

Portfolio update



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TO DECEMBER 2011

Income Portfolio's first class seal

Jason Prowd

Quality stocks and generous dividends have extended the Income Portfolio's market-beating returns. Jason Prowd explains.

Rarely does hope trump quality. This was a costly lesson many investors learnt in the heady days of the dot.com boom (anyone remember [boo.com](#)? No, thought not). This lesson was reinforced—happily in the opposite direction—by the performance of the model Income Portfolio over the past six months.

Established in 2001, our ambition was to craft a low-risk, market-beating portfolio that delivered a reliable dividend stream. Since inception, it's done just that, generating total returns of 13.0% a year (capital growth plus dividends) and convincingly trouncing the All Ordinaries Accumulation Index (Index) by 6.6% a year.

Over the past six months, our approach of selecting under-priced, high quality stocks has been amply vindicated with the Income Portfolio widening its performance gap over the index by 0.8% a year and producing a running yield of 6.7% (see Chart 1). That figure would be higher still if franking credit were included. Disappointingly, the portfolio was down 2.7% for the period, but remained well clear of the Index, which fell a further 6.9%.

This admirable result comes amidst increasing concerns about the global economy. But as fear takes hold of the markets, higher quality businesses, such as **Metcash** (up slightly for the period including dividends), have fared better, underpinning the portfolio's returns.

Dividends, as one might expect, played a crucial role. The portfolio banked \$5,492 in dividends for the period, bringing the annual total to \$10,733 (see Chart 2). While this remains below boom year levels, we can and should expect future growth.

The portfolio assumes these dividends are spent on living expenses such as groceries, rather than reinvested. Whilst that mutes capital appreciation, it doesn't stop it altogether. Since inception in 2001 the portfolio has risen by 60%, or nearly 5% a year, well ahead of the average inflation rate over the period of around 3% a year.

Changes to portfolio composition over the past six months have been minor. We've tweaked our holdings to ensure it's stacked with the highest quality businesses. We've purchased stakes at attractive prices in **IAG**, **Australand** and **Perpetual** (see [Portfolios pounce on bargain prices](#) from 10 Aug 11).

TABLE 1: INCOME PORTFOLIO TRANSACTIONS

STOCK (ASX CODE)	BUY/SELL	SHARES (NO.)	PRICE (\$)	VALUE (\$)	DATE
INFOMEDIA (IFM)	Sell	20,000	0.21	4,200	10/08/11
AUSTRALAND (ALZ)	Buy	1,500	2.30	(3,450)	10/08/11
PERPETUAL (PPT)	Buy	400	21.80	(8,720)	10/08/11
IAG (IAG)	Buy	2,150	2.95	(6,343)	10/08/11
FOSTER'S (FGL)	Sell	1,250	5.40	6,75	01/12/11
SYDNEY AIRPORT (SYD)^	Capital return	3,280	0.80	2,624	20/12/11

^Formally MAp Airports

KEY POINTS

Returning a generous running yield of 6.7%

Continues to extend performance lead over Index, although down 2.7% for half year to 31 Dec 11

Added positions in Australand, Perpetual and IAG. Sold Infomedia



CHART 1: INCOME PORTFOLIO PERFORMANCE VS. ALL ORDS. ACCUMULATION INDEX

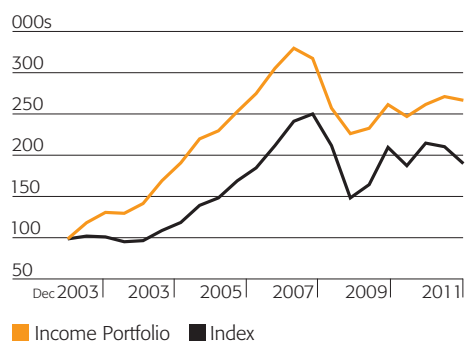
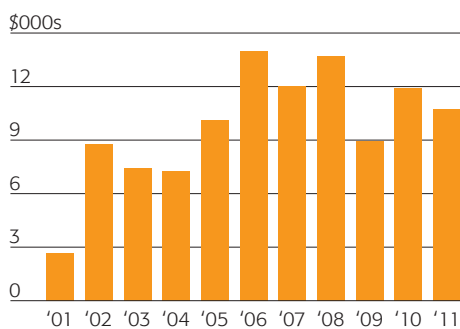


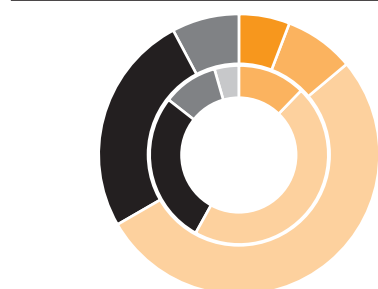
CHART 2: INCOME PORTFOLIO DIVIDENDS PAID



WANT MORE HELP?

If you need help constructing and maintaining a portfolio, we highly recommend reading our special report *Building and managing your portfolio*.

CHART 3: INCOME PORTFOLIO ALLOCATION BY RECOMMENDATION TYPE, JUN 11/DEC 11



	Jun 11 (inside)	Dec 11 (outside)
Strong Buy	0%	6%
Buy	12%	8%
Long Term Buy	46%	53%
Speculative Buy	0%	0%
Hold	28%	26%
Cash	10%	7%
Take Part Profits	4%	0%

Stocks for inclusion, however, don't just have to meet our rigorous criteria to get in. They have to deserve their place to stay there. With **Infomedia** no longer meeting the 'quality' test, we sold our stake (see *Portfolios pounce on bargain prices*). We've also been carefully considering our total exposure to the property sector, which now stands at 22.1%. No stock currently deserves selling, but we're carefully monitoring this exposure.

Additionally, **Servcorp** and **STW Communications** are, perhaps, not quite the right fit for the Income Portfolio. Servcorp's yield has dropped over the past few years as it attempts to bed down its massive expansion program (see *Riding the Servcorp escalator* from 17 Oct 11 (Long Term Buy—\$2.75)). But having just increased its prospective dividend for 2012 to 15 cents per share, and owing to the recent price falls, we're reluctant to sell.

Similarly, STW Communications is, perhaps, too risky to warrant inclusion. But having recently earned an upgrade in *The mad men of STW* on 08 Dec 11 (Long Term Buy—\$0.85) its value is too compelling to sell right now.

TABLE 2: INCOME PORTFOLIO (AS AT 31 DEC 11)

STOCK (ASX CODE)	PRICE MOV. SINCE 30/6/11 (%)	CURR. YIELD (%)	MOST RECENT RECO.	SHARES (no)	PRICE (\$)	VALUE (\$)	% OF PORT.
ABACUS PROPERTY GROUP (ABP)	-18	8.7	Long Term Buy (330—\$1.98)	2,350	\$1.90	4,465	2.8
AUSTRALAND (ALZ)	-16	9.2	Hold (333—\$2.61)	3,060	\$2.40	7,344	4.6
AUSTRALAND ASSETS (AAZPB)	-11	0.7	Hold (304—\$89.99)	100	\$91.00	9,100	5.7
CHALLENGER INFRA. FUND (CIF)	10	10.7	Long Term Buy (331—\$1.09)	3,600	\$1.12	4,032	2.5
IAG (IAG)	-12	5.4	Long Term Buy (332—\$3.15)	2,150	\$2.98	6,407	4.0
METCASH (MTS)	-3	6.8	Long Term Buy (334—\$4.24)	2,500	\$4.04	10,100	6.3
PERPETUAL (PPT)	-18	9.1	Buy (332—\$20.74)	400	\$20.43	8,172	5.1
PLATINUM ASSET MGMT (PTM)	-15	7.1	Long Term Buy (332—\$3.75)	1,500	\$3.52	5,280	3.3
QBE INSURANCE (QBE)	-25	9.9	Strong Buy (329—\$12.17)	700	\$12.95	9,065	5.7
SERVCORP (SRV)	-8	3.8	Long Term Buy (331—\$2.75)	1,800	\$2.61	4,698	2.9
SEVEN NET. TELYS4 (SVWPA)	-6	8.2	Hold (331—\$89.00)	93	\$85.00	7,905	5.0
SPARK INFRA. (SKI)	7	8.6	Long Term Buy (327—\$1.32)	7,000	\$1.38	9,625	6.0
STW COMMUNICATIONS (SGN)	-18	8.3	Long Term Buy (334—\$0.85)	7,000	\$0.84	5,880	3.7
SYDNEY AIRPORT (SYD)*	-20	7.9	Hold (334—\$2.83)	3,280	\$2.66	8,725	5.5
TREASURY WINE ESTATES (TWE)	8	1.6^	Hold (332—\$3.77)	417	\$3.68	1,535	1.0
WASHINGTON H SOUL PATTS. (SOL)	6	2.9	Long Term Buy (330—\$13.75)	700	\$13.83	9,681	6.1
WESTFIELD GROUP (WDC)	-10	7.1	Long Term Buy (332—\$7.86)	1,086	\$7.81	8,482	5.3
WESTFIELD RETAIL TRUST (WRT)	-8	3.36	Long Term Buy (332—\$2.51)	2,343	\$2.49	5,834	3.7
WESTPAC BANKING CORP. (WBC)	-10	7.8	Hold (332—\$21.56)	320	\$20.00	6,400	4.0
WHK GROUP (WHG)	-10	8.4	Buy (332—\$0.84)	5,500	\$0.83	4,538	2.8
WOOLWORTHS (WOW)	-10	4.9	Long Term Buy (333—\$24.56)	400	\$25.10	10,040	6.3
CASH BALANCE (\$)					12,278	7.7	
TOTAL PORTFOLIO VALUE (\$)					159,585		
CURRENT ANNUALISED YIELD (%)					6.7		
RETURN SINCE INCEPTION (P.A)					13.0		

^Prices as at 31 Dec 11 | *Formerly MAp Airports, price fall relates to capital payment

^Calculated using actual dividends aid, expected full year yield for TWE-3.2% and WRT-6.6%

We've also boosted our cash reserves thanks to a \$2,624 capital return from **Sydney Airport** (formally MAp Airports) and \$6,750 windfall from the takeover bid for **Foster's**; an investment that netted the Portfolio a 37% total return. The net result is an increase in our cash holdings to \$12,278.07.

These positive developments were balanced against many stock prices falls. **QBE** and **WHK Group**, for example, dropped 24.9% and 10.3%. These price falls however, have—in most cases—prompted upgrades; demonstrating our underlying confidence in the businesses' intrinsic value. This has helped shift the portfolio's weighting more towards cheaper stocks; positive recommendations now make up 67% of the portfolio, up from 58% at June 30 (see Chart 3).

This places the Income Portfolio in a better position than it has been for years. Our balanced collection of excellent, high quality businesses augurs well for long-term outperformance.

Plus, with the kitty replenished, it's also well placed to pick up a few carefully selected bargains over the coming year.

Look out for a review of the *Growth Portfolio* next week.

Disclosure: Staff own many of the stocks discussed in this article, please refer to the [staff portfolio](#) online for a full list. First published online on 11 January 2012.

Growth Portfolio ready to pounce

Jason Prowd

After trailing the Index during the GFC, the Growth Portfolio is now out in front. Jason Prowd draws out the salient lessons of the past 6 months.

The *Growth Portfolio*, unlike its *Income* cousin, has the more audacious goal of chasing market-beating returns by investing in companies with higher growth prospects, with correspondingly higher risks of course. Higher returns are the aim.

So far, the portfolio hasn't met that goal. While outperforming the All Ordinaries Accumulation Index (Index) by 1.2% a year since inception in 2001, it lags the Income Portfolio by 5.5%. That's the bad news. What of the good?

For reasons we'll soon explain, the Growth Portfolio is poised to claw back some of this underperformance.

The past six months has seen the portfolio chalk up a few significant wins, exit a couple of investments, add a new position and increase its holdings in three existing stocks.

We eagerly pounced on grocery wholesaler **Metcash** following the market rout in August, buying a 1.9% position at \$3.87 per share. Metcash won't triple overnight but the 6.8% dividend yield and opportunity for organic growth should deliver excellent, low risk returns.

Market panic

We also used the market panic to increase the portfolio's positions in **Computershare**, **Perpetual** and **Macquarie**. Again, these are high-quality businesses with significant growth potential. We're pleased to be able to include them at such attractive prices.

To fund these transactions, and owing to a reassessment of each stock, we sold out of **Harvey Norman**, **Infomedia** and **Catalpa**.

TABLE 1: GROWTH PORTFOLIO TRANSACTIONS

STOCK (ASX CODE)	BUY/SELL	SHARES (NO.)	PRICE (\$)	VALUE (\$)	DATE
CATALPA (CAH)	Sell	1,300	1.41	1,833	11/07/11
HARVEY NORMAN (HVN)	Sell	2,650	1.87	4,956	10/08/11
INFOMEDIA (IFM)	Sell	25,800	0.21	5,418	10/08/11
COMPUTERSHARE (CPU)	Buy	515	7.29	3,754	10/08/11
MACQUARIE GROUP (MQG)	Buy	340	24.17	8,218	10/08/11
PERPETUAL (PPT)	Buy	160	21.80	3,488	10/08/11
METCASH (MTS)	Buy	1,000	3.87	3,870	10/08/11
SILVER LAKE RESOURCES (SLR)	Sell	850	3.59	3,052	17/11/11
SYDNEY AIRPORT^ (SYD)	Capital return	4,027	0.80	3,222	20/12/11

^Formally MAp Airports

KEY POINTS

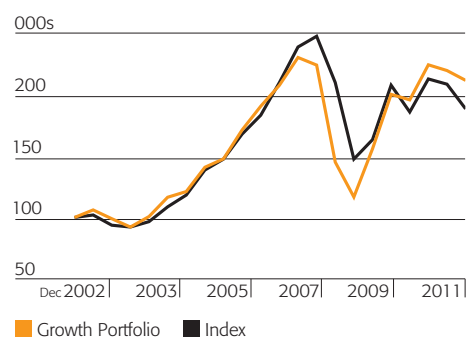
Outperformed Index by 6.0% but fell 3.6% in six months to 31 Dec 11

Added position in Metcash; Increased stakes in Computershare, Macquarie Group and Perpetual

Replenished cash reserves to \$11,759



CHART 1: GROWTH PORTFOLIO PERFORMANCE VS. ALL ORDS. ACCUMULATION INDEX



“The past six months has seen the portfolio chalk up a few significant wins, exit a couple of investments, add a new position and increase its holdings in three existing stocks.

Over the past 12 months, we also sharpened the focus of the portfolio by reducing the number of holdings from 30 to 26. That’s still a tad too many stocks, which is why we’ll look to cull a few more positions if we get an opportunity to do so at a satisfactory price.

We’ve also doubled our cash holdings to \$11,758.50 due to \$5,415.34 in dividend payments and Sydney Airports’ (formally MAp Airports) \$3,222 capital payment. The increase in cash reserves is a deliberate strategy; it’s likely that the next few months will produce plenty of opportunities and we want the cash available to take advantage of them.

Combined, these changes have shifted the weighting of the portfolio towards cheaper stocks; positive recommendations (those on which we have a ‘buy’ recommendation of some sort) now represent 71% of the Portfolio, up from 67% six months ago.

Many of the portfolio’s investments have proved successful. Silver Lake Resources and Integra Mining, for example, are respectively up 50.5% and 21.6% over the period (see Table 2). The rise in Silver Lake’s price also gave us an opportunity to trim our holding and bank \$2,057 in profits (see Silver Lake: Profits and prophecy from 17 Nov 11 (Take Part Profits—\$3.59)).

Other more conservative holdings have also performed well. Spark Infrastructure gained 6.6% over the half and paid a 4.75 cent per security distribution. Investments such as this help underpin the portfolio’s longer term performance and offset riskier holdings like Tap Oil.

CHART 2: GROWTH PORTFOLIO ALLOCATION BY RECOMENDATION TYPE, JUN 11/DEC 11

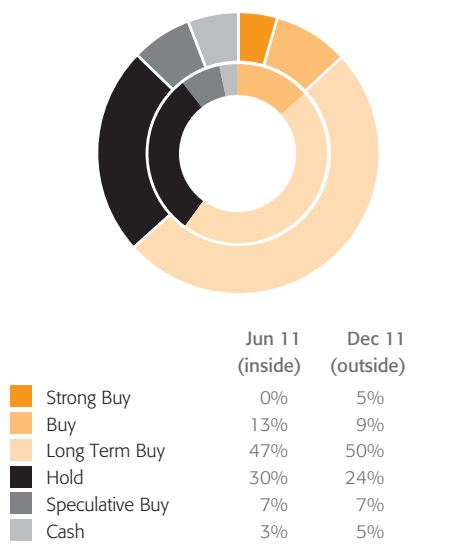


TABLE 2: GROWTH PORTFOLIO (AS AT 31 DEC 11)

STOCK (ASX CODE)	PRICE MOV. SINCE 30/6/11(%)	MOST RECENT RECO. ISSUE NO.—PRICE)	SHARES (NO.)	PRICE^ (\$)	VALUE (\$)	% OF PORTFOLIO
ABACUS PROPERTY GROUP (ABP)	-18	Long Term Buy (330—\$1.98)	3,060	1.90	5,814	2.7
ARB CORPORATION (ARP)	2	Hold (333—\$7.87)	2,000	7.73	15,460	7.3
ARISTOCRAT LEISURE (ALL)	-9	Speculative Buy (329—\$1.98)	3,000	2.20	6,600	3.1
AUSTRALAND (ALZ)	-16	Hold (333—\$2.61)	2,180	2.40	5,232	2.5
AWE (AWE)	2	Speculative Buy (334—\$1.38)	4,175	1.31	5,448	2.6
BRICKWORKS (BKW)	6	Long Term Buy (330—\$9.95)	600	10.85	6,510	3.1
CHALLENGER INFR. (CIF)	10	Long Term Buy (331—\$1.09)	9,000	1.12	10,080	4.8
COCHLEAR (COH)	-14	Hold (335—\$62.72)	2006	2.00	12,400	5.9
COMPUTERSHARE (CPU)	-10	Long Term Buy (332—\$8.31)	1,515	8.01	12,135	5.7
CSL (CSL)	-3	Long Term Buy (331—\$30.07)	1503	2.00	4,800	2.3
ELDERS PREF. SHARES (ELDPA)	-24	Hold (333—\$38.50)	703	1.62	2,213	1.0
INTEGRA MINING (IGR)	22	Hold (330—\$0.48)	4,100	0.54	2,194	1.0
MACQUARIE GROUP (MQG)	-24	Buy (332—\$23.62)	4902	3.79	11,657	5.5
METCASH (MTS)	-3	Long Term Buy (334—\$4.24)	1,000	4.04	4,040	1.9
NEWS CORP NON-VOTING (NWSLV)	8	Long Term Buy (326—\$14.25)	7101	7.54	12,453	5.9
PERPETUAL (PPT)	-18	Buy (332—\$20.74)	3312	0.43	6,762	3.2
PLATINUM ASSET MMT (PTM)	-15	Long Term Buy (332—\$3.75)	2,700	3.52	9,504	4.5
QBE INSURANCE (QBE)	-25	Strong Buy (329—\$12.17)	7501	2.95	9,713	4.6
SERVCORP (SRV)	-8	Long Term Buy (331—\$2.75)	1,636	2.61	4,270	2.0
SILVER LAKE (SLR)	51	Hold (335—\$3.11)	850	3.01	2,559	1.2
SONIC HEALTHCARE (SHL)	-12	Long Term Buy (335—\$11.32)	1,0001	1.28	11,280	5.3
SPARK INFRASTRUCTURE (SKI)	7	Long Term Buy (327—\$1.32)	6,493	1.38	8,928	4.2
SYDNEY AIRPORT* (SYD)	-20	Hold (334—\$2.83)	4,027	2.66	10,712	5.1
TAP OIL (TAP)	-28	Speculative Buy (332—\$0.72)	4,600	0.60	2,737	1.3
WESTFIELD GROUP (WDC)	-10	Long Term Buy (332—\$7.86)	695	7.81	5,428	2.6
WOOLWORTHS (WOW)	-10	Long Term Buy (333—\$24.56)	4302	5.10	10,793	5.1
				CASH BALANCE (\$)	11,759	5.6
				TOTAL PORTFOLIO VALUE (\$)	211,480	
				RETURN SINCE INCEPTION (P.A)	7.5	

^Prices as at 31 Dec 11 | *Formally MAp Airports, price fall relates to capital payment

Not that there haven't been mistakes. **Elders**, for example, hasn't progressed as we might have hoped. Falling assets values and a delayed turnaround of the key rural service division prompted a downgrade of **Elders' hybrids** (see *Forest fells Elders' hybrids* from 13 Oct 11 (Hold—\$37.95)).

Position sizing

This highlights a crucial point about portfolio management (for more see our special reports *How to build a portfolio from scratch* or *Profitable lessons for two market-beating portfolios*): Position sizing is critical. It's simply not enough to pick the right stocks; you also need the right amount of money invested in each. By only taking a small 1% position in **Elders' hybrids**, the capital invested was proportionate to the risks involved and a mistake hasn't done any serious damage.

In general, most of one's capital should be in the best ideas, which is why we have allocated 4.6% of the Growth Portfolio to **QBE** (increased post 31 December to 5.5%) and 5.5% to Macquarie Group.

For similar reasons, we're currently reviewing our largest position, **ARB Corporation**. This has been a spectacularly successful investment, generating total returns in excess of 250% and the company continues to impress.

But at 7.3% of the Portfolio's total value, its weighting is almost too high for a stock that's edging towards a downgrade. For now, we're not making any changes but we may well do so in the future.

The returns of the Growth Portfolio, whilst beating the index, remain below our expectations. But the changes made over the half are helping move it to a position where it's poised for an even better performance.

Disclosure: Staff own many of the stocks discussed in this article, please refer to the [staff portfolio](#) online for a full list. First published online on 16 January 2012.



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