FULLERTON FUND MANAGEMENT

FULLERTON INSIGHTS

Fullerton Fund Management Investment Views – 3Q2019

Executive Summary

- Central banks have responded to a global economic slowdown by accelerating a shift towards monetary policy easing.
- Slowing global growth and prolonged uncertainty over US-China relations generate downside risks to an earnings recovery in equity markets; overall equity valuations are not overly compelling.
- On a more positive note, risk appetite and positioning are not overly extended; flow dynamics and positive risk seeking sentiment could remain supportive for markets in the near term.
- Risk premia in markets are likely to remain elevated, given the uncertainty around US-China trade relations.
- We remain engaged in risk assets, either on a tactical basis or selectively in those assets offering better value.
- Dovish central banks in Asia provide support to bonds. We selectively prefer duration exposure in markets with steep curves and attractive real yields.
- We remain constructive within the credit space, as spreads still offer attractive value for credit and duration risk.

US-China trade relations reignited downside risks for markets and economic activity in Q2. Although tensions seem to have defused again for now, the underlying threat of renewed and unexpected twists in negotiations suggest to us that risk premia in markets are likely to remain elevated. On the other hand, it is important to note that central banks have markedly shifted toward monetary policy easing. This provides strong positive offsets to the negative headwinds arising from trade uncertainty.

We had adopted a more cautious stance on risk assets during the market volatility of Q2 and continue to position this way into Q3. However, given the competing forces on risk assets, we do want to remain engaged; either on a more tactical basis or selectively in those assets offering better value.

Trade Tensions versus Central Bank Policy Easing

Market volatility increased in Q219 as sudden shifts in trade rhetoric between the US and China undermined the market's complacency of a smooth path towards a deal. Although negotiations are seemingly back on track, overhanging risks remain. This uncertainty is likely to weigh on market risk appetite as well as economic activity.

Indeed, we note that global economic activity has slowed over the past few months, with previously observed green shoots retreating. Export and manufacturing cycles remain in the doldrums, with renewed weakness in leading indicators.

Importantly, underlying capital expenditure cycles are still weak as a lack of clarity over US-China relations continue to be a persistent weight on long term corporate expansion plans.

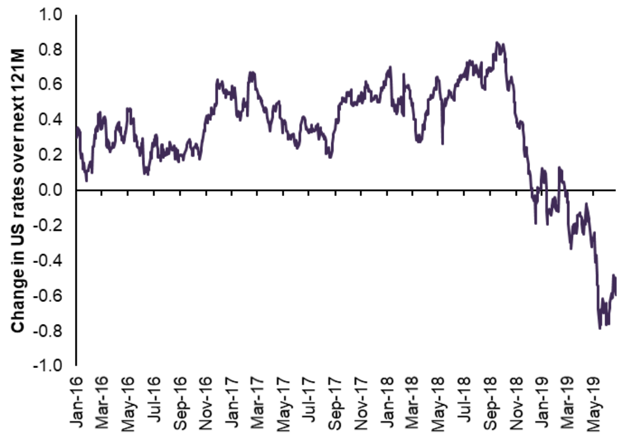
Central banks have responded to this slowdown by accelerating a shift towards monetary policy easing. In particular, a marked shift in tone from the US Federal Reserve and other major central banks have led to sharp moves lower in developed market bond yields.

Asian central banks have also followed suit to an extent. Indicators of global liquidity have thus recovered strongly, and we would expect this to provide offsetting support for risk assets and economic activity. We are conscious that central bankers are able to respond to slower growth with easier policy largely because inflation remains muted. A turn in inflation poses the largest hazard to risk assets, although that risk appears low.

Trade and Capex Cycles Remain Weak

Source: Fullerton, Bloomberg, Jun 2019

Policy Easing Provides Powerful Buffer



Source: Fullerton, Bloomberg, Jun 2019

Engage Selectively and Tactically

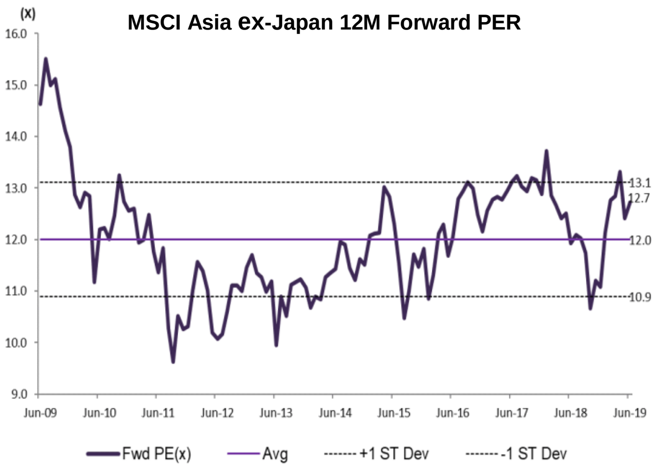
Slowing global growth and prolonged uncertainty over US-China relations generate downside risks to an earnings recovery in equity markets. Moreover, we do not find overall equity market valuations to be overly compelling, offering insufficient risk premia on a medium term basis. Valuation re-rating may be boosted by central bank rate cuts, but such policy easing is already well-priced. On a more positive note, our assessment is that risk appetite and positioning is yet to be overly extended; flow dynamics and positive risk seeking sentiment could thus remain supportive for markets in the near term. We would expect, therefore, that near term equity market gains are still possible; however, we would be tactical in participating in such a rally given the overall soft earnings outlook.

We remain selective in our bottom-up stock selection, identifying single security names where valuation provides a sufficient buffer and where we expect relatively resilient earnings momentum. In particular, we currently have greater exposures in Singapore and the Technology sector. We also like REITs as they still offer an attractive yield. More structurally, we expect demographic change and inflows of liquidity from the physical real estate sector to provide support for the REITs asset class.

Within the fixed income space, the richness of US Federal Reserve pricing and flatness of the US yield curve make us cautious on duration in general. However, within Asian local currency fixed income, dovish central banks in Asia provide support to bonds. We selectively prefer duration exposure in markets with steep curves and attractive real yields, such as Indonesia and the Philippines. We are cognisant that growth headwinds from trade tensions present risks and we will hedge our currency exposures accordingly, especially in the more open economies. Within the credit space, we remain constructive as spreads still offer attractive value for credit and duration risk, especially in the BB segment and in the Asian high yield space. Despite macro headwinds from growth, we expect credit fundamentals to remain resilient in the investment grade space. In the high yield space, loosened financial conditions will provide an important buffer. More broadly, we do not expect default rates to rise significantly as default events remain non-systemic.

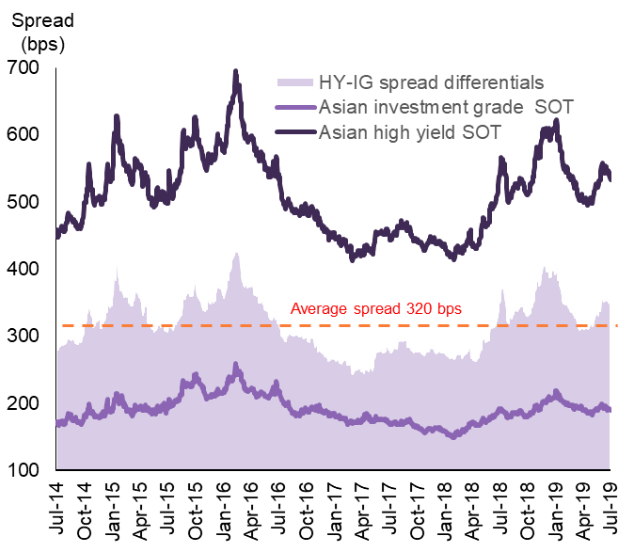
In conclusion, we expect short-term market volatility to remain high with the potential for shifts in market direction in response to the evolution of US-China trade negotiations. Central bank easing provides support for risk assets, but with a dampened earnings outlook we do not find valuations compelling enough. We remain cautious on risk assets, but will look to engage selectively and tactically.

Asian equity valuations are not overly compelling



Source: Fullerton, Datastream, Jun 2019

Asian credit spreads offer decent pick-up (over Treasuries)



Source: Fullerton, Bloomberg, Jun 2019

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