Switzer Super Report

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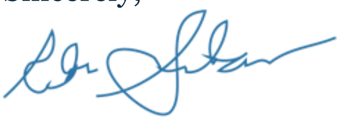
Hold your breath

Europe will continue to dominate sentiment well into the new year but the US may play its 'wild card' this week as the deadline for agreeing on budget cuts looms. This is the issue that kick-started the market dive, so today I look at what this new round of debt talks means for our portfolios.

Also in the Switzer Super Report, stockbrokers continue to downgrade companies, with one even placing a 'sell' on one of the Big Four banks. Our new contributor Vas Kolesnikoff from the Australian Shareholders' Association looks at how the 'two strikes' legislation on executive pay impacts you. We also give you a heads up on what art to buy for your SMSF this auction season, and we highlight some of the issues faced by the self-employed when making super contributions.

Sincerely,



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A big market move might be ahead

by Peter Switzer

While Europe and its debt predicament will remain the main focus for financial markets right into 2012, this week investors will be tuned in to the decisions of the US Congress's 'super committee' as the 23 November deadline to slash debt looms. That's Wednesday – one day before Thanksgiving — so let's hope the Yanks have something to be thankful for.

The super committee is made up of six democrats and six republicans and their job is to find US$1.2 trillion worth of budget cuts to be introduced over the next ten years. Early indications suggest the group won't reach an agreement, but if the expert Congress watchers are wrong, the market could spike higher.

But a failure to agree might not be so bad for stocks because automatic budget cuts are earmarked to start in 2013 if the super committee proves to be less than super.

Of course, the last time the Congress goofed up on deficits and debt, S&P downgraded the US credit rating and the stock market dived.

In a nutshell, the Republicans don't want the tax increases that the Democrats want and the Democrats don't want to can their more generous health care and social security programs, which the Republicans don't support.

By the way, in case you are counting, the US government's debt is now at US$15 trillion!

And what about Europe?

Well, the word is the European Central Bank (ECB) is buying bonds and yields are falling as a result, but will they be successful in keeping yields down?

Lower yields will keep borrowing costs down, which can be a make or break for governments over their heads in debt.

So it's these bond yields that market expert players will be watching closely and Mohamed El-Erian, the CEO of PIMCO – the biggest bond trading business in the world – is doing exactly that. He told CNBC there are signs the market can swing big time either way.

He is worried the European debt issue is leading to lots of deleveraging by financial institutions, while others in good financial positions are reducing their willingness to play the usual game of banking. This is not good for business and ultimately stock prices. El-Erian told CNBC that regulatory developments and traditional end-of-year behaviour is influencing the actions of financial institutions right now.

This shows up as liquidity problems as fewer players play, putting pressure on the ECB to increase the eurozone's money supply to keep funds pumping through the economy. However, some think the ECB won't deliver its potential shock and awe actions until they are sure the troubled governments of the eurozone have committed to fiscal reform.

Spain is going to an election on Sunday, Europe time, where the current government looks like 'dead meat' and this could mean the ECB will have to wait and see what a new government proposes for its reform agenda.

But it's not all bad news with Dick Bove, a US banking expert from Rochdale Securities, telling CNBC that it is time to buy US banks – despite European concerns!

US banks as a group are down 28% for the year, while financials in the S&P 500 are down 22% for the year.

Bove has gone from being all cash around mid-year to 50% in stocks now and he argues banks are over-beaten up.

I certainly believe Europe is still a loose cannon but a hell of a lot of onetime negatives are turning positive. Only the political nincompoops in Europe and the US stand in the way of some solid improvement for stocks.

Go the ECB!

How to invest in artwork

by Alistair Bailey

Millions of dollars have been invested in art over the course of the last 10 months. Indeed, 579 works globally have sold for more than US$1 million this year. But art, like all assets, carries risk, even at the very top end of the market.

Why invest in fine art?

What we call 'passion' investments have increasingly formed a percentage of ultra-high net worth individuals' investor portfolios. This is primarily because fine art carries a similar DNA to gold and silver.

The physicality and longevity of the asset are immediately attractive, particularly in a highly volatile market. Its performance is relatively uncorrelated to equity markets providing further insulation against volatility. There is no incumbent debt associated with the asset and it is generally an asset that is relatively easy to transport and store (assuming you haven't purchased Jeff Koon's very large sculpture *Balloon Dog*). A finite supply creates scarcity, which in turn helps drive prices.

Most importantly, a sovereign default in Europe would have no impact on these underlying traits.

Fine art purchased wisely continues to demonstrate its capacity as a strong long-term alternative and store of wealth, and it is a great way of providing added diversification to a broader portfolio. Of course the trick is buying wisely – the investment will always lie in the quality. So how do we get started?

Rules for investing in art

Entering any market for the first time can be a daunting prospect, particularly when that market operates and reacts to a different set of market forces and has a reputation for being somewhat opaque.

Rule # 1: We come back to those traditional bedfellows of sound portfolio management – research, market intelligence and expertise. It is worth taking the time to educate yourself and familiarise yourself with the market. Attend gallery openings and fine art auctions, read publications to get a feel for how the market is reacting and behaving.

Rule # 2: Establish what your budget and risk profile are going to be and make sure the two are aligned. The opportunity to purchase a key work by a blue-chip artist with a budget of $25,000 simply doesn't exist in Australia. The key is to acquire the best possible work for your budget. A budget of $25,000 will get a major work by a very good mid-career artist, but the risk is heightened. Adam Cullen is a good example of an artist in this category.

Rule # 3: Understand the risks. Making an acquisition made in the primary market carries a unique risk that would seem to conflict with every ounce of an investor's psyche – particularly when investing in an emerging artist's work. Coming to terms with the fact that if you try to on-sell the work within a month or a year or even a couple of years, you will probably not get what you paid for the work initially. The less established the artist, the higher the risk. The key is that you are investing for the long-term and prior to investing, you should understand the risks and how to manage them. In many respects it is no different from looking at a small-cap speculative stock – the lower the entry point, the higher the risk, but if acquired wisely, there is the potential to realise a higher return.

Rule # 4: Avoid the three deadly sins of art investment: Taking auction data at face value, underestimating liquidity and chasing the masterpiece.

Rule # 5: Remember artists don't create investments – they create 'art'. Appreciate the skill.

Rule # 6: Check the artist's CV and profile, curatorial acclaim, whether corporate and major collections have acquired their work, and their consistency of selling out exhibitions.

What to buy this season

So as we head into the last round of auctions in Australia, which works am I interested in? The two Tim Storrier works to be auctioned by Menzies (Lots 24 & 55) are of interest and I think estimates of $60,000 to $80,000 are still a little on the soft side. Both Deutscher and Hackett and Sotheby's Australia have an editioned work *Wet Afternoon* by Ethel Spowers going up on estimates of $20,000 to $30,000. Christies sold a work from this edition in London during March this year with an all-in price of AU$88,000. If they are in good condition, a purchase at the bottom end of the estimates could be worth a look.

I'll also be keeping an eye on the Quilty, Amor and Lister (Menzies) and the David Noonan and Andrew Browne at Sotheby's Australia because these are artists that have been movers in the auction and private treaty markets over the past couple of years. These works are likely to sell for 10-15% more than top-end estimates.

In my previous column, I mentioned the Del Kathryn Barton Lithographs *When I was another Tree I, II & III*. Editions of these are back up at Deutscher and Hackett, but this time with estimates of $6,000 to $9,000. Time will tell whether or not they'll nudge the high-teens as last time.

Alistair Bailey is an executive director at Art Equity.

Shareholders get what they pay for

by Vas Kolesnikoff

As of 1 July 2011, new 'two strikes' legislation has come into effect which has created significant debate in business and investment circles. It also has significant consequences for SMSF trustees, with many of you owning companies for the long-term.

The legislation states that if 25% or more of the shareholders of a company vote against the remuneration report of executives in two consecutive years, thereby incurring 'two strikes', then within 90 days of the second strike, the board of that company must answer to shareholders and stand for re-election.

This legislation has been enacted because there have been many instances of shareholder disapproval of boards and management on the issue of company performance and paying executives for it. However, the resolution relating to the remuneration report is only of an 'advisory' nature at AGMs, such that, it is not binding on the company and many boards have generally ignored the shareholders' votes. This new legislation, which the Australian Shareholders' Association (ASA) was instrumental in driving, now creates a consequence for boards who ignore the vote of a significant percentage of the owners of the company. All shareholders finally have an incentive to cast their votes to influence the decisions in the company.

The issue of executive remuneration is not singular and without consequence, as it has wide-ranging implications for investor returns.

It is one of the measures of appropriate governance in existence in a company, and demonstrates how a board, which represents the owners of the company, puts in place appropriate rewards. This is to ensure the company performs to its maximum potential, with regard to safeguarding investors' interests and maximising returns.

The ASA and numerous other governance experts point out the perils for investors where poor governance leads to poor results. Executive remuneration in a company goes to the heart of what outcomes shareholders seek to reward. ASA policies require alignment of executive remuneration with investors' interests and returns with a long-term perspective; that is, investors must see outperformance before bonuses or incentives are paid to executives. Most superannuation and savings plans involve long-term investments and when we see reward given for short-term risk taking, there is immediate concern for the longer-term consequences and potential loss.

The ASA is mindful in pointing out misalignment of executive remuneration with investors' interests, which could potentially cause losses or sub-optimal results for investors. This year we have seen numerous examples, where any concept of executive entitlement to incentives or bonuses are not seen in the performance of the company or results for investors.

Let's go through two examples, so that DIY super investors can see what they should be looking for:

- The **Fairfax Media** (FXJ) share price in the last five years has fallen significantly from a high of $5 in 2007 to a low of 68 cents in August 2011, while dividends have fallen from 20 cents to five cents per share. In 2011, the company reported a $390 million loss. In the five-year period, executive remuneration has increased from $7.25 million to nearly $14 million. This company is not rewarding results.

- This year, **Leighton Holdings** (LEI) reported a $409 million loss and conducted a highly dilutive $758 million capital raising to prop up its balance sheet after an urgent business review resulting in a $1 billion write-off against long term contracts. In the meantime, current and former executives received multi-million dollar one-off short-term related bonuses and payments, including to the CEO of less than one year, David Stewart, who will walk away with over $7 million. Again, there is a disconnect between company performance and executive rewards.

The ASA wants SMSF trustees to be mindful of all factors when picking their stocks. In the case of executive remuneration, you get out of your investment what you reward.

Vas Kolesnikoff is the chief executive of the Australian Shareholders' Association.

The broker wrap: downgrades continue

by Rudi Filapek-Vandyck

Change to stockbroker recommendations in past week

Code	Company	Old Rating	New Rating	Broker
BLS	Bluescope Steel	Neutral	Buy	Macquarie
GFF	Goodman Fielder	Sell	Neutral	Macquarie
LLC	Lend Lease Corporation	Neutral	Buy	JP Morgan
SHL	Sonic Healthcare	Sell	Neutral	UBS
AZT	Aston Resources	Buy	Neutral	Macquarie
CPB	Campbell Brothers	Buy	Neutral	BA-Merrill Lynch
CPB	Campbell Brothers	Buy	Neutral	UBS
CCL	Coca-Cola Amatil	Buy	Neutral	JP Morgan
CBA	Commonwealth Bank	Neutral	Sell	Citi
ILU	Iluka Resources	Buy	Neutral	RBS Australia
IPL	Incitec Pivot	Buy	Neutral	Credit Suisse
JHX	James Hardie Industries	Buy	Neutral	Citi
MAP	Macquarie Airports	Neutral	Sell	JP Morgan
MGX	Mount Gibson Iron Limited	Neutral	Sell	Macquarie
PPC	Peet & Company	Buy	Neutral	Macquarie
16	Peet & Company	Buy	Neutral	UBS

Source: FNArena

Downgrades have dominated yet another week, with brokers in the FNArena database lowering ratings on 12 stocks while upgrading just four. This brings total Buy ratings to just a touch under last week's 57.7%.

Among the upgrades was **BlueScope Steel** (BSL), Macquarie moving to an Outperform rating from Neutral on expectations the 'new' BlueScope will be a closer play on the domestic economic cycle as a result of a reduction in some loss-making export operations as part of an operational restructuring.

Macquarie expects the market's confidence in BlueScope to lift as earnings improve, which should be enough to drive a re-rating of the stock in time.

A strategic review by **Goodman Fielder** (GFF) has also prompted an upgrade to Neutral from Underperform by Macquarie, the broker taking a slightly more optimistic approach to new management's proposed cost estimates. Improved valuation also supports the upgrade in rating, as do increases to earnings estimates.

J.P. Morgan meanwhile has upgraded **Lend Lease** (LLC) to Overweight from Neutral driven by what it sees as a solid medium-term earnings growth outlook and an attractive valuation at current levels. The broker has also identified some positive near-term catalysts, such as new work for Valemus and good mixed-use and residential development pipelines.

Sonic Healthcare (SHL) enjoyed an upgrade to Neutral from Sell by UBS, the broker now adopting a more positive stance on opportunities in the UK pathology sector as outsourcing momentum increases.

On the downgrade side, **Aston Resources** (AZT) has been downgraded to Neutral from Outperform by Macquarie to reflect uncertainty from board changes arising from a difference of opinion in relation to corporate strategy.

While the Maules Creek project continues to offer promise, the board issues have seen Macquarie remove a previous takeover premium, which also means a cut in price target. A similar boardroom issue at **Mount Gibson** (MGX) has also seen Macquarie downgrade it to an Underperform from Neutral.

Both UBS and BA Merrill Lynch downgraded **Campbell Brothers** (CPB) during the week on valuation grounds to reflect recent share price gains. In both cases the brokers moved to Neutral ratings from Buy recommendations previously, though BA-ML did lift its price target slightly.

Recent outperformance was also enough for JP Morgan to downgrade **Coca-Cola Amatil** (CCL) to Neutral from Overweight, while earnings estimates have been trimmed in anticipation of another wet summer impacting demand.

Citi's downgrade on **Commonwealth Bank** (CBA) to Sell from Neutral is based on the view a new CEO will be looking for growth avenues, so potentially putting some downward pressure on the share price. As well, Citi's view is the recent trading update by the bank implies a slow start to the new fiscal year.

A strategy day was enough to prompt RBS Australia into making minor changes to its model for **Iluka** (ILU), with earnings and price target both adjusted. While the stock now offers an attractive yield there is potentially less growth on offer, which supports the broker's move to a Hold rating.

While **Incitec Pivot's** (IPL) full-year earnings broadly met expectations, Credit Suisse downgraded it to a Neutral from Outperform to reflect a tempering of expectations in coming years. The price target was unchanged, so the downgrade was a valuation call by the broker.

Valuation also explains Citi's downgrade of **James Hardie** (JHX), as the company delivered a solid second quarter update with some signs of volume and margin improvement.

For **MAp Group** (MAP), valuation is also an issue in the view of JP Morgan, who has downgraded it to Underweight from Neutral given the share price is now in line with its estimate of value. Also supportive of the downgrade is that the stock is trading at a premium to the market despite the possibility of softer passenger numbers in coming months.

Peet (PPC) delivered a weak update and a lowering of earnings guidance for the full year causing UBS and Macquarie to downgrade it to Neutral from Outperform as weak operating conditions and capital levels suggest outperformance is unlikely in the short term.

Change to earnings forecasts (EF) in the past week

Code	Company	Former EF	New EF	Change	No. of brokers
AZT	Aston Resources	25.275	39.460	56.12%	5
LYC	Lynas Corp	0.540	0.580	7.41%	4
CAB	Cabcharge	53.333	54.450	2.09%	5
JHX	James Hardie	29.712	30.223	1.72%	8
CHC	Charter Hall	22.467	22.800	1.48%	6
IPL	Incitec Pivot	32.054	32.413	1.12%	8
CPB	Campbell Bros	283.886	286.857	1.05%	7
STO	Santos	61.163	61.775	1.00%	8
CWN	Crown	54.025	54.525	0.93%	8
MAP	Macquarie Airports	7.259	7.287	0.39%	6
PPC	Peet	12.833	7.108	- 44.61%	6
GBG	Gindalbie	1.157	0.771	- 33.36%	6
AQG	Aquarius Platinum	67.394	59.400	- 11.86%	5
SGM	Sims Group	128.943	115.414	- 10.49%	7
ELD	Elders	5.525	5.000	- 9.50%	3
SLM	Salmat	35.350	32.017	- 9.43%	6
SFH	Specialty Fashion	8.520	8.120	- 4.69%	5
AIO	Asciano	10.025	9.650	- 3.74%	8
BHP	BHP Billiton	418.629	403.328	- 3.66%	8
ARP	ARB Corp	57.225	55.625	- 2.80%	4

Source: FNArena

Note: FNArena monitors eight leading stockbrokers on a daily basis. These are: BA-Merrill Lynch, Citi, Credit Suisse, Deutsche Bank, JP Morgan, Macquarie, RBS and UBS.

For more news and analysis, visit FNArena.com.

Planning your retirement for the self-employed

by Tony Negline

Superannuation for the self-employed is a voluntary affair – no one forces you to make regular super contributions.

As a result, anyone in small business has a number of issues to consider about the management of their retirement assets.

Timing your contributions

The first issue is the timing of contributions. Anyone who operates as an employee, for example via a small corporation or via a labour hire arrangement, probably has compulsory employer super contributions being made for them quarterly. But how often should you contribute if you're self-employed?

As the management of cash flow is very important for every small business. Often all other super contributions are dealt with near the end of every financial year and a quick trip to our accountant with our trading accounts and a review of our current bank account balance generally goes a long way to determining what super contributions a small business can afford for the proprietors every June year-end.

Since July 2007, every super investor has also had to think carefully about the contribution caps and the impact of excess contributions tax. These caps are no different for small business owners.

Selling business assets

If super isn't affordable in any year, then many small business people hope that when they retire, the sale proceeds from their business will go some way to providing their retirement assets.

The Howard Government's small business capital gains tax (CGT) concessions, which were first introduced in 1997, have been of great assistance here. It is true that these concessions are insanely complicated and expert assistance must be sought before attempting to use them. The good news is the ALP Government doesn't appear to be moving to repeal these concessions in one of their regular bouts of legislative class envy.

However, getting the proceeds of the sale of a small business or a small business asset into super is a tricky financial planning exercise because there are several special contribution caps which have to be considered.

In effect, small business people have at least two sources of potential retirement assets – their business and their super funds. Many people will fondly remember when the assets held in the super fund were often business assets, but the ability to do this has fallen away since 1992 after restrictive regulations were introduced.

The introduction of super gearing is going some way to re-introducing the use of some small business assets, especially business premises. You can read more about on super gearing strategies on our website.

Tax deductions

One area that the self-employed must be very careful about is how to access a tax deduction for their super contributions. We've discussed the seven key steps here. But it's important to note that many people don't seem to worry about their super fund exchanging written documentation with themselves. If only accountants would insist on seeing this documentation before claiming a personal super tax deduction on a person's tax return, a great deal of hassles for super administrators would disappear!

It has often been argued that super should be made compulsory for sole proprietors. According to the latest Australian Tax Office statistics (for the 2008/09 financial year) there were about 1.75 million taxpayers who earned income from a sole proprietor business, but only 193,000 people claimed personal super contributions as a tax deduction.

It's important to note that not all of the people who claimed these super contributions as a deduction may have been running their own business because this deduction is available to other taxpayers.

But one could conclude from this that many small business people have no faith in the super system and are relying on their private savings, including their business, to give them income in retirement.

Important information: *This content has been prepared without taking account of the objectives, financial situation or needs of any particular individual. It does not constitute formal advice. For this reason, any individual should, before acting, consider the appropriateness of the information, having regard to the individual's objectives, financial situation and needs and, if necessary, seek appropriate professional advice.*

Did you know?

The authorities come down very hard on self-managed super funds found to break the rules regarding 'in-house assets'. To find out what in-house asset are and how you can avoid them, read our section on Avoiding in-house assets.

The Week Ahead

Australia
Monday 21 November: Speech by RBA Assistant Governor to Australian Securitisation Forum
Wednesday 23 November: Speech By RBA Assistant to an APRA Basel III workshop
Wednesday 23 November: Construction work done (September quarter)
Wednesday 23 November: State accounts (2010/11)
Thursday 24 November: Annual address by RBA Governor to business economists

Overseas
Monday 21 November: US Existing home sales (October)
Tuesday 22 November: US GDP (September quarter, preliminary)
Wednesday 23 November: US Personal income (October)
Wednesday 23 November: US Durable goods (October)
Wednesday 23 November: Deadline for US debt negotiations

Company results
Monday 21 November: Technology One (TNE)(full year)
Tuesday 22 November: Fisher & Paykel Healthcare (FPH) (interim)
Friday 25 November: Graincrop (GNC) (full year)
Tuesday 29 November: Metcash (MTS) (interim)
Tuesday 29 November: Campbell Brothers (CPB) (interim)

Ex dividend
Monday 21 November: Australian Masters Corporate Bond Fund No 5 (AKY) 295 cents
Monday 21 November: SP Ausnet (SPN) 4 cents
Tuesday 22 November: The Trust Company (TRU) 17 cents
Monday 28 November: BT Investment Management (BTT) 10 cents