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# 5th Annual PortfolioConstruction Conference

23 – 24 August 2006 | AJC Convention Centre, Randwick, Sydney

Pillars for building better  
quality investor portfolios...

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## How to enhance returns by systematically allocating towards high Intrinsic Value

*- Single Discipline –  
Global Investment*

PortfolioConstruction Conference 2006

# Today



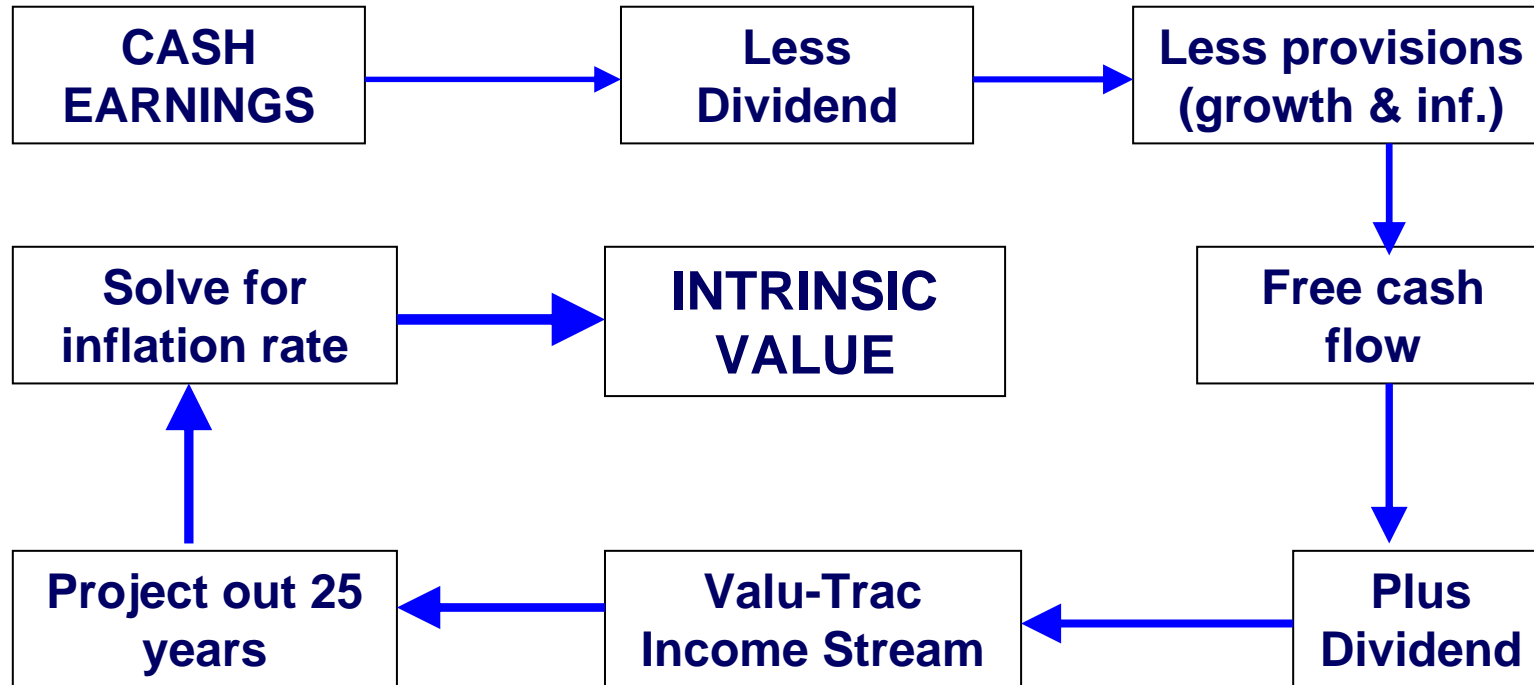
1. Positive & negative emotions distort price
2. Intrinsic value is critical in determining the value of a stock or country
3. Go further than stock selection and make investment decisions on a country basis
4. Times to allocate to cash.

## "Intrinsic Value"



- First coined by Ben Graham (Buffett's mentor)
  - Idea being that the intrinsic value (share price) of any company was a function of the size of the potential earnings that an investment might produce
- To enable valid comparisons of investments across countries, we have refined the owners' earnings concept of intrinsic value by removing the distortions of different *depreciation accounting policies* and adjusting for *local inflation conditions*

# Robust disciplined process



- Standardised calculation
- Relative more important that absolute
- Standard growth rate (GDP+Corporate Earnings)
- MSCI data

# Investment Philosophy

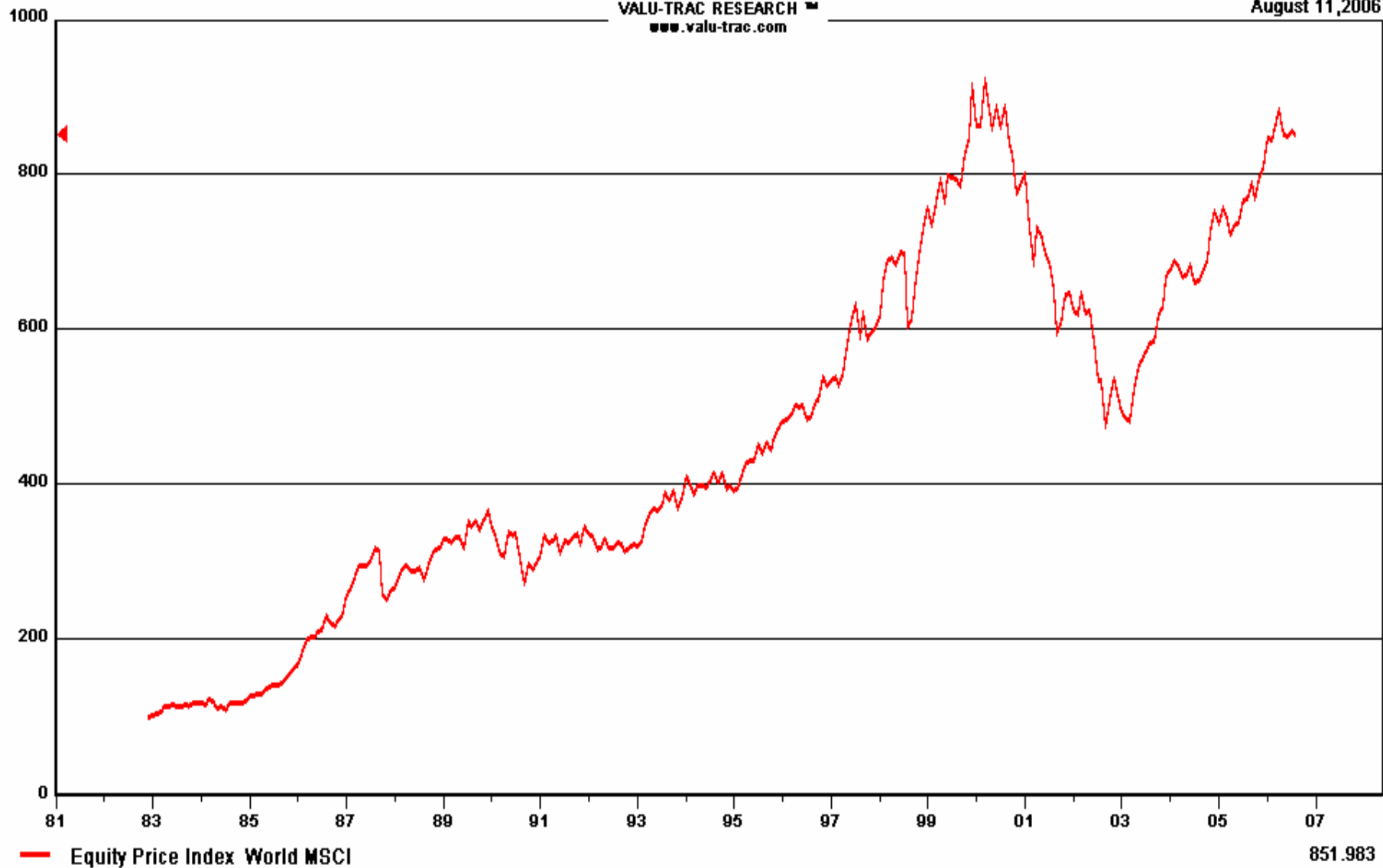


- Positive & negative emotions **distort prices**
- Prudent investment requires a **standard measure**
- All investments **produce income**
- *"Intrinsic Value"* is based on measuring income streams, ie:
  - based upon internationally comparable income returns
  - signals when movements become irrational & therefore:
  - identifies likely market turns
- Opportunity and risk can be assessed by observing the behaviour of *"Intrinsic Value"*.
  - Systematically allocating away from low intrinsic value towards high intrinsic value enhances returns

# MSCI Index (Local Currency)

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Source

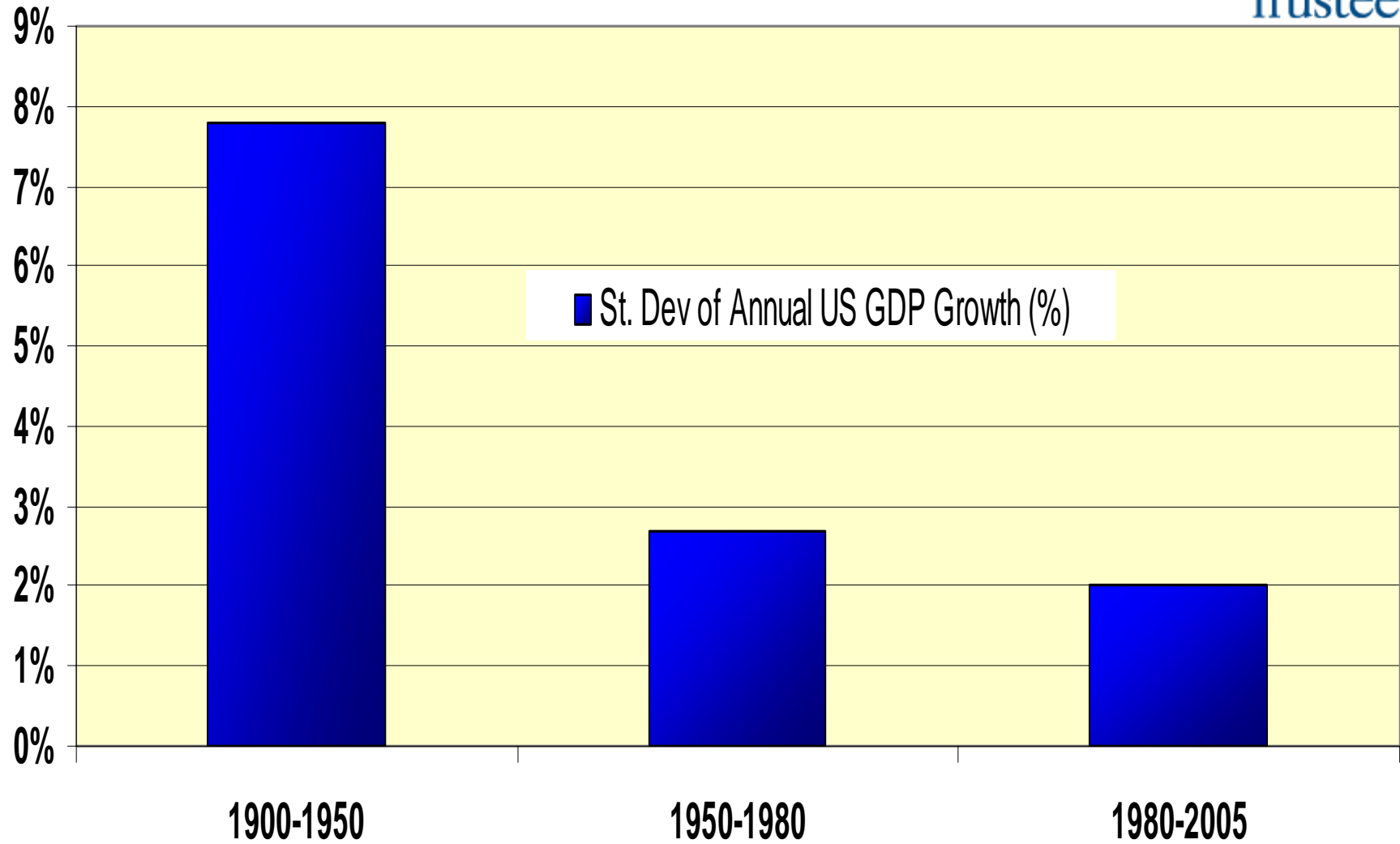
— Source :: MSCI

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# Macro Economic Stability



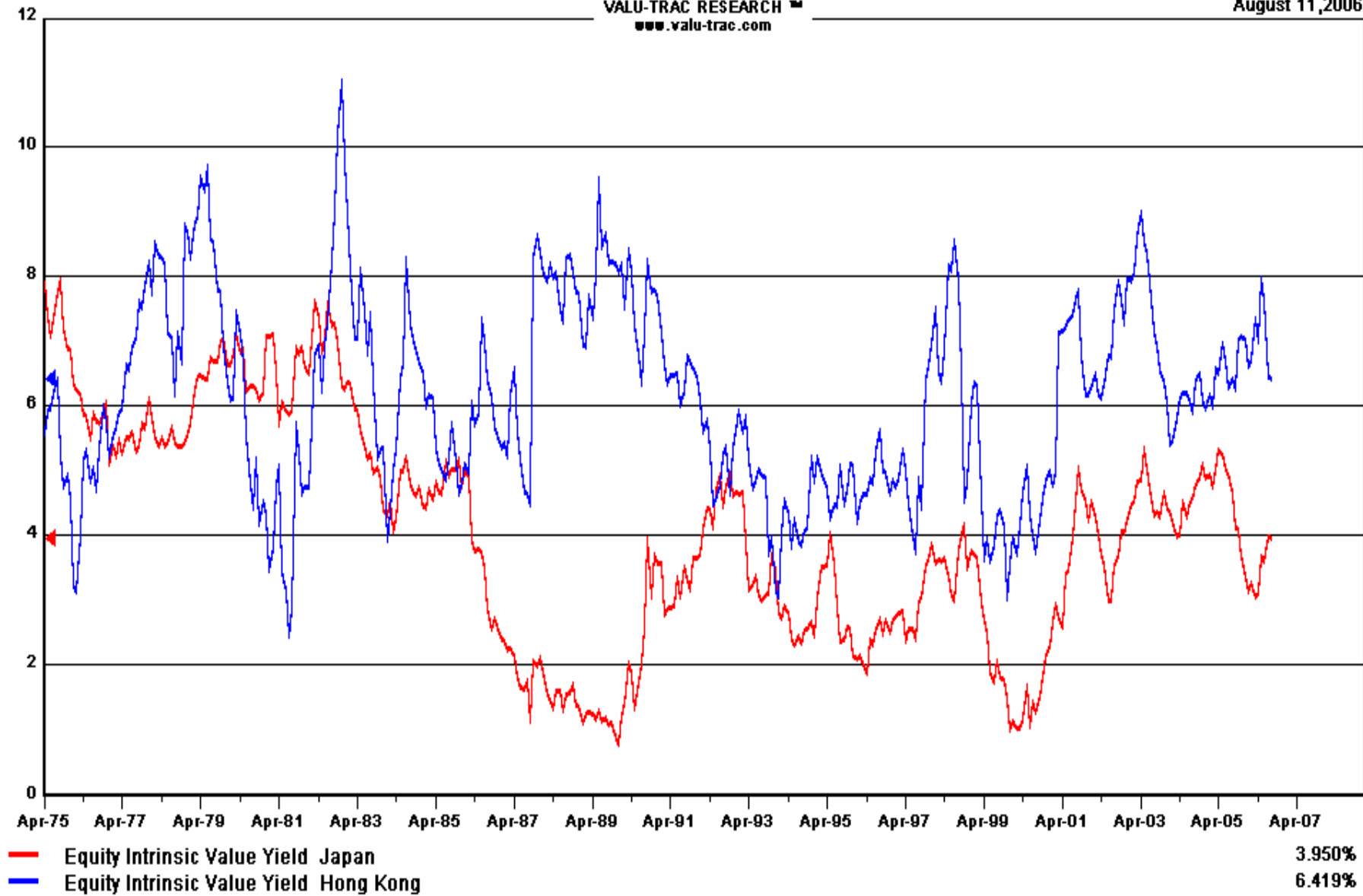
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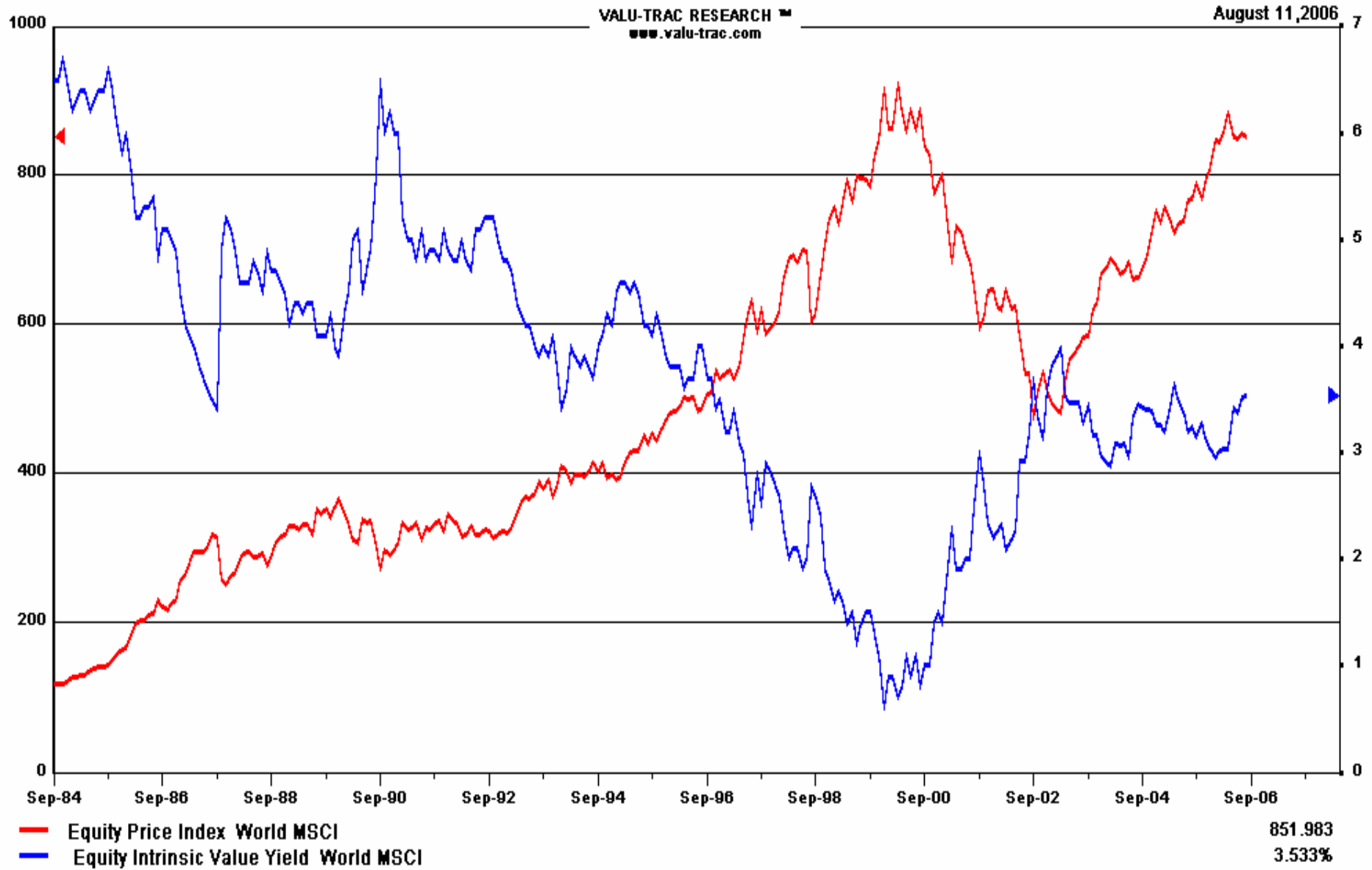
# Intrinsic Value - Hong Kong (Blue) - Japan (Red)

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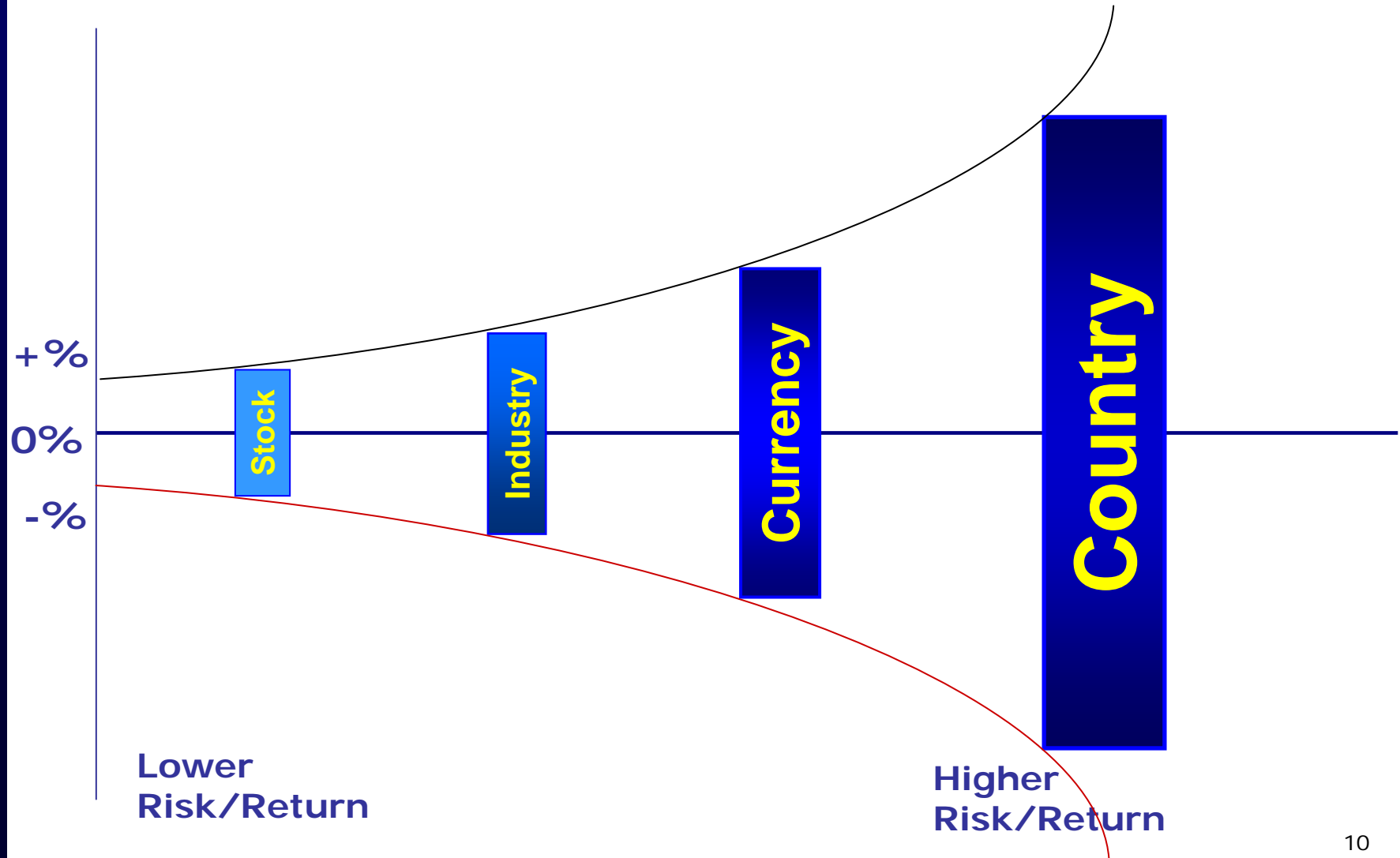
# MSCI Index (Red) vs MSCI Equity Intrinsic Value (Blue)



# Variability of Returns- theory



Equity Trustees Managed Funds



# Allocating to cash



Cash is raised progressively to a maximum of 75% when either or both:

1. The Intrinsic Value of bond and equity markets converge.....a RELATIVE VALUE signal.

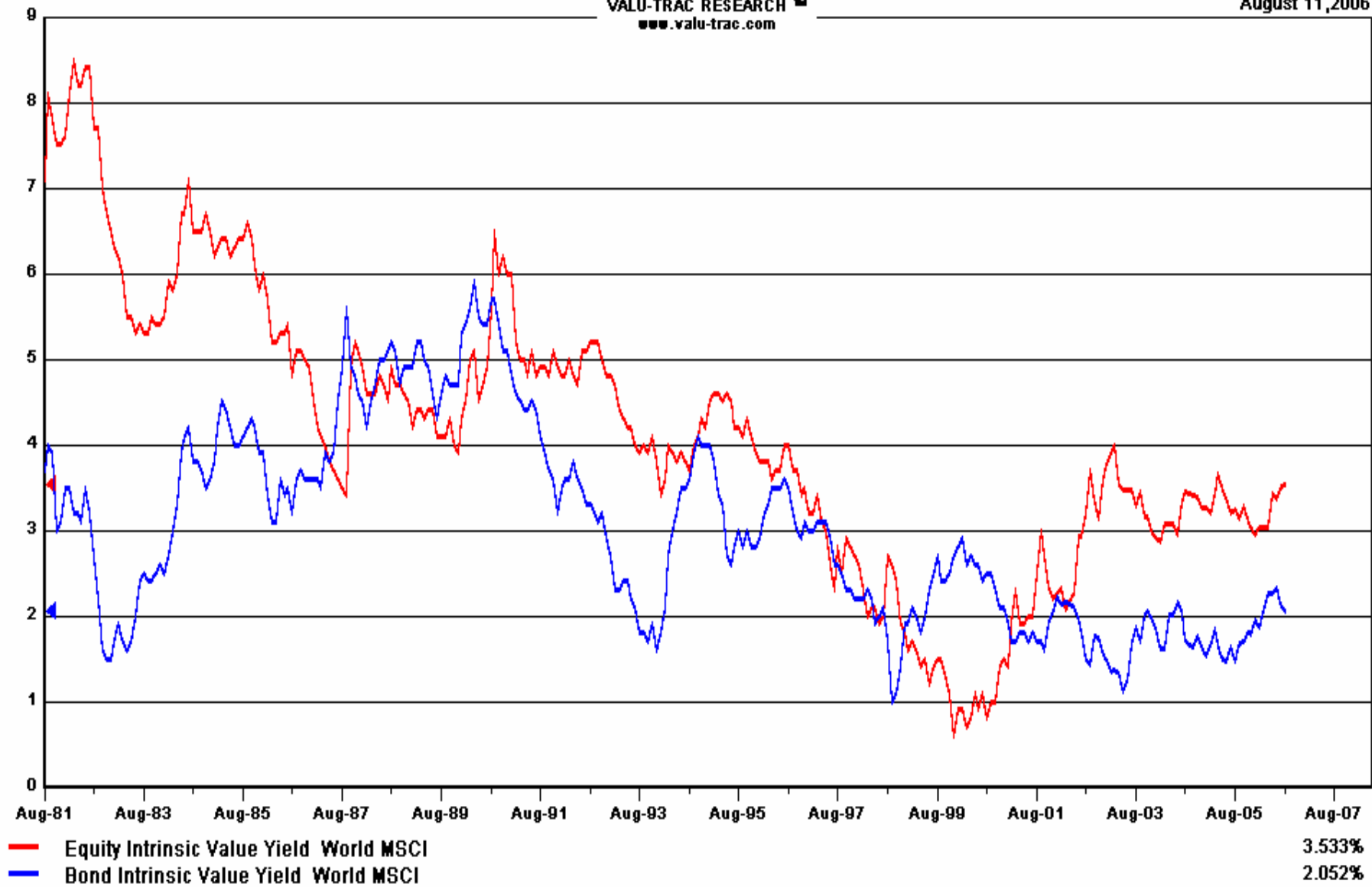
OR

2. When the behavior of the price trend of an equity market position deteriorates.....an ABSOLUTE PRICE signal.

# MSCI World Intrinsic Value - Equities (Red) - Bonds (Blue)

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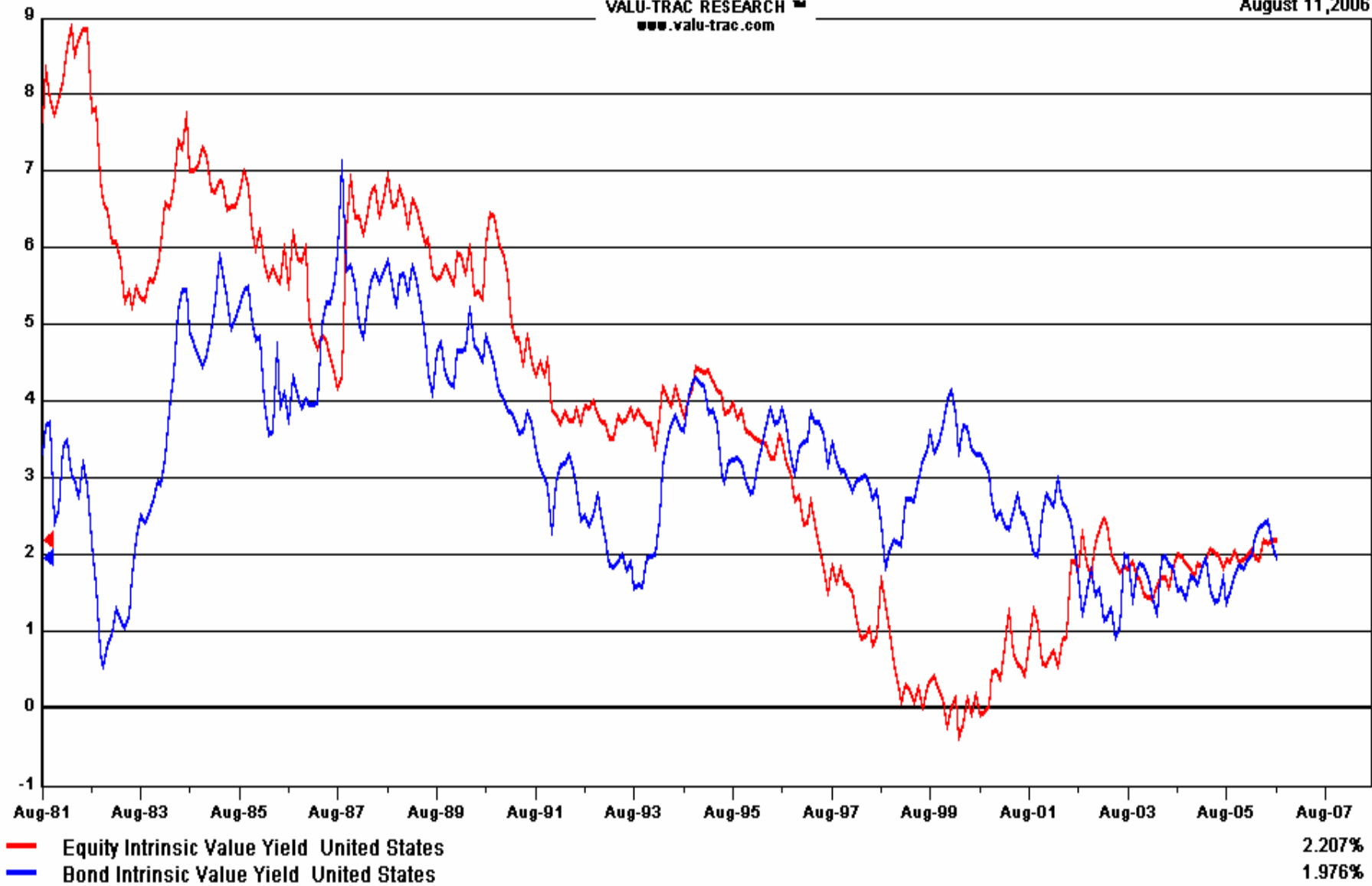
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# United States Intrinsic Value - Equities (Red) - Bonds (Blue)

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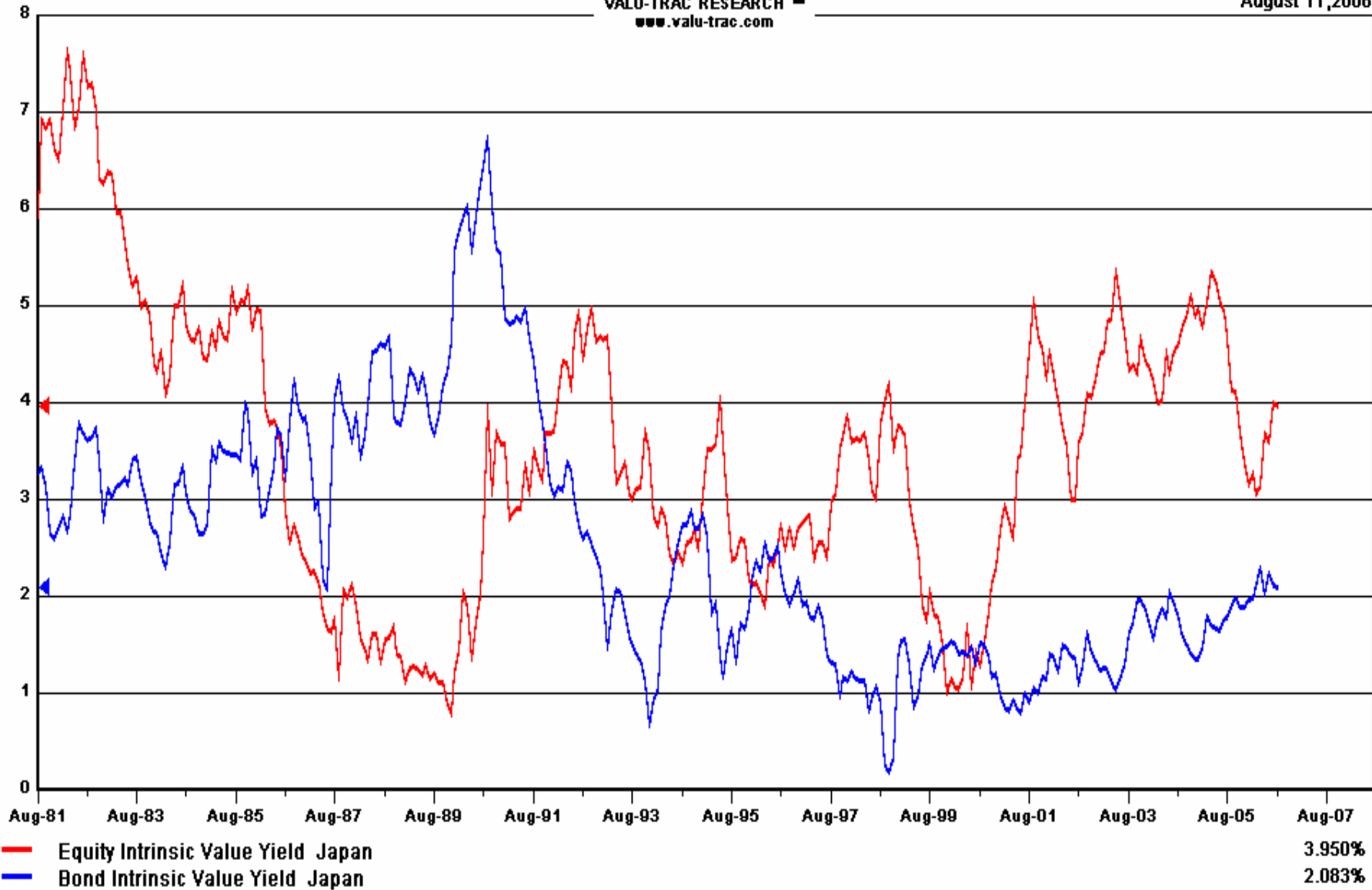
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# Japanese Intrinsic Value - Equities (Red) - Bonds (Blue)

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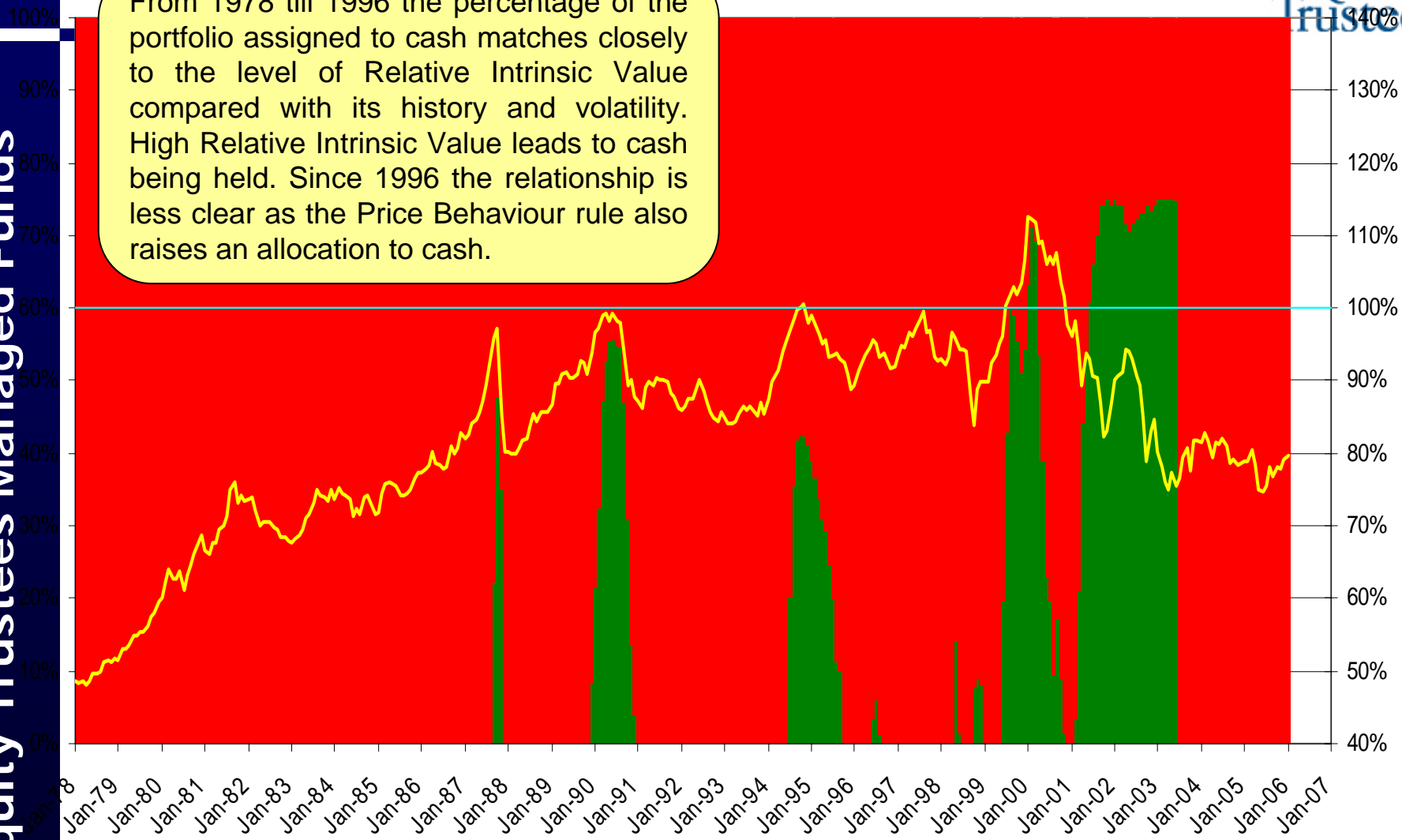


EQT IVI Plus using Latest Model  
 History of Equity:Cash Split  
 January 1st 1978 to December 31st 2005



Equity Trustees Managed Funds

From 1978 till 1996 the percentage of the portfolio assigned to cash matches closely to the level of Relative Intrinsic Value compared with its history and volatility. High Relative Intrinsic Value leads to cash being held. Since 1996 the relationship is less clear as the Price Behaviour rule also raises an allocation to cash.



■ Cash 
 ■ Equity 
 — Relative Intrinsic Value (World ex Australia Bonds vs World ex Australia Equities Equally Weighted)

Equity Market	Market Trending	Level Daily Std Price Momentum	Latest	Slope Daily Std Price Momentum	Latest	MA's Above 120d M/Ave	Latest	Result
Australia	YES	Above 0.2	1.1	Above 0.1	0.4	N/A	100%	Stay In
<b>Austria</b>	<b>YES</b>	<b>Above 0.2</b>	<b>1.1</b>	<b>Below -0.1</b>	<b>-1.9</b>	<b>&gt; 30%</b>	<b>92%</b>	<b>Neutral</b>
<b>Belgium</b>	<b>YES</b>	<b>Above 0.2</b>	<b>0.7</b>	<b>Below -0.1</b>	<b>-0.8</b>	<b>&gt; 30%</b>	<b>94%</b>	<b>Neutral</b>
<b>Denmark</b>	<b>YES</b>	<b>Above 0.2</b>	<b>0.6</b>	<b>Below -0.1</b>	<b>-1.1</b>	<b>&gt; 30%</b>	<b>91%</b>	<b>Neutral</b>
<b>Canada</b>	<b>YES</b>	<b>Above 0.2</b>	<b>1.0</b>	<b>Between 0.1 &amp; -0.1</b>	<b>0.0</b>	<b>&gt; 30%</b>	<b>92%</b>	<b>Stay In</b>
<b>France</b>	<b>YES</b>	<b>Above 0.2</b>	<b>0.8</b>	<b>Below -0.1</b>	<b>-0.3</b>	<b>&gt; 30%</b>	<b>96%</b>	<b>Neutral</b>
Germany	YES	Above 0.2	0.9	Between 0.1 and -0.1	0.0	> 30%	95%	Stay In
Hong Kong	NO	Between 0.2 and -0.2	0.1	Between 0.1 and -0.1	-0.1	> 30%	99%	Neutral
Italy	YES	Above 0.2	0.6	Below -0.1	-0.4	> 30%	95%	Neutral
Japan	YES	Above 0.2	2.1	Above 0.1	0.8	N/A	97%	Stay In
South Korea	YES	Above 0.2	0.8	Above 0.1	0.2	N/A	98%	Stay In
Netherlands	YES	Above 0.2	1.0	Between 0.1 and -0.1	-0.1	> 30%	92%	Stay In
Norway	YES	Above 0.2	1.0	Below -0.1	-0.3	> 30%	97%	Neutral
Singapore	YES	Above 0.2	0.5	Below -0.1	-0.6	> 30%	98%	Neutral
Spain	YES	Above 0.2	0.7	Below -0.1	-0.6	> 30%	93%	Neutral
Sweden	YES	Above 0.2	0.6	Below -0.1	-0.7	> 30%	90%	Neutral
Switzerland	YES	Above 0.2	1.1	Between 0.1 and -0.1	-0.1	> 30%	93%	Stay In
Taiwan	NO	Above 0.2	0.3	Above 0.1	0.4	> 30%	99%	Neutral
UK	YES	Above 0.2	1.1	Below -0.1	-0.5	> 30%	91%	Neutral
USA	NO	Between 0.2 and -0.2	0.1	Below -0.1	-0.7	> 30%	87%	Neutral

# WHY



To exploit opportunities by:

- **Ranking investments** by Intrinsic Value Yield (IVY)  
(Bonds, Equities, Currencies, and Commodities)
- **Selecting systematically** according to IVY
- **Weighting** selections systematically according to differences in IVY
- **Timing** investment according to leading and lagging behavior of IVY

# Don't Ignore *Country*

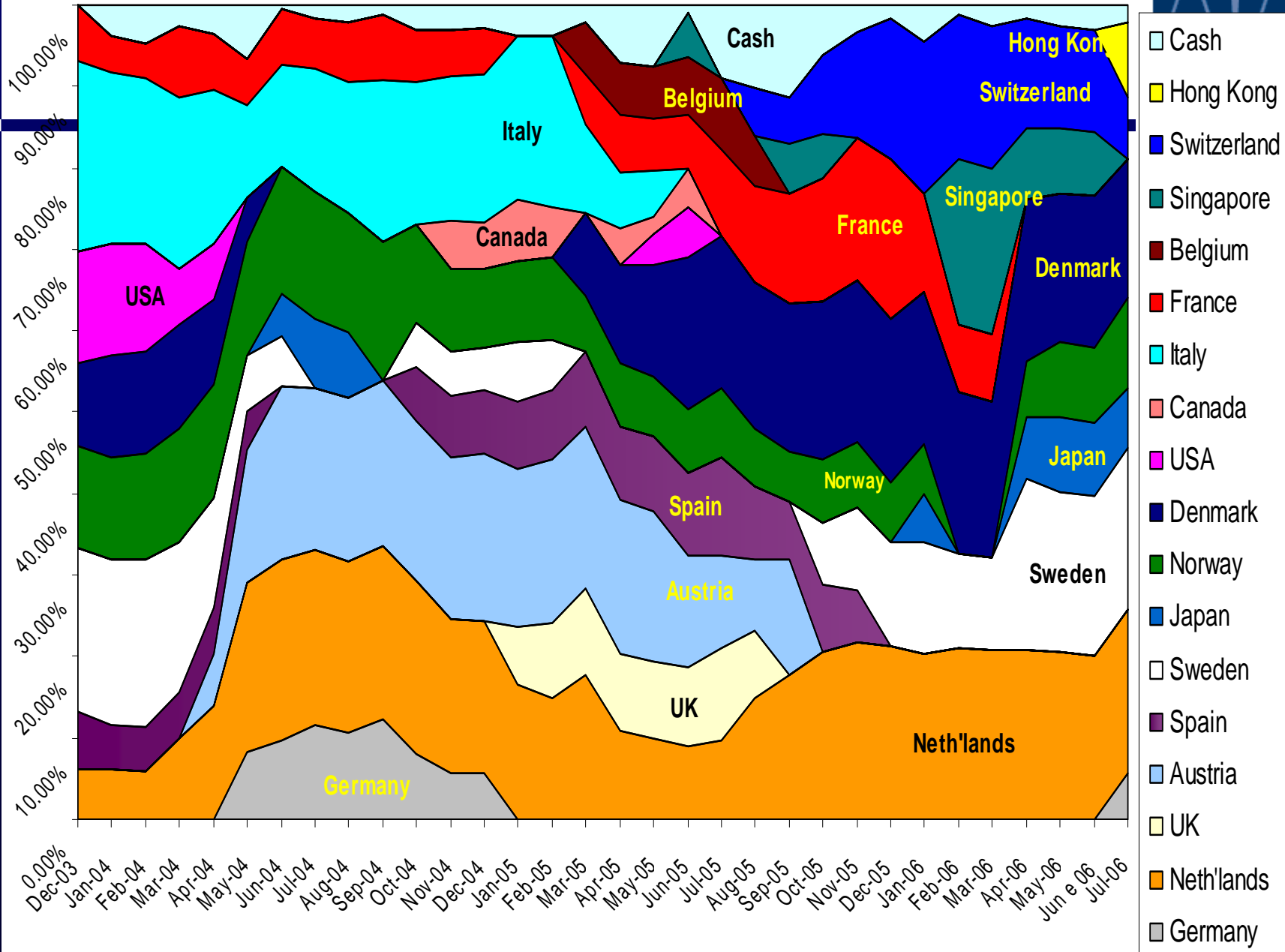


- **Too good an opportunity to ignore**
  - Larger stocks have high beta relationship within
  - Has largest swings ie USA flat last Year, Japan 44%.
- **Avoid stock selection risk**
  - Don't buy the house, buy the neighbourhood
- **Avoid FIF Blacklisted stocks through OPAL's**
  - But still own each stocks within the basket

# EQT IVI Country allocations



Equity Trustees Managed Funds



# The process works



Equity Trustees Managed Funds

	1 Yr*	2 Yr*	3 Yr*	Inception p.a <sup>+</sup>
Distribution Return	6.51%	9.67%	10.95%	7.97%
Capital Growth	3.86%	7.67%	6.39%	6.02%
<b>Total Net Return</b>	<b>10.37%</b>	<b>17.34%</b>	<b>17.34%</b>	<b>13.99%</b>
Total Gross Return	11.91%	18.88%	18.88%	15.53%
<b>Index Return**</b>	<b>12.14%</b>	<b>10.23%</b>	<b>9.74%</b>	<b>0.74%</b>
<b>Value Added**</b>	<b>-1.76%</b>	<b>7.12%</b>	<b>7.60%</b>	<b>13.24%</b>

\*To 30 July 2006

+ Inception 12 April 2002

\*\*Inception 12 Distribution Return is the return due to distributions paid by the Fund, Capital Growth is the return due to changes in initial capital value of the Fund, Total Net Return is the Fund return after the deduction of ongoing fees & expenses. Total Gross Return is the Total Net Return with ongoing fees & expenses added back both assume the reinvestment of all distributions. *Past performance is not indicative of (or necessarily a guide to) future performance.*

# Correlations



Equity Trustees Managed Funds

3Yrs to 31 July 2006	BGI	Dimens.	EQT IVI	Hunter Hall	MSCI	Platinum	Vanguard
Barclays International Share Fund		0.96	0.78	0.65	<b>0.99</b>	0.78	0.98
Dimensional- Global Value Trust	0.96		0.80	0.71	<b>0.97</b>	0.75	0.96
EQT Intrinsic Value Fund	0.78	0.80		0.58	<b>0.80</b>	0.56	0.80
Hunter Hall- Global Ethical Trust	0.65	0.71	<b>0.58</b>		<b>0.65</b>	0.70	0.64
MSCI World Acc Index Net Div Reinv \$A	0.99	0.97	0.80	0.65		0.77	1.00
Platinum International	0.78	0.75	<b>0.56</b>	0.70	<b>0.77</b>		0.76
Vanguard Index Int'l S/F	0.98	0.96	0.80	0.64	<b>1.00</b>	0.76	

Source: EQT Funds

# *WHY this style of fund*

- Offers a different source of Alpha
- Minimises specific risks
  - Key person risk
  - Stock selection risk
  - Liquidity
  - FIF
- True to label with a Replicable process
- Diversifies a portfolio
  - Reduces volatility
  - Stabilise overall portfolio returns
- Is Benchmark agnostic
- Signals when to allocate to cash

## *How to use this approach*

- Intrinsic Value- single discipline for investment in:
  - Fixed Interest, Commodities & Currencies *as well as* Equities
- A different source of outperformance
  - Who *only* uses Value Funds, or *only* Growth Funds?
  - IV is uncorrelated to traditional investment strategies
- Blends well with & complements most managers in multi-manager portfolios
- Global Equities Allocation.....“Best of both worlds”
  - Replace or use with preferred **Index Fund** (ie 1 of 3 @ 33% ea)
  - Replace or use with preferred **Active Fund** (ie 1 of 3 @ 33% ea)
  - Use **Between** an Index & Active Fund (ie 1 of 3 @ 33% ea)
- IVI / IVI PLUS- *Your choice* (5% vs 75% Cash max. holding)

## Disclaimer

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