CFA Institute Annual Conference: 2013 Singapore (19-22 May 2013)

The conference was held at the Marina Bay Sands Hotel over three days with general sessions held during the mornings and concurrent workshops during the afternoons. This was the largest ever CFA conference held outside of the USA and **first ever held in Asia** itself, with c.1 300 attendees from 61 countries including around 250 from Singapore itself (25th anniversary of Singapore CFA society with 2,300 members). 30% of attendees are non-members, with about 10% from investment research category. 20% of the speakers were from Asia. As has become the trend in recent years, the **South African contingent** at the conference was substantial, **exceeding 10% of total delegates.**

There were plenty of opportunities to chat informally with other CFA attendees around the Exhibition area close to the Main Hall where the plenary sessions were held. There was a welcome reception on Sunday 19 May in the early evening with the subsequent highlight being a cocktail reception in the Flower Dome at the Gardens by the Bay (within walking distance of the Marina Bay Sands Hotel) on the final evening of Tuesday 21 May 2013. The conference was well organized and ran very smoothly indeed.

Informal discussions among participants included the outlook for the Australian dollar where further weakening was the consensus view.

Dr George Friedman delivered a fascinating closing address entitled: "Geography's Role in Shaping History, Politics, Economics, and Societal Imperatives". This is available as a webcast on the CFA Institute website: http://www.cfainstitute.org/learning/products/multimedia/Pages/87398.aspx?WPID=RelatedProducts

An interesting individual to meet was John Hempton from Bronte Capital. His hedge fund comprises a few concentrated long positions up to 120% with lots of small shorts targeting scum bags with dodgy accounting practices. He uses an internet blog to expose those dodgy companies with questionable accounting practices.

Low European PE's reflect consumer headwinds and risk and uncertainty around margins. This includes top line growth uncertainty and consumer down trading.

Overall the whole experience for me was extremely worthwhile indeed in the valuable insights from the various speakers together with the opportunity to reflect on the global investment landscape and re-examine my own investment thinking. This was my first visit to Asia and I was most impressed by Singapore itself. The next CFA conference in 2014 will be held in Seattle in the United States.

John Rogers (CFA President and CEO): Welcome address

Need a trustworthy forward working investment industry that better serves society. Putting investors first in terms of fiduciary duty else the investment industry risks regulation. The industry is a profitable industry with low barriers to entry. Standards to promote honest financial markets. Safeguarding the system includes stability and minimizing systematic risk.

Need, speed and greed – Welcome to the Innovation economy by Vijay V Valtheeswaran

- Need the importance of innovation working to deal with extraordinary challenges of urbanization and demographics.
- Population growth rates fall with education and democracy for girls and women.

- Energy revolution including more efficiency and clever enhancements. Greed is good for the customer centric model in social need areas.
- Speed in terms of move nimbly, open wisely and fail gracefully in demanding markets (fail fast). Gave the example of throwing a party when a project is cancelled.
- Too much innovation led to the financial crisis. Plumber job more secure in the knowledge economy.

The Singapore Deputy Prime Minister and Minister of Finance, Tharman Shanmugaratnam was impressive and very eloquent in his analysis of global financial markets and associated risks. While the world is in a better place than a year ago, central bank action does not reduce tail risk. The European banking system remains in a fragile state with more co-ordination required. Unemployment levels remain elevated with not much confidence in growth which is not a normal cyclical recovery. Debt issuance to buy back shares rather than new investment. There is globally an over-reliance on monetary policy with a lack of structural and fiscal reform. Central banks are doing too much of the heavy lifting. The information value of prices is being devalued. Risk information is diminishing. Easy monetary policy carries the risk of the long term growth potential deteriorating. Can't exit QE too quickly yet need more focus around fiscal reform and fiscal consolidation. Labour market reforms are needed to help the young have a chance of a job and what will be the consequences if they stay out of a job too long.

We are seeing more volatile capital flows with risk on and risk off trades. Too much capital leads to asset spikes and currency spikes. Relevance for central banks which need to avert asset market bubbles, especially in emerging markets. Secular shift of funds into emerging markets including institutional investors underinvested in Asia and diversification away from home markets. More short term assets and more liquidity compared with long term infrastructural requirements in young societies leads to a mismatch. Those who can afford to take a long term view act as shock absorbers. Moving up from low income to middle income is easier than the next step which is much trickier. Reduce regulatory risk, institutional reform and investment in education is critical for emerging markets. Get back to normal growth need tax, labour market and pension reform. Window of opportunity to get back to normal growth with a decade to decide between long term stagnation and less reliance on central bank medicine.

Global investment implications of a rising China – panel discussion
What should be China's sustainable share of the global economy and growth rate? There has been good execution by the Chinese authorities. China's high growth rate c.10% for almost 25 years can be compared with Japan's high growth for 25 years and Korea / Taiwan for 20 years. The growth rate for China must come down, but China is bigger than Japan and less than half of its population is urbanized. China will need to depend more on consumption. Wealth is trapped in China which has been reflected in the stock exchange and property market, yet the risks are manageable. Local government is funding a lot of infrastructure investment. High investment to GDP depends on funding exposure with the contrasting example of Singapore in 1985 with predominantly local funding compared with Thailand in 1990 which collapsed from the actions of offshore lenders. China urban infrastructure with zero return in some case has no funding stress due to a closed system. China is going to slow and have to live with lower growth rates. China will see bad debts yet have no funding crisis. China looks a lot like Singapore and not like Thailand.

Disconnect between China stock market and the underlying economy (A vs. H class shares). Chinese government has controlled supply and demand. They ensure valuations are high when selling assets so retaining cheap capital. With high PE's high and companies have had to grow into valuations (earnings have been there). Need to be careful as Asian market can be like a casino.

The Chinese stock market has never traded cheaper than currently. While there are policy risks the market is being underpriced for the strength of corporate. Best to play good managers in China and consumer brand names (consumer sector). Opportunities exist in logistics and underinvestment in healthcare.

Lessons from a Whistleblower – Michael Woodford telling his story at Olympus Corporation
This was a fascinating account of corporate intrigue where the speaker actively engaged the audience in the way in which he accounted his story in a rather long winded manner. He ran out of time before reflecting on the whole saga or being able to take questions from the audience. He has a jaundiced view of Japan and its board culture after his experience. Japanese weak at assessing Westerners and they find it difficult to close weak performing areas in Japan. His experience is that everything decided outside of board meetings. As CEO he was undermined by the Chairman who told his staff not to brief the president (CEO). As CEO he saw it as his responsibility to his shareholders for them to be made aware of an accounting fraud that had been covered up. He highlighted the significance of non-verbal communication in Japan in an amusing fashion and how it is not good to raise your voice in Japan.

Living with noise: Valuation in the face of uncertainty by Aswath Damodaran
How we deal with uncertainty especially with a young company. A choice made early in the process to either value the entire firm or equity valuation. If something does not affect cash flow or alter risk, then it cannot affect value. For an asset to have value, cash flow has to be positive (some time over the life of an asset). Young high growth companies should have negative cash flow in the early stages. Assets that generate cash flows early in their life will be worth more than assets generating cash flows later (however the latter may have greater growth and higher cash flows to compensate). When will your company be a mature company and what are the potential road blocks?

Amazon in January 2000 trading at USD84 was poster child of dot com era with the valuation then hopelessly optimistic despite big operating losses and small revenue. Small revenues to large revenues and big losses to small profits. Make up revenue growth of +42% over next decade. Target margin of 10% in line with non e-retailers, else they would gravitate on line too. He got USD 35.08 per share.

Valuing Facebook pre IPO is more difficult than Amazon. What business is it in and what is the revenue model? Bit like stores with lots of foot traffic and nothing on the shelves. He got a value of USD25 per share. How did Morgan Stanley get USD 45 for Facebook? More of a pricing exercise than a valuation exercise. Subsequent huge over-reaction on the downside with a 50% drop in the Facebook share price whereas was too early in the process and more akin to a six year old report card. His view on Google is that the company has done some clever acquisitions complementing organic growth, so he is not that impressed.

Estimation uncertainty means could have the wrong model or estimated inputs such as getting the margin wrong (mitigated by doing your homework). Economic uncertainty comes from real sources that markets and economies can change over time and that even the best models will fail to capture these unexpected changes (here to stay). Micro vs. macro uncertainty and discrete vs. continuous uncertainty.

Modeling less is more effective (revenue and margin forecasts) and building in internal checks on reasonableness. High growth rate pre IPO – is this sustainable? Consider the currency and use an appropriate related discount rate. Growth rate is lower in USD vs., rupees for Tata yet the valuation for Tata should be the same irrespective of the currency used in the valuation. Don't let the discount rate become the receptacle for all uncertainties. Uncertainty will increase as you go forward in time and thus it is better to create simple algorithms that estimate specific numbers. In particular as you approach your terminal year make sure that the company you are creating is one that is feasible and viable in terms of market share size and profitability (operating margins and return on capital are supportable given the industry average).

Questions to ask are does a deal make sense. How does a company change its pathway to success? Is it going to be more rocky in the future? To maintain sustainable growth, a company has to reinvest a high percentage of its earnings, while maintaining a high return on that investment. Growth has to come from increased efficiency and new investments. High growth is easy, yet high quality growth is more difficult. Scaling up as companies get larger is hard to do.

In a simulation you can enter get a distribution of values rather than a single estimate of value which can provide substantially more information. If an investor does not believe in intrinsic value and make no attempt to estimate it then you have no moorings when you invest. Everything becomes relative and you can lose perspective. A valuer's dilemma is uncertainty about the magnitude of the valuation gap and uncertainty about the gap closing such as looking for a catalyst.

Read his blog on http://aswathdamodaran.blogspot.com/ where he shares his thoughts and ideas with interested readers including his update of historical risk premiums for countries for use in valuations.

Dambisa Moyo: Investing in the Frontier
She comes across more as an economist rather than a savvy investor and indicated a preference for Ghana over Nigeria in the short term. She mentioned the commodity slowdown impact on Africa and suggested that Zimbabwe could get cheaper still. While South Africa is still seem as the gateway she diplomatically highlighted a bearish view citing structural problems including lower growth, importing inflation, the impact of shadow and micro lending on the broader economy.

Investing in a low yield world – Lim Chow Kiat (Group CIO Singapore Investment Corporation)
Need to focus on the end game 5 to 10 years out. Investing is not speculating. We are dealing with 3 speed global financial markets. There has been a 30 year credit expansion cycle where investors have mostly seen good equity returns, although very little over the last 10 years. Non-investment grade bonds generally look unattractive in his view. More money has been lost chasing low yield than by gunshots. Gold as an asset class has low intrinsic value apart from a hedge against hyper-inflation or the financial system collapsing. He recommends reducing risk over time by buying tail insurance.

Detecting asset bubbles before they burst – Vikram Mansharamani
He recommends using five lenses (micro-economics, macro-economics, psychology, politics, and herd behavior) for insights as bubbles are mysterious and result in the information value of prices being distorted. A higher price leads to higher demand whereas a lower price has lower demand. Mal-investment involves excess capacity with borrowed money. Art auctions are a good bubble indicator (Sotheby's). Popular conversations such as the taxi driver and bellman around flipping condominiums or a 2007 TV program "Flip the house'.

Possible bubbles to analyze include:

- China slowdown (more nuanced, Ghost cities, psychology of the Chinese buyer, politics driving GDP target, Chinese economic growth unsustainable has huge implications for commodities with consumption likely to take off. While China is not a casualty, Australia is a casualty which is where the risk is together with impact on Brazil and South Africa)
- QE bubble
- European break up

He highlighted a very amusing YouTube video on quantitative easing in 2010 which is worth listening to http://www.youtube.com/watch?v=PTUY16CkS-k

Challenging industry norms: The Future of finance (Panel discussion)
Asia Pacific finance model (pools of wealth) with retirement as a nation seeing lots of money set aside in Singapore, China and Australia. Traditional pay as you go system is not sustainable especially with a rapid aging population.

Capping the compensation of asset managers including agency conflicts. In the West the formal sector is shrinking whereas in Asia the formal sector is growing.

Too much liquidity and money flowing into Asia gives rise to other problems with due diligence and Asia's ability to manage the flows.

Other people's money (OPM's) and often the more complex the products the less good the outcomes. Sub-prime was not regarded as to great a risk initially. Greece as the straw that broke Europe's back. Asia's Achilles heel may be real estate.

Inappropriate financial innovation. Cheap borrowing used for share buybacks. Are there better opportunities for the youth in terms of housing prices and job opportunities?

The Risks that Securities Analysts Face by Jeremy Bolland (Supervisory analyst and securities research consultant)

- Analysts owe a fiduciary duty to clients and without their trust there is no business model.
- Advisable to justify conclusions and highlight all the possible risks including sensitivity and scenario analysis in published research.
- Ensure that do not lose the trust of clients and if you are not treating them fairly be honest and upfront so clients know where they stand.
- Address specifically how you treat clients fairly despite having tiered client structures in place. Need to distribute research by email and then engage with marketing the research to clients according to their priority.
- Difference between research defined by its content and non-research. Informal emails to selected clients. If commentary on company business and maintain our recommendation then is research.
- Channel checks on potential non-public information. Do you change your estimates as a result? Do not do the company's dirty work in terms of leaking information.
- Managing conflicts of interest where corporate finance activities or else sales pressure for comments / trading ideas (or giving a heads up about a forthcoming change of rating) or where clients have a position and want written research.
- Pressure from listed companies to write favourable research. Personal trading contrary to recommendations is a conflict of interest.
- A short term call is a separate research product.
- Be careful about putting companies into play as there is the risk of trading on material price sensitive information if true or else spreading false rumours. Make clear where the information comes from including good research and reasonable assumptions to convince clients (mosaic theory).
- Be careful that no defamation of companies in titles of research reports and use of copyright and plagiarism. He advises to state conclusion in the title and never to have a question as a title.
- Potentially more risk in what is not published

Mark Hodgson
23 July 2013