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Year End 2014

Dear Helvetic partners and friends,

2014 was an interesting year and as it draws to a close, we are thinking back to the start of the year where we relocated to our newly renovated premises late December 2013 in a charming old shop house from the 1920s within the central business district, and realized better Feng Shui here as in the former office building. Here we find history and tradition combined with the dynamic financial district and still with a spot of the old Singapore environment with its bars and restaurants.

It has been a turbulent year on the international front; with the Russian annexation of the Crimea peninsula as a consequence of the "revolution" in Kiev, the more or less intensive fighting in eastern Ukraine, the tragic loss of MH17, Europe struggling on the edge of recession and maybe deflation? And the heavy falling oil price since late summer, falling commodity prices - especially hurting EM - and the horrific spread of terrorism and violence in parts of the Middle East.

The Russian supported unrest in eastern Ukraine prompted a number of governments to apply sanctions against individuals and businesses from Russia and Ukraine. Sanctions were approved by the US and EU and other countries and international organizations. Russia on its side responded with sanctions against a number of countries, including a total ban on food imports from EU, US, Norway, Canada and Australia, which harmed our investments in Norwegian salmon producers – exporting rather heavy to Russia – but only for a short while, as the salmons seem to find their way upstream to Russian supermarkets and restaurants.

Some EU countries felt the impact of the embargo more severe than others. Russia has become a booming market for Western consumer goods in the past decade. Germany's exports to Russia totaled 38bn euros in 2013. And in fact the EU seen as a group does more business with Russia than with the US. So the pain felt in Europe is indeed real, and contributes to already existing deflationary forces.

The International Monetary Fund (IMF) halved its forecast for Russia's economic growth next year to 0.5% from 1%. Geopolitical uncertainties are having a big direct impact on the Russian economy, and Russia is more likely to contract in 2015. We felt the pain from the embargo and the drop in oil prices via our investments in the highly modern and regulated Norwegian offshore drilling sector which was working closely with private Russian oil companies in providing clean and safe drilling equipment, especially in the harsh weather regions. Within 3 weeks, a number of drilling rigs had to be out of Russian waters. Even contracts for years in the future had been closed before the sanctions were implemented. This shows how political risks can and should not be underestimated.

In our own region we cover a part of the broader Asian area via some selected funds, i.e. the Carnegie Asia Equity Fund. We are pleased to find it up 16% YTD in USD terms (as per 12.12.2014) – versus the broader market; Asia ex. Japan at 7%.

The Fullerton Bond funds are still funds we are happy to hold. The Singapore Dollar Income Fund and RMB Fund did well so far; 4.9% and 3.1% respectively until November. The Chinese RMB depreciated from 6.06 to 6.16 versus USD (-1.6%), in EUR this relates to a gain of 8%. The RMB was quite flat versus the USD until lately. The big drop in especially the JPY to the USD is now biting in China and other countries competing with Japan, and lately the RMB was slightly down versus USD.

The geopolitical uncertainties were mostly disregarded by the market except for a harsh draw-down in the autumn. The market is still climbing the wall of worries and might very well continue doing so for a while though with increased volatility. The USD appreciated versus all peers, and will most probably be able to show the euro and most other currencies the back wheel for the foreseeable future. Short-term traders and trend-followers are massively long – but a number of managers we talk to quite miss the wave and will have to move in at some point. Short-term, though, the USD probably needs a consolidation period.

In Singapore things were as usual, thank heaven for that, peaceful and problems here seems manageable compared to problems abroad. But the fast changes in the international regulatory environment is changing the way banks and fund managers like ourselves handle their business and relationship to clients and partners. Breaches of regulation, especially connected to tax issues are seen as serious matters by regulators. FATCA is now up and running with Singapore signing an Intergovernmental Agreement (IGA) with the United States about reporting of all clients with indices of US tax obligations. The burden of "policing" is more and more put on financial institutions, and these costs are exploding.

2015 and ahead

After a long period of massively support from most central banks and rather low market volatility, the macro environment likely will become more fragmented and challenging next year. The US Fed stopped QE and Japan is speeding up and Europe's ECB will likely launce early 2015, maybe already in January. Some points and risks issues, that likely will make it harder for investors to achieve their target return forward going, are:

- The majority of news coming out of the US is good news, from improving employment numbers to a robust consumer confidence and stable GDP growth. However, the weakness of other currencies will create a drag on US companies' profits abroad. A tumbling oil price will cause the oil industry to cut capital expenditures more than expected just weeks ago, which poses a certain drag to the economic recovery fueled by an energy renaissance. A third of US GDP growth comes from the energy industry and Texas has been contributing 40% of all new jobs since 2009. In general, lower oil prices are equal to lower taxes on consumers and enables higher spending in other areas. But if saved and not spent, it also supports the deflation process that central banks desperately try to prevent. On the way to a better economy for consumers due to lower oil and gas prices, default by nations (Venezuela?) and overleveraged energy companies might come first, creating storms in the market place. If this happens, and the velocity of money stays low, things might quite suddenly look less bright, at least for a while.

- Europe has been edging towards a deflationary recession that the ECB will aggressively try to prevent unfolding. Will the expected European style QE, mixed with a lower currency, be enough to spark a recovery? Or will it have no effect on an economy with a lot of structural problems remaining (even some improvements are seen in some parts of the EU)? Greece has just pushed forward its election that could lead to the radical Syriza party gaining real influence or even power. The party, which is currently ahead in the polls, opposes the terms of rescue by the European Union and International Monetary Fund and if elected, might reopen the Eurozone's woes and currency crisis.

- In the UK election is coming up, where the UK's relation to the EU will be an issue. Volatility from this side is likely, though the final outcome might not at all be that the UK chose to go it alone.

- The Japanese macroeconomic experiment has taken center stage this year. The significant fall of yen was largely expected after the QE2 was announced, but the move towards USD/JPY at level 120 seems to have come too fast in recent months, in the sense that it is precisely what Japan wanted, but if done too fast might upset competitors, not able to devaluate versus USD at same speed (China and Korea) without causing political issues in Washington. Will the BOJ lose control of the yen, and how will Japan's competitors act? And throw in a mix of 240% debt-to-GDP (even much debt is in fact internal) Japan could develop to a huge potential tail-risk, on a big move into unknown territory with no way back. Nevertheless, we see chances being bigger as risks for now and stay invested in Japan with a USD-hedged JPY.

- China, which is now the largest economy measured by PPP (purchasing power parity), is clearly slowing down, but by how much? Its economic indicators have to be taken with a grain of salt; they might be lower than we thought and are told. The impact on its trading partners, in particular those having benefited from huge commodities exports, is seen around the EM region. An overleveraged shadow banking system and the transition from an export-driven towards a consumption-oriented economy have to be managed carefully. With all the challenges lying ahead, we still think the Chinese management will get there over time. Another question is how will the increasing internationalization of the Renminbi play out in the process? As per now, there are more questions than answers. But we will continue to stay invested in China for now.

- The emerging markets as a group are now contributing 50% of world GDP and have become overleveraged too; largely dependent upon portfolio and direct investments. The average emerging market currency is now back down to a level last seen in 2002 versus the USD, which also creates opportunities for those not serving a huge USD debt. Low oil prices are good for consumers but are going to create problems for some EM. Energy related high yield bonds are also a significant source of risk, as we have seen recently (for our part in Norway) – making up 16% of the high-yield area. With banks providing lesser liquidity to the secondary corporate bond market and a risk of a spill-over to other areas, there are risks lying ahead.

We have decided not to send out Season's Greetings letters, but will instead contribute to "Doctors Without Borders", as we think this non-political organization is doing an amazing job, supporting refugees wherever needed, and often risking involved staff's own lives, as we tragically saw happening in Syria. http://www.doctorswithoutborders.org/

We thank you all for your trust and commitment again for this year and we are looking forward to a challenging but hopefully happy year 2015.

Best regards,

Your Helvetic Team Singapore