Switzer Super Report

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Best of 2011

Well, here we are at long last - 2011 has come to an end and many of us will be glad to see the back of it as far as stocks are concerned. This really has been 'The Year of the Nicompoop' and I tell you why in my column today.

Also in the Switzer Super Report, our editor has pulled together our best calls of 2011, and there's some good ones in there. And since many of you have come on board just recently and missed some of the great advice we put out in our early reports, we've re-visited four popular articles that have stood the test of time. These include a road test of Commonwealth Bank's Super Gear Loan, the best Aussie index ETF, Ron Bewley's 'Dear Diary' on how he managed the market dip, and six legal traps for your SMSF to avoid. Thanks for your support in 2011 and have a Happy New Year!

Sincerely,

Peter Switzer

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by Tony Negline

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2011: The year of the nincompoop

by Peter Switzer

It turns out 2011 has been the year of, not living dangerously, as some might believe, but more like living 'nincompooperishly'.

The year started with so much promise after the typical end-of-year rally in the United States inspired our S&P/ASX 200 index to jump from 4,584 at the beginning of December 2010 to a New Year reading of 4,745.

But it didn't end there with buyers outnumbering sellers in the early months of 2011, and April 11 brought us the best close of the year at 4,971.2. That's a long way from the low 4,000's we find ourselves in as Christmas looms.

My take on 2011

What we have here is a historically significant year of investing because the third year of a US presidential cycle has traditionally been the best for the market and this is then followed by the actual year of the poll, which President Obama faces in November next year. However, we are living in unique times with the global economy and financial markets still dealing with the debt fallout from the Global Financial Crisis of 2008-09.

If I had to tag 2011 and what it brought, I would have to remember it as the year of the 'nincompoop policymaker'.

Markets are driven by economic data, company fundamentals and speculation, which of course can be heavily influenced by politicians and regulators. Governments played politics with a dangerously precarious economic and financial market situation and that's why the likes of Associate Professor Steve Keen from the University of Western Sydney is still being given oxygen for his doomsday debt view.

On my *SWITZER* Sky Business program in April, I found history a more reliable guide when I reminded viewers that on Wall Street, the cliché "sell in May and go away" has had a very high strike rate. My charts guy, Lance Lai of Accountancy Invest, had his own Asian take on the rhyme, which he explained on our Switzer website under the title "Sell in May and Go to Shanghai", which is exactly where he went while being absolutely on the money.

It didn't have to happen

This year's disappointing market result, which could see us down 15% or more, is really testing the long-term patience of many investors. But it didn't need to happen — not everything went wrong.

Equity markets were battered by the effects of the earthquake followed by a tsunami and then a nuclear disaster in Japan. It brought out the alarmists who claimed the US was heading for a double-dip recession. They were wrong, with the US recovering and showing signs that it is poised to grow by 2-3% next year.

Meanwhile, US companies outperformed all expectations and even our own have done well enough for the likes of RBS Morgans chief economist, Michael Knox, to say that our S&P/ASX 200 should be over 5,000 by a long chalk! However, economic data and company fundamentals have played second fiddle to the fiddling of EU politicians and regulators as Europe burned.

Things were made worse by the US Congress, which fought out a battle over debt and deficits. The Republicans, who dominate the House, frustrated President Obama and his Democrats on the basis that enough debt had been run up; the lack of decisive action saw US Government debt downgraded.

Chaos breaks loose

August brought the collective chaos of the USA and the EU political processes to a head, driving markets down. Our focus gradually went off the US, as it seemed likely that the Yanks were defying the doomsday merchants who talked about double-dip recessions.

The new focus became Greece and then Italy and inevitably the EU's process of garnering support for debt rescue action. This was like watching paint dry in a Tasmanian winter, but even more impossible and even more frustrating.

As the calendar flipped over to November, hopes were raised that the Europeans would come up with a credible plan, but once again they underwhelmed financial markets. While the Dow Jones index gave up its positive return for the year, our stock market indexes were down 10% and you can blame the local Reserve Bank of Australia (RBA) for our relative weak performance.

The RBA Board and its Governor, Glenn Stevens, have completely misinterpreted the negative effects of a year of market anxiety, too-high local interest rates, a dollar on steroids and Europe's falling demand impact on China, along with that country's own policies of restraint to beat inflation.

They shouldn't have missed it – the Shanghai Composite Index has been falling precipitously since May — how could they have missed that? 'Nincompoopery' can be the only answer and there is a lot of it around nowadays.

And that's where we find ourselves at the end of 2011 — we are still waiting for action from the procrastinators and poor performers of the EU, and the US Congress is still playing silly buggers — excuse my French.

As an economist, financial planner and media commentator for over 25 years, I have never seen the role of politicians being so critical to our bottom lines. I can read and predict economies and company results pretty damn well, but as Paul Keating once said: "Never get caught between 'politicians' and a bucket of money!" (He actually said "premiers" but I have taken licence with this very apt observation.)

2012 has to be better

One final point: calendar years are milestones, but not as significant as the financial year, which we pay the tax on our investments on. In 2009-10, if your portfolio of shares matched the S&P/ASX 200, you made 8.7% plus dividends and franking credits; in 2010-11, you pocketed 7.9% plus.

This is why I like income-yielding stocks of companies I want to hold for a long time. It is the only defence from the nincompoops who can make a year of investing bloody hard work!

I believe 2012 has to be better. The close on Wall Street on 20 December, which saw the Dow end up over 337 points on better European Central Bank and bond yield news, shows how important the EU story has been and gives us hope that 2012 will bring an overdue bull market.

The best calls of 2011

by Alia McMullen

The ASX 200 has rallied and retreated by more than 100 points 10 times since the birth of the Switzer Super Report almost six months ago – how's that for a baptism of fire!

Of course, as investors aiming to build enough wealth to carry us comfortably through retirement, we'd all prefer to see a less temperamental market. The volatility has been of great concern to many of you, and as editor of The Report, it's been fascinating to speak with some of you and hear your stories. This has helped us focus on the topics you would like more of.

For those of you who have been with us from day one, I hope The Report has helped you sleep more soundly at night. I'm pleased to say we've made some very strong calls in the past few months – particularly given the flip flopping market.

The calls

Our founding father, Peter Switzer, has been right on the money with his cautious optimism and economic insight. His mantra about DIY super investors buying good companies for the long-term has also helped many to focus on the bigger picture and avoid the daily whiplash of the market.

Back in August, when the daily news was still focused on what was going on in the United States, Peter turned our attention to Europe in Why Europe's my biggest market concern right now. In that same article, he mentioned that US companies would outperform expectations – another scenario that played out.

And in September in The rally is close at hand, Peter said there was a high chance a relief rally would break the market slump that week. Sure enough, one broke out the next day taking stocks up from a closing low of 3,863.9 on 26 September to end at 4,004.6 the next day.

At the time of writing, the market has managed to steer clear of revisiting these lows, keeping in line with Charlie Aitken's call on stocks having hit the bottom of the dip. He made the call back on 22 September in Have we hit the bottom? and Bottom fishing: What to buy? Charlie has also been very bullish on Telstra (TLS) from day one, and that company has continued to grow this year, despite the market madness.

On the money

One of our best calls of the year was made by Paul Rickard back in July in Term deposit rates set to drop , when he advised those who were interested in moving money into term deposits to do it right there and then because term-deposit rates would begin to fall within a month. Right on cue, term deposit rates began to fall and economists began to talk about the growing chance the Reserve Bank of Australia would start to cut rates too, which they did in November and December.

Paul, who was the founding CEO and managing director of CommSec, also made a brilliant call when he advised those who were excited about the float of iconic Australian cheese maker Bega, that interest in the company would wane shortly after listing. Since Is Bega Cheese too tasty? was published in July, shares were offered at \$2, debuted at \$1.90, and have since slipped to about \$1.65.

Our art expert, Alistair Bailey, also made some good calls on the recent art auction season when he said in November's How to invest in artwork that sale prices for a number of works were likely to blow estimates out of the water. And that's exactly what happened, with Menzies's auction of a work by artist Tim

Storrier selling for $104,950, well above the estimate of $60,000-$80,000, and a work by Ben Quilty selling for $81,000, compared with an estimate of $30,000-$40,000, just to name a few.

We've also had some great advice from Ron Bewley, who as many of you would know, has been tutoring us in how to build an SMSF investment portfolio. He's explanation of how he managed his assets in How to manage pensions during market dips was the perfect demonstration of how to avoid selling stocks at low prices in order to raise cash to meet pension needs.

And I haven't yet mentioned our technical experts – Tony Negline and Andrew Bloore – who, while they don't bring you 'calls', have done a fantastic job at keeping you up-to-date with all the strategies, regulatory changes and tax rules you need to know to run your SMSF.

I can continue to blab, but you get the picture. It's been gratifying to bring you such high calibre experts in 2011, and all of them, plus a few new surprises eagerly waiting in the wings, will be back in 2012.

Thank you for your support over the past six months and best wishes for the New Year!

Road test: Commonwealth Bank Super Gear loan

by Paul Rickard

Borrowing to buy property has become the hot topic for SMSFs since the Australian Tax Office released a draft ruling that clarifies some of the key concepts related to gearing within your super to buy or renovate property. And given the enquiries we've had from Switzer Super Report readers, we've found out what 'pre-packaged' solutions are offered by the major banks and given them a quick road test for you.

If you haven't already, you can bring yourself up to speed with the ATO's draft rules in Tony Negline's column New opportunities open for SMSFs investing in property.

The good news for SMSFs is that the Commonwealth Bank has a product called Super Gear. The bad news is that some of the other banks are still working out what to do. Our guess is that within six months, most of the banks will have a packaged solution that allows SMSFs to gear to buy property because in a quiet lending market, this is one of the fastest growing parts. St.George has a product called Super Fund Home Loan, which I have also reviewed on our website.

So what do I mean by a 'pre-packaged' solution? Simply, a compliant structure that passes the test for gearing – formally known as a Limited Recourse Borrowing Arrangement. You don't have to prepare separate documentation and set up a bare trust to hold the asset – the financial institution has done the hard work for you.

Like any pre-packaged solution, Super Gear comes with a number of rules, and not unexpectedly, some fees and charges.

The rules

Let's start with the rules. On paper, you can borrow within your SMSF to invest in residential property, commercial property or rural property. That's fairly straightforward.

It becomes more complicated when determining how much you can borrow because this depends on your SMSF's trust structure (is it a corporate or individual trustee?) and whether the members are willing to provide 'individual indemnities' (that is, personal guarantees).

Following recent changes to the Consumer Credit Legislation, the Commonwealth Bank will only lend against residential property if the SMSF has a corporate trustee. The following table sets out the maximum loan-to-valuation ratio (LVR, which is the amount the bank will lend you expressed as a percentage of the property's value) offered by Super Gear:

Super Gear maximum LVR

Property Type	Individual Trustee		Corporate Trustee	
	No Indemnity	Indemnity	No Indemnity	Indemnity
Residential Property	n/a	n/a	50%	**80%**
Commercial Property	40%	40%	40%	**65%**
Rural Property	40%	40%	40%	**65%**

Source: CBA, Switzer Super Report

Another rule worth noting is that the loan has to be positively geared and the investment income within the SMSF (including any rental income on the property) has to be more than 125% of the estimated interest expense on the loan.

Also, before the bank will lend to your SMSF, you are required to obtain a sign-off from a qualified financial planner – no exceptions. While this may seem prudent given the potential overexposure to a single asset, it seems to be an overly cautious approach by the bank and I can't really see the difference between this product and an SMSF investing in the share market through installment warrants.

So, what does it cost?

Well, it turns out there are quite a few fees. Your SMSF will pay an establishment fee of 0.8%, a product maintenance fee of $45 per month, and a loan-servicing fee of $8 per month (for residential property) or $32 per month for commercial property. So, for a loan of $300,000, your SMSF will pay an establishment fee of $2,400 plus a fee to your financial adviser, and then annual bank fees ranging from $636 to $924.

There's better news on the interest rate front. For a variable rate loan secured by residential property, you can expect an interest rate that is close to the Commonwealth Bank's standard variable rate, which was at 7.31% at the end of 2011. For loans secured by commercial or rural property, this will be quite a bit higher.

Overall, the Commonwealth Bank deserves credit for being one of the first banks to develop a specific product for the SMSF market. The fees are on the high side and it is very "Commonwealth Bankish" with an overly restrictive set of rules, however the interest rates are competitive. As some of the other banks realise the potential of this market, competitive pressure will lead to lower fees and more accommodating product structures.

One final point – the product is only available through the Commonwealth Bank's Business Bank, so if you go to a branch, don't be surprised if you get a blank stare. Ask specifically for a business banker, or telephone their business line on 13 19 98.

JP Goldman

Which Aussie index ETF is best?

by JP Goldman

The Australian exchange traded fund (ETF) market has come along in leaps and bounds in recent years, and investors now have a wide choice of cheap and highly diversified listed investments from across the world to select from.

But if you want to keep things simple, investors need look no further than the ETFs providing broad coverage of the Australian market. There are now, in fact, three competing ETFs to choose from, and each provides exposure to the top several hundred blue chip companies in Australia by market capitalisation. So how can we choose between them?

Broad Australian Market ETFs

ETF	ASX Code	Underlying Index	Issuer
SPDR S&P/ASX 200 Fund	STW	S&P/ASX 200	State Street
Vanguard Australian Shares Index	VAS	S&P/ASX 300	Vanguard
iShares MSCI Australia 200	IOZ	MSCI Australia 200	Black Rock

Note: each ETF's investment benchmark is slightly different – but for practical purposes, that doesn't matter much. Vanguard's ETF covers the S&P/ASX 300 top companies, whereas State Street's covers the S&P/ASX 200 – so the former includes more of what are called 'small cap' stocks. Yet, as the top 200 stocks account for more than 95% of the market capitalisation of the top 300 index, the two indices tend to move in virtual lockstep.

Similarly, the MSCI 200 index, followed by the iShares ETF, only includes listed companies that are registered in Australia – so compared to the S&P/ASX 200 index, it excludes, most notably, News Corporation. But again, the differences in relative performance are tiny.

Over the past 10 financial years, for example, the relative returns and volatility of each underlying benchmark have been virtually identical. This is reflected in the compound annual growth rates (CAGR) in the table below.

ETF Performance: 10-year returns and volatility

ETF	ASX Code	CAGR (%)	Standard deviation (%)
SPDR S&P/ASX 200 Fund	STW	7.2%	17.5%
Vanguard Australian Shares Index	VAS	7.2%	17.6%
iShares MSCI Australia 200	IOZ	7.3%	17.3%

We also can't really distinguish between these ETFs on the basis of the size and experience of the ETF issuer. All three companies – State Street, Vanguard, and iShares – are major players in the global ETF industry, with billions under management.

Each provider also aims to match its benchmark in similar ways – by buying underlying securities, and using derivatives (futures) only minimally to manage cash flows. Neither group engages in securities lending, nor offer dividend reinvestment programs.

That said, State Street has been operating in the local ETF market the longest, with its SPDR S&P/ASX 200 – listed in August 2001 – being the oldest and largest ETF in the Australian market place. On the other hand, iShares only listed IOZ in December last year, while Vanguard listed VAS in May 2009.

As a result, one key distinguishing characteristic is that State Street's ETF retains moderately better liquidity. As seen in the table below, STW has by far the greatest funds under management and has average bid-offer spreads marginally lower than VAS and IOZ. STW has the greatest market depth. Tracking error – or the ability of the ETF to stick close to its benchmark – has tended to be very close for STW and VAS over time, though IOZ still appears to have had a few teething problems in its first months of operation.

ETF costs and liquidity

ASX Code	MER (1)	FUM ($A mln) (2)	Av. bid/ offer (3)	Depth ($A mln) (4)	Tracking error (5)
STW	0.285%	$1,953	0.06%	$5.2	-0.09%
VAS	0.150%	$199	0.09%	$1.4	0.04%
IOZ	0.19%	$42	0.15%	$1.4	- 0.68%

(1) management expense ratio (2) funds under management in Australia (3) average percentage spend between best bid and offer price (4) average dollar value of five best bid and offers (5) 12 months to August for STW and VAS, year to date for IOZ

Source: ASX ETF Monthly Report, September 2011, ETF Provider websites

That said, due to their unique structure, provided ETFs are carefully purchased, investors should be able to buy at prices quite close to their net asset value – though the above analysis suggests STW may retain greater liquidity in times of market volatility.

Of course, State Street also makes investors pay for the privilege of potentially better liquidity, with a management expense ratio (MER) above those of its peers. The difference between MERs could account for up to 1% on performance every ten years.

Income investors should also note that STW only pays dividends semi-annually, whereas the other two are quarterly.

All up, active investors might prefer the liquidity benefits of STW, despite higher management fees, because of its higher liquidity and tighter spreads, while more passive longer-term investors should choose Vanguard's ETF because it is cheaper. The iShares ETF is relatively new, though the company's strength is mainly in the range of international ETFs it offers Australian investors. If you're still undecided between the three, I'd go with STW.

The six key reasons SMSFs butt heads with the law

by Tony Negline

There are many ways in which the Australian Tax Office (ATO) can punish self-managed super funds and their trustees who break the law. Knowing how to avoid the most common legal problems will make managing your super fund much smoother.

If your SMSF is found to have breached a law, the ATO could make it 'non-complying' – a penalty that has quite disastrous results. In the financial year a fund's complying status is removed, it effectively loses half its assets (less non-concession contributions) in tax penalties.

The ATO could also disqualify, suspend or remove the trustees, freeze the super fund's assets, accept an undertaking (or legal promise) from the trustees to fix up a contravention of a law, and seek civil or criminal penalties through the courts against those involved in the breach. And of course, it might also apply various tax penalties.

Knowing how to avoid these penalties is clearly quite important.

The ATO must establish two criteria before it can inflict these substantial penalties: the seriousness of the breach and all other relevant matters. But what do these terms mean?

The seriousness of the breach

The ATO must determine 'the seriousness of the breach' by looking at the behaviour of the trustees (was the mistake deliberate or an honest mistake?), how the breach impacted the fund's assets, if the trustees' actions have exposed the fund's assets to unreasonable risk, the number and duration of the breaches, and the nature of the breach in the overall scheme of the super laws.

Other relevant matters

The ATO is required to determine any 'other relevant matters', such as whether the trustees have fixed-up the breach, the skill and knowledge of the trustees, the compliance history of the fund before the breach occurred, and the events that led to the contravention.

If the tax office makes a super fund non-complying, the trustees can object to either the ATO, the Administrative Appeals Tribunal (AAT) or to the Federal Court (there are different objection processes available depending on how you prefer to proceed with your complaint). Typically, most people object to the ATO first and if they get knocked back, they tend to take it to the AAT for another review.

If you've run into problems and plan to approach the AAT, prepare yourself well because the AAT has recently been taking a harder-line approach to non-complying cases than it has in the past.

Key mistakes

So, what are some of the key mistakes SMSF trustees make?

1. Using fund money for personal or business reasons – for example, paying personal bills or loaning super fund money to your relatives or your business.
2. Using fund assets for personal purposes prior to retirement – this is often a breach of a test called the Sole Purpose Test, which tests to make sure that the SMSF exists for the 'sole purpose' of providing for your retirement.
3. Withdrawing money from the super fund illegally.
4. Placing business assets in super and then using those assets without a formal lease in the running of your business – often the mistake here is that no lease payments are being made.

5. Not completing statutory and income tax reporting requirements – a surprisingly large number of SMSFs do not complete their statutory reporting requirements to the ATO and many also fail to pay their annual levy.
6. Making the fund a non-resident super fund – such funds may not be non-complying but they face similar tax penalties. It's important to look into this rule if you plan to move overseas temporarily or permanently.

As mentioned above, there are other penalties that could be applied. In a recent AAT case, the owners of a small business got into financial difficulty and borrowed money from their SMSF on behalf of the business. In time, the business's trading performance recovered and they repaid the loan. Although the breach of the super laws had been rectified, the ATO elected to tax the money withdrawn from the super fund as an illegal withdrawal of fund assets.

The super laws allow the ATO to tax such withdrawals at a taxpayer's marginal tax rate rather than at the SMSF's preferential rate. The ATO applied this section of the law in this particular case. The taxpayers complained to the AAT, but the tribunal rejected their application and found that the ATO penalty was appropriate because they had not operated their super fund appropriately.

Special Feature: How I handled the market dive

by Ron Bewley

I'm interrupting my series on What not to buy to explain what I think was going on with the market during the dip in August and how I protected my investments during the uncertainty.

It was the week that threw so many people into turmoil. I'm not pretending I enjoyed it or found it easy; I certainly didn't predict it. But I do like having to make calls. In my view, there was a lot more order than meets the eye. Here's how my week unfolded:

Dear Diary,

Saturday 6 August: Wake at 8am to find that the US has lost its AAA rating. Don't feel good at all, particularly as our market has already lost 7.2% this week. Spend the morning addressing risk issues in my margin loan – which is outside of my super fund, of course. Checking my plan takes me a few hours on top of the work I've already done in preparation for such events. I make a plan that would further insulate me from a margin call. I work out how much cash I have on hand and what I could sell if necessary – about 10 steps, and in order – depending on the severity of the situation. It's a list that would allow for a massive fall in the market, just in case. I determine that if I do nothing, I could handle a 9% fall.

Read the news and realise that the US jobs data is quite good, but there have been more problems in Europe. Why is there no focus on the good jobs data? Slow growth, yes, but I don't subscribe to US double-dip recession speculations.

Sunday 7 August: Rested. Don't feel in the mood for our usual Sunday lunch out.

Monday 8 August: Wake to find that S&P has reaffirmed its short-term debt rating for the US of A-1+ (equivalent to AAA). Good news. Bloomberg explains that it's this short-term rating that's the key to money market operations. The previous downgrade of the US's long-term debt rating is more symbolic than anything. So there are no short-term problems in the US, and Europe announces a plan; maybe things won't get too bad, but I keep my plan of what to do at hand.

An easy morning. After an early fall, half of my stocks are up by lunch; but then the market slips 2.9% on the day. My plan is at the ready, but I take no action. Is the Bloomberg opinion on the money?

Tuesday 9 August: The US market falls more than 6% overnight. I give a teleconference to my clients explaining it's just panic and not like 2007/8. Companies in the US and Australia are cashed up with really good earnings. Importantly, the relationship between our market and the US – when expressed in US dollars – leads me to argue that we have a 7% cushion due to the 7% fall in our dollar from near US$1.11 to US$1.03 in a few days.

Foreign investors needn't mass evacuate our falling stock market because the stronger US dollar has protected them from losses. Conclusion: our market doesn't have to fall as much as the in the US.

The market falls a couple of percent, so I transfer cash into my margin loan and sell some stock. I hold a little bit of the index in the form of an ETF (Exchange Traded Fund) – specifically STW – in my margin loan and my super fund for days like these. The index tends to fall slower than individual stocks on high fear days. I sell STW in my margin loan as well as some AGK as it, being defensive, also holds up a bit. Margin loan safe again. No damage done.

At this point I feel safe with my super, so I just sit tight. But I now have no spare cash in case the margin loan gets pressured again, so I sell my STW and a tiny bit of each of AGK and LYC from my super fund. This will give me cash in three days (upon 'T+3' settlement) to transfer as a tax-free pension to my personal account and then onto my margin loan. I have an overdraft facility to see me through the intervening period.

By lunch the market has fallen below 3,800, which is over 5% down on the day. The dollar slips below parity. I lie in the dark watching Law & Order Criminal Intent. Focus. I'm stressed, even though I've averted any significant damage. I assume the market is still falling.

At 1pm I go back to the computer to find the market experiencing a baby recovery. It screams up to close 1.2% higher on the day after being down over 5% – that's a rally of about 7%. No obvious explanation from the wire services. Could it be the dollar story?

European markets open at 5pm (Sydney time) for their Tuesday. They're not following our lead and go down heavily, but they too turnaround after an hour or two before my bedtime. The FTSE and DAX finish with a 7% rally from the intra-day low – just like us.

The US opens at 11:30pm in Sydney and looks bad when I wake at 3am to watch Bloomberg TV. US Federal Reserve chief Ben Bernanke speaks after Europe closes. The market falls further as he speaks and then does a 7% rally in the last hour.

So Australia, Europe and the US all have big downs then 7% rallies – unsynchronised.

Wednesday 10 August: Rumour is a big sovereign wealth fund was doing business yesterday, accounting for the large swings. There's been a 5% rally in the US overnight. Our market's up 2.6%, and 10% from yesterday's low. Pressure lessened, but it's not over 'til it's over.

Thursday 11 August: Carnage on Wall Street again – down over 4%. I check my dollar story and find that we and the US are now dead level. Send out email to clients at 10am saying that there's no need for our market to fall. It does fall, but then recovers to finish dead flat. More belief in the dollar story?

Friday 12 August: Big lead from Wall Street (+4.5%). Our futures market looks more modest. Decide to enact phase two of my plan. Lynas (ASX:LYC) is strongly up from its Tuesday low. I'm massively 'overweight' LYC from when they did the 1-for-1 capital raising in October. Back then, I had to sell some stocks (a reasonably balanced portfolio of BHP, COH, CSL, RIO, SHL, WBC and WPL [sold at a joint capital gain of 12%]) to pay for the parcel at 45 cents, which doubled my stock holding of LYC.

I didn't want to sell the stocks but I couldn't afford to bypass the 1-for-1 on LYC. The plan was to sell the superfluous 1-for-1's at a good price over time and in an orderly fashion. Since LYC started climbing nicely, I started selling at about $1 late last year up to $2.57, and down again to $2.13. The ones I sold on Tuesday at $1.71 were a 'no jealously' risk sale. I sell today at $2.01 (average $1.95 for the week) but still have some of the 1-for-1's left in my DIY.

My reason for selling LYC is that I've made a tidy profit and who knows what will happen next week. I plan to pay the proceeds of the transaction as a pension to myself in three days (which is the time stipulated under the T+3 rule) and whether I use the cash to bolster my margin loan or buy RIO outside my super will be determined when I get the cash on Wednesday after the close. If it seems we are back on track, I'll sell the rest of the 1-for-1's and get some more BHP before it retraces to above $40. If I do that, it will have taken 18-24 months to get that rebalancing right from the 1-for-1, but well worth it. Interestingly, the portfolio I sold in 2009 to pay for the 1-for-1 can be repurchased at a discount of about 10% on what I originally paid!

Saturday 13 August: Quiet night in the US (up 0.5%). Our futures (SPI) market is up 1%. And US retail sales are up 0.5%; Australia could do with some of that. Spend morning writing this column.

Lessons to be learned

I didn't expect the intense volatility of this dip at the beginning of August. I, like everyone else I've heard from, assumed that the deficit ceiling in the US would have been handled responsibly. It wasn't, and so S&P hurt the ego of everyone in the US who understands what a credit rating is. I question why S&P waited for the weekend to reaffirm the US's short-term debt after downgrading the long term. It could've done both at the same time for less damage. Pay back?

My conspiracy theory, and my dollar story, made it easier for me to work through the week. I'll never know whether I was right in my thinking, but if I hadn't had a story, I would've sold a bit more.

I hope any interested readers understand why I have some stocks – like STW and AGK – ready to sell in a crisis. I knew that when I bought them. And the orderly way in which I've tried to handle my LYC over-weight position. Planning takes me a lot of time, and I stick to it.

My DIY 'net position' for the week was that I crystallised capital gains of 37% on stocks I'd bought over the last 18-24 month flat period, and I had no capital gains tax because my DIY is in pension mode. I made a capital loss in my margin loan of a little more than I made as profit in my DIY. That capital loss can be set against uncrystallised gains at some future point. So I was close to square for the week with no margin call. I can now take a further 21% fall in the market if I do nothing, or a 27% fall if I tip in my LYC proceeds on settlement. I also de-risked my overweight LYC position and I might even make money out of RIO going forward. The broker consensus target price would give me about 50% capital gain plus dividends over the next year, and my capital loss on STW and AGK will be set against that.

I don't subscribe to this being a repeat of the Lehman Brothers collapse. And I know a lot about that as I was a technical expert witness in the Federal Court this March on some of what went on. This is not 2008 all over again. I hope the coming weeks will be quieter, but volatility clusters usually last a lot longer than this one has so far.

It's always better rebalancing when the market is quiet. I try not to let the market catch me by surprise, but I never predict these things – nobody does on a consistent basis. I just know something bad will happen from time to time. I don't know what it will be or when it will arrive, I'm just ready for the unknown. Next fortnight I hope to return to my What not to buy series. But if the market hits the fan in the next two weeks, I will update you on how I'm reading the market.

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Did you know?

Investing in art can be a great way to diversify your SMSF investment portfolio and help protect it from declines in other asset classes. Al Bailey of Art Equity joins Peter Switzer on Super TV to talk about the art market and how to invest in it.

Don't miss this!

The next holiday edition of the Switzer Super Report is due in your inboxes on Thursday 5 January, 2012.
We hope you have a Happy New Year and we look forward to returning to our normal scheduling of sending you reports every Monday and Thursday starting Monday 9 January, 2012.