Switzer Super Report

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Bye bye bear?

While many market commentators are optimistic about stocks, including yours truly, no one is as bullish as Charlie Aitken, who today declared that the bear market is over. Regular readers would know that I think this month will be a turning point for stocks and Charlie could well be right. Even so, I'm not convinced the rally we're in now can continue without coming up against some hurdles.

Also in the *Switzer Super Report*, JP Goldman gives his Aussie dollar outlook and talks about easy ways you can hedge your portfolio with foreign exposure. Plus, we explain how to claim small business CGT tax breaks in super, and run you through a 'health check' for funds planning to invest in property. Happy reading.

Sincerely,

Peter Switzer

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I don't think this rally has legs

by Peter Switzer

The theme I've been testing this week on my *Switzer* program on the Sky Business Channel is one that is near and dear to anyone investing in stocks – can we trust this rally?

Mike Kendall from JB Were is more confident about this market spike than he was a week ago and Lance Lai is comfortable with the Shanghai Composite rising for the past few days, but it is hard to get anyone positively pushing that this rally has legs.

Why? It rests on potential actions of central banks and in particular the European Central Bank (ECB).

Sure the Yanks are sweating on a third quantitative easing package (QE3) from the US Federal Reserve, but there's a case that Ben Bernanke will hold out as long as he can and might even hope he doesn't have to use it.

The US economy is doing OK with consumer confidence up, retail sales up in July, the services sector expanding, the housing sector improving and company reporting beating expectations.

Meanwhile China seems to be improving and Rio Tinto's view on its best customer's projected growth of 8% yesterday was a nice positive. Today we get new data on Chinese industrial output and other key indicators, but these could still be backward looking. I think the China story looks better as we approach Christmas and that would be a nice gift.

It's all about Europe

However, Europe is the market maker or breaker. Overnight, McDonald's reported flat sales, but most of its bad news wasn't from burger-loving Yanks but from their European operations.

The next time the ECB can take action is tipped to be September and I suspect bond markets could test the ECB's resolve to do anything real that will make a difference. Spanish 10-year bond yields crept above 7% overnight, which is the worry-level.

This is how Reuters explained it:

"Although the ECB has outlined plans to buy sovereign debt alongside the eurozone's bailout funds, it will not happen before September…"

There are some who think Spain and Italy could ask for bailout help before. I reckon that's unlikely but we have a bit of a standoff, which won't be settled before September. This is a threat to this rally.

Out of puff

I don't think this rally will keep on marching up and it will be tested, but it – like I have been predicting since March 2009 – will create a buying opportunity to buy good companies at good prices.

This strategy gave us Commonwealth Bank (CBA) at $43 and Telstra (TLS) at $2.53 and even Westpac (WBC), which was around $20 not long ago.

I think the Europeans will come up with something this year, but their procrastination will again test the market's stamina. It's not quite at the Brownlee boys' level just yet!

Bottom line

So I don't trust this rally yet, but any fall won't be like August and September last year.

I will be buying on any dip as interest rates are falling, price to earnings ratios (P/Es) are attractive and I'm a long-term investor who knows that the nervousness around now creating attractive share prices will not

last forever.

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I'm calling an end to the bear market

by Charlie Aitken

The five-year S&P/ASX200 chart's downtrend from its 2007 highs has BROKEN. The five-year bear market is over (at least in my head).

I believe the market will test the near-term technical target of 4,500 followed by 4,800 over the medium term. This is a great chart.

Source: Bell Potter Securities, Reuters

We need resource stocks, led by BHP Billiton (BHP), to recover and lead the index, and the one-year chart of the ASX100 Resources Index (XTR) is showing a bottoming pattern.

All this means is that if you are bullish, like me, you need to be heavily overweight cheap large-cap Australian resource stocks because they will lead the index recovery from here.

It is interesting the feedback I get when I make a contrarian call. This call has been polarising. Even the people who want it to be right don't think it will be! I haven't had a single reply completely agreeing with my view, which is actually a good thing.

Too early?

The unanimous feedback on my call is 'too early'. Interestingly, nobody seems to argue that there is deep contrarian value in leading Australian cyclical equities, or that the Australian economy is improving (as the Reserve Bank confirmed this week), or that Australian earnings are bottoming, or that Australian residential property prices are bottoming, or that 99% of Australians are servicing their mortgages, or that bank bad debts are bottoming, or retail sales are bottoming, or dividends are sustainable, or that hybrids are great for the equity of the issuer, or that a change of Federal Government will be good for sentiment and confidence etc. etc. They simply believe I'm too early in my timing. This is a classic consensus response to the 'grow on scepticism' phase of a market turning point. Markets always turn ahead of the consensus view.

The very last thing I want to be is just another useless market commentator who predicts the present. I'll leave that to others. Similarly, what use is a broker who urges you to act after the event? You will never get certainty and deep value contrarian investment opportunities together; that's all I know.

So what else am I looking at to justify my bullish call on Australian equities?

Risk appetite is growing

Australian 10-year bond yields have bottomed and are headed back to 3.70%. As bond yields continue to rise, so too will Australian equities, but led by cyclicals, financials and growth stocks, not the pure defensives. The 'bubble' in safety will continue to unwind and there will also be asset allocation from domestic bonds to domestic equities in the second

half of this year.

I am also hugely interested in Australian post full-year results price action. I have a view this reporting season that 'low expectation' stocks will outperform 'great expectations' stocks on confirmation of earnings. The low expectation stocks have very low hurdles to jump, while the great expectations stocks have fences as high as those in the Olympic show jumping!

For 'great expectations' stocks to rally further, they need to deliver something exceptional that leads to further earnings upgrades. Low expectations stocks just need to show up. I also believe if I'm right about broader investor risk tolerance increasing, that the reporting season will be an excuse to rotate to higher risk laggards.

Bottom line

I can't stress enough how different my view is to other domestic equity strategists who continue to recommend being parked in 'earnings certainty' stocks. My view is to be very careful in the 'great expectations' stocks and aggressive in the 'low expectations' stocks. Share prices were already onto the 'haves' and 'have nots'. Now that reverses on confirmation.

Just remember, you will never overtake anyone by driving in the same lane. I think I am driving on my own lane on my own freeway at the moment.

Top five stocks

My top-five Australian mega cap candidates for the 'buy-the-fact/short-cover the fact' response to full-year 2012 earnings and dividends are:

1. AMP (AMP)
2. BHP Billiton (BHP)
3. National Australia Bank (NAB)
4. Newcrest Mining (NCM)
5. Woodside Petroleum (WPL)

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Does your SMSF need foreign exposure?

by JP Goldman

Despite falling export commodity prices over the past year, the Aussie dollar has so far remained remarkably firm, leading to concerns for Australia's export competing industries.

The combination of falling export prices and a high Australian dollar has not helped mining sector profits and the sector has significantly underperformed the overall share market over the past year.

But will the Aussie remain firm, or ease back to normal levels? There are investments out there that will let you hedge your bets.

Diversification benefits

Internationally exposed investors need to be aware of the impact of the Aussie dollar because currency shifts can affect the Aussie-dollar value of unhedged offshore equity or fixed-income investments.

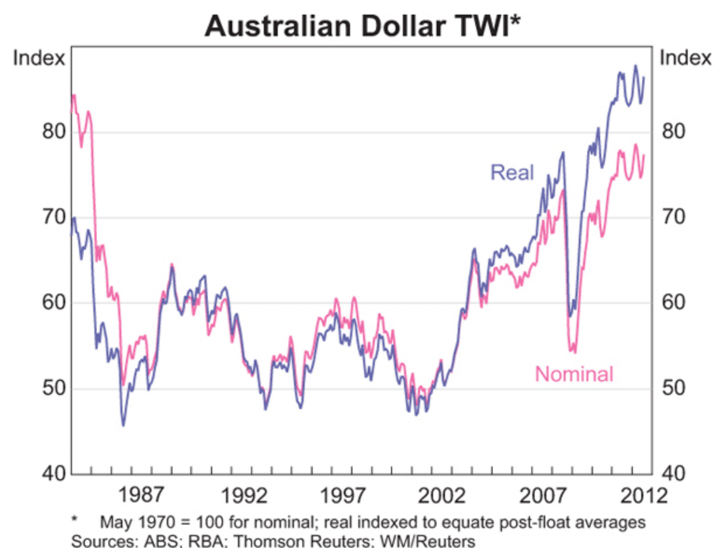
Currencies offer another means for risk averse investors to diversify their portfolios – even if you want to remain in low risk cash products. For example, it's easy to spread risk among a number of currencies. Should the Australian dollar fall, for example, the value of US dollar or euro cash holdings would rise in Australian dollar terms.

So where next for the Aussie?

Against the US dollar, the Aussie peaked earlier last year at around US$1.10, before sinking as low as 94 US cents late last year. It has since rebounded in line with stronger global equity markets and was last seen hovering around US$1.055. The Aussie also remains below its pre-global financial crisis peak against the Japanese yen.

The real standout has been the euro, against which the Aussie has marched on to record highs. In turn this reflects the desire of European investors – and in particular European central banks – to diversify their foreign exchange holdings given pressures on the euro and sovereign debt credit-rating downgrades across the globe.

On a trade-weighted basis, and allowing for inflation differentials, Australia's real exchange rate remains near record highs and hasn't followed export commodity prices down in sympathy.



Since mid-2011, Australia's sky-high export commodity prices have fallen from their peaks due to both slowing growth in China and a belated pick-up in global supply. Spot iron ore prices have fallen from around US$180 to US$120 a tonne, while spot coal prices have fallen from US$120 to US$90. The Reserve Bank of Australia's (RBA) index of non-rural commodity prices in US dollar terms is down around 13% from its peak in early 2011.

But can the record high levels last?

If Europe's problems get a lot worse, the safe-haven flows into Australian-dollar investments could intensify.

Even at only 3.2%, Australian 10-year government bond yields remain relatively attractive by international standards – especially among the dwindling number of countries that retain a triple-A credit rating.

Adding to the risk of heightened inflows, the European Central Bank has recently indicated it stands ready to print cash to buy up sovereign bonds in troubled countries such as Spain and Italy – which could be a further negative for the euro.

The outlook

Longer-term, however, it still seems there's more downside than upside risk to the Australian dollar. With global commodity supply picking up and commodity prices easing, the continued high value of the Aussie increasingly risks crushing local trade-exposed sectors – so much so that it could eventually goad the Reserve Bank into cutting interest rates more than otherwise and/or intervene in currency markets. The economy simply can't support the Aussie staying this high in the absence of a continued commodity price boom.

What to buy

Investors might consider using this period of unusual Aussie dollar strength to gain offshore currency exposure. These days, with exchange traded funds (ETFs), one of the easiest ways is through buying unhedged exposure to foreign equity markets – such as via the **iShares S&P 500 ERTF (IVV)** or even **iShares Europe 350 (IEU)**. And if you only want foreign cash exposure, **Beta Shares offers a US dollar (USD) or Euro (EEU)** cash product that will gain in Aussie-dollar terms when and if the local currency begins its downward correction.

Of course, picking currency direction is never easy. But given the volatility in global currencies, these days, investors should not ignore the diversification benefits – and potential reduction in portfolio volatility – that would come from spreading cash and equity exposure among a number of different currencies.

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How to use small business tax breaks

by Andrew Bloore

Small business owners have potential concessions available to them to reduce a capital gain when they sell their business or certain assets. These are aptly called capital gains tax (CGT) small business concessions.

In certain circumstances, these concessions allow or sometimes require the business owner to contribute the proceeds of the sale to super, subject to certain conditions.

As the CGT small business concession tax rules are complex, here I'll focus on its interaction with super.

What's first?

There are two basic conditions that you must meet in order to qualify for CGT small business concessions.

1. (a) The business is a Small Business Entity, with an annual turnover of less than $2 million for the income year; or

(b) The maximum net asset value of the business doesn't exceed $6 million; and

2. The business owner, affiliate or related entity uses the asset or holds it ready for use in the course of carrying on a business.

Further conditions apply if the asset is a share in a company or interest in a trust.

The concessions

Once these conditions are satisfied, the business owners can potentially access the following concessions:

15-year exemption

This permits the entire capital gain to be disregarded for tax purposes on assets that have been owned for 15 years. However, the business owner must be 55 years or over and retiring, or they have been permanently incapacitated. This exemption takes priority over the other concessions and the CGT discount. If it applies, the capital gain is entirely disregarded so there is no need for other concessions.

Small business 50% reduction

This reduces the capital gain on an active asset by 50%. Unlike the other concessions, this applies automatically if the basic conditions are satisfied, unless it's chosen not to apply.

Small business retirement exemption

This exempts up to a lifetime limit of $500,000 of the capital gain. Despite the wording, there is no requirement to retire, but if the business owner is under 55, the exempt amount is to be paid into a complying super fund.

Small business rollover

This defers the capital gain on the sale of an active asset where the proceeds are used to purchase a replacement asset.

These concessions may be used in isolation or combined subject to age restrictions and lifetime limits, which refers to any previous use of the concession.

Also, if applicable, the general individual 50% discount for assets held for 12 months or more must be applied before the small business CGT concessions two and three above.

Contributing the proceeds to super

If a business owner qualifies for these concessions, they may contribute the sale proceeds to super subject to the lifetime CGT cap. For 2012/13, the cap amount is $1.255 million. Note that this is in addition to the concessional and non-concessional cap.

Further, the business owner must comply with the work test if they are between 65 and 75. From age 75, no super contributions are permitted.

Maximising super contributions

Whilst there is a choice to use the concessions in combination, a business owner might choose not to claim a certain concession in order to maximise the amount contributed to super. This is illustrated in the following example:

A 58-year-old small business owner sells her business that she has owned for the past five years and makes a gain of $550,000 and a separate capital loss of $50,000. She qualifies for the CGT small business concessions. Since she is not retiring and hasn't owned the business for 15 years, she can't use the 15-year exemption.

Capital gain	$550,000
Other capital loss	-$50,000
Net capital loss	**$500,000**
General 50% discount	-$250,000
Balance	**$250,000**
CGT 50% discount	-$125,000
Balance	**$125,000**
Retirement exemption	$125,000
Balance	$0

The gain has been reduced to $0, and she can contribute $125,000 into super under the CGT cap.

The lifetime cap is reduced by $125,000 and it doesn't affect her concessional or non-concessional caps. The amount exempt under the CGT 50% discount may also be contributed to super, but it's not counted towards the small business CGT cap. Instead it will be counted towards the general contributions caps.

An alternative would be not to claim the CGT 50% discount.

Capital gain	$550,000
Other capital loss	-$50,000
Net capital loss	**$500,000**
General 50% discount	-$250,000
Balance	**$250,000**
Retirement exemption	$250,000
Balance	$0

The gain has still been reduced to $0, however she can contribute $250,000 into super under the small business CGT cap. This way she contributes more to super without affecting her concessional or non-concessional caps.

Accessing the ability to disregard gains and maximise super contributions is a valuable tool for business owners, and ensuring the business qualifies for the concessions is the first important step. However, due to its complexity, it's important to consult an adviser in order to get the most out of the small business CGT concessions.

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Buying property? Take this SMSF health check

by Chris Gray

If you'd like to invest in property using your SMSF, you'll need to ask yourself a few questions to determine whether your self-managed super fund (SMSF) is healthy enough to finance the purchase.

Financing the investment can be broken up into two main elements:

a) 'Setup' – funding the deposit; and
b) 'On-goings' – meeting the loan repayments and maintenance costs.

Here's what you need to consider:

The setup stage

How much do I need in my SMSF to buy property?

Most advisors recommend the SMSF hold a minimum of $150,000 to $200,000 in order to invest in property safely and responsibly. Switzer recommends at least $200,000.

There are a number of reasons for this level of funding, but the main ideas are as follows:

Diversification – As most investors will look at property starting from approximately $350,000, a minimum of $200,000 allows you to allocate a sizeable deposit to a property purchase, leaving you with sufficient funds to allocate to cash and equities as well.

Lower levels of debt – Where you may typically borrow up to 80% or 90% of the value of the property from a bank in the general market, most advisors and risk profiles would prefer you to lower your exposure to debt within your retirement fund, limiting the loan to 50% to 70% of the value of the property.

The advantage of such a strategy is that it reduces mortgage-stress and allows you to hold the asset with a much lower year-on-year outlay. The disadvantage is that property investment in your SMSF may require a much larger deposit compared with the general market.

How much should I allocate for a deposit?

Again, this can depend on the financial advice you are receiving and the advisors appetite for risk, however there are also general market limitations on SMSF loans that you will need to consider.

Loans to SMSFs are considered 'limited recourse' by the banks. This means that the bank is 'limited' to seizing only the asset that the loan is attached to and can't gain access to other assets you may also own.

As a result, lending institutions have a limited range of products for SMSFs, some ranging as high as 80% but many peaking at 70% to 73%. This means that for a purchase price of $500,000, a minimum of $100,000 should be considered as a deposit, plus costs. You can find out more on SMSF loans here. [insert link]

What if I don't have the funds for a deposit?

Buying property through your SMSF can be a very tax-effective way to build a property portfolio, so if you don't have the funds for a deposit straight away, you may want to consider lending the deposit to your SMSF rather than miss out.

There is no limit to the amount you can lend to your SMSF and you can do so at an interest rate equal to or less than the 'market rate' of interest. Having said that, there are strict rules you will need to satisfy. You can find out more about this strategy in Lend to your fund at a low interest rate.

The 'on-goings' stage

Do I have the funds to service my loan?

Many people find they may not have been able to afford a property purchase in the general market, but because of their compulsory super contributions, they now have a portion of income that can go to paying for the shortfall between the rent (income) and the loan repayments (expense).

As a general rule, 1% to 2% of the property's value is a good benchmark to use as an 'out of pocket' expense for the first four or five years on a property investment, at least until an increase in rent can compensate more effectively for the loan repayments and the ongoing maintenance and levies.

Achieving a much higher rent return and contributing a larger deposit will reduce this cost dramatically though, so you should consult your accountant or planner to determine a number of scenarios that will suit your financial position.

Can I meet the repayments as I move into the pension phase?

As you move into retirement, the opportunity to service your investment loan out of your own pocket will decrease dramatically. If you have ventured into property at the end of your working career, then it's essential you have a plan for servicing the shortfall in your investment, at least until the rental income has increased sufficiently to make the property cash flow positive.

For a diagram showing the property timeline, please click here or read Are you too old to invest in property using super?

It's essential to consider both the setup and ongoing costs of a property investment in order to make an informed and educated decision on whether you should own property in your SMSF. Making allowances for these factors will put you in a superior position when you do decide to invest.

If you feel confident you meet all the above conditions, then you're ready to take the next step.

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Don't miss this!

These companies are still to report this week:

Friday 10 August: Crown (CWN)
Friday 10 August: Goodman Group (GMG)
Monday 13 August: Newcrest Mining (NCM)
Monday 13 August: Downer EDI (DOW)
Monday 13 August: UGL Limited (UGL)
Monday 13 August: JB Hi-Fi (JBH)

Did you know?

I had the incredibly intelligent Ron Bewley on the show this week and he gave us his prediction for the stock market. You can watch it here on Super TV.