QUARTERLY COMMENTARY

31 December 2023

Manager Update: January 2024

John Qiu, Founder

This quarter marks the two-year anniversary for the Orlog Capital Fund and four years since I started investing independently. It started in early 2020, a few months after I had resigned from my job at Overlook Investments to focus on my new role as a father to my first child. As the world woke up to the threat of the Coronavirus, financial markets were in turmoil. I was working part-time from home and finding ample opportunities within panicked markets which encouraged me to steadily increase my investment exposure[1]. By the end of 2020, I had significantly grown my role in managing our family office assets which progressed to the business decision to raise my own shingle and establish Orlog Capital in 2021.

Despite the increasingly competitive environment, I believe there is a clear niche and advantage to Orlog Capital's investment approach, especially in today's volatile markets. To understand why, one must first take the mindset of investing as a competitive game. Like all such games, the key to winning is understanding the rules, game environment, fellow participants and one's own position. Some general observations:

- The system is geared towards short-term gratification
- There are many tourists and charlatans playing this game
- Many participants' primary motivation isn't to maximise risk weighted-returns
- Many investment decisions are heavily influenced by cognitive biases and heuristics

Given this, it can be seen why standard game strategies of exploiting differences in player skill, player characteristics and profiting from idiosyncratic features can generate above par performance for a small number of players. Investing isn't a game of baccarat.

Within investing, we see three primary domains of competence: current price behaviour anticipation, future price behaviour anticipation and technical (e.g. arbitrage, HFT). With the rapid rise in computing power and big data collection, the current pricing and technical parts of investing are increasingly becoming dominated by quant systems. The rapid development of AI is an arms race which few can hope to win. We don't seek to compete in this arena.

Instead, the hill on which we raise our flag and stake our claim, starts with the belief that the factors which drive current price behaviour are often different to long-term price behaviour. We believe over a longer time frame, earnings and events mean revert towards normalised fundamentals and asset pricing reflects intrinsic value, losing the influence of short-term market and investor characteristics. This is why we are short-term contrarian and long-term fundamental value in our approach. We try to understand companies using first principles-based frameworks which means simplifying situations, focusing on a few key factors, and minimising our assumptions and forecasts. Where necessary, expectations are built on mean-reversion (supported by a long history), existential necessity (minimum outcome for survival) or a few high confidence factors. Our objective is to capture broader value with a large margin of safety rather than precisely predicting the future. We think this approach sets us apart from our peers.

To further optimise execution and lever our competitive advantages, we integrate our investment philosophy with operations as described by the Orlog Capital Model[2]. This is a practical blueprint for our organisation to consistently deliver investment decisions true to our core investing beliefs. It describes how we curate people, capital and the incentive systems that help maximise the alignment of interests:

1. Investment Team with Investment Philosophy
2. Investors with Investment Philosophy
3. Investment Team with Investors

Our model seeks to avoid the comfortable trap of mediocrity which besets our industry. Starting from process, institutional fund managers tend to do the same things: hire similar profile analysts who do similar work based on similar ways of thinking ending up with similar conclusions. The remuneration and fund capital structures are also similar so when prices fall a lot, motivations on job security and preserving the capital base outweigh the objective of pursuing returns. How can they beat the market when there are so many biases towards consensus? Hence most funds tend to be glorified beta trackers rather than alpha allocators and why even with the presence of retail investors, the 'sophisticated' institutional investors on average still underperform the market.

Investing is a highly competitive business and without extreme conviction and execution of a distinct strategy, the average investor has no relative advantage. Our model is that advantage.

[1] My investment diary during this period is found at: https://www.investin1.com/

[2] A simple outline of the Orlog Capital Model: https://www.orlogcapital.com/orlog-model

The Fund ended 2023 with the disappointing net performance of -2.5% QTD, -27.8% 1 year and -1.9% since inception (Jan 2, 2022). In hindsight, the ~-10% impact from side-pocketing assets in February 2023 would have been avoided if Fund investors (all internal) had bought back those assets from the Fund instead. Irrespective of all that, 2023 was a bad year where we were severely penalised for our large positions in offshore listed Chinese companies.

We maintain our view that this current period is a once in a lifetime golden opportunity for investing in China. Investors are weary after three years of falling markets. Western asset allocators have mostly given up and sold down the bulk of their positions. Local institutional investors are bunkered down in the trenches while remaining retail investors are holding only to avoid realising losses. This is reflected in the slumping market capitalisation, turnover and IPO activity in Hong Kong and among ADRs. This is also one of those rare occasions where for large swathes of industry, listed assets are priced significantly lower than their private market counterparts.

Perhaps society and markets need a bit of sobriety: things always move towards balance with time. In any case, Chinese stocks have fully discounted the current macroeconomic woes and heightened geopolitical fears. Even based on low expectation outcomes, we see the fundamentals of our portfolio companies supporting much higher valuations.

Given we hold a high conviction, concentrated portfolio, we are sensitive to individual company and industry events. The beginning of 2024 has started with a bang as we were hit by two consecutive black swan events related to our major positions: Spirit Aerosystems[3] and DADA[4]. Their share prices reacted swiftly, falling as much as -20% and -50% respectively in the hours that followed. The formal investigations into these incidents are still ongoing so the final outcomes are yet unknown. We have formed our internal assessments of both situations and are executing on a plan of action. We will refrain from commenting for now but this will be the subject of discussion in our next quarterly report.

Looking forwards, our Fund will begin the next stage of growth by slowly opening to external investors starting from the June 30, 2024 dealing date. If you are interested, please check out our website and complete our Prospective Investor Form:

https://www.orlogcapital.com/invest

We will add you to our mailing list and be in touch regarding your application. Please leave plenty of time for the process.

[3] Jan 6, 2023: Alaska Air incident: https://www.reuters.com/business/aerospace-defense/us-investigators-probing-whether-boeing-737-max-panel-was-properly-bolted-2024-01-09/
[4] Jan 8, 2023: DADA Nexis internal audit found suspicious transactions https://www.reuters.com/business/jdcoms-dada-identifies-suspicious-practices-internal-audit-2024-01-09/

Portfolio Overview

ORLOG CAPITAL

Top Five Major Holdings (in alphabetical order)	
CNOOC	Oil & Gas Exploration & Production
DADA Nexus	E-Commerce
JD.com	E-Commerce
KION	Materials handling
Spirit Aerosystems	Aerostructure Manufacturer

Performance	
Annualised Net Returns in US$[1]	
Since Inception (Jan 3, 2022)	-1.9%
1 Year	-27.8%
Non Annualised Net Returns in US$[1]	
3 months	-2.5%
6 months	-7.4%

1. Net of 1.5% annual management fee and 20% performance fee (excess return above 5% hurdle rate and subject to HWM)

ORLOG CAPITAL

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