

Smart Money

investor

High-stakes guessing game



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Jason Beddow says Argo will keep adding to its portfolio. Photo Michele Mossop

issues locally and the global uncertainty, he was cautious on the short-term outlook for the market.

But, longer term, he said Argo would keep adding to its portfolio as it did in 2010-11 (when it peeled off almost \$50 million for more ANZ shares and popped \$37 million into its BHP holding. Since June 30, it has spent \$56 million buying more banks (ANZ, CBA and NAB) and more Coca-Cola Amatil and Santos.

Big investors like Argo tend to stick to the biggest, bluest-chip stocks but still like to keep an eye on the relative value of the market. Most investors use the level of price-earnings multiples (the lower the better) and dividend yields (the higher the better) to judge if the market is "good value".

So, is the Australian market good value (or even, as the enthusiasts might say, great value)? It all depends on your yardstick.

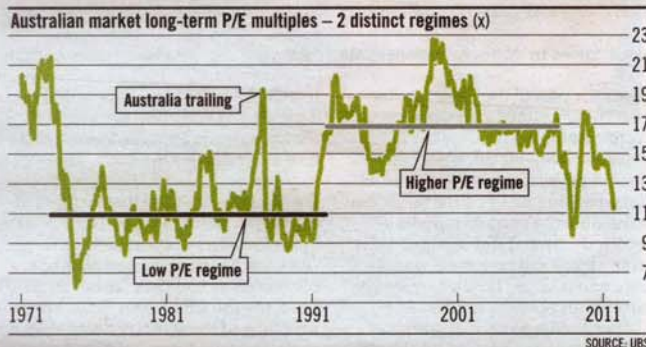
Many assessments can be based on a long-term historical price-earnings ratio of 14 or 15 times earnings. But P/E ratios can and do shift. P/Es might best be described as a measure for investors' confidence in shares and a rise or fall in individual or market P/Es will often account for all of the change in share values over a period.

The graph from investment bank UBS, which Argo included in its presentations, raises questions about just what is the long-term P/E ratio for the Australian sharemarket.

For much of the 1970s and 1980s it shows that P/Es clustered around 11 times, with outliers more than 20 times and others below seven times. But from 1991 it moved up to about 20 times and stayed at an elevated level, averaging around 17 times until the onset of the recent global crisis. Now, it looks like the trailing (or current) P/E is flirting with the previous, lower average levels.

All sorts of things can affect P/Es or the market's confidence: falling interest rates can cause P/Es to rise as investors become more confident. Beddow says it's possible P/Es may be moving back to the lower levels. He says if growth looks sluggish, historically, P/Es have tended to move lower.

True value



He was talking about the big economies such as the US, the UK and Japan as well as the major euro members and not just the obvious basket cases in southern Europe.

Confronted with such fears, investors turn very cautious. The reason is that such scenarios present extreme risks to markets, as the Towers Watson thinking ahead group recently demonstrated.

Of the 15 biggest risks, it put depression at the top, followed by sovereign default and then high inflation.

If investors want to hedge against these risks, however, they are confronted with very different approaches - long-term bonds for a depression, insurance via credit default swap for default or real assets like gold for hyperinflation.

You can do a lot worse than study the tactics of really long-term equity investors.

And even for those brave investors still prepared to buy shares, it's a tricky timing decision. Smart investors can do a lot worse than study the tactics of really long-term equity investors such as the big listed share investment companies like Argo Investments.

Argo's new chief executive, Jason Beddow, warned shareholders at the annual meeting this week that because of the generally negative

Woolies in demand

Its hybrid security issue has been recommended for its yield and simplicity - but best of luck trying to take advantage.

Alison Kahler

Woolworths' hybrid security issue has got the thumbs up from analysts but will prove hard to get.

Woolworths dropped plans for an offer to the public after institutional demand for its second issue of notes was overwhelming. The rate for Woolworths Notes II is set at 3.25 per cent over the bank bill rate, which now equates to about 7.9 per cent.

Unfortunately, only Woolworths shareholders and investors with a relationship with brokers or an advisory firm with an allocation to the issue will be able to buy it - although the offer has been increased to \$700 million.

Shareholders will get only \$25 million worth and Suleiman Ravell, from advisory company Funds Focus, suggests people shouldn't expect to get many notes from the shareholder issue as allocations are likely to be smaller than requested. It will be possible to buy notes on the stock exchange after listing and Ravell calculates that anything under \$102 will be a good price for the yield on offer.

Analysts at Morningstar and *The Intelligent Investor* recommend the issue to clients, due this yield and the simplicity of the issue.

"We think it's a much better offer than bank hybrids offered in recent months," says James Greenhalgh at *The Intelligent Investor*.

Nathan Zaia, from Morningstar, told clients recently the new issue was the only low-risk hybrid in the market outside the major banks.

He noted the issue might not be as easy to sell as bank hybrids, so investors should expect to hold the notes until maturity - likely to be in 2016. "While offering no capital upside, the yield is more attractive than our grossed-up dividend yield forecasts on [Woolworths shares]."

"Much better than the 6 per cent-odd from bank term deposits, while still being an investment that allows you to sleep at night," Zaia said.

statistics