Veteran Fund Manager Bent On Bull Markets Ahead

David Lee

05 November 2009

Perspective

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The recent stock market pullback may have dampened investors' sentiments about the pace of the global economic recovery but at least there is certain guy who boldly claims that a bull and a V-shaped recovery is definitely in the making, a view that runs counter to most analysts.

Presenting in a Media Conference held in conjunction with the 2009 i Capital Global Fund Gathering on 3rd Nov 2009, veteran fund manager Tan Teng Boo gave the audience a shot in the arm in the morning as he ran through the slides that depict a likeable bull market story that may have already unfolded itself.

Tan, who is the founder and managing director of boutique fund management firm Capital Dynamics, gave his presentation titled "Global Investment & Economic Outlook" in four parts – what he thinks was the de facto culprit behind last year's economic crisis, the solutions that the various governments in the world implemented and their

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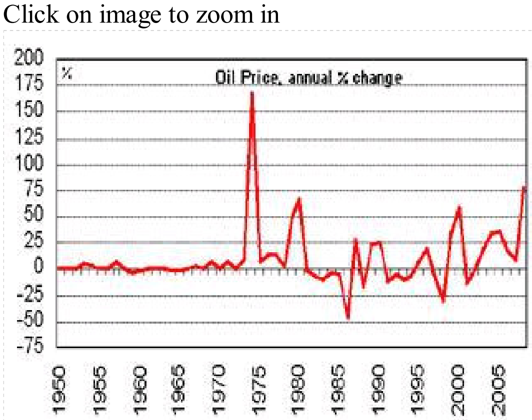

Chart A (courtesy of Capital Dynamics)

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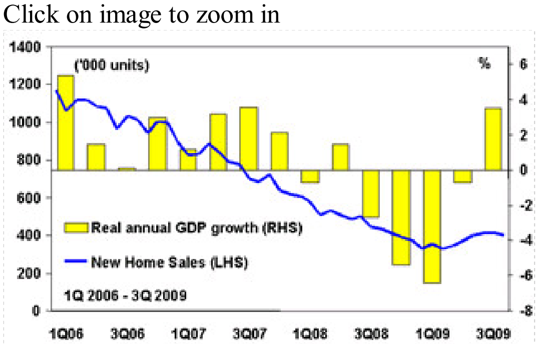

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resultant outcomes so far, as well as the future outlook on the global economy.

De Facto Culprit Of Last Year's Crisis

As opposed to general consensus that the most recent global recession was caused by the subprime mortgage problems, Tan argued that the world economy was already on the verge of breaking down even in the absence of Wall Street titan Lehman Brothers' bankruptcy.

For one, it was attributed to the price of oil – not for its sky-high valuation at that time but because of the manner it has surged over an extremely short period of time.

"If you look at the rate of change of oil price on an annual basis, you would realize that a global recession would be triggered off when the rate touches a certain level, explained Tan. "This was what happened in 1974, 1980, early 1990s, 2000 and in mid-2008, had oil price stayed at the US$140-US$150 level, the world economy would have sunk into a recession even without the Lehman panic. (refer to Chart A)"

Unlike the blame which condemned the subprime mortgage problems as the root of last year's financial crisis, the US housing industry had in fact already started its slump 3 years ago after peaking back in 2006. House prices and housing starts had virtually gone into a free fall since then. During that period, the US GDP was, however, still doing well and it started to contract only in 3Q08 (refer to Chart B).

So it was really the fear triggered by Lehman's fall that was the "mother of all triggers". The fear magnified massively when financial institutions throughout the world suddenly turned skeptical in all their lending activities and most normal business activities virtually came to a standstill as a result. The psychological impact also dealt a major blow to consumers.

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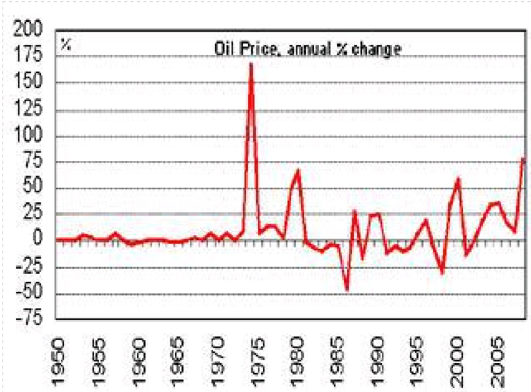

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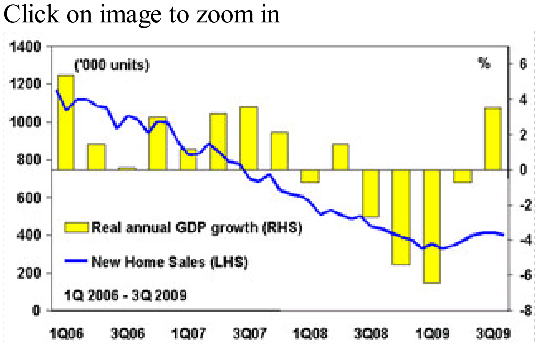

No Double Dip Or "New Normal"

Credits to the Great Depression scholar - the US Fed Chairman Ben Bernanke - for trying all sorts of unconventional policy wisdom collectively known as "quantitative easing" to save the "sickened the financial system", the credit market eased sooner than expected and markets have started to see "green shoots" sprouting since a few months ago.

Addressing the current fear of many economists regarding a double dip or "new normal" when the governments' bailout policies are eventually extracted and with consumer demand creeping back into the doldrums in recent months - i.e. US retail sales slowed in September and October after rising sharply in June and July this year, Tan once again challenged the wary undertone by forecasting that markets would continue to do well.

Back in early 2009 before the March rally,

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Tan had already been uniquely bullish over the economics and stock markets, a view that did not go down too well with most analysts then. However, he has now been proven right and has reaped handsomely from the rally. His fund, the i Capital Global Fund, has gained a whopping 63.9% in return over the Jan-Sep 2009 period.

Now, he is confident that final consumer demand will be healthier than what is generally forecasted and that US Consumer Price Index would swing back to positive by 2010. Another sign of stabilization is the US job losses figure which has subsided for the past few months after a sharp spike in the months following Lehman's fall.

Tan further illustrated that the all-important driver for US consumer spending is in fact disposable income instead of US housing prices. Past data has shown that the former has exhibited a much stronger correlation since the early 1940s in both real and nominal terms.

And to determine personal disposable income, the major factor lies in job losses caused by businesses. To boost personal disposable income, sources of economic growth are needed to preexist. And these could be found in the four types of investment - housing, commercial real estate, equipment and software, and inventories – that are already on the recovery path.

"What you need to pay attention in terms of recovery investment spending is not the 10% of people who are unemployed but the other 90% which are employed and their confidence levels," added Tan. "Government stimulus measures have done well in instituting a return in confidence and result in these people buying again."

So much for the fear of the exit strategies by the government, Tan also reminded us that the stimulus packages still have much to offer in 2010. For instance, China still has a 2010 component remaining in its stimulus package while in the case of the US, the 2010 component is even bigger than that in 2009.

Positive export contribution to US GDP and a weakening US dollar which would boost corporate earnings are also expected to reduce job losses and thus boost disposable income.

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Once-In-A-Millennium Catalyst For Economic Recovery

The future lies in the hands of China – no doubt about it, at least according to Tan. Describing the next era of global economic growth as the i Capital Long Boom, an eponym of Capital Dynamics' "i Capital" brand, Tan is extremely adamant that China will be at the "heart of things".

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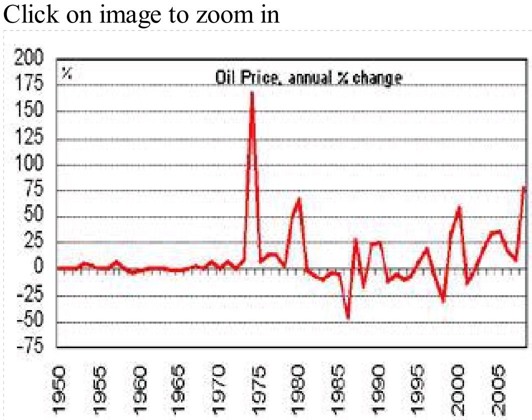

Chart A (courtesy of Capital Dynamics)

The i Capital Long Boom is a theory developed by Tan seven years ago where it postulated that a secular global economic boom has started years ago and is unfolding.

"Combined with two enablers, namely computer & Internet revolutions and globalisation, as well as a magnifier in the form of the "rest of the world", the global economic growth will, for the "first time in a millennium", be driven by China," highlighted Tan exaggeratedly to stress the significance of it.

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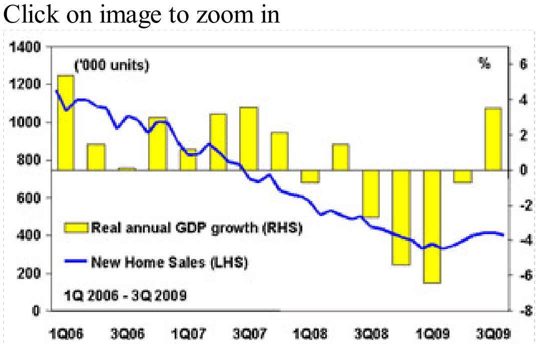

Dismissing the myth that the emerging economies, particularly Asia are

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"perpetually" tied to advanced economies, Tan showed that the global economy in fact decoupled way back in 1999-2000 (refer to Chart C). The emerging economies had long outgrown that of the advanced economies and China, especially, has never been coupled to the US economy before.

A case in point would be the total vehicle sales in China vis-à-vis the US. In the period 2001-2008, the declining US auto sales was more or less compensated by a steady rise in Chinese auto sales. In Jan-Sep this year, China has finally overtaken the US by approximately 2m units to become the largest car market in the world.

Other tell-tale indicators of a nascent global economic resurgence driven by China include its urban fixed asset investment rate which has already been hovering at around 25% since 2005, even before the Rmb4t stimulus packages was unveiled last year.

China's real retail sales, which reflects the country's own consumption, has been on an uptrend since 2001. Both the country's monthly manufacturing and non-manufacturing PMIs have also stayed in expansionary territories for most of the times except for the period from 4Q08 to 1Q09 when the global financial crisis first broke out.

A worrying sign, however, that is causing Chinese officials many sleepless nights is its bank lending figure which has catapulted to a dangerously high level. Tan warned that he expects to see some "announcements" after the 2010 Chinese New Year.

Thus, as China imports for its huge production and fast growing consumption, it has definitely created an impact on the rest of the world, resulting in a China-Led Economic Block termed CLEB.

In 2008, the nominal GDP of CLEB, which includes countries that benefit from China's consumption such as Australia, Vietnam, South Korea etc., has exceeded that of the US for the first time. CLEB's nominal GDP was US$16,677b compared to $14,441b of the US.

Tan added, "The best example was in energy consumption between OECD (Organisation For Economic Co-Operation And Development) and Non-OECD countries. For the very first time in modern economic history, the latter has overhauled the former in 2008. (refer to Chart E)"

The Next Leg Up

When asked on his views about the current stock market, Tan remains bullish and even hopeful of a whopping 30%-40% surge in the next leg up. He said that the stock market has already recovered from its Mar 09 low when the prices of equities were extremely cheap. Now it is onto the next recovery stage where the economy and corporate earnings are set to grow.

Tan also pointed out that with the rapidly transforming global economic structure, it is beneficial to watch the Shanghai stock market and not just the NYSE. Not because of fundamental reasons as the Shanghai stock market is still not open to foreigners and is rather illiquid, it is the sheer confidence that it can resonate throughout the global business community that makes it such an important barometer.

In summing up his presentation, he ended with a personal quote – "Bull markets are born in bear markets" – and thus urged the audience to take advantage of the next leg up.

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