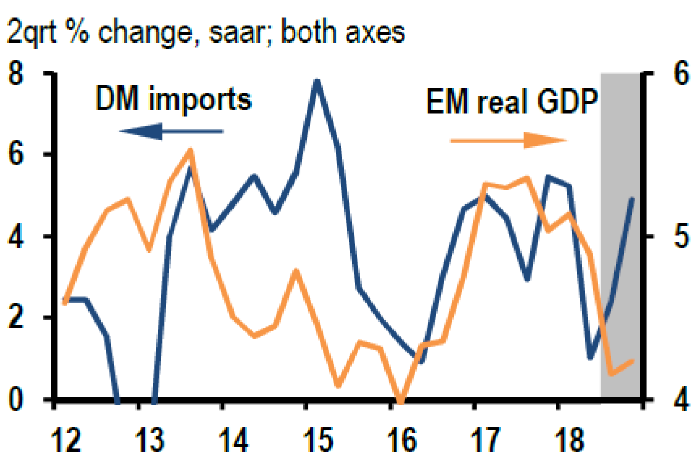
O Captain! My Captain!

The iconic elegy was written by Walt Whittman in 1867 as a tribute to President Abraham Lincoln in celebration of the causes he fought for during the American Civil War. The Civil War is considered by many Americans as their greatest moral, constitutional and political war they have ever fought. Through his leadership, tenacity and even well-planned political patronage, President Lincoln was able to preserve and strengthen the Union, abolished slavery, modernize the economy while averting a war with British which could have potentially aided his domestic political opponents clamouring for the split of the United States. However, contradictory to most non-Americans' perception today, the hero of President Lincoln wasn't a Democrat, in fact he was a Republican. How many of us wish that he could rise from his grave and bring some sense and sensibility to the chaotic mess of American politics.

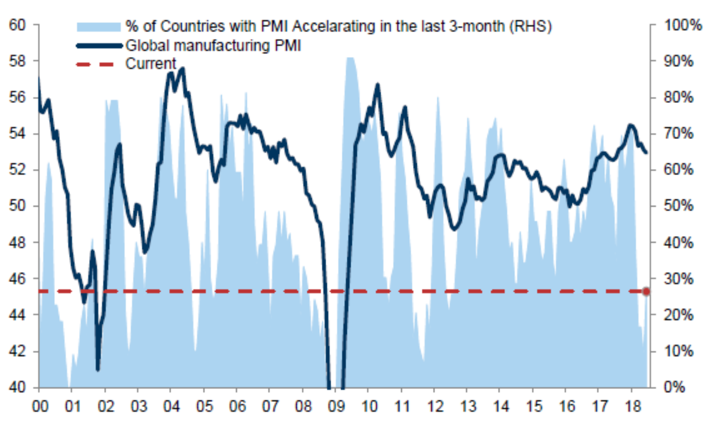
We have written in June's Memories fade but the scars still linger and followed up with our thoughts on risk of contagion in Turkey to rest of emerging markets in August's, Turkey is a delicious bird if cooked correctly. The views taken in the collective Navigators were that global growth remains above trend underpinning our overweight on global equities/ commodities but will necessitate higher policy rates therefore our preference to underweight fixed income. While the synchronicity of growth that we have forecasted at the start of the year is no longer the case, a robust DM should be supportive to EM economies, confines the risk of Turkey and Argentina to an idiosyncratic concern rather than symptomatic of the whole EM's complexes. Global PMIs remain relatively stable despite all the macroeconomic uncertainty while hard data such as DM imports and North Asia exports are accelerating in recent months.

Rising DM imports should support EM GDP



Source: J.P. Morgan

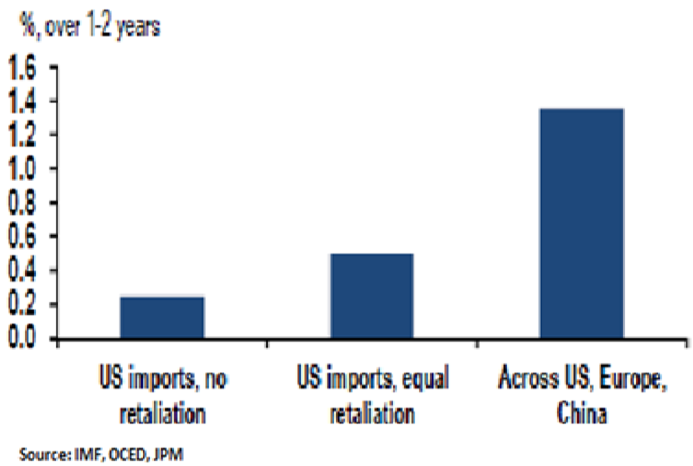
After sharp fall, more countries seeing PMI accelerating



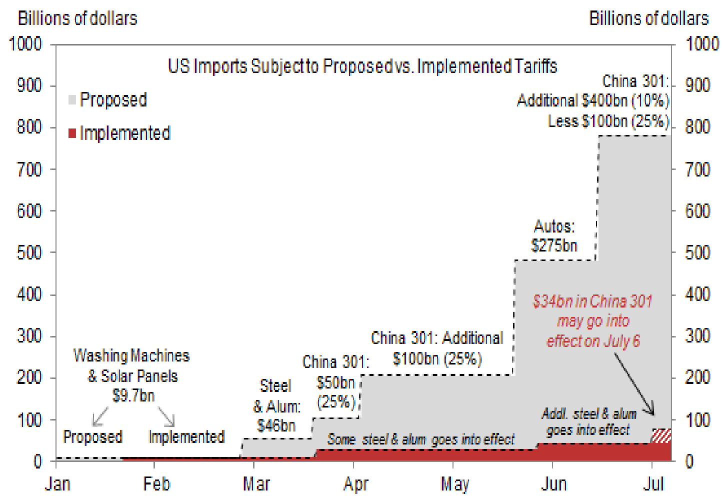
Source: Haver Analytics, Markit, Goldman Sachs Global Investment Research

We note the biggest risk to our sanguine view is the risk of full-scale multi-lateral increase in trade tariffs. If that happens, it would shave off 30-40% of global growth forecast in 2019 putting global growth to as low as 2.6%, which is below its long-term potential of 3.1% and setting back the global economy to 2011 level during Europe's existential crisis; 3Q18 Investment Outlook. We have argued that neither US nor China nor the rest of the world would want to wage a Pyrrhic war and will conclude with re-negotiated deals. This week announcements of an in-principle agreement with US-Mexico and positive overtures from Canada and US over the weekend alongside last month's EU-US willingness to relook at their auto tariffs are providing some confirmation to our views. In the coming weeks, how much, in what form and any remote possibility of a deferment to the purported $200bn new tariffs between China and US will be the most critical issue of 2018. It is worth reminding our readers that the $58bn enacted so far has a marginal impact to both economies as it omitted many key consumer goods.

Multi-lateral trade wars will be impactful



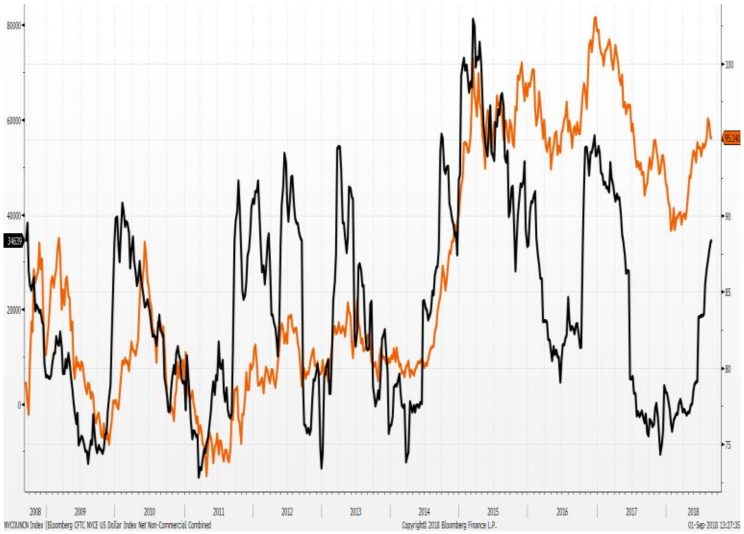
But actual implemented has been less deleterious



Asset Allocation Strategy

FX: Neutral. We do not often start our asset allocation strategy by looking at FX in part due to the fickleness of FX markets and our track record on FX views is far from perfect. However, as the sell down in EM assets was exacerbated by the strength in the USD, it is important to at least anticipate the next move on the dollar. In our June's Navigator, we cited the massive unwinding of dollar short speculative position as the reason to believe the USD rally is coming to its tail-end. The latest data from CFTC has reinforced this near-term view that USD rally have peaked. Speculators have gone from net short USD from 2H17 to Jun 2018 and within the last 2 months, they are now net long the USD to level last seen in 2015 when Fed has begun its quantitative tapering and hiked rates for this first time in Dec 2015. In past ten years, when speculators switch to dollar bulls/or bears at such rapid delta of change, often it marks the peak of the directional change and is followed by the reversal of the dominant trend. When we analyzed previous EMFX weakness, this current episode is already one of the largest and longest occurrences. RSI is already oversold at this level.

Specs went from $short to massive $long in 2mths



Source: Bloomberg

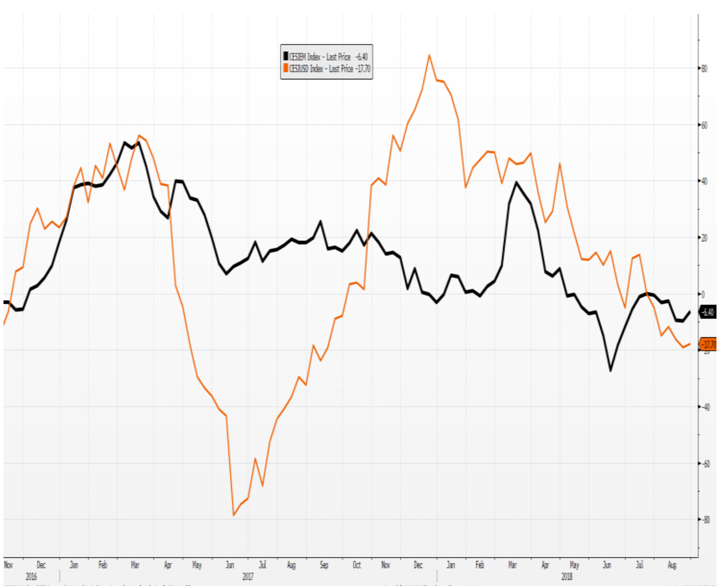
2018 is already one of the worst EMFX sell-off

EMFX Selloff	Size	Duration (calendar days)	RSI
May 8, 2013 to Sep 3, 2013	8.04%	118	70
Oct 22, 2013 to Feb 3, 2014	6.75%	104	81.71
Jul 9, 2014 to Mar 13, 2015	20.04%	247	80.51
May 15, 2015 to Sep 28, 2015	13.02%	136	68.78
Oct 15, 2015 to Jan 20, 2016	8.80%	97	81.39
Aug 16, 2016 to Nov 24, 2016	6.69%	100	76.48
Jan 25, 2018 to Aug 13, 2018	13.04%	200	79.22
Median	8.80%	118	79.22

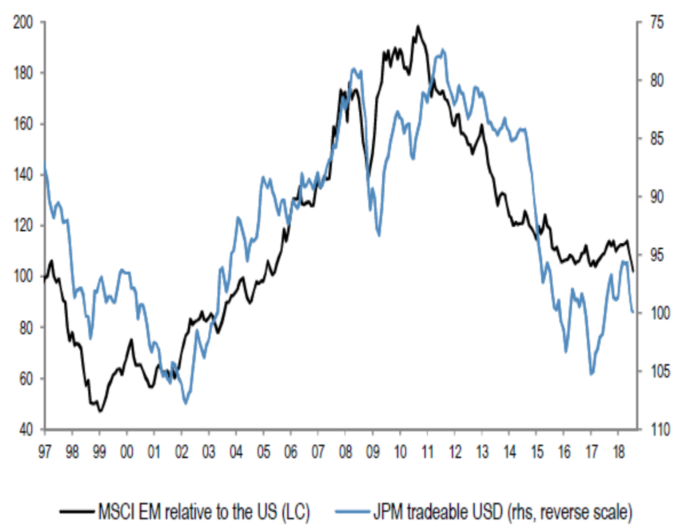
Source: Citi Research, Haver

Beyond technical reason why we believe the USD strength has peaked, the fundamental reasons underpinning the dollar strength should also wane. In particular, the risk of market underpricing Fed path of interest rate has largely dissipated in contrast to the start of the year when we warned market was complacent on inflation risk and the expected path of policy rates. For rest of 2018, the market is pricing in-line with Fed's 2 more hikes and for 2019 they are only 2 hikes lower than Fed's guidance. This is in stark contrast at the start of the year, market participants expect only one hike each in 2018 and 2019 versus Fed's guided dots of 3 hikes each in 2018/2019. The second reason is that economic surprise differential between the US and EM are narrowing. As seen in the chart below, since 4Q17 to Jun 2018, US incoming data has surprised forecasters in contrast to EM's data that surprise little and subsequently disappointed much since April. However, it recent weeks, incoming EM data has become less bad and is now offering a spread of improvements over the US.

Economic surprises in EM improving now vs the US



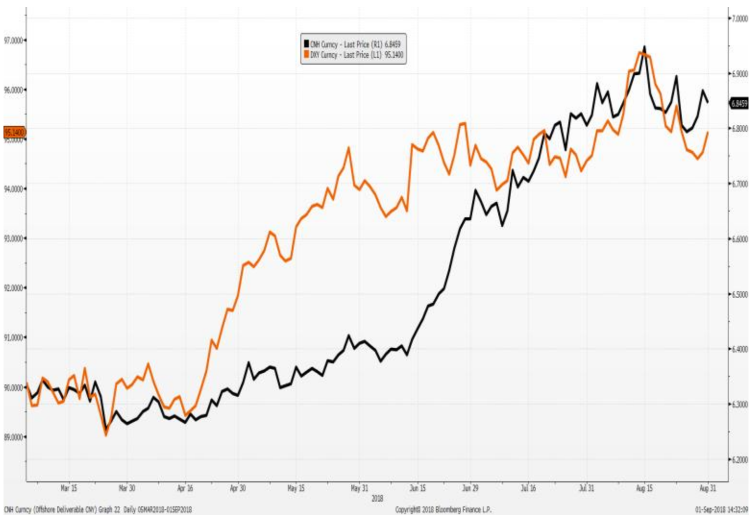
EM equities are +ve correlated to EMFX



Source: Bloomberg, Datastream

While we cast an eye of concern in Argentina, Turkey and even South Africa, it is China's upcoming policy moves that are far more important than these 3 countries. It is very clear that China has reinstated its pro-growth policy with fine-tuning on the fiscal as well as monetary fronts. We expect China to reaccelerate its fiscal policy which has been hampered in the first half as authorities clamped down on shadow banking and PPP infrastructure approvals. 1H18 fiscal deficit of RMB726bn is not only RMB192bn lower than last year but is only 30% of their current year deficit financing target. If they were to stick to this target, 2H18 will see RMB1.64trn fiscal spending which is 13% higher than 2H17 and a big jump of 115% jump hoh. On the monetary front, there have been 2 targeted RRR cuts of 150bps this year while we expect another 1-2 more RRR cuts in the next 12 months. Recent announcements for greater flexibility to NPL provision and guided lending to SME and export sectors should also translate to a stabilization of total social funding in the second half. The most important signals that are supportive for overall EM FX and CNH, in particular, are PBOC announcements to increase margin requirement by 20% in 3 August and to re-introduce counter cyclical adjustments to the CNY daily fixing on the 20th indicate the central bank's resolve to curb further CNH depreciation.

CNH weakness trough, DXY strength peaked in mid Aug?

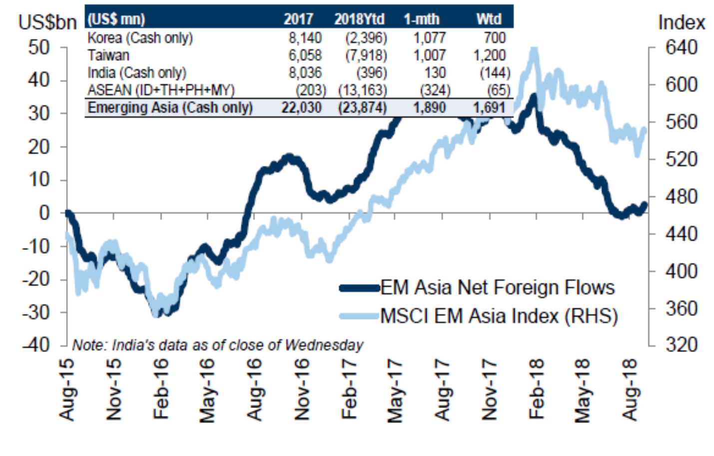


China financial condition index easing

Source: Bloomberg

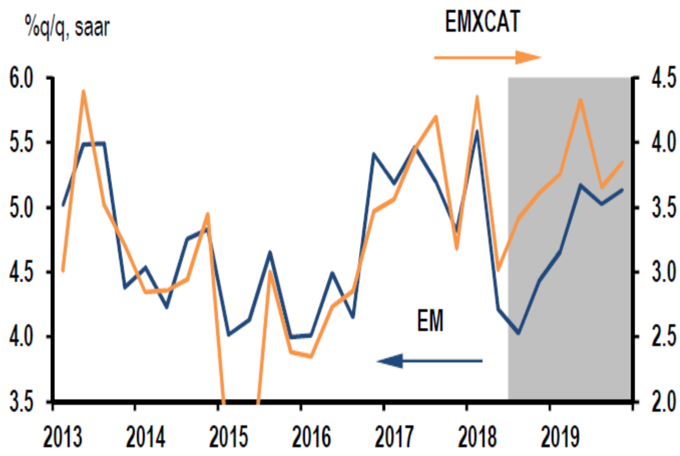
Equities: Overweight. Investors in EM Equities have clearly capitulated. Year-to-date outflows from EM Asia has reversed all of the 2016-2017 inflows. This marks the 2nd worst capitulation of foreigners as a percentage of market capitalization in Asia with only the 2008bGFC surpassing this current pessimism. However, the extent of this price retrenchment does not make rational sense since EM GDP growth excluding Argentina, Turkey and China is still at levels better 2014-2016 lows. The latest global PMI of 53.7 was a positive welcome and project stability at the economy. At this level, the PMI is consistent with 3.2% annualised global growth not far from consensus top-down forecast. PMI- New orders held stable while finished good inventory tapers further which is a good set-up for manufacturing recovery in coming months that tends to be positive for EM equities. Hence, we are expecting EM GDP growth to rebound in the coming quarters unless we have a massive multi-lateral trade war.

2018 has reversed all of 2016-2017 inflows into Asia



Source: Bloomberg, Respective Local Stock Exchanges, Goldman Sachs Global Investment Research

Exc China,Arg, Turkey, EM Growth is fine



Note: EMXCAT is EM excl China, Argentina, Turkey. Source: J.P. Morgan

Before we despair and assume EM asset is a waste of time, it important to take stock that EM assets have always experienced sharp drawdowns in a year and 2018 is no exception while 2017 bull market with little drawdown was an anomaly. There have been only 3 years since 2000 for which EM Equities did not experience a more than 10% drawdown in a year. In congrats, there have been 20 times since 2000 EM Equities have experienced an average decline of -21% in a year, sometimes twice. However, with benefit of hindsight, for each of these large drawdowns, EM Equities rebounded 1 and 3 months after. For 6months after, 85% of the times EM Equities returns are positive as well. The average rebound in performance ranges from 11% to 17% in 1,3 and 6 months later. To put into context the current drawdown, it has been 2 longest in duration and the extent of the decline is similar to past episodes. If we are right that Turkey and Argentina do not present contagion risk to rest of EM, China growth accelerates into 2H18 and US-China trade tension are negotiated away, it is quite possible to expect a significant rebound in EM Equities. While we have reduced our EM cash Equities exposure moderately, we remain overweight in EM Equities expressing the bullish view via numerous call options as a better risk-return option. We are overweight US, neutral Japan and underweight Europe.

Large drawdowns in EM Equities a year are not unusual; this episode is up there with norm. Rebound can be significant

MSCI EM Equities		days	Drawdown	T +1 mth Performance	T +3 mth Performance	T +6 mth Performance
10-Feb-00	23-May-00	103	-23.2%	7.7%	4.87%	-17.89%
17-Jul-00	30-Nov-00	136	-28.4%	2.3%	5.41%	1.47%
1-Feb-01	4-Apr-01	62	-21.4%	11.0%	7.14%	-15.18%
8-Jun-01	3-Oct-01	117	-26.2%	11.3%	31.99%	43.00%
19-Apr-02	10-Oct-02	174	-29.9%	14.9%	18.87%	11.34%
12-Apr-04	10-May-04	28	-17.0%	3.3%	2.46%	19.09%
10-May-06	13-Jun-06	34	-24.3%	10.4%	15.33%	31.68%
23-Jul-07	16-Aug-07	24	-17.7%	15.8%	30.20%	19.32%
19-May-08	20-Nov-08	185	-62.8%	25.4%	8.23%	62.84%
6-Jan-09	2-Mar-09	55	-21.8%	29.0%	67.46%	74.93%
12-Apr-10	25-May-10	43	-17.8%	10.8%	12.52%	28.47%
1-Aug-11	4-Oct-11	64	-27.6%	19.1%	12.79%	24.80%
29-Feb-12	1-Jun-12	93	-17.2%	7.0%	6.60%	12.73%
9-May-13	24-Jun-13	46	-16.7%	9.4%	14.40%	12.68%
22-Oct-13	4-Feb-14	105	-12.1%	4.2%	9.07%	16.51%
24-Jul-14	13-Mar-15	232	-13.1%	10.8%	3.29%	-14.04%
28-Apr-15	29-Sep-15	154	-27.2%	9.0%	3.01%	4.96%
16-Oct-15	21-Jan-16	97	-20.4%	8.2%	23.99%	26.53%
8-Sep-16	14-Nov-16	67	-9.5%	4.0%	11.34%	20.41%
26-Jan-18	20-Aug-18	215	-19.8%			
Average ex 2008 GFC		97	-20.60%	10.5%	15.60%	16.70%

When we extend this analysis of EM Equities to EM FX, we have similar conclusions. This drawdown is one of the second longest and the fourth-joint largest since 2000. Post such big drawdowns the probability of positive returns are significantly large and rebound can be meaningful too.

<u>EM FX larger yearly drawdown is not unusual as well and rebound are quite certain post such episodes</u>

EM FX Index						
EM FX Index		days	Drawdown	T +1 mth Performance	T +3 mth Performance	T +6 mth Performance
10-Feb-00	23-May-00	103	-0.5%	1.2%	3.2%	1.4%
17-Jul-00	30-Nov-00	136	-1.2%	1.3%	1.6%	0.9%
1-Feb-01	4-Apr-01	62	-2.5%	1.7%	1.2%	-1.0%
8-Jun-01	3-Oct-01	117	-2.5%	1.6%	0.7%	3.7%
19-Apr-02	10-Oct-02	174	-0.7%	3.7%	8.3%	10.9%
12-Apr-04	10-May-04	28	-3.8%	2.4%	4.4%	8.4%
10-May-06	13-Jun-06	34	-4.5%	1.1%	2.2%	6.7%
23-Jul-07	16-Aug-07	24	-3.7%	3.3%	7.8%	9.3%
19-May-08	20-Nov-08	185	-15.9%	5.6%	-0.4%	11.9%
6-Jan-09	2-Mar-09	55	-7.5%	7.7%	15.8%	16.2%
12-Apr-10	25-May-10	43	-5.6%	2.7%	4.2%	7.8%
1-Aug-11	4-Oct-11	64	-9.8%	4.4%	2.3%	6.0%
29-Feb-12	1-Jun-12	93	-6.8%	3.0%	3.2%	5.6%
9-May-13	24-Jun-13	46	-5.5%	2.1%	2.9%	2.3%
22-Oct-13	4-Feb-14	105	-3.7%	1.0%	3.4%	4.2%
24-Jul-14	13-Mar-15	232	-9.9%	2.6%	2.6%	-3.3%
28-Apr-15	29-Sep-15	154	-8.5%	2.4%	0.5%	2.4%
16-Oct-15	21-Jan-16	97	-6.3%	2.1%	7.7%	8.0%
8-Sep-16	14-Nov-16	67	-3.5%	1.1%	3.8%	6.3%
26-Jan-18	16-Aug-18	201	-8.5%			
Average ex 2008 GFC		**96**	**-4.9%**	**2.5%**	**4.2%**	**5.3%**

Fixed Income: Underweight. While we believe there will be another 3-4 more hikes from hereon till end 2019, we believe much of the rates risk is already discounted in the market. With spreads now widening to fair value for some bond classes and possibly outright cheap for others, we have been increasing our bond allocation albeit it remains an underweight. We remain careful not to trade too much credit risk for yields pick-up and having a bar-bell approach within the fixed income holdings allow us to achieve that. On the low-risk spectrum of our bond holdings are in a combination of investment grade bonds mostly in the US and high quality bond managers to ensure diversification. For the riskier part of our bond, it is confined to fund managers rather than to own single names to ensure a larger spread of issuers and strategies. Preference is for US IG, mortgage and asset-based securities and even US Treasury on the low-risk portion and EM credits and Alt1 capital bonds of European financials,

If we extend the same analysis for EM equities and FX to EM Credit, the conclusions are the same. It is not unusual for big drawdown in a year, this drawdown is large and long by historical standards and they tend to be have high probability of positive and meaningful returns post such large drawdowns.

JPEICORE Index		days	Drawdown	T +1 mth Performance	T +3 mth Performance	T +6 mth Performance
10-Feb-00	23-May-00	103	-3.6%	6.4%	13.5%	11.5%
17-Jul-00	30-Nov-00	136	0.9%	4.5%	9.4%	9.9%
1-Feb-01	4-Apr-01	62	-2.2%	0.5%	3.0%	-0.1%
8-Jun-01	3-Oct-01	117	-4.4%	2.0%	6.0%	11.2%
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10-May-06	13-Jun-06	34	-2.1%	0.6%	5.8%	10.8%
23-Jul-07	16-Aug-07	24	-2.6%	4.6%	6.8%	7.7%
19-May-08	20-Nov-08	185	-23.8%	12.6%	12.8%	28.7%
6-Jan-09	2-Mar-09	55	-3.1%	6.0%	15.7%	22.4%
12-Apr-10	25-May-10	43	-2.9%	3.4%	11.4%	11.3%
1-Aug-11	4-Oct-11	64	-5.3%	6.4%	5.8%	10.6%
29-Feb-12	1-Jun-12	93	-0.9%	5.0%	10.1%	14.0%
9-May-13	24-Jun-13	46	-12.5%	6.1%	5.2%	6.1%
22-Oct-13	4-Feb-14	105	-1.9%	2.6%	5.8%	9.0%
24-Jul-14	13-Mar-15	232	-2.4%	3.9%	0.8%	0.7%
28-Apr-15	29-Sep-15	154	-5.3%	3.6%	2.0%	6.6%
16-Oct-15	21-Jan-16	97	-3.8%	3.1%	9.4%	15.1%
8-Sep-16	14-Nov-16	67	-7.1%	2.0%	5.6%	8.7%
26-Jan-18	13-Aug-18	197	-6.6%			
Average		103	-5.4%	4.2%	7.3%	10.9%

Commodities: Overweight. We retain the view that oil price will range between $70-80 till 1H19 when the US shale gas distribution bottleneck is resolved. Our preference to express this sanguine oil view throughout the last 12 months were to invest in high dividend paying oil majors and service providers whose earnings are inflecting higher. We remain positive in our view on copper and are exploring other basic materials like steel, coking coal and lithium.

Alternatives Investments: We added a long/short Asia equities in addition to our for long/short Asia credit manager and total return fixed income fund manager.

Cash: Cash level remains 5 to 15% providing enough dry powder. Adopted significant downside put protection opportunistically.

Featured Picture/Quote:

A celebration of tenacity, uniqueness, courage and a life extraordinaire. Go Go!

https://www.tnp.sg/sports/others/young-racer-christian-footsteps-schooling


Young racer Christian in the footsteps of Schooling

His parents let go-karter, 11, live his dreams by moving to Milan where he can train and compete

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