CROSSINVEST

Wealth & Asset Management
Private Equity & Venture Capital
Family Office Services
Since 1985

Q4 Quarterly
&
Outlook 2023

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Market Stress

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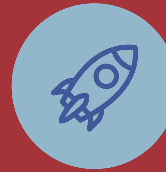
Relative Value

Three Key Market Drivers

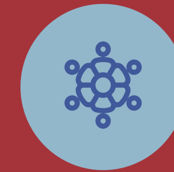
Valuations

As central banks seek to remove excess liquidity to fight inflation, valuation discipline will become increasingly important in driving returns.



Quality

Rising refinancing costs and the high likelihood of a drop in earnings mean that we are positive on quality assets across both equities and fixed income.



Liquidity

Poor liquidity in Treasuries, fiascos in gilts and private markets are for us a sign of things to come. We stay nimble and liquid to take advantage of dislocations.

Overview

2022 was a historic year, where numerous stocks once held to be darlings fell over 75%. Worse, assets which were once thought to be safe also faced historic drawdowns as fixed income had its worst year in well over multiple decades. As we go into 2023, the primary risks we see today are not only elevated probabilities of recessions across the United States and Europe. It is normal for business cycles to occur, and it is necessary for recessions to clear away the deadwood and inefficiencies of the economy. Rather, it is the unwinding of central bank excess, dysfunction in multiple areas of the market, excessive valuations, asset quality and leverage masquerading as illiquidity premiums. Market bubbles tend to wear the façade of narratives and companies previously thought to change the world have seen their valuations deflate rapidly. Asset returns are not only driven by discount rates but also of their underlying quality. While macro winds continue to blow, we remain anchored by fundamentals of the assets we hold. Looming market stress in private markets and the blowup in gilts lend caution to our portfolio construction. We remain flexible and liquid to take advantage of potential market dislocations.

Valuations Matter

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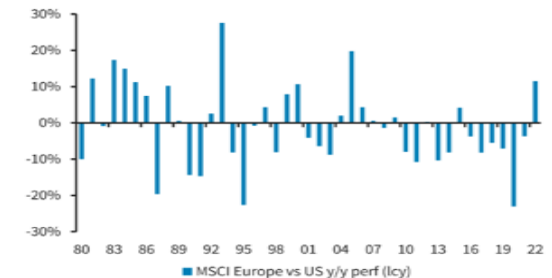
It may seem trite, but valuations do matter. Asset returns are a function of the price you pay. However, the need to account for valuations evaporated as central banks flooded the markets with liquidity during the pandemic. Companies without profits were elevated to sky-high valuations. Like a house of cards, this all came crashing down as economic gravity reasserted itself. Tiger Global, a high-flying hedge fund with over $100 billion USD in assets, lost over 50% in 2022. The danger we see is that even with such huge losses, market carnage may not be over. A stock that has lost 50% of its price may look cheap but many profitless companies have seen their valuations drop by 50% multiple times. We point to Snap Inc. as an example. The stock's price was above $80, then at $40, then $20. Today, the stock is trading below $10.

Market bubbles tend to form around narratives that eventually broke. In the 1970s, the Nifty Fifty was a designation for companies thought to change the world. Today, we have an acronym of FAANG+ for Facebook, Apple, Amazon, Netflix and Alphabet's Google. While valuations look relatively reasonable when compared to the profitless growth companies that mushroomed during the pandemic years when central banks were printing money, we remain bearish. Not only is their runway of future growth increasingly short, but they are also highly exposed to consumer discretionary spending which will be very vulnerable in an economic slowdown which we think is highly likely.

Growth stocks have outperformed value stocks since the Global Financial Crisis of 2007 due to central bank stimulus and low interest rates. However, the onset of inflation mean that higher discount rates will likely enforce valuation discipline. Market leadership within equities have always changed during financial crises, and we believe the current environment will trigger a lasting rotation of equity market leadership from Growth to Value, from US to the other parts of the world, and from the digital economy to the real economy.

To the other end of the spectrum, EU equities have outperformed US equities by the most since 2005, even amidst all the headlines of war in Europe. We had a contrarian position to be overweight European equities as they were at a record discount relative to the US. This shows that unloved assets can generate returns when valuations have discounted the worst-case scenarios, and that media favorites can underperform when too much optimism is baked into the price. We believe this represents a key danger in passive investments such as ETFs which track indexes based on market capitalization. This means that the weightage would be highest for assets which are the most richly valued.

EU equities outperformed US the most since '05

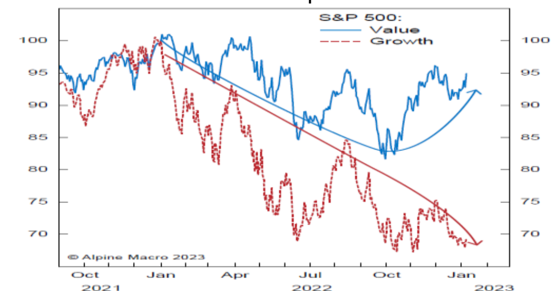


Source: Barclays

Profitless companies were hit the hardest

Source: Société Générale

Growth stocks have underperformed Value



Source: Alpine Macro

Quality

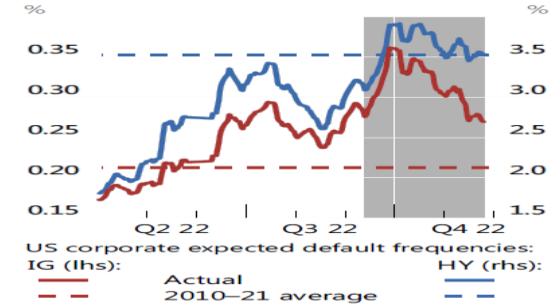
Valuations are not only restricted to equities, however. A comparison of valuations from a multi-asset perspective also show US equities to be especially unattractive to other assets including cash and fixed income. After a historic year which saw the worst returns for the asset class in more than 200 years, income has returned to bonds once more. However, we remain positioned in high quality fixed income such as investment grade credit and Treasuries for now rather than high yield. Firstly, credit spreads do not look particularly attractive at 400 bps. In prior recessions, high yield spreads can blow past 800 or more. Secondly, profit margins are historically high due to central bank liquidity and government largesse in previous years. If profits fall as we expect, debt metrics would worsen significantly. Lastly, periods of yield curve inversion have not been supportive of outperformance in credit.

We remain underweight equities overall but are overweight quality stocks within the allocation. We believe quality stocks are well poised to outperform as rates are likely to turn from a headwind into a tailwind. Quality stocks were hurt by rising discount rates as the Federal Reserve undertook an aggressive hiking campaign. As interest rates went from 0% to 4.5%, we see a much lower probability of interest rates going up by another 450 bps to reach 9%. Quality stocks also have profit margins and balance sheets that are much more likely to hold up in a recession.

2022 has shown the need for asset managers to be cognizant of macroeconomic conditions. Many views abound today on the direction of inflation, interest rates, the business cycle, and the US dollar. We note that many commentators who believe inflation is likely to stay elevated this year were also the ones who believed inflation would be transitory last year. While we acknowledge the need to alter portfolio construction macroeconomic conditions evolve to protect capital and provide robust risk-adjusted returns, we highlight that fundamentals drive returns over the long run.

That few analysts saw inflation coming should give us all a healthy dose of humility about our predictions. That the Federal Reserve has 400 PhDs. in economics and still got inflation wrong is a sharp reminder of why economics has been called the dismal science. Being positioned in quality stocks means that the companies we own are relevant in today’s world, have resilient profit margins and strong balance sheets. Amidst such high uncertainty, we remain anchored by fundamentals.

Default risks are climbing

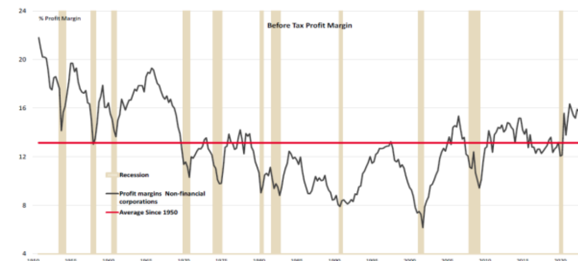


Source: Bank of International Settlements

Bonds offer compelling value vs equities

Source: Brandywine Global

US margins look extended



Source: Société Générale

Liquidity

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In 2007, global liquidity was enormous right up to the eve of the subprime mortgage crisis. Chuck Prince, the former Citigroup chief executive officer infamously said that "As long as the music is playing, you've got to get up and dance", when queried on why his bank was participating in the leveraged lending business even as the subprime crisis worsened. In periods of excessive liquidity, discipline evaporates as investors chased returns. Institutions follow because of the huge disincentives from lagging behind peers. We believe a similar story is happening as investors chased returns in assets such as cryptocurrencies and speculative growth companies.

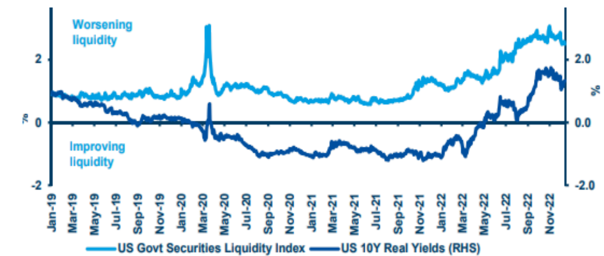
The recent episode in gilts where yields spiked, bid-ask spreads widened, and sterling depreciated were consequences of hidden leverage in the global financial system. Years of low interest rates and ample liquidity have encouraged risk taking that may prove especially haunting when the tide of liquidity is receding, as it is today. Blackstone is one of the world's largest investment firms with over $880 billion USD in assets. That it had to limit withdrawals from its $125 billion real estate investment fund is to us a canary in the coal mine and a sign of things to come. We believe financial accidents in unexpected places are highly probable in this environment.

Liquidity conditions have deteriorated significantly in US Treasuries and the spreads in the government bonds of the Eurozone periphery such as Italy have remained elevated over Bunds. Monetary policy works with long and variable lags as it takes time to work itself fully into the economy. The Federal Reserve has undertaken one of the most aggressive hiking and quantitative tightening campaigns in history. The full impact is unlikely to have been fully felt across economic activity and asset valuations so far.

It may appear to be paranoia in due course but as the guardians of capital it is our job to worry and prepare for worst case scenarios. Investing is never a sprint for us but a marathon. We eschew private assets today as many of them tend to take on high leverage under the masquerade of the illiquidity premium. While we remain bullish on fixed income and believe they are poised to generate equity-like returns in 2023, we also retain a healthy allocation to cash to take advantage of market dislocations should financial accidents occur.

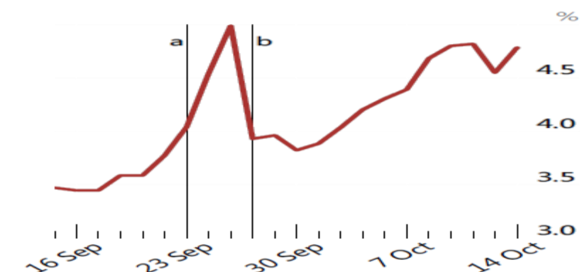
The aggressive hiking campaign by the Fed means that cash is now offering a higher yield than junk-rated bonds a year ago. In addition, should inflation prove stickier than expected, it will also be a beneficiary of higher terminal rates. The combination of flexibility and yield make cash a very attractive asset in today's environment where two-way risks abound.

Liquidity conditions are deteriorating



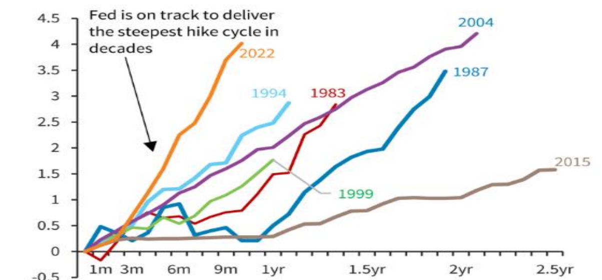
Source: Amundi

30y gilt yields spiked in the September turmoil



Source: Bank of International Settlements

Historically aggressive hiking campaign by the Fed



Source: Barclays

Key Calls

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Looking Forward

We were overweight duration tactically when the 10-year Treasury was trading at 4.2% but have since taken profits of 10% to reduce duration to neutral. We also reduced our overweight to European equities as they surged 27% off their September lows. While European equities have outperformed their US counterparts by the most since 2005, they are no longer cheap.

- We are underweight risk assets across equities and fixed income and are overweight recessionary beneficiaries.
- We have taken positions that benefit from the weakening of the US dollar including the Euro and Emerging Markets.
- We remain overweight on liquid alternatives and market neutral products to generate return while avoiding market risk.
- We are overweight cash as we believe staying nimble and flexible will be key to capitalize on trading opportunities.

Our current views are as follow

- United States: Underweight – US equities are the most expensive globally while earnings estimates have yet to fall.
- Japan: Overweight – Attractive valuations and globally competitive franchises make for a small overweight.
- Developed Europe: Neutral – We took profits tactically as valuations have come off historic lows.
- Asia ex Japan: Neutral – The region is set to benefit from China's reopening, but we prefer fixed income to equities
- Emerging Markets: Neutral – The dollar has turned, and we have added to a position as EM offers attractive yields and fundamentals.
- USD Rates: Neutral – We are neutral on US duration as recessionary risks have become elevated.
- DM IG Credit: Underweight – We are overweight quality securities but prefer Treasuries and cash over credit.
- DM HY Credit : Underweight – We have zero HY exposure in developed markets as spreads do not offer compelling value.
- Cash: Overweight – We are overweight cash as yields are attractive while offering flexibility amidst uncertainty.

Crossinvest (Asia)

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About Us

We are a privately-owned financial institution, with over 38 years of Swiss heritage that exemplifies the finest wealth & asset management traditions.

Our key business areas are asset & wealth management, private equity & venture capital and family office services. We work exclusively with high & ultra-high-net-worth individuals, families and institutions.

We have won over 24 industry awards for our portfolio performance, client servicing and proprietary technology. As an independent asset manager, we are keenly aware of the importance of considering the cross generational impact of investment and wealth-management decisions.

We appreciate that every client is unique, and every need is different. This leads us to create tailored solutions to meet our clients' goals while maintaining institutionalized processes of asset management.

Our Mission

Our clients' wealth is the result of the time they sacrificed away from their families to ensure their financial security; it is our mission to protect and build on this sacrifice.

We achieve this through

- Building long term value
- Our independence & open architecture
- Operating as a dedicated fiduciary advisor
- Our commitment to provide the best investment solutions & services
- Crafting the best solutions for our clients' individual needs

Recent Awards

2022

Best Client Service

Best Innovative Use Of Technology

Best Overall Digital Engagement

Most Effective Investment Service Offering – Highly Commended 2022

2021

Rising Star for Asia-Pacific

Best Multi-Family Office Singapore 2021

Best Independent Wealth Manager Singapore

2020

Best Asset Manager Serving Family Offices & Private Banks

Best Next – Generation Offering – Highly Commended 2020

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Contact

CROSSINVEST

Telephone: +65 6220 9339
Fax: +65 6220 6556

Email: relations@crossinvest.sg

Web: www.crossinvest.sg
Address: 1 Phillip Street, #15-00, Royal One Phillip, Singapore 048692

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