Quarterly Market Update

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2Q 2022

Five Key themes over the 2nd Quarter, 2022

The Future of the Traditional 60/40 Portfolio

Historically, the correlation between bonds and equities is mostly negative when valuations for both asset classes are not expensive. 2022 is unique in that both asset classes traded at relatively lofty valuations post-COVID, and we saw both asset classes experience large drawdowns recently. Time horizon is an important aspect when considering the case for a traditional 60/40 portfolio. Strategic asset allocation (SAA) has shown to be the most significant contributor in meeting a portfolio's return objective over the longer term (five to ten years). Hence, the recent selloffs do not on its own weaken the case for a 60/40 portfolio. Valuations for both equities and bonds have improved dramatically since the start of the year. Whenever the peak in inflation materializes this year, it may imply that the 60/40 strategy could resume its strong performance over the coming decades.

Revisiting China

China's high frequency data such as car sales, mobility trackers, oil refinery run rates and truck transportation rebounded in June. There is even some positive news for the property sector with smaller month-on-month declines in home sales, new home prices and mortgage loans. Regulatory headwinds also seemed to be abating with reports suggesting that the cybersecurity probe on Chinese internet companies is likely to be concluded soon. Chinese regulators have also been gradually issuing more gaming licenses, a step towards normality. Greater stability in China's tech and property sectors would be key in lifting employment. Meanwhile, global funds have trimmed their allocations to Chinese equities in the last 12 months – hence positioning is seemingly light and has room to grow, and one to watch on the radar.

ASEAN – Growth & Inflation

Taking a closer look with Asia, specifically the ASEAN Economies, we can see that there are differentiated effects of the growth slowdown across the varying countries. Singapore is especially affected, while Indonesia is more insulated against global shocks on an exports level. China's zero COVID strategy is also hurting Singapore (Thailand and Taiwan as well). However, since ASEAN countries are quite far-flung vs Russia, we don't see much of an impact from the Russia-Ukraine conflict here. Rising commodity prices are also differentiating the large number of commodities importing countries vs the select few exporters. It also depends on the type of commodity too. For example, if oil maintains its high levels, Philippines and Thailand could be hurt, but price increases in foods may benefit Thailand

ESG Considerations

As decarbonisation gains importance in driving investment decisions, investors should be aware of the data quality and gaps. Carbon emissions can be classified into Scopes 1, 2 and 3. Scope 1 refers to direct emissions produced by a company while Scope 2 is the emissions produced by electricity generated or purchased by the company. Scope 3 refers to emissions that are in the company's value chain and can be split into upstream (suppliers) and downstream (customers). According to the Greenhouse Gas Protocol, most emissions come from Scope 3. Yet it is sparsely reported as it is the hardest to measure. It is therefore important to understand these risks when making decisions based on carbon targets. Meanwhile, massive funding is required to combat the significant climate challenges confronting Asia. A large part of the financing will come from Asia's bond markets, in the form of sustainable and green bond issuances, presenting investors with even more opportunities.

Source: Eastspring Investments.

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Key Risks That May Impact Markets Over the Next 6-12 Months

Geopolitical tensions remain an on-going source of market volatility. Equally, global growth could continue to be impacted by supply chain disruptions, higher inflation, aggressive rate hikes, and increasing recessionary fears. Even as these risks loom in the background, a cautious stance against excessive investor bearishness should be prudent. Global growth in unlikely to fall off a cliff due to the waning impact of the Omicron variant, robust US labour market, generally healthy US corporate fundamentals, and increasingly attractive equity market valuations. Separately, policy error is a key risk, be it excessive rate hikes or China's zero COVID strategy. China's National Party Congress and US mid-terms election are key events to monitor later in the year. While policymakers in the past may have dealt with these risks separately, it is the confluence of these risks which is unprecedented. This means that policymakers have no similar experience to rely on. Given the range of potential outcomes, having a diversified portfolio that remains nimble to adapt to a fast changing macroeconomic environment, is now more relevant than ever.

Source: Eastspring Investments.

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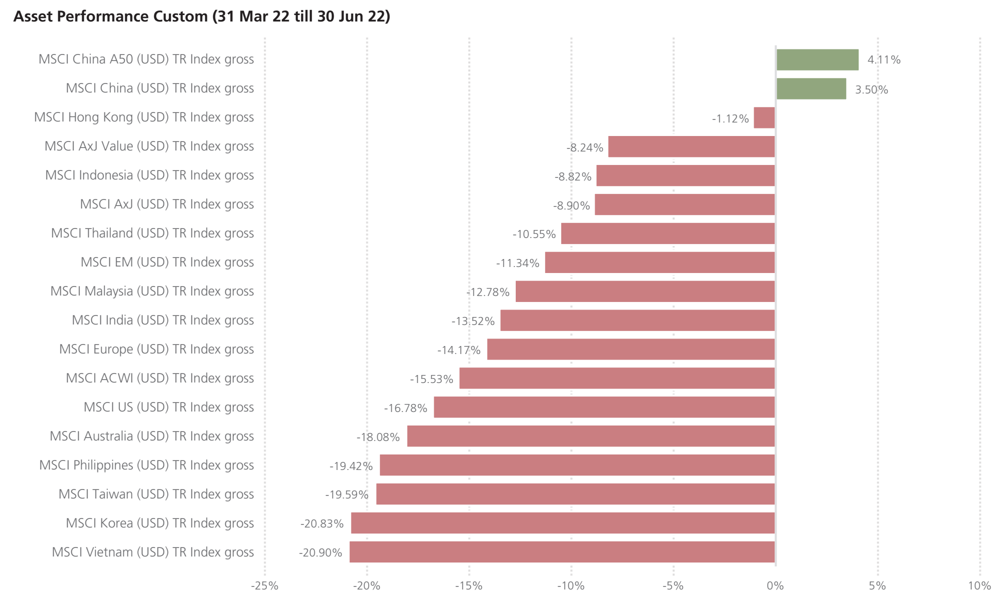
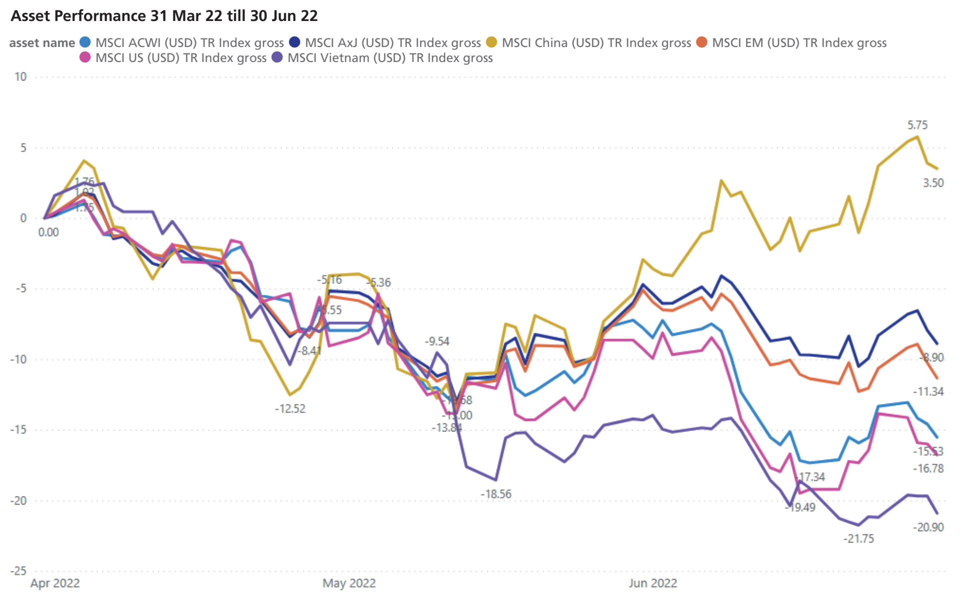
Equities

- Global equity markets declined steeply in June, as recession fears grew and as investors become increasingly concerned that aggressive central bank action to bring down inflation will slow the global economy. The S&P 500 index also saw the worst first half of the year total return since 1962.

- MSCI China A50 and MSCI China were the outliers ending in positive territory for 2Q of 2022, rising 4.1% and 3.5% respectively. The broader markets represented by MSCI ACWI (-15.5%), MSCI EM (-11.3%), MSCI Europe (-14.2%) and MSCI Asia ex Japan (-8.9%) all finished the quarter in negative territory. MSCI Hong Kong finished the quarter also in the red, down -1.1%.





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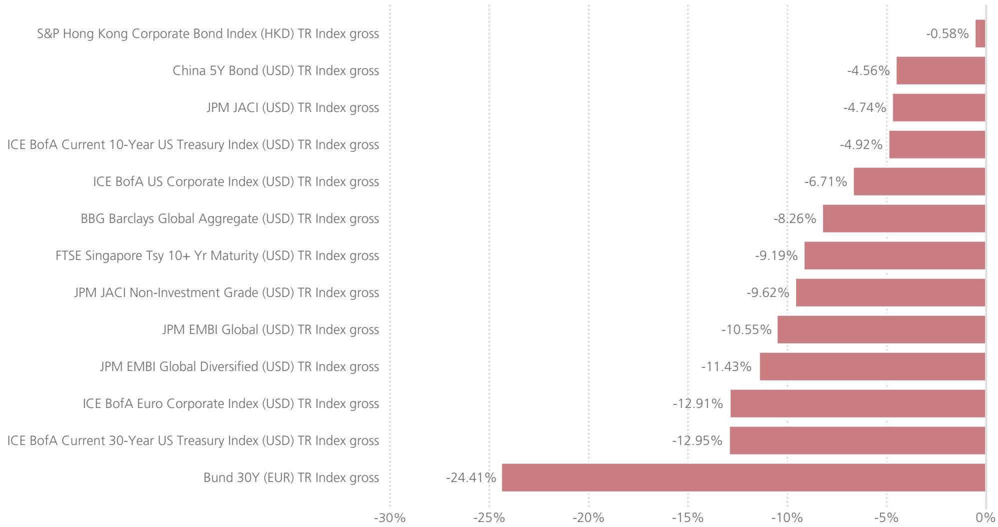
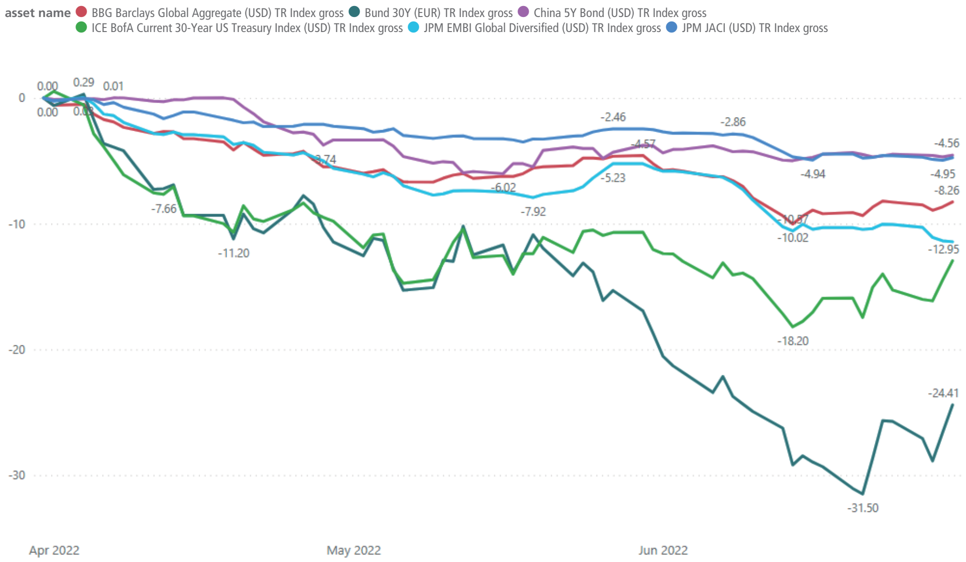
Fixed Income

- In the Fixed Income markets, the 10-year US Treasury yield soared to 3.5% mid-June, the highest level in a decade, as investors priced in an aggressive Fed rate hike trajectory, in light of hot inflation readings. During the tail end of the second quarter, the 10-year yield retreated to 3.0%. In Asian Credit, the JACI posted its worst monthly return in June (-2.3%) over the last 1 year, dragged down by both High Yield and Investment Grade. Returns across the various segments of the bond markets were in negative territory. The Bloomberg Barclays Global Aggregate index finished the quarter lower by -8.3%. The JACI Index finished above the Global Aggregate index, declining 4.7%. The JP Morgan EMBI Global Diversified index (-10.6%), JACI non-investment grade index (-9.6%), ICE BofA Current 30-Year Treasury Index (-13.0%). 30 Year Bunds were hit particularly sharply giving back -24.4% in the second quarter of 2022.

Asset Performance Custom (31 Mar 22 till 30 Jun 22)



Asset Performance 31 Mar 22 till 30 Jun 22



Source: Eastspring Investments.

Currencies

- The USD Dollar built on the upward trajectory seen in 1Q, with the DXY index rising a further 6.5% in the second quarter of 2022. The Japanese Yen continued to struggle against the dollar with the greenback rising 11.5%. The Dollar posted positive numbers relative to the British Pound (7.9%), Thai Baht (6.3%), and the Malaysian Ringgit (4.8%).
- The Yuan, (-5.3%), Korean Won (-4.9%), Indian Rupee (-3.9%), the Taiwan Dollar (-3.6%) and the Singapore Dollar (-2.5%) all edged lower against the dollar over the quarter.

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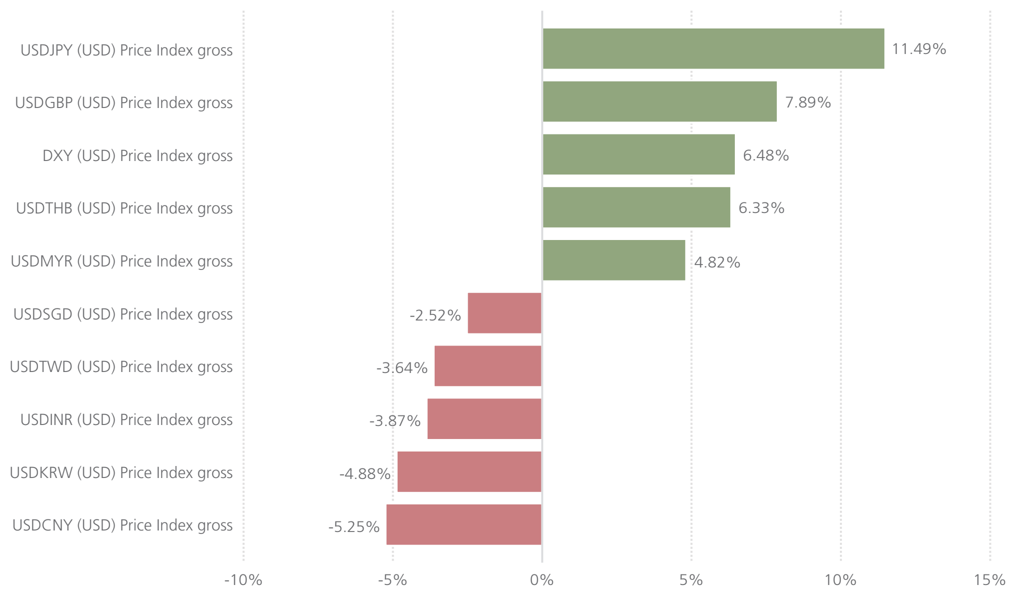

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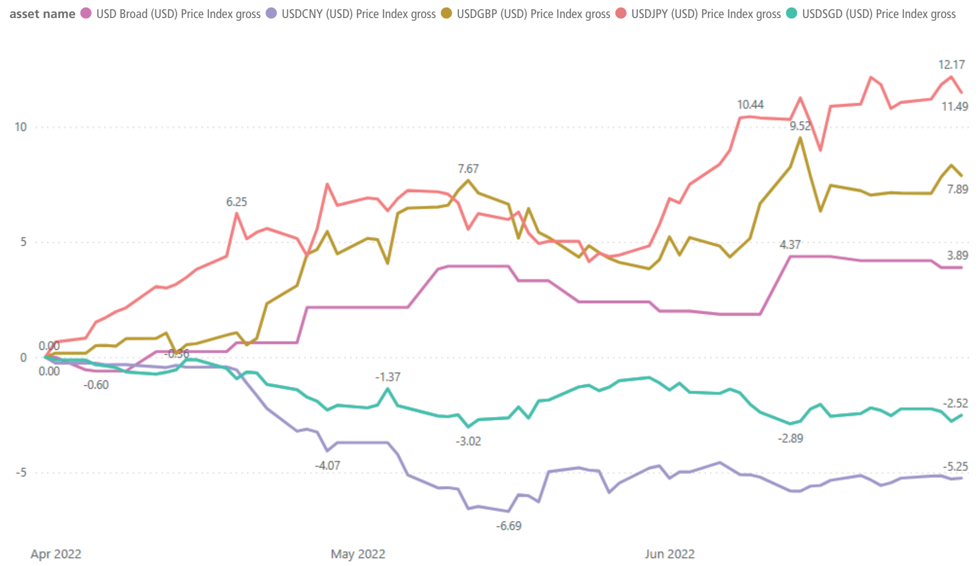

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Economics

- Global growth conditions will continue to be challenged in 2022 by a confluence of existing headwinds (e.g., Russia-Ukraine crisis, hawkish central banks, rising yields, supply shocks), in addition to China's zero COVID policy. Developed market economies, largely the US, are still transitioning to a 'late business cycle', and thus it may be too early to call for a recession, though we acknowledge that recessionary fears are increasing. The US Federal Reserve ("Fed") is seemingly prioritising its fight against inflation over boosting near-term growth. There is a risk that it may hike rates into a growth restrictive territory and tip the US economy into a recession. The outlook for the emerging market ("EM") economies is more mixed. While EM Asia anchors on China's growth trajectory, other EMs face imported inflation, due to a stronger US dollar and supply disruptions.
- On balance, economic re-openings post COVID should be supportive of global growth, but tightening financial conditions alongside hawkish central banks, imply a wide range of outcomes. IMFs latest projections saw downward revisions in the global growth slowing to 3.6% in 2022 and 2023, down 0.8% and 0.2% lower for 2022 and 2023. This contrasts from the estimated 6.1% growth seen in 2021.

Source: Eastspring Investments.

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