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## LICkety split in race for cash

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27nov04

GETTING to your destination can be tricky if your transport has been thrashed hard or is costing too much. Managed funds - a vehicle for many investors - have laboured so much in recent years that they have been overtaken by flashier listed investment companies, yet these still need to be driven carefully.

Indeed, the latest listed investment companies cannot get started in the market and remain with high cash levels. And those that succeed will have fees as big as the managed funds they aim to replace.

Peters MacGregor and MMC, for example, respectively have 90 per cent and 60 per cent of their assets in fixed interest and cash, ready to plonk down in a fallen market. It's simple prudence, they claim.

"They are in fact true to style," says Lonsec general manager of research Grant Kennaway. "They see no value in the market and are keeping their powder dry while they wait for opportunities.

"And this is totally consistent with the management's stated investment philosophy."

LICs that have listed this year alone are sitting on more than \$450 million in cash, in passing paying little heed to an ASX rule that requires them to be 50 per cent invested within six months of listing.

Among older LICs such as AFIC and Argo - each with assets of more than \$2 billion - bank stocks comprise close to 22 per cent of their portfolios. Several others are even more heavily invested in bank stocks that might be vulnerable to an interest rate rise. Research by Aegis has found that some LICs, such as Whitefield, Milton and Sylvastate, have 35 per cent of their assets in bank stocks, or more than the 25 per cent that the banking sector forms within the S&P/ASX 200.

"Older funds are comfortable with this holding," says Aegis head of managed investments Angela Ashton. "All they have ever professed to want to do is to generate good dividend flows, and that is what they are doing."

Whitefield managing director Angus Gluskie points out that his numbers include a holding in the non-trading bank Macquarie, though "we are overweight in banks and happily so".

The history of LICs has three phases: the older-style Argo and AFIC that have been in existence for more than 40 years and carry annual fee levels of around 0.22 per cent of total assets, in addition to the usual entry brokerage charges.

This contrasts with typical retail managed funds that have annual fees (called management expense ratios or MER) of around 1.8 per cent of assets invested, or eight times bigger than the older funds.

A variation is the so-called index-hugger fund, that seeks to replicate a stock exchange index and generally charges less than half the fees of an actively investing retail fund.

This year has seen the arrival of a new breed of LICs, which promise more and charge more. They are in part a response to the dud performance of several big retail funds, and while they might deliver in time, they also come with a sting in the fees.

In addition to an annual fee similar to other retail funds, there's a success fee that can cut in very quickly, such as simply beating the ASX/S&P all ordinaries accumulation index. These fees can be 20 per cent of the total gain.

Examples of these new LICs this year include Brickworks, Granite Three Pillars, Premium Investors and Contango MicroCap.

In fairness to the newer funds, their pitch is a little different. They claim to invest for the long term in a way that might involve more risk, of a kind to put the wind up asset consultants who advise big super funds.

"These people don't like to see a lot of tracking error," says Ashton. "They prefer a more predictable performance - say, the index plus or minus a few per cent."

The new breed of LICs is not constrained by the nerves of asset consultants and have their sights on the long term.

A tearaway equities market that has risen 40 per cent since April last year has been good for investors who were set in the market, but has left the newcomers struggling to find investing value. This is because they perceive everything to be overpriced.

At least four LICs have cash and fixed interest assets that equate to more than 50 per cent of their portfolio. All floated in the past 12 months. They are MMC Contrarian, Wilson Investment Fund, Clime Asset Management and Peters MacGregor Investments. A second set of listed LICs sit just under the 50 per cent level.

Wilson Investment Fund, run by Geoff Wilson and Matthew Kidman since August last year, has about 60 per cent of its assets in cash. "Our mandate as a manager is to invest in companies that offer exceptional value, and if we can't find them at the moment, then so be it," says Wilson.

"An even bigger mandate is to not lose money. Of course it can cost us investment performance if we are not fully invested in the meantime, but that's a reflection of the state of this market."

MMC Contrarian, managed by MMC Asset Management and HGL, has just over half of its \$200 million in funds invested in cash or a form readily converted to cash.

"It's nothing to do with having certain cash levels," says director Erik Metanomski. "It has become very difficult to find companies that meet our strict criteria for value investing. Looking at some of those small to mid-cap resource stocks, for example, you would have to say they are very special companies to have got to their valuations." Nor is Metanomski enamoured of banks: "We think their earnings are overstated and their (loss) provisioning understated."

On the other hand, Whitefields and Sylvastate's Gluskie believes that bank shares have already factored in an interest rate rise. "The banks only have to generate a very low level of earnings growth over future years to give investors a rate of return that will be higher than the market's."

Meanwhile, most established LICs are trading at their lowest levels in years - in many cases at a discount to their NTA. In the view of research house Aegis this is due to their exposure in banking stocks.

For example, Australia's largest LIC, Australian Foundation Investment Co, closed yesterday at \$3.60, or nearly a 3 per cent discount to its latest net tangible asset backing of \$3.70. Argo closed at \$5.24, on its last announced net tangible assets (NTA) of \$5.26.

AFIC's largest holdings are in Commonwealth Bank, Westpac and National Australia Bank, which have been sold off in recent months. NTA are simply the value of a LIC's investments. NTA are expressed per share and released to the stock exchange every

month by most LICs.

A LIC with a share price of \$3.30 and NTA of \$3 a share would be trading at a 10 per cent premium to NTA. At \$2.70, it would be trading at a 10 per cent discount.

Despite the backing of some big-name managers, most of the new entrants are trading as much as 10 per cent below their NTA. These include Van Eyk Three Pillars, Brickworks Investment Co, Century Australia (managed by Peter Morgan's 452 Capital) and Premium Investors (managed by Anton Tagliaferro's Investors Mutual, among others).

Some LICs are at a slight premium to NTA, such as Peters MacGregor, and some more so, such as Wilson's WAM Capital (up 12 per cent above its last recorded NTA of \$1.45) and Kerr Neilson's Platinum Capital (up 34 per cent).

Lonsec's Kennaway finds Platinum Capital's premium "hard to justify" and recommends a switch to Platinum International Fund, a managed fund that mirrors the investment style of the LIC but does not have the premium price.

A further feature of the new breed of LICs is the length of management contracts of up to 25 years, instead of the more typical three to five years. Such longer contracts generated an annuity-style income to the managers that enabled them to sell out if desired to new managers, while retaining the fund and its pile of assets to manage.

In contrast, shorter management contracts in times past have led to the winding-up of funds that were trading at, say, a 10 per cent discount to NTA.

In its inaugural annual report, Peters MacGregor chairman Wayne Peters declares he is happy to be waiting for the opportunities to emerge. "Although we do not glean any joy from sitting in cash (currently earning 5.5 per cent a year), we invariably prefer that than to be sitting in overvalued equities," he said.

"How long this position will remain is anyone's guess (yours is probably better than ours)."

Apt words, but at least an investor knows the managers promise to be patient.

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