Investment Monthly

Stay invested but be (portfolio) resilient

September 2021

Key Takeaways

- We remain **positive on the stock market** and other cyclical investments like **high yield bonds** but portfolio resilience will be key.
- Risks including Covid-19 and central bank tightening mean we have a renewed focus on high quality companies in portfolios. We favor **large-cap, high quality companies that pay attractive dividends**.
- We still **prefer US, UK and Asian equities** which should rally further, driven by strong earnings. Short-term, we upgraded European equities to Overweight thanks to strong growth momentum in the region.

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Asset class	Short-term view (3-6 months)		Long-term view (>12 months)	
Global equities	▲	We enter mid-cycle and the combination of easy policy and global recovery is still a positive mix for stocks but the scale and pace of returns may slow. We focus on quality and yields.	▲	We remain positive on risk assets as growth expectations and inflation projections trend up, but advocate being selective given a more subdued level of expected returns following a strong 18-month rally.
Government bonds	▼	Returns are still unattractive in a low yield and low interest rate environment, we remain underweight.	▼	Bond prices have recently risen due to negative growth concerns and technical factors, and current policy settings mean that bond prices are unlikely to be volatile resulting in a sharp jump in yields.
Investment grade (IG) corporate bonds	▶	Against expectations of lower US Treasury yields, we are neutral IG as yields remain unattractive.	▼	We remain underweight on investment grade bonds as prospective returns are unattractive and spreads are at historically tight levels, especially for longer-duration credit.
High yield (HY) corporate bonds	▲	We look for a yield pick up in quality high yield credits in a low yield environment, where falling US Treasury yields and lower new bonds supply support bond prices and tighten spreads.	▼	In the long term, High Yield bonds spreads are unattractive and valuations are demanding. Out of the HY universe, Asia bonds represent the most value and carry opportunities.
Gold	▶	Gold prices have been range-bound as there are a lack of catalysts when markets remain largely risk-on and demand has not recovered meaningfully.	▶	Higher bond yields, a resilient US dollar, reduction in global economic uncertainties and geopolitical risks remain key hurdles for higher gold prices.

Note: Short-term view (3-6 months): a relatively short-term tactical view on asset classes. Long-term view (> 12 months): a relatively long-term strategic view on asset classes.
▲ "Overweight" implies a positive tilt towards the asset class, within the context of a well-diversified, typically multi-asset portfolio.
▼ "Underweight" implies a negative tilt towards the asset class, within the context of a well-diversified, typically multi-asset portfolio.
▶ "Neutral" implies neither a particularly negative nor a positive tilt towards the asset class, within the context of a well-diversified, typically multi-asset portfolio.
Icons: ↑ View on this asset class has been upgraded; ↓ View on this asset class has been downgraded.

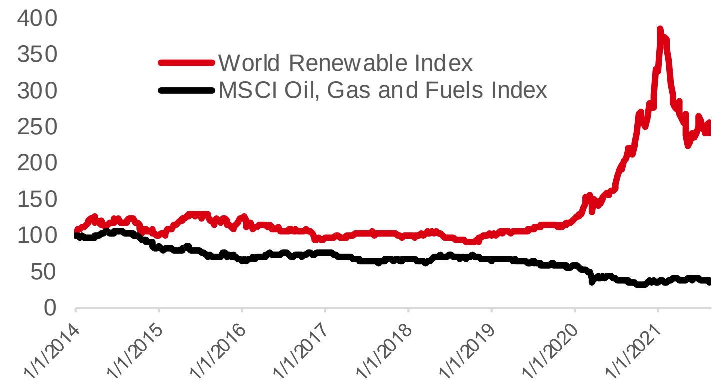
Talking points

Each month, we discuss 3 key issues facing investors

1. Why does ESG matter even more now?

- The UN's climate change authority (IPCC) has confirmed the climate has changed and attributed by human activity. At the current rate, temperatures will rise by 1.5 degrees (from pre-industrial levels) by 2040. Reaching and surpassing the 1.5-degree threshold means more frequent and severe extreme weather.
- Adaptation is critical. For example, better flood and fire management measures caused by extreme rainfall or heat. But mitigating the temperature rises is the key. The damage caused by going beyond 1.5 degrees can be managed if we achieve Net Zero emissions by 2050.
- Financial markets will reward companies better adapted to the sustainability revolution. Broader investor and consumer appeal in sustainable companies may enhance earnings, lower costs of capital and reward them with higher valuation multiples.

Chart 1: Renewable energy stocks have outperformed Oil & Gas
Performance of renewable energy stocks vs Oil & Gas stocks since 2014

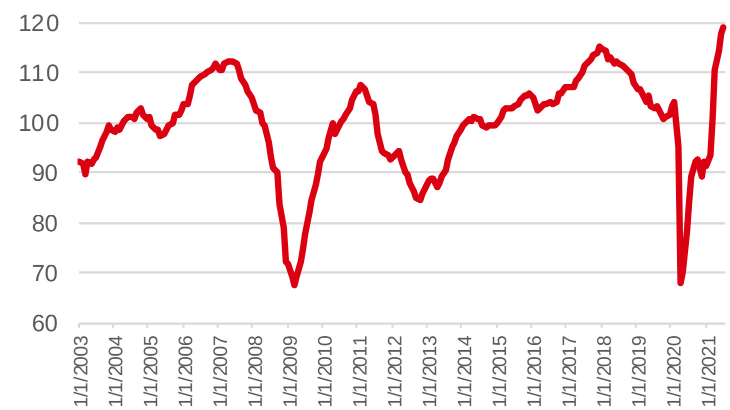


Source: Bloomberg, data as of 24 Aug 2021
Investment involves risks. Past performance is not an indication for future. For illustrative purpose only.

2. Can stocks push higher and why portfolio resilience?

- We think stocks can rally further. In addition to our preferences for US, UK and Asia, we have upgraded Europe equities to Overweight due to the region's strong growth momentum and Europe GDP forecasts from 4.4% to 4.9% for 2021. Sentiment is high and the European Central Bank has emphasised its commitment to stimulate the recovery.
- There are 2 key risks to our positive outlook. First, market volatility is possible depending on how delicately the Fed handles its messaging around the tapering of quantitative easing. Second, Covid-19 remains a risk to the recovery even though our base case is that vaccine progress allows the recovery to continue.
- Our focus is on large, high quality companies that are more resilient in the face of volatility. In particular, we like those companies that also pay attractive dividends. This is especially compelling in a low-yield world.

Chart 2: Positive on Europe equities because of growth momentum
Eurozone economic sentiment indicator



Source: Refinitiv Datastream, Data as of 25 Aug 2021.
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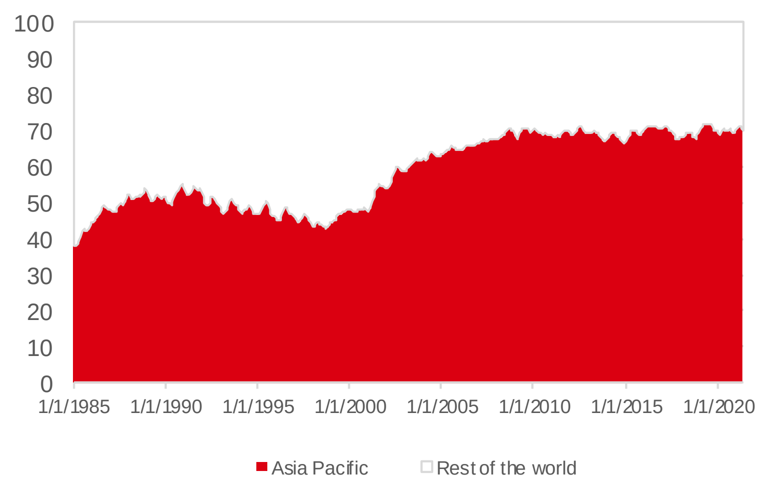
3. What is the outlook for Asia?

- Recent Asian equities weakness has been driven by new Covid-19 cases. Despite this, we remain positive on Asian investments. Over the next 3-6 months, we remain Overweight Asian equities and see opportunities particularly in Singapore and Taiwan. Both markets benefit from the recovery and favourable supply/demand dynamics in semi-conductors.
- We believe Chinese equities have a place in portfolios as a structural long-term investment. However, we have a Neutral allocation in the short-term because of ongoing regulatory risks.
- On fixed income, investors can gain exposure to more attractive yields through Asian high yield bonds and EM debt, in particular Asia and China credits.

Chart 3: Asia accounts for 70% of global semi-conductor sales
% of total sale – 3-month moving average



Source: Refinitiv Datastream, Data as of 26 July 2021.
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House views

Our latest short-term (3-6 months) and long-term (>12 months) views on various asset classes

Asset class	Short-term view	Long-term view	Comment
Global equities			
Global	▲	▲	Equity markets have the scope to rally further but momentum and scale may reduce, hence we focus on quality, large-cap names that have robust balance sheets, sound business models and strong cash flows to pay dividends.
United States	▲	▶	We remain overweight US equities on strong profitability, exposure to quality and mega-cap tech stocks. Inflation risks should subside as supply picks up. The normalisation of monetary policy should be gradual with supportive fiscal policies. We prefer exposure to financials, technology, consumer discretionary and real estate.
United Kingdom	▲	▲	Whilst we remain positive on UK's leading vaccine progress and strong re-opening dynamics, there are fewer reasons for the markets to outperform in the near-term hence we equalised our views between UK and Eurozone.
Eurozone	▲↑	▲	We lifted Europe GDP forecast from 4.4% to 4.9% on strong economic momentum and a supportive ECB, subsequently we upgraded European equities to overweight but strong rally YTD could cap upside.
Japan	▶	▲↑	We upgraded Japan equities on value as long-term prospects are improving on domestic recovery, strong export and global cyclical exposure. They underperformed US and Eurozone despite its earnings recovery.
Emerging Markets (EM)	▶	▶↓	USD has been strengthening which may put pressure on EM currencies. ASEAN underperformed due to wide-spread Covid cases and the region's economic reliance on tourism but there is scope to catch up once Covid clears.
Central & Eastern Europe, Latin America	▼	▶	EMs outside of Asia face headwinds from low vaccination rates to political uncertainty. Russia and some countries in Latin America have already started to lift interest rates, which could weigh on corporate profitability and equity valuations.
Asian equities			
Asian ex-Japan	▲	▶↓	The structural growth story remains. A key reason of our less bullish LT view on Asia ex Japan is due to our downgrade of China, which accounts for almost 40% of stocks in the index. Slow vaccination and low mobility hurts economic recovery in some parts of the region.
China	▶	▶↓	On-going regulatory risks in China lead us to take a neutral stance over both the short and long-term. Valuations are not particularly cheap but we still think there are merits to investing in China structurally in the long run.
India	▶	▶	Indian equities notably outperformed since the second wave sell-off and more than doubled from the low point in late March of 2020, outperforming emerging markets by 50% in dollar terms but valuations are high.
Hong Kong	▶	▲	There are a lack of positive catalysts in the near term but we are positive on HK equities in the longer run due to its cyclical exposure. It remains an attractive listing hub for access to China onshore and offshore equities.
Singapore	▲	▲	Singapore is a key beneficiary from global rotation into cyclical and manufacturing sectors, and leads in vaccination.
South Korea	▶	▶	Korea gives beta exposure to growth via EV and tech, but is challenged by elevated Covid cases and high valuation.
Taiwan	▲	▶	Taiwan benefits from structural digital demand in semi-conductors and 5G but we are neutral on high valuation.
Government bonds			
Developed markets (DM)	▼	▼	US Treasury yields have stabilised at below 1.3% as at 31 August and negative bond yields are still unappealing for key government bonds including Japan, German and UK.
United States	▶	▼	The Fed will begin 'tapering' in 4Q 2021 or 1Q 2022, and will 'normalise' rates. Credit spreads and valuations are tight. We prefer short duration and quality bonds to mitigate risks such as Covid and inflation.
United Kingdom	▶	▼	The BoE is supportive in the near term and there is scope for stronger-than-expected UK economic recovery. However prospective risk-adjusted returns and gilt yields are unattractive in the long term.
Eurozone	▼	▼	The ECB is supportive of the markets and default rates should fall towards 2-4% range, but policy rates are likely to remain at or below -0.5% until the 2% inflation target is met.
Japan	▼	▼	Japanese government bonds (JGBs) are overvalued and the bond risk premium remains negative.
Emerging Markets (Local currency)	▲	▲	Our positive stance on EM debt is unchanged on higher yields and undervalued EM currencies. Being defensive and resilient is key as risks emerge in certain issuers and countries including China's state-owned issuers.
Emerging Markets (Hard currency)	▲	▼	Prospective returns are relatively high as EM government bond yields are attractive, and EM fixed income valuations are more attractive than EM equities.
Corporate bonds			
Global investment grade (IG)	▶	▼	We moved global and US IG to neutral along with the Fed's hawkish tilt and projection of inflation being transitory, but it remains important for investors to continue to have an allocation to IG for portfolio diversification reasons.
USD investment grade (IG)	▶	▼	Long-term US Treasury yields have tightened, IG bonds spreads are compressed and we took profits.
EUR and GBP investment grade (IG)	▶	▼	Europe and UK economies are catching up on economic recovery as the re-opening continues but spreads and returns are unattractive. Meanwhile, we keep a close watch on corporate fundamentals and Delta variants.
Asia investment grade (IG)	▲	▲	Asian credit remains attractive on higher yields and strong fundamentals.
Global high-yield (HY)	▲	▼	In the near-term, we are still positive due to higher real yields and earnings.We downgraded HY for the long term as default-adjusted spreads are at multi-year lows and uncertainties remain, implying an asymmetric return profile.
US high-yield (HY)	▲	▼	The US economy is performing well on re-opening, stimulus and low rates. Whilst we are positive in the short run, we are cautious on rising default rates and tight spreads in the long term.
European high-yield ex UK (HY)	▲	▼	Ultra easy ECB monetary policy and accelerating EU's vaccine rollout are positive factors, though valuations are nc attractive and corporate fundamentals could be fragile in the long run.
Asia high-yield (HY)	▲	▲	Asia HY benefits from robust macro trends in the region and strong investor demand. Although default rates are rising amid tightening policy in China, spreads look more interesting relative to other global opportunities.
Commodities			
Gold	▶	▶	Softer US bond yields, low real rates and declining geopolitical risks can support gold, but price upside is limited.
Oil	▶	▶	Oil is supported by disciplined supply by OPEC and allied producers, as well as a positive demand outlook.

Sector Views

Global and regional sector views based on a 3-6 month horizon

Sector	Global	US	Europe	Asia	Comment
Consumer Discretionary	▲	▲	▲	▲	Consumer discretionary spending continues to rebound as economies re-open, bolstered by record high savings, falling debt levels and pent-up demand. This would benefit auto, luxury, hospitality and restaurants, with further earnings upside as consumer sentiment improves.
Financials	▲	▲	▲	▶	Stimulus packages in the US and Europe can help offset a persistently lower interest rates environment. Financials sector valuations are not demanding, banks have resumed paying dividends whilst 2Q 2021 earnings beat is encouraging. Other catalysts are strong capital markets activity, lower loan provisions, high savings rate and a hot real estate market.
Industrials	▶	▶	▲	▶	Industrial stocks have rallied strongly over the last 12 months in anticipation of a demand rebound as economies re-open and the need to rebuild inventories. Concerns of slowing Chinese economy, rising input costs and supply chain issues are weighing on sentiment. Europe is starting to gain momentum but the supply chain issues may provide a headwind.
Information Technology	▲	▲	▶	▲	We became more constructive on US IT as valuations are now more reasonable. Long-term structural play in digitalisation and innovative technologies is firmly in place. Despite semiconductor and chip shortage, hardware, cloud, automation and 5G should benefit from rebound in economic activity.
Communication Services	▲	▲	▶	▲	The sector benefits from continuous growth from digitalisation of businesses and way of life. Media companies are likely to see continued robust demand. The 5G roll-out is positive for telecom equipment provider but neutral/negative initially for service providers.
Materials	▶	▶	▲	▶	The economic outlook remains constructive but this is somewhat reflected in valuations. In the medium term, demand is likely to grow as infrastructure spending related to fiscal stimulus continues in Europe, Asia and the US, but the current cycle may be close to peaking in the near term.
Real Estate	▲	▲	▶	▲	High savings and lower interest rates support strong demand for private housing, while commercial property suffers low demand as companies look to reduce office space and retail moves online. REITs provide attractive dividends in a low yield world.
Consumer Staples	▼	▼	▼	▼	Staples tend to underperform during periods of rapid economic recovery. After the surge in 'panic purchases' of consumer necessities at the outset of Covid, the sector continues to face headwinds in 2021 as investors reduce defensive exposure for a more cyclical sector bias. Rising input costs and labour shortage may hurt margins in some industries.
Energy	▶	▶	▶	▶	Oil prices are supported by tight supply and demand rebounding to approach pre-pandemic levels as economies re-open. We expect further volatility in energy prices and stocks with ongoing narrative of geopolitics. Oil prices have rallied almost 50% from March 2020 trough to peak at US$75/bbl (on 13/7/2021) and have stabilised at around US$80/bbl (on 31/8/2021).
Healthcare	▶	▶	▶	▶	Healthcare spending should remain a priority, and medical technology and biotechnology companies are preferred. However, the sector is subject to regulatory and reforms risks (e.g. pricing pressure in the US when Covid is contained), such that stocks may see some volatility.
Utilities	▼	▼	▼	▼	Various green initiatives provide short-term potential and the sector can add resilience to tactical portfolio allocation in a volatile environment, but utilities as a defensive sector is likely to underperform in the cyclical recovery. The sector appears less likely to fall prey to the next potential regulatory crackdown in China.

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