

December 2018

Should 2018 be forgot and never brought to mind

by TriLake Partners' resident [lords a-leaping](#)



Can you imagine placing a bet on every team in the English Premier League to win this weekend (yes, Patrick, even Fulham), only to see all matches end in a draw? A horrible analogy, yes, but none of the expectations of returns in any asset class at the beginning of 2018 appears to have resulted in a payout.

Beta represents the risk you take for taking your cash out of your safety deposit box or deposit account and investing it in the length and breadth of the capital markets. You expect a return higher than what you would've otherwise earned by leaving the cash in the box or bank account. Many fund managers attempt to improve on that risk/return through smart security selection and opportune buying and selling. That excess alpha return can be elusive and many managers do not produce alpha consistently. Beta is compensated risk but the time it takes to get compensated varies. It may take years but a broad exposure to markets has always been rewarded eventually.

Invest during a market trough, say 2009, and the reward can come quickly. Invest during a peak and the reward may not come during your intended investment horizon.

This is why most serious investors maintain diversified multi-asset portfolios. Asset classes don't always move in lockstep and the total risk of a properly diversified portfolio should be less than the sum of the components' individual risks. We also know that correlations between pairs of assets can approach one during market stresses and the benefits of diversification disappear at the very moment when you most need protection.

Which leads us to what happened in 2018. With less than ten trading days left, it may be safe to declare 2018 as the worst year *ever* for multi-asset portfolios. Never have we seen a year where practically every major asset class had a negative return. Unless you had a portfolio heavily tilted toward USD cash, Brazilian stocks, natural gas futures or uranium, this year's portfolio return is probably feeling radioactive for the first time this decade. Even the US stock

markets which diverged from its less fortunate counterparts most of the year gave all its returns back in recent weeks. This result is all the more jarring when contrasted with the uncomfortable risk-on consensus at the beginning of the year.

Market sentiment is harder to gauge than market fundamentals. Whilst the February swoon could arguably be a case of exuberant valuations, the rest of the year was more of a slow realization of the seriousness of the trade tensions and belligerent intentions and the deadening effect on corporate investment and profits worldwide. There was no shortage of idiosyncratic risks that threatened to spill over into contagion as well.

Stock markets are a part of several countries' panel of leading economic indicators and the data-driven Fed can see the recent downturn in the light of global trade tensions, the Chinese slowdown, Brexit uncertainty and Eurozone politics. As late as Shoctober, many observers stuck to their conviction of three or four more rate hikes. The most recent statements from several Fed officials have turned dovish. US unemployment continues to scrape the bottom of the charts but the housing and construction numbers have turned over. The forward-looking Purchasing Managers Index and other countries' PMIs have recorded several monthly declines in a row.

Inflation appears contained. Declining oil and food prices dropped US inflation to 2.2% in November. Wage inflation is a mixed bag. Look no further than the [PNC Christmas Price Index](#) which rose 1.2% this year. PNC has tracked the prices of the twelve gifts listed in "The Twelve Days of Christmas" for the last 35 years. The whimsical index has actually mirrored the official Consumer Price Index quite well. This Christmas, if your True Love is the annoying sort that likes to sing the entire song, all 364 gifts would set him or her back \$170,609.46. This 1.2% increase continues the benign yearly rise of the index since 2014. Sure, golden rings fell by 9.1% this year. However, prices for geese a-laying were a-soaring by 8.3%, bucking the otherwise flat avian trend for partridges, turtledoves, French hens, calling birds and swans. The record unemployment rate in the US has also bumped up wages for drummers drumming, pipers piping and lords a-leaping. Wages for milkmaids and

dancing ladies remained stagnant which I think calls for a sexual discrimination lawsuit, amiright?

Do today's lower security prices provide a launchpad for a better 2019 or do they represent an acceleration toward recession? Nobody has the definitive answer. One can argue that political issues have had a greater effect on this year's markets than rising interest rates and there's no reason to believe that the political overhang will go away in the new year.

Our collective post-QE hangover that punctuates this Decade of Liquidity will challenge governments, corporations and households. But the world's market economies will continue to reward well-run businesses that manage and improve profitable business models and

governments that run current account surpluses and find the most NPV-positive uses of their tax revenue. Households that participate in the capital structure of these entities—by investing in their equity or debt—will **over time** earn commensurate rewards that will exceed returns that can be earned on the sidelines of cash. We at TriLake remain optimistic about the long-term prospects of beta and

continue to seek alpha where it can be sustained.

We wish our readers a happy holiday season, lessons learned in 2018 and greater prosperity in the years to come. We end the year with our own "Twelve Days of Christmas" which we caution you is more wishful thinking than prediction:

*On the twelfth day of Christmas
My true love gave to me:
Twelve Feds reporting
11 districts growing,
Tencent rebounding,
Nineteen bourses booming,
Eighties climate warming
Seven billion people,
Sixty-five per barrel,
Five golden REITs,
4% from bonds,
Three rate hikes,
2G phone for Trump
And a market remaining bear-free.*

| DESCRIPTION | QTY | UNIT PRICE | AMOUNT |
|--------------|-----|------------|--------|
| Partridge | 1 | 20.18 | 20.18 |
| Pear Tree | 1 | 199.95 | 199.95 |
| Turtledove | 2 | 187.50 | 375.00 |
| French hen | 3 | 60.50 | 181.50 |
| calling bird | 4 | 149.99 | 599.96 |
| ld ring | 5 | | |
| o a-laying | 6 | | |
| t-swimming | | | |
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