

**Clime Asset  
Management Pty Ltd**  
Private Portfolio Managers

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BEATING THE FUND MANAGERS  
TO YOUR SHARE OF THE  
RETURNS.

*“One of the most obvious and predictable variables that can be harnessed into a workable investment strategy is the continuous overreaction of man himself.”*

David Dreman  
*Contrarian Investment Strategy*  
1979.

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The first year of the new millenium was tough on fund managers in Australia. Those that held shares in the internet sector were burnt severely and those that held old economy stocks didn't fair much better. Overall however the year 2000 was a rough year. Just look at the results.

The latest Intech Financial Services survey revealed some big names had disastrous years. BT funds management recorded a -4.10% for the twelve months to Dec 31, while Macquarie Funds Management recorded -4.20% but did not include its results in the survey. Other big names ranked in the ten worst performers list. IOOF (3.57%), Invesco (-3.17%), Aberdeen formerly Equitylink (1.30%), GIO (4.25%) and Credit Suisse (4.20%) were listed in the ten worst performers but BT ranked last.

You have to wonder don't you. All that money, all that research, all those PHD's, 'quants' and analysts and still -4.2%? The results also come after a year in which, other surveys revealed a lack of independence between stock-broking corporate-finance and equity-research departments. There was also a survey conducted that revealed the results achieved by fund managers in excess of the All Ordinaries Index were largely due to luck, rather than manager's skill. Overall it hasn't been a great year.

It is all enough to make an academic proponent of the efficient market hypothesis or 'EMH', jump up and down with glee. You see supporters of the EMH believe that markets are highly efficient in factoring-in or pricing-in, all available knowledge and even some knowledge that is not available. If the markets are highly efficient then it is very hard if not impossible to make money in the market, because the market has already moved to factor in the information, before you get to it. Markets however don't just move to factor in information all by themselves. Someone has to move the market to the new level. The EMH is tantamount to the idea that you would never find \$10.00 in the gutter because someone else would have already picked it up. As you may recognise, sometimes you are the one that picks up the \$10.00. If it is possible for you to pick up \$10.00 then markets cannot be highly efficient. Markets and their participants also regularly make incorrect assessments about the impact of various news stories and announcements on the markets and as a result, the markets overextend up and down, providing opportunities for investors and traders.

Taking advantage of these opportunities have been some of the world's greatest investors including Warren Buffett, Peter Lynch, Ben Graham and Philip Fisher. All of them have demonstrated methods and techniques for selecting shares that have consistently beaten the market over many years if not decades. Some of these individuals are living examples that the markets are not efficient. You can beat the markets. It requires Knowledge, A Strategy and Discipline.

The best performing fund manager in the Intech survey was Alpha, a boutique Melbourne-based manager with a return of 15.75%. Off the official list however indeed off all lists of any description was our hypothetical portfolio with an approximate 19% return. The portfolio took half an hour to construct and beat the country's best fund managers. The portfolio of stocks selected on January 1, 2000 are listed in the accompanying table.

| OUR POPTFOLIO to Dec 31, 2000 |     |          |             |              |                     |                    |  |
|-------------------------------|-----|----------|-------------|--------------|---------------------|--------------------|--|
| Name                          | Qty | Price    | Start Value | End Value    | Capital Profit/Loss | Dividend Received* |  |
| PDP                           | 462 | \$ 2.16  | \$ 997.92   | \$ 693.00    | -\$304.92           | \$ 46.20           |  |
| BAM                           | 72  | \$ 13.70 | \$ 986.40   | \$ 950.40    | -\$36.00            | \$ 54.00           |  |
| BLD                           | 418 | \$ 2.39  | \$ 999.02   | \$ 865.26    | -\$133.76           | \$ 75.24           |  |
| CSR                           | 270 | \$ 3.70  | \$ 999.00   | \$ 1,260.90  | \$261.90            | \$ 48.60           |  |
| MIG                           | 709 | \$ 1.41  | \$ 999.69   | \$ 1,673.24  | \$673.55            | \$ 70.90           |  |
| MAY                           | 257 | \$ 3.89  | \$ 999.73   | \$ 1,500.88  | \$501.15            | \$ 43.69           |  |
| UEL                           | 518 | \$ 1.93  | \$ 999.74   | \$ 1,667.96  | \$668.22            | \$ 42.74           |  |
| WAN                           | 190 | \$ 5.25  | \$ 997.50   | \$ 993.70    | -\$3.80             | \$ 85.50           |  |
| AMC                           | 149 | \$ 6.70  | \$ 998.30   | \$ 782.25    | -\$216.05           | \$ 56.62           |  |
| GMF                           | 735 | \$ 1.36  | \$ 999.60   | \$ 933.45    | -\$66.15            | \$ 55.13           |  |
|                               |     |          | \$ 9,976.90 | \$ 11,321.04 | \$ 1,344.14         | \$ 578.61          |  |
|                               |     |          |             | <b>TOTAL</b> |                     | <b>19.27%</b>      |  |

Note: This is a theoretical portfolio and results are hypothetical and historical. Historical results such as these are not a guide to future earnings or returns and no action should be taken without first consulting a financial adviser who is familiar with your personal financial needs and circumstances. Dividends are approximate and may vary.

So can anyone do it? Can anyone beat the fund managers at their own game?

The truth is, not everyone and not always. Many people simply don't have the time nor the attitude to devote to research and developing a strategy. If that is you then consider managed funds. If however you are prepared to take on the risks involved in investing in the stockmarket directly, and if your financial adviser suggests you should have some direct equity exposure, and if you are prepared to adopt a strategy with solid historical results, then it is entirely possible to beat the market and some of the fund managers.

How can you do it? Last year we took readers through a simple method for ranking stocks using a single variable. The variable was a ratio that is widely published for all stocks in the papers. You don't even need a computer to select these stocks. Look only at the Top 100 companies by market capitalisation, and pick the top ten stocks as ranked by this ratio. Then we held those stocks for twelve months. At the end of the twelve months we re-rated all the stocks and removed those that didn't make the grade and replaced them with those that did meet the criteria. We also evenly re-weighted the portfolio at the end of

each year meaning that we made sure we had the same dollar exposure to each of the stocks in the list at the beginning of each year.

The results of this technique demonstrate some robustness. That means the methods appeared to work acceptably in a variety of market conditions. In case you are wondering, the method can have losing years. This method is not a panacea. As our other research shows, individual losing years of 25% or more are possible and so are individual winning years of more than 40%. Over longer periods however, the strategy has beaten the market on average here in Australia over the last decade and in the US S&P500 over nearly 50 years.

This strategy takes just half an hour a year to implement and for the rest of the year you get yourself a hobby. Go fishing, go surfing, play golf or take a holiday or work at your job and have fund managers working hard on the rest of your investment portfolio.

It is astounding - half an hour a year and for last year would have ranked you the number #1 fund manager in Australia with a return of 19%. Pretty good? Sure it is, and anyone with a pen, a newspaper and an ability to calculate ratios such as price-to-cash-flow-per-share, dividend yield or price-to-book could replicate it. As any fund manager would tell you however, past results are no guarantee of the future. In fact when it comes to the market, nothing, not even your capital, can be guaranteed to be returned. You may lose money. If you are not comfortable with this, then stay away. Simple as that. If however you are keen to conduct some regular investing of your own, perhaps you already do, then applying a strategy of any description should put you more than one step ahead.

Sincerely,  
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