Switzer Super Report

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Go USA!

It's been a bit of a funny week so far on markets - and that's funny peculiar not funny ha ha. One step up then one step down. A public holiday on Monday for Martin Luther King Jr. Day, meant there wasn't much to go on from offshore.

But Charlie Aitken is back from his US holiday with some good news. He's convinced that the US economic recovery is real, and the US dollar is going to continue to rise, which means we all need more US dollar exposure.

Also in the *Switzer Super Report* today, we have an update on Sirtex, one of Roger Montgomery's favourite fund holdings, and in *Buy, Sell, Hold - what the brokers say*, Incitec Pivot and GUD Holdings get upgrades.

Sincerely,

Peter Switzer

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An Aussie at 75 cents means you need more US in your portfolio

by Charlie Aitken

I spent the last month in the United States of America and I am absolutely convinced the US economy is continuing to recover strongly.

America is buzzing, it's got its Mojo back. Unemployment is falling, Restaurants are full, airports are choked, flights are oversold, hotels are fully booked, house prices are up and Wall St is at an all-time high. Shale gas and the tech boom Mark II have revolutionised the place. Even those grandstanding clowns in Washington have agreed on a budget deal until September.

This will be the major investment story of 2014 (and beyond) and the ramifications are across all asset classes.

The US dollar story

The very simply point is, if I am right and the US economy is back as the world's growth engine, then the US dollar will be back as the world's reserve currency.

The Federal Reserve (Fed) will keep winding down bond purchases as the data confirms what I write above, ending what is effectively a US dollar rights issue, and the investing world will pile back into the world's reserve currency –
the US Dollar.

The Fed has already announced a tapering of bond purchases by $US10 billion a month to $US75 billion per month, but at the end of January I expect another $US10 billion reduction to $US65 billion per month. By mid this year I expect a "QE-less" USA, with cash rates importantly remaining at 0%. It's worth noting US cash rate futures are 0% right out to 2015 in line with the Fed's guidance.

I am setting my entire investment strategy around a resurgent US dollar. That served me well in 2013 as the US economy improved, but 2014 will be the year when that view becomes consensus, and we get the multiplier effect on prices.

US long bond yields will continue to rise as the US economy gains momentum, while concurrently the Fed ends QE purchases of bonds. Rising US long bond yields will also add to demand for US dollars once US long bond yields reach attractive levels (4.00%).

Of course, rising yields mean falling capital values in long bonds and I expect to see a further "great rotation" from US bonds to US equities, further propelling Wall St as the year progresses.

Stay ahead of the pack

Just remember, economic data and equity earnings lag the "real world" by three to six months. I strongly believe you can be ahead of data and earnings via simple observation in your day-to-day life. I call it "Peter Lynch Theory", the author of "One up on Wall St". Even in today's world of instant "information" and social media, I believe you can still position yourself ahead of the investing pack by simple observation.

On that basis, what I observed in America was very bullish. For example, every single flight I took saw multiple people "brought off" because the flight had been oversold. I always believe the airline industry is reflective of the broader US economy. I note Delta Airlines shares hit a record high after reporting quarterly earnings this week.

Hotels were also fully booked, while restaurants, theatres and sporting games were also very hard to get into. Again, I think that is reflective of a stronger US economy.

Instead of wars in Iraq and Afghanistan and "debt ceilings" leading nightly news bulletins, Wall St and the economic recovery led them. There was also story after story about America's oil independence, which is a massive structural change we have written on before.

My point is that "good news" dominated US news bulletins and this is a huge change from the headlines of the last five years. This is an important point in an economy that is 70% driven by US consumer spending, which requires consumer confidence.

The game plan

In terms of investment strategy for Australians, what does this all mean?

Clearly, if I am right, the Australian dollar will continue to fall versus the US dollar. The currency has already fallen by 17% versus the US dollar but I expect further similar falls in 2014.

In terms of the Aussie dollar, the numerator is weakening and the denominator is strengthening. However, the AUD/USD cross is still massively over-owned by central banks and global carry traders. This will unwind in 2014 and the AUD/USD cross rate will head below 80 US cents in my view. I reckon we will see it trade 75 US cents at some stage.

So my point is, even just shifting some cash to the USA could "make" you 15% plus this year by simply avoiding Aussie dollar depreciation. If you pick the right US equities, you should get the double-whammy as occurred last year.

Outside of direct investment in the USA (disruptive technology, cashless society etc.) all my highest conviction ideas in Australian equities are direct beneficiaries of the falling Aussie dollar. My top three remain Crown (CWN), Fortescue (FMG) and Platinum (PTM), but make no mistake, if we see AUD/USD at 75 US cents, it will be great for the entire Australian economy.

The 5-year chart of the AUD/USD just looks awful. Remember, this period was entirely dominated by the Fed's QE policies. Now that is ending, you can see the rug being pulled from the Aussie dollar.

Source: Yahoo

What I have been telling my clients all through 2013 and again now, is to get some capital into US equities, but use a proven fund manager or hedge fund manager to oversee the investment. None of us are US stock experts and I am prepared to pay fees for experts to do that for me.

I see up to -15% further downside in the AUD/USD cross rate this year and that will all be driven by US dollar strength, on confirmation of the US economic recovery and QE ending.

All Australians are too exposed to the still overvalued Australian dollar. We are all under-exposed to US dollars. I strongly encourage you to either directly or indirectly reduce your exposure to Australian dollars and increase your exposure to US dollars.

The continued recovery of the US economy and the associated resurgence of the US dollar will be the big story of 2014. I continue to position all portfolios for that scenario.

Just ask yourself: is an 88 US cents Australian dollar a "high" or "low" Australian dollar versus long-term history? When you have answered that question further, adjust your portfolios towards the USA and US dollar.

Buy, Sell, Hold – what the brokers say

by Penny Pryor

Revisions of sector forecasts and input prices were still a theme this week, as analysts reviewed their outlooks for a number of key commodities, which resulted in mostly upgrades for companies like Newcrest Mining and Incitec Pivot.

Macquarie downgraded Woodside Petroleum ahead of its financial results, with a big projection of a 35% drop in earnings over the next 10 years, if no new growth projects or acquisitions eventuate.

In the good books

GUD Holdings (GUD) announced its interim result and was upgraded to Neutral from Sell by Citi and Neutral from Underperform by Credit Suisse. The FY14 guidance was unchanged after the first half and this implies a substantial improvement in the second half, according to Credit Suisse. The broker would prefer a cheaper valuation to compensate for the risk profile but, at current levels, the risk/reward balance is fairly even. Citi considers the company's controllable improvements, such as cost cutting and restructuring, will be the primary drivers of earnings growth in the short term, rather than any fundamental improvement in the underlying businesses.

Credit Suisse was one of the last to move on Super Retail (SUL), following its trading update last week, when CEO and group managing director Peter Birtles confirmed the result was below expectations. The market reacted poorly to that news, which showed seasonal issues are affecting the BCF leisure segment. Credit Suisse believes this reaction reflects the fact the stock was priced well above the market and has moved the rating to Neutral from Underperform.

UBS upgraded Newcrest Mining (NCM) to Neutral from Sell, following a review of its gold and copper commodity forecasts. Long-term gold price forecasts were increased by 18% and long-term copper price forecasts by 16%. This has lifted the valuation of Newcrest by 71%. The broker's short-term earnings forecasts have also been lifted on higher copper prices and lower Australian dollar forecasts for FY14 and FY15.

Citi upgraded Incitec Pivot (IPL) to Buy from Neutral following a revision to fertiliser prices and a reduction in the AUD/USD forecast, which resulted in an increase in forecast earnings for FY14-15 by 12-18%. As prices for the fertilizer diammonium phosphate (DAP), rally from their lows in November and the new year signals improved demand from Brazil, Asia and the EU, Citi now expects DAP prices for FY14 and FY15 of US$425/t and US$450/t respectively. If IPL meets the Citi target, it will return approximately 14% (excluding dividends, fees and charges).

In the not-so-good books

Macquarie downgraded its rating on Woodside (WPL) to Underperform from Neutral, ahead of the company's 2013 financial results. Macquarie calculates that, without any further growth project developments or acquisitions, Woodside's earnings will fall around 35% over the next decade. Production will peak in 2014 but this will merely buy management time to consider how it might proceed. Given there appears limited upside in oil prices, WPL's individual issues will come to the fore amongst energy peers, the broker suggests. Falling earnings mean falling dividends.

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.

My SMSF – a shared responsibility

by Super Report Subscriber

Name: Graeme
Age: 60
Other members of your SMSF: My wife

Where do you live? Newcastle

How long have you had your SMSF?
We started it up around four years ago.

Why did you start it up?
I wanted to have more control over our investments. We were in a retail fund before that, which was ok, but I just wanted to be more involved.

How big is it?
Let's just say it's a reasonable sum and much more than the minimum suggested balance of $250,000.

Is it more or less difficult to manage than you thought it would be?
I have a financial adviser who helps, so it's not that hard. Personally I would be happy to do it myself but my wife wanted to use a financial adviser in case something happened to me. She felt she wouldn't be able to take control if I wasn't around.

Are you glad you have it?
Yes I am. I would be happy to do the investments myself, but it's not just my money, it's our money, and my wife is probably right to be careful.

Do you use an adviser or other kind of service provider?
The financial adviser helps with investments, and suggests what to do, but they also help with the administration and the tax side of things. They do more on the accounting side.

Are you pleased with its performance?
Yes I am, it's done just as well as the big funds, if not better, since we've had it.

Where are you invested and what is your asset allocation?
At the moment, we're mainly in cash but that's only because of my view of the market, which is pretty conservative at the moment. I believe, and so does our adviser, that we could be in for a correction and a lot of companies are overvalued. But in terms of sector allocation, I do like the yield-producing sectors, like the financials and Telstra. I also have a bit of "play money" on the side where I've invested in some more speculative stocks in the mining sector. They've had their good and bad days.

What stage is it in?
The fund is in both pension and accumulation mode, its setup is fairly straightforward at the moment.

Would you recommend SMSFs to your friends and family?
Yes, if you're prepared to put a bit of time in to it. There's a lot involved these days. Gone are the days where you could just buy and hold or set and forget. If you're setting one up to just save on fees you probably shouldn't do it. You also need to have an interest in equities, and a reasonable amount, which is, as they say, more than $250,000.

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.*

Sirtex offers promise on good results

by Roger Montgomery

It's that time of year again – the blackout period – one of two windows in the year when senior management teams of many listed businesses refuse to take calls and meetings with investors.

With their books, budgets and results largely signed off in preparation for half-yearly reporting season, given the risk of selectively briefing market participants and the penalties that could be levied (and although as fund managers, we find lack of access frustrating), it's fair enough.

During a void of information and in what many others call their down time, we have instead been reviewing our existing portfolio positions, scratching around for anecdotal evidence and also hunting for new ideas.

As you will find below, we have put together a list of companies whose recent market announcements since the start of January have caught our attention, both in terms of the business being considered by us to be a quality operation, and also the announcement reflecting encouraging prospects for future growth.

Some of these might be worth following more closely in the months and years ahead. Click here to enlarge table.

Code	Company Name	Business Activity	Announcement - What we liked;
SOM	SOMNOMED LIMITED	Diagnoses and treats Sleep-related Breathing Disorders	Announced 2nd QTR results which showed excellent sales growth across all regions. Revenues for the first 6 months of $12.55m +ve 39.1%.
SRX	SIRTEX MEDICAL	Manufactures and distributes liver cancer treatments.	Announced 2nd QTR results which showed highly encouraging dose sales growth rates of 18.7%.
ALU	ALTIUM LIMITED	Sells software for the design of electronic products.	Announced 2nd QTR results which showed sales growth of 14% to USD $19.4m in what is generally the businesses slowest period.
CTY	COUNTRY ROAD LIMITED	Retailing of apparel, homewares and related accessories.	Trading and Profit update - Reported very strong revenue, NPAT and EPS growth. EPS growth is lower than NPAT given recent acquisitons.

The darling

Of these four, we currently hold shares in just one – Sirtex Medical Limited (SRX). A business we believe has very bright prospects and whose share price rallied an amazing 25%, within just two days after announcing their second quarter growth in dosage sales on 8 January 2014.

Sirtex is an Australian medical device business whose core medical device, a product known as SIR-Spheres, has been refined over the years to deliver a highly-focused radioactive dose directly to liver cancers (Hepatocellular Carcinoma, or HCC). We wrote extensively about what the company does in early November here.

While SIR-Spheres are by no means a cure for liver cancer, as we can show below (even without statistically significant clinic results being available to support the use of Sir-Spheres; a usual medical requirement), actual clinical success of the device and excellent patient outcomes over many years throughout Europe, America and the Asia Pacific, has resulted in quarterly dose sales growing strongly.

Quarterly Dose Sales Growth

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr
2014	4%	19%		
2013	37%	25%	6%	13%
2012	11%	22%	34%	26%
2011	16%	17%	21%	19%

SIRTeX

And while focusing on quarter-to-quarter growth isn't something we encourage, 38 consecutive quarters of dosage growth (we have shown just 14 quarters above) suggests the business is on to something special.

The next phase

Growth rates averaging 20% per annum over this period also suggests that this exciting but still largely unknown treatment and its success to date has forced management to take the next logical step. This being to undertake a large and expensive Phase 111 clinically significant randomised medical study: one that is now fully recruited (with hundreds of patients) and slated to be completed later this year.

Potentially stemming from positive test results, and likely to be released in 2015, is a step-change in both Sirtex's market position and addressable market. This step-change is possible because SIR-Spheres currently operate in the salvage setting. This means they are administered once all other medical treatments have been exhausted.

The current study pairs the medical device with chemotherapy (SIRFLOX) in an attempt to show that the combination as a first line of defence significantly improves patient outcomes both in extending and improving quality of life.

Rather than being the last cab off the rank, the potential to expand the number of patients who can receive the treatment by a factor of six, is an exciting outlook and a potentially exciting development in healthcare technology.

Management is therefore focused not only on the trial, but also what happens afterwards. In that regard, an expansion of their sales teams and manufacturing facilities in anticipation of servicing strong future demand is currently being undertaken.

There are risks, of course. SRX is largely a one-product company, and if the study is unsuccessful, the impact on the business would be disastrous.

Source: Yahoo

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Keep your binding death benefit nominations and your will aligned

by Tony Negline

With each new court case, our understanding of SMSFs and death benefits continues to expand.

A recent case highlights just how important it is to get these right in both your will and Binding Death Benefit Nominations (BDBN).

The details

In October 2013, the WA Supreme Court handed down a case involving a death benefit totalling about $650,000 of Francesca Conti from The Conti Superannuation Fund. The two members and individuals of this fund were Francesca and her estranged husband, Augusto Conti.

Francesca died in early August 2010. Probate was granted for her will in October of that year with two of her children, Rosario Ioppolo and Grace Hesford, appointed as executors.

Her will stated that she wanted her super fund death benefit to be paid to her four children and also specifically said she didn't want any of this benefit paid to her husband.

Upon her death, Augusto was the sole trustee until February 2011 when Augusto Investments Pty Ltd was appointed as the fund's corporate trustee and Augusto was appointed its sole director.

The fund had been created in July 2002 and when joining the fund, Francesca had signed an indicative non-binding nomination saying she wanted Augusto to receive her death benefit.

In July 2002 and April 2006, Francesca had completed two BDBNs. Both said that her husband was to be the sole recipient of her death benefit. In relation to these nominations, the court said the following: "a binding beneficiary nomination lapses after three years. Consequently, neither was of any force and effect as at the date of death of the deceased. Curiously, the second of these two binding beneficiary nominations was in effect as at the date the deceased made her will. So the direction in her will that the benefit be paid to the nominated beneficiaries was not a direction with which the trustee could comply at the date the will was signed."

The lapsing rule

The comment about three years is fascinating. The three year lapsing rule typically doesn't apply to SMSFs – this applies to funds regulated by APRA – unless it has been specifically inserted into the fund's trust deed. It's unknown if this was the case here.

Some lawyers who specialise in super and trust law, have argued that in some cases the terms of your will could be viewed as a BDBN. The WA Supreme Court seems to have rejected this view (assuming it was advanced by the plaintiffs) on the basis that, at the time it was executed, a valid BDBN was in place.

By now, you can probably guess why this case came about – Francesca's husband refused to pay her benefit to their children and had decided to pay it to himself. The family couldn't reach an amicable agreement themselves and the court has been tasked with sorting the mess out.

The outcome

The children failed in their bid to receive their mother's death benefit and it seems that they'll have to pay the defendants costs.

The case in question is called *Ioppolo & Hesford v Conti [2013] WASC 389,* court details can be found here.

At the end of last year, I wrote about a Victorian Supreme Court case known as *Wooster vs Morris*. In that case, the surviving trustee failed to adhere to a Binding Death Benefit Nomination, which had been independently deemed to be valid.

In this particular case, the second trustee was the deceased's second spouse and the beneficiaries of the BDBN were the children of his first marriage. The court decided that the death benefit had to be paid as the deceased wished and the super fund's trustee lost the case (and had costs awarded against her).

One reader of this publication wrote to me and said that this case shows that in super funds with two or more members, it's essential to make sure that your other trustees aren't only happy with your BDBN but are also willing to implement it. This seems to me to be quite a sensible point. This wouldn't stop disgruntled beneficiaries from seeking to overturn your wishes, nor will it stop your co-trustees from acting mendaciously at a later date. Ultimately, we just have to accept that there is only so much we can do to make sure our families are adequately and suitably cared for, if something happens to us.

This WA Supreme Court case makes it clear that your BDBNs and your will need to be consistent. It remains an unfortunate mystery as to why this wasn't done in this case.

Super Retail's future and Buffet's Berkshire Hathaway

by Questions of the Week

Question: We invested in Super Retail (SUL) in November and have so far lost over 10%. I'm not sure whether to cut our losses and get out or persist with them, as again the Switzer program was pretty positive around that time and they had done pretty well previously. Maybe I got in too late?

Answer (By Paul Rickard): I think you may have got in a little late – and as I don't know your objectives, I am not sure what you are looking for. There is no news to say that anything in the business for Super Retail has changed – so if you are a long-term investor, then it may pay to be patient. If you are trading – well, it may be a different story.

Question 2: Looking at stocks on the ASX, I noticed two stocks that look like they are associated with Berkshire – ETSBRK and RBSBRK. Could you please give me some information about them? Are they ETFs following Berkshire Hathaway in the USA?

Answer 2 (By Paul Rickard): RBSBRK is an 'exchange traded certificate' issued by RBS Australia over an underlying share, Berkshire Hathaway (see http://markets.rbs.com.au/au/learning/market-access-products/etis.aspx). This product is listed on the ASX, however liquidity is pretty low.

I can't find any current information on ETSBRK.