

EQUITIES

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COORDINATOR'S MESSAGE

By Owen Richards

We ease ourselves into the New Year with three members discussing their own particular portfolios. The great lesson to be drawn from these and all other My Portfolio articles is that we are each confronted initially with something new and strange and quite daunting.

There seems so much to understand and to come to terms with and yet with education, experience and perseverance we all seem to get there. Some lessons are both expensive and painful but help is always available and many members are grateful for their AIA membership and how much this has helped them in their journey.

As we are still in the Silly Season, here is a piece of silliness which is a parody of the song, *Monster Mash*. Appropriately, this one is entitled, *Monster Market Crash*:

<http://www.youtube.com/watch?v=28l0JK0byLU>

We covered short selling in the last issue and this will be my last word on the subject (well, for a while anyway!). The following diagram provides a graphic illustration of how little effect the banning of shorting had in preventing the US market's decline in 1932. I suggest that the ban imposed by the ASX over the last few months will, in time, be shown to have been equally futile.



Figure 1: 1932 Ban on Short Selling

I attended the Melbourne Sunday Traders Club (STC) recently. The STC is convened and chaired by Alan Hull and meets every second month. There is no joining or membership fee and everyone is welcome. Ten dollars is payable at the door to cover room hire (the Wantirna Club on Stud Road) and refreshments. Alan is a long-term friend of the AIA and he is well known to many members for his ActVest and Blue Chip investing systems.

Alan has propounded an entirely new way of looking at stock markets and this was the subject of his presentation at the STC, which he called 'Financial Markets as Complex Adaptive Systems'. It is not possible to do justice to his hypothesis in this space, but Alan has applied elements of Chaos Theory and certain self-organizing activities which apply in the natural world, to provide a cogent and elegant explanation as to why markets perform in the way that they do.

The complex adaptive nature of, say, the ASX All Ords is illustrated in the diagram below. Always a pragmatist, Alan believes that if we can understand how the market will probably perform, especially after its transitional phases, we can better select the appropriate tools to exploit this knowledge.

If you would like to know more about this unique approach, a full set of notes from his (non-mathematical, illustrated) presentation is available from alanhull@bigpond.net.au. Please mention the AIA and ask for the notes on Complex Adaptive Systems.



Figure 2: Complex and Transitional Phases of the ASX All Ords

Lastly, of course, all best wishes for 2009 and with the fervent hope that we will see the bottom of you-know-what, and that it will be onward and upward for the balance of the year and thereafter!

Owen Richards is a member of the AIA.

OUR EQUITIES PORTFOLIO

By Diann & Glenn Gonsal

Background:

At retirement, our superannuation entitlements consisted of defined benefit pensions and lump sum payouts.

The lump sum payouts and some personal contributions constitute the funds in our SMSF. We started our SMSF in 2003 and moved into pension phase at the start of 2008.

This article is about how we allocate and manage funds across various investment styles and through varying market conditions.

Caveats:

We do not have any high level of insight or experience. Nor do we have a record of above average performance. We are only half way through the 10 years of experience that some wise heads in the industry suggest is needed.

Our system is neither back-tested nor has it stood the test of time. It is our attempt to synthesise our research and experience into a management system that suits our skills, aptitudes, life style and tolerance for risk. It is very much a work in progress.

Research:

Our research consisted of reading and seminars - AIA; ASX; Guppy; Hull; Lynch; McNiven/Montgomery; Nicholson¹ and StockDoctor. It raised questions such as:

- Fundamental or technical?
- Investing or Trading?
- Short term or long term?
- Growth or value?
- Income or capital appreciation?
- 'Time in' or 'timing' the market?
- Risk management?

There are pros and cons to each of these. We were not sure which would suit us and serve us well over the long term. The idea of one method for all market phases seemed rigid and restrictive. Also, as individuals, we did not hold the same view on each method.

As a consequence, we decided to develop a multi-method system that could be adapted to changing market conditions and portfolio priorities.

Guiding Principles:

1. Our system is for long-term investors who recognise that the timing of entry and exit involves risk.
2. We are not short-term traders. Our aim is to stay with every position we take, just so long as it obeys the rules of the trading / investing method under which it is managed. However, once we get a 'sell' signal (eg hitting a stop loss or breaching our 'sell rule') we get out of the position immediately.
3. We manage two types of risk
 - Company risk: by using stop losses for 'trades' and sell rules for 'investments;'
 - Market risk: by controlling the '% Invested' according to the (Dow Theory) market phase – as per Nicholson.
4. Periodically we will review our allocations and will re-allocate funds between methods based on market conditions and portfolio priorities.

Our Methods:

Trading:

- For our purposes a 'trade' is where we use charts as the primary management tool.
- The trading methods to be used depends on the market, the company and the state of our portfolio at any point in time.
- We are trend followers 'trading' on the long side of the market.
- 'Trading' is where we time the market.
- 'Trading' is our main avenue for managing market risk – by controlling the '% Invested'.
- 'Trade' stocks must meet our financial criteria.
- Our trading methods are:
 - Day Trades: using end-of-day price, trend lines, On Balance Volume and Twiggs Money Flow as the primary management tools. Hull Multiple Moving Averages and the Relative Strength Index for confirmation.
Holdings: Nil
 - Week Trades: using end-of-week price, Hull ActVest Range and Hull ActVest ROAR as the primary management tools. On Balance Volume and Twiggs Money Flow for confirmation.
Holdings: Nil

- Growth Trades: as per Nicholson¹.
Holdings: Nil
- Value Trades: as per Nicholson¹
Holdings: Nil

Investing:

- An 'investment' is where we use financial and qualitative data as the primary management tool.
- We time entry with reference to the state of the market, the sector and the company.
- Our investment methods are:
 - Fundamentals: Top down thematic.
Holdings: BDG; BHP; CSL; FWD; GMI; LEI; MRM; WOR; WPL
 - Value: StockVal Intrinsic Value
Holdings: Nil
 - Yield:
Holdings: CBA; TLS; WBC
 - Investment Managers:
Holdings: AFI; BTT; DJW; MIR; PTM

Allocations as 30 Nov 2008:

Trading / Investing Method	Target % Allocation	Current % Invested
Trading		
Day	7.0	0.0
Week	7.0	0.0
Growth	8.0	0.0
Value	8.0	0.0
Total trading	30.0	0.0
Investing		
Fundamentals	20.0	15.5
Value	12.0	0.0
Yield	8.0	7.7
Investment Managers	6.0	4.6
Total investing	46.0	27.8
Total Australian Equities	76.0	27.8
International Managed Funds	9.0	9.2
Property Syndicates	4.0	3.9
Interest Bearing	7.0	6.3
Operating Cash*	4.0	52.8
Total Portfolio	100.0	100.0

* Includes funds parked in online accounts and Term Deposits.

Performance to date:

We settled on our system around July 2007- just as the bull market was reaching the 'beginning-of-the-end'. At no time since 2003 have we been fully invested, due to uncertainty and lack of confidence - about ourselves until 2006 and about the market from early 2007.

Our end of financial year returns have been as follows:

2004	20.8%	2007	21.7%
2005	14.2%	2008	-8.0%
2006	15.7%	2009 (ytd)	-9.2%

Our fund has currently lost 17.4% from its all time high of July 2007.

Whilst we did not outperform during the bull market, our 'managing market risk' strategy has served us relatively well during the bear market.

Challenges for the future:

Falling interest rates and looming inflation will necessitate an increase in our '% Invested' in the foreseeable future. The timing, extent and trade/investment methods to be used at that time present us with our biggest challenge - and our greatest opportunity!

Mistakes and continuous learning:

Naively, we entered the market in 2003, well before we had a clear plan – not a good idea! Fortuitously the bull run gave us a safety net that we are only now beginning to appreciate.

We have made many mistakes in stock selection along the way but have sold out when our 'company risk' management rules dictated that we should.

Our system has not stood the test of time so we are in no position to comment on its efficacy. (Can we get back to you in 5 years on that one?)

We will continually review our system and we hope that it will provide us with the learning experiences needed to develop our skills.

We hope readers have gained some benefit from looking over our shoulders whilst we work!

Glenn & Diann Gonsal are members of the AIA.

Reference:1 Nicholson, Colin: The Aggressive Investor, Wilkinson Publishing Pty Ltd, 2005.

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MY EQUITY PORTFOLIO

By 'A Seasoned Investor and AIA Member'

My share market involvement dates back to the 1960's with my career in Brisbane being focussed initially on corporate finance, with the last 16 years to retirement in 1999 as Secretary of ASX listed entities. I now regard portfolio management as a business and have information available and systems in place to facilitate decision making.

Sources of information comprise 'StockDoctor' (fundamental analysis, financial risk rating and stock selection), 'share analysis' (stock rating, price targets, broker consensus information etc), the *Eureka Report*, Huntley's *Your Money Weekly* and facilities provided by a full service broker who undertakes transactions for a commission of 1.25%. These are supplemented by reading and benefits from memberships of the AIA, the ASA and professional bodies that have relevance to our activities. Given my business background, we do not use a financial planner.

I manage three portfolios. Two geared - one in my name and one in my wife's. The third is our two member SMSF in pension mode since July 2000. We aim to limit our borrowings to an average of no more than 20% of the value of the combined portfolios across the investment cycles.

We believe our risk profile to be 'Aggressive' and stock selections 'Conservative'. We are predominantly invested in S&P/ASX100 stocks and performance in 2008 has reflected movements in the accumulation index - marginally on the out-performance side. The value of the portfolio's grossed-up income stream is of as much or more interest to us than its capital value. I monitor the portfolios daily, when possible, and use a detailed spreadsheet to record current and historical end of week data. The composition of the combined portfolio by value is:-

ASX Listed Securities (25)

Property Trusts	Westfield	2.5%
Energy	Origin, Worley Parsons, Woodside	13.4%
Materials	BHP, Rio Tinto	13.4%
Capital Goods	Boart Longyear	0.5%
Industrials	Toll	1.9%
Consumer Discretionary	Crown	1.2%
Consumer Staples	Wesfarmers, Woolworths, Patties Foods	8.8%
Health Care	Healthscope, Ramsay Health Care	5.1%
Financials	CBA, NAB, Westpac, Macquarie, Perpetual, QBE, Suncorp	31.5%
Information Technology	Computershare, Oakton	3.5%
Telecommunications	Telstra	5.1%
Utilities	AGL Energy	3.6%
ASX Listed Total		90.5%
Unlisted Property	Stockland Direct Office Trust No. 1	4.4%
Cash		<u>5.1%</u>
Total Portfolio		100.0%

The value of the combined portfolio comprises SMSF 60% and the two geared portfolios 40%.

The top ten holdings (62%) in descending value order are: WBC, BHP, WPL, ORG, WOW, QBE, CBA, TLS, Stockland Direct Office Trust No. 1 and NAB.

Falls in value of 46% and 63% are currently required before the geared portfolios (established in 2001 and 2002) would be subject to margin calls.

The audited returns of the SMSF over the eight years from 30 June 2001 to 2008 are as follows: - +23.6%, +10.8%, +4.5%, +19.2%, +25.7%, +19.1%, +32.1% and lastly minus 10.2%. At 28/11/08 a negative return of 23.1% is evident in the current financial year.

This information and much more - both current and historical, is available in the spreadsheets that I maintain. These too are a valuable source of decision making information. Of particular significance are the day by day cash flow spreadsheets maintained for twelve months ahead, for both the SMSF and our personal finances. These include estimates of the amounts and payment dates of dividends etc and personal expenditures that, wherever possible, are paid monthly via credit card. This enables us to forecast pension draw-downs from the SMSF, daily cash balances, and interest earnings on those balances.

Our approach to investing has evolved from that of young speculators to retirees relying on our investments as virtually our sole source of income. There have been losses and low levels of success on the way through. Having options written against a specific portfolio of USA stocks in the late 1980's such as Disney, General Motors etc did not work for us. Experience gained through the 'school of hard knocks' has contributed to our current portfolio construction and performance. Investments in HIH Insurance and Aristocrat Leisure gave rise to significant realised losses - the latter recently recovered to a worthwhile degree, via a class action. Hopefully, at some distant point in time, our SMSF may similarly recover a small portion of its loss in HIH. That said, we long ago divested LPT holdings other than Westfield, listed infrastructure holdings such as MIG and TCL and have avoided hedge funds and financially engineered managed investments.

We now average less than 20 transactions per annum. Some follow corporate actions such as the Rinker takeover consummated in July 2007 and recent share splits such as the Toll / Asciano / Virgin Blue and PBL / Crown / Consolidated Media splits.

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MY EQUITY PORTFOLIO

By Keith Mundy

In 1991 we finished paying off our house and I read a book by Jan Somers called "Building Wealth through Investment Properties." This book explained the reasons for investing in property and how to go about it. I understood and liked what I read and thought I would try it, seeing we now had equity and free cash flow.

We bought our first property (one bedroom apartment) in St Kilda about six months later. It was with some trepidation and fears that we took possession and instructed the agent to rent it out. I remember thinking that no one would ever rent it and we would lose all of our money. What had I got myself into? With a short time however it was leased on a good rent and we were away. That property has been untenanted for only a few weeks at most in all those years.

It worked out so well in fact that the next year we bought another property (studio apartment), also in St Kilda, and this was leased out successfully in a short time again. How easy was this!!!

So the next year we thought "why stop at two?" and we bought another property, this time a house in Macleod. About twelve months after settling this property, my marriage ended and I lost this house in the divorce settlement, although I kept the first two properties. I still have the first and we have only just sold the second as part of our retirement plans.

I began investing in shares on 4/12/1996 when I bought 320 NAB shares at \$15.07 each. I still own these shares as the reason for buying them in the first place has not changed. I saw them as being a solid company, paying a good dividend with good capital growth prospects. The capital growth part is a bit suspect as the current share price is rapidly approaching the original purchase price.

My wife, Joan, and I have been building our share portfolio since we married in 1997. We began with a trial and error approach, ending up with a structured method using both fundamental and technical analysis. We primarily use StockDoctor and I regard it as the best source of investment knowledge and analysis in Australia. We also subscribe to the *Eureka Report* and *Marcus Today*. This structured method is still evolving.

We have joined various organisations which have benefited us very much. They include:

- Australian Investors Association (AIA)
- Australian Shareholder Association (ASA)
- Australian Technical Analyst Association (ATAA)
- Association of Independent Retirees (AIR)

In 2003 we bought another investment property in Eltham (two bedroom unit) and this has been extremely successful. The current surge in rents, although challenging to tenants, I feel repays the landlords for many years of stagnant income from property.

The current share-market crisis does not allow for any traditional investment strategy so we are not using this approach at the moment but are waiting until the bottom is reached.

We have a very small managed funds component and use dollar cost averaging each month to invest in the Sandhurst Industrial Share Fund.

We tend to buy in bursts and use fundamental analysis first to make a short list. Then we make a final choice using technical analysis to try to pick a share that is going to keep going up. We use CommSec for our own shares and NAB Trading for our Super fund. I did use a full service broker at one stage but feel that they are not worth the extra brokerage as they don't appear to have any more insight than we do.

Our current portfolio of 27 shares is composed of the following sectors:

Sector	%
Financials	51.60%
Materials	15.20%
Consumer Staples	11.40%
Telecommunication Services	7.40%
Energy	3.60%
Health Care	3.00%
Managed Funds	2.60%
Retailing	2.20%
Information Technology	1.30%
Industrials	1.20%
Consumer Discretionary	0.50%
Total	100.00%

I read the business section of the *Age* each morning and check the DOW before going to work. I also like to read investment books, Colin Nicholson being my favourite author. Over Christmas I plan to reread his books, redo my Trading Plan and when the current crisis is over, stick to it!!!

This year we have started our own SMSF and we are confident we will be successful running it. (If the market leaves us anything that is). Our Trading Plan allows for the following breakup:

- Core Top 20 companies 50%
- Trading Top 200 companies 25%
- Cash Term deposits or fixed interest 25%

We hope that the large cash component will allow us to ride out the current downturn until the market recovers.

The lessons learned would include:

- Have a written trading plan
- Stick to it
- Keep it simple (KISS)
- Don't fiddle too much

And yes, I now know the financials are too high. I only realised after doing the table for this article.

Keith Mundy is a member of the AIA.

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