Switzer Super Report

Issue 263, 20 February 2014

The boys are back in town

Charlie Aitken is very optimistic about the market reaching 6,000 given the powerful reports from those big boy miners BHP and Rio. He's very encouraged by their efforts to cut costs and thinks they may now be in for a bit of a renaissance, even as commodity prices head lower.

This week, the *Switzer Super Report* comes to you live from the SMSF Professional Association of Australia conference, where we have editor Penny Pryor with her ear to the ground on all that's going on at the forefront of the SMSF industry. Find out everything you need to know in *Short 'n' Sweet* today.

You can also watch what Paul Rickard and I think of the current market outlook, the earnings season and all this talk of the banks being overvalued on *Super TV*. Roger Montgomery is flying high on Flight Centre, in *Buy, Sell, Hold - what the brokers say*, Westpac, Ardent Leisure Group and Asciano get upgraded and Barrie Dunstan casts his cautious eye over the CBA result and explains why you need to stress test your portfolio.

Sincerely,

Peter

Peter Switzer

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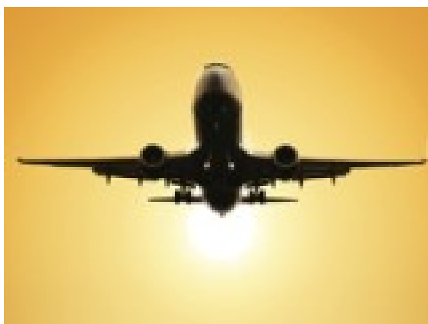

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Big miners BHP and Rio back on top

by Charlie Aitken

My friends, I bring you good news today. Big Australian mining companies finally, finally, understand what investors want.

It's taken a decade and two changes of CEOs, but both BHP Billiton and Rio Tinto have confirmed in their results that they are now on a clear pathway to less capital being ploughed back into the ground and a greater share of sustainable profits finding their way into shareholders' pockets. This is a VERY significant moment for both stocks.

Both companies, under new leadership, had promised to be more "*shareholder friendly*". That is clearly now occurring, and I believe all of us are underestimating what different animals, and total return investments, both BHP and RIO will be under this new regime.

A new era

Andrew Mackenzie (BHP) and Sam Walsh (RIO) are going to run their businesses as hard as possible. No more wastage, no more grandiose capital projects, no more M&A. They are going to maximise their strategic advantage at the very bottom of the commodity cost curve and deliver low cost production growth into, what remain, high commodity prices.

They are going to drive every return metric up, with clear evidence of that happening in both results. That translates to mountains of free cash flow, that instead of being "*evaporated*" by empire building management, will find its way, via buybacks and dividends, into shareholders' pockets.

I'll say it again — this is a monumental change for the better for both BHP and RIO shareholders.

In September last year, when BHP shares were $33.86, I flew down to Melbourne to meet with Andrew Mackenzie one-on-one. I was one of the first stockbrokers to meet with Andrew and, at that meeting, I sensed a big change in approach from the BHP CEO that I reported in these notes. To quote from the notes of that meeting…

"*It was pleasing to be asked by BHP to come and meet Andrew Mackenzie. I hadn't met Andrew before, but after our meeting in BHP's new head office I have greater clarity on the style of leader he will be at BHP.*

Mackenzie is of Scottish heritage and like all good Scotsman watches the pennies very closely. ***I believe you can look forward to a period of BHP being run hard, very hard,*** *with a through the business* ***focus on productivity, margins and free cash generation****.*

I wouldn't be expecting any wastage on Mackenzie's watch, in fact I expect the complete opposite.

It's worth noting Mackenzie has even appointed a group "productivity officer" who reports directly to him. The business unit leaders have been given productivity benchmarks and I suspect we all could be underestimating the cost out story at BHP. It's worth noting BHP reduced controllable costs by $US2.7 billion in FY13, with Mackenzie only in control for two full months of FY13.

This cost out story is coming at a time of increased group production. While all of us, myself included, get besotted with daily moves in spot commodity prices, it's easily missed that BHP, through new production coming on line and de-bottlenecking existing production, ***has guided to 8% group production growth in FY14 and 8% again in FY15, on a copper unit equivalent basis****. Considering the scale of BHP's existing production base, that is solid (16%)*

production growth on any measure. It's also worth noting this is bottom of the commodity cost curve production growth, due to BHP's tier 1 asset base, so highly profitable in the current commodity price environment."

A promise delivered

Fast forward to this week and Andrew absolutely delivered on my forecast of BHP being "*run hard, very hard*". The focus on "*productivity, margins and free cash generation*" are clearly demonstrated in the interim result which is summarised below.

Strong growth in free cash flow

- **Underlying EBITDA** of US$16.5 billion, up 16%
- **Underlying EBIT** of US$12.4 billion, up 15%
- **Underlying attributable profit** of US$7.8 billion, up 31%
- **Net operating cash flow** of US$11.9 billion, up 65%
- **Capital and exploration expenditure** of US$7.9 billion[1], down 28%
- **Free cash flow**[2] increased by US$7.8 billion
- **Underlying return on capital**[3] of 22%
- **Interim dividend** up 3.5% to 59 US cents per share
- **Net debt** down to US$27.1 billion

Source: BHP Billiton

These numbers all beat the consensus analyst view and led to consensus earnings upgrades for BHP for FY14 and FY15. The fact the interim result, but particularly the free cash generation, beat consensus analyst forecasts so clearly, suggests to me that most BHP analysts don't yet comprehend what a different beast BHP will be under Andrew.

It is somewhat counter-intuitive, but the best total shareholder returns from both BHP and RIO could come AFTER the commodity boom, as they exploit their unbeatable resource endowments instead of reinvestment.

We should also look at the RIO full year result. Every metric I look at in the RIO result was headed in the right direction in terms of what is required for investors to add sustainable P/E to the stock.

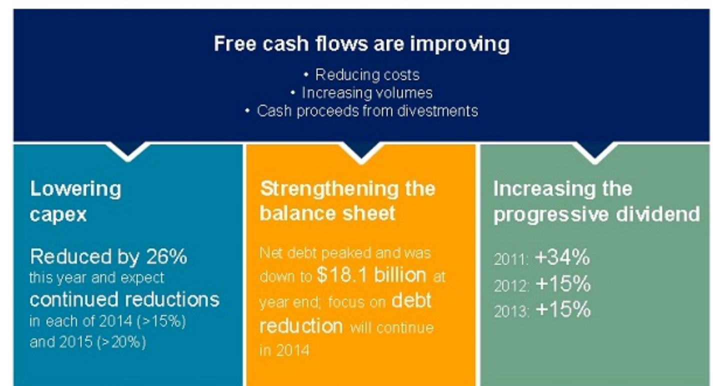
I realise the fact that RIO is currently a one trick 'iron ore' pony can cloud sentiment towards the company, on an iron view alone, but, if this was an industrial company, would the market not re-rate the stock if it produced the following?

RIO's Results

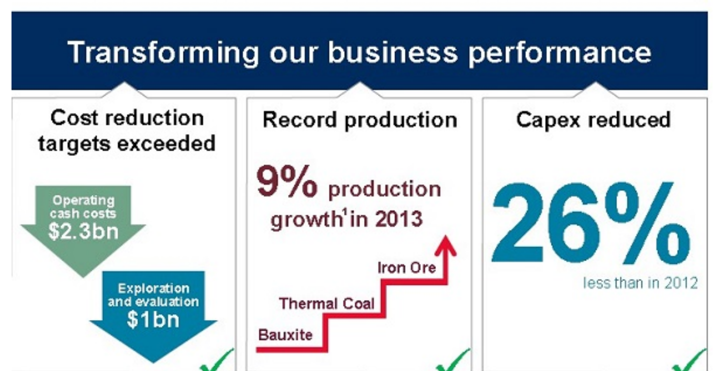
- Underlying earnings of $10.2 billion (+10%) ✓
- Cash flows from operations of $20.1 billion (+22%) ✓
- Net debt reduced to $18.1 billion ✓
- Dividend increased by 15% ✓

Source: RIO

Similarly, all through the RIO results presentation pack are the words "greater returns for shareholders".



Source: RIO



Source: RIO

The right stuff

I think Sam Walsh and Andrew Mackenzie are significantly different CEOs to their predecessors. I think you can see this already in the first FY RIO result under Sam. I think you can also see evidence of how hard Andrew runs BHP in the interim, in terms of cost out, margins and free cash flow.

The very, very clear point from the RIO and BHP results, is that P/E is going to continue to be reallocated from those who provide services to big mining companies back to the big miners. Our view has been unchanged on that for the last 12 months. Mining services are nothing more than stockbrokers in a bear market. No pricing or volume power, but even worse, most have plenty of debt. My conviction on that switch gets stronger each day. Zero weight mining services (or even short for hedge funds), and long big miners remains the way to be positioned.

I also think the corporate behaviour of RIO/BHP and even Fortescue (FMG) will set the stage for copycat behaviour further down the mining market cap food chain. That is why I remain very bullish on the right mid-cap producers.

Now all we need is for BHP to give us back some of the mountain of franking credits sitting on their balance sheet that should be in shareholders' hands. That will happen at the full-year result in August, via an off-market buyback, and would be a genuinely positive surprise.

My strategy remains overweight big, mid and small miners (producers), with the world getting better and the big boys finally understanding what they need to deliver to shareholders.

As you know, the only way the ASX200 can get to 6,000, is if BHP takes over leadership of the market. I think that happened this week and we have cleared another sentiment hurdle on the way to 6,000.

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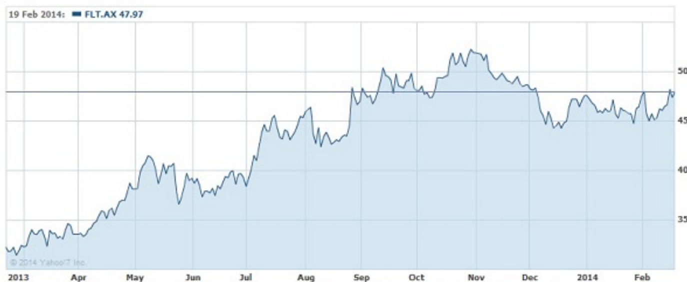
Flight Centre flying high

by Roger Montgomery

Take a casual look over Flight Centre (FLT) and you just might conclude that Australia's largest listed travel operator is a sitting duck for internet-based travel rivals. With approximately 2,480 shops worldwide, Flight Centre has a big network to maintain.

An old story

We've all heard the stories: consumers visiting bricks-and-mortar stores, inspecting products, trying on clothes and getting free advice, before buying through an online retailer at lower prices. If they're not careful, many traditional retailers may end up as free showrooms for their online rivals.



Source: Yahoo

As more consumers buy goods online, a large retail chain with physical outlets looks like a capital-intensive liability, rather than a money-spinning asset.

Against the tide of capital-light internet competition, bidding for their share of the total transaction value (TTV) pie, the same has the potential to happen in the travel industry. The traditional travel agency model – give free advice and take bookings later through a commission-based payment structure – looks outdated and vulnerable in comparison to the accessibility of internet-based travel services, like Bookings.com, Webjet Limited and Wotif.com.

The opportunity

But to dismiss Flight Centre as a traditional travel retailer, is to underestimate its presence in online travel, growing offshore footprint and outstanding long-term potential. Flight Centre has become one of Australia's great companies, even though it is rarely mentioned in the ranks of conventional blue chips.

Perhaps therein lays the opportunity. For if an observer was to take more than a casual look beneath the surface, what they would find might surprise. Flight Centre is a significant retailing innovator and not one to be left behind in the wake of newer internet-based upstarts.

Indeed, its physical presence on the ground has driven its success and created what it has become today – a blended shopfront and online retailing behemoth, and a template that other companies are watching closely and for some, trying to follow.

And why wouldn't they try? With a one-year total shareholder return of 48.3%, a three-year average annual return of 33.7%, and 66.5% annually and over five years, few businesses can claim such impressive returns.

These returns are backed up by annual earnings per share (EPS) growth of 28%, from 2009 to 2013, and the current forecast is for the growth to continue at 10% per annum until 2016. Remember, a business that can compound its earnings at 10% will be 33% larger than it is today in just three years' time.

	2009	2010	2011	2012	2013	2014f	2015f	2016f
Earnings Per Share	0.72	1.41	1.60	2.00	2.47	2.67	2.98	3.25
2009 - 2013 EPS CAGR					28%			
2013 - 2016f EPS CAGR								10%

A trailblazer

With an entrenched store footprint and well-recognised brand, imitating Flight Centre's success overnight will be a hard act to follow. FLT now has an on-the-ground presence in 10 countries (Canada, USA, South Africa, United Kingdom, Dubai, India, Singapore, Greater China, Australia and New Zealand).

Importantly, all countries are now generating positive EBIT returns after years of investment, again highlighting the success of this franchise and the strength and scalability of its operations globally. This will add to the cash flow streaming through the door and will continue to strengthen an already fortress-like balance sheet. It will also provide the financial flexibility to continue expanding, both organically and by acquisition.

Few businesses can claim such an achievement and while many have tried, fewer still have managed to export their business models overseas. Flight Centre has done it, and done it well.

While Australia still makes up the lion's share of the earnings, FLT's growth overseas continues and all but India, in the 2012/2013 financial year, recorded positive business momentum. This reflects management's focus on continuing to expand its global sales network with a targeted 8-10% annual increase in shop numbers, giving further confidence that earnings in future years will march steadily upwards.

As we all know, share prices follow earnings, and all of this has not been lost on those willing to dig a little deeper. After such stellar share price gains over the past few years, and more modest levels of growth estimated in the future, value in

Flight Centre has somewhat diminished at current market prices.

The shares are currently not cheap, but nor are they expensive. We would rate them as being fairly priced on our expectation that it will be a much bigger figure in a few years' time.

When compared to other online shopfront glamour stocks trading on stratospheric market valuations compared to their earnings profiles – such as Domino's Pizza – fair, in this context, seems more than reasonable.

Even so, patient investors might watch and wait for better value, if it ever emerges. Trying to second-guess the share price, however, is a fool's game, and, as you know, I make no claim to have any idea where a share price is going in the short term. Either way, given its quality and performance, Flight Centre deserves a pole position on both portfolio watchlists and your portfolio alike.

And while others may point to the emerging threat of online competition, Flight Centre looks superbly positioned to own the middle ground between bricks-and-mortar on one side and the internet through a blended model, creating a formidable barrier to entry for rivals. It's a repeatable model that is scaleable overseas and delivers excellent returns. So even with a lower currency, please continue to travel.

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Buy, Sell, Hold – what the brokers say

by Staff Reporter

Earnings results drove broker actions during the week but not all are in the same camp with a number of stocks – like Ardent Leisure and Asciano – receiving both upgrades and downgrades.

In the good books

Citi upgraded Westpac (WBC) to Buy from Neutral following an update on the bank which has triggered small increases to estimates due to expectations of lower credit charges. This sees Citi's price target rise to $35.75 (was $33.10).

Macquarie upgraded Asciano to Neutral from Underperform. The business may be challenged on near-term revenue, but the broker is happy that the company is creating opportunities. The balance sheet is also solid and the broker expects, once the near-term capex program is completed in FY15, that the payout ratio will increase. (See downgrades below)

CIMB Securities upgraded Ardent Leisure Group (AAD) to Add from Hold and Macquarie upgraded from Neutral to Outperform. It appears to CIMB that theme parks Main Event and health clubs have sustained renewed vigor in January, continuing the acceleration in revenue witnessed in the second quarter. Main Event stood out in the first half, recording growth from portfolio expansion and operating leverage. Macquarie also liked the momentum seen in Main Event and anticipates almost all the 13-14% earnings growth forecast for FY15 and FY16 will come from Main Event. Main Event provides exposure to a US recovery and translation benefits from a lower Australian dollar. The Gold Coast theme parks are also expected to benefit from a recovery in inbound and/or domestic tourism. (See downgrade below)

In the not-so-good books

Citi downgraded Challenger (CGF) to Neutral from Buy and Deutsche Bank to Hold from Buy. Challenger posted a strong result featuring strong sales growth in both life and funds management, but the higher share price means higher amortisation and a higher diluted share count. This prompts the odd situation of Citi downgrading to Neutral while still calling CGF its top pick in diversified financials. Deutsche Bank is less positive on the outlook. It notes life sales stalled and the second half looks bleak, while increased capital intensity required for increased annuities means the higher dividend payout might prove short-lived. The broker sees dividend risk after FY15.

BA-Merrill Lynch downgraded Asciano (AIO) to Neutral from Buy. Merrills thinks earnings guidance for FY14 looks difficult to attain and underlying conditions are subdued in the Pacific National rail and terminals. A flat period is envisaged before growth picks up in FY15.

JP Morgan downgraded Ardent Leisure Group to Neutral from Overweight. Ardent's result broadly met the broker's forecast. Main Event and Bowling outperformed the broker's numbers but Health Clubs fell short. The issue for the broker is AAD's 34% share price rise over 12 months, which brings it in line with valuation.

The above was compiled from reports on FNArena. The FNArena database 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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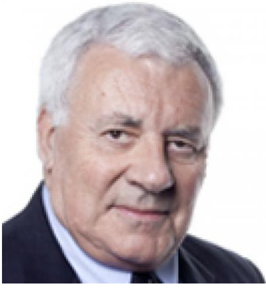

Stress test your portfolio

by Barrie Dunstan

Along with his good news for shareholders in last week's CBA interim report, chief executive Ian Narev gave some additional views that could cause SMSF investors to pause.

In an interview with the *AFR*'s Chanticleer columnist (Tony Boyd), Narev said the biggest threat to CBA's booming results were several "known unknowns" – essentially things which we know about, but which we don't know when or if they might occur.

He said these included: a freeze of global funding markets; a significant slow down in China; stagflation in Australia and the bursting of the housing bubble. While he dismissed the prospect of these events, he disclosed that the CBA had run a stress test, which showed that it could survive a scenario that included unemployment almost doubling to 11.5% and house prices collapsing by a third.

Even if the CBA could survive such a scenario, other institutions and investors might not, especially if it was accompanied by rising interest rates.

Could disaster happen?

Pessimists who believe in reversion to the mean say it's inevitable that there could be a nasty end to the growth in China and housing prices. Optimists hope they're wrong and that markets continue to behave.

But there's something called sequencing risk – a fancy term for losing money at the most inopportune time, such as when retirement investments are at their peak after a lifetime of saving. With more and more SMSFs paying pensions, trustees need to do an occasional stress test on their portfolios to see whether funds in pension mode need a different strategy to accumulation portfolios (where members may have decades left before retirement, allowing them to take a more risky approach).

Like the banks, perhaps investors also should consider the potential effect on their portfolios from events like a housing bubble bursting or China fizzling out. They may believe these scenarios are unlikely. They may conclude they can't escape the full effects of such a disaster. They might rely on the undoubted strength and reputation of Australia's Big Four banks. But, whatever their exposure to the banks, they still might consider their overall asset diversification policies.

The housing market – whether it is a boom or a bubble – depends on interest rates, employment levels, consumer confidence and the availability of funds from lenders. It now also relies on strong demand from Chinese buyers. Clearly, the government would be loath to see banks raise home loan rates or slow down housing lending. But at some stage, if inflation starts rising, this could involve a tricky balance of interest rate policies.

Run the stress test

Investors' traditional answer to such uncertainties is diversification – as long as we don't see a crisis like the GFC, which briefly affected most assets.

Bonds and fixed interest securities produce capital losses when interest rates are rising. Equities and property aren't always a guarantee (especially if financed by loans) and holders need to be prepared for potential large (if temporary) capital losses.

Cash is a safe haven in the short term, but anything other than short-term inflation can wreak havoc with pensions' purchasing power. For absolute safety, inflation-linked government bonds – currently offering a real return of some 1.7 percentage points above inflation over 10-years-plus – may be a solution outside the box.

The bottom line is that sometimes there are few places to hide if things go bad, and the difficulty in timing a move into a complete ‘safety first’ setting will deter most investors from making drastic changes.

But that doesn’t mean investors, like the banks, shouldn‘t spend some time asking those “what if” questions – even if they decide to continue with a slightly modified version of their current policy of relying on bank securities and deposits.

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Short 'n' sweet – urgent changes

by Penny Pryor

Every year, the professionals who advise SMSF trustees gather together for a conference. The issues and regulations they discuss are at the cutting edge of what's going on with SMSFs. And there are some very important changes about to be implemented that you really need to know about.

Electronic servicing address

For example – does your fund receive contributions from a large or medium sized employer (an employer with 20 or more employees)?. If it does, you will need to have an electronic servicing address by 31 May 2014 and you will have had to notify the ATO of that address, along with your ABN and bank details. The electronic service address is different to an email or website address and is also different to your bank details.

There are some exemptions if you have a significant ownership stake in the business but the change is expected to hit thousands of trustees.

This is because from 1 July this year, a new data and payment standard for employer super contribution payments will become a reality. It's part of the SuperStream reforms, which have been introduced across all superannuation funds to improve efficiency.

The ATO has said it will provide a list of electronic service address providers here. And ATO national program manager, data standards and E-commerce (SuperStream), Philip Hind, said yesterday that he has seen cost estimates for providing this address of around $25 a year. An SMSF service provider, such as an administrator or accountant, may also be able to help.

Borrowing in SMSFs

Assistant Treasurer Arthur Sinodinos also confirmed yesterday that there would be no separate review of Limited Recourse Borrowing Arrangements (LRBA). The previous government had flagged in 2012 that it would be reviewing LRBAs, but Sinodinos said that any review would be incorporated as part of the currency financial sector review.

SMSF Professionals Association of Australia (SPAA) CEO, Andrea Slattery welcomed the announcement and said the association was working on best practice guidelines for LRBAs.

Penalty update

The proposed changes to the penalty regime for SMSF trustees are also now slated to be reintroduced to parliament, which could mean they will come into effect 1 July this year.

These proposed changes will allow the ATO to use less restrictive, and arguably more constructive measures, when trustees breach their requirements.

They will be able to instruct trustees to fix the breach, a power they currently do not have, according to AMP SMSF head of policy and technical, Peter Burgess.

The ATO will also have the power to direct the trustee to undertake education, and with thousands of trustee breaches made inadvertently and accidentally, Burgess expects this directive to be the most widely used.

He said it would be an online course, which means trustees won't have to be embarrassed by fronting up to classrooms where they would need to admit their breaches to other trustees.

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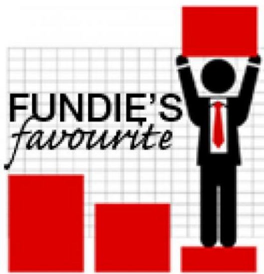


Consider this Chinese search engine for international flavour

by Fundie's Favourite

Kevin Bertoli

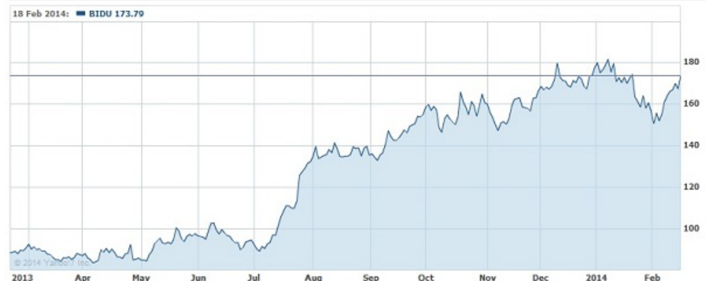
How long have you held the stock?

We initiated the position in February 2013. We have followed Baidu closely for many years but the opportunity to invest arose as investors had become increasingly worried about new competitors entering the market, as well as the shift occurring, as mobile search becomes more prevalent. This had resulted in the share price declining over 50% from its 2011 high of US$164.36. The Fund's average entry price was US$93.99.

What do you like about it?

Baidu, China's version of Google, commands a dominant position within the Chinese search market that is equal, if not stronger, than Google's in the US. Management has consistently built upon their market position, which currently sits at 70%, after gaining the number one position back in 2010. This has resulted in a very strong margin and return profile for the business with ROE of around 50%. The profitability profile of the business has allowed management to reinvest into its search technologies and ensure its market leadership continues.

On top of its position in the traditional PC based search market, the business is also well positioned, as search traffic shifts to mobile devices. Agreements in place with many handset vendors will mean they are the default search provider on most handset.



Source: Yahoo

How is it better than its competitors?

The dynamics of the Chinese search market have change dramatically over the last five years, with Google exiting the market in 2010. Prior to Google's exit, Baidu was the number-two player, and was going head-to-head with a competitor that had a far greater capacity to reinvest in the quality of their search product, the driving force behind the user experience longer term. Upon Google's exit, Baidu has taken over the mantle and now holds a similar position over peers. Baidu's continued investment in the long tail key words is a significant barrier to entry in this business. Furthermore, competitors cannot simply use price to gain share given the auction model employed in the search model.

What do you like about its management?

Chairman and chief executive officer Robin Li is very much the driving force behind the business. Robin has been with the business from the very beginning, founding the company back in 2000. He has developed a strong track record over the last decade, from both an operational and managerial viewpoint. He has proven to be a very good allocator of capital, both organically and via acquisitions. Robin continues to hold a 16% economic interest in the business and is therefore aligning his interests with minority shareholders.

Where do you see the value?

We believe the concerns surrounding competition in the traditional PC search market are overdone. Globally, we have seen that traffic market share does not translate one for one with advertising market share. The market leader commands a stronger share of advertising dollars compared to their traffic share. As mobile continues to grow as a share of total search traffic, the competitive dynamics in traditional search will also become a diminishing factor. The shift away from traditional PC based search to mobile will have a negative impact on margins and returns, given the inferior economics of the mobile search model. However, the market's expectations for margins have re-adjusted and now reflect more sustainable assumptions and, in all likelihood, may prove to be too pessimistic. With margin and earning expectations rebased, the market will again start to look at the structural growth that exists within the industry, where advertising spend has grown at 15% per annum over the past five years, and online is growing at a rate of three times faster than the market.

What is your target price on Baidu?

Given the business is currently going through a period of investment into the mobile platform, we look at it on a normalised earnings basis. Normalised earnings for 2015 should be RMB 600 per ADR (1 ADR = 10 shares). Factoring in the growth outlook for the industry longer term and the strong position of the business, we think 25 times is a fair multiple. On this basis, our target price is $US250 (currently trading around $US173).

At what point would you sell it?

The opportunity for share price appreciation in our eyes was twofold when purchasing the initial position. Firstly, there was the potential re-rating as the market become comfortable with the short-term factors impacting the share price (mentioned above). Secondly, the long-term opportunity to participate in the migration to online advertising continues to evolve from the current very low base within China. We would be a seller if the share price reached the mid $200 over the next 12-18 months.

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

The position has performed very well as it has easily beat expectations, thanks to progress in monetising mobile search and the market has again started to focus on the benefits of this longer term opportunity. The stock was a 5% position and has appreciated 75%, adding over 3.5 percentage points to performance.

Is it a liquid stock?

Yes, the stock is listed in the US and has a current market capitalisation of US$355 billion and the stock trades over US$500 million per day.

Kevin joined PM CAPITAL as an equities analyst in 2006 after graduating from the University of South Australia with a double degree Bachelor of Applied Finance and Bachelor of Business (Management). Since Joining PM CAPITAL Kevin's primary responsibility has been analysing Asian equities under the direction of Paul Moore with the purpose of developing the firm's coverage in the Asian Region. Kevin has also been responsible for managing the Emerging Asia Fund since its inception on July 1st 2008.

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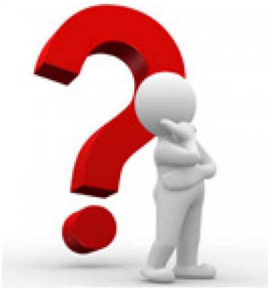


The right international share strategy

by Questions of the Week

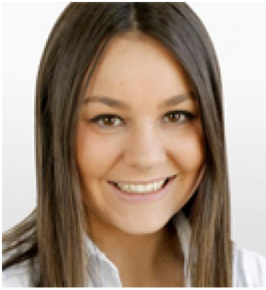
Question: *I have started investing in Platinum International Fund and have a few international ETFs, like VTS and VEU. Should I stick to just one fund or is it good to have mix – like having equal investments in Platinum or Magellan Global Fund? Or should I have a mix of ETF/funds as a long-term investment buy-and-hold strategy. I guess the issue is the fees.*

Answer (By Paul Rickard): It sounds like you are pretty much on the right track. You have taken a mix of passive funds (through the ETFs which give broad market exposure to the US and the rest of the world), and potentially, specialist active funds through Platinum and Magellan, which will be more focussed on stock selection.

With the active managers, I think spreading your investment reduces some of the “manager” risk – it is a diversification strategy.

Clearly, whether you can afford to have this mix depends on the size of your investment in offshore funds, and any resultant transaction costs.

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 is a listed investment company (LIC)?

by Brittany Ruppert

A listed investment company (LIC) is an investment fund which is listed on the Australian Securities Exchange. It is a closed-ended fund, which means that new investors participate by buying shares in the LIC from other investors.

While the price at which an investor buys shares in the LIC will be determined by the market, it will relate to the LIC's Net Tangible Asset (NTA) value. The NTA is the value of the LIC's assets (or investments), divided by the number of shares on issues. Sometimes, LICs will trade on the ASX at a 'premium' to their NTA, at other times at a 'discount' to their NTA.

The closed-ended structure of the fund allows the manager to focus on long-term investment, without needing to consider money coming into or out of the fund. However, the manager will occasionally issue or cancel shares, if they wish to alter the size of the fund.

One of the main ways they differ from traditional managed funds is in relation to their distributions, which are generally paid by way of a dividend. Often, this dividend is fully franked.

LICs mainly provide access to company shares, although the fund manager may elect to incorporate other asset classes. Like other managed funds, investment techniques vary from fund to fund, so LICs are suitable for many different types of investors. Investment styles also vary, therefore catering for both aggressive and conservative investors – and everything in between. Most funds maintain a fairly diversified portfolio.

The four main types of LICs are:

- Funds that invest in Australian shares
- Funds that invest in international shares
- Funds that invest in private or unlisted companies locally or abroad
- Funds that invest in specialised sectors, such as information technology or resources

In choosing to invest in an LIC, Paul Rickard recommends looking at the discount or premium of a fund. He also says to look at their "top 10 holdings" and sector weights to ensure these match with your investment biases. Some of his favourites are AFIC (ASX code: AFI), Argo (ARG) and Milton (MLT).

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Did you know?

Paul Rickard and I got together this week for a quick discussion on the earnings season, and all this talk about banks being overvalued. Find out what we really think on *Super TV*.