MASTERS OF THE MARKET |

# The sweet spot

The key to success is simple for this fund manager who tells **Jeremy Chunn** he looks at everything on a three-year to five-year time horizon.

Louise Kennerley

There have been a few market ructions since Anton Tagliaferro set up Investors Mutual in 1998, but it is his conservative attitude to growing wealth that has seen the manager grow funds under management to more than $4 billion and its clients enjoy returns well above the benchmark.

As the financial crisis came and went, its Australian Share Fund has returned an annualised 11.56 per cent and its Australian Smaller Companies Fund 15.34 per cent.

Tagliaferro says the rules are simple: identify value and buy at the right price.

**Some people seem to believe Australian stocks will perpetually outperform. What do you think?**
It's always impossible to predict the direction of overall markets but it's fair to say every investor should have a diverse portfolio: they should own some cash, some property and shares. The focus is to have a collection of quality companies that can pay you income, that are well managed and that can grow.

We may have a bear market or a flat period next year; it's impossible to predict. Our job is to find those companies with those criteria and hopefully buy them when they're trading at a reasonable price.

**How does a company qualify?**
Balance sheet is very important, sustainability of their earnings is really important, as well as the company's management. We look for stocks with a strong competitive advantage, recurring earnings, run by capable management that can hopefully grow over time, and at the right price.

That's your biggest protection against any correction, that's your biggest protection from any unforeseen macro event.

**To what extent is it almost impossible to have a solid view on management risk?**
It is a bit qualitative, you're right. The things we look for are the past track record: do they underpromise and overdeliver? Is there a consistency of message? Occasionally you meet companies who will change their tune depending on what the market wants to hear.

We like to back people who underpromise and overdeliver.

PROFILE

**Name:** Anton Tagliaferro
**Title:** Investment director, Investors Mutual Limited
**Fund performance over 12 months:** IML Small Cap Fund, 12.3 per cent (to September 30); Australian Share Fund, 8.7 per cent (to September 30).

**Technology and globalisation have made the world smaller – is it harder to find companies with a competitive advantage?**
Yes, you've got to be very aware of any potential competitive threats, and also the timing of them. I'll give you a couple of examples. We bought into Recall Holdings but lots of people stayed away because they said the whole world's going electronic next week, that sort of thing. We looked at the facts and saw paper volumes are still growing. We said, sure, there is that risk in five or 10 years' time but it's not here today. That seems to have paid off as the stock's gone up.

We've also been big holders of Caltex Australia, but someone might put their hand up and say, what happens when there are electric cars? Yes, well, hold on, a lot has to happen between today and when every car or every jet Caltex supplies … do you know what I'm saying? Yes, you have to be aware of competitive threats, but as well you have to ask: how realistic is that threat and what is the timing of it? You have to act on information you know today.

**Your investment teams include a "devil's advocate". Do they play the role well?**
We do a lot of sensitivity analysis around our base case, particularly when stocks are not performing as well as you'd hope. If a stock has underperformed for six or 12 months you've got to ask yourself why. Then it's a matter of retesting your base case. Markets are not totally efficient. Markets tend to be impatient, investors tend to be impatient.

**Can you give us some examples?**
Telstra was a terrible performer for a while. People were hounding us and arguing about the dividend. There was this view that its 28¢ dividend was not sustainable. We were told it was a value trap and they would cut the dividend. I used to spend more time talking about Telstra than the rest of the portfolio. Telstra was trading at about $3 at the time, and the 28¢ obviously looked very attractive. If you say, OK, the dividend's going to be cut to 23¢, well, even then the yield is almost 8 per cent franked. You ask yourself, what's everyone carrying on about?

**Do you think retail investors should work in teams, like analysts and portfolio managers?**
In some ways [working on investing solo] has become easier because there's more access to information but, in many ways, unless you have access to companies and their competitors it is a bit difficult. It's hard for the individual investor to make some of those judgments, about whether the company management is doing the right thing or not. We put a lot of emphasis on management. A lot of solo investors tend to follow the media, which tends to place emphasis often on management teams which tend to promise lots of things.

**In which sectors are there higher and lower risks around recurring earnings?**
There are big risks in the resources sector. We're not big in things like mining contractors or mining stocks because they don't tend to have those criteria I talked about. In the last few years, many of these resource companies have put in huge capacity in different industries, and I think it's going to be a long time before we see the resource sector do as well as it was. This downturn in the mining sector could be quite a long one.

**When it feels like the market is overvalued, do you keep searching anyway, or store cash?**
We may raise cash a little bit; we may sell call options on individual stocks to pick up some premium and get some protection. At the margins, we might sell some of the better performing stocks that look a bit expensive and put it into more high-yield and defensive things. We know the sort of stocks we want to own; the key then is to ask can I justify holding any of the shares I have in my portfolio based on where I believe earnings growth and dividends are going in the next three to five years. If the answer is yes, then I try not to worry too much about day-to-day or week-to-week swings in the market.

**Is it a bit hopeful to look for growth companies in a flat economic environment?**
People were expecting all sorts of recoveries but what we've done well in the last few years is recognise the new norm. The economy is not giving many companies a hand to grow. You've got to focus on companies that can grow through bolt-on acquisitions, increased market share, a locked-in annuity stream that grows, like a Transurban or a Shopping Centres Australasia. We are not focusing on companies that need world growth to accelerate to benefit. People who are waiting for that will be waiting a very long time.

**How much attention to you pay to your peers' performance?**
None at all.