Monthly Newsletter

August 2020

ROCKPOOL CAPITAL
6A, Hip Shing Hong Centre, 55 Des Voeux Road Central, HK
info@rockpoolcap.com T: +852 23631336 F: +852 23631137

INSIDE THIS ISSUE

1. Choppy as the course remains
2. Treasuries Edging Lower as Investors Face Uncertainty Regarding COVID Resurgence and Elections

Choppy as the course remains

PIER 8 – Thematic Opportunities (TO)

July proved to be a constructive month for PIER 8's Thematic Opportunities (TO) equity long short portfolio. The Hong Kong/China portfolio attributed to the bulk of the gains, and onshore China rare earths continue to be a good hedge towards an escalation in Global – China tensions as certain underlying names were up 30% in July. With the announcement of some companies listing on the STAR board in China, Hong Kong and US listed tech stocks continue to gain traction on the long side from investors. In the short portfolio, our short position in Ausnutria Diary continues to underperform peers as it fell 25% in July.

August is seasonally a brutal month for risk assets, but this year is also not a "normal" year. Looking ahead, Thematic Opportunities is in the view that risk assets will painfully grind higher, forcing cash on the side (balances in money market funds remain elevated) to chase performance. However, as mentioned in our July newsletter, there are no shortage of obstacles for risk assets and being cognizant of the risks, TO will opportunistically buy protection via puts.

Heading into choppy waters of August, TO continues to be positioned long, overweighting in companies with HK/China domestic exposure, and short India where, in my opinion, exhibits the largest disconnect between their equity market and economy.

PIER 8 – Quantamental (QM)

In July, Asia had a good start into the second week, only to settle lower as the US markets continue to hold stable into month end. Hang Seng finished with a 0.7% rally, Europe down 1.9%, Japan down 2.6%, and US up 5.5%. QM was running net long positions across most regions as we continue to be constructive equity risk from a favorable macro backdrop (both downward sloping VIX Curve and Yield Curve are two of the persistent factors). For the options book, after the conversion of most upside HK positions into Call Spreads and Flys, we have since taken advantage of the decline into month end to cover the short legs of those structures. In terms of positioning into the new month, we have covered all our USD shorts in FX and continue to build equity long positions in Japan, HK and Australia.

Monthly
Newsletter
August 2020

Treasuries Edging Lower as Investors Face Uncertainty Regarding COVID Resurgence and Elections

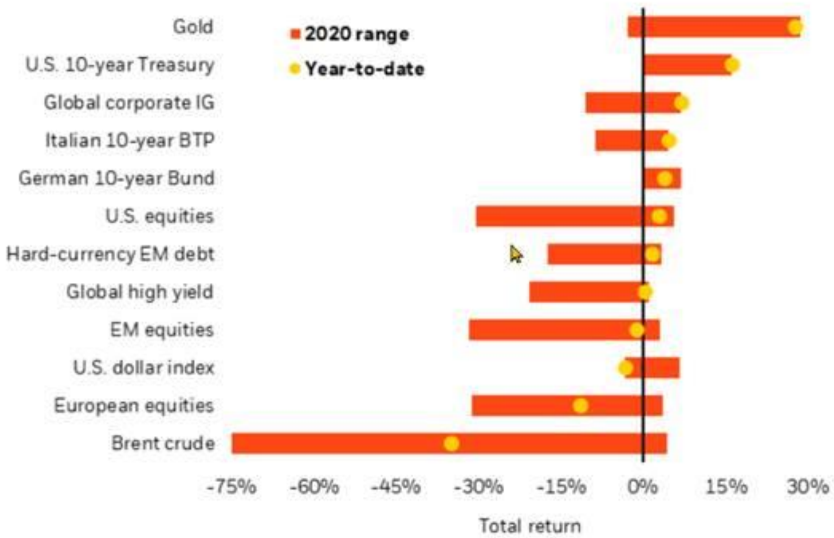
Investors seem to be buying everything, including Treasuries. This is strange as the rebound in growth and even suggestions by the Fed to let the economy run hot have not caused investors to flee Treasuries. For the time being, investors continue to buy Treasuries, signalling risk-aversion driven by headlines of resurging COVID cases in the US and uncertainty around the size of future US stimulus. Buyers must have a strong conviction at these low levels; with UST around 60bps, a 10bp move higher would wipe out a 12-month holding period return.

Index Returns Mask an Uneven Recovery

The S&P 500 has risen 9.8% in the past 12 months (period ending July 31, 2020). But the five largest stocks by market value (capitalization) represent almost all of the index's gains. These tech-oriented stocks have surged 58.1% during the same 12-month period: Apple, Microsoft, Amazon, Alphabet (Google), and Facebook. When these tech giants are stripped out of the index, the remaining stocks in the S&P 500 have risen only 0.6 percent collectively (Source: RBC). Perhaps this is another clue to why investors are purchasing treasuries.

Assets in review

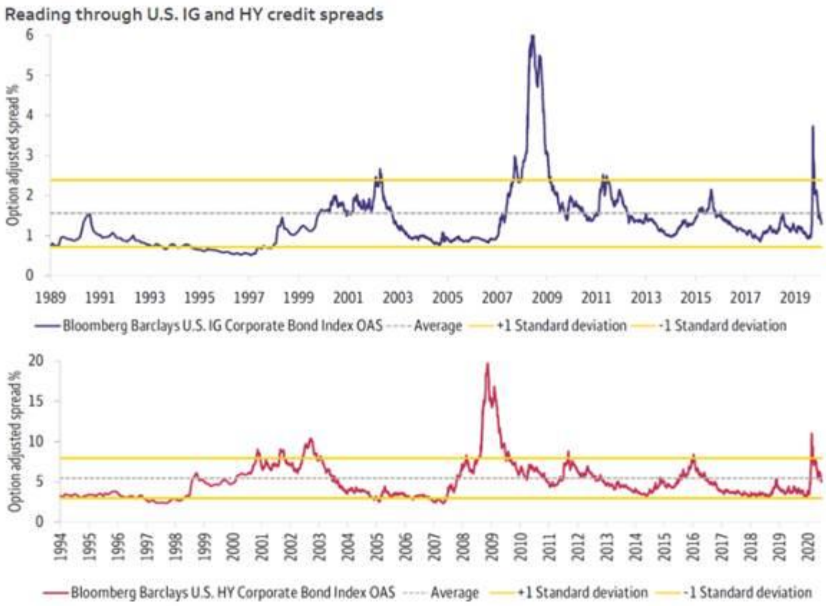
Selected asset performance, 2020 year-to-date and range



The chart from Blackrock neatly summarizes the effect of COVID across various asset classes and the effect of the policy response. The clearest outperformer has been gold due to the global monetary response to the COVID crisis. Next are US Treasuries as investors retreat to safe-haven assets and shore up cash. Next are corporate IG bonds with the Fed initiating the SMCFF. Following close behind, the Italian BTP market has recovered and continues to benefit from the ECB's support.

Credit Spreads

Credit spreads have tightened significantly from the widening in March but are unlikely to tighten aggressively further due to the absolute level of yields. Although spreads may appear to have room to tighten further versus historical levels, many investors do not invest from a spread basis, and the absolute level of returns have led investors to turn to other fixed income instruments for yield or alternative asset classes.



Sources: Bloomberg, Wells Fargo Investment Institute, as of July 27, 2020. Option-adjusted spread is the spread relative to a risk-free interest rate. Standard Deviation is a statistical measure of volatility. The higher the standard deviation, the greater volatility has been. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.** Please see the end of the report for the definitions of the indexes and the investment risks with each asset class.

Credit investors can expect volatility to pick up in September as August is a seasonally slow part of the year with many traders on summer holidays. Also, with reporting out of the way, issuers will be back to tap the market in the coming weeks.

Asia Market Recap

Asia IG CDS tightened by 13bps from 86bps to 73bps. Asia BB and B rated bonds yield at approximately 5.5% and 9.9% respectively with bond duration of ~2.7 years. B rated bond yields tightened by 1.1% from last month, outperforming BB rated bonds, which has its yield tightened by 0.6%. In Chinese HY property market, the primary market remains robust with supply being well absorbed. New issue premium remains tight. Agile issued a 5-year paper at 5.75% and traded down by 2pt, yielding 6.3% at the end of the month. While Kaisa issued a 3-year note at 10% and ended the month 0.2pt lower, yielding at 10.1%. In India, IG Corp bonds yield at 2.9% with duration of 5.3 years. In Indonesia, Sovereign/Quasi-government bonds yield at 2.6% with duration of 8.7 years. Lippo Karawaci 2025 note started to recover and traded up by 3pt, yielding at just above 10%.

RACS Portfolio

As the credit market continues to recover, we have deployed our cash to stay fully invested and used leverage to participate in new issues with attractive valuation. With the equity market approaching all time highs and absolute yield levels trading lower, we will remain cautious by rotating the portfolio into more liquid names. Long short ratio is 98:2.

6A, Hip Shing Hong Centre, 55 Des Voeux Road Central, HK
info@rockpoolcap.com T: +852 23631336 F: +852 23631137

ROCKPOOL CAPITAL