Switzer Super Report

Thursday 2 April 2015

Bumper Easter special

I've got a bumper Easter holiday special edition for you today. Charlie Aitken starts it all off with a look at some great buy-and-hold growth stocks, or a Nifty 15, for Australian SMSF investors.

Tony Featherstone also explains how you might be able to identify the next disruptors. It's hard to value these companies, and it's often better to wait until after an IPO, to see how their value settles.

Barrie Dunstan looks at the outlook for oil and iron ore prices and Tony Negline examines whether you can really stuff your mattress with SMSF cash.

For all of you looking to add to your international portfolio, we have a very interesting *Fundie's Favourite* from PM CAPITAL's Ashley Pittard on Visa.

Sincerely,

Peter Switzer

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SMSF investors should look to the Nifty 15

by Charlie Aitken

Key points

- *The two major themes of 'lower for longer' cash rates driving dividend yield compression and a resurgent US dollar (falling Aussie dollar) driving earnings translation served investors well in Q1.*
- *A good mix of equities and property is usually consistent with the requirements of both long-term capital growth and regular annuity-style income streams for SMSFs.*
- *A style of "Nifty 15" has emerged in Australia, where dominant industrial franchises, with all the attributes of the US Nifty 50, have led the broader ASX200.*

Q1 in Australian and global equities was strong. If you simply parked your investment capital in the equity markets with the strongest central bank support (then swapped the currency to US dollars), you made very strong capital gains. That included Australia, where the RBA, entering the competitive currency devaluation game, saw the ASX/S&P 200 have its best quarter since 2009, led by sustainable fully-franked dividend payers. The ASX/S&P 200 Accumulation Index (XJOAI) rose 10.2%, despite resources going backwards, while the ASX/S&P 200 Financials Accumulation Index (XFJAI) rose 13.4%, despite only one of the big four banks paying a dividend in the quarter

The quarter was a solid one in terms of my macro strategy and high conviction stock selection. My two major themes of 'lower for longer' cash rates driving dividend yield compression and a resurgent US dollar (falling Aussie dollar) driving earnings translation served me well and remain strongly in tact as we enter Q2.

As we enter Q2, I see no reason to alter my macro strategy. If anything, Q2 will see the RBA lower cash rates further and potentially the Fed make its first small rate move upwards in June. If that proves right, the Aussie/US dollar will have a "6" handle and so will the ASX/S&P 200, led by reliable yield equities and US dollar industrial earners.

I hope these articles added value to your portfolio in Q1. Let's look to Q2 and beyond.

Asset allocation tips for SMSFs

Currently, there is about $600 billion in self managed super funds (SMSFs), which represents about one-third of total superannuation assets. While SMSFs offer both flexibility and a lower cost alternative than managed funds, the trade-off is the added responsibility of proper portfolio construction. As a result, I am often asked by SMSF trustees at conferences and public forums about the weightings of individual asset classes and the stock selection criteria within those asset classes. Given the aim of super is to provide either capital growth in the accumulation phase, or retirement income in a drawdown phase, the composition of assets within an SMSF can provide headaches for many trustees.

My advice on asset weightings has always been diversification but that will also depend on individual time horizons and financial circumstances. As a general rule, I believe a good mix of equities and property is usually consistent with the requirements of both long-term capital growth and regular annuity-style income streams.

In a financial world obsessed with short termism and instant gratification, it seems the time frame for equity returns has narrowed. In the current climate, the publication of managed funds returns has been progressively compressed from yearly, to quarterly,

and now monthly performance tables. In addition, the speed of news flows within an increasingly inter-related financial world, and the rise of high frequency trading, have significantly increased equity volatility. As such, trustees overseeing an SMSF equity portfolio are being forced into regular monitoring of equity positions due to higher volatility levels.

To be sure, responsible portfolio management requires careful monitoring. But I am often asked if there is an opportunity for "long-only" investing or "set and forget" portfolios within an SMSF structure. The answer is yes and no. Yes, I believe you can still invest in a combination of growth and income stocks over the medium term. But no, I certainly don't advocate buying a portfolio of stocks and putting them in the bottom drawer for the next 20 years. The reason is that disruptive technology has the ability to quickly undermine what appears to be an enduring equity theme (see Tony Featherstone's article on this topic today).

Nifty 50 arrives in Australia

While the concept of "long-only" equity investing has subsequently lost favour with many managed funds in recent years, it dominated US investment strategy in the 1960s and the early 1970s with the rise of the Nifty 50. As the name implied, the Nifty 50 was a portfolio of 50 blue chip, "buy and hold" growth stocks. The common characteristics included: household names with dominant industry positioning and strong and stable earnings growth. The stock composition included: Proctor and Gamble, Coca Cola, General Motors, Merck, Pfizer, GE and Walmart, which still remain industry leaders today.

At the time, the Nifty 50 formed an integral part of any investment selection criteria, and became a benchmark for equity performance over the course of nearly two decades. With the index's popularity however, the PE multiples of the individual stocks soared, with many trading on 40 to 50 times earnings. In one way, the Nifty 50 was an index within an index. Considering the high index weights and big market capitalisations, a market weighting in the Nifty 50 was required, or risk underperforming the broader index. After a long period of strong performance, the recession and high inflation of the savage 1970s bear market decimated the high PEs of the Nifty 50. Subsequently, many of the stocks suffered 40%-50% falls.

Despite the long passage of time, I think the Nifty 50 still provides some very valuable lessons for SMSF trustees and equity investors. Firstly, it is most definitely a cautionary tale on the pitfalls of a portfolio comprised almost exclusively of high PE growth stocks. Secondly, it's also a reminder of the dynamic nature of financial markets given ex-Nifty 50 stocks and household names, such as Eastman Kodak, Polaroid and Xerox have all become yesterday's heroes due to the power of disruptive technologies.

Lastly, I believe that the investment criteria for inclusion within the Nifty 50 provides a perfect example of the stock selection process for a "buy and hold" SMSF equity portfolio. The stocks should have: dominant industry positioning, high barriers to entry, double digit return on equity, strong balance sheets, strong free cash generation, and strong sustainable earnings. In the current climate, I would recommend tilting towards fully-franked dividend yield growth over pure EPS growth. In essence this is virtually the same stock selection criteria used by Warren Buffett – the world's most successful and recognised "buy and hold" investor.

In line with the Nifty 50, my strong recommendation would be to only include blue chip, big cap and high index weight stocks. The idea is to create a small equity portfolio of 10 to 15 stocks with roughly a 50-60% weighting in the ASX 100. The aim would be to try and minimise the tracking error of the portfolio by attempting to partly replicate the performance of the ASX 100 benchmark index. In short, such a portfolio structure would enable an SMSF trustee the benefit of near index performance, with a balance of sustainable earnings growth and dividend yield without the fees associated with a managed fund.

A "Nifty 15" would be more appropriate in Australian equities. Interestingly, in the post-GFC, low-interest rate/low-growth environment, a style of "Nifty 15" has emerged in Australia, where dominant industrial franchises with all the attributes of the US Nifty 50 have led the broader ASX200.

That "**Nifty 15**" list would include (all are ASX100

members):

- Amcor (AMC)
- Brambles (BXB)
- Commonwealth Bank (CBA)
- CSL (CSL)
- Goodman Group (GMG)
- Macquarie Group (MQG)
- Ramsay Healthcare (RHC)
- REA Group (REA)
- Telstra (TLS)
- Transurban Group (TCL)
- Sydney Airport (SYD)
- Wesfarmers (WES)
- Westfield (WFD)
- Westpac (WBC)

Consistent with my current strategy view, I believe the majority of the stocks included in a local version of the Nifty 15 are leveraged to my sustainable yield and strong US dollar themes. They all have dominant industry positions and, in turn, high sustainable ROE's.

While many commentators, analysts and institutional investors have described most of the names in the list above as "expensive", for the last three years, they continue to deliver above market total returns. The true question is: "expensive versus what?". 'Cash' isn't the answer. 'Their peers' isn't the answer.

The lesson of the last few years remains to let winners run and be a ruthless cutter of losers. Winners keep on winning, losers keep on losing. As Warren Buffet says, very few companies can truly be turned around and you are better off paying a higher multiple for a great and enduring company. That remains sage advice in a low growth environment with heightened volatility.

I'm going to take an Easter break with my little family next week. I wish all readers a safe and happy Easter.

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The hunt for genuine industry 'disruptors'

by Tony Featherstone

Key points

- *True disruptors are hard to value because they are creating uncontested market space, at least at the start.*
- *Freelancer misjudged its IPO allocation and its shares slumped to 52 cents but it is has since recovered to 98 cents and probably has further to run in the long term.*
- *An industry disruptor with even greater potential, Xero, is also on the way back after heavy share-price falls.*

The quest for "ten-bagger" stocks – those that soar tenfold – is usually associated with speculators and penny-dreadful exploration stocks. Not conservative investors, who are allocating part of their superannuation to the next hot small-cap stock.

Record-low interest rates and falling dividend yields are forcing trustees to move further along the risk curve to lift portfolio returns. The prospect of spotting the next Seek, REA Group or Carsales.com has great appeal as trustees look for genuine industry "disruptors".

The true believers

The reality is it is hard to find genuine industry disruptors that are creating markets or reinventing existing ones, let alone buy them below fair value. True disruptors are hard to value because they are creating uncontested market space, at least at the start.

Seek, REA and Carsales.com, for example, looked expensive for years, yet kept rising. Investors, who worried about high Price Earnings (PE) multiples, overlooked their potential for exponential revenue growth and snowballing profits, thanks to super-high profit margins.

They also underestimated the barrier to entry derived from "network effects" – having the largest audience that attracts the largest advertising base, which in turn attracts more users and makes it impossible for rivals to compete. Look at how many online segments are dominated by one firm and the daylight between the market leader and number two or three player.

Technology's capacity to disrupt established markets has never been greater. Think of Airbnb's disruption of the accommodation industry; what Alibaba is doing to e-commerce; or how Uber is hurting the global taxi industry and its likely effect on the transportation of small goods.

Watch the trends

SMSF trustees with a multi-year or multi-decade focus need to think carefully about emerging long-term trends and the companies best placed to capitalise on them. Investing overseas is becoming more important to gain exposure to trends, such as robotics, self-driving cars, the internet of things (devices talking to each other via the web), and so on. Companies involved in these industries have low or no representation on the ASX.

A jump in tech listings on the ASX is at least giving investors more choice. Micro-jobs website Freelancer kick-started the tech IPO trend in 2013 when its soaring valuation after listing encouraged other aspiring tech ventures. More followed in 2014 and market talk is that several tech IPOs, some of them reasonably large, are considering listing on the ASX this year.

Nevertheless, it is often better with small- and

mid-cap IPOs to wait a year or two after listing before buying. This allows time for IPO hype to fade, to assess how the company performs as a listed entity – if its prospectus was fact or fiction – and for seed investors to sell restricted securities once escrow provisions expire.

Freelancer

Consider Freelancer's experience. It raised $15 million in November 2013 at 50 cents a share, soared to an intraday high of $2.60, and slumped to 52 cents in December. The company admits it misjudged the IPO share allocation, selling too few shares and creating illiquidity in its stock.

Freelancer has recovered to 98 cents and has further to run in the long term. It was overpriced above $2 and chronically undervalued at 52 cents. It does not suit risk-averse investors, but there is much to like about its industry, market position and prospects.

Chart 1: Freelancer

Source: ASX. Chart shows end-of-day closing prices

The emergence of global micro-job platforms that connect employers and freelancers is a fascinating trend. These platforms facilitate labour-market arbitrage, as western companies hire freelancers in developing markets for a fraction of the price, and workers in those markets earn a higher fee than they would from local companies.

Freelancer's platform has almost 15 million freelancers and employers bidding on more than seven million projects. As it acquires smaller platforms in other countries, those numbers should balloon. There is plenty of room to grow; the market has estimated annual revenue opportunity of US$16 billion and Freelancer's FY14 revenue was US$23 million.

Canaccord Equities has a buy recommendation and a $1.46 12-month price target. The broker says Freelancer is expected to deliver more than 30% compound annual revenue growth over the next five years, while sustaining 87% gross profit margins.

Using the valuation metric of Enterprise Value to Earnings Before Interest and Tax, Freelancer trades at an EV/EBIT of 9 times in FY17, falling to 3.2 times in FY20. Canaccord says: "We estimate this is a discount to the ASX Industrials index despite Freelancer experiencing a significantly stronger revenue growth profile and higher marginal return on invested capital (the two drivers of value creation)."

Xero on the way back

An industry disruptor with even greater potential, Xero, is also on the way back after heavy share-price falls. The cloud-based accounting software provider soared sixfold in 2013 to peak at $37.45, before slumping to a 52-week low of $13.76. It has great prospects, but was overhyped by some brokers.

Chart 2: Xero

Source: ASX

I could not get interested in Xero at those heady

prices and wrote as much for the *Switzer Super Report* in November 2013. I commented: “Xero’s long-term potential and management execution so far impress. But its valuation, relative to other software providers, has run too far, too fast.”

Xero rallied in February 2015 after announcing large investments from a leading Silicon Valley venture capitalist, Accel Partners, and from the company’s largest institutional investor, Matrix Capital Management. These blue-chip investors bring a lot more than just money to the table and are a serious validation of Xero’s quality and prospects.

Moreover, the looming MYOB listing on ASX, worth up to $2.25 billion, creates valuation perspective for Xero, which is worth $3.17 billion but has much stronger growth prospects overseas.

Brokers seem to love or avoid Xero on valuation grounds. Macquarie Wealth Management has a $12-month target of A$24.30 and downgraded its recommendation to underperform in late March. Macquarie wrote: “In our view, at the current share price the risk/return balance is unattractive. This is not a reflection of our view on the operating momentum of the company or quality of management. The reverse is true, and we concede that if Xero can maintain 80% growth rates its valuation metrics improve.”

Understandably, the market struggles to value companies like Freelancer and Xero that rack up large losses in the pursuit of market-share growth and the eventual monetisation of large audiences. Or recognise the latent strategic value of a dominant industry position online.

Both stocks have higher risks at current valuations. They were more attractive three months ago. But both are trading well below their peak historic valuation, look reasonable on projected valuation, and have attracted some strategic investors to their register.

Even so, SMSFs need care with disruptors such as Xero, Freelancer, OzForex Group, iSentia Group, 3P Learning or other tech-based companies with a growing global footprint. Allocating a small proportion of the portfolio equity to such stocks is critical. If they fail, portfolio damage is minimised; if they succeed, long-term returns can be spectacular.

- Tony Featherstone is a former managing editor of BRW and Shares magazines. All prices and analysis at March 31, 2015.

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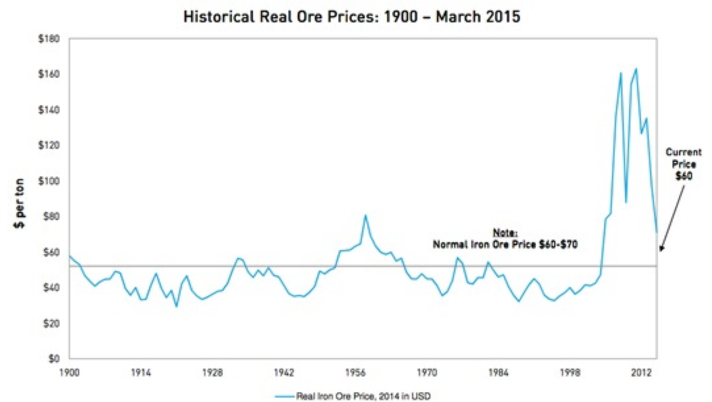
The mean is mean for oil and iron ore

by Barrie Dunstan

Key points

- *Historical charts of major commodity prices show the recent increases were an anomaly.*
- *For iron ore, current prices might be closer to long-term prices with only the larger producers to survive.*
- *For oil, the historical trend indicates $US70/bbl is a more normal oil price.*



Amid all the talk about falling crude oil and iron ore prices, investors need to stand back and take a much longer-term perspective. If they do so, they might avoid being too optimistic about world prices recovering back to recent elevated levels.

Recently, visiting American fund manager Richard Pzena (Pzena Investment Management), presented graphs of the long-term, real trend in crude oil and iron ore prices – two of the key commodities for Australian miners and our export revenue.

History does repeat

Particularly with iron ore, they show a clear period of more than a century of prices running at an average of around $US60 to $US70 a tonne (2014 dollars and showing the trend in real terms).

It is not until the early 2000s that the graph spikes upwards, as the unprecedented Chinese boom pushes prices as high as $US150 a tonne before re-adjusting down. The most recent fall (now to almost $50 a tonne) has merely brought the current prices down again to around the long-term average.

The graph is virtually a text book example of reversion to the mean – the almost universal tendency for prices to move back to their long-term average level after significant rises or falls. Reversion to the mean is the rule, which underwrites most of the strategy of value investors like Richard Pzena.

The historical picture from the iron ore graph shows a persistent price pattern, which suggests that the 2000s spike is an abnormality that has corrected. If so, it suggests Fortescue's Andrew Forrest's forlorn idea of the major producers colluding to restrict supply and regain boom levels of $100 a tonne or more was as likely to succeed as King Canute's attempt to reverse the sea tides.

The oil tide shifts

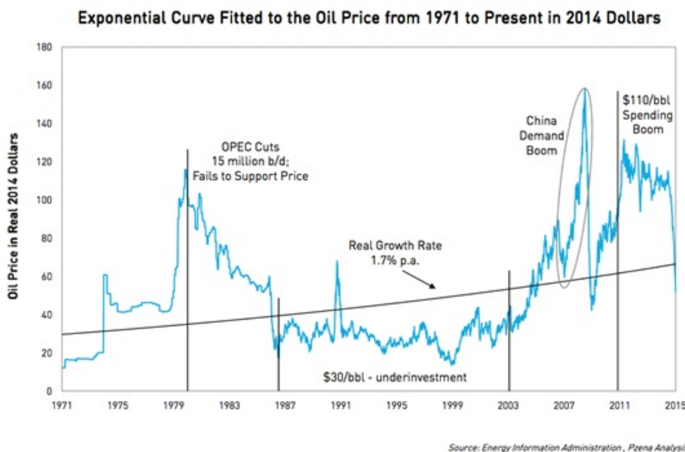
While iron ore prices have more significance for Australian investors (and governments), Richard Pzena has been looking mainly at shares in the big oil

majors – as a value investor and also as someone with extensive experience in the oil industry with major group Amoco.

His valuation models use a range of measures and suggest that major oil stocks are at their cheapest since 1968 – relative to independent oil groups, service providers or refiners. He reasons that the big integrated oil majors are in better shape to survive the falling oil price than other players.

The oil price also shows a tendency to mean reversion – except it has two major spikes instead of one like iron ore. The first was the massive late 1970s move when OPEC restricted production in an attempt to hold price levels in the face of new supplies from the North Seas discoveries. (This followed the first oil shock at the start of the graph when OPEC first decided to lift prices by restricting supply.)

Historical trend Indicates $US70/bbl Normal Oil Price



The second oil spike followed the upsurge in demand by China. This sparked a boom in spending as the industry rushed to find new supplies to cash in on the record prices. Within a few years, the so-called "fracking" boom (and Canadian tar sands) resulted in 85% of non-OPEC oil supplies coming from North America.

Now, says Richard Pzena, producers from fracking wells require something like $80 a barrel to stay in business; deep offshore wells need about the same price. The tar sands in Canada are even worse off, probably needing $100 a barrel.

Clearly, producers of oil and iron ore needed to read the warnings from the long-term price trends. Mean-reverting prices will wreak their own unrelenting, supply/demand pressure on the highest cost producers.

Once again, investors should look at the long-term trend. Above all, they need to remember the old boom-time rule: Beware – especially when everyone says "this time it's different."

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Visa - a priceless brand and a valuable stock

by Ashley Pittard

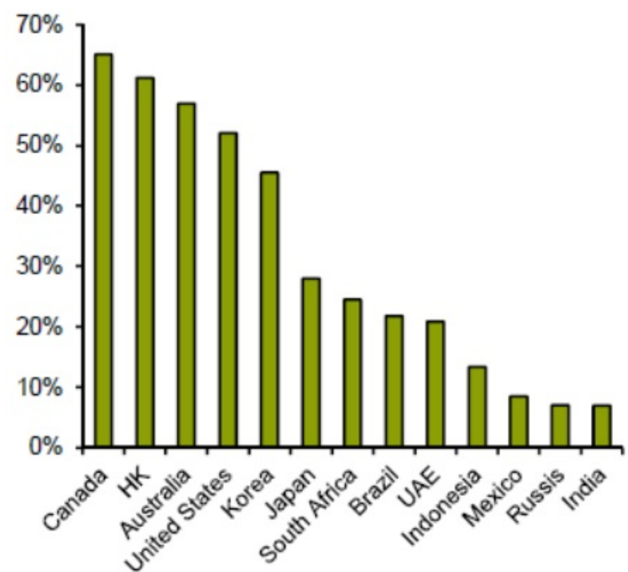
Ashley Pittard is a director and founding shareholder of PM CAPITAL. He is the portfolio manager for the company's global equities strategies. Ashley also has responsibility for analyst coverage of technology (software, hardware and semiconductors), commodities, energy, consumer and media, globally.

How long have you held Visa?

We acquired the business during the October 2014 market turmoil at a 17x P/E multiple. We have followed Visa closely for many years but the opportunity to invest arose as volatility returned to the market late last year causing a notable share price drop in five business days, falling to an attractive entry price. The share price has subsequently appreciated almost 30% since that time.

What do you like about it?

Visa is the world's largest retail electronic payments network, the essential middleman enabling the further penetration of electronic payments over cash and cheque. Over the last five years, Visa has grown sales at a low double-digit rate, with EBIT margins of 65%, whilst maintaining net cash on its balance sheet. We acquired the business during market turmoil and believe significant upside remains. We believe that significant further penetration remains, as illustrated by the chart, which stands at 35% (ex-China), up from 25% since 2007.



Source: WEO, Worldbank, Nilson, Visa Investor Day Presentation, Corporate reports and Bernstein estimates

How is it better than its competitors?

Visa is an oligopoly business (MasterCard being the other main competitor), thus has limited competition, as banks do not have the bandwidth, market share or global reach to bring these services in-house, and the likes of Google and Facebook have expressed no interest. Visa has very good scale benefits and high long-term growth potential.

What do you like about its management?

Management has executed their strategy very well so far and has been disciplined in terms of pricing. Their motto implies under promising, yet consistently over delivering.

What is your target price?

With bond rates at 2% for 10 years and Visa growing

its earnings at a minimum of 10% per annum, the stock should be able to hold a 25 times forward Price /Earnings ratio and still remain fair value. (Forecast 2015 Price/Earnings currently sits at around 25).

At what point would you sell it?

We would only sell the business if the valuation became extreme, around the 35 times forward Price/Earnings, or structurally their market changed, which does not look like it's on the horizon.

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

We hold a 2.3% position within our global portfolio, and, in the four months we have held the stock, there has been a 30% price appreciation, hence the stock has already provided a significant return for the fund. However we see greater upside to come.

Is it a liquid stock?

Yes, the stock is listed in the US and has a current market capitalisation of US$161 billion and the stock has an average daily trading volume during the last three months.

Visa Inc

Source: Yahoo!7 Finance, 2 April 2015

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Buy, Sell, Hold – what the brokers say - 2/4/15

by Switzer Super Report

Company specific actions drove broker activity this week, with the Chevron sell-down in Caltex making that a prime target for acquisitions and therefore eligible for an upgrade by some brokers. The Slater & Gordon UK acquisition also prompted some broker action.

In the good books

Morgan Stanley upgraded Caltex to Equal-weight from Underweight and Credit Suisse upgraded to Outperform from Neutral. Buy/Hold/Sell 1/4/2 With further analysis on the sale of the Chevron stake, Morgan Stanley upgrades to Equal-weight from Underweight. The broker envisages more chance of a buyback, organic growth through acquisitions over the next 12 months. Near-term earnings are unchanged but with the Chevron exit, higher trading multiples are justified, in the broker's opinion. Credit Suisse now believes cheap debt, in a low-growth world, makes defensive infrastructure plays like Caltex prime targets.

Deutsche Bank upgraded Metcash (MTS) to Hold from Sell. Buy/Hold/Sell 1/4/3 Deutsche Bank remains concerned about the company's grocery business, given independents are expected to shed market share, while Woolworths ((WOW)) is likely to become more aggressive with pricing. Nevertheless, industry feedback suggests to the broker that independents have performed better over the last few months, after a long period of underperformance. The stock's valuation is undemanding, particularly given the prospects for its non-food divisions appear reasonable to the broker.

UBS upgraded Slater & Gordon to Buy from Neutral. Buy/Hold/Sell 3/0/0 Slater & Gordon has acquired Quindell's professional services division, which operates in the UK and includes personal injury legal services business. The acquisition means the company becomes the largest UK player in personal injury, with a market share of 12%. UBS maintains its investment thesis but considers the acquisition-driven growth opportunity has diminished and organic growth must become the driver.

In the not so good books

Credit Suisse downgraded Navitas (NVT) to Underperform from Neutral. Buy/Hold/Sell 1/4/2 First semester enrolments disappointed the broker, as growth of 3.0% represented a significant slowdown from the 7.0% growth in semester three of 2014. Credit Suisse had previously not factored in any impact from the forthcoming loss of the SIBT contract in 2016 but it appears some withdrawals have been brought forward. The broker suspects guidance is beginning to look out of reach, although the company reiterated its earnings forecasts for FY15.

UBS downgraded Westpac to Neutral from Buy. Buy/Hold/Sell 1/5/2 Although banks appear expensive in absolute terms, relative to low bond yields and term deposit rates, they appear relatively attractive. The broker considers the banks still fairly priced relative to industrials. Banks may remain expensive or even rally further, provided earnings fundamentals remain intact, but they remain highly sensitive to any change in the macro environment, in UBS' opinion.

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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Short n' sweet – MYOB is no Xero

by Penny Pryor

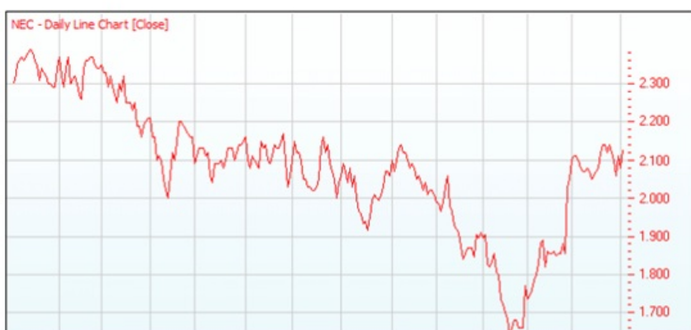
On our sister publication – *Switzer Daily* – *Switzer Super Report* expert Paul Rickard has today written about the upcoming MYOB IPO and what he thinks about it.

With an expected price of between $3 to $4, Paul writes that it would be too expensive for him at the higher end of that bracket.

"MYOB is forecasting a NPATA (Net Profit after Tax and adding back the tax effect of amortization expenses) of $90.3 million for the 12 months ending June 2016. This number is based on tight cost growth of less than 2% over the previous year, and revenue growth of just under 9%," he says.

"At a price of $3.00, this puts the company on a multiple of 20.9 times. At $4.00, the multiple is 24.9 times."
You can read the full story here. He also has some interesting comment as to why he might be one of the few voices that are not so positive on the float.

But before you start to think Paul is unnecessarily pessimistic, take a look at his track record on the big IPO calls.
In November 2013, he concluded that the Nine Entertainment IPO wouldn't rate – and it hasn't.



"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," he said then.

Paul also wasn't that impressed with the Medibank IPO – but did buy some shares.

"Despite this IPO being overpriced at the top end of the range, this is still a government privatisation and the first from the Abbott government. It is hard to imagine the government wanting to disappoint circa 1,000,000 shareholders (voters)," he said.

The FN Arena brokers also have it trading at a 5.3% discount to its consensus target price and at $2.37, it isn't that higher than its listing price of $2.21.

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Can you stuff your mattress with SMSF cash?

by Tony Negline

Legions of investors love cash.

I don't mean money deposited with the bank or old currency that's classed as a collectible. I mean notes and coins that are current legal tender.

For some, their love of cash is cultural. For others, it might be the feeling of safety or power that piles of cash gives them. For example, they might think the financial system will imminently come crashing down and don't want to lose their deposits if their bank collapses. Or alternatively, they might be keen to avoid a mooted bank deposit tax.

If you want your super fund to have "folders" or "readies", as some London east-ender scallywags might say, can you store these SMSF cash holdings at home or at your business premises? Or do you need some other location?

Well, as with all these issues, the first place to look is your fund's trust deed. I would be surprised if it didn't allow you to hold currency but don't assume I'm correct – just check this document!

In addition, there are several aspects of the super laws to consider:

1. Trustee covenants – these are over-arching attitudes that you're expected to have when running your super fund; for example, act honestly, be prudent, create and implement an investment strategy and act without bias towards any fund members and so on.
Would most people think it prudent to have super fund money under your bed? I don't think so, but maybe a fireproof safe or other similar storage facility might be more suitable.

Where would a prudent person think it best to hide the lock and/or its combination? I don't think with all your fund's paperwork would be a good place, or in typical places that thieves look, such as under a pot plant or your sock draw.

I would imagine a prudent person might think holding some sort of insurance policy on the loss of the money, due to fire or water damage or theft, would be a good idea.

Next comes the investment strategy – your fund's investment strategy needs to cater for holding physical currency. Obviously, the lack of any return on this money needs to be considered.

There are no specific penalties for breaching trustee covenants, however, a breach of these might cause problems in defending any legal action taken against a trustee.

2. Sole purpose test – this says that any benefit you obtain from your fund prior to retirement must be incidental. I think some people would find the temptation not to use their fund's cash holdings for personal reasons almost irresistible. Therefore, to help prevent problems, you might keep a listing of all serial numbers of the currency held by the fund. Despite the fact collating this information might be a painful exercise, especially if the notes are randomly numbered, it might be a job you're effectively forced to complete. Each year, your fund's auditor – as an easy way for them to confirm the notes still exist – may want to check that random numbers of notes are still in your possession and continue to be stored in an appropriate manner.

3. Is currency an asset under the super laws? – under the super laws, yes it is, but does the same apply in your fund's trust deed (see above)?

4. Artwork and collectible rules – currency that is legal tender isn't a collectible, like currency that has

been withdrawn from circulation. Collectible assets purchased after June 2010 can't be stored at your home. Given that current bank notes aren't collectibles, this rule won't apply in this case.

5. In-house assets test – this says that only a small portion of your fund's assets can be personally used. Unless you use some of the fund's bank notes for your own or business purposes, even on a temporary basis, I can't see this rule applying to cash holdings.

6. Financial assistance to members or their relatives – this is generally prohibited so even using a small amount of money would be a breach of this rule.

7. Where can you store your fund's cash? Here are two ideas – a fireproof safe in a storage facility or in a safety deposit box at the bank you think might be about to go bust!

There is one final aspect about notes and coins – if your fund wants to use more than $10,000 at any point in time, for example to purchase an asset, then that transaction will have to be reported to AUSTRAC because of anti-money laundering and terrorism financing rules.

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.*

The best admin providers and tenants-in-common

by Questions of the Week

Question: I was looking over your list of service providers for SMSFs and noticed the enormous difference in fees for services provided. Can there really be such an enormous variation in the quality of the service provided?

Answer (By Paul Rickard): There can – it really depends on what services you want.

If you have an SMSF with relatively straightforward investments (listed securities, cash, maybe managed funds), then you can usually get a pretty good deal. Things that will lower the price from the provider include:

- Listed securities only
- Using (if they have one) their preferred bank account
- Members in the same phase
- Corporate trustee

The provider's price will increase if you have:

- Unlisted investments (property, collectibles, private unit trusts)
- Members in different phases
- Pre-existing capital gain tax issues

It's very much worth shopping around – and consider all the fees (service, transaction, exit, etc.) carefully.

Question 2: Can my family trust buy a residential investment property with my super fund as tenants-in-common? Can my family trust finance its share through a loan, while my super fund pays for its share in cash?

Answer 2 (By Tony Negline): Yes this can be done, as long as the property purchased isn't used for security over the loan. There should also be an owners' agreement detailing responsibilities and actions and what happens when either party wants to exit the investment. Finally, the property can't be rented to relatives or related parties.

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Did you know?

The tide might be turning for small caps? My colleague Paul Rickard and I explain why current economic conditions may start to work in their favour.