

WORKING HARD & SMART – INVESTING IN THE INFORMATION AGE

TALK GIVEN DURING THE INVESTSMART FEST (ISF)

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INTRODUCTION

First I would like to welcome all of you to this talk. Thank you for your interest and I hope you will find the talk stimulating and enlightening at the same time. Incidentally, the full transcript of this talk will be made available on our website, dynaquest.com.my.

As you would gather from the title of the talk; I shall be dealing with two main topics – Information and Investment. My talk will be divided into three parts, viz:-

1. **THE IMPORTANCE OF INFORMATION** In the business and investment world the ability to access and use correctly information can mean success or failure.
2. **THE CURRENT INVESTMENT SITUATION IN MALAYSIA** And what are the important investment principles to follow under this circumstance.
3. **ACCESSING FINANCIAL INFORMATION & USING IT FOR INVESTMENT** Bringing the two topics together. How would a diligent investor access and use information to become a successful investor? This is the “Working Hard & Smart” part.

Part 1: THE IMPORTANCE OF INFORMATION

(1) INFORMATION & MAKING PROFIT

Stock market investment is like trading. For every transaction, there is a buyer and a seller. Why does the seller want to sell: because he thinks the price he can get for his goods is higher than what he thinks it is worth. The buyer on the other hand, thinks that the goods is worth more than the price the seller is charging. Why should the buyer think that the goods are worth more than the seller is charging? It is because the buyer has certain information about the goods which the seller does not have and which makes the goods actually more valuable than the selling price. This principle has always been the basis on which trading is conducted since time immemorial.

Why, 50 years ago my own Father was able to buy coffee beans from Sumatra and sell it to merchants in Amsterdam and made a good profit. Why should his Sumatran supplier sell to him? Because the seller did not have any information on coffee merchants in Amsterdam (which is surprising if you consider Indonesia was a Dutch colony) and the best buyer he could find was my Father. As for the Dutch merchants in Amsterdam, they had no information on Sumatran coffee producers either and they were willing to pay the price my Father charged. Thus my Father was able to make a profit from the trade because he had the two crucial pieces of information which neither the seller nor the buyer had.

One of the most memorable quotations I have ever heard of is from Victor Fung, the Chairman Emeritus of Li & Fung, a company which we shall hear more of later in this talk. He said, apropos the founding of Li & Fung: "My Grandfather was able to make 20% profit just by being able to speak English". This was in late 19th Century Hong Kong when the Brits were just starting to establish themselves as merchant traders of the East. Victor Fung's Grandfather, by being able to speak English, was able to act as middleman between the local suppliers and the British buyers. The Brits did not know the local prices of the goods while the Chinese did not know the international prices of what they were selling.

The same principle applies to stock market investment. In every stock transaction, there is a buyer and a seller. The seller wants to sell because based on the information available to him; the current market price is a fair one. On the other hand, the buyer believes he has private information which will cause the price of this stock to rise in the future (for example, its dividend may increase in the future); thus he is willing to buy based on this information. It is also possible that the seller believes he has certain private information which may cause the price of this share to fall in the future (for example, the dividend may be cut); thus he wants to sell before this information becomes generally known. Thus the possession of information is the key to making profit from stock investment, just like in trading. However, obtaining access to the right information at the right time is not an easy task.

(2) THE NEW INFORMATION AGE – A GIGANTIC REVOLUTION

I think most of you would agree that during the present time the term “Information Technology” or “IT” is probably the most commonly used term in communication. Every other article or email talks about the IT industry or the IT Age. This may give the impression that information is peculiar to the current era. This cannot be further from the truth. Information has always been in existence. As noted earlier, my Father had relied on information for running his business. Marco Polo went to China and was much feted by Kublai Khan because he had information that the Khan wanted and could not get from anyone else. What has greatly changed is the nature of information. In the last 20 years or so, there had taken place two very big changes in the nature of information:-

1. The huge amount of information available at any one time and which is being generated continuously.
2. The “democratisation” of information such that anyone who has a computer or even smart phone can access to information which would not have been available to him a few decades ago.

Let us look at these two big changes which have led to what I call the New Information Age in more detail and how they have impact on the way modern businesses are being run.

- **THE AMOUNT OF AND THE EXPLOSIVE GROWTH IN INFORMATION**

When I first started learning about computers, a 10 MB disk drive (the so-called Winchester Drive) had to be delivered by a truck. Today, I can hold in my hand a disk drive which holds 1,000,000 times more information than one which weighed several hundred pounds. This huge increase in the capacity of storage devices has led to veritable atomic bomb-like explosion in the amount of information which can be accessed by the average person. For example, an investor on KLSE can access to every single announcement and publication ever produced by any one of the near 1,000 KLSE listed PLC’s through the KLSE website. The total amount of printed pages equivalent available on KLSE’s website must run into many millions. If one were to store the available information in hardcopy form, one would probably need a library the size of a football field (or more).

What does this huge explosion in the availability of information means for the average person? There is now so much information available that the average person is finding it increasingly difficult to obtain, understand and make use of the available information. Paradoxically, too much information is as bad as no information at all. Let us go back to the example of KLSE database. Suppose an average investor wants to read up on, understand and evaluate a PLC; he can download the latest annual report together with the other financial announcements and try to make sense of it. But because of regulatory requirements and what we may call the “peacock syndrome”, modern annual reports have become huge. The average IPO prospectus runs to about 500 pages and I have seen annual reports (in multiple sections) running to well over 1,000 pages. Just downloading it from the

KLSE website will take many minutes; reading it even most superficially will take several hours. Is that what the average investor wants to do or can do?

Obviously the answer is “NO”! The average investor would need help to make use of all this information. We shall come back to this matter later in the talk.

- THE “DEMOCRATISATION” OF INFORMATION

Although the amount of information available to the average person has increased hugely, the cost of obtaining the information has dropped steadily. In olden days, even if the information as such is free, the cost of printing the hardcopy and distributing the end product to the users can be quite high. Today, the cost of data storage and transmission has dropped to almost nothing. Because of the aforesaid cheapness of storage and the speed and low cost of data transmission, much of the information is now available for free. For a research house like Dynaquest, we now have free access to the huge data archive of KLSE for free. As with low cost airlines, now everyone can fly. With low cost data, now everyone can get hold of information. Information has become a truly democratic commodity. In the New Information Age, information has become an almost free commodity and everyone who has the interest and the gumption can get hold of any information he wants to lay his hands on. But as our PM likes to say: “Too much democracy can be a bad thing”.

- THE IMPACT OF DATA EXPLOSION AND LOW COST OF DATA ON BUSINESS

The New Information Age I have described affects almost every industry, some more than others. The investment business is no exception. The change is so great that the average investor has to adopt a new approach to their investment. But before we go to that subject; let us analyse an example of how the dawn of the New Information Age has almost destroyed the business model of a much-admired company. On the other hand, a new start-up has been able to create a new business by making full use of the changes brought about by the New Information Age. Let us go back to Victor Fung and his company, Li & Fung. Interestingly enough, I first crossed paths with Victor Fung 42 years ago at Harvard where I was a student and he was a professor of finance. We were to cross paths again more recently with rather sadder outcome.

Even just 10 years ago, Li & Fung was one of the most admired Hong Kong companies. Li & Fung is engaged in what is now known as Supply Chain Management business. Ten years ago, if a departmental store wanted to buy, say, 1,000 shirts in mixed patterns and colours; it would probably go to Li & Fung. Li & Fung would be able to source all the materials required in the mix of colours and weaves that the departmental store needed and contract with shirt makers in China to produce the shirts and then have the shirts packed and organised the transportation to have them delivered to its destination, say, Fifth Avenue, New York. Li & Fung could do this faster and more cheaply than anyone else because of its enormous private database and relationships built up over many decades of operations. It was in close contact with many thousands of suppliers, shipping companies and buyers all

over the world. And because of its size, it could obtain huge economies of scale. It made only a small profit margin, 3% or 4% nett, but because of its dominance, its total profit was enormous.

However, from five years ago, its business environment started to change. It has become increasingly cheap and simple for companies to set up their own website. With the power of Internet, the information on a company's website can be accessed by anyone in the world, including all its potential customers. Li & Fung failed to think through the implication of this revolution probably because it looked at the hugely exploding number of websites and thought that it would be too difficult for a buyer to identify the optimal suppliers out of the many thousands available on the Internet. This would have been correct but for the emergence of a major disruptor – Alibaba. Alibaba provides the platform on which the suppliers can list their goods on a fairly standardised format. The buyers can quickly scroll through the website for the suppliers of the type of goods he is looking for. Instead of going to hundreds of websites, the buyer can just go to Alibaba. Once he has identified a suitable supplier (according to capability, size, delivery time etc); he can directly contact the supplier for his own specific needs. Designs, colours and all the other specifications can now be transmitted digitally and the whole transaction can be carried out without the need for a middleman – i.e. Li & Fung.

Not surprisingly the business of Li & Fung has fallen on very hard time. A company whose founder could make 20% profit just by being able to speak English has seen its nett margin fallen to 1.3% in 2016. Not surprisingly, its stock price has collapsed (please see Exhibit 1). On the other hand, the stock price of Alibaba has soared since its listing (Exhibit 2).

This is a very important lesson for all of us who use the Internet. Just because one can access information, it does not mean that it is feasible to make full use of the information available. One still needs a middleman, much like traders of the old. In the case of investment information, given the huge amount of data available, there has to be some sort of platform (like Alibaba), which processes, summarises and presents the data in a standardised format for easy sorting and comparison. Only then can the information be useful to an average investor. We shall introduce such a platform at the end of this talk.

Part 2: THE CURRENT INVESTMENT SITUATION IN MALAYSIA

(1) HOW HAS KLSE CHANGED IN THE LAST 20 YEARS?

When old people (like myself) get together and talk, they like to talk about the “old days”. When they talk to the younger people, it is likely that they would say how tough life was when they were young and that “you young people” have such an easy time – something along the line that “I had to walk five miles in my bare feet to go to school and you lot go there in your chauffeur driven cars!” Although I can claim to be an old man; I shall make no such statement. In fact, I am going to say that as far as investing in Malaysia is concerned, the “old days” were much better days. The older I get, the tougher it seems to be to make good return from the Malaysian stock market. And I am pretty sure it is not due to early onset of senility. To prove my point, let me first show you a long term chart of KLSE CI from 1995 to the present (Exhibit 3).

First let me explain that this chart is drawn using what is known as “semi-log” scale. In this type of chart, the vertical scale is based on the natural logarithm of the numerical value. It does not matter you do not know what this exactly means. Let me just explain that in this chart the vertical scale is based on percentage rather than numerical values. Why is this important? It is important to use a semi-log chart for the long term analysis of an index because the impact of a 100 point increase in the index is totally different whether the value of the index is at 100 or 1,000. When the index is at 100, a 100 point rise means a doubling in the value of the index but when the index is at 1,000, a 100 rise means a 10% increase which is much less significant. Let use the CI as an illustrative example. At the bottom of the 1998 bear market, the CI was below 300. A 1,200 point rise would mean a five-fold increase in the value of the CI. But from the bottom of the 2008 bear market when the CI was at around 800, a 1,200 point rise would mean only two and half fold increase. With this explanation in mind, let us now look at Exhibit 3.

You can see that over the last 22 years, the CI has undergone two major up-cycles – from 1998 to 2008 and from 2009 to 2014. First, the magnitude of movement was much greater in the first up-cycle. The CI moved from 263 to 1,516 (both closing value), a rise of 1,353 points or 476%. In the second rise, the CI rose from 843 to 1883 or 123%. You can see the big difference in the magnitude of the rise from Exhibit 1. The rise post-2008 was much smaller and shorter than the post-1998 rise (about 25%) from the semi-log chart.

So if you have been lucky or wise enough to invest near the 1998 bottom; you would have made a lot of money. Just to take one example, at its lowest point, Public Bank was selling at RM0.80 (adjusted for subsequent bonus issues). Over the next nine years, its price would have increased about 12 times. But in the second case, you would not have made so much. Again using Public Bank as an example, PBB was selling at RM6.88 at worst. Up to the present time you would have seen the value of your investment improved by about three times.

Not only has the growth rate of the CI tapered off a lot in the last two cycles, the length of the cycle has also shortened. The first up-cycle last nearly 10 years but the second lasted only 5 years. So your opportunity for riding a long up-cycle has been much reduced. It is

important to note that up till the time this talk is being written (late September), the CI is still more than 100 points below its 2014 peak.

There has taken place yet another significant change in the behaviour of KLSE in the last 20 years. The volatility of the stock market has fallen very sharply. You can see this clearly from Exhibit 3. In the first upcycle, the CI moved up and down with great vigour many times but since 2011, the CI has been remarkably flat. Why is high volatility important? As you know, the basic idea of investment is: "Buy Low Sell High". High volatility provides opportunities for you to enter at lower low and to exit at higher high. If the market is completely flat, you can only make gain from the organic growth of the stocks.

Taking into consideration the above three changes which have taken place over the last 20 years; the local investment game has changed greatly. I have to admit that it is now much more difficult to make high return from KLSE than before because the playing field has become much more difficult to play on. Unfortunately, over and above the much more difficult investment environment; the valuation of the stocks has also become less conducive.

(2) VALUATION OF KLSE STOCKS HAS BECOME RICHER

It matters less whether the investment environment has become difficult or not if the valuation of stocks is low. For example if one can buy a number of stocks yielding 8% per annum; it is not very important if the market does not rise much or there are few opportunities to trade because a straight 8% pa return is very satisfactory for most investors. This unfortunately has not been the case for KLSE for about 10 years. Let us look at the two common valuation methods used by the typical investor – Price Earnings Ratio (PER) and Dividend Yield (DY). Exhibit 4 shows the "MEDIAN" PER and DY for the 500 stocks in Dynaquest database for the last 21 years. Median is a type of average. If one says that the median PER of Malaysian stocks is 16: it means that half of the stocks in Malaysia would have PER of above 16 and half of the stocks would have PER of below 16. Similarly if one says that the median DY of Singapore stocks is 3.5%, it means that half the stocks in Singapore would have DY of above 3.5% and half would have DY of below 3.5%.

There are two important points I want to make about valuation of KLSE stocks. First, as you can see from the charts, the median PER of the 500 KLSE stocks in Dynaquest's database has become progressively higher and is currently above 16. Similarly the DY of the same 500 stocks has become progressively lower and is now 2.8%. During the trough of the market in 2008, the median DY was as high as 5.0% and some stocks were giving yield of 8% or higher. As late as 2012 the median DY was still 3.5%. It is therefore harder and harder to find good value stocks.

As an example of how much more difficult it is to obtain good return from KLSE in recent years; we can take a quick look at the investment return history for Dynaquest. Dynaquest is 37 years old this year. Its average compounded annual rate of return of its investment since its inception is 15.6%. But over the last five years, the average compounded rate of return

has fallen to only 10.8%. I think for the next 5 or 10 years, if I can get 8% pa return from KLSE, I would be very satisfied.

Given that the investment environment is tougher and that stock valuation is higher, this is where the “working hard & smart” comes in. I strongly believe that in order to make a decent return from KLSE from now on, one must be prepared to work harder and smarter than before. I am recommending an investment approach which is both conservative and practical for the average investor. Those of you who have read my book would remember that I introduced the concept of “Loser’s Game” strategy to use in investment. In brief, the “game” of investment can be likened to the game of tennis. If you are a good player, you adopt the “winner’s game” strategy whereby you win by beating your opponent. This means adopting aggressive and powerful strokes which the opponent cannot return. But if you are an amateur, the best chance of winning is adopting a “loser’s game” strategy. This means be extremely defensive and let your opponent beat himself by making unforced errors.

Given the difficult market condition and the existence of many market professionals; the average investor would have to adopt a loser’s game strategy in order to have any hope of getting a decent return from his investment. The next section of my talk will introduce you to certain important investment methods to adopt.

(3) INVESTMENT TACTICS TO ADOPT UNDER CURRENT CIRCUMSTANCE

In my interview with The Edge published earlier this year, I laid down SEVEN important INVESTMENT TACTICS for the readers to follow. These are designed to be used by the average investor adopting the loser’s game approach. We do not have the time to go over all seven of them here. Let us just concentrate on three of them. Let me go through them briefly here and then I shall expand the most important of these principles in the last section of my talk.

- **BUY PROGRESSIVELY**

I recommend a “Dollar Averaging” strategy by buying progressively over a period of time or even continuously. Few people are good at market timing. Even Warren Buffet says that he wishes the trading in the share he has just purchased would stop for the next two years. The principle he is trying to put across is that investment is a long term game; one should not worry too much about short term price movements. If one buys shares progressively, you would get them at an average cost. As stock market usually grows over time, the average price of your shares should be higher than their average cost.

- **DIVERSIFY**

Do not concentrate your portfolio in a small number of stocks unless you are as good as Warren Buffet in stock picking. We all make mistakes when choosing stocks to buy. If I can be 70% correct in my stock picks, I would be very happy. There are two important reasons for suggesting this approach. First, by having a substantial number of stocks (the financial economist’s recommendation would be at least 30); the loss on a single stock would be well spread out. For the sake of argument, let us say that in the worst case scenario, one of your

stocks may lose 100% of its value (very unlikely), the overall impact on your portfolio of 30 stocks would be just 3.33%. Second, by spreading your net wide, you may occasionally snare a high return stock. You must remember that the maximum loss on a single stock is 100% of your original investment but the maximum gain on a stock is theoretically infinite. By owning shares for the long term, I have had a number of stocks which have returned more than 10 times my original investment. Even if one stock out of 30 provides a 1000% return while the other 29 provides, say, zero return: the total return on the whole portfolio would be 33% (example adopted from one used by Peter Lynch).

I am reminded of this principle in a recent incidence. I help a religious organisation to invest their funds on a pro bono basis. Recently, a kind old lady passed away and left it her complete portfolio accumulated over her lifetime as a saver. I took a look at the portfolio and the most striking fact is that even though the portfolio has nearly 30 stocks, one single stock provides about 80% of its value. She was not a particularly skilled investor and many of her selection were poor but a single good choice had provided the bulk of the return for her savings over more than 30 years. I think you can probably guess which stock that is (it is Public Bank). One cannot marry 30 wives to ensure that one has the perfect spouse but you can buy 30 stocks with little difficulty. There is a good chance that some of them will turn out well and their impact on the portfolio value would be a lot more than the impact from a number of poor selections.

- ADOPT A CONSERVATIVE STOCK VALUATION APPROACH

There are a number of commonly practised investment methods – e.g. Price/Earnings (PER), Price/Cashflow (P/CF), Enterprise Value/EBITDA (EV/EBITDA) etc. Unfortunately, apart from the Dividend Yield (DY) method, all of these other methods are quite difficult to apply for a non-expert investor. Although the DY method is not perfect, it is a lot easier to use than the others. I am hence concentrating on the DY approach to stock valuation today. Perhaps if there is another opportunity, I can discuss these other methods.

When my first book came out more than 30 years ago; I strongly recommended the DY approach. I was literally laughed off the street by investors and pundits alike. I was called “an idiot” or worse. I am very pleased to say that 30 years later, Malaysian investors and PLC’s have moved a long way towards my original position. Most PLC’s now pay a great deal of attention to their dividend policy and try to pay out a consistent amount of dividend every year. At the same time, many investors have also come to the realisation that dividend return is an important part of stock return and they now pay an increasing amount of attention to high dividend paying stocks.

As with all investment methods, it is relatively simple to define but not that simple to apply. Today I shall introduce what is known as the Gordon’s method. The basic principle behind this method was thought of as early as in the Nineteen Twenties but it was only later that it was formally defined by Myron Gordon and other financial economists. Briefly put, the Gordon model can be described as follows (top part of Exhibit 5).

TOTAL RETURN ON STOCK INVESTMENT =
DIVIDEND YIELD + PRICE GROWTH.

(Definition: Dividend Yield (DY) = Dividend Per Share/Price Per Share)

This model explains that the return we can expect to obtain from a stock over the long run is dependent on the amount of dividend it pays out and the gain in its price. I would like to bring to your attention to the most important concept which is embodied in this simple equation. Stock return is made up of two components – Dividend Yield and Price Growth. Both are equally important. However, many investors forget this fact and this forgetfulness can lead serious investment errors. We shall return to this important issue later in my talk. Let us briefly look at what determines the amount of dividend a stock pays out and price growth of a stock.

The amount of dividend a company pays out is determined by many factors – the need for re-investing in its business, the amount of cash inflow, its dividend policy and its financial strength. Generally speaking, under the same dividend policy scenario, the stronger is a company financially and the lesser is the need for re-investment, the greater would be its ability to pay out dividend. On the other hand a company which has high re-investment requirement and which is less strong financially, would not be able to pay out a high dividend. In general therefore, if we are looking for high dividend payment, we should go for companies in the first category.

What determines the gain in stock price? Two factors are the major determinants of the change in stock price.

GROWTH IN DIVIDEND AND/OR EARNINGS PER SHARE As I shall be able to show you later in this talk, the rise in stock prices over the long run is strongly determined by the growth in its dividend and/or earnings per share. The faster is the growth rate of a stock's DPS and/or EPS, the faster would be the growth in its stock price. Why is this so? For example, let us consider a share which is currently selling, say, at a DY of 4% (or PER of, say, 10 times). If its dividend or earnings were to double and there is no change in its price, its DY would rise to 8% and its PER falls to 5 times. This surely would make the share very attractive to investors and they would rush to buy the share, hence raising its price to reflect a more normal valuation.

CHANGE IN ITS VALUATION The only certainty about the stock market is its variability. As I shall show you later: over a year or five years, the valuation of a stock (even a very stable one) is not constant. Its DY or PER would vary from time to time even if its DPS or EPS remain constant. If you are confident that a stock is a good long term performer; temporary fall in its valuation would present a buying opportunity. On the other hand temporary higher than normal valuation would present a selling (or at least no buying) opportunity. There is occasionally another cause of valuation fluctuation. Occasionally even a well managed company can trip up and suffer a sharp fall in its earnings. If the company is basically sound

and the earnings decline is only temporary, such an occurrence would present a buying opportunity. (We call this the “fallen angel” situation).

However, it is important to take note that in normal circumstance, in order to generate fast growth, a company would need to re-invest heavily, the amount of spare cash which can be paid out would be small. There is hence a balance here – a fast growing company is unlikely to be able to pay out a great deal of dividend. On the other a slow- or non-growing company will be able to pay out more dividend (if the company so desires). Therefore, a company which pays its shareholders low dividend would have to compensate its shareholders by growing its share price more quickly and vice versa. One would not want to get involved in a company which neither pays out good dividend nor grows fast.

To summarise the basic principle behind the DY approach to stock investment is that we should seek stocks which will provide us with the highest combination of both DY and Growth. Let us now consider an investment target of 8% pa that we may regard as a satisfactory return. How can an investor obtain 8% pa of return? The lower part of Exhibit 5 shows three different scenarios from each an investor may achieve the same return target. Three different shares with different growth rates but all provide the same rate of return by paying out different amounts of dividend.

An investor therefore has to be mindful of the expected future growth rate of a company. If a company has very low or negative growth rate, its dividend would have to be very high otherwise the investor would not get a decent return. At the same time, an investor has to be mindful of the fact that just because a company currently has high growth rate (say, in the teens), it does not mean he should ignore dividend totally. High growth rate is seldom sustainable for many years and high growth companies are also likely to be less predictable. We shall come back to this important issue later in this talk.

Part 3: ACCESSING FINANCIAL INFORMATION & USING IT FOR INVESTMENT

IMPORTANT REMARKS BEFORE I START ON THIS PART OF MY TALK It is important for me make a couple of remarks regarding this part of my talk, viz:-

- ❖ *First, I am putting the cart before the horse here. Logic would suggest that I should talk first about the investment platform that I would suggest you use. But for reason which will be explained later, I shall only talk about the platform right at the end of my talk.*
- ❖ *In this section of my talk I shall make frequent references to stocks. It is very important for me to say clearly that those stocks I shall mention are only used as case examples; they are not meant to encourage or discourage you to buy any of the stock in particular. Nor are they meant to be commentaries on good management or otherwise of the companies concerned.*

(1) ACCESSING INFORMATION FROM AN INVESTMENT PLATFORM

- PROOF THAT PRICE GROWTH IS STRONGLY RELATED TO DIVIDEND IN THE LONG TERM

Let me first show you a few examples of the close relationship between improvement in stock price and the growth of its dividend/earnings. The first pair of comparison consists of the local operation of two very well known multi-national companies. They are both financially very strong and I do not doubt that they are both well managed. The two companies are:-

- British American Tobacco Bhd, and
- Carlsberg Brewery Malaysia Bhd

Let us look at Exhibit 6A, starting BAT. The first column is the year and that is self-explanatory. The second column provides the annual adjusted Mid Range Price. This is the average of the high and low prices reached by a stock for the year adjusted for subsequent capitalisation issues. As you can see, the price of BAT has changed very little over the last 10 years (from RM41.50 to RM46.79); providing an average gain of only 0.62% pa over 10 years (data provided at the bottom of the column). What is the likely cause of this price performance? We can now turn to Columns (3) & (4) of the chart which provide the annual adjusted Dividend Per Share (DPS) and Earnings Per Share (EPS). Again we can look at the data at the bottom of these two columns. We can see that its DPS had lost on the average 1.65% pa over 10 years up to 2016, and its EPS lost 0.64% pa. The performance of its stock price (+0.62% pa) is not very different from the performance of its DPS and EPS (respectively -1.65% and -0.64%).

Its price performance over the last 5 years is even worse – a loss of 3.83% pa. Again, we can match the loss its price with the loss of its DPS and EPS -- -3.83% pa versus respectively: -3.12% and -1.27%.

What about Carlsberg? Over 10 years, the price of Carlsberg has gained on average 11.64% pa while its DPS and EPS have gained on average 9.75% and 9.08%. Over 5 years, the respective figures are +6.19%, +11.58% and +4.29%. Again, we can see the close relationship between price growth and EPS/DPS growth.

Had you bought BAT in 2006 and held it till 2016, you have gained only roughly 6% pa (annual dividend yield + price growth) over this period. Had you bought Carlsberg, your gain would have been roughly 16% pa. Incidentally, from these two sets of data we can see that the price of the stock is better correlated with its DPS and EPS.

If you are still not convinced of the importance of DPS (and EPS), let us turn to another pair of companies. This time I am choosing the examples from amongst the locally owned and managed companies. Again, they are both financially strong, of good reputation and I do not doubt that they are both well managed. The two companies are:-

- Paramount Corporation Bhd, and
- YTL Land & Development Bhd.

Let us now turn to Exhibit 6B which is constructed exactly the same way as Exhibit 6A.

Before we start analysing the figures, I must confess that the property sector is a confusing and difficult sector to analyse because of the nature of the industry (cyclical and geographically very diverse). As the result, the correlation between stock price and DPS/EPS is less perfect. Even so, we can learn from this set of data.

We shall start with the four columns of data on the left which are concerned with Paramount. For Paramount, the 5 and 10 years growth in its stock price are respectively +1.40% pa & +7.64% pa. As for DPS and EPS, they have changed be respectively +2.37%* pa & +8.23% pa (DPS) and -2.90% pa and -0.04% pa (EPS). From this comparison, it would seem that over 5 years, Paramount's price had closely tracked the change in DPS.

*(*Paramount paid out a very big dividend in 2011 of 20.1 sen. As this was a one time event, I use the 2012 dividend for the basis of computing the DPS growth rate over 4 years)*

For YTL Land, the 5 and 10 years changes in its stock price are respectively -10.96% pa & -9.22% pa. Because YTL Land has not paid any dividend for many years, there is no data on the growth rate of DPS. EPS has changed by respectively -11.17% pa and -21.09% pa. The correlation between price and EPS changes over 10 years is less exact. This is understandable because there are probably some investors who believe that YTL Land is a fallen angel and that its fortunes may recover soon.

Had you bought YTL Land in 2006 and held it till 2016, you would have lost 21% pa (no dividend + price loss) over this period. Had you bought Paramount, your gain would have been roughly 12% pa (average annual dividend yield + price growth).

Although the correlation between price changes in DPS/EPS changes with the second pair of companies is less good than the previous pair, the evidence is still very clear. I hope I have

managed to persuade you, by a little at least, of the importance of adopting Gordon's method.

- **SCREENING FOR THE RIGHT COMPANIES**

Earlier in this talk, I have mentioned the "atomic bomb-like explosion of information". For the average investor, it would be extremely difficult for him to sort through this mountain of data (which is also increasing by huge amounts every day) and use it to help him in his investment. As with a buyer confronting with thousands of suppliers for the product he needs, an investor need a "Data Concentrator" or an investment platform which will supply him with the processed, summarised and readily accessible form. There are investment platforms in most big stock markets of the world to help investor and Malaysia is no exception. All investment platforms have roughly similar design. In the first place they will provide the user with a "Screening Device" to select a number of stocks according to certain selection criteria (e.g. High DY or low PER). I provide as an example printed on Exhibit 7 such a screening device.

As you can see, this "screener" allows the user to sort out all the stocks in the database according to certain selection criteria. This particular user has chosen Prospective DY as the selection criterion (sorting by multiple criteria is also possible) and the screener lists out all the stocks in the database according to their Prospective DY (from high to low). At the same time as listing the stocks in accordance with the chosen criterion (criteria), the screener also provides the user with certain other data to help him to do a preliminary investigation (stock price, Current DY, Current PER, Prospective PER, Company Rating, etc, etc).

Once the user has identified a certain number of stocks he would like to investigate further, the platform would allow him to access more data on each stock. Let us say this particular user has looked at the data on the screener and concludes that FIMA Corp is worth investigating further, he can then access more information on FIMA. In the first place, he may like to take a look at the summary financial statistics – shown here as Exhibit 8. As you can see, this page from the platform provides 33 pieces of data (30 shown on this exhibit) on FIMA Corp.

This is not the end of the road as far as information on the listed companies is concerned. This particular platform can provide more information in the form of a very comprehensive report on the PLC. We do not have the time to navigate and look at every feature of this report. In the next section of the talk, I shall briefly discuss some of the important data you may want to look at before choosing a stock for investment.

(2) USING INFORMATION FROM AN INVESTMENT PLATFORM

- **LOOKING AT PAST TRACK RECORDS**

The Chinese has a saying: "Only if the road is long would we know the stamina of the horse". The same principle very much applies to PLC's. As far back as the 1920's, Benjamin Graham had recommended that an investor should look at the past 10 years at least to determine the quality of the management of a company. Although it is true that

occasionally a poorly performing company can some times turnaround or as the Cantonese would say: “Ham yee fan sang” (“Salt fish coming back to life”). This is relatively rare. Besides, there are so many poorly performing companies on KLSE, it would be difficult to determine which would turnaround.

This is not to say that a good company will always provide good results. Poor economic environment, cyclical factors, bad luck and unexpected events can cause even good companies to have a poor year or two. Sometimes, the poor business environment can be permanent. It is therefore important to determine whether a company’s current poor performance is temporary or permanent. Let us go back to Exhibit 6A. Look at the DPS and EPS track record of BAT. BAT operates in a very difficult environment. Even so, its DPS and EPS both only fall slowly. But during the past 10 years, buying it would not have constituted a good investment because its price has been very high. If we apply Gordon’s Model here and accept that there will be no price growth for BAT and that all the return will be from dividend, then it can still be worth investing, if the price is right. If the price more accurately reflects its DPS/EPS trend and provides a high DY (say, 8% pa), it may still be a decent investment. But currently its DY is only about 5%.

Let us now look at Carlsberg which can be said to be a company which has excellent track record. It has managed to deliver a very steady stream of EPS over the last 10 years. It missed paying out high dividend for a couple of years (2009/10) because it needed the funds for re-investment but its DPS stream rapidly returned to normal. If your chosen companies have similar track record as Carlsberg; I would say that they could probably be trusted to deliver good performance over the long term.

Earlier it is mentioned that even good company can have bad years. The important thing for an investor to uncover is whether such poor performance is due to a unique factor which will not recur or is the poor year the start of a long term decline. In the former case, if the management quality is good, such temporary hiccup can be overcome and the company will continue to do well in the future and it would be worthwhile to invest in it. Let us look at some examples of dividend/earnings declines in Exhibit 9. I show in Exhibit 9 the DPS/EPS track record for three companies – AEON, Magnum and KLK. All three companies have suffered falling earnings in 2015 and even subsequently. AEON has been affected by the rise of e-commerce (a bit like Li & Fung), surplus shopping space and weak consumer sentiment; Magnum has been affected by the rise of Internet based gambling and illegal gambling operations while KLK has suffered falling earnings in 2015 due to the impact of the El Nino weather phenomenon.

In the next section, we shall discuss how to combine historical information with our investment knowledge to look forward; using these three companies as examples.

- LOOKING TO THE FUTURE

Buying shares for investment requires an investor to look forward because the future is not necessarily the same as the past. If one concentrates on shares with excellent track records which we do not expect to change much in the future, the work is relatively straightforward. For these stocks, the problem is at what valuation level should we buy (we shall discuss this

question next). Given the track record and reputation of good companies, their shares are not likely to be cheap and the potential gain would not be spectacular. Some more adventurous investors practise a more risky strategy by investing in the so-called “fallen angels”. Two of the stocks mentioned in the last section may turn out to be fallen angels – Aeon and Magnum. KLK is more properly regarded as a cyclical stock. To project into the future, they need different treatment.

The price of Aeon has fallen more than 55% from its peak, driven down by the fall in its DPS (-27%) and EPS (-63%). Even then it is selling at a price which gives a DY of only about 2%. If we apply Gordon’s Model to its valuation, unless we can be sure that its DPS/EPS can recover strongly in the future, it does not look cheap. But Aeon is financially very strong and with the rise of e-commerce, its future expansion is likely to be very limited. Hence its future free cash flow may become substantial. If it were able to increase its dividend substantially and its EPS can stabilise and then start growing again even if only slowly, it can be a worthwhile investment. But its DY would have to be high enough to compensate for its likely slower future growth.

As for Magnum, its price, DPS and EPS have fallen by respectively 54%, 33% and 47%. Because it traditionally pays out a very large percentage of its earnings in the form of dividend; its current DY is good at 7.5%. Thus, provided its EPS can stabilise and its DPS not fall further, it would seem like a decent buy if its price falls a bit further.

Let us now look at KLK. This company has also suffered from falling dividend (-47% from its peak) and earnings (-19% from its peak). Surprisingly, its price has not fallen but instead has actually risen. If we study the last two columns of Exhibit 9, we see that its track record differs from those of Aeon and Magnum. Its DPS and EPS have not been falling continuously for a number of years. Instead, they appear very cyclical – i.e. good years follow bad year(s) and vice versa. How does one try to predict the future for a company with DPS/EPS streams like these? Many Malaysian companies are afflicted with this pattern of earnings and dividends. The way to get around it is by averaging the past DPS or EPS. At Dynaquest we compute the Average EPS of Five Years and the results of such computation can be seen in the fourth column of Exhibit 10. One can also do the same computation for DPS and the results can be seen in the sixth column. Let us now look at these data and see how they can help us to project the future.

(We also compute the Average PER based on its Average Five Year EPS the Average DY based on its Five Year Average DPS. We can discuss these later in the talk if there is time but can be ignored for the moment).

As we can see from the fourth and sixth columns of Exhibit 10; by averaging the EPS and DPS over 5 years, we see a very different picture of the EPS and DPS trends for KLK. We can see that both the EPS and DPS trends are quite smooth instead of being cyclical. We note however, the growth rate over the last 5 years seems much slower. If we are going to apply Gordon’s Model for valuing KLK, we should not use the actual data which show negative growth rates for both DPS and EPS, we should use the average data which show positive (albeit slow) growth. We would note that the current DY of KLK is low compared with its

past record. At the same time, the growth rate of its EPS has slowed considerably in the last 5 years. But it has considerable room to increase dividend because its payout ratio is very low (less than 50%). We need to study this company more carefully to see if its DPS can increase more rapidly and its EPS growth rate can recover. Otherwise, its current valuation seems high if we apply the Gordon Model.

- DETERMINING BUYING OR SELLING LEVEL

Earlier in the talk, I advise you that you should buy progressively over time and if possible, buy continuously. This way you are buying your investments at their average prices over a long period of time and the high and low prices would even out. However, most investors find this piece of advice quite difficult to accept, as they do not want to appear foolish or careless by buying shares at high prices. For investors who are willing to do a bit more work, an investment information platform can give you some re-assurance that you are buying at a middling price. How does one do it?

Share prices fluctuate all the time. Even in a single year, quality stocks can move up and down by 20%-30% (calculated from the low point). All investors would like to be able to buy their shares at as low a price as possible. Even though according to the Gordon Model, the shares you intend to buy may give you an expected long term return of, say, 8%, I am sure you would like it at even lower price and hence obtain higher return. How would know whether the current price is a reasonable one? For the answer, as with many things in investment, we have to look at the historical records. Let us turn to Exhibit 11 which provides Price Range as well as the DY Range together with the DPS for the last 10 years in respect of Carlsberg.

As noted earlier and you can see from the second and third columns of Exhibit 11, the annual price variation is considerable. So you can pick your time to buy more precisely you can lower your cost of purchase. Given the variation in the price of Carlsberg, the variation of the DY is also considerable. The average annual DY range for the last 5 years is from 4.51% to 5.87%. and for last 10 years, it is from 4.22% to 5.79%. We can see that the DY ranges for 5 and 10 years are quite similar. This means that should the DY at anyone time rises above 5.8% or so, Carlsberg's share can be regarded as lowly valued by its own historical standard and vice versa. Of course, we may not be lucky enough that when we want to buy Carlsberg, its price can be at all-time high DY level. My advice to my customers is usually that we should try to buy a share when its DY is at around the middle of the 5/10 year range or higher. For Carlsberg, the mid range DY for 5 and 10 years are respectively 5.2% and 5.0%. It would seem to me that if you can buy Carlsberg at a DY of 5%, it seems like a reasonable deal. Assuming that its DPS/EPS can rise by 5% pa, Gordon's Model would predict a return of 10% pa over the long term.

INTRODUCING DYNAQUEST'S ONLINE INVESTMENT PLATFORM

I am not supposed to do any marketing for our products during my talk. Hence I have left out the very critical question of how can an ordinary investor access an investment platform until now. I am very pleased that I can now officially introduce to you our Online Investment Platform. It has taken us more than three years and RM1.0 m to have it ready. It is based on our in-house KLSE database which we have been using for more than 20 years for our advisory and investment work. It is no exaggeration to say that without it the returns obtained by our clients and ourselves would not be half as good as they have been.

It comes in two packages:-

1. MARKET DIGEST – Consisting of RANKING, SCREENER & STATS (33 pieces of critical statistics/information on each PLC) Plus an extensive GLOSSARY to help you to make use of the info.
2. STOCKBASE

You can either subscribe to MARKET DIGEST separately or together with STOCKBASE. It is the largest investment platform on KLSE you are likely to come across as it covers 500 PLC's (400 under Tier-1 and 100 under Tier-2). The amount of data you can get on each PLC is truly prodigious and will take a long time to go over. I have already touched on the SCREENER the STATS PARTS of the MARKET DIGEST briefly earlier. I shall now just briefly describe the information you can obtain from STOCKBASE. It can roughly be divided into the following sections.

- An extensive GLOSSARY to help you to understand and use the data provided.
- A concise but complete COMPANY PROFILE
- Analysis of latest RESULTS and EPS & DPS FORECASTS
- 14 years of PRICE RANGE, EPS, DPS DY PER and their GROWTH RATE/AVERAGE for up to 10 years.
- 3 years of detailed balance sheet, PROFIT & LOSS, CASHFLOW and CRITICAL FINANCIAL STATISTICS & RATIOS

We have prepared a brochure for you to read up fully about our Online Investment Platform. But most important of all we want you to have the opportunity to try it on your computers (dynaquest.com.my) and navigate all over it carefully and fully exploit its power. Although this platform will only be officially launched on 01-11-17, it is available for Free Trial until the launch date on a limited basis. You can sign up for the free trial right now on your smart phone or you can do it from your home devices. You can subscribe for it from the launch date when the platform will be fully operational and your term of subscription will only start from 01-11-17.