Switzer Super Report

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Buyers' market

If there's one thing that's becoming increasingly clear, it's that there's an abundance of investment opportunity in the stock market right now. Not only are many experts pointing to a case for a stock market rally, as I talk about in my column today, but the stock brokers have been boosting their 'buy' recommendations. For the brave, the time to invest is now.

Also in today's Switzer Super Report, Roger Montgomery identifies 10 stocks that have been reliably growing their dividends, Paul Rickard analyses some alternative investments to cash for those looking to shake up their portfolios a little, and Tony Negline explains the seven rules for claiming personal super tax deductions.

Best of luck for the week.

Sincerely,

Peter Switzer

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When to buy the dips

by Peter Switzer

Okay, let's get fair dinkum. Things are not looking great on the stock market and we're all feeling the pain. But what do the experts say long-term investors should do?

That's simple; they say buy the dips! Well, right now is what the dips look like.

We're being dominated by Europe's procrastination about resolving the Greek bailout and European bank exposure problem. But when it finally gets resolved, what will we have left?

Try this for an optimistic take:

- A better-than-expected US economy with the recent run of data pointing to no double dip recession.
- US company earnings possibly could come in better than expected, and I reckon they will be on the strong side.
- US companies have a record US$2 trillion of cash on their balance sheets, which eventually will have to be put to work.

Right now the market isn't trading on fundamentals, but fundamentals will win out in the long run. This is the convincing argument that Robert Froehlich, Executive Vice President and Chief Investment Strategist for Wealth Management at The Hartford, put forward on CNBC recently.

Sure, the critical decider will be the health of the global economy and my guess is Europe will be weak, the USA will be stronger than expected, China will again surprise to the high side and the rest of Asia will deliver reasonable growth.

In a sense, the worst-case scenario is being factored in by stock markets. But we might only get a slightly negative scenario and that sets us up for a big market rally.

We need a catalyst and that can only be Europe coming up with a credible, united approach to managing Greece as well as any other European Union member struggling to meet its debt obligations.

I think better-than-expected US company earnings could be another catalyst and if we put these two together, then it could send stocks up – big time.

Froehlich recognises the unemployment challenge in the US, but he thinks productivity will win out over people and so he is currently favouring tech stocks. However, it all depends on an uptick in the global economy.

Many central banks have been raising interest rates – and that's a good sign that economies are repairing, although the European Central Bank has jumped the gun and a rate cut is coming. This will help Europe and the global economy.

So can we rely on Europe to come through?

Seth Waugh, the CEO of Deutsche Bank Americas, says the EU has the willingness to fix the problem. He says the market wants the "immediate gratification" of a quick solution like we saw in the US after Lehman Brothers failed. The problem is that with 17 countries involved in Europe, it's going to be slower.

"We don't fear the bailout won't happen, but the time could be the issue," he said to CNBC. "Greece is different from the rest of Europe. Ireland now has positive growth."

He made the point that if "the sovereigns are fixed, then the banks will follow."

"Until we get some resolution out of Europe, the market's going to keep bouncing back and forth," Alan Valdes, director of floor operations and VP of trading at DME Securities said. "I don't see any change in volatility either."

And while volatility is here for some time, there will be a turning point from basically down to trending up.

That's why I will be buying the dips. And to back that up, take a look at this from a US expert with a great track record: "We hope to become manifestly, aggressively, stunningly bullish of equities," Dennis Gartman, hedge fund manager and author of *The Gartman Letter*, said in his Monday commentary. "Until then, we are sellers of rallies."

Three alternatives to cash

by Paul Rickard

It is pretty easy to get turned off by the share market at the moment, and while I feel that this is the time for some selective 'courageous buying', many trustees are sitting on the sidelines. So, what are your options for the cash sitting in your SMSF?

Option 1 – Boring old term deposits

With the government set to continue to guarantee up to $250,000 of each depositor's funds on a per institution basis (read, What deposit guarantee changes mean for term deposits), a strong case can be made that the 'name' of the bank or credit union is irrelevant for deposits up to the cap amount. It is important, however, to check out what happens on the maturity date – a nasty practice that some banks still employ is to let the funds automatically rollover to a new term at an uncompetitive carded rate, unless you contact them prior to the maturity date. The current term deposit rates from the major providers are in Table 1.

Table 1: Term deposit rates

	3 months	6 months	1 year	2 years	5 years
Majors					
ANZ	5.50%	5.60% [1]	5.60%	5.80%	5.80%
Commonwealth	5.50%	5.50% [1]	5.30%	n/a	5.90%
NAB	5.50%	5.50% [1]	5.30%	5.40%	6.00%
Westpac	5.50%	5.60% [2]	5.60%	5.40% [3]	6.00%
Regionals					
BankWest	5.90%	5.80%	5.50%	n/a	n/a
BOQ	5.75%	5.90%	5.65%	5.65%	5.00%
St George	3.25%	5.80% [2]	5.65%	5.40% [3]	6.05%
Others					
ING Direct	5.60%	6.00%	5.80%	5.80%	n/a
RaboDirect	5.50%	5.90%	5.60%	5.70%	6.10%
U Bank	6.06%	5.81%	5.71%	n/a	n/a

Rates current as at 28 September, 2011 for term deposits of > $10,000, with interest on three- and six-month TDs paid on maturity, interest paid annually on one-year, two-year and five-year TDs.
[1] ANZ, Commonwealth, NAB rate is for five months. [2] Westpac, St George rates are for five to < six months.
[3] Westpac, St George rates are for 48 to < 60 months.

Option 2 – Bank hybrid securities that pay fully franked distributions

The new ANZ CPS3 issue got off to a good start when it listed on the ASX last week and was trading at par on Friday – not bad given that ANZ raised $1.34 billion and anyone who applied in the public offer received their subscription in full. Two actively traded older issues that represent reasonable value are in Table 2.

Table 2: Hybrid securities

	CBA PERLS V	ANZ CPS2
ASX Stock Code	CBAPA	ANZPA
Margin	90 Day Bank Bill + 3.40%	90 Day Bank Bill + 3.10%
Likely Conversion/Redemption	31 October, 2014	15 December, 2016
Next Distribution	$2.9101 on 31/10/11	$1.3904 on 15/12/11
Market Price	$205.50	$101.40
Accrued Distribution	$2.04	$0.29
Capital Price	$203.46	$101.11
Effective Margin	90 Day + 2.80%	90 Day + 2.85%

Option 3 – A professionally managed fixed income fund

Bond funds have done pretty well over the last few months due to the fall in long-term interest rates. With three-year Australian Government Bonds now yielding only 3.65%, and 10 years at around 4.3%, you will need to be quite bullish on interest rates (bearish on the economy) to expect a material increase in bond prices. Then again, whoever thought 10-year US Treasury Bonds would touch a yield of 1.75%!

Some of the leading Australian bond funds are in Table 3.

Table 3: bond funds

	Type	1 year rtn to 31/8	3 year rtn to 31/8	5 year rtn to 31/8	MER
Aberdeen Fixed Interest Fund	Active	6.74%	9.52% pa	7.34% pa	0.51%
Blackrock Indexed Aust Bond Fund	Index	7.08%	7.90% pa	6.90% pa	0.26%
CFS Wholesale Aust Bond	Active	6.38%	7.56% pa	6.61% pa	0.41%
UBS Aust Bond Fund	Active	6.41%	8.09% pa	6.96% pa	0.40%
Vanguard Aust Fixed Interest Fund	Index	6.86%	7.90% pa	6.87% pa	0.29%
Market Index (UBS Composite All Mat)	n/a	7.10%	7.95% pa	7.03% pa	n/a

The very low government bond yields makes a five-year, government guaranteed term deposit yielding 6.1% look pretty attractive – I'm not sure how many bond funds will beat that over the next five years! If you want to invest directly by buying secondary market issues of government, semi-government or corporate bonds, the fourth option is to talk to one of the specialist fixed interest brokers such as FIIG. The minimum parcel size will usually be $100,000, but it may be as high as $500,000 for some of the corporate bonds.

There you have it – four alternatives to cash that have relative security and essentially, income characteristics. For my book, it is probably a mix of longer duration term deposits and the fully franked floating rate bank hybrids.

Ten value dividend-paying stocks

by Roger Montgomery

The stock market has not been offering much opportunity to make a profit, and these conditions could continue for some time, says Roger Montgomery of Montgomery Investment Management and RogerMontgomery.com.

In a market like this, one good strategy – particularly for SMSF trustees – is to buy companies that have reliably grown their dividends year after year, Montgomery says in his latest video for the Switzer Super Report.

"Did you know that the stock market today is trading exactly where it was in December 2004 – that's nearly seven years with no capital appreciation," he says in the video. "Now, of course, in that time there have been companies that have grown three-fold, four-fold, six-fold, but the comparison still remains, there are companies in a market that has gone nowhere for seven years, that have grown their dividends phenomenally."

Montgomery says many people incorrectly believe he doesn't like dividend-paying companies, but he says that is not the case. In fact, he has a clear distinction between when he believes companies should and shouldn't pay dividends. He says companies that generate high rates of return on equity (ROE) should keep their profits, while those that don't should pay them out as dividends.

Companies that have reliably grown their dividends year after year, that are investment grade, generating good ROE and are trading below their intrinsic value could be good additions to your portfolio, Montgomery says.

"Did you know, for example, that if you buy $20,000 worth of shares that are earning a 5% dividend yield today and that dividend grows by 5% a year, you're going to be generating a yield on the purchase price of 37% in 15 or 20 years' time? So it's worth finding companies that can grow their dividends significantly," he says.

To help you out, Montgomery has put together this list of companies that have the potential to grow their dividends.

"They might not all achieve it, but these are companies worth investigating for their potential," he says. "In a market that's likely to go sideways or lower for a number or months, if not another year or so, it's quite possible that these are the sorts of companies you should be investigating."

Ten companies with dividend growth potential:

1. Imdex Limited (IMD)
2. Cabcharge Australia (CAB)
3. Retail Food Group (RFG)
4. Credit Corp Group Limited (CCP)
5. Seymour Whyte (SWL)
6. M2 Telecommunications Group (MTU)
7. Breville Group (BRG)
8. Thorn Group (TGA)
9. JB Hi-Fi Limited (JBH)
10. NRW Holdings (NWH)

Seven rules for claiming personal tax deductions

by Tony Negline

Personal super tax deductions, if you can access them, significantly increase the tax effectiveness of superannuation because they reduce the cost of investing in super, meaning more money for you!

In order to claim these tax deductions, it's essential to avoid some common traps for the unwary.

Before we look at the tax deductibility issue you'll need to make sure you understand when contributions can be made to super and how those contributions will be taxed. If you haven't already, you can bring yourself up to speed by reading How your SMSF is taxed on our website.

There are seven key rules for claiming a personal super contribution as a tax deduction:

1. You can't be employed. In effect, this tax deduction may be available if you're a semi-retiree who is not in any formal employment arrangement.

2. If you're employed, then you might still be eligible for a personal super contribution tax deduction if you satisfy the 'maximum earnings test' or MET.

This test says that from 1 July 2009 onwards, a tax deduction for personal super contributions will be available if, during a financial year, less than 10% of your total assessable income for income tax purposes, reportable fringe benefits and salary sacrifice contributions were received from employers who would have to make compulsory Super Guarantee contributions for you.

There are some exceptions and exemptions to these MET rules, which I won't discuss here in detail, but you should seek further information if you're one of the following:

- Not an Australian resident for tax purposes;
- Your employer doesn't have to make Super Guarantee contributions;
- You may receive a PAYG Payment Summary from a former employer, but this doesn't mean you're employed.

3. Remember, you play the part of a member and of a trustee for your SMSF. So, in your role as a member, you must trade documentation with your SMSFs trustees before you can actually claim your personal super contributions as a tax deduction.

You begin this process by putting in writing to the trustee that you'll claim some or all of your personal contribution as a tax deduction. This known as a "Sec 290-170(1)(a) Notice" – ATO document reference NAT 71121. Then, in your role as a trustee (and any other trustees of the fund, such as your spouse) acknowledges in writing that you've received this information. This is called a "Sec 290-170(1)(c) Notice".

4. You must submit your Sec 290-170(1)(a) Notice either by the end of the financial year following when the contribution was made, or when you submitted your individual tax return – whichever falls earlier.

This is a very important step. There has been an Administrative Appeals Tribunal case about not completing this documentation process in the required timeframe.

5. Make sure that your Sec 290-170(1)(a) Notice is valid. Your notice will be invalid – and can't be accepted by the super fund – if before submitting the notice to your super fund:

- You cease to be a member of the super fund;
- You have rolled over or transferred some or all of a contribution to another super fund;
- The super fund has begun to pay a pension with some or all of the contribution.

6. You can vary your Sec 290-170(1)(a) Notice, although you can only reduce the amount you want to claim as a tax deduction. However, you can't vary your Sec 290-170(1)(a) Notice if you've rolled over or transferred some of the contribution or you've started a pension with the contribution before verifying the amount you want to claim.

This last problem, in particular, catches some people unawares, which sometimes sees taxpayers paying contribution tax and not being able to get it refunded.

7. Finally, you can only claim so much of your personal super contributions so that your taxable income is not negative. For example, suppose you have income of $30,000 and personal super contributions of $50,000. The maximum you can claim as a deduction would be $30,000.

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