Quarterly Investment Insights

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HEALTHIER, LONGER, BETTER LIVES

1 MINUTE DIGEST:

- The Delta variant now makes up most of the new cases globally. Since the start of July, the global effective reproduction number has been north of the 1.0 threshold and climbing steadily upward, indicating the spread of Covid-19 is back to exponential growth.
- The current recovery remains highly policy driven, especially with Delta infections likely to extend the progress of reopening and the uncertainty around the variant continues to weigh on sentiment.
- Relative valuation continues to favour equities over bonds and \credits, and the gap has widened given lower Treasury yields and improving earnings.
- On a monthly perspective, the funds delivered a mixed bag of performance relative to their benchmarks as market volatility in May saw rotation from Growth to Value stocks where Covid-laggards (Value and Cyclical stocks) played catching up.
- On the quarterly basis all the funds except the SGD Conservative fund underperformed their respective benchmark due to the volatile performance in May 2021.
- Since inception, all the funds have outperformed their respective benchmarks due to a higher asset allocation towards equities.

OUTLOOK & POSITIONING

The Delta variant now makes up most of the new cases globally. Since the start of July, the global effective reproduction number has been north of the 1.0 threshold and climbing steadily upward, indicating that the spread of Covid-19 is back to exponential growth. The silver lining is both hospitalisation and fatality rates appear to be manageable compared to previous waves, at least for countries with high vaccination rate. In this regard, we have not seen levels which indicate the global economy is returning to the tight lockdowns we once saw back in March and April 2020. Indeed, quarantine fatigue, especially during summer, has given governments the incentives to accept some gradual lifting of restrictions even though cases continue to climb. With over 50% of the population, or 70% of adults, fully vaccinated, the case of the UK reopening will be a key reference for other governments and investors. As we go to print, the confirmed cases have peaked in the latest wave caused by Delta, but hospitalisation and fatality rates are only edging up from relatively low levels. It remains to be seen if some form of herd immunity is driving this positive development.

Economic recovery remains on track in major economies despite market expectations are adjusting from (overly) elevated levels. Services are recovering strongly at global level thanks to the combined efforts of easing social distancing measures, active policy support and vaccine rollout globally. Along with solid manufacturing activity, this should lead to strong economic growth in the remainder of the year, supporting the prospects of risk assets. Inventories will be restocked when supply-chain disruptions are eased, providing additional tailwind to activity. China is perhaps the only exception among the major economies that investors are worried about growth slowdown, its first mover advantage is fading when the cycle matures. However, recent policy actions should alleviate some of the concerns. Overall, since vaccines are still highly effective in reducing severe Covid illness and fatalities, countries with high vaccination rates should see a clear divergence in economic performance (and inflation trajectory) compared to those with low vaccination rates. Vaccinations remain key to the broader reopening process.

Inflation concerns have receded over the past couple of months. We reckon that inflation is elevated only in a few countries, and in the case of the US, it is mostly concentrated in goods and services sensitive to Covid and the subsequent reopening of the economy. In China, producer price inflation has probably peaked on the back of stabilising commodity prices, while consumer prices remain benign. Therefore, we are in the view that rapid rise in inflation prints is transitory in nature.

On company fundamentals, Q1 earnings season ended on a high note with over 85% of S&P 500 constituents reported earnings surprise. The strong momentum looks to be carried on into Q2 – out of the companies reported earnings so far, the magnitude of surprise is also stellar at near 20% on average. In addition, we expect strong share repurchase activities for this year with the announced share buyback so far beating last 3-year average in the US markets. We believe these factors would provide additional tailwinds to developed market equities going forward under this ample liquidity environment.

The outlook for Asian equities is however less rosy. Chinese equities continue to soften on the back of rising uncertainty from the regulatory scrutiny over key sectors. Although the ongoing structural reforms of capital markets and boarder economy could be positive to the markets in the long run, investors are pricing in a higher risk premium in the near term. Outside of China, in major ASEAN markets barring Singapore, sentiments are largely weighed by the renewed Covid infections from Delta combined with relatively low vaccination rates in the economies. Meanwhile, momentum in Taiwanese and Korean equities is receding as the upcycle in electronics and chips manufacturing is gradually priced in.

Policy Actions

The current recovery remains highly policy driven, especially with Delta infections likely to extend the progress of reopening and the uncertainty around the variant continues to weigh on sentiment. Policy makers will have to keep accommodative policies for some more time. Managing the transition between ultra-loose economic policies and a sustainable setting continues to be the focus of the markets.

As the Fed continues to maintain its accommodative stance, Chair Powell reiterated the view that recent inflationary pressures are likely to prove transitory and acknowledged that the Fed will continue its discussions about tapering in coming meetings with “advance notice” on any tapering decision. Similarly, the European Central Bank (ECB) remains its dovish stance with no sign of moderation in Pandemic emergency purchase programme (PEPP) purchases and expects interest rates to remain at their present or lower levels until inflation reaching 2% well ahead in their forecast horizon of 2 to 3 years.

In Asia Pacific, there have been some notable changes to central banks’ stance. Notably, the Peoples Bank of China (PBoC) surprised the markets with an unexpected cut in reserve requirement ratio (RRR) in July and future policy guidance is expected to be on the dovish side as the recovery continues

Being Tactical

Apart from the Delta infections and the idiosyncratic risks in Asia and China as discussed above, we are still cognizant of the other risks in the system. We nonetheless maintain our view that these risks shouldn’t derail the overall direction of relative performance between equities and fixed incomes, and within equities, developed markets vs Asia/emerging markets.

For this quarter, fixed income allocation has the following focus:

- Treasury yields declined recently on the back of reduced inflation compensation. That said, our view is that the eventual path of tapering asset purchases should put a dampener on Treasury performance.
- With US investment-grade default rates below historical averages, we believe the downside risk remains low. However, we continue to see limited upside for US IG credit given the tight spread range and its higher sensitivity to interest rate movements.
- Comparatively, Asian credit remains more attractive as spreads widened while default risks appear to remain stable as spill over risks from certain distressed Chinese corporates remain contained.

We see equities to continue to perform reasonably well against bonds. More specifically:

- Global equities should continue their run relative to fixed income, likely driven by developed markets.
- Major central banks remain accommodative for the time being, with any tapering discussion appears to be well communicated with the markets.
- In the US, reported earnings and sales continue to surprise on the upside with magnitude trending upward. Strong buyback activities likely provide additional tailwinds.
- Within equities, we have turned cautiously neutral on Asian equities given the region-specific headwinds including China’s regulatory scrutiny and low vaccination rates among the ASEAN countries.

Thinking Ahead

Concerns surrounding the Delta variant remains our focus as governments are attempting to adapt to the new normal of living with the endemic Covid-19. The UK sets the prime example on what to expect as we achieve high levels of vaccination, yet highly transmissible but less deadly variants continue to stress the reopening narrative.

Relative valuation continues to favour equities over bonds and credits, and the gap has widened given lower Treasury yields and improving earnings. Hence, agility on adding or trimming equity in correction or for profit taking is necessary to balance the return potential against risks. We continue to monitor the factors driving recent weakness in Asian equities, which potentially could provide a good entry point in the region.

At the same time, 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 among our views in these quarterly newsletters.

PORTFOLIO PERFORMANCE

While our investments are all made with a long-term outlook, our portfolios performance have been delivering positive returns since inception.

On a monthly perspective, the funds delivered a mixed bag of performance relative to their benchmarks as market volatility in May saw rotation from Growth to Value stocks where Covid-laggards (Value and Cyclical stocks) played catching up.

On the quarterly basis the all funds except the SGD Conservative fund underperformed their respective benchmark due to the volatile performance in May 2021.

Since inception, all the funds have outperformed their respective benchmarks due to a higher asset allocation towards equities.

Absolute Performance		Jun - 21	May - 21	Apr - 21	Q2 2021	Since Inception (Annualised)
SGD Funds	AIA Elite Adventurous Fund [1]	3.0%	0.0%	3.4%	6.5%	22.8%
	AIA Elite Balanced Fund [2]	2.9%	0.1%	2.4%	5.5%	14.6%
	AIA Elite Conservative Fund [3]	2.8%	0.2%	1.7%	4.7%	9.5%
USD Funds	AIA Elite Adventurous Fund [1]	1.8%	0.2%	4.0%	6.1%	23.7%
	AIA Elite Balanced Fund [2]	1.7%	0.3%	3.2%	5.3%	19.1%
	AIA Elite Conservative Fund [3]	1.6%	0.3%	2.2%	4.2%	13.0%

Relative to Benchmark Performance		Jun - 21	May - 21	Apr - 21	Q2 2021	Since Inception (Annualised)
SGD Funds	AIA Elite Adventurous Fund [1]	-0.2%	-0.7%	0.1%	-0.8%	5.7%
	AIA Elite Balanced Fund [2]	0.2%	-0.5%	0.1%	-0.2%	1.4%
	AIA Elite Conservative Fund [3]	0.5%	-0.3%	0.3%	0.4%	0.2%
USD Funds	AIA Elite Adventurous Fund [1]	0.5%	-1.2%	-0.3%	-1.1%	5.4%
	AIA Elite Balanced Fund [2]	0.8%	-1.0%	-0.2%	-0.4%	4.8%
	AIA Elite Conservative Fund [3]	1.1%	-0.8%	-0.2%	-0.03%	2.9%

Source: AIA Singapore
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. Past performance is not necessarily indicative of future performance of the ILP sub-fund(s).
[1]: Current benchmark is 90% MSCI World Total Net Return Index and 10% Bloomberg Barclays Global Aggregate Corporate Total Return Index
[2]: Current benchmark is 60% MSCI World Total Net Return Index and 40% Bloomberg Barclays Global Aggregate Corporate Total Return Index
[3]: Current benchmark is 30% MSCI World Total Net Return Index and 70% Bloomberg Barclays Global Aggregate Corporate Total Return Index

Underlying Fund Allocation

During the quarter, we continued to remain overweight to equities for the Adventurous, Balanced and Conservative Funds, adding to the outperformance since inception. The global recovery stemming from the flood in liquidity (fiscal and monetary policies) and lifting of lockdown restrictions around the world is still very much on track even after the recent two months of rising Delta infections. We believe new waves of infections from further coronavirus mutations will only delay the recovery, not completely derail the reopening narrative.

We increased the allocation to AIA Global Multi-Factor Equity Fund over the past quarter by rebalancing the profits from the AIA Global Quality Growth after an impressive run-up following the equity trough in March 2020. To position the overall portfolios to best take advantage of the global recovery, we calibrated the overall allocations among managers to capitalise on the rotation towards value, quality, and cyclical stocks. We have recently also liquidated our tactical allocations in the AIA Asia Ex. Japan Equity Fund and AIA Greater China Equity Fund due to the ongoing uncertainties surrounding Chinese regulatory actions on Tech, Education and Healthcare sectors. Uncertainty on where Beijing will target next has placed a dampener on sentiments, removing much of the potential upside and unless we see a clear resolution to regulatory scrutiny, we plan to avoid these non-benchmark allocations in the short term.

Fund Allocation as of 30 June 2021

SGD Funds		AIA Elite Adventurous Fund	AIA Elite Balanced Fund	AIA Elite Conservative Fund
Equity	AIA Global Multi-Factor Equity Fund	22.9%	15.3%	7.9%
	AIA Global Quality Growth Fund	27.5%	18.4%	9.5%
	AIA New Multinationals Fund	41.1%	27.6%	14.3%
	AIA Asia (Ex Japan) Equity Fund	0.7%	0.6%	0.5%
	AIA Greater China Equity Fund	0.3%	0.3%	0.2%
Fixed Income	AIA Diversified Fixed Income Fund	6.5%	36.8%	67.4%
Cash	Cash	1.0%	0.9%	0.1%
	TOTAL		**100%**	

USD Funds		AIA Elite Adventurous Fund	AIA Elite Balanced Fund	AIA Elite Conservative Fund
Equity	AIA Global Multi-Factor Equity Fund	23.0%	15.4%	7.9%
	AIA Global Quality Growth Fund	27.7%	18.5%	9.5%
	AIA New Multinationals Fund	41.3%	27.7%	14.2%
	AIA Asia (Ex Japan) Equity Fund	0.7%	0.6%	0.5%
	AIA Greater China Equity Fund	0.3%	0.3%	0.2%
Fixed Income	AIA Diversified Fixed Income Fund	6.5%	37.0%	67.2%
Cash	Cash	0.5%	0.5%	0.5%
	TOTAL		**100%**	

INSIGHTS: 60 SECONDS WITH…

Baillie Gifford's *Iain McCombie, sub-manager of the AIA Global Quality Growth Fund, shares his views on stock picking fundamentals, the macroeconomic environment and short-term volatility.*

Baillie Gifford has a long-term growth investment thesis for the AIA Global Quality Growth Fund. What are the advantages of this strategy in the current cycle?

The environment this year provides strong evidence for why a strategy based on market timing and economic forecasting is fraught with challenges. At the beginning of this year, "re-opening" stocks came into vogue as the expectations of a strong and sharp economic recovery gathered pace. As the number of Covid-19 cases has spiked again, the shine has been taken off these re-opening beneficiaries in favour of more defensive names. It would be fantastic if we could accurately predict the see-sawing of the market between these two poles, but we think that it'd be near impossible to do consistently. Instead, we seek to own a small number of the world's most exceptional growth companies. These are structurally advantaged businesses with differentiated cultures and large markets to grow into.

Ultimately, portfolio positioning is driven by our bottom-up stock picking and is reflective of where we are currently finding the most attractive growth opportunities on a 5-10 year view. Key portfolio themes that emerge would include: climate and the energy transition, the opportunity in innovative healthcare, and the new wave of technology companies supporting entrepreneurship by offering 'scale as a service' – this includes companies like Amazon Web Services, Shopify and Twilio which are helping to level the playing field between the largest and smallest, essentially lowering the barriers to entrepreneurship.

What are the key risks that might derail your long term growth investment thesis?

There is a lot of time and effort spent by market commentators on the likely risks created by rising interest rates and inflation. Higher rates have traditionally been bad for equities (and growth equities in particular) because a larger proportion of their earnings lie further into the future, so a higher discount rate means a lower present value.

However, within the Global Quality Growth Fund we would highlight a clear preference for companies with strong balance sheets (many holdings have net cash), pricing power and a market leadership position which should, on average, leave them better positioned than rivals in this type of environment. For example, software businesses that operate subscription models rather than one-time only charges, and companies like Alibaba, Netflix and Amazon have illustrated that their customers stick with them even when they put prices up.

So, we're pretty relaxed about the potential for a modest uptick in rates and inflation going forward. The main reason we are unconcerned is that we are much more interested in how the world might look a decade in the future. We're currently seeing a level of economic disruption that perhaps only presents itself once a century, so if our vision of the world in the 2030s is even close to correct – a world where there is abundant clean energy, where vast amounts of data is thrown off by innumerable connected devices, and where technology and healthcare collide to significantly improve the quality of people's lives – then a bit of near-term inflation will seem insignificant in the context of the long term gains we can make for clients by looking past seemingly high near term valuations and investing around these structural mega trends.

What are some of the recent portfolio developments and the rationale behind them?

Perhaps one of the most exciting themes emerging in the portfolio at the moment is in healthcare. Some have predicted that the 21st century will be the century of biology, as our increasing ability to analyse and understand human diseases at the genetic level leads to a transformation in medicine. This potential exploded into the public consciousness during 2020 with the rapid development of Covid vaccines. Famously, it took Moderna (not held in the Global Quality Growth Fund) just four days to create its version: two days for Illumina (a longstanding holding in the Fund) to sequence the coronavirus genome, then two days for Moderna to apply its technology to the problem.

We firmly subscribe to the view that we're on the cusp of something quite extraordinary in healthcare and the Fund has been gradually increasing its exposure in this area. Alongside current holdings Illumina, Staar Surgical and Denali Therapeutics, we've recently taken a new position in 10X Genomics, which develops instruments and consumables for the analysis of single cells, and added to the holding in Exact Sciences, which offers molecular cancer diagnostic tests. We also own firms looking to improve the efficiency of new drug discovery and development, such as Dassault Systèmes, a software company that helps with the design and development of new products, and Codexis, a protein engineering company that creates custom enzymes.

Since our clients are mostly Asia based, how does Billie Gifford identify companies with high quality growth potential in the long run given the idiosyncratic differences from this side of the world?

At Baillie Gifford, we've been investing across the globe since our inception in 1908. Indeed, our very first investments as a firm were in the rubber plantations of Malaysia, predicated on the growth of the car industry in the US. The key point being, as investors, we've always retained a global outlook in our approach, married with a willingness to remain openminded to different business models and consumer preferences emerging from different parts of the world.

A case in point is China. Many investors have and continue to view China largely through a Western prism. How often have we heard the descriptions: "Alibaba is the Amazon of China" and "Meituan is China's Grubhub"? The danger with these lazy comparisons is that firstly they ignore the scale differences between the US and China, but they also infer that these are copycat businesses. The reality, however, is that many of China's internet businesses are leading rather than lagging on the innovation front. The deep relationships we've been able to build with companies across Asia over the past few decades has helped immensely in educating us on these rapid developments and cultural differences.

In addition, the emphasis we place on alternative sources of information in our research process has also been hugely helpful. Rather than relying on traditional, financial sources of information which are typically short-term and US and Europe centric, we've spent the last couple of decades cultivating alternatives that we believe help us to see the world differently, expand our horizons, and help us generate value for clients. Within China, as an example, these relationships span industrial and market experts but also experts within academia. We sponsor the University of Oxford's China Centre and have developed a relationship with Tsinghua University's Computational Biology Department. We are also continuing to grow and develop our own Shanghai investment research office. Having an on-the-ground presence will help to deepen existing relationships with companies we own, get closer to exciting growth companies of the future, and provide a cultural lens to enhance and challenge existing perspectives.

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