Mr. Goldman's article in the May edition of the Journal raises a subject which certainly requires much more research than it has so far received in Australia. I would think that most of the principles of portfolio diversification which are followed in this country are based on those which have been formulated in the United Kingdom with perhaps some modifications from U.S.A. sources.

Before considering the diversification of the equity section of a portfolio, it may be as well to look at the diversification by type of security that has been achieved by the largest group of investors in Australia, namely the Life Offices. From the official statistics, the percentages seem to be as follows in the main groups:

- Government Securities \( \ldots 24.9 \)
- Other Public Securities \( \ldots 9.9 \)
- Corporate Fixed Interest \( \ldots 10.0 \)
- Preference Shares \( \ldots 2.1 \)
- Ordinary Shares \( \ldots 10.0 \)
- Property \( \ldots 8.0 \)
- Mortgage Loans \( \ldots 30.4 \)
- Other Investments \( \ldots 4.7 \)

Total \( \ldots 100.0 \)

While the percentages in Government and Other Public Securities are virtually forced on them, one wonders if the other percentages are by accident or design and if the latter, to what extent considerations other than those of obtaining the highest possible yield have affected the distribution between these groups. Because of the tax situation and because there seems little prospect in the foreseeable future that the life offices will need to realise on investments to meet claims, it would be very difficult to make out a case for mortgage loans which probably yield less than four per cent. after tax and expenses as against ordinary shares which should yield at least six per cent. effective over a long period.

Although there is a general tendency to invest a rather greater proportion of their funds in equities, the pension funds also seem to follow an investment policy which is more conventional than realistic. As an example, the official statistics indicate that 21.4 per cent. of the total investments were held in "Other Public Securities" as at the end of 1961. This group of investments is neither high yielding nor highly liquid in Australia but is a popular pension fund investment in the U.K. where there is an active market in such securities.

Non-Life insurance companies' investment portfolio details are not available in aggregate from official sources, but from an addition of the figures appearing in the published accounts of three of the larger ones the proportions are roughly 17 per cent. Property (including their offices), 32 per cent. Public Securities, 23 per cent. Mortgage Loans and 28 per cent. Company Securities. These percentages suggest that, despite the very different type of liabilities, the proportions in which the investment portfolio is distributed are very similar to those of the Life Offices. When one considers that the same tax "incentives" do not apply so far as the public securities are concerned, this similarity is even more surprising.

Mr. Goldman's article deals mainly with industry diversification of an equity portfolio and he concludes that so far as the two Swiss managed funds are concerned "the difference in emphasis must reflect either differing views on the prospects of an industry in the different countries or the availability of stocks", and so far as the U.S.A. Investment Trusts are concerned "the marked variations, in part, are the result of the much wider choices available to the U.S. portfolio manager". Unfortunately, Mr. Goldman rather spoils his argument by using different industry groupings for his overseas portfolios to those he has chosen for his Australian ones and so far as the U.S.A. portfolios are concerned it is rather noticeable that 1 and 2 are very heavily weighted in Oil and Natural Gas (22.6 per cent. and 27.8 per cent. respectively) while 3 has no less than 34.3 per cent. in Public Utilities. I wonder if these portfolios are representative of the type of full diversification practiced in the U.S.A. So far as the Swiss managed funds are concerned, if they are re-classified to conform with the Australian classification, they would compare as follows with the four Australian portfolios:

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(Continued Inside Back Cover)
PORTFOLIO DIVERSIFICATION (From Page 5)

Even with the "much wider choices available", the Swiss managers do not seem to have taken noticeable advantage of them so far as their U.S.A. and Canadian portfolio is concerned.

Because of the problems involved in any international comparison, I hesitate to try to draw any conclusions from these percentages. However, the similarity in the proportions in Industry Groups 12 (Automotive) and 13 (Non-Ferrous Metals) is apparent and if Basic Materials and Steel & Engineering (Groups 8 and 9) were taken together there would also be some noticeable similarity. The wide international divergencies occur in Groups 10 (Building and Construction) and 11 (Electrical). No doubt, a large number of explanations could be thought up in this connection.

It is again unfortunate that Mr. Goldman should raise the old catch-cry (or bleat)—"Shortage of scrip". No shortages exist at the "right" price and it is only necessary to look at the figures for overseas portfolio investment and compare them with the total investment in equities made by the Australian Life Offices, Unit Trusts, Mutual Funds and selected larger Pension Funds. It will readily be seen that very substantial quantities of ordinary shares have been changing hands over the last five years. With the decline in overseas portfolio investment, it should follow that the local institutions will increase their buying of equities. Perhaps this may happen but the low volumes and low prices on the Australian Exchanges make it abundantly clear that the local institutions were certainly not so starved of equities that they could not reduce their intake at a time when the supply increased.

I believe that the fairly close correlation between the industry distribution of Australian equity portfolios (or rather those portfolios where this information is available) and the industry distribution of the Sydney All Ordinary Index is due mainly to a natural caution. With such a distribution there is every possibility that the market value of the portfolio will follow the Index fairly closely and it has been demonstrated that the "yield" that can be expected over a long period is about 11½ per cent. (see "Ordinary Shares and Inflation" by W. D. Owen, B.Sc., F.I.A., F.S.S. — a paper presented to the then Actuarial Society of Australia and New Zealand in 1962). With such a high yield apparently available "without even trying", one wonders whether there is any point in trying—that is, to improve the overall yield by varying the industry proportions.

As mentioned in the first paragraph, much more research is needed to see if rather more aggressive investment portfolio management could have paid off that much better than the "run of the mill" type of management over the last decade or so.

T. P. KEENE
26th June, 1965

INDUSTRY SURVEYS

A notice in the May, 1965, issue of the Journal drew attention to the Society's plans for undertaking selected industry surveys in parallel with its regular company studies.

A general invitation was also extended to members to indicate their interest in participating in these surveys and to suggest particular industries for incorporation in the programme.

For those who may have overlooked the matter at the time, a reply slip has again been included in this issue.

The Honorary Secretary,
Australian Society of Security Analysts,
Box 5085 G.P.O.,
SYDNEY, N.S.W.

Dear Sir,
I would be interested in participating in a survey of the industry.

I also suggest that the following industries be incorporated in the Society's industry survey programme:

Yours faithfully,

(Name in BLOCK Letters)

THE AUSTRALIAN SECURITY ANALYSTS' JOURNAL

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