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Money

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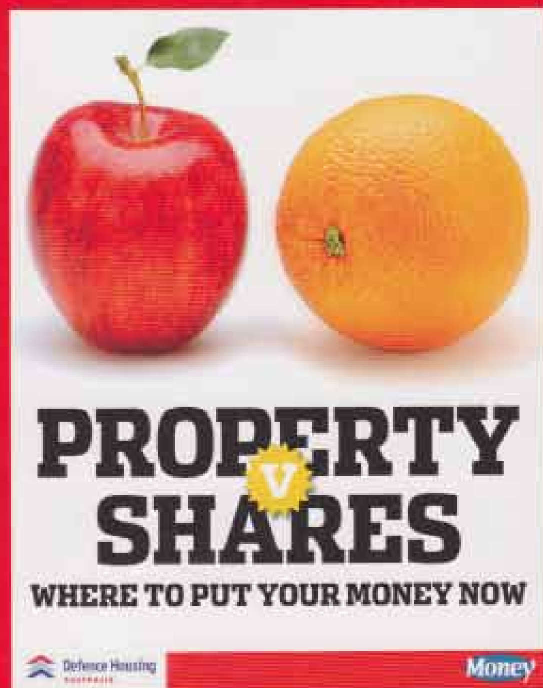
DOUBLE YOUR MONEY

4 WAYS: PROPERTY, SHARES, SUPER, CASH



PLUS

SMALL FUNDS – BIG GAINS
Returns up to 32%

AN EXTRA $200 A MONTH
Renting out spare space

WORK IN RETIREMENT
Wind down and still get paid

SUPER TRAPS
How to avoid a 93% tax hit

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SHARES TO BUY: WINNERS FROM PROFIT SEASON

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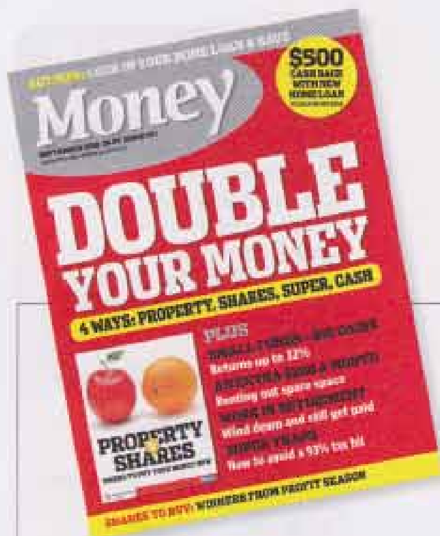

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How you can be a long-term winner

Money's Value.able columnist, Roger Montgomery, sets out his principles for long-term sharemarket success in a new book

TODAY I WILL REINVENT the way you invest. If you are like many people your portfolio has enjoyed bouts of strong returns but otherwise lurches from one crisis to the next. Why?

The way many people buy stocks and manage their portfolios is misdirected and much of what passes as advice may be misguided. The problem goes all the way back to the way we even look at the market. But perhaps the most stunning revelation is that, despite an obvious and superior alternative, few people have taken the time to investigate it.

As a professional investor I didn't have the time either. Then one day I found myself with the time, the curiosity and, most importantly, the energy.

Why, for example, do most portfolios merely rise and fall with the market, despite the best efforts of investors and their advisers? Why can't all the brainpower the financial industry is able to muster warn you that a crash is imminent?

Don't be a sucker

Why do so many investors act as if crashes are rare? And why do investors continue to be suckered into clearly dubious "opportunities"? Why are there billion-dollar losses that are clearly avoidable?

One of the major reasons the sharemarket proves to be such a contest for so many investors is that we are approaching it the wrong way.

Does a rising share price mean the company is a blue chip? Does a falling share price mean the shares are more risky? For my money, a rising price increases the risk of loss as well as pushing up the opportunity cost.

A falling share price should be seen as a friend of the investor, allowing you to buy more of a good thing at even more attractive prices. Most investors don't think this way.

We have been mismeasuring risk. The market is much more volatile than we thought and more than we would like. A blue-chip stock is not a low-risk investment.

A high-yield one is not defensive. There is nothing defensive about paying a high price for any business.

The conventional approach to investing is fraught with guesswork and presumptions that have been left unchallenged by those applying it to your portfolio and risking your money on your behalf.

Whether you are a full-time, part-time or first-time investor, a professional adviser or self-directed investor, I wrote *Value.able* to show you that there is a far simpler and more successful way to invest in the stockmarket, and that your portfolio does not need to be beholden to the intoxicating and frequently wealth-destroying influences of the stockmarket.

As I have demonstrated here in *Money*, in real time you can beat the market and it is not as hard as you might think.

Sure you won't beat it every year and you need to be patient but over time, beating the market is not the greatest challenge in share investing.

Once you discover how to identify extraordinary businesses and estimate the right price to pay, the only challenge left is to avoid being distracted by the market's noisy and often destructive temptations.

Most people, however, take their cues from prices. If prices rise, the stock is "good". If prices fall the stock is "bad". In reality the reverse may be true.

Without turning the stockmarket off however, it's hard not to be swayed by its temptations. Approach stocks the same way you would approach buying a business and quite suddenly the way you look at the stockmarket changes.

> The conventional approach to investing is **fraught with guesswork**

If you were going to buy the local newsagency or a fast-food franchise, what would you look at to assess it?

The same things you should be looking at when buying shares. If you were buying an unlisted business, I doubt you would be buying it with the objective of selling it next week or next month either.

Once again, approach the exercise of buying shares the same way. And if you stick to buying businesses with the metrics I suggest, you might even be happy if the stockmarket were closed for several years.

I know of some businesses that generate

returns of more than 50% on their investors' funds. Compared with the 6% available from a term deposit, such a business would be a very attractive proposition.

No wonder renowned investor Warren Buffett says that he doesn't mind the stockmarket being closed for a few years.

The very exciting thing about the market is that once you are able to turn away from its distracting influence, you can begin to take advantage of its almost bipolar nature.

Recognising value

If Cochlear is really worth $48, then you can ignore all the enthusiasm that drives the price to $78 and wait. If it doesn't fall to a price that represents a bargain, you can look for opportunities elsewhere.

Conversely, if the price of a great business has been pushed below its intrinsic value because of some temporary event that is being judged as though it is permanent, you can see the opportunity for what it is.

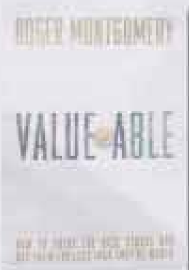
Knowing the intrinsic value of a great company for an investor is like seeing a lighthouse in a storm for a captain. The changing tides of opinions and speculation can wash around you but the valuation doesn't move. You are free to take advantage of the market's indecision or ignore it. Just don't be influenced by it.

As Ben Graham, the "intellectual dean" of Wall Street, once instructed, it's the market's wallet you want, not its wisdom. Just three or four steps, if followed sensibly, should produce satisfactory results over time. They will reinvent the way you invest.

Turn the stockmarket off, think about shares as pieces of businesses in which to invest rather than as gambling chips on which to bet on "up" or "down" – and know how to value a company. Do these things and over time, you should do reasonably well.

ROGER MONTGOMERY

Roger Montgomery's book is *Value.able: how to value the best stocks and buy them for less than they're worth.* My 2 Cents Worth Publishing $49.95 (postage included). It's available only through the website rogermontgomery.com.
Five *Money* readers can win a copy. In 25 words or less tell us your favourite tips on investing for the long term. Send entries to Value.able, Money, GPO Box 3542 Sydney NSW 2001 or email money@acpmagazines.com.au. Don't forget to include your name and postal address. Entries close October 5, 2010.



SECRETS OF STOCKMARKET SUCCESS

Follow these steps and you should have all the tools you need to win over the long term

STEP 1. Forget about the sharemarket
Instead of watching the stockmarket's every zig and zag, turn the stockmarket off. Yes, you heard correctly.

Turn away from its noisy and distracting influence. Instead focus on businesses.

That's the first thing that Value.able teaches.

STEP 2. Avoid the bad businesses
Let's suppose I offer you the opportunity to invest in a business with me. We will invest $110 million of our own money and borrow $31 million from the bank. In our first year we earn $5 million.

Now suppose we run the business for another 10 years and today, we earn a profit of $108 million. Sounds pretty good doesn't it?

Many investors' analysis stop there. They focus on the earnings coming out of the business and how much those earnings grow. But it is a trap.

Any business owner knows that it's not only the profits that come out of a business that are important, but also how many of those dollars are required to be reinvested to keep the business running.

How would you feel, for example, if I told you that in the past 10 years we have had to inject a further $2 billion of our own money, to grow the business, as well as borrow an additional $1.4 billion in debt? No wonder the profits have grown from $5 million to $108 million!

You could do the same thing by putting a couple of billion extra into your bank account and buying a rocking chair.

The company now has the benefit of over $2 billion of our own capital and it's earning $108 million. This represents a return of just 5%.

And this is not some hypothetical example. The numbers I have given you belong to a company called Primary Health Care. It is listed on the Australian Securities Exchange.

You should approach buying shares in a businesslike manner. If you are not prepared to own the whole business, don't buy a little piece of it.

And if you aren't happy to own the business for 10 years, don't own the shares for even 10 minutes.

So it's easy – when you know what to look for – to avoid the bad businesses.

And that's the second extraordinarily simple discovery Value.able uncovers.

STEP 3. Stick to extraordinary businesses, those that generate wonderful returns
If you know what to look for, finding them is as easy as avoiding the bad businesses.

Have a look at Oroton's numbers since Sally MacDonald joined the company in 2006. The year before Sally was appointed CEO, Oroton earned just $1.6 million dollars in profit. Today it earns $22 million. Like Primary Health Care, this company has also had the benefit of additional capital but, while owners have put in another $10 million since 2005, each one of those dollars has produced a return of almost two.

Ten million additional dollars has increased profits by more than $21 million.

This 200% return is impossible to achieve in a bank account and represents the sorts of returns that make me want to own the whole business. You can see why you would be quite content to see the stockmarket turned off for several years.

Finding great businesses is as easy as avoiding the bad ones, if you know what to look for.

And that's the third thing that Value.able will show you.

It's easy when you know what to look for **to avoid the bad businesses**

STEP 4. Find out the business's real value
Buying a great business is the goal of long-term investing because time is indeed the best friend of the great business. The longer you own shares in it, the more likely your returns will mimic the performance of the business.

Now, imagine how your returns might be boosted if you could buy such a business at a bargain price as well.

Because of the sometimes bipolar nature of the stockmarket, extraordinary businesses are occasionally treated like second-class citizens. As a result you receive mouth-watering opportunities to buy them at prices that do not reflect their true worth.

Look for businesses with demonstrated track records of success, that have been met by temporary difficulties and a stream of negative press. Woolworth's comes to mind today.

The last job is to estimate its true worth. This can be done with a few simple steps and you really only need a handful of numbers. With Value.able you can see when a bargain price is available. By learning to turn the stockmarket off, to separate the extraordinary businesses from the ordinary and to understand what they might truly be worth, you will have all the tools you need to beat the market over the long term.

• *See page 48 for another view of investing in the sharemarket.*