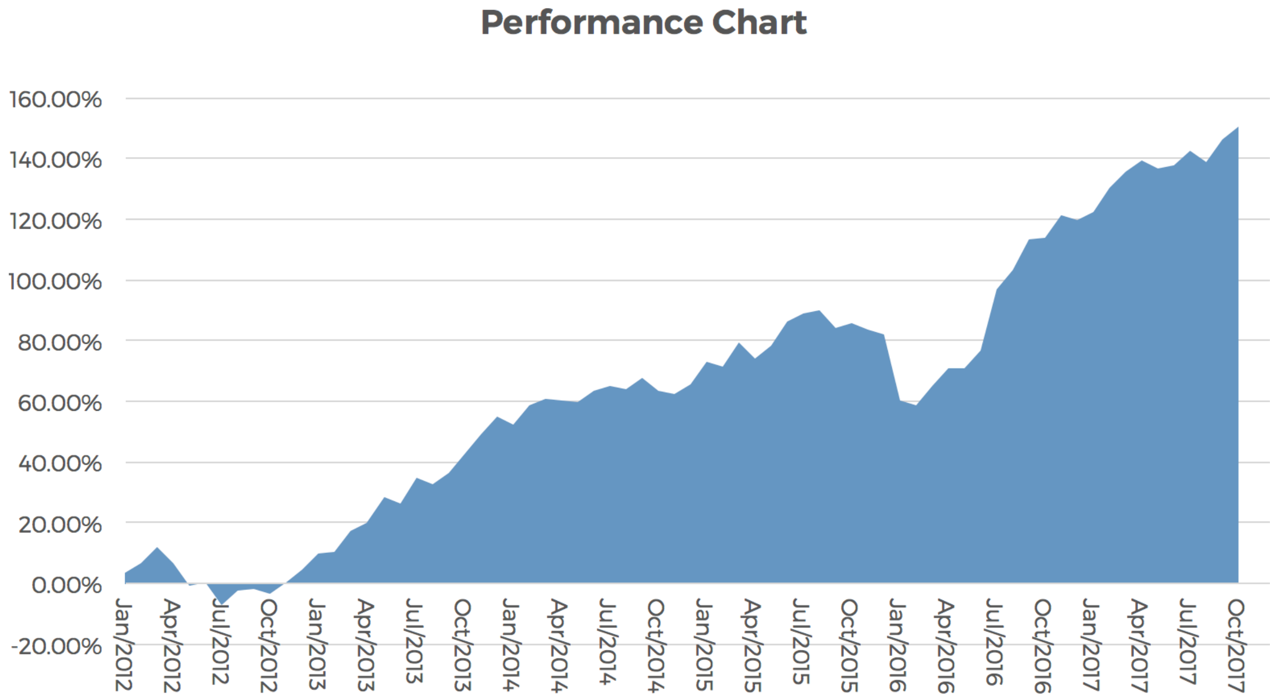
Reviewing the Market One Year On



Year	Returns
2012	+4.58%
2013	+47.98%
2014	+7.09%
2015	+9.91%
2016	+20.73%
YTD	+13.86%

Since inception in November 2016, the Heritage Global Capital Fund has returned **+17.01%.** Year to date (October 2017), the fund has returned **+13.86%**. The investment strategy has been built and refined over the years.

It was first implemented in January 2012 in a private investment vehicle prior to the fund's inception. Taking into account of both records, the fund's investment strategy has returned a cumulative +150.41%, or +17.04% net fees annually.

Market Review

When we first started the fund in 2016, the world was in a much darker place. Oil and commodity prices were plunging, fears of a hard China landing were abound, Britain had voted to leave the EU and the Singapore property market was in doldrums.

The stock market is akin to a pendulum, swinging either from optimism to pessimism and back again. The exuberance from the Chinese stock market bubble that had propelled the STI to its highest level in a decade in 2015 soon gave way to panic and fear in 2016.

Donald Trump's election in November of 2016 proved to be the turning point in the markets, with market sentiment swinging decisively towards optimism again.

This improvement in market sentiment has a very real effect on investment activity. Capital market activity has increased significantly, with the SGX forecasting more than 20 IPOS alone this year.

The property market which has been in doldrums since 2013 registered its first rise in over 4 years. As a result, property developers and conglomerates have benefited directly with a significant revaluing of their stock prices.

Carving Out Niches

The fund often looks at small to mid-sized companies within depressed industries. Many of these stocks are "fallen angels" – companies that once enjoyed widespread analyst coverage as the industry thrived.

Unfortunately, deteriorating business conditions led to many of these businesses entering prolong downturns. Analyst coverage of these companies had since evaporated.

The construction and engineering industry is one such sector which had until recently fallen on hard times. As the heady days of the construction boom led by both infrastructure spending and property construction boom ended (refer to "Up and Down Again - The Story of Singapore's Property Market**"** for more information), the industry fell on hard times with declining order books and significant overcapacity. Firms found it hard to secure orders, margins fell and financial positions deteriorated.

While all this may make for grim reading, it has always been our modus operandi to invest in sectors that have poor outlooks. The negative sentiment that pervades the sector translates to poor investor interest and consequentially, less competition and cheap valuations.

A case in point is **OKP Holdings** which had helpfully recorded its analyst coverage on the IR section of its website for the past few years. Sell-side coverage picked up dramatically as the company reported significantly better earnings in 2010. As the industry begun to slowdown, coverage turned increasingly spare and bearish. An ill-timed foray into property development and declining dividends landed the final blow and coverage ceased all together completely in 2014-2015 as the industry entered a prolonged down cycle.

Having an informational advantage is key to delivering out-performance. In this situation, the lack of coverage, the presence of retail shareholders who had seen the values of their shareholdings plummet dramatically were just some of the advantages we had.

Construction, like most industries are inherently cyclical. For a firm such as OKP that depended heavily on civil engineering projects, understanding how the government responded to the booms and busts of the economy was crucial in helping us understand the intrinsic earning power of the business over the long run.
When we first initiated a position in OKP, it was trading at 0.90x BV, a 24% discount to its historical average of 1.12x.

The company suffered a setback in July this year - where a worksite accident took the life of a worker and injured 10 others. This incident resulted in the Company losing 14% of its market capitalisation after the trading halt.

While public backlash was understandable; was OKP's safety record worse than the average contractor? More importantly, was the earning powers of the company permanently impaired?

Looking at Figure 1 below, it shows the Ministry of Manpower's record of Stop Work Orders (SWOs) issued over the past 10 years provides a telling clue of the demerit points of the companies in this industry.

Listco	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017 1H	Total F	Total P	Demerit pts
Tiong Seng	PP	P(JV)/P				PF	P			PF		2	7	55
Low Keng Huat		P	P		P			F		F		2	3	35
Soilbuild		P	P		P	P	P			F		1	5	35
Lian Beng	P					P	PP	P			P	0	6	30
Keong Hong		P		P			F		PP			1	4	30
Lum Chang	PP							P	F			1	3	25
Wee Hur	P		F							F		2	1	25
Tiong Aik	PP	P						P		P		0	5	25
Chip Eng Seng	PP		P			P						0	4	20
KSH	P						P		F			1	2	20
Sim Lian	PP											0	2	10
OKP	P								P*			0	2	10
Koon Holdings		P		P								0	2	10
Hor Kew	P				P							0	2	10
Koh Brothers			P		P	P(JV)						0	2	10
Hock Lian Seng								P				0	1	5
Total listco group	**15**	**7**	**5**	**2**	**4**	**6**	**6**	**5**	**5**	**6**	**1**	**10**	**51**	**355**
Total SWOs	**130**	**130**	**79**	**86**	**80**	**123**	**93**	**87**	**102**	**115**	**28**			

Figure 1: MOM's SWO (Source: MOM, StockResearchAsia

Careful analysis of OKP and its fellow SGX listed contractors' SWO records reveals a safety track record far better than its peers over the years up till its recent accident.

While the accident is truly an unfortunate incident, OKP is still a Company with solid fundamentals backed by a robust order book and strong net cash position. This combined with attractive valuations put it in good stead to benefit from increased government infrastructure spending over the next few years once the incident blows over.

Final Comments

Equity markets continue their advance, oblivious to a whole host of worries. High valuations, escalating geopolitical tensions and increased risk taking behaviour give us pause.

While valuations in our core markets continue to remain reasonable, we remain cautiously optimistic on the outlook in the coming months. As we end the first year of the fund's operations, we will like to express our gratitude to all investors for your support.