset prices.

We think the best and most basic framework to think of global markets over the past six months is that the global economy was being driven by issues relating to the maturing economic cycle. The global expansion had continued for over a decade leading to the longest current expansion on record. As the cycle matured, central banks including the US Federal Reserve (Fed) were eager to normalise rates. By the end of 2018, there were significant fears that growth was slowing and that the Fed was hiking rates too aggressively. However in 2019, when the Fed stopped hiking rates and the economic environment looked more moderate than recessionary, investors reversed the panic selling in the early part of 2019.

Even as the global economic cycle was mature, growth appeared to continue at low levels and while trade tensions are growth negative, these should not trigger significant growth problems and both stocks and bonds could give reasonable returns.

"However, the conflict between the US and China could become a tipping point issue amid a slowing global economy."

The assessment of the trade risks into two parts. Firstly, we try to estimate the risks of a prolonged and escalating trade conflict against the odds of a near-term trade agreement. While in April, all reports were that the US and China were near a significant new trade deal. By early May, the talks had fallen apart and the US quickly escalated matters by raising tariffs to 25% from the 10% implemented in 2018. While it is still in the interest of both sides to come to an agreement, our assessment is that we do not expect a near-term resolution. We remain concerned that the conflict does not align with specific issues that can be resolved. Neither side has left itself much room for negotiation with the US President, in particular, giving a "take-it-or-leave-it ultimatum". It is hard to see what compromise will be acceptable to either side.

The second part of the assessment of the trade risks rests on quantifying the potential economic impact of a prolonged trade conflict. The consensus of global economists appears that the US economy is at risk of losing 0.5% of its gross domestic product (GDP) growth and the China economy is at risk of losing 1% of its GDP growth. To date, economists lack clear examples of this type of conflict at this scale and there is a large margin of error on the estimates where growth could bear up fairly well or deteriorate more sharply. As investors, we have to accept a substantial amount of uncertainty regarding the economic impact of trade tensions.

In an environment of moderate and slowing global growth with rising uncertainties, we think the outlook for fixed income becomes increasingly attractive and the outlook for equities becomes more uncertain. The rate of further interest rate hikes has declined even more and the outlook is pointing more toward rate cuts that would serve to boost fixed income markets. Within equities, we expect the trade conflicts to be negative for emerging markets that are more trade dependent. We thus overweight developed market equities and underweight emerging market equities. Within fixed income markets we lean toward longer duration portfolios with a focus on solid investment grade bonds.

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US Equity

Country Allocation	View	Notes
US	+	**Rationale:** Trade wars are likely to hurt consumers and overall GDP growth. However, relative to other countries and especially relative to emerging markets that are trade-dependent, we would expect the US economy to be more resilient. **Risks:** US policy is increasingly risky on many fronts including raising conflict with Mexico and India in addition to warnings on Singapore as a currency manipulator. Tensions with Iran have been increasing and N. Korea has been testing missiles again.

Summary

Valuations that have been higher than other regions but these are justified with the strong return on equity on US companies.

Europe Equity

Country Allocation	View	Notes
Europe Equity	–	**Rationale:** Economic trends deteriorated in Europe in 2018 and have not meaningfully improved in 2019. But expectations are low and other regions like emerging markets are more likely to take the first hits from trade, especially in their currencies. **Risks:** The Brexit process remains uncertain, and European politics continues to look fragile in places like Italy.

Summary

Much of the growth disappointment in Europe has largely been priced into markets, and with rising trade tensions between the US and China, we expect that Europe can perform at levels that are neutral compared to the global index.

Japan

Country Allocation	View	Notes
Japan Equity	■	**Rationale:** Valuations are attractive (at a discount to developed market peers US, UK) but below-trend GDP growth is vulnerable to downside risks arising from the re-escalation in US-China trade tensions given the economy's high leverage to global industrial production. **Risks:** Deterioration in US/Japan trade negotiations, improvement in US-China trade relations, sharp appreciation in the yen.

Summary

Japan equity valuations are attractive against the developed markets, however, GDP growth is vulnerable to downside risks arising from the re-escalation in US-China trade tensions given the economy's high leverage to global industrial production.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

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Asia Ex-Japan Equity

Country Allocation	View	Notes
China	-	**Rationale:** Risk of valuation de-rating and earnings cut due to a re-escalation of US-China economic war. Manufacturing activity has slowed while fiscal and monetary easing measures can only have a partially offsetting effect. **Risks:** Status quo or de-escalation in US-China trade tensions, stronger-than-expected domestic economic data and earnings in 2H2019.
Hong Kong	+	**Rationale:** Dovish interest rate outlook, recovery in property transactions. Office rentals remain resilient. HKD is a safe haven among Asian currencies as the USD remains strong amidst rising risk aversion. **Risks:** Weaker tourism spending from the mainland alongside RMB depreciation amidst heightened US-China tensions. Stretched affordability with residential housing.
India	+	**Rationale:** Valuations are not cheap but inflationary pressures are stabilising. A strong return of the National Democratic Alliance should facilitate structural economic reforms, whilst the fiscal budget deficit should boost domestic consumption. **Risks:** Weak INR with further downside if the USD continues to strengthen on risk aversion. Negative foreign fund flows.
Indonesia	+	**Rationale:** Valuations have turned more attractive post recent market correction whilst the re-election of President Jokowi has removed political overhang. Relative outperformer amidst US-China trade war and global tech supply chain disruption given low exposure to tech and Asian trade flow. **Risks:** Sharp slowdown in domestic economy, elevated current account deficit, further IDR weakness.
Malaysia	-	**Rationale:** Valuation broadly fair and earnings revision cuts have been more acute vs peers. Revival in mega projects against a tough economic backdrop is likely to limit upsides to GDP growth. **Risks:** Sharp spike in oil prices could strengthen MYR and boost the market.
Philippines	-	**Rationale:** Inflation headwinds fading but the government's aggressive infrastructure roll-out, persistent current account deficit and deterioration of fiscal balance are likely to weigh on the Peso. **Risks:** Continued healthy domestic demand. A reversal in USD strength could support the peso and the market.

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Singapore	+	**Rationale:** Slowdown in 1Q 2019 GDP growth has been largely discounted and valuation is attractive. Government has fiscal flexibility to support growth. SGD is relatively resilient among Asian currencies. **Risks:** Adverse slowdown in GDP due to escalation in US-China trade tensions, quicker Fed rate hikes.
South Korea	-	**Rationale:** Headwinds to corporate earnings have increased given risks of delay in 5G rollout and slowdown in tech demand caused by re-escalation in US-China tensions. Non-tech sectors such as tourism/duty-free sales are also vulnerable to a deterioration of relations with China. **Risks:** De-escalation in US-China trade relations, improved Korea/China trade relations, semiconductor memory prices and demand stabilising.
Taiwan	-	**Rationale:** Most vulnerable to escalation in US-China trade tensions and disruption to global technology supply chain. Increased downside risks to exporters with production facilities in China in the long run from potential tariff expansion by the US on China made products. **Risks:** De-escalation in US-China trade tensions, stronger than expected recovery in smartphone sales, success of Apple new launch sales.
Thailand	■	**Rationale:** Near term weakness from slowing exports growth but government's stimulus measures in 2H 2019 could drive moderate upside for Thai stocks. **Risks:** Weaker than expected regional exports, sharp decline in oil price, delays in government infrastructure investments.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

The re-escalation in US-China trade tensions and deterioration in macro fundamentals has caused a sharp reversal in the Asian equity market recovery. An imposition to tariffs have already resulted in a decline in global capital goods demand and led to a slowdown in regional exports. The US embargo on Huawei and other Chinese companies and consequent retaliation by China threatens to further disrupt global technology supply chains and exacerbate the slowdown.

Asian equity market valuations have de-rated following this turn of events, trading below its 18-year historical mean on a price-to-earnings basis and at one standard deviation below mean on a price-to-book basis. However, markets could see another leg down on corporate earnings downgrades as the global economy absorbs the full impact of US-China tariff actions and disruption of supply chains.

Any prospects of any US-China trade resolution look dim in the near term. We are aware of the downside risks and have switched to a defensive portfolio positioning in an absence of any clear catalysts. Hence, we now favour countries with lower exposure to global trade namely India and South-East Asia. We are also underweight cyclical sectors and overweight more defensive sectors e.g. healthcare, utilities.

The key downside risks to our bearish view include an improvement in US-China trade relations or a trade truce. However, we assign this outcome a low probability in the near term. We believe the US and China economies and markets likely have to go through more pain before both sides are pushed to come to the negotiating table again and reach a resolution.

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Global Fixed Income Strategy

Sector Allocation	View	Notes
Developed Market (DM)	■	**Rationale:** Should trade war tensions continue, there could still be value in central DM fixed income sectors. However, we prefer defensive positioning in low beta names insulated from the trade war. **Risks:** DM credit spreads could widen significantly should the Trump administration continue to run a trade war on multiple fronts, especially against certain DM nations.
DM Government	–	**Rationale:** Overbought metrics are now showing up in most DM sovereign bonds and we would be wary of chasing the market in an environment where events can turn sharply. **Risks:** Even as DM bond yields hit all-time lows, we cannot rule out them from moving lower.
DM Credit	■	**Rationale:** Our stance on DM investment grade is now on overweight from neutral for defensive positioning; however, sector and credit selection in view of the impact of the ongoing trade war is key to outperformance. **Risks:** Merger and acquisition activities that will see spreads moving wider.
Emerging Market (EM)	+	**Rationale:** Dovish stance across global central banks should support EM bonds, while expected Chinese stimulus may provide potential upside with positive spill over effects. Despite US-China trade tensions, EM bonds have remained resilient and valuations are still attractive relative to US high yield bonds. Favourable bond supply and strong underlying sovereign fundamentals are likely to re-assert themselves year-end. **Risks:** Protectionist measures, further US-China trade escalation, rapid FX depreciation, Chinese deleveraging, inflation surprises, and geopolitical risks.
EM Government	+	**Rationale:** Generally dovish tone from central banks, with rate cuts seen from India, Philippines and Malaysia this year. High oil prices are expected to remain from Iran sanctions, reduced supply of Venezuela and compliance of supply cuts by OPEC. **Risks:** Sensitivity to sharp commodity price declines and/or sharply higher USD funding costs and rapid FX depreciation. Risks such as an escalating trade war, geopolitical and political events would particularly impact manufacturing exporters negatively.
EM Corporate	■	**Rationale:** Credit fundamentals continued to remain stable, with lower leverage compared to its US counterparts. Overall, EM corporate credit is trading fair to EM sovereigns and quasi-sovereigns. **Risks:** Protectionist US trade policies, EM political risks, geopolitical risks. A potential recovery in the capital expenditure or mergers and acquisitions cycle would be cash flow negative.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

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Sector Allocation	View	Notes
EM Local Currency	■	**Rationale:** Given that EM local currencies' performance has lagged hard currencies' returns in the face of USD strength, valuations look attractive. **Risks:** Continued USD strength, trade war escalation, and EM slowdown.
Duration	+	**Rationale:** The market is too aggressive on the short end in terms of rate cuts and we would still prefer being long duration, especially on dips in the long end. **Risks:** There has been talk of rate cuts from the Fed and while we do not expect them to materialise in 2019, a strong dovish tilt could see the short end outperforming.
Yield Curve	-	**Rationale:** Any steepening of yields curve is unlikely to last as the market still holds a fundamental view that the yield curve will eventually flatten. **Risks:** Risk appetite could remain in a big way if trade tensions be resolved and the yield curve could steepen again.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

With escalating threats of a trade war in the background, we would shift toward defensive carry, and move away from sectors that are sensitive to trade including technology and automobiles. The preference will be toward utilities and domestic consumption names. Hence, we also like investment grade credits across the developed markets, emerging markets and Asia, and we try to avoid developed market sovereigns due to overbought metrics.

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Regional Allocation	View	Notes
Latin America	■	**Rationale:** Progress in pension reform in Brazil is encouraging, though we are wary of watered down reform being passed. Macro fundamentals in the region are still solid but we remain mindful of the policy uncertainty, especially from Mexico. Stronger external balance sheets and somewhat better starting points on inflation should insulate most Latin American countries better against a potential adverse external environment. **Risks:** Policy direction could shift, raising medium-term risks to growth.
CIS/EE*	■	**Rationale:** Excluding potential US sanction risks, Russia's external vulnerability remains low given its conservative central bank, a fiscal rule and twin surpluses. In Poland, growth is projected to increase while fiscal outlook will remain positive, buoyed by robust economic growth and a tighter tax system. However, Turkey is a source of concern with its low FX reserves and continued erosion of institutional strength. **Risks:** Risk of further sanctions on Russia. Liquidity and solvency risk from Turkish banks.
Middle East/Africa	+	**Rationale:** After the expected victory of the ruling African National Congress party and announcement of the cabinet, South Africa's political situation has largely stabilised. However, risks from delays in key reforms' timelines and state-owned utility Eskom's mounting debt levels remain a potential growth detractor. Meanwhile, we are constructive on countries in the Gulf Cooperation Council given their pegged currencies and limited exposure to trade wars, in addition to a still-healthy oil price backdrop. **Risks:** Weakening oil prices would adversely impact fiscal budgets. However Middle Eastern sovereigns have the lowest debt to GDP ratios and strong access to capital markets.
Asia	–	**Rationale:** Focus will be on trade wars which are expected to drag on global macroeconomic and corporate earnings. Direct impact likely limited for Asia credit debt issuers while market performance remains driven by risk sentiment. Moreover, reduced pricing attractiveness after recent sharp rally suggests some consolidation. Nevertheless, committed efforts from global central banks to provide support for economy will help offset some of the negativities. **Risks:** Trade tussles are likely to be a prolonged episode as differences remain challenging to resolve. Political instability in other countries have also been an increasing threat and will dampen risk appetite.
Singapore	■	**Rationale:** Outlook on growth and inflation might be downgraded but fundamentals should be strong enough to withstand ongoing trade tussles. **Risks:** Being an open economy, an escalation of trade rhetoric might inevitably have a negative impact on Singapore, especially if the Trump administration extends the trade war on multiple fronts.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

* Commonwealth of Independent States and Central and Eastern Europe

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FX Allocation	View	Notes
US Dollar **US$**	■	**Rationale:** If rate cuts are on the table, the USD is a sell against other majors by virtue of the fact that the Fed has more room to cut vs other central banks. **Risks:** An expansion of trade rhetoric against other trading partners is not out of the question.
Euro **€**	■	**Rationale:** Euro might be facing a multitude of headwinds including widening spreads. However, it should still outperform other relatively high beta currencies due to its status as a funding currency. **Risks:** President Trump could start a new trade war with Europe which could see the Euro being sold off.
Japanese Yen **¥**	++	**Rationale:** JPY remains steadfastly the safe haven of choice during risk-off episodes, and should continue to see demand on trade war tensions. **Risks:** The Bank of Japan could ease in the face of JPY strength, though its options are severely limited.
Singapore Dollar **S$**	■	**Rationale:** SGD should outperform as the safe haven amongst EM currencies and eke out further gains even as monetary policy remains neutral against other central banks which are putting rate cuts on the table. **Risks:** Risk of a global negative shock remains and emerging market currencies could sell-off.
China Renminbi **CNY**	–	**Rationale:** An eventual break of 7.00 in USDCNY is not totally unrealistic should there be no resolution in trade tensions. **Risks:** US and China could yet come to a peaceful resolution and USDCNY could fall back to the 6.7 level again.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

We may need to reassess certain orthodox view such as the status of the US dollar as a perpetual safe haven. The US dollar had not been performing as it should during risk-off episodes, which was why we are neutral on the US dollar instead of turning bullish in view of escalating trade tensions. We are more comfortable staying defensive with the low yielders, though idiosyncratic risks remain.

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Sector Allocation	View	Notes
Commodities	■	**Rationale:** The energy outlook is somewhat subdued as demand slows and hostilities between the US and Iran pose a risk of disrupting oil supply. **Risks:** The expectations for a better China outlook appear to be deteriorating as data has disappointed in the past month.
Gold	+	**Rationale:** The current Fed monetary policy is positive for gold and any further rate cuts will be positive. Additionally, we see continued EM central bank reserves increasingly holding more gold. **Risks:** The trade sanctions could result in higher US-led inflation which could put upward pressure on benchmark yields which in turn makes gold less attractive.
Energy	■	**Rationale:** Weaker global growth is hurting the outlook for energy, but tensions with Iran is constraining supply which helps put a floor on the price of energy. **Risks:** Trade wars could significantly disrupt supply chains and weaken demand for metals that are tied to industrial growth.
Others	-	**Rationale:** The outlook for bulk and other base metals was improving earlier in the year when China growth appeared to be improving in 1Q19. However, the latest macro growth data from China is more questionable and trade conflicts increase uncertainties. **Risks:** There are upside risks for many commodities if China seeks to support growth with significant stimulus programs that are focused on property. Such projects would be supportive of most bulk and metal commodities.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

We are neutral on commodities largely due to gold being uncorrelated with other growth assets. Other commodities such as energy, metals and bulk commodities are likely to be adversely affected by slowing China growth and trade tensions.

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Sector Allocation	View	Notes
Hedge Funds	+	**Rationale:** Concerns about global economic growth, on-going US-China trade dispute, US-Iran tension and Brexit are unlikely to be resolved in the near term. **Risks:** A broad-based market rally may occur if trade talks reach a positive conclusion or the Chinese government introduces more stimulus to spur economic growth. This may lessen the attractiveness of hedged strategies.
Private Equity	+	**Rationale:** Many fast growing companies with disruptive business models are private and are benefitting from long-term trends. These include technology companies targeting a wide range of industries and growth companies in emerging countries such as Indonesia and Vietnam. These companies have superior growth and can provide superior returns with low correlation to the equity markets to enhance a portfolio's risk-return profile and diversification. **Risks:** Valuations are not cheap after a prolonged period of inflows amid abundant liquidity although this is in the process of correcting and more effort and greater discipline will be required to find attractively priced opportunities.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

More investors are increasing allocation into alternative assets as investors recognise its importance as building blocks to enhance return and reduce risk in a multi-asset portfolio. By diversifying sources of potential investment return, hedge funds can improve risk-adjusted returns for investors who can tolerate moderate illiquidity. An important factor in creating excess return is the selection of best-in-class, hard-to-access fund managers. The proven ability of hedge fund managers to generate uncorrelated alpha through up and down markets is highly valuable.

The private equity (PE) sector today is better prepared in times of stress than it was before the financial crisis. PE fund managers are not rushing to deploy capital - they have been doing smaller deals at a slower pace. Over time, PE markets have outperformed public markets. Unlike investments in traditional asset classes, the commitment to PE is gradually drawn over the investment period, allowing managers more time and control to implement value-creation strategies.

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