

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

| BY TRINITY CHUA |

Eric 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 61.8% 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, who used to be a fund manager at another boutique fund house called Yeoman Capital, co-manages the fund with Kevin Tok and Wong Seak Eng. Tok was a manager at Manulife while Wong was also from Yeoman.

Over the years, Wong says, “our investment style has not changed much. We always want to pay below 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 had delivered a three-year return of 35.67%. Similar-sized funds in the same asset class and geographic cat-



Wong (left, with Tok): Our investment style has not changed much. We always want to pay below the asset value.

egory (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 ended June, the Aggregate Value Fund returned 23.62%. That is roughly in line with most of its peers. And in 1H2017, the Aggregate Value Fund returned just 8.54% — putting it in the 75th 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 founders say they would not rule out holding 1,000 stocks in their portfolio.

Holding a diversified pool of stocks prevents a single stock from decimating 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 rerate, 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 RM4.50 in 1Q2013. 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. Cutting dividends provides an opportunity for the investor to buy when all the chips of the investee 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 Octo-



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ber 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 scoring stocks 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 patches 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.”

Among the stocks that the model uncovered was **Oriental 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 down or up or sideways. Do not worry about The Donald or May or Jin Ping,” 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 [at least] 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\$5 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 with a dividend yield of 7.6%. This is what we mean by hunting for undervalued stocks,” says Kong. The stock has returned more than 130% since its addition to the portfolio.

No-fee 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 uncomfortable with. “The Hong Kong market did not put on 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% and 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 hundreds of stocks.”

Creating value

The six Asia-Pacific ex-Japan equity funds closest to the Aggregate Value Fund by size have performed better this year but not as well over a three-year period

NAME	FUND SIZE (\$ MIL)	MORNINGSTAR CATEGORY	TOTAL RETURN YTD (%)	TOTAL RETURN 1-YEAR (%)	TOTAL RETURN 3-YEAR (%)
Investec GSF Asia Pacific Eq A Acc USD	476	Asia-Pacific ex-Japan equity	20.5	33.2	8.2
Schroder Asian Equity Yield A	383	Asia-Pacific ex-Japan equity	11.0	19.4	8.3
Eastspring Inv Asian Low Vol Eq Adm USD	371	Asia-Pacific ex-Japan equity	8.9	NA	NA
Emerise Pacific Rim Equity R/A USD	243	Asia-Pacific ex-Japan equity	8.8	21.9	2.7
Threadneedle (Lux) Asia Contr Eq ZU	190	Asia-Pacific ex-Japan equity	13.9	23.4	NA
Fidelity Asia Pacific Opps I-Acc-USD	142	Asia-Pacific ex-Japan equity	15.2	21.6	12.6
Performance of the full Asia-Pacific ex-Japan equity fund universe					
Seventy-fifth percentile	39		11.5	19.9	6.1
Fiftieth percentile	142		14.1	23.7	8.2
Twenty-fifth percentile	476		16.7	27.9	11.7

Note: As at June 30

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