



It's time to get defensive

Don't let market jitters scare you off, just ensure you're in the right fund, **Penny Pryor** writes.

IS the current market turbulence here to stay or is it just a healthy correction? This is the million-dollar question and those who get it right are probably already millionaires. But how should the rest of us be investing our cash?

The important thing to remember is that markets fall as well as rise but, over time, the overall movement is up. If you're investing for the long term, rather than speculating, you should probably be sitting tight or looking for funds that have good defensive characteristics and are promising solid long-term returns.

WHAT'S IN THE NUMBERS?

Any researcher that looks at managed funds will tell you that past performance is no indication of future performance. That's particularly true if you're looking at short-term performance. If you avoided a fund just because it fell over the past month, you could be missing out on a hidden gem.

The list of Australian equity funds in the table compiled by Morningstar, shows the top-performing funds over a three-year period to the end of June.

Han Lee, Prime Value Asset Management managing director and the portfolio manager of the top-performing fund over this period, likens the current global situation to travelling on an aeroplane.

"We are all passengers at the moment, travelling on a Chinese airline," he says.

Australia, due to its strong resources sector which produces something China desperately needs, is fortunate enough to be travelling first class. Other countries aren't so lucky. The US, although used to travelling at the front of the plane, can't really afford it under current market conditions.

First-class passengers are better insulated from any slight turbulence than passengers in business or economy, but if the plane crashes it doesn't matter where you're sitting.

So, as long as global markets don't go into free fall, the Australian market will probably be able to weather this storm.

Lee forecasts another 10 years for the Chinese growth story, which is good news for Australian companies and Australian equity funds.

IF THE CAP FITS

But how do you know if a fund manager is investing in the right stocks? The 10 fund

managers in our table are all large-cap funds, which means they generally look for opportunities in the top 200 or 300 companies listed on the Australian Stock Exchange.

BlackRock Merrill Lynch Investment's Robin Young is portfolio manager for the Merrill Lynch growth fund. He says the large-cap companies such as BHP and Rio Tinto, that are benefiting from the China boom, will offer steady growth opportunities even when markets are volatile.

The core of the BlackRock Merrill Lynch fund is invested in the ASX 100 and the rest of the fund is often invested in mid-cap companies that are doing business with, or somehow benefit from, the larger companies.

"The vast majority of our assets are in blue-chip stocks," Young says.

Prime Value's growth fund also likes blue-chip stocks and its top holdings include investments in BHP, Orica, Rio Tinto and News Corp.

Although the fund has returned 34 per cent a year annualised for the past three years, Lee says that is well above the fund's target returns of 15 to 20 per cent.

"We didn't aim for 30 per cent. When you aim for higher returns you have a higher risk," he says. "If mistakes are to be made we prefer to err on the conservative side, even at the expense of giving up a few percentage points of performance."

TEMPER EXPECTATIONS

In Australia markets have been surging ahead for the past six years, avoiding some of the bumps that other global markets have come up against.

Schroders global chief investment officer Alan Brown says Australia should not expect to avoid global downturns "like you did last time".

"It's been a long run. There are an awful lot of people here who don't know how bad it can be," he says.

So take note of your particular fund's target return. Even if your fund is delivering more than 30 per cent a year, don't get used to it.

SAFETY IN DIVIDENDS

Some funds focus on a company's dividend yield as well as capital growth expectations, which provides a good safeguard for investors. These funds are called imputation or income funds.

Jack Chemello, portfolio manager for the BT Imputation fund (which appears in our top 10), says this screening process means the fund is relatively well positioned if markets get choppy. In fact, last month was one of its best performing months.

Its focus on dividends means it avoids many of the "high momentum" companies or those that may be growing but not making enough to return their profits to investors.



How to choose a managed fund

- **Fees:** Compare the fees of various funds and confirm that the returns cited are net of fees. Get fund returns from a research house rather than the fund itself.
- **Ratings:** Compare the ratings of a

particular fund, provided by research houses such as Morningstar.

- **Strong long-term returns:** Go straight to the three-year, if not five-year performance numbers of a fund.
- **Compare returns against benchmark:** A fund may be doing well in absolute terms but if it's not delivering against its benchmark there may be better opportunities elsewhere.

- **Check the top 10 holdings of a fund:** Usually available on the fund manager's website, these can give you a good idea of what investment process is used.
- **Dividends:** Imputation or income funds that focus on companies with good dividend growth offer good defensive opportunities.



TOP 10 PERFORMING FUNDS

Fund	Min. Inv. \$	Fee % pa	Return 1 yr %	Return 3 yr %pa	Return 5 yr %pa	Morningstar rating
Prime Value Growth	40,000	1.44	30.80	34.34	28.84	★★★★★
Merrill Lynch - Growth	1000	1.46	30.73	30.88	20.22	★★★★★
ANZ OneAnswer IP ING Select Leaders	5000	2.35	32.87	30.46	18.94	★★★★★
BT Imputation	5000	1.80	31.23	29.34	21.67	★★★★★
IOOF/Perennial Flexi Trust - Growth Shares	2000	1.74	30.78	28.98	19.27	★★★★★
Challenger Select Australian Share	5000	1.85	33.22	28.61	20.54	★★★★★
AXA - Wholesale Australian Equity - Value	25,000	0.78	27.34	28.52	-	★★★★★
ABN AMRO - Australian Equity	20,000	0.79	25.40	28.44	20.06	★★★★★
AXA - Wholesale Aust'n Equity-Growth	25,000	0.85	29.54	27.89	19.11	★★★★★
Suncorp Australian Shares	2000	1.95	27.27	27.31	19.59	★★★★★

Source: Morningstar (data as at June 30, 2007)