

EUREKA *report*



It's about the stocks, not timing

By Michael Pascoe
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PORTFOLIO POINT: Hugh MacNally says picking the right stocks, rather than trying to time the market, has helped PPM post consistently strong results.

Distressed about not pulling your money out of the market before the crash? Worried now whether you should be piling back in or staying out? Are you concerned by Alan Kohler's warnings that this is a bear market rally that's doomed to die?

Don't be – it turns out that it really doesn't matter much what the market is doing.

That is the reassuring if somewhat surprising lesson from the success of Private Portfolio Managers (PPM).

PPM has been a relatively quiet achiever among the boutique funds managers, with \$300 million under management, but its value investment strategy is now giving it something to crow about.

PPM ruled off its 13th year on March 31 with its Australian Equities Growth Portfolio achieving an average return of 11.7% and its Australian Equities Growth and Income Portfolio 10.2%.

In the latest year, PPM outperformed the All Ordinaries index by 15.3%, which would put it at about the top of the Mercer Australian equity fund ratings for that period.

And it's all done while ignoring market timing. That should be reassuring for the investors out there who can't seem to time the market – which means all of us.

To see how you can invest successfully while not worrying about what the market might be doing, I spoke to PPM's founder and director, Hugh MacNally.

The interview

Michael Pascoe: Is it a fair description to say PPM is outperforming the

market by ignoring market timing?

Hugh MacNally: Yes. I guess our strategy is to focus on the individual results, but we seem to have a long-term growth aspect. Our view is that trying to time the market is a very unreliable approach and over the long term it generally doesn't produce good results. There's a lot of data that shows that if you miss the turning point by a small margin, your return is generally reduced by a significant margin.



So what we do is just focus on a small number of stocks. The portfolios contain generally about 20 to 25 companies. We're basically a buy-and-hold strategy and tend to only sell when there is a significant change in the position of the company that we're investing in.

Well what do you look for in those 20–25 companies?

We look for a strong strategic position. I guess there's a lot of Porter's analysis (competition guru Michael Porter of Harvard Business School) in our strategy in that we're looking for companies that have a strong competitive position, that they're stronger with their suppliers and their customers, and the structure of the market that they operate in is such that there is not excessive or irrational competition.

For example, what are your top five stocks?

I suppose the classic one is Woolworths. Its position to the various suppliers and customers is a wonderful one – for Woolworths that is – and in an industry where the competition is very limited.

Others we hold – we've always been a large holder of the main retail banks. We think particularly now, where there is vastly reduced competition, they're in a wonderful position for the next few years.

Other stocks we're investing in are things like REA Group, previously known as realestate.com.au. This is essentially a position that is tending towards monopoly. They really have only one competitor of any significance and what we're seeing there is growing margins and growing volume. This is a situation that can produce pretty decent returns for many, many years.

Hugh MacNally's favourites

Name	ASX	Price	P/E	Yield (%)
Origin Energy	ORG	\$16.14	2	2.3
REA Group	REA	\$4.32	21	0
ResMed	RMD	\$5.37	28	0
Woolworths	WOW	\$26.65	19	3.6

In the year to end of March you outperformed the All Ords Accumulation

index by 15.3%, but you were still about 16% negative. Does that hurt?

Obviously it's disappointing to have a negative result but I think in the circumstances it's an acceptable result as it's significantly below the market's decline. I think we're in a position to go on to the front foot for the next few years where we think that there's going to be a recovery from the very soft level in quite a number of areas at present.

You really run two funds and two strategies. One is absolute return; the other, a minority for your clients, is more income-focused. Is there much difference between their performance over time or not?

It's not an absolute return fund in the sense that it tries to have no negative returns. Its focus really is on long-term after-tax growth. The second fund has two objectives, to produce a particular level of income and also capital growth. The difference has tended to be an average of around about the 2% per annum higher return for the growth fund.

Has that changed? Has that been the case since the crash over the last year or so?

The growth fund has declined more than the growth and income fund because the growth and income fund had a high yield and had greater emphasis on income-producing securities.

I'm just wondering if the sort of parameters you set for yourself tend to result in companies that are paying a reasonable dividend anyway; not always, but often.

Not always. We have a big holding in Origin. Origin's income yield is not high, nor is it in Woolworths or some of the other holdings we have. ResMed is another that we have, and REA has no income at all. I guess the funds have a yield just slightly above the market yield, but not dramatically.

If you don't even try to time the markets, I guess you're fairly relaxed then whatever the markets are doing.

We'd hope to be. In difficult times, you'll always have concerns about some of the stocks you're investing in. I suppose one of the other things that benefited us during the past 18 months has been that we've never invested in stocks that have a high debt burden; we've always tried to avoid companies that have a high risk profile in this area.

The other area that we have avoided for this particular reason was property. We had virtually no property exposure in the funds. It might have been there was a small amount in some funds where the cost base was very, very low, but it was a very small proportion of the portfolio.

We generally invest in a stock where the financial structure is very strong and that gives you a bit of comfort even during difficult times. These are difficult times for everybody but we think that in these sorts of times you also get terrific opportunities. As long as one holds the belief that eventually the market will recover, it's a great time to buy if you've got the luxury of taking that extended view. If you're being measured on a monthly or quarterly basis you might not be able to do that. If it's a genuinely long-term investment strategy, then these are great times.

So it is very much the story of a value investor?

Yes. I think we've grown the funds under management by word of mouth over 12 or 13 years now and the strategy that we have is generally a long-term one, but does tend to do well during these more difficult times. During the dotcom boom and the latter stages of the bull market, we underperformed, but during these periods we've done significantly better than the market.
