Switzer Super Report

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Wise guys

There's nothing more annoying than seeing the market flip-flop on moronic mutterings from 'wise guy' officials. In today's *Switzer Super Report*, I talk about why the market isn't panicking despite its wild swings.

Charlie also has a bone of contention to pick with the market and it has to do with high-frequency trading systems. Despite the way these systems trade, he's sticking to a low-frequency strategy and he talks about two stocks in particular. Plus, we look at three easy ways you can gain US-dollar equity exposure as the Aussie dollar sinks, and we explain how to boost your retirement income by using the age pension. All the best.

Sincerely,

Peter Switzer

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The market is at the mercy of wise guys

by Peter Switzer

There is nothing more annoying than seeing markets at the mercy of wise guys, but that's what we are dealing with right here, right now.

There is no panic, but market drivers are leveraging off the bad news every time some moronic European Union (EU) official opens his or her big mouth or we get a bad economic reading.

But, as I said, the panic is not an issue – yet. It could happen and the market's fate will be sealed by the European Central Bank (ECB), the Greek election on 17 June and the banks in Spain.

On a day-to-day basis, US economic data could be used to spook Wall Street, but I think the mixed run of info on the economy will be largely OK.

This Friday's jobs numbers will be interesting to watch, however a good number is not expected because the warm winter has robbed spring of great retail figures. Also, European-related fears and China doubts have made investors nervous, which has helped those who like to test a jumpy market.

The good news

But there is some good news.

"There's certainly no panic – the S&P bounced at 1,311, which is right where we're supposed to bounce," said Stephen Guilfoyle, trader at Meridian Equity Partners, on CNBC.

"We're going into two very heavy macro days in the US where the focus could shift to domestic reports – the GDP and non-farm payrolls."

For those who want the latest scoreboard from Wall Street, this is how the market played out: the Dow dropped 160.83 points or 1.28% to 12,419.86 while the S&P 500 gave up 19.10 points or 1.43% to finish at 1,313.32.

Euro-mess

As I have been arguing for ages, the ECB has to support Spain, and the eurozone leaders need to help Greece grow so it has the jobs and the incomes to raise taxes and pay back its debt. This will help the Greeks vote in a sensible coalition government.

And while I am critical of the leaders of Europe, the Greeks really have to get their house in order.

The Greek central bank calculated that between 2.5-3.8% of GDP goes missing because of personal income tax evasion, but the problem is much bigger than that; the so-called 'shadow economy' where legal and illegal goods and services are traded, is said to have been equivalent to about 25.4% of GDP in 2010, and this is where tax is totally avoided!

When this European mess is sorted, the market will shoot up, but there is a lot of voting and negotiations that need to happen before there is a sound footing for a big rally.

Market reaction

Finally, shares will eventually rally higher once Europe comes up with a plan, but as investors, we will always have challenges.

Sav Savouri, an economist with UK hedge fund Toscafund Asset Management, thinks the Aussie dollar could become a reserve currency and could be $2 to the greenback!

Making money on stocks can be a challenge and that's why you need access to good info and strategies that keep you committed to a winning plan.

But it sure is hard when the short-term gyrations really give you the 'you know what's'!

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The ASX has never been more opaque

by Charlie Aitken

Dealing in the Australian equity market really has changed over the last 20 years, and in my view not for the better.

On Tuesday, a client gave me 125,000 AMP shares to buy at $3.87. The bid was $3.86, the offer was $3.87 and there were 131,300 available. To my stunned disbelief, I saw that despite there being 131,300 shares on the offer when we placed the buy order in the 'total market', we only ended up with 123,000 shares. To add insult to injury, we didn't even have priority on the new bid at $3.87 for our small balance.

The scourge of the market

How does this happen? Because high-frequency trading (HFT) has the technology and speed to pull off an offer and replace it with a bid in the millisecond it takes for my genuine buy order to 'sweep' the total market. To my way of thinking, that leads to a false and misleading market.

Basically, my buyer of AMP shares was 'scalped' by HFT trading technology. If new ASX management are looking at why ASX volumes are in structural decline they should look no further than this example. My view remains that HFT and other computer/algorithmic ultra-short-term trading strategies are the key drivers of the increased volatility and lack of transparency that is driving investors away from equities.

Genuine liquidity has been replaced by useless scalping volume, volume which ends the day with no net position and only runs interference over genuine users of the share market who have a technology and speed disadvantage. Yes regulators, that means mums and dads as well.

The ASX has never been more opaque in my view; the integrity of the market never lower, and that is a bad thing for all of us. This really needs to change if you want the equity market to play the crucial role it should in funding economic growth and providing reliable income streams to investors. We continue to have a 'reduce' recommendation on ASX shares.

Change needed

Australia needs to control its own capital markets destiny. Right now for calendar year 2012, we are the worst performing regional market despite having the best fundamentals. Ask yourself how that happens when we have compulsory superannuation? It all comes down to retail investors who have control of their superannuation losing faith in equities as an asset class because they rightly believe the equity market has become a casino. Double the after-tax yield is available in leading Australian equities over term deposits, yet term deposits continue to attract inflows at the expense of domestic equities. That says it all.

To get retail investors interested in equities again, which is fundamental to gross domestic product (GDP) growth, there needs to be major regulatory and legislative change in how Australian equities are traded.

The first move should be reintroducing broker numbers to improve transparency; the second move would be to outright ban HFT. That is the only way you can start bringing integrity and trust back to equities as an asset class.

Deep value

Yet the good news is a lack of retailer buyer interest drives deep value in high-quality, high-yield, long-duration Australian equities. Unsurprisingly, value and yields have never been better with retail investor interest in equities at all-time generational

lows.

For those of us still in the ‘equity cult’, we are spoiled for choice. We are being paid record premiums by Mr Market to simply take a risk in equities.

I need to take a low-frequency investment approach in a world where high-quality stocks are currently priced by high-frequency traders.

ANZ, AMP, BHP, CWN, FMG, NAB, STO, SUN, SVW, TLS, WBC and WPL remain my large-cap high-conviction ideas.

Go Australia, Charlie.

Suncorp Group (SUN): Buy

Suncorp provided an upbeat strategy update on Tuesday. The highlights were as follows: (1) Management is now more confident about the outlook given stronger underlying fundamentals in terms of robust/sustainable top line growth and tight cost control; (2) Suncorp should achieve $190 million in cost savings by 2012 and $235 million by 2013 from the Building Blocks program; (3) the company has upgraded the underlying insurance margin guidance back to at least 12% (+3%), citing better performance in January-May from premium increases, unit growth in the motor book, lower claims especially in the motor book and generally greater GI efficiencies; (4) it expects a further $200 million in cost savings by 2016 from across the GI and Core Bank businesses, arising from simplifying the legal structure, operating platforms and processes, and organisational hierarchy; (5) reinsurance capacity is intact; and (6) Suncorp is more comfortable about capital return prospects with the likely timing to be confirmed at the August results.

- Last closing price: $7.75
- Target (12 months): $9.60 (unchanged)
- Expected capital growth 22.9%
- Expected dividend yield 6.1%
- Total expected return 29.0%

AMP (AMP): Buy

We believe in the wealth management theme as revenue drivers turn positive, specifically higher levels of funds under management through higher market levels, improving asset mix and a return of net flows. In addition, we believe there are significant synergies on offer following the AXA-ANZ transaction. We see AMP as a relatively low-risk investment at a fiscal 2012 price/earnings ratio of 11-times, a 7% dividend yield, and with $132 million of remaining cost-synergies yet to be realised. We believe the current share price has not factored in any benefit for the pending cost-synergies, let alone the revenue-synergy potential. We believe AMP is at the lower end of its potential PE band, given the annuity nature of its diversified earnings base and its ability to pay regular and stable dividends despite volatile markets.

- Last closing price: $3.87
- Target (12 months): $5.50 (previously $5.70)
- Expected capital growth 39.9%
- Expected dividend yield 7.1%
- Total expected return 47.0%

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How to make the most of a sinking Aussie dollar

by JP Goldman

The long-mighty Australian dollar has taken a few knocks in recent weeks and more analysts are starting to consider the possibility that it's seen its highs for quite some time.

As we've seen in the past, when the trend in the Aussie dollar turns, it can be quite dramatic. Back in 2008, for example, the Aussie fell from 97 US cents to 60 US cents within three months.

Therefore the question arises, how can investors best position their portfolios to account for a possible new downtrend in the Aussie?

Investment options

Thankfully, with the listing of US dollar and international equity market exchange-traded funds (ETFs) on the Australian Stock Exchange, investors have a lot more options for taking advantage of currency swings than in earlier years.

Of course, predicting the direction in currencies is hard – especially over the short term. But over a longer time frame, the Australian dollar has clearly moved in broad cycles related to the direction of commodity prices and global economic growth.

That cycle appears to be turning.

The next cycle

Lower local interest rates, China's slowdown, falling commodity prices, and European-related concerns over global growth have all recently conspired against the Aussie.

Perhaps most importantly, due to rising supply and signs of over capacity in China's steel industry, Australia's key coal and iron ore export prices have likely peaked, albeit at historically high levels. The commodity price correction has seen mining stocks tumble over the past year – far harder than the market overall – and this has caused major companies such as BHP Billiton to review their investment plans.

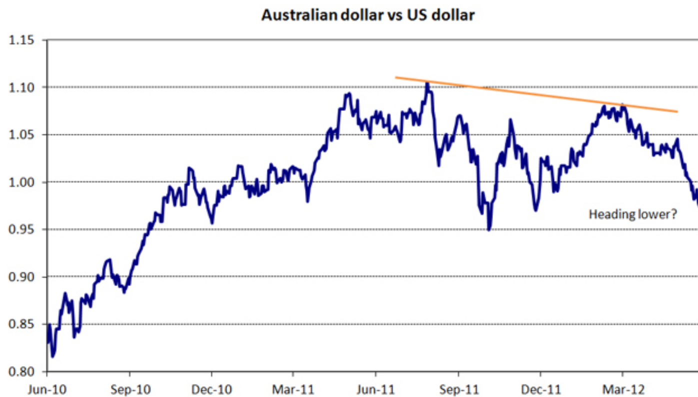
Indeed, while the Australian dollar has broadly moved in line with global growth sentiment in recent years, signs of a more negative trend for the currency have recently become evident – possibly reflecting greater investor concerns over the Chinese economy and commodity prices, and more confidence in America's economic recovery.

A recent history

Note, the Aussie first broke above parity to the US dollar in late 2010, and reached a high of US$1.10 in late July last year. With last year's jitters in Europe, the Aussie briefly slumped to 94 US cents in early October, which also coincided with the bottom in global equity markets more generally. Along with the rebound in global equity markets, it then staged a rebound to reach US$1.08 by late February this year.

However, despite America's S&P 500 index reaching new post-GFC highs earlier this year, the Aussie was not able to push back above $US1.10. In fact, it peaked a month before the US stock market entered its current correction phase in early April.

With the correction in world stock markets in recent weeks, the Aussie broke back below parity two weeks ago.



Three ways to take advantage of a swing

So if the Aussie dollar is headed lower, what can investors do?

For starters, if you're still bullish on global stock markets – particularly the United States – you could boost exposure to Wall Street through buying a US equity ETF, such as the iShares S&P 500 (ASX :**IVV**). Note, its management expense ratio (MER) is only nine basis points a year.

Vanguard also has a US equity market ETF (ASX:**VTS**) with a MER ratio of just six basis points! Both these ETFs are unhedged, meaning their Aussie-dollar value will rise (even with no change in share prices) if the US dollar appreciates against the Aussie.

Investors less sure about the outlook for global equities, but who still want some US dollar exposure, could also consider the BetaShares US dollar ETF (ASX:**USD**), which effectively invests in US dollar bank deposits on your behalf. Of course, the interest rates on US bank deposits are currently much lower than those available in Australia, but this would be offset by exchange rate gains should the Aussie slump.

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How to use the Age Pension in retirement

by Andrew Bloore

A common misconception is that retirement income is either self funded from superannuation savings or government funded by means of the age pension. While this may be true for some, many retired Australians receive a part-age pension as a supplement to their super. It's therefore essential to understand how super impacts eligibility to receive the age pension.

Are you eligible?

Firstly, to receive the age pension, a person must meet the age criteria. Currently, men must be 65 years old and women, 64 and a half years old to qualify. The age pension age will gradually increase from 2014 for women, and then from 2017 for both men and women until it reaches 67 in 2023.

Secondly, the pensioner must be an Australian resident who is present in Australia on the day the claim is lodged. A 10-year qualifying residence is necessary, unless certain conditions are met.

Lastly, age pension entitlements are means tested by Centrelink using two tests: the income test and the asset test. Eligibility is based on whichever test provides the lowest entitlement.

Super balances, assets, contributions and benefits may affect the income and assets tests, and therefore a person's ability to access the age pension, in the following ways:

The income test

Super in accumulation phase

Super assets held by anyone of pension age will be included in the income test, where deeming provisions apply. Deeming assumes a percentage of income on the investments at a rate that depends on the value of the assets and whether they belong to a single pensioner or a pensioner couple. The actual income derived from the asset is disregarded. Income from assets held by anyone under the pension age is exempt.

Super in pension phase

Income derived from the super pension, less any exempt amount, is assessed in the pension phase.

The exempt amount is the purchase price of the super pension divided by the pensioner's life expectancy when the super pension commences. For example, if the super pension was started with $100,000 and a 20-year life expectancy, up to $5,000 of the annual amount withdrawn will not count towards the income test.

Also taken into account are any salary sacrifice contributions into super. While lump sums from super are not included, the income and/or asset test may apply if those funds are later invested, such as in shares, term deposits, bonds or managed investments. Further, a lump sum will reduce the exempt amount under the income test. In the previous example, the $100,000 super pension would be reduced by a lump sum withdrawal, of say $20,000, and over the same life expectancy will result in a lower exempt amount of $4,000.

The asset test

Super in accumulation phase

Super assets held by anyone of pension age will be included in the asset test and assessed at the market value equal to the account balance. Super assets held by anyone under pension age are exempt.

Super in pension phase

The capital value of the super assets are assessed,

unless an asset test exemption applies.

The asset test exemption of income streams depends when they were purchased. Income streams purchased before 20 September 2004 will continue to be 100% exempt from the asset test. Complying income streams purchased from 20 September 2004 to 19 September 2007 are entitled to a 50% asset test exemption.

Any income stream purchased on or after 20 September 2007 is fully assessed under the assets test. As purchasing an income stream requires an identifiable account balance, certain defined benefit income streams that have no identifiable account balance will have a 100% asset test exemption regardless of commencement date.

Maximising your age pension entitlements

When someone reaches age pension age, starting a super pension (if not already in place) may be more beneficial for age pension entitlements than having funds outside of super. This is because super pensions receive more generous income test treatment. As discussed above, this is due to an exempt amount of a super pension that is not assessable.

If an individual reaches age pension age but their spouse is still under it, super assets or income from those assets held in the spouse's accumulation account will not be counted towards either the income or assets test.

It's worth exploring whether building up a younger spouse's super – for example, with eligible spouse contributions or contribution splitting – before the individual reaches pension age will result in a greater age pension entitlement. However, be conscious of age-related contribution restrictions and contribution caps.

Also consider the timing of when the younger spouse commences a super pension because this will determine whether their super is counted towards the income and asset tests. As super benefits are able to be withdrawn at preservation age, currently 55 (which is below pension age), there is scope to delay super withdrawals and shelter super from counting towards age pension tests until the spouse reaches age pension age.

Investments in super that are counted under the income test should earn at least the deeming rate that applies for financial investments (as defined for age pension). An individual will be better off under this test if their returns are higher, since it's the deemed rate that applies and not the actual rate of return. Greater returns on financial investments will not affect age pension entitlements under the income test.

Do the maths

Be careful to ensure that the benefit from accessing the age pension is greater than other investments that, while reducing age pension entitlements, may achieve greater returns.

Also be mindful of living expenses. Even though a spouse under age pension with their super in the accumulation stage may increase the age pension available to the older spouse, the total amount of income including the age pension should be sufficient to meet the couple's expenses. If this is not the case, the couple may be better off receiving a super pension from the younger spouse, assuming a condition of release has been met.

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Did you know?

Term deposit rates have slumped in the past few weeks, but there are some institutions that are offering much more attractive rates than others. You can compare updated term deposit rates on our website by following the link on our homepage, or by clicking here.

Don't miss this!

Meet Peter Switzer and Paul Rickard at the last of their talks in a series on investing in SMSFs for the Australian Shareholders' Association in Sydney. Get in now to secure early bird tickets for just $20.

Topic: **How to turbocharge your super and take money out**
When: Friday 22 June
Where: Mechanic's School of Art, Sydney

To book your seat, call the ASA on 1300-368-448 and mention you're a Switzer Super Report subscriber for your discount.