

Hong Kong's BosValen places big bets on the future of Asia's artificial intelligence revolution

Ken Xu, BosValen CIO, says firms will see a dramatic rise in productivity and value creation from what he calls the 'AI revolution'. Rodney Diola uncovers how Xu is taking advantage of this technological trend

There is no escaping the excitement over Artificial Intelligence (AI) among hedge funds in Asia. One of the more ardent enthusiasts of the technology is Ken Xu, CIO of the BosValen Master Fund, a Hong Kong-based fund he founded three years ago.

Xu, in buoyant mood when *AsiaHedge* sat down with him at his Hong Kong Club building office in Island City's financial centre in mid-December, was eager to share during the meeting how his investment philosophy has evolved and how it is again being reshaped by powerful mega-trends such as AI.

"We have since been actively trying to connect the dots in our investment universe towards identifying most of the companies that will benefit from the AI revolution," says Xu.

Xu's 11-man team at BosValen believes that the impact of the AI revolution has already reached an inflection point and will soon completely transform the world we live in, resulting in greater productivity and value creation.

The results have backed up his thesis with the near \$500m BosValen Master Fund, which invests mainly in markets across Greater China, Japan and the US, contributing to portfolio returns in excess of 25% last year.

Xu says his firm started to identify the AI mega trend in early 2016 and began investing in a number of companies that benefit from the improved productivity and viral value creation that AI is expected to spawn. Among those that are already in the BosValen portfolio are Shenzhen-listed Hikvision and Nasdaq-listed Nvidia, and both are big contributors to the strategy's performance.

Xu is excited about Hikvision given that it has successfully evolved its business from a camera and security hardware producer into

what is now a world leader in image and facial recognition technology. The latter gained worldwide renown after a 2012 murder case in Nanjing City that took 1,500 police more than two months to solve after scanning video footage from 10,000 CCTV cameras around the city. Skynet, its facial recognition system – eerily named after the fictional neural net consciousness in the Terminator movies – identified in just one minute the culprits after scanning hundreds of thousands of faces from 50,000 cameras.

The firm has invested hundreds of millions of dollars to further develop graphics processing-based deep learning technology, and has enjoyed success with China and western governments ordering its systems and deploying them to identify terrorists. The company also received critical success with HikVision, which ranks number one globally in Yahoo Finance's 2016 ImageNet competition for large scale "Scene Classification" recognition – where the goal is to identify the scene depicted in a photograph.

The "AI revolution", Xu argues, has already supplanted the Industrial Revolution and will make its impact felt in a much shorter time and more powerful way, bringing significant investing opportunities that will completely reshape the global

business landscape in the future.

He cites a recent PwC report which forecasts AI creating more than \$15 trillion in economic value in the next 12 years.

"That's the total output of India and China combined, with China seen as the biggest beneficiary gaining as much as \$7 trillion in output compared with \$3.36 trillion for the US," the study says.

Xu says the strong gains from AI counters helped the BosValen Master Fund to its strongest performance since its launch three years ago.

During the year the strategy scored nine positive monthly performances while the biggest monthly drawdown was just 40 basis points. It gained in seven of the 11 industry sectors it was focused on and enjoyed a robust 3.16 Sharpe ratio.

Adding to the success of BosValen is the strong pickup in global interest for Asia-focused hedge funds. Riding this wave of interest BosValen hired three people last year, including two analysts that have expanded its coverage of Asian corporates.

Meanwhile, the Asian gaming industry was also a significant contributor to BosValen's returns last year.

Paradise, a Korean-listed casino operator, launched a new casino in Incheon in the second quarter of 2017 at the height of the tension over North Korea, and with war of words between the nation, its neighbours and the US escalating. Occupancy at the casino hotel operation dived to just 10-15% and led hedge funds to aggressively short the stock which tumbled to 13,000 Korean won, against the 42,000 it was at trading two years ago.

Xu says that at 13,000 the shares had limited downside, with all the negativity already factored into that price, and so began to steadily accumulate them through the summer. But not before his team made a visit to

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Ken Xu



The "AI revolution": Xu argues that it has already supplanted the Industrial Revolution

In the spotlight: Xu explains how his previous roles have shaped BosValen's investment DNA

Prior to establishing BosValen in early 2015, Xu had worked at some of the hedge fund industry's marquee names, including: SAC Advisors, Och-Ziff Capital and Goldman Sachs.

It was at Goldman where Xu says his core investment DNA was defined. A focus on deep-dive, fundamental research, alongside a private equity long-term mindset. He adds that Goldman's highly-vaunted business principles that focus on integrity, dedication to clients and teamwork also influence how he runs BosValen.

Xu's career began after he graduated from the Shanghai University of Finance and Economics in 2001 and joined Arthur Andersen, which PwC soon acquired after the Enron debacle. At the firm, he worked on M&A advisory for international companies investing in China and was part of the team that advised Interbrew's acquisition of a stake in Zhejiang Beer.

He spent around three years at PwC where he says he picked up in-depth financial and business due diligence skills before joining Goldman Sachs in Hong Kong as an equity research analyst in 2004. The firm moved him to the bank's highly-regarded Asian special situations group focused on private equity

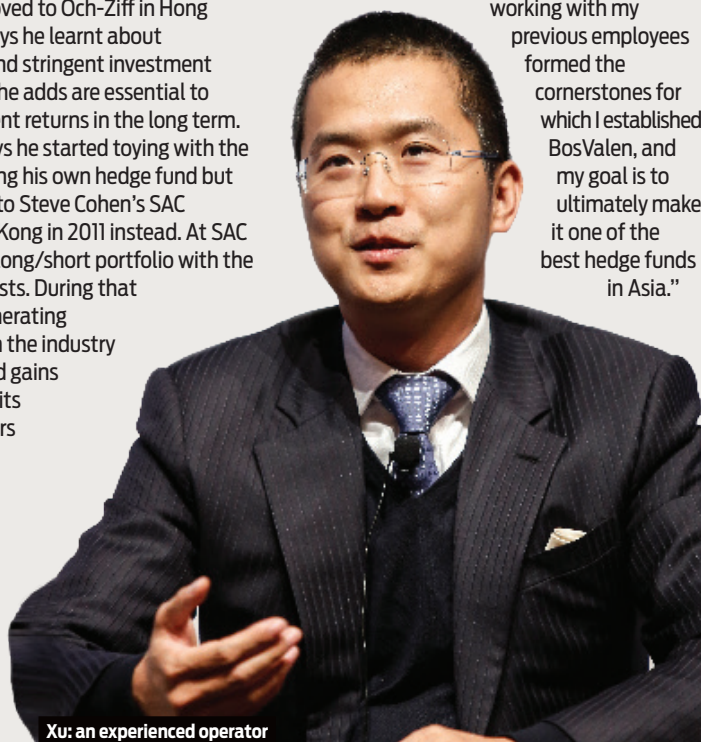
investments after 18 months.

In 2006, he moved to Och-Ziff in Hong Kong where he says he learnt about comprehensive and stringent investment processes, which he adds are essential to generate consistent returns in the long term. At Och-Ziff Xu says he started toying with the idea of establishing his own hedge fund but decided to move to Steve Cohen's SAC Advisors in Hong Kong in 2011 instead. At SAC he ran a sizeable long/short portfolio with the help of two analysts. During that time SAC was generating significant buzz in the industry given the outsized gains made by most of its portfolio managers globally.

Xu says his experience at SAC instilled in him a significant respect for robust risk management.

"All the skills and

experience I gained from working with my previous employees formed the cornerstones for which I established BosValen, and my goal is to ultimately make it one of the best hedge funds in Asia."



Xu: an experienced operator

the property, returning there many times to convince themselves that it was an attractive casino for premium players, and was in fact comparable to some of the leading casinos in Macau and Las Vegas.

"It was a great property with a great location and was just two hours away by plane to Beijing and Tokyo where most of its target premium clients reside," says Xu, who adds that generating consistent alpha often requires a lot of legwork and research, and more importantly adopting a business operator mindset when faced with such a challenging scenario.

Xu, who has been following Macau's gaming industry since 2006, recalls that Galaxy Entertainment Group went through the same experience as Paradise when its new casino opened eight years ago in the former Portuguese colony.

Galaxy also had a period of loss making at the ramp-up stage and saw its share price plummet to as low as \$3 before it bounced back several years later to around \$80.

Paradise meanwhile surprised the market in October when it reported third quarter numbers that were so robust they prompted a round of short covering on the shares that

resulted in an 80% price rally and made it a top contributor to BosValen's performance that month.

Xu says that while his investment thesis on Paradise was validated much earlier than he anticipated, he is optimistic that the shares continue to have a strong upside — notwithstanding the fact that they have already gained since last year — given that the casino's financial performance continues to improve as it further ramps up operations. Xu says the shares will likely see more gains in the next 12 to 18 months.

This casino bet emphasises that BosValen's strategy is not dependent on market directions to generate alpha, says Xu. He adds that he expects global equity markets to remain constructive this year, but that for the last three years his firm has deftly avoided big monthly drawdowns due to hedging most of the unwanted risk arising from volatility in the macro environment.

He was unfazed in early December as a degree of nervousness crept into the market when big counters like Alibaba and Tencent surrendered some of their gains from the previous months.

At that time, many investors whom Asia-

Hedge spoke to were notably wary of the market's strong advance since last year, with many keen to switch to small and mid-cap stocks that have not gained as much.

But, Xu says that at BosValen the focus on the investing process was paramount to reduce the risk of loss from unwanted macro factors. "Since we are not a macro fund, I do not pretend for instance to know where the macro factor, such as Japanese yen, is headed, and so early on take that risk out through portfolio construction. Because we have taken out the currency volatility for the portfolio, our portfolio has not been impacted from very volatile currency movement, but our company-specific alpha return has gradually materialised over a three to nine-month period."

Xu's strategy is chiming with investors, with BosValen's 25% plus return in 2017 coupled with around 10% in 2016 making it the best performing strategy for two of its existing institutional investors, according to a person familiar with the matter.

As such Xu expects BosValen to see inflows during this period from both existing and new investors. For BosValen, long live the AI revolution.

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