The ultimate bear

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Market doomsayer Tan Teng Boo is predicting a cataclysmic slump in global equity markets, which could free-fall to their 2008 lows over the next 12 to 24 months. Find out why the grey-haired fund manager is so bearish.

The recent carnage in global equities, which is a continuation of the downturn that started in 3Q2015, is just the beginning of a nasty bear market that will cause stock markets around the world to slump to their 2008 lows, according to perennial bear Tan Teng Boo, the 62-yearold founder and CEO of regional boutique fund management firm Capital Dynamics.
Unlike the fleeting market selloffs of recent years, the ongoing global equity slump is here to stay and could worsen in the coming quarters as more investors come to terms with the fact that a vicious bear cycle has emerged. As more investors get bearish, the selling pressure on global equity markets will intensify, predicts Tan, who runs two global equity funds and a closed-end Malaysian equity fund listed on Bursa Malaysia.

At the moment, the doomsayer says, many stock-market participants, including retail investors and professional portfolio managers, are still not convinced that equity markets are in a bear cycle. The deep slumps and shallow rebounds exhibited by global equity markets in recent months are obvious indicators of a bearish downturn, he points out.

“Many investors are still in the bullish camp. People can only be convinced [of a prolonged stock-market downturn] when the pain is so unbearable. Then, they will look back and say, ‘Yes, that is a really bad bear market,’” says the globetrotting Malaysian fund manager in a recent interview with Personal Wealth when he was in town. “Fasten your safety belt, and get a strong one, because the plunge will be steep,” warns Tan, who has been bearish on global equities since 2011.

Battered by the devastating downturn in global equities since the beginning of 2016, many bourses around the world, including those in Asia and emerging markets as well as the developed regions of Europe and Japan, have since entered bear-market territory — defined as a 20% price drop from a recent peak.

The only major bourse that has yet to enter a bear cycle is the US. But Tan is convinced the Standard & Poor's 500, which is currently down more than 10% from its May 2015 peak, will continue to free-fall. The Russell 2000 Index (a US small-cap equity index) and Dow Jones Transportation Average (the world's oldest stock-market index that gauges the transportation equity sector in the US) are already in a bear cycle, he observes. Fragility in the transport industry, which is at the core of the US economy's supply chain, is portending a downturn for the world's largest economy, according to Tan.

"With the Russell 2000 and the Dow Jones Transportation Average having fallen into bear territory, it is only a matter of time that the Dow Jones Industrial Average, S&P 500 and Nasdaq Composite will follow suit." Lacklustre corporate earnings, weaker-than-expected economic indicators and potential policy missteps by the Federal Reserve will plunge US stocks deeper into the bear cycle, he warns.

In the near term, the Straits Times Index, which is hovering near its 52-week lows, could fall to a range of 2,000 to 2,200, while the Hang Seng Index could trend lower to a range of 15,000 to 20,000, according to the grey-haired Tan. "In terms of market correction, countries such as Singapore and Hong Kong are already more or less near the midway mark." He also expects Japan's Nikkei 225 index and the S&P 500 to plunge to 14,000 and 1,650 respectively in the near term, while the KLCI will decline to a short-term range of 1,500 to 1,700 before bottoming out at the 800 and 900 levels.

"Ultimately, my longer-term target for the STI is 1,500. The STI will retest the levels set in 2008 and early 2009. My ultimate targets for both the Hang Seng Index and Nikkei 225 are 10,000, and 1,350 for the S&P 500. These are the 2008 lows and I see them being repeated," says the fund manager who has more than 30 years of investment experience.
But after January's steep downturn, global equity markets could see some short-term reprieve. Still, any market rally will be a shortlived, "dead cat bounce", says Tan. "A rebound would be a good time for investors to sell. It is not a time to buy."

Global recession
Not only is Tan expecting the global stock-market rout to worsen over the next 12 to 24 months, he is also warning of a severe global recession. "In terms of the economic pain, we are just at the beginning. We could end up with a great depression like in 1929."

Originating in the US after its stock market started free-falling in September and October 1929, the Great Depression was the deepest, most prolonged and widespread recession of the 20th century. That protracted economic downturn, which lasted till the late 1930s, wiped out nearly 90% of the value of US companies listed on the New York Stock Exchange.

Chapter one of the global financial market downturn started in 2008 and lasted until 2012, according to Tan. The second chapter of the prolonged financial crisis, which started in 2015, could last until 2017, he says. Tan notes that many economies around the world, including the US, will enter into a recession this year.

"The signs are everywhere. I am not just looking at financial markets but also economic and corporate fundamentals." Free-falling oil prices, gloomy manufacturing data and dreary export numbers in many countries, and the lack of investments and R&D by global companies are the tell tale signs, he points out.

"People will ask how the US could be in recession when its employment market is so strong. My answer is that a recession can only start when you have a strong employment market. A recession can never start when the employment market is very weak. When you have significant job losses, you are already in a recession," Tan argues.

"In countries such as Japan, the US and Europe, nobody wants to invest. A huge amount of the money that the US corporations are making has gone into share buy-backs and dividend payouts. In the US, the companies have been more interested in financial engineering, which involves share buy-backs, to boost earnings, rather than in investing capital and creating jobs," he adds.

The fund manager correctly predicted in late 2014 that oil prices would slump to a range of US$30 to US$40 in 2015. Oil prices have been falling, owing to a significant global supply and declining demand in the emerging markets. The price of US West Texas Intermediate crude oil slumped below US$27 a barrel on Jan 20, the first time in nearly 13 years since 2003.

Falling oil prices over the past several quarters indicate that all is not well for the global economy, Tan points out, adding that falling oil prices signal a plunge in global economic activities. "Why is it that when oil prices fall, the Dow Jones Transportation Average plunges? Falling oil prices should be a boon for US transport stocks. Yet, the index has been plunging," he says. After hitting a high of 9,257.44 on Dec 31, 2014, the Dow Jones Transportation Average has since lost more than 20% of its value. "A bearish DJTA has a very negative message for the global economy. Peaking at end-2014, this could mean that deterioration of the global economy could be seen in 2016," adds Tan.

The full benefit of a drop in oil prices has not propelled global consumers, such as those in the US, to spend more, Tan observes. "In the US, people do not want to spend more because this is not a cyclical economic downturn. This is a structural recession. Consumers in the US realise that they have to save more because their real wages have been falling in recent years. So, why would a drop in oil prices lead them to consume more when they have to take care of their balance sheet?" he asks.

Oil prices hit a record high of US$145 a barrel in July 2008, but free-fell to US$30 in late December 2008 in the aftermath of the global financial crisis. But the price of oil rebounded quickly in 12 months, surging to more than US$80 a barrel in 2009 and to US$100 a barrel in early 2011. Now that the price of oil has plunged again, it is not going to bounce back anytime soon, according to Tan. "It may make a technical rebound above US$30 a barrel, but could fall to US$20. Oil price is going to stay at very low levels for years to come," he adds.

Unjustified China bashing

At the moment, the Capital Dynamics founder says, the only country that is keeping the global economy afloat is China, which has been experiencing slower economic growth over the past four years. It is easy for the Western media to finger China as the main cause of the recent stock-market downturn, says Tan. “China is a very convenient scapegoat. But its economic slowdown is an old story. You may blame the recent handling of the Shanghai stock market on very inexperienced people.”

But the rise and fall of the Shanghai stock market is “irrelevant to the rest of the world”, according to Tan. “When the Shanghai stock market went up, did it contribute to China’s economic growth? The answer is ‘no’. When the Shanghai stock market plunges, will it affect China’s economic growth significantly? The answer again is ‘no’. So, it is a sideshow. From the real economy’s standpoint, [the slump in Chinese mainland equities] doesn’t really matter.”

China’s economic slowdown has been going on for years, Tan points out. The economic slowdown in the world’s second-largest economy was “well-telegraphed and well-planned”, he says. “If you look at China’s GDP growth since 2012, it has been slowing at 7% to 8%. China’s slowdown has already affected economies around the world. Singapore’s exports have not been growing over the past four years. Malaysia’s exports too, and it is the same for Taiwan and South Korea. What’s the big deal [if China grows at] 6.9% now? Why make such a big fuss and a ruckus? The Western media knew for years that it was coming.”

When the global economic downturn worsens and “push comes to shove”, Tan says, the Chinese government and its central bank will have an arsenal of policy options to deploy, while the US, Europe and Japan have already “run out of policy ammunition”. The Bank of Japan, for example, has repeatedly failed to achieve its inflation target of 2%, he points out. With Japanese economic data getting from bad to worse, the BOJ has “become even more desperate and joined the negative interest rate camp” that includes the European Central Bank, as it has run out of policy ammunition, Tan adds. Recently, the BOJ set its policy rates to - 0.1% on the back of weak economic data. A plunge in oil price, a strengthening yen during a period of risk aversion and weak exports in Japan will make it difficult for Prime Minister Shinzo Abe and the BOJ to revive inflation and economic growth in the Land of the Rising Sun, according to Tan.

“But the US economy is the one I am most worried about. The situation facing the global economy is grave. For many economies, there are very few policy options available to handle an economic contraction, let alone one that will be on a global scale,” he notes.

High cash levels

In recent years, Tan has been loading up cash in his global equity fund in anticipation of a severe crash in global equities. His Singapore-registered iCapital Global Fund, which is sold only to accredited investors in the city state and has about US$146 million ($204 million) in assets under management, currently has nearly 80% of its assets in cash, mainly in US dollars. Tan also runs a listed closed-end Malaysian equity fund called the iCapital.biz Bhd, which has more than 55% of its assets in cash.

To be sure, Tan's large holding in cash has not gone down well with some investors of his global equity fund, which charges an annual management fee of 1.5% and a 20% performance fee when the net asset value of the fund exceeds 6% of annual rate of return. Investors of the iCapital Global Fund can easily buy into a cheaper US dollar money fund if they want a high level of cash exposure.

"Yes, a few investors do complain. The City of London [Investment Management Co, which is the biggest shareholder of iCapital.biz Bhd] is making a lot of noise that we are just sitting on cash and doing nothing," he admits.

But Tan could not care less, arguing that it is his fiduciary duty to protect the capital of his investors. "Why am I holding so much cash? The simple truth about investing is that it is never symmetrical. If you lose an investment opportunity, that is fine, as you still have your capital intact. But if you lose 50% of your capital, then you have to make 100% back to break even. It is not easy to make 100% returns," he reasons. "In a bear market, cash is the only asset that appreciates in value," says the long-only, value-focused fund manager. He argues that his funds were fully invested when equity prices were cheap, such as the post-crisis years of 2009 and 2010.

Despite its large holding of cash in recent years, the long-term performance of Tan's iCapital Global Fund still looks decent compared with returns achieved by its benchmark — the MSCI All Country World Index. Since its inception, the iCapital Global Fund has turned in gains of 15.31% in US dollar terms from Jan 7, 2007 to Dec 31, 2015, while its benchmark delivered -2.11% over the period.

Stock bets

As the global bear market is still in its early phase, Tan says it is not the time to "deploy cash" to buy the undervalued stocks he likes. "It is still too early to run down our cash levels. I still cannot find many good undervalued stocks."

Despite being a value investor, Tan reveals that he is not interested in bombed-out energy- related stocks or counters whose earnings are linked to the oil industry. Persistently low oil prices will be a bane to the earnings of these companies, he explains.

"In Singapore, there are quite a number of cheap stocks. But they are cheap for a good reason. For rig builder Keppel Corp and Sembcorp [Industries], I wouldn't want to touch these stocks. I bought Keppel Corp in March 2009 at $4 a share. The stock [currently trading below $5] is going to hit $4 very soon. But now, I wouldn't even buy it when it is trading at $4 because the economics of its business has changed. And for the longer term, it is not attractive," says Tan.

The fund manager observes that one of the bombed-out stocks in Singapore that has hit a floor in its trading price is China New Town Development, which is trading in both Singapore and Hong Kong. Tan reveals that he is interested in purchasing a small amount of this counter, which has limited downside. The stock has slumped from more than 60 cents in 2008 to its current price of four cents.

"We are looking at China New Town Development, which is trading at four cents. I am interested in it because it is not the usual property developer in China. It is more of a township developer. The company is not building on vacant land, but is more of a redeveloper [that implements the] policies of the Chinese government. If the local government has a shanty town and wants to redevelop it, it will partner China New Town Development," Tan says. He declines to say when he will pick up shares of the company.

At four cents, shares of China New Town Development have reached a major support line, which was established since 2011, according to Tan's technical analysis team, which has a "buy" recommendation on this counter, with a price target of nine cents.

Elsewhere, Tan says there are many global names he and his team have been "watching patiently" over the past several years. In the US, he likes Church & Dwight Co, a manufacturer of household products. "But Church & Dwight is still not cheap enough," he points out. The US stock, which is up more than 2% this year, is currently trading at a one-year forward price-to-earnings ratio of more than 24 times and price-to-book of 5.6 times. "The company operates in an unglamorous industry, but it has a proven business model. The company is very focused on the US market. You could say it is a very 'recession-proof' company that would be a good stock to have for the long term. I have been waiting for years to buy Church & Dwight, but the price hasn't dropped. That is one of the stocks we are looking at in the US," says Tan.

His iCapital Global Fund is currently invested in Hong Kong-listed stocks such as REXLot Holdings, which provides lottery related services, systems and machines to the lottery market in China; Concord New Energy Group, which specialises in wind power electricity generation; and Dah Chong Hong Holdings, which is in the auto distribution, food and consumer, and logistics businesses in China. The fund also has holdings in QBE Insurance Group, Australia's largest insurer.

"There will be many cheap stocks, which I will buy in a bombed-out market when there are no buyers," beams Tan. "I have been a lonely bear in recent years, and I think I will be a lonely bull when global stock markets collapse to unthinkable levels."

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