Thinking about the outcome you want

LIZ MORAN

THERE is too much talk in super about aims and promises, and not enough about properly thought through outcomes.

In his speech to open the Griffith University Personal Finance and Superannuation school last month, one of Australia's leading experts on the super system, Michael E. Drew, continued his decade-long campaign to shift our thinking about how we invest from focusing on promises to looking at reliable outcomes.

If we did this, he believes, there would be less focus on volatile "growth" assets, and more focus on building portfolios that generate predictable returns.

One-year returns, as widely reported this week, were good in a number of sectors and reminded me of Professor Drew's comments. The ASX 200 ended the year 12.35 per cent higher, but just seven companies — CBA, Westpac, BHP Billiton, ANZ, NAB, Macquarie Group and Telstra — accounted for more than half of all the gains. Holding a share portfolio of the big four banks, Macquarie, BHP Billiton and Telstra is concentrated and high-risk from a portfolio management perspective.

There are another 193 stocks in the ASX 200; even in a concentrated share portfolio, investors should seek diversification.

The GFC showed us banks are cyclical, sometimes get into difficulty and are not immune from economic cycles; share prices can fall and dividends cut.

Instead of looking backwards at historical returns to help make investment decisions, a more productive approach is to stop and think about the outcome you want to achieve.

Providing certainty of a minimum cashflow in retirement would serve many investors well. Others may include preserving a lump sum for descendants. Identifying the path to achieve your outcomes is the problem. A portfolio concentrated on any single asset class will be more susceptible to economic cycles.

Diversifying assets will help smooth returns and minimise shocks. For example, one of the major benefits of investing in bonds is that they are generally countercyclical to shares.

An allocation to each of the three types of bonds (fixed, floating and inflation-linked) will help protect your capital under various economic cycles.

A truly diversified bond portfolio would hold allocations to the full range of risk and rewards available and would include government and high-yield bonds.

Under a GFC scenario, higher-risk bond prices would fall, but there would be a corresponding flight to quality and we would expect government bonds to outperform, cushioning returns.

Elizabeth Moran is a director of education and research at FIIG Fixed Income Specialists.

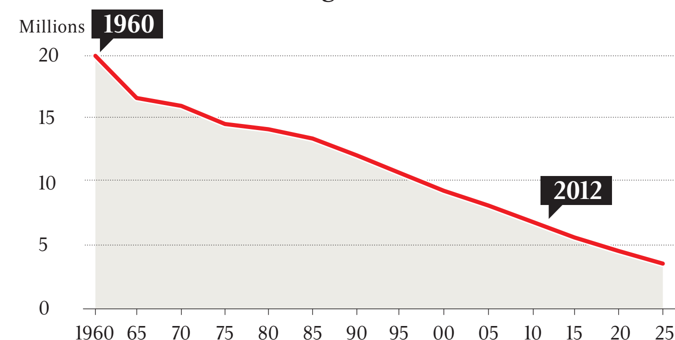
www.fiig.com.au

Australian philanthropy finds purpose

Ultra-high net worth Australians would like to lead the way

STIRLING LARKIN
GLOBAL INVESTOR

Children who die before age 5



Source: Bill and Melinda Gates Foundation

A HIGHLY positive trend is emerging in Australia and Asia whereby philanthropy is becoming as much a central focus for ultra-high net worth (UHNW) individuals and families as it has been for their North American equals.

This transformative phenomenon is a challenge and responsibility considered equally as important as prudent wealth management and family governance. Also encouragingly, even though we are told that the role of the middle classes is diminishing in our developed economies, recent research in the US highlights that these individuals, defined as those earning between $US50,000-$US75,000 a year, contribute around 7.6 per cent of their incomes towards progressive social and environmental causes.

This highlights that philanthropy is not only an increasing focus of UHNW's but also of society at large. But here in Australia, important misconceptions continue about the difference between what is charity and philanthropy. Although instances of charity can be considered philanthropic, they are not, importantly, one and the same. In short, charity attempts to relieve the consequences of society's problems whereas philanthropy strives to solve those problems at their core.

More than mere semantics, this distinction is clearly important and acknowledges why both charitable giving and philanthropic efforts are of equal importance to society. Traditionally, there is a perceived contrast between philanthropy, which is seen as private initiatives for the greater good, and business, which is thought of as private initiatives for private good.

However, like most aspects of civic and commercial life, things aren't always black or white and there are new Australian pioneers seeking a third way.

The concept of "impact investing" has been introduced and is about doing good while doing commercially well. It endeavours to make sound investments which generate profitable returns as well as deliver social and environmental outcomes.

Ingrid van Dijken of the Impact Investment Group (IIG) believes that impact investing is reaching a tipping point. And she says: "We are seeing increasing demand from private investors, foundations and institutions here in Australia. Our role is to create high-quality investment opportunities to meet this shift in demand."

IIG is co-owned by chief executive Christopher Lock and Small Giants, the family office of Daniel Almagor and Berry Liberman. IIG recently purchased the prestigious global headquarters of Roy Morgan Research at 401 Collins Street in Melbourne and intends to execute a strategy to dramatically improve its overall energy performance.

As an active and ethical manager, IIG benchmarks its fees to the long-term performance of its assets. The distinction between the roles of philanthropy and government is also important and, wherein government should only embrace public initiatives for public good, philanthropists can address broader social problems from different angles.

This was exemplified by Andrew Carnegie, one of America's greatest ever philanthropists, who became famous not just for the money he gave away and the example he set to other philanthropists but also for the way he prompted the American government to address education, civic programs and social reforms.

Here in Australia, this social activist tradition is being reinvigorated by the increasing support of UHNW and affluent contributors who are aiding transformative programs that are endeavouring to better society, humanity and our environment both directly and through the lobbying of government.

In relation to charities, according to Alex Ottaway, vice-president of the Animal Welfare League NSW, "in recent years, we have noticed an increased volume of inquiries from affluent prospective donors". He goes on to say: "This has not yet translated into an increased volume of donations but we are optimistic about the near future."

Internationally, of course, groups such as the Gates Foundation are championing these programs at an impressive scale never before seen. Chairman Bill Gates says that "the world is a far better place because of the philanthropists of the past and the US tradition which is the strongest and is the envy of the world".

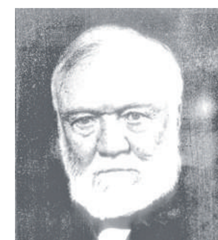
Gates also believes that both the beauty and the role of philanthropy is to pick different approaches to solving problems at their core that often governments and international organisations, such as the UN, cannot address.

Efforts led by the Gates Foundation and others have seen, for example, infant deaths before the age of five reduce globally from around 20 million per year in 1960 to fewer than five million today.

Gates credits this to a story of vaccines provided by his and other foundations, which together have near eradicated smallpox, measles and other comparatively curable diseases in the developing world.

Committing to rolling up their own sleeves and working with the foundation coupled with the devotion to give away 95 per cent of their wealth during their lifetime, Melinda and Bill Gates have personified what it is to be a modern-day philanthropist and global citizen.

Gates Foundation chairman Bill Gates says 'the world is a far better place because of the philanthropists of the past'



Andrew Carnegie

Australian philanthropists are also continuing to increase their support for the arts and sciences. The benefactor of the arts, Cyril Stokes, recently announced that he would bequeath his world-acclaimed art collection to the people of Australia, which would then be our largest ever endowment.

Larkin Group through the Larkin Foundation, for instance, is committed to help save the silverback gorillas of western Africa by both charitable and philanthropic means. Unless reversed, it is said that by 2030 our nearest genetic cousins will be entirely wiped out and become extinct.

Encouragingly as well, the importance of philanthropy is beginning to be recognised in China, with the notable establishment of a new foundation by Alibaba founder and chief executive Jack Ma.

Even though many UHNW Chinese are fearful of publicly acknowledging their affluence in what is still supposedly a communist society, the trajectory of this new trend is heartening and obviously should be supported.

As philanthropy continues to transform the world for the better, we should heed the words of the most significant philanthropist of all time, John D. Rockefeller, who said that we should not be afraid to give up the good to go for the great.

Larkin Group is a wholesale wealth adviser focusing on high yielding global investments.

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Software that slices and dices just the recipe for hot tech stocks

UNDER THE RADAR

RICHARD HEMMING

TECHNOLOGY stocks are hot, with institutions big and small reweighting their portfolios towards listed software and internet "cloud" orientated companies in the wake of a raft of new listings.

And why wouldn't they? These companies offer recurring revenue streams; in most cases zero debt; a low and largely fixed cost base, and the potential for high returns on invested capital. But investors might like to think carefully: technology companies are notoriously volatile.

Some small cap fund managers Under the Radar spoke to have upwards of 25 per cent of their funds invested in software companies, which compares with their weighting in the Small Industrials Index of just over 11 per cent. This doesn't include their investments in telecommunications and in medical technology companies.

Andy Gracey, a small cap portfolio manager for Australian Ethical Investment, has almost half his fund in technology-related companies. These include financial services and accounting related companies GBST (GBT), Technology One (TNE) and Reckon (RKN).

"Technology is getting better for administration and these companies are all about efficiency and slicing and dicing administration, which we like," Mr Gracey said.

One new listing that he has looked at but is not investing in is OneVue, which is one of an increasing number servicing the wealth management industry as an administration provider. OneVue is being listed by Bell Potter and is raising $15 million.

Based on its 35c issue price, it should have a market cap of just under $55m when it lists later this month. The company is forecast to produce EBITDA of only $450,000 in fiscal 2015.

Richard Hemming is an independent analyst who edits undertheradarreport.com.au. The author does not own shares in the stocks mentioned.

Sometimes it's best to hold cash

ROGER MONTGOMERY

ACCORDING to Richard Puntillo, in theory, publicly traded corporations have shareholders as their kings, boards of directors as the sword-wielding knights who protect the shareholders and managers as the vassals who carry out orders. In practice, however, managers have become kings who lavish gold upon themselves, boards of directors have become fawning courtiers who take coin in return for an uncritical yes-man function and shareholders have become peasants whose property may be seized at management's whim.

Now consider an index dominated by such companies; would you want your portfolio invested in that index?

Collectively, my team has seen a great many companies whose management saw the goal of "biggering and biggering" as paramount, who saw shareholders as an annual annoyance, and those who believed profit growth was more important than profitability — in other words; how much money it took to grow those profits didn't matter. If you are like us, you may want to avoid exposing any of your wealth to these businesses.

There is, however, a cost associated with turning your back on the greedy, the prideful and the ignorant. There may be extended periods where the prices of the shares in these businesses rise, and rise significantly. Some of them will even receive takeover bids and their share prices will rise stratospherically. And you will miss out.

With the market at that frustrating point in the cycle, where finding high-quality companies trading at attractive prices is difficult, missing out is something we are loath to do but must accept.

There is a deluge of IPOs hitting the market but at best we must remain cautiously optimistic because so many vendors jumping through the IPO window is a reminder that the in-the-know vendor thinks it's a good time to be selling.

Holding cash in a rising market is painful, but that is the nature of long-term investing.

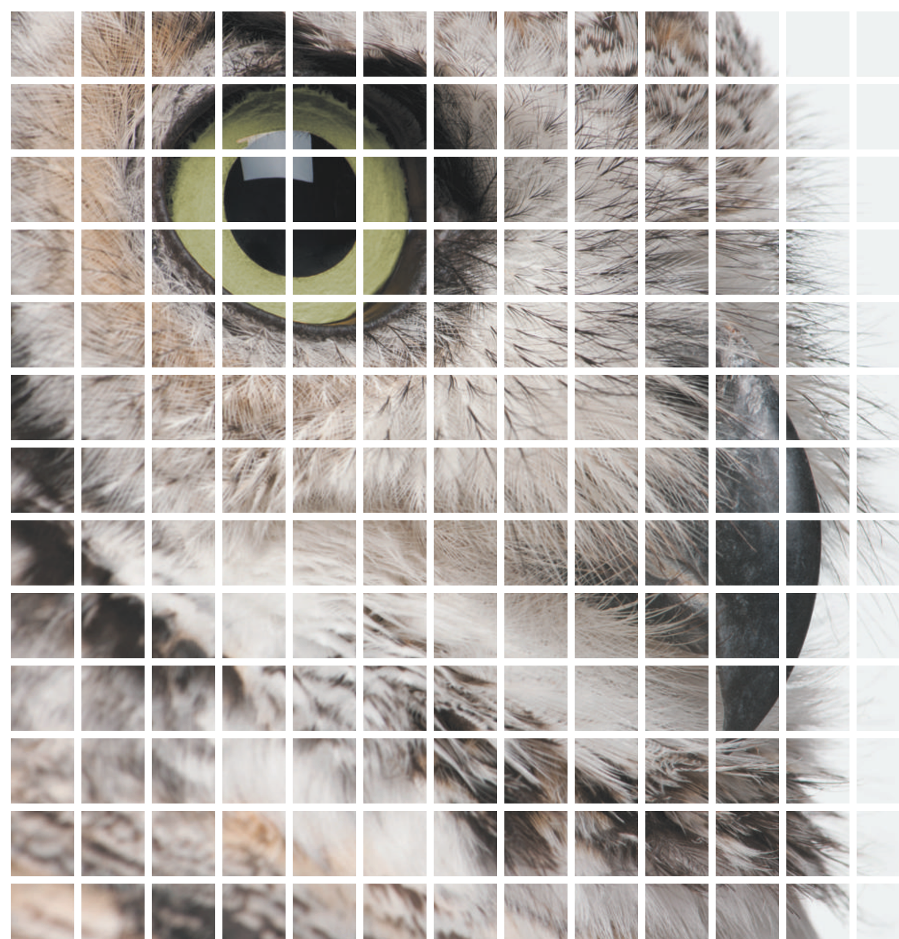
Montgomery has just completed a study — you can find it at rogermontgomery.com — to answer the question of where we are in the valuation cycle. We found the current market to be on the expensive side of fair value and the model indicated the market appears to be about 10 per cent overvalued, relative to the 10-year average. But don't count on an imminent correction. The market can remain overvalued for several years and given the large number of fund managers chasing a relatively smaller number of high-quality stocks, a small overvaluation seems intuitively like a normal state to find oneself in. In any case, we can certainly say the market is not replete with bargains.

That bargains are not ubiquitous may surprise because many companies have fallen significantly from their highs. Orica and Seven Group Holdings, as well as high-quality companies Magellan Financial Group and Flight Centre, have all seen their shares sold off by more than 20 per cent from their highs. Companies like OzForex, Southern Cross Media and Myer have fallen by more than 25 per cent and companies in iron ore or those that service mining companies like BC Iron, NRW Holdings and MACA have declined by 30-40 per cent. By any measure, these declines are nothing short of a crash, and at the very least it explains part of the reason why the index is up just 0.5 per cent over the six months to June 30. However, one would expect some bargains to be present.

The net result is that most investors are left with two choices; hold significant cash balances waiting for quality opportunities to emerge or invest in the stuff that is simply going up — even if it is junk. If it were your wealth on the line, would you prefer we approach investing in a businesslike fashion or would you prefer we roll the dice and approach the market as we might a casino?

Aiming to grow your wealth without losing money inevitably means going through periods where share price gains are missed. And missing out is always painful. But the perceived pain of missing out is not nearly as painful as actually losing real money if you invest in companies and management who treat you like peasants. Remember that when you are thinking of lavishing gold upon yourself.

Roger Montgomery is the founder of Montgomery Investment Management.



Numbers speak louder than words.

Since its beginning in 2000, Paradice Investment Management has developed a solid track record of producing outstanding returns.

Our aim has always been to add value for our investors and, since inception, all our strategies have exceeded their benchmarks.

We believe that too much FUM spoils performance, so we close strategies when they grow to optimal size.

Annualised returns since inception to 31 May 2014

Strategy	Gross Return	Benchmark	Value Add	FUM	Inception Date
Australian Small Caps (closed)	15.90%	4.22%	11.68%	$1.08b	4 March 2000
Australian Mid Caps (closed)	8.65%	0.79%	7.86%	$1.85b	10 Nov 2006
Australian Large Caps (closed)	5.59%	2.83%	2.76%	$4.17b	14 June 2007
Global Small Mid Caps	17.30%	13.09%	4.21%	$748m	1 July 2010
Total funds under management (FUM)				$7.8b	

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