



Prosperitas

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Prosperitas: Latin for prosperity & good fortune

Sentimental Value

What to make of the current state of affairs. Trade wars, Brexit, Turkey, Argentina, yield curve inversion, housing prices, and inequality have all been in the news in the last 12 months, some more than others. One could be forgiven for thinking that the equity markets are a challenging place to be, yet the domestic and international equity markets returned 11.85% and 14.94% p.a. respectively over the last 3 years.

So how can there be such a discrepancy between sentiment and markets? Part of the reason, relates to the 24 hour news cycle but a far bigger reason relates to the way investors overstate current risks and promptly forget those of the past. It was around a year ago that the Dow Jones dropped approximately 17% in a matter of weeks. Fears about the Federal Reserve's proposed interest rate rises were poorly received by the market (anyone remember the Taper Tantrum of 2013?) and it took the Federal Reserve's assurance that they would delay interest rate rises for the market to recover its position early this year.

We remain optimistic that the market can deliver good risk adjusted returns over the coming years as the cash rates remain low. The price you pay for the businesses you buy remains ever important as share markets will always reflect earnings in the long term. With this in mind, we've dedicated the middle page to a real business case study discussing share price earnings and underlying value for investors.

We introduce our newest member of staff, Claudia Sheers who joined us in May this year. We have also introduced 'The Stylus Council' to the mix with a review of the greatest double albums of all time. As always, these lists are highly subjective but it seems incomprehensible to me that Lou Reed and Metallica's collaboration from 2011, *Lulu*, missed out.

We hope you enjoy the latest edition of *Prosperitas* and look forward to seeing you next time you come into the office.

Martin R McIntosh
Managing Director

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Thinking like a Private Owner

By Andrew Clifford
25 June 2019

During Platinum’s 2019 Roadshow, CIO Andrew Clifford used a real life example to demonstrate how an investor might try to obscure the noise of the stock market, by thinking like a private owner when making decisions.

A framework is required to assess potential returns from an equity investment. The proposition is that “thinking like a private owner” is a sensible approach, and protects investors from the affliction of “loss aversion”. To illustrate this we use a real example, a company Platinum owns in several portfolios. Profits have been indexed to simplify this paper, but reflect that company’s reality.

Date	1.1.2010
Price	1,236
Earnings	100
Earnings Yield	8.1%

2009 earnings indexed to \$100. Source: Data from FactSet, Platinum Investment Management Limited.

The company earned \$100 in 2009 and its shares cost \$1,236 on 1.1.2010*, for a P/E ratio of 12.4x, or inversely, and preferably, an earnings yield of 8.1%. The share earned 8.1c in 2009, for every \$1 invested. If this continued forever, 8.1% would be the rate of return.

Prior to this time, sales had grown steadily, even during the GFC but as a cyclical business, profits had been volatile, so the earnings yield may not be reliably maintained, though the track record was of earnings growth. The company illustrated is large and a global leader in its key business segments. It has strong technological leads over its competition. Our analysis led us to believe that the company had good prospects of increasing its earnings over time.

At the start of 2010, US 10-Year Treasury Notes yielded a “guaranteed” 3.8% p.a. The shares provided an uncertain, but probably growing, return starting at 8.1% p.a, looked solid.

Looking out over what happened in the next six years is informative.

Date	1.1.2010	2010	2011	2012	2013	2014	2015
Price	1,236						1,921
Earnings	100	165	140	242	312	241	195
Earnings Yield	8.1%						16% pa
Avg.Earnings Yield (2010-...)							17% pa
Total Return							9% pa

2009 earnings indexed to \$100. Source: Data from FactSet, Platinum Investment Management Limited.

Based on the initial cost (\$1,236 per share on 1.1.2010*) the company generated an earnings yield 13% in 2010, and averaged 17% per year out to 2015. This looks far superior to the guaranteed 3.8% from US government bonds, or the S&P 500, which averaged 9% over the same timeframe.

The sole owner of a private company would have evaluated returns this way. Ironically, though most stock market investors just focus on the share price. On that basis, with the price at \$1,921 after six years, this represented a total return, including dividends of 9% pa.

For the same period, the S&P500 Index returned 13% pa including dividends. Most investors would prefer this to the company, even though a private owner would have chosen the company's earnings outcome. When focussing on the share price, it changes investors' thinking.

This is a mirage. The share price is an abstraction, not the business itself. Investors should be more concerned

with underlying returns of the business than fluctuations in the share price.

The S&P 500 Index far outperformed the underlying earnings of its constituent companies. This simple re-rating is good fortune for their shareholders. An investor in our company would have hoped for the same, but despite the underlying value of the business increasing significantly, it did not happen.

This is one of the hardest parts of investing. By 2015, many shareholders of the company would have felt despondent, and it would have been tempting to sell, and invest elsewhere.

However, in 2016 and 2017 the profits really took off, reaching record levels. And finally, the stock price followed.

By the end of 2017 the shares had returned 16% pa including dividends, beating the S&P500' (now 14%pa) and trouncing the bond's 3.8%.

Date	1.1.2010	2010	2011	2012	2013	2014	2015	2016	2017
Price	1,236								1,921
Earnings	100	165	140	242	312	241			195
Earnings Yield	8.1%	13%	11%	20%	25%	20%	16%	19%	35%
Avg.Earnings Yield (2010-...)									20% pa
Total Return									16% pa

Indexed to 2009 profits = \$100. Source: Data from FactSet, Platinum Investment Management Limited.

Moreover, on 2017 earnings, the company still had a starting earnings yield of 12%. Compare this with S&P 500 Index below 5% and 10-Year US Treasury Notes at 2.4%.

This company is **Samsung Electronics**.

True Value Investing

The core of true value investing is to look at implied returns from securities as this Samsung example illustrates.

An investor should seek to build a portfolio of equity and debt securities with good implied returns and achieve appropriate diversification across geography and sector. This should achieve a good result over time if we have the requisite level of skill.

The challenge is the assessment of any company's earnings potential. This requires a true understanding of what the future holds for a company, not just observing a set of numbers.

At no times, do we use an index as a reference point. For adequacy of returns, we can look at the risk-free rates of return on government bonds or bank deposits, and, the implied rates of return from all the individual companies that we choose to examine. To assess the index, requires an assessment of all companies, which is a huge task. We can assess a company against a broad range of alternatives, rather than every single alternative.

At no time, does one need to predict the company's future share price. The efficiency of markets should eventually bring the company's share price to reflect its intrinsic value.

*Source: Factset

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Interview with: Claudia Sheers

The newest addition to the Planning Partners' team, Claudia joined us in May this year after a stint at Generation Life where she worked in the Investment Bond division.

With a football background and growing up in Park Orchards, we expected that another Hawthorn supporter was joining our ranks given it's only around 440 drop punts away; however, it was not to be and somehow we have drafted another Magpie to add to the mix.



Claudia's résumé was quite an impressive document and we are still trying to work out how much is fiction as it seemed like there was some poetic licence taken in the preparation of the document. It included: waiter at a hatted restaurant, student at the Royal Academy of Dance, multi-instrumentalist, fluent French speaker, and trainer at Upper Ferntree Gully FC.

In discussing Claudia's football ability it became apparent that she wasn't backward in coming forward when she described herself as 'a bit of a gun'.



Claudia Sheers

We managed to drill a little deeper into what this actually meant and it turns out that she considers herself a 'utility' i.e. effective in all areas. And, this is certainly how she operates at Planning Partners with a hand in implementation, review preparation, and client meetings.

Claudia has just successfully completed her Commerce Degree and Majored in Financial Planning. When she isn't working diligently for Planning Partners' clients she enjoys skiing, camping or working through her favourite songs on the piano and saxophone.

The Stylus Council - Greatest Double Albums of All Time

The Clash: London Calling

It was 40 years ago today that phony Beatlemania bit the dust. If ever an album cover was an autoglyph, London Calling was it. An angry Paul Simonon smashing his guitar in a rock pastiche pose accompanied by title lettering stolen - how punk! - from Elvis' self-titled debut, this album showcased every musical style from 1956 to its release in 1979: punk, rockabilly, jazz, reggae, ska, and straight-up rock 'n' roll. It's flawless.

The Rolling Stones: Exile On Main St

This album had more substance than was taken by Keith Richards at Villa Nellcote, and was looser than a gin-soaked bar room queen in Memphis. Their best album, if not the best mixed, it was not written for chart-topping singles but for repeated lounge room rotation.

The Beatles: 'The White Album'

As observed in Spinal Tap "there was nothing on that goddamn cover". But there was plenty on the vinyl and it came from all four members, separately, yet all came together.

Prince: Sign O' The Times

The sign o' the genius.

Neil Diamond: Hot August Night

Spent 239 weeks in the Australian charts and was estimated to be in 3 out of every 4 households. Good Lord!

Led Zeppelin: Physical Graffiti

It's been a long time since we've rock and rolled like this. For the complete Led Zep experience, this is the band at the peak of their powers.

Elton John: Goodbye Yellow Brick Road

Nothing Elton has done since can hold a candle to this masterpiece.

Daft Punk: Random Access Memory

If ever you need to test audio gear, this is the record of choice.

Paul Kelly & The Coloured Girls: Gossip

Leaps and bounds ahead of anything else Kelly has produced, this is a worthy Australian entrant. Before too long he was on the path to making some serious gravy.

Pink Floyd: Ummagumma

Not for the casual fan, but after your mind is thoroughly blown by Dark Side of the Moon or Wish You Were Here, set the controls for the heart of where it all began. The elements of the famous albums are in embryonic form on the first glorious live record; and the second studio record is Floyd's White Album: a series of experimental compositions by each of the four members.

Honourable Mentions

- Bob Dylan: Blonde on Blonde,
- The Who: Quadrophenia,
- Bruce Springsteen: The River,
- Pink Floyd: The Wall.

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