

## DUNSTAN

## Bellwether leads way to success

Astute trading in blue chips has allowed one boutique Melbourne manager to stay highly profitable, writes **Barrie Dunstan**.

**S**mall investors who look longingly at the performance of some of the growing number of boutique equity fund managers and imagine it's all done with slick deals and small, obscure stocks, can take heart from the outperformance of Bellwether Partners, a newish Melbourne boutique manager.

Bellwether has beaten the market index by investing in a concentrated portfolio of basically the largest stocks on the list.

Of course, it takes more than just selecting the big stocks — although having the right mix of BHP and Rio Tinto helps — but Bellwether has been beavering away for almost four years building a track record for its Australian share fund.

Up to the end of May, it produced an annual return of 23.73 per cent, some 5.25 per cent ahead of the S&P/ASX 300 Index performance of 18.48 per cent.

Bellwether's reward has been its first institutional mandate from the \$430 million Combined Fund, (previously the Combined Schools Superannuation Fund). In the process, Bellwether also thinks it has quietly proved something about boutique managers as a whole — and something about its own investment process.

Founded almost four years ago by former stockbroker and fund manager Bruce Bell, Bellwether now has a new chief executive — Paula Allen, former chief executive of industry super fund LUCRF Super — and has appointed a non-executive director, Tony Hodges, an executive director of IOOF



Andrew Bell says Bellwether must inspire confidence that it will keep on producing the goods.

Photo: JAMES DAVIES

Holdings. Founding managing director Bell is focusing on his role as chief investment officer and chairman of the group.

Bellwether is a typical boutique, with low levels of funds under management and low staffing levels. Allen says Bellwether has been able to prove its process in the recent difficult market conditions. She admits the firm has built up its position the hard way, without any foundation investor but relying on consistent outperformance.

"It's one thing to have good numbers," says portfolio manager Andrew Bell, "but we need to provide people with the confidence that we can continue to produce that in the future." Bell, the son of the founder, came to the firm at its start-up after experience in stockbroking.

He was working as second in command to the previous portfolio manager, who left. Bell stepped into the role while Bellwether was looking for a replacement and so impressed that he kept the job. "Andrew has an old head on young shoulders," Allen says.

The fund runs a high conviction

portfolio of only 30 stocks which it selects using a bottom-up approach, seeking growth-style investments, largely the biggest stocks by market capitalisation. The firm's initial universe involves the most widely covered 400 stocks and, using its own quantitative process, Bellwether screens these down to 50 top-ranked stocks.

After applying its process and a strategic overlay, it comes up with its portfolio of 30 stocks.

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So the process is somewhat more complex than investing in the top 20 or 50 stocks. In particular, it requires enough research to really believe in stocks — that "high conviction" — and the ability to construct a portfolio with the right weightings of stocks which maximises returns and minimises risks.

At June 30, Bellwether had about 52 per cent of its portfolio in its

10 largest holdings, of which nine were from the 20 largest stocks on the list. A concentration of 15.5 per cent in BHP and another 6.6 per cent in Rio Tinto obviously helped its performance, although its portfolio is still underweight the total materials sector of the market.

The rest of the top 10 comprises Telstra, three banks (Westpac, NAB and St George), CSL, Wesfarmers, Woolworths and Leighton. Bell says the portfolio aims to avoid areas of likely financial contagion from the US sub-prime crunch, with an underweight in the property sector and in the financials.

He says the fund also has been cautious about riding the spike in oil prices, with 8.2 per cent in energy stocks (more than 2 per cent under the benchmark). With questions over future oil prices, Bell says, "Right now, it is probably one of the more difficult periods in the last five years."

While the fund produced great outperformance in its first two years when the bull market was running, it now has also done well in the more difficult times. The fund

has proved that, as a boutique, it is not vulnerable to volatile, falling markets. In the past year, it has outperformed the market in five of the six "down" months.

Apart from its detailed stock selection, Bell says the fund also runs a strategic overlay which aims to reduce its risk and position the portfolio for difficult market conditions. Unlike a long/short fund which can go "short" stocks it doesn't like, Bellwether relies on its fundamental approach — selecting strong companies with good market positions with solid earnings growth and, hopefully, limited downside.

As a small boutique manager, Bellwether is driven by the need to produce outperformance and also to convince investors that it can repeat this. Bell doesn't see a concentrated, 30-stock portfolio as necessarily risky; rather it's all about having the confidence in your process and a conviction about the stocks.

He says adding another 20 or 30 stocks might, in theory, enable you to sleep more easily at night but adding some "stocks which might save you" might not necessarily improve the performance.

With such a concentrated portfolio like Bellwether's, clients might well argue that the manager also had better be right.

"We've got no problems with that," Bell says. "This is our job and we want to make sure we do it well. If we make a mistake we want to rectify it."

Holding the largest stocks provides the fund with plenty of liquidity and provides a lower tracking error (deviation away from the benchmark). There are big risks in holding illiquid stocks in the current market, Bell says.

He says the fund doesn't want to be holding stocks where "just because two guys got out of bed and weren't happy that morning . . . they dumped a holding and pushed the stock down 15 per cent. That's not the sort of stock we want to have."