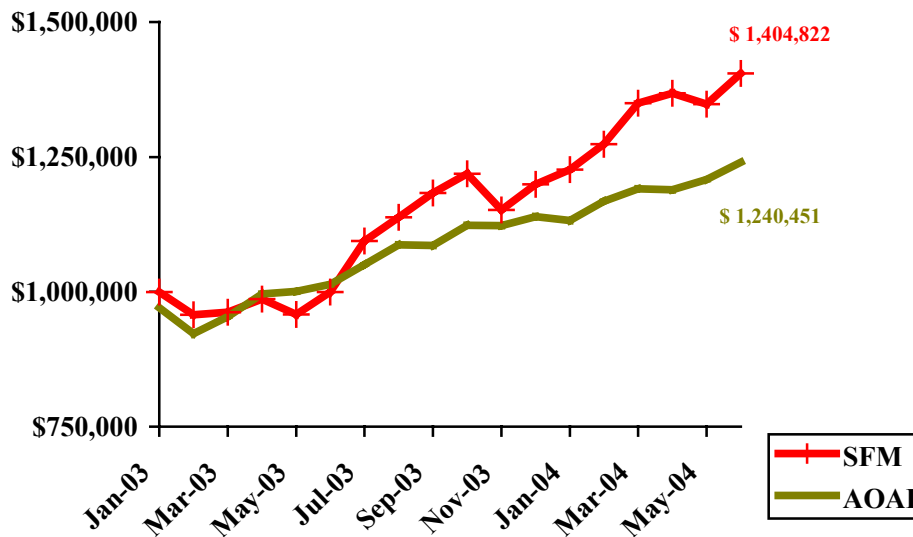


**QUARTERLY GROSS RETURN WITH SFM<sub>MP</sub> SINCE INCEPTION\***

Last 4 Quarters	\$ Valuation	% SFM Quarterly return	SFM return since inception	All Ords Accumulation Index	% AOAI Quarterly return	AOAI return since inception
Sep Q 3 2003	1,183,388	18.36	<b>40.48 %</b>	16,941	7.10	<b>24.05 %</b>
Dec Q4 2003	1,199,095	1.33		17,787	4.99	
Mar Q1 2004	1,349,847	12.57		18,581	4.46	
Jun Q2 2004	1,404,822	4.07		19,356	4.17	

\*Selector Fund Model Portfolio Start Date 21/01/2003. Only last 4 Quarters shown in table.

**GROSS VALUE OF \$1.0M INVESTED WITH SFM<sub>MP</sub> SINCE INCEPTION**



**Model Portfolio:**

Again we acknowledge the tail wind provided by the market. A great return over the past financial year is evident with a 40.48% return of the model portfolio since inception. What does it mean for the future? Not much – other than we have demonstrated we can achieve great returns when they are on offer. Our original marketing document stated that we viewed the market as friendless and volatile - our favorite.

***“40.48% return since inception.***

***What does it mean for the future? Not much”***

Today, evidence of growth in major economies is met with fear of fiscal tightening as interest rates come off historic lows (US, Japan). Coupled with major elections, oil prices, terrorism and higher stock markets, it remains a volatile mix – or relatively normal if you accept, as we do, that volatility in equities is normal.

We believe sound stock selection will prevail in the long run. And we agree with Ben Graham (*Intelligent Investor*), that focusing on the market’s recent returns will lead to “a quite illogical and dangerous conclusion that equally marvelous results could be expected from common stock in the future”. We think this logic is applicable to any market including shares, real estate and property development. On our recent visit to Kagara Zinc (Atherton Tableland QLD) we were astounded by the near dozen high-density developments yet to turn the first sod in Port Douglas, presumably chasing last year’s record returns. **SFM**

**Comment:**

The days are shorter, it’s getting colder in Sydney and while snow is settling nicely in the Southern Alps, the country remains dry. Lake George is about half way to Thredbo and it is always a wonderful sight, but early morning has an eerie silence when it is bone dry. Most of the sheep we spotted on a recent trip south are being hand fed or at least supplemented. Many seem to live huddled in dirt paddocks while the wind whips dust (topsoil) through the sky. Sounds bleak? Actually in terms of the cycles it’s not much different to the equities market, you only have to remember back 16 months!

We are not good enough to predict when rain will fall and likewise we don’t pretend to be able to foresee the next phase of the market. The market will continue to do what it will. We simply continue to focus on finding good management teams running good businesses rather than worrying about the next phase.

***“It’s not that easy to find a ski boot fitter  
who has 10 – 15 years experience”***

“Chillfactor” is an Australian ski magazine. They suggest if you are going to buy a pair of ski boots, you should spend a little extra and go to a boot fitter with 10 – 15 years experience! It makes sense really. Find someone who is passionate about what they do - because they will do it well.

We relate this back to management, as we believe good management is the key to business success. Can we trust them? Are they committed? Do they possess the drive and ability? Can we understand the vision? These are some of the qualitative issues we seek each time we evaluate a business.

The reality is that it’s not that easy to find a ski boot fitter who has 10 – 15 years experience, or a great business. But if you apply 100% effort, look long enough and often enough, you will probably come across a couple. The alternative is to take a short cut and hope for the best. **SFM**

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### Model Portfolio

In **Cochlear** we see other *investors* fleeing for greener *investment* pastures. We view it as a buying opportunity into the world's leading bionic ear implant manufacturer at a price we consider to be a bargain. No doubt, the new managing director of **COH** has his work cut out dealing with some short-term issues (STI's), but that's the point, we believe STI's will be forgotten in the years to come. In the meantime, while **COH** builds upon its market leadership it remains both debt free and paying wonderful dividends. In our Dec 03 quarterly we noted "stocks that take you the farthest in the long run tend to give you the most bumps and bruises along the way. We like the company, knowing there are issues to be resolved but this is a rare opportunity for the patient investor". Nothing has changed. **SFM**

### BIG PICTURE

Last quarter we looked at emotions that drive selling. This quarter we take a look at the brain that drives the emotions. Psychologists have shown that if you present people with a random sequence and tell them it is unpredictable they will nevertheless insist on trying to guess what is coming next. This is the basis for the success of powerball and lotto.

Jason Zwiig, (CNN Money 2002 – *Intelligent Investor*) reported ground breaking research in neuroscience that showed that our brains are designed to perceive trends even where they might not exist. After an event occurs just two or three times in a row, regions of the human brain called the anterior cingulate and nucleus accumbens automatically anticipate that it will happen again. If it does repeat, a natural chemical called dopamine is released flooding the brain with a soft euphoria. Thus, if a stock goes up a few times in a row, you reflexively expect it to keep going like a speeding train – and your brain chemistry changes as the stock rises, giving you a "natural high". You effectively become addicted to your own predictions.

***"If a stock goes up a few times in a row, ...  
your brain chemistry changes ...  
giving you a natural high"***

But when stocks drop, that financial loss fires up your amygdala – the part of the brain that processes fear and anxiety and generates the famous "fight or flight" response that is common to all cornered animals. Just as you can't keep your heart rate from rising if a fire alarm goes off, you can't help feeling fearful when stock prices are plunging. In fact psychologists have shown that the pain of financial loss is more than twice as intense as the pleasure of an equivalent gain. Losing money is so painful that many people, terrified at the prospect of any further loss, sell out near the bottom and refuse to buy more.

We are not building an argument for a boutique management service. We are trying to convey the importance of independent thinking and the need to reduce the psychological impact of the day-to-day swings of the market and the resultant "cheap information flow" that is generated. We call it cheap because it does not add value.

***"independent thinking can counter the  
biological tendency to buy high and sell low"***

Neuroscience has shown that you will be much more in control if you realise how much you are not in control. Best of all, independent thinking can counter the biological tendency to buy high and sell low. If you don't believe this, ponder the following question. Would you allow a stranger to dictate your daily mood – agreeing to be euphoric or miserable just because he thinks you should be? With the only reasonable answer being NO, nor should you allow the market to dictate your portfolio activities. Cont'd

**BIG PICTURE**

An example of independent thinking - The better the investment performs, the more powerfully your brain will believe nothing can ever go wrong with it. Each time it rises 20 percent, study it again more closely; revisit the roadmap\* on the business and its near term milestones\*. Ask what could go wrong? What can derail the speeding train? Seek out negative opinions. The time to do the most homework is before bad news can catch your brain by surprise. There are no guarantees, but doing extra research, just when things are going well is the best way to prepare you in case something later goes wrong or seems to. You'll then have a better sense of whether it's a false alarm or a real one. If you're not doing this, you should consider a boutique manager, as investment without independent thinking is mere speculation. **SFM** \* *road map / milestones - see last issue*

**Contact us to discuss the merits of investing with Selector Fund**

**The minimum investment in the fund  
is \$500,000 or other  
for those investors who meet the  
wholesale exemption criteria  
within the Corporations Act.**

Back issues of this newsletter – [www.selectorfund.com.au](http://www.selectorfund.com.au) or contact us on

[corey@selectorfund.com.au](mailto:corey@selectorfund.com.au) or telephone (612) 9241 5831

[tony@selectorfund.com.au](mailto:tony@selectorfund.com.au) or telephone (612) 9241 5830

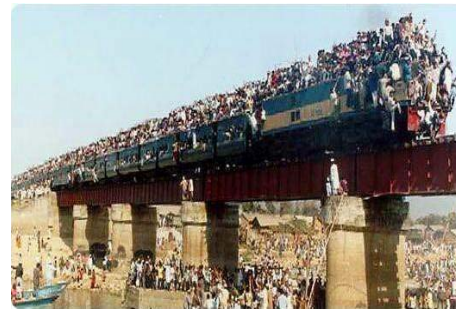
**Selector Diary Q2 2004**

Companies visited in Q2 2004		
15-04-04	Transonic Travel	TNS
21-04-04	Peppercorn Management	PMG
21-04-04	Flight Centre	FLT
22-04-04	Westfield Group	WSF
27-04-04	Arrow Pharmaceuticals	AWP
29-04-04	Just Group	JST
04-05-04	Aristocrat	ALL
05-05-04	Prime Television	PRT
10-05-04	Macquarie Infrastructure	MIG
10-05-04	Macquarie Airports	MAP
10-05-04	Auckland Airports	AIA
10-05-04	USCOM	UCM
11-05-04	Kagara Zinc	KZL
11-05-04	Herald Resources	HER
11-05-04	Zinifex	ZFX
11-05-04	Korea Zinc	-
11-05-04	Consolidated Broken Hill	CBH
11-05-04	Perilya Mines	PEM
14-05-04	IOOF	IFL
19-05-04	Patrick	PRK
19-05-04	ROC Oil	ROC
19-05-04	SFE	SFE
25-05-04	STW Group	SGN
25-05-04	Petsec Energy	PSA
27-05-04	TEN Group	TEN
28-05-04	Eqitx	EQX
04-06-04	Avastra	AVS
11-06-04	Structural Monitoring	TBA
16-06-04	Record Investments	RCD
16-06-04	Kagara Site Visit	KZL
17-06-04	SAI Global	SAI
21-06-04	Pharmaxis	PXS
24-06-04	Broadcast Services Aust	BSA
29-06-04	Biota	BTA
29-06-04	Buka Minerals	BKA

SFM MP Activities during Q2 2004	
Share transactions	7
Purchases	6
Sales	1
Takeovers (still current)	1
# Investments in fund	27
# Investments > 3% fund	16
# Anchor stocks	11
# Situations	12
# Turnarounds	4
# New Public Listings	0
# Placements	0
Other Issues	0
Company visits	25
New Companies Reviewed	9

"The key to making money in stocks is not to get scared out of them".

Peter Lynch



The speeding train?