

# FROM THE undergrowth

NOVEMBER 08



What a month! All sorts of records broken, but not the sort we really want to celebrate. The Dow Jones fell 14% in October, its biggest monthly percentage fall in 10 years, in spite of lifting 11% in the final week, its biggest weekly percentage gain for 38 years. The volatility made for great headlines, which would have done little to calm your nerves. The good news for the month? New Zealand outperformed the world markets and some of your portfolio companies released some very good news.

## Your Portfolios

What has been going on since we last spoke?

### At a glance

As at 31st October 2008

#### Unit Prices (\$)

NZ Growth Fund	2.7106
Australian Growth Fund	1.1714
International Growth Fund	0.7978
Fledgling Fund	0.9809
KiwiSaver	0.7109

#### Fund Sizes (\$m)

NZ Growth Fund	86.6
Australian Growth Fund	61.2
International Growth Fund	4.7
Fledgling Fund	2.5
KiwiSaver	40.0

#### Performance (October 2008)

NZ Growth Fund	-8.0%
Australian Growth Fund	-23.8%
Intl Growth Fund	-12.9%
Fledgling Fund	-6.7%
KiwiSaver	-13.4%
NZ50 Gross index	-8.7%
S&P/ASX 300 (\$NZ)	-15.8%
MSCI Global Small Cap Index	-11.2%

Rather than spend a lot of time talking about the markets and the behaviour of share market investors during October, we have devoted rather more space to news and developments from your portfolio companies. This is deliberate because, well frankly, we cannot explain much of the behaviour during October without criticizing the actions of others, and we reckon the politicians have been doing more than enough of that lately! But more importantly, we must remember that it is your individual companies that will determine your investment returns over time; the short-term irrational behaviour of other investors will NOT have a lasting effect. October was a melting pot of disappointing economic news from around the world. Clearly economies everywhere are slowing and investors shouldn't really be surprised when economic data is released confirming that consumers are not spending as much, and therefore businesses are not as profitable and may need to cut costs in the years ahead.

The fact that disappointing economic data came on top of a credit squeeze which saw credit virtually dry up overnight, was just too much for a lot of investors to take, leading to October's vertiginous trading patterns that we hope never to see again.

“Everybody has a plan... until he gets hit.”

Mike Tyson

We've been caught out before for calling the bottom of the market, but we are pleased to see some up days in November, and hope that post the elections in US and New Zealand, at least some of the uncertainty that has driven investor panic lately will disappear.

## Your Companies

A summary of news from your companies in the past month

The **Pumpkin Patch** share price was weak during October as investors responded to a broker's report that incorrectly reported that its debt facilities were due to expire shortly. The **Mainfreight** share price was affected by Paradise Investments (an Australian fund manager) reducing its holding in the company from 6.3% down to below the disclosure threshold of 5%. Mainfreight is due to report its interim result in the next two weeks. **Freightways** noted a solid first quarter trading period at its recent AGM and the directors expressed confidence in the resilience of the business and strength of the management team. We similarly found a confident management team when we visited **Delegat's** in October. Management indicated that first quarter case sales are still

very strong into export markets at higher price points than last year. It seems that people really do continue their drinking habits, even when times are tough!

Many of our Australian portfolio companies held their AGMs over the month. This provided an opportunity for us to get an update on current trading activity:

For **Aevum**, the picture is mixed with the company forecasting net profit to fall in the range of 10-20%. The more important news was the entry onto the shareholder register of Stockland Group. Stockland has a clear strategy to increase its exposure to the retirement living sector – in our view Aevum is now in play.

## Your Companies continued

**Arrow Energy** continued to make significant progress in its business. In October the company published an estimate of the likely gas reserves across its total Australian tenement portfolio. The number is big – to put it in context, the massive Maui field in New Zealand, which is now in run out mode, and has provided enough gas to fuel the North Island's gas needs for almost 30 years, was around 3 TCF – Arrow owns gas more than 10 times this amount.

**Pipe Networks** reconfirmed its full year guidance at its AGM of profits in excess of \$11m. This equates to NPAT growth in excess of 50% over the prior period.

**Vision Group** was a stock to focus on (pardon the pun). A new CEO with an optometry background was appointed. Mr Craig Stamp is well known to Vision's doctor partners and looks well placed to roll out the optometric model which we see as crucial for driving future profitability.

As for the International portfolios, with so many portfolio companies there was a lot of news to cover. Remember, you can read about each of the company's on our website.

**Equinix** (US ; a global internet infrastructure company that manages network neutral data centers) reported earnings above expectations and raised guidance (yes you read that correctly). They also plan to further expand their London and Singapore facilities.

**F5 Networks** (US ; the global leader in application delivery networking) reported earnings and guidance in-line with expectations and announced a US\$200m share buyback.

**Icon plc** (Ireland ; healthcare company that provides specialized services in clinical trial management) announced yet another better than expected earnings result with operating earnings growing 45% year over year.

**Sarin** (Israel ; the worldwide market leader in selling equipment and tools for the diamond industry) announced preliminary results that were below expectations as demand for diamonds and related equipment have weakened.

**02Micro** (China ; makes semi-conductors for the major LCD TV and laptop manufacturers) results were in-line with expectations although guidance for the next quarter was below expectations.

**Micros** (US ; provides software, services and point of sale equipment to the hospitality industry) earnings were in line with expectations growing 17% year over year but the company withdrew guidance as visibility is limited right now. We reduced our weighting ahead of the earnings release.

**Hyflux** (Singapore ; one of Asia's largest water treatment companies) reported earnings ahead of expectations, growing 160% over last year. Management remains optimistic due to growing orders and requests from Chinese municipalities to accelerate projects.

**Conceptus** (US ; a "new" permanent birth control system for woman) the company reported its first ever profit and it was ahead of expectations. This is typically a big catalyst and the stock rallied more than 50% on the result.

**Hansen's** (US ; sells a variety of juice drinks in a can) announced a partnership with Coca-Cola for distribution of Hansen's Monster energy drink in six European countries and selected US markets.

It is refreshing to be able to quote Stephanie DeMarco, CEO of **Advent Software**. This is what we want to hear from all of our companies:

*"I do think that downturns create opportunities for companies like Advent – we don't require funding. We have strong cash flow. We have a very sticky product. While there may be some softness in our retention rates, it doesn't materially impact our fundamentals. We have an opportunity to change the game on our competitors so we are looking at all the things we can do in this environment to really strengthen the company for the long term".*

## Up Close & Personal

Ken tells us how trains are just as interesting for big boys as they are for little boys... and they're a great investment too!



Ken at the Midas manufacturing facility in Nanjing with the CEO, Patrick Chew. We couldn't resist featuring Mr Chew in this "choo choo" story!"

During the Asian financial crisis of 1997, China successfully stimulated its domestic economy through investment in the construction of highways. Now in the current financial crisis, it is turning its attention to the railway network. In October, the Chinese government announced they will spend RMB\$2trillion (nearly US\$300bn) over the next decade to upgrade the railway network. With ample financial resources to fund this spending, it is likely to give a much needed boost to the Chinese economy. We have a link to an article regarding this announcement on our website for those interested.

The Chinese use rail more than five times as much as other countries. The development of China's rail infrastructure has dramatically lagged demand

growth making it the busiest rail system in the world in terms of traffic. Given the Chinese economic growth engine and the trend toward urbanization, the need to upgrade the railway system in the country is critical.

The Fisher Funds International Growth Fund owns three companies that benefit directly from this investment theme. All three companies are market leaders in their respective niches, have high barriers to entry and have a strong brand presence in China.

First, Midas Holdings is the market leader in producing aluminium train bodies. Aluminium is lighter and more durable than steel and it constitutes the majority of trains made in China. Our research indicates that Midas has won more than 80 percent of the announced projects over the past few years. I recently visited their manufacturing facility in Nanjing (about 2 hours by train from Shanghai) and was amazed at how automated and sophisticated the production process is. Midas has more than a year's worth of business in backlog and is expecting earnings growth of 30 percent next year. The stock has been dragged down by the overall stock market weakness and is trading at the bargain basement price of 5x P/E. The stock has never been this cheap while the fundamental outlook for the company has never been better:

The other two companies we own are Zhuzhuo CSR Times Electric (who supply electrical equipment for trains – no more coal trains as the new tracks are electrified) and China Automation Group (the leader in safety and critical control systems for train stations). Both companies are expected to grow earnings in excess of 20 percent next year. Each also has more than a year's worth of business in backlog and are trading at a 6x and 3.5x P/E respectively.

We believe that as the news of this significant Chinese government spending is digested by investors around the world they will discover these great little companies that we own. This discovery should provide a catalyst to re-rate our stocks higher. The Chinese railway investment spending is a beacon of light in this foggy economic environment... all aboard.



# A bird's eye view

## What's new at Fisher Funds?

October 2008 was a month that many of us would like to forget. It was challenging for all investors, and even the distractions of the upcoming elections in US and New Zealand were not significant enough to lift our mood given the gloomy economic and market news that emerged each day. We used the month to communicate with our investors at the Barramundi and Marlin annual shareholder meetings and to plan a series of Premium client meetings in the month ahead. What was encouraging during the month was a renewed interest from a number of clients in "dipping a toe" into the markets in the expectation that markets will bottom sometime in the next few months. For some investors, the trend towards lower interest rates is encouraging a renewed focus on assets that can generate capital growth rather than just holding their value. While capital preservation has certainly been uppermost in investors' minds this year, and we hope that you have all enjoyed stability with at least part of your portfolios, we also understand that \$1,000 in bank deposits today will still only be worth \$1,000 in three years time and we all need some capital growth to keep pace with inflation and achieve our lifestyle objectives.

We are pleased to give you a 'heads-up' about a new fund that we are launching before the end of the year. You may have read this year that the Fisher Funds shareholders have been interested in finding some new investment talent with complementary skills to ours, so that we can offer our clients additional investment opportunities. We have found a 'best of breed' investment team with expertise in managing assets that we think represents an ideal investment opportunity for virtually every investor in the current climate.

Without giving away too much information, if you could find an experienced investment team who invest in assets that have predictable and stable cashflows together with some capital growth, with nothing too flash or complicated and a fee structure that makes sense, you'd be interested, right? We'll be in touch soon.

# Your questions

We share our response to some of the questions received from you during the month

**Q:** Why doesn't Fisher Funds trade its portfolios more often? Buying and holding is fine, but surely you can add more value by selling when prices are high and buying when they are low?

**A:** A lot of people wrongly assume that our long-term buy and hold strategy means that we buy stocks and then leave them alone, hoping that they will perform and weather the volatility of economies and markets. We do talk about buying and holding, and we also talk about selling only if there is a fundamental change in our investment case. These are our broad investment philosophies, because we do not believe that we can consistently add value by tactically trading in the short term. While of course we could sell some of our shares today at a high price and then buy back next week a little cheaper, this strategy would only add value at the margin and will not make a significant difference to our returns over time, particularly when transaction costs are taken into account. Our added value, or our ability to earn better than a market return, is known in the industry as alpha. We earn alpha by selecting the right stocks, and having enough of the winning stocks to generate better returns than other investors.

It is not enough just to own the right stocks – if you owned a high performing stock that doubled its share price over the course of the year, you will have done well. But if it comprised just 2% of our portfolio, then that stock's contribution to your performance for the year would be just 2%. If you had a 10% holding, its contribution would be more significant at 10%. If you have monitored our portfolio holdings since the beginning of the year, you might think that we have added little alpha by altering our holdings, but in each of our portfolios we have constantly reviewed and managed our portfolio holdings to make sure that we had enough of each of our preferred stocks.

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An example from our New Zealand portfolio is Pumpkin Patch. This stock has been our worst performer this year, and some of you will be asking why we still hold it. We retain a holding in the company because we still believe in its long term prospects, but since the beginning of this year, we have halved its portfolio position from 8% to 4%. We invested the additional 4% in Wakefield Hospital which has been a good performer over the past four months. We have therefore added value by reducing exposure to an underperformer in favour of an outperforming stock.

# Fund facts

## Fund Performance

Fund Net Returns	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ Growth Fund	-41.3%	-18.3%	-2.7%	4.7%	10.2%
Australian Growth Fund	-57.9%	-25.8%	-9.5%	na	-7.0%
International Growth Fund	na	na	na	na	-20.2%
Fledgling Fund	-35.6%	-15.4%	-3.1%	0.7%	0.3%
KiwiSaver	-29.8%	na	na	na	-27.0%

*NB... annualised returns, after tax and fees.*

Fund Pre-tax Returns	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ Growth Fund	-40.6%	-19.9%	0.8%	8.5%	13.2%
Australian Growth Fund	-57.9%	-24.7%	-7.2%	na	-5.9%
International Growth Fund	na	na	na	na	-20.2%
Fledgling Fund	-35.0%	-14.9%	0.0%	2.4%	0.5%
KiwiSaver	-29.8%	na	na	na	-27.0%

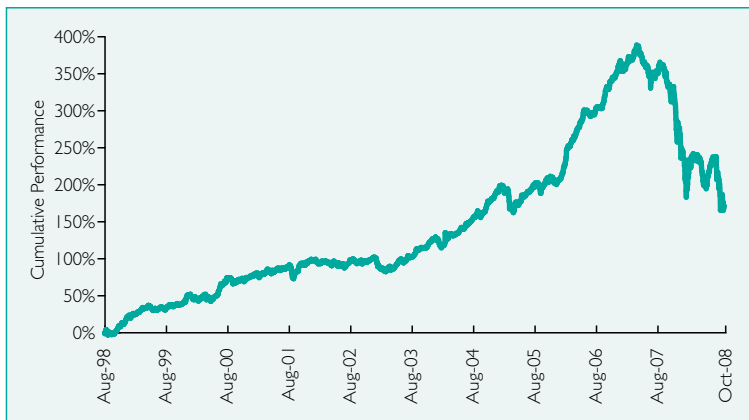
*NB... annualised returns before tax and after fees. They differ from actual returns experienced during these periods.*

Market Indices	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ50G	-33.0%	-13.6%	-5.0%	4.1%	
90day bank bill	9.0%	8.6%	8.3%	7.6%	
S&P/ASX300 (Calculated in \$NZ)	-41.6%	-10.7%	2.9%	8.3%	
MSCI Global Small Cap Index	-29.1%	-15.8%	-4.0%	1.1%	

*\*Not Annualised*

October's Biggest Movers	
<b>New Zealand</b>	
Rakon Limited	-15%
Pumpkin Patch	-17%
Mainfreight	-18%
Sealegs	-36%
<b>Australia</b>	
Vision Group	-32%
Pharmaxis	-33%
DWS Solutions	-38%
Oakton	-49%
<b>International</b>	
Sarin Technologies	-46%
Advent Software	-47%
Ultimate Software	-51%
Wellstream	-58%

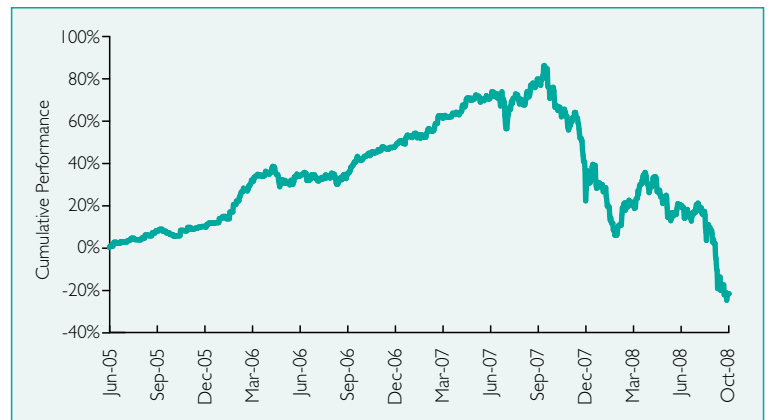
### New Zealand Growth Fund



**Fund Inception** August 1998

**Portfolio Holdings** – Abano Healthcare, Comvita, Delegats, Freightways, Infratil, Mainfreight, Metlifecare, Michael Hill, NZX, Opus International, Pumpkin Patch, Rakon, Ryman Healthcare, Sealegs, Wakefield Health.

### Australian Growth Fund



**Fund Inception** June 2005

**Portfolio Holdings** – Aevum, Arrow Energy, Austbrokers, Bravura, Centrebet, Credit Corp, DWS Solutions, McMillan Shakespeare, Nick Scali, Oakton, Pharmaxis, Pipe Networks, Reckon, Toxfree, Treasury Group, Vision Group, WHK Group.

### International Growth Fund



**Fund Inception** October 2007

**Portfolio Holdings** – Advent Software, Brembo, Celera, China Automation, City Telecom, Conceptus, EBIX Inc, Equinix, F5 Networks, Gameloft, Hansens Natural, Home Inns, Hongguo, Hyflux Limited, Icon PLC, Jumbo, Micros, Midas, Nokian Renkaat, O2 Micro, OSI Pharma, Ports Design, Qiagen, Raffles Education, Roth & Rau, Sarin Technologies, Stratec Biomed, Times Electric, Ultimate Software, Wellstream, Wirecard.

### Fledgling Fund



**Fund Inception** December 1999

**Portfolio Holdings** – Abano Healthcare, Comvita, Delegats, Freightways, Infratil, Mainfreight, Metlifecare, Michael Hill, NZX, Opus International, Pumpkin Patch, Rakon, Ryman Healthcare, Wakefield Health.

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