Is it time to hunt for bargains?

Aggregate Asset Management is embracing the recent stock market volatility and seeking out undervalued companies. What are its fund managers buying? And what are they doing differently? Turn to our Cover Story on Pages 14 and 15.

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His apartment is only 500 sq ft. Thankfully his portfolio is a little more expansive.
global markets have been hit by an unexpected bout of volatility amid concerns that higher interest rates may slow economic growth. On Feb 5, the Dow Jones Industrial Average fell nearly 1,600 points — its biggest intraday decline in history. The day after, Japan’s Nikkei 225 index fell 4.7%, and the MSCI AC Asia-Pacific ex-Japan Index (MXAP) lost 3.4%, its largest drop in nearly two years.

While some investors are panicking about the decimation of their holdings, the fund managers at boutique firm Aggregate Asset Management may be heaving a sigh of relief. Last year’s bull run, which sent major stock markets up by double-digit percentages, made it difficult for active fund managers such as Aggregate to beat the index. Its Aggregate Value Fund returned 12.7% in 2017, falling behind its pre-financial crisis high.

Nevertheless, Aggregate believes Asian equities currently trade at valuations similar to the levels of 2009, but not at the euphoric levels of 2007, the fund house says. For instance, the Hong Kong market had a price-to-earnings ratio of 23.2 times and price-to-book ratio of 3.5 times in 2007. At end-2009, valuations moderated to a PE of 17.7 times and a PB of 1.9 times. Currently, the Hang Seng Index trades at a PE of 14 times and a PB of 1.5 times.

Underdogs

Founded in 2012 by Tok, a former financial planner, and veteran fund managers Eric Kong and Wong Seok Eng, Aggregate Asset Management has one fund: the Aggregate Value Fund. It holds more than 600 Asia-Pacific-listed stocks, with assets under management (AUM) of $507 million as at end-January. That makes it a minnow in the fund management industry, where firms are getting larger rather than smaller.

Fund management is becoming an increasingly hostile game as investors’ dollars pour into exchange-traded funds and other passive instruments. Inflows for ETFs topped a record US$444 billion ($612 billion) in 2017. Mutual funds saw net inflows of just US$90 billion the same year, according to Credit Suisse.

To compete, a few fund houses have merged their operations in search of scale and cost efficiencies. Aberdeen Asset Management merged with Standard Life to form Standard Life Aberdeen while Janus Capital Group and Hender- son Group combined to form Janus Henderson Group. Firms are also launching creative products such as private debt to court investors. In addition to these challenges, fund houses face new compliance requirements. This year, the revamped Markets in Financial Instruments Directive (better known as MiFID II) came into force. Among other things, it requires fund managers to disentangle trading and research costs. According to the CFA Institute, asset managers say they will now source less research from banks and brokers. Most of them also say the cost of research is expected to rise across all investment types.

Rising costs make it even more difficult for boutique firms to survive. But Kong thinks Aggregate is in a secure niche that will allow it to thrive. “The backdrop of increasing compliance and regulatory costs is an ongoing one. Small firms like ours have to deliver performance and grow our AUM to keep up with the increasing costs,” he says. Aggregate’s strength lies in its low cost structure. The company does not buy stock research or visit the companies it invests in. It does all its research work in-house. It claims its expense ratio of less than 0.3% is among the lowest for funds in this region.

“We don’t see a lot of competition here. I think not many people employ this strategy. It requires a lot of patience and discipline.”

Uniquely, the fund does not charge its investors an annual management fee. Instead, Aggregate takes 20% of the fund’s annual profits if the fund exceeds its previous net asset value record. The fund is only available to accredited investors and has a minimum subscription of $150,000. It aims to produce absolute annual gains of at least 10%, and has managed to do so every year except one. The fund had a dividend yield of 3.5% as at end-December last year.

Kong and Wong used to run boutique fund house Yeoman Capital, while Tok was a manager at Manulife. “We take a long-term investment horizon. If you can compound your money by 10%, you can double your money every seven years,” says Tok. “We believe you can beat the average market indices over the long term by holding a portfolio of undervalued stocks.” Aggregate holds its stocks for an average period of between three and five years.

Long-term outperformance

This strategy has allowed the Aggregate Value Fund to beat other funds that invest in Asia-Pacific ex-Japan equities by a wide margin over a three-year period (see Table 1). Its three-year return to end-January this year was 33.7%, while its closest competitor gained 15.7% over the same period. It underperforms its peers over a shorter time period, though.

Kong says the fund’s short-term underperformance has a lot to do with the way Aggregate runs its fund. “The top performers in the Aggregate Value Fund portfolio delivered 256% (last year), beating the tech stocks’ return of 67%,” he says in a year-end report to investors. “The problem lies in the allocation. The top-performing stocks in our fund are only located 1.78%.”

Individual stocks in Aggregate’s portfolio typically represent no more than 2% of the fund’s total holdings. This is to minimise risk from a single stock crashing. The trade-off is that it is difficult for the fund to outperform the market over the short term, especially when market returns are driven by outpaced gains of stocks with significant weights in an index.

“We have seen many funds losing a lot of investors’ money from time to time. Many had to close too. The main reason for their demise is usually because they put large amounts of their portfolio into a single idea and borrowed lots of money to do it,” Kong says.

‘Don’t get emotional’

Aggregate’s stock selection process begins with quantitative analysis. The managers screen tens of thousands of stocks, narrowing them down to a pool of about 2,000 stocks through a scoring system. They look at indicators such as income, cash flow and dividend yield. The companies are also scored based on valuation

From left: Wong, Tok and Kong, the founders of Aggregate Asset Management
Financial performance of Asia-Pacific ex-Japan funds available to local investors.

<table>
<thead>
<tr>
<th>Name of Fund</th>
<th>YTD Return (%)</th>
<th>1-Year Return (%)</th>
<th>3-Year Return (%)</th>
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**Table 2: Aggregate’s performance as at end-December 2017**

**Valuation**
- Dividend yield: 3.5%
- Price-to-net tangible asset value: 0.6 times
- Price-to-earnings: 13.1 times
- Price-to-book: 5.3 times
- 5-year return on equity: 6.1%

**Weightage**
- Number of stocks: 470
- Top 5 holdings: 4.7%
- Top 10 holdings: 8.4%

**Top 5 Stocks**
- ROICinkings Infrastructure
- Hung Hing Printing Group
- Oriental Watch Holdings
- Ming Fai International Holdings
- China Communications Securities

**Country Weightage**
- Hong Kong: 34.9%
- Korea: 20.5%
- Malaysia: 11.2%
- Japan: 7.4%
- Singapore: 6.8%
- Taiwan: 6.3%
- China-H: 6.2%
- Thailand: 2.8%
- Australia, Indonesia, Vietnam: 1.2%
- Cash: 2.5%

Clearance stocks
Aggregates focuses on small-to-mid-cap stocks with market capitalisations between $40 million and $500 million. As at end-December last year, the fund was heavily weighted in Hong Kong and Korean stocks, at 35% and 21%, respectively (see Table 2). About 21% of the fund was in consumer discretionary companies.

Its top five holdings include Road King Infrastructure, a toll road and property firm; and printing firm Hungarian Printing Group. Others are Oriental Watch Holdings, hotel service provider Ming Fai International Holdings and property developer Chong’s Constructions International. Most of these stocks had gone through a period of depressed share prices but are fundamentally sound. For instance, Road King Group was hit by the 2008 global financial crisis. While they regrouped some ground, partly thanks to government actions to stimulate the economy, they did not breach their previous highs until last year. Aggregate bought into Road King when it had a market cap of HK$5 billion and a net tangible book value of HK$12 billion. It also had a dividend yield of 7.6%. Today, Road King has a market cap of nearly HK$11 billion.

Now, Wong is bullish about the automotive industry in Malaysia. “In Malaysia, we recently allocated more to automotive-related stocks. A lot of people rely on private transport. Every year, the country is adding 600,000 new cars on the road. They also have local plants to export to the ASEAN market.” The Malaysian carmaker’s management has been relatively weak, which has affected the share prices of local automotive companies. But Wong expects some recovery this year.

One of his stock picks is Tan Chong Motor Holders, which has a market capitalisation of RM1.1 billion ($371 million). The company distributes Nissan cars and is involved in vehicle financing as well as property development. “It went through very rough patches [as car sales slowed in Malaysia],” Wong says. “Then share prices started selling from RM6.82 at end 2013 to the current RM1.77 level. Now, sales are slowly picking up. But the share price has not. The recovery might be because of the share buy-backs that the company hasn’t caught up with new models for a while.”

Wong says, “Nissan is launching its electric vehicle Leaf in Malaysia this year. Tan Chong’s share price is only 43% of its net tangible asset value, Wong notes. “At the current enterprise value of RM2.5 billion and a dividend yield of 1.1%, Tan Chong Motor Holdings is a potential buy and wait-for-recovery opportunity.”

In Singapore, Wong likes tech stocks, which are “not really valued for us anymore.” Aggregate invested in Temasek International and Frenck En Group; both stocks have rocketed in recent years. Wong likes pallet maker LHT Holdings and electronic components trader Willas-Ar-ray Electronics (Holdings), which is also listed in Hong Kong.

Shares of LHT has been dragged down, owing to a drop in raw timber supply. But Wong likes it for its increasing free cash flow and stable balance sheet. Its cash is twice the amount of its liabilities. It is also trading at a PE of 13.5 times and a P/B of 0.8 times. It has a dividend yield of 7.5%. “Even in 2008, when there was a crisis, LHT still generated positive earnings, which shows the strength of the company,” says Wong. “We believe in buying stocks cheap and that value in itself is a sufficient catalyst.”

For Willas-Array, it is trading below its book value and at a discount to earnings. But revenue has grown by 5.1% annually. “Since 2010, the company has also been paying a steady stream of dividends, with the exception of 2016. The company’s dividend yield is 5.3%. The stock is trading at just five times P/E, which is definitely attractive,” says Wong.

**Table 1: Performances of Asia-Pacific ex-Japan funds available to local investors**