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WHO PICKED THE TOP STOCKS? STOCK PICKERS' SHOWDOWN

Twelve months ago we asked four stock pickers to select a portfolio of 10 stocks to hold for one year. So how did they fare?

By Mark Story | 06.04.2010

Twelve months ago we asked four stock pickers to select a portfolio of 10 stocks to hold for one year. At the time the sharemarket was languishing at 3353 points - so with the market awash with value, each stock picker had ample opportunity to find the low-hanging fruit that would help deliver strong returns. So how did they fare?

Independent investment analyst Roger Montgomery blitzed the field with a whopping 51.90% gain, beating off his competitors by as much as 24% as well as the All Ordinaries index by a hefty 13% margin. Following a well-known investment theory called “Dogs of the Dow,” Montgomery demonstrated the merits of backing the 10 highest yielding stocks from the S&P/ASX 50.

What’s impressive about Montgomery’s results is that for the purposes of this competition, dividends were not included in calculating gains. Therefore, had dividends been included, Montgomery’s total would have moved him even further ahead of his rivals.

Broker Justin O’Brien with Morgan Stanley Smith Barney ran the second best-performing portfolio, posting a 38.46% gain for the year. There were many standout performers in his portfolio, including Rio Tinto, Orica, Commonwealth Bank and Wesfarmers. Orica jumped by a massive 94% over that period.

So which stocks would O’Brien ditch if he had the chance? Absolutely none. He’d stick with the same 10 stocks today as he did back then, demonstrating the commitment of a true buy-and-hold investor.

Next up, trader Steve Matthews posted a 37.78% gain over the year boosted by some outstanding stock picks including Worley Parsons, 84.68%, United Group, 78.55% and JB Hi-Fi, 81.97%. To his surprise, his worst performing stocks - Telstra and CSL - were his most conservative bets.

To his credit, Matthews is a trader and not a buy-and-hold investor, which meant that he couldn’t trade in and out of his portfolio during the year. When asked how he’d alter his portfolio today, Matthews mentions ditching CSL for healthcare provider Primary Health Care (PRY), while continuing to hold Telstra due to its attractive yield. He says that he’d sell Tap Oil.

Our fourth place getter is TheBull’s wildcard, ‘The random stock picker’, which consisted of ten randomly selected stocks beginning with the letter B. While the portfolio fell short of the All Ordinaries index by over 5 per cent, it still managed to pull in a respectable 33.70% gain for the year.

And finally, we feature financial adviser Lisa Faddy who aimed to offer a low-risk portfolio with minimal volatility. Faddy’s primary objective over this risky period on the market was capital preservation.

As a financial adviser, Faddy’s portfolio was especially diverse - featuring not only top performers Wesfarmers and Boral, but fully-diversified funds such as the SPDR S&P/ASX 200 fund, Ishares FTSE/XINHUA China 25 and even gold bullion, GOLD.

Unsurprisingly, both large caps, notably banks that had been heavily sold off, and stocks with balance sheets strengthened by capital raisings were among the stock pickers’ top performers.

Here's a closer look at how they fared:

The Fund manager: Roger Montgomery of rogermontgomery.com

Stock Picker	Gains on $10,000 investment
Fund manager Roger Montgomery	51.90%
Broker Justin O'Brien	38.46%
Trader Steve Matthews	37.78%
Plan B	33.70%
Financial adviser Lisa Faddy	27.44%
All Ordinaries Index (excl. dividends and franking credits)	38.87%

*Closing prices the year 20 February 2009 to 19 February 2010 (Exc div and frankings)

The Fund manager: Roger Montgomery of rogermontgomery.com

Gains made on an initial $10,000 investment: **$5,190 or 51.90%**

Stock	Code	Price 20/2/09	Price 19/2/10	$ Gain	% Gain
Lend Lease	LLC	$5.29	$9.09	$3.80	71.83%
Incitec	IPL	$2.20	$3.45	$1.25	56.82%
Wesfarmers	WES	$17.09	$31.20	$14.11	82.56%
Suncorp-Metway	SUN	$5.69	$9.00	$3.31	58.17%
Macquarie Group	MQG	$21.89	$46.25	$24.36	111.28%
Goodman Fielder	GFF	$1.46	$1.51	$0.05	3.42%
National Australia Bank	NAB	$18.40	$25.25	$6.85	37.23%
Tabcorp Holdings	TAH	$6.36	$6.73	$0.37	5.82%
Commonwealth Bank	CBA	$29.85	$52.81	$22.96	76.92%
Aristocrat Leisure	ALL	$3.74	$4.30	$0.56	14.97%
					51.90%

Gains made on an initial $10,000 investment: $5,190 or 51.90%

Did the portfolio perform above or below expectations?

The Portfolio was based on the method known as 'The Dogs of The Dow' which was published by Michael O'Higgins' now infamous 1991 book, Beating the Dow. Instead of picking the ten highest yielding stocks from the 30 largest public companies that comprise the Dow Jones Index, Montgomery picked the 10 highest yielding stocks from the S&P/ASX 50.

While Montgomery had no specific expectations from these 10 stocks, he says their ability to outperform came as little surprise due to Australian investors' penchant for fully franked yields.

Which stocks contributed most/least to performance?

All ten of Montgomery's picks were in the black, four of the ten - Macquarie Group (MQG), Commonwealth Bank (CBA), Lend Lease (LLC) and Wesfarmers (WES) - were up 70 per cent or more, and two were up over 55 per cent. The only "poor" performances were from Goodman Fielder (GFF) and Tabcorp (TAH), which were up 3.42% and 5.82% respectively.

If you were to tweak your portfolio now, what would you do?

Nothing, Montgomery expects the 10 highest yielding stocks from the S&P/ASX 50 to always perform well, especially given that buying supports these share prices when markets are expensive. "Similarly, when markets slump they're also supported due to their strong defensive characteristics."

The broker: Justin O'Brien Morgan Stanley Smith Barney

Gains made on an initial $10,000 investment: $3,846 or 38.46%

Did the portfolio perform above or below expectations?

Given the headwinds facing the market over the last year, O'Brien regards a 38.46% return as above expectations. "Yes, I could have done better, but given the 'buy and hang-on' nature of this exercise and the state of the market at the time, I was more concerned about the preservation of capital," explains O'Brien.

Which stocks contributed most/least to performance?

According to O'Brien, the standout returns delivered by both Wesfarmers (WES) and Rio Tinto (RIO) to some degree reflects the relief brought to their balance sheets by way of major capital raisings. "As with other large-caps that raised capital, once the underlying risks were removed, we saw investors return to these two stocks," says O'Brien.

If you were to tweak your portfolio now, what would you do?

O'Brien would stick with the same 10 stocks due to their strong balance between income and growth. "We're still in a trading market that could conceivably bounce back to 3,800 points before breaking through the all-important 5,000 point barrier," he says.

But with the overall market in recovery phase, he'd rebalance more in favour of the 'late cyclical' stocks within the portfolio. "So instead of holding 10 percent equally in each stock, we'd reduce exposures in some down to 5 percent and raise it to 15 percent for others," O'Brien says.

Despite the dismal showing by AGL and Santos (STO), he still has conviction in the stocks which is further enhanced by the likelihood of corporate activity later this year. "Sometimes a stock's upside is simply outside a three, six, nine or even twelve month outlook."

The trader – Steve Matthews

Gains made on an initial $10,000: $3,778 or 37.78%

Did your portfolio perform above or below expectations?

The overall portfolio performance was on par with expectations, but Matthews says the under-performance of several of the stocks took him by surprise. “Paladin Energy (PDN) and Incitec Pivot (IPL) were opportunistic plays that disappointed. I also expected Tap Oil (TAP) to have rallied,” admits Matthews. “But Telstra and CSL were the shockers I wouldn’t have dreamt of a year ago.”

Which stocks contributed most/least to performance?

Standouts like Worley Parsons (WOR), 84.68%; United Group (UGL), 78.55%; and JB Hi-Fi (JBH) at 81.97% offset the worst performing stocks Telstra and CSL which both lost value over the 12 months. “This was a surprise as these stocks were my most conservative of the trades...and I expected CSL to be a consistent performer in any market.”

If you were to tweak this portfolio now, what would you do?

As a trader, Matthews says a long-term “buy and hold” strategy isn’t something he would ever seriously contemplate, and especially not within such a volatile market. However, for the purposes of this exercise, he says Tap Oil would be removed based on specific market concerns that could see the market drop to around 3,800 points by year’s end. “The problems in Europe coupled with the bond market bubble emanating in the US suggest that we can’t hold off the bears forever,” says Matthews.

He would also replace CSL with an alternative healthcare provider like Primary Health Care (PRY), and AGL (AGK) with Leighton Holdings (LEI) which looks better insulated against a future downturn. “I’d retain Telstra due A) to its gross yield of around 13 percent fully franked, and B) the value proposition within the current price,” says Matthews. “While I’d retain the other stocks, I’d also look to either hedge the portfolio either with a put option over the index or short sell CFDs over the ASX 200.”

Plan B - The wildcard

For our wildcard, TheBull randomly chose ten stocks that started with the letter B.

Gains made on an initial $10,000 investment: $3,370 or 33.70%

The financial adviser – Lisa Faddy Majella Wealth Advisers

Gains made on an initial $10,000 investment: $2,744 or 27.44%

Did your portfolio perform above or below expectations?

While 27.44% is below the return delivered by the All Ords, Faddy expected the conservative nature of her portfolio to have caused it to lag during the rapid reversal of sentiment that occurred.

When Faddy chose these stocks, the bottom of the market had not yet been reached and there was still significant negative sentiment and uncertainty over the near term health of the global economy.

“We felt that there was a reasonable risk of markets going sideways for a while if not lower in the near term (as they did). For these reasons, we chose to position the portfolio relatively conservatively,” says Faddy.

To manage risk, Faddy used diversification through Gold and Ishares China 25 stock (IZZ), a focus on yield and chose some stocks with lower downside risk than the general market. Some higher yielding stocks selected by Faddy included a hybrid security, an infrastructure stock and Telstra (TLS).

Which stocks contributed most/least to performance?

As expected, the return of market confidence delivered some attractive returns for the undervalued large-caps within the portfolio, notably Boral (88.36%), Wesfarmers (82.56%), and Westpac (53.84%).

The biggest under-performance came from Gold Bullion Securities Limited which had been selected by Faddy as a diversifier that should have held up when things got worse. “Due to the massive rise in the Australian dollar (up 43% against the USD), gains from Gold were eliminated when quoted in Australian dollars (down 21 percent),” says Faddy. “Our holding in China (IZZ) was also greatly reduced by the rise of the AUD, in USD the stock rose over 30%, while it was up only 8% in AUD.”

If you were to tweak this portfolio now, what would you do?

With the medium to long-term outlook for the Australian share market looking positive, Faddy would sell some of the more conservative stocks: Australian Infrastructure Fund (AIX) and the hybrid, Macquarie CPS Trust (MQCPA). She’d also sell Gold now that global risk has reduced and the USD price has risen strongly. “We would also increase the portfolio’s weight to banks and resources by buying BHP and ANZ.”

The market – All Ordinaries index

The market – All Ordinaries index

20/2/09	20/2/10	Points Gain	% Gain
3353	4656.3	1303.3	38.87%