TONG'S PORTFOLIO

What they do is not what they say ... why fund managers talk up to gain business

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							
ABF Singapore Bond Index Fund	66,000	0.8	50,185.4	0.8	52,015.3	1,829.8	3.6
DBS Group Holdings	2,300	21.1	48,492.8	26.0	59,800.3	11,307.5	23.3
Global X China Electric Vehicle and Battery ETF	3,100	15.8	48,869.1	15.2	47,257.1	(1,612.1)	(3.3)
GoTo Gojek Tokopedia-Cl A	8,400,000	0.0	50,393.3	0.0	51,156.0	762.7	1.5
Grab Holdings-Cl A	15,000	3.2	47,942.2	3.6	54,150.0	6,207.8	12.9
iShares 20+ Year Treasury Bond ETF	1,150	95.9	110,338.3	105.7	121,532.0	11,193.7	10.1
NEXT FUNDS Japan Bond ETF	7,200	7.0	50,132.7	7.0	50,648.3	515.6	1.0
SHARES BOUGHT							
Oversea-Chinese Banking Corp	7,500	9.3	69,882.5	9.5	71,380.4	1,497.9	2.1
Total shares held			**476,236.3**		**507,939.3**	**31,703.0**	**6.7**
Guangzhou Automobile Group Co	82,000	0.8	65,515.4	0.7	57,751.5	(7,763.9)	(11.9)
iShares 20+ Year Treasury Bond ETF	400	96.42	38,566.5	104.20	41,681.8	3,115.3	8.1
Cash balance (as a % of portfolio)					130,456.8		20.4
Realised profits/(losses)					106,362.1		
Week's change							
Portfolio							2.0
MSCI World Net Return USD							2.9
Portfolio returns since inception			**500,000.0**		**638,396.2**	**138,396.2**	**27.7**
Portfolio returns (annualised)							**5.5**
Portfolio beta							**0.22**
Risk-adjusted returns since inception							**126.4**

PERFORMANCE COMPARISON	AT PORTFOLIO START	CURRENT	CHANGE (%)	RELATIVE PORTFOLIO OUTPERFORMANCE (%)
MSCI World Net Return Index	5,927.2	8,289.3	39.9	(12.2)

Footnote:
Current price is as at Jan 11, 2023, 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 Jan 11, 2023 (GMT+ 8) or last close
Data sourced from Bloomberg

Most economists and analysts have come around to embracing the rising odds for recession this year. Yet, for all the talk, that eventuality does not appear to be reflected in current corporate earnings forecasts. Indeed, the majority of professional advisers, fund managers and analysts are still talking up — to get your money. According to service provider FactSet, 55% of the S&P 500 stock recommendations currently are "buys" and 39% are "holds" with only 6% "sells". This is unsurprising, since they all have a vested interest in talking up earnings and expectations, and stock prices.

Many are still holding out hope that the economic slowdown-contraction will be brief and shallow, and that central banks will be the first to blink and pause the current monetary tightening cycle. Case in point, futures trading indicates that the interest rate will peak below the US Federal Reserve's median projection of 5.1% — in fact, betting that interest rates will start to drop sometime in 2H2023. This is contrary to what the Fed itself has been signalling — that there will not be any interest rate cut this year and any perception that its commitment to the 2% inflation target is flagging, is misplaced.

Charts 1 and 2 show the historical as well as the 2023-2024 analysts' forecasts for sales and profits for companies that make up the S&P 500 and MSCI World Index. While analysts have been paring back their forecasts, very slowly, both sales and profits are still expected to expand in the coming two years. Critically, profit margins are expected to widen to record high levels — amid a global economic slowdown, if not outright recession, no less. For example, net margins for S&P 500 companies are currently estimated at 12.8% and 13.5% in 2023 and 2024 respectively, up from the projected 12.1% in 2022 and 11.1% in 2019 (pre-pandemic). We find that hard to believe. Perhaps, in addition to vested interests, many are also guilty of recency bias (where one gives greater importance to the most recent events).

After all, for more than a decade (since the global financial crisis), companies had enjoyed ever-increasing profitability, fuelled in no small part by massive liquidity and cheap money. Extreme monetary policies — enabled by the secular decline in global inflation — drove interest costs lower and lower to near zero and even negative in some countries, underpinning a sustained period of economic growth and stock-bond market gains. Against this "boom-time" backdrop, companies were able to raise selling prices even as costs fell, translating into fatter margins and profits. Returns to shareholders soared.

In fact, if we go back further, corporate profit margins have been trending broadly higher since the early 2000s, save for the brief dips during the recession years (see Chart 2). According to the US Bureau of Economic Analysis, records dating back to the late-1940s show that corporate after-tax profits as a percentage of GDP have risen steeply in the last 20 or so years, and are currently hovering at all-time highs (see Chart 3). In effect, that means a rising share of past productivity gains have accrued to capital owners, at the expense of labour.

There are many contributing factors for this phenomenon, not least of which is globalisation and cost-optimisation of global supply chains. (We wrote about the other key drivers in our previous article, "The golden decades of broad-based wealth creation (accumulation) are over" in Issue 1442, dated Oct 10, 2022.) China's membership into the World Trade Organization in December 2001 was a high watermark and the biggest symbol of globalisation. The country provided a huge supply of cheap labour to the world, driving manufacturing costs lower while diminishing labour bargaining power everywhere else, especially in developed economies. Globalisation is, in turn, one of the main reasons for the secular decline in inflation rates.

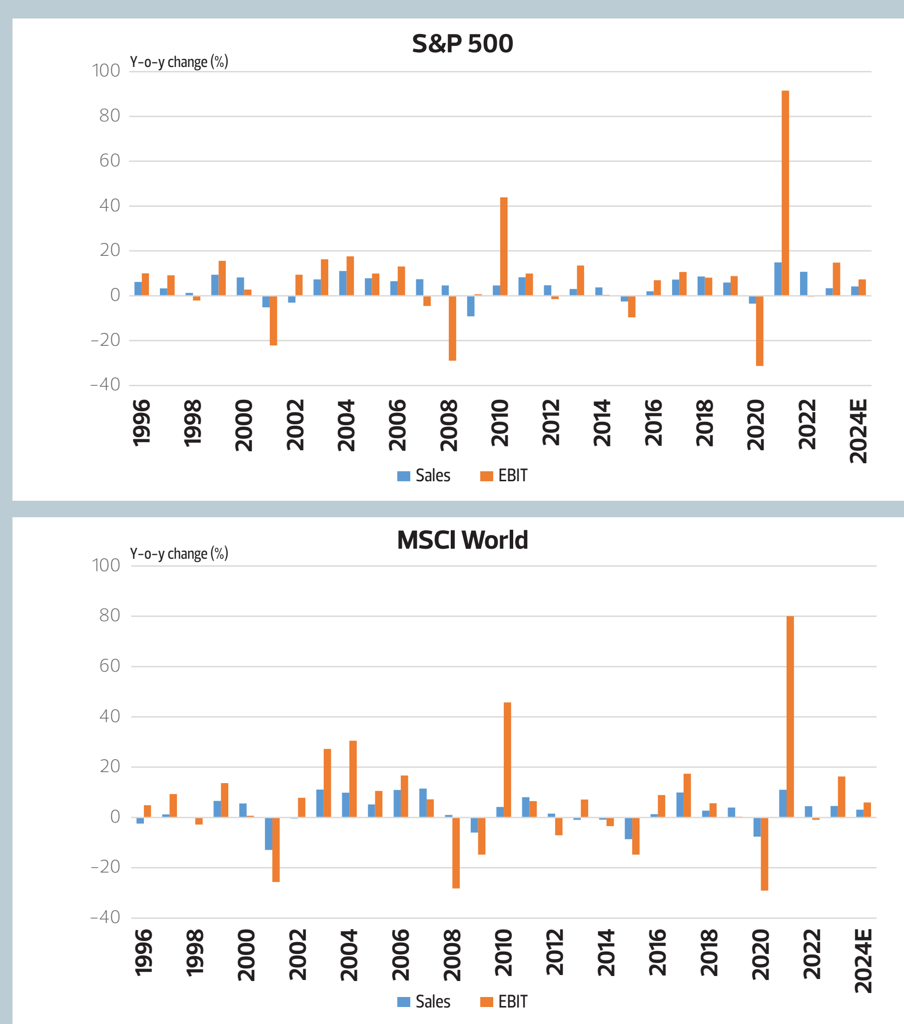
The thing is, some of these powerful secular trends are reversing. The pandemic and geopolitics have shifted the focus from cost optimisation to national security and supply chain resilience — in other words, the trend moving forward is deglobalisation. The decoupling between the US-led West and China, the Russian-Ukrainian war, weaponisation of the US dollar, payment systems and trade as well as rising protectionism and immigration friction are leading towards a more fractured global market. And the world is likely at the lower limits of taxation minimisation — the US is leading efforts to establish a global minimum tax — and deregulation. All of the above are inevitably cost inflationary, at least for the near-medium term — and will quite likely bring about an end to the current golden era of falling costs and rising corporate profitability.

Money talks, bullshit walks

Market analysts may be paying lip service to recession scenarios, but their actions — in terms of earnings forecasts and positive recommendations on stocks — say otherwise. As we said, they have vested interest in talking up mar-

Chart 1

Positive growth widely expected for S&P 500 and MSCI World Index stocks



No Santa rally yet Deep Deep did it again

BY **HARRY HUO**

The Santa Rally never came, but Deep Deep, our machine learning AI, reigns supreme again.

Over the past month, the MSCI WI and MSCI APAC have risen 0.44% and 1.44% respectively. For the same period, DJI has been flat at 0.06%, Tong's Portfolio fell by 0.86% and Aggregate own fund, Aggregate Value Fund (AVF), was up at 1.68%. Deep Deep showed a gain of 1.04% outperforming Tong's Portfolio, Dow Jones and MSCI ACWI.

This month, we added four stocks: **Helia Group**, **NSW**, **GABIA** and **Chicony Electronics Co**. The portfolio sold these four: **Aurizon Holdings**, **CL Holdings**, **Pegatron Group** and **Sungwoo Techron Co**.

It is worth noting that Deep Deep has also beaten Warren Buffett since the inception of this portfolio challenge on Oct 17, 2022. We noted in the second article of this ongoing series that **Berkshire Hathaway** is an investment holding company comprising mainly US companies and assets. Hence, we should compare our US stock picks against Berkshire Hathaway instead of just comparing Deep Deep's entire portfolio's returns. Since the inception of this contest, Deep Deep has picked the following US stocks — **Genworth Financial Inc**, **Conn's Inc** and **Citi Trend** (still in the portfolio). The US component of the Deep Deep portfolio has returned a staggering 35.35% versus Berkshire Hathaway's 16.56%.

There are real limitations Deep Deep faces in this Battle of the Portfolios. One of which is the constraint of publication space. We only have space to showcase 15 AI-picked stocks from several different countries. In an ideal AI-selected global portfolio, there should be 5–10 stocks per country to diversify away the risk. We cannot replicate it here in this column as we would need a full-page space to showcase 45 stock pickings per month (15 countries x 5 stocks =45). In other words, Deep Deep still achieved these laudable results despite being severely handicapped by the lack of diversification.

15 stock picks for January

Stock	Country	Price (US$)	% of portfolio
Helia Group Limited	Australia	1.91	6.58
Canadian Tire Corporation, Limited	Canada	113.11	6.46
Shanghai Yaoji Technology Co., Ltd.	China	2.23	6.18
Mercedes-Benz Group AG	Germany	72.68	7.46
SINOPEC Engineering (Group) Co., Ltd.	Hong Kong	0.46	7.08
PT Bukit Asam Tbk	Indonesia	0.22	5.18
NSW Inc.	Japan	15.29	6.63
Pantech Group Holdings Berhad	Malaysia	0.18	6.93
DMCI Holdings, Inc.	Philippines	0.21	7.15
Hutchison Port Holdings Trust	Singapore	0.20	6.22
GABIA, Inc.	South Korea	8.64	6.67
Chicony Electronics Co., Ltd.	Taiwan	2.88	6.66
Siam City Cement Public Company Limited	Thailand	4.71	7.11
Mears Group plc	United Kingdom	2.42	6.81
Citi Trends, Inc.	United States	29.38	6.22

** Cash level at less than 1%*
**Price (US$) as at Jan 11*

What is the commonality between Deep Deep and ChatGPT?

They are both machine learning algorithms. ChatGPT, which has taken the world by storm, uses machine learning trained by language models and reinforced learning to generate human-like responses. On the other hand, Deep Deep is a probabilistic machine learning algorithm trained by using more than 150 financial indicators. It computes the probability of a stock performing better than the median performance of a universe of stocks. At Aggregate Asset Management, we have already integrated Deep Deep with our stock selection process. Deep Deep is not experimental. Deep Deep is fully operational. Hence, you can see the neck-to-neck performance between Deep Deep Portfolio and our own fund, AVF.

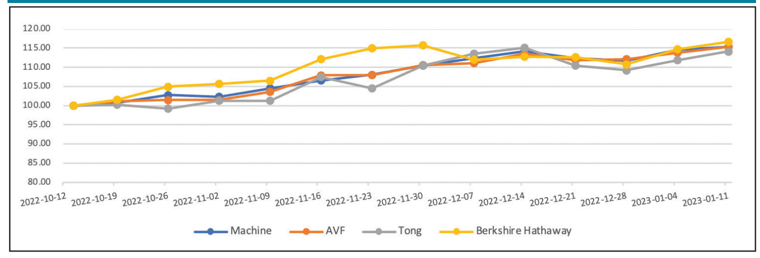
Why is Deep Deep invested 100% of the time?

A reader who has been following this column asked: "Why is Deep Deep's portfolio 100% invested all the time? Since Deep Deep does not do asset allocation, why can't the Deep Deep portfolio keep 30-40% in cash and buy some bonds to steer through this turbulent period?" The answer is that Aggregate is always fully invested in all our equity portfolios. We only have some cash positions amid rebalancing. When you invest in AAM funds, we would ascertain you have kept a portion of your wealth in cash, bonds and other assets like property, gold bars etc. As fund managers, if we keep an additional portion of your investment earmarked for equity in cash, then we are not working hard enough for your money. It is like you build an Ark-like vessel to survive the coming apocalypse and instead of maximising the ship's storage with food and survival gears, you decide to use half of it to keep cash in case the passengers need liquidity during their onboard casino gambling! Allegorically, it won't be a sci-fi disaster flick like *2012* but rather a sci-fi comedy like *Space Balls*.

The perennial question is what's the optimal mix of assets for most retiring investors? Warren Buffett took a stance in his 2013 Berkshire Hathaway's shareholders' report. He wrote that upon his passing, he had instructed the trustee of his wife's inheritance to place 90% in an equity index fund and 10% in short-term government bonds. The underlying theme is that Warren believes that long-term equity returns are far superior to other asset classes.

CHART AND TABLES: AGGREGATE ASSET MANAGEMENT

Performance comparison since inception on Oct 17, 2022



How the portfolios stack up (%)

Portfolio	1-week change	1-month change	Since inception
Machine	0.66%	1.04%	15.30%
AVF	1.42%	1.68%	15.37%
Tong's Portfolio	1.99%	-0.86%	14.08%
Berkshire Hathaway	1.62%	3.41%	16.56%
Dow Jones	2.14%	0.06%	13.52%
MSCI ACWI	3.10%	0.44%	13.12%
MSCI AC AP	2.98%	1.44%	19.88%

Top 5 Deep Deep picks (1-month performance)

Stock Name	Country	Performance
DMCI Holdings, Inc.	Philippines	15.74%
Siam City Cement PCL	Thailand	10.49%
Shanghai Yaoji Technology Co., Ltd.	China	8.25%
Mercedes-Benz Group AG	Germany	6.43%
Pantech Group Holdings Berhad	Malaysia	6.28%

Stay on target

What should we do in 2023? From Deep Deep's perspective, we should stay on target. Since its inception, Deep Deep has achieved 15.30%, beating Tong's portfolio's 14.08% gain, MSCI ACWI's 13.12% and DJIA's 13.52%. It is narrowly on par with AVF's 15.37%. However, it lost out to MSCI APAC's 19.88% due to the late surge caused by China's post-Covid re-opening. But Deep Deep is relentless. If it has a Terminator-like voice, it will probably say, "I'll be back. I will win it all." E

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Battle of the Portfolios 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.

Every month, 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 dollars for easy comparison.

TONG'S PORTFOLIO

kets. Words are cheap. Are they putting money where their mouth is?

Notably, corporate insiders — whom we presume would have a far better grasp of their business prospects — are not buying their own stocks yet, despite the recent market decline. Insider sentiment (measured by the trailing three-month average ratio of companies whose executives or directors have been buying stock versus selling) has dropped for six consecutive months, according to data from InsiderSentiment.com (see Chart 4).

The fact that company insiders are not buying into the positive analyst recommendations with their own money should tell us something — that the worst may not be over just yet. For one, the market, we think, is too optimistic on a Fed pivot. Considering all the above-mentioned factors that are cost inflationary, we suspect the inflation rate is unlikely to drop to the central bank's target 2% as quickly as investors hope.

Meanwhile, the labour market could stay tight even as the economy weakens, due in part to the ageing population and early retirements as well as behaviour changes post-pandemic. Case in point, the US labour market has remained remarkably resilient. The unemployment rate remains near 50-year lows at 3.5%. This will probably give the Fed the latitude to keep interest rates high for a sustained period, until it is rest assured that inflation is brought back under control. We pared our exposure to long-dated Treasuries last week — netting a smart 8.1% return on our average cost — cautious that recent bond gains may be underestimating how far yields could rise from hereon.

Yes, inflation rates may have peaked — US inflation rates have declined for five consecutive months to 7.1% in November 2022, from the peak of 9.1% in June — as it should mathematically, due to the high base effect. But a lower inflation rate does not mean lower prices. Far from it. It just means prices are rising at a slower rate, compared with the previous corresponding period. The cumulative effect of high inflation rates over the past two years will negatively affect consumer purchasing power — even if the inflation rate drops to zero today — particularly as excess savings from the pandemic dwindles over the coming months. Indeed, we suspect much of the excess savings for the lower-income households are gone, given the high and rising prices for necessities such as energy and food.

Real wage growth has been negative across the globe, amid high inflation. According to the latest International Labour Organization (ILO) report, global monthly wages turned negative (-0.9%) in 1H2022, for the first time in more than two decades. Advanced G20 countries were the worst hit. In the US and Canada, average real wage growth was -3.2% in 1H2022 while that in the European Union (EU) was -2.4%.

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