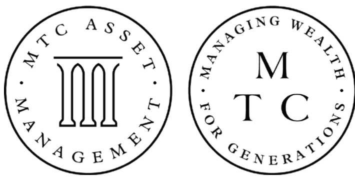

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MTC Asset Management
Founders Fund

Commentary (Founders Fund)

June 2024

Written by Devan Linus, Chief Investment Officer

Objective

MTC Founders Fund ("Founders", "MTC" or the "Fund") aims to achieve a net return of 8-12% 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 other developed countries and employs a value driven, bottom-up investment approach. MTC's benchmark is the Straits Times Index ("STI") and the MSCI All Country World Index ("MSCI ACWI"). The STI was chosen as a benchmark as MTC's investors are predominantly from Southeast Asia and benchmark themselves to Singapore. MSCI ACWI is the second benchmark as it was designed to best represent broad global equity-market performance. Performance is reported in USD.

Performance

MTC delivered a since inception net return of 128.4% (7.1% p.a.), significantly outperforming the STI but underperformed the MSCI ACWI, which returned 3.5% (0.3% p.a.) and 164.1% (8.4% p.a.) respectively.

Benchmark Comparison

Founders, STI & MSCI ACWI

We experienced a negative performance for June 2024 YTD, with a flat performance of -1.6%. In contrast, the MSCI ACWI continued to perform well, driven by the ongoing euphoria around AI stocks, and its trickledown effect on other sectors. Our lack of investments in certain AI plays can be attributed to our underperformance, coupled with our continued investment in China Blue Chips and Studios & Streaming. Our Chinese portfolio, which showed positive performance in Q1 2024, turned negative in Q2. Additionally, Studios & Streaming continued to decline in Q2 after a poor showing in Q1, leading to our overall decline of -4.5% in Q2.

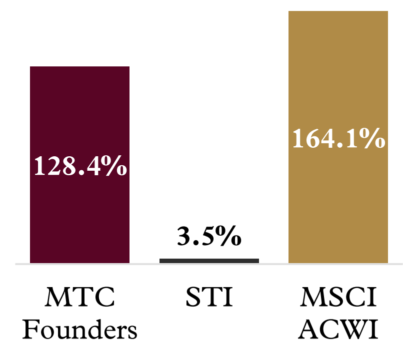
Our AI holdings in semiconductors could not offset the declines of the previously mentioned groupings, as our AI portfolio does not include the darlings of Super Micro or Nvidia, which were the top two performers of the S&P 500, 2024 YTD. We can call our lack of investment in Super Micro and Nvidia a missed opportunity or a stubborn adherence to our value investing philosophy. Additionally, our Studios & Streaming portfolio does not include the standout performer Netflix. This helps explain our negative performance of -1.6%, compared to the MSCI ACWI's 2024 YTD performance of 10.3%.

NAV

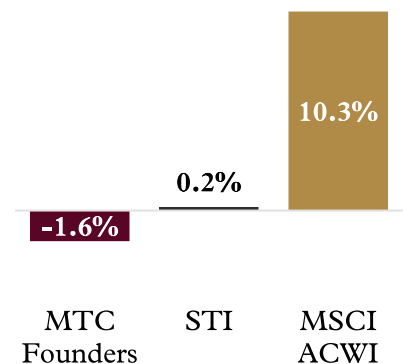
Class S: 228.40

Performance

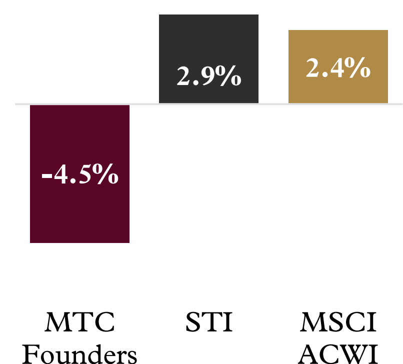
Since Inception (24 Jul 2012)



Year to Date (Jun 2024)



Quarter (Jun 2024)



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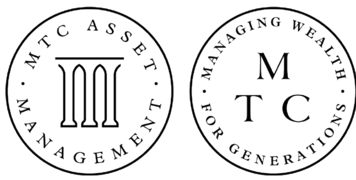

Other Comments

Wonderful Businesses at Cheap Prices & Patience

We provided a brief summary in the previous section explaining our flat performance for 2024, highlighting our missed opportunity with Nvidia (this brings up the question of how tech-savvy investors like us could have overlooked such a pivotal stock). Throughout the quarter, we debated internally, recognizing that while there is an expectation for us to invest in the AI wave or even crypto, our identity as 'value investors' remained stronger. This adherence to our investment philosophy is why we missed this opportunity. Hence, the repeated emphasis on 'Wonderful Businesses at Cheap Prices…' as discussed in our March 2024 Commentary.

Although we may have missed an opportunity with Nvidia, our fundamental philosophy has always centred around buying 'Wonderful Businesses at Cheap Prices' rather than chasing trends. Reviewing our Mar 2024 commentary can provide further insights into our ethos. It's important to reiterate that significant returns still can be achieved by patiently investing in undervalued opportunities, rather than solely focusing on the top-performing stocks of the moment.

Illustration of Top Performing Stocks that Crashed the Subsequent Year (S&P 500)

Co. Name	Period	Year 1 Return	Year 1 Ranking	Year 2 Return
Ford	2021-2022	136%	5th Best	-44%
Tesla	2023-2024 H1	102%	12th Best	-20% (1st Half)

In the example above, consider Ford, the 5th best stock in the S&P 500 for 2021, which rallied on strong auto sales amidst Covid-19 and EV excitement, only to crash -44% the following year. In contrast, Tesla, supported by the market in 2023 as the original EV leader, outpaced Ford, but then suffered a -20% decline in 2024 H1. Both illustrate the risks of chasing returns or buying 'Wonderful Businesses at High Prices,' potentially leading to significant losses. Moreover, the automotive industry itself may not be inherently wonderful, historically fraught with high capital intensity and fierce competition that has led to numerous bankruptcies over decades. EVs, while promising, could remain a highly competitive niche rather than universally transformative. Similarly, the current euphoria around AI begs the question of its sustainability. While Nvidia is likely to maintain its position due to its leading AI and graphic card technologies, the sustainability of companies like Super Micro in this evolving landscape remains uncertain.

Illustration of Bottom Performing Stocks that Rallied the Subsequent Year (S&P 500)

Co. Name	Period	Year 1 Return	Year 1 Ranking	Year 2 Return
Meta	2022-2023	-64%	6th Worst	194%
Intel	2022-2023	-49%%	22nd Worst	90%

On the flip side, the example above highlights the success of buying 'Wonderful Businesses at Cheap Prices,' which aligns with our strategy when we significantly increased our holdings in Meta starting in 2022. Similarly, investing in Intel in 2022 would have yielded handsome rewards in 2023, underscoring the potential to generate returns without always chasing the current year's top performers.

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Other Comments (continued)

Wonderful Businesses at Cheap Prices & Patience (continued)

So, if we focus on buying 'Wonderful Businesses at Cheap Prices' why are we still flat this year? The reality is that not all undervalued stocks rally immediately; some take time. Often, a stock is considered cheap because the company is grappling with significant business or industry challenges that result in temporary losses, declining profits, or slowed growth (in addition to macroeconomic factors). Therefore, management of these businesses must implement either minor adjustments or, in more drastic cases, major turnarounds. Take Meta, for example. In 2022, the company faced declining profits due to its substantial investment in the metaverse, which was seen as a risky bet and potentially a passing trend. However, management swiftly addressed these issues, leading to a return to profit growth in 2023 and subsequently driving a rapid increase in its share price.

The reality is that not all companies can turnaround quickly. Warren Buffett's analogy of "You can't produce a baby in one month by getting nine women pregnant" aptly captures the need for patience in investing. Some companies require years rather than months to rectify issues and achieve sustainable growth. As such, patience remains vital for our remaining portfolio investments, particularly for companies ranked among the bottom 25 performers in returns for the S&P 500 for 2024 thus far.

Below is a good illustration why patience is needed:

<u>Illustration of Bottom Performing Stocks that Rallied Years Later (S&P 500)</u>

Co. Name	Period	Year 1 Return	Year 2 Return	Year 3 Return	Year 4 Return
Occidental Petroleum	2019-2022	-33%	-58%	67%	117%
Chipotle Mexican Grill	2016-2019	-21%	-23%	49%	94%

Assuming you invested in the two 'Wonderful Businesses' mentioned at the beginning, in Year 0, the following two years (Year 1 & 2) would have been difficult. However, with the patience to wait not just two years, you would have finally started to make your money back in Year 3, before turning a profit in Year 4.

One of our significant mistakes was selling Chipotle Mexican Grill in 2018, driven by my impatience as the CIO. Initially acquired when we started the fund in 2012, we sold it when it reached fair value, only to repurchase it at a deep value in 2015 after it faced challenges with food contamination issues in its supply chain. Chipotle's commitment to fresh ingredients, while a key differentiator, also made it more susceptible to such issues compared to restaurants that used processed foods. Despite waiting several years and recognizing its potential, the decision to sell in 2018 reflects a desire to mimic a typical hedge fund, constantly seeking new opportunities and chasing short-term returns. This impatience led us to part with what was truly a 'wonderful business'.

It was indeed a costly mistake, driven by impatience and the inclination to abandon temporary setbacks. Prior to 2018, our annual performance averaged 15%. However, since then, our returns have been lacklustre, influenced by the decision to chase after the next big stock, which proved detrimental in 2018 (including selling Apple that year). It's clear now that we must learn from these mistakes and adopt a more patient approach moving forward.

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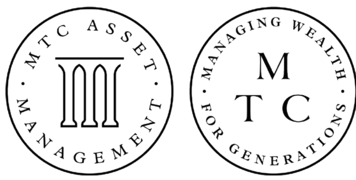

Portfolio

Changes to the Portfolio

As previously mentioned, we remain committed to our strategy of investing in 'Wonderful Businesses at Cheap Prices' that we began significantly in 2022. Meta remains our largest holding, and despite trimming our position last year, it has continued to rally by 43% in 2024 YTD. The lesson learned from our mistake in 2018 is clear: patience is key, and we should refrain from selling a 'Wonderful Business' prematurely. Looking ahead, the challenge lies in finding the balance between not trimming a stock at all and waiting longer for a stock to fully realize its potential before making adjustments. This is an ongoing debate among us as Founders/Investors, aiming always to refine and improve our approach.

In any case, our decision to trim positions has reduced our leverage from 30% in June 2023 to 20% by June 2024. During this quarter, we also completely sold off holdings that made up less than 5% of our portfolio that were profitable. We reinvested some of these proceeds into 'Deep Value' companies that have not yet experienced significant rallies. Currently, our Deep Value investments constitute 57% of the portfolio, primarily comprising the 'Wonderful Businesses' identified back in 2022 in the following categorisations:

- Studios & Streaming
- China Blue Chips
- Semiconductors (Non-Nvidia AI Stocks)

Market Insights & Outlook

Investing is a long-term endeavour, so attempting to predict outcomes every quarter, akin to being 'Nostradamus' or 'Paul the Octopus', is impractical. Our focus is not on forecasting exact quarterly outcomes, but rather on identifying potential risks to adjust our strategies accordingly. The essence of investing lies first (1) in managing risks to protect capital and avoid permanent losses, and second (2) aiming for solid returns that average out over the long term. This approach acknowledges that some years will yield significant gains, offset by years of decline, with the goal of achieving consistent high single-digit or low double-digit annual returns amidst market volatility.

Investing involves trade-offs; pursuing higher returns (2) often requires accepting greater risk (1). For those starting with less wealth, the temptation might be to go all-in on high-flying stocks like Nvidia, adopting a "buy high and sell higher" mentality rather than seeking undervalued opportunities ("buy low and sell high"). Conversely, with more wealth, the focus should lean towards preserving capital, potentially trimming or exiting AI stocks that appear overvalued. Firstly, there's uncertainty about the real necessity of AI given the budgets allocated to it. Does McDonald’s truly require Nvidia or Intel AI Cards to serve burgers? Do travellers need Chat GPT to navigate routes when Google Maps, using non-AI chips, has sufficed for years? These questions underscore that not every task warrants the expense of AI technology.

Our conclusive insight on AI is that there are alternative stocks positioned to benefit more from the AI wave, rather than sticking exclusively to the current favourites. For instance, Google's in-house AI chip development could adequately enhance search and mapping capabilities, potentially steering businesses towards utilizing Google or Baidu rather than relying on third-party data centres or developing proprietary solutions. While we have invested in AI stocks poised for future growth, Nvidia wasn't among them. At this stage, we believe it's too late to enter the Nvidia investing game, as the downside protection on its share price is no longer apparent.

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Market Insights & Outlook (continued)

To conclude, despite our recent flat returns, our approach remains steadfast in preserving capital and avoiding chasing short-term gains by diving into AI darlings or other sector momentum stocks. Our commitment to principle (1) has helped us maintain our clients' capital thus far. Now, our goal is to gradually increase our performance from 7.1% per annum to 10% p.a. and then to 12% p.a., rather than risking substantial losses by aiming for immediate 30% p.a. returns. This begins with patience in holding onto the stocks we've mentioned. Additionally, we continue to seek out 'Wonderful Businesses at Cheap Prices'. As of June 2024, here's an example list of what were previously considered 'Wonderful Businesses' that experienced significant stock price corrections this year.

Example of Bottom Performing Stocks 2024 H1 (S&P 500)

Co. Name	2024 H1 Return	2024 H1 Ranking
Walgreens	-54%	1st Worst
Intel	-42%	3rd Worst
Nike	-31%	11th Worst
Starbucks	-19%	34th Worst

Now our job is to do the research to truly determine whether businesses like the above and many others are still ‘wonderful’, its internal financials have not been damaged too much, and if it is cheap enough to invest now.

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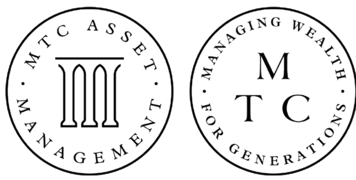
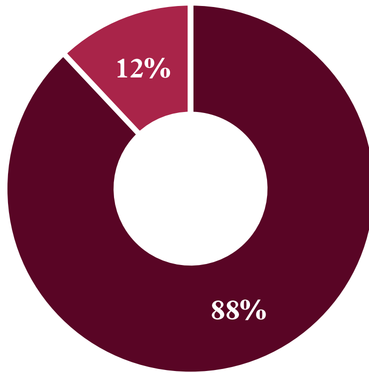
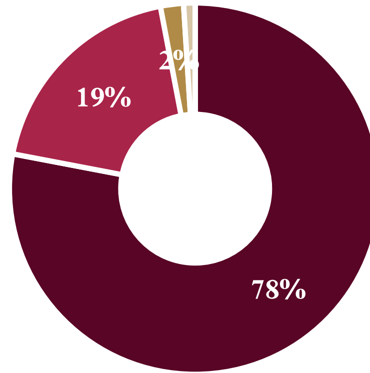


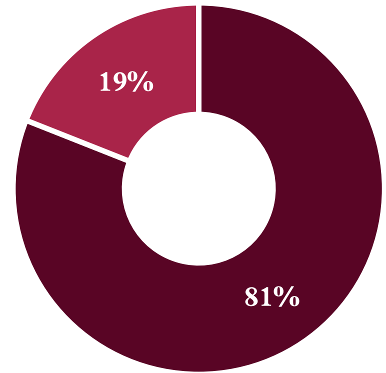
Devan Linus, Chief Investment Officer

Charts 1: Company Listing and Sector Breakdown

Company Listing Breakdown

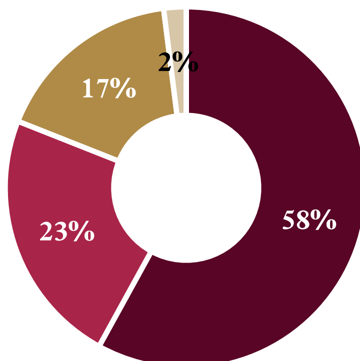


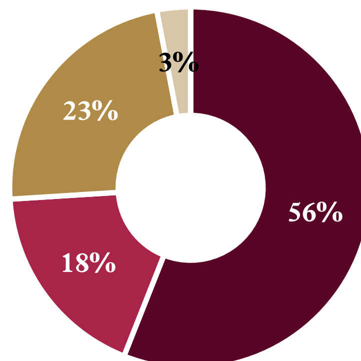


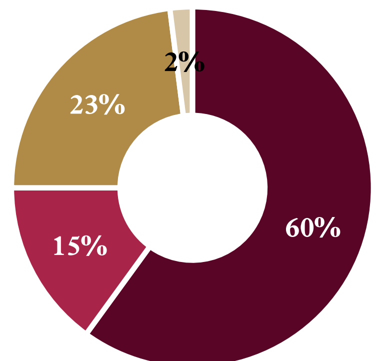


For Q2 2024, US allocation increased to 81%, as we exited stocks that made up less than 5% of our portfolio. China allocation remains at 19%.

Sector Breakdown (GICS)







Communication Services increased to 60% as we increased allocation to deep value Communication stocks, whilst exiting some AI stocks ending with a 15% allocation in Information Technology.

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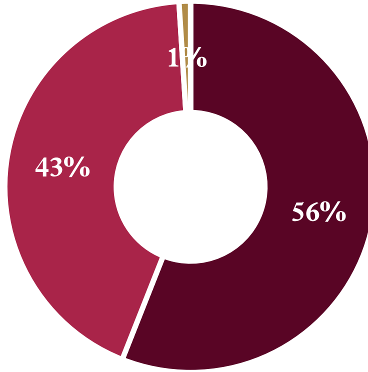
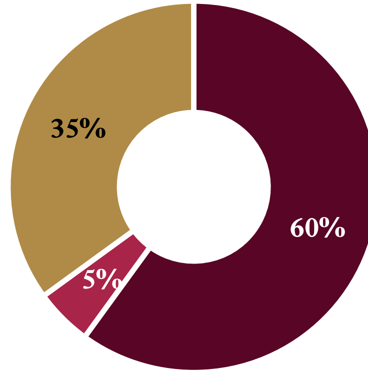
Charts 2: Value and Leverage Breakdown

Value Breakdown

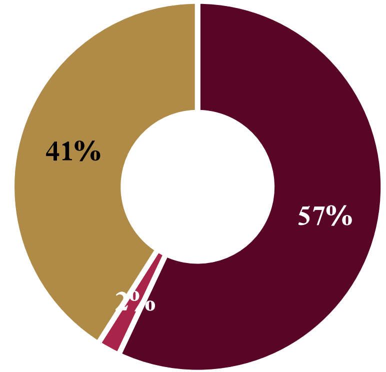
Prior Year (Jun 2023)



Prior Quarter (Mar 2024)



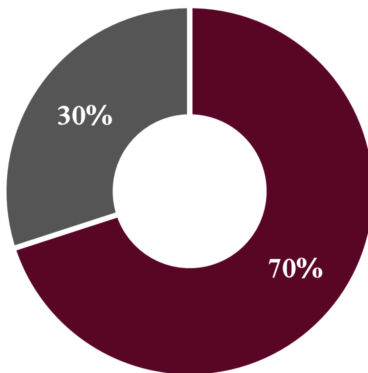
Current Quarter (Jun 2024)



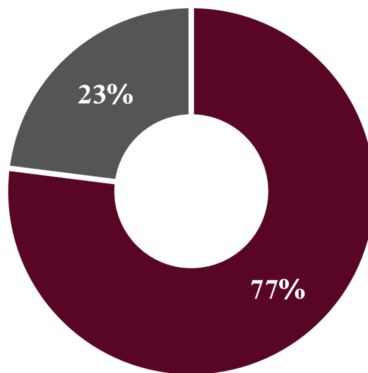
Fair Value increased to 41% as stocks in that grouping continued to appreciate, whereas Deep Value decreased to 57% as stocks in that grouping continued to depreciate.

Portfolio Leverage Breakdown

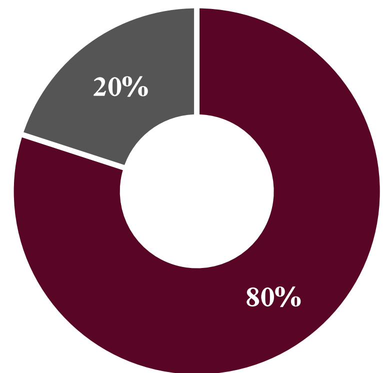
Prior Year (Jun 2023)



Prior Quarter (Mar 2024)



Current Quarter (Jun 2024)



Our exiting of stocks that made up less than 5% of our portfolio, resulted in further reduction in our leverage.

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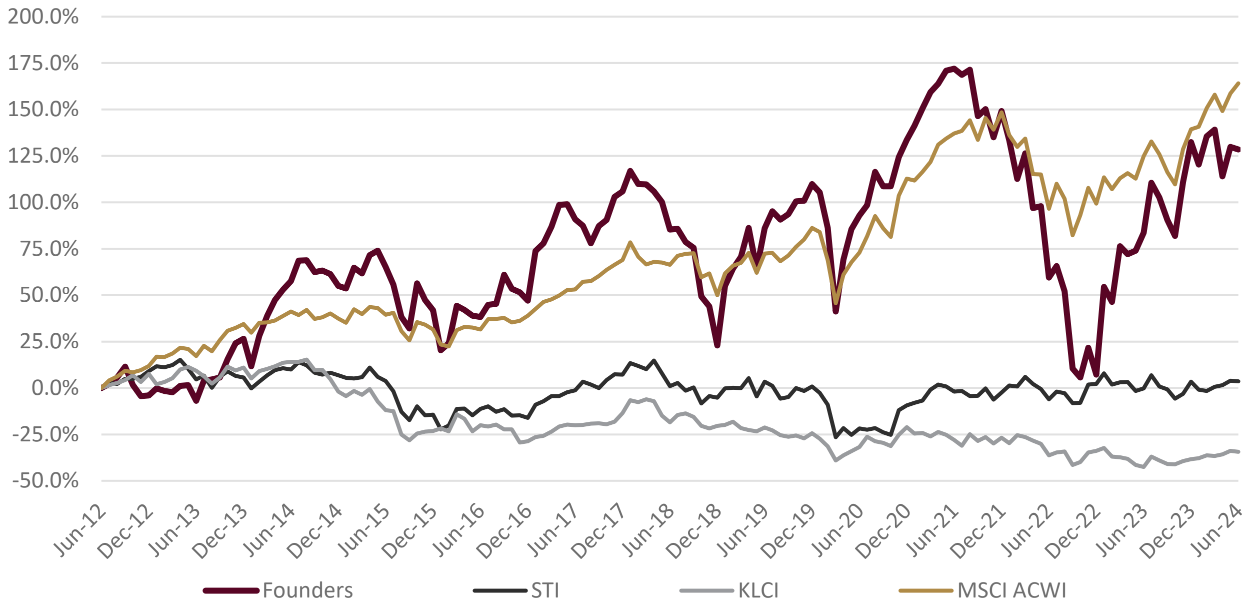
Charts 3: Performance

Since Inception (Jul 2012 – Jun 2024), net of fees, USD



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