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MTC Asset Management
Founders Fund

Commentary (Founders Fund)

June 2018

Written by Devan Linus, Chief Investment Officer

Objective

MTC Founders Fund ("Founders", "MTC" or the "Fund") aims to achieve a net return of 10-15% p.a. over a 3-5-year period by investing in a portfolio of global listed equities. MTC invests predominantly in blue chip companies listed in the US and Emerging Asia and employs a value driven, bottom-up investment approach. MTC's benchmark is the Kuala Lumpur Composite Index ("KLCI") and the Dow Jones Industrial Average ("DJIA"). The KLCI was chosen as a benchmark as MTC's investors predominantly originate from Malaysia, where the DJIA has historically been the best representation of the global companies. Performance is reported in USD.

Performance

MTC delivered a since inception net return of 85.4% (10.8% p.a.), outperforming the KLCI and slightly underperforming the DJIA, which returned -18.4% (-4.2% p.a.) and 92.4% (11.5% p.a.) respectively.

For the period of Q2, we declined substantially compared to the KLCI and the DJIA, as we shifted our portfolio away from US listed companies to those listed in Australia and Asia. The negative declines of our portfolio companies in these two markets severely affected our performance during the quarter. Specifically, the KLCI declined -13.6% for the quarter (and -5.7% YTD) in USD terms. This was due to the recent change in government from the incumbent ruling government since independence to a new government led by former Prime Minister, Tun Mahathir Mohamed, who shifted parties to improve the Malaysian economy and temper corruption. With a major change in government, a temporary stock market decline is very much expected, but it also serves as a great opportunity for value investors such as us.

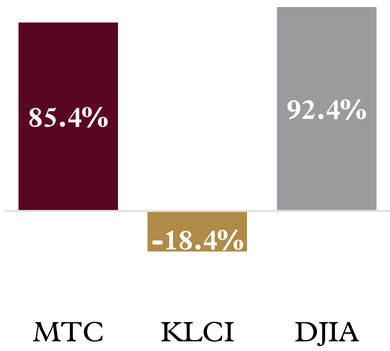
For the first time since 2013, our total returns since inception has been lagging the Dow. While it is not something we like, the recent quarter's strategy of shifting away from US Tech, having been >50% invested in the past, have impacted our performance. If we had stuck to the US and Technology stocks in a big way we would have continued to benefit from the recent momentum. However, it has always been the principles of MTC and value investors to sacrifice short-term momentum for new geography and industry sectors that will bring the next five years of growth.

NAV

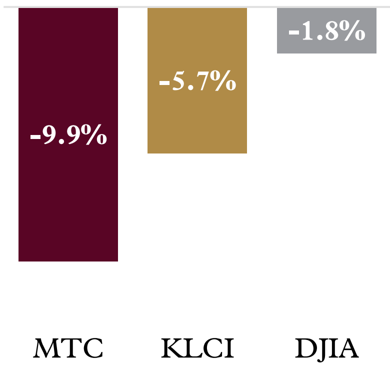
Class S: 185.35

Performance

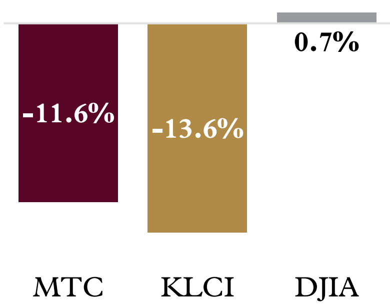
Since Inception (24 Jul 2012)



Year to Date (Jun 2018)



Quarter (Jun 2018)



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Performance (continued)

We don't see the US and Technology stocks creating the same returns as before. In addition to that, we remind ourselves consistently of the 1999 tech financial crisis and are being very prudent in our stock allocation.

Market Insights

Underweight US Tech & US Global

To understand the variance in our performance compared to the DJIA is to understand the difference between the returns of the US compared to that of other nations (we use China as an example), and the comparison with the US market versus the US tech stocks in isolation.

If you were to look at the US economy, the results speak for itself and its great: low unemployment, growing GDP, higher property prices, rising interest rates, etc. Then you look at the US stock market, where the DJIA is only down by -1.8% for the first half of the year, but close to its 10-year high. Some are calling the US market as a whole overvalued, but we disagree, as it is only the tech sector that's overvalued and consequentially propping the overall DJIA. For the first half of the year, the Nasdaq (which represents only US tech stocks) is up 18.8%. If we strip the tech stocks out of the DJIA, its performance would be much lower, with many hidden gems. Out of the 30 stocks in the DJIA, six are in tech stocks. In summary, our underperformance is because we have significantly trimmed our tech stocks to 27% of the portfolio. We have done so as we believe many companies in the tech sector are overvalued, whereas the traditional companies are undervalued.

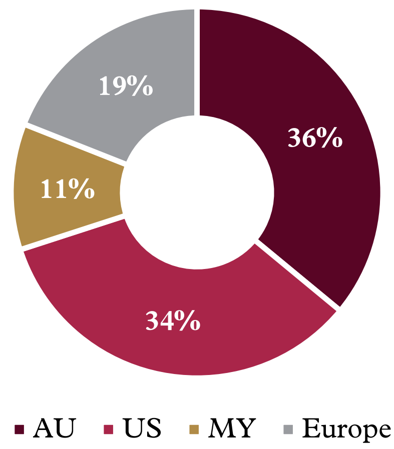
Another reason of our underperformance is that we have invested into countries outside the US. In the US, the DJIA is down 1.8% for the first half of the year, but in contrast the Shanghai and Jakarta Composite is down -13.9% and -8.7% respectively. Today, US listed companies only form 34% of the portfolio. So instead of picking US listed global companies expanding in Asia, we are now picking Asia Pacific listed companies growing in Asia. Though we are underperforming in the short term, it is because we are bottom averaging into these undervalued companies.

Portfolio

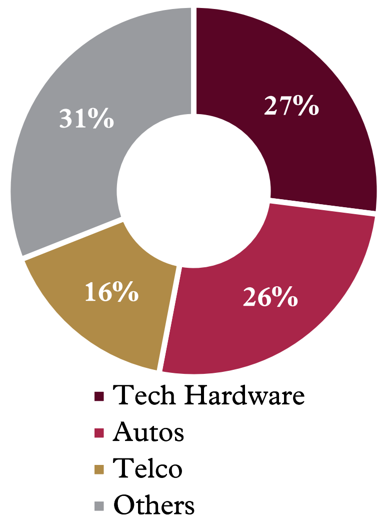
Australia the Land Down Under…Valued

For the first time in the history of MTC, US companies ares no longer the dominant allocation. Today, Australia listed global companies consist of 36% of the portfolio. In switching to Australia-listed global companies we have endured a short-term underperformance, in particular -9.9% for the first half of the year.

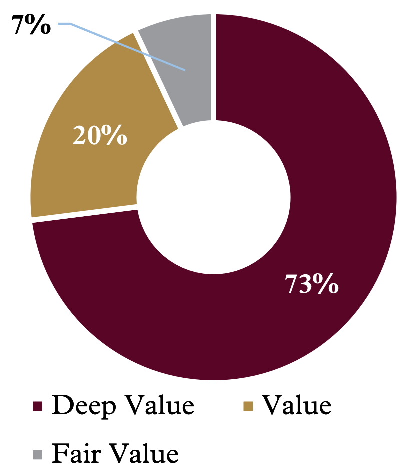
Company Listing Breakdown



Sector Breakdown



Value Breakdown



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Portfolio (continued)

Australia the Land Down Under… (performance)

MTC's style has always been to never time the absolute bottom, but to continuously invest and deliberately take short-term declines with the expectation that we will make 100% in the upcoming years. We did this in early 2016 when we doubled down on US Tech Stocks, and we are doing the same now, with a different geographic and industry concentration. The Australian market represented by the ASX200, in AUD is up 2.1%, but on close inspection, financial services are down >20% off its peak in 2018, and same goes for Australian retail and telco. We are invested in this space and are bullish on the outlook of the Australian listed companies. Among the reasons are: (1) The continued immigration from China and South East Asia into Australia, which in the long term will contribute positively to the economy. We are not invested in the real estate sector, as prices have not retracted as much compared to the industry sectors mentioned above. (2) Certain Australian companies have demonstrated the ability to expand outside Australia in particular, Emerging Asia and Emerging Europe as the US and China have largely shunned these markets. When the US listed companies think of expansion, they think China first, South America second, and everyone else third. When the Chinese companies think of expansion they think only of China. Hence, this gives an opportunity for well-run Australian companies to grow in emerging Asia. Currently, we see companies like ANZ, Harvey Norman, SEEK, etc. all operating well in Southeast Asia. (3) In isolation of the macro theme, as investable capital is shifting to both the US and China, a lot of great Australian companies have become undervalued. A lot of Australian companies are paying dividend yields above 5% when interest rates are below 1.5%. Contrast that to the US where dividend yields are below 2% but interest rates are above 1.5%. In Malaysia, dividend yields are below 5% but interest rates are above 3%. We have identified the right Australian companies and expect to benefit from the double whammy of high short-term dividend yields, and long term share price appreciation.

Lastly, since we are talking about Australia, we should also mention the current Royal Commission investigation of the financial services industry. We generally feel the issue to be overblown. First (1), we contrast that with history of the US during the global financial crisis in 2008. Certain US banks literally duped the public by selling them subprime debt investments that were worthless and got away unscathed. The US Banks that survived are now at their all-time highs. Some companies are too big to fail, US banks were one category and so are the Big 4 Australian banks. Secondly (2), the issue with Australian banks was a case of aggressive lending policies, not enough anti-money laundering checks, and some unethical practices, as opposed to hiding of losses like what happened in the US. So, we see the overall, to be minor in the big scheme of things. When MTC looks at investments we purely look at profit generation ability as opposed to the social impact generation ability. So if we were to invest in a palm oil company for example, and the risk is that it is RSPO sustainable, we would then measure the likely fines (if they are to receive them), and compare the cash flow/earnings after adjusting to the fines and compare it with its share price to see whether it's still undervalued. So if we look at Commonwealth Bank of Australia although they were fined $0.7B they make $26B in revenue, so its not as big of an issue. We see the same thing for the other banks, and when it comes to housing loans, its common for banks to write off bad debts. We do recognise that cost compliance may go up in the future, and that is something we continue to research into to know whether to buy the banks now, and if so which bank to pick. However, on an overall economy perspective the current investigation on financials is not going to dent the economy. It would be more worrisome to Australia if ,for example, iron ore prices stayed below $50 or if China was in a deep recession.

US Tech Bubble

We trimmed down our tech holdings significantly for the year and lost out on momentum as the Nasdaq was up 18.8%. However, do remember we are value investors and contrarians. Last year we were big into tech when everybody claimed doomsday, leading MTC to make 40% for 2017. Today, looking at the tech landscape it becomes even harder to grow when you are already a behemoth company. Currently, the Top 5 companies by market capitalisation in the world are all tech companies: Amazon,

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Apple, Google, Facebook and Microsoft which have a combined market capitalisation of $3,821B. This means if you are expecting a 20% growth, they would have to go up $764B, which is larger then even the GDP of Singapore and Malaysia combined at $711B. Now these are the better examples of the big tech companies, but there are many other players that we have ignored such as Alibaba, Tesla, Tencent, Netflix, etc. So the presumption is that tech companies are going to dominate the whole world, and make the likes of the Exxons, Walmarts, Nikes, McDonalds, Daimlers and maybe even Singapore and Malaysia all go irrelevant. Fortunately, we are students of history, and we point to the 1999 dotcom bubble which had similar ludicrous expectations. People at the time thought companies like Amazon, America Online, Cisco, Yahoo, and Microsoft would dominate for the next decade. Right after only Amazon and Microsoft dominated. However, as Amazon and Microsoft dominated corporate earnings, its share prices only surpassed its 1999 high, in 2010 and 2016 respectively.

We cannot pinpoint exactly which and when companies with poor fundamental will go bust (Groupon already is), but what we can say is today the advantage of pure play tech companies is not as wide as traditional players. Today if we were to compare Tesla with General Motors, we see both companies having identical technology (just different branding). General Motor today already has a driverless car, some of its car models have in-built navigation, it has electric, etc. Walmart compared to Amazon, has an online store, automated logistics, cashier-less checkouts, etc. Commonwealth Bank of Australia has a digital wallet, mobile FX transfers, online account openings, etc. We see the technology gap between the pure play tech and traditional players to narrow considerably as traditional players are now adopting in house tech teams. Furthermore, pure tech players like Amazon are now buying brick-and-mortar players like Whole Foods (a supermarket retailer). In the case of companies like Microsoft which bought Nokia, it has seen the Windows Phones disappearing today, as it is not easy to do brick-and-mortar. So, we see certain traditional companies that have excellent brick-and-mortar operations moving into technology as a strong investable opportunity. Most importantly, the traditional players biggest advantage, is its share price valuations. Hence MTC, having benefited from its expertise in investing in the likes of Apple, Google, Facebook and Microsoft before (the only company we have never invested in before was Amazon), is best primed to benefit in picking the traditional players that can also upskill themselves with technology, consequentially leading to EPS increase and ultimately rising prices over the long term.

Outlook

Although we are expecting a potential tech bubble forming, we are uncertain as to when and how it will happen. What our research has indicated however is we do not see it happening this year but having said that we have already trimmed down from the sector. As such, we are going to lose out in returns compared to the tech sector if it continues to appreciate with momentum, as particularly observed from the Nasdaq. Furthermore, in the companies we are investing in they have been stagnant and are creating new five-year lows (some even decade lows!). Hence, we are continuously rebalancing and re-investing into them which would not necessarily give us a good performance for 2018. However, it is setting up the portfolio for a great 2019 run, so now is an opportune time to invest in the MTC Founders Fund portfolio. In the meantime, we are embracing this volatility and encourage our investors to do so as well.

Disclaimer

The views expressed in this report are those of Devan Linus Rajadurai, MTC's Co-Founder, CEO & Chief Investment Officer. MTC's investment strategy is implemented by the Fund's Investment Manager, MTC Asset Management, with the support of its sister entity, MTC Asset Management (M) Sdn. Bhd. licensed by Securities Commission Malaysia (CMSL: eCMSL/A0333/2015), which provides research and operational support to MTC Asset Management. The Fund is a regulated mutual fund under the Mutual Funds Law of the Cayman Islands and is registered with the Cayman Islands Monetary Authority.

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MTC Asset Management
Meranti Fund

Commentary (Meranti Fund)

June 2018

Written by Devan Linus, Chief Investment Officer

Objective

This commentary should be read in conjunction with the MTC Founders Fund Commentary. MTC Meranti Fund ("Meranti", "MTC" or the "Fund") aims to achieve a net return of 10-15% p.a. over a 3-5 year period by investing in a portfolio of global listed equities with an approximate 30% exposure to Malaysian listed entities. Its overseas exposure is close to an exact replica of our sister fund, MTC Founders Fund ("Founders"). Besides its continuous Malaysian exposure, Meranti's investment approach is the same as the Founders Fund. Performance is reported in MYR.

Performance

The Meranti Fund delivered a since inception net return of 32.8% (15.2% p.a.), outperforming, the KLCI and matching the DJIA, which returned 1.2% (0.6% p.a.) and 32.9% (15.3% p.a.) respectively.

Meranti's first half performance mimicked Founders, but the difference is that Meranti's performance suffered in Q1 whereas Founders suffered in Q2. Reiterating our last commentary the reason for the Q1 negative performance was due to the appreciation of the ringgit as well as our Malaysia listed companies that tanked pre-election. In contrast the KLCI appreciated in Q1 but tanked substantially in Q2 (by -9.2%) due to the change in government. In contrast the average share price of our Malaysian investments remained the same.

Market Insights

Positive Malaysia and Congratulations to Tun Mahathir

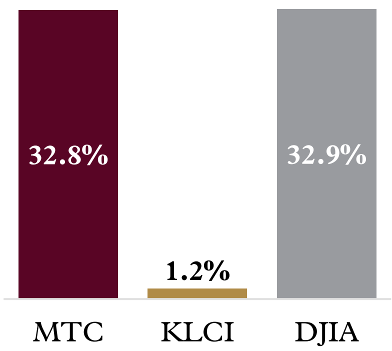
Reiterating the Founders commentary, it is expected after a new government change (the first in Malaysia's history), for there to be short-term declines in the market. However, what many feared would be a hostile post-election was surprisingly met with peace and a smooth transition among the civil servants. Any negative impact of a major government change is lessened, as Tun Mahathir Mohamed the new Prime Minister, was also Malaysia's Prime Minister for 20 years. So the economic policies, government strategies and implementation, would not be a complete shock to the business community. Secondly, the new government should be incentivised to do better than the previous government for the fear of being voted out in the next GE.

NAV

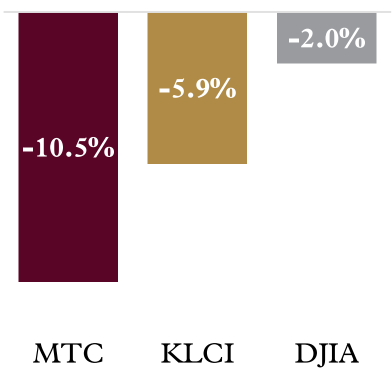
Class S: 132.84

Performance

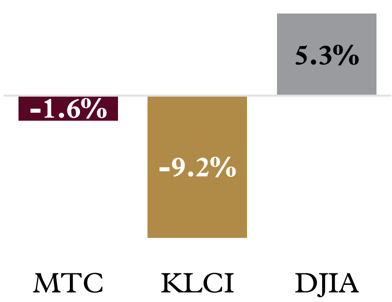
Since Inception (28 Jul 2016)



Year to Date (Jun 2018)



Quarter (Jun 2018)



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Market Insights (continued)

Positive Malaysia and Congratulations to Tun Mahathir (continued)

Regardless of the fence one sits on, (1) the removal of GST, and as a result (2) lower taxes (if you believe in the capitalist argument, which we do), is always better for economic growth. Thirdly, (3) regardless of your party of choice, one cannot deny the positive euphuism created from Mahathir's victory to be once again Malaysia's Prime Minister. For a 93-year-old man to turn against his own party that he helped to ensure dominance, must have only been done for the good he intends to do for his country. The evidence on the surface level looks highly unfavourable for its former Prime Minister, Najib Razak, where Malaysia faced global embarrassment on the 1MBD scandal, and the overreliance on China for foreign direct investments. With this change in government, on a global scale Malaysia is already being looked at more positively. For the first time Malaysia is reaching front page headlines not for scandals but for democracy. Foreign investment won't come back immediately as it takes a while for the government to confirm their new policies, but when it does come back, it will come back in droves, and by many nations. We congratulate Tun Mahathir and the new government and are very positive on the Malaysian socio-economic landscape.

Portfolio

Ringgit to Malaysian Companies

Despite our positive sentiment on the Malaysian economy, our sentiments for Malaysia as an investment opportunity will always be less positive compared to our other developed nations. This is because: (1) Malaysia's low public float and volumes, (2) Concentration of our listed entities to just a few industry sectors, namely financial services, plantation, property, and oil and gas, (3) The speculative nature of the Malaysian market participants, and (4) Majority of blue chips being government linked entities. As such when we can't find opportunities we hold Ringgit cash. However, given the general market declines post-election, we have seen opportunities. Prior to the elections we already started accumulating certain companies we believe to be undervalued, namely in the manufacturing and media space. Although these Malaysian companies are not to be considered great compared to our international counterparts, they are significantly undervalued in relation to the business that they are in. We have continually reduced our Ringgit cash exposure into these selected stocks and are also patiently waiting for the other blue-chip companies to drop further. Namely the glove manufacturing sector and food and beverage sector that have already gone up significantly over the past year to overvalued levels. A glove company trading at multiples over earnings ~40 when Google is ~30 is ridiculous. The good thing is we already have our Malaysian company allocation invested at well below these levels.

Outlook

For the Malaysia portion that comprises ~30% of the portfolio, similarly we are in a situation where we don't expect it to increase significantly anytime soon but do note that these companies are at their 10-year lows. So any positive element to the Malaysian economy in general and more specifically to the company itself would result in quick upward share price momentum. As such given we see a flattish performance for 2018 for our global investments, we see the same for our Malaysian investments. We expect the pickup in performance to continue majorly in 2019, making now a good time to invest in Meranti Fund when it is at the low. However, what we do want to reemphasize is that since inception in July 2016, we are still up 33% whereas the KLCI is only up 1%. Hence, we are still much better than any Malaysian investment out there.

Disclaimer

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