THE INTELLIGENT INVESTOR
VALUE INVESTING EXPERTS
PORTFOLIO UPDATE
AS AT 30 JUN 2008
JUN '08
PORTFOLIO UPDATE

Portfolios see bear looming—get mauled anyway

It's been a tough six months in the stockmarket. In a recent investment update an associate of ours said that 'sometimes words just aren't enough', but then he came up with 'gut-wrenching' and we'd say that almost does it justice.

In the first half of the year, the All Ordinaries Index fell 17% and the S&P ASX 300 Industrials Index (excluding resources) fell 26%. Our Growth and Income portfolios have fared worse, with falls of 35% and 23% respectively.

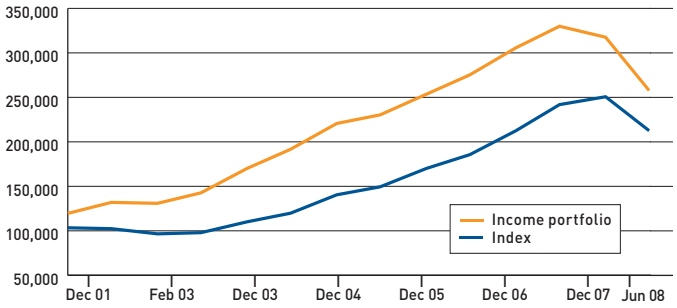
Both portfolios are relatively concentrated and, as such, we expect volatility. But the results are extremely disappointing and what makes it doubly so is that we saw many of the dangers looming – and we warned about them in articles like *Easy money signals tough times ahead* in April 2006, *Hangover will follow global binge* in June 2007 and *Dear Glenn, you have a problem* in January 2007. Predicting rain doesn't count. Building arks does.

Trigger happy

We've overestimated the value of several businesses over the years but, for the most part, we're happy with the collection of stocks in our portfolios, and we expect them to deliver reasonable returns given time. But the fact is that we pulled the trigger on some of them far too early.

Hindsight is obviously a wonderful thing, but the one clear lesson out of this whole experience is that generating extraordinary returns requires extraordinary patience. And a lack of patience is something we've been guilty of.

Income Portfolio vs All Ordinaries Accumulation Index



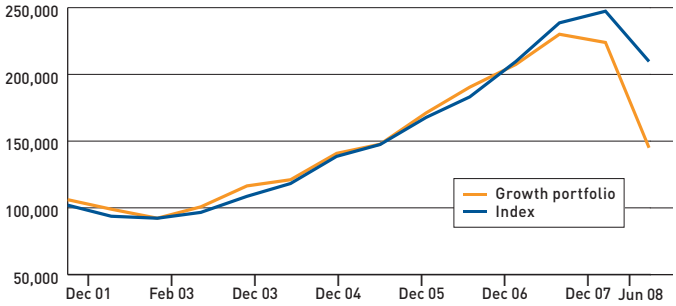
All is not lost, of course. We own a portfolio of exceptionally cheap businesses and ignoring short-term share price movements is what value investing is all about.

At times like this it's particularly important to keep your head so you can concentrate on what counts in the long run. The credit crisis, rising inflation and slowing growth are concerning, but the risks we face today are not necessarily the risks we'll face tomorrow. Giving too much weight to economic data can steer you away from more important considerations, such as a company's competitive position, its management and culture, and of course its valuation.

Selling overdone

The stockmarket has moved swiftly to take account of the deteriorating economic outlook, but in many cases the selling looks overdone. Companies such as **Infomedia**, **Mortgage Choice**, **Platinum Asset Management**, **Treasury Group** and **Flight Centre** all have net cash. So while others fret about the credit crisis, these companies can focus on building market share, or make a cheap acquisition, or simply buy back their own stock at cheap prices—as Infomedia and Treasury Group have been doing.

Growth Portfolio vs All Ordinaries Accumulation Index



Every stock in our Growth Portfolio, with the exception of **Roc Oil**, currently sports a positive recommendation, as do 11 of the 17 stocks in our Income Portfolio. Rarely is there so much opportunity at the same time.

And the Income Portfolio's long-term performance remains something to be proud of. Despite the recent knock, its 17% annualised return is well in excess of the index at 11%. But the Growth Portfolio's 6% annual return since inception seven years ago is now well short of the index, and about what you would have earned in the bank. Perhaps the difference between the two portfolios says something about focusing on a business's current performance over the potential for blue sky.

Either way, we're unhappy with some of the portfolio

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Portfolios see bear looming—get mauled anyway

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decisions we've made over the past couple of years. Just six months ago research director Greg Hoffman wrote an excellent article titled *Strong arms ready to crush weak hands*. Opportunities abound in the current market but, with our portfolios suffering along with almost everyone else's, our arm is not as strong as it should be.

Overall portfolio performance as at 30 Jun 08

	DATE OF INCEPTION	ANNUAL % CHANGE SINCE INCEPTION (INDEX)	% CHANGE SINCE 31/12/07 (INDEX)
Growth	Aug 01	5.5 [11.3]	–35.2 [–15.2]
Income	Jul 01	17.1 [11.4]	–23.5 [–15.2]

Income Portfolio

Companies in the Income Portfolio are chosen to provide capital preservation and income growth over the medium term, but that's meant little in the current panicky environment.

Some investors have found refuge in industry stalwarts, however. The conservatively managed **Washington H Soul Pattinson**, for example, rose 23%. And, although **Telstra** fell 10%, we took advantage of the relatively strong share price and sold our entire holding. However, we still have 3,120 shares after coughing up $1.60 for the second instalment of the **Telstra 3 Instalment Receipts** and collecting 120 bonus shares.

Australia's large retail banks provoke furious debate within the walls of *The Intelligent Investor* and they each fell roughly 30% over the period. There might still be some skeletons in the closet—a legacy of loose lending practices during the bull market—but lower prices are beginning to reflect the risks. The debate continues.

Sigma Pharmaceuticals fell 38% as it continues to struggle with slipping margins, but its business should prove resilient in any downturn. And despite management's best efforts, **Goodman Fielder** continues to feel the pinch from higher input costs and its stock was down 26%.

Listed investment companies **MMC Contrarian** and **Wilson Investment Fund** have fallen further than the index, thanks in large part to low weightings in resources. And higher interest rates and lower global growth expectations have even dampened enthusiasm for retail property icon **Westfield Group**, which fell 23%.

While the portfolio has gone backwards, $6,331 in dividends lessens the pain, and we still see excellent prospects for that income to increase over the years. And the capital value is still ahead of its December 2005 level. In due course we're confident of passing last year's highs.

Income Portfolio current status

COMPANY NAME (ASX CODE)	PURCHASE PRICE ($)	PRICE ($) AT 30/6/08	LAST RECOMM.—ISSUE # (PRICE AT REVIEW)	SHARES	VALUE ($)
ANZ Bank (ANZ)	16.28	18.72	Hold—247 ($22.04)	406	7,600.32
Commonwealth Bank (CBA)	27.39	40.17	Hold—249 ($41.91)	205	8,234.85
Goodman Fielder (GFF)	2.39	1.41	Long Term Buy—243 ($1.815)	4,000	5,620.00
GTP Trees2 (GTPGA)	100.00	68.50	Buy—246 ($74.75)	98	6,713.00
GWA International (GWT)	3.19	2.50	Hold—242 ($3.06)	2,000	5,000.00
Infomedia (IFM)	0.52	0.37	Buy—248 ($0.415)	42,500	15,725.00
MMC Contrarian (MMA)	0.95	0.58	Hold—240 ($0.820)	21,250	12,325.00
Mortgage Choice (MOC)	0.95	0.80	Strong Buy—246 ($0.95)	16,484	13,187.20
Platinum Asset Mgmt (PTM)	4.30	3.11	Buy—251 ($3.20)	4,200	13,062.00
Sigma Pharmaceuticals (SIP)	1.74	0.99	Buy—249 ($1.175)	7,850	7,732.25
Telstra (TLS)	3.46	4.24	Hold—246 ($4.54)	3,120	13,228.80
Ten Network (TEN)	3.34	1.37	Long Term Buy—251 ($1.485)	4,430	6,046.95
Timbercorp (TIM)	1.78	0.77	Strong Buy—251 ($0.79)	16,000	12,240.00
Washington H Soul Patts. (SOL)	9.04	11.29	Long Term Buy—248 ($9.00)	1,400	15,806.00
Westfield Group (WDC)	19.41	16.28	Long Term Buy—248 ($17.54)	1,086	17,680.08
Westpac Banking Corp (WBC)	13.49	20.00	Hold—251 ($20.20)	741	14,820.00
Wilson Inv. Fund (WIL)	0.93	0.71	Long Term Buy—238 ($1.075)	19,689	13,979.19
Cash (Dividends)					**68,607.83**
Cash (Investments)					**80.28**
Total					**257,688.75**

Income Portfolio—Transactions

STOCK (ASX CODE)	BUY/SELL	NO. OF SHARES	PRICE	VALUE ($)
MMC Contrarian (MMA)	Cap. Ret.	21,250	0.10	2,125.00
Infomedia (IFM)	Buy	16,500	0.42	6,930.00
Platinum Asset Management (PTM)	Buy	4,200	4.30	18,060.00
Santos (STO)	Sell	500	13.80	6,900.00
Telstra (TLS)	Sell	5,300	4.72	25,016.00
Timbercorp (TIM)	Buy	3,803	1.11	4,221.33
Mort. Choice (MOC)	Buy	16,484	0.95	15,659.80
Santos (STO)	Sell	1,000	15.66	15,660.00
Telstra (TLS)	Buy	3,120	4.51	14,070.00
Telstra Instalment Receipts (TLSCA)	Sell	3,000	3.09	9,270.00
Net Sales				**29.87**

Income Portfolio—Annual dividends

2001	2,657.65
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 (to 30 Jun)	6,330.69

Income Portfolio—Returns

	AVERAGE ANNUAL	LAST 6 MONTHS	HISTORICAL YIELD
Portfolio Return	17.1%	-23.5%	6.4%
All Ords Accum.	11.4%	-15.2%	3.3%

Growth Portfolio

The Growth Portfolio has given way to macroeconomic fears, with **Cochlear**, **Infomedia** and **ARB Corporation** suffering to varying degrees from the strong Aussie dollar and investors' renewed aversion to risk. On the flipside, overseas travel is much cheaper and **Flight Centre** has reaped the benefits with a profit upgrade in mid-June.

Nonetheless we roughly halved our Flight Centre holding in February thanks to its strong share price and, for the same reason, we sold our **GrainCorp** shares. During the half we also finally ended our unfortunate association with **Croesus Mining**.

On the other side of the ledger, we added 1,150 shares in **Platinum Asset Management** at $4.30—a price we felt (and still feel) was very attractive—only to watch it fall another 28% as the market continued to hammer the funds management sector. We also paid $0.42 each for a further 7,400 shares in Infomedia, and added 8,974 **Mortgage Choice** at 95 cents.

Higher funding costs have played right into the banks' hands, so they're reducing brokerage commissions and stealing market share from brokers. But with a 15% fully

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Growth Portfolio current status

COMPANY NAME (ASX CODE)	PURCHASE PRICE ($)	PRICE ($) AT 30/6/08	LAST RECOMMENDATION—ISSUE # (PRICE AT REVIEW)	SHARES	VALUE ($)
ARB Corporation (ARP)	3.05	3.85	Long Term Buy—242 ($4.12)	3,000	11,550.00
Brickworks (BKW)	12.45	12.00	Long Term Buy—245 ($9.89)	1,000	12,000.00
Cochlear (COH)	19.04	43.65	Long Term Buy—252 ($44.00)	420	18,333.00
Flight Centre (FLT)	14.10	16.67	Long Term Buy—251 ($17.60)	400	6,668.00
Infomedia (IFM)	0.53	0.37	Buy—248 ($0.415)	25,800	9,546.00
Macquarie Group (MQG)	30.76	48.64	Long Term Buy—247 ($61.85)	250	12,160.00
Mortgage Choice (MOC)	0.95	0.80	Strong Buy—246 ($0.95)	8,974	7,179.20
Platinum Asset Mgmt (PTM)	5.49	3.11	Buy—251 ($3.20)	3,150	9,796.50
RHG Group (RHG)	0.30	0.05	Speculative Buy—249 ($0.085)	41,800	2,131.80
ROC Oil (ROC)	1.36	1.69	Hold—251 ($1.73)	6,080	10,244.80
STW Communications (SGN)	2.91	1.37	Buy—250 ($1.40)	3,685	5,030.03
Souls Private Equity (SOE)	0.22	0.16	Buy—244 ($0.180)	50,000	8,000.00
Timbercorp (TIM)	1.85	0.77	Strong Buy—251 ($0.79)	11,000	8,415.00
Treasury Group (TRG)	13.49	9.21	Buy—243 ($10.61)	1,000	9,210.00
Westfield Group (WDC)	13.15	16.28	Long Term Buy—248 ($17.54)	695	11,314.60
Cash					**3,444.13**
Total					**145,023.06**

Growth Portfolio

[FROM PAGE 3]

franked dividend yield (at our latest $0.95 purchase price), net cash and a degree of locked-in earnings from trail commissions, a lot can go wrong and an investment in Mortgage Choice should still come up trumps.

Despite the high oil price, ARB Corporation fell only 7% while **Brickworks**' conservative approach saw it fall only 8%. At the pointy end, **RHG Group** showed why you should keep speculative investments to a small proportion of your portfolio, with a fall of 83%.

Macquarie Group and fund managers **Treasury Group** and Platinum Asset Management have sold off sharply following falls on global stockmarkets. And with **Ten Network** forecasting a dour period for advertising, **STW Communications** dropped 42% and earned itself an upgrade to Buy.

The Growth Portfolio got off to a poor start and we've struggled to make up ground ever since. But it comprises a broad spread of stocks, at considerable discounts to our perceived values, and we're confident that the portfolio's true value will come through in time.

Growth Portfolio—Returns

	SINCE INCEPTION	AVERAGE ANNUAL	LAST 6 MONTHS
Portfolio Return	45.0%	5.5%	–35.2%
All Ords Accum.	109.7%	11.3%	–15.2%

Growth Portfolio—Transactions

STOCK (ASX CODE)	BUY/SELL	NO. OF SHARES	PRICE	VALUE ($)
Flight Centre (FLT)	Sell	312	25.80	8,049.60
Infomedia (IFM)	Buy	7,400	0.42	3,108.00
Platinum Asset Management (PTM)	Buy	1,150	4.30	4,945.00
Graincorp (GNC)	Sell	700	12.18	8,526.00
Mortgage Choice (MOC)	Buy	8,974	0.95	8,525.30
Croesus Mining (CRS)	Sell	953	0.04	37.17
Net Sales				**34.47**

Where to start?

Those members new to *The Intelligent Investor* often ask whether they should simply dive in and replicate the model portfolio which best suits their risk profile. Our reply (apart from not being able to provide personal advice) is that your starting point should be those portfolio stocks that are currently sporting positive recommendations. With more than a dozen of those in the Growth Portfolio and nine in the Income Portfolio, now's a good time to be a budding value investor.

DISCLOSURE As at 9 Jul 2008, in-house staff of The Intelligent Investor held the following listed securities or managed investment schemes: AEA, AHC, ANZ, ARP, CBA, CDX, CHF, COH, COS, CRS, CXP, DBS, FLT, GFF, GLB, GNC, GTP, HHV, HVN, IAS, IFL, IFM, IVC, JST, KRS, LMC, LWB, MFF, MFG, MLB, MMA, MOC, MQG, NABHA, NHF, NVT, OEQ, PTM, REX, RHG, ROC, SDI, SFC, SFH, SGB, SGN, SHV, SIP, SLM, SOE, SOF, SOL, SRV, STO, TEN, TGR, TIM, TIMG, TLS, TRG, TRS, TTS, VBA, WAN, WBC and WDC. This is not a recommendation.

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