

Pengana gets the News the other miss

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The phone-hacking scandal engulfing News Corporation has hogged the headlines in recent weeks, but Rhett Kessler is doing more than having his two cents worth on the issue – he's buying the stock.

Kessler manages the Pengana Australian Equities Core Fund, which began buying News Corp shares as the scandal broke. News's share price is down 11.2 per cent this month and there are still uncertainties about management fall-out.

Paradoxically, Kessler is actually hoping the scandal may force News Corp chairman Rupert Murdoch into retirement – a positive for the company, in his view.

"When I'm feeling a bit light-hearted about it and people ask me 'Why are you buying News Corp?', I say because I might not outlive Mr Murdoch but my children will," Kessler says.

"When he eventually resigns, a lot of value will be unlocked. Because then [the company] will be run for profit rather than for empire."

News Corp has since withdrawn its bid for UK-based subscription TV broadcaster BSkyB, but Kessler doesn't believe the loss of the deal is a bad thing for the company.

Murdoch has made bad acquisitions, like social media company MySpace, on previous occasions, he says. "I'm quite happy that it fell away and I think they should give that money back to shareholders."

Pengana's Australian Equities Core Fund has just celebrated its third birthday. Since inception in June 2008, the fund has delivered a total return of 36.1 per cent, compared with a 0.68 per cent decline in the S&P/ASX All Ordinaries Accumulation index (which includes dividends).

In the 2011 financial year, Kessler's fund returned 17.4 per cent net of fees. The average return for long only fund managers in the year to June was 12 per cent, according to the most recent Mercer survey.

Kessler has good reason to be concerned about the fund's performance: "I'm the single biggest retail investor in the fund," he explains. "And I don't invest outside the fund at all. That gives my clients or my fellow investors the confidence that I'm totally committed."

Kessler puts the fund's performance down to sticking to a strongly-held belief – if you don't get it, don't buy it.

"One of the tenets of our philosophy is that if we don't understand something, or we can't predict performance, or we don't know how it's going to play out, then we don't play," Kessler says.

"For something like a Macquarie Group or AMP, we don't understand what we're buying for every dollar we put in," he says.

"If I buy something like Crown for example, I know 60¢ in every dollar goes into the Melbourne casino, 30¢ comes from the Burswood casino and 10¢ from Macau and other bits and pieces. I know each of those business streams."

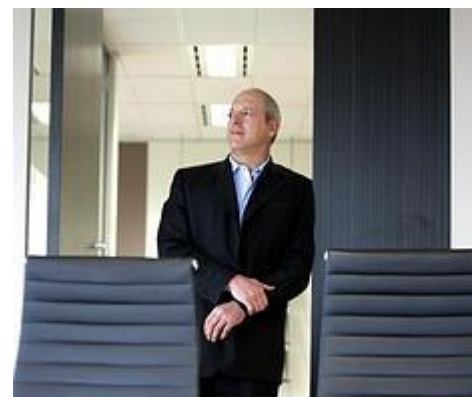
This straightforward approach has led Kessler's fund to some interesting positions, including a refusal to take on any stocks that are remotely cyclical in their earnings.

Even the resources sector, including investor favourites and blue-chips Rio Tinto, BHP Billiton and Fortescue, get the toss.

"When I think about a resource stock like BHP, Rio and Fortescue, they're driven by future iron ore and coal prices. I can't work out what the iron ore price is going to do over the next few years. If the iron ore price halves, they'll still send the ore overseas – it's just that shareholders won't make as much money."

Open to wholesale and retail clients, the Core Fund had \$39 million in funds under management at the end of June.

Its top five holdings at present are infrastructure company DUET Group, insurer NIB Holdings, Commonwealth Bank, Seven Group Holdings and McMillan Shakespeare.



Rhett Kessler only buys the companies he understands. **Photo: Rob Homer**

DUET is a top pick thanks to its ability to deliver returns through boom and bust.

“The reason we like it is because each of [the company’s] assets generate economically resilient, regulated revenue streams, which are highly predictable and sustainable.”

Kessler adds that his fund has been busy buying into DUET during the recent market sell-off, with the company trading close to a 12 per cent dividend yield.

“Dividends are a very important proxy for cash earnings.

“If a company has fully franked, sustainable dividends growing over a long period of time it’s obviously got decent after-tax cash earnings.

“But you don’t want to fall into the trap where a company pays great dividends, but they’re borrowing to pay them or they’re not sustainable,” he warns.

Pengana’s Australian Equities Core Fund has a mandate to keep itself fully invested in the sharemarket, meaning a percentage of the fund can go to cash when there is a lack of opportunity.

The fund is now 18 per cent in cash, and Kessler is looking for buying opportunities in existing holdings like DUET as well as brand new companies to add to the portfolio in a sluggish market.

“I’m very cautious about the outlook in terms of the general economy and I’m very negative about some of the global imbalances in place,” he says.

“We’re seeing opportunities. There are companies which have resilient business models that have been sold off as though they were going to be destroyed by these issues.”

News Corp now fits this bill.

The Australian Financial Review

[Correction](#)

An article on page 19 on July 18, “Pengana gets the News the others miss”, incorrectly said the Pengana Australian Equities Core Fund had a mandate to be fully invested in the sharemarket. The fund has a flexible mandate allowing it to invest in cash when there are no investable opportunities.

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