Switzer Super Report

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Happy New Year!

Happy New Year to all, and I hope 2012 brings your DIY super portfolios many happy returns. I have a good feeling about this year and I've got 10 predictions for you in my 2012 outlook in today's report.

Also in the Switzer Super Report, we take a look at what 2012 holds for the real estate market and if the two interest rate cuts we got late last year will be enough to push prices higher. Plus, Rudi Filapek-Vandyck points you to two factors that he believes need to turn in order to take stocks higher, and we have some holiday SMSF homework for you to do so you can get your fund scrubbed up and ready for the year. I hope you enjoyed the Christmas break. Welcome back!

Sincerely,

Peter Switzer

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My 10 predictions for 2012

by Peter Switzer

One prediction I will make with confidence is that this year for investors in Australia will be better than 2011. Last year was one dominated by political posturing and procrastination that left global stock markets in a no man's land.

Things will be different in 2012 and the news on Wednesday 21 December just before Christmas that Spanish bond yields had fallen significantly, the Dow Jones index was up over 300-points for most of the trading session, and the VIX – or fear index – had dropped 7% towards a reading of 23, makes me cautiously positive.

This underlines the fact that when the European Union (EU) and the European Central Bank (ECB) lift their game, then we can start taking tentative steps out of no-man's land.

By the way, the market responded positively late last year to the ECB's program that would give EU banks three-year loans at a low interest rate of 1%. This will help shore-up banks' balance sheets and provide liquidity. Some analysts even argued that some banks would take the 1% money and buy sovereign bonds with it, and these are yielding rates a lot higher than 1%.

It's getting better

As one guy put it, when it comes to Europe (with apologies to the Beatles) "it's getting better all the time." Sure it has been slower than most of us would have liked, but the potential precariousness of the situation for the global economy and markets means we are now seeing some better decisions from the people who count.

If Europe can come up with better decisions, it will add weight to optimism over the US economic recovery, where even the housing sector is starting to see some green shoots. Data from the US showed that housing starts and building permits rose sharply in November, reinforcing other economic data that showed builder sentiment and sale prices were both on the rise.

"Looking ahead to 2012, we believe residential investment will be a net positive to growth next year due to the two bright spots of the construction sector: multifamily building and renovations," said Michelle Meyer, economist at Bank of America Merrill Lynch.

The GFC started with a housing problem and a full US economic recovery needs Americans to once again feel that investments in bricks and mortar are as 'safe as houses'.

Recently, Nariman Behravesh, the chief economist at US-based IHS Global Insight, made his ten predictions for next year and this organisation is held in high regard when it comes to predictions. Let's see what these guys are predicting and I'll give my two-pence worth as well.

One

World economic growth will slow and Europe will determine how hard a landing China will have, which is slowing down faster than expected. I think Europe will do better than expected and China will turn it around; this will help the Shanghai Composite index, which has been nose-diving since May, and that will in turn help our economy as well as stocks.

Two

Asia will grow fairly strongly, around 5.5%, with Japan's reconstruction spending helping to offset Europe's recession impact.

Three

Emerging economies outside Europe will grow fairly well because they are more dependent on the US and China relative to those in Europe. This underlines the need to watch China closely.

Four

Commodity prices won't plunge, but will more than likely move sideways. This should put a floor under the share prices of the likes of BHP-Billiton (BHP) and Rio Tinto (RIO).

Five

The outlook for inflation is benign — recession in Europe has some positive effects in this regard — and contained inflation, eventually, is good for stocks once the downside from the recession is factored in. By the way, some of the end of year share sell-offs were due to the expectations of a recession in Europe.

Six

Interest rates will be kept low worldwide and our own Reserve Bank of Australia (RBA) will cut rates early in the year, which will help our stocks as well.

Seven

Fiscal policy worldwide will be tighter, which will hit demand and keep a lid on growth. Overall, this will contain stock price potential, but against this, there will be a bounce back in shares if the European rescue plan gains credibility over the next few months.

Eight

The US dollar weakens against most currencies apart from the euro and if the EU crisis worsens, Nariman Behravesh argues we will see parity between the dollar and the euro. I don't like currency predictions, but if the Europeans surprise us all, then the euro goes up, stocks go up and so does the Aussie dollar. Of course, the opposite applies.

Nine

Europe is at risk of creating a financial meltdown, which means we see a Lehman Brothers kind of market slump. I think the Europeans know this and the ECB would change its attitude and embark on a quantitative easing-style liquidity program.

Ten

China could have a problem with its real estate market and that would impact Asian growth and in turn hurt local as well as world growth. I still think this is a low order risk.

I would like to end my peering into my economic and market crystal ball by pointing out that a lot of history points to a massive upshot in share prices when the worst of Europe's problems have passed us. This year, I punted sanity and rationality prevailing in the EU — I got it wrong — but I don't believe stupidity lasts forever.

By the way, I have always argued we would muddle through these problems and what we have seen and what we are seeing is what muddling looks like — sometimes up, sometimes down — but eventually we will break out and on a ten-year basis, stocks have a very good history of nice returns.

In the absence of anything better to rely on, I'm punting positively on history!

Property to return to growth in 2012

by Alia McMullen

There was an audible sigh of relief from property investors when the Reserve Bank of Australia (RBA) cut interest rates at the end of last year and buyer enthusiasm has since perked up. But a prominent East Coast real estate agent says the two rate cuts alone are unlikely to instigate any serious growth in house prices, particularly in the 'prestige' sector of the market.

"People are looking for more good news to regain their confidence to buy and sell," says John McGrath, the chief executive of Sydney-based McGrath Estate Agents. "The underlying demand is there, people are just waiting for the bell to ring and I think there's a good chance that will happen in the first half of 2012.

Many potential buyers have been deterred from stepping foot in real estate because of the slide in house prices. Prices remain weak, with capital city values down 4% in the year to October, RP Data figures show. Prices have fallen 3.4% in regional areas. It's important to note, however, that these figures pre-date the interest rate cuts.

The RBA reduced the benchmark interest rate from 4.75% to 4.25% over two quarter-point cuts in November and December, and many economists expect another interest rate cut in the first three months of 2012.

A two-speed market

But while the rate cuts will help revive sectors of the market, it will take more than just cheaper borrowing costs to heal the dichotomy that has emerged in housing since the onset of the Global Financial Crisis. Lower fixed and variable mortgage rates have helped the market under the $1 million mark and McGrath says this segment is now strong having experienced a noticeable pick-up in first home buyer and investor activity.

But the housing market won't return to full health until the 'prestige' sector improves. Volatile stock markets and global uncertainty have taken their toll on buyers in the market for property priced above $1.5 million and McGrath says buying opportunities above $3 million are now "exceptional".

He says these lower prices combined with a consistent quarter of stock market improvement will help revive the top-end of the market in 2012.

"The European problems are a big dark cloud and if they're resolved, I think that will have a much greater positive impact on the actions of buyers than a quarter percentage point rate cut," he says.

Meanwhile, McGrath says buyer activity has begun to strengthen in some regional markets, particularly those close to major cities. He says blue chip markets like the Gold Coast and Byron Bay, which were both hit hard by the GFC, were also showing definite signs of new activity.

McGrath's best buying opportunities – Sydney Metro

Houses	Apartments
Erskineville	Bronte
Redfern	Little Bay
Rozelle	Milsons Point
Taren Point	Ryde
Vaucluse	St Peters

McGrath's best buying opportunities – Regional

Ballina, NSW	Burradoo, NSW
Burleigh Heads, QLD	Flynns Beach, NSW
Charlestown, NSW	Lambton, NSW
Paradise Waters, QLD	Mawson, ACT
Wentworth Falls, NSW	St Huberts Island, NSW

The two factors that will turn the stock market

by Rudi Filapek-Vandyck

There is an obvious analogy between what happened in the equities market in late 2011 and what happened in late 2008, and I'm certainly not the only one who has made that observation.

Just like in 2008, equities bounced in October after yet another mark down, only to be pressured lower again as the deterioration in the global macro-environment simply grew too big, too obvious and too dominant to ignore.

It's difficult to anticipate anything other than that we will see more pain before we can start zooming in on gains again. But maybe looking towards the gains is the smart thing to do right now.

The last nasty market dip ended after two dreadful opening months in 2009, when a short-covering rally started in the US on 6 March and ensured markets had seen the bottom. A rally followed.

I think we will see a similar scenario unfold in 2012. I don't know as yet when, where and why exactly it will happen, but somewhere in front of us lies the over-saturation point in negative news flow and from investors fleeing the stock market for the safety of cash, property and government bonds.

The indicators

How will we know whether that point of reversal is approaching?

There are two indicators that have in the past proved their value as reference points:

1. The OECD Leading Indicator, which at present is negative and falling;
2. Global forecasts for corporate profits and, whatdayaknow, global earnings estimates are still falling too.

When this is the case, it's usually the worst time to be in the share market as historical returns are the worst out of all available scenarios. The good news is, however, the next phase in the cycle for both these market indicators tends to be the most profitable one for equity owners.

This is why I thought a flash-back to three years ago is apt as the experience of 2008-2009 proved just that: first more pain, and during the process the foundations were being laid for the following gain.

Don't just take my word for it; analysts at both UBS and Macquarie have been doing some backward looking data analysis earlier in the year and in both cases their analysis confirmed that what happened three years ago will likely happen this time around as well.

Admittedly, things look a bit different because of the seemingly permanent macro-overhang of Europe and its problems, and it may well be that the trigger for the next rally this time will come from the European banks, but it remains my view that any rally will prove unsustainable until the two indicators above have turned for the better.

Which brings us to the obvious question: when is that going to happen?

The turning point

Analysts at Macquarie believe the turning point could be sooner than many of us are inclined to expect because the news continues to be so negative, as is the accompanying price action.

Macquarie thinks the turning point will come in the first three months of 2012 when the trough for both the OECD Leading Indicator and the downtrend in global earnings forecasts will likely manifest themselves. They expect the market to start to rally shortly after, between late in the first quarter and August.

I'm a little less optimistic than Macquarie and suspect the turning point will take a little longer, potentially in the second quarter of the year, but the difference is in timing, not in underlying principle

In practical terms, 2012 should see both the depth and the turnaround in this downtrend. I think that's something to look forward to.

In the meantime, be like an experienced hunter, be patient.

Best wishes to you all. May 2012 bring wisdom, fortune and happiness, and still leave enough to aspire to in subsequent years.

Why now is a good time to get your SMSF in order

by Tony Negline

At least half a decade ago my family and I were thinking of moving to a new home. We're still in the same house, but our experience has meant we now spend time reviewing all our investments at the end of every year.

When we were toying with the idea of moving, we contacted a number of real estate agents; all of them were happy to try and sell our house before the end of the year. Only one of them suggested we wait until the New Year.

This agent said that in his experience, late February was a better time to begin selling a house because we were likely to get a higher price than if we tried to sell before year's end. His rationale was that more people would have decided to move house after coming back from their Christmas holidays.

The moral of the story

I think our real estate agent had indirectly hit on something very important for every SMSF investor. That is, when our work is done and the busy world is all too briefly hushed, we actually have the space and time to think some important issues through – and there are many important issues you need to think about when running an SMSF.

So what are some of the structural areas you should think about these holidays?

Your investment strategy

Now is a good time to review your SMSF's investment strategy. Ask yourself these questions:

- What objectives does your fund need to achieve?
- Will the assets your SMSF owns help or hinder attaining these objectives?
- What are your fund's cashflow requirements, especially if a member of your fund dies?
- Will your fund be able to meet its pension income obligations?

For more information, read Creating an investment strategy and A sample investment strategy.

Fees and expenses

I've got in early this year on this particular point and have asked our financial adviser to detail, in dollars and cents, how much we're paying him for all our investments and life insurance policies. You should consider doing the same. As you know, it's hard to earn money and far too easy to spend it, and financial services in Australia are expensive. Don't be afraid to ask for a discount or shop around.

Your fund's advisers

Do your fund's advisers suit your needs and objectives? Should you get a second opinion about your fund?

How much longer will you work?

Are you thinking about retiring permanently or even reducing your working hours? If so, you need to carefully consider your super arrangements. Please don't assume that everything will fall immediately into place. It can sometimes take five years to structure a person's financial affairs to be appropriately set-up for retirement.

Will you have enough for retirement?

What sort of lifestyle do you want in retirement? How will your super provide the income you need for your likely retirement timeframe?

Family budget

Do you have a family budget? If you've never made a family income and expense budget, then I urge you to do one now. You'll never have any form of financial control or be able to plan for the future until you stump up the courage to complete this task.

Once that's done, put your feet up, pop open a bottle of champagne and enjoy the new year!

How much do you need in your SMSF for retirement?

by Peter Switzer

One of the surprising aspects of talking to listeners on my 2GB Super Show program each night is that a whole lot of people don't know how much money they will need to be comfortable in retirement. Of course, when I ask the same question of the experts who join me on the show they often reply: "How long is a piece of string?"

I know some listeners are happy with $50K a year, while others think $35K is fine. I often hear financial planners say $1 million in an SMSF would be ideal and they use the rule of thumb that if you want $50K and you don't want to eat into your capital, then $1 million invested for an easily gettable 5%, gives you the prized amount.

Funding your retirement

One of my guest experts on my radio show, Max Newnham, has recently written a book called *Funding Your Retirement: A Survival Guide*. He looks at the 'how much do I need?' question from his angle as both a chartered accountant and financial planner.

He says research shows 50% of baby boomers don't think their super nest egg will bankroll their retirement and that their kids are set to be disappointed as their inheritance is expected to be downsized!

Newnham points out that the old rule says that if your employment income is $100K a year, then you'll want about $75K a year in retirement. He argues that once a 60-year old retires and takes a pension, there's no tax paid, hence less gross income is needed.

For accuracy's sake, he suggests you first need to work out how much you need now for your current lifestyle. You then need to imagine retirement and forecast what expenses will rise and fall.

For example, takeaway lunches might become a lesser expense, but travel and accommodation could be more expensive. Newnham effectively argues that you should create a pre-retirement plan that covers your assets, liabilities, income, projected income, your retirement life plans, any debt reduction goals, and gifting plans.

It's about visualising the future and then coming up with the plan that will make that future more comfortable.

Crunching the numbers

In the past, the Association of Super Funds of Australia (ASFA) has surveyed retirees who said they wanted 66% of their pre-retirement income in retirement. So if you were on $100,000, you would want $66,000 in retirement. But here's the catch: to make that happen ASFA says you would need to save, via super, around 15% of your income for 40 years!

This always shocks people, but it is the strongest case for 40-year-olds or 50-year-olds to salary sacrifice.

ASFA says a single person should live a comfortable life on $40K a year, while a couple would want $55K a year. This should give you decent travel, health coverage and an ability to buy, say, better cars. A basic retired life comes with a pension of $18,962 for singles and $28,584 for couples. A modest life comes in at $21,587 for a single while a couple needs $31,263.

For a 'comfortable' life in retirement, the number crunchers say a couple wants a nest egg of about $840,000 when they retire at age 65. For a 'modest' retired life, the amount would be about $480,000 for a couple and $335,000 for a single. These figures include the belief that access to a pension is expected.

Clearly, success with everything hinges on having a clear goal of what you want to achieve – that is, a super lump sum target – and then making sure you make it happen by doing everything right every day of your life. It's called the Law of Process and it explains why great athletes, great business builders and great wealth generators make their dreams come true.

Did you know?

Using a transition to retirement strategy as you approach retirement can be very tax effective. Read what Paul Rickard has to say in How transition to retirement boosts your super.

Don't miss this!

Keep an eye out for Australian building approvals figures on Tuesday 10 January and merchandise trade data as well as job vacancies figures on Wednesday 11 January for clues to the health of the Australian economy.