Quarterly Investment Insights

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1 Minute Digest

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- Headline and core inflation remain stubbornly high in most major economies. Sticky inflation forces central banks to tighten policy to the point where a hard landing becomes increasingly likely in 2023, given the lags in the transmission channels of policy signals. Even though headline inflation has shown signs of peaking, underlying measures of core inflation have yet to slow down to a point that the Fed could consider lowering the pace of rate hikes. In addition to the fear of recession, the higher rates differential is benefiting the dollar - the global currency for most international transactions and in turn causing economic commotion in ex-US economies.

- In this challenging macro environment, we are very cautious in the positioning across our multi-asset portfolios and have significantly reduced risk levels. Since June, we have increased our allocation to cash as it is now generating meaningful risk-adjusted return. We have also put in place a tactical exposure to Asia Ex-Japan equities in our Elite portfolios, primarily on the defensiveness provided by the undemanding valuation of Chinese equities, while continuing to stay diversified with increased allocation towards Investment Grade bonds.

OUTLOOK & POSITIONING

The global economic outlook continued to deteriorate as the rebuilding of inventories reached unsustainable levels and end demand continues to be dampened by high inflation, tight fiscal policies and deteriorating financial conditions. Look ahead, the shift in consumer demand from goods to services and the peak in the electronic cycle is expected to impact Asia ex Japan exporters in the second half of 2022 and the first half of 2023. Softer industrial production globally and weak construction activity, in US and China specifically, are undermining commodity prices, even though European efforts to diversify their supply of natural gas ahead of the winter season is pushing LNG prices to higher levels.

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With risk of recession rising, credit spreads widened, pushing corporate bond prices lower alongside equities. The S&P 500 index fell 9.3% in September, setting off its worst month since March 2020. Performance is even worse outside of the US, MSCI ACWI ex-US dropped by 10.3% in September. Within bond markets, the Bloomberg Barclays Global Aggregate Bond index lost 5.1% for the month.

We expect corporate earnings to decline further due to strong inflationary pressures and falling margins – i.e., lower disposable income for consumers and higher input costs for businesses. At the same time, the Fed's aggressive pivot will continue to push rates higher, and credit spreads wider, driving up the borrowing costs of companies. Further equity downside ahead will be driven both by falling corporate earnings expectation, as well as more valuation derating from higher discount rates.

In this challenging macro environment, we are very cautious in the positioning across our multi-asset portfolios and have significantly reduced risk levels. Since June, we have increased our allocation to cash as it is now generating meaningful risk-adjusted return. We put in place a tactical exposure to Asia Ex-Japan equities in our Elite portfolios, primarily on the defensiveness provided by the undemanding valuation of Chinese equities (MSCI China 12-month forward PE at 9x vs S&P 500 of 17x), while continuing to stay diversified, adopting a more defensive tilt, with increased allocation towards Investment Grade bonds.

Policy Actions

Most major central banks are expected to continue to hike rates aggressively. With inflation running at its fastest pace in more than 40 years, our view is that the Federal Reserve officials are willing to push the economy over the edge into recession in order to tame inflation. The implication is a "very restrictive" policy stance for longer, pushing real rates sustainably above 1.5%, thereby forcing tighter financial conditions and driving equity valuations to contract in the short term. The Fed hiked 75bps in September to reach 3% and with an apparent commitment to raise the rate to about 4.50%-4.75% by end 1Q 2023 - well above the neutral rate as implied in the last dot plot. In the recent update from Chairman Powell, the Fed is still committed to using its tools to bring high inflation back in line with its target of 2% and keep long-term expectations steady, but that may take longer than expected and will be at the expense of the labour market. The dollar has also been strong in recent months, buoyed by the positive carry, and investors seeking the safe haven of dollar assets in times of recession fear.

In Europe, the European Central Bank has delivered another 75bps in October to tame inflation, with more to come at the upcoming meetings. The central bank also highlighted that it has now made "substantial progress in withdrawing monetary policy accommodation". The euro has tumbled more than 14% against the US dollar year-to-date as the economic outlook in Europe has deteriorated significantly. As a consequence, imports are more expensive for eurozone countries, especially goods priced in dollars such as crude oil. This could in turn contribute to even higher inflation in the eurozone, which has hit a new record high of 10% in September.

Across Asia, central banks in the region accelerated their rate hikes as FX reserves fell. We expect more hikes to come as the Fed is heading to 4.25% by year end. The BSP of Philippines and the Reserve Bank of India have become the most hawkish central banks in the region, raising their policy interest rates by 225 and 190 basis points respectively, so far this year. The Philippine peso and the Indian rupee, hit all-time lows against the dollar. In contrast, China's PBoC is far from hiking rates amid the weak economic momentum. The increasing rates differential vs the US has nevertheless prompted the central bank to pause monetary easing and keep the key rates unchanged. Given the diverging US China monetary policy trajectories and the uncertainty of its economic outlook, centred around the property market, economists have been downgrading their growth forecasts to levels below the government's target of 5.5%. Unclear direction of zero-covid policy adds further risk of crippling the country's outlook.

Being tactical

For this quarter, we expect higher rates volatility and weaker price performance to continue in the fixed income space as the major central banks are calibrating between preserving growth momentum versus taming inflation. That said, we are also evaluating the merit of building positions into long duration bonds, even though we have not seen the smoking gun to indicate US rates have peaked and started to roll over. We reckon the opportunity to start building positions is approaching.

For now, fixed income allocation has the following focus,

- We are cautious on credit and hold a neutral position. Credit spreads are looking increasingly unattractive after the recent rally in the context of a potential hard landing where we expect default rates to push higher. We underweight US credits as its spread widen further amid economic slowdown and worsening corporate news flow. Bond yields are rising broadly across credit ratings, with borrowing costs already rising to the highest levels in a decade or more, resulting in increasing pressure on corporates.
- Retain preference for Asian credit over US credit as the Asia ex-Japan region should be more resilient given the spread premium over the US has widened again lately, adding to its attractiveness. Within the region, we prefer shorter duration Asian credit for now.

We remained underweight equities as the risk of hard-landing recession increases. Aggressive policy tightening in the face of sticky inflation has made recession in the US a near-certainty while Europe is likely already in recession. With weaker macro conditions worsening corporate fundamentals, analysts' earnings expectations remain too optimistic and should continue to adjust downward. Outlook on both earnings and valuations is pessimistic, and hence being underweight in equities while setting aside allocation to cash will be our preference for defensiveness for the time being.

Within equities, we maintain a neutral view to Asian Ex-Japan equities. Chinese equity outlook remains murky, given the political and economic uncertainties. However, ongoing policy easing, and low Chinese valuations (MSCI China 12-month forward PE at 9x) should limit downside and lend some defensiveness to Asian Ex-Japan as a region.

Thinking ahead

It's far from smooth sailing from here with heightened risks stemmed from the deteriorating growth outlook, prolonged Russia-Ukraine war, monetary policy tightening, high commodities prices and stickier inflation prints. We expect volatility to stay elevated across asset markets in 2022

Keeping in mind our investment propositions of Stewardship, Long-term and Global Expertise, the investment teams of our sub managers are looking to find the winners and losers for the next cycle. The focus remains on recognizing the regions, industries and trends that would build the next generation of companies. We have included their perspectives in the newsletter.

This all fits with our goal to provide stewardship through a long-term approach – which we hope you benefit from these quarterly newsletters.

PORTFOLIO PERFORMANCE

Our investments are all made with long-term outlook and opportunities in mind, portfolios performance is expected to deliver consistent positive returns on a long-term basis and since inception.

In the short term, the portfolios could potentially underperform their benchmark due to market volatility as was the case with concerns over the high inflation, tight fiscal policies and deteriorating financial economic. In such a period, it is inevitable to see dislocation between prices and fundamentals.

A summary of absolute and relative portfolio performances is set out below.

Absolute Performance		Q3 - 22	1 Year	2 Year*	3 Year*	Since Inception*
SGD Funds	AIA Elite Adventurous Fund [1]	-3.96%	-23.01%	-3.13%	5.13%	4.22%
	AIA Elite Balanced Fund [2]	-3.67%	-21.15%	-4.93%	1.86%	0.78%
	AIA Elite Conservative Fund [3]	-3.33%	-19.56%	-7.10%	-1.29%	-1.35%
USD Funds	AIA Elite Adventurous Fund [4]	-5.85%	-25.55%	-4.61%	4.96%	3.31%
	AIA Elite Balanced Fund [5]	-5.53%	-23.47%	-6.01%	2.97%	1.85%
	AIA Elite Conservative Fund [6]	-5.49%	-22.45%	-8.60%	-	-2.61%

Relative to Benchmark Performance		Q3 - 22	1 Year	2 Year*	3 Year*	Since Inception*
SGD Funds	AIA Elite Adventurous Fund [1]	-0.67%	-7.83%	-6.19%	0.18%	-0.63%
	AIA Elite Balanced Fund [2]	-0.32%	-5.53%	-4.20%	-0.32%	-1.63%
	AIA Elite Conservative Fund [3]	0.11%	-3.38%	-2.58%	-0.60%	-1.28%
USD Funds	AIA Elite Adventurous Fund [4]	0.35%	-5.80%	-5.13%	1.29%	-0.09%
	AIA Elite Balanced Fund [5]	0.73%	-3.29%	-2.84%	2.04%	0.92%
	AIA Elite Conservative Fund [6]	0.85%	-1.75%	-1.73%	-	0.55%

Source: AIA Singapore
**Performance figures for a period greater than a year are annualised*
Performance of the funds are in SGD on a bid to bid basis with net dividends reinvested, without taking into consideration the fees and charges payable through
deduction of premium or cancellation of units
[1] [4]: Current benchmark is 90% MSCI World Total Net Return Index and 10% Bloomberg Barclays Global Aggregate Corporate Total Return Index
[2] [5]: Current benchmark is 60% MSCI World Total Net Return Index and 40% Bloomberg Barclays Global Aggregate Corporate Total Return Index
[3] [6]: Current benchmark is 30% MSCI World Total Net Return Index and 70% Bloomberg Barclays Global Aggregate Corporate Total Return Index
Fund inception date: [1] 24/7/2019; [2] 25/7/2019; [3] 1/8/2019; [4] 20/7/2019; [5] 31/7/2019; [6] 20/12/2019

Past performance is not necessarily indicative of future performance

Underlying Fund Allocation

There is a growing risk that the global economy should continue to slow while the US economy could slip into a recession as central banks continue to tighten with major drags on economic activity. Corporate earnings expectations remain too optimistic and have started and should continue to fall, adding to downside risk. Elite portfolios have put in place a tactical exposure to Asia Ex-Japan equities on the back of the reopening of ASEAN economies as well as ongoing policy easing and low valuations of Chinese stocks.

In terms of Fund allocation, we reduced our exposure AIA Global Quality Growth and AIA Global Select Equity Fund and added to AIA Global Multi-Factor Equity fund given its exposure to low beta and dividend styles. The fund 's risk-controlled profile serves to offer downside protection in periods of bear market shocks. We continue to monitor the portfolios and make the necessary adjustments as needed to best position the Fund to capitalize on opportunities ahead.

Fund Allocation as of 30 September 2022

SGD Funds		AIA Elite Adventurous Fund	AIA Elite Balanced Fund	AIA Elite Conservative Fund
Equity	AIA Asia (Ex Japan) Equity Fund	1.00%	1.00%	0.99%
	AIA Global Multi-Factor Equity Fund	25.51%	16.69%	7.72%
	AIA Global Quality Growth Fund	4.27%	2.76%	1.27%
	AIA Global Select Equity Fund	12.82%	8.17%	3.85%
	AIA New Multinationals Fund	42.97%	27.96%	12.95%
Fixed Income	AIA Diversified Fixed Income Fund	13.15%	42.75%	71.73%
Cash	Cash*	0.28%	0.67%	1.49%
	TOTAL		**100%**	

USD Funds		AIA Elite Adventurous Fund	AIA Elite Balanced Fund	AIA Elite Conservative Fund
Equity	AIA Asia (Ex Japan) Equity Fund	0.99%	1.00%	0.99%
	AIA Global Multi-Factor Equity Fund	25.04%	16.63%	7.76%
	AIA Global Quality Growth Fund	4.2%	2.76%	1.28%
	AIA Global Select Equity Fund	12.6%	8.16%	3.87%
	AIA New Multinationals Fund	42.19%	27.88%	13.02%
Fixed Income	AIA Diversified Fixed Income Fund	12.91%	42.63%	72.15%
Cash	Cash*	2.07%	0.94%	0.93%
	TOTAL		**100%**	

Note:
1. *Fund Allocation Totals would not add up due to rounding*
2. ** Cash includes derivatives*

 

INSIGHTS: 60 SECONDS WITH…

Wellington Management's Yolanda Courtines *and* ***Mark Mandel,*** *co-managers of AIA New Multinationals Fund, share their views on generating returns by investing in companies that are well-placed to deliver value over the long term.*

Both equity and fixed income markets have dropped sharply YTD and there is general pessimism for FY 23 with likelihood of recession. How can the investment strategy be calibrated to balance long term growth versus loss of capital?

Given our long-term investment approach, we tend not to focus on top-down views such as the direction of the market, as we do not feel that is where can add value for investors. Rather, we believe our edge is focusing on the long term and finding high-return businesses with superior management teams with track records of adapting or innovating to remain market leaders in their industry. Our focus on high return on equity (ROE) businesses predisposes us to large cap, durable and lower beta businesses. Valuation is a secondary discipline, and largely used to influence position sizing. Given the quality and defensive characteristics profile of the New Multinationals Fund, we believe we are well positioned to weather near term volatility to the extent we do see a market correction.

What do you think are some key drivers of growth for the rest of 2022 and into 2023 as global covid restrictions ease?

While the New Multinationals Fund is not managed with thematic biases, the past year has put a spotlight on how companies approach stewardship. We are convinced that the health pandemic represents a seminal moment for sustainable investing. We organized an extensive list of questions to help us understand how companies are navigating the crisis financially and how they are balancing the needs of all stakeholders. We carefully track company responses to the crisis across global large-cap stocks, evaluating companies on their capital allocation decisions and the wide range of actions taken to protect employees, customers, suppliers and communities during this difficult period.

We believe our company engagements are very relevant for evaluating long-term shareholder value. Companies' actions in this crisis will be remembered for a long time, even after a successful rollout of vaccinations globally. Their ability to hire, rehire and retain talent will be shaped by reputations developed now, and brand loyalty will be built or lost based on how customers are treated.

We want to emerge with our shareholder capital in the hands of the companies best positioned to benefit from a rebound in business overall, and best positioned to capitalize on new opportunities and reshuffled market shares. We also want to ensure that shareholder capital is in the hands of responsible companies, and there is no better time than a crisis to test a company's commitment to long-termism and its resolve to prioritize all stakeholders.

Every crisis tends to have winners and losers who lead the equity markets. How does Wellington manage this process/ risk to be able to deliver long term outcomes?

2022 is a further reminder of the unpredictability of markets. The launch of the Russia-Ukraine conflict introduced new disruptions in supply chains and to the energy complex just as we were emerging from the COVID pandemic. Stock market volatility followed, with most markets trading lower to start the year. These events underpin the importance of owning companies with the strength of returns and the level of stewardship to foster resilience and adaptability. Managing a portfolio for the long-term requires patience in the face of disruption. We do not try to predict the next macro event. Rather, we remain focused on finding companies with the potential to create value for shareholders and stakeholders in a wide variety of environments and over the passage of time.

We believe this portfolio will resonate with clients looking for a highly diversified set of global companies that exhibit superior stewardship attributes. We believe this portfolio can offer clients compelling investment returns with less risk than the broader market over the long term, without exposing them to unintended style factor, sector, or country biases.

The fund has outperformed the benchmark over the last 12-month despite a volatile environment. What are some key portfolio actions that have helped manage the downside risk?

At the issuer level, our top relative contributors were Merck and Progressive Corp. Merck was a top performer in the portfolio. The sector's relative strength and Merck's continued execution in key drug categories like Keytruda, along with progress in their R&D efforts supported the stock. We like Merck due to its stable return on capital which we expect to accelerate due to its new drug pipeline and efficiency measures. Merck has a strong balance sheet and a conservative capital allocation strategy, having never done any transformative M&A. Merck has a forward-looking approach to long-term strategic issues, with a strong focus internal talent development alongside a strong board and great management team.

The share price of Progressive rose over the period as management provided favorable results driven by strong net premiums written. Additionally, the board renewed the company's authorization to repurchase up to 25 million of its common shares in May. Progressive has strong competitive advantages in distribution, branding and cost, which the company gets by applying segmentation strategies to everything they do, making them one of the world's best insurers at pricing risk. Progressive also has a clear and sensible capital allocation policy and we are confident that Progressive will be successful in the long term as they apply more and more data in order to grow faster and underwrite more effectively, both in existing markets like auto and in new markets like home. Progressive has 2 million customers who have been with them a decade or more. They are able to attract the best and the brightest employees to serve those customers, thanks to a distinctive culture and an emphasis on diversity and inclusion.

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