Manulife Asset Management

Fund Commentaries (Monthly)

August 2018

Thailand Equity Market

Market Summary

August review: The SET Index was sideways within the range of 1,670-1,730 points and ended August at 1,721.58. Foreign investors had a net sell position of THB10.4 billion, while local institutions which were the major movers of the index, had a net buy position of THB12.6 billion. 2Q18 earnings were THB260bn, +16.7%YoY and -11.5%QoQ, setting a new record for second quarter. A high number of positive surprises were seen in banking and automotive companies while negative surprises were seen in companies within the energy, commerce and transportation sectors. After the 2Q18 announcements, the path for 2H18 is clearer, with the market expecting strong growth of 19%YoY and 2%HoH. Sectors poised to outperform are commerce, construction materials, electronics and food. Meanwhile, emerging market currencies crisis deepened. The Turkish currency crisis early in the month put global investment sentiment in risk-off mode as seen in the sale of risky assets and the inflows into bonds led global stock markets lower. However, there was no real fear of a contagion and it did not take long for investors to return.

Monthly Strategy

September outlook: For the first eight months of 2018 the SET total return index (TRI) delivered negligible YTD total return despite 7.6% YoY growth in earnings in 1H18 together with a five-year high for GDP growth at 4.8%. Consensus expects 8% EPS growth in 2018F, which implies 12% full-year total return. Higher domestic consumption and investment in 2Q18 helped balance growth away from overreliance on exports. Recovery in farm prices and grassroots stimulus measures will support the future economic growth. The BOT (Bank of Thailand) is now preparing the market for rate hikes. Plots showing SET index seasonality over the past 15 years indicate recovery ahead in the remainder of the year, particularly when LTF-RMF inflow begins. Important events to watch out for are as follow 1) Sep 5 – US public hearing on tariffs on USD200bn goods from China winds up; 2) Sep 13 – ECB meeting, with markets expecting a signal on rate hike (EUR appreciation); 3) Sep 19 – MPC meeting, where the market also expect we a signal for a gradual rate hike, and the BoJ will also meet on the same day; 4) Sep 25 – Minister of Energy will accept the Erawan and Bongkot oil well bidding envelopes; 5) Sep 27 – FOMC meeting; 6) late Sep – US may impose tariffs on USD200bn worth of Chinese goods.

Index and Trading Summary by Investor Types

SET Index closed at 1,721.58, rising by 1.16% from the previous month.

Investor Types	Buy (MB)	Sell (MB)
Institution	124,837	112,226
PropTrade	129,781	125,138
Foreign	402,798	413,217
Individual	413,148	419,983

Net position (MB)

	WTD	MTD	YTD
Institution	10,922	12,611	123,677
PropTrade	1,300	4,642	(12,204)
Foreign	(6,207)	(10,418)	(201,117)
Individual	(6,015)	(6,835)	89,644

Fixed Income Fund Market

Market Outlook

In August, Thai government bond yield curve bear flattened as yields on the 2-year maturity jumped by 13 bps whilst the 10-year bucket merely rose by 3 bps. All in all, yield on the very short end of the curve (0-1 year tenors) varied between -4 to +7 bps as a result of higher supply of Bank of Thailand bonds together with higher inflation outlook stemming from higher oil prices, but flush liquidity. Similarly, the yield on 15-20 year maturities soared by 3-8 bps following higher US Treasuries yields and heightened tension surrounding the Trade War. Furthermore, the Trade War between US and China has worsen as US threatened to slap 10% tariffs on an additional USD 267 billion of Chinese goods. To make the matter worse, the FX turmoil in Turkey weighed down on other emerging market currencies and has exacerbated the situation. In short, the market reverts to Risk Off mode and more negative towards emerging markets. In effect, yields at 1-3 year tenors which is normally linked to BOT policy rate, increased by 7-13 bps, whereas the yields between 7-10 year tenors edged up by only 3 bps. Therefore, the yield curve flattened partially, and the 2-10 year spread declined to 85 bps versus 95 bps in July 2018. Foreign wise, international investors switched to be a net buyer of Thai bonds by THB 56.9 billion in Aug. 2018 vs. a net seller of Thai bonds by THB 1.7 billion in July 2018. Thus, net holding by international investors has increased from THB 842 billion to THB 891 billion for the same period.

Economy

According to BOT, The Thai economy in July 2018 continued to expand underscored by both domestic and external demand. Merchandise exports grew, albeit at a slower pace. Exports growth expanded 8.3%YoY versus 10.0%YoY growth last month. Excluding gold, exports grew 8.2%YoY (previously +10.0YoY). Private consumption rose solidly by 0.4%MoM and 4.7% YoY driven by strong durable goods consumption and higher service activities. Growth on tourist arrivals subsided to 2.8%YoY in July, down from the 11.6%YoY in June owing to the lethal Ferry Accident in Phuket. All in all, the total number of tourist arrival surged to 3.2 million in July versus 3.0 million in June. Meanwhile, government expenditures also supported the economy last month, with the current expenditures increased (5.5%YoY in July 2018), and the capital spending increased by 8.2%. Nevertheless, private investment index was disappointing, contracting by -5.4%MoM and grew only 2.7% YoY hampered by shrinkage in capital goods imports and decline in Permitted Construction Area. Overall we expect the Thai economy to accelerate in 2018, provided the 2Q2018 GDP at 4.6%—BOT has revised up the GDP forecast from 4.1% to 4.4% growth in 2018 and the MOF has estimated the GDP of 4.5% for base case and is very likely to revise up to 4.5-4.8% thanks to Supplementary Budget spending of THB 100-150 billion within this fiscal year.

August headline inflation surprised on the upside and surged by 1.62%YoY from 1.46% in the previous month, surpassing the market estimates at 1.51%YoY. This is the fifth months in a row that inflation breached 1.00%, which is the lower bound of BOT's inflation target of 1-4%. The main drivers for the inflation rebound have been the rising oil price and raw food prices. Core CPI, on the other hand, was comparatively benign at 0.75% versus 0.79% last

month. YTD, headline CPI averaged at 1.11% and Core CPI at 0.71%. Thus, the Ministry of Commerce still amended the inflation forecast from 0.7-1.7% to 0.8-1.6% but keep the midpoint unchanged at 1.2%. Meanwhile, BOT revised up inflation forecast from 1.0% to 1.1% in 2018.

Outlook for Bond market in September 2018

From the Macro perspective, the US economic expansion gained traction, as the second reading of annualised US GDP in 2Q18 revised up to 4.2% versus 4.1% in the first reading and 2.0% last quarter thanks to Tax Cut in US. This is also slightly ahead of 4.0% estimated. However, the US private job market was softer than expected with the ADP private jobs in August registering new job creation of 163K vs. 200K expected. Nonetheless, U.S. nonfarm payrolls (NFP) were solid and exceeded of the market expectation. In short, the economy created 201K jobs versus 190K new jobs creation from consensus survey. Nevertheless, the unemployment rate stayed at 3.9% vs. 3.8% forecasted as the labour force participation rate declined from 62.9% to 62.7%. On the back of the solid employment data, coupled with the tension over Trade War and FX turmoil in emerging markets, the market has priced in the probability of Fed rate hike in Sep. 2018 and Dec. at c. 96% and 99% respectively. Furthermore, the PCE Core was at 2.0% in July 2018 versus 1.9% in June 2018, and in line with the Fed's target of 2%. Moreover, CPI YoY in July remained relatively high at 2.9%, against 2.9% in the previous month. In addition, Fed's staff s continued to project that inflation as measured by PCE would run near the Committee's 2% objective over medium term. In the meantime, U.S. Initial jobless claims in the last week of August 2018 were in line with forecast. Jobless claims came in at 213K in the last week of August 18 (vs. 212K projected). On the contrary, US retail sales Ex Auto for July 2018 were slightly stronger than expectation at 0.6% MoM against 0.3% estimated, and versus 0.4% in the last month.

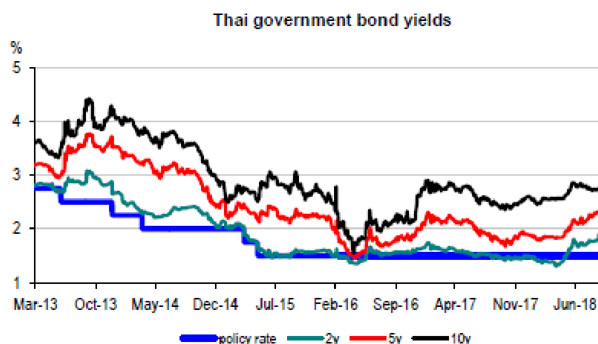
In contrast, U.S. July durable goods orders contracted more than expected at -1.7% vs. -1.0% by consensus survey, and 0.8% in the previous month. However, U.S. consumer confidence from Univ. of Michigan in August was stronger than projected, registering at 96.2 versus the forecast of 95.5. Besides, U.S. house prices in 20 main cities as represented by the S&P CoreLogic CS index continued to expand solidly from prior month. House price index increased by 6.31%YoY in June, after a gain of 6.51%YoY in May. Nonetheless, U.S. existing home sale number in July was comparatively weak, with the data showing a -0.7%MoM contraction against 0.4% expansion expected and a -0.6% decline in previous month. Likewise, US New Home Sales surprised on the downside, falling by -1.7% MoM in July 2018 compared to 2.2% anticipated. Meanwhile, the US ISM Non-Manufacturing sector in August accelerated to 58.5, well above the market forecast at 56.8. Similarly, U.S. ISM manufacturing indicator also handily beat the expectation recording at 61.3 vs. 58.1 in the preceding month, and above market's estimates at 57.6.

According to FOMC Minutes on August 22, 2018, "Many participants suggested that if incoming data continued to support their current economic outlook, it would likely soon be appropriate to take another step in removing policy accommodation". The stance of monetary policy remains accommodative, thereby supporting strong labour market conditions and a sustained return to 2 percent inflation objective in near term. However, many officials "noted that it would likely be appropriate in the not-too-distant future to revise the committee's characterization of the stance of monetary policy" in its statement, the minutes said. Describing policy as "accommodative" would at some point "fairly soon," no longer be appropriate, the minutes said. As such, given the market turmoil following risk off sentiment and tension surrounding the Trade War as well as market turmoil in EM FX, the market has raised the possibility of rate hike in Sep. and Dec. 2018, as reflected by the Fed Fund Futures contract, which stand at c. 96% and 99% respectively versus 83% and 93% last month. Meanwhile, European Central Bank (ECB) held policy rates unchanged but cut the size of the Asset Purchase Programme from EUR 30 billion per month to EUR 15 billion per month starting Sep. 2018 and ended completely by year end. ECB is likely to maintain its accommodative stance for the near future, whilst the Japanese yield curve steepened following reports that the BOJ may facilitate an increase in longer-term interest rates.

Given the 4.6% 2Q2018 GDP for Thailand and return to inflation target band of 1-4%, BOT is expected to hold rate for most of 2018, whilst Fed is expected to raise the rate 2 times. Hence, policy divergence to continue. According to Fiscal Policy Office's officials, GDP forecast for 2018 is estimated at 4.5%. However, the probability of the incumbent gov't implementing an interim budget spending of c. THB 100-150 billion is high provided the election is scheduled for Feb. 2019. This could boost 2018 GDP to 4.8-5.0% range depend on the external factors

August headline inflation soared to 1.62%YoY from 1.46% in the previous month, and slightly above market consensus at 1.51%YoY. This is the fifth consecutive month that inflation breached 1.00%. The main driver of inflation resurgence has been the rebound in oil price and raw food prices. Core CPI, on the other hand, was comparatively benign at 0.75% versus 0.79% last month.

Domestically, yield for 3-mth bill has decreased from 1.26% to 1.18% vs. policy rate at 1.5% on the back of rising inflation number in the last 5 months, flush liquidity and higher supply of Bank of Thailand bonds. Provided the higher inflation in 2Q18, we opine that BOT will keep rate unchanged in the medium term. Small chance of rate hike in 4Q18 or 1Q19. According to MPC Minutes as of 22 August 2018, the MPC Members opine that Inflation in trading partner economies increased in line with the previous assessment mainly on the back of rising energy prices. Inflation in the US rose as the economy grew above potential. In addition, the MPC assessed that if the economic growth and inflation are in line with target, the need to raise the rate to build some policy space would increase.



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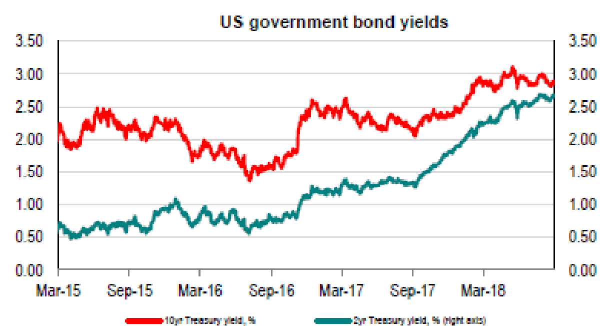

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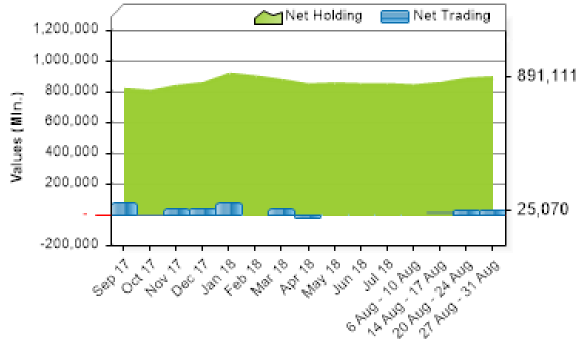
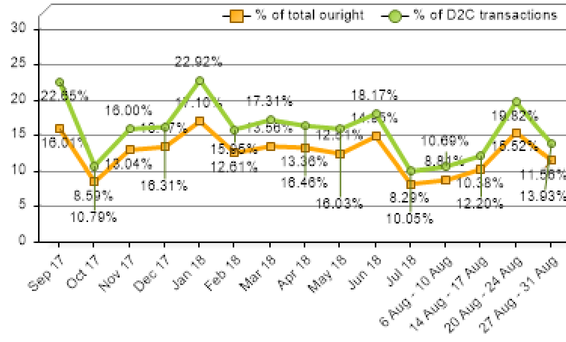

Net Holding
Net Trading
Values (Mln.)
1,200,000
1,000,000
800,000
600,000
400,000
200,000
-200,000
891,111
25,070
Sep 17
Oct 17
Nov 17
Dec 17
Jan 18
Feb 18
Mar 18
Apr 18
May 18
Jun 18
Jul 18
6 Aug - 10 Aug
14 Aug - 17 Aug
20 Aug - 24 Aug
27 Aug - 31 Aug


% of total ouright
% of D2C transactions
30
25
20
15
10
5
0
22.92%
18.00%
17.31%
18.17%
19.82%
10.69%
12.61%
13.36%
16.46%
16.31%
16.03%
8.29%
10.05%
10.79%
10.38%
12.20%
13.93%
Sep 17
Oct 17
Nov 17
Dec 17
Jan 18
Feb 18
Mar 18
Apr 18
May 18
Jun 18
Jul 18
6 Aug - 10 Aug
14 Aug - 17 Aug
20 Aug - 24 Aug
27 Aug - 31 Aug

Fund Managers' Comment of Master Funds (As of July 2018)

MGF-Asian Small Cap Equity Fund

Market Review

Asia-Pacific ex Japan small cap equity markets ticked higher in July on the back of a rebound in ASEAN markets and strong corporate earnings amid continued US-China trade tensions. Regional corporate earnings also stayed strong for the second quarter, as forecast earnings-per-share (EPS) growth for 2018 stayed robust at 13.5%, although future estimates showed downward pressure.

In China, rising trade tensions and economic slowdown worries sent China's equity markets lower. The US and China placed reciprocal 25% tariffs on US$34 billion worth of goods, with more tariffs threatened by the US government. Although second-quarter GDP came in at consensus, fixed asset investment and industrial production growth slowed for June, indicating sluggish demand. In response to these economic pressures, the Chinese government released a raft of economic supportive measures as the State Council announced a fiscal stimulus package, while the People's Bank of China (PBoC) injected funds into the banking market.

Strong performance by large cap technology stocks led Taiwan's equity market higher in July. Better-than-expected second quarter sales and earnings prints, as well as higher earnings guidance, helped the IT sector outperform.

South Korea equity markets were impacted by negative economic data with continued US-China trade friction. Second-quarter GDP came in marginally below expectations due to a deceleration in capital investment and exports, while export growth also slowed in June.

The macro backdrop in India turned favourable as crude oil prices declined, which helped ease concerns of current account pressures, thus bringing some stability to the country's currency.

The rebound of ASEAN markets was the main positive regional catalyst. After a difficult second quarter, relief rallies in Southeast Asia provided strong support as macroeconomic headwinds subsided and capital outflows lessened or even turned positive. In Indonesia, equity markets rebounded into positive territory in July after a volatile second quarter. The country's financial markets showed signs of stabilisation after substantial capital outflows in the previous quarter: the rupiah stabilised and foreigners were net buyers (US$54 million), breaking the streak of five consecutive months of outflows. In Thailand, strong earnings among financials and positive domestic demand data propelled Thailand to the top regional performer in July. The four largest banks posted above-consensus second-quarter earnings that bolstered market sentiment and sparked a sector rotation back to exporters and domestic-demand driven stocks.

Portfolio Review

The Fund's stock selection and asset allocation decisions detracted from performance. Stock selection in Taiwan, South Korea, and Hong Kong, in addition to the overweight in South Korea, were the primary drivers of performance detraction. Offsetting some of the performance detraction was stock selection in Australia, India, and Indonesia – especially in technology.

The Fund's holding in an Australian company that provides short-term funding for small-ticket retail purchases was the biggest positive contributor to performance. The company continued to perform strongly – the company should benefit as consumption growth slows, given that merchants will increasingly employ this service to drive sales growth. The company also announced stronger-than-expected growth with contributions coming from their US expansion. Also contributing was a domestic Chinese manufacturer of capacitors and resistors that rallied as the undersupply of passive components continues to drive prices higher.

One of the primary detractors was in the Taiwan healthcare sector. A biotech company detracted from performance given the slower-than-expected sales for their HIV drug. Another detractor was a foundry that reported sales growth that were lower than expected.

Market Outlook

We expect trade concerns to linger over the next few months and feel the US president's reaction to the Russian investigation also poses risk. Near-term we have become cautious, while of the view that companies will respond well to earnings announcement. Fundamentals throughout the region, including positive earnings revisions and improvements in return on equity, generally support outperformance of Asian equities along with potential for catch-up by small cap equities.

MGF-Dragon Growth Fund

Market Review

Rising trade tensions and economic slowdown worries sent China's equity markets lower. The US and China placed reciprocal 25% tariffs on US$34 billion, with more tariffs threatened by the US government. Although China's second-quarter GDP came in at consensus, fixed asset investment and industrial production growth slowed for June, indicating sluggish demand. In response to these economic pressures, the Chinese government released a raft of economic supportive measures: the State Council announced a fiscal stimulus package, while the People's Bank of China (PBoC) injected US$74 billion's worth of funds into the banking market.

For equity markets, utilities and materials outperformed; consumer discretionary underperformed due to decelerating sport-utility vehicle (SUV) sales, while healthcare fell on the back of a public health scandal regarding substandard vaccines. Finally, northbound and southbound capitals flows recorded net inflows of HK$3.9 billion and RMB28.5 billion, respectively, for the month.

Portfolio Review

The Fund's stock selection from consumer discretionary and technology sectors contributed positively to performance. Offsetting some of the performance was asset allocation decisions, particularly the overweight in healthcare.

The primary contributor to performance during the month was the underweight position in one of the index's largest technology constituents. Within the healthcare sector, a biopharmaceutical company specialised in oncology drugs benefited from its unique position in developing a drug with promising results in preclinical studies that could apply to many cancer types. The company announced positive pre-clinical trial results in China and was granted Fast Track status by the US Food and Drug Administration (FDA) for another one of its cancer treatments.

From a sector perspective, healthcare has been the best performing sector in the China year-to-date, but the overweight was a performance detractor as the sector was subject to profit taking. We continue to believe that the companies the Fund is invested in should be beneficiaries of a more favourable regulatory environment.

Market Outlook

Looking ahead, while the trade tensions will continue to be one of the swing factors to market movements, we believe investors should refocus on the sound macro and corporate fundamentals – the two key drivers for Hong Kong/China equities. We continue to focus on the companies that are benefiting from either on R&D/innovation or consumption upgrade, as trade tariffs have limited impact on their operations.

While we believe the MSCI A-shares inclusion is an important milestone, we are selective in China A-shares. We are aware that A-shares is a market where 85% of the volumes are driven by retail investors (vs 35% in Hong Kong), and thus, is more prone to momentum market behaviour. As such, we look for attractive, unique A-shares opportunities that are not available in the offshore universe and are trading at reasonable valuations.

MGF-India Equity Fund

Market Review

Indian markets gave positive returns in the month of July 2018 and was one of the best performing markets in the region as trade tensions remained heightened; India outperformed as it is less export-dependent compared to other countries in the region and is more of a domestic economy driven investment story. Also, strong results from domestic economy focussed sectors buoyed the markets. The quarterly earnings season kicked off in India and almost 70% of earnings declared till end of July were either ahead or in-line with expectations.

The macro situation for India remains mixed; while oil has cooled off its' previous highs, it remains elevated. Inflation numbers are still within the Reserve Bank of India's (RBI) target range, but upside risks exist if oil prices continue to stay strong. GST revenues in June 2018 showed marginal improvement over May but remains below the targeted run rate of the budget. On the positive side, monsoon is advancing as expected and this bodes well for rural recovery.

Portfolio Review

Energy and financials outperformed. On the other hand, healthcare, telecommunications, utilities, industrials, consumer discretionary, materials, and IT were the underperformers. Consumer staples broadly performed in line with the markets. Financials both outperformed after key companies within the sector posted results ahead of expectations. Energy outperformance was stock specific. Healthcare underperformed as companies are facing increasing competition in multiple products in the US generics markets. Telecommunication underperformed on the back of weak results by the incumbents. Utilities underperformed given their defensive nature in the rising market. Industrials, materials, consumer discretionary, and IT underperformed as cues from the earnings season were mixed for these sectors.

The Fund benefitted from stock selection in energy, utilities, industrials, IT, and healthcare. It also benefitted from an overweight in financials; underweight in materials, telecommunication, and IT. On the other hand, stock selection in materials and financials detracted performance. An underweight in energy, as well as an overweight in consumer discretionary and industrials were value detractors from allocation point of view.

Market Outlook

We remain optimistic on the domestically driven India story driven by (1) better quality government spending in rural development and infrastructure, and (2) formalisation due to reforms undertaken.

Despite the cyclical challenges of inflation, trade deficit, and the transitory problem of lower tax collection, we continue to remain positive on these two themes. We have seen better government spending in infrastructure areas like roads and power in rural areas, housing, sanitation, cooking gas connection, etc. which is helping to drive income. On the other hand, we note formalisation driven by structural reforms, e.g. GST, The Real Estate (Regulation and Development) Act, Bankruptcy Act, etc. Formalisation should lead to market share gain for better managed companies, this in turn means bottom up faster growth opportunities are there in the listed market. There are substantial opportunities in organised retail (apparels, jewellery, food), retail lending, temp staffing, and real estate which will benefit from this trend of formalisation. We see bottom up opportunities in these sectors. We believe two of the earlier longer-term trends that we were playing are seeing a slowdown. While we continue to believe that formalisation of the economy should improve household financial savings in the long run, it seems to have peaked for now. We also believed that recapitalisation of Public Sector Banks (PSBs) will re-vitalise the credit flow in the economy. This may see a slowdown as the recent fraud in the second largest PSB is likely to make the PSBs as a whole more risk averse and increase scrutiny of credit applications in the corporate and SME book.

Accordingly, we remain overweight on financials, consumer discretionary, and real estate. These sectors are all beneficiaries of the formalisation trend. During the month we have raised our weight in consumer staples in names where we see potential of margin expansion from falling input prices after a strong monsoon. We have reduced our weight in IT as the tactical call has largely played out after the outperformance of the sector in recent months. We remain underweight in cyclical sectors such as energy and materials. We remain underweight in healthcare which is seeing pricing pressure in the US market. We also remain underweight in telecommunications, which is capital-intensive and seeing disruptive pricing competition.

MGF-American Growth Fund

Market Review

Positive US economic data and better-than-expected quarterly earnings drove the US stock market to its best monthly gain since January. In the US equity market, stocks in the industrials sector were notable outperformers, especially following late-period concessions from the EU that eased trade tensions. The healthcare and financials sectors also stood out. In contrast, energy stocks disappointed as oil prices pulled back. More defensive, dividend-paying sectors also were laggards.

Portfolio Review

A large overweighting and stock picks in the financials sector contributed positively to performance. Top individual contributors included a financial services company that reported a 33% year-over-year rise in profits driven by solid loan growth, higher trading revenues, lower corporate tax rates, and higher interest rates. Elsewhere, in the consumer discretionary sector, a non-benchmark stake in an online used car site rallied nicely; this was helped by the growing popularity of the site, favourable publicity, and prospects for expanding its share of the US$37 billion US auto industry advertising market.

By contrast, security selection in the consumer discretionary, IT, and Industrials sectors hampered performance. Individual detractors included a non-benchmark holding in a recreational vehicle company. Despite market share gains, increased sales, and better-than-expected earnings, the consumer discretionary stock price fell as tariffs and higher commodity costs led to reduced earnings guidance for the second half of 2018. Elsewhere in the consumer discretionary sector, a sizeable overweighting in an ecommerce retailer declined after the company reported a slight deceleration in revenue growth and lowered revenue guidance for the full year.

Market Outlook

We remain cautiously optimistic about the stock market's prospects, given that the US economy is in good shape, interest rates are still relatively low, the banking system is solid, and consumer balance sheets seem healthy. Plus, we've seen some progress on trade issues and demand for housing continues to outstrip supply. The Fund has retained an economically sensitive bias, with overweightings at period end in the consumer discretionary and financials sectors.

MGF-European Growth Fund

Market Review

European equities were buoyed by an easing of trade tensions between the US and Europe, as US President Trump appeared to focus his efforts on persuading China to liberalise its economy. However, second-quarter results showed that metal tariffs and trade war uncertainty had impacted some European exporters, which suffered from deferred orders and gross margin pressure on rising steel costs. Having led the market year-to-date, the energy sector was the laggard this month. Investors were concerned about the risk of near-term oversupply of crude oil after Russia and the Organization of the Petroleum Exporting Countries (OPEC) agreed to raise production to offset the impact of fresh sanctions on Iran. Financials were strong in July, benefiting from a rise in long bond yields driven by global monetary tightening, which should improve banks' lending margins. The healthcare sector rose on a multitude of upgrades following better-than-expected second-quarter results.

Portfolio Review

Over the period, stock selection in the consumer staples sector contributed to the Fund's performance. Stock selection in the consumer discretionary, industrials, and materials sectors detracted from performance. A multinational electrical and telecommunications retailer and services company was negatively impacted by data showing that UK high-street spending was deteriorating. In the industrials sector, a company that manages and operates the Channel Tunnel between England and France sold off on the rising risk of a difficult Brexit in 2019, as negotiations between the UK and the EU appeared to be making little progress.

Over the month, we reduced several positions in the Fund, such as the world's largest brick producer, where valuations appeared full and the most recent trading update data was lacklustre.

Market Outlook

It has become more difficult to find value in general as the stock market has recovered again. Good long-term opportunities still exist in idiosyncratic stock situations, although we will likely encounter many unattractive opportunities along the way.

A modestly rising interest rate environment with gentle economic expansion – such as the one we are in now – should be positive for financial companies, as it typically translates into stronger earnings. For this reason, we continue to hold a favourable view of this sector. The difficulties the banks faced following the global financial crisis are no longer a major factor owing to the banks' far higher capital reserves. Within non-bank stocks in the financials sector, we like the exchanges and long-term emerging markets growth story as opportunities for some of our holdings.

Elsewhere, we believe oil and mining companies still offer ongoing restructuring and rising cash generation stories. In our view, a good number of companies are trading at attractive dividend yields, backed by healthy cash flows at current commodity prices. The restructuring efforts will likely continue to reduce cash operating costs, while capital expenditure spending may fall to levels that can generate substantial cash flows to be returned to shareholders. One business we like, for example, in the oil industry, is promising much higher cash flows and dividends that are attractive at current oil prices. Therefore, we do not need to take a specific view on oil price appreciation. The new projects that this business has yet to fund offer more than 20% internal rates of return at US$50, as it has cut operating and capital expenditures costs thus far.

MGF-Emerging Eastern Europe Fund

- Eastern European markets finally broke their losing streak in July in notching up a small gain for the month. The Polish market was particularly strong, lifted by banks which are in the process of going through an encouraging earnings season marked by strong revenues and low impairments.

- Turkey suffered as the lira plunged with the appointment of President Erdogan's son-in-law as Finance Minister exacerbating fears that Erdogan is intent on increasing control of economic policy making. New strains in US Turkey relations and the central bank's decision to leave interest rates unchanged put further downward pressure on markets.

- Going forward, top-down issues should continue to determine market direction in major Eastern European markets. Trade war fears and its effects on local currencies, economic policy commentary from Turkey, US Turkey relations and the impact of the various Russian sanction bills going through the legislative process in the US will be key.

MGF-Healthcare Fund

Market Review

The healthcare sector posted solid gains during the period and modestly outperformed global markets, as measured by the MSCI World Index. Favourable initial earnings reports drove the performance of healthcare sub-sectors, despite some noted pressures on high-multiple and small-capitalisation biotechnology companies. Initial profit gains from US tax reform were mitigated somewhat by foreign exchange swings in the first half of 2018.

Portfolio Review

Security selection within pharmaceuticals, as well as healthcare equipment and supplies companies, contributed to the Fund's performance. Individual contributors included a global pharmaceuticals company that posted strong second-quarter earnings results. Multiple growth drivers from recent and pending product launches plus the announced divestiture of the company's animal health business were well received by investors. We took a timely initial stake in a Danish biotechnology company following undue correction in its share price owing to a minor clinical trial failure for the company's lead cancer treatment drug. A multinational pharmaceutical and biopharmaceutical company benefited from the strong inflection of its revenue trajectory that was driven by the company's emerging oncology launches and diabetes portfolio. Moreover, the company continues to show impressive growth trajectory in China.

Security selection within the biotechnology, as well as the life sciences tools and services industries detracted from the Fund's performance. Individual detractors included a healthcare equipment, supplies, and medical device company as the higher-multiple stock was under pressure. A clinical-stage biopharmaceutical company detracted as small-cap emerging biotechnology companies were under pressure amid evidence of a market rotation to large-cap companies. Shares of a healthcare provider and services company were affected by a legal trial concerning an aborted acquisition.

Trading activity in the Fund reflected the ongoing debate over the prospect for drug costs and intermediary companies. We added new positions to the Fund in the life sciences tools and services industry, as well as a Japanese pharmaceuticals company. We sold the Fund's position in a healthcare equipment and supplies company.

Market Outlook

We believe there are still attractive investment opportunities in the healthcare sector that offer strong long-term growth potential. Volatility in the biopharmaceuticals industry in recent quarters was largely attributable to diverging fundamentals as well as the mentioned drug pricing debate, according to our analysis. However, we believe the intensity of the debate has been redirected. Within the healthcare equipment and supplies industry, fundamentals remain attractive. In our view, sustainable revenues and earnings have improved the risk-adjusted returns profiles of many of these stocks. In the healthcare providers and services industry, we believe that managed care entities are well positioned for continued growth. We also see an emerging threat to select healthcare supply chain companies. We will continue to assess these stock-specific fundamentals along with macroeconomic considerations as we seek to rebase the portfolio under new leadership.

Please consider the product features, conditions, returns, risks and information of tax benefit as specified in investment manual before making an investment decision.
Past performance/ performance comparison relating to a capital market product is not a guarantee of future results.
The value of investment units may go down as well as up due to exchange rate fluctuation and investors may not get back their original investment.