

**Market Review**

2016 was an eventful year for global markets. Investors had to grapple with a slew of concerns – worries over a slowdown in China, RMB depreciation and a decline in oil prices – at the start of the year. Central bank actions also were also in the spotlight after the European Central Bank (ECB) and the Bank of Japan (BOJ) adopted a more hawkish tilt; the Federal Reserve (Fed) later turned more cautious and backedpedalled on its more hawkish stance, citing concerns over global economic uncertainties. All these led to a strong relief rally for global financial assets.

The unexpected outcome of the Brexit vote roiled global financial markets; nonetheless, bond markets rallied in the aftermath of the Brexit vote as demand for safe haven assets rose sharply. Following Brexit, the US Presidential election was another major risk event that had investors on the edge of their seats. The surprise election of Donald Trump as the country's 45<sup>th</sup> US President contributed to even greater uncertainty for global debt markets, particularly for emerging markets. While policy direction under the new Trump administration remained unclear, expectations of fiscal stimulus from infrastructure spending and tax cuts were enough to send US Treasury (UST) yields higher. Furthermore, expectations of a more hawkish Federal Reserve contributed to market volatility; all these factors affected bond markets negatively.

US Treasuries were choppy overall, as 10-year UST yields see-sawed within a significant range, in reaction to rhetoric from the Fed, ECB and BOJ, as well as other market moving events in the course of the year. The 10-year UST yield was driven down to a record low of 1.36%<sup>1</sup> at one point after the Brexit vote, as investors took refuge in safe haven assets. Markets then focused on central bank policy actions where uncertainty over potential Fed rate hikes and ECB, as well as the shift in policy stance by the BOJ saw UST yields vacillate while trending higher. Treasuries subsequently sold off sharply in November, as markets digested the potential repercussions of Trump's election victory in the US. The UST sell-off continued in December after the Fed's hawkish revisions to its policy forward guidance, which was less anticipated by the market. The 10-year Treasury yield climbed to 2.59%<sup>1</sup> before retracing to 2.44%<sup>1</sup> at the end of December.

Asian credits saw strong performance for most of 2016, helped by falling Treasury yields and a tightening in credit spreads over the course of the year. The JACI Composite Index (JACI) returned 5.8% for the full year, with spreads tightening by 55bps, propelled by investors' search for yield. Returns for Asian credit markets turned negative in the last quarter of the year, with the JACI down 3.0%, driven by negative Treasury returns, even as credit spreads continued to grind tighter. Investment grade sovereigns and quasi-sovereigns were the laggards, reflecting both segments' higher sensitivity to Treasury yield movements due to their longer duration.

**Investment Strategy and Outlook**

We expect the global outlook to remain challenging in 2017 given the current uncertainties in the market, as well as the global geopolitical environment. Active management will thus be the key to navigating the uncertain investment landscape and delivering returns over the year.

For 2017, we believe that risk events in the market could surface, given i) the current uncertainties surrounding US policies under a largely untested Trump administration, and ii) the impact of Trump's policies on China and the rest of Asia. Furthermore, the Fed's policy path could potentially be affected by the scale of Trump's fiscal reflation policies, which remains unclear.

We anticipate that USTs are likely to continue to see periods of volatility, particularly during periods of risk-off sentiments. Managing through periods of volatility will be a key consideration over the course of the year for our fixed income strategies.

Against this challenging backdrop, we continue to stay prudent on our duration positioning and prefer to maintain a lower duration relative to the benchmark across our credit portfolios. That said, we remain prudent on credit selection and continue to broadly prefer investment grade names over high yield, which provides more attractive relative valuation. We also intend to remain nimble in our duration strategy, particularly as we gain more clarity on Trump's fiscal policies and the accompanying Fed rhetoric over coming months.

Within the Investment Grade (IG) space, we prefer standalone investment grade, 'BBB' credits that offer higher spread cushion against rising interest rates. This is reflected in the average credit rating of 'BBB' for our portfolios. In terms of credit selection, the focus is on rigorous and careful credit selection, based on recommendations made by the credit research analysts, who are sector specialists in their respective areas of coverage. Within high yield, we stay cautious on overall sector valuation levels, though we expect stabilising fundamentals and lower net supply to provide some technical support to the sector. We seek to remain nimble in managing our high yield exposures and will selectively add to our high yield positions for carry.

We have provided further details on performance attribution for FY2016 and how we are positioned across the following credit portfolios – **Fullerton Short Term Interest Rate Fund**, **Fullerton SGD Income Fund** and **Fullerton USD Income Fund**.

#### **Fullerton Short Term Interest Rate Fund**

The fund returned 2.85% on a bid-to-bid basis<sup>2</sup> over 2016. The strong spread compression in credits and the positive yield carry were the key drivers of performance over the year as bond markets rallied on the back of the strong appetite for yield. The key performance detractor was the fund's duration exposure. Despite the lower duration stance that the strategy adopted, fund performance was affected by the sharp rise in UST yields in 4Q16, post US elections.

Looking forward, we expect to keep portfolio duration close to 2 years for the fund. From a sector perspective, we continue to like financials, which are expected to benefit from rising rates. Within Financials, we are comfortable with strong, systematically important global banks. We also like non-bank financials that play important policy roles, or which are leading players in their respective segments. We continue to have higher exposures to real estate, preferring blue-chip real estate and property names in the region, as well as selective Chinese property players with improved credit fundamentals.

#### **Fullerton SGD Income Fund**

The fund returned 5.63% on a bid-to-bid basis<sup>3</sup> over 2016. The strong spread compression in credit and the positive yield carry were the key drivers of performance over the year as bond markets rallied on the back of the strong appetite for yield. The key performance detractor was the fund's duration exposure, as fund performance was negatively affected by the sharp rise in UST yields in 4Q16, post US elections. Weakness in the Singapore offshore marine sector also detracted from overall fund performance.

Looking ahead, we expect to keep portfolio duration between 3.5 to 4 years. From a sector perspective, we continue to like financials. We maintain a diversified exposure within financials, favouring banks and insurance companies with sound credit fundamentals in strong financial regulatory jurisdictions. We continue to have higher exposures to real estate, preferring blue-chip real estate and property names in the region, as well as selective Chinese property players with improved credit fundamentals.

#### **Fullerton USD Income Fund**

The fund returned 2.09% on a bid-to-bid basis<sup>4</sup> over 2016. The strong spread compression in credit and the positive yield carry were the key drivers of performance over the year as bond markets rallied on the back of the strong appetite for yield. The key performance detractor was the fund's duration exposure. In particular,

the fund's positions in long-dated bonds were negatively affected by the sharp rise in US treasury yields in 4Q16, post US elections.

Looking ahead, we have maintained portfolio duration at 4.3 years as at end January but could look to modestly extend duration further as Treasury yields stabilise within a more attractive yield range. From a sector perspective, financials and real estate continue to be our larger sector exposures within the portfolio. We maintain a diversified exposure within financials, favouring banks and insurers with sound credit fundamentals in strong financial regulatory jurisdictions. Within real estate, we maintain a diversified portfolio, preferring blue-chip real estate and property names in the region, as well as selective Chinese property players with improved credit fundamentals.

*Please do not hesitate to contact us if you require further clarification.*

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<sup>1</sup>Source: Bloomberg

<sup>2</sup> *Bid-to-bid returns for **Fullerton Short Term Interest Rate Fund – Class C**. Returns are calculated on a single pricing basis in SGD with net dividends and distributions (if any) reinvested. Bid-to-bid adjusted returns of -0.15% include an assumed preliminary charge of 3% which may or may not be charged to investors. Source: Fullerton Fund Management Company Ltd.*

<sup>3</sup> *Bid-to-bid returns for **Fullerton SGD Income Fund – Class A**. Returns are calculated on a single pricing basis in SGD with net dividends and distributions (if any) reinvested. Bid-to-bid adjusted returns of 2.63% include an assumed preliminary charge of 3% which may or may not be charged to investors. Source: Fullerton Fund Management Company Ltd.*

<sup>4</sup> *Bid-to-bid returns for **Fullerton USD Income Fund – Class B**. Inception date is 15 April 2016. Returns are calculated on a single pricing basis in USD with net dividends and distributions (if any) reinvested. Bid-to-bid adjusted returns of -0.91% include an assumed preliminary charge of 3% which may or may not be charged to investors. Source: Fullerton Fund Management Company Ltd.*

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