EUREKA report

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April 13, 2007

Printed for: Prime Value on May 21, 2007

‘I hate to lose money’

By Alan Kohler

PORTFOLIO POINT: Han Lee regards investment as being as much about avoiding losers as picking winners. He sees some mis-pricing among the big miners.

Han Lee, chief investment officer of Prime Value Asset Management, is one of the market's more low-key, high-achievers. His fund has managed a stunning 21.5% return since 1998 and, with funds under management of “only” $260 million, is still nimble enough to exploit a range of trading opportunities.

Lee offers a unique perspective operating as a value investor with a truly global perspective. One of his chief concerns for global market is the prospect of a new protectionism emerging in the crucial trading axis of China and the US. Today's interview also reveals he is as much concerned with avoiding losers as picking winners … it's a strategy that's paid off handsomely to date. Lee also reveals the resource stocks he favours on the ASX.

The interview

Alan Kohler: Obviously these are slightly more volatile times we’re seeing in the past few weeks. Do you think that in general, just looking at the market overall, that risk has been underpriced in global markets in recent months?

Han Lee: What I am telling my investors and prospective investors is that the [Australian] economy in the long haul grows by 2, 3, sometimes 4% per annum … and so every year a growth rate of 3% and inflation rate of 3%. I would say that in the long haul the Australian market can sustain possibly a growth rate of somewhere between 8% to 10% per annum.

And in fact that is the historical average. If you go back long enough, that’s the sort of returns that the stockmarket does provide.

Yes. I am telling my investors that I am hoping to achieve a return somewhere around 10–15% per annum. Not in a straight line, of course, but in the long haul.

And what have you actually been able to achieve?

We have an annualised rate of return of 21.5% for the growth fund, that’s since inception.

Which is how long?

Since April 1998. And for the imputation fund which started later, about six years ago or so [December 2001], we have a return after performance fees of 27.3%. I did not aim for these high numbers, I’m only aiming for somewhere around 15–20%.

But over the past three or four years the entire market has produced returns of over 20%, so that hasn’t been too difficult to achieve has it?

That’s right. But over the same period actually we outperformed the benchmark by 8.7%. And the imputation fund by about 14.3%, actually.

Above the benchmark?

Above the benchmark, which is ASX 300 Accumulation index.

Can I ask you whether you think these sort of performances we’ve been seeing over the past few years can be sustained?

No. I would say no.

And so what are you looking for this year?

This year is a bit hard to predict. Over the past few years we have been experiencing good conditions in the sharemarket. But that is mainly courtesy of China rather than Canberra, if I may be so unkind to the people in Canberra.

But there’s no sign that the Chinese boom is coming to an end.

No, there’s no sign there at the moment because China at the moment is something like Europe or Japan after the Second World War, isn’t it?

Despite the development process, this has been managed without foreign debt. But it doesn’t mean that China’s massive growth rate will be achieved without hiccups.

Just with China itself, the People’s Congress is about to consider new property rights laws in China. Do you think that will be a smooth transition to private property ownership or do you think it will be difficult?

This issue in China that I see now is that the gap between the urban centres and rural centres is widening; the gap between rich and poor is widening. And if they are not successful in addressing that, then it may well create a lot of social issues there. That is what I’m afraid of in China, but from the international perspective there are other issues of economic power.

Are you predicting some sort of protectionism in the United States?

I would say that history has taught us for many, many years that when a new power emerges and challenges the existing ruling power – economic power – that may not happen in a smooth manner. I hope I’m wrong.

Well, in relation to the disparity you’re talking about between the urban and rural areas in China – are you predicting unrest, possibly even some sort of revolution?

No, I don’t see any signs of that happening. I saw that a few years ago but apparently the central government is now addressing that issue very quickly and they are decentralising the industrial centres to the hinterland.

And what’s your investment stance about China. Are you deliberately gaining exposure to China through Australian equities or avoiding it?

Think of the tale of two cities; imagine it set between Melbourne and Sydney. Everything used to centre around Sydney and Melbourne, but now there is dualistic economy developing between the resource-based states and the non-resource-based states. And the resource-based states are booming because they are selling products to China, products that China needs and cannot produce itself, while the manufacturing-based states are producing things that compete against China.

The Chinese are, on the one hand, paying very high prices for their commodity input but are not in a position to pass on the cost increases to the consumer, so then they finally sell their finished products to the world market. Put it this way: China is exporting dis-inflation, in a sense, to the world. And so if you happen to compete against China selling manufactured goods, then you are in quite a difficult spot.

The mining companies that rely too much on commodity price increases to survive, I think they will be under pressure in future. I think the companies that have the capacity to increase production levels should at least be OK.

Which companies are you thinking of?

Being a realist, I am thinking of companies that are to a certain extent price makers but they also have the capacity to increase production levels. So in the long haul, I would argue that stocks like BHP Billiton and Rio Tinto should be doing quite well.

You’re an investor who looks at intrinsic value, or attempts to buy companies at less than their intrinsic value. How do you assess the value-versus-price equation of the big miners such as BHP and Rio at the moment?

When you look at BHP or Rio, they are selling at a prospective price/earnings (P/E) multiple of somewhere around 10 times. They are selling at well below their market [multiples], which are somewhere around 16 or 17 times at the moment.

And what do you put that down to – the fact that they’re so much below the market?

I prefer to use a somewhat moderate assumption on pricing but even using that kind of assumption, the prices for the big miners seems to be still reasonable in my view, but prices of mining stocks are notoriously volatile. So I am more inclined to include companies or stocks servicing the mining sector itself. As they say, it is often better for people not to invest your money with the gold diggers themselves, but with the people who are selling the shovel and spade to the gold diggers … less risky and less capital-intensive.

Have you found that strategy rewarding over recent times?

Yes, I started working in this investment since the early 1970s and it’s always been the case.

And can you tell us how you go about choosing your stocks? How do you go through a process of assessing a company’s value?

Yes. Well I often compare investment to military strategy. In a war, two opposing armies are facing each other, maybe of equal strength. Usually what happens first is that the commander of the army will ask his intelligence officers to brief him on what is going on. In the same way, when you are an investment manager you ask your analysts to brief you of what is going on in the market and, as usual, this intelligence is not perfect.

There is always something that they missed but despite that, despite the imperfect information input, the commanding officer or the investment manager has to make decisions and those who make the least errors will succeed.

So what do you do to avoid errors?

You try to avoid being a hero. There’s no sense being a dead hero in a stockmarket or in a war. So I don’t try to make spectacular decisions. To try to make a coup, whatever. Just try to be slow and steady and boring, very boring. Do your homework right.

I don’t believe that the market is completely efficient. You can always arbitrage in the market. You can always pick up some market imperfections and mis-pricing in the market, so that is contrary to the modern (portfolio) approach, of course, which says that you cannot beat the index and you cannot beat the market.

And how do you decide when to sell a stock?

First, you look at the numbers. But, you know, investment is a combination of science and art. Or common sense, if you like. Sometimes it's difficult to describe. I often get asked to write down my investment approach but it's hard. If you ask, say, Roger Federer to write down a manual of how to play tennis and you forced him to follow his own manual, you would have a disaster on the court.

Do you believe that sometime in the next few years there may be a time to get out of the market entirely in some way? Do you think that there is a dangerous time ahead?

That is a bit hard to predict, to be frank. Impossible, really. Our brief is only to invest in Australian shares.

And to be fully invested all the time?

Yes. Beating the index is only a way of measuring our performance fees.

And what do you think of the advent of private equity?

I’ve been long enough in the game to remember the time of the mid-1980s when people were showing a similar psychology to what they have now. Maybe I get too frightened, but I remember an article in the US investment journal *Barron’s* in the 1980s, which said, “never entrust your money with a fund manager more than 27 years old”, or something like that, because they tend to be over-cautious and will not turn you into an instant millionaire. This quotation sticks in my head so I tend to be over-cautious in a way.

We put our money in the funds ourselves there, so we would like our fortune to rise and fall together with the other unit holders. So we have a common interest with our unit holders. I’ve been somewhat overweight in cash and that has punished performance a little bit over the past two years, but you know, Alan, I hate to lose money.

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