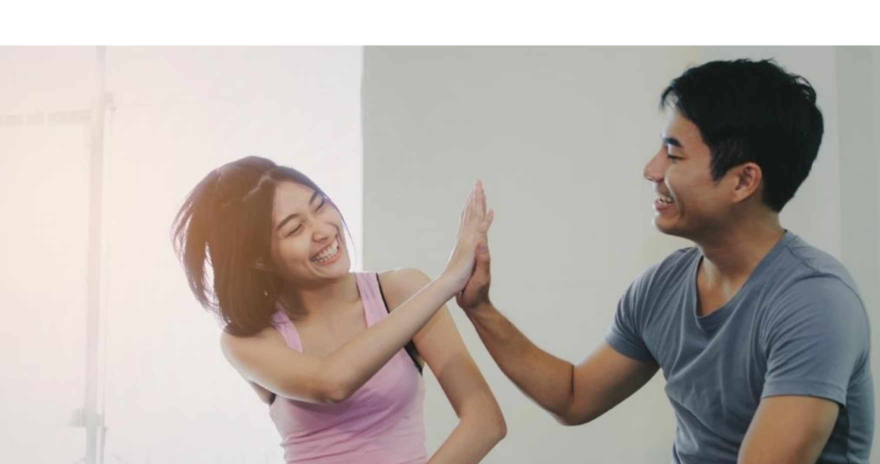

Quarterly Investment Insights

Issue: 1st Quarter 2023

Minute Digest

1. Lending conditions are likely to tighten even further in the coming months due to the recent stress in the banking system and falling corporate earnings expectations will likely drive further equity downside where a recession in the US this year is a near-certainty.

2. We remain underweight equities with a preference to Asia ex-Japan as the region continues to benefit from China's re-opening, reasonable valuations, and possible earnings upgrades.

3. Credit spreads, especially the lower quality issuances are expected to widen amid economic slowdown and worsening corporate news flows.

4. Volatility is expected to remain across asset markets in 2023 as the growth outlook continues to deteriorate and risks remains elevated.

OUTLOOK & POSITIONING

Global equities gained in the first quarter of the year, buoyed by optimism that interest rate hikes are nearing an end as inflation data continues to ease downwards. The strength of growth stocks, particularly the Technology giants that were beaten badly last year, helped propel markets higher in the quarter. The gains came despite the market turbulence that followed the collapse of Silicon Valley Bank (SVB) and Signature bank in early March, as well as the takeover of Credit Suisse AG (CS) by UBS AG. Q1 also saw 2 rounds of 25 basis points (bps) interest rate hikes, bringing the Fed Fund Rate (FFR) to 4.75% to 5%.

The Federal Reserve (Fed) continued to express confidence in the resilience of the US banking system as they acted swiftly to provide stability and liquidity to the financial system by announcing a newly created “Bank Term Funding Program” (BTFP) and relaxed terms for its main direct lending facility. Equity markets cheered on these news as they continue to expect that the systemic risk arising from the collapse of SVB and Signature Bank were minimal.

The recent US earnings season was mixed, with strong earnings beats from the big US banks and Technology firms but lackluster forward guidance while small caps underperformed. Equity Analysts have since revised their outlooks and are pricing in a short earnings recession over the next few quarters. This will likely introduce further volatility into the markets as bulls and bears continue their tug of war over the economic outlook. Our view is that earnings recession should last longer than 3 quarters, which is what consensus is expecting. On valuations front, the forward Price/Earnings ratio of the S&P500 Index is currently trading at about 19X, which may not reflect the increased likelihood of lower growth and an impending recession. Any downside in equities is likely to be driven by both falling corporate earnings expectations as well as more valuation de-ratings to a more reasonably priced level of around 12-14X during historical recession periods

With this earnings backdrop, rate path uncertainties, and tightening lending standards, it is pre-mature to declare the end of the current bear market. Instead, markets are likely to enter a deep bottoming phase in coming months, before inflecting towards a recovery in the later part of the year. Historically, the transition in and out of the deep bottoming phase has profound impact to asset classes returns – risk assets tend to underperform notably before the trough and rebound before the end of bottoming phase.

Within equities, there is a preference for Asia ex Japan (AxJ) for 3 key reasons – the re-opening of China and relaxation of its policies, the undemanding equity valuations in the region, and likelihood of earnings upgrades. In Fixed Income, we have tactically downgraded bonds to neutral after their recent rapid fall in yields due to flight to safety, which may have overshot and could reverse in the short term.

Policy Actions

Global major central banks are expected to continue maintaining their restrictive monetary policies, amid at a slower pace as signs of cooling inflation continues. Although the current FFR is close to the Fed's terminal rate, they have left no ambiguity that they are willing to tolerate higher rates for longer to cool inflation towards their long-term target of 2%, even at the expense of pushing the economy over the edge into a recession. The recent banking turmoil is a consequence of tightening credit conditions, which may help ease inflation but also acts as a constraint to Fed tightening policy.

European equity markets notched up strong gains in Q1 despite volatility in the banking sector, with gains mostly led by Information Technology, Consumer Discretionary and Communication Services. The European Central Bank (ECB) raised their policy rates by 50 bps in both February and March as Eurozone inflation data declined to a one-year low in March. However, given that it remains significantly above the ECB's target of 2%, the central bank signalled that it will need to continuously raise rates further to narrow the inflation gap towards its target level.

China equities achieved robust gains at the start of the quarter benefitting from the Government's efforts to continue its re-opening and relaxation of policies and restrictions. The formalisation of the list of top government officials who have been appointed to work alongside President Xi Jinping as he begins his third term as China's president helped reduce political uncertainties and reinstated confidence in the ruling party. Supportive policy measures to expand domestic demand, stabilize the property market expansion, loosening of the regulatory crackdown on its technology companies, and modernising the industrial system also bolstered investor sentiments. At the same time, the People's Bank of China (PBOC) will continue to use timely reserve ratio cuts, alongside other monetary policy tools to keep liquidity reasonably ample.

Being tactical

Moving forward into Q2 2023, we expect volatility to remain across asset markets. We are far from smooth sailing with heightened risks stemming from deteriorating growth outlook, prolonged Russia/Ukraine war, restrictive monetary policy and elevated inflation prints in certain parts of the world still plaguing investors' sentiments and clouding the outlook ahead. At the same time, possible earnings revision downgrades have not been fully priced into equity markets, which may see another bolt of volatility. As such, for allocations within equities

- We remain underweight equities as the downside to equities are likely to come from both lower PE multiples and lower earnings. Both top down and bottom-up profit forecasts have further room to fall to reflect the weak growth outlook. Although the unemployment rate remains low in the United States (US), cracks are gradually appearing in various economic indicators which we expect will deteriorate further as the effects of recession materialises.
- Continue to maintain preference on Asia ex Japan (AXJ) equities on reasonable valuations, beneficiary of China's reopening, and possible earnings upgrades. Within Asia, ASEAN is likely to remain defensive due to its exposure to China and its ongoing re-opening efforts.

We are tactically neutral on bonds as the recent rapid fall in yields may have overshot and while it is now reversing, we are looking for the right levels to overweight soon. We are of the view that peak FFRs are nearing, and inflation should continue its downward trajectory as global growth continues to weaken. We are also neutral on Investment Grade Credits as we expect credit spreads to widen from current tight levels amid economic slowdown and deteriorating corporate news flows. Furthermore, default rates have already started to pick up amongst weaker issuers and we expect to see this rate increasing as companies are faced with higher borrowing costs coupled with higher inventory build-ups and lower corporate earnings.

Thinking ahead

Our base case is for markets to enter a “Deep Bottoming” phase in coming months before inflecting towards a recovery in the latter months, representing a year of inflection. Equity valuations should compress as corporate profits diminish and as the global growth outlook continue to deteriorate before staging a rebound as investors look ahead to a rosier outlook. Historically, the equity markets bottom out during the middle of a recession as peak bearishness entrenches the market, neither before nor after.

Keeping in mind our investment propositions of Stewardship, Long-term and Global Expertise, our sub managers continually seek to improve the portfolios’ diversity and resilience to identify winners in this new regime. This is part of our stewardship through a long-term approach – which we hope you will benefit from these quarterly newsletters.

PORTFOLIO PERFORMANCE

Our investments are all made with long-term outlook and opportunities in mind where the portfolio performances are expected to deliver consistent positive returns on a long-term basis.

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 monetary 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		Q1 – 23	1 Year	2 Year	3 Year	Since Inception*
SGD Funds	AIA Elite Adventurous Fund [1]	4.79%	-12.68%	-5.59%	11.29%	6.15%
	AIA Elite Balanced Fund [2]	3.73%	-11.93%	-6.19%	6.47%	2.24%
	AIA Elite Conservative Fund [3]	2.82%	-11.18%	-6.92%	1.68%	-0.41%
USD Funds	AIA Elite Adventurous Fund [4]	5.58%	-10.13%	-5.00%	13.81%	7.06%
	AIA Elite Balanced Fund [5]	4.65%	-9.28%	-5.29%	9.38%	4.90%
	AIA Elite Conservative Fund [6]	3.68%	-8.72%	-6.38%	3.67%	0.45%

Relative to Benchmark Performance		Q1 – 23	1 Year	2 Year	3 Year	Since Inception*
SGD Funds	AIA Elite Adventurous Fund [1]	-1.57%	-4.10%	-5.51%	-0.76%	-0.43%
	AIA Elite Balanced Fund [2]	-1.36%	-3.50%	-3.87%	-0.47%	-1.51%
	AIA Elite Conservative Fund [3]	-1.01%	-2.76%	-2.28%	-0.23%	-1.33%
USD Funds	AIA Elite Adventurous Fund [4]	-1.72%	-3.18%	-5.45%	-0.83%	-0.43%
	AIA Elite Balanced Fund [5]	-1.36%	-2.49%	-3.48%	-0.04%	0.29%
	AIA Elite Conservative Fund [6]	-1.06%	-1.94%	-2.24%	-0.60%	-0.23%

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 increasing evidence that the global economy could continue to slow as a 2023 recession in the US is a near certainty. Global central banks are likely to continue their restrictive monetary stance which will drag economic activities to tame the stubbornly high inflation. Meanwhile, corporate earnings expectations should taper and continue to fall, adding to market volatilities. The Elite portfolios have put in place a tactical exposure to Asia Ex-Japan equities as the region continues to benefit from China re-opening, reasonable valuations, and possible earnings upgrades.

In terms of Fund allocation, we have reduced exposure to Developed Market equities as well as Fixed Income, although we still maintain an overweight to the latter. On the other hand, we have increased cash allocation as dry powder to take advantage of future dislocation opportunities as 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 31 March 2023

SGD Funds		AIA Elite Adventurous Fund	AIA Elite Balanced Fund	AIA Elite Conservative Fund
Equity	AIA Asia (Ex Japan) Equity Fund	0.97%	0.99%	0.97%
	AIA Global Multi-Factor Equity Fund	20.62%	13.63%	6.25%
	AIA Global Quality Growth Fund	8.22%	5.49%	2.50%

	AIA Global Select Equity Fund	12.49%	8.21%	3.78%
	AIA New Multinationals Fund	41.05%	27.17%	12.51%
Fixed Income	AIA Diversified Fixed Income Fund	13.07%	42.14%	69.72%
Cash	Cash*	3.58%	2.37%	4.27%
	TOTAL	**100%**		

USD Funds		**AIA Elite Adventurous Fund**	**AIA Elite Balanced Fund**	**AIA Elite Conservative Fund**
Equity	AIA Asia (Ex Japan) Equity Fund	0.98%	0.99%	0.97%
	AIA Global Multi-Factor Equity Fund	20.74%	13.73%	6.29%
	AIA Global Quality Growth Fund	8.27%	5.53%	2.51%
	AIA Global Select Equity Fund	12.57%	8.27%	3.81%
	AIA New Multinationals Fund	41.29%	27.37%	12.59%
Fixed Income	AIA Diversified Fixed Income Fund	13.14%	42.47%	70.18%
Cash	Cash*	3.01%	1.64%	3.65%
	TOTAL	**100%**		

Note:

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

INSIGHTS: 60 SECONDS WITH…

Capital Group's Andy Budden who is an investment director and has 30 years of investment industry experience and has been with Capital Group for 19 years. He holds both a master's degree and a bachelor's degree in engineering from the university of Cambridge and is an associate member of the Institute of Actuaries.

How has Capital Group's multi-managers system helped the portfolio navigate the recent periods of volatility?

One of the key reasons behind the fund's history of consistent of excess returns is the multiple manager approach. We deliberately try to blend a team of Portfolio Managers (PM) (using both quantitative and qualitative input) who have different and, therefore, complementary styles as they each independently construct their own portfolios. The outcome of this investment process is conviction at the individual PM portfolio level, and balance and diversification at the total portfolio level. As markets inevitably shift in the nearer term favouring different types of companies, we find that some PM portfolios may not do so well whilst others may fare better. But by helping to offset one another over shorter time periods, over the long-term we find that this creates more consistent investment results.

More recently, in the narrow growth-driven environment of Q1 2023, the portfolio still outpaced the global equity market despite a number of PMs having already significantly reduced exposure to selected growth companies and the total portfolio entering 2023 with an even greater sense of balance by sector, style and types of companies. The outperformance was broad-based across a range of companies, which is credit to the well-balanced and diversified portfolio that is the aggregate of each individual PM.

Another important feature of our multiple manager approach is the culture and incentivisation of investing for the long-term. One of the significant consequences of financial market turmoil is the dramatic shortening of investors' time horizons. However, looking beyond short-term noise and market volatility, and maintaining a focus on the long-term is critical at times like now. Our portfolio managers are investing in companies with a 3-5 year time horizon (sometimes even longer) and are not getting distracted with what next quarters' or even next years' earnings are going to be. We believe this is a key competitive advantage for our investment team, allowing them to focus on what are good companies over the long-term, and not necessarily on what might be good 'stocks' over the near-term.

With China's reopening and expected economic activity recovery, how do you think the portfolio can benefit from it, and how is it positioned for that?

As long-term bottom-up investors we don't take top-down views on allocations to specific countries. Country/regional exposure is purely the outcome of our bottom-up company selection. Additionally, PMs are less concerned with where a company is domiciled and believe it is more insightful to understand where a company is earning its revenues. From that lens, China is a market that cannot be ignored and one that we view as important levers to the growth thesis for many of our portfolio companies.

Whilst China-domiciled companies represent just a smaller percentage of the portfolio by weight, China represents close to 10% of the portfolio's revenue exposure, making it the second-largest country exposure behind the United States. With the country reopening and a potential economic recovery in sight, examples of various trends that the portfolio is accessing via selective investments in companies on a bottom-up basis includes Urbanization, Travel and Leisure, Global Trade, Health Care

Looking ahead, what are some key drivers of growth and sectors/industries that are expected to benefit in this new regime of higher-for-longer interest rate environment?

Firstly, it is important to recognize that we don't think there will be a small number of specific industries that could benefit from this new regime. In fact, we think this new equity market environment will result in a greater breadth of market leadership over the next cycle and be less one-dimensional than the prior decade; not driven by a small of stocks, sectors, style, or regions. We think there will be opportunities across the full global equity universe to find individual companies that can prosper, and fundamentals will matter the most in terms of drivers of shareholder returns.

That said, there are certain areas of types of companies that portfolio managers are particularly excited about looking ahead over the next market cycle:

- **Commodities-related companies**. The root cause of higher-for-longer interest rates is stickier inflation, and exposure to commodities (either directly though mining and energy companies or indirectly for example through railroads transporting those commodities) can provide a degree of inflation mitigation. In addition, we continue to see evidence of medium-term supply/demand imbalances in commodities such as oil, lithium and copper, the latter two are key for the energy transition whilst the former will continue to play a role as we transition. We are also expecting a renaissance for industrials companies

- **Short-duration growth companies**. Higher interest rates have meant that investors have needed to become more discerning and raise the bar for those companies whose valuations are based on cashflows/earnings expected to arrive further out in the future, which are now getting discounted at a higher rate. Conversely, we have been pivoting toward short-duration growth companies where some good examples include Semiconductor companies which benefit from long-term secular growth in demand for chips but are also earnings strong cashflows right now. Another example would be large cloud computing and software providers such as Microsoft Corporation (MSFT)

- **Companies with highly visible and durable earnings**. Similar to the above, in addition to earnings and cashflows that will arrive less far out in the future, we expect companies whose earnings have a higher degree of visibility will be in higher demand. This may include companies with high portion of revenues that are recurring which includes Heating, Ventilation, and Air Conditioning (HVAC) and aircraft engine manufacturers, where in many cases the majority of revenues come from the servicing and maintenance of their existing install base. Elsewhere, Health Care is a sector that many portfolio managers are excited about, not only because of the pace of innovation but also because of the fact that proven drugs treating prominent and common illnesses can benefit from many years of predictable revenue growth.

- **Incumbents and scale leader internet platforms** that can benefit from competitive 'flushing out' of weaker competitors. The prior decade of ultra-low interest rates fuelled a rush of capital towards

fast-growing but unprofitable platforms in areas such as E-commerce, Payments and Games. Now that capital funding is becoming scarcer, we see opportunities for the competitive positions of larger, more profitable companies in such industries to benefit from a potential decrease as investors become less tolerant of smaller, non-profitable competitors.

- **Selected financials**. High profile bank failures over recent months have reminded investors that higher rates aren't necessarily a good thing for banks. Whilst portfolio managers have generally avoided smaller/regional banks (many of which do not meet the strategy's multinational criteria), many have been selectively investing in larger, more diversified, and better capitalised multinational banks. Such banks could be net beneficiaries of the challenges facing smaller banks as depositors switch to larger banks perceived as 'safer'. Additionally, non-bank financials could also benefit from higher rate environment. Examples of those include insurance companies, which can now enjoy higher rates of returns on their asset portfolios that they collect from insurance premiums.

- **Multinationals**. With corporate financing becoming more expensive, companies with access to more favourable terms to finance their own growth may be more attractive. We believe that multinational companies – those with large geographic footprints, diversified businesses and seasoned management teams – have better access to capital and are at a relative advantage in such an environment.

With so much anticipation for a recession this year, how will this recession differ from previous ones?

Our US economist continues to believe that the US economy will enter a recession later this year, which will be worse than the short-lived COVID downturn but not nearly as severe as the 08/09 global financial crisis. Whilst the fallout from the recent banking turmoil will likely be negative for credit growth in the coming quarters as the sector undergoes more regulatory scrutiny, competes more aggressively for deposits, and tightens lending standards. In turn, this will likely lead to lower demand and slower economic growth. On the positive side, this should help with the Fed's goal of lowering inflation.

On average, the market tends to peak about 7 months before the cycle peaks (as proxied by industrial production), whereas Earnings Per Share (EPS) peaks about the same time as industrial production. Following the peak in production, the market tends to fall for another 4-6 months, and then start to rise in advance of the turn in economic activity and EPS. If one assumes the economic cycle peaked in September (which the industrial production data currently show), then things have been playing out somewhat to script. If this continues, and the economy does enter into a broader downturn, then the traditional post-economic-peak decline in the market could still be in front of us

That said, we maintain that long-term investors keep the faith and stay invested. If/when we see a market bottom later this year it's not going to feel great, but that'll be the moment that we begin to build for hopefully another decade of bull markets. What we have seen previously is when the market anticipates the end of a recession and an economic recovery, it can move fast. When the market turns it will likely happen quickly, and the strongest gains have often occurred immediately after a bottom. The benefits of capturing a full market recovery can be powerful - in all cycles since 1950, bull markets in the US had an average return of 265%, compared to a loss of 33% for bear markets. Therefore, waiting on the side-lines for an economic turnaround may not be a reliable strategy.

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