THE AUSTRALIAN
Business
WITH THE WALL STREET JOURNAL.

August 12, 2009 07:08am AEST

Little and large the perfect recipe: Northward Capital

Sara Rich | August 12, 2009

Article from: The Australian

IT was a common story during the boom years: a senior portfolio manager -- or entire investment team -- gets that niggling feeling that they could be doing for themselves what they have been doing quite well for a big financial institution.

Talk to the head of any boutique fund manager who previously worked for an institution and they will most likely tell you that they launched the new firm because they wanted more control over their own destiny.

It was a large part of the reason Northward Capital chief investment officer Simon Rutherfurd supported an offer from nabInvest in 2007 to uproot the entire Australian equities investment team at Insurance Australia Group, where he was the head of research, and set up a boutique with his colleague Darren Thompson. The move included the institutional client portfolios the team had held since May 2004, giving the new boutique -- Northward -- a continuous five-year track record.

In that period, the boutique's flagship fund, the Northward Capital Australian Equity Fund, has been the third best performing fund of its kind in the market, according to Mercer.

In the five years to June 30, the fund returned 12.5 per cent a year. Its one-year return to the end of June was minus 18.2 per cent, but it beat its benchmark, the S&P/ASX 300, which returned minus 20.3 per cent.

Northward Capital is 51 per cent owned by nabInvest, a division of National Australia Bank, with the balance held by the boutique's staff.

The beauty of nabInvest for someone such as Rutherfurd is it allows the boutique to operate independently, under its own leadership and governance, but with the backing of a large company.

"It has been great, there's no step off in terms of the drive to succeed and meet your key performance indicators and beat your performance targets, but we are in charge of our own destiny now so we don't have excuses to make about things any more; we can do as well as we want to do," Rutherfurd says.

Rutherfurd, who started his career in New Zealand as a stockbroking analyst, co-manages the Australian share fund with Thompson, Northward's chief executive. They have a team of seven working with them.

Retail investors can access the retail version of the fund, which was launched in April last year with $1.5 billion funds under management and returned minus 18.8 per cent for the year ended June 30, via a variety of investment platforms or by investing directly. The fund charges a 0.95 per cent a year management fee and a performance fee of 15 per cent of any outperformance (after fees and expenses) above the S&P/ASX 300 index, calculated quarterly.

How would you describe the fund?

We look to identify mispriced Australian stocks through fundamental research. We are bottom-up stock pickers looking for investment ideas across the market, which are likely to include value and growth stocks. Our multi portfolio manager approach means our analysts each manage a portion of the fund and ensure that the team's best investment ideas are captured.

What is your investment philosophy?

We believe that growth and value investing are joined at the hip, hence our style-neutral investment process. We think the market is relatively inefficient during the short to medium term, but during the longer term companies that increase their return on equity as well as increase earnings and cashflows will be rewarded with higher share prices.

What has the fund's performance been like since inception?

The fund has returned 12.7 per cent a year since May 2004. Since inception we have delivered excess returns of 5.7 per cent against the S&P/ASX 300 Accumulation Index.

How do you value companies?

We like to get out and meet management and competitors, as well see their operations to see how they make their money. We typically look for companies with solid management in good industries who are focused on improving returns on equity. We are also a signatory to UN Principles for Responsible Investment, so we are engaging with companies on various environmental, social and governance issues.

Our primary valuation technique for most companies is the price-earnings ratio in the current year and predictions for up to two following years.

In Australia, what sectors and stocks do you like most?

We tend not to take large sector positions but prefer to be invested across the market. Doing this allows our returns to be driven by a larger number of stock ideas rather than a couple of sector positions. From a stock perspective our largest active positions include infrastructure group Asciano, Woolworths, Rio Tinto, casino operator Crown and Telstra.

What investments have been the best performers for you?

For the past year these were Woolworths, Coca-Cola Amatil, medical device company Resmed and retailer Metcash, while for the past quarter they included miner Western Areas, Equinox Minerals and Macquarie Airports.

Is the investment climate good for your type of fund?

As an active fund manager the present volatile environment creates potential opportunities to buy mispriced stocks. Historically we have outperformed in both up and down markets and aim to outperform in all market environments.

Various assets have taken a beating in recent months, has that enticed you to buy up?

Stocks we expect to show strong cyclical earnings rebounds that we have been buying include OneSteel, News Corporation, ASX, funds manager Henderson and Asciano. We hold a little more than 1 per cent in cash at the moment.

Where do you see markets heading in the next 12 months?

There will be inventory restocking, gross domestic product upgrades for Australia, a domestic building cycle recovery, higher commodity prices and a better unemployment outlook. This suggests the market will trade higher during the next 12 months, led by the cyclicals.

What do you see as the main themes that will dominate markets in the next 12 months?

We would expect the US economy to look better as it finally comes out of recession during the next quarter due to fiscal stimulus, inventory restocking and some stability finally emerging in the housing sector. The next milestone is the present reporting season in Australia. Given the return of the big economic cycle in terms of peak to trough earnings, investors will be looking for signs that some cyclicals have reached a base and that the earnings upgrade cycle can begin again.

What do you think of the banks and financial services sector globally?

Profits from the banks and financial services sector globally have benefited from strong growth in credit since the early 1980s. More recently profits have also benefited from unusually low bad debts because of strong economic growth and asset price appreciation. As economic growth slows and credit growth contracts, earnings for financial services companies will increase more slowly than previous years.

Global banks are facing further loan losses because of continued falls in asset prices, particularly in residential and commercial property. The speed and degree of these future loan losses will determine bank profitability and requirements for further equity capital. We are underweight banks in our portfolio.

FIVE HOT TIPS

BUY value, not market trends or the economic outlook.

DON'T dwell on missed opportunities.

DON'T confuse good companies with good stocks; some of the most unpopular stocks will represent the best value.

MAKE sure your companies match profit growth with solid operating cashflows.

NEVER be afraid to buy back a stock you have previously sold at a lower price