

Giddy's standing tall in dizzy market



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IML Head of Research and Senior Portfolio Manager, Hugh Giddy was featured in The AFR, the article has been re-published below:

What should you expect from a Value Manager?

- Resilience in falling markets
- Reasonable capital growth in rising markets
- Consistent dividend income
- Low volatility
- Tax effective

A low-growth sharemarket allows a value-investment strategy to come into its own, but it is still a stock-pickers' game, Investors Mutual senior portfolio manager Hugh Giddy says. Giddy oversees investment decisions for the Australian Share Fund and Concentrated Australian Share Fund, collectively worth nearly \$1.5 billion.

The Australian Share Fund is one the two flagship funds Investors Mutual has had since it was established by Anton Tagliaferro in 1998. The Concentrated Australian Share Fund is the Investors Mutual's latest fund, set up last September, and can ignore benchmark weightings. Its top five holdings are Telstra, Ansell, Metcash, Ramsay Health Care and CSL. That fund has returned 10 per cent since its inception.

Giddy acknowledges the past year hasn't offered the easiest market for value managers. "The best performers have tended to be concept stocks like Mesoblast, Lynas Corporation - no earnings, but lots of potential," Giddy says. "They're very difficult for us to own when they have low cash flow, can't pay a dividend, and sometimes they're not making earnings."

Since the recent market sell-off, several blue chip shares are hovering near yearly lows - seemingly rich pickings for value managers. But Giddy warns discretion is still key. It's a real stock-pickers market. Value helps, because you have to be careful about what you're paying for something, but in any market, being wrong on your earnings expectations is going to hurt you if you are overly optimistic."

The secret to success, according to Giddy, is deceptively simple. He follows what he calls a 'lazy' investment strategy. 'Investing is not about hope and speculation, it's about getting a return. The way to get that return is to invest in a company that you know will make a profit, have good cash flow, pay a dividend, and do it again next year as well.'

Ever since I started in this industry I've been using a lazy investment philosophy. It's about top drawer-quality stocks you can put in the bottom drawer and forget about them. They have recurring earnings, good management, good qualities to the business ... I think that's much better than picking stocks of dubious quality, and hoping that you get the timing right, because they have their little runs."

For his two funds, Giddy looks closely at dividend-paying cash flow as a basis for value. That is a criteria he thinks will become more important in the present market, in terms of returns, in which stocks struggle to find real upward momentum. As long as you have realistic expectations about the environment, then dividends help you and that's a major part of your return," he said. "They never used to be, when the market was going up 20 per cent and the dividends four, four is not so important. But if the market's only going up 6 per cent, well four is a large part of six."

Giddy has had a long-term commitment to Metcash, owner of the IGA independent supermarket chain, as a safe, slow growing investment. I always think of myself as one of the people in the market who discovered Metcash first," Giddy says. "Since 2000, they've done a fantastic job. The share price has gone up 10-fold and you've had a decent dividend stream, but over the last few years it's become cheaper ... because people are worried that they are going to shrink or go backwards, because they were in love with Woolworths and Coles. I have a lot of respect for what Woolworths and Coles are doing, but there will always be a place for the independent sector." Shares in the company have fallen 5.6 per cent this year as investors fret about pressure on margins in the midst of the cost-cutting 'price wars' between Wesfarmers' Coles stores and Woolworths.

Giddy acknowledges that the continuing stoush with the Australian Consumer and Competition Commission over the purchase of more than 80 Franklins stores has weighed on the stock over the past year. This Franklins thing, it's dragging on and on," Giddy says. "To me it's extraordinary the judge didn't throw [the ACCC] out of court for their injunction. To me, what came out showed the ACCC in a very bad light - they were negotiating with Woolworths...

I think how can you do that? You're letting the market leader get more market power. It's extraordinary. It has probably hurt the stock over the past year."

But Giddy thinks Metcash's qualities as a defensive stock outshine any of its near-term problems. Investing in the share market is all about uncertainty. You have no certainty, but you have a much greater degree of certainty in the ability of a Woolworths or a Metcash or a hospital operator like Ramsay Healthcare to actually hit their earnings numbers and produce the cash flow and so forth than you do in a cyclical stock," he says.

Supermarkets are a sector I know is not growing that fast, but not growing that fast is actually the new normal. Nobody's going to grow that fast in my opinion. People have to readjust their expectations in an environment where growth is harder to come by."

Stocks that have fallen out of Giddy's favour in this risk-averse environment are discretionary retail - an obvious candidate - but also banks, which are sometimes favoured for their defensive qualities. Banks are fundamentally risky," Giddy says. "The banks have this huge leverage. You have equity of \$10 billion and a loan book of \$200 billion - if your loan values are wrong by a few per cent, there goes your equity. So when people talk about them being on low-ish price-to-earnings ratios you think, well, are they really low?"

Giddy is not among value managers looking for opportunities to buy into discretionary retail, and he will be out for a long time, on the belief that the pattern of consumer spending in Australia has undergone a permanent structural shift. For the moment cyclical stocks and discretionary retail are out the window. That's why we've outperformed - because we haven't had any of those disasters.

We have had a wonderful ride where debt went up to gross domestic product ... households took on more and more debt ... it went into credit cards, people took equity out of their homes, bought yachts, went on holidays," he says. "Now ... people will have the same income but they realise they have to spend more on the grudge things rather than the bigger plasma TVs."