Switzer Super Report

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Go east

Yesterday it was Greece, today it is Italy, and tomorrow it will be Spain. The volatility is not over for the stock market and prices are going to continue to swing back and forth on every squeak out of Europe. It's becoming tiresome for SMSF trustees to watch, but some of us out there are quite enjoying the opportunity to snap up bargains.

In today's Switzer Super Report, I talk about my strategy for investing in the current unruly market. We also have a raft of stock tips, from energy stocks that will outperform, to two attractive materials stocks. And we take a look at the benefits of moving commercial property into your super fund. I hope you've been surviving the market ride. Let us know how you're going at questions@switzer.com.au.

Sincerely,

Peter Switzer

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My stock market strategy for SMSFs

by Peter Switzer

It was always going to come, and now Italy has become the new Greece. While stock markets cheered the end of Italy's PM Silvio Berlusconi yesterday, today's focus is: will the European Union rescue Italy?

European officials are saying "no", and that has rocked the markets. But is this the making of another buying opportunity for the courageous and consistent long-term investor? In case you don't like drawn-out dramas — the answer is 'yes', but timing could be crucial.

Overnight, the Dow Jones lost more than 389 points. The driver of that was the fact the EU has no plans to rescue Italy based on quotes from unidentified EU officials. This is true to form, so you wouldn't doubt they said it, but it doesn't mean that some kind of assistance isn't forthcoming.

Worryingly, the European Central Bank (ECB) did try to take on two-year and 10-year Italian bonds to keep rates low, but they lost out with the yield on both going over the key 7% level, which was the trigger for rescue plans for both Greece and Portugal.

Making matters worse is the fact those nincompoops in the Greek parliament can't decide who will be the interim Prime Minister. At one stage it was thought someone had been selected, but then this hope for Greek maturity and understanding was whisked away, as per usual.

There's also worries about who's going to replace Berlusconi. The trouble for Italy, and the same goes for Spain, is that they are too big to fail. The Italian Parliament will have to take action to allay the fears of lenders, but more will be needed and the ECB is going to have to take a role – and I'm sure this will happen.

Christine Lagarde, the boss of the International Monetary Fund (IMF), has made the point that Europe's plight could infect the global economy. She is calling on the other nations of the world to help with the solution or else we will all have a "lost decade" of economic growth. She is underlining how pathetic the G20 meeting was last weekend and how an Italian solution can't be left to end up being a rerun of the Greek debacle.

So, where's the buying opportunity?

Well, it is fraught with danger to try to work out the timing of the Italian solution, but one will come, even if it is IMF-created. The tactic here for the long-term investor is to buy the companies you have earmarked as long-term holds and pick them up when the share price falls with the negative sentiment.

There is no question that the safest and most intelligent stock play for most SMSF trustees is to buy great dividend, fully franked plays and the lower the entry or dollar cost-averaged price, the better your yield will be.

My guess is that an Italian solution will eventuate and there still could be a 'Santa Claus rally' in the US, but eventually, what is today an Italian story, will become a Spanish tale of woe – the volatility is not over.

However, sometime over 2012 there will be a belief that a reasonable rescue plan has been created for Europe and the stock market will take off in anticipation that 2013 will be the line in the sand when the bulls really take over.

By the way, in October, Wall Street went up by more than 20%, which means there has to be profit-takers in the big funds ready to dump stocks when the news is so frustratingly bad.

That's why buying great dividend-paying companies when the dips or sell-offs happen is the courageous and wise play.

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Energy stocks that will outperform

by Charlie Aitken

I realise all the wise sages out there who use big scary words to describe their degree of bearishness can't understand why anyone sane would believe in a V-shape recovery in east-facing equities, but I believe, and that remains my core trading and investment strategy, even when the market takes a beating like last night's.

It's even more lonely today being bullish than it was in April being bearish, despite share prices being 20% to 50% lower. Every Australian stockbroker and analyst is now an expert on Italian bonds, when three months ago they wouldn't have known what the Bloomberg ticker was. Everyone is obsessed by daily European sentiment developments, and have completely taken their eye off Australian stock-specific developments and fundamental analysis.

Similarly, everyone seems convinced the very low ASX trading volumes are a sign of a prolonged bear market, whereas I believe low trading volumes are a derivative of very low investor and trader confidence, which is actually a very bullish development. You never get confidence and deep contrarian value together. I am convinced volume will return to Australian equities at higher prices once the investing world has the confidence to believe Euromess is resolved (or at least not getting any worse). In my view, that day remains closer than most people believe.

My strategic view remains that you want to exit Euromess with a very east-facing portfolio – that is, Asia! While Perth is about as west as you can get in Australia, Western Australia has the greatest direct and indirect leverage to the rise of Asia.

At a strategy level, we are heavily overweight in mining services, believing this structural growth cycle has many, many years to run, yet it's priced to end tomorrow by the very short-sighted equity market.

I promise that you will all look back with the benefit of hindsight in a few years' time and say, "I should have been braver in Asian equities during the Euro debt crisis", just like we all said two years after the peak of the GFC when Australian banks had doubled from their lows, ditto BHP.

It's exactly the same playbook. The trading community targets the weakest link. The global central bank and government response is the same – print money – and the market ramifications will be exactly the same as we come out the other side of this crisis. In an Australian context, that means the market will be led higher by resources, discretionary retailers, media, banks and high sustainable dividend yield stocks (as interest rates fall).

I also believe you can see commodities starting to look across the European valley and out the other side. The WTI and Brent Oil prices remain firm, industrial metals are rising, precious metals are rising, led by gold, and even spot iron ore has clearly bottomed. This commodity firmness is all about the medium-term effect of coordinated global money printing and the growing and correct view of a soft landing in China. Note, commodity prices are outperforming the Australian dollar as we enter a rate cut cycle, which is very important for the domestic resource sector.

In my view, Australian commodity equities simply follow Australian dollar commodity prices in the shorter-term.

My top three energy sector stock picks:

The energy sector has suffered in line with market weakness and this has created some great investment opportunities. Our recommendations in order of preference are as follows, keeping in mind that the risks in some of these stocks are high.

1. **Neon Energy** (ASX:NEN) – Neon is still our number one pick in the sector. The Californian oil assets are arguably worth more than the current share price and Vietnam exploration offers big upside.
2. **Sundance Energy** (ASX:SEA) – Sundance is our preferred shale play, with the Bakken production assets worth more than the share price. Upside to other emerging US shale plays comes for free.
3. **Antares Energy** (ASX:AZZ) – Antares is our most undervalued shale play and we are confident that the results will come through to demonstrate value.

Aquila Resources (ASX:AQA) – Buy

The West Pilbara Iron Ore Project (WPIOP) is the key asset in Aquila's portfolio of growth projects. Aquila must prove that it can finance this project ASAP to be appointed the lead proponent for the Anketell Point port development, the key to (WPIOP). Otherwise Fortescue Metals may be appointed and could delay the port to suit its timetable, a negative for Aquila. The suggestion that its joint venture Anketell Point has adjusted its proposal to be amenable to other users, and that significant progress is being made on the financing front, is a key positive.

Our target price is $9.82. AQA closed at $6.76 on 9 November 2011.

Dart Mining NL (ASX:DTM) – Spec Buy

Targeting a new molybdenum porphyry province in Australia, Dart Mining is an exploration company focused on developing a pipeline of base metals and gold projects near Curryong in Victoria. It emerged strongly in the fourth quarter, notwithstanding volatile markets. While exploration is at an early stage and metallurgical results are pending, the October resource estimate represents a milestone towards de-risking the Unicorn project. With few ASX-listed molybdenum companies, Dart is well placed to benefit from an encouraging resource development opportunity in an underexplored porphyry province. Value is speculative.

Our target price is $0.18. DTM closed at $0.12 on 09/11/11.

Disclosure: Bell Potter Securities acted as underwriter for Dart Mining's 15.4 million listed options (DTMO) exercisable at 10 cents by 31st of December 2011 and received fees for that service.

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Two stocks for SMSFs

by Ron Bewley

As the dust settles on the Greek debt crisis, and thoughts turn to Italy, it is time to take stock of what is really going on in equity markets.

I have no view on the former Greek Prime Minister's ability to run a country, but I do doubt any other incumbent can swiftly change the will of the people to pay taxes and the culture of the country to accept international standards for retirement ages and wage comparisons between the public and private sectors.

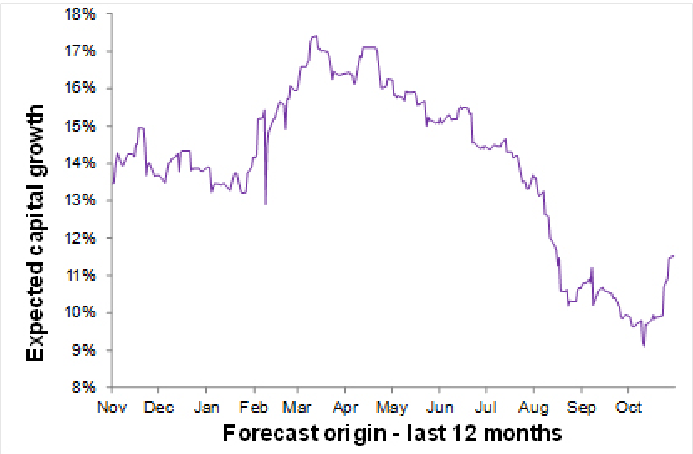
What has happened is that Greece, about the economic size of Philadelphia, has been swept aside by the media while it looks for bigger fish to fry.

Just as the US has not moved forward on pushing the American Jobs Bill through, the putative Bill's mere existence took the spotlight off the United States. While all of these deliberations have been going on, broker analysts have been quietly updating their forecasts of Australian company earnings over the next 12 months.

Indeed, as can be seen from the chart, my analysis of these forecasts has produced a sharp jump in less than three weeks – up from a low of 9.1% to the current 11.5%.

With around 7% being the long-run average capital gain, this latest forecast is a sign of optimism indeed. Of course, circumstances may change to alter broker perspectives, but these forecasts take into account everything that is currently on the table.

12-month forecasts of ASX 200 capital growth



Woodhall Investment Research

Importantly, this update in expectations takes us back to the value at the end of August, which was around the end of the company-reporting season in Australia. Brokers seemingly had painted in a worst-case scenario for the European situation, and the worst case just didn't happen!

There is another move starting to take place. Many fund managers have suffered through the last few months and they only have about six weeks to go before they calculate their performance statistics for the quarter and the year. Such situations often lead to rallies that sometimes fade after the end of the year. To me, it looks like you should either be in the market now (like me), or wait to see what January has to offer if the rally does get its second wind.

Other statistics I calculate include mispricing – or irrational exuberance – of the market. Currently, I have the market underpriced by about 4%, up from the 20% underpricing at the start of October. This 4% can be added to the expected capital gain of the market for the next 12 months to give a return of over

15%.

With the materials sector being 9% underpriced by my reckoning, and a 15% capital gains forecast for the next 12 months, it's hard to go past BHP Billiton (BHP) and Rio Tinto (RIO). They may be big and boring compared to small cap gems, but superannuants need to take risk into account even more than other investors.

And what of the interest rate cut I wrote about last time? We got it because half of the economy is suffering and unemployment is one to watch. Unemployment has remained relatively well contained at 5.2%, but there is the potential for this to change. The peak unemployment rate during the GFC was 5.9% and, if we creep up in that direction, more cuts will follow.

With no RBA meeting in January, and December being a bit too close for another cut, a lot could happen in the labour market over the next two to three months to cause a big cut in February. I think the fact that rates were cut at all will be a massive boost to consumer and business confidence because that puts rate rises off the table for a while. People can now budget with a little more certainty. However, it will take some time for stronger hiring to commence and work its way through to reducing unemployment.

Interested readers can now keep up with our forecasts, exuberance statistics and other measures on www.woodhall.com.au, which we update weekly.

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Four reasons to put commercial property in super

by Tony Negline

Suppose you or your business owns commercial business property and you're thinking of transferring it into your self-managed super fund.

There are two main reasons why doing this makes a lot of sense, especially if you have a reasonable sum of money in your SMSF.

One

Firstly, the asset would be held in super, meaning the tax on income and capital gains may be less than you or your business would ordinarily pay.

Two

Secondly, if your SMSF purchases some or all of the asset from you or your business, then extracting the cash may help you refresh your own capital structure. For example, you could use it to pay off debt.

Three

Depending on which state your commercial property is in, you can also add a third reason to why this strategy makes sense – stamp duty exemptions or concessions. New South Wales, Queensland, South Australia and Victoria all contain stamp duty concessions when a commercial property is transferred into a super fund.

However, the concession is different in each state. For example, in South Australia it only applies to rural land, while in Victoria it only applies if the property is transferred for nil consideration – that is, it has to be an in-specie contribution (click here for further details on these contributions).

In all states, you should obtain specialist legal advice so that you're sure you can claim the concession and that you obtain it in the correct way.

Four

There is also a fourth potential reason why this transaction might be attractive to you. Once the asset is held in a super fund it is often difficult for creditors to get hold of the asset to repay any debts. The bankruptcy laws, however, contain various allowances that might allow these transactions to be unwound in some circumstances.

Paying capital gains tax

One important consideration that needs to be factored into these transactions is capital gains tax (CGT), which would be paid by the current owner. As the asset is moving from one owner to another owner, CGT will be payable. This will apply even when an in-specie contribution is made.

You may be eligible for small business CGT concessions that would reduce or even remove the amount of CGT owing. Again, if this applies to you, get some specialist advice about these rules because they're some of the most complex tax laws around.

Super Gearing

Using super gearing is popular when the super fund doesn't have sufficient money to purchase the property outright. Officially called a limited recourse borrowing arrangement, this can be executed if the commercial property is unencumbered (read, How to use super gearing to buy property and Top 5 super gearing traps.

One feature of super gearing is that anyone can loan money to the super fund and, as a result, many small business property owners are using these provisions to loan money to their SMSF so it can purchase the commercial property. There are a number of essential steps in such transactions, such as the need to make sure the terms of the loan are based on similar 'arm's length' arrangements, for example, the interest rate charged on the loan should be in line with the going market rate, such as that charged by the banks.

Before this type of transaction is contemplated, it's essential to consider your super fund's investment strategy. Ask yourself questions like, what is the cash flow impact on the super fund if the property remains vacant for an extended period of time?

Also, it's normally essential to hold real estate for the medium- to long-term and this must be a key part of your consideration.

And finally, your business will need to formally lease the property from your super fund. Once again, this transaction must be at arm's length, which means you will have to pay the rent – so make sure you factor in this cash flow impact into your business' budgets.

Key points:

- In some cases, you may pay less tax by moving your business property into your SMSF.
- You could access cash in your SMSF by selling the property to your fund.
- Most states offer stamp duty concessions for such transfers.
- You might be eligible for small business CGT concessions.
- Make sure you receive specialist advice about all tax aspects of these transactions.

Did you know?

The Government has launched a new superannuation calculator on its MoneySmart website that gives you an estimated superannuation balance at retirement based on the information you provide as well as a retirement planner that helps you determine how much you'll have to live on.

Don't miss this!

We've got some great tips on Super TV this week; John McGrath from McGrath Estate Agents talks about the outlook for the Australian property market now that interest rates are falling, and Gary Stone from Share Wealth Systems names the small cap stocks to watch.