

# Smart Money

HOW TO MAKE IT AND HOW TO KEEP IT

## TOP PERFORMERS AS WELL AS SMOOTH OPERATORS

Clever fund managers do much more than ride stockmarket sentiment, finding opportunities that others can't spot. Here we profile some of the best performers of the past three years.

**Report** John Wasiliev

**E**asy tests of skill make even mediocre students look good. Fund managers, for instance, have ridden the bull stockmarket of the past three years to produce eye-popping double-digit gains.

But fewer than 10 funds out of the 2725 sold in Australia can claim to have done significantly better than competitors over this period.

The funds have beaten the return of their average rivals by 6 to 16 percentage points, often without big ups and downs along the way.

Smallco Investment, for instance, gained 46.36 per cent in the three years to April 30 against average returns of 22.5 per cent. Even better, there was less volatility in its returns.

True, stockmarkets have fallen over the past month and dragged down the returns of most funds. But all markets undergo corrections in bull periods: in fact there were two in the Australian market last year.

The rough ride could last several months if the predictions of experts such as AMP's head of strategy, Shane Oliver, are correct and test both fund managers and their investors for the first time in several years.

Even the outstanding funds identified by research house Morningstar at the request of *Smart Money* could find the going tougher.

Everyone expected the latest pullback and there is a universal view it is a short-term phenomenon rather than the start of a bear

market. Anyway, financial planners say that share investing is a long-term exercise that requires at least five, if not seven to 10 years, to work properly. Ignore short-term fluctuations, they advise.

There were a number of interesting findings in Morningstar's figures, including the fact that no less than four funds from Platinum Asset Management were among those funds that beat average rivals by a significant amount.

These were its Asian Fund, its Japan Fund, its International Technology Fund and the global share fund that it runs for MLC.

Morningstar's head of research, Justin Walsh, says this shows clearly that Platinum is good

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## SMOOTH OPERATORS

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across the board. "Although the market conditions over the three years have generally worked well for them, where its funds have been around for longer periods... this manager has also been able to add value," Walsh says.

A global small company fund that came up on the radar was Hunter Hall's Global Ethical Fund. Two boutique managers were found to offer Australian share funds that have performed exceptionally well - Melbourne's Prime Value Asset Management and Sydney-based Smallco Investment. Prime's fund is a large Australian company fund.

Morningstar also measured the volatility of the fund's gains, or the variation in their past performance. Financial markets, in particular, can rise or fall sharply over short periods. Managed fund returns can also jump around from year to year but most investors prefer funds with low volatility.

Some of the funds delivered their impressive gains with less volatility than their average rival, others were more volatile than competitors.

Volatility is measured according to a mathematical concept described as standard deviation and is inevitable in sharemarkets.

Morningstar's communications manager, Phillip Gray, says this is why fund managers issue regular comments that state that investors should always have a long-term horizon and ignore short-term fluctuations in the price of stocks.

One standard deviation gives an indication of the variation over two-thirds - or the majority - of a time period.

Two standard deviations - the standard deviation multiplied by two - illustrates the variation over 95 per cent of the time.

As an example of volatility, Morningstar calculated that over the three years to the end of April the average annual performance of the S&P/ASX 200 accumulation index of 25.7 per cent had a variation of 9.5 per cent.

These calculations suggested that for two-thirds of the time, the return was between 35.2 per cent and 16.2 per cent (the average performance plus or minus 9.5 per cent). For all but 5 per cent of the time, the two standard deviation return was 44.7 per cent to 6.7 per cent (the average performance plus or minus 19 per cent).

cent in industrials. The fund's top five holdings in its 60-stock portfolio at the end of May were Nippon Oil, TDK Corporations, West Japan Railway, Toyota Motor Corp and Hitachi. All these holdings each represented between 3 per cent and 4 per cent.

While the fund was running hot with a one-year performance of nearly 44 per cent at the end of April, the May market reversal saw this retreat to a still respectable 33 per cent. The three-year performance slipped from 30.5 per cent to 27.8 per cent, while the five and seven-year performances were 12.9 per cent and 19.6 per cent respectively.

Morningstar describes Platinum's investment management approach as one of identifying companies with business and growth prospects that are currently not appreciated by the market.

It says Japan has been a major theme for a number of years, reinforcing the belief that Platinum develops ideas that it is then patient to watch unfold over time. Platinum has a thoughtful and individual style that should deliver performance that will look different to any index.

As a far as the risks of investing with a Platinum fund are concerned, Morningstar says the manager will often take large country positions, both long and short, that can lead to bumpy performance.

### Platinum Asia Fund

In only three years, this fund has attracted a remarkable \$1.82 billion to its diversified portfolio. More than 35 per cent of its assets are invested in China and the balance of its 97-stock portfolio is invested in Korea, India, Malaysia, Thailand and Indonesia.

Its major investments are Hong Kong telecom giant China Mobile, Korean shipbuilder Samsung Heavy Industries, Chinese

Barring a sharp downturn globally, the Japanese market still has the potential for good gains, with the Nikkei index capable of reaching 20,000, over 35 per cent higher than its present level.

### Platinum Japan

This eight-year-old, \$1.06 billion fund from the Platinum Asset Management stable invests in the Japanese and Korean sharemarkets, both of which have performed strongly over the past three years.

Its portfolio manager, Jim Simpson, believes that the Japanese market, in which the fund has 70 per cent of its money, is only midway through its current bull phase.

He says that barring a sharp downturn globally, Japan still has the potential for good gains with the Nikkei index capable of reaching 20,000.

This is more than 35 per cent higher than its present level.

Simpson says that while the easy gains have been made in this market, there is money to be made in such sectors as the financials and heavy industrial companies. It currently has 22 per cent of its money in financials and 20 per

## TOP OF THE CLASS

Funds that beat rivals by a big amount

	Start date	Min inv (\$'000)	Net assets (\$bn)	Return 3 yr %pa	Extra gain over average fund	Volatility 3 yr %pa
<b>JAPAN</b>						
Platinum Japan	Jun98	25	1.06	30.55	6.29	16.52
Peer group average				24.26		21.42
<b>ASIA EX-JAPAN</b>						
Platinum Asia	Mar03	25	1.80	42.40	16.51	19.62
Peer group average				25.89		16.37
<b>GLOBAL TECHNOLOGY</b>						
Platinum International Technology	May00	25	0.06	18.80	8.64	17.73
Peer group average				10.16		17.63
<b>WORLD MID/SMALL-CAP VALUE</b>						
Hunter Hall - Global Ethical	Nov01	10	0.32	29.12	10.76	10.53
Peer group average				18.36		13.48
<b>AUSTRALIA LARGE-CAP VALUE</b>						
Prime Value Imputation	Dec01	40	0.06	33.12	10.62	11.53
Peer group average				22.50		9.08
<b>AUSTRALIA MID/SMALL-CAP BLEND</b>						
Smallco Investment	Oct00	40	0.06	46.36	12.30	12.30
Peer group average				34.06		14.46
<b>WORLD LARGE-CAP BLEND</b>						
INVESCO Wholesale - Global Matrix Hedged	Sep94	50	0.16	26.67	11.48	10.25
Peer group average				15.19		10.15
<b>WORLD LARGE-CAP VALUE</b>						
MLC MasterKey Unit Trust - Platinum Global	Jun94	5	1.54	24.05	8.95	13.83
Peer group average				15.10		10.75
<b>WORLD MID/SMALL-CAP GROWTH</b>						
Merrill Lynch - Hedged Global Small Cap	Mar01	1	0.02	32.86	10.58	16.99
Peer group average				22.28		15.52

Source: Morningstar



software company Sohu.com and Korea's SK Telecom and Kookmin Bank.

Manager Andrew Clifford says its highlights of 2006 include taking profits by selling down its Indian holdings as they reached full valuations.

It is building its investments in China, although the fund has also let its cash build up. It had a net cash exposure at the end of May of 29 per cent.

The May correction saw the fund's one-year performance dip to 30.3 per cent from the 46 per cent at the end of April, although one must remember that it wasn't all due to the correction.

One-year performance can be affected by a fund leaving behind a good month in 2005 and replacing this with a negative month in 2006. Longer-period performance is therefore a better indicator of fund returns.

The three-year performance of 38 per cent a year contrasted with the April figure of 42 per cent.

In an observation on the Chinese market, Clifford says what

continues to surprise is how when one sector appears to be overheated and due for an adjustment, another will come up and take its place. For example, two years ago there were grave concerns about the level of investment in power generation. This translated into a booming market for coal which in turn became the destination of choice for new investments.

In the same way, there has been much concern about investment in manufacturing leading to profitless prosperity. However, this is driving increases in wages in China, which have the potential to make consumption the key driver of growth. Clifford cannot see what will cause the Chinese economy to slow, although he cautions that this growth will not necessarily translate directly to stockmarket returns.

### **Platinum International Technology Fund**

This \$60 million fund has a diversified 41-stock, 11-country portfolio and has been a solid outperformer since its establishment in 2000. In the year to May 31, it gained 27.8 per cent. This contrasted with the 8.9 per cent return delivered by the MSCI World Information Technology Index.

It had a very good first quarter which saw it improve 12.4 per cent, compared with a gain of 7.6 per cent by the index. Like all funds it was affected by the May correction, although not as badly, with a 2.7 per cent retreat compared with 6.5 per cent for the index. Its three-year performance is a compound annual 15.6 per cent, compared with the index return of 5.7 per cent.

The fund's top investment is Swedish telecom equipment company Ericsson, which represents just under 5 per cent of the portfolio.

At 4 per cent, its Microsoft holding is the second largest single investment by the fund. Other prominent holdings include Japan's electrical equipment manufacturer Hamamatsu, Korea's Samsung Electronic and France's Alcatel.

The latest fund summary shows it being well cashed up with about 40 per cent in cash. It follows the Platinum investment management approach of identifying companies with business and growth prospects that are not appreciated by the market.

Portfolio manager Alex Barbi says this year's delayed launch of the Microsoft Windows Vista program will miss the crucial Christmas season and is likely to have a moderating effect on consumer personal computer demand for the rest of the year.

There is expected to be strength however in mobile products such as notebooks, phones and MP3 players, improved sales of software and greater capital expenditure on telecom equipment.

### Hunter Hall Global Ethical Trust

With \$322 million of funds under management, this four-year old international investment fund is described by Morningstar as a fund with an investment strategy that dares to be different. Under its founder Peter Hall, the manager has traditionally been a bargain hunter in the small companies sectors of global markets. In recent times however, says Morningstar

analyst Tim Murphy, it has added members to its investment team and they have each been given money to manage.

It is now a fund with a multiple portfolio manager strategy, a style that the researcher says it is watching closely.

Recent developments as a result of the new style are investments in soap manufacturer PZ Cussons and chemical company Pfizer.

That said, whether it is the old or the new strategy, the fund delivered a one-year return to the end of May of 36 per cent and a three-year average annual return of 25.9 per cent with low volatility.

Chief executive and portfolio manager David Buckland says that over the same period, the MSCI World Accumulation Index in Australian dollars posted a 12 per cent, three-year average annual return.

The fund's returns came from a portfolio that few investors would be familiar with. The top holding is a South Korean educational material publisher Woongjin Thinkbig, which represented nearly 7 per cent of the portfolio when it was last published.

The second largest holding is 4 per cent of the fund's money in a French company Vallourec, a manufacturer of seamless pipes. Both investments have done very well this year, says Buckland.

Woongjin was added to the portfolio 18 months ago and has trebled in value and it has been a similar story with Vallourec. Buckland describes the investment management style as digging for sharemarket gems.

The fund has a 50-stock portfolio, although the top dozen represent about 50 per cent of the portfolio value. The fund's value growth style means some describe it as a global small companies complement to the Platinum funds, which own much larger stocks.

### As co-investors with the fund, the Smallco team says this gives them an extra incentive to deliver top performance, with the fund generating nearly 39 per cent for the year to the end of May.

cash holding was a positive in the negative market, as were overweight positions in the consumer sector and underweight positions in health care.

Its National, Westpac and Noni B investments dragged its performance down but its Zinifex, Integrated Group and Coles Myer investments were positive contributors. Although cautious and anticipating continued volatility, Lee and Pan remain positive about the sharemarket's prospects, in particular energy and diversified resources investments.

management. Why is this so? While many small company funds are much larger, up to \$600 million, they are too big for the sector, he reckons. He has observed that because of this, the managers often include investments they don't really like just to fill up the portfolio. "We're determined to only include stocks we are excited about," he says.

### Invesco Wholesale Global Matrix Hedged Fund

The basis of a quantitative investment approach is to utilise the number-crunching power of computers to identify opportunities. Its central themes are that computer analysis of potential share investments can reveal patterns of price behaviour as well as potential investment risks and returns.

Invesco's San Francisco-based quantitative investments team starts with a global universe of 5000 companies in diverse countries and industries, filtering them down to about 120 companies. The analysis aims to identify how shares may perform over a six- to 12-month period.

According to the latest information, about 50 per cent of the fund is invested in US and Canadian shares, about 30 per cent in European and British shares. There is about 11 per cent in Japan and about 4 per cent in Asia and other countries.

To the end of April, the fund delivered close to 29 per cent as a one-year return and an average annual three-year return of 26.7 per cent. The fund has hedged and unhedged versions, with the hedged fund appearing in the Morningstar study.

According to Morningstar, after a rocky start in 2000 and 2001, the Global Matrix Fund has been a strong performer with low volatility. The researcher suggests the fund may be considered as a possible core holding for an international portfolio.

### Prime Value Imputation Fund

Winning magazine and trade press fund manager of the year awards in 2005, along with some top performance, has boosted the profile of this four-year-old \$83 million fund.

Managed by Melbourne boutique manager Prime Value Asset Management, the fund has a three star rating from funds management research house Standard & Poor's.

The management team is headed by managers Han Lee and Leanne Pan, who moved from running the \$500 million Shell Australia superannuation fund's equity portfolio to setting up their company in 1998.

At least half the imputation fund is invested in ASX top 100 shares and one third in companies outside the top 100. The balance is in cash. The top five holdings at the end of May were all household names: BHP Billiton, National Australia Bank, Wesfarmers, Westpac Bank and Noni B.

Prior to the May downturn, the fund was in the spotlight and making headlines with 24 per cent one year and 33 per cent three-year returns to the end of April. The market reversal, however, pulled this performance back to 16.5 per cent and 28 per cent for these periods.

The managers stated that investors should look at the long-term fundamentals of its portfolio holdings rather than the day-to-day fluctuations in markets.

They said the fund's 16 per cent

### Smallco Investment Fund

It is not uncommon for fund managers to state they are different to their peers. This claim by small company investment specialist Smallco has a couple of twists. To start with, the directors say they own 20 per cent of the nearly \$61 million five-year-old fund.

"We're co-investors with those who invest in our fund," claims managing director and former stockbroking small company researcher Rob Hopkins of himself and executive director Bill Ryan.

This gives them an extra incentive to deliver top performance, he says, with the fund generating nearly 39 per cent for the year to the end of May.

The average annual three-year performance, also to May, is an even more impressive 43.4 per cent. Both returns were achieved with below peer group volatility. According to researcher Lonsec, which studied the fund last year, it follows a bottom-up approach looking to buy shares in the small companies sector.

The fund can go "short" on shares as well as buy them and also has an ability to gear, though this is related more to its capacity to short sell. Lonsec gave the fund a recommended rating.

More recently, another researcher Zenith Partners also gave the fund a recommended rating.

Hopkins describes the target investments as companies with a market value of between \$100 million to \$500 million, which he says gives his small team about 250 companies to choose from.

From this, a portfolio of up to 35 shares is developed, with some of the prominent ones including the Sydney Futures Exchange, data provider Iress as well as leasing company Record Investments. These companies focus on the financial sector and, he says, offer consistent profit growth.

Being the manager and an investor, says Hopkins, also encourages them to stay in the business, although they do plan to close the fund when it reaches \$200 million in assets under

### MLC MasterKey Platinum Global

This fund has been closed to new investors since June last year, largely because of disappointing performance back then. Returns, however, improved from April (although the May correction has not been factored in to its gains as the fund reports quarterly). While new investors can't join, existing investors can continue to add to their positions.

As a joint venture between Platinum and MLC Investments, which acts as the administrator, Platinum Global invests in traditional and emerging markets around the world and can have up to 200 shares in its portfolio.

According to Morningstar's head of research, Justin Walsh, Platinum uses a value strategy to choose stocks but the growing size of its fund has seen it invest in more large companies than small ones.

Indeed, in its larger funds, Platinum appears to be changing from a deep value manager to one that uses a "blended" approach, says Walsh.

Value managers seek to buy shares in companies whose share prices do not reflect the current value of the businesses, while growth managers seek to buy shares in companies with a likelihood of strong earnings growth. Fund managers who use a blended strategy opt for a bit of both.