

# FROM THE undergrowth

NOVEMBER 09



Winter is not very pleasant, but we adapt. We know it's going to be cold every day so we dress appropriately. Spring can be harder to handle. We get a couple of warm sunny days, pull out our lighter clothing and then shiver through a week of cold, wet weather. The markets are the same. Earlier in the year, we got used to investors being universally pessimistic. Now we have to endure mood swings as the economy teases us with recovery and then squashes our optimism with poor retail sales data or a bad jobs figure. Oh well, at least summer is coming.

## Our Portfolios

What has been going on since we last spoke?

### At a glance

As at 31 October 2009

#### Unit Prices (\$)

NZ Growth Fund	2.8801
Australian Growth Fund	2.0424
International Growth Fund	1.0847
Fledgling Fund	1.0446
KiwiSaver Growth	1.0039
Infrastructure Fund	1.1588

#### Performance (October 2009)

NZ Growth Fund	1.3%
Australian Growth Fund	6.8%
International Growth Fund	-2.2%
Fledgling Fund	1.0%
KiwiSaver Growth	1.7%
Infrastructure Fund	-1.5%
NZ50 Gross index	1.7%
S&P/ASX 300 (\$NZ)	0.6%
MSCI Global Small Cap Index	-3.3%

In last month's newsletter we looked forward to impending profit results and annual shareholder meetings providing a catalyst for market performance, and company performance. A month on, it's fair to say that the profit results and management commentaries offered little in the way of catalyst, with economic news (or the anticipation of it) taking centre stage instead.

The economic news in New Zealand was a bit of a sideshow to the main act in the US, and while the wild ride of the New Zealand dollar copped some attention, it was the bipolar nature of the American economic recovery that drove markets. Early in the month we had news that US GDP growth was better than expected and was similar even to "normal" times. Unfortunately subsequent news releases confirmed that this economic growth spurt was largely due to the government's free and easy spending, rather than it being a sign that consumers were perkier or businesses were more productive. Company profits released during the month were not bad, however the growth in profits didn't tend to come from the companies selling more goods or hiring more staff. To the contrary, unemployment numbers continued to increase and much of the improved profitability came from cost-cutting.

Of course, as investors in the New Zealand, Australian and international share markets, we know that the US is only part of the story, but markets and economies have become so interconnected

that if the US economy falters, we all feel the effect. Thus, although China announced a great GDP number during October, and the Australian economy maintained its momentum to the extent that interest rates were lifted so that growth didn't take off too fast, the US economy, the economy that only a mother could love, remained the focal point.

"We're having a jobless, homeless, loanless, and maybe a recoveryless recovery, in an economy only a mother could love."

Rick Newman, US News correspondent

The mood swings of investors were not only about economic news releases. After eight months of share market rallies, the murmurings about double dips and markets "giving back their gains" have grown to a crescendo. Investors have become nervous that markets have lifted too far, too fast, and they don't want to be the last man standing if markets fall back to levels seen earlier this year. Newton's law says what goes up must come down. Some investors have extended this law way beyond its original purpose as an explanation of gravity to use it as an explanation of share market trading patterns. This doesn't necessarily make sense, but it becomes easy to believe if enough people say it.

Have you joined KiwiSaver yet? \*

## Your Portfolios (cont.)

Our view is that this is not the time for sweeping generalisations about the market. While some stocks and some markets might have rallied too far, others remain undervalued. Some businesses and economies are faring better than others right now and will likely see growth before the rest of the world catches up. Rather than looking to the sky for signs that it's about to fall on our heads, we should be looking at the ground, rolling over stones, and digging in the undergrowth for those businesses that will do well in the years ahead, despite the ambiguous economic recovery.

Each month we include in the newsletter a list of the top contributors to our monthly performance. Some months the divergence between the positive and negative contributors can be enormous. And often, our individual stock performances can be completely different than the market. Last month our two top performers for the month were Australian company Vision Group, lifting 32% over four weeks after management made positive statements at their annual shareholders meeting; and China Automation lifted 25% after winning another round of contracts that assures future profit growth. These are large price movements in a month where world share markets hardly moved. These large price movements, which are generally related to something going on within each company, rather than to the market overall, will determine whether our funds perform over time. Because of this, we do not need to waste time and energy predicting the next market dip. We agree with renowned investor Peter Lynch who once said "If you spend more than 13 minutes analyzing economic and market forecasts, you've wasted 10 minutes!"

### New Zealand

The 1.3% net return for the month was slightly behind the NZ50 Gross Index (+1.7%). The two retirement village operators **Metlifecare** and **Ryman** were the biggest positive contributors. This undoubtedly reflects the renewed buoyancy in the housing market. NZX was the largest negative contributor following a strong performance in September. Overall, news flow was relatively light.

### Australia

The Australian portfolio continued its strong run posting healthy absolute returns in October and beating the benchmark Small Industrials index by 5.6%. The leading contributors to performance for the month were **DWS Advanced Business Solutions** (+24.6%, on nascent signs of a pick-up in IT services spending), **Pipe Networks** (+10.6%, on a profit upgrade) and **Vision Group** (+32.0% on supportive ASM comments). Laggards were **Bravura Solutions** (-11.5%, following a strong recent run) and **Arrow Energy** (-4.0%, on volatile global energy markets).

### International

Our more defensive posture assisted in our outperformance this month as volatility was back again. This was evident in both stock markets and currency markets. The NZ dollar versus the US Dollar rallied more than 5% intra month only to close back where it started. We sold our holding in **Ultimate Software** during the month. Nothing has changed fundamentally and it remains a good company, but the valuation more than reflects this. In addition, we have also identified some other businesses where the valuation and growth prospects are more compelling. Keep an eye out for these next month.

### Infrastructure

The Infrastructure fund outperformed its benchmark indices again during October. Morrison & Co provided an extract from this month's Journal of Commerce which summarises why we like railroads (as does Ken!). "The United States may be crawling out of the worst recession since the Great Depression, and transportation providers and shippers may be reeling from slack demand and weak rates, but you wouldn't know that by looking at North America's largest railroads. As the railroads over the past two weeks reported another quarter of solid earnings, they again demonstrated they know how to make money - a lot of it. At a time when casualties are piling up among ocean ship lines, trucking companies and air cargo carriers, when the freight industry is weak and could remain that way for years, railroads have remained reliable profit centers, drawing cheers from investors, criticism from some customers and questions from other carriers about what the railroads know about supply and demand and how they are applying that knowledge so profitably to a volatile market."

## Your questions

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

**Q:** I am interested in your comments around how directors are appointed to listed companies. I would like to see one (perhaps two) more applicants to vote for than there are vacancies, and this to be compulsory. This would give shareholders some semblance of choice. It would also stop the complacency of the applicants to be re-elected basking in their "unanimously supported by the board" tag.

**A:** Thank you for taking the time to share your thoughts on the appointment of directors, and also for attending our roadshow.

The whole issue of board composition and appointment is topical and people can have polarised views. When I talked about asking directors how they were appointed, I can understand your scepticism and you are correct in thinking that no director has ever responded "I was part of the old boy's

network". But the answers to that question have been useful – some directors have been appointed because they knew or worked with the chief executive or another director (for which we score them negatively) while others have been identified and then appointed because they had a particular skill set that was important to the board and were otherwise unknown to the directors (for which we score them positively).

# A bird's eye view

We take a closer look at a topical issue and give you our five cents worth!

There has been a lot of talk recently about IPOs (Initial Public Offerings) and we have had investors ask us whether they should participate in them, and how we think they will fare. What investors really want to know is whether they will list at a premium on the first day so they can sell them and make a quick profit.

To a lot of people, investing in IPOs seems more exciting than investing in public listed companies. Perhaps it is the fact that IPOs have a time limit, so there is a sense that you need to 'be in to win'. Or it may be that every IPO is accompanied by a marketing programme which puts the company under a spotlight and highlights its merits. Listed companies might be equally attractive, but without the IPO marketing campaign, we can sometimes forget they exist.

Or it may just be that IPOs appeal to our gambling mentality. The idea of applying for some shares in an IPO and flicking them once they list feels more like placing a bet at the races than making an investment. You know pretty quickly whether your punt paid off, and if it did, you get the same feeling of elation that you do when your horse crosses the line first.

But investing in an IPO is really no different than investing in an already listed company. You still need to complete your research, you need to invest with a long-term perspective, and a bad company wrapped up in an IPO ribbon is still a bad company. The good thing about an IPO is that the promoters need to prepare a prospectus which is current and comprehensive. This prospectus should form the basis of your research. If you have some doubts about the company or the pricing, then leave it alone. Rather than taking the Ed Hillary approach and buying into an IPO "just because it's there" you should remember

that you will have plenty of time to buy. As a long term investor with an investment timeframe of years, it shouldn't matter to you whether you buy on day one or day fifty.

As with any investment, profit results will determine whether an IPO is successful or otherwise. If an IPO company achieves or exceeds its prospectus forecasts, chances are the share price will lift above the IPO price over time. If an IPO company falls short of its prospectus forecasts, its shares will likely underperform.

The share price performance in the days and weeks after the IPO do not tell you anything about whether you've made the right decision or not. Australian IPO Just Group (which own Just Jeans, Portmans, Jayjays and other fashion labels) debuted with a 6% share price fall. Nine months later, following a profit upgrade, the shares were trading 39% higher than the IPO price; and three years on, IPO investors had more than doubled their money.

The other thing to bear in mind is that generally companies choose to IPO because they want to raise some money. An IPO is an alternative to getting a bank loan, or selling shares privately. It is important to understand why they want to raise some money – if it's because the owners want to get out, you should ask why. If the company needs money to shore up its accounts, you also need to ask why.

IPOs can be wonderful investment opportunities. But not all IPOs are created equal.

## Your questions (cont.)

I agree that it would be great to have a wide choice of directors and for shareholders to feel that they have actively played a role in the appointment of directors, but I believe that the universe is small in New Zealand resulting in limited choice. We have seen companies in New Zealand spend many months trying to identify one suitable director candidate, let alone several. As for shareholders choosing the ideal candidate, I am not sure that shareholders are always well placed to be able to make that call. Rather than settling for the 'popular vote', I would rather that boards have the final say on selecting new directors on the basis of the skill set needed, impact on board dynamics (while it is not good for boards to be too cosy, they need to be functional), availability and cost, relevant experience and the board's rotation/succession policy.

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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	6.3%	-21.0%	-10.8%	2.2%	9.9%
Australian Growth Fund	74.4%	-14.3%	-1.3%	na	7.4%
International Growth Fund	36.0%	na	na	na	4.2%
Infrastructure Fund	na	na	na	na	18.9%
KiwiSaver Growth Fund	41.2%	-0.43%	na	na	0.2%

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

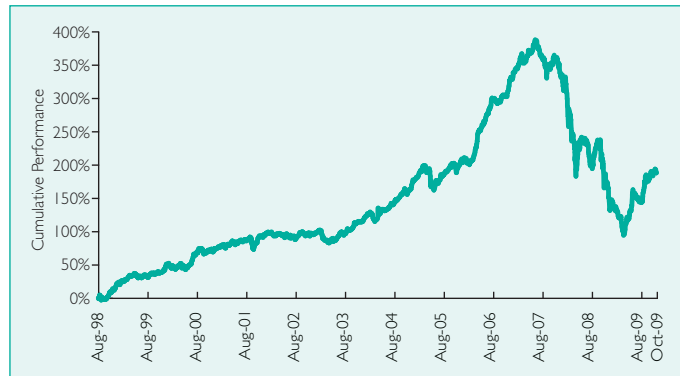
Fund Pre-tax Returns	1 Year	2 Years	3 Years	5 Years	Since Fund Inception
NZ Growth Fund	7.4%	-20.1%	-11.7%	5.2%	12.7%
Australian Growth Fund	75.2%	-14.1%	-0.2%	na	8.4%
International Growth Fund	36.0%	na	na	na	4.2%
Infrastructure Fund	na	na	na	na	18.9%
KiwiSaver Growth Fund	41.2%	-0.4%	na	na	0.2%

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	14.0%	-12.6%	-5.3%	2.7%
90day bank bill	4.1%	6.5%	7.1%	7.2%
S&P/ASX300 (Calculated in \$NZ)	33.8%	-11.6%	2.2%	11.7%
MSCI Global Small Cap Index	4.2%	-14.0%	-9.6%	1.2%

October's Biggest Movers	
<b>New Zealand</b>	
Metlifecare	12%
Rakon	-6%
Michael Hill	-6%
Fisher & Paykel Healthcare	-5%
<b>Australia</b>	
Vision Group	32%
DWS Advanced	25%
Reckon Limited	11%
Bravura Solutions	-11%
<b>International</b>	
China Automation	25%
F5 Networks	14%
Sarin Technologies	-21%
O2 Micro	-16%

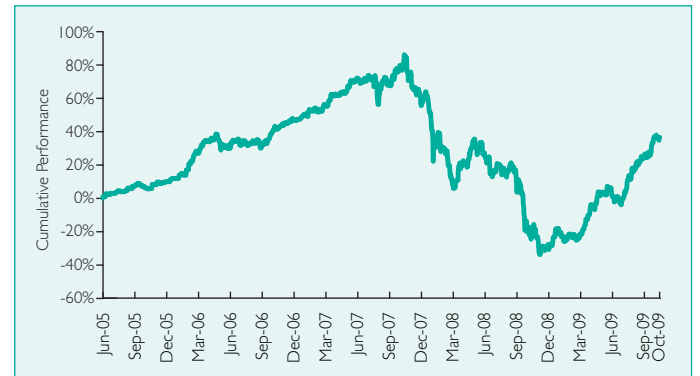
## New Zealand Growth Fund



**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.

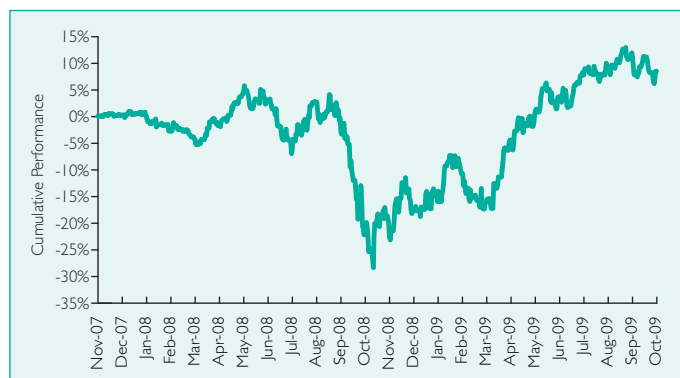
## Australian Growth Fund



**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.

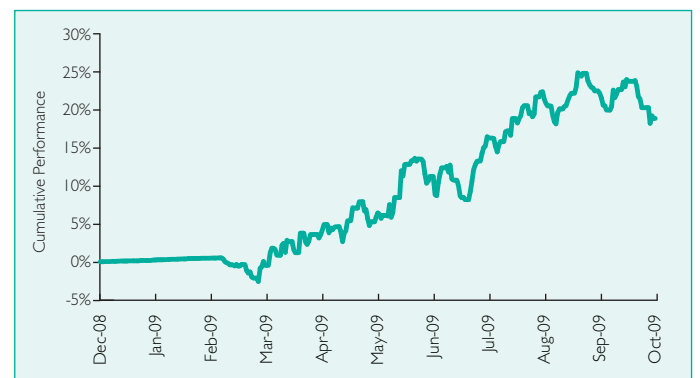
## International Growth Fund



**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, Northeast Utilities, Flughafen Zuerich AG, Contact Bonds, Genesis Bonds, NZ Post Bonds, Vector Bonds

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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).