Switzer Super Report

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Stocks to bounce?

A number of positive developments could see stocks head higher this year, with predictions of 20% and even 40% being thrown around! I explain what to expect for 2013 and why history could help.

Also in the *Switzer Super Report*, Paul Rickard makes some changes to the 2013 income biased stock portfolio including a sector and stock rebalancing. Margaret Lomas reveals why it's important to assess your risk level before thinking about investing in property in a mining town. And Tony Negline looks at a recent Administrative Appeals Tribunal case that reveals the importance of ensuring you have the documentation to prove you are retired.

Have a great day.

Sincerely,

Peter Switzer

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Could stocks be up 40% in 2013?

by Peter Switzer

Regular readers of the Switzer Super Report know it has been a great year for those who took our guidance to be in great income-paying stocks for 2012. In fact, the dividend stocks portfolio we constructed for safety and say a 6-10% return, depending on your tax situation, actually topped 20%.

I love investing in companies that are safe dividend conveyances and deliver capital gain. The CBA stock is a classic case where you have been able to get 6-7% dividend yield, plus its share price went from $49.26 on December 30 of 2011 to $62.18 by the same day last year!

The dividend play is still a goer for 2013 but you will have to expose yourself to more cyclical stocks.

Unexpected stock rebound

Last year my family's SMSF portfolio of stocks actually recorded a total return of over 27% and that was helped by a decision to go long BHP Billiton and Rio Tinto when their stock prices fell to $31.28 and $50.08 respectively. I didn't expect such a quick rebound in share prices but I did believe in the China "won't have a hard landing" story and that these two companies are leveraged to China's overall future growth.

Helping my decision was analysis by a number of regular contributors to the *Switzer Super Report*. Recall, I often argued last year that this was a year to buy the dips. Ron Bewley and his sectoral analysis convinced me that materials were oversold and due for a rebound. Meanwhile, Lance Lai's technical analysis generally told me when a sell-off was about to bottom. Before I buy a stock a lot of boxes have to be ticked — Buffett-style — but I like it when market analysts I respect add more weight to my assessment.

What to expect

Overall I think 2013 will be good for stocks. Most of the US analysts I watch think US markets will be up around 10%. Sam Stovall of S&P, who was on the money with his tips for 2012 sees the S&P 500 index going up 8.5% this year. He points out that the first year of a presidency is usually the worst for stocks with the S&P up 5% on average but he says company valuations, expected earnings and the outlook for GDP growth are all very favourable for share price appreciation.

Meanwhile Matt Kidman who appears on my Switzer program on the Sky Business Channel points out that he thinks stocks could rise 20% this year. He argues after a period of protracted stock market performance you can have a big rebound year as scaredy cat investors get out of safe term deposits to join the market rally. The average 12-month rise of the All Ords in these years has been 42.55% and this happened in 1932, 1975, 1983 and 1993.

The positives

Now maybe we got the first leg of this big rise in the second half of 2012 after Mario Draghi said: "Whatever it takes!" and it could roll into 2013 but when you look at the positives lining up, it is easy to be pro-stocks.

Here are those positives in a nutshell:

- The fiscal cliff is fenced off temporarily;
- The Fed has promised easy money until unemployment hits 6% and it's now 7.8%;
- The outlook for US economic growth is on the rise and US companies have enormous cash on their balance sheets which good growth could draw out and into the economy via investment;
- China avoided a hard landing and manufacturing is roaring back;
- Japan intends to ease up on monetary policy to chase growth and this is still our second best export customer;
- Our Reserve Bank could cut interest rates by 1% this year but I reckon it will be closer to 0.5%;
- The bond yields in Europe reflect less uncertainty and fear in the EU;
- The ASEAN countries are expected to go back to pre-GFC economic growth rates this year; and
- Energy costs are being contained by LNG developments, especially in the USA.

Look to history

Sure there are worries in the Middle East and we will have to cope with the nutcases in both European parliaments and the US Congress. And then there is the ongoing debt problem that will have to be addressed one day but for the moment, the goal is to get the world economy growing strongly again, and that's when it is easier to repay debts.

I am expecting a nice rise of 10% plus for stocks but I will cop a 20% or 40% if it happens along. Remember, we are around 4,723 now but before the GFC hit we were at 6,828.7 and there is a bit of history, which says another crash does not come until you pass the old high on the index.

Of course, history can let you down – but it's worth remembering if you are too nervous.

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Our higher income stock portfolio for 2013

by Paul Rickard

We have made some changes to our income biased stock portfolio for 2013. These include sector and stock rebalancing, base-lining for the start of the year, and the replacement of David Jones with an additional industrial stock, Toll Holdings.

With the S&P/ASX200 increasing by 14.6% in 2012, and company earnings growing at a much lower rate, forecast dividend yields have fallen. Our income-biased portfolio is forecast to generate a yield of **5.23% pa** in 2013, franked to 98.3%.

Construction Rules

The construction rules we applied are:

- we used a 'top down approach' looking at the industry sectors, and introduced biases that favour lower PE, higher yielding sectors;
- so that we are not overly exposed to a market move, we have determined that in the major sectors (financials, materials and consumer staples), our sector biases will not be more than 33% away from index. For example, the 'materials' sector weighting on the S&P/ASX 200 is 21.6%, and under this rule, our possible weighting is in the range from 14.4% to 28.8% (ie plus or minus 7.2%);
- we eliminated property trusts (as there is no real tax advantage to a SMSF), the IT sector is small, and from an industry perspective, we are no real fans of the consumer discretionary sector. Consequently, we are overweight financials, consumer staples, utilities and telecommunications; underweight materials, energy and consumer discretionary; and broadly index-weight healthcare and industrials.

On a sector basis, our portfolio compares as follows:

Sector	ASX 200 Weight	Portfolio Weight	Difference
Consumer Discretionary	3.4%	0.0%	-3.4%
Consumer Staples	8.5%	10.5%	2.0%
Energy	6.2%	5.5%	-0.7%
Financials	34.8%	45.0%	10.2%
Health Care	4.4%	4.0%	-0.4%
Industrials	6.7%	7.5%	0.8%
IT	0.6%	0.0%	-0.6%
Materials	21.6%	17.0%	-4.6%
Property Trusts	6.9%	0.0%	-6.9%
Telecommunications	5.1%	7.5%	2.4%
Utilities	1.8%	3.0%	1.2%

Stock Rules

The stock rules are:

- we require 15 to 20 stocks (less than 10 is insufficient diversification, over 25 it is too hard to monitor);
- we confined our stock universe to the ASX 100;
- we avoided stocks from chronically underperforming industries such as airlines or general insurance;
- within a sector, the stocks are broadly weighted to their respective index weight. That said, we have applied some biases to favour those stocks that pay higher dividend yields. For example, in the 'financials' sector, we are overweight NAB and underweight Commonwealth Bank; and
- of course, we looked for companies that pay franked dividends and have a consistent earnings record.

Portfolio

Our income biased portfolio per $100,000 invested (using prices as at the close of business on 31 December 2012) is as follows:

Sector	Stock	Price 31/12	Value	PE (F)	Div (F)	Franking
Consumer Staples	Coca Cola	$13.45	$2,500	17.6	4.29%	100%
	Wesfarmers	$36.85	$4,000	18.7	4.75%	100%
	Woolworths	$29.33	$4,000	15.5	4.55%	100%
Energy	Woodside	$33.88	$3,000	14.0	3.83%	100%
	Origin	$11.62	$2,500	15.0	4.35%	100%
Financials	ANZ	$25.05	$10,000	11.1	5.98%	100%
	CBA	$62.18	$10,000	14.0	5.53%	100%
	NAB	$25.00	$12,000	10.2	7.37%	100%
	Westpac	$26.04	$13,000	12.3	6.66%	100%
Health Care	Primary	$4.00	$4,000	14.2	3.45%	100%
Industrials	Brambles	$7.51	$2,500	17.1	3.70%	30%
	Toll Holdings	$4.56	$2,500	10.9	5.55%	100%
	UGL	$10.88	$2,500	11.3	6.49%	100%
Materials	BHP	$37.10	$12,000	15.5	3.09%	100%
	Rio Tinto	$66.01	$5,000	14.0	2.31%	100%
Telecommunications	Telstra	$4.37	$7,500	14.8	6.41%	100%
Utilities	AGL Energy	$15.38	$3,000	13.5	4.20%	100%
			$100,000	**13.56**	**5.23%**	**98.3%**

Forecast Returns

Using consensus forecasts from FN Arena, the portfolio has the following characteristics:

- Forecast PE for 2013: **13.56**
- Forecast Dividend Yield for 2013: **5.23% pa**
- Franking: **98.25%**

For an SMSF in the accumulation phase, the 5.23% dividend yield will translate to a return of **6.32% pa** (after tax), and for a fund in pension phase, the income return will increase to **7.43%** pa.

In a bull market, we expect that the income biased portfolio will underperform relative to the standard S&P ASX200 price index due to the underweight position in so called “growth” sectors, and conversely in a bear market, it should moderately outperform.

We will keep a close eye on the portfolio, and report back in coming editions of the *Switzer Super Report.*

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Investing in mining town properties risky business

by Margaret Lomas

Whenever I attend a property expo or homebuyer show, I am inundated with investors asking me about the potential to make money on a mining town property investment. Their eyes glitter as they recount the untold riches which they believe lie in such a purchase, and often they are fresh from listening to yet another spruiker peddling the benefits of a house and land package in a far flung mining town.

Big returns

It's easy to understand their enthusiasm. Years ago a number of risk- taking investors made the fortuitous decision to buy the equivalent of a 'donga' (a mobile or prefabricated house) in towns like Karratha on the WA far north coast, for small sums of around $80 – $100,000k. Some 10 years later the aforesaid dongas fetch a cool $1m on the market and many have a whopping 13 – 14% return on that million – making the return on initial investment ten times that.

Who doesn't want a few of those little gems in their portfolio?

Of course we all do, but in buying one an investor often ignores one of the most fundamental rules about investing – and that is to understand one's own appetite for risk, and then purchase appropriate investments for that risk level.

A question of risk

Go to any financial planner and the first thing they will do is ask you to complete a risk profile questionnaire. Once you have done this, their subsequent recommendations will reflect a consideration of this profile – cash and fixed interest for those needing capital protection and the surety of a return of at least the entire invested principal, and managed funds and direct shares for those with longer investment periods and the potential to withstand short-term losses.

Why, then, don't property investors consider each of their purchases with this same approach?

When I developed and included in all of my books a 'property risk profile' questionnaire, many property investors considered risk for the first time! That questionnaire forced them to consider that not all property is created equal and simply seeking the 'highest' returns possible in property could spell financial disaster to those who needed more protection around their invested capital.

Risks for mining town properties

There is no question that, particularly while we are experiencing a mining boom, a property in a mining town can provide a great return. However, a property in a mining town must be placed within the high-risk category of property investment. As with any investment, the higher the potential return, the higher the risk, and property in mining towns have more than their fair share of risks, including:

- The lack of diversity of industry means the entire workforce's reliance on a single industry places the security of the whole town at risk, should something adverse happen to that one industry
- The prevalence of 'fly-in, fly-out' workers results in a weak underlying economy, as workers take their earnings out of town
- That same economic weakness means most councils lack the financial resources to provide infrastructure to the community, meaning that the towns are often severely under-resourced
- The entire town is highly exposed to 'hidden risk' – the risk that an unforeseen event, government decision or world economic turmoil impacts directly back on the only industry supporting the area. This is a risk

which cannot be mitigated as it most often cannot be foreseen, and in some cases has never actually happened before.

A gamble

If your risk profile is such that you have plenty of capital and loss would not cripple you, or you have ample time available as an income earner within which you could replace lost capital, then the potential for great yields and significant capital gains may well make these risks worth taking. Of course these days, few mining towns have the ‘cheap’ properties available, and you are likely to pay an already well inflated price to buy in to this risky investment.

However, if you are buying within your super fund, which you are likely to be doing if you are reading this article, you are gambling with what may become one of your only income sources, one which needs to last a significant length of time and will not be easily replaced if you are already close to retirement.

The surety of a house in an area with a growing population, diversity of industry and abundant infrastructure development is more likely to be the appropriate investment for your fund. You may not make as much money (although well- chosen property can still do really well), but the chances of you having both the capital and a reasonable amount of yield and growth available to use for all of your retirement years are much greater than these high risk mining town investments.

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Case study: retired? Sign a declaration

by Tony Negline

Under the super laws if you cease gainful employment before age 60, you can receive some or all of your super monies as a lump sum if you're aged over 55 and your fund's trustee is reasonably satisfied that you'll never again be gainfully employed for more than 10 hours per week.

In an official document telling large funds how to comply with the super laws, the Australian Prudential Regulation Authority (APRA) has told these large funds that they need to get evidence of a fund member's intentions before releasing benefits under this rule. APRA and the ATO – the two superannuation regulators – have a written agreement which says neither will issue a document that the other super regulator disagrees with so it's reasonable to assume the ATO agrees with this view.

In most cases large super fund trustees satisfy their obligation to determine your intentions by accepting a declaration that you signed stating that you're not working and you don't intend to work again. Many SMSF trustees follow a similar rule.

Given a recent Administrative Appeals Tribunal case you might want to rethink this requirement because tax penalties might apply. This case actually contains another common situation that we'll also look at.

The Case

In 1999 Mr Trevor Peach set up a SMSF. In 2003 he used $120,000 in his super fund to renovate his house. This was classed as a loan and after it was discovered he was told to repay it.

Unfortunately he kept on taking money out of the super fund and in total more than $150,000 of the SMSF's money was used. He repaid $80,000 which meant that more than $70,000 remained unpaid.

The Tax Office decided that it should apply tax penalties to this $70,000 unpaid amount. Mr Peach took the Tax Office to the AAT because he disagreed and represented himself before the Tribunal.

In September 2008, Mr Peach lost his job. His accountant prepared a letter for him, dated 1 February 2009 to the super fund which declared he was fully retired from the workforce and had no intention of working again.

As mentioned above presumably the purpose of this letter was to provide evidence that he was permanently retired and could access his super monies. Under cross-examination Mr Peach "agreed he did not sign the document on 1 February '09. It was signed much later, although it is not clear when". He also agreed that as he needed income to live, he couldn't afford to retire. As if to prove this point in May '09 he commenced a consulting role and received a regular retainer for this work.

The AAT said that his February '09 letter wasn't enough for the super fund trustees to determine if he was permanently retired.

The Tribunal determined that Peach wasn't entitled to access his super benefits under either the financial hardship rules or compassionate grounds that allow access to super monies before retirement in hardship cases.

Mr Peach had illegally withdrawn his super monies before retirement. In these situations the Tax Office can include the amount taken out in a taxpayer's income tax return, meaning that the benefit withdrawn wouldn't get concessional tax treatment but would be taxed at marginal rates.

What to do

So what should you do if you want to receive a lump sum from your super fund after turning age 55 (if you're born before 1 July 1960)? Perhaps a signed statutory declaration might be sensible as signing these documents in error is a criminal offence. It might seem a bit of overkill but in a small number of cases your circumstances might be examined like Mr Peach.

You can also see that Mr Peach got caught for signing documents after the event. You need to avoid this as much as possible.

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The week ahead

Australia
January 8: International trade (November)
January 9: Job vacancies (November)
January 9: Retail trade (November)
January 9: New home sales (November)
January 10: Building approvals (November)

Overseas
January 8: US Consumer credit (November)
January 10: US Wholesale sales (November)
January 11: US International trade (November)
January 11: US Federal budget (December)