PORTFOLIO MANAGEMENT SEMINAR IMPRESSIONS

By R.E. Hayes, Sydney

I am a bit apprehensive writing on this topic as I still have memories of the recent "Security Analysts Meet the Press" meeting at which the press were attacked for not being fearless in their reporting. The press panel replied to this criticism by disclosing that they were inhibited by the strongest libel laws in the world. So with this in mind I will proceed with my subdued impressions.

To me the concept of getting 50 or so portfolio managers from around Australia together for a week has a lot of merit. With the participants fairly evenly drawn from the broking fraternity and major institutions it provided a balanced forum for the interchange of ideas between some of Australia's leading security analysts, a feat which, to my knowledge has never previously been accomplished.

Formal Proceedings

The subject matter presented at the various seminar sessions comprised of a spread between the practical applications of portfolio management and the academic approach to various portfolio management problems with the emphasis being on the measurement of performance and the risk/reward beta theory.

Unfortunately there are only a handful of academics within Australia who devote their research energies towards various aspects of the securities industry and whether or not they are all using their energies in the areas which have the greatest practical benefits is open to question - but I will have more to say about this aspect later.

The papers delivered by leading investment managers from the banking, insurance and merchant banking industries provided the participants with a clear picture of the problems facing these companies in deriving their investment policies and a fairly good insight into how they solve them.

The academic papers were of a different nature inasmuch as they were generally based on a particular concept and describing how it works. For instance, did you know that there is no use buying a stock after a good or bad announcement has been made to take advantage of this information as the market price has already immediately adjusted the moment it was announced. This is the efficient market concept and we now have empirical evidence with the assistance of computers etc. that this is so.

Well perhaps the computers etc. would like to take a look at Marrickville Holdings and Bell Bros. and tell me if it would have been too late to sell these stocks during three or four days following their recent dismal revelations. The answer will undoubtedly be that the Australian market is inefficient but perhaps that is not all that is inefficient.

Whilst I am reluctant to criticise the academic contributions, as these people have spent considerable time in preparing their material and some of it was indeed quite good, inevitably each academic session seemed to develop into a "did-you-know" routine which wears a bit thin after a week and in many cases was only a theory.

Apart from the practitioner and academic contributions there was a third category, namely Statex which is worthy of mention. Of the five evenings spent at the seminar, four included a lengthy session of Statex which unfortunately were not well received or supported after the first few nights. I say unfortunately because I believe that Statex is an excellent system and has a lot to offer the security analysts and portfolio managers.

It is somewhat complex in its terminology and an analyst who is accustomed to a simpler type of statistical format, requires a reasonable amount of time to acclimatize before he can diligently extract and decipher the wealth of statistical information it provides.

I was very surprised in talking to a number of institutional representatives at the seminar that many did not use the service, but back to the point, the Statex sessions were devoted to explaining how the Statex computer operator would draw-up his instructions to obtain a special run and extract data from the Statex files.

This may have been interesting for perhaps half a session one night but with the entire series of sessions on the same topic, it quickly became very uninteresting. I can see what the Statex boys were trying to achieve, and that is making portfolio managers aware of the versatility of the system and how it could be harnessed to benefit them, but on this occasion their approach was wrong and I am sure that with hindsight they will probably agree with me.

Statex certainly should have a place in the seminar as I am convinced that many portfolio managers do not have an awareness of the virtues of the system possibly because they do not subscribe to it and consequently do not understand the Statex terminology or concepts.

The Statex people have lectures on the basic application of their system but to understand it thoroughly one must work with it regularly.

Let's have Statex back at next year's seminar but possibly with a reduced session allocation and more interesting subject matter which has a little more meat in it such as:-

Average price earnings multiples - problems of collation and comparison with overseas figures

or

The treatment of Deferred Tax in arriving at earnings per share figures - overseas approaches to the problem

or

Non-recurring items, what constitutes above or below the line appropriations - variations from industry to industry

I am sure that the Statex evangelists could fill a couple of sessions on topics such as these which are very relevant to understanding the system and would no doubt enlighten or even convert some of the ardent non-believers.

Informal Proceedings

Under this heading I refer to the between session breaks, after hour activities at the local inn and the late night discussions over a few drinks at which the proceedings of the day and other associated problems were informally discussed in a casual and relaxed atmosphere. This impromptu type of discussion yielded some very interesting food for thought and provided an ideal setting for the interchange of ideas. Indeed I believe that this unplanned often spontaneous nature of discussion provided some of the more valuable rewards of the seminar whereby portfolio managers and security analysts were putting their heads together and discussing the various problems they have struck and hearing how other people approach these problems.

Even more important, however, was the spirit in which most of these informal chats took place often resulting in a clearer understanding of the other persons point of view (even if you did not agree with it) and if the other participants experience was the same as mine they would have come away from the seminar with a large number of newly established friendships.

Thoughts for Future Seminars

The most insufferable part of the seminar was created by a long term problem which has existed since the first University was erected and unfortunately, no doubt, will continue for some time yet. The problem in one word is "ac-endemics". These are the people who stand on the side lines, watch the play and think they know all about the game without ever having played it themselves.

Whilst my comments are not directed to all the academics who participated in the course, many of whom were capable of seeing both sides of the coin, I could not help thinking that there were, one or two times during the week, when the overbearing attitude of "we've looked at this and its right and you (the portfolio managers) must be fools because you do not know about it" penetrated the usually thick skin of the market seasoned portfolio managers.

In particular I remember one specific session where the entire group was lost after the first five minutes because of the over-complex typically academic nature in which a subject was presented. Towards the end of the session the lecturer sensed that he had not got his message across and commented that he could not explain it in any simpler terms with a firm implication that portfolio managers must be second class idiots, and to rub salt into the wound the session ended with a ridiculous question which in practical terms had about as much usefulness as pockets in singlets. No one knew the answer or could have hazarded a semi-intelligent guess but when challenged by one of the seminar members who was still awake at that stage, "that the portfolio manager generally would not consider the question relevant" the terse reply was "well they should".

This attitude is just not good enough, here is a person with an apparently great ability who is one of the very few academics in Australia actually looking at various aspects of security analysis and portfolio management and yet I seriously doubt if he had ever approached a portfolio manager and asked him what type of problems need answering. It would appear that he has a pre-conceived idea of what he thinks is the problem and will spend a year or two researching it, ultimately writing a few papers on it.

I will make a prediction now that some of the major work presently being undertaken by academics in Australia in the field of portfolio management when finally completed will have absolutely no practical value to the securities industry and will ultimately become buried in the University archives.

A lot of people may think that my criticism of academics is too harsh and more destructive than constructive, but I feel that unless this situation is discussed frankly, no progress will be made in bridging the gap between the practitioner and academic. Ideally the relationship should be one of close consultation and co-operation. The practitioner can recognise the major problems which require solving but generally because of the pressure from day to day work he does not have the time to devote to them.

If a country, community or industry sector is to utilise its resources to achieve the greatest productivity, the academic should be solving the practitioners problems while he gets on with the job, but what value is there in the academic pursuing research which is of limited interest or usefulness to the practitioner.

The problem as I see it is one of communication and although I have just slammed academics, perhaps the ball is in our court inasmuch that we do not appear to have at this stage the machinery in our organisation to collate problems within the industry which require solving.

Perhaps a classic example of this is the treatment of the major problem facing the security analysts at present, that is the lack of company disclosure. Some valuable work was done on this topic last year by the Society and the matter was again raised as part of the subject content of the seminar, but nothing further has been done.

This topic I believe is the most vital problem within the industry at present as the standard of disclosure is well behind the requirements of other major international financial communities and what is the point of looking at the improvement of other areas of security analysis if our raw material is suspect.

The way the political scene is shaping up it appears inevitable that there is going to be some kind of regulatory body imposed upon the securities industry and I believe that if we are going to be an effective organisation we should have a submission fully researched and documented on the requirements for company disclosure to present to this body when it is promulgated.

As a suggestion, not only for the benefit of the compilation of subject matter for future seminars, but to facilitate the solution of existing problems during the course of the year, perhaps a sub-committee could be formed to gather and collate the problems of our industry and to form a work panel including a spread of both practitioners and academics to set about formulating a solution. In turn this could result in some of the more enlightened academics looking at problems which could benefit the practitioners and at the same time provide more interesting and practical subject content for future seminars.

Some members may argue that we are exceeding our charter by taking on this nature of work particularly in respect to company disclosure which could infringe on the areas of the Corporate Affairs Commissioners and the Stock Exchange Committees responsibilities, but as I see it we have to formulate some system for solving our problems or they will continue to plague us for years to come and the general efficiency of security analysis within Australia will not improve.

In conclusion, I offer my congratulations to planners of the 1973 Seminar and in particular our friendly American guest Mr. Jack Treynor who contributed a considerable amount to its success. I look forward to an even better seminar being planned for 1974 now that we have the benefit of the few short-comings of the inaugural one behind us.

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EMPIRICAL VALUATIONS OF FIXED INTEREST SECURITIES?

In the February issue of the Journal, Mr. N.E. Renton detailed a most ingenious method of overcoming one of the difficulties associated with the valuation of certain fixed interest securities. The difficulty which was treated by Mr. Renton arises out of the fact that some such securities are rarely traded and some problems may be experienced in applying a yield basis which was appropriate, say, six months' earlier, to a current valuation. Mr. Renton made an important contribution towards solving this problem in his suggestion that the yield margin between the security to be valued and Commonwealth loan at the time the last sale of the fixed interest security took place be transposed on to the yield at which the Commonwealth loan is being traded at the time of valuation. As Mr. Renton says, this method is completely objective and automatically allows for any changes in interest rates as well as for shortening of currency since the date of the last sale of the fixed interest security.

However, Mr. Renton's formula is based on an important assumption, viz: that movements in yield on Commonwealth loan are matched by identical movements in yield in other fixed interest securities. While this may be true on most occasions, and certainly is the case as far as Semi-Government loan is concerned, it has happened that yields on corporate debenture stock and Commonwealth loan have failed to maintain a constant margin. For example, at the present time we have seen a movement of approximately ½% in the top yield on corporate debenture stock even though the long term Commonwealth loan yield has barely moved. Similarly, in the early 1960's, there were several issues of Commonwealth loan which offered a higher yield on the short term section (two years) than on the twenty year section, and this situation was certainly not matched by corporate debenture yields.