THE INTELLIGENT INVESTOR
VALUE INVESTING EXPERTS
PORTFOLIO UPDATE
AS AT 31 DEC 2008
DEC '08
PORTFOLIO UPDATE

Portfolios down but not beaten

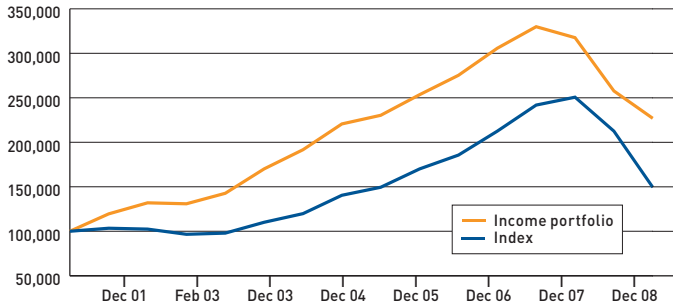
The six months to 31 December were tumultuous, to say the least. The collapse of the 158-year old Lehman Brothers sparked a panic in the banking industry which reverberated around the world and saw governments stepping in to guarantee retail bank deposits.

As the US and key European economies slid into official recession, the 'stronger for longer' chorus around commodity prices fell silent. Oil lost a one from its price, down from US$140 a barrel at 30 June to just US$40 at 31 December. Copper fell from US$8,775 per tonne at the end of the financial year to US$2,900 at 31 December and nickel fell from US$21,675 per tonne at 30 June to US$10,800 by calendar year end.

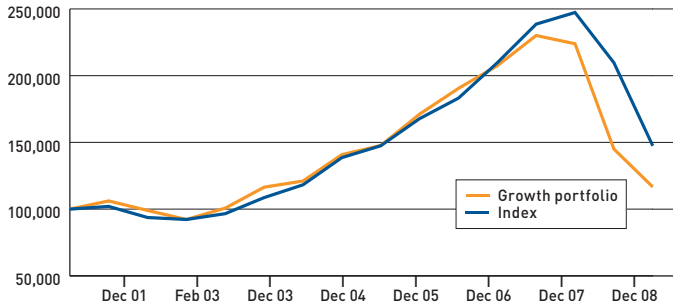
In the face of those falls, the prices of larger Australian resources stocks held up remarkably well. **Santos**, **Woodside** and **BHP Billiton**, for example, saw their share prices fall by 'only' 31%, 46% and 30% respectively.

Rio Tinto fell a breathtaking 72%, though, after BHP Billiton withdrew its takeover offer. And, incredibly, after boasting a market capitalisation of more than $8bn at 30 June, **OZ Minerals** (formed by the marriage of Oxiana and Zinifex) found itself in serious financial strife and suspended its stock at the end of November.

Income Portfolio vs All Ordinaries Accumulation Index



Growth Portfolio vs All Ordinaries Accumulation Index



Smaller mining stocks were creamed in the fallout. These included the likes of **Straits Resources** (down 87% for the half-year), Aditya Birla (down 94%), Kagara (down 90%), **MacArthur Coal** (down 82%) and many others.

Former darling 'blue chips' like **BlueScope Steel** (down 69%), **Caltex** (down 45%), **Sims Group** (down 58%) and **WorleyParsons** (down 63%) also came tumbling back to earth, providing a graphic lesson in cyclicality.

All in all, it was one of the most trying periods for investors in living memory.

Returns and transparency

Apart from inflicting massive losses on investors, 2008 was also remarkable for the uncovering of what's likely to prove the world's largest ever fraud. Investment funds run by Bernard Madoff appear to have been a gigantic Ponzi scheme (where old investors are paid out of money received from new investors, rather than genuine returns).

Madoff's funds had a long track record of steady returns, month in, month out. What they lacked was any transparency. Our own model portfolios are the complete opposite. The returns are lumpy but the transparency is total. Investment positions are disclosed on our website at all times and discussed in detail at the end of both the financial and calendar years in special reports such as this one (as well as in between times on an ad hoc basis). Any changes are also highlighted as they are made.

Latest results

Overall portfolio performance as at 31 Dec 08

	DATE OF INCEPTION	ANNUAL % CHANGE SINCE INCEPTION (INDEX)	% CHANGE SINCE 30/6/08 (INDEX)
Income	Jul 01	14.1 [5.5]	–16.3 [–29.7]
Growth	Aug 01	2.1 [5.4]	–19.6 [–29.7]

Theory suggests that during a grinding bear market an income-focused portfolio should outperform the broader index. That's because of the generally defensive nature of traditional income stocks. But 2008 provided some harsh lessons to the unwary.

In fact, many income investors would have fared much worse than the index with the near annihilation of many property trusts, income securities and the structured products which investment bankers had pushed on unwary dividend seekers during the boom years.

So, even though the overall return was negative, we

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Portfolios down but not beaten

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were quite chuffed with the 16.3% loss from our Income Portfolio, when set against the 29.7% fall in the All Ordinaries Accumulation Index. The portfolio's return since inception (in July 2001) now averages 14.1% per annum—a healthy lead over the benchmark's return of 5.5% pa.

The Growth Portfolio also came through the turmoil relatively well, with a loss of 19.6%, but its long-term performance has been less satisfactory, with a gain of 2.1% pa since inception (in August 2001), compared to the benchmark's return of 5.4% pa.

We'll examine the performance of each portfolio more closely in the following pages.

Income Portfolio

It was a good half-year for the Income Portfolio, at least in a relative sense, with its loss of 16.3% comfortably beating the All Ordinaries Accumulation Index's loss of 29.7%.

The standout performers were **Platinum Asset Management** and **Sigma Pharmaceuticals**, both of which rose roughly 10% (and delivered dividends on top). Platinum is recognised as a contrarian fund manager, and its flagship—the Platinum International Fund—has outperformed its benchmark over the past six months, helped by some significant short positions, a major investment in the Japanese yen and by avoiding much of the trash in the financial sector.

Sigma Pharmaceuticals had a horrible first half of 2008 and the stock looked cheap at the beginning of this period. It was also helped by operational improvements and the defensive nature of its business.

Mortgage Choice and **Goodman Fielder** also helped performance, being down just a little in a market that was down a lot (the former actually delivered a positive return when its hefty fully franked dividend is included). Like Sigma, both stocks were beaten up badly in the first half of 2008, and earned some deserved respite.

Numerous other stocks were down 'just' 12–20%, such as **ANZ**, **Ten Network**, **Washington H Soul Pattinson** and **Westpac**. Decent diversification and a little luck helped mask very poor results from **Great Southern TREES2**, down 69%, and **Timbercorp**, down 84%. We've highlighted the travails of these stocks in numerous recent reviews.

Income Portfolio current status

COMPANY NAME (ASX CODE)	PURCHASE PRICE ($)	PRICE ($) AT 31/12/08	LAST RECOMM.—ISSUE # (PRICE AT REVIEW)	SHARES	VALUE ($)
ANZ Bank (ANZ)	16.28	15.29	Hold—260 ($17.55)	406	6,207.74
Commonwealth Bank (CBA)	27.39	28.90	Hold—259 ($42.40)	205	5,924.50
Dexus RENTS (DXRPA)	70.00	61.00	Buy for Yield—250 ($89.95)	56	3,416.00
Goodman Fielder (GFF)	2.39	1.33	Hold—263 ($1.39)	4,000	5,320.00
GTP TREES2 (GTPGA)	100.00	21.00	Hold—258 ($54.90)	98	2,058.00
Infomedia (IFM)	0.52	0.29	Buy—263 ($0.295)	42,500	12,112.50
MMC Contrarian (MMA)	0.95	0.41	Hold—259 ($0.53)	8,375	3,433.75
Mortgage Choice (MOC)	0.97	0.76	Buy—263 ($0.71)	16,484	12,527.84
Platinum Asset Management (PTM)	4.30	3.45	Buy—262 ($3.40)	4,200	14,490.00
Seven Network TELYS (SEVPC)	84.11	75.50	Buy for Yield—258 ($94.00)	93	7,021.50
Sigma Pharmaceuticals (SIP)	1.73	1.08	Buy—258 ($1.19)	7,850	8,478.00
Southern Cross SKIES (SAKHA)	71.00	70.00	Buy for Yield—260 ($73.30)	55	3,850.00
TAPS Trust (TTXPA)	78.00	80.10	Buy for Yield—258 ($82.65)	50	4,005.00
Ten Network (TEN)	3.34	1.17	Long Term Buy—251 ($1.485)	4,430	5,183.10
Timbercorp Corp. Bonds (TIMHB)	80.00	50.00	Hold—262 ($74.90)	97	4,850.00
Timbercorp (TIM)	1.77	0.13	Hold—263 ($0.125)	16,000	2,000.00
Washington H Soul Patts. (SOL)	9.03	9.35	Long Term Buy—254 ($10.50)	1,400	13,090.00
Westfield Group (WDC)	19.40	12.95	Long Term Buy—256 ($17.29)	1,086	14,063.70
Westpac Banking Corp (WBC)	13.49	16.97	Hold—260 ($22.07)	741	12,574.77
Wilson Investment Fund (WIL)	0.93	0.53	Long Term Buy—260 ($0.60)	19,689	10,336.73
Cash (Dividends)					**75,961.46**
Cash (Investments)					**31.03**
Total					**226,935.61**

Out with the old, in with the income securities

Portfolio changes during the half all occurred in late October, and revolved around a push into income securities. The sector was highlighted as an unusual opportunity in our special report, *Income securities come in from the cold*, and we naturally wanted the Income Portfolio to have some skin in the game. All but the **TAPS Trust** have fallen, at least a little, since our purchases, and they remain compelling opportunities for income investors.

The portfolio collected $7,354 in dividends during the half, a nice distraction from the larger capital losses incurred. We wouldn't be surprised to see the dividends of some of the portfolio's investments falling over the coming year, especially if the economy continues heading south. But they should hold up better than average, if we've done our job properly.

Income Portfolio—Transactions

STOCK (ASX CODE)	BUY/SELL	NO. OF SHARES	PRICE	VALUE ($)
GWA International (GWT)	Sell	2,000	2.70	5,400.00
MMC Contrarian (MMA)	Sell (buyback)	12,875	0.709	9,128.38
Telstra (TLS)	Sell	3,120	4.08	12,729.60
Seven Network TELYS3 (SEVPC)	Buy	93	84.11	7,822.23
Timbercorp Corp. Bonds (TIMHB)	Buy	97	80.00	7,760.00
Southern Cross SKIES (SAKHA)	Buy	55	71.00	3,905.00
TAPS Trust (TTXPA)	Buy	50	78.00	3,900.00
Dexus RENTS (DXRPA)	Buy	56	70.00	3,920.00

Income Portfolio—Annual dividends

2001	2657.65
2002	8,796.08
2003	7,437.59
2004	7,236.89
2005	10,124.95
2006	14,005.43
2007	12,018.55
2008	13,684.32

Income Portfolio—Returns

	AVERAGE ANNUAL	LAST 6 MONTHS	HISTORICAL YIELD
Portfolio	14.1%	–16.3%	9.1%
All Ords Accum.	5.5%	–29.7%	6.3%

Growth Portfolio

It's probably little comfort to any investor down 19.6% in six months, but the Growth Portfolio also significantly outperformed the All Ordinaries Accumulation Index's loss of 29.7%.

Behind this overall result, though, was a very mixed bag of individual performances. Despite more than halving our holding in October, **Cochlear** remains the portfolio's largest investment, and its 27% stock price increase during the half, mostly before we'd sold any, provided a major boost. Cochlear was helped by the lower Australian dollar and its generally defensive business.

Growth Portfolio—Returns

	AVERAGE ANNUAL	LAST 6 MONTHS
Portfolio	2.1%	–19.6%
All Ords Accummulation	5.4%	–29.7%

Growth Portfolio—Transactions

STOCK (ASX CODE)	BUY/SELL	NO. OF SHARES	PRICE	VALUE ($)
Cochlear (COH)	Sell	220	55.15	12,133.00
Australian W'wide Petroleum (AWE)	Buy	1,025	2.40	2,460.00
TAP Oil (TAP)	Buy	4,600	0.535	2,461.00
Corporate Express (CXP)	Buy	1,500	4.630	6,945.00
Harvey Norman (HVN)	Buy	2,650	2.630	6,969.50

The 11% rise from **Platinum Asset Management**, the portfolio's next largest holding also contributed handily, as did the 160% appreciation of **RHG Group**.

Offsetting this was a horrendous showing by **Timbercorp**, which fell 84% as concerns increased over its ability to survive, and **Roc Oil**, which fell 70% thanks to a falling oil price, poor exploration results and what we view as an unforced error in the acquisition of Anzon Australia.

STW Communications fell 50% because of concerns over its debt and the increased likelihood of a significant business downturn. **Treasury Group** fell a similar amount as its funds under management dwindled.

Flight Centre's share price dropped 53% after its business slowed dramatically in the last three months of the year, prompting a profit downgrade. We think the stock is shaping up as an unusually good opportunity as a result. And **Macquarie Group**'s 41% slide also didn't help, although it fared much better than most in its sector.

Well positioned

The part-disposal of Cochlear during the period raised funds to diversify into two other high quality stocks: **Corporate Express** and **Harvey Norman**. And we used the portfolio's small cash pile, and dividends received during the half, to acquire two small, speculative oil

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Growth Portfolio

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stocks—**Australian Worldwide Exploration** and **Tap Oil**. Both have risen since our purchase in late October, despite the oil price falling 40% in the last two months of the year.

The Growth Portfolio is filled to the brim with cheap stocks, with 18 of the 19 holdings currently attracting a positive recommendation. In fact, we'd say that the portfolio as a whole is trading at its biggest ever discount to intrinsic value. If we're right about that, then it should be well positioned for when the market finally turns.

Growth Portfolio current status

COMPANY NAME (ASX CODE)	PURCHASE PRICE ($)	PRICE ($) AT 31/12/08	LAST RECOMMENDATION—ISSUE # (PRICE AT REVIEW)	SHARES	VALUE ($)
ARB Corporation (ARP)	3.05	2.85	Long Term Buy—255 ($3.86)	3,000	8,550.00
Aust. W'wide Exploration (AWE)	2.40	2.57	Speculative Buy—259 ($1.93)	1,025	2,634.25
Brickworks (BKW)	12.45	9.70	Long Term Buy—245 ($9.89)	1,000	9,700.00
Cochlear (COH)	19.04	55.40	Long Term Buy—255 ($51.52)	200	11,080.00
Corporate Express (CXP)	4.63	4.20	Buy—263 ($4.06)	1,500	6,300.00
Flight Centre (FLT)	14.10	7.80	Buy—263 ($7.29)	400	3,120.00
Harvey Norman (HVN)	2.63	2.65	Buy—263 ($2.35)	2,650	7,022.50
Infomedia (IFM)	0.53	0.29	Buy—263 ($0.295)	25,800	7,353.00
Macquarie Group (MQG)	30.76	28.81	Long Term Buy—262 ($26.44)	250	7,202.50
Mortgage Choice (MOC)	0.95	0.76	Buy—263 ($0.71)	8,974	6,820.24
Platinum Asset Mmt (PTM)	5.49	3.45	Buy—262 ($3.40)	3,150	10,867.50
RHG Group (RHG)	0.30	0.13	Speculative Buy—262 ($0.13)	41,800	5,434.00
ROC Oil (ROC)	1.36	0.50	Buy—259 ($0.61)	6,080	3,040.00
Souls Private Equity (SOE)	0.22	0.11	Buy—258 ($0.125)	50,000	5,250.00
STW Communications (SGN)	2.91	0.68	Buy—260 ($0.67)	3,685	2,505.80
TAP Oil (TAP)	0.54	0.77	Speculative Buy—259 ($0.59)	4,600	3,519.00
Timbercorp (TIM)	1.85	0.13	Hold—263 ($0.125)	11,000	1,375.00
Treasury Group (TRG)	13.49	4.55	Long Term Buy—262 ($5.21)	1,000	4,550.00
Westfield Group (WDC)	13.15	12.95	Long Term Buy—256 ($17.29)	695	9,000.25
Cash					**1,301.22**
Total					**116,625.26**

DISCLOSURE As at 9 Jan 2009, in-house staff of The Intelligent Investor held the following listed securities or managed investment schemes: AEA, AHC, ANZ, ARP, AWE, BEPPA, CBA, CDX, CHF, COH, COS, CRS, CXP, DBS, FLT, GFF, GLB, GNC, GTP, HVN, IAS, IDT, IFL, IFM, IMF, IVC, KRS, LMC, LWB, MFF, MFG, MLB, MMA, MOC, MQG, NABHA, NHF, NVT, OEQ, PMV, PTM, REX, RHG, ROC, SAKHA, SDI, SFC, SFH, SGN, SHV, SIP, SLM, SOF, SRV, STO, TEN, TGR, TIM, TIMG, TLS, TRG, TRS, TTS, VBA, WAN, WBC and WDC. This is not a recommendation.

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