Strong turnaround at APS

Wong Kok Hoi is smiling again

When Wong Kok Hoi established APS in 1995, he wanted the firm to always pride itself in partaking in rigorous bottom-up research and seriously managing institutional money. He started with a mandate of US$10 million and built APS into the largest independently-owned Asian asset management firm in 2006. He produced nine straight years of strong outperformance, stumbled for three years – but now he is smiling again. *Asia Asset Management* interviewed him recently to find out why.

Wong Kok Hoi

Asia Asset Management: *You have built APS using a bottom-up research approach over the past 14 years. However, this method ceased to work for three years, which must have been very frustrating. Have you ever thought that your approach was possibly defective and that you should try to adopting a new one?*

Wong Kok Hoi: Investing is a tough profession. The mind of a portfolio manager can sometimes be compared to that of a golfer. A competitive golfer seeks to master a swing that will be reliable and consistent under all kinds of conditions and pressure. I am not talking about a perfect swing here because there is probably no such swing. Ian Baker Finch will tell you that there is no such thing as a perfect golf swing. As in golf, there isn't a fail-proof investment approach.

As far back as 2003, I already felt that in order for APS to stay on top, it needed to further improve on all the things that we had done well already. I thought that the most important thing I had to do then was to build a larger investment team and adopt a team approach in managing money. In this approach, analysts would be given more responsibilities. It did not work for us and that cost us dearly. With the benefit of hindsight, taking on too much assets too quickly was also not wise nor the right thing to do. All said and done, there is no doubt in my mind that our investment approach is fundamentally sound. Hence there was no need to experiment with another approach.

Why are you such an idealist? Shouldn't you keep with the old ways of managing money?

I am pragmatic. I do not think that I am the fictional swordsman Miyamoto Musashi in the novel 'Musashi' by Eiji Yoshikawa, who sought to perfect his swordsmanship and consciousness. Musashi had to make a lot of sacrifices in his life in order to achieve his goal. I am quite sure that I do not have his qualities as I have other interests. In that sense, I am not a perfectionist. Nonetheless, I thought that it would be important to establish an Asian fund specialist firm with sustained success and staying power. That was, and still is, my desire. I thought that resting on my laurels after having achieved initial success would be the last thing I should do. I know the road to realising that goal is long and challenging, but it is one that I am determined to achieve.

Your performance turned around last year. And this year, your Asian product, APS Alpha Fund was ranked first amongst all Asian funds in Q1. You were up 17% in US dollar terms and outperformed by 10%. Your APS long short hedge fund was up 25%. Last year, it was down only 10% when your peers were down 20%. What changes have you made to turn around performance so convincingly?

I made two fundamental changes. I changed the way we hire people and decided who will manage money. Firstly, we primarily hire experienced portfolio managers, and more importantly, those with proven track records. Secondly, we entrust only senior and proven portfolio managers to manage money. We have upped the bar for our analysts. What we have not changed is our investment process.

Another minor change is to manage slightly more concentrated portfolios. We aimed to achieve 10% alphas for our APS Alpha Fund this year – and we managed to achieve that it in just one quarter. We are also well ahead of our target for our hedge fund. April may end as the best month for us in a long time. I am also pleased that our China A-share Fund has also done well for five years in a row. The firm currently has assets under management of US$1.2 billion.

Does that mean that your work is done for the year?

Oh, no. In this business you cannot be complacent. We have revised our target to 20% for the whole year. Our morale is high now and we also feel confident. As in golf, when you feel confident, you swing well. We feel very good about our current portfolio holdings. More importantly, we must ensure that we do not lose this confidence again.

Are you confident that you will not stumble again?

We must recognise the fact that there is no such as thing as a 'sure thing' in our kind of business. That is why my team and I still work long hours. There is no doubt in my mind that we will face challenging times ahead. Yes, we have learnt from our past mistakes and we are now better armed to overcome future obstacles. As the saying goes, 'good times become good memories and bad times become good lessons'.

One can never rest on one's laurels and must always seek to improve. It reminds me of another great golfer, Jack Nicklaus, who once said: "Success depends almost entirely on how effectively you learn to manage the game's two ultimate adversaries: the course and yourself." We have more of both these experiences now and we believe that the same saying applies to investing.

In a January 2008 Pulses interview, you made a very prophetic prediction at close to the peak of the last bull market to beware of the 'unknown unknown'. Not only did you make an accurate prediction, but you switched your portfolios to a more defensive stance which has rewarded you handsomely. What caused you to be nervous at that time?

We did not like the valuations at that time. Everything looked expensive to us. When investors go on a rampage and buy up all the stocks that stand in their way, we get nervous. We did not believe that the lofty valuations the market was implying were justified going by the fundamentals and intrinsic values of the companies. Our company research showed that the markets had been exuberant and were over- pricing high growth expectations. We were probably the solitary guy out there that left the party early (at least that was what I was told by the editor of Pulse investment magazine when she interviewed me). To cut a long story short, I felt that the market was like a very dry forest where the slightest spark could cause a burning inferno.

In these unprecedented times where global economies are under severe strain and depression is not unthinkable, do you think your strategy is still relevant? Will your strategy suffer again when markets recover?

We think that our strategy and style are even more relevant in times like these! Markets like these really test an investor's mettle – and our recent good performance is testament that we have it. We look for quality businesses selling at bargain prices. This is a formula that works in any market environment over the long-term. To quote Charlie Munger, vice-chairman of Berkshire Hathaway: "The basic concept of value to a private owner and being motivated when you're buying and selling securities by reference to intrinsic value instead of price momentum – I don't think will ever be outdated."

Many established and experienced fund managers have suffered badly in this bear market but APS has stood out from the crowd. What do you attribute this to?

I attribute this to our research and contrarian and critical thinking. We cover the extra mile when analysing an investment opportunity. Just looking at the financials and fundamentals of the business is not good enough. We look for potential warning signals to avoid the traps. For example, the history of paying low taxes and/or low dividends, cash rich companies raising more cash from investors, frequent changes in CFO, resignations of independent directors, etc. So far we have managed to dodge the bullets. Things are not always what they seem, especially in Asia.

In a bull market, fewer questions are asked and so these companies can get away with questionable behaviour. However, the skeletons fall out of the closet in a bear market.

In these challenging times, do you think that APS is able to ride the storm? If so, what makes you so confident when other firms are making losses and closing down?

Just like other firms, we are naturally concerned. Strangely, however, we feel quite good about it because our hunch tells us that our investment process and our portfolio managers will stand up well in this trying test. Stocks have been sold indiscriminately in this bear market but our research shows that there are significantly mispriced stocks out there. In a savage bear market like this current one, there will also be lemons out there. Hopefully, our rigorous company research will help us avoid them. Based on past experience, and I concede that this may not be reliable sometimes; we did quite alright in the post-Asian crisis and post-TMT bubble years.

We see ourselves in today's market environment as prospectors panning for gold. The current bear market has provided an abundant riverbed of cheap stocks but at the same time it has thrown out a lot of fool's gold. Only the discerning and diligent stock picker/prospector will be able to distinguish the two. Just like the prospector, one has to roll up one's sleeves and do some dirty work.

You still do not forecast commodity prices, currencies, interest rates, etc? Why don't you make these macro forecasts?

That's correct. We do not have the talent for forecasting such trends. We stick to what we know best, namely stock-picking.

What is the single most important asset in APS?

We have two, our people and our investment process.

Rumours have been circulating the market about APS. For instance, that you don't pay your people well hence you have lost a number of senior fund managers. Please explain?

I can assure you that there is no basis to these rumours. It is encapsulated in our mission statement that we reward investment excellence. Management would be silly to have this incorporated in our mission statement if we did not believe in this compensation principle. I can tell you that our investment appraisal methodology is a 100-page document which we put together with the help of two consultants. We take our most important resource seriously and go to great lengths to attract and retain the best. Can we ever achieve our goals if we do not pay decently? A year ago, our top fund manager was paid US$3 million – and we are only a boutique firm. From this, you should be able to draw your own conclusion about the compensation policy of APS. Our China team has ran the most successful China product in the last five years and we have not lost any of our staff to any of our competitors in the same period. It is true that we do not pay every staff well? We only reward good performance. We do not reward mediocre performance. This is our philosophy.

Yes, the attrition rate in our Asian team was high. Just as in soccer teams, in our business the attrition rate should correlate with the success of the team. If the team succeeds then it should be retained. However, if it is a losing team, then there is no purpose in keeping it. I have been trained to think that a low attrition rate in our business is desirable but experience has taught me otherwise. I have since learnt that such thinking is both simplistic and flawed. For the record, the three most senior fund managers of APS, each with 13-14 years service with APS, are still with the firm.

There is a persistent rumour that APS is up for sale. In fact, this rumour has been around for more than five years. Is this true?

It is true that we have been approached by numerous institutions in the past. Perhaps I should have cashed in. I thought hard about these offers and decided against selling. A synergistic joint venture may make sense. I can tell you that APS will probably continue to be independent and still be owned by its staff. It is good to be independent as you don't have to subject yourself to the institutional imperative of chasing monthly performance.

Many firms have downsized and are still downsizing. Have you done the same?

We are cutting costs but we are not downsizing. In fact, last month we hired a portfolio manager and have just made an offer to a senior investment manager. We are still interviewing candidates for portfolio manager positions. We will take this rare opportunity presented to us in this economic environment to hire quality people in order to strengthen our investment team.

Do you think that APS will emerge stronger from this financial crisis?

We are determined to emerge from this financial crisis a much stronger firm. Performance is the name of the game and we believe that we can find gold in this environment. Interestingly, as the storm worsens, we become better sailors.

What is your vision for APS, and where do you see the company five years from now?

The vision of APS is to be the best Asian specialist fund manager. We concede that this is a shade ambitious, but we will work hard to achieve this goal. We believe that we can move closer to our vision within the next five years.

It seems even Warren Buffett likes your investment picks! Fortune magazine this month is profiling Buffett's investment in BYD, one of your key investment holdings.

Yes, we invested in BYD about six months before Buffett's investment in this company. Just like him, we are value investors. We like buying US$1 bills for 25 cents. We like companies that have competent and honest management. We like businesses with high entry barriers or occasionally companies which are best-in-class where there is intense competition. In addition to BYD, we own many undervalued names which the markets are beginning to uncover. ■