

intelligentinvesting

QUARTERLY INVESTMENT NEWSLETTER

CEO's ADDRESS The Road to Recovery

Enough has been said and written about the reasons behind the global financial and economic crisis. There will be text books and best sellers written about it.

Now there is talk of the recovery – the eventual road to recovery. In all likelihood, a comparatively long, windy, and bumpy one. But a recovery there will be.

At this stage, the markets are still very volatile and investors remain risk-averse. Governments around the world are lowering interest rates and pumping money into the system in an effort to encourage all of us to be less risk-averse and to spend more. The world's better business leaders are adapting and will start to pick up bargains and get on the "front foot" again. Eventually, markets will become calmer, stimulus packages will have some effect, cashed up businesses will start to invest, and confidence will return.

We are mindful that no-one will ring the bell at the point at which markets calm and confidence returns. Accordingly, one of the themes of this newsletter is that, in the meantime, there are ways to deal with situations like the one we all find ourselves in. We are still running the portfolios in which you are invested in a conservative manner. The amount of cash in the portfolios remains relatively high and we are well placed for further market volatility. However, we have cautiously been taking advantage of these lower prices and very slowly putting some of the cash into the market. We have also been diligently reviewing our manager selection and have added some high quality managers to the portfolios who we believe are well equipped to deal with the current market conditions.

Most importantly, our portfolios remain very well diversified. In the Market Overview we highlight that even the world's greatest investor can make an "unforced error" and we see diversification as the best tool a smart investor can use to mitigate this risk.

Further, there are potentially beneficial investment techniques explained in this newsletter such as dollar cost averaging and portfolio re-balancing that your Western Pacific advisers can work with you to implement on your behalf (see pages 3 and 4).

The Western Pacific Investment Committee is also constantly looking for new initiatives to deal with the current environment. This time around, "pockets of value" in the market (the places we, as value investors, strive to find on your behalf) may be harder to find and may open and close more quickly than in the past. Different types of investments may behave very differently than was the case in

the "bull market" and in the "bear market" aftermath when all asset classes fell as one, yet we are not deterred by these differences and are committed to finding ways to seek out these "pockets of value".

It is important to stay focused on positive initiatives and sound investment principles. It is also worth remembering that any recovery this time round will not be without its ups and downs. This recovery may well be very different from previous instances. The world has changed. It took a long time for the world, including ourselves, to realise that this economic downturn was profoundly different.

Some confusion along the road to recovery is inevitable as the world comes to terms with the economic downturn and its consequences. We, however, remain committed to filtering out as much of the "noise" as we can in order to capitalise on the initiatives referred to above and any others that may arise.

There is one thing we know for sure and would urge you to consider as well. Beware of the media coverage, the Government promises and the inevitably silent recovery. As one of the wisest US financial advisers commented recently at a closed briefing:

"The financial crisis ends when risk takers unexpectedly build new companies from the broken assets and policy makers (i.e. Governments) unexpectedly fail to deliver what they have promised to their citizens. The former is a silent process, which attracts no media coverage. The latter is a noisy process, which will attract exaggerated media coverage. The latter increasingly has the possibility of undermining political stability to the point of conflict. So, the recovery process will be well underway before anyone notices and before the data reflects the change, as is always the case."

Dr Philippa Malmgren of Canonbury Group

Keep an eye on these companies. We will be too.

TONY McDONALD
CEO

Snowball Group Limited
(incorporating Western Pacific Financial Group)



MARKET OVERVIEW

Uncertain Minds in Uncertain Times

It is hard to believe that we are already one quarter of the way through 2009. After the turmoil of 2008, which saw the Australian Stock Market (as measured by the All Ordinaries Accumulation Index) decline by just over 40%, it was refreshing to get to the end of the March quarter with only a small decline of 1.7% (not that one would have thought that we would ever describe a negative quarter as “refreshing” – it is amazing how perspectives change). However, quarter ends are arbitrary points, and what this figure does not show is that from the low point of the quarter on March 6th, the index was 15.2% below the high point of the quarter, which at that point in time represented a five year low in the Australian Share Market. It also fails to show, that from that low point, the market then rallied 13.8% to be down only 1.7% by quarter end. Whilst it would be nice to think that we would never revisit the depths of 6th March 2009, it cannot be categorically ruled out, and it should almost be considered likely that we are going to continue to see some volatility in markets for some time.

This inherent uncertainty and unpredictability causes significant stress for many investors, and often leads to poor investment decisions being made. The act of making poor investment decisions based on an investor's current state of mind is an area that has been studied extensively recently, and is now known as “behavioural finance”.

To understand better how investors' mindsets can influence their decisions, consider the following examples. Anecdotal evidence suggests that there have been recent sales of luxury properties at prices substantially below what they would have sold at one or two years ago. The normal reaction when hearing of these sales is that they represent great bargains for the purchasers. However, on the other hand, when investors review their investment portfolios, and see high quality investments that have fallen substantially in price, their reaction is not normally that these investments now represent “bargains” or great value, but often the exact opposite, that they now represent “bad” investments and they may well want to sell them, out of fear that prices may fall further. This reaction is normally irrational, and when comparing the example of a luxury beachfront property selling at 50% of its previous price being a “bargain” and a high grade investment selling at 50% of its previous price being a “bad” investment, the key difference comes down to the perspective of the person making the assessment. In the case of the property, the perspective is that of someone who would like to be an owner, versus an actual owner in the case of the investment.

The reality is that investors should make decisions on their investments based on the underlying value of the investment, and not their current state of mind, which may well be unduly influenced by their own recent investment experience. Thinking logically, if

“behavioural finance” results in large numbers of investors acting irrationally, and to their detriment, the wise thing to do would be to take advantage of this, fight natural instincts, and purchase the investments they are selling. This is easier said than done, and the ability to go against the crowd is a distinguishing feature of many of history's great investors. It is also one of the main reasons why, for most people, it is better to leave investment decisions in the hands of professionals who can make cold, rational decisions on investing based on sound analysis, rather than being influenced by irrational thoughts.

So, whilst the irrational actions of many provide rich opportunities for the brave, unbridled enthusiasm must be tempered by a few salient facts.

1. As everyone knows, we are in the midst of a severe economic crisis, and whilst governments around the world continue to take whatever action is available to them to resolve this, how long and how deep the recession turns out to be is still unknown.
2. The above mentioned government actions can often have unintended consequences, both positive and negative, for various companies (i.e. these actions can create an unlevel playing field which results in some companies getting an easier downhill run and others suddenly finding themselves running uphill). These unforeseen actions can adversely impact an otherwise sound investment.
3. Even the most revered investors can “get it wrong”. In his annual letter to shareholders of Berkshire Hathaway, Warren Buffett discussed some investments he had made in Irish Banks that had declined by over 89%. If he can get it wrong, anyone can.

So how does a smart investor, with cash to invest, deal with all of this? In relation to the first point above, the process of slowly “averaging in”, which is discussed in detail in the next article, provides some protection against uncertainty and volatility. Just because something is currently cheap, does not mean it cannot get cheaper, and having multiple entry points into an investment helps to mitigate this risk.

In relation to points two and three, the best protection against these risks is to maintain a well diversified basket of investments managed by high quality investment professionals. Putting too many proverbial eggs in one basket can prove costly if unforeseen circumstances adversely impact on a particular investment. In the case of Warren Buffett and Berkshire Hathaway, the poor investments in Irish Banks were only a small part of an enormous and diversified pool of investments.

MARKET OVERVIEW

And what of a smart investor who is already comparatively fully invested? Ensure you are well diversified and fight the natural urge to “get out before things fall further” – look at your investments from the perspective of a buyer rather than a seller and the outlook should seem more favourable. Remember, deciding to not sell an investment is in many ways the same decision as deciding to buy it.

So what can be learned from “behavioural finance”? Investors should realise that their irrational thoughts are entirely normal, and rather than be concerned by them, they should accept that they are part of human nature, and if they can be overcome (usually by letting professionals make investment decisions), the irrational thoughts and behaviour of others can work to their longer term benefit.

A (RE) BALANCING ACT

As explained, the psychology of investing can often work against an investor’s best interests. Two tools designed to take some of the “irrational thinking” out of investing are active re-balancing and dollar cost averaging.

Put simply, the long term goal of re-balancing is to “buy low” and “sell high”, which is the opposite result to that often achieved when investor emotion interferes. In contrast, dollar cost averaging solely focuses on buying and is designed to ensure investors buy more when prices are low and less when they are high. However, when investors let instinct take over, this too often produces the opposite result. Like re-balancing, dollar cost averaging counters irrational buying. People will often buy more of something that has risen in price (because human nature is to assume it will continue to rise) rather than buying more when the price has fallen.

Simplified examples illustrating these two techniques in practice follow.

RE-BALANCING

Let’s assume our investor has a portfolio with only two asset classes represented. Asset class A (A) and asset class B (B). Let’s also assume that the portfolio mix for our theoretical investor is a

40% weighting in A, and a 60% weighting in B. The table below shows the different outcomes achieved when our investor actively re-balances the portfolio, compared to the results that our investor would have achieved if the portfolio was set on day one and then never adjusted.

As shown, in this simple, but illustrative example, the re-balancing adds an extra \$624 to our theoretical investor’s portfolio. Whilst this is an over-simplified example that does not consider account factors (i.e. transaction costs or actual returns), the benefit of periodically re-aligning a portfolio to desired weightings is highlighted.

DOLLAR COST AVERAGING

Dollar cost averaging is a tried and tested investment tool that simply involves buying the same dollar value of an investment periodically over a set period. By keeping the dollar amount constant, investors buy more units in a managed fund or shares in a company when prices are lower, and less when they are higher.

Again, a simplified example is the best way to illustrate this. Assume our investor wants to invest \$1,000 in a company every month for the next year. At the end of month one the share price of the company is \$10 and our investor therefore buys 100 shares.

Portfolio Without Re-balancing

ASSET CLASS	TARGET WEIGHTING	INITIAL PORTFOLIO	YEAR ONE		YEAR TWO			
			RETURN	BALANCE (END)	PORTFOLIO (START)	RETURN	BALANCE (END)	
A	40%	40,000	12%	44,800	44,800	-4%	43,008	
B	60%	60,000	-8%	55,200	55,200	9%	60,168	
		100,000		100,000	100,000		103,176	
							Total Return over 2 years	3.18%

Portfolio With Re-balancing

ASSET CLASS	TARGET WEIGHTING	INITIAL PORTFOLIO	YEAR ONE		YEAR TWO			
			RETURN	BALANCE (END)	PORTFOLIO (START)	RETURN	BALANCE (END)	
A	40%	40,000	12%	44,800	40,000	-4%	38,400	
B	60%	60,000	-8%	55,200	60,000	9%	65,400	
		100,000		100,000			103,800	
							Total Return over 2 years	3.80%

Benefit of Re-balancing

\$ 624

A (RE) BALANCING ACT

After a month the price has fallen to \$8 and this time our investor buys 125 shares. At the end of month 3 the price is now \$20 and our investor only purchases 50 shares. As can be seen below, more shares are bought at lower prices than at higher prices. If this were to continue throughout the year, our investor's portfolio would have been built up as shown below.

MONTH	SHARE PRICE	NUMBER BOUGHT	TOTAL OWNED	PORTFOLIO VALUE
1	\$ 10.00	100	100	\$ 1,000
2	\$ 8.00	125	225	\$ 1,800
3	\$ 20.00	50	275	\$ 5,500
4	\$ 17.00	59	334	\$ 5,675
5	\$ 15.00	67	400	\$ 6,007
6	\$ 10.00	100	500	\$ 5,005
7	\$ 8.00	125	625	\$ 5,004
8	\$ 6.00	167	792	\$ 4,753
9	\$ 6.00	167	959	\$ 5,753
10	\$ 8.00	125	1084	\$ 8,671
11	\$ 9.00	111	1195	\$ 10,754
12	\$ 10.00	100	1295	\$ 12,949

As indicated, even though the share price ended the year where it started, for a total investment of \$12,000 (\$1,000 per month) our investor now has a portfolio worth \$12,949. This is because shares were purchased at "low prices" in months 2, 7, 8, 9, 10 and 11. Of course, shares were also purchased when they were "on the up" but, at the end of the day, our investor "averaged in" to end up with 1,295 shares, at an average "entry price" of \$9.27 per share.

Although both examples provided are simplified, the underlying principles are as applicable to normal, well diversified portfolios as they are to these simplified examples. Trying to "time" the market perfectly is virtually impossible, and generally speaking, it makes more sense to use unemotional, mathematical techniques such as re-balancing and dollar cost averaging when making intelligent investment decisions.

DISCLOSURE

Although all reasonable steps have been taken to ensure that the information contained in this review is accurate, no warranty of accuracy or reliability is given. To the extent that it can be excluded at law, Western Pacific Financial Group Pty Ltd, Officium Group Pty Ltd, together with their respective directors, officers, employees and agents will not be liable for any loss or damage whatsoever and howsoever arising in relation to any representation, act or omission, whether express or implied (including responsibility to any person by reason of negligence).

The information contained in this review is of a general nature only and has been prepared without taking account of your objectives, financial situation or needs. You should consider the information contained in this review having regard to those matters before making any decision about any of the financial products mentioned. If you are considering any particular financial product you should obtain and read the applicable Product Disclosure Statement in relation to that product before making a decision about that product. The Product Disclosure Statements for the products referred to in this review are available for download by following the links on www.westernpacific.com.au.

Officium Capital Ltd (ACN 108 747 637), AFSL no. 275101, is the responsible entity of the Officium Aggressive Fund, Officium Assertive Fund, Officium Balanced Fund, Officium Cautious Fund, Officium Conservative Fund, Officium Global Fund, Officium Income Fund, Officium Property Fund, Officium Special Situations Fund, Officium Australian Shares Fund, Emerging Resources Company Share Fund, Ganes Value Growth Fund, MMC Concentrated Fund, and the Peters MacGregor Global Fund, and receives remuneration in relation to those financial products. Western Pacific Financial Group Pty Ltd and Officium Capital Ltd are both subsidiaries of Officium Group Pty Ltd, which is indirectly owned by parties associated with many of the Authorised Representatives of Western Pacific Financial Group Pty Ltd. In addition, some of those Funds and other parties associated with Western Pacific Financial Group Pty Ltd, its officers, employees and agents, including the author of this document, may hold interests in the securities mentioned in it.

OFFICE LOCATIONS

NEW SOUTH WALES
BONDI JUNCTION
Level 23, Tower 1, 520 Oxford St
Phone: (02) 8013 5205

NORTH SYDNEY
Level 6, 121 Walker Street
Phone: (02) 9959 0510

QUEENSLAND
CLEVELAND
29 Middle Street
Ph: (07) 3286 9499

CLEVELAND – BENCHMARK
29 Middle Street
Phone: (07) 3821 3355

GATTON
20 William Street
Phone: (07) 5462 2277

KAWANA BUSINESS VILLAGE
Suite 3, Level 1
2 Innovation Parkway
Phone: 1300 663 887

TEWANTIN
Suite 12, 91 Poinciana Avenue
Phone: (07) 5440 5937

SOUTH AUSTRALIA
UNLEY
15 King William Road
Ph: (08) 8373 3333

PORT AUGUSTA
16 Young Street
Ph: (08) 8641 9399

VICTORIA
TOORAK
Level 1, 429 Toorak Road
Ph: (03) 9824 0001

VERMONT
Suite 2, 628 Canterbury Road
Phone: (03) 9872 4736

WESTERN AUSTRALIA
DUNSBOROUGH
Shop 12, Dunn Bay Centre
31-33 Dunn Bay Road
Phone: (08) 9755 3233

MANDURAH
Suite 1/32 Spinnaker Quay
Phone: (08) 9535 7655

NARROGIN
Suite 6, 2 Williams Road
Phone: (08) 9881 1242

OSBORNE PARK
The Garden Office Park, Building B
355 Scarborough Beach Road
Phone: (08) 9443 6833

SUBIACO EAST
Level 1, 4/65 Hay Street
Phone: (08) 9489 7040

SUBIACO NORTH
Suite 6, Level 1, 94 Rokeby Road
Phone: (08) 9381 6622

SUBIACO WEST
Unit 8, 232 Churchill Avenue
Phone: (08) 9381 6333