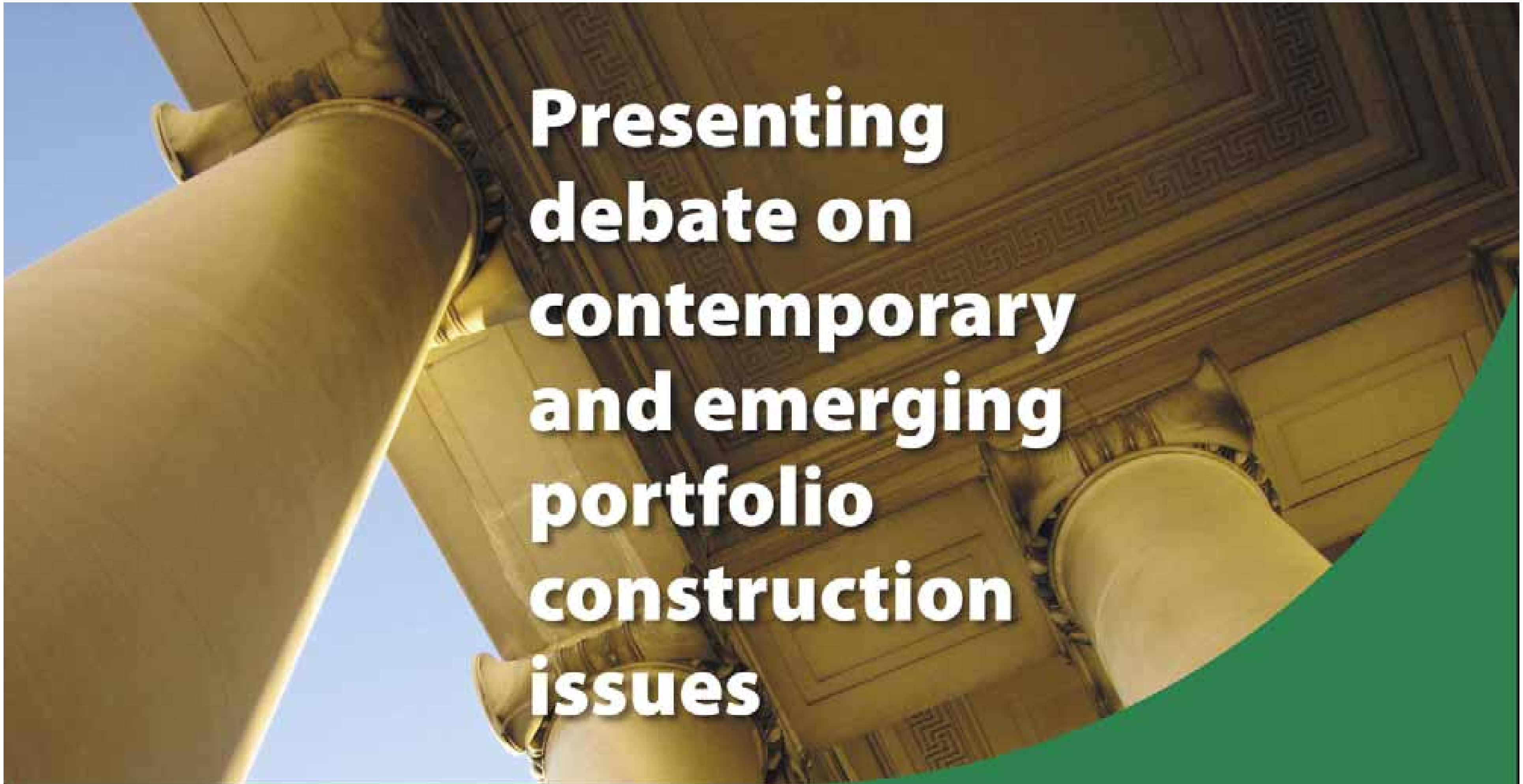

portfolio construction

CONFERENCE

15 & 16 August 2007 | AJC Convention Centre, Randwick, Sydney

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ASSET MANAGEMENT

PRESERVING CAPITAL, CREATING WEALTH

Absolute Conviction – at what price?

Peter Constable, Chief Investment Officer
MMC Asset Management

Presentation to PortfolioConstruction Conference 2007

Introduction

- Setting the scene
- About MMC
- Peter Constable, Chief Investment Officer

Agenda

- Considerations
- What is absolute conviction?
- Portfolio benefits
- Conclusions

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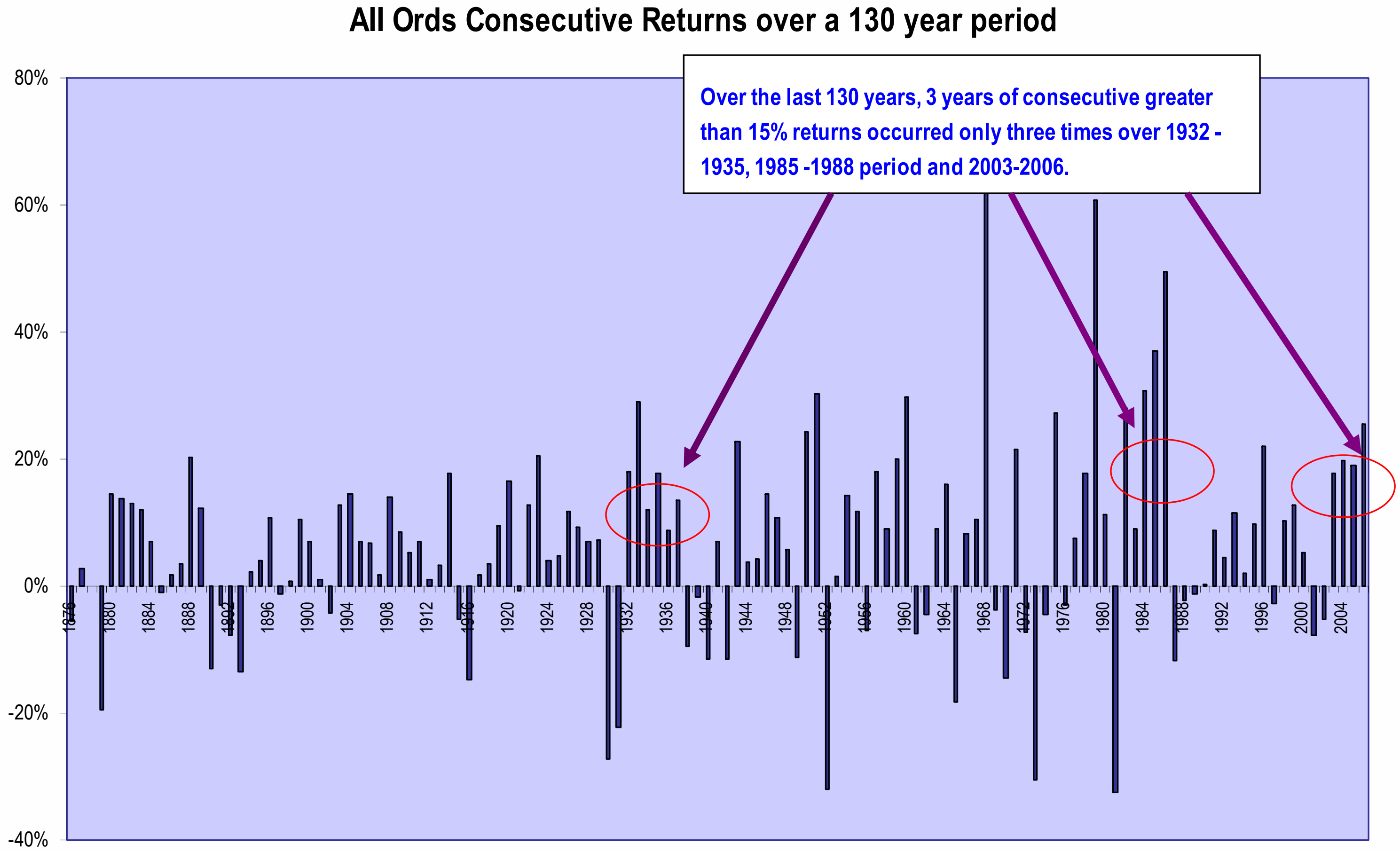
Unprecedented times



Source : Australian Stock Exchange and MMC

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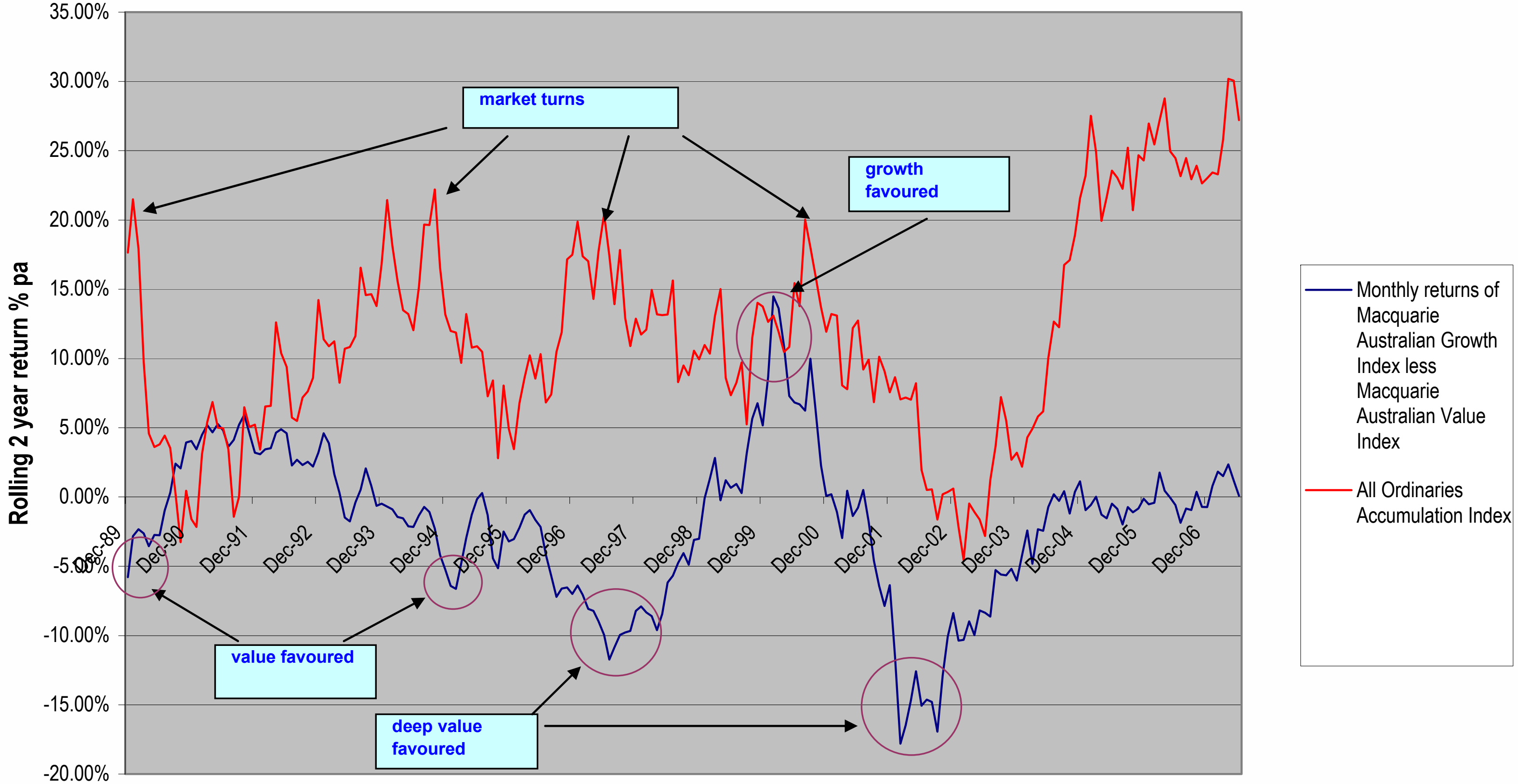
When does value outperform?

Relative performance of growth versus styles over rolling 2 year periods



Source: Macquarie Equities, IRESS, MMC Asset Management

High conviction absolute value: Defined

- High conviction
- Absolute value

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Risk in the eye of the beholder?

- Modern Portfolio Theory → risk = standard deviation
- Absolute value manager → risk = capital loss
- For example:
  - Stock A – share price of $3 and intrinsic value of $4 (33% upside)
  - Share price drops to $2
    - absolute value manager = ↓ risk (increase in margin of safety)
    - modern portfolio theory = ↑ risk (increase in volatility)

Misunderstanding…

- Individual Investors mainly think of risk in terms of downside risk. They are concerned about the maximum they can lose
- The Professional Investors view defines risk in terms of variance, and doesn't discriminate gains from losses
- There is a great deal of miscommunication and misunderstanding because of these very different views of risk
  - Beta does not do it for most people, who are more concerned with the possibility of loss

"Risk can be greatly reduced by concentrating on only a few holdings"

Warren Buffet

Putting diversification into context

- Modern Portfolio Theory – systematic and non-systematic risk
- Risk – measure of loss of capital or standard deviation?
- Greater diversification may or may not decrease a value managers view on risk ie. the chance of capital loss
- Profiting by knowing a lot about a small number of holdings versus diversification (which is a poor surrogate for knowledge)

Portfolio context

- Low benchmark correlation ie. AOAI
- Case study conducted
  - Mean/variance analysis
  - Hypothetical Australian equities and hypothetical balanced fund
  - Funds based on benchmark returns

The study

Comparative risk/return metrics

Metric	AOAI	High conviction absolute value manager	Balanced Fund*
10 years			
Return	13.07%	12.63%	8.61%
Risk (SD)	9.79%	8.08%	6.66%
Return/Risk	1.34	1.56	1.29
8 years			
Return	14.55%	13.90%	8.66%
Risk (SD)	9.98%	6.05%	6.43%
Return/Risk	1.46	2.30	1.35
5 years			
Return	19.56%	14.50%	12.61%
Risk (SD)	8.83%	6.63%	5.85%
Return/Risk	2.22	2.19	2.16

* Balanced fund comprises a blend (Aust equities 35%, global equities 25%, Aust LPTs 10%, Aust bonds 25%, cash 5%)

Equities Correlation

- High conviction manager added to the AOAI
- Various weightings applied

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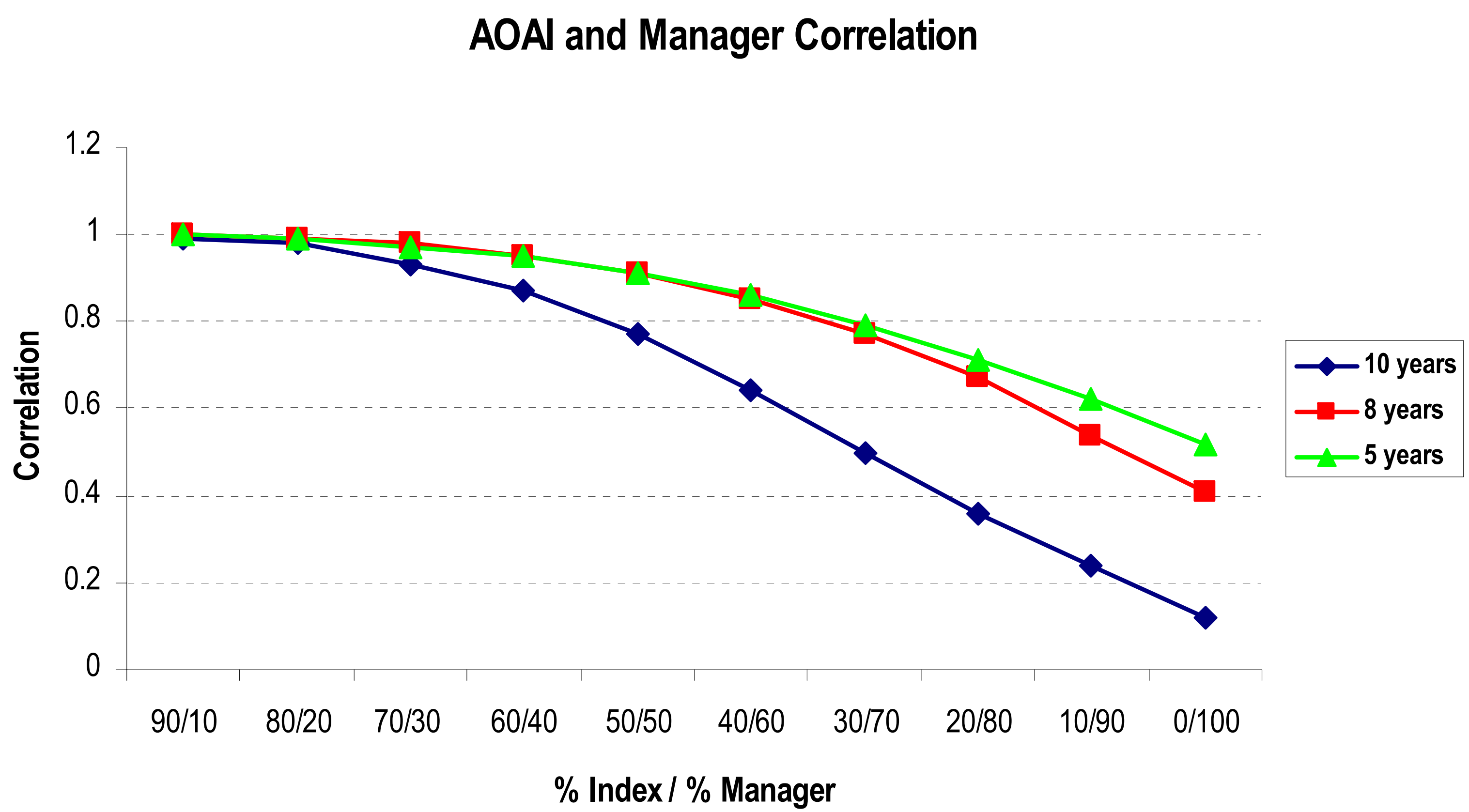
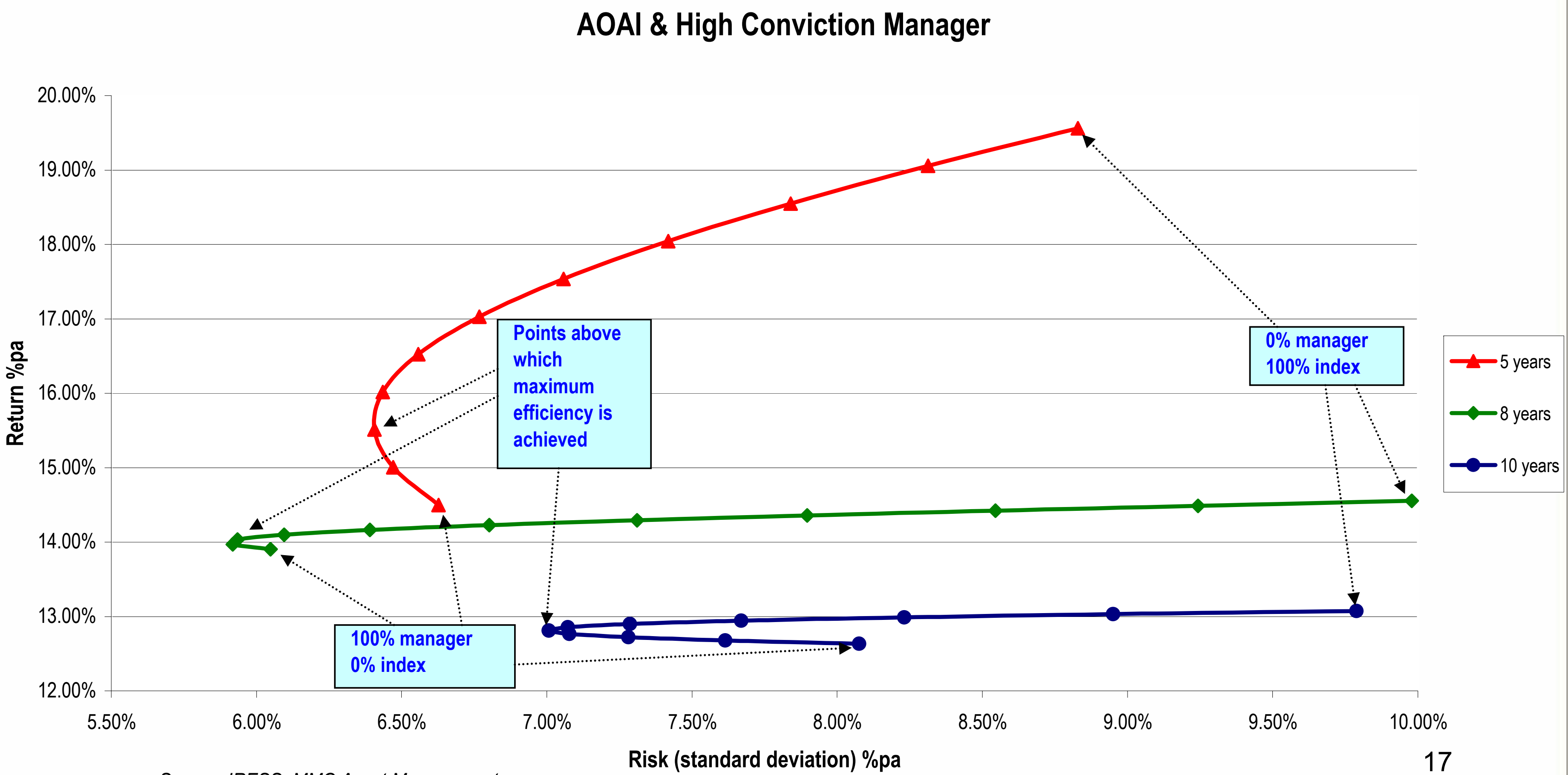
Correlation



Efficient frontier



Source: IRESS, MMC Asset Management

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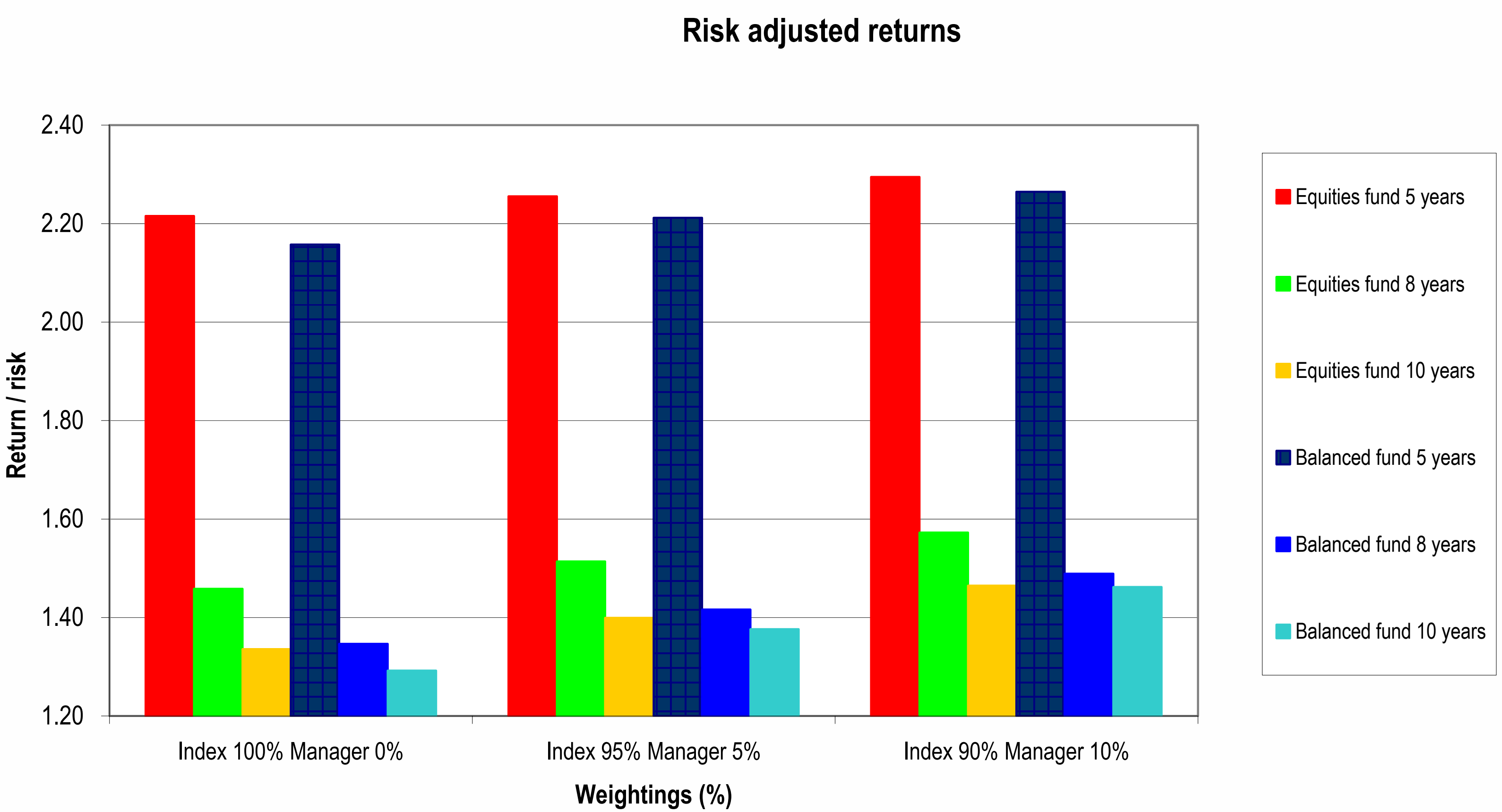
How much is appropriate?



Source: IRESS, MMC Asset Management

Conclusions

- Challenging 4+ years for absolute return value managers
- Points of difference
  - Interpretation of risk (standard deviation versus capital loss)
  - Concentrate portfolios (know a lot about a small number of stocks = lower risk)
  - Risk adjusted performance (understand the true performance of each fund you select)
- Value proposition
  - Potential to improve a portfolio's risk adjusted returns

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Questions?

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MMC key characteristics…

- Deep value stock selection process (absolute not relative)
- Aim to return at least 4-5% over cash
- Absolute/positive return focus with low beta portfolio
- Hold cash in the absence of finding value
- Diversification benefits to portfolios
- Benchmark unaware
- Concentrated portfolios of between 10 and 30 stocks
- Patient approach to managing capital

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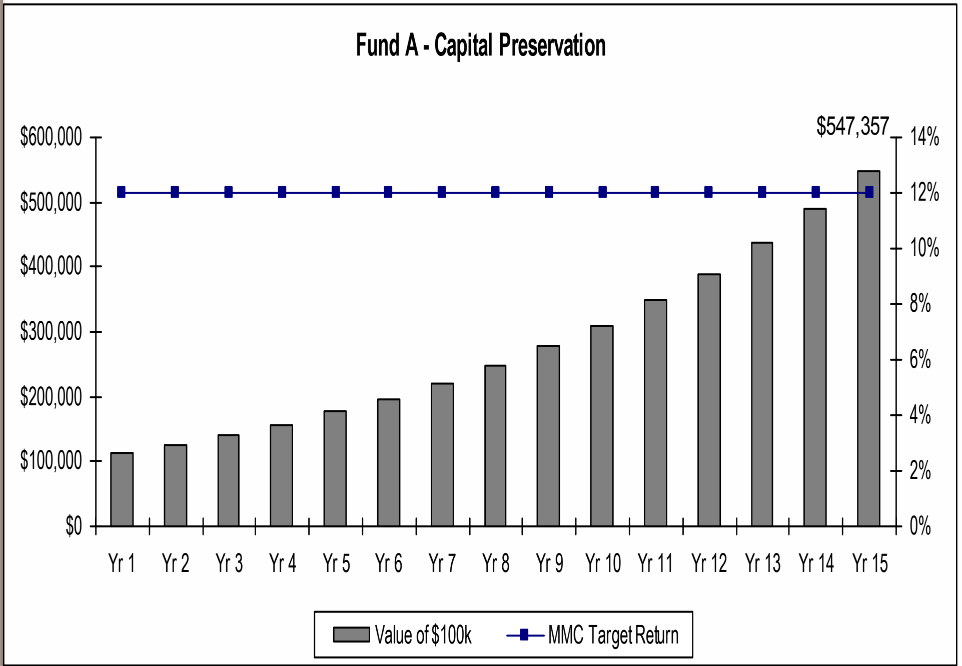
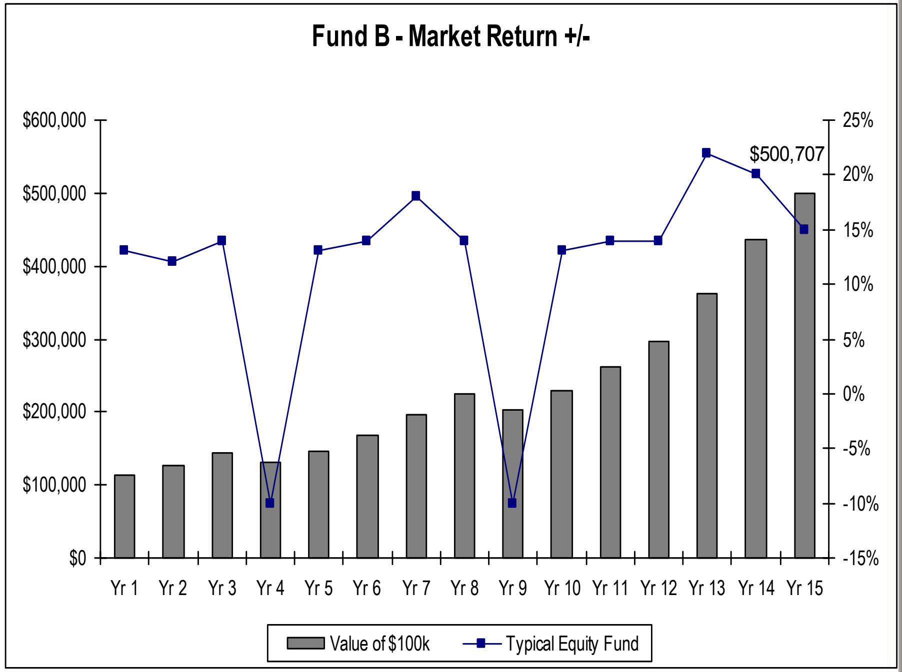
The compound effect of positive returns drives MMC's philosophy…





Fund B 'outperforms' Fund A on 12 in 15 and equals it on 1 in 15 occasions but losses overall – the impact of two negative years over 15 has large wealth impacts.

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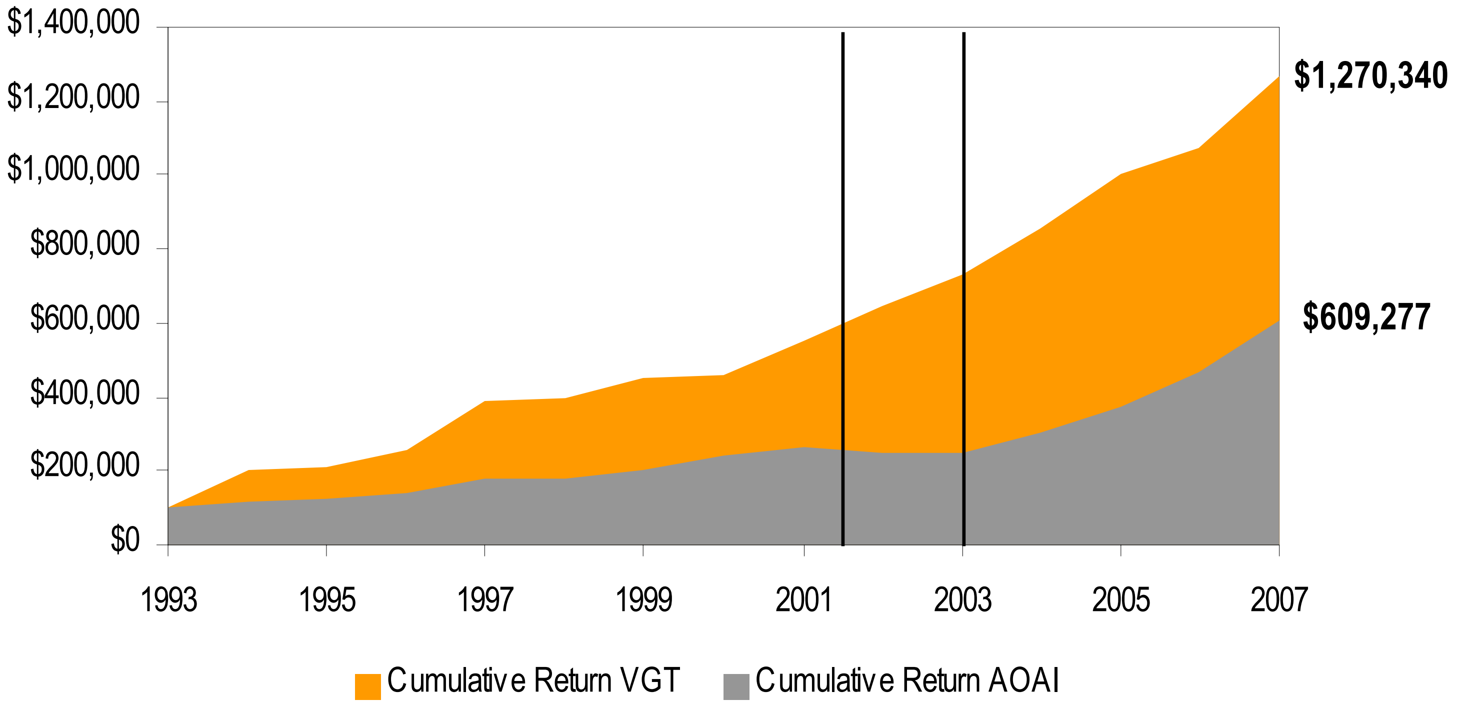
The process at work

MMC Value Growth Trust cumulative returns since inception in July 1993 to June 30, 2007

($100,000 invested versus the All Ordinaries Accumulation Index)



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