Switzer Super Report

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Pension survival

Stock markets sure have had a great run over the past week, just as we predicted, and sentiment continues to improve. But that doesn't help the fact that some retirees were forced to sell shares at the bottom to pay pensions.

So in today's Switzer Super Report, Ron Bewley talks about how he successfully managed the recent market dip so you don't find yourself in this position ever again, plus he names some stocks to buy for your SMSF. We also shine the spotlight on two alternative ways to grow your DIY super; the first, by using your SMSF to develop vacant land, and the second, by giving you an insight into the entertaining art market auction season. And don't forget, Charlie Aitken has his weekly stock tips. Happy reading!

Sincerely,

Peter Switzer

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Will Europe ruin this year's Santa Claus rally?

by Peter Switzer

As we close in on the end of 2011, we look primed for a possible big finish on the stocks front with Americans historically inclined to create a 'Santa Claus' stock market rally. However, the question is, will the Europeans ruin Christmas for all of us?

I'm betting 'no', with one of the greatest kicks in the pants for Europe, its squabbling finance ministers and other grandstanding politicians, being the near collapse of the Belgian-Franco bank Dexia. That scare has given the debt solution some momentum.

There will be a series of European meetings over Greece and the expansion of the region's bailout fund – the European Financial Stability Facility (EFSF) – that could trip up the market; but I believe it's now clear to all European finance ministers that for the sake of global financial markets and then the underlying world economy, they can't play a self-interested game.

Even the Slovaks, who made a point of voicing their anger at the Greeks by voting down the proposed expansion, are expected to tow the line and approve the measure by the end of the week.

Meanwhile, the economic outlook is improving over in America, as I've been predicting, with the Philadelphia Federal Reserve president Charles Plosser (who has opposed much of Fed chairman Ben Bernanke's monetary stimulus programs) predicting that the US will grow by just under 2% this year and up to 3% next year. That's sufficient progress to help stocks go higher.

On top of that, Goldman Sachs recently raised its US growth forecast for the third quarter of 2011 to 2.5% from 2%, blasting recession fears out of the water (at least for now).

This also followed news that the number of jobs created in the US in September rose by 103,000, which was better than the 40,000 expected by economists.

So things are looking up!

Having said that, I agree with some of the bear forecasters when they say that stock markets will find it hard to reproduce the great annual increases of more than 20% that we saw in the years leading up to the 2008 crash.

However, good quality companies known for paying dividends, could easily return a portfolio average dividend of around 5% and if you add in the 2-3% from franking credits, this return climbs to about 7%. So even a tepid market gain of 4-5% means we can hope for a 10-12% gain from stocks in 'okay years' and maybe 5% or so in bad years, which compares well to term deposits.

For Wall Street in the year ahead, two arguments make me think 2012 will be alright for stocks. First, as the Presidential election in November looms, history says stocks go up in the fourth year of a presidency.

Also, Stan Stovell from Standard & Poor's has shown that when the collective yield of the S&P 500 has been greater than the yield on the 10-year US Treasury bond, the stock market on average has gone up 20% in the following 12 months.

Locally, I suspect the Reserve Bank of Australia will cut interest rates in November. I think only surprisingly strong employment and inflation data will stop the bank throwing out a lifeline to businesses, the economy and home loan worriers.

This will keep a lid on the rising dollar and help the slow part of the Aussie economy and encourage foreigners to look at buying local stocks.

The US growing better than expected, Europe getting its rescue act together and our economy enjoying lower interest rates plus a relatively weaker dollar, makes for a great cocktail to encourage some celebrating from stock market investors.

Why Australians have lost control of share prices

by Charlie Aitken

American employment and economic data has improved, Chinese data remains firm, quantitative easing is in place in the UK and the EU, the Reserve Bank of Australia has opened up to the idea of a rate cut and most importantly of all, the eurozone, albeit slowly, is headed for a comprehensive solution to its sovereign debt problem by the end of the month.

My view remains that this fourth quarter rally in equities will continue into year-end, particularly as momentum now swings positive in a market where everyone has been defensively positioned or outright short, despite the best outright value in cyclical equities in living memory.

I read an amazing statistic recently that 85% of NYSE daily volume is accounted for by high frequency trades (HFT) and those following short-term algorithmic momentum strategies. On that basis, it's no surprise that we are seeing unprecedented intraday volatility in US and global equities.

With ultra short-term strategies dominating short-term equity pricing, it's also no surprise that when momentum changes it has an extremely large influence on prices.

As you know, I believe HFT increase 'volume' but not true 'liquidity'. So when momentum changes and all the computer programs say 'buy', there really is a lack of genuine stock supply. That is why you now see 'melt up' events, like the ASX200 rallying sharply, with riskier stocks up as much as 40% last week from Tuesday's lows. That sure beats being parked in cash at an interest rate of 4.75% per annum, unfranked.

There's just no such thing as a flat market anymore, not in the new world in which we operate. Markets move with unprecedented speed. That is why when I'm writing my Australian trading and investment strategy, I have to be focused well ahead of the market. You simply can't get yourself in the position of playing 'performance catch up football', or as I call it 'chasing alpha'.

For the entire year, the Australian equity market has not controlled its own performance destiny. Australian pricing and sentiment has been entirely hostage to global market developments. We now operate in a fully correlated financial world where information travels at unprecedented speed.

In all my time in dealing in Australian equities, I can never remember a period when Australian investors have had less influence over the daily pricing of Australian equities. The new marginal pricers of Australian equities are global fast-money accounts, and global fast-money accounts are driven by global macro and sentiment events.

Yet, while the global fast money has a massive short-term influence, the simple fact is they hunt as a pack and take markets to extremes. They eventually crowd out their own positions and then when the unwinding starts, they realise they have been playing a game of pass the parcel with themselves. That was easily evidenced last week when just about all Australian stocks gapped higher with real money sellers almost impossible to find.

'Short the rumour, short cover the fact' has been a trend right across Asia, but probably no more so than in Australian banks.

Aussie banks have been an easy short as we warned you back in April. They are over-owned by pretty much every Australian investor, which means in a correction nobody really has the firepower to take on the short-sellers unless they want to buy more and go more overweight. You find that shorters find very little resistance in Australian banks, that is until the momentum changes.

My view is shorting the fundamentally strong is rarely a profitable medium-term strategy. Eventually, the fundamental strength supports the stock price, particularly when they are driven down to undeniable fundamental value.

That is why we continue to bang the drum hard on the cheapest and most leveraged banks ahead of the full year reporting and dividend season. And there is no cheaper and leveraged bank than National Australia Bank (NAB), which in my view is also the most shorted by global fast money accounts. This is confirmed by NAB leading the sector off the lows, a development we think will continue.

National Australia Bank (ASX:NAB) – Buy

NAB remains our highest conviction buy recommendation in Australian banks. NAB commands a major price-to-book discount due to UK exposure, but my view is they will sell some UK assets and release $5 billion in capital. Instead of issuing capital, NAB will be buying it back. On fiscal 2012 multiples, NAB is the cheapest bank when comparing price to earnings (P/E), yet it has greater earnings per share (EPS) growth than the rest of the Big Four banks combined. It also has the highest yield. NAB continues to gain profitable market share from all others in a zero credit growth environment. It is priced, for historic yet unjustified reasons, as the risk bank, and risk is on. I met with Cameron Clyne last month and I rate him above all others in the sector. He is absolutely excellent in my view. NAB's P/E at 8.7x is lower than its 9% EPS, which is ridiculous! Our new technical share price target is $26.30.

ANZ Bank (ASX:ANZ) – Accumulate

ANZ's momentum shows it has the right strategy in place and the right focus on the core markets for growth (Australia and APEA). The long-term benefits of its Super Regional strategy far outweigh short-term headwinds (such as, trading income and acquisition risks) and we maintain the $22.60 price target and Accumulate rating, with substantial value upside if the bank were to acquire Macquarie Group (MQG).

Challenger (ASX:CGF) – Buy

Challenger is in a unique position, as it is one of just a few financial companies that benefit from some market volatility. In terms of our earnings revisions for Challenger, we've upgraded our retail annuity sales outlook for fiscal 2012; increased our Cash Operating Earnings (COE) margin over the medium-term given the robust asset spreads available; reduced our mark-to-market funds under management in Wealth Management for the year; and lowered our transaction and performance fee expectations in Wealth Management for the 2012 financial year. Overall, our earnings revisions are net-neutral. Our Strong 'buy' recommendation is maintained along with our $6.20 price target.

How to manage pensions during market dips

by Ron Bewley

Last week's market rally gave me the chance to catch my breath. I'd been sitting on the sidelines throughout September's intense volatility and market dive, holding my breath and waiting for the recovery. Some of my stocks fell sharply – the so-called high beta stocks. These stocks tend to go up and down faster than the overall index. I knew that. So while I didn't like it when they fell, I also wasn't tempted to overreact and dump them.

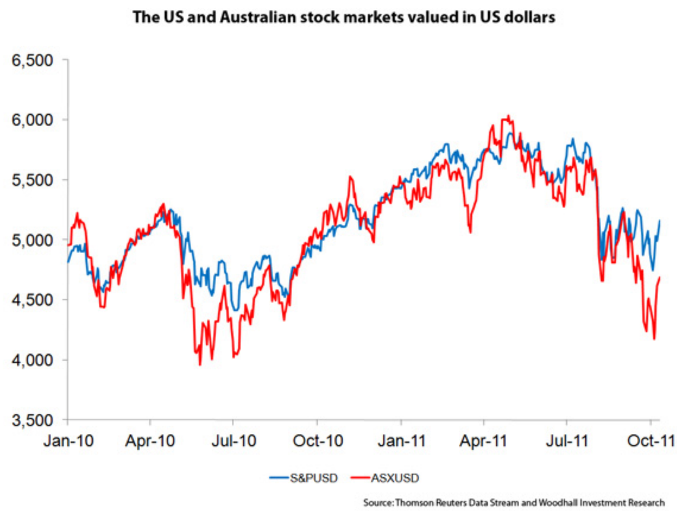
Readers might recall my column two months ago where I wrote that I had just sold some stock in my super fund 'just in case' I needed cash to pay my pension (read, Special Feature: How I handled last week's dive). Well, that moment arrived at the end of September. I needed some cash, but I didn't need to sell any stock to pay my pension at the market low because I had planned for an event of some sort.

Thankfully, my dividend cheques had also started to arrive, further helping my cash position. I normally like to hold 1-3% in cash in my SMSF and I'm now in the middle of my comfort range.

The research question I'm now focused on is whether the market has overreacted to the European debt crisis in September. Stocks became very cheap last month – many were about the same multiple (price-to-earnings ratio) as at the bottom of the market in 2009. Yet, companies are generally more cashed up now compared to 2009 and earnings growth outlooks are strong, if not stellar.

Against this backdrop, I've been paying a lot of attention to the relativity between the US and Australian stock markets.

For 22 months or so from the start of 2010, our market lagged the S&P 500. But, when I convert our market index into US dollars (to compare apples with apples) the two indexes moved very closely together (when scaled properly) as you can see in this chart.



As you can see from the chart, the Australian market was relatively cheap compared with the US market at two periods over the past year. The first disturbance in this otherwise stable relationship was for a month or two near the middle of 2010 when the mining tax was first put on the table.

The second was in the middle of September, when something happened that I can't (yet) explain. Our market became so cheap relative to the US that I believe we will have a stronger bounce back over coming weeks.

Of course, I have to consider the possibility that my theory – that foreigners are buying the Australian market as a hedged outcome (that is, valuing our market in US dollars) – might have broken down.

As I have no spare cash at present, I'm not in a position to buy, but I would otherwise have been tempted. I was happy buying BHP Billiton (BHP) at $38.40, Rio Tinto (RIO) at $70.01 and Boart Longyear (BLY) at $3.02 between the August and September dips and

would do so again if I had the cash on hand at these slightly lower prices today.

Of course, I would have preferred to buy these stocks (and others) at these lows. But, in a few weeks, I suspect I will still be sitting on some modest profits from these stocks.

Last week's jobs data in the US was much stronger than analysts expected, and European leaders are at last getting their act together by addressing the region's sovereign debt problems. These events are good news and I'm eagerly awaiting the ride up in stock prices.

I'm also working on setting target prices for all of my stocks to note at which point I will start taking profits. I wrote about this strategy previously when I sold Lynas (LYC) on the way up.

Without a plan, I might sit and hold onto a company for too long. A correction of some magnitude is bound to happen time and time again; such is life in the equity markets. By taking some profits from time to time, I might again be able to get through future dips without trading at the bottom – it's called managing risks.

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How to develop vacant land using your SMSF

by Tony Negline

As financial markets continue to flounder, SMSF trustees are increasingly looking at different ways to build their retirement wealth.

A typical example might involve using super to buy vacant land with a view to developing it at some stage.

But what sort of development is – and just as importantly isn't – allowed?

At the outset, it's important to note that the super laws don't demand that you follow State Government or local government planning laws. For example, if vacant land is zoned as residential, but you decide to put a nuclear enrichment plant on it – to take a slightly outrageous example! – then there is nothing in the super laws that will penalise you if you've executed the transactions correctly.

Obviously, anyone breaching planning laws opens themselves up to penalties and fines of various types, and therefore, such an action might be considered a breach of trust because you haven't done all you can to run your super fund appropriately.

But in relation to the super laws, before we answer this question, we need to know what type of land you've bought and what you hope to use it for.

The vacant land might be farm or pastoral land that you intend to agist. If you want to rent this land to a third party, then typically there would be nothing stopping you doing this (assuming your local property and planning laws permit this). If you want to rent this land to a related party of your super fund, then you need to be 100% sure it is 'business real property'.

This is a term found in the super laws and essentially means premises or property that can be used wholly and exclusively in the running of a business.

A related party of the fund is another term found in the super laws and it means any member or their relative or any company or trust that the members or relatives control or who are deemed by the law to control.

Perhaps your super fund's vacant land is zoned for business purposes, such as commercial, industrial or retail. In these cases, if you would like to use it to develop premises, then this can be done and it can be leased to a related party of your super fund because it will probably be considered 'business real property'.

A key issue will be who the developer is. One task for the developer is to purchase all goods and materials for construction directly from the supplier. A super fund is unlikely to receive any trade discounts, so you might be tempted to use another entity to act as developer.

Perhaps your super fund might want to enter into a contract with a member of the fund in order for them to act as the developer, purchase all materials and engage contractors. Stop! This is a breach of the super laws because the super fund is acquiring assets from the member – namely, the building materials.

The super fund must buy the materials. However, a member can provide their services as a development manager or co-ordinator to oversee what's done with those materials. This arrangement has to be clearly spelt out in writing. Importantly, the member can't receive a fee from your super fund for their services.

Another key issue will be GST. Many super funds don't bother registering for GST because it's typically not compulsory and it provides a marginal financial benefit. Super funds and the GST are strange bedfellows and we don't have space here to discuss all the related issues. However, in a property development situation it's often a good idea (and given the cost of the goods purchased, often essential) to be registered for GST purposes.

Without going into too much detail, sometimes it's essential to factor in GST adjustments, and these can have a significant financial impact.

You might be interested in developing vacant land for residential purposes. This is fine, as long as you and your relatives don't use the house, flat or apartment – it must be leased to a non-related party.

Finally, just a brief word about super gearing cases. One of the most important rules about super gearing is that the asset held in these arrangements often can't be replaced (red, New opportunities open for investing in property). In nearly all cases, development of vacant land would be considered to be replacing an asset – so basically, you can't use your SMSF to borrow funds to build on vacant land – you must support the development with existing funds within your SMSF.

Contemporary art prices lead auction recovery

by Alistair Bailey

German painter Gerhard Richter was recently asked his thoughts on the estimate of £6-9 million (about $9.4-15.7 million) placed on one of his *'Candle'* series works due to go under the hammer with Sotheby's in London.

"It's bewildering – it's absurd that within a financial crisis we can see these figures," was his answer.

How prices are determined, particularly in contemporary art, is not a new dilemma for collectors or investors. The post-war contemporary art sector is traditionally the most volatile and this stands for a reason: it is very much regarded as a barometer for market confidence and as such, it carries greater risk than the more established sectors of the Old Masters like Leonardo da Vinci and Rembrandt, or Impressionists like Cézanne and Monet.

At present, the contemporary art barometer is rising, and the auction activity in that sector is perhaps the most fascinating in the Australian market.

When we look at the recovery in the auction rooms on a global scale, there is no escaping that it's the growth in the contemporary sector that has (and continues to) underpinned the recovery in art prices. In fact, according to the Mei Moses Index – which tracks the financial results of the art market – the Contemporary Art Index is up 28.76% in the year to date, well above the 7.86% rise in the broader World All Art Index.

Contemporary art is as perplexing as it is fascinating as a market to monitor and analyse.

There are times when the cynic within can't help but dominate a mindset. For me, lot 1 of Australian art auction house Deutcher and Hackett's most recent sale was just one of those moments. Denis Beaubois' *Currency 2011* was presented for sale with estimates of a $15,000-$25,000 price tag. The 'artwork' – which was funded with a $20,000 grant from the Australia Council – consisted of two stacks of 100 uncirculated (legal tender) Australian 100 bills. That's right, two piles of cash with a face value of $20,000. What is perhaps more perplexing than the essay accompanying the work was the final result, which saw the work set a new auction record for the artist of $21,000 (including the buyer's premium).

But here's the thing with contemporary art in particular; in this instance, you could be forgiven for wondering whether or not this is simply a case of the Emperor's new clothes or a high-stakes game of Who's the Greatest Fool being played out between high net worth individuals.

In the year to date, we have seen a total $71.12 million turnover at art auctions in Australia, which is up 8.23% on this time last year. Yet despite this, our market confidence is still shaky. The secondary market (sales of pre-owned works) is clearly going through a transition – something that is long overdue in my view – so recovery in this end of the market is likely to remain sporadic.

The continued concerns surrounding sovereign-debt are sending shockwaves through the broader markets, which is undoubtedly testing the resolve of investors – particularly when we see the volatility extending to gold.

Fine art, purchased wisely, continues to demonstrate its capacity as a strong long-term alternative to stock markets.

Investing £6 million in a classic Richter all of sudden doesn't seem quite as bewildering or quite so absurd. Of course, the secret is buying wisely because the investment lies in the quality.

One name that has experienced explosive price gains in recent years is that of 2008 Archibald prize winner Del Kathryn Barton.

Barton's painting *Keeper of the Polka-Dotts* was offered in the Deutcher and Hackett sale (lot 31) selling for $192,000 – a new auction record for the artist. I remember seeing her *Confetti Rain* (2005) go under the hammer with Bonhams and Goodman in 2007. It was up with estimates of $8,000–12,000, having been purchased in 2005 at her Melbourne exhibition for around the same price as the lower-end estimate. The work sold that evening for $49,000 (inclusive of the buyer's premium), setting a then new record for her work.

What was perhaps even more interesting though were the results for lots 94, 95 & 96 – a series of limited edition lithographs by Del Kathryn entitled *That's when I was another Tree*. Originally released as an edition of 50 for $3,500, the gavel fell with two of the three works selling for $18,000 and the other for $19,200.

What's interesting about this is it very much bucked the trend we have seen in the rooms throughout the 2010-11 auction season where the 'edition market' has underperformed as a sector. Barton's name is one that has enjoyed good momentum.

However, investing in a famous 'name' doesn't guarantee that prices will always go up, demonstrated by Menzies' sale of *Country Child* by celebrated Australian artists Russell Drysdale. The painting, circa 1948, sold for an impressive $1.32 million, however, it actually realised a $350,000 loss on its previous sale in 2008.

One observation from the season is that the work of Jeffrey Smart – one of the country's most widely known living artists – is not enjoying as good a run in the auction rooms since breaching the $1-million barrier back in May. The major lots at both Deutcher and Hackett and Menzies both passed in.

Meanwhile, Sotheby's Australia hit a winner with the sale of the 1958 Arthur Boyd's *The Frightened Bridegroom*, which set a record auction price for the artist of $1.2 million.

The final and perhaps most striking aspect of the most recent auction season was the presence of new buyers in the market. This is encouraging, but also explains the sporadic nature of the recovery in the auction rooms and in part the variety filtering into the catalogues as a rule of thumb. Certainly, the nervousness in the rooms appears to be making the auctioneers work hard to get any semblance of momentum into the bidding.