Switzer Super Report

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Best of the best

Last year was a good year for the market and *Switzer Super Report* subscribers. The ASX 200 ended up 15% and I think after a few bumps at the beginning of this year, we're on track for another 10% rise in 2014.

One of most read articles over the last year was the introduction of our growth-based stock portfolio on 14 January. We introduced this stock portfolio following the success of our income-oriented portfolio.

Also today, I wanted to share with you what we do with our Switzer family SMSF. The history of our fund, and how we decide our asset allocation, is our *My SMSF* for today. You can also check out our end of year clean-up here.

Thanks for all your support in 2013 and here's to another fabulous year in 2014.

Sincerely,

Peter Switzer

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Portfolios hold ground in November

by Paul Rickard

In the first down month for the share market since May, our income and growth-oriented portfolios largely held their ground in November. Both portfolios increased their relative outperformance to the benchmark indices.

Portfolio recap

In January, we made some adjustments to our Australian share 'Income Portfolio', and introduced a 'Growth-Oriented Portfolio' (see here and here)

The income portfolio is forecast to generate a yield of 5.23% in 2013, franked to 98.3%.

To construct the income portfolio, the processes we applied included:

- using a 'top down approach' and introducing biases that favour lower PE, higher yielding industry sectors;
- to minimise the market tracking risk, adopting a rule that says that our sector biases in the major sectors (financials, materials and consumer staples) will not be more than 33% away from index;
- identifying 15 to 20 stocks (less than 10 is insufficient diversification, over 25 becomes too hard to monitor), with a stock universe confined to the ASX 100;
- within a sector, weighting the stocks broadly to their respective index weights, although there are some biases; and
- of course, we looked for companies that pay franked dividends and have a consistent earnings record.

The growth-oriented portfolio takes a very different approach to the sectors in that it introduces biases that favour the sectors that we judge to have the best medium term growth prospects. Critically, it also confines the stock universe to the ASX 100 (there are many great growth companies outside the top 100).

Performance

The income-oriented portfolio to 29 November is up by 23.11% and the growth-oriented portfolio is up by 25.57% (see tables at the end). Compared to the benchmark S&P/ASX 200 Accumulation Index (which adds back income from dividends), the income portfolio has outperformed by 3.8% and the growth-oriented portfolio has outperformed by 6.3%.

	31-Dec	29-Nov	Change
S&P/ASX 200	4,649.0	5,320.1	**14.44%**
S&P/ASX 200 Accumulation Index	37,134.5	44,285.13	**19.26%**
Income Portfolio	$100,000	$123,112	**23.11%**
Growth Oriented Portfolio	$100,000	$125,571	**25.57%**

All sectors down in November

All sectors went backwards in November, with Energy the standout at -6.3%. With three of the major banks going 'ex-dividend' during the month, the Financials sector arguably performed the strongest. Although its price index lost 1.3%, the accumulation index for financials finished mildly positive — adding 0.2%.

On a calendar year-to-date basis, the major yield sectors continue to lead the way – with Financials up 29.3%, Telecommunications up 16.8% and Consumer Staples up 11.4%. Consumer Discretionary, which includes companies as diverse at 21st Century Fox, Crown and JB Hi-Fi, leads the way at 34.1%. The materials sector is the only sector in the red at -5.9%.

	Sector Weight	November	YTD
S & P /ASX 200		-1.9%	14.4%
Consumer Discretionary	4.5%	-1.4%	34.1%
Consumer Staples	8.2%	-2.9%	11.4%
Energy	5.8%	-6.3%	6.3%
Financials	38.6%	-1.3%	29.3%
Health Care	4.6%	-0.4%	22.1%
Industrials	6.4%	-3.6%	9.7%
IT	0.7%	-1.4%	22.7%
Materials	17.4%	-0.7%	-5.9%
Property Trusts	7.0%	-2.8%	4.4%
Telecommunications	5.1%	-2.6%	16.8%
Utilities	1.6%	-3.1%	2.3%

Income Portfolio

The income portfolio is overweight financials, consumer staples and telco, and underweight materials. It remains within the portfolio sector rules (see above), with Financials representing 49.5% of the portfolio by market value on 29 November (effectively overweight with 1.28 times the sector weigh), and Materials 14.5% of the portfolio (effectively underweight at 0.84 times the sector weight).

With all companies having declared their final dividends for the year, the portfolio has exceeded its income objective, returning 5.55% compared to a forecast yield of 5.23%. This is largely due to the higher than expected dividends paid by the major banks. The franking percentage is marginally below forecast at 96.3%.

Details of the portfolio and its performance are listed on the following page.

Growth-oriented portfolio

The growth-oriented portfolio is overweight stocks in the materials, energy and healthcare sectors, underweight financials and consumer staples, and broadly index weight the other sectors. It has benefitted from some stock biases, particularly an overweight position in NAB, and the selection of Crown, Brambles and Toll.

At the end of October (see here), we reduced some of these stock biases by:

- Selling the BOQ holding (up 64% this calendar year), and re-invested these funds into Commonwealth Bank;
- Selling 25% of the NAB holding – and reinvesting these funds into Westpac shares.

The portfolio at 29 November is on page 6.

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Income Portfolio

Sector	Stock	Price 31/12	Value 31/12	Price 29/11	Value 29/11	Profit/ Loss	Income*
Consumer Staples	Coca Cola	$13.45	$2,500	$12.09	$2,247	-$253	$115
	Wesfarmers	$36.85	$4,000	$42.92	$4,655*	$655	$195
	Woolworths	$29.33	$4,000	$33.69	$4,595	$595	$181
Energy	Woodside	$33.88	$3,000	$37.40	$3,312	$312	$192
	Origin	$11.62	$2,500	$13.95	$3,001	$501	$108
Financials	ANZ	$25.05	$10,000	$31.90	$12,735	$2,735	$655
	CBA	$62.18	$10,000	$77.82	$12,515	$2,515	$585
	NAB	$25.00	$12,000	$34.58	$16,598	$4,598	$912
	Westpac	$26.04	$13,000	$32.88	$16,415	$3,415	$969
Health Care	Primary	$4.00	$4,000	$5.00	$5,000	$1,000	$175
Industrials	Brambles	$7.51	$2,500	$9.51	$3,166	$666	$90
	Toll	$4.56	$2,500	$5.72	$3,136	$636	$148
	UGL	$10.88	$2,500	$6.45	$1,482	-$1,018	$90
Materials	BHP	$37.10	$12,000	$37.39	$12,094	$94	$388
	Rio Tinto	$66.01	$5,000	$66.06	$5,004	$4	$140
Telco	Telstra	$4.37	$7,500	$5.06	$8,684	$1,184	$481
Utilities	AGL Energy	$15.38	$3,000	$15.01	$2,928	-$72	$123
			$100,000		**$117,567**	**$17,567**	**$5,546**

* Income includes dividends declared and payable. Wesfarmers includes capital return of 50c per share, consolidation to 0.9876 new shares

Growth-Oriented Portfolio

Sector	Stock	Price 31/12	Value 31/12	Price 29/11	Value 29/11	Profit /Loss	Income*
Con Discret	Crown	$10.67	$4,000	$16.90	$6,336	$2,336	$139
Consumer Staples	Wesfarmers	$36.85	$4,000	$42.92	$4,655*	$655	$195
	Woolworths	$29.33	$2,500	$33.69	$2,872	$372	$113
Energy	Origin	$11.62	$2,500	$13.95	$3,001	$501	$108
	Santos	$11.10	$2,500	$14.00	$3,153	$653	$68
	Woodside	$33.88	$4,000	$37.40	$4,416	$416	$255
Financials	ANZ	$25.05	$7,000	$31.90	$8,914	$1,914	$458
	CBA	$62.18	$7,000	$77.82	$8,761	$1,761	$410
	CBA (New)	$76.08*	$4,931	$77.82	$5,043	$113	$0
	NAB	$25.00	$6,000	$34.58	$8,299	$2,299	$456
	Westpac	$26.04	$6,000	$32.88	$7,576	$1,576	$447
	Westpac (new)	$34.29*	$2,825	$32.88	$2,709	-$116	$81
Health Care	CSL	$53.90	$3,000	$68.73	$3,825	$825	$59
	Primary	$4.00	$3,000	$5.00	$3,750	$750	$131
	Ramsay	$27.28	$3,000	$38.74	$4,260	$1,260	$78
Industrials	Brambles	$7.51	$3,500	$9.51	$4,432	$932	$126
	Toll Holdings	$4.56	$3,000	$5.72	$3,763	$763	$178
Info Tech	CPU	$8.99	$3,000	$10.89	$3,634	$634	$93
Materials	BHP	$37.10	$14,000	$37.39	$14,109	$109	$453
	Orica	$25.07	$3,000	$23.18	$2,774	-$226	$112
	Rio Tinto	$66.01	$7,000	$66.06	$7,005	$5	$196
Telco	Telstra	$4.37	$4,000	$5.06	$4,631	$632	$256
Utilities	AGL Energy	$15.38	$3,000	$15.01	$2,928	-$72	$123
					$120,848	**$18,092**	**$4,535**
Realised							
	BOQ	$7.35	$3,000			$1,931	$114
	NAB	$25.00	$2,000			$825	$74
			$100,000		**$120,848**	**$20,848**	**$4,723**

* Income includes dividends declared and payable. Wesfarmers includes capital return of 50c per share, consolidation to 0.9876 new shares. CBA and Westpac prices at 31/10/13

My SMSF – Maureen Jordan Switzer

Super Report Subscriber

Name: Maureen Jordan Switzer
Age: Forever young (I'm a Baby Boomer)
Other members of your SMSF: My husband, Peter (Switzer) and our two sons.

How long have you had your SMSF?

We started it about 10 years ago when our sons joined us in our business.

Why did you start it up?

We were unhappy with the charges and the performance of retail super funds, and we could see enormous advantages in being in control of our investments. Clearly, super is a very tax-effective way to gain exposure to the stock market, and an SMSF gave us an opportunity to give us the asset mix in our portfolio that suited both our appetite for risk and what we prefer to invest in to build wealth. We were also intending to offer the same solutions for the right clients who came to our financial planning business. And we thought it was a great way to get our two sons more involved in a critically important wealth generation issue all young people need to be engaged with.

How big is it?

It is a significant amount of money designed to give my husband and I sufficient cash drawings when we eventually decide to retire, which is some time off at this stage. From the point of view of our sons, the SMSF will be a fantastic vehicle for them when they retire and as parents it is very comforting to know that there will be a wonderful legacy left for your children of which they have also had a part in building.

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

Given our background in the finance industry, we were aware of the obligations – especially administrative ones – and so we put in place a system that ensures the necessary work is completed according to the rules. As a group, we love the investing side, because we understand the companies and other assets we invest in, and so all we needed to do was to create an efficient system to make sure all the I's were dotted and the T's were crossed. It adds to costs, but they are tax deductible inside the fund, and it means we can concentrate on making money for the fund.

Are you glad you have it?

Definitely, as it has meant that we have bought great companies we like when share prices were low and conventional fund managers might have played it cautiously as they are publicly accountable. From early 2009, Peter was publicly advising that stocks would make a comeback and so we put our money where Peter's mouth was, so to speak!

Are you pleased with its performance?

The performance has been solid with our returns beating the index on a 1, 3 and 5-year basis. That's not surprising, as we have had a 'buy the dips' strategy.

What is your asset allocation?

Since 2009 we have been fully invested in stocks, as we have a high-risk profile and we don't intend to retire for some time. We were invested in Aussie stocks as we did not want to have a currency hedge issue and we like to invest in great companies selling at attractive prices, which also offer good dividends and franking credits. We keep cash of course for when buying opportunities arise, such as we are seeing right now.

What are your favourite investments/stocks and why?

We play stocks through our SMSF but have three investment propertiess we have held for some time outside of our SMSF. And of course we have our family home. They have all been great investments, once again bought in great areas where there is good capital gain and they were bought quite a few years ago during challenging times for the real estate market.

What investments do you have outside of superannuation?

We were always big fans of property, as the answer above shows, but as we became more mature we started to recognise the value of investing in great companies, which pay solid dividends. We still like property at the right price and the next one will probably be bought inside our SMSF. We've also built up a number of businesses with a considerable workforce. One of these is Switzer Financial Services, and Paul (Rickard) is our partner in this business. These businesses have substantial value but have required a lot of investment of owners' capital to get them to where they are today. That said, we have great delight in investing in our family and staff and seeing great returns!

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

Yes – three! Peter, my son Marty and myself as well are all advisers! Though it's our other son, Alex, whose opinion we definitely listen to as well.

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Getting in doesn't mean I got out

by Peter Switzer

The other week I suggested it was getting close to the time when we get back in, which, not surprisingly, led some subscribers to ask the question: "When did Peter get out and why didn't he tell us?".

The simple answer is: I have not gotten out and that's why I didn't share this advice with anyone.

However, I did use the term "get back in" incorrectly and what I meant to say was that it was "time to do some buying again."

An explanation

Let me explain how I play my SMSF, which I share with my wife, Maureen and my two sons Alex and Marty.

Despite our age difference we have the same high-risk profile and therefore we are heavily invested in stocks. Sure, Maureen and I will one day become more cautious, but my sons, who are 29 and 33 years of age, can be risk-takers for some time yet.

We buy quality companies at low to good prices and sometimes we hold back on our next round of purchases when we think the market has gotten ahead of itself. From about March I was thinking that and regularly told you – my subscribers – that I expected a sell-off or correction was due to happen.

It has happened, and that's why I say we are now in buying opportunity territory but I have also kept stressing the fact that we were down about 8% while the US market was down only 2% or so. I suspected, and I argued it here, that when the Yanks start dumping stocks, no one is going to say: "Oh, the Aussies have had their sell-off and so they won't have to follow Wall Street."

We saw last week that this would be a silly proposition to believe in. Mind you, it is possible that the Yanks won't sell-off deeply because there are a lot of owners of cash on the sidelines, hoping to get into stocks with bonds and other fixed-interest investments looking so unrewarding.

What's the deal?

In other words I'm getting close to buying the local market. However I wouldn't be surprised to see another leg down when the start of QE3 taper begins, therefore I might put half of my cash in now and hold some cash back as my hedging plan.

Alternatively it could be played out over the next few weeks, but it would need a trigger of a shock event or a run of bad economic data. The former I can't predict, while I expect the opposite when it comes to US data – I reckon it will pick up.

So I could wait to see if an uptrend takes hold or I could gamble and buy on some big down days holding back a portion of cash in case my stocks fall further – I am always happy to dollar cost-average stocks I want to hold.

Like Geoff Wilson of Wilson Asset Management, who I spoke to on my Sky Business program last week (you can watch that here) I expect stocks to rise over the next two or more years. But I will get more nervous when interest rates in the USA start to get back to normal levels.

That's when I might opt to go to cash but when that happens, you will be the first to know.

Sorry, if I created confusion with that "get back in" line – blame it on the soporific implications of a week in Turkey, which was a 'riot' and a week on the Greek island of Patmos, which clearly took off my sharp edge.

For more on why Forbes magazine loves Patmos, click here.

Why you need international shares

by Barrie Dunstan

SMSF trustees need to tread a careful path between avoiding the trap of constantly switching shares to follow current fads and of remaining stuck in a portfolio, set perhaps years ago. This particularly is a problem when share valuations are at an extreme and when there might be some significant changes in the market.

Managing potential risks

We don't know when the markets will change – though we can keep an eye out for warning signs – but investors can look at their portfolios' upside and downsides on a "what if?" basis. Banks and institutions do this regularly; it's called risk management.

While Switzer readers have varying share portfolios and allocations, the ATO's figures tell us that, on average, SMSFs have below average or virtually no overseas shares compared with the large institutional funds. These patterns might be explained by risk aversion, following the GFC fright and the persistent high $A relative to the $US, which hobbles gains from US-denominated investments.

But the recent strong performance of the most likely share holdings – the banks, Telstra and BHP – in many portfolios is likely to have increased many share exposures. And, because these six stocks represent about 40% of the index, many funds could have a quite concentrated exposure to the share market. While such portfolios also have produced better returns than cash or short-term fixed investments, there is a greater risk of capital loss, if the share market gets the hiccups.

Realistically, there is a good chance that conditions will change sometime in 2014, when the US Federal Reserve is expected to ease its Quantitative Easing (QE) policy of injecting cash and holding interest rates low. In theory, markets should have built in some allowance for this, but whether markets are prepared or not, the US Fed's action is likely to still affect interest rates, stock prices and the exchange rate.

In addition, the flush liquidity from QE has encouraged investors, with worrying signs emerging of over exuberance at the speculative end of the markets, as evidenced by the rush for Twitter shares. And it's not just in the US; the India share market has been bubbling away and there has been a rush of hot new IPOs from China. All this suggests caution if the Wall Street stock market runs into major adjustments – whether from a rise in interest rates or just a change of investors' mood.

Time for a change

Potentially, however, the biggest impact may come from the foreign exchange markets, if any Fed boost to bond yields lifts the $US in relation to the $A. This would improve local investors' returns from holding US shares. While the gains would depend on the extent of the adjustment, it would reverse the recent pattern, where a stronger $A eroded gains from overseas shares. So the timing might be right for a tactical shift of some equity money from Australia to the US (or even Europe).

This might not entirely solve the problems of some over-priced shares (like local banks) but it would produce some geographical diversification into share portfolios and increase the quality of shares held.

Low-cost Exchange Traded Funds now enable a move into overseas markets via a listed index fund. ETFs are liquid, so investors can act quickly if conditions change. For those seeking exposure to top US stocks, iShares S&P 500 ETF (IVV) is one active fund. For a broader exposure, a SPDR fund based on

the S&P world index, ex-Australia, (WXOZ) gives exposure to 25 overseas stock markets and I gave my broker an order last week to buy some WXOZ.

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Kids and SMSFs

by Tony Negline

I've never been much of a fan of children joining their parents' SMSF. Family disagreements and personal preferences can cause severe problems for an SMSF.

And I've always taken the view that employers who don't pay Super Guarantee contributions after they've been nicely asked to fix the problem now should be reported to the Tax Office.

That's the theory. How have these two views fared in my own life? I regret to say not so well.

Retail or industry super?

My daughter is about to start her second year at university. For the past year she has worked part-time at a local cafe.

Now that she has some income, the issue of employer super has come up. At the rate she's going, it'll take at least five years before her account balance reaches $10,000.

Until she reaches that threshold, by my reckoning, all retail and industry super funds are too expensive. Most industry super funds charge $1.50 per week or $78 per year. They also charge about 0.9% per annum investment management fee. On the face of it, these fees seem pretty reasonable. And in truth given the potential amount invested, we're not talking sheep stations.

But with a $2,000 account balance, these fees are 4.8% per annum. With a $5,000 account balance, total fees are 2.5% per annum.

Super funds offered to the public must be fair to all fund members. Also you would expect that people with lower account balances probably cost more to have on the books than the fees they earn.

Moreover I'm a little unwary of managed funds and those in super in particular. A major part of my concern, which I'll describe in another article is primarily caused by the lack of transparency.

Some retail and industry super funds offer investors the ability to invest directly into Australian listed equities but these products aren't available for small account balances.

Her own SMSF?

I don't think setting up an SMSF for her makes sense. Her account balance is too small so her contributions would be eaten up by fees. In any case, she can't personally afford the setup costs and whilst we, as parents, could fund the establishment, we think this sets a bad precedent. Moreover, she freely admits she doesn't know enough about investing money so having total responsibility isn't really acceptable.

Ultimately the only logical solution seemed to be that she should join our SMSF. She's become our third member and trustee director. We've had to organise the fund's bank account so that all three of us sign cheques.

Extracting SG from recalcitrant employers

Since she started work her employer hasn't been that flash at meeting their SG obligations. I've given her tips on how to quietly get that money out of them. I even asked our accountant to write to me asking where the employer contributions were given the fines that will apply if the contributions aren't made on time. This solved part of the problem.

Her job roster is very flexible and if she pushes too hard she can be frozen out of future work. So hitting the employer hard carries the risk that she'll lose her

job which she can't afford because the employment market for low skill workers is pretty poor.

To make matters worse her employer changed hands and the former owner still hasn't paid anything. We have to find the former owner and make contact with the ATO.

It's a nasty conundrum for her and one that I think is fairly common.

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