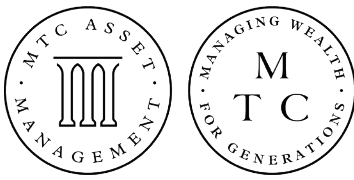

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MTC Asset Management
Founders Fund

Commentary (Founders Fund)

December 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 22.8% (3.2% p.a.), outperforming the KLCI and underperforming the DJIA, which returned -20.4% (-3.4% p.a.) and 84.9% (9.9% p.a.) respectively.

Benchmark Comparison

Quarter

The DJIA declined -11.8% for the quarter as fear of overvaluation hit the market. The FAANG stocks (Facebook, Apple, Amazon, Netflix and Google) all declined significantly at an average rate of over -20% which were a major factor in the DJIA decline. In the last week of December, it was particularly more negative as specific DJIA component stocks crashing over -5% on a daily basis leading up to the end of the year, with the Volatility Index (VIX) at its highest point for 2018. We commented on the overvaluation in the market, particularly in the FAANG stocks in our last few commentaries and our foresight were proven right during this period.

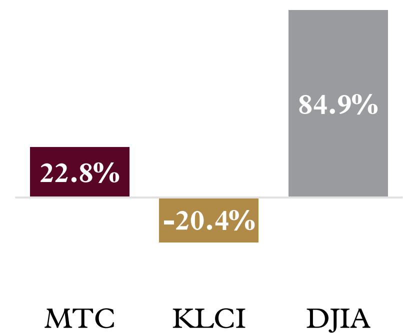
Despite our foresight, the portfolio performed significantly worse than the benchmark as we adopted a more concentrated portfolio in the first quarter of 2018. Our new stocks in the tech hardware, retail and media sectors performed terribly for the year (on average a decline of 20% from our purchase price). To add to this, we decided to increase our leverage in the 4th quarter of 2018 to take an opportunity in a depressed market and buy back into one of the FAANG component stocks at its 2018 lows. The last week of December's stock market rout combined with our leverage of ~35% resulted in the fund's significant decline of -30.0% for the quarter.

NAV

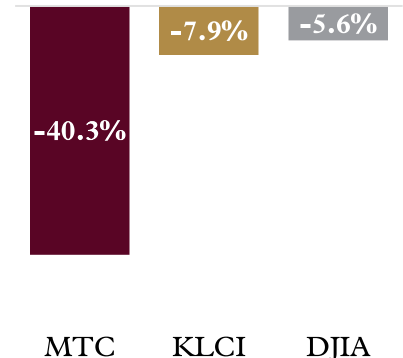
Class S: 122.80

Performance

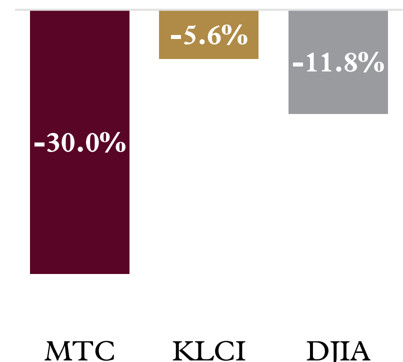
Since Inception (24 Jul 2012)



Year to Date (Dec 2018)



Quarter (Dec 2018)



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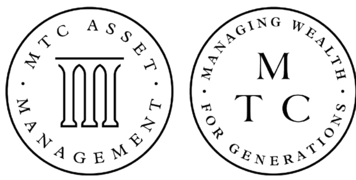


Benchmark Comparison (continued)

Quarter (continued)

The KLCI on the other hand, performed negatively for the year and quarter at -7.9% and -5.6% in USD terms respectively. In comparison to Founders and DJIA, it may not seem that much but we do have to take into account that since the inception of our fund in 2012, the KLCI performed negatively at -20.4%. This just reaffirms our strategy of investing outside the emerging markets into developed markets which historically has been proven to be a better and less risky investment destination.

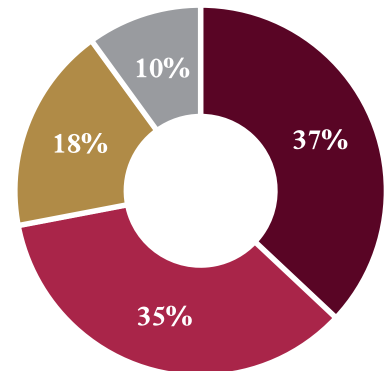
Portfolio

Quarter 1 Rebalancing Efforts

In the 1st Quarter of 2018, we made a major change in our portfolio by notably making the decision of fully selling our position in Apple. In the next two quarters after the sale, we somewhat looked like idiots as Apple's share price continued to appreciate to an all-time high of $232 which would have technically given us a further 20% appreciation if we have kept it. However, selling at the absolute top is always a challenge for any investor. Our rationale for selling Apple was shared in our March 2018 Commentary, which we summarise as (1) Apple's oversaturation of sales globally, (2) its historical failure in the iPhone SE and our foresight in continued failure in moving to the non-premium segment, and (3) lack of opportunities of further growth and higher risk of revenue declines. The three points mentioned showed our research was proven right as Apple crashed to a share price of $146 at the close of the year which would bring its performance to a decline of -37% from its peak. To add on this, the iPhone XR has not sold very well since its release, and Apple has dropped from third to fifth place in market share in China which is approximately 20% of its revenue. We still do like its products and services, but we are no longer fans when it comes to looking at Apple as an investment as we feel there are more risk for the company than gains in the coming years.

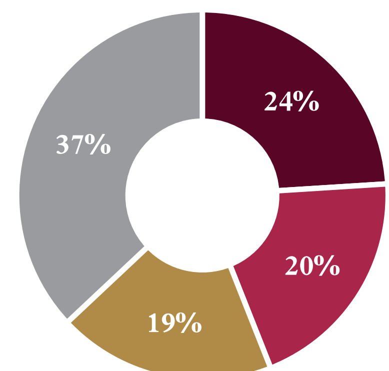
As it is incredibly hard to capture the absolute top, it is also equally as hard to capture the absolute bottom in terms of share price. As we sold Apple and the other companies in our portfolio that we saw had very little growth opportunities, we shifted the portfolio immediately into new companies that were on average more than -40% of its peak. Unfortunately, after we got into these new companies, it continued to decline a further -20% from our purchase price which is why our performance suffered in 2018. We would like to reiterate that the goal for us and any other successful fund managers is to sell at 20% below its peak price and buy at 20% above its lowest price. Our analysis and research have indicated that our new portfolio of stocks in Tech Hardware, Media and Retailing based on December figures are at its lowest point, giving us an 81% allocation to deep value companies.

Company Listing Breakdown



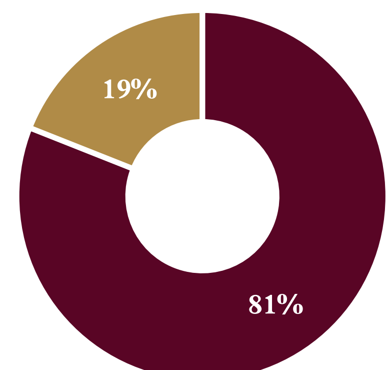
▪ AU ▪ US ▪ GR ▪ Others

Sector Breakdown



▪ Tech Hardware
▪ Media
▪ Retailing
▪ Others

Value Breakdown



▪ Deep Value ▪ Value
▪ Fair Value

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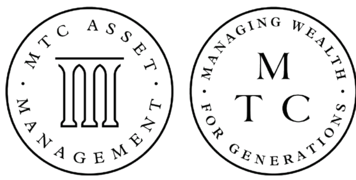

Portfolio (continued)

Dividend Yield Strategy

Even though our portfolio has declined substantially in 2018, our saving grace is that our average dividend yield for the portfolio is over 8% on a gross basis. We started shifting into these new companies in the 1st quarter of 2018 when we realised that these companies were paying dividend yields of more than 5%. And a good long-term strategy to deploy during bad times when the market starts getting heaty, is to invest in high dividend yielding companies while waiting for better growth stocks to emerge. For example, if we had stuck to the FAANG stocks, we would have experienced a similar negative performance for the year, and without any dividends. Now with this new portfolio of companies and should the stock prices of these companies not move in the next five years, we would still be up 40% naturally from the dividends we receive. Therefore, despite the negative performance, we doubled down on our leverage in 4th quarter to buy further into these companies that will not just benefit from the high dividend yields but also the potential of capital growth.

A good example of this would be our investment in automobiles which pays us a high dividend and there's a big potential in share price growth as their new pure electric models are being introduced this year. As for our tech hardware companies, the evolution to machine learning and continued focus of the cloud should also result in share price growth opportunities. In retailing, our companies will continue to benefit from the appreciation of the ownership of real estate (e.g. its stores) as its growth opportunity, moving from offline to both offline and online. We expect for these companies to naturally appreciate >20% from its December lows which will adjust our average portfolio dividend yields to approximately 5%. Subsequently, we would collect these dividends for the next few years while waiting for the growth opportunities to materialise.

Mistakes

After evaluating our performance for 2018, we have concluded that our two major mistakes were (1) the timing of our 'buy and sell' during the rebalancing of our portfolio and (2) holding on to a dud in our portfolio which we made in 2016. We will comment on the two below.

Whilst we note the mistake in our timing, we have also concluded that this is something the portfolio and our value investing strategy must naturally deal with. In a strategy of picking value stocks, we at times give up future momentum by selling earlier if we feel the stock is overvalued and buy in a little earlier than we should when a stock is declining. The ultimate dream is to buy at the absolute bottom and sell at the absolute high, but we know from history this feat is almost impossible and requires a lot of luck. Therefore, a strategy of dollar cost averaging is more prudent in actually reality. In the past our portfolio fell twice from a NAV of 112 in September 2012 to 93 in June 2013 (-16% decline), and a NAV of 174 in May 2015 to 120 in January 2016 (-31% decline). In both instances, the portfolio has appreciated to gain new peaks with a peak NAV of 218 in January 2018. It's the very nature of our fund to be volatile, in our pursuit of new peaks and new performance. As we said earlier, we would rather sell 20% before the top and buy 20% below the bottom in that pursuit of a 10-15% p.a. return (though with volatility).

In the past we've had some duds, one was a in a retail company in the US, a few in agriculture and commodities and our most recent is in a semiconductor supplies manufacturing company in Malaysia that we invested heavily in 2016. MTC Founders Fund is a global portfolio and on occasions, we do invest in Malaysian companies that we think are equivalent to our global counterparts. Much like the glove sector in Malaysia, the OEM semiconductor has been a thriving sector in Malaysia where Malaysia has been the key manufacturers for the region for companies like Western Digital, Intel, etc. As such we observed an undervaluation in a sector that we were familiar with.

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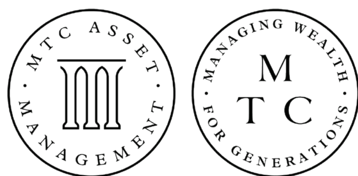

Portfolio (continued)

Mistakes (continued)

Unfortunately, despite all the advantages a company may sometime have, whether it be (1) monopolistic market share, (2) high barriers to entry due to a strong manufacturing facility, (3) high cash flow generation and high dividends, and (4) an intelligent workforce, a company can end up becoming a wasteland if management does not continue to innovate. Unfortunately in Malaysia, the political and economic situation in the country has resulted in a serious brain drain which has not only impacted the young Malaysian workforce but has also affected at times business owners themselves. A very good comparison of this company would be Foxconn. In fact, in their heydays, they could have been the Foxconn of Malaysia. Just like how Foxconn primarily derived its revenue from manufacturing the iPhone, they knew they would have to use their cash and expand their business to diversify and manage risk. This resulted in Foxconn purchasing Sharp which produces TV's and other electronic consumer goods as part of their diversification and growth strategy. This Malaysian company we invested heavily in DID NOT do the same with its cashflow. In fact, it also suffered as other Southeast Asia countries (e.g. Thailand and Indonesia) opened up its semiconductor manufacturing facilities which created extra competition for this Malaysian company. It also failed in its transitioning of it being a family managed to a professional managed company which is something developed markets companies do better as they grow. One of the big risks investing in Malaysia and other emerging markets is when you find value in a company that is family owned and managed. Sometimes it's hard for family managed companies to give up power and authority to independent professionals even though it may be the best solution to grow the company. If this company we invested in, invested in an independent management team, it could have been a completely different story altogether.

Market Insights

US-China Trade War

Our commentary on the US-China Trade War is leaning more towards an analysis on how it affects our portfolio as opposed to a deep analytical piece on who will win. However, our view is that US is most likely going to come out on top, for a couple of reasons. One, when China retaliates against the US, it doesn't just affect US companies, but it affects the rest of the world. For example, China tried to put tariff measures on automobiles, and it affected the Germans as well as the US. Second, one of China's big export story is their low-cost manufacturing and one big sector is electronics. The recent investigation of Huawei and ZTE by the US have caused countries like Australia publicly saying that they are no longer going to use Huawei in the country. Some might argue the right or wrong of this act, but the question we ask ourselves all the time in investment is who is going to win, and it seems with the issue of Huawei, US is winning. Finally, the Chinese has really been dependant on the US for growth for the last decade, and with the current US's nationalistic policies, there is nowhere else that China can turn to. If China was to put tariffs on the US, the US can still sell their goods and services to South America, and Europe. Most recently, we are seeing the Western nations trying to develop Vietnam to be a counter to China. In summary, although there are many points, we really see the US coming out on top in this battle.

So, what does this mean for our portfolio? In the short-term, we have certainly been affected because of the volatility that creeped in a result of this trade war. But as mentioned previously, our US companies have always been companies that are global, therefore is able to sell throughout the globe if China decides to block them from their local market. Also, our weightage and allocation to the US is much lower than before at 35%. Our other big allocation is to Germany with a 18% allocation and that's into automobiles. We see the risk at further depreciation as small, as we doubled down only after China started putting further tariff measures thereby buying the German Autos at a further discount.

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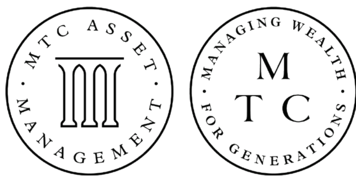

Market Insights (continued)

US-China Trade War (continued)

In fact, recently, the owner of Geely bought more than 10% of Daimler (Mercedes), so I am sure he will work with the Chinese government to make sure the German Autos are not as affected as the US Autos. For US Autos, they derive majority of their earnings from the US, with Ford generating close to 90% of their profits from the US alone, so the lost of China is just the lost of growth potential but not the demise of the business. So, for the unlikely scenario that China wins the trade war, I think the reasoning above should still be calming for our portfolio companies as the impact may not be as bad as they are global unlike companies that are only US and/or China centric.

Outlook

Our performance for the last quarter of 2018 was dreadful for the reasons mentioned above. But the core reason why the performance was so awful was because of the panicked that creeped into the markets in the last week of December where anything and everything crashed more than 5% a day for a few days. We expect to see a quick rebound in the portfolio by the 1st quarter of 2019 to a more normalised level, erasing all losses and allowing the portfolio to appreciate back up by 30%. Then we expect to experience further volatility in the coming months, but with our portfolio averaging a dividend yield of 5%, this would hopefully smoothens out the returns for the rest of the year.

For the lucky clients that invested or topped up in December, you would be pretty happy with the performance that entails in the coming months but for the rest of our clients, the portfolio is still depressed making it a good buying opportunity following the concept of dollar cost averaging. Investing for the long term has to be constant, and the best method to ride the volatility is to keep on investing every year when there is a dip, as opposed to holding cash for years. The US is at an all-time-high in terms of currency, so if you held cash and should the cash weaken (which is a big possibility) you would be worse off. A similar thing happened to Malaysians in 2014 when they held cash waiting for the next crash, instead the MYR crashed and they missed the great US run of 9.9% p.a. (DJIA, since 2012).

Even as we expect a quick recovery from a performance standpoint to 2018 and a potential 30% rise from our December lows, we honestly still consider our portfolio as cheap and deep value based on the above reasons. Therefore, the real question remains if we would see the extra growth in performance this year. Unfortunately, we don't see it happening so quickly in 2019 as these new companies in our portfolio will take time to double in value. For example, with the Autos releasing their new EV cars later in the year, we should technically only see the increase performance in share price the following year. For the media sector we might get lucky should it go into a steep recovery and therefore see some gains in the short term this year. Therefore, if the portfolio NAV is below 180, we would say it's still a great time to invest at that point in getting that 10-15% returns p.a.

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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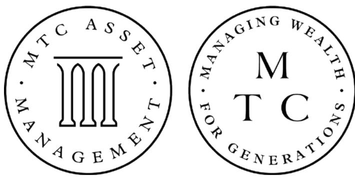

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MTC Asset Management
Meranti Fund

Commentary (Meranti Fund)

December 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

MTC delivered a since inception net return of -12.0% (-5.0% p.a.), underperforming the KLCI and DJIA, which returned 1.2% (0.5% p.a.) and 30.8% (11.3% p.a.) respectively.

Benchmark Comparison

Meranti and Founders

In MYR terms, Meranti performed similar to Founders where the currency impact was minimal for the year. Although Meranti has a 32% allocation to Malaysia, our 4th quarter performance of our Malaysian investments was similar to our global investments.

KLCI

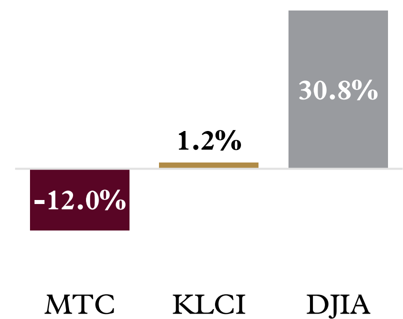
Along with the global markets, the KLCI also retreated in the 4th quarter although not with the same velocity, as the KLCI has not moved since 2016, and was also battered with negative market sentiment due to the change in government. We say negative market sentiment with regards to economic policies and growth, as compared to positive social sentiment, as the citizens of Malaysia are genuinely happy with the change. However, the business community has not been willing to spend on investments with the government lacking some clear policies. We believe in fact that it's a good strategy that the new government does not act hasty in terms of releasing new policies until it has assessed the current countries finances and analyse the data of the past to determine the right economic plans for the future. We have to be patient with the new government as they have 70 years of history and issues to analyse, but more importantly sorting out the mess of corruption that we all know exist. We predict by the end of this year when the 2019 Budget is out, the government will produce more concrete plans for the future of Malaysia, as a strong economic plan will assist them in winning the next election.

NAV

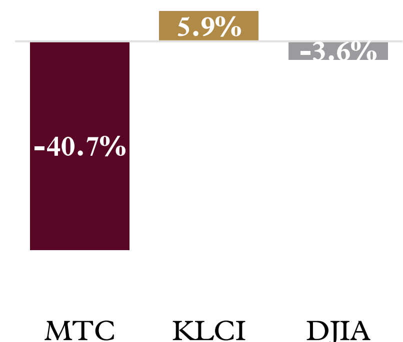
Class S:	87.99

Performance

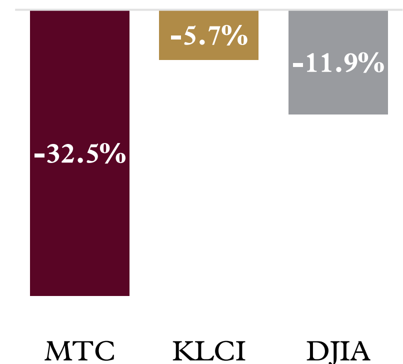
Since Inception (28 Jul 2016)



Year to Date (Dec 2018)



Quarter (Dec 2018)



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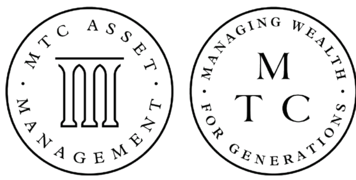

Devan Linus, Chief Investment Officer

Portfolio

The dud investment we made in our Meranti portfolio was in a tech hardware company which we mentioned in our Founders commentary. Please refer to the above Founders commentary for further details. If we are lucky, it might rebound with the usual Malaysian speculative activities, where stock prices can go up and down more intensely than their global counterparts. If it doesn't recover by the 1st quarter of 2019 by pure momentum, we are happy to cut loss and shift to cash or buy more of our other investments if it's still undervalued.

For the commentary of our media investments, please re-read the September's commentary, however we have recently added an investment in the construction sector. The negative press of the cancellation of the KL-Singapore high speed rail and other mega projects has dented the construction sector quite hard, with many companies falling more than 50% in the year. We are being very prudent in picking only the big blue-chip companies that have no significant taint of ex-government connections in terms of our choice for investment. This means we are avoiding companies such as George Kent and Malton as an example. Secondly, by investing in a big-name player that provides a good dividend, it creates a good floor on its share price. Thirdly, a few of the construction companies have genuine engineering and operational specialities that are unique in Malaysia. Some in building infrastructure like projects historically over the last two decades in Malaysia and overseas, others in terms of tunnel boring machines, and others with a good graduate engineering program that ensure that top talent remains in the organisation. With this we feel we have found a safe pick, and the company we invested in might actually do better than before as the government changes to a merit-based awarding of contracts. That means no more middle-men's and higher profit margins. Otherwise, if it's the same profit margin and no middle-men (thereby lower contract prices), then there is a higher chance of winning then before.

Outlook

Our outlook is similar to Founders where we expect the global portion to appreciate 30% from the its bottom in Quarter 1, 2018. After that we expect a similar flatness and volatility in terms of performance for the rest of the year. However, if momentum or speculation starts coming back in Malaysia we might get an extra bump for our Malaysian companies.

Disclaimer

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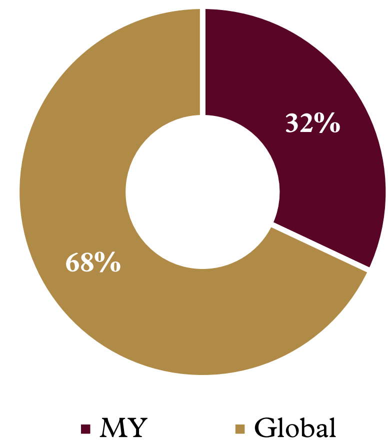
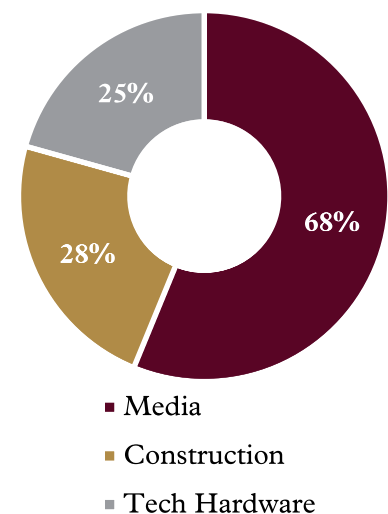
Listing Breakdown



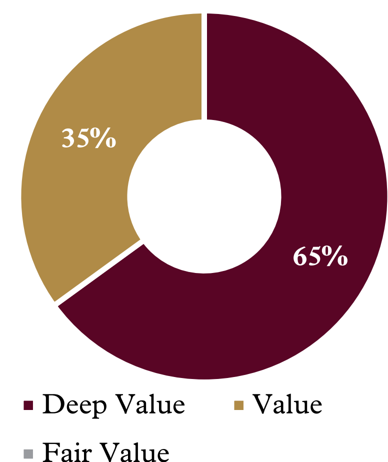
▪ MY ▪ Global

MY Sector Breakdown



▪ Media
▪ Construction
▪ Tech Hardware

MY Value Breakdown



▪ Deep Value ▪ Value
▪ Fair Value

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