First Quarter 2024 shareholder letter

Dear shareholders,

During the first quarter, our fund generated a return of +8.5% for Class A shares. Since our inception in February 2019, our fund has achieved a cumulative return of +1530%. Several of our holdings have performed well so far and our trading team has made positive contributions too.

Quarterly movements in stock prices are almost meaningless to draw any conclusions from (assuming no change in company's intrinsic value) and we usually ignore its short term impacts on NAV changes. We advise you to adopt the same attitude in investing.

In any case, following a sharp upward move, investors should ask themselves the following: 'Have the underlying investments become 10% more expensive in just 90 days? Do they still offer a sufficient margin of safety at current valuations? Should I be concerned about holding them? These are the right questions to ask, and it is of course the portfolio manager's duty to select the right companies and constantly monitor their fundamental developments. In this regard, we believe our overall portfolio remains attractively priced compared to their long-term earnings potential. To illustrate our reasoning, we'll briefly discuss two of our holdings below. (Detailed breakdown on performance attribution will be shared in our annual letter)

Taiwan Semiconductor Manufacturing Company (TSM US, 2330 TT)

We remain optimistic about the company's long-term prospects and envision ourselves holding shares for an extended period. As we've previously discussed, we believe the company's two key competitive advantages - consistently manufacturing cutting-edge semiconductor chips while offering highly competitive pricing - will drive robust profits for years to come. These advantages position the company for sustained success, and we're confident in its ability to maintain its leadership in the industry.

The past two years have seen the company coming off a difficult semi-con downcycle period, as the industry worked off the excess inventories manufactured during the Covid-19 years. We believe TSMC is now in a good position to experience a combination of both cyclical recovery and structural growth in an increasingly high computing era.

We view the company as the "Toll Road" of the semi-con industry, particularly for Artificial Intelligence (AI) computing. This perspective is succinctly captured by TSMC's CEO, Mr. C.C. Wei, when he was asked by an analyst during a result briefing, 'Which company will win the AI race?' He answered, "No matter who wins, most of them are already all our customers." This is similar to the enviable position held by CATL, the world's largest EV battery manufacturer, which boasts a 37% market share as of 2023 and counts industry giants like Tesla, BMW, Toyota, and NIO among its clients. Absent a substantial decline in rate of EV adoption, CATL seems a more attractive investment option than speculating on which automaker will emerge victorious in the EV race.

In 2024, TSMC anticipates that revenue from AI-related revenue will comprise a modest percentage of their overall earnings, falling in the low-teens range. However, their projections for the subsequent five years paint a more dynamic picture, with an anticipated CAGR of 50%. This trajectory points towards AI-related revenue contributing to over 20% of TSMC's total revenue by 2028. Such growth is underpinned by substantial capital investments, notably from tech giants like Microsoft, Google, Meta, and Amazon. These companies are intensifying their efforts to design and produce bespoke AI processors, tailored to meet their burgeoning computational demands. TSMC, boasting a dominant 90% share in manufacturing leading-edge nodes, stands poised to capitalize significantly as the preferred and reliable manufacturing partner for these hyperscalers.

We are closely monitoring Intel's efforts to reenter the foundry market, an area of concern for some. From a manufacturing expertise perspective, we believe it's unlikely that Intel can challenge TSMC's current dominance. The capital expenditure requirements to sustain R&D and manufacturing leadership are enormous (TSMC will spend approximately US$30B in capex this year, twice Intel's projected EBITDA). Furthermore, Intel's internal systems and manufacturing processes, shaped by its narrow product focus over the past few decades, are not well-suited for the foundry business. In contrast, TSMC has been a pure-play foundry since its inception in 1987, serving external clients and their diverse products. This has enabled TSMC to assemble over 70,000 design systems related IP solutions in its Open Innovation Platform. This provides a vast library of knowledge, offering a comprehensive design technology infrastructure, that streamlines chip design, reduces barriers, and increases first-time silicon success rates for its partners. This capability is a significant advantage that Intel currently lacks, and catching up will likely require substantial time and effort. Nonetheless, we will continue to closely monitor Intel's progress, as well as Samsung's developments, in this area.

CNOOC (883 HK, 600938 CH)

CNOOC (China National Oil Corporation) is one of the largest state-owned oil and gas company in China. In a cyclical industry, we favor this company for its position as one of the lowest-cost producers (with a cost per barrel of oil equivalent (boe) of $28 as of 1Q24, compared to Exxon Mobil's $42). The company has diligently prioritized cost reduction and efficiency improvements, resulting in a steady decline in costs over the past 11 years from a high of approximately $36/boe to its current level.

While managing costs, the company has also consistently pursued a strategy of increasing exploration reserves and production growth, leading to increased profitability despite fluctuations in oil prices. This has resulted in an impressive return on equity of 18%. The management's excellent execution has not gone unnoticed, and the share price has risen sharply over the past two years, now trading at a “nose-bleeding” valuation of 6x FY24 earnings. Notably, despite the significant increase in share price, shareholders continue to receive an attractive 6.5% prevailing dividend yield. This compares favorably to other US oil and gas majors, such as Exxon, Chevron, and Occidental Petroleum, which despite having higher production costs, trade at 10-15x earnings multiples and offer low single-digit dividend yields. (We believe the significant difference in valuation multiples is largely due to existing US sanctions, which are likely to remain in place for an extended period.)

At the same time, we are also encouraged by the China government’s ongoing capital market reforms aimed at improving corporate governance in state-owned enterprises (SOEs), including the various initiatives to prioritize market value and overall shareholder returns[1]. This will not only benefit Cnooc’s shareholders but also improve the overall investing climate of China’s capital markets.

While the company's long-term fortunes will ultimately depend on oil and gas prices, which are difficult to predict, we like the dominant position of the company and think it will continue to benefit from the country’s energy self-sufficiency agenda for many years to come.

[1] SOE profits, share value prioritized - Chinadaily.com.cn

Concluding words

Since our last update, the macro and geopolitical landscape has indeed become more uncertain. However, it is important to remember that there will always be uncertainties and risks for the equity investor. We will continue to remind ourselves that the most important risk ultimately is business risk itself. One of the advantages of bottom-up investing, rather than a macro driven one, is that we spent almost no time on ‘predicting’ what will happen to interest rates, oil prices, currency fluctuations, real estate prices or the general level of the overall market (Our traders may ‘react’ to them if a compelling trading opportunity presents itself).

In the equity markets of the US, China/HK, Japan, and Southeast Asia, we have a vast universe of over 10,000 companies to research and carefully select from. These markets present numerous pockets of opportunities. We often find extremes in valuations among small and mid-cap companies with understandable and predictable businesses, creating buying opportunities. Additionally, entire sectors or groups of companies can temporarily fall out of favour, providing patient investors with attractive entry points and margin of safety.

We're honored that you've entrusted us with your hard-earned money. We take this responsibility seriously and promise to manage your funds with utmost care and prudence. We will first seek to preserve your wealth, and then we strive to generate a reasonable long term return on your investment. As the saying goes: “In order to finish first in the race, you have to first finish.”

Thank you for reading. Will write to you soon.

Best regards

Greg,

On behalf of the whole AGT team