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MTC Asset Management
Founders Fund

# Commentary (Founders Fund)

## December 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 109.8% (10.4% p.a.), outperforming the KLCI but underperforming the DJIA, which returned -24.4% (-3.7% p.a.) and 126.2% (11.5% p.a.) respectively.

## Benchmark Comparison

### Quarter & YTD

We end 2019 with another positive quarter, delivering 8.4% for Q4 2019 and 70.8% for 2019 respectively. One of the main reasons of our significant 2019 performance was the recovery from our -30% return in Q4 2018. Occasionally, the market and any fund managers' portfolio can go haywire unexpectedly like it did in Q4 2018, however with the knowledge that your companies are fundamentally sound and undervalued, just being patient will result in a natural recovery in due time. In Q1 2019 alone, we were +39%, recovering most of our losses of Q4 2018. However, the reason we did not end the year at a much higher NAV was due to our deliberate action of holding cash in the second half of 2019 – we are ending the year with ~25% cash, thereby providing safety from a significant pullback, but sacrificing returns from momentum and beta as the market continued to appreciate.

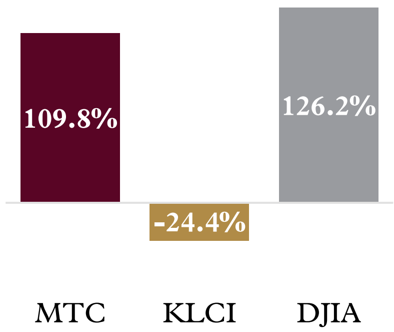
Despite the positive 2019 the DJIA had at 22.3%, we are in the 11th year of a bull run (since 2009), and the market appears to be approaching levels of overvaluation (for more detail please see our past commentaries such as 'Unicorns Losing its Horns' and 'Outlook' in our Sep 2019 Commentary, or 'Outlook' in our Sep 2018 Commentary). Given these observations, we are holding cash at this time to capitalise when another pullback occurs (such as Q4 2018), where we will use this dry powder to invest big again.

## NAV

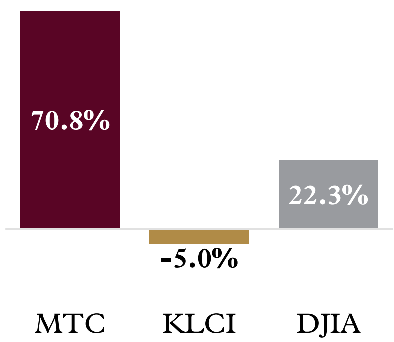
Class S: 209.77

## Performance

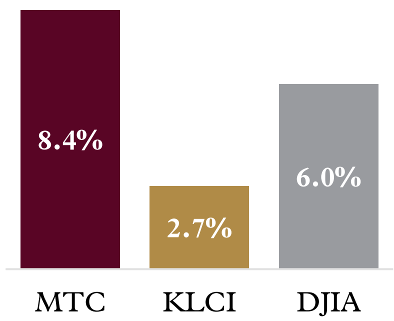
*Since Inception (24 Jul 2012)*




*Year to Date (Dec 2019)*




*Quarter (Dec 2019)*



*Devan Linus, Chief Investment Officer*

# Benchmark Comparison (continued)

## Quarter & YTD (continued)

Learning from our past experiences, we are entering the next correction with some cash rather than be fully invested. Lessons from our forefathers have also taught us that after 11 years of a bull run, it is best to be safe than to be sorry. It is for this defensive approach that, despite outperforming the DJIA significantly in 2019 (by 48.5%), we still trail the DJIA on a since inception basis (8.5 years) by 16.4%. However, do note that we have significantly outperformed the KLCI (by a whopping 134.2%).

An absolute return fund's goals is not about always beating every single index, but rather to generate positive returns over the long term (MTC: 10.4% p.a.), and generally beat MOST other indices. In MTC's case, we outperformed the KLCI, Singapore Straits Times Index ("STI") and MSCI All Countries World Index ("ACWI"). The STI and ACWI returned 0.8% and 86.1% since our inception, and MTC has outperformed them by 109% and 23.7% respectively. Hence, it is notable with hindsight that investing in the US was great over the last decade, whereas investing in emerging markets (e.g. KLCI) and other developed markets (e.g. STI & MSCI ACWI) were not. Our strategy of being 50% invested in the US has obviously paid off.

# Portfolio

## Diversified Across Strategies & Cash

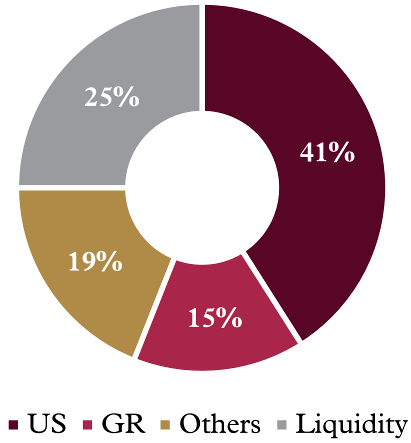
Ultimately, we are value investors who invest in blue-chip companies, and are sticking to this mantra going into the new decade. The implementation of our approach is in understanding the different types of value and blue-chip companies out there; in our case we are diversified across multiple industries, where Tech Hardware and Media are the most pronounced. In terms of stock composition, we have allocated our capital predominantly in high dividend yielding and growth at reasonable price stocks (the latter of which are mainly our Tech Online and Tech Hardware companies). If you compare our sector breakdown chart with previous quarters, you will notice that the composition has evolved, however we have not switched our positions, and still own Autos and Retailing (which are categorised under 'Others'). We believe this is a good and balanced portfolio as we enter the new decade, complemented with our 25% allocation in cash for when other companies become cheap.

# Market Insights

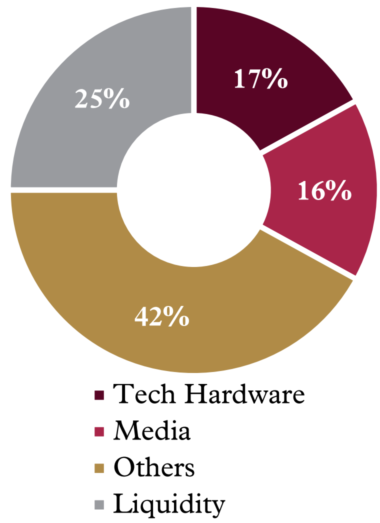
## No Crisis Observable in the Near Term but Overvalued

Based on the current macro-economic environment, it appears that a major crash like the global financial crisis in 2008 is unlikely in the near term, for the reason of a lack of catalyst and a low interest rate environment that is pumping in a lot of liquidity into the system and encouraging widespread purchasing of securities.

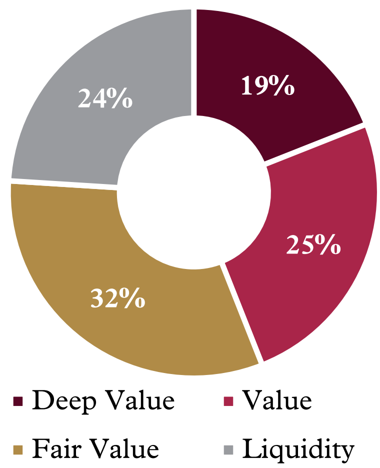
# Company Listing Breakdown




# Sector Breakdown




# Value Breakdown



# Market Insights (continued)

## No Crisis Observable in the Near Term but Overvalued (continued)

Also, from our observation of the current start-up tech bubble we mentioned in our last few commentaries: 'US Tech Bubble' in Jun 2018 Commentary and 'Unicorns Losing its Horns' in Sep 2019, the euphoria and overvaluation are, for the moment, largely contained to private and newly listed tech companies. In 2019, the mainstay tech companies such as Microsoft, Intel, and Apple all appreciated significantly. There is unlikely to be a crash there as they are profitable and are growing as they expand their industries into new areas such as cloud, IoT, and services. However, we must not overweight the sector as it is indeed approaching levels of overvaluation. We must remember that when you invest at high multiples (PE >30 or other metrics of overvaluation), when the market decides to correct (which can happen very abruptly), your highly valued company can suffer massive stock price declines and potentially zero long-term appreciation. For example, In H2 2018, for a period of 6 months, Facebook lost 33% and Netflix, -32%. If you compare longer time periods, for a period of 5 years from Jan 2001 to Dec 2005, Microsoft just made excl. dividends 21% (3.9% p.a.), while IBM lost investors' money by delivering -3% (-0.6% p.a.). Why? Because though they were growing and profitable, they were trading at too high multiples that ultimately, the business results of these companies were not able to meet these lofty investor expectations.

Hence, whilst we do not see a crisis, we do acknowledge that possibly over the course of the next year, there will be corrections for certain stocks, and even a correction of the indices. As such, we remain defensive so that we can take advantage of such corrections and perhaps repurchase some of our beloved tech companies at more reasonable prices. On the other hand, if there is not a correction, we still do not want to be investing in companies where their five-year outlook has growth but is highly valued (i.e. overpaying for growth), as getting a return of <5% p.a. like Microsoft or losing money like IBM did from Dec 2000 and Dec 2006 is not ideal. For further context, the year after the 2000 tech bubble popped, Microsoft still lost -63% and IBM -21% from Jan 2000 to Dec 2000.

# Historical Insights

## Apple: Learnings of Letting Momentum Run

In our Mar 2018 Commentary: 'We are out of Apple!!', we commented on how we sold Apple around ~$180 for the following reasons: we did not believe it was a >20% p.a. stock anymore for the lack of growth and finally taking our profit after 10 years of owning the stock. At 31 Dec 2019, Apple closed at $293, which means we lost out a further 63% of returns compared to our last sale price. In Mar 2018, its PE was around ~15x and in Dec 2019, at ~25x, where the bulk of the stock price appreciation came from multiple expansion. In contrast, the revenue and earnings of the company has not grown and has remained the same for the last two years. Furthermore, there is nothing exciting or successful in its new offerings such as the Apple TV. So, as proponents of value investing, you could theoretically argue it was right for us to sell it then.

However, we are not operating in the university, but rather the real world where fundamentals don't always correct immediately (efficient markets theory only goes so far!). As our ultimate goal is to make as much money possible for the lowest amount of risk, a key learning for us is to be better in our timing when we exit a stock, and in this case let our investments run further, i.e. sell when they are overvalued and not when they are at fair value. Apple was not an overvalued company when we sold it, whereas now at a multiple of 25x and limited growth, coupled with a lack of success in its new offerings, it can be strongly argued to be overvalued. Again, we must learn the lessons of our forefathers, where in Warren Buffett's case, he never sold his Coca Cola stock even until today, despite it being overvalued many times over with a >30x PE, and still obtained a decent return over the last two decades. Then there is my grandfather, Kok Ah Too, who never sold his Guinness shares for decades when he was managing the portfolio. Hence, we must do better with letting the company run further before we sell.

# Historical Insights (continued)

## Cutting Losses: Learning to Time it Better

We generally tell our investors and the general public that one should not attempt at timing the market, and though that holds true, timing can play a significant role in delivering outsized returns. Specifically for MTC, it is not about timing the market per say but rather the prices of the individual stocks that we invest in. In evaluating our investment process and buy/sell discipline, we conclude that though we have executed our strategy well in 'selling your losers and buying your winners', there is always room for improvement. In both 2018 and 2019, we cut losses on two different companies which both proceeded to appreciate more than 50% from the price at which we exited, thereby reducing our losses. We would be at a much higher NAV if we held on longer before we exited, as although they were not great companies that we'd own in the long term, sometimes (irrational) market sentiment offers us a gift which we should take advantage of. This is a lesson to learn from.

In the evaluation of this lesson, there are still no good reason to necessarily own these two companies over the long term, as one is a  company in the consumer staples industry that although growing slightly with revenue and profit growing at single digits, the stock price appreciation came solely from sentiment and multiple expansion where it is now at PE >80x, rather than the same PE but growing earnings. The other is a supplier of industrial components to the tech sector that failed to pivot into a new alternative technology that is still disrupting its core business (we bought it when it was making a profit, now it is loss making and its revenue is continuously declining).

Regardless, more work can be done when we decide the timing to sell a stock, for example (1) identifying if there is a catalyst for change in sentiment, such as management change, increased foreign fund flows, etc.; (2) understanding of our peers and their propensity to speculate; and (3) recovery of the general market and beta effect. Overall, in the past we would cut our losses with zero regards to sentiment and the price at which we are selling at. We can learn from this and do better, with the solutions and analysis as stated above. Note however that it is not a simple task: for context as to why the job of an investment manager or individual investor is so challenging – in many other cases, sometimes the non-sentiment driven cut-loss decision is the correct approach. For example, we had a retail player where we unemotionally exited, just before the stock declined by >50%. In summary, though sentiment can boost returns, we can do worse than being logical. That said, we ought to and will be increasing our thoroughness in making better timing decisions.

## Diversification: Learning that Less is More

We commented in our 2018 Letter to Investors that ultimately, concentration produces a better return than diversification. The problem with diversification is that with 20 stocks invested in, you might only have 10 stocks doing on average 20% p.a. and the other 10 stocks doing on average 0% p.a., resulting with an overall return of 10% p.a. That is what transpired with our portfolio since inception: in an effort to be diversified, we invested in companies in Agriculture, Commodities, Retail, etc., a few of which ultimately lost us money, and dragged our returns. If we had held on to our (large) allocations to tech stocks such as Apple, Google and Microsoft rather than forcefully diversify, we would have had a far better return. Note also that it was not just tech that we exceled in, we had picked a winner in Resources and in Financials, and of course Nike, which we should had kept.

The reality of the matter is that you have a finite amount of cash, and you can only invest 100%. So, if you want to diversify and own a new company, you may have to sell something good to own the latter. If the new company is not better than the one you have to trade it with, your returns will get weighed down. What's worse is that your new company turns out to be bad.

### Diversification: Learning that Less is More (continued)

For historical evaluation, over the last decade we trimmed some of our Apple, Nike, Google and Microsoft over the years to buy these other companies, which in hindsight resulted in a lower return as the other companies were not as good as the four mentioned above. The learning here – owning a very select, crème de la crème stocks such as these four and just a few others were good enough for the portfolio to thrive over the last decade.

## Outlook

At the tail end of 2019 we noticed general market momentum, which we expect to continue going into 2020 as the market is generally feeling positive after a dismal 2018, where fears of the US-China Trade War and many other macro concerns resulted in the DJIA performing -5.6% for 2018. With the DJIA ending 2019 at 22.1% and with a stellar 6% Q4 2019 performance, we see the momentum continuing throughout Q1 2020. Specifically, MTC's companies in the 'growth at reasonable price' category looks like they are going to keep appreciating. If we are wrong and they do not appreciate, we also have the 'high dividend yielding' companies to support and contribute to our portfolio returns. However, because we are holding cash at 25% of the portfolio, we will probably sacrifice some beta going forward and accordingly, revise our return target for the next five years to ~8-12% rather than the ~10-15% target we set for ourselves over the past decade, where we were at the early to middle stages of the bull run. Same goes for the general market: after a strong bull run in the US (DJIA returned 11.5% p.a. since inception), one should revise your expectations with a lower return going forward. If you expect the same or even higher return, you are most likely taking too much risk. Hopefully, despite the expected returns being revised lower in the next decade, with our cash hoard and with our learnings mentioned above, we can still beat our new target of 8-12% 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 (M) Sdn. Bhd. licensed by Securities Commission Malaysia (CMSL: eCMSL/A0333/2015). 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)

## December 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 43.8% (10.9% p.a.), outperforming the KLCI but underperforming the DJIA, which returned -4.9% (-1.4% p.a.) and 58.3% (14.0% p.a.) respectively.

## Benchmark Comparison

### Meranti and Founders

In MYR terms, Meranti performed positively at 1.8% (4.3% in USD) for the quarter, significantly less than Founders which returned 8.4% in USD. The reason for the relative underperformance is the negative returns from our Malaysian investments (those not in Founders), which detracted from our overall performance.

### KLCI

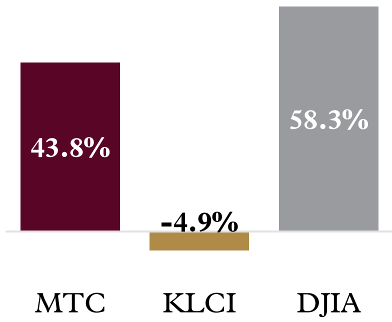
We have once again beat the KLCI this quarter, ending the year with a 63.4% return, whereas the KLCI ended the year with -6.0%. Both the investor and business community in Malaysia continue to have negative sentiments of the country’s economy and politics, resulting in a dire stock market. Furthermore, foreign participation remains weak in listed equities. This poor Malaysian stock market is not unexpected, as we mentioned since we incepted the firm 7.5 years ago, in that the Malaysian stock market is lacking innovative listed companies and that private companies are not given sufficient support from the government to list. For those who have forgotten, Grab, the privately owned unicorn was previously known as MyTeksi and started in Malaysia back in 2011. After finding local regulations an impediment to growth, it moved its operations to Singapore, and receives tremendous support by way of subsidies and tax breaks from the Singaporean government. It is not unreasonable to see more and more

## NAV

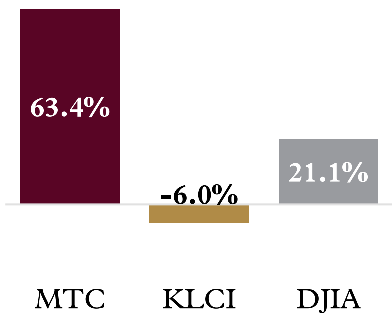
| | |
|---|---|
| Class S: | 143.77 |

## Performance

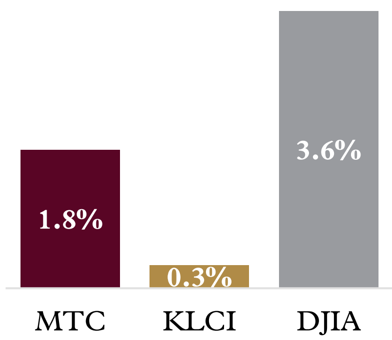
*Since Inception (28 Jul 2016)*




*Year to Date (Dec 2019)*




*Quarter (Dec 2019)*



*Devan Linus, Chief Investment Officer*

Malaysian start-up and private companies move to Singapore, leaving Malaysia once again in the doldrums.

## Portfolio

We finally fully exited the company in the Tech Hardware sector in the Q4 2019 at a higher price than its closing in Q3 2019. Often we see Malaysian companies prone to speculation, and for no concrete reason, this company continued to appreciate in December, definitively as a result of stock market manipulation and speculation given that despite an absence of new disclosures or news, its trading volumes spiked up from hundreds of thousands to tens of millions. We probably could have waited a quarter or two before we exited, but these are the challenges we face when investing in Malaysia. From this sale, we have largely held cash and have partially used part of the proceeds to invest in Financials which are paying good dividends. Last year in 2018, we saw an opportunity in the Construction sector and bought big, whilst taking profit in 2019 at a >50% gain. As for our Media investment, we have trimmed it down whilst also taking profits at a >30% gain. We continue to believe that Media is undervalued, and for the most part are holding on to this stock while we patiently wait for it to appreciate. In Malaysia, you must be very patient in finding opportunities, and given that there are none within our sphere currently, we are holding cash and safe high dividend paying Financial stocks for the moment.

## Outlook

Given that our Malaysian allocation of 27% has 74% sitting in financials (i.e. 20% of the portfolio), we aspect the Malaysian aspect of the portfolio to have a reduced return target of ~6-10% p.a. over the next five years (if we are unable to identify other opportunities). Our target for our overseas portfolio, namely what is invested in Founders is now ~8-12% p.a. given a lower expectation of return we must now have given that we are in the tail end of an 11-year bull run. However, with patience and a bit of luck, we hope to find more bargains like we did last year in the Construction sector and Media companies. We note that we are observing some companies in Consumer Staples, and if their stock prices continue to decline, we may be able to capitalise on them.

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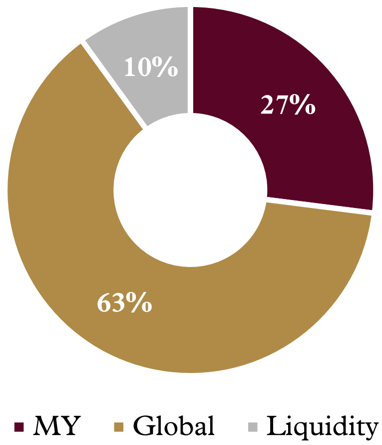
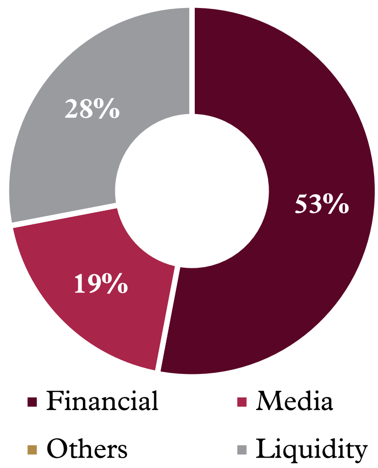
## Listing Breakdown




## MY Sector Breakdown




## MY Value Breakdown