finexis ASSET MANAGEMENT 汇信资产管理有限公司

# FAM ASIA FUND

INVESTOR LETTER

July 2018

Dear Investors,

The volatility of Q1 persisted into Q2. Market commentators can come up with many reasons for this. It could be the trade war, the adage "sell in May and go away", or even the World Cup which has kept spectators, and speculators away from the markets.

This World Cup will be remembered for its many upsets, where small teams outplayed and won against the most storied giants of football. One of these early upsets was the match between Argentina and Croatia. Argentina has a bevy of stars including the world's best player. What was crucial to note was that Argentina essentially lost its motivation after an error, while Croatia was dogged in its determination.

Amid challenging markets, the Fund was -0.99% in Q2 while the Asia index was -3.51%. Evidently, David can beat Goliath even when it comes to investments. It is timely then that we ask the provocative question: "does size matter?"

## THOUGHTS ON INVESTMENT

### Size matters

What comes to mind when one thinks about Big Business? Mass production and economies of scale are some of the obvious features of being big.

Volkswagen AG (VW) is the world's largest automotive manufacturing company. Its Golf model is one of the world's most popular and is VW's best-selling model. All in, the award-winning Golf is a great car, so long as one is looking for a mainstream and commoditized rather than a performance-driven vehicle.

There are a few less desirable aspects of being big. First, there is the anchor of past success that reduces the motivation to innovate ("if it ain't broke, don't fix it"). Even if incumbents can get past complacency, they have to deal with the Innovator's Dilemma; or in Jeff Bezos' words, how "to kill your own business". When it comes to decision making, bureaucracy and red tape makes it challenging to make the right decision in a timely manner. Sometimes, being big even makes making the right decision difficult. Looking at the VW emissions scandal from 2015, contributing factors could be from the issues that afflict big businesses.

## Bigger $\neq$ Better

Does size matter in the fund industry?

Let's look at it from a conceptual standpoint. "Nobody ever got fired for buying IBM" was coined in the 1970s referring to companies choosing the obvious but expensive system vendor. Extending this to investments, investment managers can find similar "safety in numbers" when sticking to stocks of large, blue-chip companies. If one is in a herd, the corollary is that it will be hard to distinguish from the herd.

Being evidence-based, I could not help but look at research on the size conundrum. Numerous studies done over the years by institutions such as the University of California (UCL), Singapore Management University, and City University of London, indicate the persistence of outperformance by smaller funds. In 2004, a team from UCL, Columbia, Cornell, and Syracuse universities studied fund data from 1962 to 1999. This was the first research to find that size erodes performance, which subsequent research over the years by different groups also corroborate. The 2004 study also found that costs due to hierarchy costs contribute to the organisational diseconomies.

What do we expect to get out of our investments? Since we prefer to manufacture Porsches rather than VW Golfs, being where we are suits us just fine.

## PORTFOLIO DISCUSSION

The term "willing and able" is used in contracts to describe a prospective buyer who is prepared and capable to make the purchase. Even though the research above puts the odds in favour of small funds, I feel that managers also need to be "willing and able" to outperform.

- Being Nimble: Investors may see volatility as bringing uncertainty and risk. The recent volatility was also coupled with dispersion; more differentiation between stocks. We were able to act on pre-determined plans for stocks being monitored as the combination of volatility and dispersion presented opportunities. Over the quarter, cash levels averaged 18%, hitting a high of 33% as positions with adverse risk factors were sold, and stocks with better valuations and prospects were bought.

- Buying IBM syndrome: whether it's our internal systems or investments, we don't default to the popular options. It is that same focus on favourable risk/reward that guides our decision making. Since inception, the Fund has had active share[1] over 90%, meaning its holdings are less than 10% in common with the benchmark.

- Dogged Determination: The fiduciary culture we build has resulted in a few things. We fight tooth and nail to get the best sustainable terms from our counterparties for our investors. Our team members work longer hours than their peers and spend their waking (maybe even

[1] "Active share" is a way to see how a portfolio differs from market benchmarks. In 2006, researchers from the Yale School of Management found that managers with high active share outperform the relevant market benchmarks.

sleeping) hours thinking about how to improve. Furthermore, a performance fee structure is in place to crystallise this alignment.

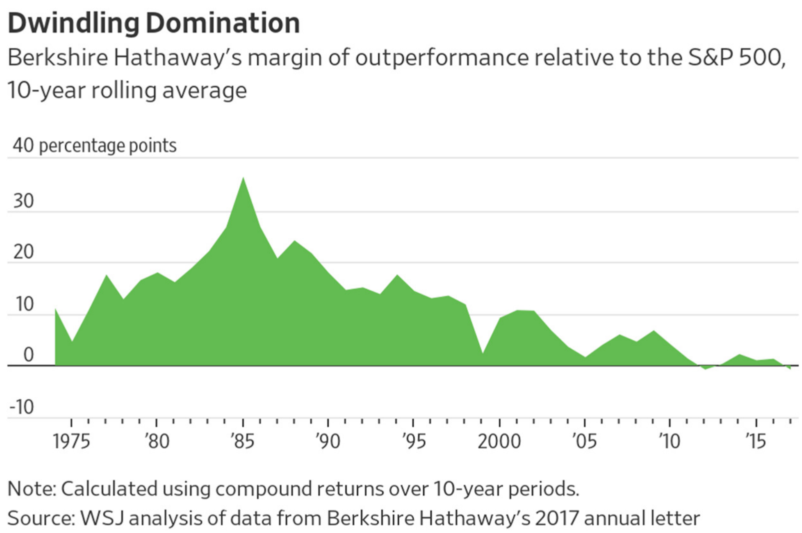
The table shows the 2018 YTD returns of the portfolio's holdings compared to the Asian market. The portfolio's median and bottom percentile stock return is more defensive, without compromising upside in the top percentile. It reflects our process to mitigate negative compounding (for details, please refer to our January letter).

Performance statistics of underlying holdings

| **2018 YTD return as of 30 June 2018** | **FAF** | **Market** |
|---|---|---|
| Median | -1.92% | -8.44% |
| Bottom 10 percentile | -11.50% | -27.76% |
| Top 10 percentile | 15.27% | 15.18% |

*"The giant disadvantage we face is size: In the early years, we needed only good ideas, but now we need good big ideas."*

Warren Buffett wrote this in his 1995 annual letter, aware that Berkshire Hathaway's success and resultant size would make it challenging to replicate going forward. The chart below shows how prescient the Sage of Omaha was.




Source: https://blogs.wsj.com/moneybeat/2018/03/02/is-warren-buffett-too-big-to-beat-the-market/

Fortunately, our good ideas can, but don't need to be big.

Best regards,

Alvin Goh

Alvin Goh
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