THE EDGE THE WEEK OF MAY 20, 2013

MANAGING YOUR MONEY

personal WEALTH

Fixed income
Fund managers abandon ship on bonds

Hedge funds
Daniel Loeb bullish on Japan stocks, takes profit on Herbalife

Collectibles
Cezanne's *Les Pommes* top lot at Sotheby's US$230 mil sale

Sector views
For growth investors, it may be time to look beyond tech stocks

Asian-style global investing

Capital Dynamics founder and fund manager Tan Teng Boo uses a flexible 'bamboo'-style value approach towards international equity investing. Find out which stocks and markets he is betting on.

COVER STORY

BLOOMBERG

Models stand outside the Tiffany & Co branch in New York. The company is the best player in the global diamond jewellery business, says Tan, who recently bought its shares.

Asian-style global investing

Capital Dynamics founder and fund manager Tan Teng Boo uses a flexible 'bamboo'-style value approach towards international equity investing. Find out which stocks and markets he is betting on.

| BY KELVIN TAN |

Veteran fund manager and car enthusiast Tan Teng Boo loves the thrill of taking his high-performance Lotus Exige for a spin "around the corner or up a steep hill" whenever the 58-year-old globetrotting Malaysian is back home in Kuala Lumpur (KL).

"I enjoy driving, whether it is a fast or slow car. I just love to test the handling of a car," says Tan in an interview with *Personal Wealth* when he was in Singapore recently. "The Lotus is the one that is really enjoyable to drive. Even if you drive up a hill like Genting in fourth gear, you wouldn't feel a difference. You will feel that you are still on flat road," says Tan, who also owns a BMW 7 Series and Volkswagen Sharan (a seven-seater MPV), both of which, he says, are used more for his company-related events and travels.

Cars aside, the money manager is equally enthusiastic about the stocks that he owns in his two global funds — the iCapital Global Fund, which is sold to accredited investors in Singapore, and the iCapital International Value Fund that is marketed to investors in Australia. Indeed, the founder and managing director of asset management and investment advisory company Capital Dynamics, which has assets under management of around US$300 million ($347 million) and offices in KL, Singapore, Hong Kong and Sydney, spends more of his time on the road visiting companies around the world, especially those that he is invested in.

"For hotels such as the Hilton, I am at the highest level [in terms of the number of stays]," says Tan, who has a diamond membership at the hotel chain. Hilton's diamond memberships are given to regular customers who have registered at least 30 stays or 60 nights in a calendar year at any of its hotel chains. "That shows you the amount of travelling I have been doing," says the fund manager who also makes it a point to visit each of his regional offices once a month.

The main objective of these "on-site trips" is to get a deeper understanding of his invested companies' operations, businesses, products and services, according to Tan, who has more than three decades of investment experience. "I remember going to [the] Rolls-Royce factory in Derby, the UK where they make the jet engines. That was fascinating because you get to understand the physics of jet engines."

Among his most recent company visits were trips to a supply base of Australia-listed oil and gas servicing company **Mermaid Marine** in the remote town of Karratha in Western Australia as well as a diamond mine of London-listed **Petra Diamonds** in South Africa. Tan is invested in both companies.

In 2H2012, more than 80,000 South African workers in platinum and gold mines went on strike for higher wages and better working conditions, crippling the mining operations of companies such as **AngloGold Ashanti** and **Anglo American Platinum**. Concerned about the industrial action taken by mine workers in Africa's third-largest economy, Tan went on a site visit to Petra Diamonds late last year to assess the working conditions of its mine workers after being told by the company that it was not facing the same labour problems as the other troubled mining companies. "The worst thing that could happen to a mining company is when your workers go on strike. So, you need to see for yourself what the working conditions were like," explains Tan, who was pleased with what he saw at Petra Diamonds.

"True enough, the working conditions were very different," says Tan, who was surprised that Petra Diamonds' mines were wide and large enough for excavators, loaders and trucks to be operated with ease. "The whole mine operation is also highly automated. They were using a big machine operated by a person for excavating. So, we got the reassurance that the working conditions were a lot better than the other mines," he recalls.

After his visit to Petra Diamonds' mine in South Africa, Tan increased his stake in the diamond mining company in January on the back of positive long-term demand and supply dynamics. As he sees it, demand for diamonds, which has been growing steadily in recent years, could be stronger going forward as the economies of China and the US enter a sustainable growth path. But supply for new diamonds produced by existing mining companies remains constrained. Such supply-demand dynamics favour price increase for diamonds and that should benefit diamond-mining companies such as Petra Diamonds over the longer term, explains Tan, who also recently took a stake in high-end jewellery company **Tiffany & Co**, which is listed in the US. "The best player in the diamond jewellery business, in my perspective, is Tiffany," says the fund manager who is a long-term buy and hold value investor.

'Bamboo' approach

To achieve long-term gains, Tan basically uses a value investing approach with a global macro overlay. Like most value investors, the fund manager evaluates the attractiveness of companies by comparing their long-term intrinsic value and current traded stock prices. Companies which are traded at a deep discount to their intrinsic value are said to offer "a good margin of safety", he says. But for stock-picking in emerging markets, Tan — differing from traditional bottom-up value investors — takes into account macro economic factors such as GDP growth, inflation rates, interest rates, and politics.

He reasons that using a pure value investing approach in Asia and other emerging-market regions does not work because there are many other external macro factors that influence the price of stocks. "If you invest in the US, you don't have to worry about capital controls and you don't have to worry about who will be the next prime minister. If you apply [the] Fisher/Graham [value investing] method in Vietnam, South Africa or Malaysia, you will be dead," says Tan.

A classic case is Malaysia, where politics is a crucial factor that could impact the prices of stocks, according to the Capital Dynamic founder whose company manages a Bursa Malaysia-listed, closed-ended Malaysia equity fund called **iCapital.biz Berhad**. "If you see a new government the next day, all those existing government-related companies would have been bashed. So, in emerging markets, you cannot take the typical Benjamin Graham and Warren Buffett value investment approach because valuations of companies are not just a function of how well they are run. The social and political milieu should also be taken into account," says Tan, who describes his value investing approach as "intelligently eclectic".

However, many of his fund investors would have trouble understanding, or even pronouncing, the word "eclectic". So, Tan recently started to use a simpler term to describe his investment style, which he now calls the "bamboo approach" towards investing. "When we say that our investment approach is 'intelligently eclectic', many people ended up calling it 'electric'," he laughs. Essentially, Tan says he likes the characteristics and structural quality of a bamboo, which is strong but flexible. A bamboo — unlike other trees — is thin at the roots. "Yet, when the wind blows, it doesn't break," Tan explains. "It is able to bend and bounce back. This relates to our philosophy, which is anchored on value investing. But we also combine a lot of things and we adapt and innovate."

Philosophy aside, Tan also has a unique way of running his funds. Supported by a large team of analysts, he is the only decision maker for all his funds. It is "a one man show" without an investment committee and no one with differing views. Tan says he likes to take all the credit for the success of his funds as well as all the blame should they perform below par.

In recent years, Tan's flexible value investing approach and shrewd stock picks have generated decent gains for his fund investors. Indeed, despite launching the iCapital Global Fund near the peak of the global equity cycle in January 2007, a year before the big collapse in stock prices in the aftermath of the 2008 global financial crisis, this fund still managed to turn in gains of nearly 45% (in US dollar terms) from inception to May 9, 2013, significantly outperforming the MSCI World, which was up by just 1.8%

"If you have the discipline to buy [during times of] maximum pessimism, you will make a lot of money," says Tan, who enjoys flipping through annual reports of global companies in the hope of uncovering "hidden gems".

Recent stock buys

Tan's iCapital Global Fund, which has assets of nearly US$150 million and holds less than 20 stocks, has recently added new stock positions in US-listed TV channel company **Discovery Communications Inc,** Hong Kong-listed car retailer **Dah Chong Hong Holdings**, which is a distributor of 22 mid- to high-end car brands in China, and Tiffany.

Convinced that the US economic recovery will be robust and sustainable going forward, Tan is betting that US consumers, whose wealth has increased of late on the back of rising US stock prices, will start their buying spree at Tiffany, boosting sales at the high-end jewellery company. "The US economy has been powered by the recoveries in its retail sales and housing market. The consumers in the US will be a lot more confident over the next couple of years. The wealth is coming back with the US stock market at an all time high and US house prices in some areas have actually gone above the 2007 peaks. When US consumers are feeling more confident, Tiffany's operations in the US will bounce back more strongly than what is expected," says Tan, who points out that the US is still the main market for Tiffany, which is also experiencing strong growth in emerging markets such as China.

To the "new rich" in emerging markets, diamond jewellery such as those produced by Tiffany have better allure compared to gold ornaments, which, according to Tan, are not "exactly fashionable and trendy". "In terms of growth, there is still a long way to go for Tiffany in China," he adds. Shares of Tiffany were up more than 33% this year as at May 14.

Another stock that is benefiting from the strong consumption pattern of wealthy Chinese is Dah Chong Hong, which distributes a range of European, Japanese, American as well as Chinese cars in the world's most populous nation. Tan tells *Personal Wealth* that he is not keen to invest in car manufacturers that are vying for a bigger market share in China. "If you are a car manufacturer, you have to be correct in your pricing, design and technology. That is not an easy business to be in. For the China car-related companies, the area which they are good at is on the distribution side. That is where Dah Chong Hong is well positioned," says Tan, who observes that car ownership in China is still relatively low compared with developed markets. He is therefore confident that car sales in China will continue to be robust over the next several years. Shares of Dah Chong Hong were down 10.55% this year as at May 15 and at a forward price earnings ratio of 11.23 times, the company looks attractive, according to Tan.

On his reasons for buying Discovery Communications, the Capital Dynamics founder says the TV channel company not only produces high-quality and politically-neutral content, which is accepted in most countries, the cost of production for these shows — most of which are documentaries — is also low compared with other TV channels. "Discovery and History channels are entertaining but have lower running costs. In their case, the actors and actresses very often work for free. When filming a documentary, they often interview experts such as university professors or eye witnesses and those people are more than willing to talk for free. The cost of producing those types of shows is not expensive and not risky," says Tan. In his view, the international business of Discovery Communications is still at an infant stage. "The US is still an important market for them. As they continue to expand, the international markets have got a lot of room to grow." Shares of Discovery Communications were up 23.4% this year as at May 14.

Other stocks that iCapital Global Fund is currently invested in include German luxury car maker **Porsche,** provincial Swiss bank **St Galler Kantonalbank,** Chinese cigarette paper packaging firm **Shanghai Asia Holdings,** China property developer **Beijing Capital Land,** Chinese retailer **New World Department Store China,** Chinese power company **China WindPower,** Australia-listed bank **ANZ,** Hong Kong-listed sport lottery organiser **REXLot,** Australian human resource company **Skilled Group** and Singapore-listed **K-Green Trust**, which invests in environmental friendly infrastructure assets.

BRYAN TAY/THE EDGE SINGAPORE

Tan: If you apply [the] Fisher/Graham [value investing] method in Vietnam, South Africa or Malaysia, you will be dead

Potential buys

Like most value investors, Tan has a list of stocks he wants to buy when their share prices reach bargain territory. Some of the stocks he is eyeing include out-of-favour Chinese oil & gas producer **China National Offshore Oil Corp** (CNOOC), Singapore small and mid-cap counters such as diamond cutting tools manufacturer **Sarin Technologies** and heavy equipment rental company **Tat Hong Holdings**.

CNOOC's acquisition of Canadian oil & gas company **Nexen** in mid-2012 will enhance the technological edge of the Chinese oil producer in the area of shale gas, says Tan. "In terms of shale gas, China has the largest deposits in the world. But the Chinese have not succeeded [in extracting large amount of shale gas] because the geological formation in China is very different from that of the US. And the technology in China is also quite far behind the US. But I think Nexen will be able to help CNOOC become a more diversified player in terms of production, especially in the area of shale gas." In addition, CNOOC's operations in Bohai Bay, which is a mature oil base, remain highly productive, according to the fund manager. "They are still able to find quite major oil fields there. That will last for quite a long time to come."

Weighed down by slumping global energy prices, shares of CNOOC have of late been out of favour with global investors, Tan observes. CNOOC is very exposed to the volatility of global prices because it is a pure oil producer, which does not have a refinery or retail distribution business. "Investors are still worried about the global economy and that's why you continue to see oil prices dropping. But at this point, valuations of CNOOC do look attractive," says Tan, who declines to reveal when he will start to buy into the Chinese oil producer.

For the Singapore small-cap counters that he is eyeing, Tan says he is still waiting for prices to come down. "We are looking at a few such as Sarin and Tat Hong, which we have been following for many years. These are small caps and we just have to wait for prices to come down."

Market views

Although the Capital Dynamics founder is generally a bottom-up stock picker, Tan says stock markets such as those of the US and key Asian ones such as Hong Kong, Singapore and Australia will continue to do well over the medium to long term. For sure, short-term market corrections are likely to happen in the near future as global equities cannot move up in a straight line, he warns. But over the mid to long term, global equities propelled by US stocks will continue to rise because the "worst is over" for the five-year global financial crisis that started in 2008 and ended in 3Q2012, Tan points out.

The US' economy is dynamic and the country currently has a lot of "economic cylinders" to sustain its recovery, according to the fund manager. "We are very confident that the S&P 500 will continue to hit all-time highs," says Tan. He reckons that the US stock index, which is currently hovering around 1,650, will reach 1,800 to 2,000 over the next three to five years. "If you look at key Asian markets such as the STI, Hang Seng, ASX, they are still way below the 2007 peak. Their economies are doing pretty well, so it is [only] a matter of time before you see these indices getting past the 2007 peaks."

Tan, however, is negative on the stock market of his home country, which he says is currently plagued by political uncertainties. The recent general election results in Malaysia spell bad news for long-term investors, he says. "On the surface, BN [Barisan Nasional] has a simple majority but if you look at it in total, the overall state seats won were reduced. More importantly, they only had 46.6% of the popular votes," Tan notes. In the May 5 polls, BN won 133 parliamentary seats out of 222, compared to 140 seats in 2008.

Now, Tan doubts that Malaysian Prime Minister Najib Razak will be able to carry out the "necessary reforms that the Malaysian economy so desperately needs". In fact, he fears Najib might be replaced at the coming Umno general assembly, which will take place later this year. "His performance is worse than [former prime minister Abdullah Ahmad] Badawi. If they kicked Badawi out, what justification do they have in keeping Najib?"

The recent relief stock market rally in Malaysia is not going to last, according Tan, who points out that Malaysia currently has "an expensive currency and uncompetitive manufacturing sector". "The current economic problems Malaysia faces are very serious. Yet, you have a major political headwind coming up." Over the longer term, Tan predicts that the KLSE Composite Index could slump to a range of 1,000 to 1,560 from its current level of 1,783 (as at May 15).

New fund

His bearishness on the Malaysian bourse is the main reason why there are currently no Malaysian stocks in his global equity portfolios. To give his Malaysian fund investors an option to invest in global stocks, Tan reveals that his company will be launching a dual market-listed closed-ended global equity fund in Malaysia and another Asian country, which he declines to name, by year-end.

"We hope that all the approvals will be obtained by 3Q2013. It will be a global fund. In terms of investment philosophy, it will be value investing. But it is a listed fund and that makes it very different from our unlisted open-ended global funds offered to Singapore and Australian investors," says Tan.

With the IPO of the new dual market-listed fund, Tan says detachable warrants with maturity of 10 years will also be given to fund investors. "[Investors] can treat the warrants like a very short-term instrument or a long-term investment because their maturity is 10 years. Overall, the dual market-listed fund is pretty innovative as you can trade it in Malaysian ringgit or a foreign currency. There will also be arbitrage opportunities on the mother share as well as on the warrants," says the ambitious Tan, whose long-term goal is to transform his company into a global fund management company.

"I am going to be 59 this year. Most people at 59 would be semi-retired and taking life easy. But I am still working seven days a week and working even harder now compared to 24 years ago [when his company was established]," says the self-confessed workaholic. "We don't want to be just a global company. We want Capital Dynamics to be a true global fund manager from Asia," says Tan. E