

# FROM THE undergrowth

FEBRUARY 10



One of the most common New Year resolutions is to eat less and lose weight. This year we might need to lose some weight from above the neck as well as below... the weight of the world that we've carried on our shoulders throughout the global financial crisis and even now as things are getting better. Fortunately, this extra weight can be lost by exercising our minds, and no huffing and puffing is required!



## Our Portfolios

What has been going on since we last spoke?

### At a glance

As at 31 January 2010

#### Unit Prices (\$)

NZ Growth Fund	3.0457
Australian Growth Fund	2.0505
International Growth Fund	1.1575
Fledgling Fund	1.1031
KiwiSaver Growth	1.0447
Infrastructure Fund	1.1785

#### Performance (January 2010)

NZ Growth Fund	-0.5%
Australian Growth Fund	0.4%
International Growth Fund	2.5%
Fledgling Fund	-0.4%
KiwiSaver Growth	0.9%
Infrastructure Fund	-0.7%
NZ50 Gross index	-2.0%
S&P/ASX 300 (\$NZ)	-4.0%
MSCI Global Small Cap Index	0.5%

The first newsletter of the year can be a challenge to write. It should set the scene for the year ahead, but it can't ignore completely the year that has just ended. Certainly last year's February newsletter was a horrible one to write and began with the following words: "This is not the New Year we were hoping for. Whipsawing share markets are giving everybody heartburn – share prices collapsing, years of gains erased in just months, what next?" It is therefore a relief to write this year's newsletter as the news is infinitely better already.

Many of our clients don't pay too much attention to markets over the Christmas holiday break, and look to this first newsletter to provide a quick summary of what the year ahead might hold. This year, the clients who did pay close attention to world markets during January will be none the wiser as to what lies ahead. The year started quite well with generally positive economic and corporate data confirming that most countries are beginning a gradual recovery. And then the mood changed to an unpleasant shade of grey in the last ten days of the month.

It is hard to point to one particular factor that caused the market mood to change, but it is likely to be due to what one industry writer describes as the *pessimism of disbelief*. This is the scenario where people notice all things bad and pay no attention to anything good. Bad news is considered really bad, and good news isn't believed because it too will probably turn bad. Take the US economy for example. People

fear the recovery isn't real or lasting, so they react negatively by selling stocks, or not buying them in the first place. They believe that the only thing driving the recovery has been the stimulus package, and that's bad because it has led to the US now having major debt to deal with. But they don't want the stimulus package to end, because that will kill any economic recovery dead in its tracks.

**"Despite all you may fear, today's negatives are lesser ones than we've often faced".**

Ken Fisher, money manager and author, Forbes magazine

President Obama's comments about the banks in January exemplified the pessimism of disbelief. For many people, banks are now considered bad – they are responsible for the global financial crisis and they should be punished for their behavior. But when Obama talked about actually punishing the banks by implementing new rules and holding them to account, world markets reacted negatively because such intervention would stifle the banks' activity and we need activity for a recovery.

The reaction to China's "tightening" last month also scared investors, particularly in Asia and commodity-sensitive markets such as Australia. Throughout 2009 as China was defying other economies and growing

Have you joined KiwiSaver yet?\*

## Your Portfolios (cont.)

at a rate close to 10%, investors refused to believe that it would last, fearing instead that this growth would become a bubble and ultimately burst, producing the dreaded “double dip” recession. When the Bank of China gently applied the brakes in January (so as to maintain an orderly level of growth) by lifting interest rates slightly and encouraging banks to pace themselves in their lending, investors around the world immediately reacted, calling it the end of China’s growth phase.

It is certainly a challenge to maintain a disciplined investment strategy in such a “half-empty” environment. News that should be rewarded goes unnoticed and news that is slightly disappointing is treated as being dire. Still, we have built our business around independent thought and investing in individual businesses, rather than in the broad share market. We know that at some point, it will be obvious to even the most pessimistic that the world economy is recovering. At some point, money that has been sitting on the sidelines earning sub-optimal returns will be reinvested in the share market. At this point, quality businesses whose stocks are undervalued will be returned to their fair value, and at this point, investors who have stayed the distance (or come back in as things have improved) will fare well.

It is hard to predict when this tipping point might be – indeed we’ve never believed that markets or investor behavior can be consistently well-timed. The profit reporting season in February/March might be a catalyst – it certainly was last year. It might take a few more economic data releases to convince people. President Obama or another world leader might give an inspirational speech which proves sufficient to turn sentiment around, or it might just be a gradual change of mindset. Whatever the timing, we can only be assured of success if we have our investment strategy in place and our portfolio well invested, to take advantage. We were well positioned for the March 2009 turnaround and are delighted at our 2009 performance in all portfolios.

So, those are our early thoughts for 2010... how did the portfolios fare in January?

### New Zealand

The New Zealand share market was a relative outperformer, falling just 2% compared to world markets that were down around 4% on average. There was little in the way of corporate news, other than a sales update

from **Michael Hill International** which was better than expected and evidenced a strong Christmas. Our portfolio outperformed the market with **Michael Hill** (up 4.5%) and **Mainfreight** (up 2.9%) making the largest contributions.

### Australia

Profit taking was the focus over January with positions in **Arrow Energy**, **Reckon** and **Credit Corp** all reduced into early month strength. In New Zealand dollar terms the portfolio managed a small gain in January having been up strongly intra month. Registering a gain in January was a great result with the market down strongly. For the month the portfolio outperformed the benchmark S&P/ASX Small Industrial index by 3.4%

### International

**Bare Escentuals** received a takeover offer from Shiseido. The offer for US\$1.7billion or US\$18.20 per share represents more than a 40% premium to the market price. We initially purchased the stock in August last year at US\$9 and think the offer is more than fair and we will be taking this opportunity to sell our shares.

The management of **Hongguo** has made an offer to acquire all of the outstanding shares for S\$0.439, a 37% premium to the market price. This values the company at around 9x 2009 earnings. We believe this undervalues the business as there is significant earnings potential over the next 3-5 years as well as the opportunity for multiple expansion. The management clearly share a similar view which is why they are looking to take the company private. We are the largest institutional shareholder and are continuing to have discussions with the management, bankers and other large shareholders in order to maximise the value for our investors.

We continued to reposition the portfolio by trimming “winners” such as **Midas Holdings**, **Stratec Biomedical** and **F5Networks** and buying into what we believe will be the winners in 2010.

### Infrastructure

The Infrastructure fund finished January broadly flat, which was an achievement given the negative global share market environment. A new portfolio stock was introduced during January – **TNT**, a Netherlands based Courier/postal company.

## Your questions

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

**Q:** What is Fisher Funds’ take on the potential changes to the taxation system?

**A:** The recent proposals by the Tax Working Group (TWG) could have a significant impact for all of New Zealand, but particularly for property owners. Happily, we expect the proposals to be positive for our investors.

The TWG key recommendations are to align the top personal, trust and corporate rates at 27%, to increase GST to 15% to help pay for the drop in the tax rates, and to increase tax on property and particularly rental properties, as this is a significantly under-taxed investment area currently.

The working group’s intentions of simplicity, fairness and international competitiveness are sound. Aligning tax rates so people focus less on minimising the tax they pay, by setting up complex trust and corporate structures, makes sense. Lowering tax rates so people are encouraged to work, don’t feel over-taxed and skilled people from offshore are attracted here, is also a good thing.

The two controversial aspects will be where they have suggested an increase in tax to pay for those tax cuts. The first is an increase in GST to 15%. This should encourage more saving and less spending. The challenge is

# A bird's eye view

## Ken shares some thoughts on the likely increase in corporate activity during 2010

Take an under-gear'd balance sheet, add some cheap financing, a dash of improved economic outlook and mix it up with a large dose of liquidity and you have the recipe for merger & acquisition activity.

In 2008/9 the US Federal Reserve and central banks saved the world from falling into the financial abyss by flooding the system with cheap money. But instead of borrowing, companies have been paying down debt and shoring up balance sheets to the point where some have too much cash or are under-gear'd for a 'normal' economic environment. Shareholders are concerned about return on invested capital and governments are encouraging companies to borrow so that the economic recovery continues.

If companies do borrow it is unlikely they will finance capital spending, as capacity utilisation in developed economies remains low (that is, they don't need new machines, they just need to use existing machines more often). There is a chance of an increased technology spend, where companies upgrade their computer systems, and we discussed our outlook for the technology sector late last year. The other obvious uses of capital are share buybacks and merger and acquisition activity.

The reality is we are likely living in a world of slower economic growth. Large multinational companies are now looking to China and the emerging economies to generate profit growth. But barriers to entry can be high and the environment competitive. Instead of relying on organic growth, companies will also look to acquire growth. Smaller companies tend to have best of breed products or services and

generate faster growth, which fits nicely into larger companies who often possess brand presence and distribution capabilities. In addition, small companies are often undervalued as they remain undiscovered, making them attractive takeout candidates.

We don't invest in a company because we think it will be acquired, but part of our process is thinking through who the logical buyers for a business are. If we are willing to buy the company we need to convince ourselves that others will also want to buy it, whether those buyers are other investors or corporations.

We have commented on this time and time again; it's not a stock market, it's a market of stocks. The way to generate superior long term returns is to invest in high quality businesses and buy them at the right price. We have already had two of our portfolio holdings acquired during January and believe that corporate activity will continue to be a dominant theme in 2010.

### Fisher Funds and the Oxfam Trailwalker Challenge 2010

This year, Fisher Funds has entered two teams of four in the Oxfam Trailwalker challenge. This event is described as the world's greatest team challenge and involves teams of four crossing the finishing line together after walking or running 100kms of terrain. Each team is to raise at least \$2,000 to help to overcome poverty and injustice in some of the world's poorest communities.

If you would like to sponsor the **Fisher Funds Flyers** (James Paterson, Frank Jasper, Matt Logan and Hugh Fisher) or the **Fisher Funds Fledglings** (Carmel Fisher, Carolyn Clark, Nivedita Findlay and Jeremy Cooper), please visit the Oxfam website and sign up. We would also be delighted if you would like to form a team of four to participate in this event along with the rest of the Fisher Funds family. [www.oxfam.org.nz](http://www.oxfam.org.nz).

## Your questions (cont.)

to ensure that those people on low incomes who simply don't have a choice to save or spend do not get forced into poverty by a higher GST rate.

In our view the changes are positive for share market investors and building a productive economy over the longer term. How far the government goes toward implementation is yet to be seen but expect to see at least some of the recommendations in the May budget.

The TWG also talked about broadening the tax base by removing the current incentives to invest in property over other asset classes. We like the concept of people's investment decisions being made on the basis of the best place to invest their money without the influence of tax. It doesn't

make sense for example, to have \$200 billion of investment assets in rental properties but collect no tax from those investments. In fact, it costs other tax payers \$150-\$200m a year to fund the paper losses of those landlords.

If the TWG recommendations are implemented, the short term impact will be negative for property owners, especially landlords. In the medium term the changes will be positive for share markets and the economy as rental property becomes relatively less attractive and more money flows into productive sectors.

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# Fund facts

## Fund Performance

Fund Net Returns	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ Growth Fund	37.0%	-10.0%	-12.5%	1.0%	10.2%
Australian Growth Fund	84.9%	2.4%	-3.4%	na	7.0%
International Growth Fund	27.7%	8.5%	na	na	6.8%
Infrastructure Fund	21.8%	na	na	na	19.1%
KiwiSaver Growth Fund	45.5%	7.28%	na	na	1.9%

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

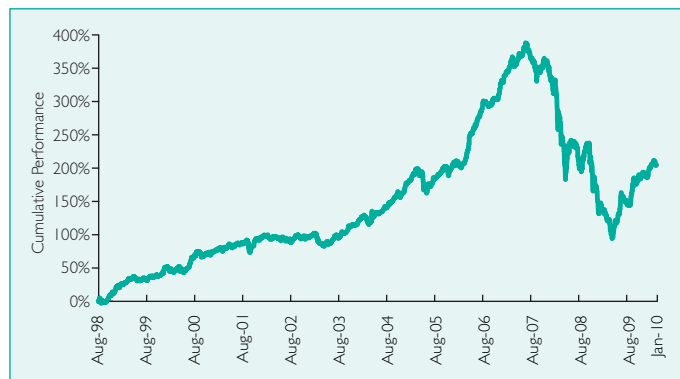
Fund Pre-tax Returns	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ Growth Fund	38.7%	-8.9%	-12.7%	3.4%	13.0%
Australian Growth Fund	85.8%	2.7%	-3.1%	na	8.0%
International Growth Fund	27.7%	6.1%	na	na	6.8%
Infrastructure Fund	21.8%	na	na	na	19.1%
KiwiSaver Growth Fund	45.5%	7.3%	na	na	1.9%

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
NZ50G	14.1%	-7.1%	-8.7%	0.6%
90day bank bill	3.1%	5.8%	6.7%	7.0%
S&P/ASX300 (Calculated in \$NZ)	37.7%	-0.5%	0.5%	9.9%
MSCI Global Small Cap Index (in \$NZ)	8.6%	-1.8%	-8.7%	1.3%

January's Biggest Movers	
<b>New Zealand</b>	
Michael Hill	4%
Freightways	-4%
Pumpkin Patch	-4%
Abano Healthcare	-6%
<b>Australia</b>	
Centrebet	22%
Credit Corp	12%
Vision Group	-13%
McMillan Shakespeare	-26%
<b>International</b>	
Bare Escentuals	53%
Hongguo	38%
City Telecom	18%
Wasion Holdings	-32%

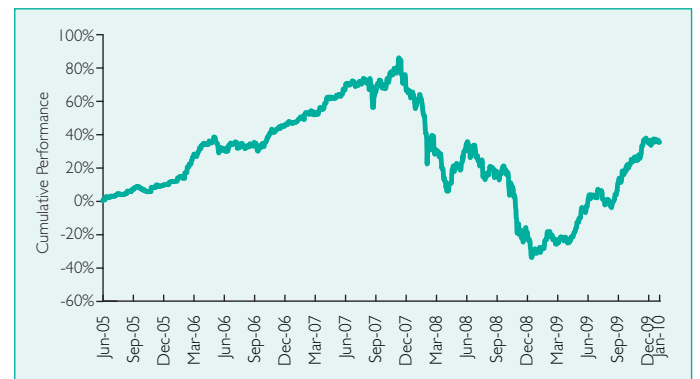
## New Zealand Growth Fund



**Fund Inception** August 1998

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

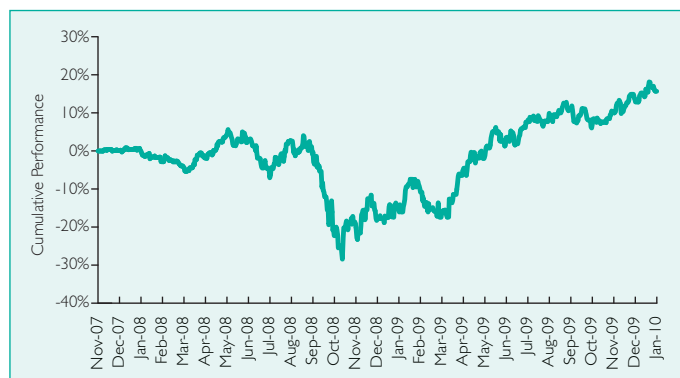
## Australian Growth Fund



**Fund Inception** June 2005

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

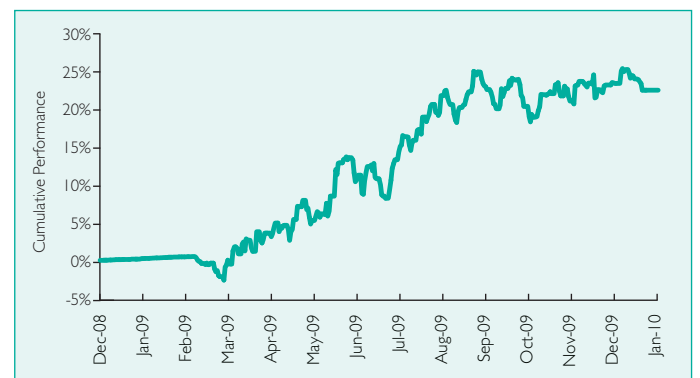
## International Growth Fund



**Fund Inception** October 2007

**Portfolio Holdings** – Advent Software, Bare Escentuals, Biotest, Brembo, China Automation, China Zaino, City Telecom, Conceptus, EBIX Inc, Equinix, F5 Networks, Gameloft, Hansens Natural, Home Inns, Hongguo, Hyflux Limited, Icon PLC, Jumbo, Midas, Nokian Renkaat, O2 Micro, OSI Pharma, Ports Design, Qiagen, Raffles Education, Sarin Technologies, Shinko Plantech, Stratec Biomed, Telvent Times Electric, Ultimate Software, Wasion Holdings, Wellstream, Wirecard.

## Infrastructure Fund



**Fund Inception** December 2008

**Portfolio Holdings** – CSX Corp, Flughafen Wien AG, Fraport AG, Norfolk Southern Corp, TNT N.V., Flughafen Zuerich AG, Asciano Group, Auckland International Airport, Contact Bonds, Genesis Bonds, NZ Post Bonds, Vector Bonds, Wellington International Airport.

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\* For an investment statement on any of our funds, please go to our website or call us on 0508 FISHER (0508 347437).