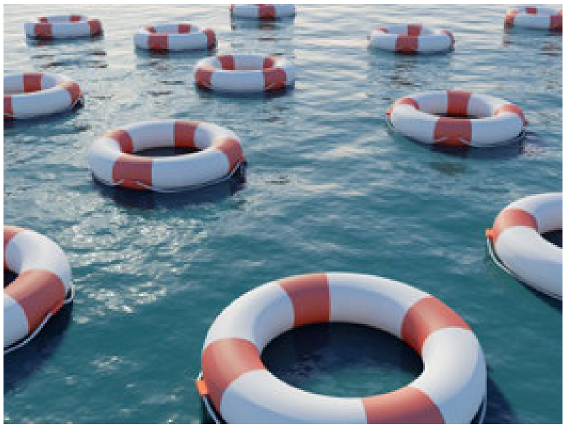

Check out these stocks for volatile times – listed investment companies (LICs)

Mark Story - August 28, 2008

If you thought all 40-plus, ASX-listed investment companies (LICs) were born equally – wake up and smell the chai. There's a structural shift afoot, and with it a growing divide between the old guard and new.

The 10% discount (to NTA) that traditional LICs typically traded at seems to be closing. So far this year traditional LICs have achieved share price performance superior to both the market and their less established peers. This suggests that within volatile markets, investors are happier paying more for traditional LICs offering low-cost exposure to a diversified and relatively stable basket of assets.

While traditional LICs have been trading at or close to NTA over the past 12 months, newcomers have been trading on a substantial discount (averaging -14.5%). It's going to be hard for newer LICs to shed this discount until they can demonstrate why they're more deserving of the management fees associated with actively managing (and sometimes hyper-managing) their portfolios.

While portfolio turnover within traditional LICs is under 15%, some newer LICs are rotating their investment portfolio every year. This means that in addition to a litany of higher fees, investors are also copping C.G.T on any holdings that are flicked-off within 12 months. Interestingly, while the market is bracing itself for a barrage of negative announcements this reporting season, some traditional LICs have already posted encouraging results. Laced within their reporting commentary is the warning that 2009/2010 will be a tougher market.
But given their sizable war-chests, Matt Hollyman private client adviser with ABN Amro Morgans says traditional LICs still provide an attractive risk and return profile within highly volatile markets. And with the classic investor profile of traditional LICs comprising the 'buy and hold' brigade, he says the share price is less likely to be sold down on short-term market sentiment.

The sector's biggest stock, AFIC (the Australian Foundation Investment Company) revealed cash reserves of $261 million when it announced its 60.5% bounce in 2008 net profit to $416.10 million. Much of the result was due to capital gains, driven by takeover sales in its investment portfolio stock including: Alinta, Coles Group, and Dyno Nobel.

While traditional LICs, like AFIC won't be throwing their money around, Hollyman says they're well positioned to capitalise on any value emerging from current market instability. He expects transactional profit from corporate activity to compensate for any underlying weakness in operating profit.

So given that LICs were down 25% in the full year to 30 June, how do you select those likely to outperform within tougher times? Hollyman recommends buying LICs trading at a discount to NTA and watching that discount erode over time. "But beware the 'value-trap', it's better to buy LICs on a smaller discount to NTA than those languishing for good reason," says Hollyman.

NTA aside, Hollyman favours larger, cashed-up, internally managed LICs with low management expense ratios (ranging from 0.3% to 2%). He says they should also display a strong investment history, quality management offering good disclosure into underlying portfolios, plus future upside from corporate activity. "I recommend steering away from mid-caps and focusing on larger-cap LIC's offering capital growth over three to five years," advises Hollyman.

Due largely to the long-term sustainability of commodity prices, Hollyman's standout LIC is Global Mining International (GMI). But for those who haven't got the stomach for the volatility accompanying resources, he says AFIC, Argo Investments (ARG), Milton Corporation (MLT), Djerriwarrh Investments (DJW), and Australian United Investments (AUI) should offer investors a good risk/return profile.

Benchmarked against the HSBC Global Mining Index, GMI's top five holdings at 31st March were: Vale (10.1%), Rio Tinto (7.8%), BHP Billiton (7.4%), Impala Platinum (5.4%), and Anglo American (5%). GMI invests in metal/mining companies both in Australia and globally. Trading at a 24% discount to NTA, GMI was only one of five LICs reviewed by Bell Potter to achieve a positive (25%) portfolio return (at 31 March). Interestingly, the only other resources-specific LIC, LinQ Resources Fund (LRF), currently trading at a severe discount to NTA (of 41%) delivered a 12 month portfolio return of 45%.

While traditional LICs typically prefer banks (due to consistent dividend yield), market conditions have attracted them to more resource stocks than usual. Even ARG, a value-orientated, bottom-up stock-picker renowned for buying & holding on price weakness, recently elevated BHP Billiton to its number one holding (6.8%), followed by Macquarie Bank (5.4%), Rio Tinto (4.7%), Milton Corporation (4.0%), and Wesfarmers (3.7%).

Meantime, veteran LIC Milton Corporation Ltd, (MLT) celebrated its 50th anniversary with a 42.3% surge in reported profit to $122.02 million. Trading on a pre-tax discount to NTA of -7%, MLT plans to stick with its core bank holdings despite continued market turbulence. The company issued 88cps in full year dividends, and despite economic headwinds is forecasting a 2009 dividend of at least the same amount.

Given that the inherent value of most companies LICs invest in are significantly higher than levels indicated by market prices, Chris Hall investment executive with Argo Investments says traditional LICs look well positioned to continue outperforming the market. "Investors are waking up to the fact that after tax and fees, there's a huge difference between traditional LICs and a plethora of more actively managed newcomers."

Traditional LICs to watch

Company	**Current Price**	**Discount/premium To pre-tax NTA (%)**	**Div yield %**	**Market Cap**
AFIC	$4.88	-5%	3.8%	$4.585 billion
ARG	$6.72	-1%	3.7%	$3.802 billion
MLT	$17.70	-7%	4.8%	$1.484 billion
DJW	$4.20	-2%	5.5%	$885.2 million

AUI	$7.26	-9%	3.0%	$689.7 million