Aggregate AM looks to large portfolio of undervalued stocks to beat the market

BY TRINITY CHUA

E ric Kong says shopping for stocks is a lot like shopping for anything else: Steer your cart away from the “new arrivals” and down the bargain shelves instead. Kong is one of the three co-founders of boutique fund management firm Aggregate Asset Management. Founded in 2012, the firm manages a single Asian equity fund called the Aggregate Value Fund. The fund has $442 million in assets. It currently holds about 637 stocks, all of them purchased for their deep value. The Aggregate Value Fund is available to accredited investors with a minimum subscription of $150,000. The fund currently has more than 200 investors, mostly individuals with a net worth of between $3 million and $5 million.

“In the last four years and five months, we delivered a 6.8% net return for our investors,” Kong tells The Edge Singapore. That works out to a compounded 11.63% a year, and exceeds Aggregate’s target of a 10% yearly net return.

Kong was named to be a fund manager at another boutique fund house called Yeoman Capital, co-manages the fund with Kevin Tok and Wong Seok Kong. Tok was a manager at Manulife while Wong was also from Yeoman. Over the years, Wong says, “our investment style has not changed much.” The fund has been looking to own one of each of the asset value. “[So, we] shy away from stocks that have a sexy growth story!” Even in the current bullish market environment, Wong says there are bargains to be found. “At current valuations, we are still able to find stocks at 40% discount to assets. If we buy [them], we can generate a 3% to 4% dividend yield.” The Aggregate Value Fund had a dividend yield of 3.12% at end-June.

The value of a large portfolio
On a mid-term basis, the Aggregate Value Fund measures up well against its peers. As at end-June, the fund has delivered a three-year return of 35.67%. Similar-sized funds in the same asset class and geographic category (Asia-Pacific ex-japan equity) have returns that are roughly a third or less.

Over the shorter term, though, the fund does not shine as much. For the one-year period ending June 30, the Aggregate Value Fund returned 23.62%. That is roughly in line with most of its peers. And in H22017, the Aggregate Value Fund returned just 8.54% — putting it in the 75 percentile for Asia-Pacific ex-japan equity funds.

“Tok says this is to be expected. “[The fund aims] to create a core portfolio for retirement planning. It is low-volatility and low-risk. It targets to give investors an absolute gain of 10% each year. With a compounded 10% return, they can triple their money in 10 years.”

To reduce the volatility and risk profile of the fund, Aggregate AM aims to hold over 200 stocks at any one time. The fund’s exposure to a single stock is unlikely to exceed 2%. Its top five holdings make up 5.5% of the portfolio. The fund managers say they would not rule out holding 1,000 stocks in their portfolio.

Holding a diversified pool of stocks prevents a single stock from dominating returns. But it also makes it difficult for the fund to beat the index over a short period of time. “We behave more like a mid-cap or small-cap index,” Tok says. “But we only invest in undervalued stocks. [Their] profits may be down during a rough patch, but when they re-rate, they can go back to the good old days… This strategy’s benefit is evident in our track record: We have market-beating returns but very low volatility.”

Kong gives the example of Malaysia-based shipping company MISC, which was down on its luck in 2012 owing to its loss-making container business. The rest of the business, however, was profitable. “We started purchasing the stock in the region of RM450 in IQ42013. It was trading at just one time its book value, and its share price was at an eight-year low (amid a depressed shipping cycle). Dividends were cut to zero,” Kong explains. “This is a case where investors should not be afraid to invest in companies that do not pay dividends. Dividends cut to zero provide an opportunity for the investor to buy when all the chips of the investment company are down.”

Based on his calculations, MISC was capable of a 5% dividend yield on a share price of roughly RM4 once the industry recovered. And in October 2015, by the time Aggregate AM sold its stake, the shares had hit RM9.

Looking for a track record
How does Aggregate go about finding and selecting its stocks? Kong, who used to develop computer models at the Ministry of Defence, worked with his co-founders to build a quant model for stock picking based on fundamental data. “We screen for a few criteria, such as price-to-book ratio, price-to-earnings ratio, dividend and cash flow,” Kong says.

The team avoids companies with too much debt and too little cash, because that would spell trouble when interest rates go up. They also filter out companies that may have over-invested their working capital. There is no fixed criterion for market capitalisation. “Big caps can come on our radar, [which] is likely [when] they are going through rough patch- es and they become a value stock,” Wong says.

The team also looks at an extensive amount of historical financial data. “We go at least five years back,” Tok says. “We don’t invest in pre-IPO or IPO-type stocks because we don’t have confidence in them. We want them to be tested by the market to see what their true colours are.”

The fund seeks to invest in the stocks that the model uncovered was Orienta1 Watch Holdings, which has exclusive distribution rights for Rolex watches in Hong Kong. Over the last two years, the stock has declined significantly as an aggressive anti-corruption campaign in China has adversely affected the luxury products market.

“Well, [Rolex watches] are not perishable,” Tok says. “This company has been around for [56] years. We know that it has the financial muscle and expertise to ride through any storm.” Oriental Watch is currently the second-largest holding in the portfolio, at 1.09%.

By sticking to the numbers, Aggregate AM’s founders say they need not be distracted by noise in the mar- ket. “Do not worry about whether the market is going up or down ways. Do not worry about The Donald or May or Jim Png,” Kong quips. “We only have one question: Which stock is undervalued?”

Even if a company’s share price remains the same for five years, Kong thinks investors need not be worried about holding on to their stock if it was carefully picked. “Let’s say the return on equity is 5%, which would add let’s say 15% to 20% to the book value in five years. So, you are getting this 15% to 20% of free assets.”

Another example is Road King Infrastructure, a toll road and property company. Its shares have been depressed for several years amid slower growth in China. But the company had a market capitalisation of HK$35 billion when Aggregate AM acquired it and a net tangible book value of HK$12 billion. “Imagine paying HK$5 billion for net assets worth HK$12 billion; and you receive a dividend yield of 2.6%. This is what we mean by hunting for under-valued stocks,” says Kong. The stock has returned more than 130% since its addition to the portfolio.

No-free model
Currently, 42.3% of the fund’s holdings are in Hong Kong and another 20.3% in South Korea — both markets the founders consider to be relatively undervalued. “The KOSPI 200 Index did not move much in the last five years, partly because of the conflict with China,” says Wong. China is North Korea’s largest trade partner, a position that South Korea is eager to exploit. “The Hong Kong market did not put up much either compared with other Asian markets,” he adds.

Among the big-cap South Korean companies that Aggregate AM has recently invested in are carmaker Hyundai Motor and steel producer POSCO. “We haven’t looked at Kia Motors, but it is kind of undervalued,” says Wong.

The founders of Aggregate AM have strong incentive to research their stocks thoroughly. The Aggregate Value Fund does not charge investors a management fee. Instead, the fund takes a performance fee of 20% of profits once the fund’s net asset value exceeds its previous NAV record. “We had no fee for 1½ years between July 2015 and December last year,” says Wong. The fund has an expense ratio of 0.3%, with zero leverage.

The performance fee model is growing in popularity among fund managers today. Critics argue that this remuneration method may encourage fund managers to window-dress their portfolios for quick gains. But Wong says window dressing is more difficult than it sounds. “In theory, it is true. You can use the money to keep buying the same stocks and push up the share price. But if you have 700 stocks, to dress that up, you don’t have the resources to push up the prices of those stocks.”