invest@mtcasset.com
+60 3 2289 5055

MTC Asset Management
Founders Fund

Commentary (Founders Fund)

June 2019

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 large cap 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 global companies. Performance is reported in USD.

Performance

MTC delivered a since inception net return of 86.1% (9.3% p.a.), outperforming the KLCI but underperforming the DJIA, which returned -21.2% (-3.6% p.a.) and 110.8% (11.2% p.a.) respectively.

Benchmark Comparison

Quarter

Our stocks have continued to appreciate for the quarter, though not without some (expected) volatility. For the first half of the year, we significantly outperformed both the KLCI and the DJIA by 37.5% and 52.6% respectively, owing to our continued conviction in the same stocks we have held since early 2018. It should be noted that the KLCI on all three measures i.e. since inception, year-to-date, and quarter, has continued to materially underperform its global peers, cementing our belief in our strategy of being global and unconstrained when it comes to public equity investing.

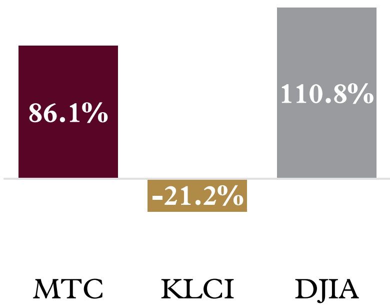
During the period and given the significant appreciation of the portfolio, we took profits and trimmed our holdings somewhat evenly to preserve cash for future investments. During the quarter, we experienced tremendous volatility, particularly in our Autos and Tech Hardware stocks as the Trade War issue hammered their stock prices by >20%. With the excess cash from our trimming, we repurchased stocks in these two sectors at these lower prices. This rebalancing exercise has resultantly increased our exposure towards US listed companies (now 45% of the portfolio) at the expense of AU listed ones (29%), noting that we had a more balanced geographic composition in Q1'18, when we had an allocation of 37% in US and 38% in AU.

NAV

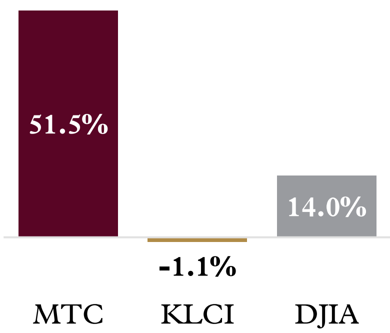
Class S: 186.07

Performance

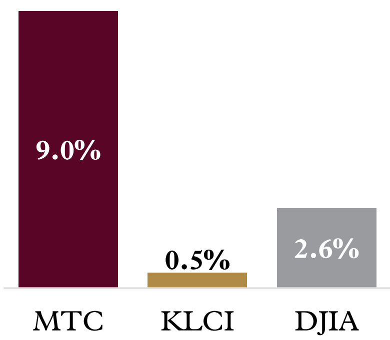
Since Inception (24 Jul 2012)



Year to Date (Jun 2019)



Quarter (Jun 2019)



Devan Linus, Chief Investment Officer

Benchmark Comparison (continued)

Quarter (continued)

Our sector composition has also changed as a result of the rebalancing, with Autos now becoming the third largest sector at 17%. In addition to the repurchasing of these stocks, we added new stocks in the portfolio that we have owned years' back in the Media and Tech Hardware sector. With the additional cash in our portfolio from the trimming, we were able to take advantage of the stock market drop in May and purchase some bargains. These new (opportunistic) stocks comprise less than 15% of the portfolio and we do not intend to increase our exposure to this sector.

As observed from the pie chart, our Value breakdown has also changed, with Fair Value (companies that are reasonably priced) accounting for 21% of the portfolio. We continue to monitor our portfolio as our Deep Value (companies that are bottom priced) stocks convert to Value (companies that are cheap); and our Value move toward Fair Value territory, with the intention of trimming such shares accordingly. As for the Malaysian semiconductor company, we are continually selling the stock when prices permit.

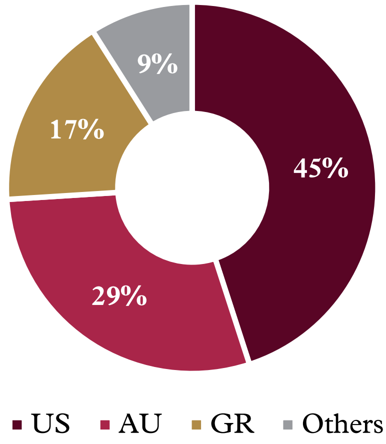
Portfolio

Autos: Taking Advantage of the China-US Trade War

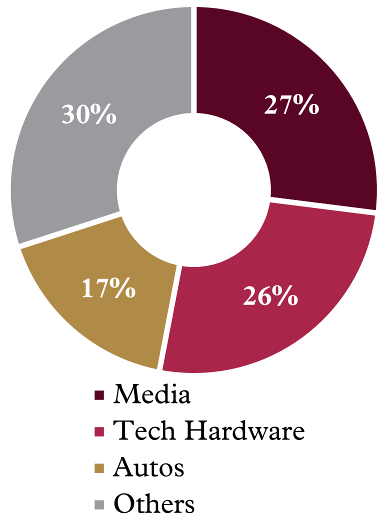
The volatility in our portfolio over the quarter was largely driven by the uncertainties created by the China-US Trade War, which impacted our Autos and Tech Hardware holdings. Particularly for Autos, the Trade War has impacted China negatively, resulting in China car sales declining materially from prior years: in May, China car sales tumbled 16.4% from a year prior, the 11th consecutive month of a decline. In March and April alone, YoY declines were 5.2% and 14.6%, respectively. This has made the first half of 2019 one of the worst car sales contraction in China since the 1990s.

Furthermore, the tariffs on car parts are also dampening exports from China to the US, putting further pressure on the stock prices of car manufacturers all over the world. When it comes to automakers, our research indicates that the US are succeeding in cornering the Chinese. With China moving away from US automakers and towards local manufacturers such as Great Wall and Geely, coupled with the dampening local Chinese demand, by luck or smarts somehow the Trade War has worked against the Chinese car market. Further, Chinese manufacturers are yet to be competitive on an international level, and hold a very small market share (Korean and Japanese carmakers lead the pack for mass market cars). Consequentially, this tension within China has created fear in the overall autos market, pushing prices of automakers down unilaterally without any consideration of merit or distinction.

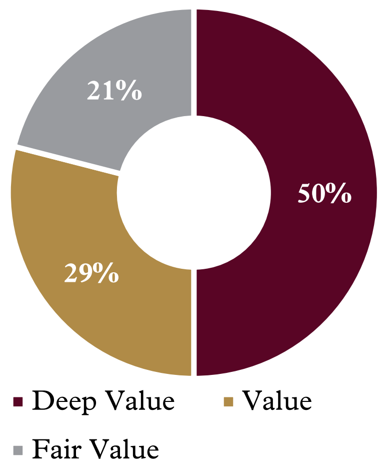
Company Listing Breakdown



Sector Breakdown



Value Breakdown



Portfolio (continued)

Autos: Taking Advantage of the China-US Trade War (continued)

As we always do, we took advantage of this mispricing and purchased more shares cheaply, and as a result increased our holdings in our preferred car manufacturer.

Car Manufacturer of the Future: Germany and US

Although our car manufacturer's stock price is being impacted by the Trade War, its business over the long-term is not. To explain how we have picked our preferred company, we ask the following: First, instead of focusing our efforts on the near term, we have to shift from asking which car manufacture is going to be less impacted by the Trade War, and instead ask (1) who has better ongoing innovation in terms of autonomous and electrification; (2) who has superior production and supply chain penetration to navigate not just the Trade War, but any other macro event that may occur in the future; and (3) who has the brand power to capture and win more customers when the China and global market recovers, and thereby gain market share. Lastly but as important, we need to then weigh the three points against the share price of each respective car manufacturer.

Our analysis of the three questions above, followed by the assignment of value relative to the respective share prices of each automaker, conclude that German and US car manufacturers have the best prospects for share appreciation over the medium to long term. If we look at the US carmakers, Tesla leads in question (1) and (3), but nevertheless has a serious disadvantage in (2) i.e. getting economies of scale to produce and sell its cars at a lower cost base. So, we are then left with the big three American automakers – Ford, General Motors and Fiat-Chrysler, all with varying strategies but a major commitment to (1). Across the Atlantic in Germany, however, you see BMW and Daimler partnering on (1), with joint investments in ride hailing (e.g. Car2Go), and charging infrastructure (e.g. ChargeNow); Volkswagen is partnering Ford. Then, looking closer into each car manufacturer's individual unique product offering and development initiatives and you see the Americans and Germans dominating the market for hybrid and EV launches, with Japan now lagging behind. While still nascent, we are mindful that this could turn out to be another Sony Walkman incident, where Apple surpassed Sony as the No. 1 audio hardware manufacturer in a blink of an eye. We believe the car manufacturer we are invested in is leading on all of the three questions above, and is being purchased at a low valuation with a >5% dividend yield. Interesting to take note that besides Geely (who owns Volvo), the rest of the Chinese manufacturers are failing on all three questions above. The problem with Geely, however, is that it is trading at extreme valuations, and its stock price is just as volatile as its Western peers, with its share price sinking more than 50% in the last 1.5 years.

China-US Trade War – China Won't Win in the Next 10 Years

A lot of discussion and volatility in the market is caused by the China-US Trade War. We believe that it is unlikely for China to win in the near term. Our reasons? (1) bar a small subset, China is still largely a copycat of US innovation, and not innovators themselves; (2) China continues to have underlying social repression issues (e.g. HK); and (3) China remains a semi-closed economy. Although our Fund is not macro-based, having this view is important as it directs us to which companies we choose to invest in for the long term. The last time we held a Chinese company was in 2014, and we've not re-entered since, and are unlikely to do so unless significant retreat occurs in perhaps the Tech sector which we know quite well. Some may argue that we missed out on the appreciation of Tencent, Alibaba, etc. However, in 2014, we invested in Apple and Google, two of the dubbed "FAANG companies" that performed just as well as Tencent. In hindsight, we should have perhaps also invested in Netflix and Amazon, however we conclude that we would not have invested in Tencent and Alibaba (an Amazon clone). Elaborating on the first point, and a key reason why we are investing in US semiconductor companies, is our view that China is still very much inferior in its innovation capabilities compared to the US.

Portfolio (continued)

China-US Trade War – China Won't Win in the Next 10 Years (continued)

The consortium of US and their Western counterparts that invented 4G wireless technology are still the frontrunners for 5G, and which Qualcomm, a US company, is arguably leading the pack. Ultimately, when people talk about Huawei, it is not seen as the inventor of 4G or 5G, but rather the manufacturer of telecommunication equipment that pays royalties to the inventors. When it comes to today's technology, it is not just the hardware but also the software, i.e. the logic being tailored to your industry and business. How did the US reach superiority in terms of innovation in software/logic? It comes down to decades of structure and support of the country towards innovation. One just has to look to the country's university system that has leading tech research universities like Caltech and MIT conducting multiple streams of research to undercover revolutionary technology. This is a system built over a century, that consists of an entrenched research system, attracting the best professors/researchers across the globe. The founder of Baidu, a Chinese national Robin Li, studied in the US; Jack Ma, who although studied in China, started Alibaba with early backing from American company Yahoo, which propelled them to the next level; and even Elon Musk, a South African, reinvigorated American Tesla. It will take many decades to convince the best and brightest minds in the world to go to China and innovate, and even more so with its red tape.

Now, let's move on to the nearer term and focus on the Trade War. We just observed the US banning of Huawei and many nations following suit. Is it fair? Perhaps or perhaps not, but it is something they can do to stifle Huawei. Contrastingly, China could not impose a similarly drastic ban on say Microsoft, because of their heavy reliance on its Operating System. It is examples such as these that give reasons for us to see the US winning it out in the Semiconductor and Tech Hardware space, led by a US President whose commercial aptitude and acumen has won the full support of US companies. Even if the US President does change, I am sure they will continue to support US technology.

On the second point, while we talk about China becoming a leading nation, we keep forgetting there are embedded social issues that have yet to be resolved. The protest in Hong Kong is a good example. Excluding Hong Kong, the average Chinese is still struggling to move up in society and in work, while an elite class continues to dominate the scene. If you observe, the elite in fact are not necessarily investing back into China – once they make their money, they are buying expensive assets like hotels, etc. in the US. This is not contained to just the ultra-rich individuals; companies like HNA are also doing the same and are investing out of China. Why is this critical? History and studies have demonstrated that in order for an economy to thrive sustainably, you need all income groups of the nation to benefit. Unfortunately, the income gap is not closing (some reports show that it is actually widening), and the social ladder in China does not exist because it is being supressed by the communist party. There is a lot to talk about structural reforms etc., but the main point is that with this social situation not sorted, it is going to be challenging for China to attract talent other than sweatshop workers or one-sided financiers and developers. One can simply count the number of "Ghost Towns" in China to see their effects first-hand. Hong Kong citizens have had enough, and though I am sure there are still ways to make money investing in China, you have to be very careful. As mentioned before, you could get the same returns elsewhere, with less political, social or corruption risk.

On the last point: China is still very much a protected economy, which makes it difficult to compete on a level playing field globally. The reason certain companies like Alibaba or Baidu thrive is because they are protected by the government; they benefit greatly from bans the government places on foreign companies from operating in China. Can we really say Alibaba or Baidu is better or more innovative than Amazon or Google?? No. I will, however, admit that one anomaly and a huge success in China is Tencent, that innovated the "Super App".

Portfolio (continued)

China-US Trade War – China Won't Win in the Next 10 Years (continued)

However, with privacy issues rising, would any other country allow ONE company to monopolise everything? Even Facebook, now facing a lot of scrutiny on its alleged involvement in the US presidential elections, does not have a financial services offering (yet) or an e-commerce store. In China's defence, China has been steadily opening up their economy since the economic reforms during Deng Xiaoping's leadership. So, I'd probably now consider it a "selectively-closed" economy. They are open when it comes to exporting low cost products to the world, but closed when it comes to allowing imports of innovative service or products. If you look at the construction, property, banking, tech and media industries, they favour their own Chinese producers/manufacturers. In instances where they do allow foreign players to participate, there are strict JV conditions. It is probably a good economic strategy, compared to the other nations in the East, but when the whole West collaborate and team up, it's pretty difficult for China to compete globally. So, when we say closed, we are emphasizing the fact that for China, the truly investment worthy companies have their income derived mainly from China alone as opposed to companies listed in Europe or the US, whom derive their revenues from diversified global sources. When the companies do succeed in becoming truly global, the US has better leverage to pressure them, as they did against Huawei. Whereas China cannot apply much pressure on US companies, they may succeed in applying pressure on Europe. However, our research indicates that Europe will stick with the US and circumvent any hostilities from China. Even Malaysia has retreated from China under the new administration and is considering strengthening its ties with Japan.

Outlook

We expect the value of our companies to continue appreciating over the course of the second half of the year, barring any unforeseen circumstances. Even with the temporary depreciation of our automobile and semiconductor companies, our other companies have appreciated and have more than covered those paper losses, resulting in the portfolio still being up 9.0% for the quarter. However, as these other companies appreciate, we are constantly monitoring their valuations and will consider trimming the portfolio further, while still keeping some cash to capitalise on any future downturns.

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.

invest@mtcasset.com
+60 3 2289 5055

MTC Asset Management
Meranti Fund

Commentary (Meranti Fund)

June 2019

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 34.9% (10.5% p.a.), outperforming the KLCI but underperforming the DJIA, which returned 0.1% (0.0% p.a.) and 49.1% (14.2% p.a.) respectively.

Benchmark Comparison

Meranti and Founders

In MYR terms, Meranti performed positively at 9.5% (8.2% in USD) for the quarter, similar to Founders. Meranti continues to have a 1/3rd allocation to Malaysia, with a 2nd quarter performance of our Malaysian companies appreciating in line with our global companies.

KLCI

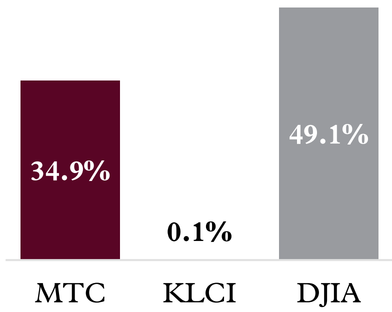
KLCI barely moved for the quarter at 1.7%, ending with a half year return of a paltry -1.1%, significantly underperforming our Fund's returns and the DJIA. Since our last commentary, no further economic initiatives have been observed with regards to the Malaysian economy. However, what is more disappointing is that in June, the country's Minister of Economic Affairs was publicly embarrassed with a release of a homosexual sex video which might either be true or fabricated. Regardless, whether it's true or not, it is sad to see politicians (assuming the perpetrator of the video release is a politician) using old tactics similar to 1998, when they got rid of the then Deputy Prime Minister, Anwar Ibrahim from power. Today, Anwar Ibrahim is the Prime Minister in waiting, and rather than looking forward, we have yet another political scandal, which is really not good for business. Hopefully, the companies of Malaysia can still continue moving forward, just like those in the companies in the US that continue to grow,

NAV

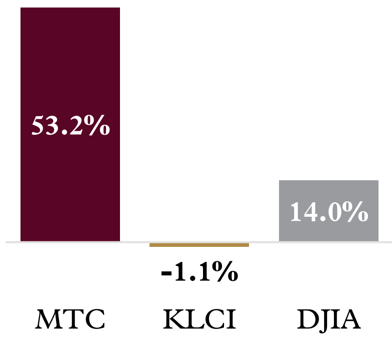
Class S:	134.87

Performance

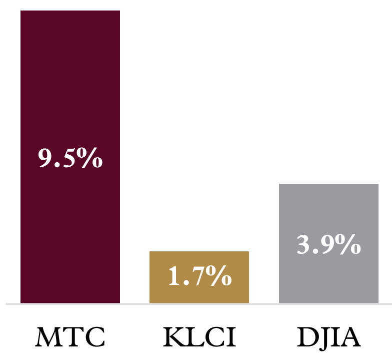
Since Inception (28 Jul 2016)



Year to Date (Jun 2019)



Quarter (Jun 2019)



despite the controversial President Trump. Overall however, we do not see the KLCI performing any better the next quarter.

Portfolio

Last quarter we had a 0% allocation to Fair Value stocks, whereas we are at 37% this quarter. The main reason is the appreciation of our investments in the Construction sector, which currently comprises 37% of the portfolio (Q1: 29%). This is a confirmation of our value investing strategy where you buy a company at a significant discount noting the potential risks; let it appreciate to Value and Fair Value; and then sell it. We will admit that generally, we are not sanguine on the Construction sector. However, in Malaysia there are so few quality blue chips that can be acquired and held on to for five years, that you have to branch out to other, less familiar industries to find value. Fortunately, our headquarters is in Malaysia, allowing us superior access to information to ensure our analysis is equally as thorough as our global research and thereby enabling us to take advantage of investing in industries that we otherwise are less familiar with. However, we would not replicate this globally and as such Founders is not invested in Malaysian or Global construction.

As mentioned prior, we do know tech, and we have to admit our mistake in that our Malaysia Tech Hardware position is a dud. For the moment, as there are no alternatives currently and as this company is still in Deep Value territory, we are being patient before we clear it from our Meranti portfolio. The Malaysia stock market tends to have bouts of speculation. Hopefully and with some help from Lady Luck, someone runs the stock up and allows us to get a more decent return. That said, if we do find something superior, we will obviously clear this position. Our Media investments on the other hand continue to remain in Value to Deep Value territory, and we are being patient with their eventual appreciation.

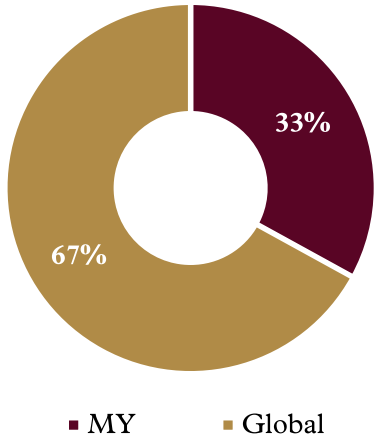
Outlook

Although our general Malaysian outlook is bleak, the outlook for our Malaysian stocks is assured, as we see continued appreciation in our holdings moving upwards from Deep Value. As prices reach Fair Value, we will start to trim our Malaysian holdings and hold cash. As mentioned before, in Malaysia we have to think in 1-2 year periods as opposed to 3-5 year terms. We had long term blue chips before, but unfortunately, they are now all expensive. So, in summary, we might potentially see a better return in Founders compared to Meranti in the coming quarters.

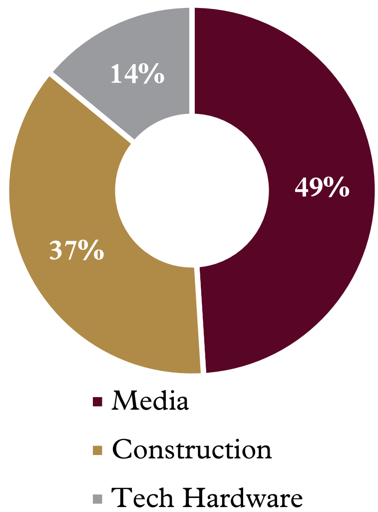
Disclaimer

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 (M) Sdn. Bhd. licensed by Securities Commission Malaysia (CMSL: eCMSL/A0333/2015). The Fund is a regulated wholesale fund under the Capital Markets and Services Act 2007 (CMSA) of Malaysia.

Listing Breakdown



MY Sector Breakdown



MY Value Breakdown