Switzer Super Report

Issue 238, 14 November 2013

Animal farm

Today in a bumper issue of the *Switzer Super Report* we have Charlie Aitken explaining the East Coast recovery, and why JB Hi-Fi, Bendigo Bank and CSR will benefit.

In *Buy, Sell, Hold - what the brokers say,* Orica and Incitec Pivot get upgrades, while in a special *My SMSF,* Ron Bewley tells us what he's doing with his SMSF. And in the first of a two part series, we talk to some savvy grandparents, who have been investing for their grand kids.

Paul Rickard gives a rundown of NAB's latest hybrid issue and, in *Short n' Sweet,* we examine the IPOs that have come under our microscope over the past few months, while elsewhere Tony Negline reminds us that trustees should never forget inflation. And finally, our Question of the Week is an explanation of the meaning of short positions.

Sincerely,

Peter Switzer

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36-40 Queen Street, Woollahra, 2025
T: 1300 SWITZER (1300 794 8937) F: (02) 9327 4366

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East Coast recovery rolls on for JB Hi-Fi, Bendigo and CSR

by Charlie Aitken

I want to continue with the East Coast cyclical recovery theme again today, but this time focus bottom up on a trio of mid-cap industrials that have clear leverage to the theme.

But firstly, I just want to add a couple of top-down points that add to my conviction on this recovery.

Around 85% of residential mortgages in Australia are variable rate. Unlike the USA, where fixed rates set off the 30-year bond yield dominate, in Australia, mortgage rates are a function of the RBA cash rate and bank wholesale funding costs.

On the other side of that, cash management trusts generally offer an interest rate equivalent to the cash rate, while term deposit rates are set at a small premium to cash rates.

My point is cash rate cuts are extremely effective in Australia to both increase free cash flow to mortgagee households and reduce the return on cash deposits. In Australia, long bond rates really don't mean much directly for households. It's all about cash rates.

Yield rotation

The initial reaction to 175b of cash rate cuts to a 70-year low of 2.50% has been a rotation to high fully-franked dividend yield domestic equities by SMSF trustees, who need income to fund their retirement lifestyle ambitions, alongside strongly increased demand for residential property, for both investment and primary residence. The property price and volume reaction is both a reaction to record low mortgage rates (affordability) and investors seeking income.

The secondary reaction to the rise in equity prices and property prices is a cyclical activity response.

This is exactly how the USA playbook worked two years ahead of us. Next comes a home building cycle, a home renovation cycle and a consumer discretionary spending cycle. That, in turn, drives business confidence and the capex cycle.

Alongside this will be a major upgrade in nation building infrastructure projects, again adding to the cyclical multiplier.

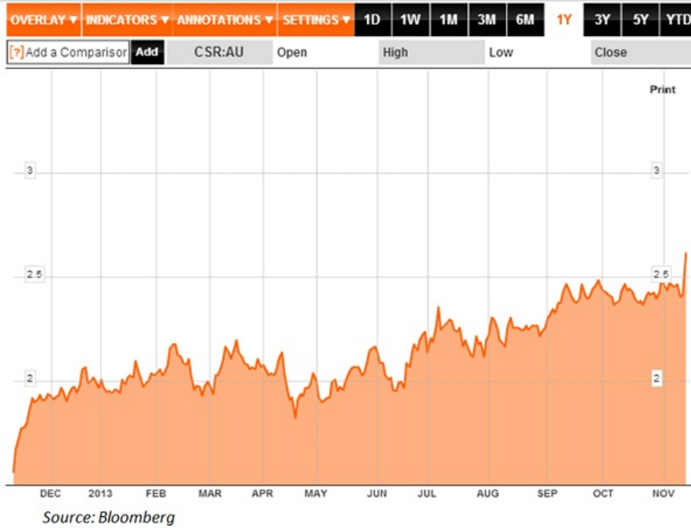
But the very good news is that while Australian long bond yields are rising to reflect this brighter growth outlook, the all-important RBA cash rate is going nowhere (potentially even lower), while the rates offered on term deposits continue to fall right as $600 billion is parked in them, earning a negative real after-tax return.

Rate outlook

I see absolutely zero chance of the RBA raising rates, or even diverting from an easing bias, while the AUD/USD cross rate remains above 90 US cents and inflation is subdued. The RBA, like all of us, wants the AUD/USD down. They know it is a key required element of the East Coast recovery and rebalancing of the Australian economy.

That steepening Australian yield curve is telling you to be bullish East Coast cyclicals, where top line and bottom line leverage remains badly underestimated by the consensus setting analysts. There was a textbook example of that in CSR yesterday.

CSR stock chart



Source: Bloomberg

Along with JB Hi-Fi and Bendigo Bank, CSR suffers from consensus scepticism but these three stocks are some of the best placed to benefit from the East Coast recovery.

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Buy, Sell, Hold – what the brokers say

by Penny Pryor

Analysts were much more upbeat in the first half of this week, with upgrades outnumbering downgrades. A couple of companies – Incitec Pivot and Orica – reported their FY13 results during the week, but these were mostly within, or slightly above, expectations.

In the good books

Credit Suisse upgraded Incitec Pivot (IPL) to Outperform from Neutral, following its FY13 results, as six other brokers left their ratings unchanged, with five Holds or Neutrals and one Buy. Credit Suisse believes 2014 will be a transition year for the company. The broker sees prices for fertilizer diammonium phosphate (DAP) improving and urea prices bottoming, alongside an easing of currency headwinds. An earnings inflection point is therefore near, and the market is likely to price Incitec based on more “normal” earnings in FY15.

BA-Merrill Lynch upgraded Mirvac (MGR) to Buy from Neutral in the wake of the acquisition of three assets with significant value-adding potential. This leaves Mirvac best positioned of the major A-REITs to benefit from the current demand for Australian commercial property. The turnaround of the development business, supported by an improving housing market, means the company is on track for the 10% or more return target.

Macquarie upgraded Orica (ORI) to Outperform from Neutral, as UBS upgraded from Sell to Neutral following FY13 results. Macquarie says the FY13 results highlighted stronger cash flow and a lower debt position and were 3% ahead of analyst forecasts. The explosives business shows some resilience and Orica looks well placed to benefit from recovery in Europe and North America. The company’s profit was also 3% ahead of UBS’ forecasts and cash flow was helped by better working capital.

In the not-so-good books

Credit Suisse downgraded News Corp (NWS) to Neutral from Outperform following its first quarterly result as a new entity. The result was mixed and reflects the transition, with revenues and earnings after tax, both down, the broker notes. Cyclicality suggests this result should not be used as a gauge for the full year. Aust Publishing was weak and News’ investment in REA was the standout.

Credit Suisse downgraded Sims Metal Management (SGM) to Underperform from Neutral. The broker has reduced its target to $10.00 from $10.20 to reflect the “chronic” overcapacity of shredding facilities in the US, which has meant any cost cutting has gone straight to price discounting and not to margin support.

Ahead of Sims’ AGM, the broker expects the company to be marginally profitable in the first half and sees improvement in the second, but in the meantime, the rating has been downgraded to Underperform.

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 I'm changing my sector allocation

by Ron Bewley

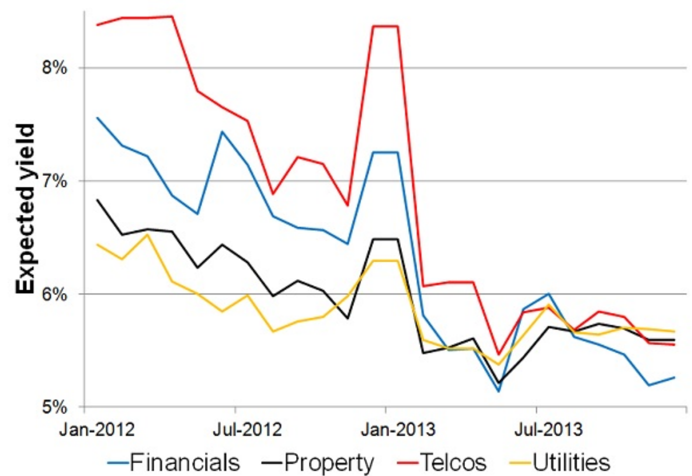
Before I start my next cycle of sector reviews, I want to take a big step back and review my whole SMSF portfolio with you, as I decide my next steps. Readers from two weeks ago may recall I was selling banks in my margin loan account (outside of super) but not in my SMSF. I now have no banks – or, indeed, any financials, property or telcos – in my margin account because I see no capital gains of note in these sectors – so I don't want to borrow just to make very small gains on the dividends.

It is timely for me to review my own SMSF portfolio since I haven't rebalanced it for at least six months, although I monitor valuations and stock prices every business day. But first, let me reinforce my dividend convergence story, so that I can clarify my different positions in my SMSF and margin accounts.

Dividend convergence

I have been arguing my case on *Switzer TV* for over six months using a chart such as that in Chart 1. As can be seen, telcos came with an expected yield of nearly 8.5%, financials about 7.5% with property and utilities in the high 6%'s – all as measured at the beginning of 2012. With the chase for dividends, stock prices in these sectors have shot up at a much faster pace than dividends. As a result, yields have fallen and, interestingly, the range of yields across these sectors has been compressed into a very tight range – much tighter than any other time on record.

Chart 1: Dividend convergence



Source: Woodhall Investment Research and Thomson Reuters Datastream; data to market close 8th November 2013

Since April/May 2013, these yields have moved very closely together. If yields fall too low, these sectors are no longer 'yield plays' and so future capital gains become less likely. APRA has now told the banks to not increase dividends and this message further reinforces the imaginary 'floor' I have put on these yields, at about 5.0% to 5.2%.

Since my SMSF is in pension mode, I do not pay tax on my SMSF dividends. I have a modest inflation-protected reversionary pension flowing from my academic days, my bank dividends give me a sufficient top-up to my pension for a 'comfortable' lifestyle – but I would prefer something more comfortable. Therefore, I am interested in some capital gains in my SMSF, so that I have all bases covered – but I think I can easily wait 10–20 years for these capital gains to come to fruition! One can (and should?) have a long-term view at 64 years of age, as I do.

I have tabulated the index weights for each sector of the ASX 200, along with my own SMSF portfolio in (the column headed Ron) Table 1. I have almost exactly index weight on financials at 39%. However, I am almost double index weight in energy and

materials. I have steadfastly stood by my version of the China story for 18 months, as some analysts and investors deserted these sectors. I only hold 14 stocks at the moment.

Table 1: Sector statistics

Sector	Weights				Forecasts		
	Index	Ron	Less aggressive	Aggressive	Gains	Yield	Volatility
Energy	6.1%	11.5%	7.6%	9.1%	25.3%	3.6%	11.7%
Materials	17.3%	32.2%	19.1%	15.4%	14.1%	3.2%	16.0%
Industrials	6.4%	8.1%	5.2%	9.3%	11.9%	4.1%	12.6%
Consumer Disc.	4.4%	0.0%	5.5%	6.6%	10.6%	3.4%	11.4%
Consumer Staples	8.3%	0.0%	10.4%	12.4%	6.4%	4.5%	10.5%
Health	4.6%	8.9%	5.7%	6.8%	10.2%	2.4%	12.5%
Financials-x-REITS	39.0%	38.3%	29.3%	19.5%	0.2%	5.3%	12.9%
REITS	6.4%	0.0%	8.0%	9.6%	3.7%	5.6%	8.9%
IT	0.7%	0.0%	0.9%	1.0%	10.8%	3.1%	15.3%
Telecom	5.2%	0.0%	6.5%	7.8%	-0.2%	5.6%	11.2%
Utilities	1.6%	0.9%	2.0%	2.4%	10.8%	5.7%	11.1%
Expected capital gain	6.8%	9.5%	7.7%	8.5%			
Expected yield	4.5%	4.1%	4.4%	4.3%			

Source: Woodhall Investment Research and Thomson Reuters Datastream; data to market close 8 November 2013

I have also tabulated my forecasts of capital gains, yield and volatility for each sector in Table 1. These figures clearly show part of the reason why I have 'tilted' my portfolio the way I have. But to get the full story, one needs to also take correlations into account. I publish two sets of 'optimised weights' in my Quarterly Report on woodhall.com.au. Neither is designed for implementation but they do give readers some insight into how all of these forecasts of returns, volatilities and correlations interact. The aggressive weights are particularly aggressive allowing major deviations from the index weights, while the less aggressive weights still allow for very big positions.

The aggressive and less aggressive weights for financials are both well below index weight. But I have elected not to own property and telco stocks so, in a sense, I have reallocated those two sectors' weights to my financials. My portfolio is punching above its weight in energy and materials. One reason for this tilt in my portfolio is that I think the brokers' forecasts of earnings and dividends – which form the basis of my gains' forecasts – are seemingly slow to react to the plethora of great numbers coming out of China.

Changes ahead

The item that catches more interest from me is my underweight position in utilities. Given the strong forecasts of gains and yield for utilities, I now plan to increase my exposure to this sector – to be well overweight! I am looking at possibly buying more AGL (ASX code AGK) and returning to owning Spark Infrastructure (SKI) after a long absence. However, my mispricing model tells me the market is overpriced and I will await a small correction. Perhaps Monday was the start of it. The big banks dominated the fall – it is consistent with my view but day-to-day calls are beyond what I try to do. I am in no rush to rebalance.

I am also considering increasing my weight in energy – for obvious reasons given Table 1. I am looking at Oil Search (OSH) but again I want a pull-back first. My problem is, I do not have any significant cash holding in my SMSF that could fund these possible purchases. Therefore I must sell before I buy. It seems logical to sell a little from materials – but they seem to be on a charge. Therefore, I must watch carefully and sell a little of my materials if they get sufficiently highly priced before the other stocks get cheap. If I miss the rebalance – it will be because I am making too much out of materials and that can't be bad.

Expected returns

At the bottom of Table 1 you can see the impact of the various strategies on expected portfolio capital gains and yields – if you use my forecasts. The portfolio return is calculated by multiplying the appropriate weights column (or your own!) by the column of forecasts. The index comes in at a modest capital gains' forecast of 6.8% and an expected yield of 4.5%. I expect only a slightly lower dividend of 4.1% with my allocation but a much bigger gain of 9.5%. If inflation runs at 3% per annum, the inflation-adjusted index return is 3.8% while mine is 6.5% – and that is not far off double the index forecast! Of course my forecasts could be very wrong and a very different set of results would then follow. But this is how I have done my modelling for 10 years or so.

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Short n' Sweet – IPO watch

by Penny Pryor

As the share market rebound continues, the number of initial public offerings (IPOs) and capital raisings are on the rise too.

There are the big names, such as Channel Nine and freelancer.com, but over the past 12 months, the *Switzer Super Report* has had a look at some of the lesser-known ones as well. Given freelancer.com lists tomorrow, it's a good time to look at our track record of IPO calls

The big names

Last week Paul Rickard shared his view on the Channel Nine IPO and whether or not it was worth buying. The *Switzer Super Report* view is as follows:

"Avoid. It is not a buy for yield, the growth story rings a little hollow, and given the pricing premium, there is no compelling case for it over Seven West. And that's without worrying about all that stock held (or more realistically, not held), in escrow."

Freelancer.com lists tomorrow but the offer closed earlier this month with over 600 investors, including Joel Sng, who was also one of the initial investors in Facebook and Twitter. This stock was pretty hard to get a hold of in the offer and we said just under a month ago that there would be significant buying interest come tomorrow.

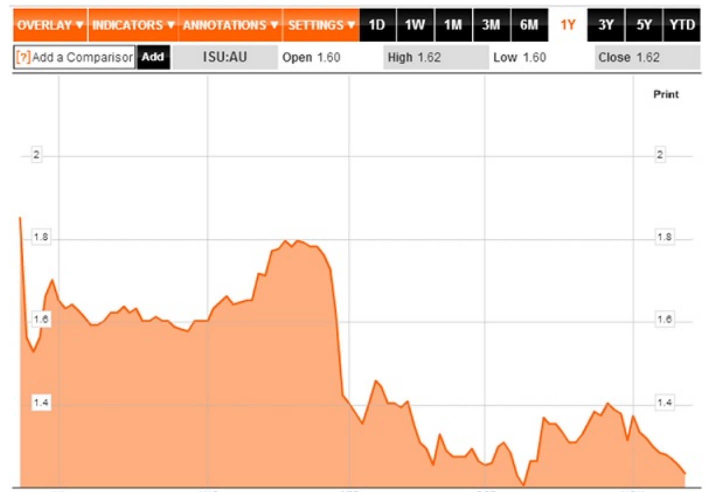
The health club

Then there were the two companies in the health sector – iSelect and Virtus.

In May, we said that the market was going to love iSelect *"because of the scaling-back of broker and fund manager applications, but once listed, the stock has to be valued appropriately."*

And the market did love it for a while, but then it got into a bit of trouble with the Australian Securities and Investments Commission (ASIC), after failing it meet its full-year revenue forecast. It has since been cleared but the share price is yet to recover.

iSelect share chart



Source: Bloomberg

We also said in May that if you did manage to get some of the limited stock on offer that *"it's probably best to sell into the initial strength and then let the professional investors sift through the working capital cycle and assess what it is really worth"*. Advice we hope you have followed.

As for the other health offering – IVF business Virtus Health – it is now trading well above its listing price of $5.68 and is in the $8.50 range. So we were right when we said that, although the market is usually pretty wary of unique investments like this one, Virtus was different because it is a product not subject to discretionary spending.

"Demand for it is driven by one of the most basic, but strongest, human needs. In effect, Virtus sells hope."

Vistus Health share chart

Source: Bloomberg

The trouble maker

In June, we reported the IPO of Domus US Multifamily Real Estate Fund was in deep water.

"Bell Potter and Ord Minnett are clearly having trouble selling the stock. Given this weak appetite for Domus, investors who are interested in Domus US Multifamily Real Estate Fund can afford to wait to see (a) whether the IPO goes ahead, and (b) if so, the size of the discount at which they can buy the stock in the after-market."

That stock hasn't yet made it to market almost six months later.

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Don't let inflation be a distraction

by Tony Negline

Inflation causes distortions and problems in many areas of a market-based economy like Australia.

So it's a good thing that over the last 10 to 15 years, it has been quite low.

The problem with a low inflation rate is that it seems to have made many retirees complacent about its potential impact on their future lifestyle.

In my view, inflation is the biggest problem retirees face. It's a bigger problem than running out of money.

Over 30 years, prices have increased by a factor of three

In the last 30 years, the ABS has estimated that consumer prices have increased by a total of 292%. That is, prices have gone up almost three times.

This result actually surprised me because I didn't realise it was this high.

To help you understand what this means, here's a simple example. Today, many of us would spend about $3.50 on a cup of coffee. Thirty years ago, based on this data, we would have only spent $1.20.

Obviously, some prices of consumer goods over that time have increased faster than this rate (for example private health insurance), whereas others have fallen over this period, (for example, some international air travel) while others haven't changed too much.

This 292% increase is an average rise of about 3.7% a year over the 30 years, which doesn't sound too high.

However, most of these price increases occurred in the 1980s, because in the last 10 years prices have only increased by 31.4%.

How much do you need in retirement?

Sometime ago, the Association of Superannuation Funds of Australia (ASFA) began estimating how much income retirees need to have a reasonable retirement.

For the end of December 2004, ASFA said that a couple would need $43,350 and singles $32,800 per annum to have a so-called comfortable retirement. Importantly, these numbers assume you own your retirement home.

By September 2013, these numbers had increased to $56,404 and $41,197 respectively.

In percentage terms, these are increases of 30% for couples and 25.6% for singles. Since 2004, ASFA has revamped its assumptions about how retirees spend their money because how we spend our money has changed. For example, during the last 10 years, people have been spending more on communications, such as mobile phones and the internet.

Over the same period, the official consumer inflation increase has been 27.6%. ASFA is saying that the income needed by retiree couples has had to increase slightly faster than the inflation rate.

In its latest announcements about this retirement income data, ASFA says that recently there have been quite significant increases in electricity prices, property rates and charges, and water and sewerage charges. On the other hand, food and private health insurance costs were reasonably stable.

If inflation averages 3% a year over 24 years then prices will double. Obviously, during the intervening

years, prices are also on their way up.

Assuming average life expectancies, health, occupations and leisure pursuits, anyone retiring before age 70 needs to assume that they will live for at least another 25 years.

Prepare for it

In my view, inflation is a slow debilitating disease and, unless retirees take action to allow for it, they run the real risk of going backwards. Because the drop in purchasing power occurs so slowly when inflation is low, there's a real risk you mightn't notice it until it's too late and your standard of living is forever adversely affected.

Retirees need to think very carefully about what type of asset will generate income that increases faster than inflation so that they avoid its impact. Just as employees look for jobs that provide for regular wage increases to improve their standard of living and protect against inflation, retirees need their assets to deliver the same result.

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NAB's new hybrid security

by Paul Rickard

After a drought of almost four months, the hybrid securities market has suddenly come to life with two new issues in the space of a few days: a $300 million subordinated note issue from AMP and a jumbo issue of at least $750 million from the NAB. When the window in this market opens, the borrowers and their advisers are pretty quick to roll out the new issues.

This NAB issue, Convertible Preference Shares II (or CPS II), is structurally very similar to raisings earlier in the year in the hybrid market from the major banks – ANZ Capital Notes (ANZPA), Commonwealth Bank's PERLS VI (ASX Code CBAPC), Westpac Capital Notes (WBCPD), NAB's first issue of Convertible Preference Shares (NABPA) and Macquarie Capital Notes (MQGPA). Like these earlier issues, the funds that NAB is raising will qualify as Additional Tier 1 capital.

Dividends

NAB CPS II will pay a quarterly floating rate dividend, which is expected to be fully franked. The dividend is set every three months at a fixed margin over the 90-day bank bill rate, and then adjusted for the company tax rate (to take into account the franking credit benefits). The indicative margin for this issue is in the range of 3.25% to 3.40%.

With the 90-day bank bill rate around 2.59%, this implies a gross dividend rate of 5.84% per annum for the first three months (2.59% plus 3.25%). The actual dividend in cash, which is fully franked, would then be 5.84% x (1 – Company Tax rate) = 5.84% x 0.70 = 4.09% per annum.

These CPS are effectively a form of capital for the NAB and the payment of any dividend is discretionary and subject to no 'payment condition' existing. If a dividend is not paid, it doesn't accrue and won't subsequently be paid. To protect CPS holders from this discretion being misapplied, if a dividend is not paid, NAB is then restricted from paying a dividend on its ordinary shares ('dividend stopper').

Conversion into NAB shares

NAB CPS II are perpetual and have no term. However, NAB must (subject to a test) convert the CPS into ordinary shares on 19 December 2022 (in about nine years). If conversion occurs, holders are issued NAB ordinary shares at a 1% discount to the then weighted average market price. The test for the conversion is the price of NAB ordinary shares at the time – provided they are higher than approximately $19.04, then the conversion occurs – otherwise, it is retested on the next and subsequent dividend dates until the test is met.

To qualify as Additional Tier 1 capital, there are two further conversion triggers (known as "loss absorption events") – a 'common equity trigger event' and a 'non-viability trigger event'. Under these tests, the Australian Prudential Regulatory Authority (APRA) can require NAB to immediately convert the CPS into ordinary shares, if NAB's common equity tier 1 capital ratio falls below 5.125% (the ratio was 8.43% as at 30/9/13), or if it believes NAB needs an injection of capital to remain viable. In these distressed circumstances, conversion would most likely result in a holder receiving considerably less than $100 of NAB ordinary shares, as there is a cap on the maximum number of ordinary shares that can be issued.

NAB also has a "once" only call option on 17 December 2020 (in about seven years), when it can elect to redeem the CPS by paying holders the face value of $100, or converting the CPS into NAB ordinary shares.

Details of the issue are |ã c^åÁ[} Á@Á[||[¸ ã * Á æ*^È

The institutional book build on Tuesday will set the final margin.

Our view

Over the last few months, margins in the hybrid securities market have come down due to the lack of new supply, and a general tightening in margins in the institutional bond markets. At an indicated margin of 3.25%, this issue is priced on par with the existing secondary market issues (ANZPA, NABPA etc).

That said, new issue margins for securities from the major banks of this type have ranged from 3.20% to 3.80%, so at 3.25%, this is no standout. With the prospect of more issues in the pipeline, and the likelihood that any surplus demand will be met by an increase in the issue size, hybrid investors and others building a portfolio of securities may want to keep some powder dry. It is unlikely that this issue will trade at much of a premium (if any) when it lists on the ASX.

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Issue Size	$750m, with right to accept more or less
Security Type	Perpetual, convertible, unsecured preference shares ('CPS II')
Listing	ASX, stock code NABPB, expected 18 December 2013
Issue Price	$100 per CPS II
Mandatory Conversion Date	19 December 2022 (into ordinary shares at 1.0% discount)
NAB Optional Redemption/Conversion	17-Dec-20
Mandatory Early Conversion	Loss absorption event or acquisition event
Dividends	Fully franked, floating, based on ((90 Day Bank Bill + Margin) x 0.70)
Margin	Range of 3.25% to 3.40% (to be determined in book build)
Dividend Dates	Paid quarterly, 17 March, 17 June, 17 September & 17 December
Payment of Dividends	Payable at NAB's discretion and no 'payment condition' existing. Non-cumulative. Dividend stopper on NAB ordinary shares.
Ranking	Behind all deposits, senior debt, unsecured creditors, subordinated debt incl. NABHB; equal with preference shares such as CPS1 (NABPA) and NABHA; ahead of NAB ordinary shares.
Offer Opens	Wednesday 20 November
Offer Closes (scheduled)	Monday 9 December
Issue Date	17-Dec-13
Minimum Subscription	$5,000 or 50 CPS, then in multiples of $1,000 or 10 CPS

Set your kids up financially... for life - Part 1

by Penny Pryor

When you're thinking about what to get your kids and grandkids this Christmas, it's a safe bet that shares will be last on the list. Let's face it – bikes and toys are much more fun.

But gifting shares to young kids is a growing trend, and while the under-the-tree reactions may be slightly less excitable than unwrapping an xBox, you'd be surprised at how soon they will appreciate it and gain an interest in a subject that could set them up financially, for life.

Clare Tilley is a mother of two teenagers, and works here at Switzer Media & Publishing. Since her kids were five, their grandparents have been helping them create their portfolios. We asked Clare the following questions:

What have your parents been doing for your kids?

For every birthday since the grandkids were about five, their grandparents have bought them shares. This has resulted in the kids, who are now 17 and 19, having significant share portfolios and an interest in investing that is unusual for teenagers.

How often and how much did your parents give them, and what's the value of their portfolios today?

For every birthday, my parents would add $500 to their trading account.

The grandson (aged 19) has a portfolio now worth $14,000 and the granddaughter (aged 17) has a balance of $8,000. The grandson's balance is significantly larger as he asked for shares from his mum and dad for his 18th birthday, so we added to his trading account as well.

What shares are they holding? Is it a balanced portfolio?

Currently they hold shares in Westpac and ANZ, as well as Telstra. In the past, they have had some mining shares (particularly gold), but not anymore.

Who makes the decisions about what they buy, hold and sell?

Their trading accounts have been managed by their grandfather. He will sit down with his grandkids a few times a year and show them what shares they have, how they have performed, the dividends, and then make decisions about what to buy, sell, keep. He would get the kids involved by asking them for their opinion as to what they should do.

How has the portfolio performed?

The bank shares have performed very well, both in capital growth and dividends. These shares have been a good long-term investment for the kids. The dividends go back into their trading accounts.

What share(s) have performed the best/added the most to their portfolio?

WBC and Telstra.

What share(s) has performed the worst?

The mining shares performed the worst, the remaining have all performed about the same.

What did your kids think about getting shares for their birthdays when they were younger?

At first they did not seem to understand share trading, so they were somewhat indifferent. There were times, especially for the granddaughter, that money for

clothes seemed more important.

What do they think about it now?

The grandkids are both very happy now to have share portfolios, especially when the dividends arrive and they see the balance of their portfolios. My daughter does business studies at school and the teacher asked her class if any of them own shares and she was the only one. She was able to explain to the class the shares she owns and how dividends work. She was very pleased with herself.

Has this given them a better understanding of investing?

This has definitely given the grandkids a solid understanding of investing. They always had bank accounts but the interest was so small it didn't mean anything to them. They now understand that you can have investments that increase in value over time and also pay dividends on a regular basis. They still think it's crazy that this money just keeps showing up in their accounts without them having to do anything. They both have jobs and have yet to invest their own money outside of cash (they both have very active social lives) – but that's the next step.

In Part 2 of this story, *Switzer Super Report* expert, Paul Rickard, will explain in detail the sometimes tricky process of buying shares for kids.

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.*

What's in a short?

by Questions of the Week

Question: *I read with interest each week your "Stock Shorted" report but have trouble assessing just what the impact is of the levels of shorting being experienced. Intuitively, it seems that a level of shorting around 10% to 20% would be disastrous for a stock, as it would really disturb the balance of trades – but it doesn't seem to be so. Myer, for example, has 13% shares shorted but its price does not, to me, seem unduly impacted.*

Answer (by Paul Rickard): The value of the information is that it tells you that at least one group of investors is fairly convinced that the stock is overpriced – either on a gross basis and/or relative basis. Often, these investors are the more nimble hedge or long/short funds, and the investment banks.

Short positions over 10% are pretty high. The sustainability really depends on the ability of the shorters to borrow the stock. If the share register is pretty open and shorters can make long term borrowing arrangements, these sorts of positions can be sustained for many months. If the share register is tightly held, shorters become vulnerable to the classic "short squeeze" – meaning that these positions are not sustainable and the price of the stock can go up very quickly as shorts cover their positions.

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