Volatility demands safe plays

Managing risks rather than chasing stellar returns should be the key focus in the present uncertain environment, writes **Brendon Lau**.

In competition for investor inflows, fund managers may catch the eye with an edgy new approach to stock picking, but the recent bout of market uncertainty is likely to put "old-school" fund managers back in favour.

The 30-day average volatility on the S&P/ASX 200 Index has surged around 60 per cent since the start of the calendar year as a series of regional disasters, the strong Australian dollar and signs of weakening growth here and overseas have cut into corporate profitability and clouded the outlook for most industrial companies.

This is the sort of environment where traditional managers who typically focus more on managing risks than generating stellar returns can shine, and Prime Value Asset Management is right at home in this nervous market.

"Minimising mistakes is our basic investment philosophy, which really means avoiding those stocks which are at risk of not delivering or, worse still, falling," said Prime Value's chief investment officer, Han Koen Lee.

"It is tempting to praise big winners in investment, but the reality is that the manager who makes the fewest mistakes usually comes out on top. In this current environment, it is particularly important to remain focused on certainty."

The roots of this conservatively run fund manager are different from most. Its senior investment team has come from the corporate sector and not investment banks. Mr Lee, for instance, used to run Shell Australia's in-house superannuation fund in the 1980s and 90s before the industry began outsourcing the management of employee retirement funds.

Prime Value's Han Koen Lee: 'It is important to focus on certainty.' Photo: JAMES DAVIES

"[Our background] allows us to talk the language of the companies we invest in," said Mr Lee. "Our portfolios invest across the ASX so this experience on the other side of the fence becomes invaluable."

Prime Value believes that the market is close to peaking due to significant downside risks from inflation and contagion fears from sovereign debt issues outweighing the prospect of economic growth.

Sector rotation is the best way to generate value once this peak occurs, according to Mr Lee.

"We favour the sectors and industries that are in a position to take advantage of growth in the emerging economies," he explained.

"Directly, we have overweight positions in the materials and energy sectors. Indirectly, we gain exposure through mining services companies, which are theoretically less volatile as they have less commodity price risk."

On the flipside, Prime Value is avoiding sectors that are struggling with weak demand conditions, cost pressures and currency headwinds. These include large discretionary retail and consumer-related services.

Stocks that stand out in the fund manager's opinion include mining giant Rio Tinto, mining contractor Monadelphous Group and mineral testing group Campbell Brothers.

Mr Lee's preference for Rio Tinto is based on the miner's large exposure to iron ore and the fact that its recently acquired Riversdale Mining business is trading at a deep discount to its book value.

"We like that it is not pursuing big, high-risk blockbuster deals, and its strong relationship with the Chinese is a plus," he added.

As for Monadelphous and Campbell Brothers, Mr Lee is taken with their strong management teams, the companies' track records in creating shareholder value and their strong positioning in their respective markets.