Are Investments in the International Market Pure Speculation

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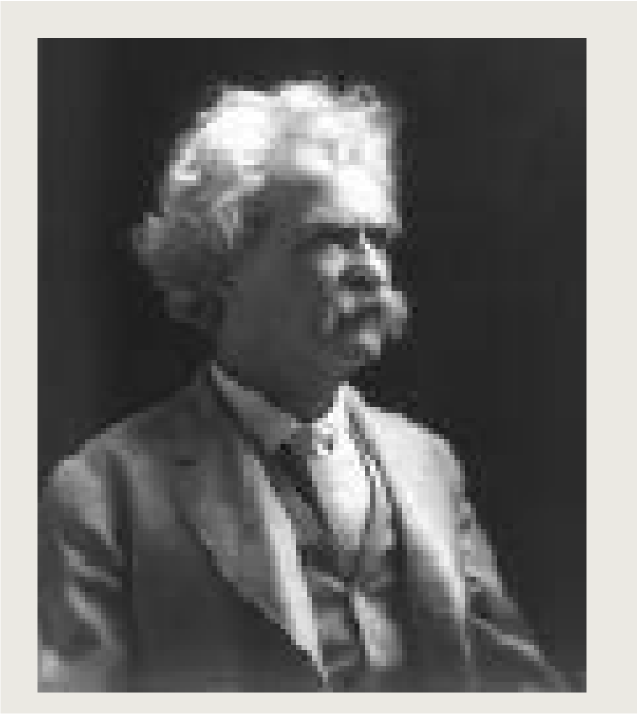
Mark Twain’s view

“October is one of the peculiarly dangerous months to speculate in stocks…

The others are July, January, September, April, November, May, March, June, December, August and February.”

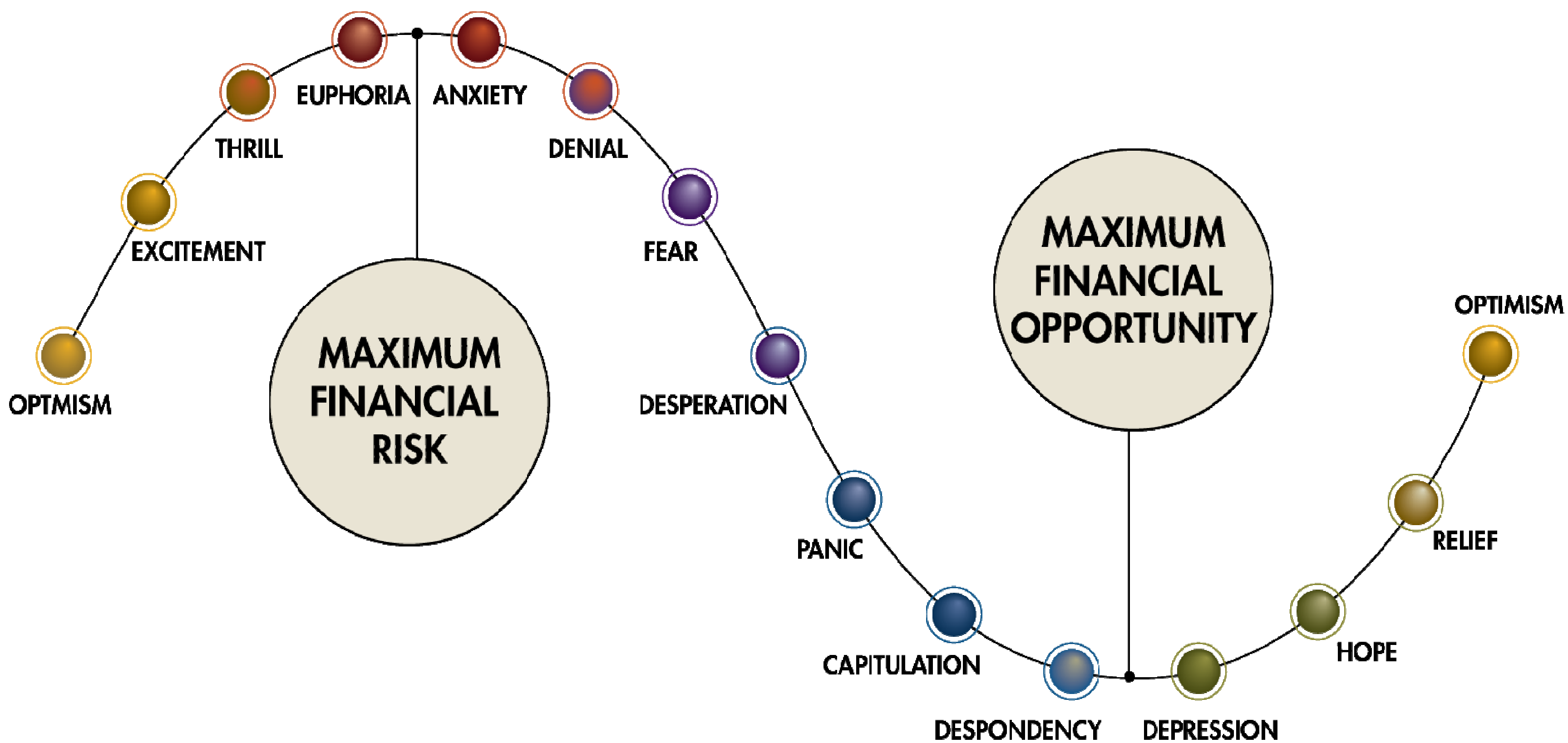


Discipline is Paramount

"The investor's chief problem – and even his worst enemy – is likely to be himself."

Benjamin Graham

The danger of letting emotion drive investment decisions

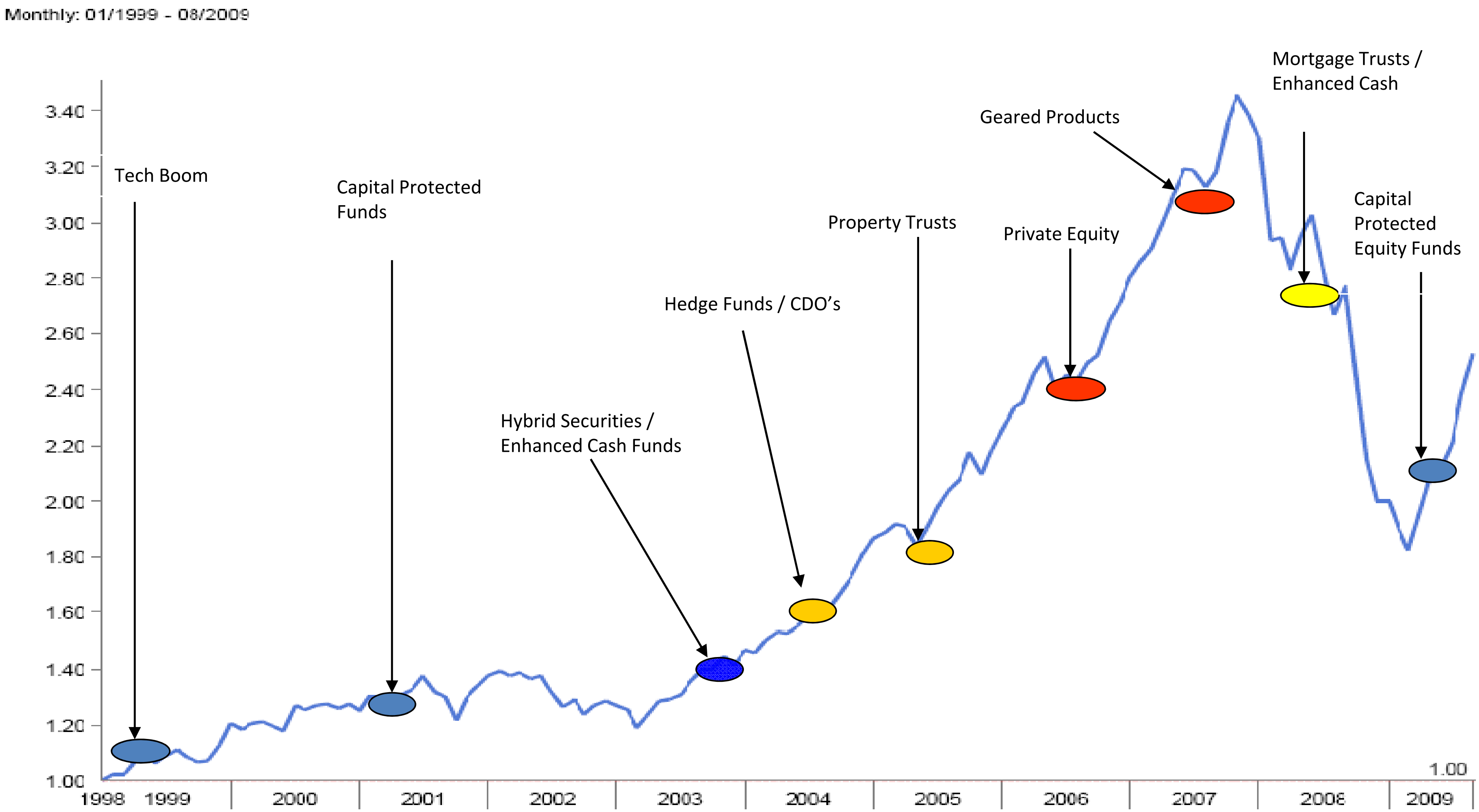


Investors vs Speculators

"The psychology of the speculator mitigates strongly against his success. For by relation of cause and effect he is most optimistic when prices are highest and most despondent when they are at the bottom."

Benjamin Graham

Security Analysis 1934 p12



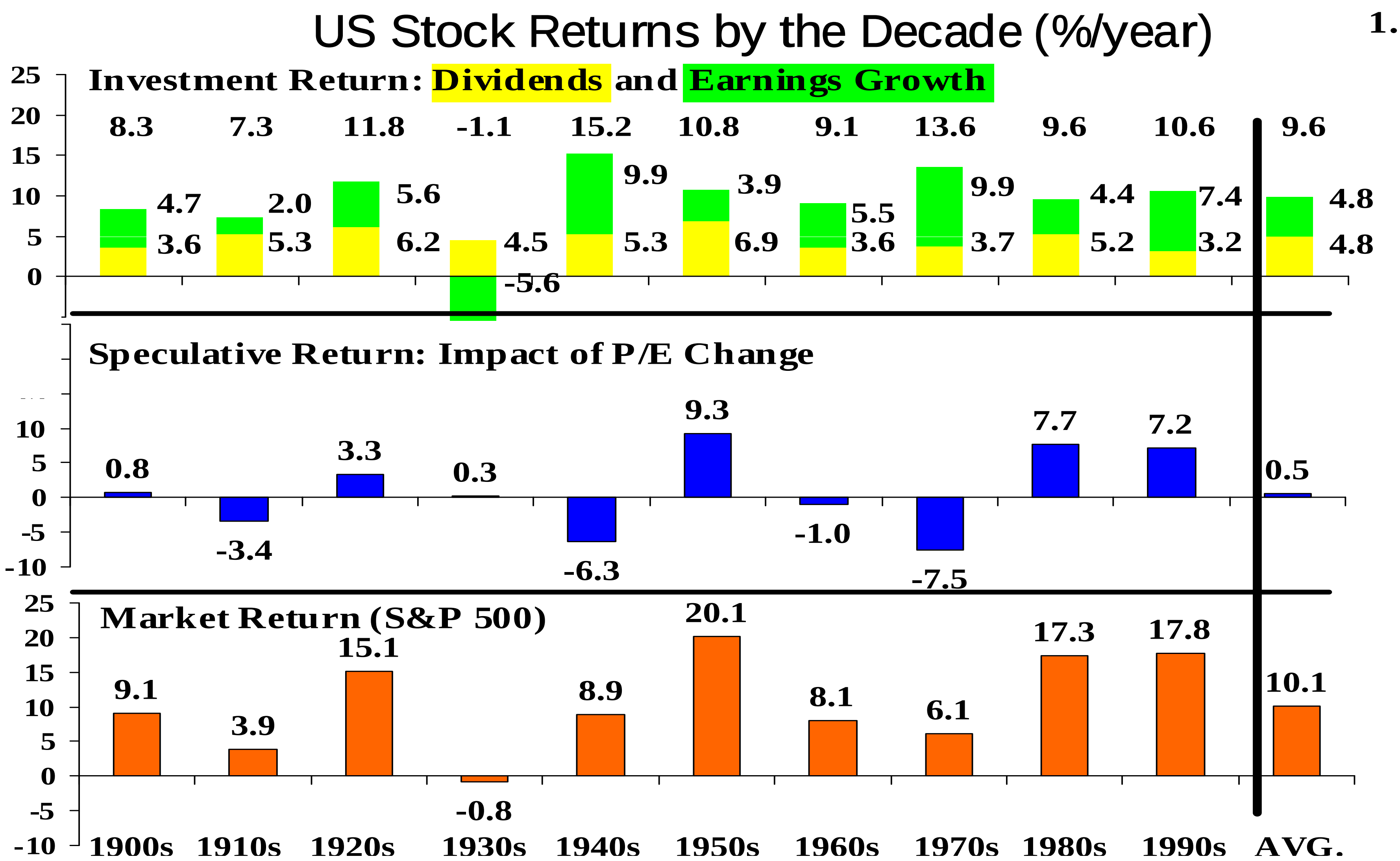
Monthly: 01/1999 - 08/2009
3.40
3.20
3.00
2.80
2.60
2.40
2.20
2.00
1.80
1.60
1.40
1.20
1.00
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
1.00
Tech Boom
Capital Protected Funds
Hybrid Securities / Enhanced Cash Funds
Hedge Funds / CDO's
Property Trusts
Private Equity
Geared Products
Mortgage Trusts / Enhanced Cash
Capital Protected Equity Funds

Understanding the source of returns

You buy three things with every investment

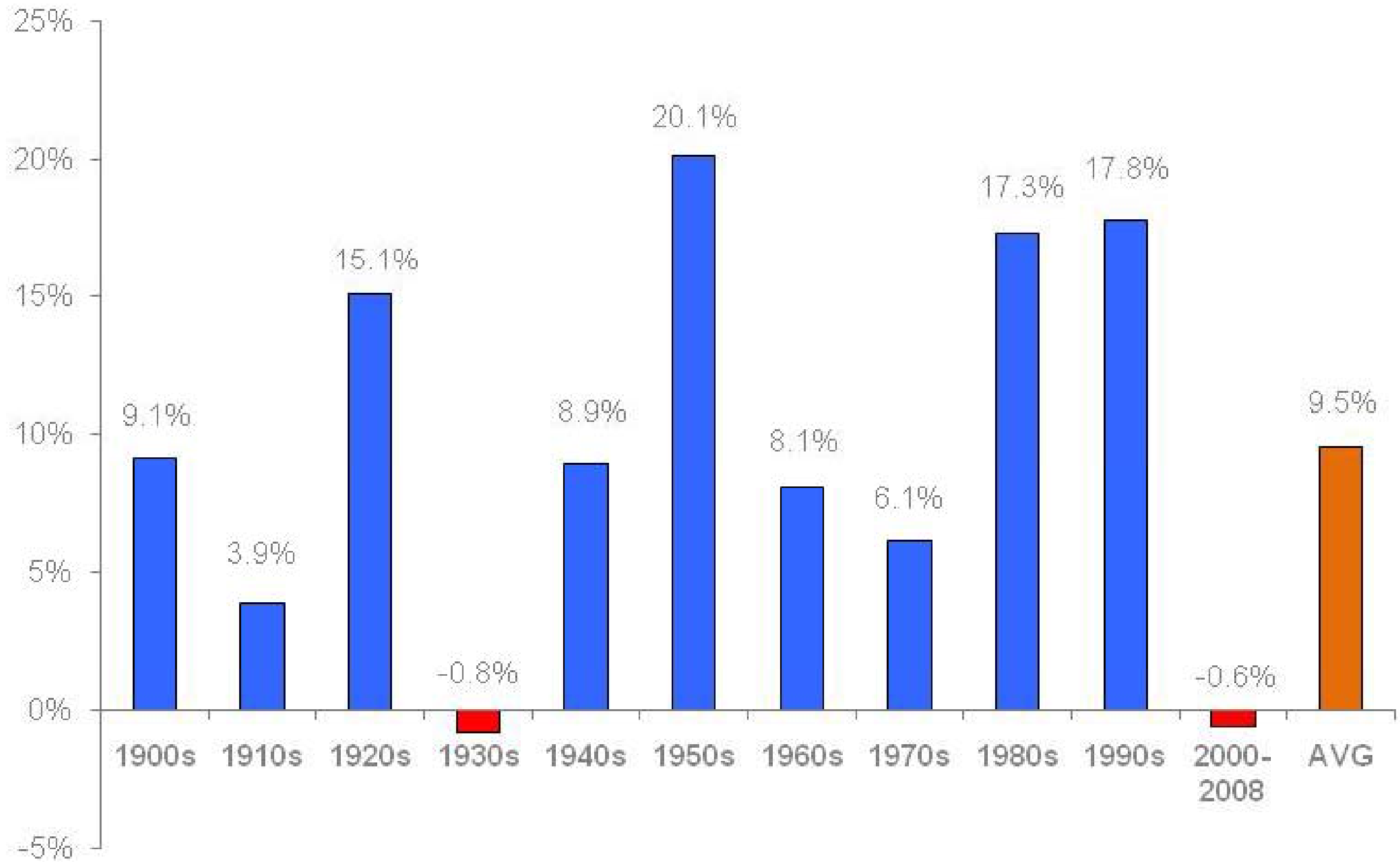
1. An Income Stream
2. Expected Growth of the Income Stream
3. An Optimism/ Pessimism Multiple

US Stock Returns by the Decade

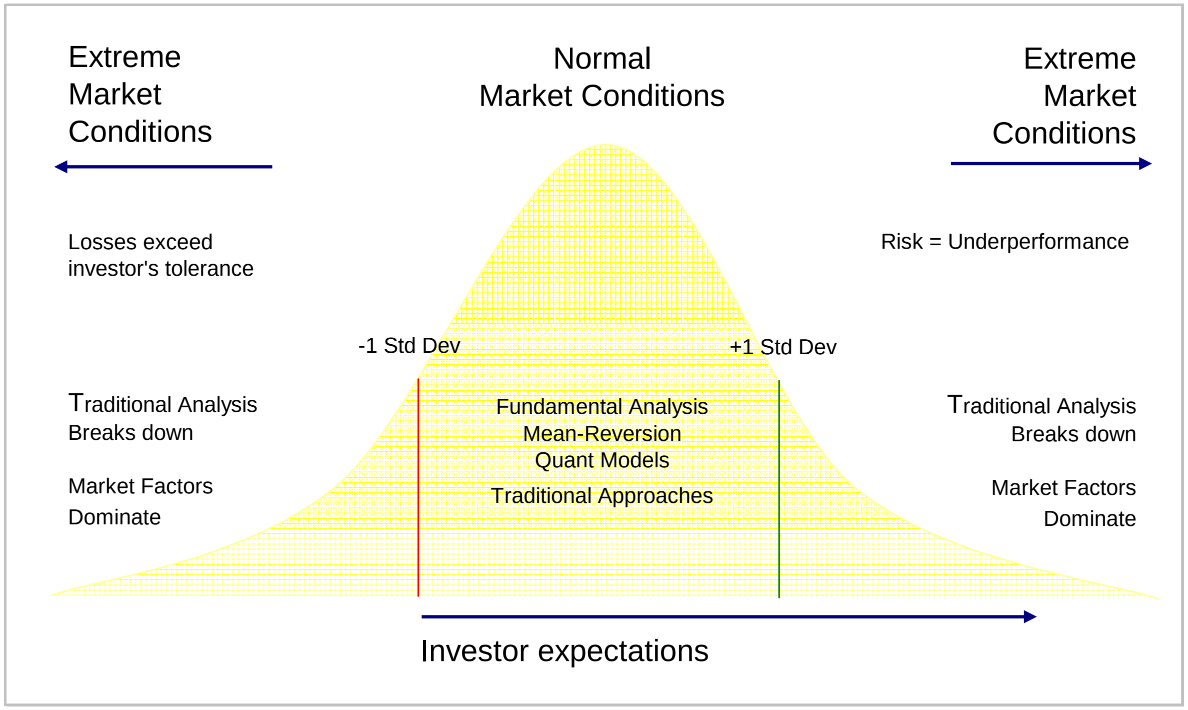


Periodic Returns

S&P 500



Extreme Events

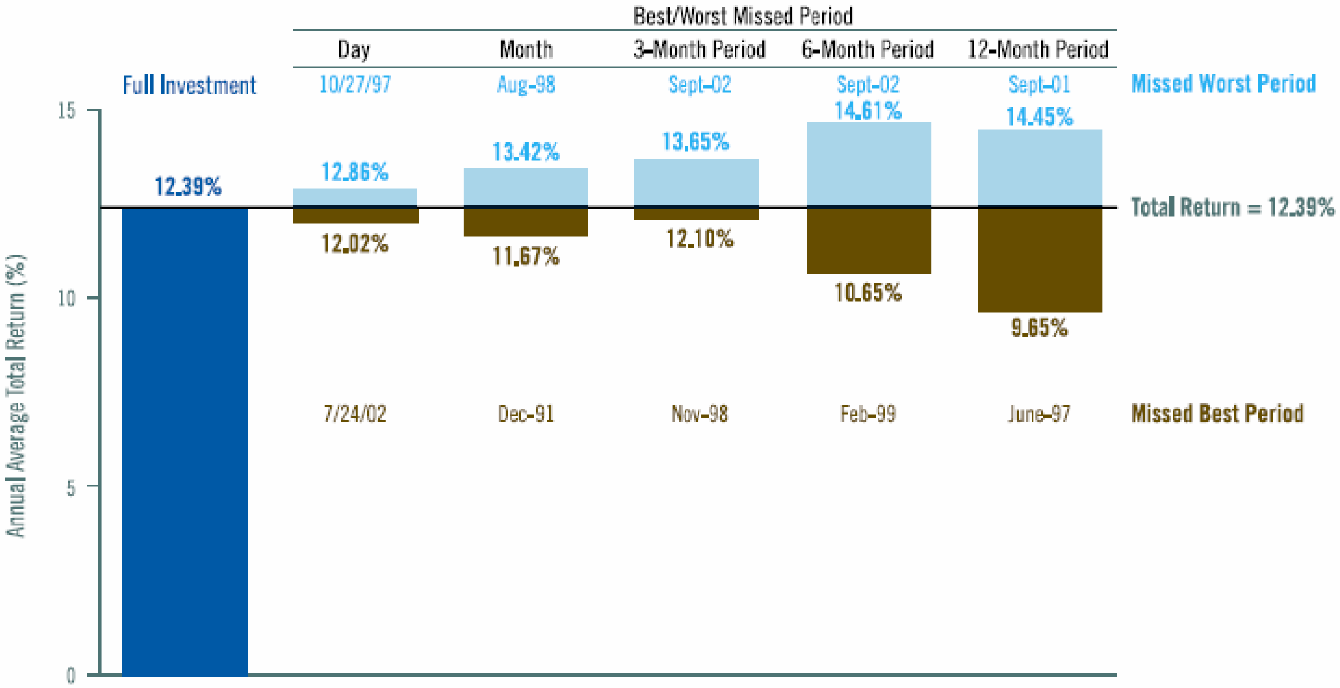


- Investors do not have symmetric expectations of risk and return. Happy to take the extreme upside, but not the extreme downside
- Extreme events distort the very long term picture of what works and what doesn't
- Need to separate out investors' short term needs from the long term possibilities

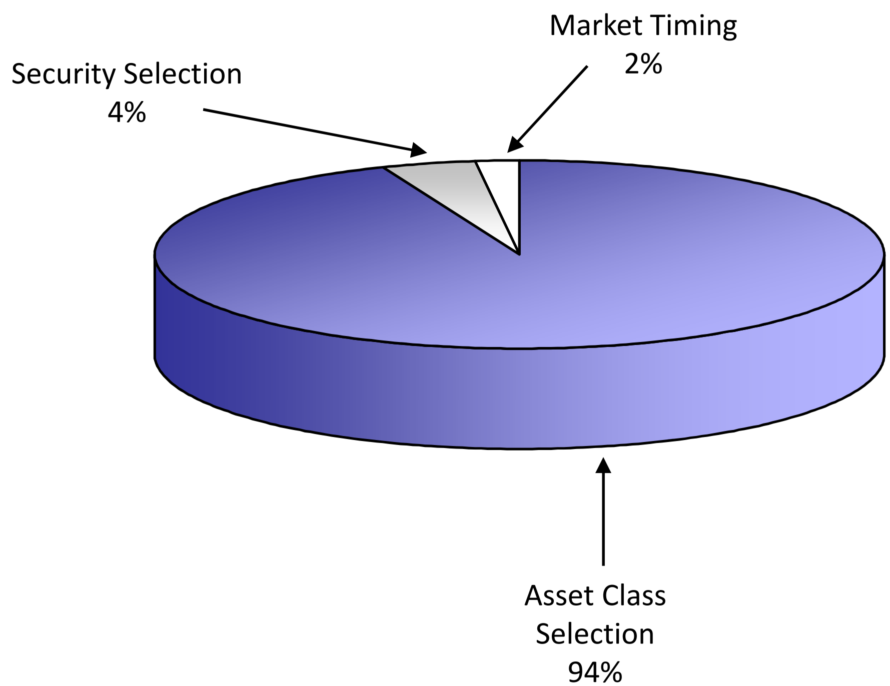
Market Timing Is Risky

S&P 500 Index
January 1988-December 2004

- Periods of strong and poor performance are unpredictable.
- Timing markets exposes you to the risk of missing the best periods.
- **The risk is not worth taking: Capital market rates of return are strong and more consistent over time.**



Asset Allocation explains return



DEFINITIONS

Asset Class Selection

How assets are allocated in a portfolio.

Market Timing

Shifting portfolio assets in and out of the market or between asset classes.

Security Selection

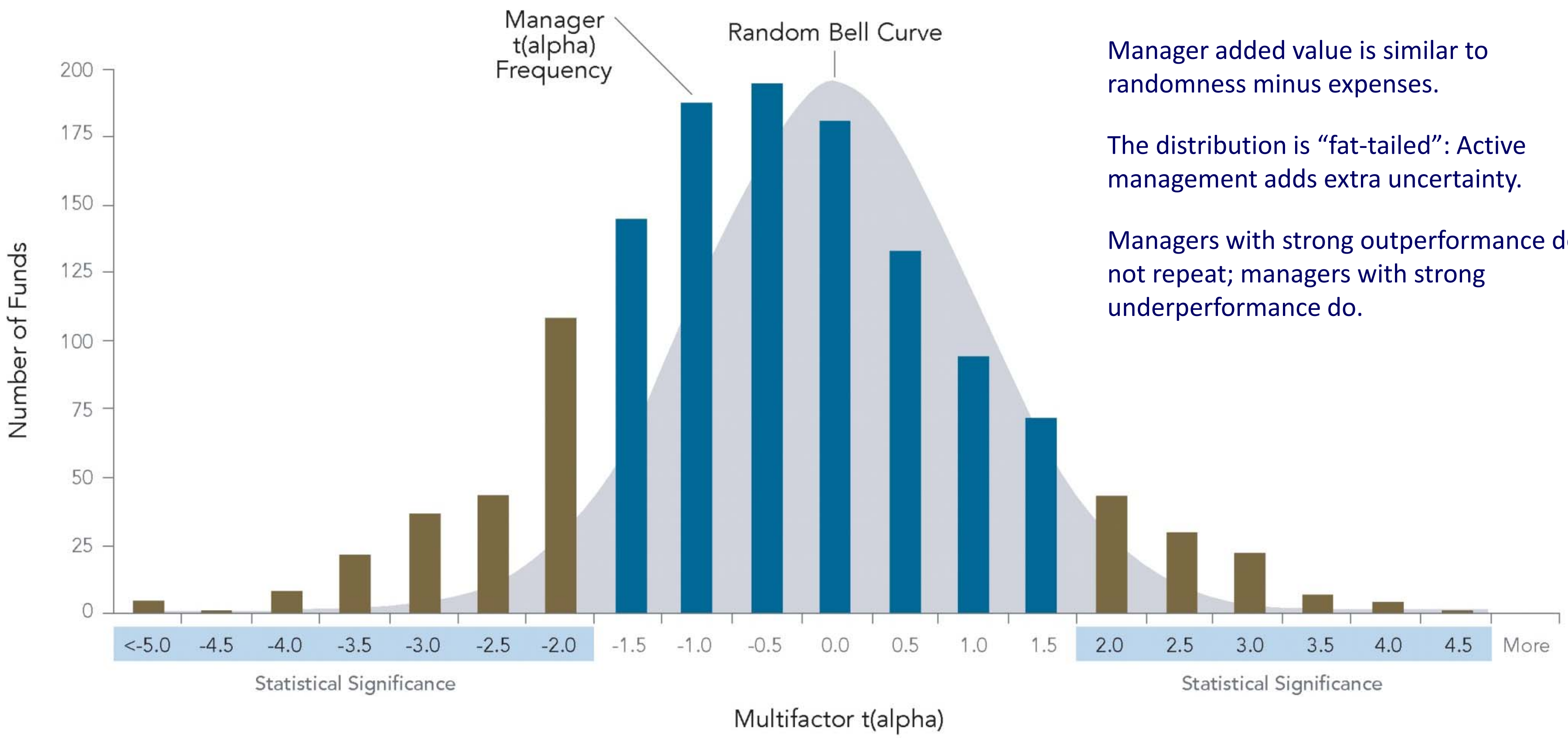
Finding 'underpriced' companies or industries.

- The vast majority of a portfolio's return is determined by asset allocation selection.
- Only a small portion is determined by market timing and security selection.

Source: Study of 91 large pension plans over a 10 year period. Gary P. Brinson, L. Randolph Hood and Gilbert L. Beebower, 'Determinants of Portfolio Performance', Financial Analysts Journal, July-August 1986, pp.39-44; And Gary P.Brinson, Brian D. Singer and Gilbert L. Beebower, 'Revisiting Determinants of Portfolio Performance: An Update', 1990, Working Paper.

Dispersion of returns from selecting fund managers

Distribution of Multifactor t (alpha)
1,302 Managers
1962 - 1995



Manager added value is similar to randomness minus expenses.

The distribution is “fat-tailed”: Active management adds extra uncertainty.

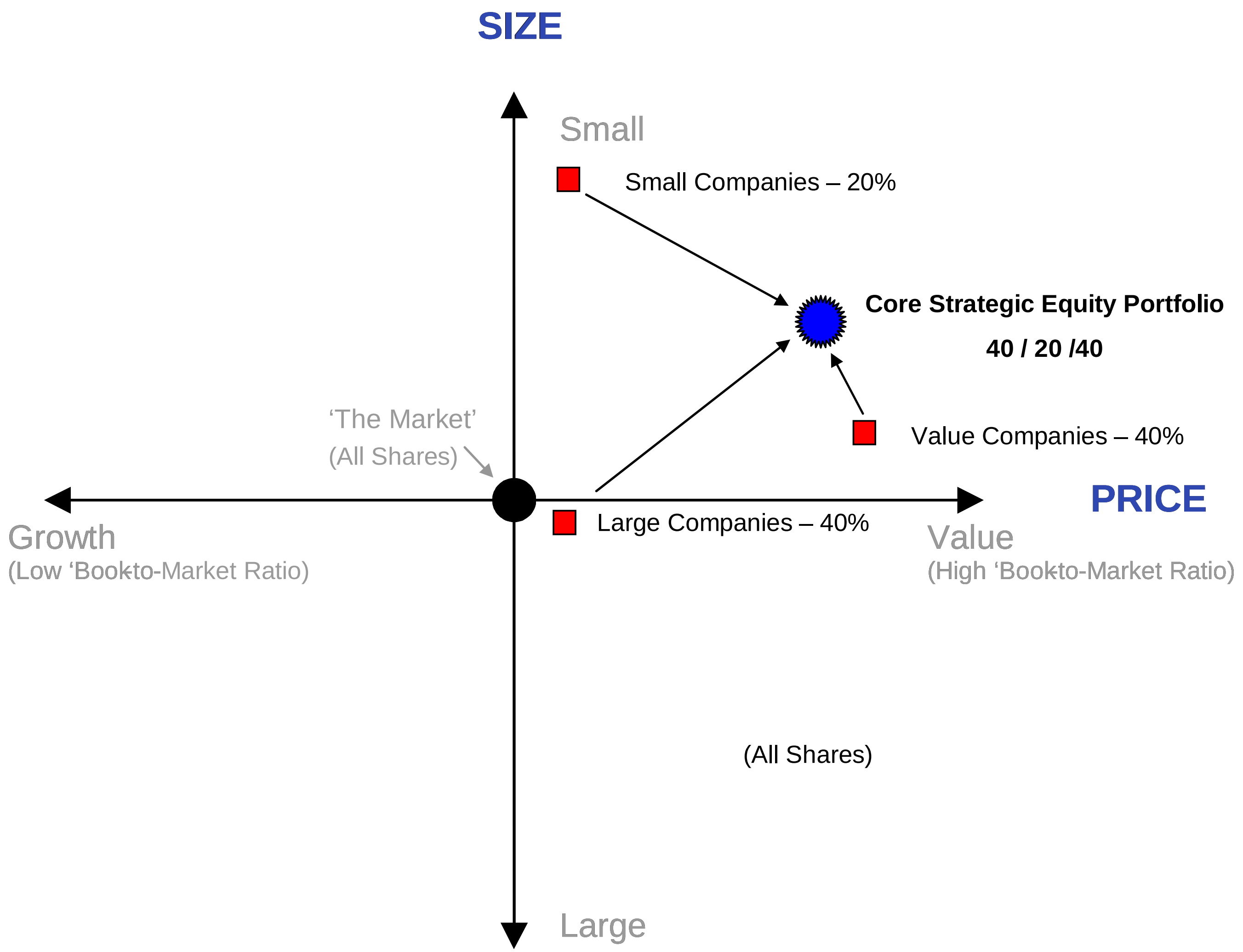
Managers with strong outperformance do not repeat; managers with strong underperformance do.

Source: Dimensional – DFA Australia Limited. Mark Carhart, “On Persistence in Mutual Fund Performance,” Journal of Finance, V. 52 no.1 (March 1997)

- “The idea that any single individual without extra information or extra market power can beat the market is extraordinarily unlikely.
- Yet the market is full of people who think they can do it and full of other people who believe them.
- Why do people believe they can do the impossible?
- And why do other people believe them?”

- *Daniel H Kahneman*
- *2003 Nobel Laureate in Economics*

Assembling a Core Strategic Portfolio of Equities



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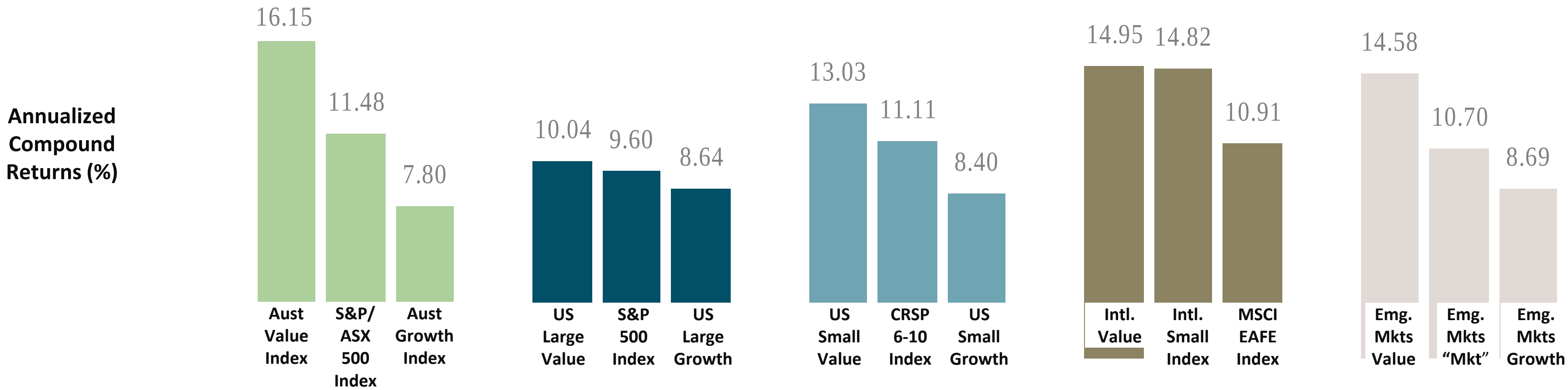
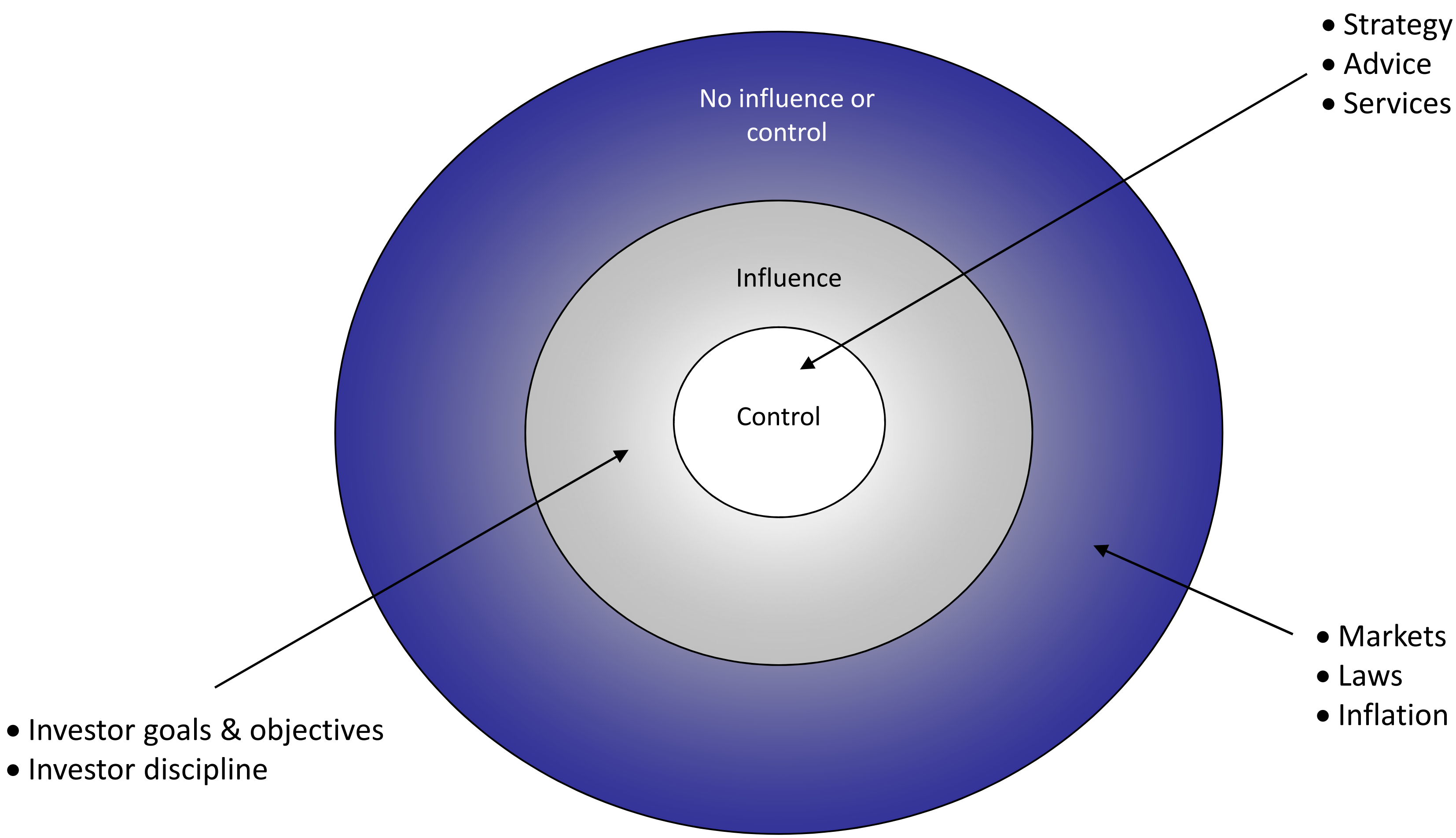
Size and Value Effects Are Strong Around the World



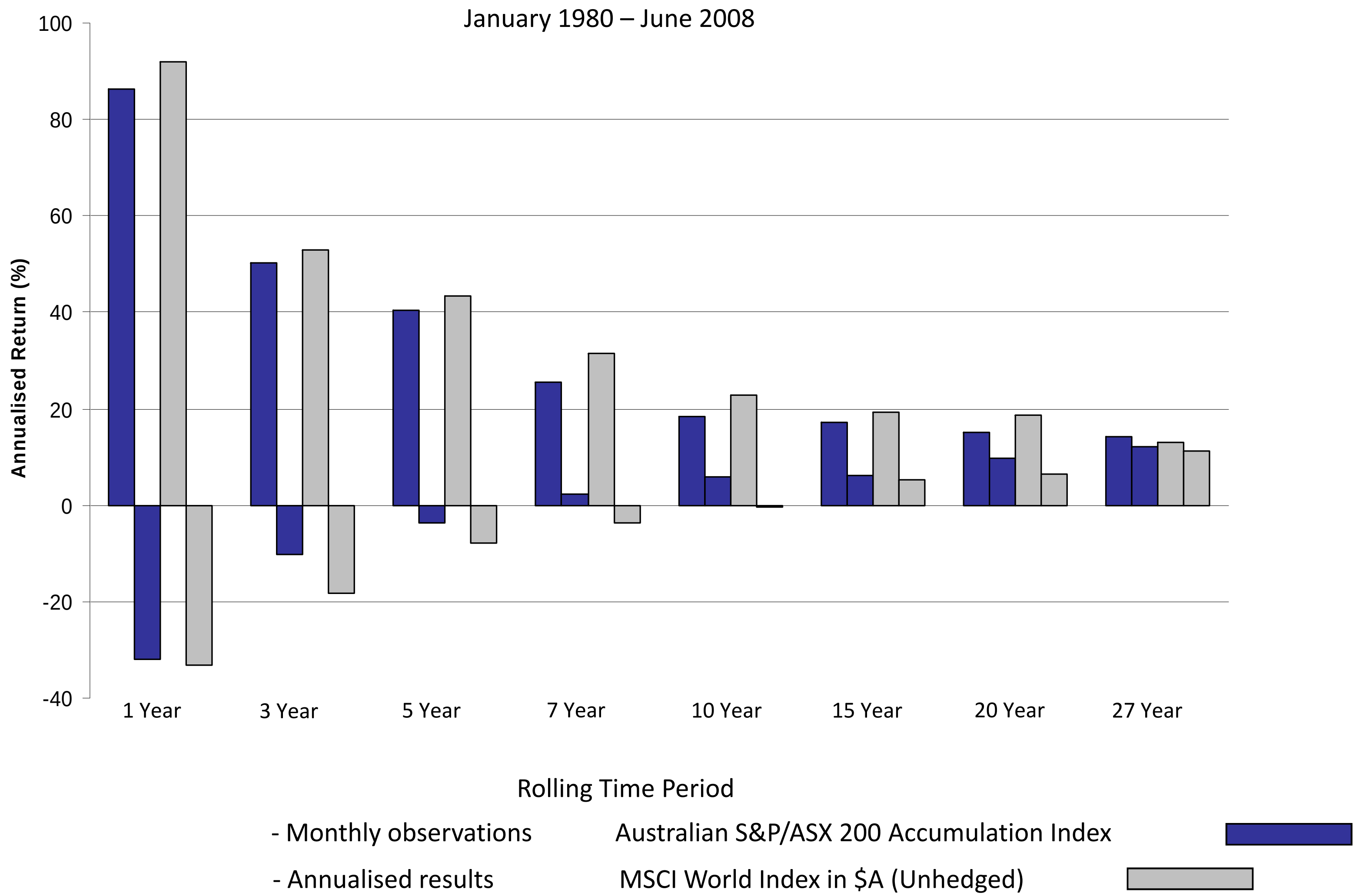
	Australian Stocks 1980-2008			US Large Capitalisation Stocks 1927-2008			US Small Capitalisation Stocks 1927-2008			Non-US Developed Markets Stocks 1975-2008			Emerging Markets Stocks 1989-2008		
Average Annual Return (%)	**19.24**	**13.95**	**10.50**	**13.67**	**11.67**	**10.95**	**18.36**	**15.43**	**13.44**	**17.66**	**18.36**	**13.27**	**20.82**	**16.29**	**14.33**
Annual Standard Deviation (%)	**27.56**	**23.62**	**24.06**	**27.21**	**20.69**	**21.99**	**35.05**	**31.08**	**34.30**	**24.60**	**28.61**	**22.70**	**39.24**	**35.47**	**34.96**

Refer to Appendix for Reference to these charts and statistics.

Know what we can control?



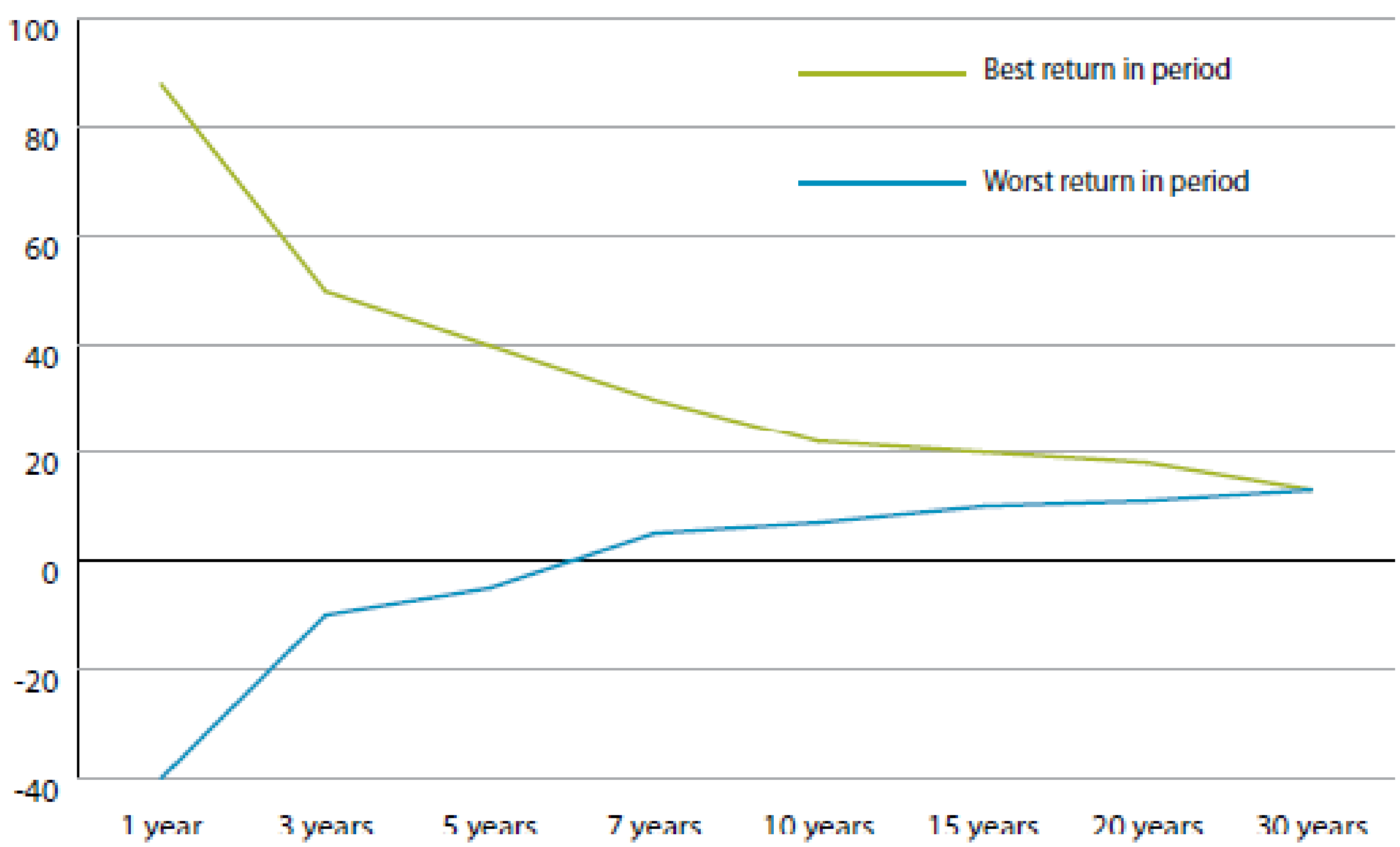
Historical Range of Equity Market Returns



Source: Dimensional

Time Provides Certainty

Graph 4: Historical range of percentage equity market returns, January 1960 – June 2009



- “Share markets are a vehicle for transferring wealth from the impatient to the patient”

- *- Warren Buffett*
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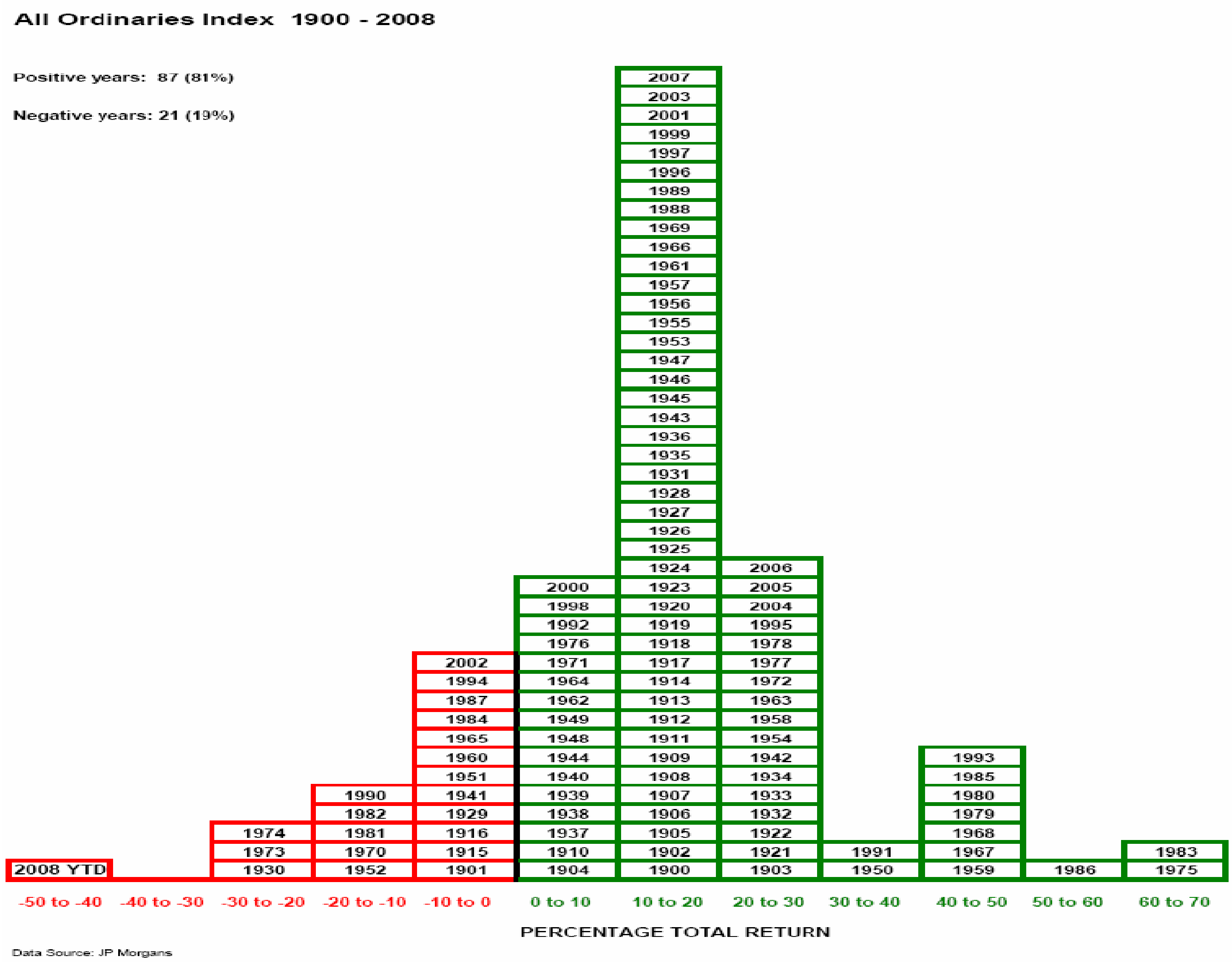
Is it different this time?



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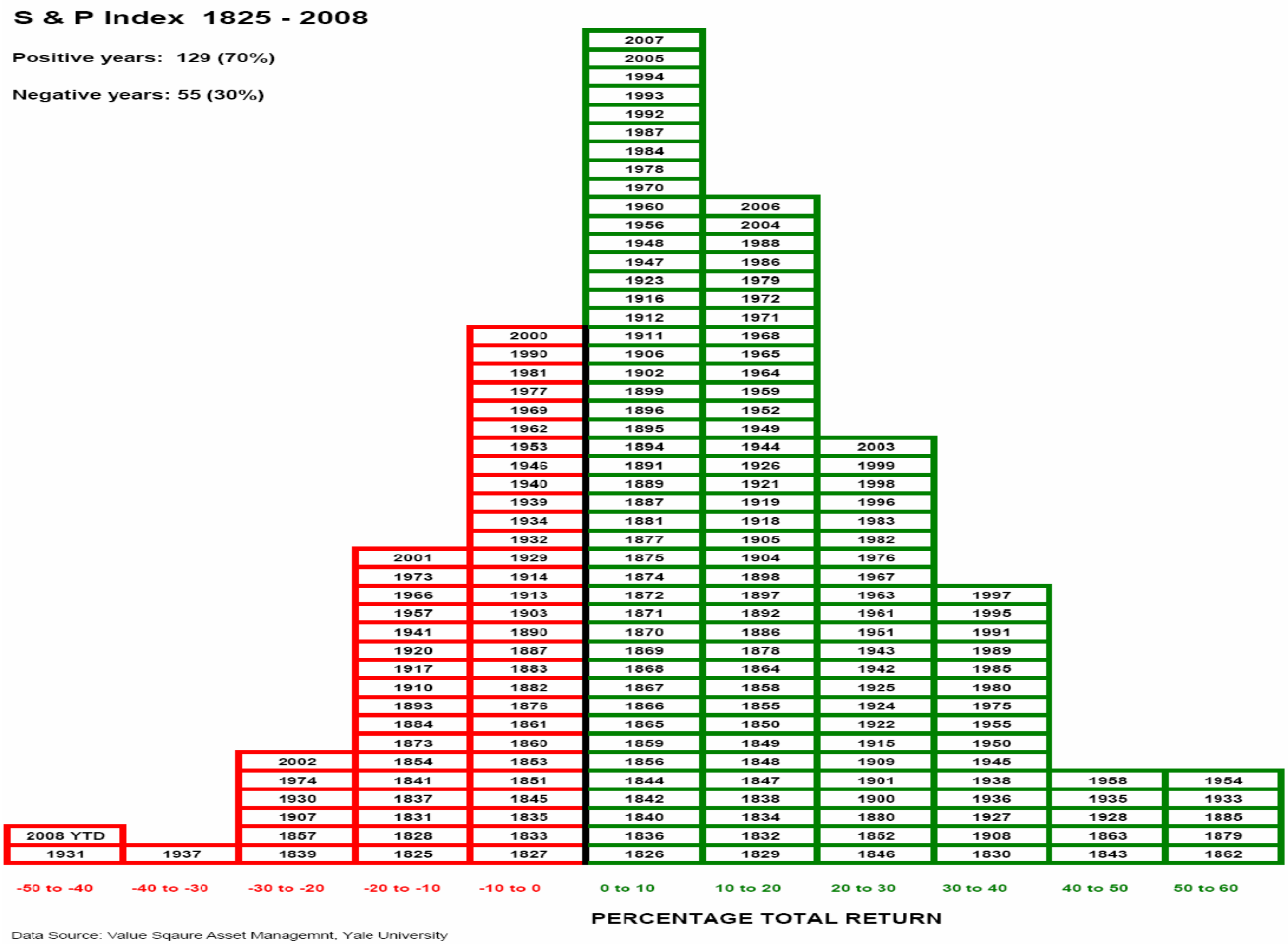
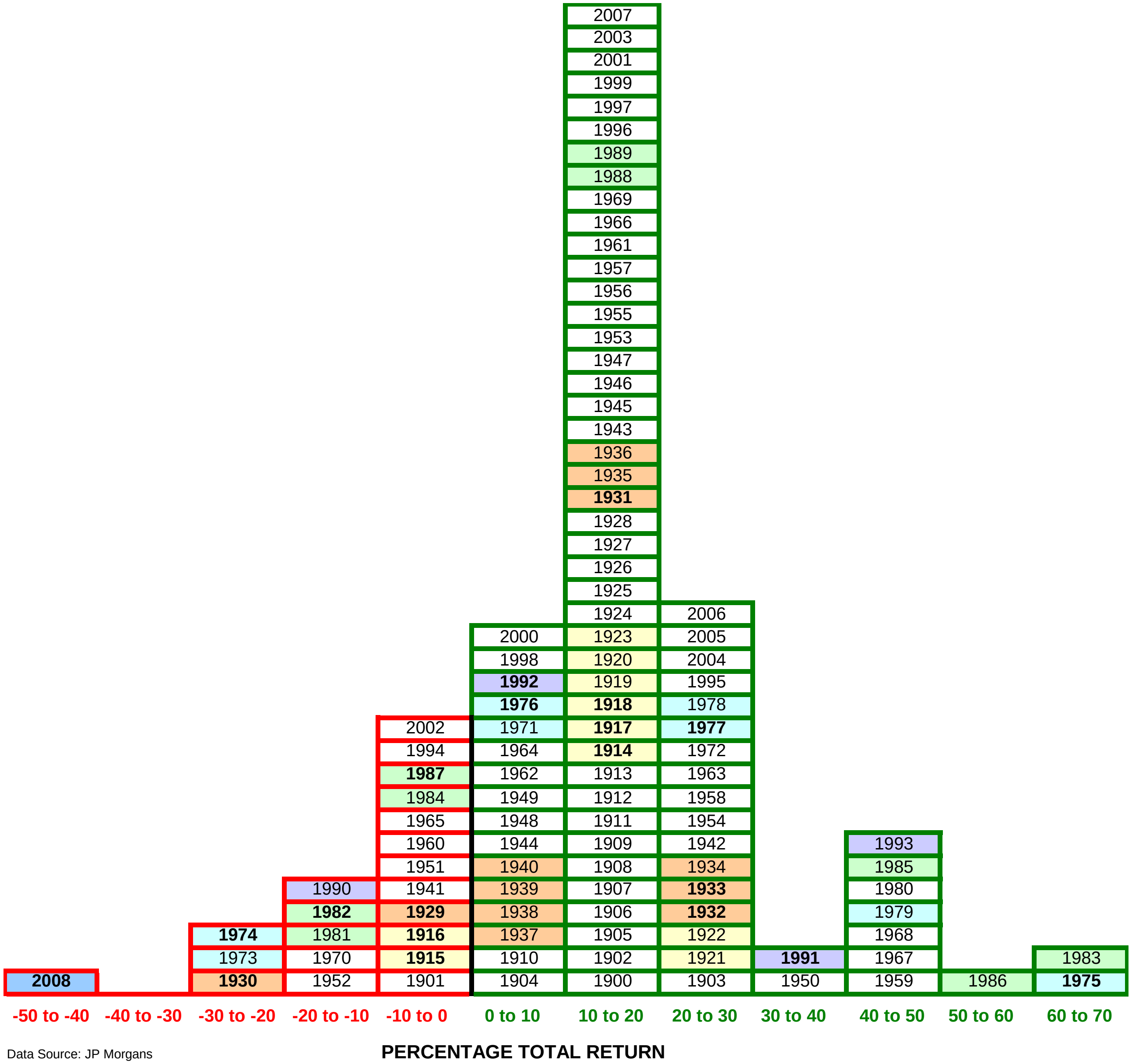
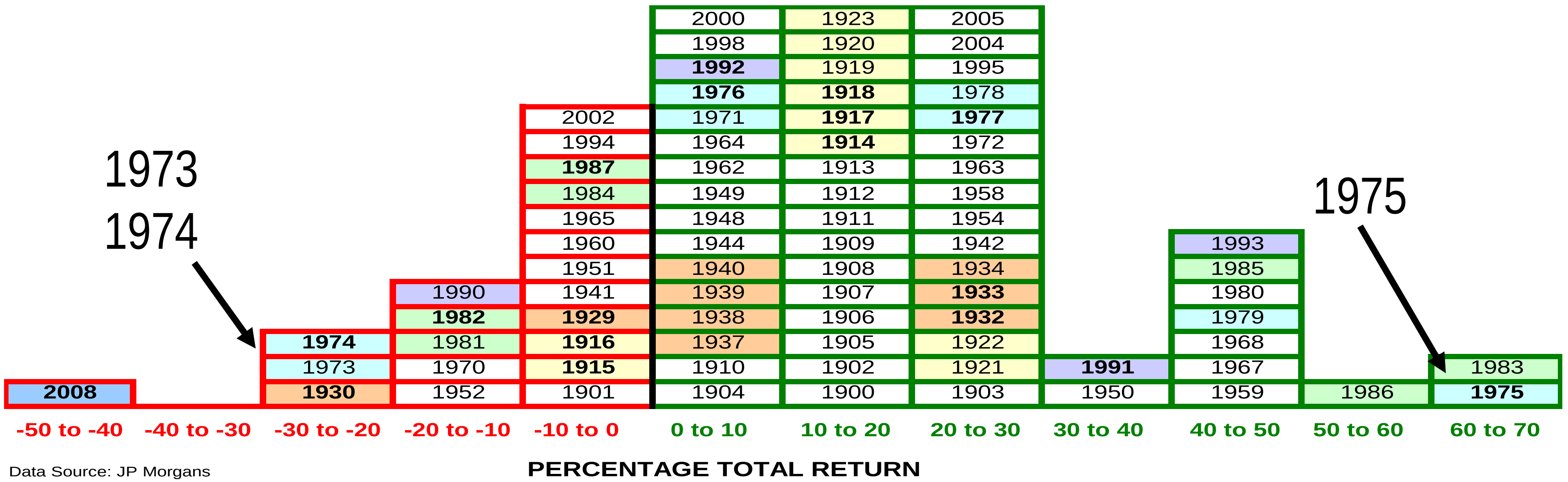


All Ordinaries Index 1900 - 2008

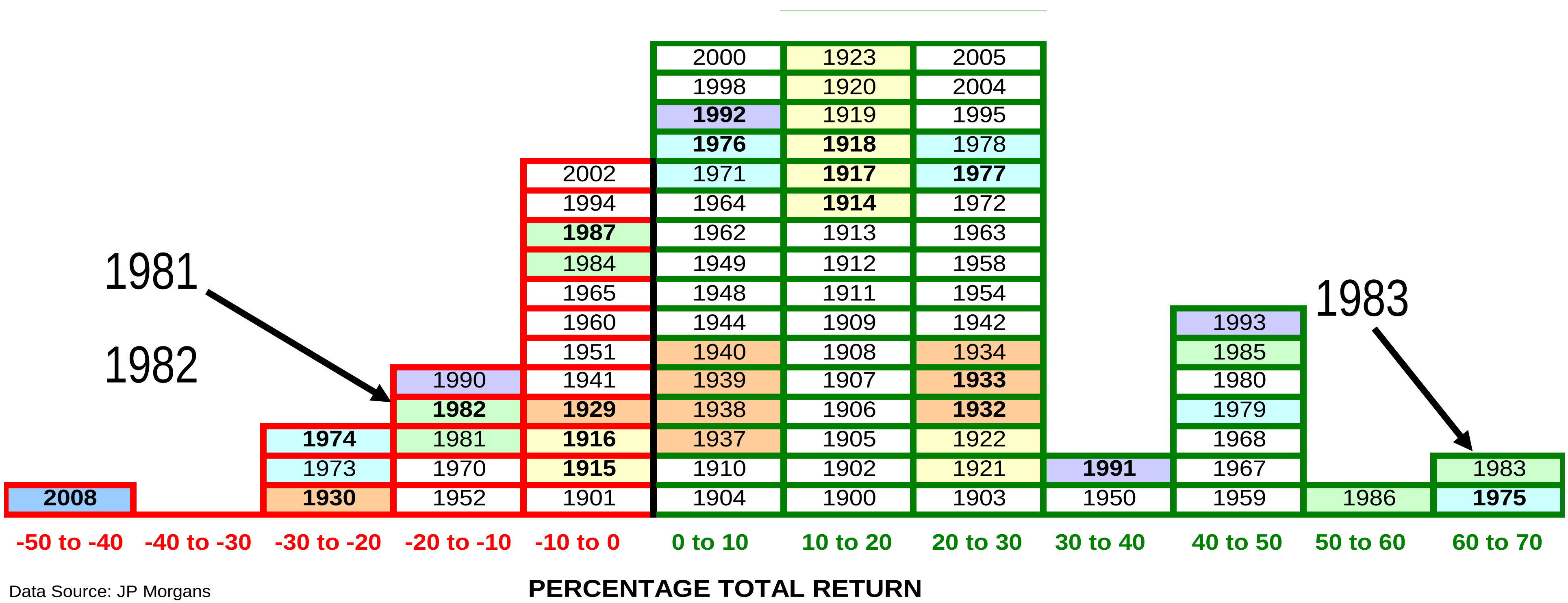


Data Source: JP Morgans

All Ordinaries Index 1900 - 2008

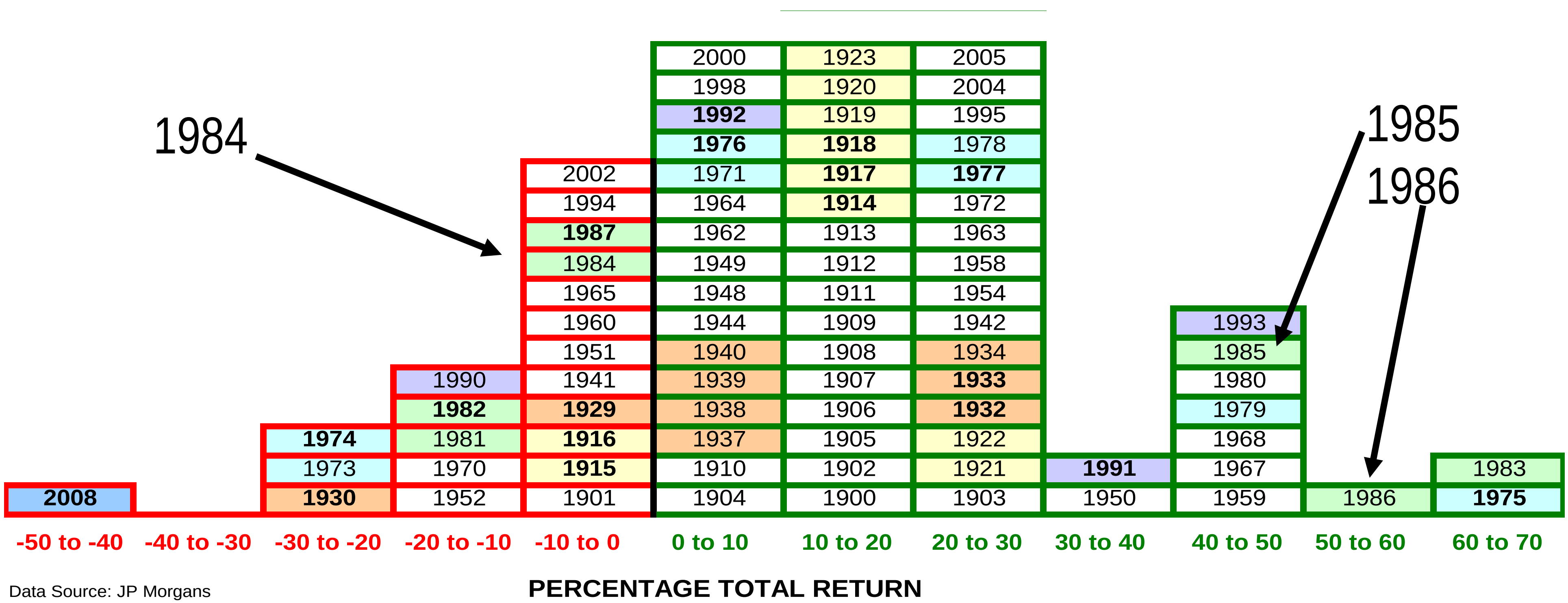


All Ordinaries Index 1900 - 2008

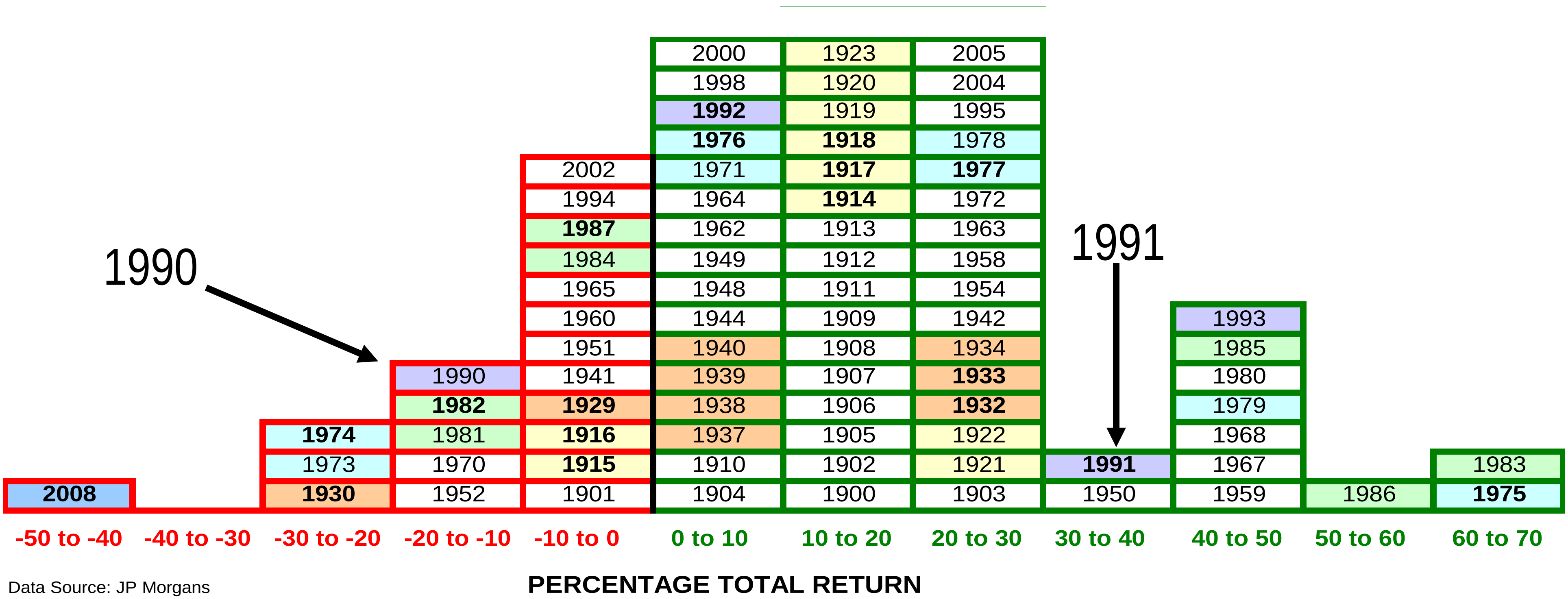


Data Source: JP Morgans

All Ordinaries Index 1900 - 2008

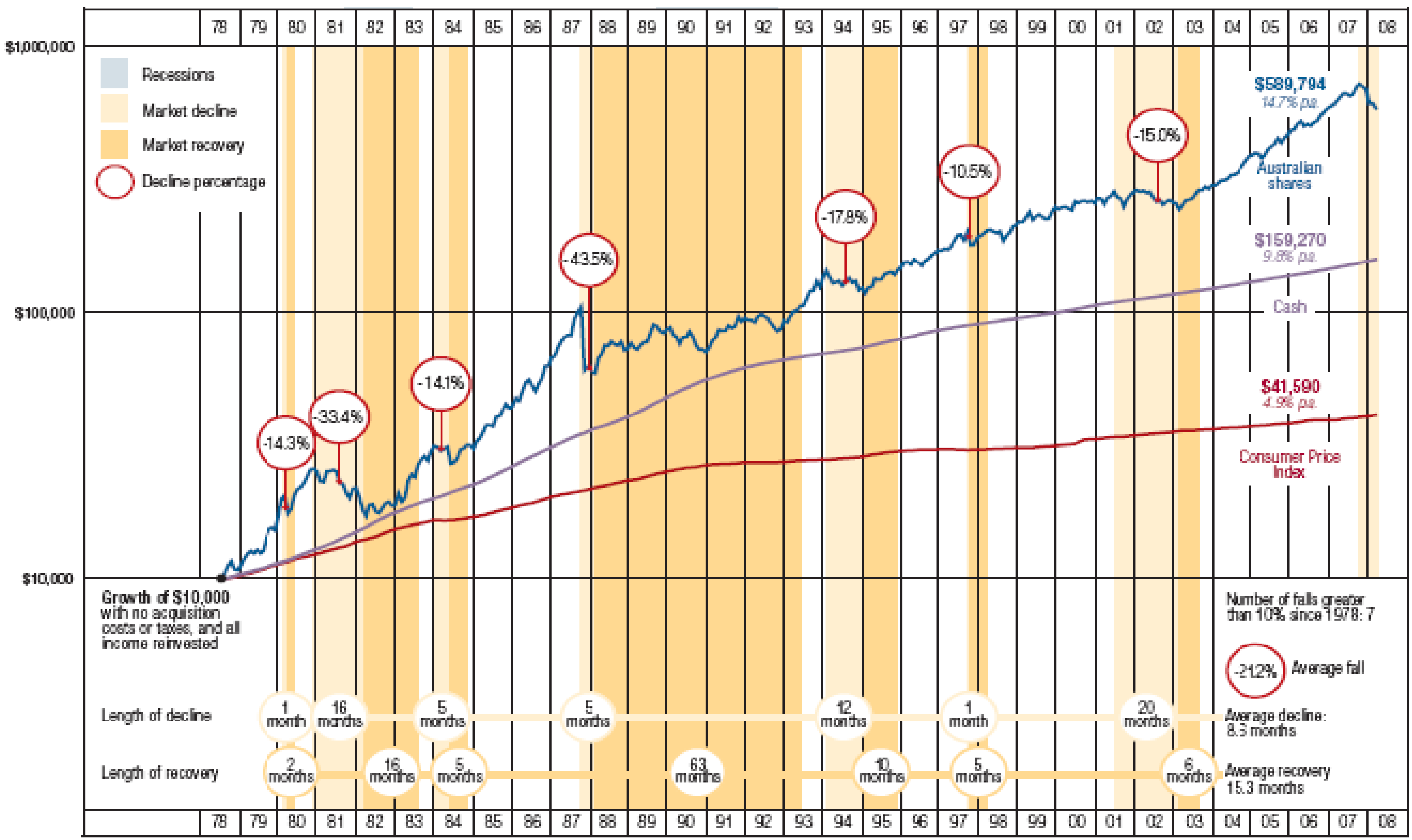


All Ordinaries Index 1900 - 2008



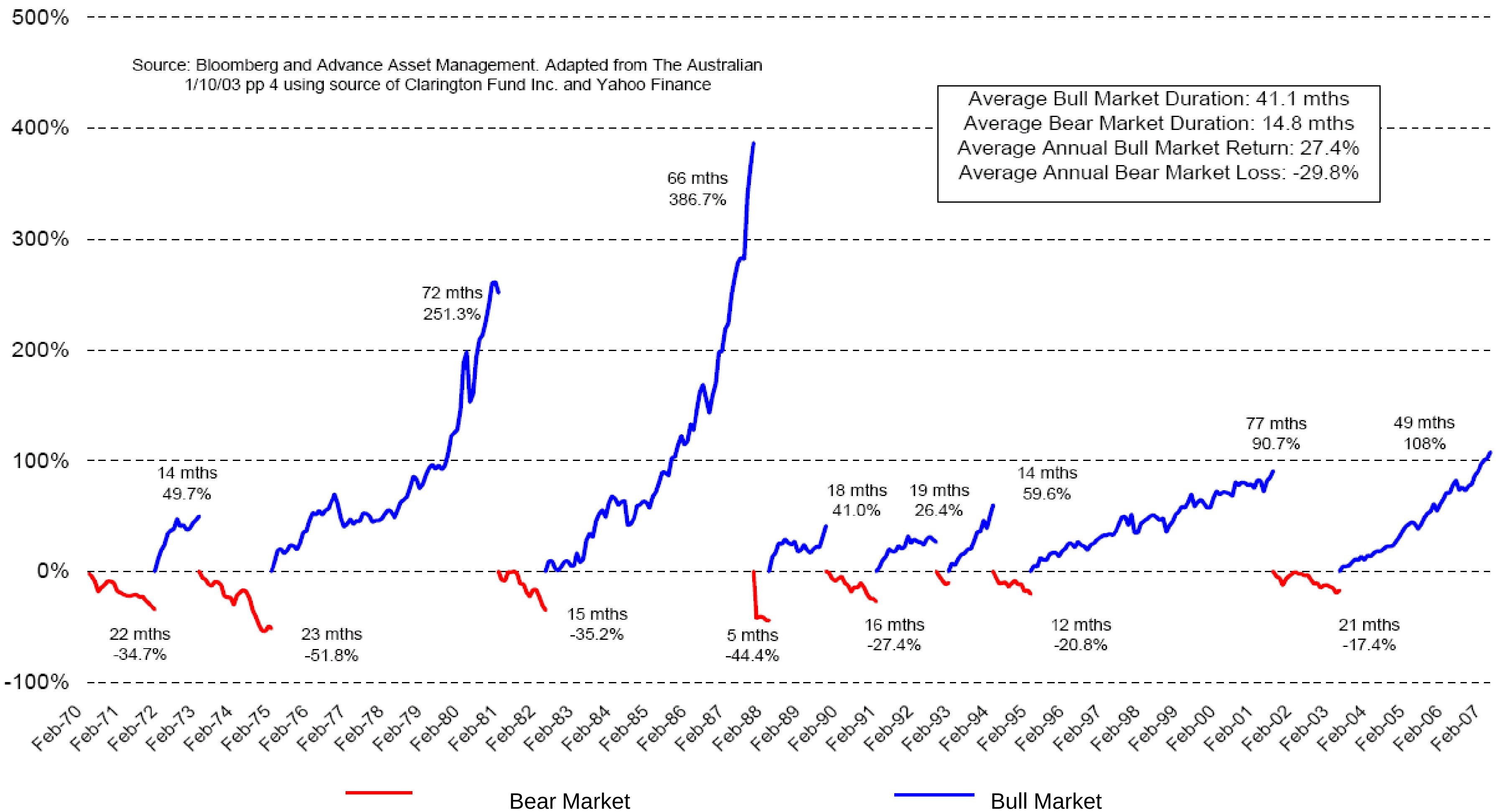
Data Source: JP Morgans

Stick to the strategy



This graph shows downturns greater than 10% and the time it has taken the market to recover

Australian All Ordinaries Bull & Bear Markets



Source: St.George Investment Solutions & Bloomberg

Principles & Beliefs

- **Markets Work**
- Prices for financial assets find equilibrium quickly and it is difficult to consistently predict and profit from any perceived inefficiencies in these prices.
- The capital market rate of return is available to every investor at a reasonable price and the rate of return generated over the long term has proved to be attractive.

Principles & Beliefs

- **Risk and Return are Related**

- The higher the risk, the higher the potential return. It is possible to outperform markets, but only by accepting increased risk.
- However, not all risks are worth taking. Certain risk factors can be controlled to minimise risk and aid long-term return. Remaining invested is a key risk management tool.

Principles & Beliefs

- **Diversification is Essential**
- Concentrated, non-systematic risk is unrewarded in investment portfolios over time. Diversification is the antidote to many avoidable risks.
- Therefore, investment portfolios should be comprehensively diversified across and within asset classes and sub-asset classes.

Principles & Beliefs

- **Portfolio Structure (Asset Allocation) Explains Performance**

- The dominant contributor to portfolio performance is the relative exposure of capital to the various asset classes and sub-asset classes.

- Use of strategic asset allocation, together with careful rebalancing, is likely to be more rewarding than speculative strategies such as market timing or tactical asset allocation.

Principles & Beliefs

- **Costs and Taxes Matter**

- Investment portfolios should be constructed and maintained with costs and taxes in mind.

- Costs and taxes may be implicit or explicit in an investment portfolio.

Principles & Beliefs

- Capital Markets Work and Are Efficient
  - for investment purposes, assets are fairly priced
- Risk & Return Are Related
  - priced risk factors determine expected return
- Diversification Is Essential
  - Diversification is the antidote to uncertainty. Concentrated investments add risk with no additional expected return
- Structure Explains Performance
  - Asset Allocation principally determines results in a broadly diversified portfolio

What have we learnt so far?

The bad news:

- If there are investment Superheros out there, we can't find them with any degree of consistency or certainty
- Successful stock picking is extremely difficult and increases risk
- We can't predict the future – it is a series of unforeseen events

The good news:

- You don't need to know the future to be a successful investor
- The market return in each Asset Class is there for the taking
- Asset Allocation determines results

The Question:

How can we best access the market returns that **YOU ARE ENTITLED TO?**

Shadforth Financial Services

In Summary

"To invest successfully over a lifetime does not require a stratospheric IQ, unusual business insight, or inside information.

What's needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework."

Preface by Warren Buffett in the
"Intelligent Investor", by Benjamin Graham