INVESTMENT MANAGEMENT: AVOIDING THE DOWNTURNS

Peter Johnston of the AIOFP meets Hugh MacNally Executive Chairman of Private Portfolio Managers and discovers how outsourcing the management of your client's investments to an Investment Management specialist could not only save you from a knock on the door from ASIC but could also preserve your client's capital whilst giving them long term consistent returns.

"It really is a case of just sticking to some key disciplines: Manageable levels of debt in the investments and don't buy hugely valued stocks. The reversion to the mean of valuations is brutal."

Introducing Private Portfolio Managers

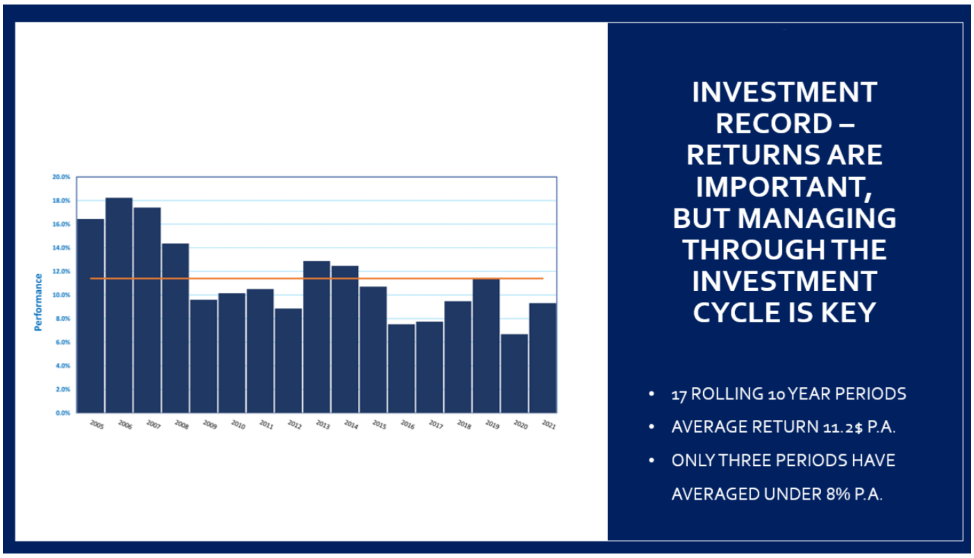
Peter Johnston: Hugh, over the next few minutes I'd not only like to introduce Private Portfolio Managers to our members but also get your views on what's facing investors in the coming months. I think it's a critical time for us with headwinds ahead of us economically and, what with clients having had ten years of pretty good performance they'll no doubt be expecting that to continue as we move forward. So, one of my questions to you will be how we are going to deliver that for them moving forward. In the first instance though, do tell us about PPM including the company's impressive track record.

Hugh MacNally: I founded PPM 26 years ago. We're a team of 15 who have been together a long time which, as I'll go on to explain, is I believe critical when it comes to managing client's investments. The actual investment team itself numbers 6 which is made up of 4 Fund Managers and 2 Analysts.

Peter Reed who manages the domestic strategy has been with PPM for 17 years. I manage the global strategy. The team itself comprises a progression of ages which again is important as this caters for continuity. Strategy-wise we've been managing the same strategy for quarter of a century.

Peter Johnston: And I know your track record over the years is pretty impressive. I've spoken to advisers recently, and I won't mention names, but they simply haven't delivered over the long term since they've tried to make the investment decisions themselves which I think can be dangerous particularly now since consumers are aware they can turn to AFCA. I certainly wouldn't want to be an adviser now getting a knock on the door from ASIC saying "you've been doing the asset allocation for your clients. They're now complaining. What experience and qualifications do you have?" They would be difficult questions to face. It's a particularly litigious world out there, particularly with AFCA, and it's a bit of a kangaroo court if anything against the adviser so this is where the PPM service, particularly with your track record, is something our members should be looking at to deliver for their clients.

There are rocky times ahead, particularly with what's happened over the past two years; global recession, high inflation, interest rates going up etc. and I think it's time to take stock of that and make some important decisions for your business as well as your clients.



predictions on economic conditions or the direction of the market over a short period of time is essentially futile. It's like weather forecasting. Outside a short period of time, it's useless.

If you look at the chart of equities markets over the past 100 years, it's bottom left-top right. All you've got to do is survive the downturns and that's essentially the job of the Investment Manager: make sure the client's assets survive.

Hugh MacNally: The thing is an Investment Manager is a full-time job. You can't do it part-time. It's also very important to have an experienced team that can provide sounding boards for all the opinions that come up. It's also important that the team has continuity because there needs to be a lot of trust and a lot of freedom to express opinion. When Peter Reed or I have an opinion the PPM Analysts feel able to state their views and there's very little mercy shown. That's really important.

You've got to spend time going to see the companies and a lot of time analysing the data. It's not just picking off a brokers list.

Peter Johnston: So, what type of headwinds do you see over the next 3 years, globally and locally here in Australia?

Hugh MacNally: To put it in perspective PPM has been through 4 major downturns in the past 26 years. They typically occur every 6 to 13 years. Let's say on average every 10 years. So, in the client's timeframe – let's say they're 45 years old – their superannuation fund is going to go through about 4 major downturns. The downturns are very rarely picked. You've got to pick the top and the bottom and the data shows that if you miss the top by a month, you pretty much halve your return.

So, we're going through a period where there's concern about rising interest rates, inflation etc. That's not an unusual situation and we may well have a period of economic downturn. Whether we have a period of major downturn is very hard to predict but that's not the key element for a client's overall strategy. The key is focussing on the sorts of investments they've got and whether they can survive difficult times, more difficult possibly than the last 10 years.

It's a classic thing. You're going to hold these investments for long periods of time and making

Peter Johnston: I also think a key point for advisers is that if something does go wrong, they have a third party they can blame. I think that's more than a mild consideration.

The PPM SMA Philosophy – client transparency

Peter Johnston: So, tell us about the PPM SMA model.

Hugh MacNally: Well, we use a domestic and a global strategy. They both comprise about 20 stocks. These are major companies both domestically and globally that have set characteristics that we look for. Firstly, that they're financially very strong and secondly that they're not excessively valued. If you avoid these two things, then you avoid most of the problems of major downturns.

Peter Johnston: So, this is the IMA model for Financial Advisers?

Hugh MacNally: Yes. So, the IMA's that we run are essentially $1M minimum, whilst the SMA's are run on platforms so the investment is driven by the minimum size that platform has. It works well with Advisers who have clients who are looking to invest a little bit less.

Peter Johnston: And can you explain the philosophy behind it?

Hugh MacNally: Well, we think the SMA is a really good product. What it does is offer total transparency to the client. And we think that transparency is absolutely vital. Clients really need to know what assets they hold and with an SMA they can see every stock that's in the portfolio. It gives the client a clear view that the Investment Manager is doing what they say they're doing. Everybody's got an investment philosophy and under pressure that philosophy may change. If you've got your entire portfolio in front of you, then it's a very easy way to know that your Investment Manager has not got some weird and whacky derivative strategy and not gearing up with options and all sorts of things to try and juice up the performance. In a pooled fund you will get the good news. You might not get the bad news.

Introducing Warren Jones & Jill May

Peter Johnston: So, who are the key contacts at PPM if our members want to make contact?

Hugh MacNally: All your members will know Warren Jones. Warren has been with us a while now. We went to the AIOFP conferences in Tasmania and the Hunter Valley and thought Warren such a great and knowledgeable character. There's also Jill May who heads up the PPM Client Services. Both of them are readily available. They handle the initial enquiries and if anyone wants to talk to the Portfolio Managers, they're available too.

Peter Johnston: And what's the classic type of client for PPM?

Hugh MacNally: It's a wide range and with the SMA's it's particularly wide. The minimum amount to invest in a domestic strategy is $20K whilst it's $50K for the global strategy. In the past retirement assets have been weighted heavily towards fixed rate but over the last 10 years returns have been close to Zero, even negative in real terms. As anyone in cash and fixed interest would be aware equities have formed a big part of most people's strategies.

Peter Johnston: So, what has been your track record over the past 10 years? What has been the return to the investor?

Hugh MacNally: Well firstly it's important to note that the most common strategy with clients is a growth strategy that tends to comprise about 35% global equities and 65% domestic. Returns over the past 25 years have been a little over 11%.

What we tend to do is measure the returns over rolling 10-year periods. So, 1995 to 2005 for instance would be the first one (since PPM was founded in 1995). Why 10 years? That tends to be the cycle. The important thing is that only in one 10-year period has the return been less than 8%. So, we're really aiming to deliver a return between 8 and 12% .. let's say around 10%. We're not trying to shoot the lights out with aggressive stock selection. This may look great during a boom but during downturns a lot of their stocks will just disappear.

We recognise that clients have a timeframe that may be 30 to 40 years and we need to ensure they survive the 3 or 4 downturns they're going to encounter.

Peter Johnston: I gave advice for 20 years and the first thing clients care about in my view is return of their capital. If you can preserve their capital and then give them a reasonable return, then they're happy. It sounds like you've done that over the past 25 years which is an attractive proposition.

Hugh MacNally: Well, it really is just sticking to two key disciplines: *manageable levels of debt in the investments and don't buy hugely valued stocks*. The reversion to the mean of valuations is brutal. Certain stocks might appear glamourous but the valuation when it's as huge as it was a huge risk. It may take decades to recover or may never get back to the value it was.

Peter Johnston of the AIOFP was talking to Hugh MacNally Executive Chairman of Private Portfolio Managers.

For further information on Private Portfolio Managers and their IMA and SMA service offering please contact either Warren Jones, Business Development Manager or Jill May Senior Client Relations Manager.

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