FINANCIAL REVIEW smartinvestor

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HD **Beating the benchmarks**

BY Jeremy Chunn

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MASTERS OF THE MARKET

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Name: Paul Xiradis

Title: CEO and head of equities at Ausbil

Fund performance over 12 months:

Australian Active Equity Fund, 20.66 per cent (to June 30)Australian Emerging Leaders Fund, 23.69 per cent (to March 31),Ausbil MicroCap Fund, 42.26 per cent (to June 30)

Careful analysis and a focus on opportunities are part of the mix for this stock picker, writes Jeremy Chunn.

Ausbil's Active Equity, Emerging Leaders and MicroCap funds have posted returns since inception of 10.81 per cent, 12.63 per cent and 31.87 per cent respectively. Behind the wheel of the equities specialist is CEO and head of equities Paul Xiradis, who started in investment management in 1979 and "still gets a kick out of it every day".

How does your stockpicking process start?

We look at the bigger picture first. It's important to understand the economic drivers over a rolling 12-month period, because it ultimately influences how companies drive their earnings. We follow the same process for large caps, emerging leaders and small caps [Ausbil's "micro cap" universe includes stocks outside the ASX200 to a market cap of around $100 million].

Do you have a holdings limit for small caps?

As a manager you want to make sure you can move in and out of a company without having too much market impact. We test our positions for liquidity, which helps us determine our exposure. Getting beyond 10 per cent ownership is problematic; we tend not to go there. With some companies we have more than 5 per cent, and that's fine.

Do you limit the number of companies held in each fund?

The minimum holdings for large cap and emerging leaders is 30 and the maximum is 40. There are a lot of good companies out there, don't get me wrong, but what you are trying to do is really focus on the best.

Is there a cap on cash?

We tend to be fully invested. If you've been given an amount to manage, the expectation by the end investor [is] they want to be exposed to the equities market and it's not up to the manager to second-guess.

If you don’t hold meaningful levels of cash, what do you do when the market looks overvalued?

If we think the market is looking fully valued we can alter our portfolio by becoming quite defensive. We have done that in the past.

How does that help you beat the benchmark?

During the global financial crisis the overall market came down substantially, and we fell as well, but not by as much because we were defensively positioned.

The GFC was an18-month grind from top to bottom. How did you cope?

It was probably one of the most testing times for an investment manager. The challenge was to keep focus on your stocks and also the opportunities. I must admit it got really scary at one stage … the financial system was put under enormous pressure.

Fast forward to today and there are pockets of concern around the globe. The US looks exciting as a growth prospect and Europe is a bit of a concern but the worst is over. There is concern about **China** but our view is that growth in the second half of this year will be stronger than the market is expecting.

What about Australia specifically?

The reason I talk about the bigger picture is that around 35 to 40 per cent of earnings for our large cap companies is sourced internationally, so having an appreciation of global economies is important. It's also a benchmark which values companies. If the environment is positive for equities it means the Australian market should perform well.

Which sectors do you like at the moment?

We like companies which are more exposed to an improving economic environment, such as cyclical stocks … and those that have been heavily discounted because of the softness of global growth. We also like those groups who have been working under a fair bit of pressure and taken out costs and streamlined their business, so they're pretty fit and any up-tick in volume may see them deliver surprising performance.

Are companies good at reinvesting profits?

They're getting better at it, and the market rewards companies that get positive outcomes from reinvesting. In the past there have been opportunities taken by companies to grow just for the sake of growing, which has delivered negative performance.

Is a high payout ratio a good thing?

I think it is. Shareholders should enjoy the benefits of rising earnings in the form of increased dividends.

Should small cap managers liquidate holdings and hand money back when a fund reaches a certain size?

I can't speak for all funds, but there are always opportunities. Equally, you can get too big in the small cap side. Our emerging leaders and micro cap funds are generally only available to private clients or smaller investors. That's how we manage capacity.

Should we always expect huge returns from small caps?

No, that's not realistic. One of the traps of investing in smaller cap companies is that you can be locked into a situation when things turn down. That plus-30 per cent can equally become a negative 30 per cent. Liquidity is a very, very important criterion.

When should we quit yield and buy cyclicals?

Once rates start moving up, which we think will be in the latter half of this year or early next year, that yield chase will start reversing. That could be a problem for anything which offers quite a high yield, and I would include A-REITs, infrastructure and utilities, potentially banks and the likes of Telstra in that category. There will be a time when things unwind.

Is your portfolio prepared?

We have no REITs, because of that concern. We're underweight utilities, neutral on the banks and we're out of Telstra. We're directed more to the recovery phase.

We have a good exposure to building material companies and we're overweight resources. We also believe retail is an opportunity and companies with US exposure, such as Fox, Brambles, Amcor, Computershare and QBE.

Got any warnings about investing?

Smaller investors should focus on the quality end. If they're going to invest in smaller companies it's best to leave it to an expert. There are a lot of traps.

Also, when markets get more buoyant, speculation by hearsay seems to go up a notch, and that's when you should be turning down that noise.

There is too much focus on the near-term [in the media], and that tends to **lead** to too much trading. At times you end up zigging when you should be zagging.

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