



Next Big Thing

Name: Rob Hopkins

Title: Managing director,
Smallco Investment Manager

Flagship fund: Smallco
Investment Fund

Performance:
20.2% per annum net of fees
since inception in 2000

Small is beautiful

Rob Hopkins invests money for a living. He shares his investment philosophy and advice for the future with George Liondis.

Why do you focus exclusively on small companies stocks?

As a fund manager you can really add value in the smaller part of the market. The key thing is to focus on the smallest part of the market that is still reasonably liquid. For us, that means a market capitalisation of \$100 million to \$500 million. About 80 per cent of the companies we invest in are in that range.

What's in it for investors, and how much should they allocate?

You tend to have much higher earnings growth potential with small caps [companies with relatively low market capitalisations]. Small companies can double easily over the next two or three years. Obviously, if it is the biggest company in the market, that is very hard. I have 100 per cent of my portfolio in smaller companies but I think asset consultants would say 10 to 20 per cent is an appropriate amount. It depends on an individual's appetite for risk.

Are small caps risky?

They have been very strong performers for quite a long time and you now have some of the smaller companies trading on a bit of a premium compared with larger companies. In my view, that is unsustainable. At some stage, small companies will underperform quite badly. Usually it happens when there is a correction in the market. All of a sudden people say smaller companies are riskier and more dangerous. You get a flight

to perceived quality and people go back to the big caps.

How will you survive when this happens?

We are very cautious on the stocks that we buy and make sure they are backed up by high dividend yields. Stocks like Sydney Futures Exchange and IRESS Market Technology are great quality businesses, so I am not going to sell them (although they are now expensive so if you gave me a whole heap of money I wouldn't go out and buy them today). But if you have a bear market, they will go backwards. That is just life. But they won't go back far because they have very high dividend yields underpinning them. Also, we can short-sell stocks [selling stocks you don't own in the hope of buying them back later at a lower price]. "Shorting" is typically 10 to 20 per cent of our portfolio.

What impresses you about a stock?

What we really look for in an ideal world are companies that will double over the next three years. The key is to find companies whose share price is trading below their intrinsic value and where we can see long-term earnings growth coming through.

Which sectors of the market do you prefer?

The sector we like is diversified financials. In that sector, we hold stocks like Sydney Futures Exchange and IRESS. We also tend to like software companies, like Reckon.

Which sectors do you avoid? And what about resources?

Sectors we are very cautious on are the cyclical sectors, including retailers and housing. Resources we stay away from as well. Resources at the moment are a brave man's game. It has been a great performing sector over the past year, but if you have a look at it on a month-to-month basis, it's a fairly rough ride. To me, that smacks of a market that is close to the top. There is certainly a feeling that you are missing out, but you just go back and think about all those occasions when you bought into things when they were too expensive and they have gone backwards on you. And keep those memories very vivid.

What did you last sell?

Macquarie Communications Infrastructure Group. We have been in that since shortly after its

float. It is a great business but it has now got to a stage where it is hard to see the stock doubling over the next three years.

What are you looking at now?

We have been shareholders of Record Investments and that has been very good to us. The merger with Allco Finance looks very interesting. We are looking at other companies within that group, such as Record Realty and Allco Max.

What is your investment philosophy?

We believe that a small number of good companies are much better than a large number of mediocre stocks. We think that when you find really good stocks at a discount to their intrinsic value, and if you really believe in that story and you have done all your homework, you should just dive in and buy a heap of it.

Any tips for someone starting out?

You need to understand when a stock becomes expensive and when it becomes cheap. So, you need to understand the concept of price-earnings ratios and how they relate to future earnings growth and forecasts. Also, you need to be really critical of reading broker research. Some broker research is superb and some of it is really, really bad.

What do you think will be the next big thing?

I reckon Allco Max will be the next big thing. **SI**



Shoot from the hip

Property or shares? Shares
Australian or international shares? Australian
Small cap or large cap stocks? Small
Value or growth stocks? Growth at a reasonable price
Diversification or concentration? Concentration