

FINANCIAL REVIEW

How Lanyon beat the market with 50pc cash

Buying unloved stocks and holding cash doesn't win you friends but it's a winning strategy says Lanyon's David Prescott.

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Lanyon's David Prescott and the lonely pursuit of the deep value investor



Lanyon's David Prescott: "Everyone thinks you are nuts but often these are the stocks that have turned out to be the star performers."



by [Jonathan Shapiro](#)

Famed investor Seth Klarman's observation that "you don't become a value investor for the group hugs" has resonated with David Prescott who can't help but feel that the beaten down stocks the fund buys leaves him lonely and unloved.

"Everyone thinks you are nuts but often these are the stocks that have turned out to be the star performers," he tells *The Australian Financial Review*.

The value-investing path isn't an easy one, says Prescott who began investing in stocks in the late 90s by taking stakes in Ten Network and NSW TAB via their public floats.

There was "no independent thought or any form of analysis," he explains but it gave him the investing bug. He then set about reading every investment book possible to understand how the best investors achieved their masterful long-term returns.

"Their success was never due to luck, but painstaking hard work and disciplined value process," he says.

Prescott cut his teeth at institutional fund manager CP2, where he learnt the importance of conducting independent, thorough and detailed analysis. He found himself there during the financial crisis and saw that despite the destruction, the investment landscape was "littered with some truly remarkable opportunities".

To take advantage he created a fund that had a broad flexible mandate but resisted the temptation to grow assets too quickly. "I have always felt investment firms are conflicted and are tempted to grow assets, which does compromise their ability to generate returns to investors."

That led to the creation of Lanyon Asset Management with well-known Australian investor Erik Metanomski.

"Erik was the first call I made and we've been partners ever since. Value investing should seek to first protect and then enhance capital and that remains our primary objective," he says.

"Investors live in an absolute world and spend absolute dollars. The relative performance is absurd to us.

"We think the best investments are those that have a considerable margin of safety – so that even bad luck and business cycle challenges won't derail an investment decision."

The fund has \$200 million of assets under management, and after briefly opening to new investments earlier this year, is closed again after securing \$35 million. Lanyon also launched a smaller global equities fund to expand its search for value beyond Australia.

Since inception in July 2010, the fund has returned over 120 per cent, after fees, more than double the 60 per cent return of the All Ordinaries and S&P/ASX 300 indices. The annualised performance is 16.4 per cent (14.1 per cent after fees) compared to 8 per cent for the broader indices.

But value investing does come with costs. Prescott says the focus on value often means buying and selling too soon.

The other pitfall of value investors are the so-called "value traps" – stocks that look cheap but either never realise their value or simply turn out to be duds.

To avoid that Prescott says the fund seeks investments where there is a catalyst that will result in the value being realised.

One of Lanyon's points of difference is the ability to hold as much cash as it wants if it so desires. During the six-year life of the fund it has averaged a 50 per cent weighting to cash, which makes its performance all the more impressive.

The high cash position, he says, means that the fund "has been able to deliver twice the sharemarket return with half the volatility".

"We feel privileged to be afforded the luxury to not have to maintain a fully invested posture. Cash is a luxury and despite the simple maths we don't think our returns would have been twice as high.

"It's an advantage to have it available to act more swiftly and decisively and we think our returns would be lower without the ability to hold cash."

So what hidden valuable gems is Lanyon polishing in its portfolio?

One stock that has performed well for the fund is PMP, the once out-of-favour printer that is up 300 per cent since the start of 2013. With consolidation inevitable in the industry, he says, profits and the share price could rise further.

Another is telecommunications contractor BSA – a company that Prescott says had lost its way and was crippled by leverage. Lanyon took part in the rights issue that repaired the balance sheet. The disorder and chaos, he says, created an opportunity for a new management team to improve margins for the business.

The roll-out of the National Broadband Network is creating a sizeable revenue opportunity, he says, and it's only a matter of time before the market catches on and re-rates the stock.

Lanyon has also found what it believes to be a couple of overlooked gems in the offshore markets. One is Hong Kong-listed Cross Harbour Holdings which Prescott says is the "cheapest infrastructure company in the world".

Another is NASDAQ-listed RMR Group, a property management company that found its way onto the stock market via a complex spin-off in which stock was distributed to investors in certain US Real Estate Investment Trusts that partly owned the business.

Finally, an entirely new frontier for Lanyon is resource stocks and in particular Australian gold shares. The king of value investing Warren Buffet has made his thoughts on the irrationality of buying gold well known but in a world of negative interest rates and falling production costs, Prescott says its worth a look. Newcrest Mining, one of its holdings, has doubled this year, and Prescott believes it could double again in time.

"It's interesting, as old school value guys, it's not typically an area we would hunt but we see value."

Prescott says the stock market is both a hobby and a passion. But it can be all encompassing and all-consuming which means it is important to have interests beyond investing. For Prescott, who was a "keen but average" amateur footy player, his passion is Port Adelaide, the club his grandad represented in the 30s. He is a member of Port Adelaide chairman David Koch's eastern state advisory board to promote the club outside of Adelaide.

Much like footy, the stock market can pound a player that takes their eye off the ball.

"It is a great leveller. The minute an investor becomes complacent or gets overconfident the market finds a way to catch you out."