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ASSET MANAGEMENT
汇信资产管理有限公司

INVESTOR LETTER
July 2020

Dear Investors,

What a difference a quarter makes! In Q1, investors were worried about how bad markets would get, while the recent quarter had them worrying about whether markets had rallied too much. In our past letters, I've occasionally quoted from investors such as Howard Marks and Warren Buffett. These investors have gone through multiple market cycles and are kind enough to share their wisdom. As Howard Marks said in his June memo, "thus far in 2020, the swing from flawless to hopeless and back has taken place in record time. The challenge is to figure out what was justified and what was aberration". I have seen my fair share of market cycles, and this cycle of swings between extreme pessimism and optimism is playing out yet again.

On the heels of the declines in March, financial markets across asset classes bounced strongly in April and had gains in all three months of Q2. Our Asia fund gained an estimated 19.2% as its focus on quality at the right price benefitted. Our multi-asset FGO and FGOP gained 9.37% and 10.51% respectively, with contribution from all our investment themes: resilience, recovery, yield.

Our returns look good on their own given that our portfolios were positioned for both recession and recovery. However, articles have surfaced about how some first-time investors on Robinhood have "cashed in on the market comeback that billionaire investors missed"[1]. It seems these day traders, by piling into the market, have achieved much better returns than investors like us who have shield positions in place for a much longer recession. With this kind of quick profits at one's fingertips, Robinhood's band of merry men are asking "who needs professional investment managers?"

"Why there are no brave old people in finance"

So, the good news is that major markets have bounced back from last quarter's unexpected and swift declines. This is presumably on the heels of prompt stimulus by global central banks to bring confidence back to the financial system. Indeed, "don't fight the Fed" seems to be entering the strategy playbook of many investors. The flip side is that this Fed 'put' has imbued investors with a certain sense of invincibility; a "there's no way I can lose"[2] mentality. It has gotten a new breed of investors caught up in a feeding frenzy, mopping up all manner of stocks from those in bankruptcy to those at extreme valuations, and with borrowed capital.

The central banks' stimulus has given Wall Street a shot in the arm, but has also left many wondering about the disconnect with Main Street which is facing grim circumstances. Apart from the obvious moral hazard, one cannot help but think that despite the central banks' good intentions, investors piling into stocks regardless of fundamentals will end up getting the short end of the stick in the event of another crash.

The quote above is from Stephen Schwarzman, chairman and CEO of The Blackstone Group. He added "Because if you're brave, you mostly get destroyed in your 30s and 40s. If you make it to your 50s and 60s and you're still prospering, you have a very good sense of how to avoid problems and when to be conservative or aggressive with your investments." We prefer to be brave when fundamentals and valuation are aligned so

[1] https://www.cnbc.com/2020/06/09/robinhood-traders-cash-in-on-the-market-comeback-that-billionaire-investors-missed.html

[2] https://www.bloomberg.com/news/articles/2020-07-08/-there-s-no-way-i-can-lose-inside-china-s-stock-market-frenzy

that we can get above-market returns over the full market cycle, even when we have to choose a less crowded path to walk.

“You can’t predict, but you can prepare”

How does one prepare for a recession that you cannot predict? During Q3 2019, we saw some recession indicators starting to flash. While these indicators themselves do not guarantee a recession, we invested into quality growth and healthcare stocks which are expected to cope better if indeed there was a recession. More importantly, because we invested at attractive valuations, we did not have to agonise over predicting a recession for them to contribute to the portfolio. On 8th June, after the sharp drop and rebound, the National Bureau of Economic Research (NBER) announced that recession was official, and that it started in February. This lag is understandable as the NBER needs time to observe “a significant decline in economic activity that is spread across the economy and lasts more than a few months”. Our decision 11 months ago did not require us to predict whether a recession would happen, but helped the portfolio to hold up much better when it did.

When we make any investment decision, we are never 100% sure about how it will turn out in the short term. Our switch to quality growth seemed to be spot-on as it outperformed the S&P 500 right away. A month later, we were “proven wrong” as quality growth gave back its outperformance and even lagged the S&P 500 by 2.4%. Yet, 11 months later, having gone through a recession with swift and unprecedented losses, quality growth has gained 12% while outperforming the S&P 500 by 6%. How were we able to hold on to our conviction?

Our initial fundamental analysis showed that quality growth had better profit growth compared to the broader market during recessions, and better profit growth will provide better support for stock prices. In the current recession, profits generally have declined but quality growth profits are still holding up.

Net income growth	**Initiated switch 31 July 2019**	**2020 Recession 10 July 2020**
Quality Growth	42.2%	1.1%
S&P 500	12.0%	-13.8%

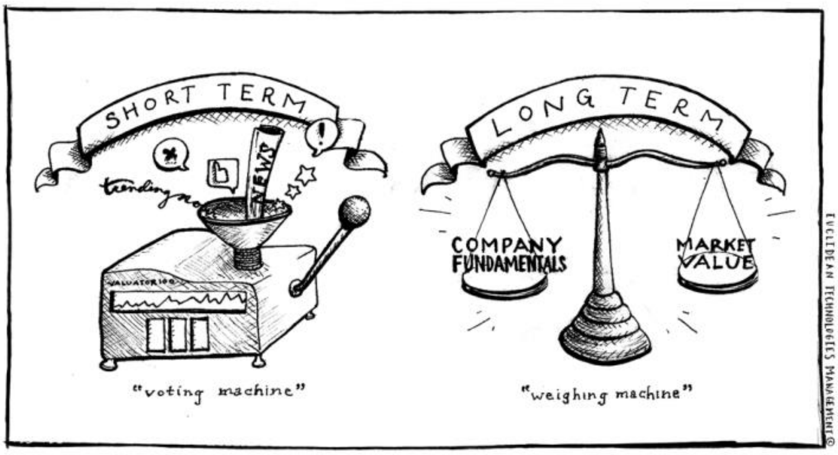
Source: Bloomberg. Quality growth as proxied by Seilern America Fund.

Our recession resilience shield allows us to be more aggressive when opportunity shows up. April saw us allocating to the energy sector after crude oil prices crashed to $25. Some investors questioned this decision as the media was awash with reports of slowdowns and cuts. Indeed, our timing was not spot-on as oil prices crashed further, even going negative for the first time to -$38. What is important to note is that despite this unprecedented volatility in oil, our energy sector investments declined a maximum of 12%. Our argument is simple: an interruption to economic activity had reduced short term demand for energy but as long as we still need to use energy in our day to day lives, it was impossible for oil prices to stay at that level. Sure enough, the energy sector recovered within a month and by the end of Q2, gains from the energy sector exposure were equivalent to the Nasdaq 100 which includes the FAANG stocks. In April, few would have bet that energy would do as well as tech. But having a margin of safety improved the odds to be right over the longer term, even when things looked gloomy.

By now, readers should know that this section's quote is from Howard Marks. Whether it is for a declining or recovering economy, our FVT process is robust enough to guide us to invest by being prepared instead of having to predict, improve our accuracy to get it right over the full market cycle, and more importantly shut off most of the noise when the market goes through extreme moves such as March 2020.

<u>"In the short run, the market is a voting machine but in the long run, it is a weighing machine"</u>

Benjamin Graham alluded to this in the 1940 edition of his book 'Security Analysis', and it still holds true today. The voting machine exists because markets are comprised of participants and some of them respond to short term inputs such as headline news more than others. Such emotional responses and the accompanying extreme pessimism and optimism generate market swings, creating opportunities for those who are process and evidence driven.



Our FVT process makes use of these swings to allocate to more attractive opportunities as shown in the resilient and recovery examples above. As long as we are confident of the opportunity fundamentally as a going concern with no permanent capital loss, and invest with a margin of safety at attractive valuation, we are able to hold the position, and have the patience to allow it to play out.

Warren Buffett, a student of Benjamin Graham, put it a bit more bluntly. He said "the stock market is a device for transferring money from the impatient to the patient." With sound processes and patience, we are confident of above-market returns as we capture not only the market return but also the mispricing that almost always happens.

Best regards,

Alvin Goh

Alvin Goh
Chief Investment Officer

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