Switzer Super Report

Issue 39, 1 December 2011

Rally time

Europe finally gave the markets a reason to rally last night, although it came with some help. Six of the world's biggest central banks came to the rescue by providing Europe's banks with access to cheap loans. But the region's sovereign debt remains the big elephant in the room. Will that pressing issue be resolved in time for a Santa Clause rally? I tell you what I think in my column today.

Also in the Switzer Super Report, we look at how low interest rates may go and the stocks you can buy to benefit from the cuts. We also pick out the best Aussie ETFs to get international exposure, explain a strategy for moving large sums of money into your SMSF, and discuss lifetime pensions. Enjoy today's report!

Sincerely,

Peter Switzer

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Switzer Super Report is published by Switzer Financial Group Pty Ltd AFSL No. 286 531
36-40 Queen Street, Woollahra, 2025
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This rally could have legs

by Peter Switzer

Europe really needed some help and it got it with six central banks — the European Central Bank (ECB), the US Federal Reserve and counterparts from Japan, Canada, Switzerland and the UK — turning on the liquidity tap overnight to help arrest the looming European recession and potential blockages in the banking system.

This, and a solid run of good US economic data, explains why the Dow nearly topped 500 points overnight, but the question remains: can we really see a Santa Claus rally?

Let's have a look at the run of positive data that is getting me a little excited:

- The Beige Book, which looks at regions and sectors around the US economy, came in more bullish than expected.
- The US ADP private sector jobs report came in at 206,000, which KO'd the forecast of 130,000 in November.
- Black Friday retail sales rang up a very positive outlook of the upcoming holiday shopping season in the States.
- These results follow very bright durable goods figures, solid ISM manufacturing data as well as ISM services data and a massive rebound in consumer confidence.

The simple summary is that the US is recovering and only a disaster in Europe could derail it and so the good sense of the central banks' 'shock and awe' play was timed to perfection.

This action has increased speculation that the next step could be the ECB lending money to the International Monetary Fund (IMF), which in turn will help out the likes of Italy and Spain. An action like this will get around the ECB's rule that stops it providing assistance to sovereign countries, although it can help banks, which was what today's play was all about.

Come Friday, Germany's Chancellor will outline her plan for tighter fiscal discipline for European Union (EU) members and I reckon the run of news – if it can remain positive and indicate that Europe is heading in the right direction, step by step – then we could see a melt up of stocks.

Of course, if recent history prevails, then a meltdown is always a possibility, but I have to say I'm getting the feeling that the pendulum of news and economic data is swinging to the positive, meaning this rally could have real legs.

Another shock and awe play that could be in the wings would be the likes of China stepping in to support the IMF as well based on the fact that it is now seeing the other countries of the world riding to the rescue of Europe.

What we have now is a window, which has been opened up by this central bank play, but now the Europeans have to start pushing their slack and procrastinating politicians and key regulatory bodies through this opening to build on the shot of confidence this co-ordinated central bank action has given Europe, the stock market and ultimately the global economy.

We are not out of the bears' woods just yet, but we could be close to the edge where the paddocks of resting bulls are grazing, waiting to charge.

As the old movie line nearly went: "One false move and the fat PIIGS cop it!" *

* PIIGS is the acronym for the EU's debt ridden countries of Portugal, Italy, Ireland, Greece and

Spain.

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.*

Don't pile into fixed interest

by Charlie Aitken

One of the reasons I remain unflinchingly bullish on Australian equities (particularly those with high sustainable/growing fully franked dividend yields) is because Australia is one of the few countries left with conventional monetary policy levers to pull.

The Australian government bond markets and the Australian dollar have now seen right through the RBA's jawboning and realise the RBA has no choice but to put policy in reverse. Yes, this started with November's 25 basis point rate cut, but in my career I can never remember the RBA being so far behind the curve, metaphorically and literally. The table below shows the Australian government bond yield curve out 15 years. Note how the entire yield curve is significantly below the RBA's current cash rate of 4.50%.

Sure, an element of these very low government bond yields is a 'flight to safety' and the giant fixed interest bubble, but to see an Australian Government three-year bond at 3% when the RBA cash rate is at 4.5% is telling you how big this rate cut cycle potentially can be. This won't end at a 'neutral' monetary policy setting, which is about where we're at now – particularly given the $10 billion hole in Treasurer Wayne Swan's budget that needs to be filled by widespread Federal spending cuts.

We also need to remember the average Australian residential variable mortgage rate holder is paying around 7.5% per annum, the highest mortgage interest rates in the first world by a huge margin. With the 'Big Four' banks still (wrongly) obsessed with margin maintenance and wholesale funding costs remaining persistently high, the RBA will have to cut rates harder than it suspects to actually have a noticeable economic effect. This is another reason I believe the Australian Dollar has peaked for the cycle and will settle in the new lower trading range of 95 US cents to 100 US cents that we have been forecasting.

Significantly lower cash rates and a lower Australian dollar trading range will be positive for the Australian economy and Australian companies. It's that simple.

Commonwealth Government Bonds

Coupon Rate	Maturity Date	Yield
4.75	15 Nov 2012	3.28
6.50	15 May 2013	3.13
5.50	15 Dec 2013	3.04
6.25	15 Jun 2014	3.02
4.50	21 Oct 2014	3.04
6.25	15 Apr 2015	3.05
4.75	21 Oct 2015	3.15
4.75	15 Jun 2016	3.19
6.00	15 Feb 2017	3.29
4.25	21 Jul 2017	3.39
5.50	21 Jan 2018	3.49
5.25	15 Mar 2019	3.63
4.50	15 Apr 2020	3.76
5.75	15 May 2021	3.85
5.75	15 Jul 2022	3.94
5.50	21 Apr 2023	4.01
4.75	21 Apr 2027	4.21

Bell Potter

I just hope all those Australian retirees and approaching retirees piling out of equities at the bottom know they are piling into fixed interest ahead of a substantial rate cut cycle. Yes, you might well sleep better at night with the 'certainty' of fixed interest, but in my view you are only truly locking in the 'certainty' of significantly lower unfranked total returns than the equity market will give you over the next few years. National Australia Bank shares returned more in capital growth on Monday alone than an Australian Government 10-year bond annual yield.

Eventually, in perhaps a year's time, there will be a 'fear of no income' (FONI) switch back to high fully franked equity yield. You will look back in amazement that you could buy Big Four Australian banks or Telstra at 9% per annum fully franked dividend yields. But not only will the Big Four Banks and Telstra pay you 9% per annum fully franked yields simply to own them, but on our analysis we forecast 20% capital gains on top of that annual yield.

This is why from an investment strategy perspective I remain very positive on Australian banks, Telstra, Australian discretionary retailers, Australian unhedged resource stocks with US dollar revenues and Australian dollar costs, resource service companies, all things West Australian and am getting interested in east coast building materials stocks. Interestingly though, when you analyse the biggest short positions in the Australian equity market now, it's in these sectors where they reside. Therein lies the contrarian opportunity.

Rio Tinto Limited (RIO) – Buy

We retain our 'buy' rating on Rio Tinto, with a target price of $98.45 per share derived from an average of 12.5-times peak year earnings, 13-times long-term earnings, and 1.06-times Calender year 2012 net present value. Growth for the next decade is underpinned by Pilbara iron ore expansions from 220Mtpa currently to 333Mtpa by 2015, and copper projects beyond 2015 (Oyu Tolgoi, Resolution, Bingham Canyon, Escondida). Coupled with the awakening 'sleeper', its aluminium business, and its strong balance sheet and cash flow, Rio is undervalued.

- **Target price: $98.45**
- **Wednesday's close: $62.95**

Alacer Gold (AQG) – Buy

Alacer is consolidating its position as a leader of the mid-tier gold sector by moving towards about 800kozpa Au in 2015. At forecast, considerable value has been added by the ongoing ramp up of the Çöpler oxide mine. The share price is near the base of a steep trading range, partly due to recent negativity over an unexpected change in accounting method that accelerated D&A for the WA assets (affecting forecasts). We believe there's potential for a near-term gain. Share price catalysts could be the Çöpler resource upgrade and sulphide feasibility study, a $40 million exploration program and a definitive feasibility study on the HBJ open pit expansion in WA. We maintain our 'buy' recommendation.

- **Target price: $12.70**
- **Wednesday's close: $10.74**

Chalice Gold Mines (CHN) – Spec Buy

We maintain our 'speculative buy' for Chalice Gold Mines, which recently signed a mining agreement with Eritrea and announced high-grade gold intercepts at the Zara Project. These developments have further de-risked Zara and opened the way for funding and development of the Koka Mine. The mining agreement shows that Chalice's patience in developing the Koka Gold Mine is paying off. The next critical steps will be the mining licence, and CHN/ENAMCO project finance for more than US$120 million capital expenditure.

Disclosure: Bell Potter Securities acted in the placement of CHN shares in May.

- **Target price: $0.46**
- **Wednesday's close: $0.25**

JP Goldman

The best Aussie ETFs for international exposure

by JP Goldman

The growing market in locally listed exchange-traded funds (ETFs) is offering Australian investors an ever-expanding range of options to gain international diversification for their portfolios cheaply and easily.

Of course, investing in offshore markets has been a fairly thankless task over much of the past decade – due to the strong rise in the Australian dollar and our booming resources sector. Note: a rising Aussie dollar tends to dampen the returns, in Aussie dollar terms, from unhedged offshore investments.

That said, even with the hindsight of recent underperformance, there's still a case for offshore exposure on the grounds of diversification alone. Australia's market is very top heavy in banks and resource companies and underweight in technology and consumer stocks. And with the Aussie dollar and export commodity prices looking toppy, it's probably not a bad time to dip one's toes into international waters.

But what are the best products?

There are now just over 20 international exchange-traded funds listed on the local market, providing exposure to a range of markets including the United States, Europe, Japan and China. There are also more broadly diversified regional ETFs providing exposure to developed and/or emerging markets, or global industries such as health care, consumer staples and telecommunications.

To narrow the field, I'll concentrate on some of the more popular international ETFs providing broad global diversification.

As seen in the table below, iShares' S&P 500 ETF (IVV) is the most popular international ETF on the local market, with $290 million in funds under management at the end of October 2011. It is almost the second cheapest, with a management expense ratio of only 0.09% per year. Only Vanguard's US offering (VTS) is cheaper, with an MER of 0.07%. Due to its greater size, however, IVV retain moderately better liquidity, with a tighter average bid-offer spread and greater market depth.

Another popular choice is the iShares Global 100, which provides exposure to both the US and non-US developed markets, although it is somewhat less liquid than IVV.

iShares' emerging markets ETF (IEM) is also popular, with $154 million in funds under management, but it can still suffer from wide bid-offer spreads due to the difficulty traders face in hedging their risks for markets that's don't trade in the Australian time zone.

ETF Costs and Liquidity

ETF Provider	ASX Code	MER (1)	FUM ($Am) (2)	Av. Bid/Offer (3)	Depth ($Am) (4)
ishares S&P Global 100	IOO	0.40%	$183	0.61%	$0.65
ishares US S&P 500	IVV	0.09%	$290	0.18%	$1.86
Vanguard US Total Market	VTS	0.07%	$53	0.49%	$0.35
Vanguard All-World ex US	VEU	0.25%	$36	2.13%	$0.19
ishares MSCI EAFE	IVE	0.35%	40	1.5%	$0.36
ishares MSCI Em. Mkts	IEM	0.72%	$154	1.38%	$0.21
ishares China 25	IZZ	0.72%	$30	0.69%	$0.17

(1) management expense ratio (2) funds under management in Australia (3) average % spread between best bid & offer price

(4) average dollar value of 5 best bids & offers (5) 12 months to August for STW and VAS, year to date for IOZ

Source: ASX ETF Monthly Report October 2011, ETF Provider websites.

There remain a few holes in the local ETF marketplace. For starters, there are as yet no hedged international ETFs – meaning, for good or bad, investors must accept the currency risk of the markets in which they invest.

Oddly, there's also no single ETF that provides broad exposure to both the US market, non-US developed markets, and emerging markets. Investors need to mix and match these themselves. Indeed, a difference between the non-US international ETFs – IVE and VEU (in the table above) – is that the latter holds an almost 30% exposure to the emerging markets, whereas the latter is focused on developed non-US markets alone. iShares S&P Global 100 (IOO) provides exposure to both the US and non-US developed markets, but not emerging markets.

In terms of risk, US market Aussie dollar returns have tended to be relatively less correlated to Australian market returns over the past decade or so, due likely to its different sectoral composition and the Aussie's tendency – especially against the greenback – to rise and fall in line with global markets. Interestingly, US ETF risk alone has not been materially different to that of the broader Global S&P 100.

Risk Measures: 1995-2010

ETF Provider	ASX Code	Correlation (1)	Beta (2)	Std. Dev (3)
ishares S&P Global 100	IOO	0.40%	0.58	0.24%
ishares US S&P 500	IVV	0.38%	0.54	0.23%
Vanguard US Total Market	VTS	0.41%	0.55	0.22%
Vanguard All-World ex US	VEU	0.77%	0.80	0.17%
ishares MSCI EAFE	IVE	0.68%	0.71	0.17%
ishares MSCI Em. Mkts	IEM	0.71%	1.10	0.26%
ishares China 25*	IZZ	0.63%	0.97	0.34%

(1) Correlation in annual returns with the S&P/ASX 200 index (2) Beta estimate against the S&P/ASX 200
*(3) Annual returns *For China since 2003 only*

In terms of valuations, the good news is that most markets – both here and abroad – appear relatively cheap based on recent historical price to earnings averages. And if you believe the Australian dollar is heading for a fall, it only enhances the expected returns from offshore markets.

Valuations*

ETF Provider	Latest PE Ratio	Average PE Ratio	% deviation
MSCI World	10.9	14.3	-23.8%
US S&P 500	11.6	13.8	-15.9%
MSCI EM. Mkts	9.5	10.9	-12.8%
S&P/ASX 200	11.1	13.8	-19.6%

**Price to 12-month forward earnings, latest end-November 2011. Average since 2003.*

What to buy

All up, good options for offshore exposure seem to be iShares' S&P 500 index (IVV) due to its low cost and good liquidity, which could be complemented with Vanguard's non-US market ETF (VEU), which is also reasonably cheap and covers both non-US developed and emerging markets. Otherwise, investors can combine IVE and IEM to generate non-US international exposure, and tailor their desired exposure to emerging markets (IEM) to suit their risk preferences.

Note: the downside of broadly diversified international ETFs – such as VEU – is that they can suffer from relatively wider bid-offer spreads due to the difficulties in hedging price risk during the Australian time zone. This means they are best used as long-term portfolio diversifying investments rather than short-term trading vehicles.

Is your lifetime pension financially sound?

by Tony Negline

Today I'm going to explain lifetime pensions, a type of income stream that provides defined income payments for the duration of the pensioner's life as well as the life of their reversionary beneficiary (if one was nominated when the pension commenced).

Lifetime pension payments are a benefit promise – that is, they're guaranteed to be paid.

These pensions are purchased and they typically commence when the purchase price is converted into an initial annual income amount and, if required, an agreed level of periodic indexation (typically, payments are adjusted for consumer inflation but occasionally some people have managed to negotiate a better arrangement such as wage increases).

These products are similar to annuities, the major difference being that lifetime pensions are purchased from a super fund, while annuities are purchased from a life insurance company.

Lifetime pensions are the oldest form of pension available from super and have been around since retirement benefits began in the nineteenth century. Before December 1992, only lifetime pensions could be paid from an Australian super fund.

There are two major disadvantages with these products. Firstly, when you and your spouse die, any remaining lump sum stays in the super fund, which means nothing is available for your estate. Secondly, if you had to start this type of pension when market interest rates were low, then your pension income would often be quite low too. The reverse of this could also occur, and this has benefitted some people who started a lifetime pension in the early 1990s when interest rates were more than 15% plus indexation.

Typically, these pensions could only be paid from larger retail and corporate super funds. The financial management of these products has always been left to actuaries.

You might recall that between 1988 until 2007, the Reasonable Benefit Limit (RBL) boondoggle reined over the Australian super system. For reasons that are unimportant now, these lifetime pensions were treated very favourably under this RBL assessment system. This delivered significant tax advantages to investors who used this type of product.

In addition, the assets used to purchase these pensions were exempt from Centrelink's Assets Test.

In the early part of this century some wiser heads asked actuaries if a lifetime pension could be payable from a self-managed super fund. Investors were after three extremely valuable and attractive benefits:

1. the RBL tax advantages;
2. the distributable assets left in the SMSF when the pensioner and their spouse died; and,
3. Centrelink's Assets Test exemption.

For a while, SMSF lifetime pensions enjoyed a moment in the sun with many reasonable wealthy retirees using these products.

But in the 2003 Federal Budget, the Government announced that SMSFs would no longer be allowed to provide new lifetime pensions. This restriction finally came into effect in late December 2004.

Any SMSF still paying a lifetime pension must get it reviewed by an actuary each year. The purpose of this review is to make sure the pension is financially sound and the super fund trustees will be able to meet their future pension payment obligations.

A lifetime pension will only be financially sound in an SMSF if an actuary is very confident about its future prospects.

The GFC – and its lingering financial market impacts – have caused many SMSF lifetime pensions to become financially unsound.

As a result, many of these lifetime pensions in SMSFs have had to be restructured. Typically, the investors have had to move to another type of pension called a Market Linked Income Stream or they have had to agree to reduced pension payments.

Under normal Centrelink rules, if you restructure or get out of a lifetime pension, you lose any concessions that were attached to those pensions. However, Centrelink has put in place rules to be lenient in some circumstances.

How to move large sums of money into super

by Andrew Bloore

Trustees who receive a large inheritance or wish to make substantial catch-up payments into their super prior to retirement face some restrictions in their planning. However, by setting up a unit trust, SMSF trustees can better utilise large sums while keeping within the super contribution caps.

Effective 1 July 2007, non-concessional contributions were capped at $150,000 per annum or $450,000 averaged over three years if you choose to take advantage of the bring-forward rule.

Individuals with large amounts earmarked for super are required to limit their non-concessional contributions to these amounts.

It is still believed that the most flexible way to work with the cap on non-concessional contributions is for individuals to invest jointly with their SMSF and progressively transfer the component of the investment that the members hold personally into their fund using a variation on a strategy in which an SMSF jointly owns assets with their members.

The strategy

A joint investment by an SMSF and its members is permitted under section 71(1) of the Superannuation Industry Supervision Act 1993 (SISA). This can be achieved by either the fund and the member acquiring the asset as 'tenants in common' or alternatively, a trust could be settled with units being allotted to the fund and its members in their desired ratios.

An investment by an SMSF in a related trust is permissible provided the related trust does nothing more than the fund would otherwise have been able to do in its own right.

Discussion regarding the merits of the two alternatives generally revolves around the flexibility afforded by the unit trust in that, if the co-owners wish to change their respective ownership proportions, one would simply transfer units to the other. Unit trusts offer a more commercial means by which co-owners' interest can be changed over time.

The appeal of using an SMSF in this manner, rather than investing by way of a public offer fund, is that super and non-super capital can be aggregated at the outset without the need to split the capital, thus resulting in the ability of the SMSF trustees to fully utilise their funds for investment purposes.

For example

If a member received a large settlement from the sale of an investment property, say $1 million, and wished to contribute it into their SMSF, they would have to gradually transfer the amount into the fund over a number of years and their capital would be split, with some in super and some held personally in their own name during this period.

If on the other hand an SMSF was established with a related unit trust, with one million $1 units being allotted to the member, the trust would hold the entire capital and be able to invest it at the time the inheritance settled. Over time, the member could transfer, in-specie, the beneficial ownership of their own units in the trust to the SMSF up to the annual cap on non-concessional contributions.

While this cap on non-concessional contributions would still limit the amount able to be contributed into the super fund, the member's capital would be fully productive in a single investment and be able to be drip fed into a concessionally taxed super environment over time. The transfer of business real property into an SMSF could be done in much the same way.

Andrew Bloore is the chief executive of [SuperIQ](#).

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Don't miss this!

The Reserve Bank of Australia meets this Tuesday 6 December for its last monetary policy meeting of the year. Will we get another interest rate cut? Economists think rates will go down, but they're undecided whether it will be this year or early next year. Visit the Switzer Super Report website at 2.30pm AEST Tuesday to read about their decision.

Did you know?

Charlie Aitken was on Peter Switzer's SWITZER program on the Sky Business channel earlier this week, and he named his Top 10 stocks to watch in 2012. Find out which companies he has his eye on for the year ahead on Super TV.