BATTLE OF THE PORTFOLIOS

TONG'S PORTFOLIO

Into a recession or stagflation? Sold stocks to raise cash

BY TONG KOOI ONG + ASIA ANALYTICA

Global Portfolio

	QUANTITY	AVERAGE COST (US$)	COST OF INVESTMENT (US$)	CURRENT PRICE (US$)	CURRENT VALUE (US$)	GAIN/(LOSS) (US$)	GAIN/(LOSS) (%)
SHARES HELD							
Alibaba Group Holding	4,900	17.5	85,539.0	11.1	54,375.8	(31,163.2)	(36.4)
Apple	390	155.9	60,794.6	155.3	60,570.9	(223.7)	(0.4)
Commercial Bank for Foreign Trade of Vietnam	15,000	3.3	50,136.1	3.3	49,785.9	(350.2)	(0.7)
DBS Group Holdings	2,300	21.2	48,828.5	23.7	54,541.3	5,712.8	11.7
Guangzhou Automobile Group Co	82,000	0.81	66,154.1	0.83	68,429.8	2,275.8	3.4
Yihai International Holding	24,000	2.6	62,611.6	2.3	54,000.0	(8,611.6)	(13.8)
Total shares held			**374,063.9**		**341,703.7**	**(32,360.2)**	**(8.7)**
SHARES SOLD							
Airbnb-Cl A	395	166.6	65,812.4	114.1	45,068.4	(20,744.0)	(31.5)
Bank Rakyat Indonesia	166,000	0.31	50,904.2	0.30	49,858.1	(1,046.1)	(2.1)
Chinasoft International	46,000	1.04	48,028.0	0.72	33,103.1	(14,924.9)	(31.1)
Cash balance (as a % of portfolio)					256,437.9		42.9
Realised profits/(losses)					130,603.7		
Week's change							
Portfolio							(0.5)
MSCI World Net Return USD							0.2
Portfolio returns since inception			**500,000.0**		**598,141.6**	**98,141.6**	**19.6**
Portfolio returns (annualised)							**4.1**
Portfolio beta							**0.33**
Risk-adjusted returns since inception							**60.1**

PERFORMANCE COMPARISON	AT PORTFOLIO START	CURRENT	CHANGE (%)	RELATIVE PORTFOLIO OUTPERFORMANCE (%)
MSCI World Net Return Index	5,927.2	7,998.7	34.9	(15.3)

Footnote:
Current price is as at Sept 14, 2022 or last close
Portfolio started on Dec 18, 2017 with US$500,000
All returns and stock prices are reflected in equivalent US dollar terms
MSCI World Net Return Index is as at Sept 14, 2022 (GMT+ 8) or last close
Data sourced from Bloomberg

We sold some stocks in the Global Portfolio last week (before the sharp selldown in the US markets on Tuesday), primarily to raise our cash holdings. Following the disposals, cash now accounts for roughly 43% of total portfolio value. To be sure, the US and global stock markets have seen more stability in recent weeks, recouping some losses from the steep selloff in 2Q2022. However, we are cautious that markets may still have more downside risks from hereon, including from weaker corporate earnings.

Although earnings expectations in the US have seen some downward revisions following the latest reporting season for 2Q, the 5.5% reduction for 3Q estimates from end-June is relatively modest. Furthermore, average net margin for S&P 500 companies, though slightly pared down, remains high at 12.3%, in part, because macroeconomic conditions in the US remain quite strong. However, the probability of a global recession is rising, especially in Europe, which is facing an energy crisis. Eventually, weaker global growth will feedback negatively into the US economy and corporate earnings and margins (according to FactSet, 40% of S&P 500 revenue are derived from overseas).

As we have previously explained, US households are, on average, in (too) good financial shape and consumers have kept spending, even as inflation rises. Plus, the labour market is still very tight, with approximately two job openings for every unemployed worker currently. Workers are demanding higher wages. Unemployment rate, at 3.7%, has barely budged and is still near 50-year lows. This is partly attributable to low labour participation rate, currently 62.4%, which remains below the pre-pandemic level of 63.4% in February 2020.

All these are, no doubt, complicating the job of the US Federal Reserve, which needs to lower demand for goods and services, and bring down inflation. The central bank may be laying the groundwork for a third consecutive 75-basis-point rate hike in its upcoming policy meeting, slated for Sept 20-21 — if only to ensure future expectations for inflation remain anchored. Indeed, we believe it will err on the side of caution — including inflicting economic pain — to prevent the possibility of a wage-price spiral, as what transpired through the 1970s. **(We will write more on why we suspect the current supply-demand imbalance — in the labour market and broader economy — will lead to recession, perhaps stagflation, next week.)**

We think the current optimism that the US economy would emerge largely unscathed may be misplaced. Interest rate hikes take time for their impact to filter through the economy. Quantitative tightening (QT) has only just begun — in June 2022, and stepped up in September. Although the pace and quantum of QT is far more gradual and in smaller amounts than the two years of quantitative easing (QE) during the pandemic, reduction in liquidity must have some reversal effect on asset prices.

One of the stocks we disposed of was Airbnb. We like the company, as a beneficiary of reopening and recovery in travel demand. And it did deliver its most profitable 2Q results yet last month. Revenue grew 58% y-o-y and was up 73% from that in 2Q2019, driven by pent-up demand in North America and Europe. Demand from the Asia-Pacific region remained depressed. Average daily rate (ADR) for bookings was 40% higher as compared to 2Q2019, thanks to price appreciation and better sales mix. Airbnb's operating income improved from a loss of US$51 million in 2Q2021 to a profit of US$383 million in the latest quarter — handily beating market expectations. The company guided for another record revenue for the current 3Q2022.

Despite the upbeat results, however, its share price had stayed quite flattish — likely due to prevailing negative sentiment for high-growth stocks, even profit-making ones. Airbnb's valuations are higher than the market average, estimated at about 40 times earnings for 2023. As mentioned above, we think the Fed will lift rates beyond current market expectations, and keep them there for longer. If so, sentiment for growth stocks could remain downbeat in the foreseeable future.

We also sold off our holdings in Bank Rakyat Indonesia, for a small loss. Its loan book in 1H2022 grew 9% y-o-y, driven by a 15% y-o-y increase in micro and ultra-micro loans. Net interest income grew at an even higher rate of 18% y-o-y, on the back of wider net interest margin. Combined with a 24% y-o-y fall in provision expenses, the bank's net profit was up 98% y-o-y. In short, the bank is doing well so far — but we are cautious of the potential for a bigger fallout from rising US interest rates on emerging market currencies and economies.

Meanwhile, earnings for Chinese companies are hit by the country's stringent Zero-Covid policy where new outbreaks and lockdown measures are continuing to affect tens to hundreds of millions of its population at any point in time. It is hurting consumer confidence and spending, and raising pressure on businesses, large and small. The sudden lockdowns, quarantines and mass testing are very disruptive and costly to business operations. China has since abandoned its modest 5.5% GDP growth forecast for the year.

We sold our holdings in Chinasoft, whose profits fell in 1HFYDec2022, hit by weaker margins as a result of the difficult operating environment. The company's key customer, Huawei, reported a 52% drop in profits in the first half of this year, and intends to scale back non-core businesses to preserve profits and cash flow. As such, Chinasoft, which provides IT outsourcing services to Huawei, would face some headwinds in the near term.

Alibaba's revenue in 1QFYMar2023 was flattish y-o-y, while its operating profits fell 19% y-o-y — as Covid-19 restrictions affected contributions across most business segments. Profits from biggest income contributor, the China commerce segment, fell while losses from logistics outfit (Cainiao), digital media and entertainment as well as innovation initiatives and others widened in the quarter. The e-commerce business was affected by supply chain disruptions in April and May. Gross merchandise value (GMV) generated on Taobao and Tmall declined 5% during the quarter. Although there were signs of improvement beginning in June, renewed widespread lockdowns in parts of the country will prove a challenge.

Positively, losses from its local consumer services segment narrowed, from RMB4,770 million a year earlier to RMB3,044 million in 1QFY2023, due to improved unit economics per order for its food delivery business. Ele.me's economics per order turned positive during the quarter, thanks to higher average order value, lower delivery cost per order and optimisation in user acquisition spending.

On the other hand, revenue growth for the cloud segment was affected by the loss of one of its top internet customer ByteDance's international business as well as softening demand from customers in China's internet and education industries. The 10% y-o-y revenue growth for the segment was mainly contributed by non-internet industries such as financial services, public services and telecommunication industries. Operating earnings fell 27% y-o-y to RMB247 million due to investments in technology, as well as increases in co-location and bandwidth costs.

We are uncertain if and when China will shift from its current hard stance on the pandemic. But Alibaba will be a main beneficiary of any government stimulus measures for consumer spending and easing of restrictions, with more than 900 million annual active customers in China. Plus, valuations are low.

Following the sale of Airbnb, our only remaining US stock holding is Apple. Apple's revenue in 3QFYSep2022 grew 2% y-o-y on the back of 12% y-o-y growth in services revenue and 1% y-o-y decline in product sales. iPhone sales, which contributed around half of the company's revenue, were resilient during the quarter, growing 3% y-o-y. Sales of Mac and tablets declined 10% and 2% respectively, due primarily to supply chain constraints caused by the Shanghai lockdown. The only notable slowdown in demand was from its wearable, home and accessories sales, which dropped 8% y-o-y.

Increases in subscription numbers drove the

BATTLE OF THE PORTFOLIOS

Can Man beat Machine in stock investing?

BY **HARRY HUO**

Hollywood depictions of artificial intelligence or AI have often painted a bleak picture of humanity. From the murderous Hal-9000 in *Space Odyssey 2001* to the genocidal Skynet in the *Terminator* series, AI is a bad boy.

A more down-to-earth example is the documentary *AlphaGo* in which an over-confident South Korean GO Master turned pale white when he was pitted against a neural network-trained AI by Google.

He soon realised that not only he would lose badly but that no human challenger will ever win again. However, we can take comfort that humans fare much better in less structured decision-making situations. For example, in deciding the value of a piece of art or evaluating a manager's performance, humans have not lost all the battles yet.

What about fund management? Can machine beat man in managing a stock portfolio? Data scientists have often labelled financial data as "noisy" because it is extremely hard to find a correlation between stock performance and a data set — be it price data, financial ratios or stock market news. There are simply too many reasons why a stock price will go up or down.

It is with such a fascinating backdrop that I joined Aggregate Asset Management (AAM). Eric Kong, co-founder, and fund manager of AAM, convinced me that he has been perfecting his stock selection process using machine learning (AI) for the last four years and has delivered some very credible results.

AAM is a zero-management fees, globally diversified fund management company and its foundational belief is that a cash-weighted, highly diversified global portfolio is the best way for capital preservation for our high-net-worth clients. Presently, we use AI as a stock screener to add value to our decision-making process. AI is a mere tool to improve our stock-picking abilities.

AGGREGATE ASSET MANAGEMENT

Deep Deep AI picks for October

Stock	Country	Price(US$)	% of Portfolio
Aurizon Holdings	Australia	2.24	6.7%
Doman Building Materials Group	Canada	4.05	6.6%
Guangdong Tapai Group Co	China	1.07	6.7%
Fresenius SE & Co. KGaA	Germany	19.63	6.7%
China Communications Services Corporation	Hong Kong	0.32	6.9%
PT Indofood Sukses Makmur	Indonesia	0.40	6.6%
Kanematsu Corporation	Japan	10.17	6.7%
Kossan Rubber Industries	Malaysia	0.24	6.6%
DMCI Holdings Inc	Phillipines	0.17	6.6%
Hutchison Port Holdings TR-U	Singapore	0.18	6.7%
MK Electron Co	Korea	6.90	6.8%
Everlight Electronics Co	Taiwan	1.08	6.9%
Supalai Public Company	Thailand	0.50	5.2%
IG Group Holdings	UK	8.39	6.7%
GENWORTH FINANCIAL INC-CL A	US	4.07	6.7%

* Cash level less than 1%
** US$ Price converted at date of trade

Kevin Tok, our co-founder and executive director, posed this challenge to us: Can AI beat human fund managers and analysts in stock selection? It begs the next question: Can an all-powerful AI picking just 15 stocks per month beat a highly diversified global portfolio using both AI and human inputs? The proxy for this would be Aggregate's own Aggregate Value Fund (AVF). Eric Kong, our fund manager and co-founder, coined this contest "Machine versus Human". I share both the founders' innate curiosity and the result is this new column for *The Edge Singapore*. It will be a fun and exciting "thought experiment" as Albert Einstein was fond of saying.

For the next 12 months, the proprietary AI of Kong's team will pick 15 stocks. We will publish the purchase price of each stock and the portfolio valuation. The AI portfolio will be rebalanced once a month. It is a real and "live" portfolio starting with an investment of US$500,000 ($710,510).

In essence, our concentrated AI-powered 15-stock portfolio called "Deep Deep" (in honour of **IBM**'s historic AI Deep Blue) will be competing against the following benchmarks:

- Aggregate Value Fund, a global value fund by AAM using both AI and human inputs with nearly 1,000 stocks
- The Edge Publishing chairman Tong Kooi Ong's portfolio has garnered a tremendous following and has achieved sterling results since its inception. We are honoured to have his portfolio's participation.
- Warren Buffett's **Berkshire Hathaway** stock price.
- We will include Dow Jones Industrial Index, MSCI All Country World Index (MSCI ACWI) and MSCI All Country Asia Pacific Index (MSCI AC APAC) benchmark comparisons.

At the end of 12 months, we will declare the winner.

Let's agree on the implications of this contest. If the AI machine fails to beat man miserably, it does not mean AI is useless in stock selection. It merely means we need to get back to the drawing board and improve our version of the machine. If the machine wins convincingly and hopefully, spectacularly, then as a fund management firm, it behoves us to explore further. Additionally, it will be fascinating to see if an AI-picked portfolio comprising only 15 stocks can outperform a diversified AI-enhanced portfolio comprising nearly 1,000 stocks. I will also use this space to share with our readers what we have learned in our AI discovery journey.

Join us in this AI discovery journey and may the best portfolio — humans vs machine; concentrated vs diversified, win. E

Harry Huo is head, special projects, at Aggregate Asset Management

Machine vs Man Challenge

The table above shows the 15 stocks picked on Oct 17 by Aggregate Asset Management to form a concentrated, proprietary AI-picked portfolio. This machine-picked portfolio will challenge human stock pickers via the following competing portfolios and benchmarks:

a. Aggregate Asset Management's diversified fund, Aggregate Value Fund, with nearly 1,000 stocks picked by human inputs but enhanced by AI stock screening.

b. Tong's Portfolio which has been published in *The Edge Singapore* since December 2017.

c. Warren Buffett's investment vehicle Berkshire Hathaway's stock performance.

d. Dow Jones Industrial Index, MSCI All Country World Index (MSCI ACWI) and MSCI AC Asia Pacific (MSCI AC APAC) will be included as reference benchmarks.

Next month onwards, we will publish an updated table showing the relative performance of these portfolios and benchmarks, and we will continue to do so monthly for a year. In October 2023, we will declare the winning portfolio based on the highest portfolio return. For simplicity, all our portfolios' returns and benchmarks will be in US dollar for easy comparison.

TONG'S PORTFOLIO

double-digit y-o-y growth in services revenue. Total number of paid subscriptions across Apple's platform hit 860 million in 3QFY2022, up 160 million y-o-y and 35 million q-o-q, as the company continued to improve the breadth and quality of offerings on Apple TV+, Apple Arcade, iCloud and Apple Music. Services revenue from China also grew strongly during the lockdown as people spent more time at home. There was, however, a slowdown in digital advertising during the quarter due to the macroeconomic environment.

Despite higher revenue, Apple's operating income fell 4% y-o-y mainly due to a 19% y-o-y increase in research and development expenses and an 11% y-o-y increase in selling, general and administrative expenditures. CEO Tim Cook indicated that the company will continue to invest through the downturn but will be more deliberate in doing so.

Looking forward, a slowdown in the global economy and strengthening of the US dollar will hurt overseas contributions for multinational companies. Nevertheless, we think Apple's loyal and higher-income customer base should fare better than many of its peers.

With over 1 billion unique iPhone users and 1.8 billion installed devices, Apple has a large pool of potential customers for its subscription services. Contribution of services to overall revenue has been increasing, from 14% at end-2019 to 21% in the latest quarter. Increasing contributions from services can improve the company's profitability in the long run due to its higher gross margin (71% in 3QFY2022) as compared to the products segment (35% in 3QFY2022).

The Global Portfolio declined 0.5% for the week ended Sept 14, led by losses from **Guangzhou Automobile Group** (-3.5%), **Commercial Bank for Foreign Trade of Vietnam** (-2.1%) and **Apple** (-0.4%). On the other hand, **DBS Group Holdings** (+3.3%) and **Yihai International Holding** (+0.6%) closed higher for the week. Total portfolio returns since inception now stand at 19.6%, trailing the MSCI World Net Return Index's 34.9% returns over the same period.

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