

Diversify the fund managers

Forget the spread of asset classes, concentrate on the class of people making the decisions, a portfolio chief tells **Claire Stewart**.

The secret to a lucrative investment portfolio lies not in the diversification of asset classes but in diversification of a fund's portfolio managers.

And K2 Asset Management has that in spades, according to its managing director, Campbell Neal.

He credits the performance to a cap on the funds under management and the use of performance fees as a means of aligning manager and client interests, as well as variety of investment styles, which result in a smoother investment curve.

"I want to ride the middle line, so I find a fund manager who makes money and put systems around him that hopefully make him a better manager, but I don't tell him what style to be," Neal says.

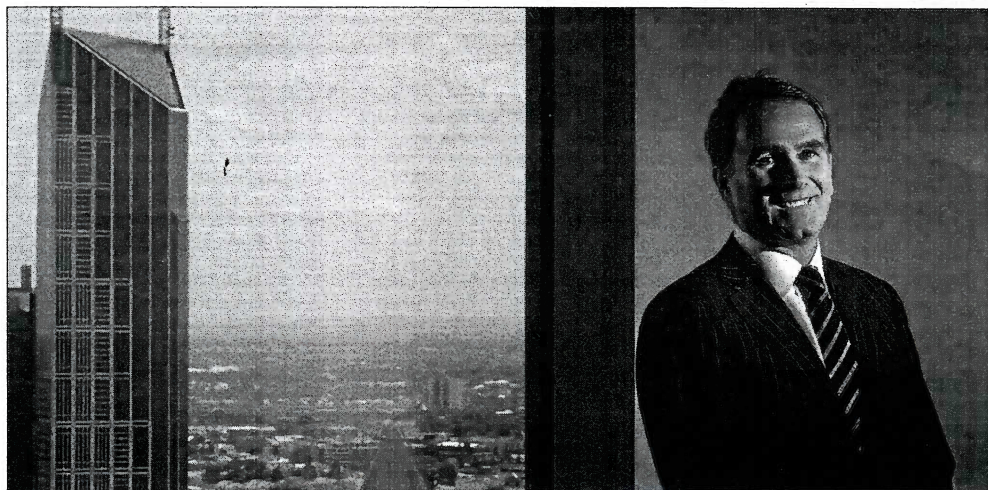
Of K2's 10 portfolio managers, he says there are growth, value, distressed equity, momentum managers and "guys who trade noise" working for him.

Value stocks are doing slightly better in the current environment, primarily because the growth stocks have taken a battering during recent market volatility.

"I love banks and I love Telstra. I'm a dividend man; it's the yield that pays you. I also like JB Hi-Fi, not because of the yield but because their [price earnings multiple] is so low. I won't look at something like News Corp as much."

Since the fund was established during the 1999 financial year, the compounded monthly returns have outperformed the All Ordinaries accumulated index by 328 per cent to 144.6 per cent.

Against the performance of 140 managers ranked by Morningstar, the K2 Australian Equities fund rates No. 1 for three- and 10-year



Campbell Neal . . . 'Our system takes the human emotion out of buying and selling.'

Photo: JESSE MARLOW

returns. Neal says it's not necessarily because its fund managers are smarter than the rest, but because of the specific business model. "And it's also the system in place behind it all through, which we try to make good fund managers better."

K2 has what Neal describes as a pile of stop-loss guidelines — about 16 in total — including triggers to sell a stock if it hasn't returned a minimum of 1.2 per cent within 30 days of the trade, or if it has fallen 20 per cent at any one time.

"It allows us to take the human emotion out of buying and selling and put some science behind the acts. Managers can defend their choice if they are stopped out but they have to convince nine others their decision to hold is the right one."

Market volatility doesn't affect the type or number of stop-loss guidelines in place. What does become an issue is a "9/11"-style event or a 2008-type credit crunch. "That'll put you on your heels for a while as you re-sort your systems."

K2's Australian equities fund fell just over 11 per cent in the financial year to June 2008 but performance was saved the following year because the system triggered a change to cash. The fund's mandate allows up to 100 per cent cash, long positions and some opportunities for short selling, but without gearing the fund.

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Campbell Neal,
K2 Asset Management

Neal says there are triggers for shorting stocks because of the inherent risk on short positions. "Short in theory looks easy; in reality it is very hard. We have five categories of shorts we have monitored over 12 years. Three you can't make money on."

As of a week ago, the fund was again fully invested, with Neal bullish on the outlook for the next 12 months, pointing to the big liquid stocks such as BHP Billiton, Rio

Tinto and Fortescue Metals Group, which he says are "priced perfectly" because they have been smashed.

Many of the largest listed companies are trading on a price-to-earnings multiple of less than 10 times and it is a situation the market hasn't seen for many years, he says.

"I do believe the earnings forecasts for these companies. It's a lot easier not to believe the 'E' of the mid and the small companies, particularly in the resources sector, with concerns about a world slowdown in growth."

And while economies such as the US and Europe might be approaching recessionary conditions in the near term, Neal expects their equity markets will provide solid returns on the presumption of a medium-term recovery.

"I think we are very close to the bottom. The question is, where are these economies going to be 12 months from today? You have this volatility now which is impacting markets, but people will start to say the worst is behind them."