Switzer Super Report

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China bull

There has been a waft of optimism in the market over the past few days, and there's good reason to believe that we're reaching a true turning point. Our stocks expert Charlie Aitken certainly thinks so. He also thinks the rush to sell China has been overdone, and he has some stock tips for you that will take advantage of the rush back into Asia.

Also in today's Switzer Super Report, I discuss how 'not' to become the richest guy or gal in Australia, JP Goldman looks at how to exploit fluctuations in the Australian dollar with easy ways to boost your offshore exposure, and Tony Negline makes sure you know how to date your contributions for maximum tax efficiency.

I hope you enjoy this edition of the Switzer Super Report.

Sincerely,

Peter Switzer

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How 'not' to become the richest person in Australia

by Peter Switzer

I recently received a facetious Twitter response to one of my daily tweets about a story I'd just posted on my Switzer website. I had written on why I wanted to hold good quality, dividend-paying stocks, which were exceptional value for the long-term investor (and still are!).

The Great Depression economist, John Maynard Keynes, once observed, "The market can stay irrational longer than you can stay solvent". And while that is wise advice for anyone who is an active player of the market, it doesn't apply to a long-term investor who has a balanced portfolio and isn't in a desperate cash flow situation.

I recently interviewed the founder of Cape Lambert Resources, Tony Sage, who reportedly had lost $17 million since the GFC, and when I brought it up with him on my *SWITZER* program on the Sky Business channel, he replied, "That's only on paper and as I am not a seller, it is not a big deal."

I've seen analysis of some 1,200 ten-year periods for the Australian stock market (yes – 1,200!) and never once would an investor have lost their capital over that period of time. The repeated historical average of share returns on a per annum basis over a ten-year period continually comes up with gains of about 10-12%; and if that kind of history repeats, our money doubles every six to seven years or so. This is just a rough patch, which always looks shocking on a daily basis — it's like getting a stubborn tooth pulled out without a shot!

But back to the Twitter response. The smart alec looked at my worldly wisdom on investment and tweeted: "That won't make me the richest guy in Australia." And he's right.

That was a lesson I taught myself on a beach in Sifnos, Greece in June 2008, a few months before Lehman Brothers failed and we were thrown into a worse version of what we are seeing play out in Europe right now.

Being 'the money guy' I'm billed to be, I wasn't reading Wilbur Smith or Tim Winton, but the latest BRW Rich List issue. As a little survey, I read each story of top 100 richest people in the country to see if there were common themes to explain their success – and there were.

First, many had made their money by starting businesses, which ultimately became listed. Think names such as Packer, Lowy, Pratt and many more who fit this pattern. The second theme for wealth success was a high exposure to property and the connection between business success and property often showed up.

Few people apart from some executives on improbably big salaries, performance bonuses and payouts could link their wealth to shares.

Shares won't make you the richest guy or gal in Australia, but they are a conduit through which you can tap into the wealth of business builders. You can become a co-owner in a business and the better that business does, the wealthier you will become.

I always argue that we aren't just buying shares when we invest in the stock market; we're buying companies. The best goal for most of us who will never become the richest person in Australia is to aim to be the wisest investor in Australia, and if you aim for that, you'll build some seriously impressive wealth.

By the way, Nabi Saleh, the guy who built Gloria Jean's Coffees into an international success story, always aimed very high. He said by doing that, even if you missed out on what you really wanted, you would still be in a pretty good place.

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What to buy in a déjà vu market

by Charlie Aitken

There's an amazing sense of déjà vu about this market, with the same playbook from 2008 likely to be the right one to use now and into early next year.

Think about it; all the headlines right now are about 'financials', 'global growth' and 'China'. Financials and materials led the third quarter rout in global equities, with Bank of America falling 44% and Alcoa losing 40%, for example. Every guest on CNBC or Bloomberg TV is bearish, expects more volatility, and recommends investing in the defensive sectors. Well, that's useful after-the-event advice.

The most surprising aspect of the last two weeks has been how everyone has become a 'China bear'. Resource stocks globally are down 50%, luxury goods retailers have fallen 25%, with US-listed Chinese companies down more, US-listed Asian casino operators have dropped by 25% and industrial commodities are down 20%, on average.

Yet bulk commodity prices (which can't be traded by hedge funds), such as iron ore, coking coal, manganese and thermal coal, have hardly dropped at all, suggesting to me the rout in all things 'China' is a hedge fund exodus just as it was in 2008, rather than a genuine slowdown in China. Even this week's positive Chinese PMI (Purchasing Managers' Index) was ignored by markets that continued to dump or sell short China.

Back in 2008 this proved to be the single best buying opportunity in markets. If you bought commodities, commodity equities and commodity currencies at the peak of a 'financials crisis', you made anything between 100% and 500% over the following two years. There is every chance this will happen again and that's why our number one strategic recommendation remains to hold Australian resource stocks in Australian dollars.

Also note that almost every day that the hedge fund world 'shorts China', China Inc bids for another strategic resource stock globally. This week it's Sundance's (SDL) turn in Australia. This China Inc buying was also evident at the bottom in 2008.

I personally believe equity markets are now discounting a far more bearish global economic growth outcome than is likely to be delivered in 2012. Yes, there will be slow global growth, but there will still be growth! The equity market is discounting negative growth or in some cyclical cases much worse.

That is why I continue to believe it's the time to become an investor, not a trader. It is not the time to trade, it's the time to invest and set portfolios for the years ahead. The equity market is paying you an enormous equity risk premium over bonds to simply invest. The equity risk premium is a derivative of the extreme volatility we are seeing, but that volatility will ease and risk premiums will fall.

The entire world is waiting for a eurozone solution, which they will get this month in terms of a $2 trillion EuroTARP, associated eurozone bank recapitalisations, a partial Greek default, and coordinated liquidity pumping by the big five global central banks. The RBA may even wake up and realise they have Australian cash rates 100 basis points too high. This will all be occurring as the third quarter reporting season in the US comes in solidly.

So there you go. I am bullish, in fact VERY BULLISH. I believe we could see a V-shaped recovery over the next six months. Yes, V-shaped! The risk of further losses from here is minimal, with the risk/reward pendulum firmly pointing to reward. We were bearish on Australian equities at 4,900 in April, now we are VERY BULLISH at 3,850.

In today's research pack, we start with BHP Billiton (BHP) after a site visit. BHP shares are currently trading $20 below our price target. If you believe anything I write above, the very first thing you should do is buy all four major Australian bulk resource stocks in the first hour today (BHP, FMG, RIO, WPL) in Australian Dollars.

BHP Billiton Ltd (ASX:BHP) – Buy

We continue to rate BHP as a 'buy'. BHP remains cheap, trading at a fiscal 2012 price to earnings ratio of 7.8x and a fiscal 2012 price to net present value of 0.74x, which compares to its 15-year average of 1.14x. A strong platform of capital expenditure is expected to total some US$80 billion over the next five years and that will underpin organic growth for the next decade. BHP stands out as one of the best-managed companies in the Australian market, which is matched globally with a market capitalisation ranking it in the top 10 in the world. We have a price target of $56.05.

Sundance Energy (ASX:SEA) – Buy

We are initiating research coverage of Sundance with a 'buy' recommendation. The stock appeals to us as an established oil producer in the Bakken, one of the two premier shale regions of the US. The company's growth targets look achievable, but our forecasts are more cautious. The share price is trading well below our conservative valuation of just the Bakken assets and the upside from the Niobrara could be higher than we have estimated. The company has already established good support from a number of institutional investors, and the new CEO, Eric McCrady has injected some new energy and financial discipline to the company. Our target share price is 86¢.

JP Goldman

Options to exploit Aussie dollar weakness

by JP Goldman

After having powered to 110 US cents earlier this year, the once mighty Australian dollar has fallen back to earth in recent weeks, touching a recent low around 95 US cents.

Concerns over global economic growth and falling commodity prices – together with heightened expectations that local interest rates could be cut – have fuelled the decline.

It begs the question: does this mean the Australian dollar's rise is over, and if so how should investors be best positioned?

If the Aussie dollar has truly peaked, then it would clearly pay to have some money offshore in unhedged investments – as the value of these will rise as the Aussie dollar weakens.

For example, $10,000 invested in the US market when the Aussie was at 110 US cents would have bought you US$11,000 in shares. With the Aussie's fall to 95 US cents, that same parcel of shares – assuming the US market had not fallen – would be worth $11,580 here.

If the Aussie were to slump to 85 US cents, it would be worth almost $13,000.

But whichever way the Aussie goes from here, as a general rule, investors should still consider some international exposure as it helps diversify and dampen the volatility of investment returns.

Because the Aussie dollar is considered a 'commodity currency', its movements often tend to be correlated with those of global equity markets. As we saw in 2008, the Australian dollar tends to fall when the global economy is in trouble and equity markets are falling. Yet, as demonstrated in 2009 and 2010, it tends to rise when the global economy and equity markets are improving. This positive correlation generally dampens the Aussie dollar volatility of offshore investments.

Since mid-May, for example, America's S&P 500 index has fallen by around 20%. Over that same period, the Aussie has fallen by almost 15%. The net result is that the S&P 500 in Australian dollar terms has fallen by only around 8%.

Gaining access to unhedged international investments is becoming increasingly easier, with a wide range of exchange traded funds or ETFs available on the stock exchange, that track markets as diverse as America, Europe, Japan, emerging markets and China.

For long-term investors, perhaps one of the more attractive international investments around is China (ASX:IZZ). After its share market bubble exploded in late 2007, shares have since gone nowhere – but value has been building.

For an economy likely to keep growing around 8% a year, the market looks exceedingly cheap, with the China MSCI index ending September on a price-to-forward-earnings ratio of only eight – well below its longer-run average of 13.

At the same time, China's currency is still considered cheap and should rise against the US dollar over time – which itself is arguably still cheap against the Australian dollar.

If you prefer the security of developed markets, there's a range of US market ETFs to consider, such as IVV which tracks the Aussie's value of the S&P 500 index. The annual management fee for this ETF is only 0.09%.

Of course, predicting where the Aussie dollar goes over the short-term is fraught with difficulty.

With debt problems in Europe intensifying and America's economy struggling, the Australian dollar has fallen notably in recent weeks and could easily fall a lot further in a short space of time – as was evident during the 2008 global financial crisis.

But if Europe gets on top of its problems, and the US Federal Reserve starts printing more cash to boost its economy (sinking the US dollar), the global economic outlook could improve – and the Aussie could easily rebound and stay relatively high for a while longer.

Either way, what does seem evident is that even allowing for China's booming economy, the Australian dollar is likely to remain above its long-run average of 74 US cents since it was floated in 1983.

Rising global commodity supply will eventually see the commodity price cycle turn down, and Europe and the United States will eventually raise interest rates to more normal levels once their economies recover.

That said, due to the rise of China, it's probably the case that the average value of the Australian dollar over the next 10 years will be higher than in the previous 10 – say closer to the mid-80 US cents mark. Adding to your offshore exposure at times when the Aussie dollar moves above parity with the greenback should not only help portfolio diversity, but enhance longer-run returns.

How to date your super contribution

by Tony Negline

When does the Tax Office consider a super contribution to have been made? It may seem like a silly question, but the date on which you make a super contribution may not necessarily be the same date that the contribution is received – and that can have consequences.

Making sure your super contributions fall within the periods you mean them to is important to make sure you can control the tax effectiveness of the fund. If your contribution lapses into a different period, you may exceed your contribution cap and be hit with a tax penalty.

Likewise, if you're over 65, then the timing of when a contribution has been made may actually determine if that contribution is legitimate or not, and if it's not, then that money will also be taxed at a very high rate that will make you wish you never put it there in the first place. And remember, it's exactly because of the tax breaks afforded to super that we put our money there in the first place.

Here's a summary of how the Australian Tax Office determines the date that a contribution is made:

This one is fairly straightforward. Contributions made using **money or money equivalent** (this includes cheques, bills and in some cases promissory notes) are dated from when it's received by your super fund. This will not apply if a cheque is subsequently dishonoured. If a cheque is post-dated, the contribution date will be determined by selecting the later of either the date shown, or the date received.

Electronic Funds Transfers are dated from when credit enters into a super fund's bank account.

Money order or bank cheques are dated by determining either the date the fund receives it or the date the payment can be demanded. It won't be received if it's dishonoured. If the cheque is delivered by a related party, the contribution will be dated on the day it's received by the super fund if it's presented a few business days after receipt.

Property or in-specie contributions will be dated from when legal or beneficial ownership passes to the super fund. If you want to rely on a change in beneficial ownership, then you'll need to retain sufficient evidence of the transaction.

In particular, for some types of property this might be when a super fund acquires legal possession of the property. For other types of property, ownership might move to your super fund when a deed of transfer is executed.

For **ASX-listed companies or unit trusts**, a contribution is made when a super fund receives a properly completed off-market share transfer form.

As you can see, working through when a contribution has been made is sometimes difficult. Careful record keeping is often required.