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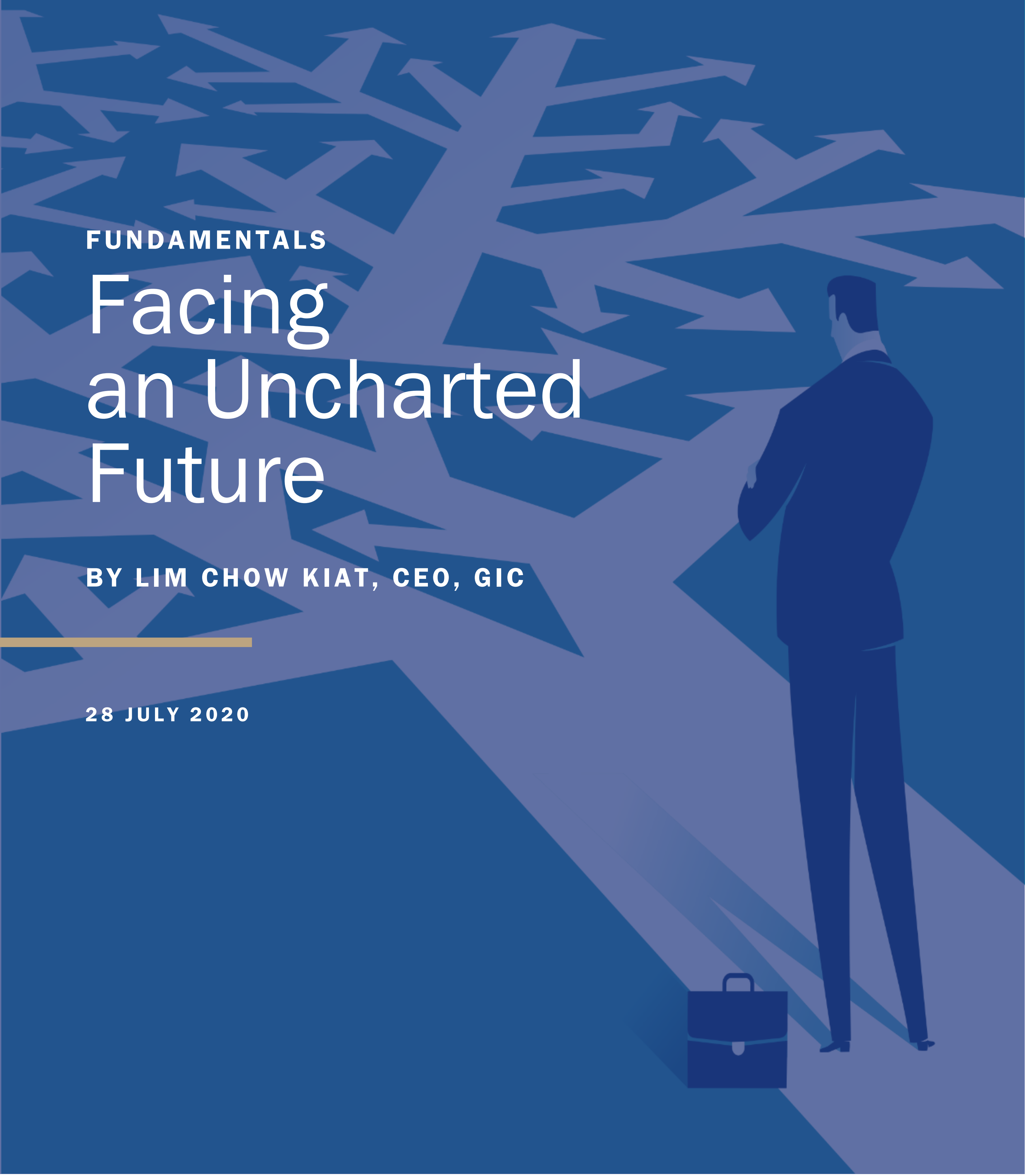

FUNDAMENTALS

Facing an Uncharted Future

BY LIM CHOW KIAT, CEO, GIC

28 JULY 2020

*This article is an extract from the chapter "Letter from the Chief Executive Officer" in the GIC Report FY2019/2020. You may read the full Report **here**.*

These are extraordinary times. We are at the confluence of a public health, economic, and financial crisis. We have seen extraordinary developments and swift responses, including drastic mobility restrictions, draconian public health measures, record fiscal and monetary stimulus, urgent steps by businesses to conserve cash, and wild financial market movements.

NAVIGATING THE TURBULENT ENVIRONMENT WITH CAUTION AND RESILIENCE

Despite the turbulence, GIC's portfolio performance has remained resilient. This year, the 20-year annualised USD nominal return of our portfolio was 4.6%. Adjusting for global inflation, the annualised 20-year real return was 2.7%, down from 3.4% last year. The reduction was largely due to the dropping out of a very strong tech-bubble year return 21 years ago, rather than the recent market moves.

> **WE NOW STAND POISED TO INVEST AND SEIZE OPPORTUNITIES THAT CAN ENHANCE OUR LONG-TERM RETURNS.**

The COVID-19 pandemic was unforeseen, but it catalysed this global recession. It has accentuated vulnerabilities in the investment environment highlighted in our past annual reports. Prior to this crisis, GIC had concerns over high asset prices, weakening fundamentals, limited policy room, and growing geopolitical uncertainties. These conditions could have significantly and permanently impaired our portfolio. Fortunately, we had pre-emptively de-risked by reducing our allocation to equities in favour of cash and evaluating investment transactions with more caution.

This defensive position has helped cushion our portfolio from the worst of the volatility[1] in the financial markets in the first quarter of 2020. GIC's portfolio returns have consistently been less volatile than our risk reference portfolio whilst providing a creditable, sustained long-term real return. This has been the case particularly over the last five years. We now stand poised to invest and seize opportunities that can enhance our long-term returns.

OUR ROLE AS CUSTODIAN OF THE NATION'S RESERVES

In these difficult times, we are even more mindful that the reserves entrusted to GIC are a key resource for Singapore. This year, with Singapore expected to experience a deep recession[2], the Government rolled out four relief packages totalling S$93 billion to support households, workers, and businesses. This required an extraordinary draw of S$52 billion from past reserves, in addition to the annual Net Investment Returns Contribution (NIRC)[3], estimated at S$18 billion for FY2020. Before this, Singapore had only drawn on past reserves once, for the 2008 Global Financial Crisis (GFC). The S$52 billion expected to be drawn this year is more than ten times the amount drawn for the GFC.

Singapore's ability to tap its national reserves in times of crisis is a significant strategic advantage. This avoids burdening future generations of Singaporeans with large public debt and is an important buffer for a country with no natural resources. It is also possible only because of the foresight of our founding fathers and consistent

[1] The global equity markets fell by over 20% in 1Q 2020, its worst quarterly performance since the Global Financial Crisis (GFC). Source: MSCI World Index.
[2] Source: Ministry of Trade and Industry, Government of Singapore
[3] The NIRC comprises up to 50% of the net investment return from the reserves under management by GIC, Monetary Authority of Singapore and Temasek, and up to 50% of the net investment income derived from past reserves from the remaining assets. It is the single largest revenue source for the Government.

prudence on the part of our government and people. The draw on reserves can only be taken in extraordinary circumstances by the government with the approval of the Elected President.

COVID-19 will not be the last crisis that Singapore faces. Looking ahead, with growing societal needs and climate change adaptation measures adding to the country's expenditure, our reserves will continue to be a vital revenue source for the government through the NIRC. GIC must continue to protect and enhance the reserves under our management.

FACING A CHANGING GLOBAL INVESTMENT ENVIRONMENT

The global investment outlook, with the wide range of potential outcomes and downside risks, has become even more challenging. In addition to the pandemic unknowns, such as the possibility of subsequent waves of infection, other pre-existing problems have been accentuated. These include fundamental issues such as poor productivity growth, weakened social compacts, high debt burden, and rising geopolitical tensions.

The pandemic has accelerated several shifts that could shape the investment landscape.

First, uncharted policymaking. Governments and central banks are resorting to unconventional policies of large magnitudes to support their economies. With global interest rates at 140-year lows, growing political divides, and corporate and public debt levels set to climb even higher, it will be very difficult to calibrate or withdraw these massive stimulus measures as the economy recovers. This introduces policy risks for inflation and currencies that investors have not had to contend with in recent history.

Second, headwinds to globalisation. The commitment of major countries to globalisation has diminished. The COVID-19 crisis has also sped up the push to diversify or re-shore supply chains, increase domestic production of certain essential goods, and adopt technology such as advanced robotics, additive manufacturing, and content digitalisation. Modularisation and duplication of supply chains will become more widespread. To further protect domestic interests, governments could also tighten restrictions on foreign labour and capital. A major retreat from globalisation is likely to hurt global productivity growth and be particularly detrimental to emerging markets that have historically relied on foreign investments and export-led growth.

In particular, we are likely to see a reconfiguration of Asian economies' links to the world. The pandemic has added pressure to the already strained US-China relations. Potentially tighter restrictions on China with regard to trade, technology, and capital will affect the rest of Asia. However, certain markets, given their lower production costs, comprehensive supplier ecosystems or large domestic markets, could also benefit from the diversification of global supply chains away from China. Over the long term, intraregional trade should still strengthen in Asia, as companies seek to produce where most of the world's consumers are[4].

> **WE ARE LIKELY TO SEE A RECONFIGURATION OF ASIAN ECONOMIES' LINKS TO THE WORLD. OVER THE LONG TERM, INTRAREGIONAL TRADE SHOULD STRENGTHEN IN ASIA.**

Third, governance will matter more. With the global recession, public health challenges and geopolitical tensions, the preparedness and responsiveness of governments, countries' relevance to global supply chains, and their ability to retain the trust of their populations will be key drivers of their performance.

Fourth, industry consolidation will be catalysed. COVID-19 has drastically weakened the finances of many companies, particularly small- to medium-sized ones. Given the depth and duration

[4] *It is estimated that 40% of global consumption will take place in Asia by 2040. Source: Asia's Future Is Now Report, McKinsey (July 2019)*

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of this crisis, many will not survive while others will require additional funding, seek alliances or be acquired. Companies with stronger balance sheets and technological edge are likely to become bigger and stronger.

Adding to the profound uncertainty is the challenge of high valuations. Recent policy stimulus has lifted asset prices to levels where investors risk overpaying and suffering permanent impairment. Given our mandate, the first order of business is to reduce this risk by keeping a cautious stance on broad markets. At the same time, with structural shifts and likely episodic market volatility, we are prepared to deploy capital into individual opportunities. You can read more on this in our Feature Article, "A Changing Global Investment Environment".

FOCUSING ON OUR VALUES AND STRENGTHS

Amidst the uncertainty, we should maintain our focus on our mandate, values, risk capacity, capabilities, and constraints.

We continue to follow the principle, "Prepare, not Predict" and emphasise portfolio diversification and, where appropriate, optionality. We should maintain a long-term perspective. This means emphasising fundamental Amidst the uncertainty, we should maintain our focus on our mandate, values, risk capacity, capabilities and constraints.

Lastly, we reaffirm our focus on sustainability. We believe climate change and other sustainability risks will greatly affect the physical environment and capital markets, which in turn will influence the long-term value of our investments. Therefore, sustainability is an essential part of our investment strategy, risk management, and corporate culture and processes. We are focused on supporting "transition", where businesses are taking actions to improve sustainability. We share more on our sustainability approach in the chapter on "Managing the Portfolio".

BUILDING A STRONG AND RESILIENT ORGANIZATION

Organizational resilience is fundamental to GIC's investment mandate and purpose, and enables us to sustain performance, particularly through times of crisis. Our resilience was tested during the COVID-19 pandemic, which not only posed risk to the health and safety of our staff, but also curtailed GIC's office operations across the world. GIC's Business Continuity Programme includes a detailed response plan for infectious disease outbreak, which was adapted and improved from our experience in SARS. This, together with our continuous investment in technological solutions, allowed us to respond to the COVID-19 pandemic effectively, including the rapid roll-out of safety measures and large-scale telecommuting.

> **AMIDST THE UNCERTAINTY, WE SHOULD MAINTAIN OUR FOCUS ON OUR MANDATE, VALUES, RISK CAPACITY, CAPABILITIES, AND CONSTRAINTS.**

This year, we appointed Mr Choo Yong Cheen, Ms Liew Tzu Mi, and Mr Bryan Yeo to our Group Executive Committee (GEC), where they took on formal responsibilities at the enterprise level, whilst remaining as the Chief Investment Officers for Private Equity, Fixed Income, and Public Equities respectively. We also congratulate Mr Jin Yuen Yee who succeeded Dr Chia Tai Tee as GIC's Chief Risk Officer and a member of the GEC. Having these four new GEC members is part of our ongoing process to ensure a strong bench of current and future leaders for GIC.

I would like to express my deep gratitude to Tai Tee for his many years of service and contributions to GIC. His strong emphasis on taking risks that are compensated, informed, and authorised has strengthened our risk culture, and enabled careful expansion and innovation into new investment areas.

Externally, we continue to build on our engagement efforts not only with our partners, but also the local communities. For example, *GIC Sparks and Smiles*, our leadership and community engagement programme for students from disadvantaged households, turns five this year. Since its launch, over 650 students have volunteered some 17,000 hours to mentor children and youth. I am heartened that many have gone on to serve the community after graduating from the programme. This year, we also started *GIC X Change*, a mentorship and volunteering scheme which matches GICians and youths to jointly develop community service projects for long-term impact.

More recently, in response to COVID-19, GIC embarked on a dollar-for-dollar matching donation drive, supported numerous ground-up community projects led by our staff, and contributed funds to relief efforts in Asia, the US, and Europe. As the manager of Singapore's reserves, GIC wants to do our part to help vulnerable communities.

I would also like to convey my deep appreciation to our staff across our global offices. Their resilience and dedication have enabled GIC to deliver sustained long-term real returns and manage the considerable disruption in our operations. They have gone to great lengths to safeguard our portfolio and support one another, despite a highly stressful work and living situation. Likewise, I wish to thank our Board and partners for their continued support and trust during these difficult times.

> **EXTERNALLY, WE CONTINUE TO BUILD ON OUR ENGAGEMENT EFFORTS NOT ONLY WITH OUR PARTNERS, BUT ALSO THE LOCAL COMMUNITIES.**

BEING PREPARED

We have been preparing for a challenging investment environment for some time and our defensive position has helped in navigating the current turmoil. We remain vigilant, guided by our mandate, values, and investment principles. We are ready to face an uncharted future and will continue to invest the nation's foreign reserves prudently.