News & Events

Hedge Fund Interview with Vincent Lam, Chief Investment Officer, at VL Asset Management

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VL Asset Management Limited was founded in 2009 in Hong Kong by veteran investor Vincent Lam and ex-lawyer Adrian Wong. The company, being a home-grown boutique house though, has strengthened its team from two to nine members in less than seven years. Its flagship, VL Champion Fund, with a long-short equity mandate, was launched in mid-2009 and has been up and running with a loyal and steadily-growing investor base. VLAM launched an authorised fund VL China Fund in August 2015.

1. **Please share with our readers a bit of history about VL Asset Management Limited, the background of your key personnel and an overview of your flagship VL Champion hedge fund.**

   VL Asset Management Limited is owned by me, Adrian and Victor Tsang. I started my professional career as a financial journalist in the mid-1990s, then moved on to become an equity research analyst, head of research and later portfolio manager. I also served as managing director for Ramius Asia from 2008 to 2009 and looked after their Asian event-driven portfolio. I have long planned to set up my own company and an opportune moment surfaced when the global market crush, post-Lehman Brothers' collapse, dragged stock valuation to very attractive levels.

   Adrian, one of the earliest investors of my first hedge fund more than a decade ago, is now our Compliance Officer and Chief Operations Officer. Having solid experience in listings and M&As as a commercial lawyer in England and Hong Kong, he was a member of the Listing Committee of the Hong Kong Stock Exchange from 2006 to 2012. Victor worked with me for almost eight years at a financial group before he took up major investment roles first at Ping An China Asset Management (HK) and later CICC HK Asset Management. He then joined VL Asset in 2011 as Portfolio Manager. The three 'musketeers' share the same philosophy that, in addition to creating value for investors, virtue and vision are vital to building a long-lasting business.

   VL Champion Fund aims to deliver risk-adjusted absolute returns in the long run through active management - We adopt a value-investing with catalyst approach and look for undervalued stocks riding on an accelerating globalization trend or a sustainable growth business model. The Fund's mandate is to invest at least 50% of its NAV in Greater China markets and there is flexibility to invest the remainder in any other markets as opportunities arise. We invest only in what we know well and what we see with decent growth prospect instead of what is in vogue.

2. **What are some of the main challenges you have faced so far when investing in mainland China markets? Has the opening of the Shanghai-Hong Kong Stock Connect helped in increasing your access to the A-shares market?**

   The main challenges our team has faced investing in mainland China markets are the rising policy risks, ever-evolving business environment, and the shortage of good businesses with strong economic franchises.

   The opening of the Shanghai-Hong Kong Connect did help increase a portfolio manager's access to the China A-shares market. However, due to valuation concern, we do not currently have any China A-share exposure.

3. **The VL Champion hedge fund was one of the top performing Greater China hedge funds in 2013, returning 23.88% during the year. Can you share with our readers some of your key winning themes during the year especially with reference to the long and short side of your trading book?**

   As we advanced towards 2013, the research we were doing at that time led us to focus increasingly on 3 long themes: information technology, healthcare, and green economy. Two most profitable positions on our long book then were Softbank (9984 JT), the major shareholder of the then unlisted Alibaba Group, and Sunevision (8008 HK), a data centre operator based in Hong Kong under the Sun Hung Kai Properties (16 HK) group. Some of our other top performers included the then Stryker-acquired orthopaedic product manufacturer Trauson (325.HK) and PRC-based medicine distributor China National Accord (200028.CH).

   On the short side, we shorted Silver Base (886.HK), a distributor of Wuliangye, as the business environment for baijiu (China liquor) grew tough due to the anti-corruption campaign. We were also bearish on the traditional natural resources related stocks, such as PetroChina (857) and Jiangxi Copper (358 HK). Fast-forward to the present day, we believe that the above long themes remain sound. We are less certain on the short book though, especially after two consecutive years of massive decline in international commodity prices.

4. **Since the high point of 2013, the average Greater China hedge fund has seen difficult times. How would you highlight your experience in the markets since then – what went right and what went wrong?**

   The business environment in China grew more challenging than anticipated. For instance, the deterioration in the operating environment in the domestic consumption markets (such as the catering, food & beverage, supermarkets, department stores, fashion retailing etc.) came much faster and deeper than imagined. Incessant policy changes increased the haplessness of hedge fund managers investing in mainland China markets.

   One key lesson learnt was that one should not get tempted by the low valuations in the market, as the prices of those cheap stocks could keep falling. It is natural that every market will have ups and downs and we constantly bear in mind that, where there are challenges, there are opportunities.

5. **What is your average exposure across small, medium and large cap equity like? Do you target some optimal ratios for this or is it more a function of your opportunity set? In our previous interview back in early-2014, you had mentioned decreasing your exposure to small and mid-cap stocks since 2013 – what led to this change and how well has this worked for you?**

   For the past 24 months through April, the fund's average exposure to small caps is approximately 49%, and 30% for medium caps and 24% for large caps respectively. Our preference is 1/3 each in small, mid and large cap stocks, but ultimately it is dictated by the prevailing opportunities and market liquidity conditions.

   Market liquidity has deteriorated further for small & mid cap stocks trading on the Hong Kong Stock Exchange, although market liquidity risk has been less of a concern in the China A-shares and Taiwan markets. That said, we have not since 2013 further changed our market cap allocations, and this balanced approach should help us sail through this difficult market environment.

6. **What is your current exposure across Hong Kong and China listed companies, and how has it evolved since the inception of the fund? Again, are there any predetermined limits on your regional allocations? Does the fund still carry limited exposure to Japanese equity markets?**

   Ever since inception, the fund has been Hong Kong & China-centric. The main geographical focus of the fund has always been in stocks listed in Hong Kong, which has historically represented some 40% to 60% of our net exposure.

   Due to our value biased approach, we have not participated in the China A-share markets but we do have a strategic allocation of approximately 8% to 12% in China B-share markets.

   Outside of Hong Kong & China, we also own a few US, Taiwan and Japanese equities, but the majority of them have business exposures in China. For example, most of our US listed equities are China ADRs, and a lot of Taiwan listed equities have substantial business exposures in China.

   We remain interested in the Japanese equity market, given its breadth and depth, and China and Japan are two major trade partners in North Asia. That said, the fund will always comply with our mandate to maintaining a Greater China exposure of more than 50%.

7. **As a long/short equity fund focused on value-investing, what investment process does the VL Champion hedge fund employ? Could you take us through a typical transaction of the fund that will help illustrate your investment process?**

   We adopt both bottom-up and top-down approaches in initiating an investment idea but we rarely proceed further if the idea does not weigh up in the bottom-up assessment, as we believe it is the measure of management and asset qualities against the price paid that matters in determining the potential reward of an investment. A brief description of our investment process is as follows:

   Idea generation by all → Preliminary research and valuation model by analyst → evaluation by manager → in depth due diligence → recommendation → CIO to decide whether to put the stock in actionable list → constant review

   For example, last year we initiated an idea to invest in Transport International (62.HK). It was inspired by an attempt to seek out potential beneficiaries and sufferers after international oil price nose-dived. The natural conclusion would be that one should short those oil explorers such as PetroChina (857.HK) and CNOOC (883.HK) whilst, amongst the key beneficiaries, we preferred Transport International to the Chinese airlines as we had concerns over the forex exposures in their mountain-high debt loads.

   Turning to Transport International, we noted the introduction of a SHKP key management to head the bus company for the first time in its corporate history ever since SHKP took over majority control some two to three decades ago. There was another catalyst besides the fuel cost savings - the company owns a number of parcels of industrial lands with very good potentials to be re-developed into residential and commercial property. Those lands are currently booked at historical costs minus accumulative depreciations over a period of some 25 to 35 years! Having identified and satisfied ourselves with these positive factors, we knew we could proceed without hesitation to build a sizeable position in Transport International and confidently and patiently wait for its market price to rise above its intrinsic value.

8. **Greater China hedge funds posted their worst 3-month losses in August 2015 when Chinese equity markets went into free fall. How did you fund fare over this period and adapt to the steep drawdowns in the market? Could you shed some light on your experience from last year with reference to the short-side of your book?**

   During that three-month period, our fund experienced a drawdown of 22.96%, against a 26.93% drawdown in the MSCI China Index and 30.93% in the Hang Seng China Enterprises Index (HSCEI). During that period, we unloaded some high beta stocks and switched into companies with better earnings and cash flow visibility. At the same time we increased our exposures in HSCEI put options and index futures to hedge the market risks.

   On short side, we were bearish on the Hong Kong retail and Macau sectors given their rich valuation and high correlation to the PRC economy. Accordingly, we shorted landlord Wharf and jewelry retailer Chow Tai Fook as both of them suffered from a contraction in tourist spending. Chow Tai Fook was particularly vulnerable given its high operating leverage. We also shorted Wynn Macau (1128.HK), which is more exposed to the VIP market and therefore saw its revenue dive sharply amid the deteriorating economy and collapse of stock market. However, if we could have closed out more short side of our book during those three months, our performance in the subsequent months would have fared a lot better.

   Our team has sailed through the 9/11 attacks in 2001, SARS period in 2003, global financial crisis in 2008 and the European sovereign bond crisis in 2011. The market jittery during the three months ending August 2015 was not much different from the previous financial crises. The best strategy during such interesting times as those I mentioned is to keep calm and have the courage to bottom fish the long-term winners in the market.

9. **In our previous discussion, you had mentioned being optimistic about the prospects of the e-commerce and TMT sectors, and how you gained partial exposure to Alibaba via a long position in Softbank. Could you share with our readers an update on your sectoral level convictions and some of your stronger convictions given the concerns about the health of the Chinese economy?**

   Our conviction level of the e-commerce sector remains high. Although we have taken profit on our position in Softbank shortly after the IPO of Alibaba, we are gaining alternative exposure in Alibaba via our long position in Yahoo on the expectation that the company is undergoing certain exercises to unlock the hidden value of its underlying assets by way of divesting its non-Alibaba businesses. Meanwhile, VL China Fund, the long-only authorised fund launched in August 2015, has a direct investment in Alibaba. Alibaba is the unchallenged leader in one of the world's fastest growing e-commerce spaces, which should be a core holding in an investment portfolio and this is particularly the case for a China fund.

   Some of the weaknesses in the Chinese offline consumption were more or less a direct or indirect outcome of the upsurge in e-commerce demand. Alibaba reported more than 40% year-on-year sales growth in 1Q16, and we see no reason that this momentum is going to reverse its course any time soon.

However, the best time to invest in the healthcare industry, another sector that we have had rather high conviction, may be behind us. We have heard a lot of negative news on government intervention into the pricing of medicines in the governmental hospital channels.

10. **The average Greater China investing long/short equity hedge fund has seen relatively more volatile returns in comparison to its peers investing with a pan-Asia or global investment mandate. In this regard, how do you manage your risk and guard against drawdowns especially given the high beta of long/short equity hedge funds to underlying equity markets?**

Greater China hedge funds has in fact created a lot of alpha for their investors, with superior investment returns and a lower beta relative to the MSCI Greater China indices. For our fund, its weighted average beta against the Hang Seng Index during 2014-2015 was only 0.65. The greater China markets have had a very tough seven-year period in terms of generating equity investment returns, but right now China equity markets is probably the world's cheapest (with probably the exception of the smaller and mid cap China A shares). When investor interest is back, we shall do a lot better than other pan-Asia or global emerging market hedge funds.

China is the world's second largest economy with more than 1.3 billion population. Even in the toughest market environment there are still ample investment opportunities in the 'blue ocean' (such as the information technology industry). We remain confident that there are enough investment opportunities in the market.

11. **What sort of investors do you cater to with the VL Champion Hedge Fund? What should their risk appetite be and what time horizon must they have for their investments in order to achieve optimum returns? In this stead can you also share with us the rough breakdown of your investors, e.g. 40% high net worth individuals, 20% family offices, 20% funds of hedge funds.**

We treat our investors as our business partners. The fund is designed for those who have the vision for long-term capital growth instead of those favouring momentum-chasing. Many investors have invested in funds/investment portfolios that I have managed for them ever since early 2002. With a 14-year strong track record delivering multiple times of investment returns for them, our investors have high confidence in our ability to generate superior returns. The optimal investment period is probably throughout at least one stock market cycle (typically between three to seven years), which shall provide investors with enough information to tell if a portfolio manager is performing against the benchmark indices and his/her peers.

A typical investor in our fund invests in us for a period of no less than five years, and actually the majority of them have regarded our fund as part of their retirement benefit plan, and the most common reasons for an investor to (usually partially) redeem from our fund were to finance their expenses in child's education, retirement expenses and upgrading their living standard. As of April, 12% of the fund's investors was derived from the directors of the fund or staff of our company, 18% from family offices and 70% from high-net-worth individuals. Further, among our top 10 investors, they have, on average, entrusted our services for close to 10 years and the longest has a relationship with us for 14 years already.

12. **Lastly, what are your expectations regarding a recovery in the Chinese economy, and how well is your fund equipped to capitalise on these opportunities, especially in relation its equity long/short peers?**

For an economy that is still growing rather fast, and which may continue to grow at a pace of 4-6% per annum in the next decade, it seems that there is no lack of growth, but the key question is in the quality of growth. Our investments do not rely on a 'recovery' in the macro economy, as it will be unrealistic to expect China's GDP growth to reaccelerate any time soon. However, we do see that both over-capacity and over-competition are fading out in various industries with the Chinese sportswear industry as an example.

Choosing the right stock at the right price at the right time is the key to investment success. This is particularly the case in a market that the overall profitability growth has been sluggish. We have been doing particularly well in a sideway market, as we rely a lot more on our stock picking skills to generate investment returns, rather than the overall market performance. We try not to care too much about our peers' performance, as we understand that the biggest enemy of our performance is our own weaknesses. Having said that, we believe that we have the right investment team to make the right investments for our investors, and a superior investment return for our investors is the natural outcome of one's right efforts.

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