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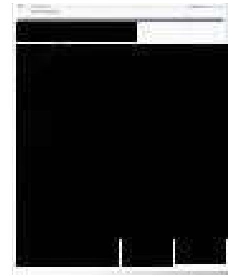
MediaTitle	The Edge		
Date	03 Sep 2018	Language	English
Circulation	25,785	Readership	77,355
Section	Corporate	Page No	14,16
ArticleSize	1222 cm²	Journalist	TONG KOOI ONG
PR Value	RM 63,120		



From sovereign wealth fund to sovereign catalytic investor

TONG'S VALUE INVESTING PORTFOLIOS

BY **TONG KOOI ONG**

Khazanah Nasional was formed in 1993 as a strategic investment fund of the government of Malaysia. Its stated objectives are to "hold-manage select commercial assets of the government, undertake strategic investments on behalf of the nation and play a catalytic role in driving various strategic industries and national initiatives, nurturing their development in pursuit of Malaysia's long-term economic interests".

In the aftermath of the Asian financial crisis, Khazanah took over some of the financially troubled assets deemed to be of national strategic interest. These include the Renong/UEM/PLUS and MAS/TRI/Celcom group of companies.

In 2004, the sovereign wealth fund (SWF) spearheaded the government-linked companies (GLC) transformation programme. The aim was to strengthen governance and transparency, imbue companies with professional management, improve performance and create greater shareholder values.

At the same time, Khazanah has also made new investments, domestic and overseas, in the innovation, technology, biotechnology and other sectors.

By most yardsticks, it has performed well.

One of the notable investments was in Chinese e-commerce giant Alibaba Group Holding prior to its IPO, where it subsequently realised substantial gains selling part of its holdings post-listing.

It successfully restructured and rehabilitated troubled assets back to health. Some such as Time Engineering, Proton, Crest Petroleum and Time dotCom have since been sold to the private sector. Malaysia Airlines is slated to return to profitability by early 2019.

Its portfolio net worth grew at a compound annual growth rate of 9.6% from 2004 to 2017, or more than triple over the period through both the organic growth of existing investments and capital appreciation.

As at end-2017, Khazanah had a realisable asset value totalling RM157.2 billion ($52.3 billion) and net worth of RM115.6 billion after adjusting for debts and other liabilities.

The SWF has come under the microscope of late, after the change in government. Subsequently, its entire board of directors resigned and a new board was formed, led by Prime Minister Mahathir Mohamad.

This followed a rash of public debates and criticisms over whether the fund had diverged from its intended objectives and, if so, what its direction should be, going forward.

First, although Khazanah is a government-owned investment fund — hence the name "sovereign wealth fund" — it is different from your typical SWF that is set up primarily to manage-invest a country's surplus oil revenue and/or foreign exchange reserves.

These are some of the world's largest SWFs — Norway's Government Pension Fund Global, Abu Dhabi Investment Authority, China Investment Corp, Kuwait Investment Authority, SAMA Foreign Holdings (Saudi Arabia), Hong Kong Exchange Fund and Government of Singapore Investment Corp.

Khazanah, on the other hand, raises most of its financing from borrowings. There is no constant inflow of fresh money from oil revenue or trade surplus and savings to invest.

Its current core holdings include stakes in GLCs such as Tenaga Nasional, CIMB Group Holdings, IHH Healthcare, Axiata Group, Telekom Malaysia, UEM Sunrise, Astro Malaysia Holdings and Malaysia Airports Holdings. Having successfully transformed and turned these companies around, is it now time to dispose of these mature assets back into private hands or funds such as the Employees Provident Fund and government-linked investment company Permodalan Nasional, entities whose fund size grows annually?

Governments should have a lighter hand in businesses, to avoid crowding out private investments and allow the private sector

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to compete more effectively for greatest

efficiency. Inevitably, government-owned companies have unfair advantages simply because of their shareholder.

It is the responsibility of the government to attract productive investments and create employment, especially those that generate higher wages.

This entails cultivating an environment

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Malaysian Portfolio

	QUANTITY	AVERAGE COST (RM)	COST OF INVESTMENT (RM)	CURRENT PRICE (RM)	CURRENT VALUE (RM)	GAIN / (LOSS) (RM)	GAIN / (LOSS) (%)
SHARES HELD:							
SCGM Bhd	11,066	1.74	19,273.7	1.40	15,492.4	(3,781.3)	(19.6%)
Ajinomoto (Malaysia) Bhd	1,500	11.81	17,720.0	21.32	31,980.0	14,260.0	80.5%
Panasonic Manufacturing Malaysia Bhd	600	28.64	17,182.0	40.00	24,000.0	6,818.0	39.7%
Kerjaya Prospek Group Bhd	11,000	1.02	11,225.0	1.44	15,840.0	4,615.0	41.1%
Y.S.P. Southeast Asia Holding Bhd	10,500	2.41	25,340.0	3.08	32,340.0	7,000.0	27.6%
Luxchem Corporation Bhd	16,500	0.72	11,825.0	0.66	10,890.0	(935.0)	(7.9%)
Formosa Prosonic Industries Bhd	18,000	1.54	27,720.0	1.40	25,200.0	(2,520.0)	(9.1%)
Hong Leong Industries Bhd	2,000	9.28	18,551.0	11.48	22,960.0	4,409.0	23.8%
Willowglen Msc Bhd	19,900	0.50	9,950.0	0.51	10,049.5	99.5	1.0%
Hock Seng Lee Bhd	14,500	1.52	22,040.0	1.38	20,010.0	(2,030.0)	(9.2%)
Malayan Banking Bhd	3,000	10.50	31,500.0	9.96	29,880.0	(1,620.0)	(5.1%)
Mah Sing Group Berhad	19,000	1.07	20,330.0	1.18	22,420.0	2,090.0	10.3%
Eco World Development Group Berhad	15,200	1.24	18,772.0	1.25	19,000.0	228.0	1.2%
TOTAL			**251,428.7**		**280,061.9**	**28,633.2**	**11.4%**
Total shares held			**251,428.7**		**280,061.9**	**28,633.2**	**11.4%**
Cash balance (as a % of portfolio)					45,697.1		14.0%
Realised profits / (losses)					97,125.8		
Change since last update Aug 23, 2018							
Portfolio							(1.9%)
FBM KLCI							0.5%
Portfolio returns since inception			**200,000.0**		**325,759.0**	**125,759.0**	**62.9%**
Portfolio returns (annualised)							**16.2%**
Portfolio Beta							**0.55**
Risk adjusted returns since inception							**115.0%**

PERFORMANCE COMPARISON	AT PORTFOLIO START	CURRENT	CHANGE	RELATIVE PORTFOLIO OUTPERFORMANCE
FBM KLCI	1,829.7	1,819.7	(0.6%)	63.4%
FBM EMAS	12,700.4	12,719.4	0.1%	62.7%

**Current price is as at August 30, 2018* **Portfolio started on Oct 10, 2014 with RM200,000.*

Global Portfolio

	QUANTITY	AVERAGE COST (US$)	COST OF INVESTMENT (US$)	CURRENT PRICE (US$)	CURRENT VALUE (US$)	GAIN / (LOSS) (US$)	GAIN / (LOSS) (%)
SHARES HELD							
Alibaba Group Holding	288	173.333	49,920.0	178.5	51,408.0	1,488.0	3.0%
Alphabet-Cl A	22	1100.832	24,218.3	1,264.7	27,822.3	3,604.0	14.9%
Amazon.com	16	1553.684	24,858.9	1,998.1	31,969.6	7,110.7	28.6%
Apple	120	215.785	25,894.2	223.0	26,757.6	863.4	3.3%
DIP Corp	2,900	25.794	74,802.0	23.6	68,406.5	(6,395.5)	(8.5%)
Facebook	70	173.986	12,179.0	175.9	12,313.0	134.0	1.1%
Nine Dragons Paper Holdings	33,000	1.498	49,423.8	1.2	38,299.8	(11,124.0)	(22.5%)
Shanghai Haohai Biological Technology Co	10,000	4.812	48,117.4	7.5	75,165.0	27,047.6	56.2%
Sunpower Group	190,000	0.397	75,488.3	0.4	77,858.2	2,369.9	3.1%
TOTAL			**384,902.0**		**410,000.0**	**25,098.0**	**6.5%**
SHARES BOUGHT							
Facebook	80	176.799	14,143.9	175.9	14,072.0	(71.9)	(0.5%)
Total shares held			**399,045.9**		**424,072.0**	**25,026.1**	**6.3%**
Cash balance					94,226.6		
Realised profits/(losses)					(6,727.5)		
Week's change							
Portfolio							1.02%
MSCI World Net Return USD							1.64%
Portfolio returns since inception			**500,000.0**		**518,298.6**	**18,298.6**	**3.7%**
Portfolio returns (annualised)							**5.2%**
Portfolio beta							**0.65**
Risk adjusted returns since inception							**5.6%**

PERFORMANCE COMPARISON	AT PORTFOLIO START	CURRENT	CHANGE	RELATIVE PORTFOLIO OUTPERFORMANCE
MSCI WORLD NET RETURN INDEX	5,927.2	6,258.7	5.6%	(1.9%)

Current price is as at August 30 or last close. Portfolio started on Dec 18, 2017 with US$500,000
All returns and stock prices are reflected in equivalent US dollar terms
Data sourced from Bloomberg

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Bursa trades sideways pending fresh catalyst

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that is conducive for businesses to grow and flourish. The factors for such an environment include political stability, an independent legal system and a transparent operating framework to minimise corruption, deregulation and open competition to reduce rent-seeking, tax incentives and treaties, strong infrastructure as well as the availability of both human (trained workforce) and capital resources.

Crucially, there is also the need for a far-sighted, strategic blueprint that will create long-term competitive advantages for the country in the global market. Such comparative advantages seldom happen by nature.

The Malaysian capital market is not fully developed. While the bond market is quite efficient, the equity market lacks breadth and depth. Foreign investors and exchange-traded funds focus only on companies with the largest capitalisation. As such, many listed small- to mid-cap stocks often do not get fair valuations. As a result, quality companies have been taken private and some have sought listings abroad.

Funding options are even more limited for innovation and start-ups as well as small and medium-sized enterprises (SMEs). We have few private equity and venture capital funds.

This is the area in which I believe Khazanah can truly bring about the greatest impact and value. It can bridge this funding gap as a sovereign catalytic fund and drive strategic industries and national initiatives.

After all, it already has private equity and venture capital operations, though investments thus far have been comparatively small. This could be very quickly scaled up, for example, with cash proceeds from liquidating its portfolio of mature assets-stocks.

As a catalytic fund, Khazanah can foster local entrepreneurship, providing capital to start-ups and supporting SMEs. Investments in overseas start-ups and companies can acquire and transfer technology and skillsets to help the country develop higher value-added manufacturing and high-tech industries.

Over time, these would add breadth and depth to the local equity market and feed a virtuous cycle — create new drivers of growth and attract further talent-investments — thereby resulting in more vibrant economic development.

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In fact, Khazanah as a catalytic strategic investor could be a model for other smaller, emerging countries — and even developed ones such as Singapore — where capital market development is still lagging.

Certainly, it will be a huge challenge and involves a mindset change — the shift from "safe" blue-chip companies such as Tenaga and CIMB, which generate a dividend stream and gradual capital appreciation, to risky start-ups and SMEs with little or no track record.

It requires highly capable people to analyse and identify successful investments. But Khazanah has the experience; it should be up to the task. Importantly, Malaysia needs someone in this catalytic role — to jump start businesses, industries and future growth areas. Economies are changing rapidly with continued advances, particularly in the areas of digital technology, biotechnology and artificial intelligence. We cannot afford to stand still on innovation, not if we want to build the Hartalega Holdings, QL Resources and Grab of tomorrow.

My Global Portfolio gained 1.02% in the past week, lifting total portfolio returns to 3.7% since inception. Emerging markets steadied on hopes of progress on trade talks and China's move to support its currency from a rapid slide. The portfolio is, however, still underperforming the MSCI World Net Return index, which is up 5.6% over the same period.

Meanwhile, stocks in my Malaysian Portfolio fell in the holiday-shortened week. This pared total portfolio returns to 62.9% since inception. Nonetheless, this portfolio continues to outperform the benchmark index, FBM KLCI, which is down 0.6%, by a long way.

I wish all Malaysians a very special 61 st Merdeka Day celebration, Sayangi Malaysiaku. E

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