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To:	Our Valued Investors	**From:**	Chan Wai Chee
Letter:	M02/2021/04	**Dept:**	Managed Accounts
Email:	MAenquiries@phillip.com.sg	**Date**	30 April 2021
Re:	Bond yields, REITs, China, Commodities, Vietnam, Others	**Re:**	Functions, as fundamentals

Bond yields

A security has one or more functions. An important function of the US Treasury securities is its use as a collateral in secured financing transactions. In an October 2020 study, done using confidential supervisory data, Sebastian Infante & Zack Saravay of the Federal Reserve Board are able to determine the degree of collateral re-use at the dealer level.

https://www.federalreserve.gov/econres/feds/files/2020103pap.pdf

There are 2 issues we could grasp from this study.

One: 4 market disruptions a year – *"Collateral re-use increases the total amount of leverage in the financial system. When market conditions deteriorate, market participants become more reluctant to extend new secured loans or roll over existing transactions. As a result, there will be less collateral available for re-use, and re-use will drop, intensifying the contraction in secured financing activity. High levels of collateral re-use can contribute to pro-cyclicality. Repo collateral multiplier for the 30 days around quarter-end, across the 16 sampled quarter-ends showed non-U.S. dealers' repo collateral multiplier tends to decline sharply on quarter-end dates, consistent with well-documented window dressing."*

Two: Shortage of collateral – The aggregate collateral multiplier is 7X. Incentives keep this going, with higher profits at non-US dealers. *"Changing the Fed's holdings of Treasuries is an important tool to adjust the level of re-use. Put differently, a $33B increase in weekly Fed purchases leads to a 0.5 increase in the collateral chain."* Yet, QEs continue! *"From this perspective, if policymakers are concerned about the level of leverage and interconnectedness in the financial system, shrinking the Fed's balance sheet is an effective tool to decrease the average length of collateral chains. However, a smaller Fed balance sheet increases dealers' exposure to sharp changes in external demand and supply of Treasuries, and thus, can result in disruptions similar to those triggered by the COVID-19 outbreak."* No solution.

As US Treasury securities serve this important function in funding, then such shortage would boost Treasury security prices and keep the yields down.

We take the current belief by Wall Street to link higher yields to likely inflation as a buying opportunity.

Understanding economic and market fundamentals is not a difficult task. But judging how long certain market players will sing along to the tune of wrong market calls remains difficult.

This, we ask for your patience.

S-REITs

Interest rates aside (we can discuss this in future issues), we focus on finding REITs that are able to increase its margin of income over interest expense, have redevelopment opportunities, have sponsors' ability to inject properties at 'cheap' valuation, have existing properties with good revaluation potential, and trade at good market volumes.

Going on a short history, S-REITs surged in 2019 when interest rates were plunging.

China

FDI grew by 39.9% y-o-y to RMB 302B in 1Q2021. This is also a 24.8% improvement from pre-Covid 1Q19. This is important because foreign reserves remain the fundamental basis of the RMB monetary system. If this trend persists in the coming quarters, we would see improvements - in industrial production, retail sales, currency, and stock prices – like in 2016-17. Our holdings should benefit.

We are still taking buying opportunities afforded by regulatory actions.

Meanwhile, our portfolio manager, Ian Lew, is interested in the opportunities arising from the upcoming quarterly review for the Hang Seng Index.

On the negative, we are wary of the SOEs in fixed income.

Commodity price inflation

Disruptions to demand and supply happened after the 2008 and 2020 market crashes.

When we tried to return to the normal after 2008, we returned to the same jobs, same industries, and same ambitions. Although it is early to conclude for the recent one, we sense a difference. The forced lockdowns may have altered family roles, business behavior or business plans. Or, even a total change of business.

A mine or factory might never open again. Workers might never need to return to their offices again. Goods might never be transported by the same mode again. Bank branches might never reopen again.

There is consensus that the supply shock had caused price increases to date of many commodities. The supply shock could end up with some permanent changes, when it does get back to 'normal'. We would trade this trend to higher levels, and see how the return to the normal works out eventually.

Commodity prices took two years to top out in 2011, after the 2008 crash. We are only one year from the March 2020 bottom. And, the supply shock seems to be more permanent than 2009-2011. Will we have one more year?

The China-US trade war (supply) and infrastructure spending (demand) would benefit copper and iron ore, and food commodity prices would benefit. And prolonged lockdowns could make food commodity prices surge.

One more year looks reasonable.

Just to play safe, we are invested in companies that control many stages (or the whole) supply chain; have NPVs of reserves (calculated at lower commodity prices) that far exceed current market capitalization); paying dividends or on the verge of paying dividends due to the recent and very positive cash-flows; or, other comparative advantages.

Vietnam

Our funds' portfolios have a 6% stake in a Vietnam fund. The fund manager believes Vietnam is a growing economy with stable inflation, and an expanding middle-income population. We acquiesce in his belief that Vietnam's current account surplus should keep the Dong stable. However, we do find risk as the Dong is not big in supply, and can be volatile.

Other issues

We are still concerned with high valuations in the US market in our core services. What little we bought, we bought with strong reasons.

We are tilting towards a weaker USD. But, not around quarter-ends.

We are re-examining banks with a slight difference, as we do not equate bank reserves as money. Reserves not lent out is not money.

We are puzzled by the continuing obsession by central banks' interest rate (which they could not control anyway) monetary policies. Singapore's MAS succeeded for 40 years with its exchange rate monetary policy. Our digging in this area may shed some light on currencies.

Thank you

We are grateful for your continuing support.