TAKING A CONSERVATIVE approach PAYS DIVIDENDS

The Australian sharemarket has boomed over the past three years. But as one fund manager has shown, you do not have to take excessive risks to be a successful share investor.

Two things distinguish Perth-based Growth Equities from other Australian fund managers. The company does not invest in mining or international shares, and it has developed a track record that leaves most of its competitors - listed and unlisted - in its wake.

There's nothing of the 'Wild West' about Growth Equities, which boasts a true blue thoroughbred pedigree. Long-term investors will recall Growth Equities Mutual Property Trust (GEM), which was established in Perth in 1980 and went on to become the largest and most successful unlisted property trust in Australia before being acquired by Lend Lease in 1994.

The name lives on, and so does the lineage. Growth Equities' managing director is the son of GEM founder, Dick Lester, and both Dick and former GEM chairman, Bill Cawley, apply their considerable market knowledge to the selection and management of Growth Equities' two managed funds.

Growth Equities has a highly disciplined investment process, which it adheres to rigidly. The company has a small portfolio - usually focusing on 20 companies, with a turnover of as few as five stocks in a year.

Even the two-fund structure has echoes of the old GEM 'split trust' philosophy, offering capital growth and income options to investors via its Growth Equities Accumulation and Growth Equities Imputation funds.

Track record

A glance at Growth Equities' track record highlights the strength and consistency of this relatively new fund manager's performance. In the three years to the end of December 2006, Growth Equities Accumulation Fund has produced a return of 34.5 per cent each year on average for its investors after all costs. In doing so it has outperformed all ASX listed investment companies and was also the *Australian Financial Review's* 'pick of the litter' of unlisted fund managers.

Perhaps the most interesting aspect of this performance is that it was achieved without the help of Australia's high-flying resource sector. In today's resource-focused environment, why would a fund manager deliberately exclude mining shares from its portfolio?

Growth Equities' managing director, Russell Lester, explains why his investment committee has made a conscious decision to avoid highly cyclical stocks. "There's plenty of money to be made in mining stocks, but it doesn't suit our investment style. Our strict value approach would require us to make short and long-term calls on commodity prices. There are so many factors influencing commodity prices that we don't believe we can do that accurately and consistently. We stick to what we know, and it's paying off handsomely for our investors," says Russell.

International shares

The same 'stick to the knitting' approach also applies to Growth Equities' position on international shares. "There's plenty of choice on the Australian sharemarket, and we have proven you can produce the results from local stocks without the risks inherent in investing on global markets. More detailed and accurate information is available to you if you deal locally, and in many cases we are able to get very close to the companies we invest in," Russell continues.

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Growth Equities has a highly disciplined investment process, which it adheres to rigidly. The company has a small portfolio – usually focusing on 20 companies, with a turnover of as few as five stocks in a year. "Research shows that 85 per cent of the benefits of diversification can be achieved from a portfolio of 15 stocks," says Russell.

"Doubling the portfolio will only buy you the remaining 15 per cent benefit of the additional diversification, but it comes at a disproportionate cost, doubling your research and management commitments."

WA companies

Russell observes that, while Growth Equities did not deliberately take a parochial attitude in setting its portfolio, WA companies feature strongly in both the company's funds, with an average of 35 per cent representation in the top 10 holdings in each of the two funds.

"Not all the businesses in WA are miners, and there are some very good local companies that tend to be under-researched by eastern state investors. A good example is Port Bouvard, which has consistently been one of our best performers," he says.

The resource boom has not slipped completely under Growth Equities' finely-tuned radar. The portfolio includes some notable mining services providers, but these – like Macmahons and Boom Logistics – have been selected for their capacity to continue to perform strongly in industrial areas in the event of a weakening in the resource sector.

Growth Equities' disciplined and conservative approach to portfolio management involves a regular, detailed review of the performance of individual investments.

"We have very clear investment criteria, and it's often the stocks we don't buy that set us apart from the rest. We expect companies we invest in to consistently meet our criteria over time. That doesn't mean we dump a stock as soon as it underperforms. As long as we are satisfied with its long-term direction we're prepared to hold a stock that is moving sideways – or even down – for a reasonable period. For us, the 'bail out' signs are a change in business fundamentals that we're not comfortable with," says Russell.

Specifically excluded from Growth Equities' review criteria is share price fluctuation. "Share price is simply a reflection of market sentiment. It has nothing to do with the economics of a company," says Russell.

Also absent from Growth Equities' investment philosophy is the 'wild card' component. "We're not here to gamble on long shots with our investors' money. If a stock doesn't meet every one of our criteria, it doesn't make it to our portfolio.

"People call us rigid, conservative – even unadventurous – and they're right on every count. But people in the know are also starting to call us one of Australia's top performing fund managers, and they're right about that, too," says Russell.

Growth Equities plans to outgrow its boutique status over the next two years, and is already building staff numbers to achieve this. The goal is to take the current investment portfolio of $25 million to $100 million by the end of 2007, and $200 million by the end of 2008.

"At that stage we'll have the critical mass to take a serious look at listing. But whatever our growth, the fundamentals that have built Growth Equities' track record will remain unchanged. We won't be lowering our investment criteria, we won't be going into the resource sector, and we won't be substantially expanding the number of stocks in our portfolio," Russell says.