Switzer Super Report

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# Market rout

Most of you know by now I like to buy the dips, but is this a dip we should be buying into? In my note today, I look at why Greece has the markets spooked as well as the potential ramifications of Greece leaving the eurozone and tell you what I'm doing.

Also in the *Switzer Super Report*, Paul Rickard reviews National Australia Bank's new hybrid security and how it compares with others in the market. Charlie Aitken examines the market and names two stocks that are looking cheap. Plus, we reveal the levels to take profit in Telstra, and we bring you the first of a two-part series on the things you need to check off your to-do list before the end of the financial year. Hang in there, and I'll be back with more market updates on Monday.

Sincerely,

Peter Switzer

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# Who really cares about Greece anyway?

by Peter Switzer

Believe it or not, there is no legal provision for a country to leave the eurozone despite the Greeks looking like they are searching for the exit door – but the issue is spooking markets. Of course, we have seen this sell in May and go away panic for two years now and since the highs this year, stocks are down over 6% here and it has been bigger overseas.

Regular readers will recall I was expecting a sell-off, but now I have to guess how bad this will be for both my readers and for my own advice, which is to "buy the dips".

**The Greek drama**

Let's look at the Greek drama and its wider implications.

First, the Greeks would have to set a date to exit the eurozone, reintroduce the drachma, reset wages and prices, and adjust to a new exchange rate. There would also be an exodus of money from the banks with euro owners fearing capital loss from the changeover. On Tuesday night, Greeks reportedly took out €700 million from Greek banks.

The lower currency would make a Greek holiday cheaper and so it would be great for business, but inflation would kick-up as the drachma would be a dud currency. European banks would be left holding Greek debt of dubious quality and the European Central Bank (ECB) would no longer buy it. Further, the Wall Street Journal (WSJ) says the ECB would not lend to banks against Greek government debt!

Under international law the debt would have to be redenominated into drachmas and there would be a lot of dramatic negotiations, which would affect the balance sheets of the banks exposed to Greek debt. This is why share prices head south when such uncertainty is in the wings. The WSJ reported Institute of International Finance estimates that the cost of Greece leaving the eurozone could be about €1 trillion! Yep, that's why stock markets are spooked.

**The domino effect**

There would be widespread bankruptcies in Greece as businesses would be caught between existing debts in euros and the fact they are earning income in drachmas, which in all likelihood would be under depreciation pressure.

This would compound onto Greek banks which would already be under insolvency pressure but are currently being helped by the ECB. That would end and a real financial crisis could ensue. But this is why stock markets are selling off as the global financial system is so heavily interdependent.

This is only the start of the potential panic because the next fear would be that of contagion where no one trusts the likes of Portugal, Ireland, Spain and Italy, and this would push up bond yields and screw up international lending.

So this is the scary story in a nutshell and it is why European Union (EU) forces will be working hard to come up with a better resolution than one where the Greeks leave the eurozone. Now they might, but the EU has time to be prepared for this and to contain the damage.

**Cautiously optimistic**

AMP Capital Investors' Shane Oliver is cautiously optimistic about 2012 compared to the past few years where we saw stocks devastated between May and October.

"The key differences compared to the last two years – where share markets fell by around 15-20% from

April/May highs – are a stronger US economy (particularly the housing sector which is looking more and more like it is starting to recover), global monetary easing and cheaper share markets," he pointed out.

He argues it should limit the downside in shares and help result in much stronger share markets by the end of the year.

Of course, if you followed Warren Buffett, you would not invest when you don't understand what is going on. On the other hand, he does recommend buying great companies that are solid businesses and to especially buy them when external factors – not internal factors to the company – are driving down share prices.

I am a dip buyer… but not just yet!

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# A new hybrid security to be issued NAB

## by Paul Rickard

National Australia Bank (NAB) has announced its first domestic retail offer since 1999 with 'NAB Subordinated Notes'. The issue reflects investors' preference for simpler hybrid structures (as demonstrated by the reception to the recent ANZ issue, ANZHA), and as such, this is about as straightforward as a hybrid gets.

A hybrid is a security that combines the elements of debt and equity.

### The details

NAB's issue is of a 10-year term floating rate note, paying interest every quarter at a margin of between 2.75% and 2.85% over the 90-day bank bill rate. With the 90-day bank bill rate at around 3.75%, this is equivalent to 6.50% per annum for the first quarter.

The notes are subordinated and unsecured, which means they rank behind all deposits, bonds and unsecured creditors, and ahead of National Income Securities (NABHA), preference shares and ordinary shares. Interest payments can't be deferred and aren't discretionary, however interest will not be paid if NAB is not solvent.

The Notes will qualify as Tier-Two capital. With the approval of the Australian Prudential Regulation Authority (APRA), NAB may elect to redeem the Notes five years out (and then on every interest date thereafter) by repaying the outstanding principal plus any interest to note holders.

| Issue Size | $500m, with right to accept more |
|---|---|
| Security Type | Subordinated, unsecured term debt |
| Listing | ASX, stock code NABHB, expected 19 June |
| Issue Price | $100 per Note |
| Term | 10 years, maturing 18 June 2022 |
| Optional Redemption by NAB | 18 June 2017, then every interest payment date |
| Interest | Paid quarterly, 18 Sept, 18 Dec, 18 Mar, 18 June |
| Interest Rate | 90 Day Bank Bill rate + Margin |
| Margin | Range of 2.75% to 2.85% (set in book build) |
| Interest Payments | No deferral – only not paid if NAB is not solvent |
| Ranking | Behind all senior obligations and unsecured creditors, ahead of National Income Securities, preference shares and NAB ordinary shares |
| Offer Opens | 21 May |
| Offer Closes (scheduled) | 8 June |
| Issue Date | 18 June |
| Minimum Subscription | $5,000 or 50 Notes, then in multiples of $1,000 or 10 Notes |

The institutional book build this Friday evening will set the final margin. At the lower end of 2.75%, this implies an interest rate of around 6.5% for the first quarter; at the higher end of 2.85%, the rate would be 6.6%.

### Pricing

The NAB issue is almost identical to the ANZHA issue launched in March, which matures on 20 June 2022, and also pays interest at bank bill plus 2.75%. It closed on Wednesday at a gross price of $100.35, having traded at around $101.20 mid last week. With approximately $1.14 in accrued interest, it is now trading at bank bill plus 2.85%.

There is better value in the original NAB Income Securities (NABHA), although it is worth noting they are perpetual securities and rank behind the new NAB Subordinated Notes. At a price of $71.10 and interest paid at a margin of the bank-bill rate plus 1.25% on the whole $100 face value, NABHA are yielding 7.03% per annum.

**The bottom line**

Among financial stocks, NAB's new issue looks fairly priced for investors who want simpler hybrid structures and a different 'name'. At more than 1.3% over term-deposit rates and given the market reaction to the ANZ issue, it should be well bid at the top end of the range (2.85%) and the issue size will likely be increased to accommodate demand.

For those seeking diversification away from financial stocks and willing to accept more complex hybrid structures, have a look on the ASX at ORGHA, AGKHA and TAHHB, which are all yielding around 4% over the bank-bill rate.

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# Two grossly cheap stocks emerge in rout

by Charlie Aitken

I have to admit I am somewhat stunned that the entire year's performance in Australian equities has been wiped out in ten trading sessions. In US dollar terms, the ASX200 is now down 0.7% on the year, while in Australian dollar terms we are still up 2.7% for the year. I feel like the mayor of Hiroshima after the last two weeks.

All the good work our equity market did grinding up on domestic issues has been wiped out by a global macro re-correlation trade that has been brutal and indiscriminate. High frequency trading exacerbates the downside, but it is what it is.

Yesterday the rout got so aggressive it even brought out 'winners selling' in the cash equities market, confirming the old adage "even the pretty girls get hurt in the bus crash". I got the rate cut and shorting the currency right, but have been sideswiped in some, but not all, of my favoured large cap equities by global risk aversion.

## What history shows us

However, the history of trading corrections is that when people start selling winners, the peak of the correction is near. Similarly, the speed and scale of the fall almost ensures some rebound to reclaim at least half the fall at some stage.

There are periods when share prices disconnect from fundamentals, but particularly when a major macro fear event is upon us. Obviously, I am completely on the wrong side of this trading correction, feeling this May would be different to the last two. How wrong can you be? A Greek election got me; a bloody Greek election!

The problem with aggressive market events like this is they simply destroy investor confidence. That confidence takes months to build up, and days to destroy. However, events like this also lower expectations and clear the way for a recovery. We have now had biannual market events like this since 2008 and the peak of them all has been a buying opportunity in mispriced growth stocks, or those with sustainable dividend yields.

## Focus on the bottom up

All I can do in these top-down market events is to focus all our efforts from the bottom-up on companies. Eventually companies are priced on their sustainable earnings and dividends, not fears of a Greek exit from the eurozone.

While it may seem years away in market terms, the 2013 financial year starts in less than a month and a half. In writing investment strategy I have to focus on 2013 and where I see attractive multiples.

So today I thought the most useful thing I could do was look at the fiscal 2013 investment arithmetic for the 10 large cap stocks in my high conviction buy list. All the multiples are based off last night's closing price.

| Company and code | Price to earnings (P/E) multiple | Earnings per share (EPS) growth | Yield |
|---|---|---|---|
| AMP (AMP) | 9.8x | 7.7% | 7.5% |
| ANZ Bank (ANZ) | 9.0x | 5% | 7.3% |
| BHP Billiton (BHP) | 8.4x | 13% | 3.7% |
| Crown (CWN) | 13.7x | 15% | 4.3% |
| Fortescue (FMG) | 5.9x | 42% | 1.8% |
| NAB (NAB) | 9.1x | 5% | 7.7% |
| Santos (STO) | 16.5x | 1% | 2.5% |
| Seven West (SVW) | 7.9x | 18% | 4.0% |
| Telstra (TLS) | 12.3x | 5% | 7.7% |
| Westpac (WBC) | 10.0x | 2% | 7.7% |

## Two grossly cheap stocks

This list is actually telling me the first two stocks to

shut my eyes and buy are FMG and SVW. They are grossly cheap on price-to-growth multiples and are the two stocks most likely to deliver me upside alpha in any more normalised risk tolerance environment.

Obviously STO's numbers don't look great, but that's a bit unfair as STO is a calendar year company and the growth in calendar year 2012 is very strong. If you averaged it out over the two years, it is acceptable and I am going to stick with STO at these prices.

Despite the short-term share market action I remain convinced the second half of the year in the Australian economy will be better. The genuine positives of a lower dollar, lower interest rates and the potential for a change of government are all being overshadowed in the short-term by global macro risk events. That global macro risk dust will settle like it always does.

When everyone is a trader you need to be an investor. Everyone is an expert on Greece, but Greece won't price Australian companies in the medium-term. Just remember back to October 2011 and what you should have done at the time. This is no different in my view. Risk and growth are extremely cheap, equity yield is dramatically more attractive than bond yield, and the headlines are all the same. Defensives and all forms of perceived safety are grossly expensive. It's déjà vu all over again.

Go Australia, Charlie.

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# End of 2012 financial year checklist: part 1

by Andrew Bloore

This financial year, 30 June falls on a Saturday, so make sure all super contributions and strategies are in place well before then to avoid missing the deadline.

To help you meet your deadline, we're running a two-part series on the things you need to check off your to-do list by the end of next month. Today we'll run over the first four. Due to changes to super, it may benefit you to act on some of these issues this financial year.

### 1. Government co-contributions

The government will match dollar for dollar to a maximum non-concessional contribution of $1,000 for eligible individuals whose total income does not exceed $31,920 per annum. The co-contribution reduces for total income above $31,920 and ceases when total income reaches $61,920.

#### What are the benefits?

For eligible individuals who are able to make non-concessional contributions to their super fund, the co-contribution is a tax-free booster for retirement savings. It effectively doubles the contribution, meaning that more money is added to their super fund courtesy of the government as a reward for saving for their future. That's up to a possible 100% immediate return on the contribution – hard to match elsewhere.

#### Strategy

Potentially fewer Australians may be eligible for a co-contribution in the 2012/13 financial year as the maximum income threshold will be reduced from $61,290 to $46,920. Also, the maximum rate at which the Government will match the contribution will be reduced to 50% up to a limit of $500. It may be beneficial to get non-concessional contributions in before 30 June 2012 to get a greater reward than in the next financial year.

### 2. Transitional concessional contributions cap for over 50s reverting to general cap

On 1 July the concessional cap for those aged over 50 will be reduced from $50,000 to $25,000, bringing it into line with the general cap for all individuals. This is scheduled to increase to $55,000 in 2014 for over 50's with less than $500,000 in super.

#### What are the benefits?

A short window of opportunity exists to maximise concessional contributions by salary sacrificing or making personal contributions for which a deduction is claimed for the self-employed. Any unused portion of the transitional cap will be forfeited and cannot be carried forward. As over 50's have a relatively short time span to grow their super, making the most of the higher cap this year may be an important step to boost retirement savings.

#### Strategy

Individuals should be aware of all their fund contributions to ensure this opportunity does not create an unnecessary tax bill if the total contributions exceed the cap. Individuals should review their salary sacrifice arrangements or personal deductible contributions going forward to adjust for the reduced caps in the new financial year, and evaluate whether Transition to Retirement (TTR) strategies are still beneficial. Being aware of the reduced caps going forward is imperative to avoid excess contribution penalties which will eliminate the tax concessions on concessional contributions.

### 3. Directed termination payments (DTPs)

**benefits ending 30 June**

A directed termination payment (DTP) is an employment termination payment (ETP), including golden handshakes, made to an individual due to their employment being terminated, that is contributed directly to a super fund. The choice of transferring a DTP that was part of an agreement in force before 10 May 2006 to a super fund will expire on 30 June.

**What are the benefits?**

Rolling the DTP into a super fund will incur tax at only 15% on the taxable component up to $1 million without counting towards either concessional or non-concessional caps. This allows more funds to be rolled into super at a concessional tax rate without breaching caps. Any excess will count towards the concessional contribution cap being $25,000 or $50,000 for over 50's. After 30 June, no part of the payment can be rolled over into super. If the DTP is rolled into a super fund, not only will it be concessionally taxed into super up to the cap, the earnings from investing those contributions are also taxed at 15% instead of the individual's marginal tax rate (MTR). Additionally, when the fund is in pension phase, including TTR income streams, earnings on assets supporting the pension are tax free. This represents a significant tax saving compared to investments held outside of super.

**Strategy**

The DTP which is rolled over into the super fund must be received by 30 June 2012. After this date, no part of the payment can be rolled over into super. It will then be treated as a normal ETP with 15% tax up to $175,000 cap for those over preservation age, and 30% for those under preservation age. Further, from 1 July the part of the ETP that takes a person's taxable income above $180,000 will be taxed at the individual's MTR. For eligible individuals who are already considering termination of employment and are due to receive these termination payments, it may be worthwhile to consider it before 30 June to reduce the tax payable and maximise superannuation contributions.

**4. Off market transfers**

Currently, certain permitted assets can be transferred from a related party to an SMSF off-market without engaging a broker to facilitate the process. Under the proposed amendments from 1 July, these assets must be purchased through the market or exchange. Where an underlying market doesn't exist, the transfer must be made at a price determined by a qualified independent valuer. Any increased transaction costs due to this measure will only be incurred by SMSFs that choose to enter into related-party transactions. Note: This measure is currently pending.

**What are the benefits?**

Listed securities will primarily be affected after 30 June. If individuals are looking to transfer listed securities into their SMSF, doing so before 30 June will eliminate additional brokerage costs on SMSF members. Further, there is no risk of market movements when the securities are transferred, which may be the case after 30 June if there is a lapse of time between the individual selling and the SMSF purchasing them on market, especially given current market volatility.

**Strategy**

If considering transferring securities into the SMSF before 30 June, it is imperative that all documentation, share registry accounts and any other required information is completed and correct to avoid delays in the process. This may push the transaction to the next financial year, when off market transfers are no longer permitted. Completing forms early and ensuring the accuracy of information will assist in ensuring that the transaction is finalised before 30 June. Be aware that capital gains tax may apply to the transaction regardless how the transfer occurs.

Come back next week to read the remaining four points to check before 30 June.

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# Chart of the week: Where to take profit in Telstra

by Lance Lai

The run up on Telstra (TLS) has been wonderfully spectacular for us. On Tuesday, on a day where the market was spooked and fell 0.7%, Telstra had a high of $3.75, closing up 1.9% at $3.71. That's a 2.6% outperformance!

If you had followed my recommendations, you would have accumulated Telstra at:

1. $3.31 in morning of 19 April 2012; and at
2. $3.39 afternoon of 19 April or the morning of 20 April.

You should have also locked in at least 30% of your profits by now.

On 9 May, I said in point three, under 'What I don't like about the chart': "There are no signs to sell yet here at the time of writing, but as soon as it appears, say a close below $3.62, or on hitting my little 'r', which is first resistance at $3.73, whichever comes first, one ought to take some money off the table. Say 30%." (You can re-read [Chart of the week: take profit in Telstra?](#))

At the time of writing on Tuesday, the holding is now 30% sold since closing at $3.60 on Friday 11 May, below the $3.62 mark. If you sold a bundle of Telstra at this level, this would have locked you in for a profit of between 8.7% and 6.2% in under a month.

On Tuesday, it hit $3.75, breaking the first small 'r' resistance level of $3.73. One should have taken profit on another 10% of holdings at $3.73, pocketing gains of 12.6% and 10%.

Source: Accountancy Invest

Above is the updated Chart. The stock has traded as expected.

We are headed towards the two large 'Rs' on the Chart and these represent $3.86 and $3.99.

If you followed my recommendations, you would have holding of about 60% left. Take profit:

1. on another 30% at the first 'R', $3.86; and
2. finally, closing out any remaining positions at $3.99 if it keeps shooting to this second 'R' before I can update readers.

If you watched SWITZER on Sky Business last Thursday, you would have seen my [Sell In May and Go To Bahrain interview](#).

I am holding to that interview's view that I expect a more significant pull back in the broader markets in the coming weeks and months. We have begun to see that view play out this week.

While Telstra should hold up relatively well in this expected turmoil, I believe there will be a better time to buy if one has the chance to exit at the above stated levels and lock in what are very good profits.

I am hoping in the coming days to sell all of Telstra, as I will be off to Bahrain.

**Other calls**

The other holdings not closed based on prior articles are:

- 12 March 2012: Spark Infrastructure (SKI) $1.655, buy. Now $1.515. Up 11%. Continue to hold.
- 19 March 2012: Envestra (ENV) $0.771, buy. Now $0.785. Up 2%. Continue to hold.

Hopefully, these stocks will also present irresistible higher prices in the coming days in May, so we can sell. For now, they remain "Steady as she goes stocks".

Important note: My views are NOT for the long term. My method results in views expressed that relate to an outlook that lasts weeks or at most months. For example, my view on Shanghai's Index has for now been met and completed since 22 March 2012, 11 days later. Currently regards Shanghai, I am in a cautionary observant position. Your utilisation of this information needs to take into account the time frame I set. The stocks recommended as "Steady as she goes" may be held for the longer term, which for me means months.

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# Don't miss this!

**Meet Peter Switzer and Paul Rickard in Sydney tomorrow**

Peter and Paul will be presenting a seminar on investing in alternative assets for your self-managed super fund in conjunction with the Australian Shareholders' Association. The seminar will cover property investments as well as artwork and collectables.

What: Alternative investment strategies for your SMSF
When: Friday 18 May at 12.30pm to 2pm
Where: Sydney Mechanics School of Art

Tickets: Prices start at $20. To book, call the ASA today on 1300-368-448 and mention you're a Switzer Super Report subscriber.

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# Did you know?

Starting 1 July, low-income earners will no longer pay tax on super contributions. Under the Low Income Superannuation Contribution (LISC), a person whose income is less than $37,000 will have the contributions tax on concessional contributions returned to the fund. It's worth a maximum of $500, (15% tax rate on the 9% super guarantee of $37,000).

For more changes to super, read Paul Rickard's recent article, Government takes the axe to super concessions.