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Fund focus

Templeton's Alan Chua sees buying opportunities in cyclical stocks

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BEARISH on stocks

The Standard & Poor's 500 Index could slump to 900 over the next 12 months, predicts Capital Dynamics' Tan Teng Boo. Armed with ample cash, the veteran fund manager is waiting for equities to drop to a 'screaming buy' level before he starts bottom-fishing. Find out which stocks he is eyeing.



PICTURE: BLOOMBERG

Bearish prognosis

The Standard & Poor's 500 Index could slump to 900 over the next 12 months, predicts Capital Dynamics' Tan Teng Boo, who sees a 20%-plus downside for global stocks. Armed with ample cash, the veteran fund manager is waiting for equities to drop to a 'screaming buy' level before he starts bottom-fishing. Find out which stocks he is eyeing.

| BY KELVIN TAN |

Tan Teng Boo, founder and managing director of boutique asset-management firm Capital Dynamics, was reasonably sanguine on the outlook for global stocks late last year, especially after the US Federal Reserve announced its QE2 programme of Treasury bond purchases to aid the economic recovery in the US.

But in February 2011, Tan abruptly turned bearish on stocks after seeing alarming above-average inflation numbers coming out from emerging economies, which were also showing signs of overheating in terms of credit growth. "Looking at the inflation environment in emerging markets, I just got frightened," says the grey-haired 57-year-old Malaysian, in an interview with *Personal Wealth* recently.

The inability of policymakers in Europe to resolve the region's long-drawn debt troubles also dampened his outlook for European stocks, says Tan, who runs two global-stock funds and a Bursa Malaysia-listed closed-end Malaysian-equity fund. "Political paralysis in the Western world is causing massive obstacles for governments in their tasks to resolve fi-

ancial and economic problems," observes Tan, who has invested in UK supermarket chain **Tesco** and German luxury car maker **Porsche**.

After seeing various boom-and-bust cycles in the financial markets over the past 30-odd years, Tan's instinct and experience prompted him to immediately cut risk and embrace cash, in anticipation of a market downturn. In the months after February, he went on a selling spree, taking the cash level of his global funds from "3% to 4%" at the beginning of the year to an unprecedented "50% to 55%" at end-July.

"I guess it was a bit too early [going into cash early this year]. At that time, some of my investors were calling me and asking why I was so bearish," he recalls. "Now, I hope investors are happy with my investment decisions."

Indeed, the recent global stock-market rout, which started in late July and was triggered by various factors, including the US debt-ceiling debacle, Standard & Poor's downgrading of the US' credit rating and Europe's deepening debt crisis, has wiped trillions of dollars off the value of equities around the world.

Global equities, as measured by the MSCI World Index, are current-

ly in negative territory for the year, slumping 6.5% on a year-to-date basis as at Aug 16. Likewise, other stock indices, such as the S&P 500, Straits Times and Hang Seng indices, are in the red for the year after turning in YTD losses of 6.8%, 11.2% and 12.3% respectively as at Aug 16.

Tan, whose Singapore-registered **iCapital Global Fund** is barely in positive territory for the year at the moment, says he is "just relieved" that his investment judgement turned out to be right. "I can't be 100% correct in my timing all the time," adds the fund manager, who correctly predicted in late 2008 that global stocks would make a big rebound in the following year. "My [bearish] views were ridiculed by some at the beginning of the year. But I am glad that we still have so much buying power left." Tan recently sold **Tesco**, Indonesian stocks as well as overvalued counters such as Macau casino operator **Galaxy Entertainment Group**.

The Hong Kong-listed **Galaxy Entertainment**, whose stock surged nearly 150% this year as at Aug 16, was the star performer in Tan's global-equity fund. He bought the counter at an average price of HK\$3.20 last year. It was trading at around HK\$21 last week. "As it climbed higher

and higher — 300% to 500% within a 15-month period — we didn't know how to value it anymore. Yes, I am bullish on Macau casinos, but there must be a long-term valuation to it," says the pragmatic Tan, who sold the Macau casino operator for a big profit.

A 20% correction for stocks

Although global stocks rebounded last week, boosted by the Fed's promise to maintain low interest rates in the US of between 0% and 0.25% for at least two years until mid-2013, as well as by Europe's ban on short-selling, Tan isn't in the mood to buy equities just yet. As he sees it, there will be more severe downside for global stocks in the coming few quarters. He says a recession or a very-slow-growth environment in the US is on the cards. Also, Europe's debt crisis could get messier and inflationary pressure in emerging markets is unlikely to ease anytime soon, he adds.

All that could push the S&P 500 below the 1,000-point level to a low of 900 over the next 12 to 15 months, predicts Tan. That's a correction of more than 20% from the index's current level. He also forecasts that the Hang Seng and Nikkei

225 indices will slump to a floor of 15,000 and 8,000 respectively over the same period.

"You may not get a negative type of contraction in the US, but you may get growth like that in 1Q2011, when the US economy grew only 0.3%. When I talk about a sharp economic slowdown, it could be a recession or very slow growth. The dividing line between negative and positive growth is very fine and is actually not critical. More importantly, instead of 3% to 4% growth, we could see 0% to 0.5% growth in the US. We will have a very severe slowdown in the US that will feel like a recession," he warns.

The underlying problem for the US and Europe isn't so much the regions' debt problems, he says. It is the political problems in the developed world that are causing the lack of confidence among global investors, who are invested in Western financial markets, he points out. Just look at the "US debt-ceiling circus" that took centre stage last month, Tan adds. The politicians in the US were "totally irresponsible" to pass the bill to raise America's debt ceiling "at the last minute", a day before the Aug 2 deadline. The inadequate measures announced by US

politicians to reduce the country's huge national debt also led to the cutting of its credit rating from AAA to AA+ by S&P.

But the recent stock market sell-down wasn't caused by the down-grade of the US' credit rating, says Tan. The main factor was the political paralysis, or gridlock, that prevented government officials from effectively dealing with economic and debt problems. That was what caused the market rout, according to Tan, who reckons that global investors have lost faith in the ability of Western policymakers.

"Just look at Europe. Countries such as Germany and France and the southern European nations couldn't agree because their governments have different political agendas. The same could be said of US politicians. The root cause of the current turmoil is politics," he says. "In Thailand, the kingdom had political paralysis in the past. But its stock market recovered because the country's GDP is still growing strongly. In Europe and the US, where their GDP growth is stalling, political paralysis is worsening the situation and you could get an economic slump."

Emerging-market inflation a key concern

The US and Europe aside, Tan is more concerned about the inflationary problem in emerging economies, which are the key locomotive of global economic growth. "If you are talking about global growth, a lot will depend on what happens to inflation in China and India. If inflation continues to worsen in the emerging markets, you will be looking at a protracted slump globally," he says.

The fund manager often gets irritated when he hears economists saying that inflation in countries such as China and India will peak soon. "They said that in July last year, when inflation in China was about 3%. Now, it is 6.5%, and they are still saying inflation is going to peak." (In July, China's consumer price surged 14.8%.)

Tan says the above-average inflation in emerging markets isn't purely due to the demand factor. "If it lies with demand, monetary tightening would have worked," he notes. The problem lies with the supply side, which is being disrupted by adverse weather patterns and natural disasters. "Every month, there seems to be weather problems somewhere in the world. If you look at corn prices in the US, they have shot up, owing to the heat wave there. Corn is a major food commodity," he explains.

The Capital Dynamics founder, who has no idea whether inflation in emerging economies will head higher or lower in the coming months, says there is no way for economists to predict changing weather patterns in order to accurately forecast developing markets' CPIs, where food is heavily weighted.

"We need to be humble about all these things. The current inflation landscape is different from previous years. If you tell me that inflation is going to peak, honestly, I think you are just a conman. Weather patterns aren't within the control of monetary policies. How are you going to fight adverse weather patterns?" he asks.

Should inflation in China, India or Brazil continue to climb, the central banks in these populous nations will have no choice but to raise interest rates further. Higher rates will no doubt put a damper on economic growth in these emerging countries. And that's why Tan reckons that global economic growth, already hampered by the anaemic growth in the US and Europe, could surprise on the downside, leading to more selling in global stock markets by investors.

"In the scenario we are expecting, I think all markets will be hit. There isn't a safe place for stocks over the next 12 to 15 months. But if there is a 'screaming buy' situation, like if **Keppel Corp** falls to \$4 a share, we will start to buy for sure," says Tan, who bought more than \$1 million worth of Keppel Corp shares at \$4.50 each in November 2008. At the moment, Tan is keeping his powder dry and is happy sticking to cash.

Tan says he has parked all the cash in his global funds in Swiss francs. The currency has strengthened against the US dollar and the euro 20% and 11% respectively this year. As a long-only fund manager, he adds that cash is his only "defence tool" during a market downturn. But choosing the right currencies to park the cash in is getting increasingly challenging, he reveals. "For instance, the Swiss franc has gone up so much and now the Swiss government says it may want to peg it to the euro." (Last week, the Swiss government and the central bank held talks over a possible Swiss franc exchange-rate target versus the euro in an effort to stem the currency's appreciation.) "You think the currency is a safe haven, but the authorities may do something," says Tan, who is looking to diversify into other strong currencies, which he declines to reveal.

Unconventional fund manager

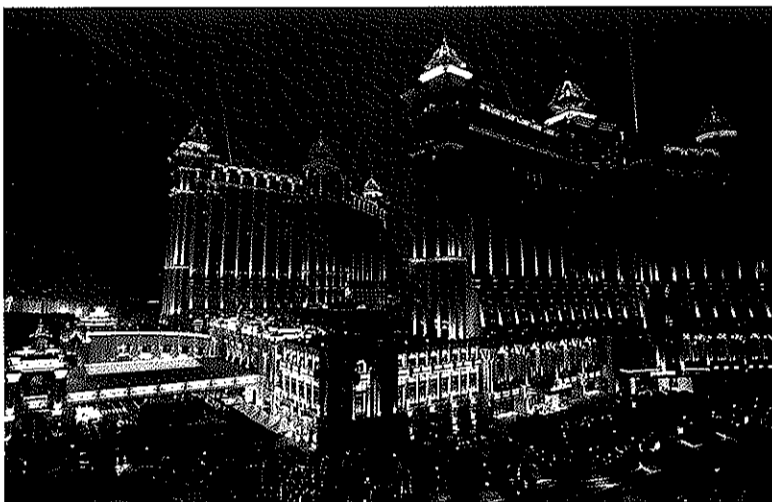
Tan was born in Alor Setar, a town in Malaysia's Kedah state, in 1954. He was 19 when he took up his first job as a Reuters, where he only did a six-month stint in 1973. He then left for the UK to study at the University of Sussex, where he graduated with a degree in economics. When he returned to Malaysia, Tan was asked by his father to help out in the family's rubber-trading business, where he spent six years, before venturing to Kuala Lumpur in 1983 to work in stockbroking firm GP Securities. After a year, Tan left with hopes of setting up his own stockbroking company. After Malaysia changed the rules for securities firms, which needed to be 70%-owned by bumiputeras, which include Malays and the indigenous people of the country.

After three years of soul searching, Tan, who has been a keen observer of the stock markets since his late teens, finally decided to try his luck in investment advisory, which was then a sector in its infancy. In early 1988, a few months after the Oct 19, 1987 stock-market crash, he founded Capital Dynamics Sdn Bhd, which became Malaysia's first independent investment adviser in 1989.

After a decade advising Malaysian clients on stock picks, though its flagship *iCapital* newsletter, Tan set up his fund-management arm called



US stocks are likely to slump further on the back of a stalling economy in the US, says Tan



Galaxy Entertainment Group's Macau casino resort. In recent months, Tan has sold off all his funds' stake in the casino operator, whose shares he feels are currently overvalued.

Capital Dynamics Asset Management (CDAM) in 1997 and, according to its website, achieved compound annual returns of 21.04% versus annual gains of 7.34% for the Kuala Lumpur Composite Index from April 27, 1998 to June 30, 2011. Since 2005, Tan has aggressively expanded his fund-management business, launching a closed-end Malaysian-equity fund called **iCapital.biz Bhd** on Bursa Malaysia in October 2005, and rolling out the Singapore-registered **iCapital Global Fund** in July 2007 and another global-equity fund called **iCapital International Value Fund** (an Australian-registered retail product) in July 2009. The US-dollar denominated **iCapital Global Fund**, with a minimum investment of US\$200,000 and a subsequent investment of US\$10,000, is only sold to high-net-worth individuals and institutional investors in Singapore.

Overseeing assets totalling US\$330 million (\$396 million), Tan runs his fund-management business by focusing on cost efficiency and performance. Unlike other fund houses, Capital Dynamics, which has offices in KL, Singapore, Sydney and Hong Kong, employs no third-party marketing agent or distributor. Marketing, distribution and selling of the funds are done in-house to "save costs" for investors, because distribution costs eat into returns, he says.

Tan doesn't pay himself a salary and director fees. He says he lives off the investment gains generated by his personal investment portfolio. "That was how I sent my kids overseas for their education," quips the fund manager, who has two US-based adult children.

In addition, Tan 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" with no investment committee and no differing views. Tan often says he likes to take all the credit for the success of his funds and all the blame if their performance is below par.

Through the years, Tan has managed to deliver respectable gains for his funds. His Malaysia-listed fund has achieved double-digit gains since inception, except for 2008, while his Singapore-registered global fund is currently up more than 30% since its debut, outperforming the MSCI World Index by nearly 50% from July 2007 to end-July 2011.

After turning in losses of 34% in 2008, the **iCapital Global Fund** surged 68.6% in 2009 and 10.4% in 2010. Tan attributes its good performance to his "intelligent eclectic" value-investment approach. The bottom-up, individual-stock-focused fund manager says all his invested counters are fundamentally sound and have good growth prospects. But most importantly, he doesn't buy stocks that are overpriced. His "margin of safety" is to not overpay for stocks and he likes to buy equities during a big market slump, like in 2008.

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

Stocks to bet on

So, which stocks will he buy when the global equity market enters a

big slump? There are three names he is keen to take fresh positions in when there is a "screaming buy" situation, Tan reveals.

The first stock is London-listed private-equity and venture-capitalist company **IP Group plc**, which provides seed capital and resources for research companies in return for an equity stake in these firms. The share price of IP Group, which has partnerships with the University of Oxford, University of Southampton and King's College London, has surged nearly 50% since the start of this year. This was despite the recent downturn in global equities. "This company is very interesting because there was a new round of fund-raising. If markets everywhere are tanking, I think it will be able to reinvest the money at a much lower price. And it also has some very solid investments," says Tan, whose funds hold a small holding in IP Group.

The second stock he is interested in buying during a downturn is a DNA-sequencing company called **Illumina Inc**, which is listed on the Nasdaq. The company develops and manufactures methods and technologies that are used to determine the structure of DNA. Its customers include pharmaceutical, biotechnology and genomic-research companies. Illumina, which has good growth potential, is a market leader in DNA sequencing, says Tan. Despite sharing more than 14% this year, shares of the company, with an estimated price-to-earnings ratio of 37 times, are still looking expensive, he adds. "I am waiting for the price to come down to a more attractive level. DNA sequencing is a business with a bright future," says Tan, whose funds hold no exposure to Illumina.

The final name that he is bullish on over the long term is his perennial favourite, **REXLot Holdings**, a Hong Kong-listed company that provides lottery-related machines and services to the China market. Tan bought around HK\$48 million worth of REXLot shares at HK\$0.21 to HK\$0.26 apiece in 2008 and early 2009. The stock, which is down more than 34% this year, was trading at HK\$0.55 as at Aug 16. Tan says he continues to like REXLot, which will enjoy significant growth over the long term as a major participant in China's welfare-and-sports-lottery sector.

Tan says he may start buying these stocks when the S&P 500 slumps below 1,000. Should that happen, there will be value across stock markets around the world, he says. At those bombed-out levels, Tan says he will be spoilt for choice as to which stocks to pick up. "I will probably feel like a bachelor in a harem at that time."

iCapital Global Fund is currently invested in European names, including Porsche and Swiss bank **St Gallier**, Hong Kong-listed China property developer **Beijing Capital Land**, Chinese retailer **New World Department Store China**, Australian bank **ANZ**, diversified marine service provider **Mermaid Marine**, as well as Singapore-listed companies such as cigarette packager **Shanghai Asia Holdings** and **K-Green Trust**, which invests in environment-friendly infrastructure assets. ■