Weekly Commentary 47 – November 2023

Migration to SGX

This is a note intended for discussion on 9 and 16 Dec regarding a plan to migrate AUM to SGX.

The background

1) The funds that are in our AUM are now held at London brokerage firms which are then further custodized at the banks used by these brokers. Previously before these brokers told us that they are themselves forced to change the rules by their regulators (FCA and BoE), they were able to allow redemptions in about a month. For the last six years, we, the fund manager, were able to extend this privilege to all investors.
2) With effect from end Nov, the regulators in London have imposed tougher regulations on the entire brokerage community. Firstly, they wanted to reduce the leverage that was typically used in the FX markets. Secondly, they wanted to avoid large transfers of funds between money centers. Hence, the first benefit of investing in London FX vanished.
3) This we understand from our own brokers is that this is a temporary thing. Temporary because in the heat of the moment, they will obviously not violate instructions and audit from their own regulators. They think in over time, the business is not lucrative for the entire community and even the regulators will relent. They think that things will be back to normal by March 2024.
4) Until we are told in writing that things are back to normal, we, as a customer of the brokers and banks, will have no choice but to comply. In the worse case scenario, we assume this will last six months to a year.
5) All investors have to keep in mind that the excellent returns of the past six years were the result of our fintech that enable us to do the trading speculatively on one side (Account A) and by hedging all losses on the other side (Account B). From what we can see, the new regulations affect both A and B sides. On Account A, because of the reduced leverage, our team of traders have to trade less often. That directly affects returns obviously.
6) On the hedging side, obviously our B Broker will find it harder to hedge all their positions. Nobody does it for us as a favour. The B broker must make money doing this – as all of you have been informed, they may money from the "payment for order flow" arrangement. And when investors redeem, they will have to check that their trades are not at a loss against people getting out. This is a valid concern for the B broker.
7) I have some investors asking questions like since our fund never loses money, why would Broker B lose money and take so long to redeem. The simple answer is tha system wide, through the fintech, the fund never loses money because these losses are transferred through Broker B to the interbank market as such. And the Broker B, to protect their firm, will have to make sure that all their trades do not have remaining losses before they will part with the money in a redemption exercise.

8) Givcn that background, the old one month redemption period is now 3 months. The B Broker will need that long to make sure that all his losses have been covered. There is nobody in the system that will give up his own P/L just because you are not making losses.
9) After the quarterly P/L accounting and determination that there are no losing positions left, the funds may be ready to be redeemed. This may take another two months to get the funds from London to Singapore. Why so long? Because the brokers have to jump through hoops to transfer money internationally. I know because I do this every month and I empathize with all those having to make these movements of funds. For 200 shareholders, I take the better part of a month to move money to the last person. If there is 2% error (including those in which pennies are wrong), there will be another week added to the process. So this is not easy. If you have been getting your dividends seamlessly, you are lucky - the banking system for international money transfer is still quite antiquated.

Putting things in perspective

10) Our operations have told us that trading will resume from end of November. Well, indeed, trading has restarted after the two week lapse in early November while they were adjusted the ops system to the new rules and the system has made money. We should be up for the whole of November.
11) Do we expect the system to be back to normal by March 2024? I cannot give definitive answer to that. But let's say this takes longer because one of the brokers fail audit by their regulator, and we are delayed. It's not like their brokers are in serious violation of rules, and it could just be that the regulators are reluctant to let them extend their normal leverage to clients. So let's plan to be conservative.
12) We will therefore begin the migration of AUM to SGX. It is the same system with the money held in their ECN. It's all good as I have written all of you a PPT on how it works. If it works as well as the system in London, and if all the AUM were there, then things will revert to normality very quickly.
13) The big issue is how each shareholder who wishes to migrate will be able to do so seamingless.
14) The easiest way is for each shareholder to make a redemption but this will mean that given the one month account opening process with the SGX broker, there will be six-seven months of zero returns.
15) We have devised a better way to do this.
16) While redemption from London is ongoing, we need to get money to start work at SGX.
17) One way would be to use the foregone leverage that London used to provide to create a "bridging loan" for the funds that we need to deploy at SGX to maintain overall returns. In other words, since the London side is trading at say 1/3 leverage, then we can top up the leverage to what we were using before Oct and move those funds to SGX. There would be no additional risk over what we used to do. And there is no risk the AUM deposited at SGX.
18) We have to obviously make the arrangements to raise the loan on the SGX side. We have three potential sources of this leverage:
    a. UOB Kay Hian
    b. Boulevard
    c. A partner institutional investor

19) Boulevard is a Private Equity firm that do leveraged lending. Min $10 min security deposit in cash for $30mio risk lending.
20) In option a) UOB Kayhian will cooperate with Boulevard to firstly lend a security deposit of $10m. With the security deposit, Boulevard will inturn lend the $30m in the SGX system and make about 45% per annum. But the cost of security deposit will be 17% per annum. Boulevard will lend $30 mio at 13% per annum. As such we will make money. The excess profit will be distributed to all those shareholders who want to participate.
21) In option b) SAL ourselves will provide $10m security deposit to Boulevard. Our security deposit will earn about 5%. Boulevard will lend $30m to SAL at 13% per annum. The economics are better than Option a. As our security deposit is secured in cash and earning about 5% interest rate. We pay only 13% for the $30 mio borrowing.
22) In option c) Our new institutional investor will join the SGX scheme with a $30m investment. As such our AUM will rise to about $130m. This is a significant boost to our fund and obviously this is good news given that the confidence the investor has in our track record and the SGX system. We can use part of the $30m to raise funds through the UOB KH channel and the total funds invested in SGX will be say $40m $45m or even$90m. We will pay out one share to the institutional investor, one share to UOB KH and one share to the rest of us participating shareholders. Win win situation.
23) To the extent that something may screw up the first round of such borrowing and investing, I am thinking of doing this thing in three rounds. If the first round works, we can then do this faster in another round.
24) There are of course costs to getting this done besides the economic costs. There would be a legal costs incurred by the partner which we have to pay up front. The $200,000 legal cost will be refundable to SAL. Again win win situation.

Conclusions and Recommendations

25) All shareholders will have to decide how much they want to do for their own situation. We have already reduce the costs to a minimum and the benefits to a maximum. We think this will work.
26) Shareholders will also be offered the Option a & b through SAL. But they will have bear all risks on their own if they entered into the deal in their own name. If you are planning to invest $1m, you can leverage it up to
$2m, or $3m and enjoy the additional gains. In that sense, it is not so different from London increasing the leverage so that trading makes more profit,
27) For most of the existing shareholders still in London, we will maintain the same AI status for them Unfortunately, we cannot do it for those who obviously cannot qualify as Ais. However, since the risks that we are asking all shareholders to participate in SGX is low, we would require all remaining shareholders to help contribute to the new capital requirements that would be required. Exact numbers will be worked out and communicated to each shareholder,
28) What are the risks? One would be that while the SGX system is proven, the track record there is shorter than that in London. So if the returns fall short of 17 percent, all shareholders will have to give up some of their gains to make the interest cost first.
29) As the revenue from London would be below normal until at least up to March, I will have to cut expenses at the Fund so that we will be able to boost returns for shareholders. There are two areas in which expenses can be cut.
    a. Platform fees
    b. Board fees.

With the approval of shareholders, I will use my discretion to implement such cost cutting until such time when our trading revenues resume.