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Commentary (Founders Fund)

June 2020

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 92.9% (8.6% p.a.), outperforming the KLCI but underperforming the DJIA, which returned -31.0% (-4.5% p.a.) and 113.9% (10.0% p.a.) respectively.

Benchmark & Market Insights

Quarter & the Great Recovery

As much as Covid-19 and the stock market decline in March was unprecedented and unexpected, so was the sharp appreciation in Quarter 2 of 2020. For the quarter, we did significantly better than both the DJIA and KLCI by an overperformance of 13.4% and 23.3%. On a YTD performance, we and our benchmark indices declined less than -10%, despite the Covid-19 situation. However, the data in this report hides the panic in March 2020, where the DJIA declined by 37% in a span of a month, and we must not forget that Covid-19 hasn't been cured, and a correction or sharp decline may result.

There are a variety of explanations to why the stock market appreciated significantly post March, our views are as follows:

<u>US Fed Stimulus & Global Loan Moratorium</u>

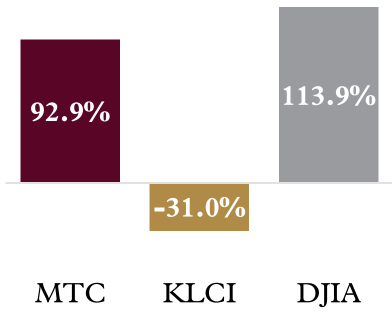
In the US, the Fed created a stimulus plan with a combination of strong capital injections and strict conditions that companies will not lay-off workers until Sep 2020. For others that worked for companies that didn't participate in the stimulus and got laid-off or furloughed, they could claim social benefits from the government.

NAV

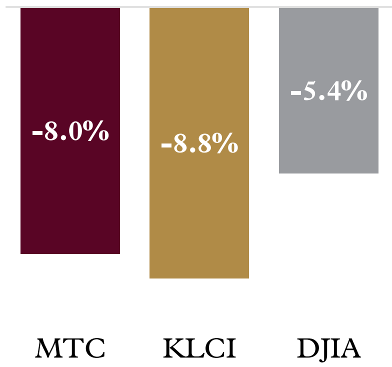
Class S: 192.93

Performance

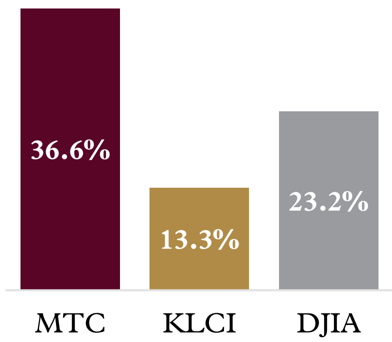
Since Inception (24 Jul 2012)



Year to Date (Jun 2020)



Quarter (Jun 2020)



Benchmark & Market Insights (continued)

Quarter & the Great Recovery (continued)

For the rest of the globe, the mechanism of stimulus varied with some choosing loan moratorium's where you do not have to pay off your loan instalment for six months while others chose direct stimulus to businesses and individuals. Globally, most nations adopted a low interest rate environment policy, in hopes people will have more indirect cash in their pockets to spend.

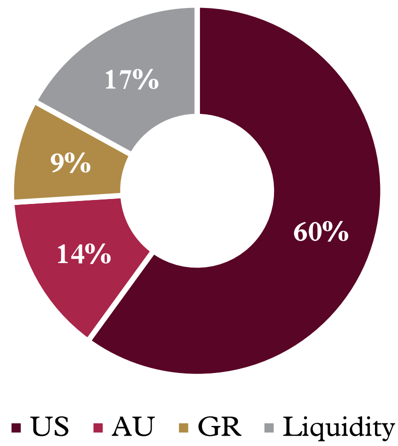
However, because of the speed in decision making of both the lockdown and the corresponding stimulus, there have been a lot of criticism on who these policies benefited. More importantly was direct stimulus, and who got it. What recently is being examined is the initial intention of the stimulus that may have gone mainly to the rich and connected as opposed to the genuine working class or small business owners who are struggling. You had instances, with institutions like Harvard University (with billions in reserves), Kanye West (++500 million dollar rapper and Yeezy fashion brand owner), and Elaine Chao's family business (wife of US Senate Majority Leader) taking the stimulus. Some who received negative press, returned the money, only to re-apply again later with other more discreet plans. Example Danny Meyer's (++300 millionaire) who owns Shake Shack and many other restaurants, original took the US PPP loans, returned it then re-applied and later received again more than $10 million plus of loans. Then you also had the government bond buying programs in the US, where the government started buying bonds directly from the market, saving certain companies for going bankrupt, thereby protecting the pockets of still rich owners.

The reason we are analysing where the stimulus went, is not to question the ethics of the rich (perhaps if we were given the opportunity, we may have taken the advantage of the system as business owners), but to highlight that (1) the stimulus may not have solved the economic problem created by the lockdown, and that there is a high chance that you are going to see more workers being lay-off post expiry of the stimulus conditions and SME companies going bankrupt. The second point (2) which is more important for us, is to explain why we think the stock market has rallied so much. The rich which otherwise had to use their personal savings/reserves to save their companies, now have this cash available to invest in the stock market which they have, hence one reason for the swift recovery.

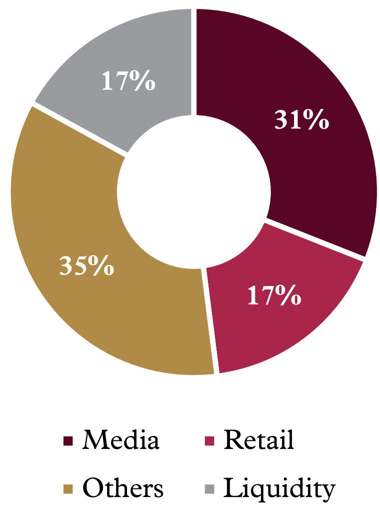
<u>Resurgence of Retail Investors</u>

We did mention in our previous commentary that buying in March was a good idea, as timing the bottom is extremely difficult, and any big dip should be taken advantage of, which we did.

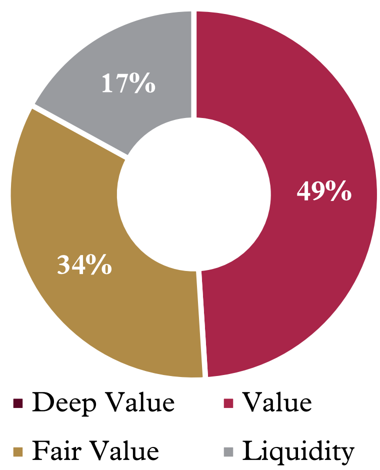
Company Listing Breakdown



Sector Breakdown



Value Breakdown



Benchmark & Market Insights (continued)

Quarter & the Great Recovery (continued)

Resurgence of Retail Investors (continued)

Correspondingly, after buying in March the stock market started to appreciate after the Fed announced stimulus. However, a natural expectation would be a negative market correction, given that we are not out of the woods yet in terms of there being a vaccine and continued increasing of cases and deaths. Alternatively, and what we did not forecast, was the immediate and swift resurgence of retail investors. The lockdown created a unique situation where many individuals who loved gambling, had no choice but to turn to the stock market as casinos were closed. Hence, account openings at retail brokerage accounts, especially those with a mobile app with good user interface, such as Robinhood and Rakutrade went through the roof. Reading, some of the blogs and listening to interactions around, they were literally gambling in the stock market, and definitely not researching and evaluating. It is not even intelligent speculating, with people making statements like “Rule 1: Stocks only go Up, and Rule 2: When in doubt whether to buy or sell, see rule 1”, which is dissing Warren Buffet’s famous phrase of “Rule 1: Don’t lose money and Rule 2: Never forger Rule 1”. In addition to the casino regular gamblers, you also have first-time retail investors who are bored sitting at home or have turned to the stock market to supplement their income for either fear of losing their job or actually losing. Each month of Quarter 2, 2020 has been an up month so these investors have not experienced a correction yet. If there is a down month the impact could be massive, especially given that most retail brokerage accounts encourage people to lever, often at 5x of their capital.

FOMO Investment Professionals

Having gone through March as an investment professional myself, being on conference calls, listening and reading comments by other prominent investment professionals from Wall Street Journal to Bloomberg, the tone was indeed very negative in March 2020. Many were saying the worse is yet to come, the current Covid-19 crisis was worse than even the Global Financial Crisis (as that was just banks, whereas now it’s affecting restaurants, to mines, to airlines). In April, people were still fearful, but after positive stock market performances ended the month, around mid-May the professionals started feeling FOMO (Fear of Missing Out) and changed from a seller to a buyer in order to participate in the rally. There should be an understanding that for the stock market to have declined 37% in March from peak to through, somebody was selling, and investment professionals were a big class of that so now they have been trying to re-coup their losses buying into the momentum.

We don’t agree with the 180 degree view turn of the FOMO investment professional, with them reasoning to themselves that the Fed will do anything to support the markets, with statements like “interest rates remaining close to 0% for years so even 1% expected returns is still better than 0%”, or “since people are staying at home watching TV and shopping online, tech companies are going to continue to rule the world, hence just buy Amazon, Apple, Tesla, etc…”. Amazon, Apple, and Tesla have appreciated more than 100% from their March lows and YTD up 30% reaching new all-time highs. However, the appreciation is not just limited to technology stocks, Chipotle the Mexican burrito chain that shut its stores for months and suffered a huge loss for the quarter is at an all-time high, being 30% up for the year. BHP the mining company with mine closures in Australia and Brazil and a second lockdown in Australia is only down 10% for the year. You have the newly listed unprofitable companies like Afterpay, a mobile/online payments company which assist in allowing retail shop customers to pay via instalments being up 130% YTD (it should be noted that during this period many retail shops have filed from bankruptcy, such as G-Star in Australia, and GNC and J. Crew in US). This is one of the other reasons why the recovery of the markets in Quarter 2, 2020 has been so good despite Covid-19, riots in the US, and second lockdowns in some countries.

MTC's View: Westerners remember 1999, Easterners remember 1997

MTC also being investment professionals, chose not to be FOMO, and actually became net sellers during the period of Apr-Jun where we ended the quarter with a 17% cash pile (it should be stated that despite our criticism of the FOMO group there is a cautious group like ourselves who while large, are not contributing to much activity, hence the lack of our influence on the current price movements. As an example, MTC is not shorting). Our fund has always been predicated with the objective to preserve capital, rather than to make money at all cost. Hence, given the steep share price appreciation and as valuations become fair or overvalued, our tactics has been to (1) not be levered and (2) have excess cash so we can buy again at the cheap if the market corrects. Of course, we sacrifice some returns by being net sellers in this unexpected bull-run, which we are comfortable with, as caution as opposed to aggressiveness is wiser given the recessionary state we are in right now. The coronavirus and lockdown have many large cap bankruptcies both in retail and other sectors. To name a few more bankruptcies other than retail, you have Hertz (car rental) and Chesapeake (oil and gas). Furthermore, using US as a proxy unemployment went from 5% Pre-Covid to 15% during that last quarter and it is still hovering at 10%. We are not sure if there is going to be a second wave or more deaths in which case there might be further lockdowns and unemployment.

Ignoring the virus, we must not forget that most of the stimulus expires around September, which removes the obligation on companies not to lay-off workers. Many people who previously criticized the US for printing money (and claiming they were bankrupt), have now done a complete U-Turn on their views and are NOW claiming they CAN print their way out of the problem. We feel this ignorance, is creating excessive greed and forming a new bubble that may pop. Ultimately, we have to go back to basic economics, when a currency prints money but does not have the growing economy to support it ultimately its currency will depreciate creating hyperinflation, which compounds the negative affect on the lower and middle class as things get more expensive. Perhaps, the US and China can grow despite the printing, and their currency does not depreciate, but every other nation will likely suffer. In summary we chose to be more cautious and hold more cash even though we generally prefer to be fully invested. Do take note that at most our cash hoard could go up to 30%, with a remaining 70% invested in well run companies who can ride of the wave. If the market does not correct and allow us to invest at lower prices during this crisis, we just have to accept practicing less macro investing and focus deeply into stock picking as there will be bargains every year for other micro reasons.

We would like to remind the Westerners who are old enough to refresh their memory of the 1999 tech bubble. After the market popped the DJIA declined from its peak in 1999 to a bottom in 2003 and only reached the same level in 2006 (7 years). It took the Nasdaq 16 years, 1999 to 2015 to get back to the same level. Therefore, index investing may not be the right strategy right now, as it normally works well during a bull run, but usually lags if your measuring since pre-recession.

Alternatively, for Easterners using STI as a benchmark, it reached a peak in 1997, bottomed out in 1998, recovered again in 1999 alongside the US tech bubble before bottoming out again in 2003 and recovered in 2006 (8 years). However, just looking at the stock market might have shielded the direness of business in Asia then, as the stock market was propped up by the country pension funds and creation of new sovereign wealth funds. The institutions made the bulk of the money, where else most individuals got wiped out in Asia, with people losing their jobs or businesses, and never recovered for years. Unfortunately, Asia did not provide as much historical documentation as the West, but a good analogical comparison of the 1997 Asian Financial Crisis, is similar to the images and write-ups of the Great Depression in the United States.

The Covid-19 could be just as bad as these two comparisons, hence there is no sense for us to get aggressive right now. Let the Retail Investors and FOMO Investment Professionals make their returns, while we be cautious.

Portfolio

Overall Strategy

Whilst we have emphasized the need to always be fully invested, during times of known crisis, holding potentially 30% of cash is not overly deviating away from our strategy. Our argument of why not to hold 50% cash, is that timing of the markets still is extremely difficult (most still get it wrong saying, like many in March that did not buy but sold… hence the decline >30%). The art is shifting between overvalued stocks to undervalued stocks, but do not do it too aggressively where you can't benefit from some momentum or innovation. If you bought a company at the cheap, perhaps the first 8 years were natural returns matching its business growth, but the last 2 years were purely momentum and multiple expansions. So the art is in the last two years, knowing when to switch and we of course have made our fair share of mistakes, like how we did not let Apple run a few more years before we switched away from it. We did own Apple from 2008 to 2018 and got a 10x return on that. Hence, our strategy would be to keep holding approximately 30% cash, and keep the exact same stocks entering the crisis but of course at different proportions as we cannot be as bullish anymore with brick-and-mortar.

Underweight Brick-and-Mortar

Since 2018 we had a big theme of Brick-and-Mortar, due to the high dividend yields, good cash flow, strong balance sheet, and close to zero net debt. This theme took ~50% of the portfolio, but given the Covid-19, this theme is obviously thrown out of the window as nobody is going out and the economy is in a recession. However, despite that huge investment in Brick-and-Mortar, we executed very well in March, of switching, selling, buying, etc. and minimised the losses from this sector. Hence, why we are only down 8.0% for the year, which although seems bad, would have been way worse if we were not so active in March. Our investment in travel & leisure at the last week of March that subsequently appreciated, also assisted in reducing our Brick-and-Mortar losses.

To re-iterate the strategy we adopted in March was to invest in companies that exhibited (1) No Debt or Minimal Debt, (2) Has Aspirational Brand Value, and (3) Large Companies and Too Big to Fail. Now with three months having passed and having more time to evaluate the Covid-19 and the economy, our assessment is that the worse is not over, but more importantly the Brick-and-Mortar sector will continue to suffer for the upcoming years. If some companies have not gone bankrupt yet, they will go bankrupt soon, and for the companies that do meet our criteria mentioned above that don't go bankrupt, they would however take a while (years) to get back to the same profitability pre-Covid. Hence, we are underweighting Brick-and-Mortar. As such retail only takes 17% of the portfolio, and autos are no longer a big part of our portfolio. Also, in the attempt to have more cash, and in determining what to sell, we will most likely have brick-and-mortar only take up ~30% of the portfolio as opposed to previous ~50%. There are arguments to have 0%, but we are bottom-up investors and not macro investors, and in the years to come, people will buy food, clothes, and cars again.

Emphasis away from Sectors & Geographies towards Innovation

In the first 8 years of Founders Fund's existence, we applied the knowledge of the CFA (Chartered Financial Analyst) textbook methodology perhaps too much, forcing us to diversify by sector and geography perhaps more than we wanted to. Today, majority of companies are global, and the world is more interconnected due to the internet and ease of travel, so trying to emphasize geography does not necessarily reduce risk in the portfolio. As an example, a US food & beverage company which is deemed safer but entered risky South America would fare worse off, then a mask manufacturer in a small country but sells globally which is better off. In the 2nd half of the 19th century, sectors could go through a boom and bust cycle longer, but these days the timing has shortened, as such you might have an investment theme of Southeast Asia agriculture stocks, but very quickly does Africa decide to compete, resulting in competition and reducing stock prices for the Southeast Asia counterpart. You would have to get the timing quite perfect to benefit from the macro in the long-term as you did in the better part of the last century just buying oil-and-gas or other commodity stocks and holding it for decades.

Portfolio (continued)

Emphasis away from Sectors & Geographies towards Innovation (continued)

We saw how oil prices crashed so easily to zero because of a virus. 2016 was supposed to be the bottom of oil and commodity prices and the start of the next super-cycle but that has now all changed.

Hence, in determining how much of each company for us to keep in our portfolio, our emphasis now is not so much what sector you're in but does the company itself have a strong management team, and a culture of innovation. In the past we might have been 1/3 in tech, 1/3 in agriculture, 1/3 retail, but now we could be 2/3 in tech. To justify this change in allocation, is to give an example of Facebook and Google which historically may have been deemed tech but today they are really more on online advertising media company as they grew their vertical businesses. Companies today are almost being more conglomerate like, but good companies are still being selective in ensuring that their subsidiaries are within their circle of competence or in businesses that are complimentary. Disney is in Media, Retail, Sports, Brick-and-Mortar, and all its businesses complement each other, example when a new movie comes out, the retail side does well selling the toys, and its Brick-and-Mortar theme park gets more visits. So, its finding more of these types of companies. Another example, Walmart may have been doing supermarkets, but they are now in e-commerce, and also potentially being a payments provider, etc. So, its understanding not so much what sector a company is in but whether they can innovate within the sector or expand to complimentary sectors and grow.

For the successes we had, this is really how the majority of our returns came. Today, expanding on this strategy to focus more on innovation rather than just pure fundamentals, we are invested in retail company, that has e-commerce, leasing, upselling sales of warranties and allowing returns to grow in emerging markets which previously was not a common practice in emerging market retail. We have a travel and leisure company that is doing collaborations with celebrities to create one day concert like events on their premises/or tours to attract a new young market to still use tour operators rather than what was previously only targeted towards old people.

This will be a balancing act, between understanding what is fad and what is innovation, and also to determine what level of valuation we wish to pay. The old strict rule of only investing in PE~10 companies doesn't hold if the company has a high chance of creating a new product that might double their revenue and earnings in three years. Then again paying a PE~100 also might not make senses if the company has been loss making for years just for the hope that they might create a new product or service that at most will won't be a good margin business.

To emphasize our capability, this strategy is not new to us, but often forgotten to be emphasized. In the past we invested in Apple in 2008 because of the iPod and just Gen 1 of the iPhone seeing that they could better expand on the iTunes and build an ecosystem with the Mac and iPod and iPhone. They did us better by creating the App Store, iPad, Apple Watch, and Apple TV. We also understood the innovation of cloud and IoT in 2016 and what it meant to semiconductor companies, where Intel now makes chips for cars, but more importantly server chips to combat the decline in desktop sales, as server farms support the mobile app world we are now living in. We also saw how Google turned from doing just search to now being a media company with YouTube and an enterprise company with Google Office and Email.

Portfolio (continued)

Emphasis away from Sectors & Geographies towards Innovation (continued)

But it's not just tech that we saw the innovation, we saw that in traditional media Disney, which was just making Mickey Mouse cartoons, to now having their own streaming service which has sports, ESPN+ and the regular known Disney shows. It may sound like tech, but really its innovation and good management, that made these companies bigger today. Another example, Commonwealth Bank of Australia, they were the first to adopt mobile banking and online banking in a big way, which increased their retail customers given the ease of using their digital banking platforms, thereby allowing the bank to have this larger deposit base and lend out more earning extra. However, more importantly the case of going digital early also allowed the bank to use sophisticated algometric and computerised calculations of their retail and business loan book, compared to the old school way of assessing profitability and risk purely based on gut feel and relationships.

So, the portfolio will have bigger allocations to this, and of course balanced with valuation, but predominantly buy-and-hold for at least three years and ideally five to ten.

Outlook

In the last commentary we mentioned our optimism that our fund NAV would probably hover around the current valuation as of March 2020 of ~140, as of June 2020, we are 36.6% higher at 192, something we thought might take a year to happen. Going forward we really don't have an outlook of where the market is headed, but what this last three months has given us is the confirmation of our strategy going forward. We commented on our portfolio strategy and our current strategy of holding close to 30% cash, as there is a huge likelihood post September when the moratorium ends and the real cost of Covid-19 and lockdown comes to sense, will the market re-correct, so we could suffer a >20% decline in which case we have cash to deploy into the same companies we are already invested in. If we are wrong, and the market never reaches March lows again, there are always new undervalued companies to find in any given year, and we will be able to use the cash to find not only the next undervalued company but the next innovative company of the new decade. Until then we have to be happy that we are back at a NAV at 192 and have done 8.6% p.a. since inception which is still better than US interest rate of 1% and better than KLCI returns of -4.5% p.a.

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MTC Asset Management
Meranti Fund

Commentary (Meranti Fund)

June 2020

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

Meranti delivered a since inception net return of 14.7% (3.5% p.a.), underperforming Founders but outperforming the KLCI, which returned 47.0% (10.1% p.a.) and -10.2% (-2.6% p.a.) respectively.

Benchmark Comparison

Meranti and Founders

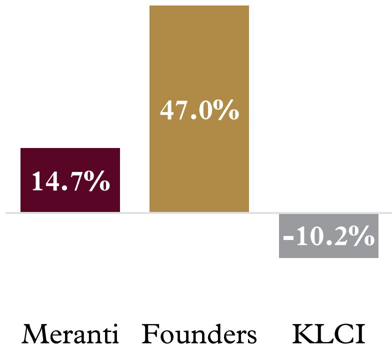
In MYR terms, Meranti performed negatively at -20.2% (-23.9% in USD) YTD, significantly worse than Founders which returned -3.6% (-8.0% in USD). Reiterating what we mentioned in our last Mar 2020 commentary, our Malaysian allocation of being invested in the retail sector prior to Covid-19 hurt us as the sector did not recover to pre-Covid share price levels. Furthermore, our investment in Travel & Leisure despite appreciating further in Quarter 2, 2020 did not offset the losses for our overall Malaysian portfolio suffered in Quarter 1, 2020. Unfortunately, in Malaysia if you did not invest in gloves or certain tech manufacturing companies you would have done quite poorly for the year compared to global stock markets. Globally the rally was not exclusive to a certain sector but was broad based into almost everything, but in Malaysia it was concentrated, with financials, agriculture and oil and gas still down for the year.

NAV

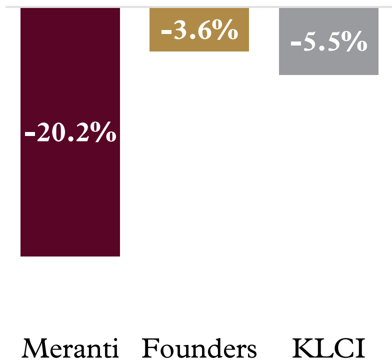
Class S:	114.68

Performance

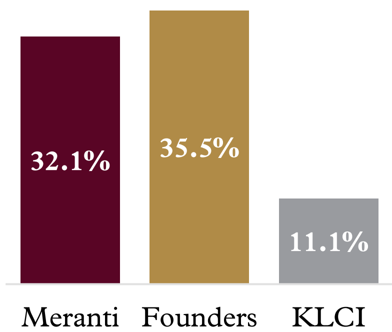
Since Inception (28 Jul 2016)



Year to Date (Jun 2020)



Quarter (Jun 2020)



Devan Linus, Chief Investment Officer

Portfolio

Despite the underperformance of Meranti compared to Founders, we are still going to adopt the same strategy i.e. trimming our stakes and holding cash and trimming our stake in brick-and-mortar. Unfortunately, Malaysia does not exhibit the innovative companies we would normally invest globally so it would be a challenge to find companies with double digit expected returns as our global counterparts. As such given Covid-19 we must expect a lower Meranti performance going forward into the decade. We do have to emphasize Malaysia continues to be a speculative market, with unknown small caps dominating the volume charts on a daily basis and the large cap high cash flow companies continue to be overvalued. Yes, gloves companies are essential and will benefit, but they are no means a growth and innovative company that should be valued at a trailing PE ~100. We will let the other strategies of momentum take the win for this period, whilst we continue to find more safer orientated companies that meet our criteria, we just have to be more patient with the returns. Hence, we will stick to our financials, but acknowledge a reduction in our travel & leisure as well as retail if its share price continues to appreciate. Just like how we invested in construction in 2018 and made a >50% return in a timespan of a year, we must continue to be on the lookout for these opportunities, but we will not deviate from our strategy and invest in gloves at today's valuation. Our sector breakdown is based on our 16% invested in Malaysia, and coincidentally also have 16% cash/liquidity but that would mainly be used for buying a bigger slice of our global allocation. Similarly, to Founders we may also bring our cash/liquidity allocation to 30% of the portfolio, unless we find some Malaysian value stocks in the near term.

Outlook

Similarly, like Founders, we don't have an Outlook of where the market is headed but are holding cash as opportunity arises. For the time being we will have to rely on our global portion to bring us the returns, lacking a Malaysian catalyst.

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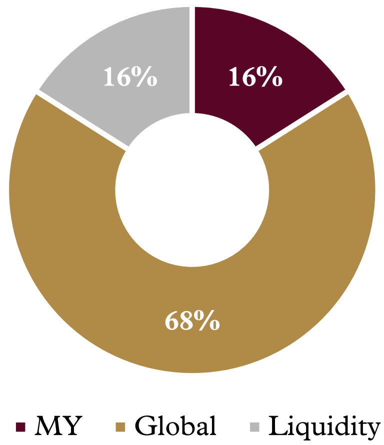
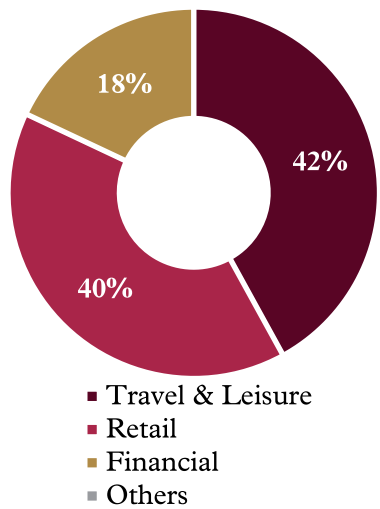
Listing Breakdown



MY Sector Breakdown



MY Value Breakdown