Switzer Super Report

Issue 210, 8 August 2013

Time to take a panadol

For those of you looking to reallocate some of that cash that is earning less and less, thanks to successive RBA rate cuts, today's fundie's favourite, by Thomas Rice from PM Capital, is an interesting small cap data company called NEXT DC. Ron Bewley's sector rundown looks at the very healthy consumer staples industry and he also answers a reader's question on what, exactly, a high conviction fund, is.

Today financial journalist extraordinaire Barrie Dunstan gives you a timely checklist for making sure your fund is in order and we have a new contributor - SMSF guru Grant Abbott - with some very helpful tips on how to make sure your SMSF is distributed as you wish when you die. He also has a horror story too!

Sincerely,

Peter Switzer

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switzersuperreport.com.au

Switzer Super Report is published by Switzer Financial Group Pty Ltd AFSL No. 286 531
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What happens to your SMSF when you die?

by Grant Abbott

The beauty of a family SMSF is that, if things have been set up right, the wealth can be transferred tax free to the spouse, the next generation and even the generation after that provided dependency can be established which, surprisingly for many, includes financial dependency.

Importantly SMSF estate planning strategies cannot, under any other circumstances, be replicated through a will, testamentary trust or family trust. So let's take a quick look at what you need to do to create an effective, compliant and secure SMSF estate plan, as the courts and the Commissioner of Taxation have ruled that binding death benefit nomination laws do not automatically apply to SMSFs, unless provided for in the trust deed!

1) Determine what's important to you in the event of your death

This is the best question to get anyone started on the quest of developing a comprehensive, strong and effective estate plan in a SMSF. Another way of looking at it is: In terms of your SMSF what's important if you and your spouse had died together yesterday?

Write down the five or six most important things and then rank them. When developing any estate plan, attention should be paid to the most important things on the list. If you can get this right then you have a great framework to build a strong, robust and secure SMSF estate plan.

Many SMSF members are surprised to find that their will is completely ineffective when it comes to disposing of their superannuation benefits on their death. There was a well-publicised case in the NSW Supreme Court in 2005 – Katz v Grosman – where a father had left $1 million in the family SMSF. His will provided that all of his worldly possessions were to be passed to his son and daughter equally. Prior to his death, the father made his daughter a trustee and member of the family SMSF. The son had not yet become a member/trustee. As the only trustee of the fund and knowing that her father had not made a special binding SMSF estate plan, the daughter paid out the $1 million in benefits to herself, excluding her brother completely. The NSW Supreme Court deliberated on the case and held that she was in her rights as trustee to do that as it was allowed for in the fund's trust deed.

The argument that the superannuation benefits were to be split equally in accordance with the will held no weight, as wills are based upon State law not Federal laws, which govern superannuation.

2) Get educated – some important SMSF estate planning rules

There are three basic rules to follow when creating your SMSF estate plan

Who is going to control the fund on your death?

As we saw above, whoever controls the family SMSF on death controls the passing of a member's benefits in most instances. For control, look to the trust deed. Unfortunately, 70% of SMSFs are deficient in the area of control.

Check your fund's trust deed to see what happens on death and whether there is built in protection for a member's interests by: firstly handing out voting power according to the size of a member's benefits in the fund; and secondly, by ensuring that a deceased member's executor is automatically appointed as the deceased member's replacement trustee of the fund to ensure that their wishes are effective. If not, then get your deed upgraded and certainly if you have not upgraded your trust deed

since 2011, you and your family are exposed!

Switch to a special purpose SMSF corporate trustee

I still see too many SMSFs where the members of the fund are acting as individual trustees. This means that on the death of any member of the fund, the remaining trustees must contact all registry offices, land titles and other registries to notify them of a change in trustees. With a corporate trustee, which has an infinite shelf life just like the SMSF, the death of a member only requires a change in directorships, not a change in trustee. They are not expensive to run or maintain as all they do is look after the trusteeship of the SMSF.

However like the trust deed, the corporate trustee must ensure that the directors have voting power equal to their member superannuation benefits. Likewise the deceased member's executor should automatically be appointed as a replacement director of the deceased member.

Certainty in passing of benefits

Unless a member of a fund has put in place an SMSF will – a set of directions and nominations to your trustees in waiting, dealing with the distribution of your super benefits upon your death, which contractually binds all current and future trustees, *the remaining trustees of the fund can do whatever they like with a deceased member's benefits.*

The Commissioner of Taxation and the courts have emphatically stated that the laws on binding nominations do not apply to SMSFs, unless the trust deed says otherwise. Check your deed and see what it says, or importantly get it reviewed or replaced by an expert.

3) Consult an SMSF estate planning expert

The key here is to employ a good SMSF coach – someone who will give you all the resources and tools for you to become educated on how your super benefits can and cannot be passed and more importantly help extract your desires and wishes and those of your family. It is not an expensive exercise but well worthwhile for long-term security and certainty.

* Grant Abbott is chairman of the Australian SMSF Members Association and director of SMSF Strategies. You can watch a YouTube video on estate planning here.

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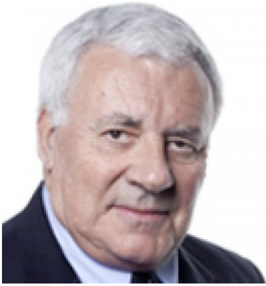

On the campaign trail with your SMSF

by Barrie Dunstan

At the start of an election campaign and just over a month into the financial year, it's a good time for SMSF trustees to run a precautionary checklist. While it's always a good time to look at investment strategy, this is probably also a time to examine administrative and governance matters. Here are three main checkpoints.

1) Government policy

On the plus side, both the opposition and, subsequently, the government, have pledged no changes to superannuation – although the statements were hedged. The opposition earlier pledged "no detrimental changes" while in late July the government promised "no major changes to superannuation tax policy" for five years.

So far, so good, but past history suggests political pledges should be taken with a grain of salt. Although largely irrelevant to SMSFs, Treasurer Chris Bowen did increase the size of inactive superannuation balances that will be transferred to the ATO, two days after the above statement.

The recent furore on changes to the FBT regime on cars is also a reminder that government decisions on administration can be just as important as alterations to the law or regulations. For instance, the change in the rule that allows SMSFs to borrow to buy property, was simply the result of a change to the ATO's rulings, which, theoretically, could be changed again.

Although the available statistics don't suggest SMSF property investment is yet at worrying levels, there's anecdotal evidence property spruikers are using the hard sell on inappropriate assets. There's always going to be a worry with the sheer size of SMSF super assets, which represent more than a third of the $1.5 trillion of retirement savings.

2) Investments

SMSF members' main task is to manage their retirement savings prudently, remembering their responsibilities as trustees. This means not only having a sound investment policy to build wealth, but also sound governance of the fund to avoid breaching the rules of the regulator, the ATO.

Trustees need a realistic view of their own abilities to assess and manage a wide range of potential investment assets. Too many amateur investors (especially men) can be over-confident – a sure recipe for losses in risky areas like trading foreign currencies, options, or contracts for difference.

3) Governance

Trustees also need to consider their formal investment strategy, which documents the percentages in various asset classes. The asset allocation is an important part of the whole investment approach, rather than just another annoying item on a checklist. (This year they also have been asked to consider whether to take out insurance on members.)

The asset mix becomes vital as an SMSF approaches or enters the pension-paying phase – especially if the portfolio has "lumpy" and illiquid property assets. Funds paying pensions also need to go back to their asset allocation models if they want their fund's income to be sufficient to pay the minimum pension (rather than having to sell assets).

Speaking of that, in the 2013-14 financial year, minimum pension payouts have reverted to their original levels. During the global financial crisis, the government lowered required payouts by as much as half, so funds didn't have to pay out more than they earned. The change back, luckily, has coincided with much higher investment returns – so far at least –

which will help pension-paying SMSFs adapt to the new, higher minimum pensions by June 30 next year.

But the record low interest rates underline the importance of asset allocation: piling into bank term deposits is much less attractive at rates of less than 4% when the lowest minimum rates of pension payout have been increased.

Members under 65 in 2013-14 have to receive at least 4% of their account balance in pensions. For those 65 to 74, it's 5%; 75 to 79 year olds must get 6%, rising to 7% for 80 to 84 year olds and a daunting 9% for those 85 to 89 years old.

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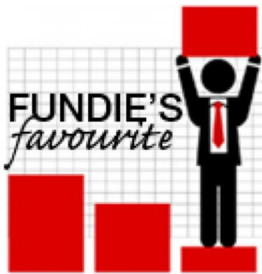


Why we love small-cap data company NEXTDC

Thomas Rice

How long have you held stock NEXTDC (NXT)?

We've held NEXTDC for eight months, with the bulk of our current position bought between late November 2012 and January 2013.

What do you like about it?

There are three key things we like about NEXTDC. Firstly, it's a key beneficiary of a confluence of technology trends – cloud computing, big data, social media, and mobile computing – which are all leading to an avalanche of data and computing requirements. At the same time, higher power requirements for new servers are pushing equipment out of in-house server rooms and into large-scale data centres, such as those run by NEXTDC.

Secondly, NEXTDC is in a unique position as the only national data centre operator that's independent of telecommunications and IT consulting firms. This independence means that NEXTDC data centres represent neutral ground for the companies driving the above trends. A company like Optus wouldn't put their servers in a Telstra data centre, but they would (and do) put their equipment into NEXTDC data centres. This leads to a diverse client mix within NEXTDC centres, that gives rise to the ability of clients to connect directly to each other within the data centre. These "cross-connects" benefit clients by saving transmission costs and increasing speeds, and transform NEXTDC data centres from mere providers of power and cooling to places where clients can do business. NEXTDC is successfully building these client ecosystems within the IT and Cloud space, which leads to a strong competitive position and high returns over time.

The third reason we like NEXTDC is due to where it is in its life cycle. The catalyst for originally buying our position in November 2012 was confirming the value proposition of the NEXTDC offering through conversations with potential clients. Strong client signups since then have reaffirmed this value proposition, yet the company still has significant growth ahead as it fills the five data centres it originally planned at IPO and potentially opens more beyond this.

How is it better than its competitors?

NEXTDC is in a unique position as the only national independent data centre provider. Most data centres in Australia are operated by IT and telecommunications companies, which don't give rise to the ecosystems that can develop within a NEXTDC centre. Equinix and Global Switch operate independent data centres in Sydney, but don't provide a national presence like NEXTDC does.

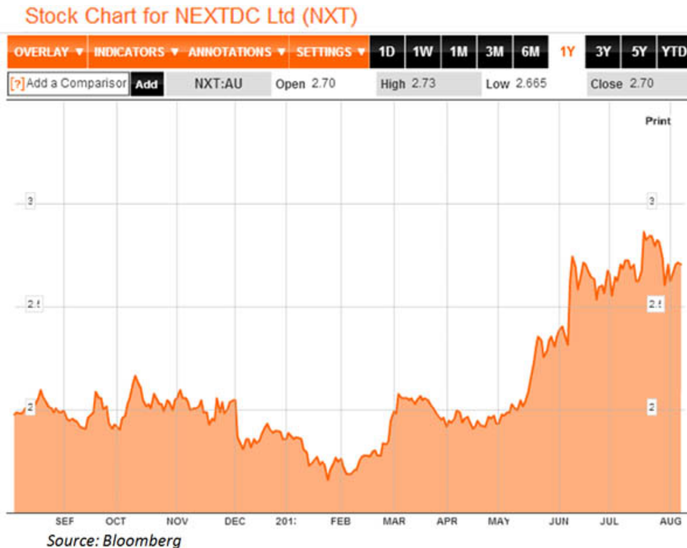
What do you like about its management?

Before becoming CEO in June 2012, Craig Scroggie ran Symantec's Asia Pacific Business and was a board member of NEXTDC. We first spoke to Craig about the NEXTDC business six months prior to his appointment as CEO, and it was clear then that he had a solid understanding of the data centre business. Since becoming CEO, he has transformed the sales organisation within NEXTDC, which has led to significant traction in signing up customers for their data centres.

What is your target price on the company?

NEXTDC is a capital-intensive business, like an infrastructure company. The return on the stock will be determined by the return on capital they earn on their data centres, and how many they can open over time to meet demand. The company has five data centres that are currently open or in the process of being built – we think the value of these five centres

equates to $3.50 per share, and if you count the value of additional data centres beyond these, the stock is worth $5-6 per share.



Source: Bloomberg

At what point would you sell it?

We like to buy stocks where we think they are misunderstood by the market, which is what creates the value opportunity. If we're right on our thesis, the market view should adjust over time, leading to the stock price reaching our target price, which would be the time to sell. With NEXTDC I anticipate this is a process that will take several years, as the company fills its existing data centres, rolls out additional data centres, and proves its return potential.

How much has it added to your overall portfolio over the last 12 months?

From November 2012 to January 2013 we paid an average of $1.87 per share. The stock has risen 44% to $2.70 in the eight months we have held it. In that time, NEXTDC has added 1.5% to the overall fund performance, with the fund currently holding a 5% position in the stock.

Is it a liquid stock?

NEXTDC is reasonably liquid with a market cap of $450 million and around $1.5 million worth of shares traded each day.

Where do you see the value?

The market underappreciates the return on capital this business can generate, with the most common misconception being that NEXTDC provides a commodity service (space and power) where competition will erode returns over time. What this misses is the customer value that is created from developing a strong ecosystem within the data centre. It's these ecosystems that are difficult for competitors to replicate, and will allow NEXTDC to earn sustainable high returns on capital over time, due to the additional value-add they are providing customers.

The best examples of similar companies are international data centre operators like Equinix and Telecity, who generate returns in excess of 30% on their mature data centres. As NEXTDC continues to gain traction and its utilisation levels rise, we think the market will better appreciate the return potential of this business, and the stock will continue to outperform.

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Staples offer security and Goodman Fielder the best bet

by Ron Bewley

I have never owned any stock from this sector because I think I can do better elsewhere in the market. Like most people, I shop at Woolies (WOW) and Coles (WES), buying our Coke or Mount Franklin Spring Water (made by Coca Cola Amatil or CCL) and general groceries etc. These are great businesses, but it is hard to think of them outperforming by much. Indeed, since my last review of this sector in January 2013, this sector has gained 7.3% against a 7.2% for the ASX 200. A good solid, predictable result and they pay solid dividends – currently 4.6%.

Don't necessarily do what I do

That I do not invest in this sector should have no impact on others pursuing returns in this sector. I just think I should declare my own position. As I showed on Super TV this week, my portfolio optimiser suggests an aggressive investor might be overweight in this sector – largely due to the low expected volatility of this sector! Clearly I am prepared to accept more volatility in my own portfolio and ride the dips in search of better average returns.

Readers might refer to my definition of a high conviction portfolio and as outlined in this week's 'Questions of the week', but, in short, my high conviction stocks are the largest stocks by market capitalisation in a sector subject to a consensus recommendation of 2.5 or better (where 1 is a buy and 5 is a sell).

My conclusions at the last review six months ago were:

"None pass my 2.5 rule – and that failure is more or less peculiar to this sector. Possibly brokers have factored in the recent strong run in prices."

"I wouldn't buy either Woolworths (WOW) or Wesfarmers (WES) now (the sector is nearly back to +6% exuberance), but I might have been tempted when it was fairly priced by our measure!"

Back to the future

Turning to Table 1, only WOW and WES from the top 100 beat the ASX 200 (7.3%) in capital gains – and not by much. Goodman Fielder (GFF) did come in quite well (14.0%) from the bottom half of the top 200. GFF now just qualifies as a high conviction stock on the recommendation criterion, but it is not big enough by market cap as my definition insists on it being in the top 100 for inclusion.

Table 1: Data on companies in the ASX 200's Consumer Staples sector

Index	Code	Company name	Capital gains from 18/1/2013 - 2/8/2013	Consensus recs. 18/01/2013	Consensus recs. 2/08/2013
ASX 100	WOW	Woolworths	9.4%	2.93	3.50
	WES	Wesfarmers	7.5%	2.71	3.00
	MTS	Metcash	2.2%	2.93	2.80
	TWE	Treasury Wine Estates	2.1%	3.31	3.30
	GNC	Graincorp	1.6%	3.36	3.00
	CCL	Coca-Cola Amatil	-4.5%	3.21	3.46
Small Caps	GFF	Goodman Fielder	14.0%	2.92	2.50

Note: the estimates in the Table are current to the close of business 2nd August 2013. They are based on Thomson Reuters Datastream.

The sector statistics, presented in Table 2, show that this sector is only just overpriced at 0.9% but its forecast capital gains are a modest 7.7%. While these statistics seem reasonable, recall it is a volatility bet – not one that brokers back with an outperform call.

It is also clear from Table 2 for readers who follow my column, this update is the first where the under/overpricing distribution across the sectors is reasonably tight. Gone is the massive underpricing in the materials sector and a general underpricing of the market at the start of July. The market is not too expensive to buy with an exuberance of 2.0%, but it does suggest investors might have been better off getting into the market earlier – or perhaps waiting a while.

When exuberance is folded into the capital gains to

produce the last column called 'adjusted capital gains', it is clear that my modelling expects little from Financials or Telcos over the next 12 months – but they do pay good dividends. Staples has the 9th best adjusted forecast out of 11 sectors.

Table 2: ASX 200 sector statistics

Sector	P/E ratio		Forecast	Forecast	Consensus	Exuberance	Market	Adj. cap.
	historical	forward	yield	cap. Gain	rec.		cap.	Gain
Energy	18.6	14.9	3.7%	25.6%	2.4	0.9%	5.6%	24.7%
Materials	14.1	11.2	3.3%	23.2%	2.2	-3.5%	17.0%	26.7%
Industrials	17.0	14.9	4.2%	13.1%	2.6	-1.7%	5.6%	14.8%
Discretionary	20.0	17.7	2.3%	12.4%	2.2	4.7%	6.6%	7.8%
Staples	18.0	16.7	4.6%	7.7%	3.2	0.9%	8.1%	6.8%
Health	23.4	20.7	2.2%	12.3%	2.5	4.9%	4.8%	7.3%
Financials	13.9	13.1	5.6%	6.2%	2.7	4.7%	38.7%	1.5%
Property	14.8	14.0	5.7%	5.3%	2.6	-2.6%	5.9%	7.9%
IT	19.2	17.3	3.2%	10.5%	2.7	0.6%	0.6%	10.0%
Telco	16.5	15.9	5.7%	3.8%	3.0	6.4%	5.4%	-2.7%
Utilities	16.1	14.8	5.7%	8.4%	2.7	-1.4%	1.6%	9.9%
ASX 200	15.5	13.9	4.6%	11.4%	2.6	2.0%	100.0%	9.4%

Note: the estimates in the Figure are current to the close of business 5th August 2013. They are based on Thomson Reuters Datastream and Woodhall Investment Research's analysis of that data.

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Buy, Sell, Hold – what the brokers say

by Penny Pryor

We are now well into reporting season, which gives brokers plenty of things to look out for. It's also a time when companies like to give the market an idea of what's coming up and Virgin Australia Holdings (VAH) certainly gave the market a surprise when it announced guidance for the financial year on Monday.

As a result of a "difficult economic and competitive environment, one-off pre-tax restructuring and transformation costs and the carbon tax", Virgin now expects a statutory loss after tax of between $95 million to $110 million.

That announcement led JP Morgan to downgrade it to Underweight from Neutral and UBS to Neutral from Buy.

Also in the not-so-good books

iiNet (IIN) announced a decision early in the week to buy Adam Internet Holdings and associated companies for $60 million in cash consideration. Four brokers maintained their ratings on the announcement – one Buy, two Neutrals or Holds, and one Underweight – but Credit Suisse downgraded it to Underperform from Neutral. Credit Suisse estimates the deal to be only around 3% cash earnings accretive in FY14. Citi also downgraded the company to Neutral from Buy. Although it believes Adam Internet has been acquired at fair value, forecast earnings fell 1% and 5% in FY14-15 and it says the company has run ahead of fair value.

BA-Merrill Lynch is getting a little concerned about the outlook for lotteries and wagering and moved to downgrade Tatts Group (TTS) from Buy to Neutral, following some cautious sector anecdotes. The broker is getting in early.

Paladin (PDN) was downgraded to Sell from Buy by Citi and to Neutral from Overweight by JP Morgan, after the company announced it had terminated negotiations for the sale of a minority interest in its Langer Heinrich Mine. It then announced an institutional placement of shares to shore up the balance sheet. Citi is concerned the share placement wont be enough and JP Morgan has similar worries with an eye on debt refinancing due from 2015.

In the good books

Citi upgraded Amcor (AMC) to Buy from Neutral. The broker likes its decision to split business down global and Australasian lines – see Greg Fraser's take on it here. Citi believes that the two new entities should provide a more positive earnings outlook and premium multiples, despite the costs involved.

The ASX (ASX) also got an upgrade to Overweight from Neutral by JP Morgan, which likes the revenue potential of central clearing of OTC (over the counter) interest rate derivatives. The broker thinks that market will be worth $47 million by FY15 and is optimistic the ASX could end up with a 50% market share.

The above was compiled from reports on the FNArena database, which tabulates the views of eight major Australian and international stock brokers: BA-Merrill Lynch, CIMB, Citi, Credit Suisse, Deutsche Bank, JP Morgan, Macquarie and UBS.

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Why the tax on pension income will never happen

by Tony Negline

The re-born Rudd government is on record as saying they won't introduce any super changes for the next five years and that they'll continue to implement all the Gillard government's super policy changes. This presumably includes the idea to impose a 15% tax on pension income when it exceeds $100,000 from 1 July 2014.

Over the years I've argued that the Federal boffins should leave the super system alone for a while, so people can be more confident with their retirement planning. I can hardly complain when a political party finally picks up this idea.

The Coalition, on the other hand, has said that they're not prepared to rule out any more super changes over the next five years if those amendments improved the super system. They've also reserved the right to implement the Gillard government's super changes to help fix up the federal government's budgetary position.

Tax on pensions is doomed to fail

The government expects that the $100,000 pension policy will earn it about $350 million in 2015/16 and 2016/17. In my view, this pension policy is doomed to fail – someone either needs to man up and ditch it, or watch as it sinks under the weight of its own complexity.

I'm highly sceptical about the estimated revenue the government expects to raise. One reason for my doubt is that Treasury regularly over-estimates the revenue impact of proposed government policy and under-estimates expenses.

In any case, this policy is simply unenforceable especially for large super funds. To work out the income for tax purposes, it's necessary to work out realised gains and income paid for each pension member of a super fund and life insurance annuity.

But this is NOT how most large super fund pension's work or how life insurance companies structure annuities. I'll use large super funds to explain what I mean.

The problem large super funds face

In most cases, people in large super funds invest in unlisted unitized managed funds which means they're investing day to day in units. The unit price reflects the value of the underlying investments, as well as reflecting the total return of these investments.

A total return fund is one that combines all income, capital gains, expenses and capital losses into one unit price. A managed fund's accounting and administration department works out what the unit price should be, based on all monetary flows into and out of a managed fund and the market value of the underlying investments.

It is simply not possible for these large unitised super funds to tell you how much each "unit" has earned in realised gains and income at an individual account level or member level (where they might have more than one pension account).

For example, suppose an investor puts $200,000 into a managed fund that has a $1.00 unit price, which means they "own" 200,000 units. Suppose that after several years, the unit price has increased to $2.00. Their 200,000 units are now worth $400,000. If the investor wanted to pay themselves $20,000 in income from this fund, they would need to sell 10,000 units if the unit price was $2.00.

Now suppose that the price of the units has crashed to 75 cents but they still wish to pay themselves $20,000 income. They now need to sell 26,666.66

units. Under this second scenario, units are walking out the door as income. This problem is exacerbated because fund managers must value all their assets at the prevailing market price.

Note that the unit price is an amalgam of realised and unrealised gains, actual and expected income and expenses and investor inflows and outflows.

Many "policy" changes are unworkable

There's no doubt politicians from time to time persevere with policy changes even when it becomes painfully obvious the policy is pretty stupid. The super surcharge (introduced by the Howard Government in 1996) and Reasonable Benefit Limits (formally introduced by the Hawke Government in 1987) are two such candidates. More recently, the suggestion of a higher concessional contributions cap for those members with balances under $500,000.

The surcharge was such a ridiculous idea that it cost more to administer the tax that it actually raised in revenue.

This pension tax policy will produce the same outcome – it'll cost a bundle to administer and won't raise too much revenue. Hopefully, the politicians will see some sense and ditch it before it does any real damage.

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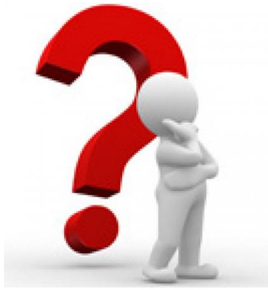

REITS and high conviction funds

Questions of the week

Question 1: *What is a high conviction fund?*

Answer (by Ron Bewley): It is a term often used but less often defined. My view is that it is a fund of quality stocks that can be left unmonitored for periods of time – usually without tinkering. There are no speculative stocks – from exploration nor corporate actions – in a high conviction fund. Importantly, a drop in price of one or more stocks is more likely to attract attention for any spare cash rather than a cause for abandonment!

I have my own rules for assembling a high conviction fund. At times like the present, I would advocate eight to 15 stocks, if equally weighted, but more if some stocks are given less weight. There are ways of determining the equivalent number of stocks for general portfolios. In more turbulent times – such as 2008 to 2010 – the optimal number of stocks is more like 12 to 20, and possibly more. I have papers in the *Switzer Super Report* and my website woodhall.com.au on these and many more associated issues.

I determine how much weight should be given to each of the 11 major sectors using my quantitative methods. Then, I allocate an appropriate number of stocks for each sector based on the size of the sector and the quality of the component stocks. Care should be taken not to have too much exposure to any one stock. Only companies from the ASX 100 belong in a high conviction fund in my world.

When I assemble a new portfolio, I only choose stocks with a 'good' consensus rating from brokers as published by Thomson Reuters. With '1' for a buy and '5' for a sell, I would only 'buy' a stock with a 2.5 or better. However, I would not sell unless the ratings fell well below that number. I have rules.

I like to think of rebalancing a 'high conviction fund' either once or twice a year. Rebalancing any more often is a sign of a trader's spirit.

Question 2: *I am currently contemplating selling one of my two Real Estate Investment Trusts (REITs) in favour of investing in an Australian income-oriented managed fund. I hold Aspen Parks and Cromwell Phoenix. Aspen Parks won't be able to be sold until early 2014. Although paying a good 8%, it has lost growth and only paid a net 2% or so in the last year. Cromwell Phoenix has been better at about 11%. I am in the pension phase of my SMSF, but still working and making $35,000 per year tax super contributions. Do you think a good income managed fund will outperform an REIT in 2013-14?*

Answer (by Paul Rickard): REITS (Real Estate Investment Trusts) as a sector did pretty well in the early part of 2012/13, however have recently come off the boil. To 31 July, the sector is up 4.9% this calendar year, compared to 8.7% for the market overall.

This is not overly surprising since there is really no growth in commercial, office or industrial rental returns. In fact, vacancy rates have been increasing – reflecting the subdued nature of the Australian economy.

As interest rates have come down, REITs have become more attractive on a relative yield basis, and been bid up in price. This downward move in interest rates is almost over.

In the next 12 months, I don't think you are going to see much capital appreciation in the price of REITS. You probably can expect a running yield of around 6% to 7% – and this is going to be reasonably attractive to some investors.

Personally, I am going to stay underweight the REITs sector (it is also not tax advantaged for a super fund).

As to your question, it really depends on the 'income managed fund' and what capital risk the fund is taking. If the fund is investing in high quality securities (with very limited credit risk), then you are probably going to do better (in terms of income return) from a REIT. If the fund is investing in securities or assets of lower credit quality with greater risk of capital loss, then the income return is going to be higher than that for a REIT.

Important: *This content has been prepared without taking account of the objectives, financial situation or needs of any particular individual. It does not constitute formal advice. Consider the appropriateness of the information in regards to your circumstances.*