

**Fund Managers Diverge On How Much Cash A Portfolio Requires**

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Managers of concentrated share portfolios agree on many things. They believe you get better performance from having a relatively small number of stocks in a portfolio, and that you can run a portfolio with a high tracking error without necessarily exposing investors to greater investment risk.

But on one issue, their views diverge markedly, and that is the issue of how much cash you should hold in an equity portfolio.

There are two clear schools of thought.

The first says the decision on how much cash to hold is not the manager's. Investors, usually in conjunction with a planner or adviser, will determine an appropriate strategic exposure to the main asset classes, including cash. If a share manager then decides to hold a high level of cash, it could compromise the investor's strategy.

These managers hold that they should remain "true to label" and be fully, or close to fully, invested in shares at all times.

The second school of thought is that if you hire a manager to run a concentrated portfolio, you're implicitly asking them only to buy those shares that they perceive to be outstanding opportunities. You don't want them to "fill up" the rest of the portfolio with things they don't really like, just to be fully invested.

A corollary to concentrated portfolios is that managers will occasionally hold a high level of cash if they can't find good equities to invest in.

Tyndall and Challenger fall into the first camp, while PM Capital, Hunter Hall and Peters MacGregor fall into the latter.

Michael Good, Tyndall's chief executive, says the manager ranks the return it's likely to get from cash (plus five percentage points) alongside the returns it believes it can get from individual shares. Its comparative value analysis (CVA) ranks a large number of stocks by expected returns, and Tyndall builds its portfolios from those ranked highest.

Very rarely does cash ever stack up favourably on this basis, and so Tyndall very rarely holds more than a few per cent of its portfolios in cash.

"We have a 'cash-plus' risk premium," Good says. "Cash is, if you like, one of our stocks.

"Because we're looking over a three-year time horizon in our rankings, it's very rare that you would ever get cash above halfway [in the comparative rankings]."

The Australian equities portfolio manager at Challenger, Pano Raftopoulos, says he doesn't like to hold a lot of cash "because our clients expect us to be invested in equities".

He has the flexibility to hold as much as 10 per cent in cash, but typically sits around the 2 per cent mark.

By contrast, Paul Moore, the chief investment officer of PM Capital, says the option of holding a high level of cash is a crucial element in running a concentrated portfolio.

In some circumstances, "we could be 100 per cent cash", Moore says, but his current holding is about 25 per cent.

"We're not finding any new ideas that we want to put money into," he says. "Twelve months ago, or probably even six months ago, we were 100 per cent invested [in equities], but in the last six months we've let that wind down."

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