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# Money

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# Look past the labels

Roger Montgomery knows a blue chip when he sees one

## IF YOU HAVE ONLY JUST JOINED ME

here at Value.Able, let me tell you what you have missed in the past six months. In the July issue of *Money*, Oronon was my value pick of the month trading at \$6.55. Today Oronon trades at nearly \$9 (see top table). In August's issue I presented a list of AI businesses, including ARB Corporation, Carsales.com, WorleyParsons, CSL, JB Hi-Fi, REA Group, Oronon Group, Cochlear, Monadelphous Group and Fleetwood.

Then in September, I changed tack and suggested that JB Hi-Fi, then trading over \$21, might have matured; mid-February, it is trading around \$19 and has traded as low as \$17.48. In September I also launched my value investing guidebook *Value.Able* and mentioned a mining services and engineering company called Decmil, which has since risen 59%.

In October the picks and shovels theme continued and I added to Decmil with Forge Group and Matrix Composite & Engineering. Finally, in November, I suggested avoiding QR National. Its price has languished since listing.

So there have been some great opportunities and an average gain of more than 27% in six months - far in excess of the market's return of 12% and even many fund managers. The fact they made money is not the point, however. My goal is to demonstrate the variety of AI value-investing opportunities available to all investors who take the time to understand the Value.able method of finding good value.

And unlike many who might be primarily oriented towards return and how much they might make, the above group of stocks was selected with risk in mind - how much we could lose. Many, if not all, of the above companies presented a margin of safety - an appreciable discount between the price and the estimate of their underlying value.

Because the future is unpredictable and

because calculations of intrinsic value are imprecise, a margin of safety is a prerequisite to minimise losses. A conventional blue-chip portfolio offers no such safety margin. A portfolio constructed of extraordinary businesses, purchased at large discounts to intrinsic value, represents a true blue-chip portfolio.

This month I would like you to consider the portfolio in the lower table and the stocks in it. It's a conventional portfolio that many investors would be recommended to buy and leave in the bottom drawer. Because the companies are large and have been around for a long time, many might describe them as blue-chip. But they're not.

In the short run the share prices of these companies can go up a lot. Quite simply, in the short run price moves have very little to do with the quality or prospects of the underlying business. There are 2000 listed companies in Australia and many of them rise and fall daily and yet more than 1100 made no money last year. When food is scarce and you are starving, even the bark on a tree might taste good. But over the long run, ingesting bark isn't good for you.

The following list of companies will be familiar to you but they aren't blue-chips. As you can see from the quality ratings, where A1 is the best and C5 is the worst, they aren't high quality. And in the "safety margin" column, a negative number means there is none. Be sure to speak to your adviser of course before taking any action, as he or she is the only person who should decide if any action is appropriate for you.

## AI BUSINESSES

COMPANY	GAIN
Oronon Group (ORL)	37.5%
ARB Corp (ARP)	29.8%
Carsales (CRZ)	0.0%
WorleyParsons (WPL)	2.0%
CSL (CSL)	10.4%
JB Hi-Fi (JBH)	5.0%
Realestate.com (REA)	16.6%
Oronon Group (ORL)	31.4%
Cochlear (COH)	90%
Monadelphous Group (MND)	44.0%
Fleetwood (FWD)	70.0%
Decmil (DCG)	59.0%
Forge Group (FGE)	35.0%
Matrix C&E (MCE)	37.0%
Average	27.6%

Performance June 30-December 31, 210

## BIG NAMES, LOW QUALITY

COMPANY	QR <sup>1</sup>	SAFETY MARGIN <sup>2</sup>	6M PERF
Arcor (AMC)	C4	-33%	2.29%
Asciano (AIO)	C5	-71%	0.30%
Foster's Gp (FGL)	C5	-47%	0.52%
Goodman Gp (GMG)	C4	-40%	9.76%
Tatts Group (TTS)	C4	-26%	7.26%
Transurban Grp (TCL)	C4	-92%	22.90%
Woodside Petr (WPL)	C4	-66%	2.28%
Average			7.17%

Performance June 30-December 31, 210

<sup>1</sup>Montgomery Quality Rating. <sup>2</sup>Discount between share price and the estimate of stock's underlying value; negative value means price is higher than the value estimate.

There are some big names on the list, companies frequently quoted in the media. They are discussed and dissected daily and yet on a scale of A1 to C5 rank down the bottom. Perhaps coincidentally, the average price performance, over six months, has been significantly less than even the market index. If you are looking for a true blue-chip portfolio, you might need to rethink conventional wisdom. A true blue-chip portfolio has nothing to do with size or longevity and everything to do with quality.

Roger Montgomery is a portfolio manager at Montgomery Investment Management. His book *Value.Able* is available at [www.roger-montgomery.com](http://www.roger-montgomery.com).