Switzer Super Report

Thursday 9 July 2015

The trend is your friend

After his appearance at our webinar last week (which you can listen to here) Charlie Aitken today has his first article for us as a fund manager. You know he likes Australia for income and the rest of the world for growth, and today he's got some suggestions for shares to nibble at, like Westfield Corp, Brambles, Macquarie Group and CSL.

If you've already got a property in your SMSF, you need to read property guru Margaret Lomas' property tax tips for a new financial year. And if you've just started thinking about investing in one, check out our *Questions of the Week* where we look at the best mortgages.

Also in the *Switzer Super Report* today, *Short n Sweet* has a preview of next week's update of Tony Featherstone's takeover potential list – we've had Vision Eye Institute in there for months – and in *My SMSF*, Kathy Evans from Albury, explains the asset allocation that has seen her fund return 10% per annum for 15 years!

Sincerely,

Peter Switzer

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In volatility there is opportunity – time to nibble on the edges

by Charlie Aitken

Key points

- *The current currency trend is your friend. Currency cycles are the longest cycles of all.*
- *Don't buy resource stocks for yield. The hedge fund shorting world could gang up on the likes of BHP if they think the yield is unsustainable.*
- *On weak S&P/ASX 200 index days, try nibbling on Australian industrial reliable dividend payers and key US dollar earners like Westfield Corp, Brambles, Macquarie Group and CSL.*

The global cross-asset class volatility I forecast has well and truly arrived, and thankfully in my new role as a fund manager I have entered this period with a blank sheet of paper.

This week alone we have seen huge intraday moves in currencies, commodities, bonds and both domestic and global equities. This is a serious pick up in volatility driven by the Greek "no" vote and a violent correction in Chinese equities.

US dollar power

In these moments the world heads straight back to the US dollar as a safe haven. That is the only certainty in all this and the US dollar Index (DXY) is about the only "green" on the screens. Gold isn't even working due to the expectation of rising US interest rates.

I remain a major structural bull on the US dollar. That clearly has negative ramifications for anything denominated in US dollars such as the euro, NZ dollar, Australian dollar and commodities.

Unfortunately for the Australian dollar it now faces the perfect storm of a rising US dollar and collapsing commodity prices driven by over-supply/falling Chinese demand. The next negative for the Australian dollar will be its relative and absolute yield premium to the world being cut.

I continue to believe the RBA will be forced to cut cash rates in the second half of 2015 as our key export prices collapse (and stay down). **I continue to target a 1.50% cash rate and 65 US cent Australian dollar (AUD).**

The AUD/USD cross rate is really about interest rate differentials. At 106 US cents the Australian cash interest rate premium to the US was 4.50%. At 74.50 US cents today the cash interest rate premium to the US is 2.00%. I am predicting that premium to fall to 1.00% over the next 18 months as the Fed raises cash rates to 0.5% and the RBA cuts ours to 1.50%. If I am right and the cash rate premium narrows to 1.00%, then you can be certain the Australian dollar will have a six in front of it.

This is important for all Australians and one of the key reasons I set up my global absolute return fund. I am trying to help you get some money out of here to protect your wealth in global dollars. The AUD/USD is already down -9% in 2015 and very few Australian's are benefitting from that fall due to a massive "home bias" asset allocation in favour of Australian assets in Australian dollars.

The key to long-term performance is a balanced asset allocation strategy. Volatility equals opportunity but volatility also increases risk. A balanced approach to asset allocation is essentially a risk minimisation strategy. This is particularly important for the majority of self-managed super funds where asset classes are predominately weighted to domestic equities.

Rest of the world for growth

You know the way I approach asset allocation: Australia for income, rest of world (ROW) for growth. The ROW for growth can simply mean being parked in US dollar cash and generating capital gains on my cash that way. US dollar cash returned 14% from mid last year to Australians and to me looks on track to return that again (or more) in 2015.

One of the very first things I have done for my fund is start moving to US dollar cash. I think the fundamentals and technicals (key support broke at 75.50 US cents) are aligned for further AUD/USD falls. On a risk reward basis I see far greater downside than upside in AUD/USD and that is why I have started allocating to US dollar cash, even at a 6-year low in AUD/USD. The trend is your friend here. Currency cycles are the longest cycles of all.

While the falling Australian dollar has clear and ongoing ramifications for asset allocation and stock selection in Australian (US dollar earners ex resources), the good news is a lower currency will eventually be good for the Australian economy. In the short term however, history shows that the prospect of further falls in the Australian dollar will deter foreign investors who invariably wait for the "currency knife to stick in the floor" before committing new investment funds.

If I am right and the Australian dollar does get a "six handle" then the ramifications for migration, population growth, inbound tourism, manufacturing, agriculture, residential property and even commodity producers are positive. We simply need a lower currency to help drive our global competitiveness and GDP growth. At this moment in time Australia is lacking growth and a lower currency would clearly help our GDP growth forecasts.

However, in the interim there is going to be continued commodity price and equity price volatility.

Reporting season outlook

I still believe the pending Australian reporting season (ex-resources) will be solid and have faith that earnings and dividends from banks, insurers, REITs, building, materials, telcos and infrastructure stocks will be solid. I remain a supporter of Australian reliable dividend income stocks as we head towards lower cash rates.

The only difference between my fund and most Australian investors is I can own these reliable dividend income streams, yet have the ability to swap out the Australian dollar currency risk into US dollars. I can also write call options against my Australian dividend income stocks to enhance the yield one more notch.

One thing I must warn you about is NOT BUYING RESOURCE STOCKS FOR YIELD. The commodity prices we see in front of us today will lead to consensus earnings and dividend downgrades for FY16. That is for certain.

What that means is the prospective resource sector dividend yields we see in front of us today are wrong. They are too high and I strongly encourage you to be cautious buying any Australian resource stock purely for dividend yield. Those dividend yields are unsustainable.

That includes BHP Billiton which, by my calculations on today's iron ore, coal, copper and oil prices, will have to borrow money or continue to cut capital expenditure (lowering future growth) to keep paying their progressive US dollar dividend. Borrowing to pay dividends is not a good look, even if the borrowings are quite small. Just be a little careful here because the hedge fund shorting world could gang up on BHP if they think the yield is unsustainable. Personally I'll be waiting for a better buying opportunity in BHP later in the year.

However, as I always say "in volatility there is opportunity". On weak S&P/ASX 200 index days I'd encourage you to nibble on Australian industrial reliable dividend yield payers and key US dollar earners (Westfield Corp, Brambles, Macquarie Group, CSL, Magellan Financial, Platinum Asset Management etc). I'd also be encouraging you to move some money to US dollar cash.

No doubt we are in a tricky period. There is very high global cross-asset class volatility. It is a time to be sensible, disciplined, yet contrarian at the right time.

I hope I can do exactly that as a fund manager.

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Your SMSF property checklist for the New Financial Year

by Margaret Lomas

Key points

- *Make sure your property has a depreciation report done on it.*
- *Revisit your loans and speak to your lender about the current interest rate on your investment loans.*
- *Review the performance of your property managers and if they're not shaping up, it might be time to ship them out.*

The new financial year means many things to many people, but for property investors it's a good chance to get ready for the coming 12 months, and ensure you head toward the next tax period ready to go! Rather than carry over any bad habits, or continue your shoebox filing system, take the chance now while the year is young to get organised!

With our lives following an ever increasingly busy pathway, the temptation to set and forget with regards to property investing in your SMSF is a hard one to overcome. While everything seems to be going smoothly, there's no point in upsetting the balance, right?

Wrong. Once a year all prudent investors and SMSF trustees should pull out the investment scrapbook, clean off the dust and ensure that everything is as it should be.

Here are just a few of my tips as to what you need to be doing, right now:

1. If you haven't already done so, make sure that all of your properties have depreciation reports on them. Even older properties often still contain many depreciable items, and usually the tax-deductible cost of having one prepared will be considerably less than the additional deduction you receive.
2. Do a rental review – check when your leases are coming up for renewal, and schedule in your diary a phone call to your property managers for one month prior to be sure you are always at market rent. Remember, a rental increase of $10 a week is only worth about 70 cents to your manager, and so it is not as important to them as it is to you. Even if rents are largely the same I find that a tenant won't move out for a $5-10 a week increase.
3. Consider any repairs and maintenance that need to be done so that a maintenance plan can be established to cover the entire year. This way your cash flow can be better managed by attending to the most urgent repairs immediately, and spreading the rest out over the year. Have your property manager do an inspection and provide you with a list of suggested repairs – some managers are better than others on this, so be sure you get onto it and have one done.
4. Review the performance of your property managers. How long have vacancy periods lasted? How good was the communication between the manager and you? Have they been pro-active in suggesting rental increases? Do they attend to requests for maintenance in a timely fashion? If not, maybe it is time to terminate and try a new manager.
5. Check local values and perhaps book to have a revaluation done on all of your properties. If you have more than one property, you only need a small increase in the value of each to create enough to give you a deposit for another property.
6. Revisit your loans and speak to your lender about the current interest rate on your investment loans. Few people negotiate this area well and I have, in the past, negotiated discounts of well over 1% off the current

variable for most of my clients. On a larger portfolio, a good interest rate discount can really boost your returns.

7. Ensure that you have started the current financial year more organised than you were last year! The more properties you acquire, the harder it gets to track the financial details of each of them, and the more costly it is to have your accountant sort through the mess at tax time. Start the year with an organised approach to your property accounting, and use an online tool like Destinylive® to track everything, so you can throw away that shoebox!
8. Make a decision early in the year about any properties that you might be thinking about selling, and ascertain what the resulting capital gains tax might be. This is because if you are thinking of selling a property with a potential gain and one with a potential loss, you want to sell the one with the loss first. Capital losses can be carried forward over future tax years to offset against future capital gains, but capital gains cannot be carried over and must have a loss elsewhere in the same year to be reduced. Those wishing to sell should have a carefully thought out and timed plan to do so.

Don't forget to review the entire portfolio. Some properties may have already had their best period of performance and it could be time to sell. Others may not have performed as you had hoped and if there is no sign of a potential change, it could be time to cut your losses. All properties within your SMSF should be reviewed every year to ensure that they are delivering a suitable return. Properties which do not perform and which exist in areas where suitable growth drivers cannot be identified should be cut loose sooner rather than later, and a better performer chosen to replace it.

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Buy, Sell, Hold – what the brokers say

by Staff Reporter

In the good books

UBS upgraded AWE (AWE) to Buy from Neutral. Buy/Hold/Sell 4/2/0 The company's Sugarloaf reserves have increased by 84% and UBS increases valuation for this high quality shale play by 16%. There is more upside if the drilling rate picks up or the potential of the upper Eagle Ford is further delineated.

JP Morgan upgraded Caltex (CTX) to Overweight from Neutral. Buy/Hold/Sell 3/3/1 Rating was upgraded as further analysis has shown continued upside from cost savings and other items, while capital management remains a key driver for share price performance. The analysts emphasise there's a significant business repositioning taking place and recent share price weakness has made entry point to gain access more attractive.

Credit Suisse upgraded NIB Holdings (NHF) to Neutral from Underperform. Buy/Hold/Sell 1/5/0 The company has acquired travel insurance distributor, World Nomads, primarily funded by debt. Credit Suisse estimates the acquisition will be 3.1% accretive in FY16 and 3.6% accretive in FY17. The acquisition fits with the company's strategy of diversifying the earnings base and providing growth opportunities in complementary areas.

In the not-so-good books

Morgans downgraded Woodside Petroleum (WPL) to Reduce from Hold. Buy/Hold/Sell 2/2/4 Morgans is worried about retail investors not yet having caught up with the fact that Woodside's interim dividend is about to take a dive, given lower oil prices are translating into lower profits and lower cash flows for the company. This, combined with a tepid growth profile, keeps the stockbroker at bay even though Woodside is liked as a high quality business.

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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My SMSF – an opportunity to invest in unlisted assets

by Kathy Evans

Name: Kathy Evans
Age: 49
Family: Husband Gary, aged 50 and a member of the SMSF, and two teenage children (not members).
Where do you live? Albury/Wodonga

How long have you had your SMSF?

Since 2000

Why did you start it up?

I wanted more control over our superannuation and more active involvement in its ongoing management. I also wanted to invest in property/unlisted investments, which we couldn't do through an industry superannuation fund.

How big is it?

It's approximately $1,000,000.

Is it more or less difficult to manage than you thought it would be?

We find it easy to manage. This is helped by using a financial planner and having on-line access to investments. Very glad we have it.

Are you pleased with its performance?

We're very pleased with how our fund is tracking. It returns in excess of 10% per annum consistently.

What is your asset allocation?

Asset allocation	
Domestic Equities	32.1%
International Equities	8.0%
Cash	3.5%
Unlisted Property Trusts	56.4%
Equities breakup	
Banks	36.0%
Resources	13.5%
Health	16.5%
Large Companies	18.9%
Infrastructure	6.1%
Smaller Companies	9.0%

What are your favourite investments/stocks and why?

Unlisted property trusts because they have good returns and we get the chance to have some investment in commercial property through this structure.

Do you use an adviser or any kind of service provider?

We use a financial planner and insurance adviser.

What investments do you have outside of superannuation?

Listed shares, property, and business investments.

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Short n Sweet – takeover time

by Penny Pryor

Takeover activity has been heating up in the Australian market, despite the goings on in Greece and China.

The latest activity was an unsolicited bid by Pulse Health for Vision Eye Institute, which we'd like to point out, is on the list of takeover targets that Tony Featherstone puts together for the *Switzer Super Report*.

The bid from Pulse of 1.60 fully paid ordinary shares in Pulse for every share in Vision valued the company at $162 million at the time of the offer early this week. Vision is yet to release a target statement, but there could be more activity around this bid.

As the table below shows, Reva Medical has been the biggest contributor to our takeover target portfolio's overall return but iiNet, also subject to takeover offers, Nearmap and Onthehouse holdings have been big contributors as well.

"I thought Reva had great prospects when it listed in December 2010 through an IPO but I am always wary of valuations of offshore technology companies that choose to list on ASX rather than US exchanges. Reva has interesting heart-stent technology and must look interesting to a bigger US player that could do more with its technology," Tony said in February.

Tony will be updating the takeover potential list next week and as the table below shows, it is still outperforming the index despite a few laggards like Ensogo and Santos.

		1-year price performance
Reva Medical	RVA	217.24%
Nearmap	NEA	30.12%
iiNet	IIN	28.24%
Onthehouse Holdings	OTH	27%
NIB Holdings	NHF	9.26%
Automotive Group Holdings	AHG	7.57%
Reckon	RKN	4.98%
Vision Eye Institute	VEI	4.05%
Australian Agricultural Company	AAC	0.40%
OzForex Group	OFX	-18.50%
Monash IVF Group	MVF	-29.76%
Ten Network Holdings	TEN	-29.83%
AWE	AWE	-31.32%
Santos	STO	-47.76%
Ensogo	E88	-56.94%
Average portfolio return		**7.65%**
1-year return S&P/ASX 200		**-0.65%**
New additions in May		
Myer	MYR	
OrotonGroup	ORL	

** Performance to 9 July 2015*

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The case of the missing trust deed

by Tony Negline

"I can't find my SMSF trust deed. What should I do about this?" There aren't too many SMSF administrators who don't have to deal with an email or phone call that starts along these lines on a regular basis.

Unlike other some other trusts, you can't run an SMSF without a written deed.

One of the most important jobs that SMSF trustees have to do is always obey the terms of their trust and these terms are set out in the fund's trust deed.

This means that without a trust deed you'll probably be materially confused about how to run your fund.

So in short, a lost trust deed must be replaced. What steps do you need to follow?

Here are some popular solutions:

- Fully amend the deed – this is the most common solution. If you can prove the fund existed (via tax returns, financial accounts etc), then you solve the lost trust deed problem by taking on a whole new set of rules. There are several problems with this option, including your ability to prove that your old trust deed allowed you to adopt a new set of rules. On the whole most people ignore these problems.
- Find it – looking and looking again is a great idea; you should also check with a range of people such as current and past accountants, lawyers, auditors, financial planners, banks and the ATO.
- Other evidence the trust exists – you might have a copy of the original deed and this might be evidence that a trust existed. Your behaviour as trustee and your copy of the deed can sometimes convince relevant third parties that the trust exists. These third parties typically want to make sure you as trustee can't get out of any legal obligations, and that a Court will support their view of the state of the trust. Commonwealth and all States and Territories have legislation in place that allows an electronic copy of a document to be deemed to be an actual document if another party consents to its use.
- Provide a verifiable copy – You can sometimes obtain an exact copy of your trust deed by approaching the law firm that supplied it. In effect you would be producing a certifiable reproduction of the original trust deed. In some States and Territories this new document has to be lodged and you will have to pay nominal stamp duty before it's recognised as your fund's trust deed.

If none of the above are appropriate or possible, you may have to resort to some of the less popular solutions such as:

- Ask a Court to assist you – this has a total cost of about $20,000 in legal work and for most people won't be a useful solution.
- Close down the existing trust and immediately create another one – this is often referred to as resettling the trust. This often creates capital gains tax and stamp duty problems and most SMSFs wouldn't elect to use this option.
- Wind up the trust – this option also isn't popular because of potential CGT and stamp duty payable. One problem with this option is that the rules for winding your fund are in the lost trust deed. So it can be impossible to know your obligations or what process to follow to wind up the trust.

A lost trust deed is very inconvenient and costs

money to fix. The best thing is to not lose it in the first place. One way of doing this is to make use of electronic document suppliers who can store and keep copies of all your fund's documentation.

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Chinese shares and SMSF mortgages

by Questions of the Week

Question: Should I sell the AMP Capital China Growth Fund (AGF) shares I purchased in June?

Answer (By Paul Rickard): AMP Capital put out a statement this morning that said that 19 of the 80 stocks in AGF were currently in a trading halt. They also say that its NAV as at 29 June was $1.83. Today, it is trading at $1.11.

I calculate that the Shanghai Composite has fallen by 14.5% since 29 June, and the Shenzen A Share index by 19.9%.

I don't pretend to have a crystal ball on the Chinese share markets – or contemplate the next steps that the Chinese Government may take to try to stop the rout.

However, on the basis of the fall and considerable discount that AGF is trading at, I wouldn't be a seller at these levels.

Question 2: I am loving your site as it has a wealth of information on setting up and running an SMSF. I have a newly set up SMSF and am committed to a property purchase within the fund. I am currently looking to arrange the finance. Do you have a current article on SMSF lenders? My research so far shows State Custodians have the best variable rate of 5.09% while Bank of Queensland has the best fixed rates of 4.29% for three years and 4.59% for one, two, four and five years.

Answer 2 (By Paul Rickard): No, we haven't published a more recent update on SMSF lenders because the talk has been that the Government will move to restrict or ban it (prospectively, not retrospectively). You may recall that this was one of the recommendations from David Murray's Financial Systems Inquiry. The Government is shortly expected to announce its response to the Inquiry's recommendations.

Recent changes I am aware of include both NAB and ANZ pulling out of this market, partly in response to APRA clamping down on investment lending for housing.

State Custodians is certainly a player, as is BOQ, which has some of the best fixed rates. I would also look at AMP and St George.

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