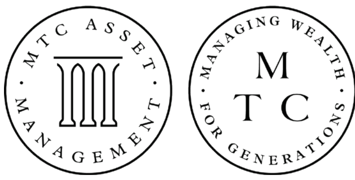

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MTC Asset Management
Founders Fund

Commentary (Founders Fund)

December 2020

Written by Devan Linus, Chief Investment Officer

Objective

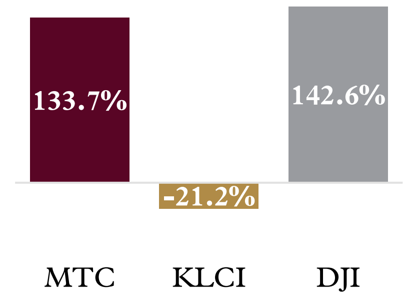
MTC Founders Fund ("Founders", "MTC" or the "Fund") aims to achieve a net return of 10-15% p.a. over a 3-5-year period by investing in a portfolio of global listed equities. MTC invests predominantly in large cap companies listed in the US and Emerging Asia and employs a value driven, bottom-up investment 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.

NAV

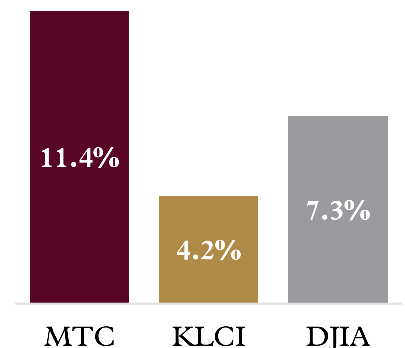
Class S: 233.72

Performance

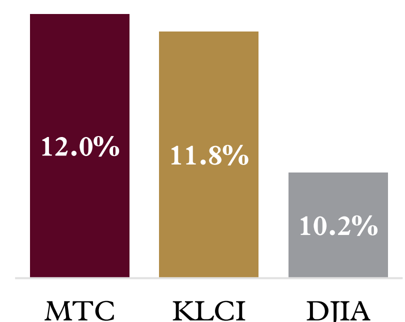
Since Inception (24 Jul 2012)



Year to Date (Dec 2020)



Quarter (Dec 2020)



Performance

MTC delivered a since inception net return of 133.7% (10.5% p.a.), outperforming the KLCI but underperforming the DJIA, which returned -21.2% (-2.8% p.a.) and 142.6% (11.0% p.a.) respectively.

Benchmark & Market Insights

2020 1st Year of the Decade & Covid

Since 2018, our Fund has experienced tremendous volatility with Q4 2018 decline of -25%++, followed by a 2019 appreciation of >50%, subsequently a Q1 2020 decline of again -25%++, and lastly another appreciation of >50% return from Q2 to Q4 2020. Hopefully, the volatility does not continue, but what a roller coaster ride it has been in the last two years, with the greatest turbulence being the unprecedented events in 2020 with Covid-19 and global economic lockdowns, but fortunately for the Fund, a good double digit returns. At this time, we recommend that our readers revisit our quarterly writings since 2018 and more importantly our Dec 2019 to Sep 2020 commentaries. This will explain the reasoning for the volatility of not only our portfolio, but also the markets in general, and how we have navigated out of it to finish the year with a positive return. We will try our best to summarise it below and give you the extra confidence we have with our current slightly altered portfolio.

Benchmark & Strategy

We ended 2020 outperforming both the KLCI and DJIA by 7.2% and 4.1% respectively. Much of this can be contributed to the well-researched and brave actions we took in March 2020 to continue to invest despite the big pullback in the global markets by -25%++.

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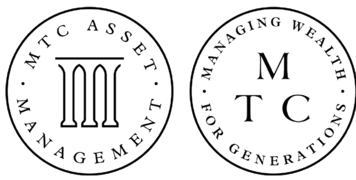


Benchmark & Market Insights (continued)

Benchmark & Strategy (continued)

For greater clarity to our readers, we started 1st January 2020 with 25% cash and deployed all of that and some leverage in March 2020. As the year went on, we adopted the philosophy of conservatism and placed greater emphasis on capital protection, we felt it was imprudent to be leveraged when the economy still had not recovered, plus the impact on the economy and its recovery pretty much uncertain despite the fiscal and monetary stimulus going around. Hence, at the end of 30 Jun 2020 and 30 Sep 2020 we had 17% and 16% sitting in cash respectively. However, despite being prudent it was not a period of complete inactivity on our part, as we continued to re-evaluate and perform stress test modelling on our portfolio companies to ensure they were the right companies to benefit for the next half decade of recovery. At the same time, some of our themes of 2018 especially retail has played out to our advantage and have allowed us to take some profit to maintain our returns and also give us the cash on hand for new opportunities. Fortunately, again in Q4 2020, despite the market rise, we still managed to find some overlooked companies that were added to the portfolio to become new long-term investments, such as healthcare and online retail.

Market Insights

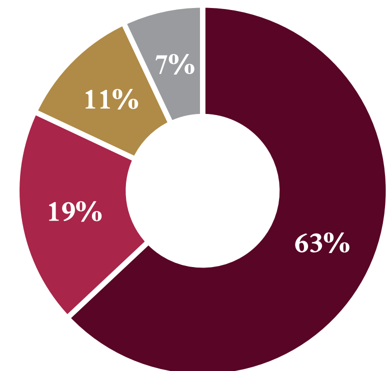
The Tale of Three Types of Returns

However, despite the positive performance on our part and also the positive performances on almost all indices (Malaysia KLCI for example had a positive 2020 after a decade of negative returns. However, its returns since 2012 is still negative -21.2%), it is important to understand how this came about and why one has to be more careful than ever before given the wide disparity between companies that are displaying bubblelike valuations and others which are actually quite reasonably priced. We can segment companies down to the Tale of Three Types of Returns:

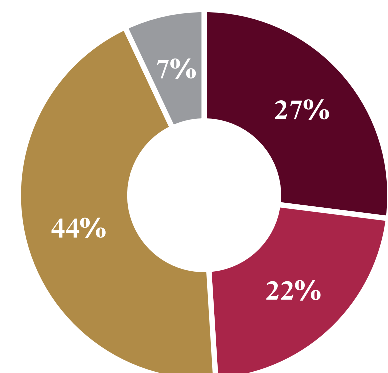
<u>Travel & Leisure and Industries Directly Impacted</u>

Even though the headline news has been investors/speculators making tons of money in Tesla, glove stocks, tech companies, newly listed IPOs, and SPACs, there were certain sectors and companies that have yet to really recover. To take a sample of a few stocks in the Travel & Leisure sector: Carnival Cruises (CCL US), American Airlines (AAL US), and Genting Berhad (GENT MK) are still down -57%, -46% and -27% respectively for YTD 2020. Let us take another example of the not so obvious industries that were also directly impacted, Oil & Gas: Shell (RDSA NA), Exxon Mobil (XOM US, former world largest company and bluest of the blue chips), and Keppel Corp (KEP SP) are still down -45%, -41% and -20% respectively.

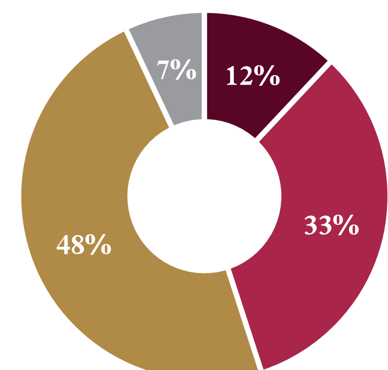
Company Listing Breakdown



Sector Breakdown



Value Breakdown



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Market Insights (continued)

The Tale of Three Types of Returns (continued)

Travel & Leisure and Industries Directly Impacted (continued)

Lastly, let us take an example of the telco industry which you would have thought share price skyrocketed because everyone is staying at home using the internet and their phones: Singtel (ST SP), AT&T (T US) and Maxis (MAXIS MK) are still down -32%, -27% and -6% respectively. There are many more industries and companies that performed terribly for the year, only for the returns to be masked by the positive indices returns. We discussed the examples above to remind the lucky few that did make good returns, that there are many others out there who perhaps had a portfolio that was more concentrated in the non-performing sectors that probably lost almost half their wealth on paper. Furthermore, it is evident that Covid-19 has not been eradicated with major threats to the economy as many nations are re-implementing lockdowns as of January 2021. For the Small-Medium Enterprise Business (SME) owners who maybe have the bulk of their wealth in their private illiquid enterprises and a tiny but declining public portfolio, they are in a more dire situations as the pandemic lingers on (remember stimulus is temporary and there is a cost to it, being higher debt, interest, etc.).

The Overvalued Speculative Gambles

On the opposite end of the spectrum are the highly unprofitable companies, but with great marketing and hype of why they might dominate in the post-Covid world with returns in excess of 100%, but accompanied with volatility of multiple -25% swings throughout the year. For illustration purposes, we take three highly performing speculative stocks: Tesla (TLSA US), Top Glove (TOPG MK), and Twitter (TWTR US) which had a YTD 2020 return of 719%, 288% and 68% respectively. We deliberately chose well established companies for this illustration, as we do not comment on the penny stock speculation where it is really a day/month trader's gamble to make a quick buck on mediocre companies (in almost all instances, the day/month trader fails to consistently make money and ultimately ends with a net loss or just slight gain, for the many trades they make in a year. There is no billionaire that I know of in this world that became so by being a day/month trader). Anyhow, going back to Tesla, as much as they produce amazing disruptive vehicles, the question is whether a loss-making company deserves the valuation of $800 billion when Daimler (Mercedes) is only valued at $80 billion and produces ten times the number of vehicles. As for Top Glove, the leading glove company in the world, the question here is whether they can maintain their one-year high average selling prices (ASP) given the additional entrants to the glove industry from property developers to IT firms. Its standard microeconomics that oversupply and the change of the market from something more oligopolistic to perfect competition will drive down ASPs and economic profits in the glove industry. Lastly, we have Twitter, that has never really made sustainable profits, with growing competition from the hundred alternative social media/news platforms. Should Twitter be valued at 100 times earnings? It might surprisingly grow its profits 100% per year, but as value investors it's about the risk return trade off, the more you pay the more risk you're assuming, as the magnitude of losses if your wrong is bigger than if you bought at the cheap. There were many instances/stocks in the past like Microsoft, Apple, etc. that were trading closer to 10 times earnings (cheap), and you ended up with 400% returns. So, there is no need to have a strategy of speculative gambles.

Regardless of whether you believe in our view that these stocks are overvalued and the only reason it appreciated is because it is being chased by the retail investors stuck at home with their stimulus money, the key thing is the volatility of the stocks you must deal with. First and foremost, its uncommon for anybody to ride the whole wave of the full appreciation of a Tesla 719% as an example, it is a group of early investors making the 100% then selling it, then a new bunch of investors riding the next 100% wave, and again another new bunch of investors riding a further 100% and repeat. What is more concerning is those who heard of others who have made huge returns that then came in at the peaks.

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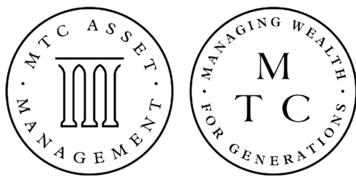

Market Insights (continued)

The Tale of Three Types of Returns (continued)

The Overvalued Speculative Gambles (continued)

So, for another illustration of the same stocks above: Tesla suffered two double digit declines during 2020:- Feb-Mar: -63% and Sep: -34%. Top Glove:- Aug-Sep: -37% and Oct-Dec: -37%. Twitter:- Feb-Mar: -49% and Oct-Nov: -25%. So, if you were a monthly trader you may have had to lock in those losses for those two periods if you bought close to the peak. Then there are the more aggressive folks that use leverage and options that got wiped out through margin calls that maybe are too shy to admit it, or maybe not as widely reported in the press (however, if you dig a bit deeper in Bloomberg and the Wall Street Journal, you do find those articles on this situation). We mention this because these are the stocks that drove the indices up, such as KLCI, DJIA, etc. and if these stocks were to crash tremendously the indices will fall as a result, if the previous sector of industries I mentioned in the previous paragraph, travel and leisure, etc. does not recover. We did not participate in these speculative companies, which is why we may have underperformed some retail investors and funds in returns, but we are comfortable with a lower but still good double digit return, but with lower levels of risk we are assuming. We still do not have leverage as of this report date and are unlikely to do so unless there is another market crash or correction.

Great Companies at Reasonable Valuations

We painted the two opposite ends of the spectrum of companies, one with losses of -50% YTD and others with returns of >100%, which ultimately gives us an average DJIA and KLCI return of 7% and 4.2% YTD respectively. However, hidden within the trove of a thousand listed companies across the globe, there are those great companies with reasonable valuations that we had invested in since 2018 based on the themes at the time (and of course others that we never looked at that we are now uncovering). An example of this is one of our traditional brick-and-mortar retailers, we have mentioned in our prior commentaries. During the lockdowns last year, not only did the company manage to pivot more to having a full fledge online presence, people living and working from home bought more home furniture, electronic appliances, etc. resulting in record revenue, profits and cash flows. The reward to us, as shareholder is a 15% YTD 2020 return with continued dividend payments at a >5% yield. In addition to our actions in March of buying more into the stock at those Mar-Apr average share prices, this newly added shares generated 74% YTD. Another big theme of ours was autos, where using Daimler (Mercedes) as an example/illustration, YTD it did 16% but if you bought more during the average price of Mar-Apr you would have had a 114% YTD return. For autos it is interesting that the people who are well-off, found themselves to have extra cash as a result of not spending on travels, and instead splurged on cars. Then you have the working class American's that worked and spent more times on their ranch, which resulted in records sales in trucks, benefiting both Ford and General Motors, both of which still made a profit for the year despite Covid-19.

The lesson from this is if you buy-and-hold good businesses with good management (or the opportunity of replacing average management with better management), the businesses itself with an army of smart and hardworking people will find a way to navigate themselves out of a crisis and prosper in the future. For most of the traditional auto players, they had to cut their dividends, cut cost, focused on their supply chain, and distribution and marketing, which resulted in them navigating this crisis and continuing to make profits. However, the most important learning is that if you buy a company cheap, your downside is therefore limited with strong capital protection whilst still being able to ink a double-digit return. There are many other examples but a concentrated portfolio within a different variety of 'Great Companies at Reasonable Valuations' can also do well. Before, we end this section of the commentary we should not leave out the old school tech companies such as Microsoft, Google, Qualcomm, etc. that are going to benefit from the post Covid-19 world where the world becomes more digitised, and with an army of a talented employees, they can continue to gain market share against their smaller peers and even disrupt other industries. Which is why we always have a tech component in our portfolio, as opposed to the 'Overvalued Speculative Gambles'.

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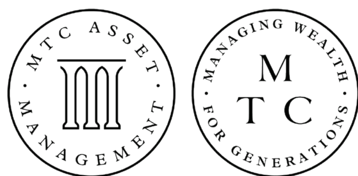

Portfolio

This section will be pretty brief for this quarter because not much has changed since our last Jun & Sep Commentaries, except for a new addition that was surprisingly overlooked and undervalued in the healthcare space. We managed to acquire a dividend paying company at single digit price-earnings multiple where almost all its earnings are cash inflows. There are many negatives of the healthcare sector that we have evaluated such as low expected growth, aging population with higher healthcare cost and lower profitability, etc., but our analysis is indicating a shift in people's behaviour and view towards healthcare especially given Covid-19. Into the next decade a few healthcare companies will be able to capitalise on this shift, and having a small allocation to this industry will benefit the overall portfolio. While we are building expertise and allocation in this sector, the bulk of our portfolio is still in the media and tech space (27% and 22% respectively) which we have studied for decades, and are confident they will continue their dominance into the next decade. There is also retail and some other industries that sits in our Others bucket. In addition to diversification by sector, we also have some geographic diversification but the bulk will always be in the United States at 63%. US is a country that you should never give up hope on, and now for the majority that lives outside US, I would presume you now should be bullish on US again given you have Joe Biden as President. Furthermore, for those who are pro-China, you have to remember China's economic policies benefit mainly themselves and their elite ruling class as opposed to even their local workers and foreign investors or countries. You only need to see the ghost towns and industries created in Africa and even Malaysia as a result of China's investments. Then when it comes to civil rights and economic participation you saw what they did to the Hong Kong people. However, more importantly for the public equity investor, after thousands of people deposited their money in Hong Kong to gain access to the Alibaba ANT IPO they killed it at the last minute leaving their monies in limbo. Not to say you can't get a good return investing in China, we just prefer choosing the older developed countries given the lower country and regulatory risk we are assuming with the same chance of landing that big five bagger returns (>500%) if we hold close to a decade.

Outlook

It is always a challenge to give a general outlook to what is going to happen in the future. The truth of the matter is that no one really has a crystal ball, and now it is even more challenging to predict the future today because of the unprecedented situation we are in globally. This global pandemic and lockdown in this modern era of the stock market is surely something not even Nostradamus could have predicted. The science itself is telling us that Covid-19 is far from over, and the vaccine rollout might take longer to administer than what some politicians are saying. Perhaps mid to end of 2021 or later will we see the world fully vaccinated (and that's assuming it works for the new strains). Hence rather than give a prediction or outlook, we are just going to draw inference from history and apply logic, that the near-term future economy is likely going to be worse than pre-Covid 2019, given that half of the world was and is still in lockdown (essentially a significant chunk of 2020 output was frozen). Given that the market runs based on emotions, just like what we experienced in March with a huge crash where for Quarter 1 of 2020 the DJIA declined -23.2% and MTC correspondingly -32.7%, there is a huge possibility that a second crash or major correction might ensue. However, the positive to take from it is that is that steely investor like ourselves can buy again at this dip and ride the next rally upwards like the second half of 2020. We were fortunate that our stocks played out well last year, allowing us in Q4 to focus on the companies that Covid-19 has thought us will do well into the new decade. If the crash/correction does not occur, comfort is studying the past crises of 2008, and even 2001, that correspondingly a multi-year bull run will always follow.

Disclaimer

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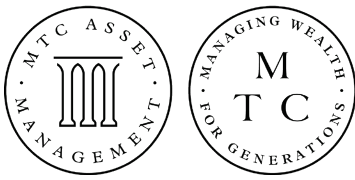

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MTC Asset Management
Meranti Fund

Commentary (Meranti Fund)

December 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 36.8% (7.2% p.a.), underperforming Founders but outperforming the KLCI, which returned 66.9% (12.1% p.a.) and -2.6% (-0.6% p.a.) respectively.

Benchmark Comparison

Meranti and Founders

In MYR terms, Meranti performed negatively at -4.8% (-3.2% in USD) YTD, significantly worse than Founders which returned 9.5% (11.4% in USD). However, for Quarter 4, 2020, Meranti outperformed Founders at 13.9% and 8.4% respectively.

Repeating from our prior Commentary "the YTD underperformance came mainly from Quarter 1, 2020 where our Malaysian specific investments in Financial and Travel & Leisure collapsed and have not necessarily recovered unlike our other Malaysian sectors". However, in Quarter 4, our newly added undervalued Malaysia stocks started to rally after lagging for the year. For comparison sake Top Glove a benchmark of the glove sector declined -25% for the quarter. We want to remind our readers that patience is often required in undervalued stocks, it lags as nobody is chasing them, but when the chasing stops this is where investors park their money.

Portfolio

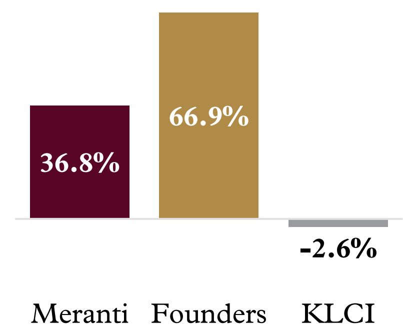
As mentioned in our last commentary, we have revised our Malaysia portfolio strategy to be more diversified (~4-6 companies), almost more of an index like return but a concentrated index of the higher performing KLCI stocks (of course based on our research and views).

NAV

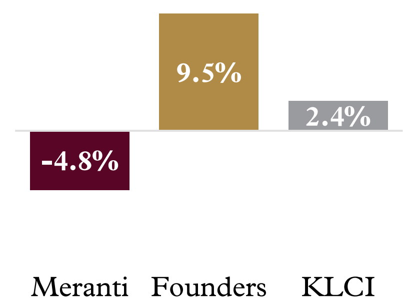
Class S:	136.83

Performance

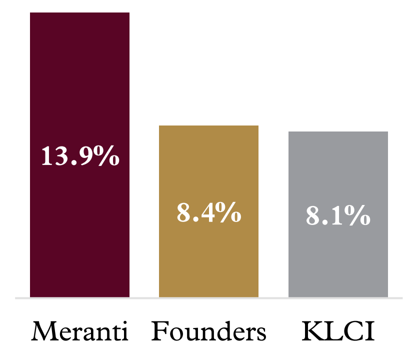
Since Inception (28 Jul 2016)



Year to Date (Dec 2020)



Quarter (Dec 2020)



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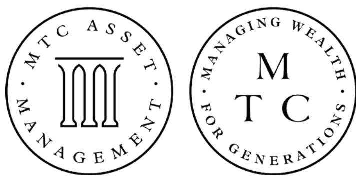

Devan Linus, Chief Investment Officer

Portfolio (continued)

Although it has just been a quarter since we added new stocks to the portfolio, the appreciation is a testament that our new index like portfolio can also generate a good return. However, going into 2021, volatility will be expected given that we are in travel & leisure and financials. The negatives of financials are that if the economy does not recover bad debts may increase, in addition to lower margins due to the decline in interest rates. However, we are long-term buy-and-hold investors, and are quite confident from our research that the companies we picked in the respective sectors would be the ones coming out on top, whether as a result of good management, better access to capital, and innovation. Hence, we just have to ride the volatility for our Malaysian stocks with an overall expected return higher than that of the KCLI over the next 3-5 years.

Market Insights

Sadly, our view of the Malaysian market generally has been negative and continues to be the case, with huge political and policy uncertainty. Furthermore, globally and possibly regionally we have fallen behind the innovation ladder. Despite our negative views, there is hope, which is why we are based here, but on an investment point of view we must focus on where the returns are most likely to come from, and as such our returns would come from our global allocation currently standing at 75%.

Outlook

Similar to Founders, we won't necessarily be giving an outlook. However, what we can say is that we are more confident in our portfolio right now (including Malaysia stocks) going into 2021 then we were in 2020. Whilst last year was a bad year on many levels, it has helped us weed out the companies that may not prosper into the next decade, allowing our portfolio to be more focused and more certain in its returns going forward. Now commenting specifically on Malaysia, the new strategy as of 2020 is to produce more of an index like return, hence single digit as opposed to our global target of double digit. However, given that KLCI been averaging close to 0% the last decade, single digit is a good outcome if the mandate is to have an allocation to Malaysia. However, having said that Malaysia is a unique market, in that its predominantly a speculative rather than a fundamental market, so luck could be on our side and potentially our travel & leisure stocks could be a target of speculative frenzy, pushing our Malaysian returns to be double digit.

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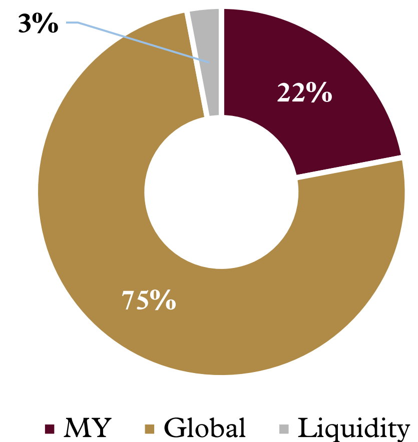
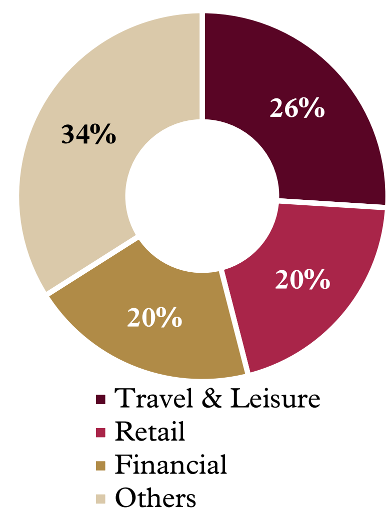
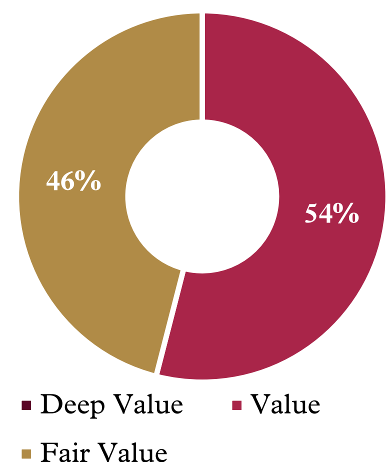
Listing Breakdown



MY Sector Breakdown



MY Value Breakdown



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