

13 March 2020

Commentary on Recent Market Turmoil

What a rollercoaster ride in the markets! Undoubtedly, we are all concerned about the spread of the coronavirus and the impact it has had on markets. We hope that it will be useful to you if we explain how we were positioned prior to the turmoil, the logic and rationale behind the actions taken during this turmoil, and the outlook going forward.

Our positioning prior to the turmoil

As we wrote in our annual letter in January, we were positioned for a US downturn coming into the year, with a short position of about 7-8% of the portfolio and another 5% in cash. We had no travel, hospitality or tourism exposure. We had almost no oil & gas exposure (except for a small Chinese position).

Also, we had already positioned ourselves heavily in favour of China and Asia, with our US positioning the lowest it has been in a decade. Finally, our top stock position was in Chinese cement, which has earnings generally independent of the macro environment, and is a beneficiary of needed stimulus in a downturn.

Actions we took during this period

Despite our positioning, the severity and speed of the downturn took even us by surprise. As China's virus numbers started improving, we removed our market shorts. In hindsight, we were too early – a sudden oil-price war broke out, which then combined with the spread of the virus in Europe leading markets into a freefall. As the situation evolved, we proceeded to raise some cash by selling our remaining oil and gas position and removing our smaller 'tail' Chinese positions and trading positions, choosing to focus on our existing long-term holdings and top stocks.

We thought long and hard about reducing positions across the board, but some of the top stocks we own have tremendous investment characteristics:

High Earnings, Dividend and Buyback Yields – 2019 Estimates

	Earnings Yield	Dividend Yield	Buyback Yield
West China Cement	30%	8%	-
Wells Fargo	15%	7%	20%
Liberty Global	-	-	50%

* Buybacks can be thought of, at the basic level, like dividends. But if done correctly, they are a great investment on behalf of existing shareholders. We wrote about this in our case study on Avis Budget in 2017, available at <http://sunspur.com.sg/publications/>.

When we look at the money we expect to receive over time through buybacks, dividends and re-investment of earnings, it is hard to justify holding cash (which yields 0%) in comparison to the cashflow and earnings these companies are generating. And that is our fundamental job as fund managers, to continuously compare investment opportunities to each other (including cash).

Some have asked - why don't we sell now if we can buy it back cheaper later? The answer is because we don't know how markets will move in the short term. We make market directional calls when there is clarity to us, but we do not do this often, and never in size. When an

investment appears very attractive over the long run, we are quite happy to hold the position regardless of market movements, and to add to them as prices come down.

Market dislocations in history

We have had many such dislocations in the history of financial markets, some larger, some smaller. Since these dislocations, markets have *always* recovered and continued to make new highs over a long-term time horizon.

We cannot identify the exact mechanism of this market turmoil, but many market dislocations are exacerbated by leverage. The futures market is a tremendous source of liquidity, which is why hedge funds tend to participate in that market. But what also happens is that, as leveraged instruments, margin requirements tend to increase as volatility increases. And as margin requirements increase, people need to raise cash by selling futures positions, which tends to increase volatility and so on, leading to a typical spiral.

As market dislocations occur with some regularity, we have always expected 'something' to occur, but never knowing the exact nature of it. Our plan has always been:

- (1) to understand if the underlying factors behind the dislocation has a permanent impact on the earnings of our investments over time;
- (2) to act if they do; and
- (3) to take advantage of any opportunities thrown up by the dislocation

Current positioning

As of this writing (at 5pm Singapore time), we are down approximately 24% for the year (which is about the same as the broader market). We are holding about 10% cash but are no longer short the market. Although it feels harrowing, we will be selectively deploying this cash into existing positions which were indiscriminately sold down in the market.

Looking ahead

Businesses are taking the right actions, by hunkering down and preparing for a steep downturn. However, we do not believe it will last for long. As China has demonstrated, effective preparation, containment and continued precautionary measures means that businesses are able to resume operations, and China is already well on its way to returning to capacity, and we expect this to have mostly occurred by the second quarter of 2020.

There are some who view this as another 'Global Financial Crisis', whilst the market action feels eerily similar, the financial conditions are not close to the same - banks are in amazing shape despite some stresses in markets, capital and liquidity is ample and realistically, the system is the most prepared for this than it has been in decades.

Governments (with a few exceptions) have generally had a haphazard response to the virus outbreak. We do not expect that Western developed countries will be able to contain the virus and must move responsibly to slow the spread. The biggest risk to human life is not the virus per se, but an overwhelmed healthcare system. We hope governments around the world will seek the counsel of countries such as China with more experience in these matters.

On markets, it is impossible to predict a path in the near term, but there is one thing I can guarantee – holding stocks at these levels over 10 years will earn you a better return than holding cash or treasuries.

If you have any queries, please do not hesitate to contact me at:
lokewenwei@phillip.com.sg or +65 6230 8162.

Regards,



Loke Wen Wei
Portfolio Manager
Sunspur Global Fund

The Sunspur Global Fund mentioned in this material is a scheme entered into the list of restricted schemes maintained by the Monetary Authority of Singapore ("MAS") under the Securities and Futures Act ("SFA") and pursuant to the Sixth Schedule of the Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations in Singapore. The Fund is not authorised or recognised by the MAS and the offer of the Fund is not allowed to be made to the retail public in Singapore. This material has not been reviewed by the MAS.

This material and information herein is provided by Phillip Capital Management (S) Ltd ("PCM") for general information only and does not constitute a recommendation, an offer to sell, or a solicitation to invest in the Sunspur Global Fund (the "Fund") or other products mentioned herein. It does not have any regard to your specific investment objectives, financial situation and any of your particular needs. The information is subject to change at any time without notice. Investments are subject to investment risks including the possible loss of the principal amount invested. Past performance is not necessarily indicative of the future or likely performance of the Fund. There can be no assurance that investment objectives will be achieved. The information does not constitute, and should not be used as a substitute for, tax, legal or investment advice. The information should not be relied upon exclusively or as authoritative without further being subject to your own independent verification and exercise of judgement.

You should read the private placement memorandum ("PPM") for disclosure of key features, key risks and other important information of the Fund and obtain advice from a financial adviser ("FA") before making a commitment to invest in the Fund. In the event that you choose not to obtain advice from a FA, you should assess whether the Fund is suitable for you before proceeding to invest. Accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss or consequences arising whether directly or indirectly as a result of your acting based on the information in this material. A copy of the PPM is available from PCM.

The Fund may invest in money market funds managed by PCM or its related companies. Investments in the funds managed by PCM are not obligations of, deposits in, or guaranteed by PCM or any of its affiliates. PhillipCapital Group of Companies, including PCM, their affiliates and/or their officers, directors and/or employees may own or have positions in the investments mentioned herein or related thereto.

This material and information herein are not for any person in any jurisdiction or country where such distribution or availability for use would contravene any applicable law or regulation or would subject PCM to any registration or licensing requirement in such jurisdiction or country. The Fund is not offered to U.S. Persons.