FINANCIAL REVIEW
PREMIUM

Meet the man who is probably Australia's most outstanding investor

Richard Fish of Benelong Fund Management. **Michelle Smith**

by **Jonathan Shapiro**

Richard "Dick" Fish is, by the numbers at least, Australia's best investor. Alongside partner Sam Shepherd and his team, the legendary pairs trader has built a 10-year track record that is second to none.

Since its inception in 2002, the Bennelong Long Short Equity Fund strategy has returned investors 10 times their money, compared to about two times for the broader sharemarket.

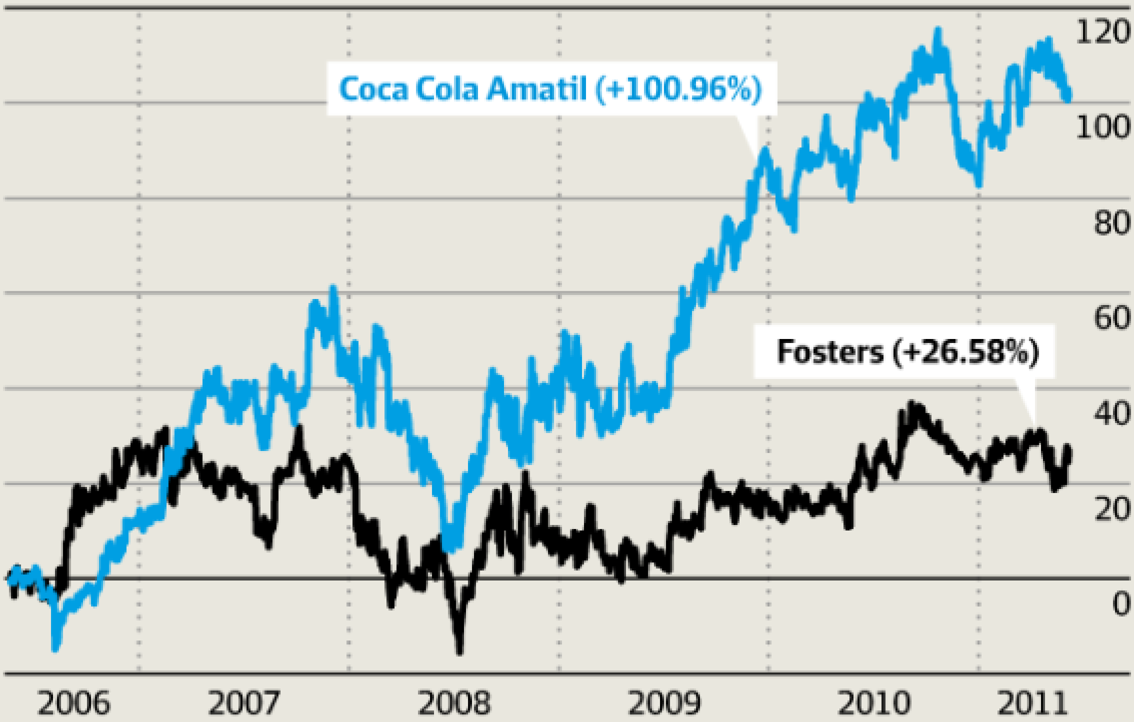
The 18.5 per cent per annum return is outstanding and should make Fish a funds management legend. But few outside of Australia's low-profile hedge fund community know of him. In his 25-year career, the softly spoken investor has avoided the media and the limelight, rarely agreeing to interviews.

That is changing this week, as Bennelong began marketing a listed investment company tied to his fund. It has led Fish away from his desk to embark on an extensive and exhausting roadshow across the country to meet a vast network of planners and advisers.

Pair shaped

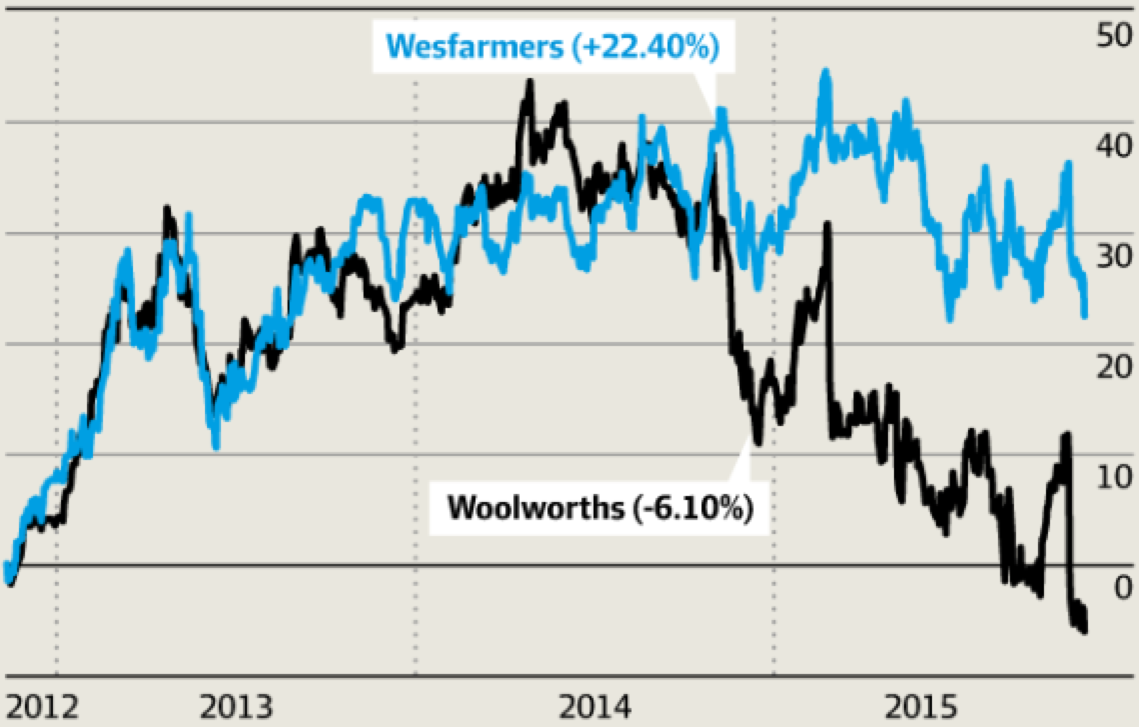
Comparative performances

Coca Cola Amatil v Fosters (%)



- Pairs trading involves buying shares of in one company and selling or shorting the shares of another, typically in a related industry.
- The trader takes a view that one company will out-perform another, regardless of whether the market rises or falls. The higher the divergence, the more profitable the trade.
- The first chart shows how beverage firm Coca Cola Amatil almost doubled in five years in 2010 while brewer Fosters only gained 25 per cent, creating profits from a trade that bought the former and sold the latter.

Woolworths v Wesfarmers (%)



- More recently Woolworth's woes have been reflected in a sharp share-price decline. Wesfarmers which owns rival grocer Coles has held up better.
- For most of the last three years, the two stocks tracked each other, but more recently the divergence has helped funds that have bet against Woolworths and bought Wesfarmers.
- The strategy is difficult for retail traders to do themselves as it requires access to a prime broker to borrow shares in order to 'short' them and to manage the risks associated with relative bets.

SOURCE: BLOOMBERG

The process is fascinating, he says, as he's meeting massive dealer groups he didn't know existed.

Equally fascinating is understanding how he's managed to deliver such consistently high returns.

"One thing I've learnt is to keep things as simple as humanly possible," Fish tells *AFR Weekend* in a small meeting room in Bennelong's Bond Street offices after a long day of meetings in Sydney.

"It sounds trite, but investing is simple and one way of simplifying it is to take out the risk you can't control."

The fund does this by trading pairs of stocks – betting on one and betting against another (this is also known as shorting) so returns are generated by how the stocks perform relative to one another.

This is stock-picking in its purest form, free from the constraints of an overbearing index benchmark and the whims of global markets.

"Mean reversion is your enemy. We want dispersion. All we are interested is the relative value between two securities that we think are homogenous."

Here's an example. A pairs trader could take a view that Commonwealth Bank was a better stock than Westpac by buying CBA shares then shorting Westpac shares. If the market sells off and both shares fall, the trader will still make money if Westpac falls by more than CBA, because the short position gains will be larger than the loss of owning the CBA shares. If the market rises and CBA gains by more than Westpac, again the trader will profit because the gains in the "long" CBA position will more than cover the losses from betting against Westpac.

The fund limits itself only to 30 to 35 pairs, or 60 to 70 positions, and only in ASX 100 stocks.

FAMILIARITY IS KEY

Some believe it's a small pond but Fish believes the "limited universe" is its edge. He has to know every stock backwards, quite literally.

"We know the companies, we know the drivers. We have the degree of familiarity."

Pairs trading sounds clever, and even simple. But it's not. Few are able to achieve the hit the same hit rate and much of the success appears to lie in Fish and Shepherd's skills. Little wonder "key man risk" is prevalent in the LIC prospectus.

Over the years, the fund has had some big wins that appeared counter-intuitive.

He shorted Woodside into 2007 even though it rallied hard – others fund managers thought he was crazy – but he made more money by being long Oil Search.

"It's disciplined and counter-intuitive to be shorting into a market that's rising or buying things that you think are expensive."

He says the trade his team "most enjoyed" was to go long Coca-Cola Amatil and short Fosters. The latter gained about 25 per cent in the five years before it was bought by global brewer SABMiller in mid-2011, while Coca-Cola Amatil doubled in value in the same period, according to Bloomberg data.

"They are similar companies exposed to similar drivers – one well-managed, the other not. People think that if a company underperforms, someone will come in with a magic wand and fix it all up. History says that doesn't happen very often."

Bennelong's Long Short Equity Fund has $320 million of funds under management. Fish and Shepherd are investors in the fund and the business. They're the latest in a string of star managers to launch a listed investment company, a closed end fund that raises money and then trades on the Australian Securities Exchange.

Fish says the LIC route is not so much about "permanent capital" but rather a means of diversifying the base of investors in the fund. There's a clear shift away from wholesale investors towards retail because of competition and pressure over fees, he says. The LIC charges a 1.5 per cent management fee and a 20 per cent performance fee on anything above zero, consistent with the wholesale fund terms. That might seem excessive to some but few could dispute that this hedge fund is delivering the alpha it's charging for.

As he meets the retail world, one gets the sense he's coming face to face with some of the owners of the stocks the fund has successfully shorted.

"We've had a successful pair being long Wesfarmers, short Woolworths, which has been running for three years. We mentioned that today we still felt Woolworths was a short candidate with structural issues that don't go away easily – and I think a fair amount of advisers had the sad face on because they probably have them in their client portfolio."

BUYING FOR THE WRONG REASONS

The lust for yield, primarily driven by retail investors and self-managed super funds, is a particularly strong theme for Fish.

"The fund struggled this time last year and it coincided with negative bond yields in Europe. Money found its way here and people were buying the stocks that populated our short book for totally the wrong reasons – high-dividend yields."

"We've seen those BlackRock income ETFs and they're filled with mining service stocks and that's just crazy – they're buying for the wrong reasons."

While companies trading on high-dividend yields have been luring investors, Fish says this is a warning bell, not an opportunity.

"Sam Shepherd always says 'yield is the last green bottle to fall off the wall'. It's a big thing for the company to change its dividend policy."

There's a big likelihood BHP is about to face this but it has an unsustainable policy of progressive dividends when its earnings are collapsing around its ears.

He also doesn't spend too much time worrying about the big banks which dominate the sharemarket index. The analysis is complex, he says. He concedes there was an "alpha" opportunity in betting on CBA versus the rest.

But a previous short position on ANZ shows how Fish and Shepherd cut to the core to make a call.

"Our premise is long good companies, short bad companies. Sometimes it's apparent with one company taking market share away from another but other times it's more subtle. With ANZ we were scratching our heads over the Asian strategy."

"The ROE on an Australian mortgage was 18 or 19 per cent and they're competing with the A team in Asia, where the average ROE on the loan book is the low teens."

The signal to short the bank was when CEO Mike Smith said they would target 25 per cent of their returns from Asia.

"We thought that was strange – like Qantas defending market share."

He's not about to go long the banks any time soon.

"They are great businesses but they've hit an earnings wall and the capital cycle has changed. They've gone from buybacks to issues. It's not advanced finance leading us to these decisions, just common sense."

The short position in ANZ was paired with a long in annuities provider Challenger, a long which it has maintained.

"We are making judgement on management and people who were around remember the bad Challenger days and don't recognise that it has transformed."

That position may surprise some. But even more surprising is Fish's revelation that he refrained from joining just about every hedge fund on the planet in shorting Fortescue Metals Group.

Fish said he thought it was "too obvious".

"You were fighting China Inc and they're just as likely to come in and buy the infrastructure assets, and somehow you could get screwed.

"Even though it was fundamentally obvious or highly likely that the iron ore price would fall and that they were highly leveraged, we just looked elsewhere. Because we could."