Fullerton Fund Management Investment Views – 1Q2019

Executive Summary

- Developed economies, in particular the US, are entering later stages of mature economic cycles.
- Slower global growth and tighter liquidity are structural headwinds for asset markets in 2019.
- In Asia, monetary policy is likely to be more supportive for growth this year as regional inflation remains under control for most central banks.
- Opportunities for nimble and selective risk exposures, especially in Asian assets which are attractively valued.
- Active asset allocation and disciplined bottom-up security selection to play greater role in generating returns this year.
- We see tactical opportunities in Asian assets in the coming months, especially Asian equities and Asian High Yield Bonds.
- Asian equities offer attractive valuations both on a historical and relative basis versus Developed Markets equities.
- Asian credits will continue to benefit from strong regional support from Asian investors, and valuations have become more attractive.

Stay Nimble and Disciplined in 2019

In 2019, global growth will slow. The developed economies, in particular the US, are entering the later stages of mature economic cycles. We do not, however, expect an overtly sharp slowdown in the US but more so a slowing in growth from an above trend rate to rates closer to trend, avoiding overly bearish market expectations for an imminent recession. In Asia, the export cycle is stalling as the lagged impact of trade tensions and slower developed market growth take their toll. Nevertheless, policy support in China is likely to buttress the largest economy in Asia, and thus provide some buffer to regional growth too.

Global liquidity is set to decline further as the major central banks continue to normalise their balance sheets in the post-QE era. As inflation still remains under control for now, we do expect that policymakers can afford to be patient in removing liquidity, providing some breathing room to financial markets.

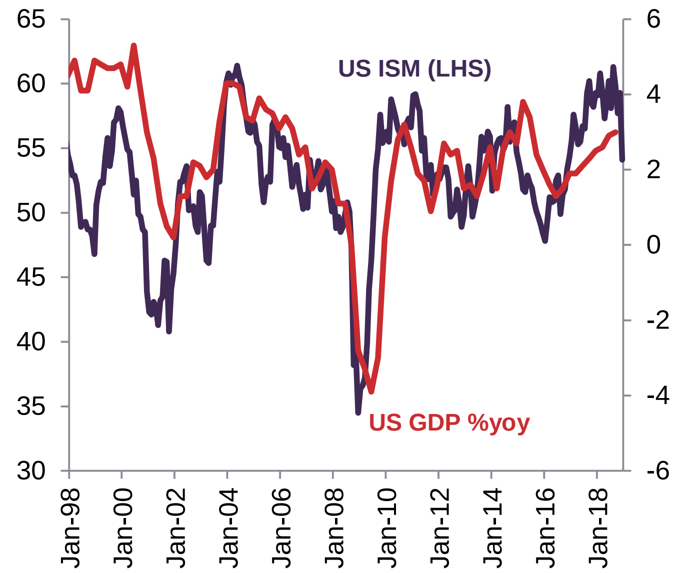
We expect slower global growth and tighter liquidity to be structural headwinds for asset markets in 2019. However, tactical opportunities can arise as the worst economic outcomes are likely to be avoided. Sharp swings in market sentiment thus provide opportunities for nimble and selective risk exposures, especially in Asian assets which are attractively valued. With greater volatility expected in financial markets, we expect active asset allocation and disciplined bottom-up security selection to play a greater role in generating returns this year.

Navigating Late Stage US Cycle Dynamics

Given the maturity of the US economic cycle, growth and policy are both at potential turning points, with wide ranging ramifications for global markets. Our expectation is for US growth to downshift from an annualised rate of 3% to levels closer to an annualised 2.5%. Recent softness seen in the capex cycle, housing market and sentiment indicators are of concern. However, the labour market remains in robust shape and leading indicators, whilst off from elevated levels, still point towards trend-like and moderate levels of growth in the US.

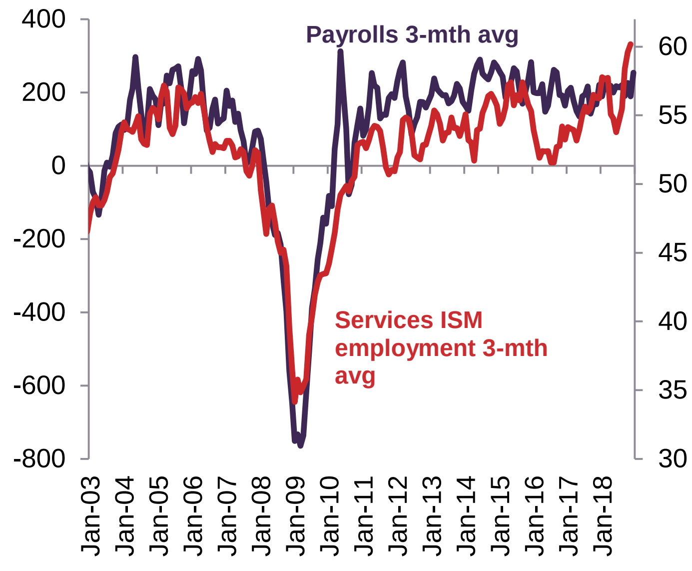
The recent market volatility has also sparked concerns of tightening financial conditions, but a shift in Fed rhetoric has offset this to an extent. Inflation in the US appears contained for now allowing the Fed to be patient in further rate hikes. With the US entering late cycle economic dynamics and labour markets tightening, we are keenly aware that inflation will be the largest negative risk for asset markets and we will monitor this closely.

Downshift in US growth from "very" strong to "just" strong



Source: Fullerton, Bloomberg, Dec 2018

US labour market remains on strong footing



Source: Fullerton, Bloomberg, Dec 2018

Asian Growth Slowing, But Policy Turns Supportive

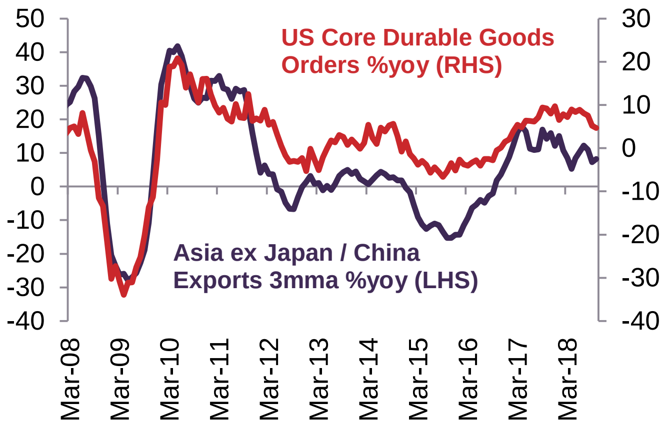
Asian growth dynamics have stalled as the export cycle has turned lower and domestic demand in the region remains muted. Tightening financial conditions and global market volatility are also further headwinds to Asian growth. However, Asian monetary policy is likely to be more supportive for growth this year as regional inflation remains under control for most central banks. The decline in oil prices removes a key source of externally driven inflation pressure. Domestic credit cycles are also generally not over-extended, giving Asian central banks leeway to be patient.

US-China trade tensions remain a source of uncertainty for the region and downside risks are still possible. However, based on recent indications, we expect a cooling of tensions to prevail and that the US and China are likely to arrive at a partial truce in the near term.

Absent a sudden escalation of trade tensions, we expect a gradual slowing in Chinese growth this year. The credit impulse in China remains weak given the lagged cumulative effects of past credit tightening, and an overhanging dampening of sentiment from US-China trade tensions. Real estate investment and export growth will drag on growth in coming months.

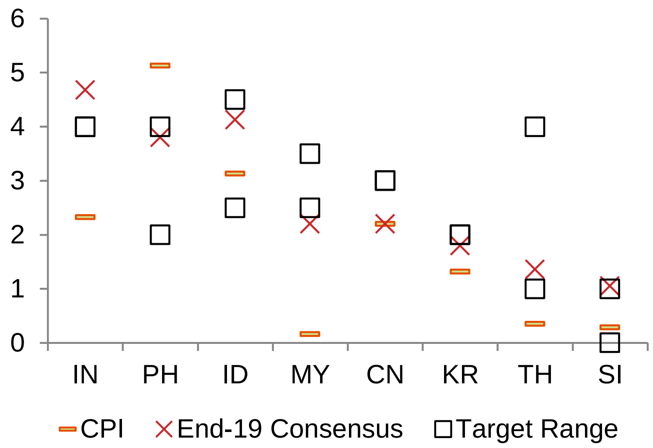
Nevertheless, we do expect a more proactive and pro-cyclical policy mix from Chinese policymakers, with growth stabilisation to be prioritised over the long term focus on structural deleveraging. Monetary policy easing through broad-based RRR cuts to boost interbank liquidity and targeted medium term lending facilities will buffer growth and market sentiment in coming months. Infrastructure investment should also be supported through tax cuts. Stability in the CNY on a trade-weighted basis is likely to remain a key priority for policymakers and this should provide an anchor to wider asset markets both in China and in Asia.

Asian export cycle stalls, especially as US demand wanes



Source: Fullerton, Bloomberg, Dec 2018

Controlled inflation allows for policy accommodation to support growth



Source: Fullerton, Bloomberg, Jan 2019

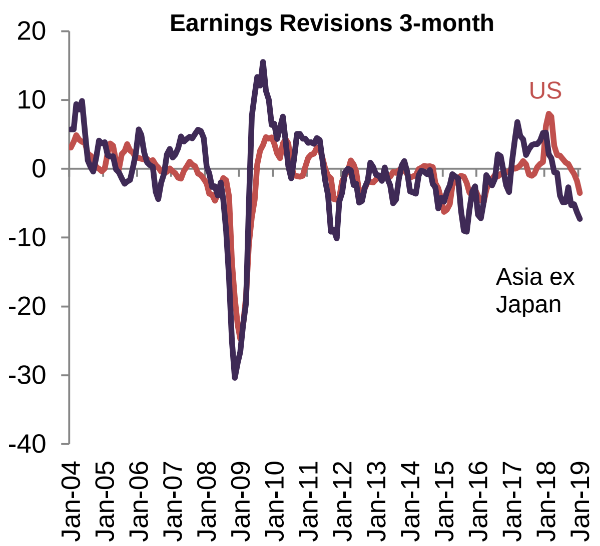
Value in Asian Assets

We see tactical opportunities in Asian assets in the coming months, especially Asian equities and Asian High Yield Bonds.

Slower global growth and tightening liquidity poses the greatest headwinds to overvalued assets. Developed Markets (DM) equities, especially US equities, remain at overvalued levels. Earnings expectations also have room to downshift further. Furthermore, high valuations will be challenged by higher US rates and yields. Given our benign view on US growth and Fed rate expectations relative to flat market pricing, we are negative on US Treasury duration at current levels as 10-year US yields are trading at the lower end of our expected ranges. Elevated US Treasury supply from an increased fiscal deficit will also pressure US Treasury yields higher. This will pose challenges for overvalued US equities.

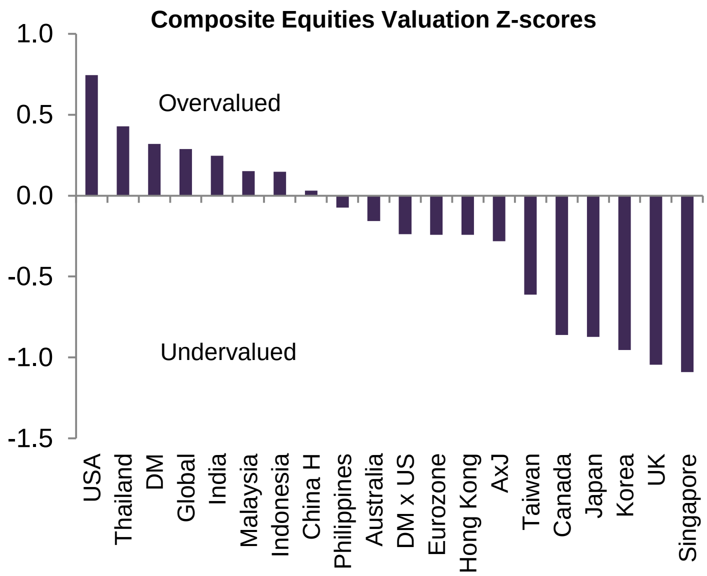
In contrast, although Asian growth is set to slow, negative earnings revisions are already quite well priced in. Asian equities also offer attractive valuations both on a historical and relative basis versus DM equities. With policy support and a cooling in trade tensions, our view is that pessimistic scenarios for Asian equities are well-priced. Therefore, we see tactical opportunities to own Asian equities either outright or as relative trades versus US equities. We remain disciplined in bottom-up stock selection in Asian Equities space, focusing on growth stocks with long term structural themes related to technology. Cyclically, we also like names in financial, communication services and consumer sectors.

Downward earnings revisions are mature, especially in Asia



Source: Fullerton, Factset, Jan 19

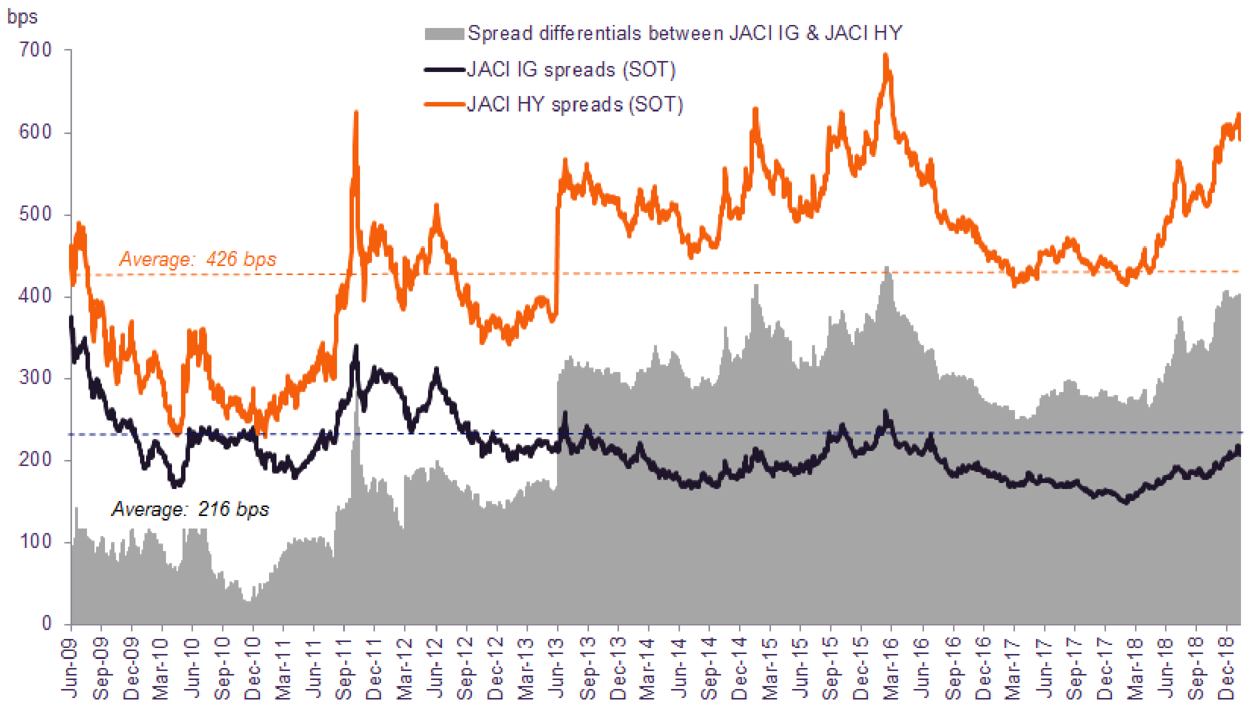
Asian Equities attractively valued, historically and relatively



Source: Fullerton, Factset, Jan 2019

Within Asian Fixed Income, despite headwinds from declining corporate earnings, we believe Asian credit metrics remain in a good position. Asian credits will also continue to benefit from strong regional support from Asian investors, as cross border capital flows remain buoyant despite tightening global liquidity. Valuations have also become more attractive, particularly in the High Yield sector, where we expect that yields now provide sufficient cushion despite our expectation for higher US rates. Default rates have risen over the past year but we expect them to stabilise at these levels, with default events remaining idiosyncratic and manageable. More broadly, our credit selection process sees attractive opportunities in Chinese High Yield property names as well as in well-structured Investment Grade perpetuals.

Asian Credit Valuations Looking Attractive, Particularly In High Yield



Source: Fullerton, Bloomberg, Jan 19. Based on the JP Morgan Asian Credit Investment Grade Spread Index and JP Morgan Asian Credit High Yield Spread Index.