

Continued from Page 3

# Winning fund deploys the art of war

These two managers say their success is driven by a style-neutral investment approach

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FOR a fund that started its life as a vehicle to manage and invest family wealth, the Prime Value Growth Fund has come a long way.

The Australian equities fund sits within a stable owned by boutique investment company Prime Value Asset Management, started by Han K. Lee and Y. Yong Quek in 1998.

In 13 years, the Prime Value Growth Fund has grown to about \$280 million in funds under management and has established a reputation for delivering solid results.

It has consistently achieved returns in excess of its benchmark, the S&P/ASX 300, and has a five-star recommendation from Morningstar.

Much of its strong performance is due to what management describes as a style-neutral investment approach. Its investment style is "driven by our view on a company, not its benchmark weight", say the co-founders.

Some of the better-performing stocks for the fund have been mining services company Monadelphous, Wesfarmers, Orica and agribusiness Maryborough Sugar Factory, say Lee and Quek.

As at February 28, the fund's top five holdings were BHP Billiton, Monadelphous, National Australia Bank, Wesfarmers and Westpac.

About 30 per cent of its asset weight is in the materials sector, followed by financials at 20.8 per cent.

"Our portfolio strategy is skewed to our belief in the structural economic shift in the emerging world," the pair say. "Australia is a major beneficiary of this shift due to its developed economy structure... combined with its proximity to the emerging economies of



Prime Value Growth Fund founders Han K. Lee and Y. Yong Quek

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China, India, Indonesia and Vietnam. "We favour the sectors and industries that are in a position to take advantage of growth in the emerging economies."

Indirectly, they say, the fund gains exposure through mining services companies, which are theoretically less volatile because they have less commodity price risk.

Since inception, the fund has delivered an average 15.6 per cent a year to investors to March 31 this year, net of base fees, but not including performance fees.

"In dollar terms an investment of \$100,000 at inception has increased to

## TOP FIVE TIPS

- Mistakes are inevitable, but try to minimise them.
- Gathering and analysing data is important, but interpreting it correctly is crucial.
- Try to understand the business you are investing in.
- Have an exit strategy. It can be too tempting to "fall in love" with a stock that has performed well in the past.
- Keep it simple.

\$583,300 [net of all fees] as at March 31," Lee and Quek say.

"This compares to \$100,000 in the market [S&P/ASX 300 Accumulation Index] which would have increased to \$291,200 over the same period."

In three years, the growth fund has achieved a return of 27 per cent a year, while the benchmark return has been 11 per cent. Its one-year return was 7.3 per cent, compared with a benchmark return of 3.8 per cent.

### Who can invest in your fund?

Our funds are open to a wide variety of investors, including private investors, clients of financial advisers and not-for-profit organisations. We are also available via many investment platforms. The minimum direct investment is \$20,000.

### How would you describe your investment style?

We are style-neutral and strive to achieve superior returns through all stages of the economic cycle. Our investment style is not limited to sector specialisation or restricted by market capitalisation restrictions.

We admire the following sentiments written by Sun Tzu in *The Art of War*: "What the ancients called a clever fighter is one who wins his battles by mak-

ing no mistakes. Hence his victories bring him neither reputation for wisdom nor credit for courage."

We seek to minimise mistakes rather than chasing returns through high-risk investments. It is perhaps a mundane and unspectacular method of investing, but we believe it generates consistently superior returns.

We have a proven investment process that is also pragmatic, in that we recognise that investing is as much an art as it is science.

In addition, we apply a different focus to risk management. Most investors interpret risk as the possibility of a loss on their investment. Prime Value shares this view of risk, rather than the generally accepted standard deviation.

We understand that when markets are strong, relative performance is important. But when markets fall, absolute returns become critical. This balance of wealth creation and wealth protection is central to our risk-management approach.

**What do you see as the main themes that will dominate the markets in which you invest in the next 12 months?**

In the short term, the continuing global shift away from developing into developed markets will equate to a local shift

away from resources to industrials, banking and cyclical stocks. But it wouldn't surprise us to see this trend reversed in the second half of 2011, by when the headline CPI in China should have peaked, while the US stock market should be refocusing after the pending end of quantitative easing.

For Australia, sectors producing goods that the Chinese badly need, but cannot produce themselves (or cannot produce in sufficiently large quantities), such as resources and companies which support the resources sector, will remain important.

Sectors that compete against China, such as manufacturing, will be under pressure. We have some concerns about consumer and cyclical stocks.

Longer term, outperformance will continue to be achieved by overweighting stocks or sectors leveraged to Asia and other developing countries. Resources-based stocks to us are not limited to mining stocks only, but also include other companies supplying and servicing the resources sector.

**Where do you see the markets heading in the next 12 months?**

Barring any nasty surprises emanating from Japan or the Middle East, we would expect the market to be up by the end of the year. Sharemarket optimism is still running high globally and has not yet peaked, but is possibly close to it. In Australia, sector rotation is significant once the peak does occur. This is something that we should be prepared for.

**What sectors or industries are you concerned about in the year ahead and why?**

Manufacturers will be adversely impacted by the high Australian dollar if they compete against imports or sell their products overseas. Their life will become harder as the dollar appreciates. Other local industries that will be negatively affected include exporters such as farmers and winemakers (companies that operate overseas and want to repatriate their profits will also lose out); tourism operators (as fewer travellers will choose to come to Australia); the education industry (as studying in Australia will become more expensive). Another potential loser is the banking sector because the rise of the Australian dollar could add up to 20 per cent to the foreign currency funding task for Australian banks.

Continued on Page 12

The value of export receipts earned by Australian mining companies has risen substantially because of the mining boom. Commodity prices, and our terms of trade, have risen strongly since this China-induced boom. Further rises in commodity prices, if any, are likely to be more modest. Export volumes, rather than prices, will have an increasingly important role in driving mining export revenues. This will not be a serious problem for the well established, lower-cost producers.

### How do you value companies and other assets?

We use a variety of financial metrics, including price-earnings ratios, net tangible assets or enterprise value as well as discounted cash flow. The appropriate method will depend on the industry and company specifics.

### Are you increasing or decreasing your cash position?

While we believe conditions remain uncertain and volatility will continue, our more positive view on company valuations supports a lower cash level and liquidity in the portfolio will remain about 5-10 per cent. This contrasts with 2007-08 (pre-GFC) where levels rose above 20 per cent in response to valuation concerns.

### What are your fees?

The management fee is 1.43 per cent a year for direct investors and 1.23 per cent for indirect investors (via platforms). A performance fee of 20 per cent of any outperformance (relative to the S&P/ASX 300 Accumulation Index) is applicable if performance (net of management fees and administration costs) exceeds the benchmark, and the performance of the fund (net of all fees) is also positive. A high water mark is applied to ensure any previous underperformance is "caught up" before a performance fee is applied.

### Do you have a cap on the amount that can be invested in one asset?

No more than 10 per cent of the funds can be invested in any one stock, with the exception of BHP Billiton. We also prefer to limit our exposure in a company to less than 5 per cent of the issued capital.