AGT Partners

Q3 2024 Shareholder Letter

Dear Shareholders,

For Q3 2024, our portfolio has generated a net return of +19.8% for Class A shares and +24.9% for Class B shares (launched in March'24). Year to date, Class A has increased by 39.1% and Class B increased by 38.9%.

During the quarter, all three strategies delivered positive returns. Notably:

- Long-term investments portfolio: 80% of total gains
- Short-term trades: 19% of total gains
- Quantitative portfolio: 1% of total gains

Several important questions need to be asked whenever such returns are generated by any fund manager, and we wish to address them upfront.

1) Firstly, how much leverage during the quarter, hence risk, is being utilised to generate these returns? Our returns were achieved with:

- Gross leverage (Long positions + Short positions) range: 139% - 185%
- Net leverage (Long positions – Short positions) range: 132% - 179%

This means for every $1 we have, our gross exposure ranged from $1.39 to $1.85 and net exposure of $1.32 to $1.79. We utilise borrowing selectively, focusing on investing in established companies with strong balance sheets. Our trades are subjected to rigorous risk criteria and our overall exposure adjusted according to market conditions.

2) Secondly, after rising so much, are our underlying investments now overvalued and hence susceptible to a rapid decline once broad market conditions become volatile?

While several underlying stocks have indeed become pricier since the time of our purchase, we constantly make 'Value versus Price' comparisons and always consider our next best opportunity from the vast universe of globally listed stocks. We will make any necessary changes on your behalf but also remind ourselves that there is risk in being "overly tactical" and wriggling in and out of stocks based on short term, temporary overvaluation. Our past experiences in stock investments have taught us that the big risk lies in missing out on the occasional 10x rise in a high-quality company just to avoid a temporary 10-20% share price decline.

Long-term Investing

We have added significantly to an existing position in the long-term portfolio and to do so, we have trimmed other positions. We will briefly describe this addition, as well as another company in the portfolio. Both are in the oil and gas industry.

Company: Undisclosed, Market cap: US$600mln

We have closely followed the company since 2019 as the oil and gas industry began to recover from its downturn in 2014-2015. At that time, it was one of the few companies globally capable of constructing critical segments in Floating Production Storage and Offloading (FPSO) units. However, when COVID-19 struck, oil demand plummeted, leading to a sharp decline in prices and delaying recovery prospects. In early 2021, we observed positive changes within the company, particularly following a management team overhaul. The new leadership successfully turned the company around from the brink of bankruptcy. Working capital improved significantly, and capital expenditures were focused solely on essential needs, enabling substantial positive cash flow generation. Debt levels decreased markedly while cash reserves grew. By the end of 2021, the company's net cash exceeded its market capitalization, and profitability metrics showed significant improvement due to enhanced margins.

Over the years, the CEO and management team have remained grounded and dedicated to their craft. Three key principles have been communicated consistently: (1) maintaining high discipline and prudence in cost management; (2) treating customers, suppliers, and subcontractors as partners; and (3) focusing on their niche market. These strategies and consistent execution have paid off well and created significant value for all shareholders.

In 1H24, the company's annualised return on equity (ROE) has improved from single digits since 2019 to an impressive 60+%, while having zero borrowings. We established a significant position in Feb-24 and have added consistently onto our commitments in the past quarter. While the share price has appreciated by >140% since our initial purchase, its outlook continues to be bright.

The company is looking to future-proof itself through exploration in sustainability projects while emphasizing its core competencies rather than venturing into entirely new verticals.

(While we are not ready to disclose the company's name yet, some details are always available to interested investors.)

Company: CNOOC Ltd, 883 HK, Market cap: US$120b

Despite not having the faintest idea where oil and gas prices will be in the short term, another company that we continue to think favourably of is CNOOC. The company owns a vast amount of oil and gas reserves (>8 years revenue coverage based on prevailing prices) and consistently increases its reserves through further investments.

While we are typically apprehensive about investing in capital expenditure heavy businesses, we like it when we can invest in a big, strategic company that is earning 20% return on equity at a rather cheap valuation (6x 2024 PE multiple), while also getting paid ~7% dividend yield annually. Importantly, the company is one of the most efficient and cost competitive in its industry having an all-in cost of production of US$28/barrel.

When reading the annual reports of large oil companies, we're often dismayed by the abundance of glossy images yet the conspicuous absence of critical information – specifically, the cost of finding oil per barrel. This omission speaks volume.

We seek transparency and candour in financial reporting, indicative of management's willingness to treat shareholders as partners. Annual reports should provide insightful discussions, not merely decorative pages. If management fails to provide essential details, we typically infer either something to hide or an unwillingness to treat minorities fairly.

Here we have high regard for CNOOC's management and have confidence in the long-term prosperity of the company and management's continued commitment to channel its fruits of success to all shareholders.

Short-term Trades

We prioritize long-term investing in quality companies with promising prospects, led by capable and minority-shareholder-friendly management, and available at attractive valuations. However, during periods where such ideas are scarce, we adopt a patient approach and pivot to short-term trades with favourable reward-to-risk profiles. All trades adhere to strict risk management protocols, including concentration limits and stop-loss thresholds.

In Q3, we remained active in trading, with some successes and stops due to risk management. For example, we bought REITs and utilities, and shorted banks post the Fed rate cut (50bps) in September. While the longs performed well, the shorts underperformed, leading to a timely exit.

China's real estate industry and monetary easing policies

Having experienced numerous market manias and speculation waves across various asset classes and industries – often characterised by widespread exuberance, followed by devastating declines after bubbles bursts, and eventual recoveries over time – we remain highly vigilant for short-term buying opportunities arising from the current state of China's real estate industry.

(Our ideas here are largely for short-term trading as we typically confine our long-term investments in companies with strong competitive advantages and thus differentiating themselves from competitors and at same time utilise minimal amount of debt to earn good returns on capital. All of which are seldom present in a typical real estate development company)

Brief background

China's residential property market has been experiencing a protracted downturn since 2021, despite several efforts to stimulate growth through interest rate cuts and relaxing property purchase restrictions over the last year.

On September 24, China's central bank, PBOC, unveiled a significant stimulus package. This package includes lowering rates on existing mortgages, reducing bank reserve requirements, and easing borrowing restrictions for financial institutions to invest in Chinese stocks.

The market responded positively to the announcement, with the Shanghai composite index surging over 4% that day. We swiftly responded by conducting a thorough search for viable investment opportunities, leveraging our expertise to identify potential beneficiaries of the stimulus.

Our trading strategy focuses on companies with:

1. Conservative debt-to-equity ratios and no imminent refinancing needs.
2. Substantial landbanks in 1st and 2nd tier cities, trading at distressed valuations.
3. Preferably also own high-quality assets in international markets.

Following the September 24th stimulus announcement, we identified two such companies and made purchases within 1-2 days. Both companies own commercial properties and shopping malls in Hong Kong and Singapore. The first company also owns thriving hospitality assets in China. (Notably, our analysis indicates that the market value of its non-mainland properties exceeds twice the company's market capitalisation at the time of our purchase. The company's valuations are at such depressed levels due to its ongoing losses, a three-year dividend suspension, and significant debt, despite recent debt reduction efforts. Post-purchase, the share price surged over 50%, now trading at a 'breath-taking' 0.28x book value.)

Our second company has underperformed peers so far with a 15% gain, but its high-quality overseas assets and consistent profitability offer reassurance. With an uninterrupted dividend history since 2018 and a 6.3% yield at our purchase price, we're well paid while waiting for an eventual industry recovery.

In all, we're optimistic about the government's policies reviving the economy and residential property sector. As consumer sentiment improves, we expect supply overhang to clear, driving transactions and price growth. We'll continue to monitor developments and adjust our strategy accordingly.

Quant strategy

In the same quarter, the quantitative investment strategy returned +6.6%, navigating volatile market conditions driven by a confluence of factors including: the CrowdStrike outage, unwinding of the yen carry trade, larger-than-expected US rate cuts, heightened political tensions leading up to the US presidential election, and a stimulus-fueled surge in the Chinese/ Hong Kong markets.

Throughout most of the period, the portfolio underweighted the China/Hong Kong market and overweighted the Value factor. Additionally, the targeted factors underperformed amid a sharp rebound in the China market. Leverage, small-cap, low-quality, and low-momentum stocks outperformed the factors targeted by our strategy as liquidity-driven rallies and speculative sentiment shifts favored higher-risk, short-term opportunities over fundamentally stronger stocks. However, we believe this to be a temporary market phenomenon and expect our targeted factors (e.g. high quality and high momentum) to outperform again in the long term as market participants refocus on fundamentals, in line with our fund's core investment philosophy of focusing on fundamentally strong companies and long-term value creation.

Looking ahead, as more attractive opportunities emerge, the portfolio is expected to continue increasing its exposure to Hong Kong, driven by China's efforts to support its capital markets and economic growth. At the same time, we remain cautious of potential market volatility and the risk of whipsaw movements during such periods of rapid sentiment shifts.

Concluding

Traditional academic theories suggest that consistent market-beating returns require assuming higher risk. However, our observations of enduring businesses and interactions with successful entrepreneurs reveal a different story.

We've found that many thriving entrepreneurs are risk-averse (there are exceptions of course), prioritizing minimizing potential losses over maximizing upside potential. These business leaders wish to grow too but they approach growth cautiously, embarking on capital expenditure carefully and preferring strategic, bite-sized mergers and acquisitions within their core competencies.

This measured approach resonates with our natural inclination, strongly shaping our investment philosophy. We prioritize preservation of capital first, then focus on sustainable growth. Our investment strategy reflects this mindset, emphasizing the partnership with entrepreneurs with proven long-term track record, quality businesses with strong fundamentals and disciplined risk assessment. To preserve your capital, our primary objective every year is to first avoid making major mistakes, before thinking about making good moves.

We exercise deep scepticism towards highly leveraged businesses and refrain from investing in companies we don't fully comprehend, industries with uncertain prospects and overvalued opportunities driven by overly optimistic assumptions.

We are deeply grateful and honoured by your trust. Our commitment remains unwavering: to work diligently and intelligently, making informed investment decisions on your behalf. Despite some success so far, we recognize the unpredictable nature of the equity markets. Volatility can shift suddenly, and complacency can only bring eventual harm to one.

As the ancient Chinese proverb advises, 'Prepare umbrellas before the rain.' We will continue to navigate markets with caution, prioritizing long-term resilience over short-term gains. Together, we will weather market fluctuations and pursue sustainable long-term growth.

Thank you for reading.

Greg,
On behalf of Avrian and Tim

By Generations for Generations – Fifty years of Temasek as told by the people who shaped it[1], is a particularly good read to understand the history and makings of an important financial institution in Singapore. Here's an excerpt from the document:

In her speech, she recalled what Singapore's founding pioneer Dr Goh Keng Swee had said in the 1970s – that population size is not the key driver for economic development. Otherwise, China and India would not have languished in the past few centuries. He had also noted that natural resources were not a key driver either. Otherwise, Africa would have been the most advanced continent. Dr Goh had concluded that the key to progress was human capital. Ho Ching then built upon that thinking by drawing a colourful analogy for success, in the form of a hawker expanding her business….“But human capital is more than just skills. It is also about individual and societal values. Do we work together as one team for the larger goal? Or do we push for selfish gains at the expense of others, and end up as a scrabbling, quarrelsome mess? “A society makes progress when there is trust – this requires a fair and just system of norms and values among its members and institutions.”….As it moves ahead into the future, the key to its success depends, as Dr Goh said, on this human capital. It also hinges on whether its people can work together as a trusted team – to deliver consistent, if not excellent, quality meals that nourish, so that every generation prospers.

Machines of Loving Grace – How AI could transform the world for the better (Dario Amodei)[2] is written by Founder and CEO of Anthropic. The author offers interesting insights on the future of AI and potential benefits to humanity (He thinks in the near future, humans can live up to 150 years old!). It possibly helps to give some perspectives to the important question on many investors' minds “Is the current AI demand a fad/bubble or is it the beginning of a new digital age?”

Both documents are free for download and their respective links are included in the footnote.

[1] By Generations For Generations (storyof.temasek)

[2] Dario Amodei — Machines of Loving Grace