Switzer Super Report

Issue 100, 12 July 2012

Our bumper 100th issue

Today marks a milestone for the *Switzer Super Report* because it's our 100th issue! First of all, a big thank you to all our readers who have joined us over the past year. We've really valued your insight and feedback and we continue to mould the *Switzer Super Report* to suit your needs. Also, a big thank you to our experts, because without them, we wouldn't be able to bring you the valuable insights that each has in their respective fields.

So to celebrate, we have a bumper issue for you today, with my stock market outlook, stock and portfolio recommendations from Charlie Aitken and George Boubouras, a detailed list of property hot spots around Australia thanks to Residex, and more ... I hope you enjoy it!

Sincerely,

Peter Switzer

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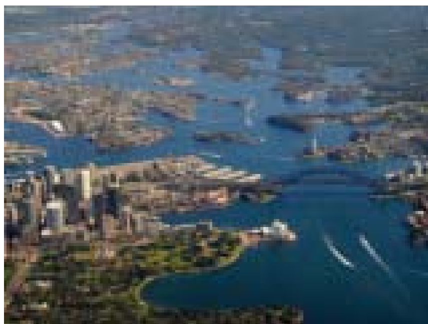

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There's a rally coming, it's just not yet

by Peter Switzer

The market news for SMSF trustees might not be crash hot at the moment, but here at the Switzer Super Report we have one thing to cheer about – this is our 100th edition. I read our first edition the other day and it was very edifying to see that we started off on the money.

My column warned of the debt challenges in Europe and the US bound to upset markets – August and September were scary months for trustees and investors – but I did dispel arguments that the US would dive into a double-dip recession. I also predicted an end-of-year rally, which happened, and my colleague Paul Rickard made it clear that term deposit interest rates were definitely heading down!

But that's the past and you are only as good as your last call in this tough game of investing for our financial futures.

Next move

Around the world, Europe remains the thorn in the bull's hoof that stops it from charging. China is in a slower slowdown than was expected, but I believe the stimulus response – two rate cuts in 30 days as well as other monetary measures – will help the most important economy for world growth avoid a hard landing. I expect by the last quarter of this year we will see positive economic data out of China.

The USA is in a slowdown and company reporting will either add to the current gloom – which is reasonably measured at the moment – or it could sow the seeds for another end-of-year rally in the States. This will be post-US election and the remaining challenge could be the so-called 'fiscal cliff' where the Bush tax cuts end. Some spending measures will also automatically end unless Congress relents and permits new measures, which will prevent layoffs and possibly even a recession.

Here I suspect good sense will prevail, but the anxiety about it all remains a roadblock to the eventual big spike in stocks that will happen, probably in 2013. Of course, if we get surprised by eurozone debt bailouts and fiscal union achievements, it could start with the Santa Claus rally I expect this year.

It's a standoff

Right now we're in an intriguing stock standoff situation. Volumes are low and so is volatility. Those holding stocks are not keen to sell, but not enthused to buy; news flow is neither great nor really bad, and so we drift down, but then retrace.

My gut feeling tells me the hedge funds, which have been performing badly in the US, are waiting for a big test and earnings season in the US will be their first chance to make money at the expense of long-term investors. The weaker US economy and stronger US dollar, which is up 11% in recent times, could hurt earnings, but this no certainty, only an expectation that could be proved wrong.

Helping this unwillingness to selloff is the hope by many that the US Federal Reserve will invoke a third quantitative easing stimulus package (QE3), which would rekindle the flame to make US stocks hot again. However, I have always hoped – and so has the Fed boss Ben Bernanke – that the US economy would recover without it.

My tip

So if eurozone leaders, US Congress, US voters and the Chinese economy all follow the optimists' script, then we are off to the races by around Cup time – that is, November – but between now and then I'm tipping this kind of market madness.

That said, I will see any big sell down (and September

is the worst month for the Yanks while October is our's) as a buying opportunity.

This has been my story for four years; when others are fearful, I am greedy for great companies paying nice dividends — and I am sticking to it.

(PS: Resource stocks such as BHP Billiton at $31 are a great buy for someone who is in this investing caper for the long-term, but as it is not a great dividend play, it looks like a more speculative punt. If only all punts could be as reliable as this company over the long term! That's the speculation I like.)

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Australian banks showing opportunity

by Charlie Aitken

I am pretty simple as you well know. This morning AAA-rated Australian Government 10-year bond yields were at 2.90% unfranked.

Offshore investors own 80% of our government bonds, which means that Australian super funds are underweight bonds. So where do Australian super funds go to find acceptable after-tax yields in an ultra-low interest rate environment? Leading Australian equities is the answer as I keep writing.

The rise in Australian three-year Government bond yields from 1.9% in early June to 2.5% is trying to tell you domestic economic growth has bottomed.

The concurrent rise in the Australian dollar from 96.8 US cents in early June to about 102 US cents, despite global weakness, is trying to tell you the Reserve Bank rate cut cycle is on hold.

The rise in the Commonwealth Bank share price from $48.72 in early June to about $54 is trying to tell you the Australian bank sector is going to report record profits and annual dividends.

While equities do have volatility and deserve an equity risk premium over long bonds, I fail to believe that the AA rated Westpac (WBC) should command a 480 basis point higher yield than an AAA 10-year Australian Government Bond (AGB10yrs). The 480 basis point yield gap between WBC and AGB10yrs will narrow over the next year. Even if WBC was only driven down to a 6.00% fully franked yield in fiscal 2013, that implies a WBC share price target of $28 – that is 28.3% above today's WBC share price!

I am simply looking at Australian bank equity as quasi-Australian corporate bonds.

Earnings have bottomed, dividend yields are sustainable at 70% payout ratios and I think a big re-rating is starting. This started in Telstra (TLS) and Real Estate Investment Trusts (REITS) and is coming to banks as we speak. There are also positive ramifications for the ASX200 index in this view.

Let's take a look at Westpac.

Westpac Bank (WBC) – Accumulate

Westpac has favourable long-term macro forces in play. It provided a BT Financial Group (BTFG) strategy update today and while no profit guidance was issued, the update was upbeat in terms of a very positive outlook based on an attractive longer-term market for wealth products and services (including superannuation and insurance) and further productivity and efficiency initiatives designed to drive the cost ratio down to the low 50's. With wealth (as opposed to credit) being the anticipated value driver in the medium term, BTFG should provide much needed revenue support for WBC Group (especially in the present low credit growth environment).

We also remain bullish about the prospects of transforming WBC Retail & Business Banking (WRBB) into a best practice bank. As mentioned previously, benchmarking WRBB against its peers is expected to lift its revenue per footing from 1.75% to 1.81% (using ANZ as best practice bank). This would increase revenues by $213 million (+1% to 2013e revenue) and net profit after tax (NPAT) by $149 million (+2% to 2013e NPAT) – the equivalent of $0.48 per share uplift. Finally, we expect improved fundamentals for the bank heading into the second half of 2012 (including net interest margin (NIM) resilience, stable asset quality, tight cost management resulting in positive ' Jaws' and sustainable return on equity of at least 15%) to be also supportive of its first half of 2012 78% payout ratio (compared with its target of 70%).

- Rating: Accumulate
- 12-month target price: $23 (unchanged)
- Last closing price: $21.82
- Capital growth: 5.4%
- Dividend yield: 7.5%
- Total expected return: 12.9%

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The best investment suburbs in a changing market

by Alia McMullen

The long predicted recovery in house prices is yet to emerge despite years of relatively low interest rates, a mining boom and a supposed undersupply. While many hold onto hopes of another bull run, some analysts say the market is oversupplied and will not only remain patchy this year, but possibly for the next decade, causing rental income and not capital growth to become the main source of return.

They could be onto something. Morgan Stanley's economists, who have been bearish on housing for some time, have attracted attention in recent weeks for arguing that the widely trumpeted national housing shortage is in fact an oversupply. In June, the National Housing Supply Council (NHSC) reported an undersupply of 228,000. However, Morgan Stanley points out a massive disconnect with the recent 2011 Census figures, which suggest an oversupply of 341,000.

Oversupplied

John Edwards, CEO of property information provider Residex, agrees. His figures suggest Victoria, South Australia, the ACT and Tasmania are oversupplied, while NSW and the Northern Territory are relatively balanced, and Western Australia and Queensland show signs of undersupply.

Mr Edwards says it will be two years before the decline in building activity and growth from the mining industry pull the country as a whole back into undersupply. However, he says poor housing affordability will continue to limit capital growth in many areas.

"Housing values throughout Australia are in a changing position where they're not going to grow; rent is going to become more important over the next 10 to 20 years," he said.

While oversupply and affordability may be dampening the housing market on a national level, the latest Residex figures (see links to tables below) show there are many pockets experiencing growth in rental returns, capital growth, or both. Rents in Clayfield, Brisbane have surged 51% in the 12 months to June, and are up 48% in The Ponds, Sydney, and a whopping 106% in Flinders, Victoria.

Meanwhile, house prices in Teneriffe, Brisbane, are up 18% in the past year, and up 29% in Tom Price, WA, and 14% in Roxby Downs, SA.

- Best suburbs for growth
- Worst suburbs for growth
- Best suburbs for rental returns

Even so, house prices in capital cities across the country were down 4.1% year-on-year in the March quarter, according to the Australian Bureau of Statistics.

Housing market supporters can be forgiven for being bullish; after all, an economic growth rate of 4.3% is nothing to scoff at, and while the jobs market may be softening, an unemployment rate of 5.2% remains historically low. Meanwhile, wages are rising and consumers are spending – just not at overpriced stores.

The benchmark interest rate, currently at 3.5%, has also been sitting below its historical norm since the Global Financial Crisis, and this combined with the pullback in house prices has improved housing affordability to some extent.

So why has the housing recovery failed to materialise?

Dented affordability

Best suburbs for growth

Region	Suburb	Median Value	Median Rent	Median Rent Rate	Capital Growth Last 3 Months	Capital Growth Last Year
Sydney Houses	CHISWICK	$1,243,500	$725	3.05%	5.54%	4.66%
	CURL CURL	$1,483,500	$1,145	4.04%	5.15%	11.34%
Country NSW Houses	MOLONG	$247,500	$275	5.78%	11.48%	6.04%
	PEAK HILL	$103,000	$185	9.31%	10.32%	3.99%
Sydney Units	ARNCLIFFE	$488,500	$515	5.48%	4.00%	14.47%
	BELMORE	$338,500	$385	5.90%	3.67%	9.23%
Country NSW Units	SALAMANDER BAY	$296,500	$285	5.01%	4.35%	2.05%
	THE HILL	$340,000	$370	5.65%	4.31%	4.89%
Brisbane Houses	TENERIFFE	$1,105,500	$805	3.79%	5.39%	18.39%
	ASHGROVE	$732,500	$585	4.18%	4.31%	0.07%
Country QLD Houses	MORANBAH	$678,000	$1,550	11.91%	11.58%	37.43%
	DYSART	$539,000	$1,395	13.52%	7.26%	21.95%
Brisbane Units	HOLLAND PARK	$379,500	$405	5.56%	4.11%	-1.16%
	FERNY GROVE	$419,000	$425	5.31%	3.93%	5.58%
Country QLD Units	SOUTH GLADSTONE	$297,500	$380	6.66%	5.63%	19.38%
	WEST GLADSTONE	$331,000	$415	6.58%	5.36%	17.35%
Melbourne Houses	KEILOR	$615,000	$460	3.90%	4.01%	-0.52%
	BELGRAVE SOUTH	$574,000	$455	4.13%	3.75%	8.24%
Country VIC Houses	INVERLEIGH	$359,500	$445	6.43%	7.81%	19.48%
	LETHBRIDGE	$310,500	$295	4.99%	7.81%	11.32%
Melbourne Units	BOX HILL SOUTH	$479,000	$400	4.35%	4.37%	4.48%
	CANTERBURY	$665,000	$500	3.91%	3.05%	-1.83%
Country VIC Units	RYE	$342,000	$305	4.68%	3.98%	4.92%
	PORTARLINGTON	$334,000	$370	5.79%	3.72%	4.72%
Perth Houses	KINGSLEY	$570,000	$550	5.02%	4.42%	4.09%
	KINROSS	$487,000	$470	5.02%	4.24%	-1.15%
Country WA Houses	DERBY	$503,500	$725	7.53%	9.02%	17.59%
	TOM PRICE	$615,000	$330	2.80%	8.34%	28.66%
Perth Units	AUBIN GROVE	$294,000	$355	6.35%	8.96%	21.88%
	WEMBLEY	$322,000	$340	5.52%	8.95%	10.51%
Country WA Units	BERESFORD	$248,500	$290	6.04%	4.23%	9.48%
	GERALDTON	$231,000	$250	5.61%	4.22%	8.80%
Adelaide Houses	GAWLER SOUTH	$294,500	$310	5.49%	3.54%	-2.41%
	SALISBURY EAST	$273,500	$310	5.88%	2.97%	-2.90%
Country SA Houses	ARNO BAY	$214,500	$215	5.22%	5.30%	13.70%
	ROXBY DOWNS	$448,500	$530	6.16%	4.55%	14.06%
Adelaide Units	HENLEY BEACH	$347,500	$315	4.73%	4.26%	3.66%
	PROSPECT	$311,000	$295	4.97%	4.07%	-0.02%
Country SA Units	VICTOR HARBOR	$297,000	$260	4.60%	10.60%	12.92%
	WHYALLA	$240,000	$235	5.15%	10.44%	10.37%
Hobart Houses	GLENORCHY	$258,000	$330	6.68%	2.60%	-3.90%
	MONTROSE	$302,500	$365	6.29%	1.80%	-0.81%
Country TAS Houses	BEAUTY POINT	$223,000	$265	6.16%	4.32%	5.01%
	MIENA	$171,500	$240	7.37%	4.07%	6.03%
Hobart Units	MOUNT NELSON	$244,000	$260	5.59%	1.97%	-6.32%
	NEW TOWN	$258,000	$290	5.85%	1.96%	-0.98%
Country TAS Units	SORELL	$250,000	$260	5.44%	-1.22%	6.85%
	SHEARWATER	$247,000	$255	5.43%	-1.58%	2.76%
Country ACT Houses	CASEY	$491,000	$505	5.36%	3.15%	7.56%
	TURNER	$1,061,000	$750	3.70%	2.80%	13.52%
Country ACT Units	BONNER	$409,500	$390	4.94%	6.16%	11.76%
	HOLDER	$450,500	$440	5.09%	5.73%	2.54%
Darwin Houses	MOULDEN	$444,000	$445	5.23%	13.60%	14.82%
	DURACK	$538,000	$575	5.56%	12.75%	4.00%
Country NT Houses	TENNANT CREEK	$209,500	$300	7.47%	7.55%	17.96%
	BORROLOOLA	$170,000	$280	8.59%	7.35%	1.14%
Darwin Units	MOULDEN	$349,000	$405	6.07%	0.48%	7.63%
	DRIVER	$334,500	$375	5.82%	0.19%	-2.52%
Country NT Units	KATHERINE EAST	$316,000	$375	6.21%	2.05%	10.59%
	KATHERINE	$261,500	$370	7.40%	-0.54%	2.72%

Worst suburbs for growth

Region	Suburb	Median Value	Median Rent	Median Rent Rate	Capital Growth Last 3 Months	Capital Growth Last Year
Sydney Houses	HARRINGTON PARK	$524,500	$610	6.07%	-5.36%	-2.12%
	NEUTRAL BAY	$1,441,000	$950	3.44%	-5.30%	-11.91%
Country NSW Houses	MALUA BAY	$424,500	$370	4.58%	-5.14%	-5.74%
	BATEMANS BAY	$350,000	$305	4.57%	-4.88%	-4.39%
Sydney Units	MILLERS POINT	$968,000	$995	5.36%	-3.60%	-5.08%
	LITTLE BAY	$738,000	$690	4.87%	-3.04%	-8.46%
Country NSW Units	MOAMA	$217,500	$210	5.06%	-3.57%	-5.03%
	LEETON	$160,500	$160	5.19%	-3.41%	-9.78%
Brisbane Houses	BEERWAH	$336,500	$340	5.25%	-8.66%	-17.13%
	CHAMBERS FLAT	$429,000	$405	4.95%	-7.93%	-16.51%
Country QLD Houses	ST GEORGE	$202,500	$220	5.67%	-9.05%	-3.86%
	CECIL PLAINS	$133,500	$200	7.89%	-8.46%	-14.41%
Brisbane Units	GOODNA	$219,000	$260	6.18%	-5.67%	-11.84%
	MOUNT WARREN PARK	$199,000	$240	6.23%	-4.60%	-13.04%
Country QLD Units	EARLVILLE	$165,500	$205	6.43%	-4.95%	-11.38%
	CARDWELL	$158,000	$175	5.71%	-4.87%	-22.49%
Melbourne Houses	IVANHOE	$996,000	$535	2.81%	-7.70%	-8.49%
	IVANHOE EAST	$1,248,000	$685	2.86%	-7.52%	-11.10%
Country VIC Houses	DONALD	$121,500	$140	5.96%	-6.83%	-11.22%
	CARDROSS	$199,000	$250	6.51%	-6.59%	-8.06%
Melbourne Units	DANDENONG	$278,500	$260	4.89%	-4.00%	-5.59%
	CLAYTON	$404,000	$355	4.57%	-3.82%	-9.46%
Country VIC Units	COWES	$299,000	$265	4.63%	-4.27%	-7.56%
	PORTLAND	$176,500	$155	4.58%	-3.82%	-8.20%
Perth Houses	YANGEBUP	$401,000	$415	5.43%	-7.62%	0.11%
	WINTHROP	$762,500	$725	4.98%	-7.35%	-9.31%
Country WA Houses	WANDINA	$463,000	$535	6.02%	-5.87%	-14.21%
	KELLERBERRIN	$137,000	$195	7.49%	-5.56%	-5.63%
Perth Units	KELMSCOTT	$279,500	$315	5.90%	0.68%	-0.59%
	GIRRAWHEEN	$306,000	$310	5.25%	0.89%	-0.37%
Country WA Units	CAREY PARK	$288,500	$300	5.45%	-5.78%	-0.11%
	AUSTRALIND	$274,500	$265	5.02%	-5.60%	-4.89%
Adelaide Houses	WINDSOR GARDENS	$356,500	$300	4.41%	-3.41%	-11.69%
	PARA HILLS	$281,000	$285	5.34%	-3.33%	-7.97%
Country SA Houses	PORT AUGUSTA	$174,500	$205	6.20%	-5.99%	-16.56%
	MENINGIE	$165,500	$185	5.76%	-5.59%	-9.41%
Adelaide Units	ASHFORD	$272,500	$255	4.86%	-3.18%	-14.78%
	NORTH ADELAIDE	$399,500	$345	4.54%	-2.57%	-4.27%
Country SA Units	WIRRINA COVE	$118,000	$150	6.67%	0.97%	-11.25%
	MOUNT BARKER	$288,000	$300	5.42%	1.05%	-6.44%
Hobart Houses	ROKEBY	$201,000	$270	7.01%	-5.76%	-12.93%
	RISDON VALE	$177,500	$255	7.53%	-5.42%	-10.00%
Country TAS Houses	WAVERLEY	$158,500	$175	5.82%	-4.22%	-12.72%
	BRIDGEWATER	$174,000	$250	7.47%	-4.04%	-8.94%
Hobart Units	BATTERY POINT	$502,500	$465	4.85%	-3.09%	-9.72%
	WEST MOONAH	$240,500	$240	5.16%	-2.89%	-10.01%
Country TAS Units	KINGS MEADOWS	$204,000	$230	5.94%	-6.57%	-9.34%
	ULVERSTONE	$219,500	$185	4.44%	-6.43%	-3.28%
Country ACT Houses	NICHOLLS	$670,000	$625	4.87%	-5.72%	-1.57%
	PALMERSTON	$502,500	$500	5.19%	-4.54%	-3.25%
Country ACT Units	FORREST	$632,500	$585	4.85%	0.54%	-2.19%
	BRUCE	$443,500	$500	5.88%	0.79%	-2.06%
Darwin Houses	LARRAKEYAH	$1,287,500	$870	3.52%	0.74%	-1.34%
	STUART PARK	$691,500	$540	4.09%	0.93%	-5.34%
Country NT Houses	THE GAP	$396,000	$425	5.62%	0.84%	1.66%
	ARALUEN	$474,000	$515	5.66%	1.34%	-2.07%
Darwin Units	NIGHTCLIFF	$332,000	$360	5.69%	-3.97%	-7.55%
	TIWI	$375,500	$355	4.96%	-3.16%	-5.92%
Country NT Units	GILLEN	$327,500	$365	5.82%	-3.97%	4.92%
	LARAPINTA	$320,000	$340	5.55%	-3.77%	0.74%

Best suburbs for rental returns

Region	Suburb	Median Value	Median Rent	Median Rent 12 months ago	Rent Yearly increase	Median Rent Rate
Sydney Houses	THE PONDS	$627,500	$660	$445	48.31%	5.50%
	CLONTARF	$2,354,000	$2,115	$1,500	41.00%	4.69%
Country NSW Houses	MURRUMBATEMAN	$697,000	$650	$405	60.49%	4.88%
	SALT ASH	$442,500	$410	$260	57.69%	4.82%
Sydney Units	TURRELLA	$664,500	$475	$325	46.15%	3.71%
	EAGLE VALE	$281,500	$420	$300	40.00%	7.81%
Country NSW Units	LAMBTON	$327,000	$370	$280	32.14%	5.92%
	THE JUNCTION	$385,000	$400	$305	31.15%	5.46%
Brisbane Houses	CLAYFIELD	$899,000	$740	$490	51.02%	4.30%
	TENERIFFE	$1,105,500	$805	$585	37.61%	3.79%
Country QLD Houses	MORANBAH	$678,000	$1,550	$770	101.30%	11.91%
	DYSART	$539,000	$1,395	$695	100.72%	13.52%
Brisbane Units	BANKSIA BEACH	$361,000	$340	$285	19.30%	4.95%
	MACGREGOR	$455,500	$465	$390	19.23%	5.35%
Country QLD Units	GLADSTONE CENTRAL	$434,000	$460	$260	76.92%	5.56%
	BOYNE ISLAND	$350,000	$470	$295	59.32%	6.97%
Melbourne Houses	DEEPDENE	$1,694,000	$960	$605	58.68%	2.95%
	PARK ORCHARDS	$1,010,500	$800	$590	35.59%	4.13%
Country VIC Houses	FLINDERS	$867,000	$1,580	$765	106.54%	9.52%
	QUEENSCLIFF	$699,500	$1,055	$545	93.58%	7.88%
Melbourne Units	ALBERT PARK	$660,500	$520	$385	35.06%	4.10%
	BALWYN NORTH	$711,500	$520	$395	31.65%	3.82%
Country VIC Units	PORTARLINGTON	$334,000	$370	$260	42.31%	5.79%
	BACCHUS MARSH	$261,000	$300	$215	39.53%	5.98%
Perth Houses	SALTER POINT	$1,154,000	$925	$565	63.72%	4.18%
	INGLEWOOD	$860,000	$680	$430	58.14%	4.13%
Country WA Houses	SOUTH HEDLAND	$776,500	$1,760	$850	107.06%	11.83%
	PORT HEDLAND	$1,170,000	$2,420	$1,170	106.84%	10.79%
Perth Units	LATHLAIN	$552,500	$575	$400	43.75%	5.42%
	SHENTON PARK	$524,000	$560	$390	43.59%	5.58%
Country WA Units	PORT HEDLAND	$976,000	$1,650	$835	97.60%	8.82%
	SOUTH HEDLAND	$621,000	$1,305	$740	76.35%	10.95%
Adelaide Houses	CLARENDON	$562,000	$490	$370	32.43%	4.54%
	WATERLOO CORNER	$557,500	$420	$325	29.23%	3.94%
Country SA Houses	FREELING	$298,000	$340	$260	30.77%	5.97%
	PORT ELLIOT	$389,000	$345	$280	23.21%	4.64%
Adelaide Units	MUNNO PARA WEST	$108,500	$255	$195	30.77%	12.24%
	INGLE FARM	$251,500	$355	$275	29.09%	7.40%
Country SA Units	NAIRNE	$291,500	$325	$230	41.30%	5.82%
	STRATHALBYN	$269,500	$295	$225	31.11%	5.70%
Hobart Houses	KINGSTON BEACH	$455,500	$445	$365	21.92%	5.11%
	TAROONA	$467,000	$425	$355	19.72%	4.74%
Country TAS Houses	ACTON PARK	$585,500	$500	$390	28.21%	4.48%
	HADSPEN	$264,500	$305	$240	27.08%	6.00%
Hobart Units	BATTERY POINT	$502,500	$465	$355	30.99%	4.85%
	LENAH VALLEY	$277,500	$300	$260	15.38%	5.61%
Country TAS Units	NEWSTEAD	$192,500	$225	$190	18.42%	6.10%
	YOUNGTOWN	$243,500	$300	$255	17.65%	6.39%
Country ACT Houses	FORDE	$619,500	$610	$375	62.67%	5.13%
	HAWKER	$766,500	$655	$510	28.43%	4.48%
Country ACT Units	FORDE	$503,500	$520	$345	50.72%	5.38%
	YARRALUMLA	$837,500	$750	$545	37.61%	4.67%
Darwin Houses	LYONS	$556,000	$770	$545	41.28%	7.24%
	JOHNSTON	$249,000	$455	$350	30.00%	9.52%
Country NT Houses	EAST SIDE	$514,500	$550	$490	12.24%	5.57%
	KATHERINE EAST	$340,500	$425	$380	11.84%	6.48%
Darwin Units	BAYVIEW	$577,000	$675	$560	20.54%	6.11%
	DARWIN	$495,000	$605	$505	19.80%	6.40%
Country NT Units	KATHERINE EAST	$316,000	$375	$320	17.19%	6.21%
	KATHERINE	$261,500	$370	$340	8.82%	7.40%

The role of the stock market can't be underestimated, particularly where it concerns high net worth individuals or those whose super nest eggs continue to suffer in the wake of the GFC. Many of these investors took a big hit, with the S&P/ASX200 still down 38% from the peak in October 2007. However, this doesn't explain why prices in suburbs comprised predominantly of young families with little stock market exposure have also declined.

The oversupply theory, which is in a large part also due to affordability, fits this bill.

"Capacity to afford housing is more important than the supply metrics in general – meaning an environment of gradual housing deleverage, housing volumes and price growth are likely to remain constrained, despite low supply volumes and falling interest rates," Morgan Stanley economists Lou Pirenc, Todd McFarlane and John Meredith argue.

The economists say more Australians are willing to bunk up together in order to keep living expenses affordable. The average number of people per dwelling rose to 2.9 in 2011, up from a bottom of 2.7 in 2006. Until recently, those figures had been trending down with conviction, registering 4.1 in 1946 and at 3.4 in 1976. Add to this an increasing demand for rental property, and you can go a long way to explaining the lull in purchase demand.

Secret listings

But the evidence of general oversupply doesn't stop there. Deirdre Macken from the Australian Financial Review points out that "never have there been so many properties for sale and so few sales." And that's based on 'official' figures. On top of that, she says agents have lists of "secret" properties up their sleeve and these are growing by the day. By secret, she means sellers who are on the books, but not listed for public view unless a buyer willing to pay above market rates comes along. This means supply in the resale market is much greater than commonly thought.

Given these conditions, Morgan Stanley is quite comfortable to retain its bearish stance on housing, although they firmly state they do not expect a crash.

"We continue to expect house price growth in real terms over the next decade to be meaningfully lower than in the past decade," they said, adding they "assume flat to negative growth in real terms in the medium term as wage growth outpaces price growth."

Stocks

For stock market investors, they remain cautious on companies with "meaningful" residential exposure, including Stockland (SGP), Mirvac (MGR) and Australand Property (ALZ), taking an "underweight" position in a stock portfolio.

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Delivering a diversified stock portfolio

by George Boubouras

The month of July is a natural time for investors to reflect on the performance of their portfolios. As the market starts a new financial year, accountants will be busy with tax reporting in the coming quarter.

While investors will review their portfolio returns they also need to address their appropriate (and realistic) expected returns, their true risk appetite (can you sleep at night?) and the time horizon. After all, defensives did what they were supposed to do over the past year (refer to Table 1 below for performance review of all markets and asset classes).

Of note, the average moderate investor risk appetite in Australia has a diversified portfolio across and within all the main asset classes.

The diversified approach

One of the aims for investors who have a conservative to moderate risk profile is to minimise the downside of their returns to assist with wealth accumulation over your life cycle. That is, meet realistic expected returns with a lower volatility versus the broader equity market. Clearly cash, fixed income and A-REITs performed well. International equities in Australian dollar terms also performed well, particularly US equities. The strategy of diversifying your earnings exposure in your equity portfolio worked well over the past year given that the local equity market has a bias towards local financials and resources.

To illustrate the benefits delivered by a diversified portfolio, Figure 1 shows the standard moderate investor profile asset allocation. This is a sample asset allocation that is sourced from our various Strategic Asset Allocation (SAA) benchmarks at UBS WM.

We have removed 'Alternatives' in this sample as we want to make it realistic for a self-managed super fund (SMSF). The one-year return to 30 June 2012 for this standard moderate portfolio was 3.79%, clearly a much better result than the broader equity market, with outperformance by double digits. Further, if an investor followed a core Australian equity strategy of dividend-seeking large cap stocks with a low beta target, the outperformance would be even higher.

Figure 1: Standard asset allocation for a moderate investor profile. This asset allocation is reflective in our UBS Wealth Management moderate investor profile, excluding alternatives.

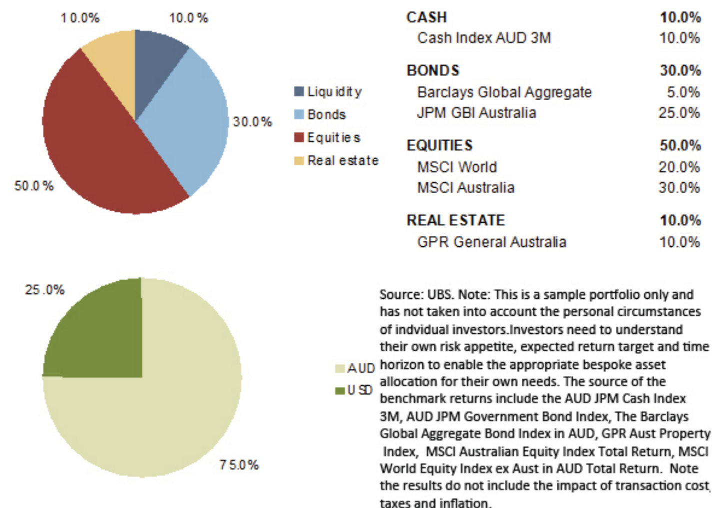
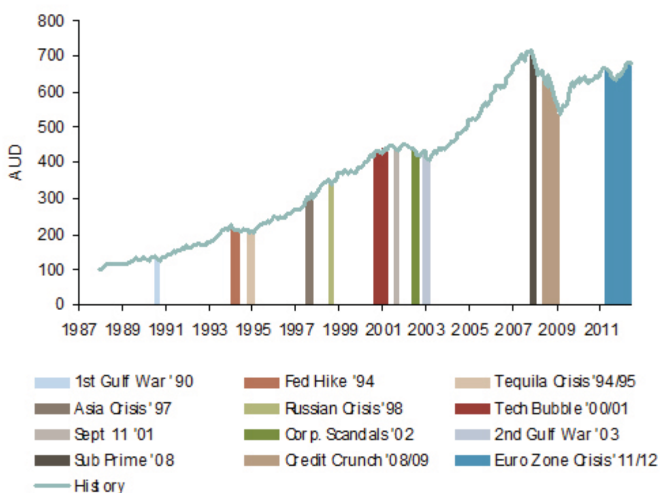


Figure 2 shows the simulated historical performance of the sample moderate investor profile portfolio since 31 December 1987 through to 30 June 2012. The time period of historical financial crises are highlighted so we can clearly see the impact of each crisis.

The key of course is that volatility is a normal part of the market, while excessive volatility is not. Therefore a diversified portfolio that reflects your risk appetite generally meets your return expectations. Further, this portfolio has averaged an annualised return of 8.13% with annualised risk of 7.01% (which, in UBS' view, is an acceptable level for a moderate investor profile).

For some additional perspective, the best calendar year performance was 25.76% in 1991 as the market began to price in the recovery from the recession of 1990-91. The worst calendar year performance was -18.19% in the 2008 GFC. While not a good outcome, it was a better return than the -40.3% return from Australian equities.

Figure 2: Simulated historical stress test of this sample moderate investor.



Note: The sample portfolio return simulation is based on the performance of the benchmarks referred to in Figure 1 above. The performance is based from 31 Dec 1987, includes total cumulative returns up until 30 June 2012.

This asset allocation assumes rebalancing of your portfolio on a monthly basis to reflect the proposed asset allocation benchmark weighting. Note that back testing the performance does not reflect the impact that past economic and market factors might have on investment decision making. There is no guarantee that the simulated past performance could, or would, have been achieved had this asset allocation been used during the years presented. Also, past performance is not indicative of future results.

In summary, we have aimed to highlight the basic concepts and building blocks regarding the 'art of portfolio diversification' through a diversified portfolio for an average moderate investor profile. It is quite clear that diversification across all the asset classes, and importantly within, are such key concepts that all investors need to be cognisant of it in their wealth accumulation.

Your asset allocation must reflect your return expectations, the amount of risk you employ (volatility) to meet your objectives and your time frame (which reflects your stage of your lifecycle).

Everyone will effectively need to explore their own bespoke SAA weighting benchmarks, as each person will have different requirements and risk appetites. It will probably differ to the weightings used in this note.

George Boubouras is the Head of Investment Strategy and Consulting, UBS Wealth Management Australia.

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A new way to profit from falling stocks

by JP Goldman

The evolution of Australia's exchange-traded fund (ETF) industry continues apace, with this week's launch of the first so-called 'inverse ETF' – an ASX-listed fund that allows investors to profit from stock market declines.

Launched by innovative Australian ETF provider, BetaShares, Australia's first inverse product tracks the S&P/ASX200 index. Aptly trading under the ASX code 'BEAR', the product takes an annual fee of up to 1.38% out of returns through each year.

As BetaShare's marketing material indicates, it's investment objective is to "generate returns that are negatively correlated to the returns of the Australian share market."

It will do this by investing most of the funds it receives in cash, but using a proportion to sell futures against the S&P/ASX200 index such that an overall net negative exposure of between 90 to 110% of the market is achieved.

Note, BEAR is not an ETF in the strict sense. It is instead an actively managed fund, but with a fairly simple quantitative strategy of maintaining close to 100% negative exposure to the market. It's effectively an indexed bear fund.

BEAR is also not leveraged – its returns are expected to match that of the market, albeit in the opposite direction.

Designed in this way, it is anticipated BEAR will avoid some of the problems experienced in the US with traditional structured inverse and leveraged ETFs.

Offshore irritants

In America, most inverse ETFs are designed to match the inverse of daily percentage movements in the market – and in this regard, the ETFs are rebalanced at the end of each day so as to re-establish their 100% negative market exposure.

This results, however, in an erosion of their value over time due to market volatility. History shows that holding an inverse US ETF over the long-term often produces results that are far different than the inverse of the market return as they only promise to return the inverse of day-to-day moves in an index, not the inverse of the market's long-term returns.

For example, if the market rises by 10% one day and falls by 10% the next, it will be down 1% over two days. It just so happens a traditional unleveraged inverse ETF would also be down 1% over this period – when an unwary investor might have expected the ETF to be up 1%.

Extending this example, if the market then rose by 10% the following day, the market would be up 8.9% after three days, whereas the inverse ETF would be down a larger 10.9%.

As evident, due to the need for daily re-balancing, the inverse ETFs found in the US (and especially leveraged ETFs) result in great deviations in performance relative to underlying markets overtime compared with traditional short positions.

In the latter two cases, if you short the market to the value of $100, your percentage return will equal the inverse of the market return over time (less financing costs).

The BEAR

Unlike typical US inverse ETFs, BetaShares will not re-balance its position each day, but rather allow its negative exposure to vary between 90 and 110% of the market. The implication is that short-run rebalancing

losses caused by day-to-day volatility should be reduced, but it still won't avoid deviations in ETF performance relative to the inverse of the market over long time periods.

The other issue with the BEAR fund is that if investors want to use it to hedge their portfolio against market declines without selling any of their shares, they will still need to raise the cash to buy it. If they don't have spare cash equal to the value of their portfolio, they'll have to borrow it.

Shorting alternatives

Already in Australia, similar protection – without the same re-balancing problems – can be achieved by short-selling a market-linked leveraged contract for difference, known as a CFD (such as the S&P/ASX200 CFD, code IQ), which effectively involves short-selling the market index with a margin loan financed at the official cash rate plus a 1.5% margin.

That said, due to the high levels of leverage, CFD trading has its own complexities and risks, and is not as straightforward as simply buying and selling ETFs. This is why the BEAR fund will likely still prove quite attractive.

The bottom line

The BEAR fund is a useful new addition to the tool kit of Australian investors. It is best seen as either a short-term trading or hedging tool that allows traders and investors to bet on near-term market corrections. Due to the 'tracking error' problems noted above, however, it is not suited for taking longer-term bearish positions in the market.

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What can I do about late contributions?

by Andrew Bloore

It may not seem like an obvious thing to check, but knowing when your employer is due to pay your superannuation contribution could prevent you breaching your cap. This is because employers don't necessarily need to pay your super in the financial year that you earned it. For some people, a delayed payment could push them over the contributions cap. Here's what you need to know.

But first, some background. As many of you are aware, employers are required to pay a minimum of 9% of eligible employee's ordinary times earnings (OTE) as a super contribution into a complying super fund, generally of the employees' choice, or a retirement savings account. These payments are officially called the Super Guarantee (SG).

Employees eligible to receive SG are:

- aged between 18 and 69 years old;
- paid at least $450 before tax in salary or wages in a calendar month; and
- working full time, part time or casually.

There is a maximum contributions base for employees who earn over a certain amount each quarter. Employers are not required to pay superannuation on amounts above this base, which for 2011/12 is $43,820. For 2012/13, the limit increases to $45,750.

If an employee has an effective salary sacrifice arrangement with the employer, the sacrificed amount is an employer contribution, and therefore counts towards the SG obligation.

Deadlines

Employer contributions need to be made on at least a quarterly basis. For each quarter, the payment must be received by the superfund by the 28th day of the month following the end of the quarter that the contribution relates to. This means that for the quarter starting 1 April to 30 June, the payment cut-off date is 28 July. Fortnightly or monthly payments can also be made as long as the total amount owing for the quarter is paid by the cut-off date.

Late payment implications for the employer

Employer contributions that are not received by the cut-off date will attract interest (10% per annum on the outstanding amount) and penalty charges ($20 administration fee per employee per quarter), which are to be paid by the 28th of the next month. This is called the Super Guarantee Charge (SGC).

The employee's SGC is based on salary and wages, which could be greater than the OTE that the SG is based on. Further, the employer is not eligible for the tax deduction that applies to employer contributions that are paid on time.

Late payment implications for the employee

Contributions made to a super fund are counted in the financial year that the super fund receives the payment. This means that contributions made for the June quarter 2012 may be received by the fund in July 2012, and would still meet the payment deadline. However, the contribution will be attributed to the 2012/13 financial year.

If the employee is making salary sacrifice contributions as well, missing the June 30 deadline can have significant implications for contributions caps, potentially unbeknownst to the employee.

This is best illustrated in an example:

In combination with an effective salary sacrifice

arrangement, an employer contributed $25,000 to a 40-year old employee's super fund for the quarter ending June 2011. The employer paid the contribution on 1 July 2011.

In June 2012, the employer contribution was received by the super fund on 30 June. Even though the June 2011 contribution was in reference to the 2011 financial year, it will be attributed to the 2012 financial year as it was received in July.

Now the employee will have an excess contributions issue since both contributions are deemed to be made in the 2012 financial year.

Avenues of appeal

The ATO has the power to treat the June 2011 payment in the 2011 financial year, however their discretion is based on special circumstances, and will not be exercised just because one of the following occurs:

- the employer's liability to make super contributions accrued in a different financial year to when they were actually made;
- an amount salary sacrificed to super in one financial year was contributed by the employer to the super fund in another financial year;
- the employee hadn't allowed for having a varying number of pays in a period. For example 53 weekly pays or 27 fortnightly pays in a year;
- a particular employer contribution was paid early or delayed in an unexpected way so that, for example, the employee benefited from 13-monthly or five-quarterly contributions in one year but 11-monthly or three-quarterly contributions in another;
- the employee didn't know something about how the employer makes contributions for them;
- the concessional contributions cap was exceeded solely due to contributions the employer had to make.

However, whether an employer's contributions often follow a regular 'pattern' or whether the employee can control the timing or amount of the employer's contributions is relevant to determining if there are special circumstances. This consideration may be important if one or more contributions were made outside of the employer's regular pattern and the employee has behaved in a particular way because they were aware of, and relied on, that pattern.

Dealing with the uncontrollable

While employees are unable to control the timing of super payments or when they are received by their fund, being aware of contributions caps, total concessional contributions payable and when past super payments have been made, will allow better management of contributions going forward.

Checking super statements and dates of when contributions have been received is one way to monitor contribution against the cap, and therefore the ability to reduce salary sacrifice arrangements accordingly.

If the employer fails to make obligated super payments within the required timeframe or is not paying enough, a query can be lodged with the ATO by calling 13 10 20 or via their website www.ato.gov.au.

For those aged 70 and over

These issues will become relevant for those aged 70 and over, as the SG age limit of 70 will be removed from 1 July 2013, and employers will be required to contribute to complying super funds of eligible employees regardless of age.

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You can browse through past articles under the 'Experts' tab on the Switzer Super Report website. You can also look up past editions in our Archive, or use our Running your Fund and Investments sections to research more about investing in super.

Don't miss this!

Today's report includes in depth tables courtesy of property information service, Residex. Look up the rates of return on the best and worst performing suburbs in Australia as well as rental returns, with the data as recent as June!