SPECIAL FEATURE

Arkenomics Capital focused and prudent on compounding wealth

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ALBERT CHUA/THE EDGE SINGAPORE

Peter Lum (centre) and Dinesh Advani (left) established Arkenomics Capital in mid-2022 alongside Reynold Tan (right), a partner

Peter Lum and Dinesh Advani could not have imagined that a chance encounter during a National Service reservist call-up some 10 years ago would eventually lead them to establish Arkenomics Capital, a registered fund management company (RFMC) with the Monetary Authority of Singapore (MAS). The pair, who are founders and executive directors, established Arkenomics Capital in mid-2022 alongside Reynold Tan, a partner. Peter is also the portfolio manager of Arkenomics Capital's flagship Arkenomics Provident Fund.

Before Arkenomics Capital, Peter spent 14 years as a remisier at Lim and Tan Securities. "I began investing in equities at 23. Lim and Tan provided me with an excellent platform to establish my brokerage business. However, as my wealth grew it became evident that my true passion lay in owning businesses and I haven't looked back since," Peter recounts.

Previously in investment banking and private equity in New York, followed by 12 years at Singapore real estate firm RB Capital, Dinesh reflects "I've had a fulfilling 20-year career in real estate. My serendipitous meeting with Peter in 2014 accelerated my investment journey, and we've forged a strong relationship since. By 2022, investing in stocks enabled Peter, Reynold and I to grow our net worth to a point where it made sense for us to focus on it full-time and establish Arkenomics."

Reynold, formerly in private equity, highlights, "Arkenomics provides us with a platform to focus on generating returns on capital with clear accountability. Moreover, our significant alignment of interest with investors ensures that we function as long-term partners."

Arkenomics Provident Fund targets to generate low to mid-teen returns annually by investing globally in listed equities. In its first year, the fund was nominated for the With Intelligence HFM Asian Performance Award: New Fund of the Year 2023, the only Singapore fund to be nominated in this category. Since its inception in October 2022, the fund has delivered a net return of 24.4% in SGD over 20 months until May 2024, translating to a compounded annualised rate of return of 14.0%.

The founding team of shareholders initially invested S$10 million of their own capital to launch Arkenomics Provident Fund. "Our initial S$10 million investment has grown to nearly S$13 million in 20 months," Dinesh notes. "Additionally, the fund's total assets now stand at S$30 million, and we own just over 40%." As he tells it, the fund has around 40 accredited and institutional investors. The minimum initial investment is S$500,000 for share class A, and S$100,000 for share class B, with the main difference being the fee structure.

Dinesh explains: "To build wealth effectively, you need to hold assets that provide full participation of the upside. Arkenomics Provident Fund allows us to achieve that by owning exceptional businesses at attractive odds and at valuations we choose."

Investment Strategy

As a strategy, the fund invests in yield and growth stocks currently in the ratio of 70:30 with a focus on acquiring these assets at deep discounts to intrinsic value. "Our portfolio generates a 5% dividend yield today with a large margin of safety vis-a-vis value. If 100% were to be invested into yield stocks, the portfolio would generate a yield of 6.5%. We are happy to forego the 1.5% dividend difference in favour of growth. We maintain a concentrated portfolio of around 40 stocks currently, with the top 20 accounting for 80% of the portfolio" Peter says. The stocks' dividend yields range from 4% to 8%, he indicates. A high starting yield for companies with balance sheet strength are a couple of factors he will look for in a stock, he points out.

Risk-free rates impact the way Peter looks at returns. He is conscious that current risk-free rates based on US treasury yields are at close to 5%. "Hence, we need to be compensated for waiting. Additionally, earning yields of the companies that we look at need to be higher."

"Arkenomics Provident Fund does not distribute dividends," Peter explains. "We reinvest the dividends received from our holdings. Shareholders have the option to withdraw from the fund as needed. We recommend a drawdown of no more than 4% annually." Peter stresses that adhering to this strategy enables investors to maintain a steady income stream while growing their wealth for future years, resonating with the concept of 'Provident' ingrained in the fund's name.

According to Peter, leverage within the fund itself is currently less than 2%. "Leverage depends on its cost; it must be low enough to benefit you. We used to take some leverage in the good old days when we could borrow below 1%," he says.

US stocks don't figure prominently in the portfolio currently with its largest geographical exposure being developed Asia. "Allocation needs to be fluid. We cannot base our portfolio on the MSCI ACWI as the US accounts for 65% of the index's weight" Peter says. Ten years ago, the S&P 500 had a price-to-earnings ratio of 18 times and now it is 29 times, he continues. "We are looking at PE expansion. If I tweak our portfolio heavily into the US, we would be overpaying," he says.

The fund comprises "pure equity" presently and is very liquid, Peter indicates and while the fund permits investment into other financial assets such as bonds, he believes that equities continue to provide the best prospects for compounding capital.

"If your goal is to build real wealth, instruments that limit your potential gains while exposing you fully to downturns will not be advantageous in the long run. The situation worsens if these investments lack liquidity. Therefore, careful selection is crucial when deciding how to allocate your capital," remarks Dinesh.

Cash Flow and Prudence

Peter began his investment journey in 2004 with an initial capital of S$30,000. "By 2007, my portfolio had grown tenfold to S$300,000," he recalls. However, he also experienced the global financial crisis (GFC) that same year, during which his portfolio saw a steep drawdown of up to 80% from its peak.

Reflecting on this period, Peter recalls advice from his mentor at Lim and Tan, who cautioned him about S-chips — Chinese companies listed on the Singapore Exchange. These stocks, while appearing attractively priced, did not offer dividends.

That prompted Peter to divest from S-chips and reinvest into real estate investment trusts (REITs) such as Suntec REIT. Post GFC, Suntec REIT offered a distribution per unit (DPU) yield in the teens, making it an attractive choice. Peter's decision was further influenced by news that the REIT manager had successfully refinanced a large loan at a much lower interest rate, coinciding with a rate cut by the Federal Reserve.

This strategic shift reinforced Peter's focus on cash flow as a critical investment consideration. "While many people concentrate on volatility, we prioritise the cash we receive and the price we pay," Peter emphasises. This approach highlights his commitment to investments that offer reliable income streams and that are acquired at favourable valuations, reflecting lessons learned from the crisis.

"Today, the investment landscape has shifted," observes Dinesh. "Given that the cost of debt ranges from 4% to 5%, it doesn't make sense for us to invest in commercial properties yielding cap rates as low as 3%. While we don't hold direct positions in REITs, we own a few select deeply undervalued property companies with solid assets and financials. The implied cap rates of these companies' real estate holdings are in the double digits," he explains.

Alignment of Interest and Accountability

Arkenomics Capital's founding team has a significant portion of their net worth invested in the fund, collectively making it its largest single investor. Peter clarifies, "We believe the most effective form of alignment is to invest substantially alongside our investors. We avoid undue risks, defining risk not as price fluctuations but as acquiring assets at prices that lack a sufficient margin of safety."

Having significant skin in the game also ensures that the fund accepts new money at only good odds and is focused on "allocating not aggregating assets". Peter elaborates that the fund has instituted a policy of capping subscriptions in the event it exceeds a high-teen annualized growth rate.

Arkenomics Provident Fund held its inaugural Annual General Meeting (AGM) earlier this year, providing all investors with an opportunity to review the fund's audited financials and participate in a Q&A session about the portfolio. "We are dedicated to hosting an AGM annually," states Dinesh, emphasizing the importance of direct interaction with investors to communicate market positioning, particularly during allocation shifts.

Arkenomics was established following the implementation of the Variable Capital Companies (VCC) Act, a favourable corporate structure for investment funds. The timing of the VCC Act was opportune for Arkenomics. "We are fortunate to be able to leverage Singapore's advantages, including the VCC framework. Behind us is an extensive team of reputable specialists from fund administration, legal to audit. By engaging them we can focus on our core competency of capital allocation," Dinesh explains. "Oversight by MAS ensures we continually improve and adopt industry best practices."

What's Next?

"A handful of companies are launching share buybacks at remarkably low PE valuations. Growth stocks are beginning to provide dividends, and yield stocks are boosting their dividend payouts. With PE contraction and attractive starting dividends, you can just hold these stocks, accumulate via dollar cost averaging and do relatively well" Peter mulls.

On the regulatory side, the RFMC regime is targeted to be repealed on 1 August 2024. Arkenomics Capital will transition from an RFMC to a Licensed Fund Management Company (LFMC) for accredited and institutional investors only.

Wrapping up, Dinesh says, "Our aim is to compound our initial S$10 million investment to S$200 million. By working our capital diligently, we can achieve that. There will be drawdowns and volatility but with prudence, patience and thoughtful selection of the businesses we invest in, our net worth will continue to rise. Above all else though, we are thoroughly enjoying the journey." E