

Investors Mutual



Morningstar Take

Despite some personnel changes, as long as the same tried and tested, long-term approach is in place under the capable guidance of founder Anton Tagliaferro, we'll continue to think this is one of the best value strategies available. High levels of staff turnover are usually a negative, and Investors Mutual has had more than its fair share of changes over the past few years. But the end impact on the portfolio has been negligible. So while the changes have obviously been a distraction, in this case we feel it's not as big a deal as it might have been elsewhere, and has led to an improved staff incentive structure. What hasn't changed, though, is this team's rigorous, disciplined approach to investing, which we think will reward patient investors over the long term. Tagliaferro resumed formal portfolio management responsibilities in February 2008 after Paul Frost's departure, although the reality is that Tagliaferro always exerted significant influence on the construction of portfolios anyway. He shaped the firm's value-biased investment process which targets companies with steady and predictable earnings streams unappreciated by the market. This process struggled to deal with the resources-led bull market of 2003 – 07, but when turbulence entered the market again, Investors Mutual did exactly what we expected and significantly outperformed the majority of its peers. Another feature of the portfolio is its low turnover and low level of volatility relative to peers, making it even more attractive from after-tax and risk-adjusted perspectives. One concern here is Tagliaferro's habit of sometimes becoming emotionally attached to stocks, and being slow to cut positions where there has been a fundamentally negative change to the business, a common trait among value investors. This contrarian approach means that this strategy's not for everyone. But if you're a patient investor looking for a value manager to anchor your portfolio over the long term, this remains one of your better bets.

Role in Portfolio:

Core

Risks:

- Will lag momentum- and growth-driven markets
- Staff retention has been an issue
- Emotional attachment to stocks can be a hindrance

Head of Research:

Anthony Serhan, CFA

Morningstar Analyst:

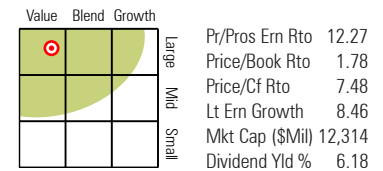
Tim Murphy

Strategy/Process

IML's bottom-up investment process initially applies a combination of quality and liquidity filters to the entire ASX universe every quarter, eliminating companies that are speculative, have excessive debt, or have negative earnings. The resulting investible pool of stocks is a mixture of large- and small-cap names, skewed typically towards sectors like consumer discretionary and industrials, and away from cyclical sectors such as resources, or financially engineered sectors like listed property and infrastructure. The research process focuses on companies with a competitive advantage and capable management at the helm. IML conducts standard Porter industry framework analysis, and maintains a rigorous company meeting schedule. The team's valuation discipline is one of the strictest in the market, assessing companies from a multitude of angles, with differing metrics for different industries – discounted cashflow for stable industries like retailing, mid-cycle price/earnings for cyclical companies, while sum-of-the-parts valuation is prevalent for banks. Valuation model outputs are cross-checked against one another to ensure that valuations look reasonable. IML's process is inherently conservative, placing emphasis on identifying stocks with predictable and recurring earnings streams, particularly over the medium term (typically three years). Portfolio positions are determined both by price targets and by the level of conviction in predicted future earnings. Turnover is fairly low, typically 20.0 – 25.0 percent per annum, making this quite tax-effective.

Flagship Fund: Australian Share Fund

Investment Style 30 Jun 2008



Stock Sectors 30 Jun 2008

Sector	%
Information Economy	13.26
Software	0.67
Hardware	0.02
Media	3.03
Telecommunications	9.54
Service Economy	48.21
Healthcare Services	1.04
Consumer Services	9.30
Business Services	8.99
Financial Services	28.88
Manufacturing Economy	38.52
Consumer Goods	7.19
Industrial Materials	24.65
Energy	3.29
Utilities	3.38

Top 10 Stock Holdings 30 Jun 2008

Stock	%
BHP Billiton Ltd	10.00
Telstra	7.62
Westpac Banking	6.20
National Australia Bank Ltd	5.92
Commonwealth Bank of Australia	5.39
Rio Tinto Ltd	4.00
Insurance Australia Grp Ltd	3.37
Australia & New Zealand Banking Grp	3.34
Transurban Grp	3.28
Amcort Ltd	3.21

Asset Allocation 31 May 2008

Asset Class	%
Domestic Equity	92.40
Int'l Equity	0.00
Listed Property	0.00
Unlisted Property	0.00
Mortgages	0.00
Dom Fixed Interest	0.00
Int'l Fixed Interest	0.00
Cash	7.60
Other	0.00
Not Classified	0.00

Portfolio Stats

Mgr Bmark: S&P/ASX300
 No of stocks: 40 - 70
 Max Weight: Varies
 Min Weight: Zero
 Expd Track Error %pa: Less than 6.0
 Expd Turnover %pa: Low, 20.0 - 25.0

People Stats

Lead Manager: Anton Tagliaferro
 Appointed: February 2008
 Years Experience: 23
 Team Size: 11
 Average Years Experience: 11
 Average Years Tenure: 3

Role in Portfolio

Core holding. This is a defensive large-cap value strategy. We'd recommend blending with a large-cap growth manager.

People

There's been plenty of staff change here over the past few years, but one constant has remained during that time – Anton Tagliaferro. IML was founded by Tagliaferro in 1998 after he left his role as head of BNP Investment Management (Australia)'s Australian equities team. Tagliaferro's a veteran of the industry, having kicked off with Perpetual Investments before spending time with County and BNP. He resumed formal portfolio management responsibilities in February 2008 following the departure of Paul Frost, while the experienced Simon Conn continues to lead the small-cap effort. IML's team is now structured along sector lines, analysts covering both large-cap and small-cap stocks in their sector. A rejigged incentive structure sees the team rewarded predominantly on the basis of the performance of the model portfolios each senior member manages. The entire investment team is also now eligible for equity participation.

Performance

Unsurprisingly, Investors Mutual struggled to keep up with the crowd during the resources-led bull market. But when the tide turned in 2008 and turbulence re-entered the market, IML did exactly what we expected – it outperformed the majority of its peers significantly. The key portfolio tilt which had caused the underperformance, the underweight to resources, helped IML avoid some of the carnage as commodity prices fell rapidly during the second half of 2008. Over the longer term, the team's disciplined approach to picking stocks has paid dividends. The starkly defensive tilt of this portfolio means that it has outperformed during up markets only a quarter of the time, but during down markets more than 85.0 percent of the time. Performance volatility is also less than the market and most peers, which is not surprising, given the team's approach, while the low portfolio turnover makes this relatively tax-efficient.

Parent

Investors Mutual is a boutique operation majority-owned by Anton Tagliaferro and the Treasury Group. The Treasury Group is a listed entity with investments in eight boutique managers, providing back office services. IML managed just over A\$4.0 billion at 31 July 2008.

Fees

The flagship Investors Mutual Wholesale – Australian Share Fund's 0.97 percent expense ratio is above the wholesale peer average.

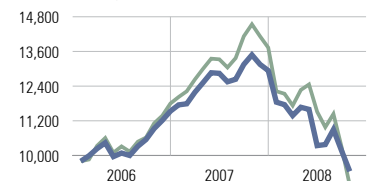
Top 5 Funds by Net Assets

	Ticker	Net Assets (\$Mil)	Quartile Rank 3yr	Total Ret 3yr
Investors Mutual Wsale - Australian Share Fund	5339	2215.79	■	1.36
CFS FC PersSuper - Investors Mutual Australian Sh	11125	76.66	■	0.91
CFS FC Pens - Investors Mutual Australian Share	11109	69.94	■	1.44
BT Investment - Investors Mutual Australian Share	10012	49.94	■	0.85
MLC MKey Super GS - Invstrs Mtl Aus Sh	10800	47.87	■	0.85

Flagship Fund: Australian Share Fund

Performance 31 Oct 2008 Fund Index

Growth of \$10,000 **\$9,651**



	1Yr	3Yr	5Yr	7Yr
Quartile Rank	■	■	■	■

Total Ret%	-29.45	1.36	7.53	8.47
Income Ret%	3.43	6.50	6.24	5.18
Growth Ret%	-32.88	-5.14	1.29	3.28

Index%	-37.79	0.73	8.69	7.44
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Index: S&P/ASX 200 Accum Index

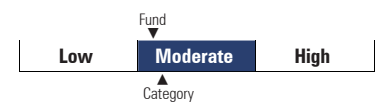
Category: Aust Large Value

Performance Analysis 3 Yrs to 31 October 2008

Value Add vs Mgr Bmark (%)	0.63
Tracking Error	4.85
Information Ratio	0.13

MPT Statistics 31 Oct 2008

	3Yr%	5Yr%	7Yr%
Beta	0.74	0.74	0.73
Alpha	-1.04	-0.62	1.25
R Squared	0.86	0.87	0.86
Sharpe Ratio	-0.52	0.14	0.34

Risk Meter (3 Year Standard Deviation)

All figures and stats relate to the Flagship Fund, and all performance figures are shown as % per annum, net of fees.

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