How managing money is like managing love

by Roger Montgomery

Key points

- *Manage your stock choices like you manage a relationship.*
- *Sirtex still has great potential, as does CSL.*
- *Challenger could offer opportunities as the superannuation pool grows.*

Remember your early girlfriend or boyfriend? Do you remember catching up with them that one fatal day when you just thought…this isn't working? You simply changed your mind. The prospects had deteriorated, a better opportunity had presented itself or you reassessed the quality of the relationship and decided it didn't meet the criteria.

It's exactly the same in funds management. While we go into every investment like a marriage, the simple fact is that our partners tend to be unfaithful and its up to us to maintain the vigilance of a private detective. Prospects, quality and value are what we look for in a 'partner'. If any of those three qualities change, we must reassess the relationship.

We might, for example, meet with a company's management and love everything they have to say. Then, we might have a conference call with a competitor and decide that everything we were previously told was based on sand. It happens all the time in funds management and it's entirely unpredictable. But being fact-based, we have to go with the knowledge we have.

When it comes to quality, prospects and value, all three need to be in place before we buy. And all three characteristics need to be maintained for us to continue to hold the company's shares too. If the prospects deteriorate, if the quality fades or the value disappears, dropping the holding and moving to the safety of cash is the best way to ensure the wealth of our clients is preserved.

So what stocks have stood the test of time at Montgomery? What are the companies that haven't let us down (perhaps, yet!) over the last weeks, months and/or quarters? In this column I thought it might be useful to take a quick look at our current thinking on the companies we currently hold in larger weightings in the portfolios. As always however, keep this in mind; we could change our mind tomorrow and/or new information could come to hand!

The simple fact is that telling you what we currently like, is not the same as managing your portfolio for you. Remember that new facts might present themselves to us tomorrow that cause us to change our mind.

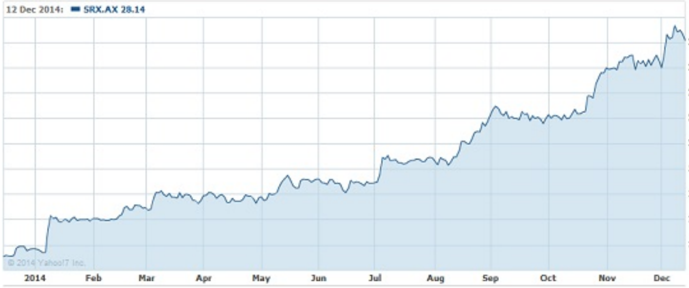
So lets have a speed read over three current, larger and completed holdings (with the emphasis on current!).

Sirtex

From the Sirtex (ASX:SRX) AGM we gleaned the following;

The 2014 financial year was a highly productive period for Sirtex, as the company recorded their 40th consecutive quarter of growth in sales of SIR-Spheres microspheres. In the first quarter of the 2015 financial year, the company observed that dose sales were up 28.7% on the same period last year. More and more medical professionals around the world are beginning to realise the enormous potential of the company's targeted liver cancer therapy to treat a wide range of patients and are hence making the decision to use SIR-Spheres microspheres.

Sirtex (SRX)



Source: Yahoo! 7 Finance, 15 December 2014

It is worth noting that ESMO, the European Society for Medical Oncology, has identified SIR-Spheres Y90 resin microspheres as an appropriate treatment for patients with colorectal liver metastases that have failed to respond to chemotherapy.

Like the company, we currently believe that the new ESMO clinical guidelines will serve to have the effect of a best practice guideline and improve patient access to SIR-Spheres microspheres across Europe.

Sirtex's business in the Asia Pacific is still very much in its infancy but has enormous potential and they continue to create a foothold in new markets.

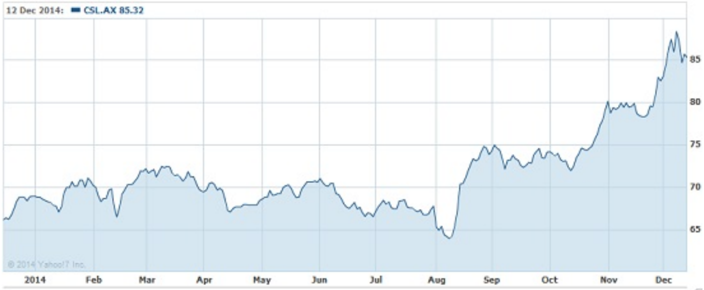
Sirtex believes the SIRFLOX clinical trial result should be positive. This is an evidence-based view, founded on the results of six previously completed, albeit smaller clinical studies and the results of two large scale retrospective analyses, which were all positive. Indeed, to date there has not been a failed study of SIR-Spheres microspheres.

CSL

In October CSL (ASX:CSL) announced a $450 million investment to expand its global production capacity.

CSL collects and transforms blood plasma into sophisticated products that treat rare and serious diseases. The products are created in a globally integrated network, with sites in the USA, Australia, Switzerland and Germany. As a result of the growing global demand for lifesaving therapies, CSL is expanding its global production capacity by investing $240 million in its Kankakee site (Illinois, USA) and $210 million in its Broadmeadows site (Melbourne).

CSL (CSL)



Source: Yahoo!7 Finance, 15 December 2014

The key takeaway from this announcement is the scale of expansion in the Kankakee site. CSL has recently received approval by the US Food and Drug Administration (the FDA) to commence operations in 140,000 square feet of new floor space. The additional $240 million investment, which is anticipated to be completed by 2017, will create more than double this area.

CSL is one of the most efficient collectors of plasma in the world, and its ongoing investment in value-added production facilities should generate robust earnings growth over the longer-term.

Challenger

Identifying segments of structural growth in Australia is no small challenge (pardon the pun). Materials are in decline, energy is unpredictable, retail is being hit hard and banking is also going through a restructure thanks to the Financial System Inquiry. Often growth occurs in niche sub-segments of much larger industries. Consider the esoteric space of Australian annuity products – a space in which Challenger (ASX:CGF) has become the clear market leader in recent years. Annuities are specially-designed insurance products that protect holders against longevity risk – the risk that you outlive your savings. If you buy a lifetime annuity product, for example, it will pay you an income stream for the rest of your life, irrespective of how long you live.

Challenger (CGF)

Source: Yahoo!7 Finance, 15 December 2014

Thinking through the structural growth potential of this niche market in Australia uncovers some interesting insights. We know that life expectancies in Australia are increasing as medicine steadily improves. While this is surely a good thing, it also increases longevity risk for all of us. We know that our nation is ageing in the sense that the older post-retirement age brackets of our population are growing at rates significantly above the younger age brackets. And we know that, due to our compulsory superannuation contribution system and ongoing capital growth of markets, total superannuation assets are set to balloon over the next two decades.

So what might this mean for the Australian annuities space? Well, over the next 20 years, total superannuation assets are expected to approximately quadruple; the share of assets in “post-retirement” phase (as opposed to the “accumulation” phase) is expected to approximately triple; and the proportion of post-retirement assets allocated to annuities could at least double. This implies that underlying demand for annuities in Australia could increase by more than 24 times over this period. This is surely a clear example of a structural and sustained tailwind. And this growth will surely make life easier for Challenger and others to earn superior returns on investment for an extended period of time.

The only caveat (and risk) is legislative changes such as the recent one by the department of social security.

Nevertheless, with Chinese demand for our commodities waning; with the government trying to rein in its spending; and with the RBA trying to cool down mortgage lending, there are not too many Australian industries experiencing structural and sustained demand growth. The niche annuities space currently appears to be a relatively rare exception and the FSI was supportive of annuities in the post retirement phase of life, including the removal of all tax inhibitors.

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