Switzer Super Report

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Mary, Mary, quite contrary

My good friend Charlie Aitken is now, more than ever, convinced that the dividend play is far from over. With interest rates at record lows and the Aussie dollar going lower, Charlie today adds a couple of companies, including the ASX and Perpetual, to his high-conviction lists. Charlie says it's no time to take profits and I have to say that I agree.

Also in the *Switzer Super Report* today, our *Fundie's Favourite* is Macquarie Atlas Roads – one of a kind according to Equity Trustees' Paul Kasian. And *Buy, Sell, Hold – what the brokers say* has a lot of downgrades and one upgrade for REA Group.

Finally, Tony Negline has a very interesting court case that highlights what can happen to your super if you separate, and our *Questions of the Week* answer queries about ex-dividend dates and lump sums.

Sincerely,

Peter

Peter Switzer

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ASX/S&P 200 in 5550 - 6000 trading range and more high-conviction stock picks

by Charlie Aitken

Key points:

- *It may only be a matter of time before the Aussie dollar/US dollar cross rate re-correlates to GFC levels of around 68 US cents.*
- *Lower interest rates mean investors will look for growth from the equity market and it is not the time to take profits.*
- *Instead increase exposure to key dividend yield/dividend growth and US dollar earnings. ASX, Perpetual and IOOF are all added to the high-conviction list.*

The Aussie dollar

Below is a chart of the Aussie dollar/US dollar cross rate (green), the Reserve Bank (RBA) cash rate (purple) and the Baltic Dry Index (white) over the last decade. Mind the gap.

Both the Baltic Dry Index and RBA cash rate are below levels seen at the peak of the GFC. I now believe it's only a matter of time before the Aussie dollar/US dollar cross rate re-correlates to GFC levels.

On that basis, this week I am DOWNGRADING my medium-term Aussie dollar/US dollar price target from 75 US cents to

68 US cents

Interest rates

Last week the RBA joined the global currency war. This is a very important development that requires a medium-term forecasting reaction.

We have now become the latest country to adopt competitive currency devaluation as a monetary tool. Welcome to the global currency wars.

Make no mistake, this was a big decision for the RBA. To suddenly change tack with the cash rate already below GFC crisis levels, and abandon "a period of stability" in favour of a new aggressive easing policy is a monetary event, which should not be taken lightly. Clearly, it surprised many economists and some institutional investors. However, against a global backdrop of deflationary forces and competitive currency devaluations, **I think there is a very real possibility of the cash rate with a "1? handle at some stage over the next 12-18 months.** I know that prospect is hard to imagine. But instead of asking "why?", ask yourself "why not?"

As the "the once in a century" windfall from the mining boom becomes a distant memory, it doesn't require a huge leap of faith to envisage our economy experiencing the same anaemic growth as the rest of the Western block in the aftermath of the GFC. As such, it is absolutely critical for the RBA to target a lower cash rate and a lower Aussie dollar. Unfortunately for savers and retirees, that means an extended period of very low (or even lower) cash rates and fixed interest returns.

ASX/S&P 200 target upgrade

The ramifications of the RBA's clear policy shift are multi-faceted and cross-asset class. To my way of forecasting, this now ensures that the Australian dollar trades in a lower trading range, Australian fixed interest yields move into a lower trading range, Australian commercial property cap rates move into a lower trading range, Australian equity dividend yields move into a lower trading range, and inversely the ASX200 moves into a higher trading range and Australian residential/commercial property moves into a higher trading range. The playbook on all this is the USA three years ago.

Outside of downgrading my medium-term Aussie dollar/US dollar forecast today, I am also upgrading my forecast for median residential property price gains to 10% from 5% in 2015 and upgrading my ASX200 trading range forecast to from 5000 – 5550 to

5550 – 6000

It also means dips in equity dividend yield stocks and US dollar earners will be **bought** by the SMSF army who are being squeezed out of cash as an asset class with negative real returns.

DO NOT TAKE PROFITS

In recent days I have had many questions from advisors and investors about **"profit taking"** in dividend yield and US dollar earning stocks that have performed well in 2015 so far. My answer to those questions is **DO NOT TAKE PROFITS.**

The investing world has not yet adjusted to what I write above and I think there's a very real chance we are all underestimating the amount of money that will attempt to move down a narrow street.

My advice is to use any **trading dips or ex-dividend dips to INCREASE EXPOSURE to key dividend yield/dividend growth and US dollar earning ideas.** Where these stocks have come from is not the issue: it is where they are going that matters.

You will read report after report from the so-called experts about how "expensive" these names have become. But **"expensive" versus what? History? Their valuation model?**

I must remind all readers that P/Es, and dividend yields for that matter, can be ANYTHING. If demand for the attribute outstrips supply, then the P/E can be ANYTHING. History is NOT a guide to future market valuations.

My theory remains that if the Australian bond market and fixed interest curves are proved right with their medium-term implied forecasts, then we are all underestimating the P/E that will be paid by investors for stocks with the right attributes for the times. That is why I am recommending **NOT TAKING PROFITS** in key dividend yield/dividend growth and US dollar earning equities. Any pullbacks will be shallow and it will prove too cute for most investors to attempt to trade short-term volatility in this theme.

Today I am going to reiterate my strongest sector and stock selections based on an extended period of ultra-low Australian interest rates and taking into account my new lower Aussie dollar/US dollar forecast/higher ASX200 forecast. I have made a couple of additions to this list, which are bolded. In next week's note, I will have a bottom up look at one or two of our key ideas after they have reported first half earnings this week.

High-conviction list

Major banks
ANZ (ANZ), National Australia Bank (NAB), Westpac (WBC)

Regional banks
Bank of Queensland (BOQ)

Non-bank dividend growth
AMP (AMP), APA Group (APA), **ASX (ASX)**, Challenger (CGF), Goodman Group (GMG), GPT (GPT), IAG (IAG), **IOOF (IFL)**, Medibank Private (MPL), **Perpetual (PPT)**, Transurban (TCL), Suncorp (SUN), Tabcorp (TAH), Telstra (TLS) Wesfarmers (WES) and Spark New Zealand (SPK)

US dollar leverage
Westfield Corporation (WFD), Servcorp (SRV), CSL (CSL), Resmed (RMD), Brambles (BXB), Macquarie Group (MQG), **Mesoblast (MSB)**, **Treasury Wine Estates (TWE)**, Platinum Asset Management (PTM), and Magellan Financial Group (MFG). In the banks, ANZ (ANZ) generates the greatest proportion of US dollar earnings.

Inbound tourism
Crown Resorts (CWN), Sydney Airport (SYD), Auckland Airport (AIA), Qantas (QAN), Air New Zealand (AIR.NZ), Village Roadshow (VRL), Ardent Leisure Group (AAD) and Sealink Travel Group (SLK). For the highly risk-tolerant, Virgin Australia (VAH) is arguably worth a punt.

Developers
Lend Lease (LLC), Mirvac Group (MGR), Stockland Group (SGP) and at the small cap end AV Jennings (AVJ).

Home improvement/renovations
Harvey Norman (HVN), Brickworks (BKW), GWA (GWA) and Boral (BLD)

Media
REA Group (REA) and Fairfax (FXJ)

Tactical trade: discretionary retailers
JB Hi-Fi (JBH), Super Retail Group (SUL), RCG Corporation (RCG), Automotive Holdings (AHE)

With my new 68 US cents Aussie dollar/US dollar price target, I also reiterate my long-held view that Australian investors need to “lose the home bias” and increase asset allocation to proven, unhedged, Australian-based, offshore fund managers. On that basis, I am sitting down with one of Australia’s best in that field this afternoon and will have more to say on this in the weeks ahead.

Go Australia, Charlie

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Buy, Sell, Hold – what the brokers say

by Staff Reporter

Broker actions have so far this week been firmly stacked to the downside as analysts do not seem to have liked interim earnings numbers. For those companies that managed to meet price expectations, the general consensus is that they are too expensive already.

In the good books

Morgans upgraded REA Group to Add from Hold to reflect the recent decline in the share price and a higher level of confidence in full year earnings forecasts. The broker considers the sell off after the results was an over-reaction that now leaves the price underestimating the potential for further upgrades.

In the not-so-good books

Citi downgraded BWP Trust to Sell from Neutral. Citi analysts saw a solid, in-line result with plenty to like, and growth should remain on offer. It's just that the share price is way too rich for the analysts.

Citi and JP Morgan both downgraded the Commonwealth Bank from Sell and Underweight to Neutral. Citi analysts saw a "typical" financial result from CBA: strong, forcing upgrades to future growth projections, but the analysts maintain that in the end, growth will still be slower in the future and this means the valuation is too high. The bank's first half result was above JP Morgan's forecasts. The broker is forecasting a further 100 basis points contraction over the next two years in returns on tangible equity and this is a key driver of valuation, which is 13% below the current share price. JP Morgan's forecast decline in returns is based on the changing composition of earnings growth – from provisions and margin improvements to volume, in addition to known regulatory capital headwinds.

Deutsche Bank downgraded Cochlear to Sell from Hold. First half sales fell short of the broker's expectations while revenue was in line, as stronger upgrade sales offset the weaker unit numbers. Deutsche Bank notes difficult market conditions are being faced and while a recovery in the second half seems likely, sales growth has now been lacklustre for four years. Despite expecting a sustained and relatively dramatic recovery in unit growth, Deutsche Bank struggles to justify the share price.

Citi downgraded Oil Search to Sell from Hold. Citi's desk of commodity specialists has taken a negative view on oil prices, short term, and a cautious view beyond the next few months, warning investors there is a real chance oil prices might be in for an extended "lower for longer" era. On this basis, the risks are seen as to the downside.

Credit Suisse downgraded Santos (STO) to Underperform from Neutral. The broker upgraded Santos to Neutral from Underperform after its big oil-related price fall but now that the price has bounced, it's back to Underperform. Balance sheet strains, a reserve downgrade at QCLNG and Santos continuing to guide to far lower sustainable capex numbers for GLNG than QCLNG suggest to the broker risk/reward is again "firmly" stacked to the downside.

JP Morgan downgraded Suncorp Group to Underweight from Neutral. Whilst JP Morgan believes Suncorp has earnings drivers in the medium term, there is a near-term concern about the insurance cycle, as well as overshooting on margins. Consensus estimates are also looking optimistic to the broker. While personal lines profits have historically been stable, market share losses in home insurance suggest to the broker that there could be some effort to normalise volumes, which could affect margins.

The above was compiled from reports on FNArena, 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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Macquarie Atlas Roads – one of a kind

by Paul Kasian

Key points

- *Macquarie Atlas Roads is the only major listed toll road operator with a diversified portfolio of European and American assets and a yield above 5.0%.*
- *It is about to benefit from refinancing a large portion of its debt at significantly cheaper rates.*
- *Equity Trustees has a 12-month target price of $3.70.*

How long have you held the stock?

We've had an overweight position in **Macquarie Atlas Roads Group (ASX: MQA)** versus the benchmark since August 2014.

What do you like about it?

Macquarie Atlas Roads is a toll road operator that provides exposure to a quality defensive distribution stream through a portfolio of toll roads in France and the US. The business has been de-risked after the GFC and is able to support its distribution from internally generated cash. Macquarie Atlas Roads is expected to benefit from refinancing a large portion of its debt (approximately €2.6 billion) at significantly cheaper interest rates. This is supported by two S&P credit upgrades since December 2013 to BBB (Positive Outlook) and a recent debt refinancing of €700 million, which reduced its interest expense from approximately 7.5% to less than 2.0%.

Macquarie Atlas Roads Group (MQA)

Source: *Yahoo!7 Finance, 12 February 2015*

How is it better than its competitors?

The company was created out of the portfolio re-organisation of Macquarie Infrastructure Group in 2010 and has extensive experience in operating toll roads. In addition, it is the only major toll road operator listed on the ASX with a diversified portfolio of European and American assets and a yield above 5.0%.

What do you like about its management?

An experienced senior management and board have de-risked the business since the GFC and have delivered earnings growth and strong shareholder returns since listing in 2010.

What is your target price?

Around $3.70 in the next 12 months.

At what point would you sell it?

We will review the value proposition for Macquarie Atlas Roads following the refinancing of the company's debt.

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

Macquarie Atlas Roads is up around 16.2% over the past year, outperforming the broader ASX 200 benchmark, which returned 13.5%, driven by a strong performance in the past month.

Is it a liquid stock?

There would be no liquidity issues for most global and domestic investors.

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Separating super – not always equal

by Tony Negline

Key points

- *A divorce settlement last year found that because the wife had expressed no interest in the couple's SMSF, the husband was responsible and all her interests were transferred to him.*
- *As the fund had made some major breaches, it needed to be cleaned up at the expense of the fund.*
- *The Court also ordered the husband "to indemnify the wife in respect of the financial consequences of her having been a member of the Superannuation Fund".*

A couple of weeks ago I was filling in for Paul Rickard on 2GB's *Switzer Super Show* and Peter Switzer and I were asked the following question from a listener – what happens to your super when you get divorced?

It's a good question and one that's often asked. In theory the super assets are included in a couple's total balance sheet and split just like any other asset.

The couple can do this by mutual agreement or the Family Court can enforce its decision on the couple. There are formal processes in place to make sure that both parties can obtain relevant information about each other's super accounts.

Sometimes when couples separate, problems with their super investments emerge and it becomes essential to fix these up before finalising the property settlement.

A case study to learn from

In 2013 the Federal Court dealt with an interesting case that involved an SMSF, which was a mess and may have been subject to fines and penalties if the ATO took action.

What value would you place on this particular super fund? Well let's look at the background.

Mr and Mrs Linder were married for more than 30 years. He was a solicitor and Mrs Linder ran the house and raised their three children. Their youngest child, while still a minor, was ill for several years with a variety of serious medical conditions. While she was in hospital, her mother provided her with a high level of care and the husband worked and looked after their home and their other children.

Their financial affairs were reasonably complicated and the main job of the Court was to determine how their matrimonial assets should be split. Here I'll only look at their super fund.

The SMSF

The SMSF had been set up in 1995. Its two members and individual trustees were Mr and Mrs Linder. The assets of the fund were cash in the bank and shares in Argo, an ASX Listed Investment Company, which had been purchased in a number of different transactions.

The husband told the Court that "at no stage did my wife ever take an interest whatsoever in the assets or operations of the Superannuation Fund or make any contribution towards it (sic) administration and management".

The Court accepted this statement and decided that the husband was responsible for the SMSF.

The parties couldn't agree about the super fund's ownership of about 22,000 Argo shares (which are currently worth about $185,000). No evidence could be produced that the super fund had purchased them or that it actually owned them.

Ultimately, the Family Court decided that these shares weren't assets of the super fund. As a result the super fund was deemed to have about $700,000 in assets.

Keep good records

This is an important lesson – clean documentation about the assets of your super fund is very important.

Since 2007, no financial accounts for the super fund had been prepared and no ATO return had been submitted.

Clearly the fund might have had ATO compliance issues. One expert accountant told the Court that in her view the fund had a "very high risk" of being in breach of a number of super law provisions and that the Tax Office might impose a penalty of $350,000. Basically she was saying the ATO would deem the fund to be a non-complying super fund and impose the high tax rates applying to super funds that apply when this occurs.

Her recommendation – for a cost of about $63,000, the super law breaches should be fixed and the fund closed, with money transferred to other super funds.

A different view

The husband and his advisers told the Court that they were confident that they could fix the fund up for a lot less and not face the penalties suggested by the accountant.

The fund's trustees had definitely been slack in preparing annual accounts, regulatory returns and keeping accurate records, but the fund does seem to have been run appropriately. For example, none of the fund monies had been lent to fund members or their relatives. The fund doesn't appear to have borrowed any money.

If the Court judgement has given us a complete picture of the fund's activities, and based on my experience of fixing up SMSFs that have regulatory problems, the husband and his advisers seem to have come to a reasonable conclusion.

Ultimately, the Court decided that all of Mrs Linder's interest in the super fund would be transferred to her former husband. But it also said the husband had "to indemnify the wife in respect of the financial consequences of her having been a member of the Superannuation Fund".

The Court gave the husband the super fund but as each trustee is liable for any ATO imposed penalties, the Court said the husband should be liable for any ATO imposed fines on Mrs Linder. The Court judgement said, "…failure to properly manage the Superannuation Fund … should not be visited on the wife".

What would have happened if all parties had agreed that the ATO would likely penalise the fund and its trustees? In my view, it would be best to sort out the super fund and see how much was left after it had been fixed and then deal with the remainder of the property settlement.

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Waiting for dividends and lump sums

by Questions of the Week

Question: We are currently holding ANZ, CBA, NAB, WBC, TLS and MPL and we are planning to sell part of these to reduce our mortgage on our investment property. We do not want to miss out on the interim dividends on the above stocks and therefore would like to know the companies ex-dividend and record dates. Do we need to wait till the record date or can we sell them once they go ex-dividend?

Answer (By Paul Rickard): You can sell the stock as soon as it goes ex-dividend. You don't need to wait for the record date. Most companies publish a calendar/diary of key dates, such as earning announcements, ex-dividend dates etc. on their website.

Question 2: My question relates to the taxation treatment of a lump sum from an SMSF for a person who is retired and is in the 55-59 age category. I understand that any lump sum is proportioned between your taxable and non-taxable percentage and that the first $180,000 of your taxable component is in fact tax-free. Is the lump sum still added to your taxable income for income tax purposes, and if so what are the implications?

Answer (By Tony Negline): Your tax-free component is tax-free. Your low-rate cap of $185,000 in 2014/15 is also tax-free. The remainder of the taxable component is taxed at 15% plus the Medicare Levy (which now also includes the NDIS levy).

The low-rate cap is reduced by previous benefits received.

All of the taxed element (including the low-rate cap) is included in your income for tax purposes. You then receive a tax offset to bring your tax rates on these benefits to what they should be.

The Explanatory Memorandum released when the amending legislation was introduced into Parliament says, "Super lump sums are considered to be in the top 'slice' of a person's total assessable income. Therefore, super lump sums will not push other assessable income into a higher than normal tax bracket."

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Don’t miss this!

I caught up with Paul to chat about what’s going on in our market and why a robust earnings season is so important.