

Equities sparkle and shine despite October rain

Equities

James Hall

So strong was the sell-off on the Australian sharemarket in October, amid ongoing fears about oil price-induced inflation and interest rate hikes, that it's easy to forget that the three months to September was an outstanding period for local equities.

A run of 12.7 per cent on the benchmark S&P/ASX 200 Index in the nine months through September meant that the 100 Australian share funds ranked by asset consultant Mercer Investment Consulting added, on average, 18.6 per cent.

The best performing active equities fund during the period was IAG Asset Management's Research Fund, which returned 26.1 per cent before tax and fees. It also leads the table for the best 12-month performance, with a return of 43.9 per cent.

Senior portfolio manager Simon Rutherford says a high-conviction approach was the key to success for the \$500 million fund, which has been running since May 2004 and has returned 62 per cent in that period.

Having no fixed value/growth or small/large bias has worked in the fund's favour.

It invests in as many as 50 stocks on a bottom-up basis and does not pile too heavily into one particular theme.

The only sector the fund does not invest in is property trusts.

Rutherford says key contributors to performance have been Oil Search, Rinker Group, Caltex Australia, Macquarie Airports and WorleyParsons.

"Although some of the stocks have done particularly well, we get a lot of equal contributors to the overall fund by having a broad approach," he says.

"We're very bottom-up, so we don't have too many overweights. We have a range of stocks across

BEST IN CLASS

RETURNS OF LEADING ACTIVE EQUITY FUNDS

Nine months to September 30

IAG Asset Management Research Fund	26.1%
Paragon Australian Equities	25.6%
Merrill Lynch High Conviction	24.8%
Hyperion Australian Growth	24.5%
Bernstein Value	24.5%

12 months to September 30

IAG Asset Management Research Fund	43.9%
Merrill Lynch High Conviction	40.5%
Lazard Select Australian Equity	39.7%
Ausbil Australian Active Equity	39.3%
JF Capital Partners	38.9%

Three years to September 30

Ausbil Australian Active Equity	27.5%
Independent Asset Management	27.2%
Dimensional Australian Value	26.3%
GMO Australian Equity Momentum	26.2%
Perpetual Australian Shares Composite	26.1%

"It's been a very good market. It would have been hard not to do well. It's a question of how well."

IAG Asset Management portfolio manager Simon Rutherford

"The idea is to have a long horizon, buy cheap assets and have patience. We are not keen to take on clients who are after hot money."

Lazard Asset Management portfolio manager Rob Osborn

Source: Mercer Investment Consulting

sectors and we try to own the best two in each."

Right now, he still likes the outlook for miners BHP Billiton, Rio Tinto and Zinifex, as well as "turnaround stocks" Bayscorp Advantage and Lend Lease.

Rutherford says having minimal exposure to Telstra shares — which lost 14.1 per cent in the nine months to September 30 — also helped.

David Pace, who runs the Merrill Lynch High Conviction Fund, also says not holding Telstra contributed to performance.

The fund sits in third place for the nine months to September 30, with gross returns of 24.8 per cent, and second place over 12 months, with gross returns of 40.5 per cent.

"We calculate that 120 basis points of the fund's outperformance has come from not holding Telstra," he says.

"You can use the fact that you're not weighted to something like

that just because it's there by investing in something you really like."

For Pace, that has included stocks such as Sonic Healthcare, Aristocrat Leisure and QBE Insurance. He is also a fan of BHP Billiton and Rio Tinto.

"There hasn't been a lot of turnover in the portfolio over the last quarter but at the margin, we're

"We try to own the best two stocks in each industry sector."

liking the resources story more than we did two or three months ago because the price-earnings ratios have de-rated while the fundamentals have only got better.

"Those two stocks, BHP and Rio, are now trading on single-digit P/Es, where I anticipate material earnings upgrades ahead."

FUEL FOR THOUGHT

- IAG's Research Fund is the best performing active equities fund.
- Key contributors to the fund's performance include Oil Search, Rinker Group and Caltex.
- A minimal exposure to Telstra helped boost a number of funds.

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Pace's fund, which has been running since August 2003, manages \$950 million and invests in about 30 stocks at any given time. Pace says 90 per cent of the fund's allocation is usually in companies from the largest 25 stocks in Australia.

Lazard Asset Management's Select Australian Equity fund was third over 12 months on 39.7 per cent.

Portfolio manager Rob Osborn says the fund accounts for about a third of Lazard's Australian funds under management of \$5 billion.

It usually has between 20 and 30 stocks, and has no exposure to domestic cyclical stocks, resources or energy.

During the year it benefited from positions in "special situations" such as Metcash, Foodland and Hills Motorway Group, which were all involved in takeovers.

"We try to buy as cheaply as possible over a five-year time-frame," Osborn says. "It's the most

attractive ideas concentrated with no index awareness."

He says the fund has done well more recently from selling stocks such as Leighton Holdings and Macquarie Bank.

"We're very comfortable because the portfolio today looks very defensive, with a major position in Telstra and the brewers."

Over three years, the best performer remains Ausbil Dexia's Australian Active Equity Fund, with a return of 27.5 per cent. It also has the best returns for two years and the fourth best return for 12 months.

Second best over the year to September 30 was Paragon Australian Equities, with a return of 25.6 per cent.

Second and third best over three years were Independent Asset Management, on 27.2 per cent, and the Australian Value Fund of quantitative manager Dimensional, with a return of 26.3 per cent.