Draft for Fund Manager Series in The Sunday Times Invest

Mr Lee Kian Soon and Mr Sean Mah are co-founders of Astral Asset Management, which manages its flagship Astral Value Fund. It is open only to accredited investors.

Before setting up the asset management firm four years ago, they worked together for eight years at a Singapore-based investment firm that manages money for the ultra-rich, also known as a family office.

Mr Lee was the chief operating officer and executive director of the family office from 2007 to 2014, and was responsible for the overall investment portfolio. Prior to that, he worked for McKinsey & Company for seven years.

He holds a first-class honours degree and a master's degree in electrical and electronics engineering from Imperial College London, as well as an executive master's degree in business administration from Peking University.

Mr Mah was the investment director of the family office for six years. Before that, he worked as an auditor for PricewaterhouseCoopers Singapore. He holds a first-class honours degree in accountancy from Nanyang Technological University and is a member of the CFA Institute and the Institute of Singapore Chartered Accountants.

Year to date, as of Sep 2019, AVF has returned 9.5% net of fees for their investors.

1. **Tell us more about Astral Value Fund. What is the fund’s investment strategy?**

   AVF is an absolute-return fund that aims to offer investors a chance to participate in the exciting growth of Asia. The fund is focused on the uncrowded space of small and mid-cap stocks in fast growing Asian regions. The advent of passive indexing means most investors can partake in Asia’s growth by buying listed ETFs of Asia stock indices. Currently, Asian stock indices are heavily weighted towards large-cap finance, technology and real estate companies, and do not consist of many consumer-related or services companies. As the economies of the Asia continue to grow, the consumption sector will grow exponentially. We are searching for the next McDonalds or Starbucks of Asia, as they scale up from being domestic players to becoming global champions.

   Our strategy is to perform extensive, bottom-up research on companies in order to buy companies at deep value to their realisable intrinsic value. Many investors have the misconception that value funds are simply funds that buy low Price-to-Earnings (PE) or Price-to-Book (PB) stocks. However, this inherently assumes that every company has the same intrinsic valuation. Investing is more an art than a science. Take Visa and Citibank for example. There is clearly a reason why they may be grouped together in the financial sector but the former trades at over 30x PE and the latter only at less than 10x. This valuation discrepancy could be due to differences in growth prospects or management competency. The key difference, in our opinion, lies in the two companies’ competitive advantage over their competitors, or what Warren Buffett terms *economic moat*. Only by fully understanding a company’s economic moat, can one come up with the intrinsic value of a company. Upon working out the intrinsic value of shortlisted companies, we purchase a final selected pool of companies that is trading at the largest discount to their intrinsic value, keeping in view the stocks’ liquidity and potential for re-rating.

2. **How can a beginner investor start to invest in the equity markets?**

   Before starting on your investment journey, it is imperative that you set aside enough buffer to meet ongoing needs or contingencies so that the cash allocated for investments is not subject to sudden

Note: Our fund is only open to “accredited investors” as defined by the Monetary Authority of Singapore withdrawals. Sudden withdrawals usually entail exiting investments at an unattractive price leading to significant financial losses.

The first step of investing is to decide on the allocation between the various asset classes such as cash, equities, bonds and properties. It is important to determine if your risk appetite is suitable for equity investments. While investment in equities generally brings higher returns than other asset classes, there will be times when the market falls dramatically. During the Global Financial Crisis in 2008, the peak to trough drop in STI and S&P were 61% and 56% respectively. Sadly, many retail investors at that time panicked and sold near or at the bottom of the market, realising their losses and missing out on the subsequent rebound. Granted a crash of this magnitude is a rare event, but corrections of more than 20% are regular occurrences. If you cannot accept such magnitude of negative drawdowns, it's best to confine your personal investments to high quality bonds and fixed deposits.

Once you have determined the proportion to be allocated to equities, you will need to decide whether it will be in the form of active or passive investment. For many investors, it boils down to whether you believe the market is efficient or not. The best returns a normal investor can hope for in an efficient market is to match the market returns. Low cost ETFs via dollar cost averaging are the best tools to achieve what investment professionals term as *Beta* type of returns.

In contrast choosing active investing means you believe parts of the market are inefficient and that *Alpha*, the difference between the current inefficient price and the fair value, could be made. For active investing, you can divide investors into the fundamental or the technical analysis camp. In the fundamental analysis camp, you can further sub-divide investors into top-down or bottom-up investors with a value and/or growth slant. The former focuses on investing based on forecasted changes in macro environment or sectors. The latter focuses mainly on the current price versus the estimated intrinsic value of a business and bets that the price will eventually rise to reflect the value.

Regardless of which active investment style you choose, the idea is to "Buy Low, Sell High". Proponents of any investment style should have reasons to support why their theory allow you to buy low and sell high. Invest time to understand which style resonates with you and suits your temperament before putting your money in them. Active investing requires much more effort than passive investing and should logically have a higher return over time. Unless you have genuine interest and can put aside the requisite time to learn and master the basics, active investing is best left to trusted professional managers.

3. What is the investing process like?

Many investors do not realise it but there is a standard investment process for investing in equities or bonds or even properties. All investors go through the steps of screening for potential investments, researching, the actual buying, follow-on monitoring and selling.

In bottom-up investing, there are more than 100,000 listed stocks and ETFs globally. You must narrow down your universe via geography, sectors or even market capitalization. The key in investing is to have an edge over others. We usually recommend investors start with companies from industries where they might be familiar with from their work or daily encounters. Ideas can come from other sources such as research reports of companies, news articles or screening on investment platforms. One oft-used strategy of a value investor is to be contrarian, which is to see opportunities in problems or vice versa. For instance, the entire Hong Kong stock market has been hit by the recent social unrest. Yet there are many listed stocks with mainly domestic exposure to mainland China and are not affected by the situation in Hong Kong. These stocks might be fertile ground to prospect.

There are no shortcuts to investing. Even a seasoned astute property investor will view various properties a few times before deciding on his chosen property. Once you have identified an opportunity, time must be spent doing research on the company. For fundamental equity investments, you will have to understand the company's economic moat. Crucially you need some knowledge of common accounting rules and financial statements to understand the current state of the business and forecast the future earnings of the company. Focus on cash earnings rather than accounting earnings as the latter may be manipulated. In general, avoid companies with dubious business models or bad corporate governance. Differentiate between a good business and a good stock. A good business trading at sky high valuations may not give you better returns than a mediocre business trading at net cash position. A good stock gives you good returns with a margin of safety. Lastly, not every idea you chance upon will be suitable for immediate investment because you may be unsure of the business or the price is not right. If you like the idea, add it to your watchlist and revisit it later.

In a stock market, it is usually the seller who knows more than the buyer because the person selling already owns the stock and is selling for a reason. Before investing, buyers should ask themselves this: "If this is such a good investment, why is someone selling it to me?" This is to make sure you don't miss out any blind spots. Form an investment thesis on why the current price is low and what will happen over your investment horizon that will enable the share price to reflect fair value. Buying over time, which is what we prefer, allows us to understand more about the business as an owner.

The work is only half done after you purchase your investment and monitoring is a step many investors neglect. You must not be afraid to cut losses if things are not developing according to your thesis. Early buyers of recently defaulted Hyflux bonds were vested as early as 2011. Alert investors would have noticed the balance sheet steadily declined over the years and could have got out at par even as late as in 2017. Advance indicators should be tracked. If you have an investment in Singapore banks, MAS releases banks' loan growth data every month, which is a key driver of the bank's earnings. If you are invested in a retailer, retail sales data are released every month and it gives you a general idea of how your company will perform.

Until you sell the equities and realise the investments, whatever paper profits you have can be easily go up in smoke if things go wrong. We should however resist the temptation to panic sell but try to understand why the stock price fell. Besides selling when the price of our equities reaches our calculated fair value, we should sell if we realise the investment thesis is wrong, when bad corporate governance issues appear or when we can switch to a much better alternative investment.

4. Why should Singapore investors invest overseas and what should they look out for?

Most savvy Singapore investors are already invested in Singapore equities, REITs, bonds as well as local real estate. As Singapore is a mature and transparent economy, investors should not expect high returns from a purely domestic portfolio. Furthermore, Singapore has benefitted from being one of the key nodes in global economy in the past few decades. With increasing disintermediation, businesses are starting to bypass Singapore and directly enter the end markets. Hence, if investors were to put all their eggs exclusively into the Singapore basket, they will miss out on the higher returns from assets located in strong growth regions in other parts of Asia. Therefore, we believe

Singapore investors should diversify and seek investment opportunities that will benefit from the strong rapid regional growth.

Notwithstanding the above, when Singapore investors venture overseas, they should not only focus on the investment returns, but also look out for liquidity, currency controls as well as the means of exiting the investments. For instance, while private investments in China may be lucrative, there are few laws that safeguard overseas investors' rights and the investment horizon is generally long. Even if an investment proves to be successful, stringent capital controls could make it challenging for investors to repatriate their capital.

5. A recession seems to be looming, do you see a global slowdown coming up in 2020. How should investors position themselves for that?

Due to the US-China trade war, GDP growths in trade-dependent nations like Germany, Singapore and Hong Kong have declined and continued slowdown is expected in the second half of the year. Unfortunately, this trade war is unlikely to resolve any time soon as US and China are looking out for their own strategic long-term interests. While we cannot control nor influence macro-economic events, investors should avoid running for the exits and hold only cash.

In terms of asset classes, we still like equities, as bond markets are delivering very unattractive yields. At present, a quarter of the world's credit or US$16 trillion of debts are negative yielding. Returns for bonds are expected to be dismal as central banks globally continues the rate reduction trajectory. To get a decent return, bond investors must gear up or accept more credit risk or do both. Nevertheless, the days of riding on the rising tide of equities market are over, and specific stock selection will be crucial to deliver investors' return.

6. What are the sectors or markets that you think are still attractive, and why is this so?

We believe that the rising middle class in Asia is a once-in-a-lifetime opportunity. Besides the burgeoning consumer sector that we mentioned earlier, we think the healthcare sector in Asia is a good buffer against geopolitical tensions and economic volatility. The business of pain management, childcare and elderly care are never highly correlated to GDP growth. Companies in this sector generally have very robust business, good growth and enjoy strong cash-flows.

Rising incomes are a tailwind for the education sector. Asian families can afford and tend to embrace the cultural values of educating the future generations. Hence schools and tuition centres will continue to thrive. Such institutions typically list their fees and enrolment numbers, which provides high levels of transparency. Cash-flows are strong as fees are collected upfront. Revenue is sticky as once students are enrolled, they are unlikely to leave the institutions until they finish their education. However, we note that this is a sector that is subject to local regulatory changes.

7. If I am not a fund manager/an investment strategist, I would be…?

Kian Soon: An artist. I have always enjoyed painting in my leisure, and find it refreshing to my mind.

Sean: An entrepreneur. My father and both my grandfathers were all entrepreneurs. While there were ups and many downs in their journey, their enterprising and indomitable spirit inspires me to take the road less travelled.

8. What is your investment advice/tips for the Asian investor in 2019?

1. Spend some time to understand your investment before you invest. There is no free lunch.
2. Focus on investment return net of all fees, and not just on the highest gross return or the lowest fee product.
3. Ensure you have some investments that can hold up their value in bad times.
4. Reduce leverage and keep some spare cash to take advantage of opportunities that may arise from uncertainties.
5. Don't be overly pessimistic from reading negative headlines. They are meant to be newsy and sensational.
6. On the other hand, don't be overly optimistic in your valuations. Bear in mind that the average lifespan of a stock listed on S&P500 is less than 18 years.
7. Have a long-term horizon of 2-3 years and stick to it! 90% of stock investors hold their stock for less than a year and, just by being more patient, you will gain an edge over them.