
SELECTOR FUND UNIT PRICE

Month Ending	Entry Price	Exit Price	Mid Price
Nov 30 2004	\$1.0270	\$1.0218	\$1.0244
Dec 31 2004	\$1.0509	\$1.0457	\$1.0483

FUND COMMENT:

The Fund gained 4.8% (net of all fees) for the two months to December 31st 2004. **SFM**

BIG PICTURE:**4000+. Is it time to sell?**

It takes time to uncover an emerging business that has great potential. Stock selection involves reviewing annual reports, holding meetings with management, staff and competitors, cash flow modeling and lots of reading. In a nutshell, this is how we build an investment roadmap. We discussed our "Investment Roadmap" in our *March 2004 quarterly report, issue # iii*.

Once carefully selected an investment requires time. All businesses, even potentially great ones, need time to develop, grow and evolve. We discussed the importance of "time" in our *September 2004 quarterly report, issue # v*. This quarter we discuss 3 main reasons we sell a stock.

3 main reasons we sell a stock

At the end of December 2004 the All Ordinaries index surpassed 4000 points for the first time. 4000 is simply a marker in the sand for an index - with an ever changing composition. Mistakenly we believe, many investors, prompted by market commentators and the fear of losing their profits, sell out or start to sell when new index levels are attained. Yet they say that, "no one rings the bell at the top". So, why should we believe that 4000 is the bell?

In our view there are 3 main reasons to sell a stock, selected on the basis of our investment road map. And they are not related to an up or downward index movement. They are philosophies that have held true and been successful for over half a century.

THE FIRST REASON TO SELL A STOCK is when a mistake is made. After an investment is made the factual background of the business may change or differ for varying reasons. Under these circumstances a swift sale of this stock should be undertaken without taking into account any investment index. We believe the only way to deal with a mistake is head on.

An investment mistake needs to be recognised early and ego needs to be left on the sideline. If a manager understands that a certain percentage of errors will be made he is less likely to be fearful of a small loss. Decisive action is more prudent than prolonging the mistake by hoping to get square.

What is important is not that a loss will occasionally occur. The real issue is if large profits continually fail to emerge. If this becomes apparent clients must question the managers methodology.

THE SECOND REASON TO SELL A STOCK is generated during a review of the investment roadmap of a business.

When reviewing a businesses investment roadmap we look for road signs that alert us to fundamental changes. A change in the; debt profile, financial ratios, management or capital expenditure all provide warnings.

Once a stock has been carefully selected... there are few reasons to sell it.

Any fundamental change in a business, deterioration of management quality, or other reasons that mean a stock no longer meets our investment roadmap would trigger a sell order regardless of the current market outlook.

Here the speed of the sale is governed by the fundamental change in the business – and its impact on future cash flow and earnings per share. Once again this selling trigger does not relate to the overall market outlook or index level.

THE THIRD REASON TO SELL A STOCK selected on the basis of our investment roadmap is opportunity based. Great stocks come along at the right price infrequently. And the timing may not coincide with excess funds at hand.

Switching from one opportunity to another requires careful consideration. Multiple elements are at play here that may lead to a misjudgment. These will typically include, comparative future earnings per share, growth rates of the stocks being considered and capital gains tax considerations. Not the least is the fact that the level of understanding of a long held stock will likely be far greater than that of the new opportunity.

The key element that emerges is that once a stock has been carefully selected, has proven itself with time and fundamentals remain intact, there are few genuine reasons to sell it.

Are other reasons for selling valid?

ARE OTHER REASONS FOR SELLING VALID? The most frequent reason an average investor sells is that a correction or bear market is due. This is no reason for selling an outstanding investment. **FIRSTLY**, you are selling a business that you know a lot about, which presumably has great prospects, for a reason that you have guessed may occur in the future. The chance of that guess being correct is further diminished by capital gains tax and transaction costs.

SECONDLY, if the stock has been correctly selected the next bull market should see the stock making a peak above its previous highs as we are seeing at present with examples such as Publishing and Broadcasting Limited and QBE Insurance Limited. Equally few investors re-enter an investment when a bear market sets in. They are more likely to hold off waiting for a stock to go lower.

FINALLY, a seemingly logical argument is that even an outstanding stock should be sold when it is overpriced. The reality is that a great stock is always likely to sell at a higher ratio to earnings than a stock with stable rather than growing earnings. And, some premium will be attached to the likelihood of future earnings growth.

We believe that what really matters is not disturbing a position that may be worth a great deal more in years to come.

We have no doubt that a careful and consistent approach to building a road map coupled with care in avoiding potholes is a more prudent long-term investment strategy than basing decisions on an arbitrary index.

As Philip A. Fisher wrote in his very worthy *Common Stocks and Uncommon Profits* nearly 50 years ago. "If the job has correctly been done when a common stock is purchased, the time to sell is – almost never". **SFM**

AND... A REALITY CHECK.

When a fundamental change in a business leads to a profit warning the reaction time is close to zero. As an investor you are in the vortex and the impact is felt almost immediately. This is the reality of equities market downgrades.

As we complete this newsletter the newly listed **LIPA PHARMACEUTICALS LIMITED** has downgraded its prospectus net profit after tax by up to 25% and the share price has fallen 36%.

We do not own shares in **Lipa** as we write.

We have watched **Lipa** from day one. We have attended briefings, the AGM, interviewed customers and a former industry Managing Director. We have had very mixed responses to date. We have a site visit scheduled for the 4th of March 2005. **Lipa's** credibility is undoubtedly tarnished.

We will continue to follow this one and try to learn from it. Will we invest? We don't know.... But we try not to shut any doors. **SFM**

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minimum investment \$500,000

or

Retail investors Visit

www.ddhgraham.com.au

Selector Australian Equities Fund (SAEF)
Issued by DDH Graham Limited
minimum investment \$20,000

Selector Diary Q4 2004

Companies Visited in Q4 2004		
1-10-04	Biosignal	BOS
13-10-04	Toll Holdings	TOL
15-10-04	SAI Global	SAI
18-10-04	Crane Group	CRG
19-10-04	Perpetual Trustees Australia	PPT
19-10-04	Cochlear	COH
26-10-04	Biota	BTA
27-10-04	Arrow Pharmaceuticals	AWP
27-10-04	Sigma	SIG
1-11-04	Vision Group	VGH
1-11-04	Gullivers Travel	GLS
3-11-04	Pharmaxis	PXS
5-11-04	Triako Resources	TKR
5-11-04	Brickworks	BKW
5-11-04	Cosmos	COO
8-11-04	Babcock & Brown	BNB
9-11-04	USCOM	UCM
11-11-04	Keycorp	KYC
11-11-04	Vision Group Site Visit	VGH
16-11-04	Count Financial	COU
16-11-04	Red Metal	RDM
16-11-04	Macquarie Bank	MBL
18-11-04	Patrick	PRK
18-11-04	Verticon Group	VGP
24-11-04	Harvey Norman	HVN
25-11-04	Challenger Financial Services	CGF
30-11-04	Cochlear	COH
1-12-04	Chemgenex Pharmaceuticals	CXS
3-12-04	Macquarie Communications Infrastructure Group	MCG
7-12-04	Institute of Drug Technology	IDT
13-12-04	ESSA Australia	ESS
14-12-04	Babcock & Brown Capital	BCM

SFM MP Activities during Q4 2004	
Purchases	12
Sales	0
Takeovers (still current)	0
# Investments in fund	12
# Investments > 5% fund	6
# New Public Listings	1
# Placements	2
Company visits	19
New Companies Reviewed	13



Winter George Koeman Vincent
Born 7.30am, 7th January 2005
W. 3.9kg L. 55.5cm

First child for Mel and Corey who are both pretty thrilled!

Disclaimer: Initial applications for units can only be made on an application form attached to the Selector Funds Management Limited Information Memorandum dated 1 July 2003. Selector Funds Management Limited or any related entity does not guarantee the repayment of capital or any particular rate of return from the Trust. Past performance is no guarantee of future performance. Investment returns have been calculated in accordance with normal industry practice utilising movements in unit price and assuming reinvestment of all distributions of income and realised profits. This report does not constitute financial advice and readers of the report should consult their financial advisers before making any further investment in or withdrawal from the Fund. Tables and charts in this report are as accurate as possible on the date of publication. Please note that they are subject to continuous change. The past performance of Selector Fund managed by Selector Funds Management Limited represents a model portfolio simulated to test the systems used by Selector Funds Management Limited from 21 January 2003 through to the end of the 2nd Quarter, 30 June 2004. Due to volatility of underlying assets of the fund and other risks associated with investing, returns can be negative particularly in the short term. The model portfolio is calculated before fees are taken into account. Selector Funds Management Limited will apply an annual MER, which will reduce the reported performance. In circumstances where a performance level is achieved as set out in the Information Memorandum a performance fee is an additional charge, which will reduce the reported performance of the Selector Fund.