Switzer Super Report

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Future trends

The Reserve Bank's interest rate cut on Tuesday was welcomed by the market, but the decision comes ahead of a predicted slowdown in mining. Where should we invest in a post-mining boom Australia? We take a look at the future in today's report.

JP Goldman delves into the companies and sectors that will benefit from lower interest rates in the years ahead, while I take a look at what to expect from the markets in the final quarter of this year. We also have a special guest for you this week: futurist Craig Rispin. It's his job to identify the new investment trends and he names them in the first of a special series for the Switzer Super Report. We hope you enjoy this edition.

Sincerely,

Peter

Peter Switzer

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Preparing for the months ahead

by Peter Switzer

I expected a nice result for stocks last quarter based on the European Central Bank (ECB) pulling off a big play – it delivered!

My prediction was also based on an expectation that the QE3 stimulus package in the United States would come if needed, and Ben Bernanke came through with the end-result being that the Dow put on 4.32% for the quarter, while the S&P 500 added 5.76%. And locally the S&P/ASX200 index was up around 6%.

So what should we be watching for the best quarter of all?

What to expect

Firstly, the technical data says a stock market pull-back is likely and it could be sparked by a dumb decision in a place like Spain. The Government there isn't asking for a bailout because it's scared about how the populace would react to the austerity measures that would come with ECB help.

This help would be in the form of the ECB buying Spanish bonds to drive down the interest rates Spain pays when borrowing. At the moment, rates have come down on the assumption the Spaniards will request a bailout, so if they welsh on the deal, then the markets could punish them; this would hurt stocks and we would cop the backlash.

Next, China is the big fly in the ointment and its sluggishness is surprising many with growth expectations recently reduced from a number with eight in it to one with a seven. That growth number may look high by Western standards, but the pullback feels painful for the Chinese and their business partners who have been used to much faster growth. This is why our export prices have slumped and why our trade deficit for August grew to just over $2 billion. The July one was also revised up from about $500 million to $1.5 billion!

I'm closely watching the new leadership change in China, expected this month, and I hope we some positive steps to pump up China's growth. I will be watching the Shanghai Composite index to see how local Chinese are playing stocks in coming weeks. This index has been slumping for months and I need to see an overdue turnaround.

US data on the mend

Of course, I'm also watching the USA and I have liked the overall run of economic data coming out of there with the housing sector – which was at the core of the subprime crisis and GFC crash – looking more healthy month by month.

This week, we saw better US manufacturing data and overnight the ISM reading for the services sector was much better than expected at 55.1, where any result over 50 means expansion for this important employment sector.

Also in the States, the ADP private sector employment report came in better than expected, so Friday's jobs report is bound to be huge for the market. Regrettably, the ADP survey has not been a great guide for the official jobs report, but I live in hope given the signs of general economic improvement showing in the States.

The next big watch issue is the upcoming reporting season in the USA, which is not expected to be flash. There have been predictions that the soft local and global economy would eventually hit the bottom line of US companies, but to date, this hasn't materialized.

The bottom line

I reckon this last point is the most vulnerable one because these results are for the quarter before the bullish Christmas one and in the March quarter, the impact of the ECB's monetary stimulation and QE3 is likely to be taking effect.

Of course, that quarter will have to deal with the 'fiscal cliff' issue, but I can't believe that US Congress will vote, via pigheaded politicising, for a recession!

I think October will bring a pullback in stock prices, but I can't see it being deep. It will be a buying opportunity and it could last into November because of the US election and the the fiscal cliff debates in Congress.

However, I suspect we will see better economic data in the USA, China and Europe by December and that will produce a nice return for those who snapped up great companies that pay nice dividends at lower prices.

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Investing in a post-mining boom market

by JP Goldman

The Reserve Bank of Australia's (RBA) decision to cut interest rates this week is great news for the long downtrodden non-mining sectors of the economy. The RBA is effectively acknowledging that the mining boom will start petering out by late next year and the economy will need a few new growth drivers to take its place.

Indeed, the RBA's intentions seemed pretty clear from its post-meeting policy statement. The RBA acknowledged "the peak in resource investment is likely to occur next year, and may be at a lower level than earlier expected. As this peak approaches it will be important that the forecast strengthening in some other components of demand starts to occur."

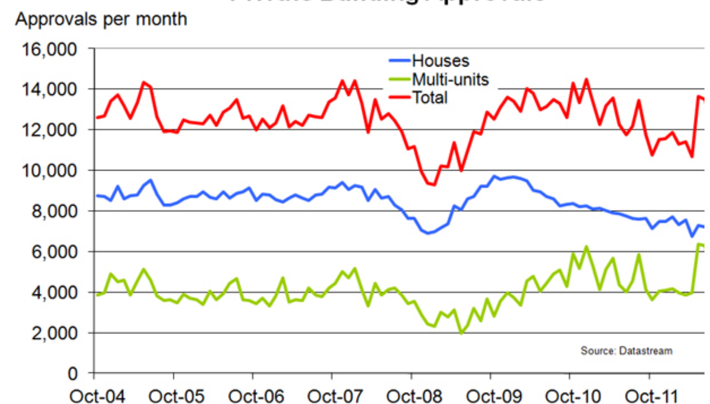
Investing in housing

Where better to look than the non-mining sectors, and interest rate sensitive sectors such as housing construction in particular.

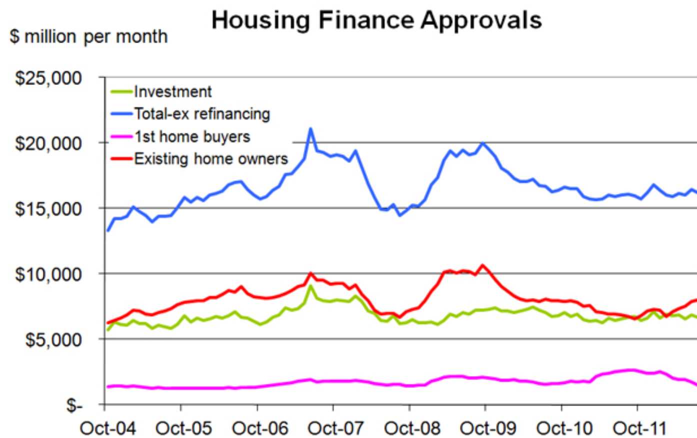
Being less subject to international competition, the housing construction sector is less hostage to the fortunes of the Australian dollar – and more sensitive to interest rates. It means that if the Australian dollar stays uncomfortably high over the coming year – due, for example, to our new status as a 'safe haven' investment destination – we might still rely on more home building to absorb the workers being shed by the mining sector.

Housing outlook

Home building approvals have been on a steady slide since late 2009, though there have been tentative signs of stabilisation in recent months. Approvals for new apartments surged over May and June, fell back to earth in July (partly due to the ending of State Government incentives) and rose again in August. But there is more new work in the pipeline. Approvals for (less volatile) single family homes appear to have bottomed in April and have been trending higher for the past three months following 29 months of decline.



Home lending is still fairly flat, with first home buyers still a declining share of the market in recent months and investor interest fairly subdued. But there has been a lift in interest by established home owners, which is also reflected in a firming in auction clearance rates and stabilisation in home prices in recent months. Some measures suggest home prices have started to rise following the RBA's earlier rate cuts in May and June this year.



Note, moreover, that the subdued level of home building in recent years has come despite still solid levels of underlying demand. The relative shortage of homes has been reflected in tightening rental markets and rising rents.

With mortgage interest rates a bit below their long-run average and house prices sliding relative to household incomes in the past two years, home affordability is improving.

Companies in the sector

If the RBA continues to cut interest rates, the stage could be set for a belated upturn in housing construction, which would benefit Australia's listed home material stocks such as Boral (BLD), Brickworks (BKW), James Hardie (JHX), Adelaide Brighton (ABC) and Alesco (ALS). Stockland (SGP) and AV Jennings (AVJ) are engaged in the construction of residential properties more directly.

Among these companies, the share prices of BKW, CSR, SGP and AVJ in particular have had smaller share prices gains to date and might be poised to benefit from a stronger upturn in the sector. Of course, it would be nice if investors could gain broad diversified exposure to this investment theme through, say, a pure homes builders exchange traded fund (ETF) – but one doesn't yet exist for the Australian market. The closest we can get is to invest in the industrials sector ETF (IDD), which includes exposure to construction and building material stocks.

Easing pressure on banks

And of course, lower interest rates and a pick-up in home lending also bodes well for Australia's much larger banking sector – which has been suffering through quite weak credit growth following the global financial crisis.

Bank profits have improved in recent years in line with reduced bad debt provisions as the economy recovered from the GFC, but sustaining decent profits in the next few years will be a challenge and crucially dependant on a pick-up in credit growth.

History suggests, however, that the financial sector – and banks in particular – tend to do well in an easing interest rate environment.

Finance stocks

Investors seeking broad exposure to the financial sector have a number of ETF options to choose from, such as State Street's financials-excluding listed property (OZF). BetaShares also has an ETF covering the whole financial sector, including listed property (QFN).

Retailers

Last but not least, should house prices start to rise in earnest in the coming year, it would bode well for household confidence and consumer spending – which might even give downtrodden retailing stocks a belated lift.

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Future investment trends: look for these three Rs

by Craig Rispin

View attached video »

I love my work as a futurist, I get involved with many different industries and many times when I'm presenting at conferences I mention companies that are on the global forefront of these major trends. Even though I'll be mentioning companies and industries that will be booming, please don't take any of my comments and opinions as investment advice.

With that in mind, let's move on to the three Rs of the future. What are the three Rs? And I don't mean Reading, 'Riting and 'Rithmatic; I mean Robotics, Remote sensors and Regenerative medicine.

Let's get started with robotics

Robots are booming world-wide. They're booming in the military, in medicine and in mining. Peter Singer wrote a fantastic book in 2009 that I think is a must read. In fact, it's on the official reading list of the Australian navy and the US air force and navy as well. He talked about the rise of the robot in modern warfare and about how rapidly it was progressing. Well since his book came out, many of these UAVs – or unmanned aerial vehicles – have been used for strategic defence and attacks and for monitoring. In fact, it's not just the US using them, over 76 countries now use UAVs in the military and for policing.

In the mining industry, robotics is booming as well; they're using robotic diggers, trucks and transports. Look carefully at these trucks (pictured in video); you'll notice they don't have any drivers. And companies like Rio Tinto (RIO) are continuing their investment in robotics and automation because of the labour shortage that they're still experiencing and according to them, it just plain makes great economic sense.

You'll see these robots used in all sorts of applications. Incredible unmanned drones that go inside caves and map them in 3D – this is dangerous for humans, but robots are expendable. You'll see them in the air, you'll see them on the ground, you'll see them underwater as well. If it's looking for surveying, broken pipelines, or mapping the coral reefs before they put things underwater, these are fantastic applications for robots and this area is booming in a major way. Hundreds of thousands of these robots will be ordered in the future.

Robots in medicine are booming as well. In 1999, Intuitive Surgical released their da Vinci surgery system and since that time, robotic surgeries have doubled in the last five years. Look at Intuitive Surgical's stock (pictured in video); they're not doing too bad for a bad new industry that has just emerged in the last decade.

Also in pharmacy, robots are being used for dispensing and reducing the error rate, which sometimes at hospital dispensing units and pharmacy, the error rate can be as much as 22%! That's not good. Robots are almost perfect when it comes to this as well.

I was presenting along with another futurist by the name of Bernard Salt from KPMG at an aged care conference down in Tasmania last year and he was talking about the problem of aged care. One of the problems in aged care, again, is a labour shortage and that the aged carers – the people who are looking after these patients – are having many injuries, mainly lifting problems.

Now Japan is ahead of us on this curve and they have been developing these robots to be assistants to nurses.

Robots are here. It's a global world-wide trend and it shouldn't be missed.

Next: Craig Rispin will discuss the rise of remote sensors in the coming weeks.

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Is your fund really an SMSF?

by Andrew Bloore

Australians are falling in love with self-managed super, and understandably so. But a number of boxes need to be checked in order for an SMSF to be truly considered an SMSF for taxation purposes, and with an increasing number of people beginning to open their own funds, it's important to make sure that you and the Australian Taxation Office (ATO) are on the same page.

The latest ATO statistics show that the number of SMSFs continue to grow with over 36,000 set up in 2012 alone, up 9% on 2011. As at June, there were over 478,000 SMSFs, holding $439 billion in assets.

When you consider this continued growth you can understand why qualifying as an SMSF is so important.

Does your fund qualify?

To qualify as an SMSF, an entity must be considered to be a 'superannuation fund' and come within the definition of an SMSF as provided in section 17A of the Superannuation Industry (Supervision) Act 1993 (SIS Act). That section basically says that an SMSF must meet the following criteria:

- it has fewer than five members
- each individual trustee or director of the trustee company is a member of the fund
- each member of the fund is an individual trustee or director of the trustee company
- no member of the fund is an employee of another member, unless those members are related
- no individual trustee or director of the trustee company receives remuneration for services as a trustee

If your fund fails to meet all these conditions, it will not be considered a complying superannuation fund, which means you won't receive any of the tax benefits of super.

Understanding your role

Within an SMSF, the members of the fund have two roles: one as a member and the other as a trustee. The fund must be maintained for the benefit of its members, who will each have an account in the fund. The objective of the fund is to grow the benefits during the members working life to provide income in retirement.

The trustee is the person (or company) ultimately responsible for both the investment decision making and the administration of the fund. Trustees are the key decision makers with the overall and ultimate responsibility for the fund. The trustees could be members, or a company could be set up to act as a trustee with the members of the fund as directors.

There is a legal requirement for an SMSF that every member must be a trustee and every trustee must be a member. If the trustee of the fund is a company then every member must be a director of the company and every director a member of the fund.

Different rules apply if there is only one member of a fund.

Example

Jack and Jill establish the XYZ Superannuation Fund. They are both members of the SMSF. Jack and Jill could choose to act as individual trustees of their SMSF or they could put in place a corporate trustee. If they chose to have a company as the trustee both Jack and Jill would need to be the directors of that company. They choose to use a company as trustee.

If Jill ceased to be a member of the fund and Jack

was the sole remaining member then Jack could continue as trustee of the fund. As the trustee of the fund is a company, Jack could be the sole director of the trustee company or he could appoint another director. This appointed director would need to be a relative or another person who is not employed by Jack.

You will need to choose the best way to structure your SMSF so it complies with superannuation law and suits you and other members' circumstances.

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Did you know?

ANZ has given its mortgage holders no reason to expect it will pass on the Reserve Bank of Australia's (RBA) interest rate cut, saying the cash rate has no effect on its funding costs.

None of the four major banks have reduced their variable home loan interest rates since Tuesday's 25 basis point cut by the RBA, which took the cash rate 3.25 per cent, it's lowest level in three years.

ANZ Australia chief executive Philip Chronican said the bank would stick to its 10-month old process of setting lending rates on the second Friday of each month.

"Our cost of funds doesn't change on the first Tuesday of the month when the Reserve Bank moves its cash rate, we fund ourselves through a range of term deposits or even wholesale funds," Mr Chronican told reporters on Thursday.

"We're trying to create a gap between the Reserve Bank's move.

"Sometimes when the Reserve Bank moves its cash rate down, long term rates go up, sometimes long term rates go down. We want to give the market time to settle and see how our rate structure works.

"We felt it appropriate to be able to look at the full range of funding costs when we made our decision and the best time to do that was with the lag after the Reserve."

Bank of Queensland is the only significant lender to have moved since Tuesday, reducing its home loan interest rates by 20 basis points.

-- AAP

Did you know?

Lance Lai, our incredibly accurate charts guy, stopped by Switzer to talk about the outlook for stocks. Watch what he has to say on SuperTV.