Switzer Super Report

Issue 66, 15 March 2012

Buy the dips

In today's report, I'm looking at the positive reasons in the market that keep me in stocks, and I'll follow this up next week with some of the negatives out there. It's a bumpy ride, but I'm still buying the dips.

Also in the *Switzer Super Report*, Charlie Aitken takes a look at our interest rates and AMP, while Ron Bewley explains a good strategy for those wanting to build-up an equities portfolio without taking on a huge amount of risk. Alistair Bailey names an artist that's gaining worldwide attention, and Andrew Bloore fills you in on a window of opportunity that's about to close for those aged over 50. Happy reading!

Sincerely,

Peter Switzer

Inside this Issue

A safe strategy for building a stock portfolio – Part 1
by Ron Bewley
06

02 **Why I'm a stock buyer**
by Peter Switzer
The positive reasons that keep me buying the dips.

04 **Is AMP worth buying?**
by Charlie Aitken
Will this financial stock make it in a two-speed economy?

06 **A safe strategy for building a stock portfolio – Part 1**
by Ron Bewley
A good strategy for starting an SMSF stock portfolio.

08 **Could this man be the next 'big thing' in art?**
by Alistair Bailey
The indicators show this artist is gaining attention.

10 **Use it or lose it: the transitional cap is about to end**
by Andrew Bloore
The window of opportunity is closing.

switzersuperreport.com.au

Switzer Super Report is published by Switzer Financial Group Pty Ltd AFSL No. 286 531
36-40 Queen Street, Woollahra, 2025
T: 1300 SWITZER (1300 794 8937) F: (02) 9327 4366

Important information: This content has been prepared without taking account of the objectives, financial situation or needs of any particular individual. It does not constitute formal advice. For this reason, any individual should, before acting, consider the appropriateness of the information, having regard to the individual's objectives, financial situation and needs and, if necessary, seek appropriate professional advice.

Why I'm a stock buyer

by Peter Switzer

With the stock market defying gravity and the legendary market expert, Laszlo Birinyi, tipping the S&P 500 to rise 24% this year, the question is, are there any other reasons to be positive on stocks in 2012?

Next week, I will look at reasons for being negative but given our market has trailed terribly behind US stocks with the S&P 500 up 103% since 9 March 2009 and the Nasdaq up 130%, there is a constant pondering on whether it will ever catch up.

The answer is yes, but it could take some time. That doesn't mean our market indexes can't start showing some real improvement.

The best ingredient for local stocks would be for the Reserve Bank of Australia (RBA) to cut rates two more times and Wall Street to follow Birinyi's script. I know most of us would be happy with half of 24% as a market return and if you add in dividends we could be in market heaven!

You can't expect much help from the Reserve Bank, though I reckon they will cut at least one more time and with China growing a little slower that could bring the Aussie dollar down a tad, which would be one reason to be positive on stocks.

Buy the dips

On the other hand, you can bank on Wall Street and the USA, so here are some reasons why I remain long on stocks and poised to buy on the inevitable dips, which will come along.

So here are my positives for stocks:

- It's a Presidential election year in the States which is good for share prices.
- The US recovery is better than expected with retail sales this week the best for five months, despite rising gasoline prices.
- The VIX, or fear index, is down to 14.8, which screams that investors are becoming less wary of stocks.
- The US Federal Reserve says it will keep rates down through to 2014.
- Europe has gone from being a crisis to a chronic issue, but the European Central Bank's trillion loans to European banks have taken away one concern about bank balance sheets.
- Volumes for shares on S&P 500 are said to be low but on a 10-year average basis they are above average.
- Also, low volumes on a more recent timeframe has actually been a precursor to rising share prices in the ensuing period.
- Some see market rallies in four phases: there's the bottom when no one wants stocks, then there is the disbelief stage, then we get to the acceptance phase which is followed by euphoria. I reckon we are still in the disbelief stage but we are getting closer to the acceptance stage.

Working the phases

The disbelief and acceptance phase is the time to make your money and you have to start getting out or reduce your exposure to stocks in the euphoria phase before it ends in tears.

Of course, if money is tight you have to wait for the acceptance period, but if you believe in stocks and you can afford some capital loss while picking up dividends on par with term deposits, then sticking to stocks is an OK game plan for you.

I have one or two clients who didn't want to risk their millions in the despair phase but they have missed

out on gains of about 12% in three months as a consequence.

But that's OK because with investing you have to be able to sleep at night!

Important information: *This content has been prepared without taking account of the objectives, financial situation or needs of any particular individual. It does not constitute formal advice. For this reason, any individual should, before acting, consider the appropriateness of the information, having regard to the individual's objectives, financial situation and needs and, if necessary, seek appropriate professional advice.*

Is AMP worth buying?

by Charlie Aitken

I watch quite a lot of *Air Crash Investigation* late at night and one thing I have learned is you don't want to ignore 'stall speed' warnings.

Australian consumer confidence plummeting 5% in March must surely catch the attention of the Reserve Bank of Australia (RBA) board. As you well know, my view remains that the east coast of Australia is in a recession, with discretionary metropolitan retail the key sector seeing negative growth.

This week's collapse in consumer confidence was just further confirmation of the negative data surprise trend in Australia. The question has to be asked, what more evidence does the RBA need for confirmation that the east coast economy has stalled? Clearly, economic growth is running below the RBA's estimates and I maintain my view that it would be negligent for the Reserve Bank not to cut rates at its April and May meetings.

Rate cuts needed

While the ASX200 again flirted with resistance at 4,300 on Tuesday, I am simply of the view that unless the RBA comes to the party it will be very difficult for the Australian equity market to clear that hurdle. We will continue to underperform the world until the RBA gets with the program.

It's blatantly obvious we need to get mortgage rates down sharply in this country, while we also need to start forcing cash hoarders out of cash and into risk-taking assets. We need the Australian dollar down. We need to follow the US Federal Reserve's example if we want broader Australian gross domestic product (GDP) growth to return to trend.

While I am currently forecasting the RBA to cut by 25 basis points at each of the April and May board meetings, my gut feel is that won't be enough to stop the east coast economic deterioration. If I was on the RBA Board, I'd be pushing for successive 50 basis point rate cuts, which would translate to around 75 basis points of mortgage relief to variable mortgage rate holders. I'd suspect savers would be hit with the full 100 basis point deposit rate cut.

After speaking to my real world, real-time private business contacts, and considering all the recent negative data surprise in Australia, I think the right policy response is not just to trim cash rates, but to slash them ASAP. This country desperately needs lower cash rates and a lower currency. The RBA is literally way behind the curve and they need to catch up very quickly before more east coast jobs are unnecessarily lost and GDP growth prints a negative for the first quarter of this year. They really should be looking 'across the ditch' to see the success the Reserve Bank of New Zealand is having with the NZ dollar and NZ economy.

Growth sectors

Until I see a clear change of policy stance from the RBA, I will continue to only recommend the few Australian stocks and sectors where I see structural tailwinds. As I've said before, the vast majority of those structural growth sectors either face China or provide services to those who do face China.

Compulsory superannuation is another clear 'structural growth' sector, with both sides of Australian politics supporting a change in the compulsory superannuation contribution rate to 12%. It's pretty hard to find any other sector where regulatory risk is positive and through time inflows into the sector, where fees are charged over asset bases, will rise by 33% and then compound.

AMP has been arguably the worst performing demutualisation in history. However, history isn't a

guide to the future and we believe AMP offers compelling value at current depressed prices. Computershare is another market-linked earner we like.

We've upgraded our estimates for AMP's earnings and valuation on the back of strong global market moves. From a trading perspective, AMP's dividend reinvestment plan pricing period has ended, while concerns about a 'capital hole' are inaccurate in our view.

The stock is cheap, leveraged, growing (9% earnings per share growth) and yielding 7%. If you are looking for a big cap, non-bank, financial idea, AMP should be the first place you look.

AMP (AMP) – Buy

AMP is entering a year of consolidation. There is a lot to look out for in the business that will deliver momentum over the year ahead. These are:

1. A growing AMP Bank;
2. Favourable mark-to-market gains year-to-date;
3. Enhanced capital position, particularly following 15% sale of AMP Capital;
4. Fiscal 2012 to be the first meaningful year of cost synergies;
5. Emerging revenue synergies;
6. Robust planner numbers; and
7. Compelling multiples and market position.

We anticipate the above to provide earnings momentum and support in a volatile market. We have upgraded our price target to $5.80 from $5.60 following positive mark-to-market adjustments and higher AMP Bank earnings. We have raised our full-year 2012 earnings by 1.7% and 2013 by 3.1%. We believe AMP provides the best risk/reward in the sector, with a 7% yield, and 11-times fiscal 2012 price to earnings

- Latest close: $4.19
- 12 months target price: $5.80 (previously $5.60)

Computershare (CPU) – Buy

CPU has announced it has partnered with a mail service provider and a technology platform provider to launch Digital Post Australia. The company provides an online digital postbox that allows the user to store mail in one area online and provides reminders for bill payments. The company expects the service to reduce costs by between 50-70% per-piece for communications service providers. The launch is anticipated later in 2012, and requires a reasonable amount of buy-in from consumers to be successful. While market conditions for the second half of this year are likely to remain tough, we see the stock being supported by contributions from the BNY Mellon (Shareowner Services), Australian utilities services Group (SWG) and United States mortgage Specialised Loans Servicer (SLS) transactions. Continued transaction synergies, coupled with an improvement in markets, in our view will led to underlying US dollar earnings rising 22% next year.

- Previous close: $8.58
- 12-month target price: $9.30

Important information: *This content has been prepared without taking account of the objectives, financial situation or needs of any particular individual. It does not constitute formal advice. For this reason, any individual should, before acting, consider the appropriateness of the information, having regard to the individual's objectives, financial situation and needs and, if necessary, seek appropriate professional advice.*

A safe strategy for building a stock portfolio – Part 1

by Ron Bewley

Perhaps you would like to use my previous column on designing your own core satellite portfolio to start your own Australian share portfolio in a self-managed super fund (SMSF).

Let's look at how it is done using the example of an investor who we'll call Bill. Let's assume Bill is new(ish) to building an equity portfolio and he has decided that he wants to invest $100,000 in Australian equities. There are lots of traps and pitfalls, so here is one strategy that has been designed to avoid some of them. It starts by using the 'core satellite' portfolio as a base and gradually adding more stocks overtime using the portfolio's earnings.

An investment strategy

From my last contribution, an investor can put 80% of this amount (or $80,000) in an index exchange-traded fund (ETF) – say State Street's STW – and 20% ($20,000) spread equally across four stocks from the ASX200 without facing too much volatility relative to the market.

We can break up the $80,000 destined for STW, say, into four parcels of $20,000 for four separate entry points to average risk over time. For amounts much smaller than $80,000, one or two parcels might suffice; for bigger amounts, take lots of advice.

When to buy

Take care with placing a limit order. I once tried that with a sizeable order for STW and only one share (worth about $50) happened to get set at a brokerage of $19.95 – not a good deal. The market rose rapidly so the rest of my order didn't get set so my brokerage cost me about 40% of the share ($19.95 ÷ $50 = 40%)!

For an order 'at market price', try to avoid early morning and the lunchtime trading as the market can get hectic around those times. Placing a market order between 10:30am and 11:30am or 2:30pm and 3:30 pm often results in only a small blip in the traded price. Those times are often fine for volume, but take a peek (if you know how) before you place your order.

Unless you have access to market timing (mispricing) data that you trust, the first day that you trade doesn't really matter unless the market is falling sharply – say over 1% a day. It might be that the market flicks back up or goes further down. It is often better to wait for a quiet day to buy.

It really hurts the ego if the market keeps falling and falling so, for me, it is better to lose a little and wait for at least some sign that the correction is over. For those who follow my indicators on my website, I usually try to wait for disorder and fear to be inside the 'tram lines' and for exuberance to be negative, but more of that in later contributions.

At intervals of no closer than a week apart, place buy orders for the other three parcels of STW noting the down-market syndrome. Let's say Bill takes all this advice; after about a month he should have $80,000 set in the index. He will also have learned a little about placing orders and the volatility of the market; if not, he shouldn't be in the market!

Choosing stocks

Next we need to choose the four stocks for him. I noted the stocks and sectors I avoid a few months ago (read more here). That is step one. Choose your exclusion list as it narrows down the research you must do to keep up-to-date.

The next step is to choose about three or four sectors and stocks from each from the ASX 100 (smaller cap stocks can be left for later in the strategy). The old

standards like BHP, RIO, big banks, etc come to mind – but they must fit with the investor's philosophy and objectives. Check their recommendations on the Reuters website (as previously suggested – start with reuters.com and drill down to the chosen stocks) and cull any stock that does not have a score of 2.5 or better (one is the best).

Buy each stock one week at a time – as with the index. During the buying process, the investor is not balanced by any normal standard until the end but the 80% core means too much damage probably cannot be done along the way.

So now Bill has a portfolio of four stocks and the index. Not very exciting, but at least he is in the market and has learnt a lot along the way.

Next week, I'll explain how we're going to choose some more stocks for Bill to buy with the money earned by his fund, with the aim of eventually growing his portfolio up to about 10 to 15 stocks.

Ron Bewley, executive director, Woodhall Investment Research Pty Ltd.

Important information: *This content has been prepared without taking account of the objectives, financial situation or needs of any particular individual. It does not constitute formal advice. For this reason, any individual should, before acting, consider the appropriateness of the information, having regard to the individual's objectives, financial situation and needs and, if necessary, seek appropriate professional advice.*

Could this man be the next 'big thing' in art?

by Alistair Bailey

In 1960, renowned Italian art collector Count Giuseppe Panza di Biumo complained bitterly that the US$3,500 price tag for the Robert Rauschenberg painting, *Winter Pool* , was far too high. The Count demanded the dealer, Leo Castelli, reduce his price to US$2,000, but Castelli declined, noting that demand for Rauschenberg's paintings was strong because, along with Jasper Johns, he was now considered the best painter of the younger generation.

Essentially, Castelli's message to the Count was simple; I've got something you want – make a decision. Count Panza di Biumo bought the painting.

Winter Pool sold through Sotheby's in 1988 for US$3.4 million – a compound annual growth rate (CAGR) of 27.85%.

Finding the next big thing

The best investments in contemporary art have almost always been made in the primary market. The number of times I have been asked to find someone the next Brett Whiteley or Andy Warhol surpasses the number of hot dinners I have enjoyed.

The benefit of hindsight is obviously a wonderful thing, so as a case study, let's consider contemporary artist Chen Ping. *Hand in White Reaching out to Her in Red* (illustrated below) was purchased for $15,000 from Chen Ping's recent sell-out Sydney exhibition. As it stands, Chen Ping's current auction record is the same as Damien Hirst's was in 1991 when Saatchi commissioned the now infamous Stuffed shark for £50,000 – zero! If *Hand in White* were to be offered at auction today in the Australian market, would it sell for $15,000? Probably not. So why is this work a strong investment play?

The lack of auction record is simply due to the fact nothing has been offered for sale by this artist. An auction house, particularly in Australia currently, will state this artist is untried and untested in the secondary market and therefore wouldn't warrant higher estimates. Couple this with the fact that on the rare occasion that works are offered for resale, they are facilitated privately due to demand for the work – hence the sell-out exhibitions. A consistency in the primary market is just as important for investors to monitor as the activity in the secondary market.

Cheng Ping

We then have to look more closely at Chen Ping's CV. Classically trained at the Guangzhou Academy of Fine Art, he has established a regular exhibition calendar which sees his work represented in the USA, China (Beijing, Shanghai and Hong Kong), Singapore, France and Australia. In 2008, his work was exhibited at a major show held at the Guangdong Museum of Art, a work from which was acquired by the Museum. He also has work held by the White Rabbit Collection in Australia.

In 2010, a major article on his work was published in Asian Art News drawing parallels between Chen Ping's work and that of the renowned British painter Francis Bacon. In 2011, Chen Ping was exhibited by his New York gallery, Tally Beck, at Scope Basel as part of the highly prestigious Basel Art Fair and was exhibited as part of a major group show with his Shanghai dealer – Pearl Lam. In that exhibition, Chen Ping's work was exhibited alongside works that are priced in excess of US$400,000.

Significantly, Pearl Lam will also exhibit a solo Chen Ping show as part of Asia One at the 2012 Hong Kong Art Fair. When it comes to Chinese art, Pearl Lam, for some background, has the ear of Charles Saatchi – the famed art collector and gallery owner – so the sphere of influence is extraordinary. All the while, Cheng's work has been increasing in price and selling

consistently well. In 2005, works of similar scale were on the wall at $7,500.

Hand in white reaching out to girl in red, by Cheng Ping courtesy of Art Equity

The investment potential

Clearly, there is potential: Cheng's classically trained; held in institutional and key private collections; attracting the attention of the arts media; significant dealers are involved in his work and career; and he's exposed to a truly global market.

The big question though is will it be realised? Only time will tell, but the above and the consistency in selling exhibitions both domestically and internationally suggests that it's a good start.

Will Chen Ping's work be selling for millions of dollars in 10 to 15 years' time as Francis Bacon's has gone on to do? I don't know, but certainly it is feasible and realistic to suggest that he has the potential to rival the prices of his contemporaries at the recent Pearl Lam exhibition.

Those who have made sound investments in contemporary art have typically purchased well in the primary market. The $8,000 paid for a painting by Australian artist Del Kathryn Barton at her Melbourne show in 2005 now sees those works trading in the auction rooms for upwards of $40,000. And then there was her record auction price move from a mere $800 (2006) to $192,000 set in 2011 through Deutscher and Hackett. Don't forget that at auction, you have decided to pay more than anyone else in the room for that work.

Long-term investments

The other thing to note about the very successful collectors / investors in this space is the term that they have typically held a work – something that is STILL all too often underestimated in the Australian market. Spreading the risk across a handful of artists is also a key. And, of course, the golden rule is that the investment lies in the quality.

Discolsure: Al Bailey is the executive director of Art Equity, Chen Ping's representative gallery in Sydney.

Important information: *This content has been prepared without taking account of the objectives, financial situation or needs of any particular individual. It does not constitute formal advice. For this reason, any individual should, before acting, consider the appropriateness of the information, having regard to the individual's objectives, financial situation and needs and, if necessary, seek appropriate professional advice.*

Use it or lose it: the transitional cap is about to end

by Andrew Bloore

The time is approaching when another financial year draws to an end. As we all bid farewell to 2011/2012, some will also say goodbye to the transitional concessional contributions cap which is due to elapse on 30 June 2012.

According to section 292-20 of the Income Tax (transitional provisions) Act 1997, the transitional cap applies if you are 50 years or over on the last day of the financial year, between 1 June 2007 and 30 June 2012. From the 2009/10 financial year to present, the transitional cap it set at $50,000, and unlike the standard concessional cap of $25,000, it is not subject to indexing.

Are you eligible?

In determining the eligibility to use the transitional cap for a respective year, it is the age of the individual on the last day of that financial year, and not their age at the time the contribution is made. Therefore an individual that will turn 50 on 30 June 2011 will be eligible contribute up to $50,000 of concessional contributions in the 2011/12 financial year without incurring liability for excess contributions tax. This is the case even if the contribution in that year occurred at the time that individual was still 49 years old.

On 1 July, the cap for those aged over 50 will revert back to the standard concessional cap. However this may not be the case for all. The government has announced that from 1 July 2012, individuals aged 50 or over with total superannuation balances below $500,000 can continue to make up to $50,000 in concessional contributions in the 2012/13 financial year and subsequent years.

Eligibility will be based on self-assessment and it will be the responsibility of the individual to calculate their superannuation account balance and any contributions made within the year. This policy announcement is currently being discussed within the Government's Superannuation Roundtable forum and is yet to receive royal assent. Changes to the policy and information regarding its implementation will be subject to the outcome of the consultation.

Window of opportunity

Therefore until legislation has passed, and certainly for those with super balances above $500,000, current concessional contribution limits for individuals aged over 50 will be halved. A short window of opportunity exists between now and 30 June to maximise their contributions into their super fund. This may be achieved by salary sacrificing amounts for employees, or a contribution to the superfund by self-employed where a deduction is claimed for the amount of the contribution. Any unused portion of the transitional cap will be forfeited and cannot be carried forward. Therefore, the 'use it or lose it' mentality applies.

Importantly, as is the case with the standard concessional cap, the transitional cap includes all contributions that are included in the assessable income of the fund. Individuals must therefore be aware of all other contributions into the fund for that year that are classified as concessional contributions to avoid incurring excess contributions tax.

Concessional contributions are defined in section 292-25(2) of the Income Tax Assessment Act 1997 and include the superannuation guarantee, salary sacrifice, self-employed contributions where a deduction is claimed, and allocations from reserves in excess of what is reasonable. Making a contribution without regard to what has already been (or will be) contributed to the superfund may lead to the caps being breached and incurring excess contribution tax.

Example

An individual aged over 50 with a super account balance of $600,000 wishes to take advantage of the transitional contribution cap before 30 June and would like to salary sacrifice $50,000 into their super fund.

While they are eligible to contribute up to $50,000, they will need to take into account any compulsory super guarantee amounts that have been contributed within the year, and ensure that the salary sacrifice amount on top of the superannuation guarantee does not together exceed the $50,000 cap. Any amount up to the cap that remains after all contributions are made will not be rolled over. At 1 July, their concessional cap will reduce to $25,000.

Even though time may be of the essence when making the most of the transitional cap before 30 June, individuals should be aware of all their fund contributions to ensure this opportunity does not create an unnecessary tax bill. Furthermore, individuals should review their salary sacrifice or personal deductible super contributions going forward to adjust for the reduced caps in the new financial year.

Important information: *This content has been prepared without taking account of the objectives, financial situation or needs of any particular individual. It does not constitute formal advice. For this reason, any individual should, before acting, consider the appropriateness of the information, having regard to the individual's objectives, financial situation and needs and, if necessary, seek appropriate professional advice.*

Did you know?

You can find information on how to set-up a self managed super fund (SMSF) on our website. Just click on Running your fund for more information.

Don't miss this!

As pressure grows for the Reserve Bank of Australia to cut interest rates, investors will be paying close attention to what the central bank says in a busy week of communications. Keep an ear out for these:

Monday 19 March: Speech by Reserve Bank governor Glenn Stevens in Hong Kong
Tuesday 20 March: Reserve Bank Board minutes from the 6 March meetings released
Tuesday 20 March: Speech by RBA Assistant Governor Malcolm Edey
Thursday 22 March: Speech by RBA Assistant Governor Guy Debelle on bank funding