Switzer Super Report
Advice you can trust

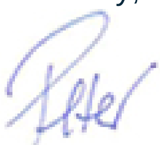
Thursday 11 February 2016

Caution urged

The markets remain crazy and we certainly saw some steep falls this week. These falls of course can create buying opportunities, but the key is to remain selective. Today Charlie Aitken advocates a cautious approach when looking at quality stocks, or as he calls them, the 'pretty girls'.

Also in today's *Switzer Super Report*, Tony Featherstone revisits our takeover portfolio and makes a new addition. Tony Negline looks at whether trustees should consider taking insurance inside or outside of their SMSFs – beware of the pitfalls! And Perennial's Andrew Smith uncovers a stock very much leveraged to our ageing population.

Sincerely,



Peter Switzer

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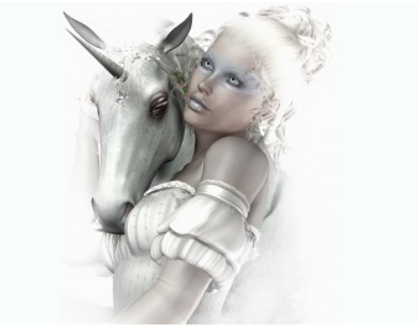

Pretty girls, FANGS & Unicorns
by Charlie Aitken
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Switzer Super Report is published by Switzer Financial Group Pty Ltd AFSL No. 286 531
36-40 Queen Street, Woollahra, 2025
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Pretty girls, FANGS & Unicorns

by Charlie Aitken

There's an old floor trader saying that "even the pretty girls get hurt in the bus crash".

That isn't meant to be sexist or tasteless; what it accurately describes is that equity market corrections, eventually, take even the best companies lower in price.

Last week, I wrote to you about whether this is a "bear" or a "scare". I told you we were in the midst of a "genuine global growth scare", with those concerns spreading to the largest economy and equity market in the world, the United States of America.

Since that note last week, both equity and credit markets have deteriorated to the point where we are now seeing "pretty girls" sold.

This growth scare has spread to highly valued growth stocks, and there has been significant share price damage globally and locally in highly valued growth stocks.

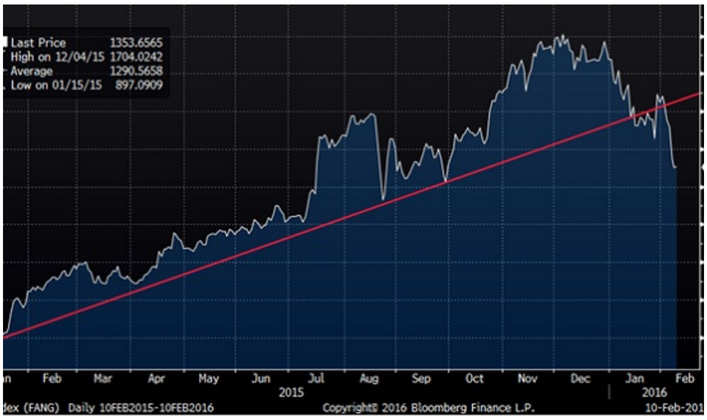
As they say, "momentum investing is wonderful until momentum is lost". That is just so true and there's probably no better example of "momentum being lost" than in the so-called FANGS.

FANGS refers to the combination of Facebook, Amazon, Netflix and Google. Google is actually called Alphabet nowadays but the stock ticker remains as 'GOOG'.

Many investors and commentators had raised concerns that US equity market breadth had narrowed sharply last year and all the heavy lifting was being done by the FANGS. That was certainly the case but now the FANGS have joined the broad US equity market correction that started mid last year.

At Aitken Investment Management, we created our own equally weighted FANG Index. I'm sure we weren't alone in doing this but the results show from a technical and momentum based analysis that the FANG Index has broken down.

FANGS: broken uptrend



Below the FANGS are the lessor known Unicorns.

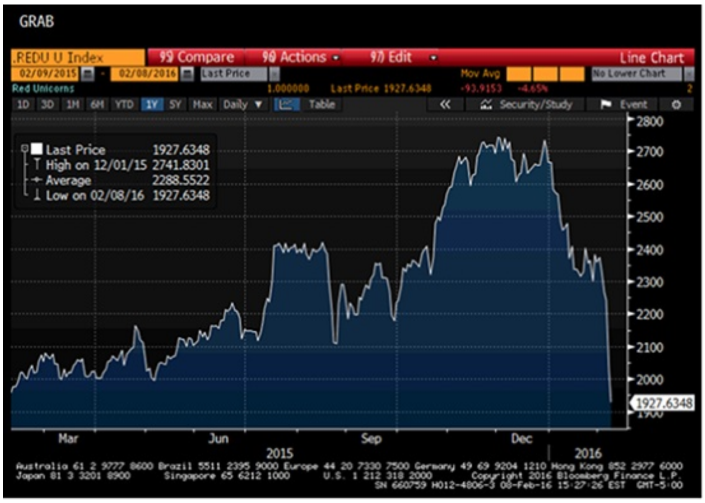
What are Unicorns I hear you say?? Unicorns are described as public companies that achieved greater than US$1 billion valuations at their IPO but currently remain unprofitable.

Yes, over $1 billion market cap at IPO yet remain unprofitable today, reminding you that "hope" isn't an investment strategy.

Goldman Sachs created a custom basket of 27 listed companies, equally weighted, to basically create a Unicorn index.

The chart is below and confirms just how much "hot air" has come out of second- and third-tier tech.

Unicorns…



Until recently, this missing part of this growth scare were growth stocks correcting.

That has now commenced globally and every indicator I look at (from yield curves through to corporate debt, credit default swaps, commodities, consensus equity earnings revisions and currencies) now confirms a genuine global growth scare, where risk premium is being added back into risk assets and leading to price falls.

In the high-flying growth stocks, it would appear to be a case of "valuations don't matter until they do".

To put this in context, I thought I'd compile a simple chart of trailing and prospective consensus P/E ratio for a number of leading US and Australian growth stocks and share price decline from the recent peak (source: Bloomberg). This is AFTER the correction we have seen.

Company	Trailing P/E	Forward P/E	SP decline % age
Facebook	77.7x	31.7x	-17%
Amazon	387x	107x	-31%
Netflix	302x	350x	-37%
Google	N/A	19.6x	-15%
Tesla	N/A	204x	-47%
Zillow	N/A	87x	-52%
Apple	10.1x	10.1x	-30%
LinkedIn	N/A	27.8x	-61%
Twitter	N/A	32x	-73%
REA	32x	29x	-11%
Carsales	23x	23x	-11%
Seek	15.6x	24x	-18%
Ramsay	31x	25x	-18%
CSL	24x	24x	-7%
IPH	40x	27x	-16%
Dominos	68x	53x	-17%

This is far from an all-encompassing list. I am just making the point that many of these growth stocks have corrected from "very expensive" to "expensive". On a raw P/E basis, Apple would not be included in that assessment, as it appears fairly valued.

Of course, I am NOT saying all companies were created equal and all P/E's should be the same. Far from it, but the premium for perceived "great growth companies" vs. everyone else has never been wider, which makes them vulnerable to profit taking.

The key problem is that investors have major multi-year profits to take in these growth/momentum names. They are sitting on HUGE paper profits even at today's lower share prices.

What causes these share prices to gap lower is the fact there is a major P/E (valuation gap) between what a growth investor and a value investor would pay for the same earnings stream. That gap is the issue and why these stocks hit "air pockets" when momentum reverses. It does remind you that "price is what you pay, value is what you get (or not)".

What happens is a growth scare turns into a valuation scare, as investors reconsider what the appropriate multiple is to reflect growth macro risks. You can see that absolutely nothing fundamental has changed for these companies other than a view on price from investors. Investors stop worrying about upside and start worrying about downside. It's a basic psychological response to a changed macro assumption (global growth).

What we all need to be prepared for is the market continuing to question the valuations of pretty much any stock whose chart has gone up on a 45-degree angle for the last three years. This doesn't mean these companies should be sold. What we need to realise is they could easily fall further on no change to their earnings growth outlook. In that event there will be opportunities, but I tend to believe this global event with local ramifications has further to play out, as I wrote last week.

I expect further volatility and high levels of stock price performance divergence. What we always need to remember, and it's damn hard some days, is it is a market of stocks, not a stock market.

In fact, just about everything has been marked down in price (ASX200 now in bear market territory -20% from recent peak) there will be stock specific opportunities to invest and make money. There should be absolutely no doubt about that.

But make no mistake — this is different to the last five years. We will need to be highly selective in where we allocate capital. We will also need to be patient and disciplined.

I realise everyone wants to be told it's a buying opportunity. No doubt it is in the RIGHT THINGS, but if I look across what different indicators are telling me, most are flashing "orange" and some "red", it is absolutely NOT the time to be BUYING EVERYTHING.

These indicators have flashed a bit more red than orange since last week's note, with the key changes being deteriorating corporate credit markets, the flattening US yield curve and global collapse in long bond yields that can only confirm one thing: this global growth scare is spreading to the USA and to world equity markets.

I realise most of us are equity focused but the credit markets are what we should be watching. They continue to warn of lower growth and lower growth isn't great for all equities.

Remain patient and disciplined.

Important*: 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. Consider the appropriateness of the information in regards to your circumstances*

Takeover portfolio update

by Tony Featherstone

The biggest, most complex issue facing institutional investors in 2016 is when to buy resource stocks. It is also the toughest challenge facing resource companies that have balance-sheet firepower to buy ailing competitors. After years of neglecting resource stocks, some of the market's better judges are starting to re-enter the sector.

Respected stock picker John Sevior of Airlie Funds Management has started buying resource stocks again, despite reservations about the capital allocation record of BHP Billiton and other large miners.

PM Capital is another that has resource stocks on its radar. The prominent international equities manager has been among the biggest bears on resource stocks over the past few years. It sees value returning but is yet to make a move on mining or energy shares.

As valuations tumble, a turning point for resource stocks is getting closer. Certainly, the near-term outlook for resource stocks is horrible as China slows, deflation fears rise and panic grips financial markets. But such conditions are often an opportunity for contrarians.

The key question, of course, is how much of the outlook is factored into valuations. The S&P/ASX 300 Resources Index (capital only) shed 25% in calendar year 2015. Share prices of the big diversified miners and energy stocks crashed. Santos, for example, which was trading above $12 for much of 2014, has plunged to $2.93.

These are interesting times for offshore resource companies and sovereign wealth funds that can acquire mining assets at a fraction of their peak valuations. However, going in too early – like this column did last year when it included Santos (STO) as a takeover target – is dangerous.

Picking takeover targets in this market is hard enough. A trickier challenge is timing. Buying stocks on the basis of takeover alone is foolhardy because such deals often do not eventuate or fall through, take longer than expected to occur, or have less upside than imagined. But the timing of takeovers in the energy sector looks more favourable, after the oil price carnage in the past six months.

The price has fallen so far that OPEC and non-OPEC producers will surely have to collaborate to normalise oil prices as best they can. If they do not, many oil producers – and oil-exporting countries for that matter – will be insolvent.

The supply response to lower energy prices is coming. More producers are shelving investment plans or curbing production in the face of weak prices and lower demand. In time, lower supply will lead to a better equilibrium in energy prices. Does that mean oil will not fall further or that incredible volatility will subside in the near term? I doubt it.

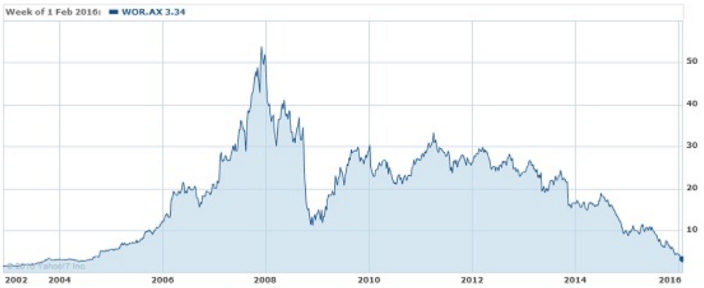
There's too much uncertainty to suggest that a floor is being built into price at current levels before inevitable gains. There is, however, enough to suggest that the largest energy stocks look more attractive at current prices for long-term investors and that takeovers in the energy sectors will emerge if prices continue to fall and market behaviour becomes increasingly irrational.

WorleyParsons in firing line

Few industries have been hurt more by commodity price falls and the end of the mining investment boom than resource service companies. They were the first to sink as investors recognised a once-in-a-generation capital expenditure cycle in the mining and energy sectors was abruptly ending. Even at current valuations, takeover volumes in resource service stocks have been relatively low. Predators are, understandably, reluctant to move.

Energy and infrastructure services provider WorleyParsons (WOR), a former market darling, has slumped from above $30 in 2011 to $3.31. Its one-year total return is -64% and over three years, the annualised return is -47%.

Chart 1: WOR



Source: Yahoo!7 Finance, 11 February 2016

As one of the world's largest providers of engineering and professional services to the energy sector, WorleyParsons is highly leveraged to the downturn. Its main business, providing engineering and project management services to hydrocarbon customers, contributes more than 70% of revenue. Services for infrastructure and mining projects provide the rest.

Lower energy prices have decimated WorleyParsons. The withdrawal of new energy projects and cutbacks in existing ones crunched its earnings and reduced market visibility in its order book and future revenue. It seems likely that WorleyParsons' cycle of downgraded earnings will continue as the commodity slump intensifies and capital expenditure budgets – a reliable, leading indicator of WorleyParsons earnings – fall.

Concerns about WorleyParsons' balance sheet, and potential for a dilutive equity capital raising, should earnings deteriorate more than expected, add to the negativity. This is not a stock for conservative investors or the faint-hearted to buy in the current volatility, or for those who cannot withstand further share price falls in the short term. But every company has its price.

As investors remain on the sidelines because of uncertainties around WorleyParsons' earnings, offshore suitors will find the company more appealing at current valuations – particularly if they believe that most of the oil price damage has already occurred. WorleyParsons' leverage to the oil price works both ways: a medium-term recovery would significantly boost its fortunes.

WorleyParsons is well aware of the takeover threat. Its board said at the annual general meeting last year that the company had prepared its takeover defences when it traded at higher prices than now. Speculation was rife in 2015 that WorleyParsons would be taken over, but the conjecture seems to have faded, despite a sharply lower valuation and lower Australian dollar. Its share price spiked 14% in April 2015 on takeover rumours.

For all of its immediate problems, WorleyParsons has a strong global footprint, blue-chip client base and excellent exposure to favourable long-term trends as developing economies, such as India, spend more on their energy and infrastructure markets.

It also has a valuation that arguably has priced in further earnings downgrades, asset write-downs and continuing bad news in the energy sector. But the market has mixed views: four out of 12 broking firms that cover WorleyParsons have a buy recommendation, five have a hold and three have a sell, based on consensus analyst forecasts.

Share price targets, ranging from $3.09 to $8.92, reflect the uncertainty in WorleyParsons' valuation, and a median price target of $7.90, which looks far too high, suggests it is significantly undervalued compared to the current $3.35. Macquarie Equities Research's $4.75 price target looks more realistic. It has a neutral recommendation and suggests investors wait on the sidelines because of the uncertainty.

Even the most bearish analyst forecasts have WorleyParsons trading near fair value at the current price. A forward price-earnings (PE) of 4.9 times

2016-17 earnings based on consensus estimates, shows how far the market has downgraded WorleyParsons' prospects.

The PE could rise, if WorleyParsons' expected earnings downgrades are larger than expected. More will be known when it reports its half-year earnings later this month. But even in the troubled energy sector, the PE looks low for a company that had $8.7 billion in revenue in 2014-15 and delivered an average 14% return on equity (ROE) in the past five financial years during the resources downturn. My main hesitation in nominating WorleyParsons as a takeover target is identifying an obvious offshore buyer.

Larger energy services companies might be reluctant to take on greater debt to acquire WorleyParsons in such an uncertain sector, and its global footprint could replicate services the acquirer provides in other markets.

It is not a simple bolt-on acquisition for an offshore predator. The prospect of an even lower valuation for WorleyParsons in the next few months could also deter suitors.

But WorleyParsons looks like an interesting takeover play for predators, who believe the oil price collapse has been overdone and that the world economy, while slowing, is not heading for recession. And who are prepared to pounce when everybody else is running for cover.

Takeover update

There was more pain for takeover targets this month as market volatility drove prices lower and scared off takeover attempts. Ansell (ANN) was particularly disappointing after a nasty earnings downgrade. WorleyParsons joins the takeover targets lists this week.

Takeover targets	**One-year total shareholder return* %**
Treasury Wine Estates	65
Gold Road Resources	18
Monash IVF Group	11
Automotive Holdings Group	10
Reckon	4
Challenger	3
NIB Holdings	-8
Nufarm	-11
Aurizon Holdings	-13
OzForexGroup	-14
Australian Agricultural Company	-25
Qube Holdings	-26
OrotonGroup	-27
3P Learning	-31
Ansell	-34
Myer Holdings	-37
iSelect	-40
South32	-50
Ten Network Holdings	-54
Santos	-54
WorleyParsons	-64
AWE	-68
Average return %	**-20**
1-year total return S&P/ASX 200 index %	**-13**

Source: Morningstar (one-year return), Standard and Poor's (S&P/ ASX 200 total return).
** assumes dividend reinvestment*

Tony Featherstone is a former managing editor of BRW and Shares magazines. The column does not imply any stock recommendations. Readers should do further research of their own or talk to their adviser before acting on themes in this article. All prices and analysis at 10 February 2016.

Buy, Sell, Hold – what the brokers say

by Staff Reporter

In the good books

Ansell (ANN) Upgrade to Buy from Neutral by Citi B/H/S 3/5/0

Post the shock pre-released financial update, management proved remarkably confident of improvement in the second half due to a major contract win plus resolution of operational variances, observe the analysts. They have amended estimates accordingly.

Citi believes the shares look attractive, post sell-down, despite negative momentum operationally.

JB Hi-Fi (JBH) Upgrade to Accumulate from Hold by Ord Minnett B/H/S 4/4/0

First-half results were ahead of what the broker expected, with sales growth the key driver. The broker upgrades the stock, confident that sales growth can be sustained, supported by the positive impact on industry structure from the demise of Dick Smith (DSH).

Ord Minnett notes margins were soft in the first-half but the company has a track record of strong cost management, with scope for medium-term margin expansion as the investment in the Home division comes to an end.

Nufarm (NUF) Upgrade to Outperform from Neutral by Credit Suisse B/H/S 2/4/1

While Credit Suisse's investment case is unchanged, the fall in the share price and no substantial change in the outlook means the rating is now upgraded.

The broker expects declines in Brazil should be offset by cost savings and growth in other markets. Trading conditions do not seem to have worsened in the December quarter, the broker observes, judging by results commentary from the company's peers.

REA Group (REA) Upgrade from Outperform to Neutral by Credit Suisse B/H/S 4/4/0

First half earnings were in line with forecasts and Credit Suisse expects Australian revenue growth to remain strong in the second half. Price increases in May/June should support revenue into fiscal 2017.

REA Group is upgraded following the recent dip in the share price. The broker believes online property offers significant scope both in the near and longer term.

The only negative, in the broker's opinion, was the guidance for cost growth to be higher than revenue growth. Full year estimates are trimmed by 2.0% to reflect this.

In the not-so-good books

Bank of Queensland (BOQ) Downgrade to Hold from Buy by Deutsche Bank B/H/S 2/5/0

The bank has warned of rising funding costs impacting on margins for the second time and this makes Deutsche Bank's analysts wonder whether BOQ is receiving more pressure than the others.

The broker suspects, on the balance of probabilities, that its margin is probably more susceptible compared with the major banks in an environment of widening credit spreads.

The broker believes a re-rating in the short term is unlikely and downgrades the stock.

Lifehealthcare Group (LHC) Downgrade to Neutral from Buy by UBS B/H/S 0/1/0

Lifehealthcare's sales are exposed by around 35% to prices set by the government's prostheses lists, where key changes have been proposed to reference pricing, UBS observes.

This could be moderated by the company's specialisation areas such as spinal, which may be less affected, and the opportunity to cut supplier margins. The broker envisages potential upside from the government's examination of anti-competitive structures.

At this point, given the regulatory risk on prostheses pricing and the difficulty in apportioning a potential impact on earnings, UBS had downgraded the stock.

Whitehaven Coal (WHC) Downgrade to Hold from Add by Morgans B/H/S 4/3/1

Morgans is impressed with the company's ability to protect its cash margin ($14/t) in the first half but expects this will compress towards $10/t in the second half because of lower coal prices.

De-gearing has begun but is expected to remain slow at current prices. The broker suspects the stock is being priced for balance sheet stress but that the market is underestimating the options the company has to de-gear more quickly if necessary.

Morgans downgrades the stock, believing that investors should wait for the risks to the balance sheet to ease further.

Insurance inside and outside of SMSFs

by Tony Negline

Are you best to hold your life insurance policies inside or outside superannuation?

Well, there are advantages and disadvantages with both approaches.

Before we discuss the merits of both approaches, I will briefly detail the different types of insurance policies.

Overall, there are really four different life insurance policies available:

1. Death insurance – this is quite straightforward; clearly money is payable when you die.

2. Total and Permanent Disability (TPD) insurance pays a lump sum if you can't work due to physical or mental ill health. In broad terms, there are three different types of disability – one where the insurer determines that it is unlikely you will ever do any future work; another where the insurer decides if it's unlikely you'll be able to do a job which involves your training and years of experience; and the last which you will receive a lump sum payment if you can't do your own occupation or something very similar to it.

3. Salary Continuance, which pays you an insurance benefit in the form of regular monthly installments if you can't work due to physical or mental ill health; the definitions of disability used for this insurance are similar to that used for TPD insurance.

4. Trauma Insurance pays a lump sum, if you were to suffer some type of medical problem, such as heart attack, various cancers, brain tumours and major organ failure.

There are about 28 life insurers operating in Australia and some of them will use different names for their insurance products than I have above.

Often these types of insurances can be purchased as standalone policies or bundled into a single contract.

Now let's look at which of these insurance policies can be purchased in superannuation.

The major restriction is that your self-managed superannuation fund (SMSF) can't purchase any insurance policy, if claim proceeds can't be paid out immediately.

For example, suppose your fund's trust deed didn't allow any death benefit proceeds to be payable (admittedly this would be an unusual provision.) But if this were the case, your fund wouldn't be allowed to purchase a death insurance policy. There is a concession to this rule, however, if your fund purchased a policy before 1 July 2014.

Insurance outside of super

The primary reason you might insure outside super is that if the policy is owned by you personally, then any claim proceeds are paid to you tax free. In other words, it can seem simple.

However, in this situation, other than death benefits, all the proceeds would be paid to you personally. In the event of financial difficulty, you might have to use this money to settle debts and other obligations.

In addition, any death benefit proceeds that are paid to your estate can be subject to challenge by dissatisfied or disgruntled beneficiaries.

The negatives with insurance outside super are that there are no potential tax savings on any contributions you make to super to cover the cost of the insurance. This can be a big deal for those relying on employer super contributions to help meet the cost of this insurance.

Insurance in super

One of the advantages of insurance in super is that you can use tax concessions on contributions to effectively reduce the cost of the insurance policies.

As noted above, those who find cash flow tight can rely on employer contributions – both compulsory and/or salary sacrifice contributions – to pay for the insurance.

One advantage of insurance inside super is that sometimes you can delay paying benefits in the event of your financial difficulty, thereby potentially avoiding the need to pay creditors. (This is the exact reverse of the situation that can arise for personally-owned super policies above.)

One disadvantage with holding insurance inside super is the two-step claims process.

Let's suppose your SMSF owns a TPD policy. In the initial instance, you claim a benefit from your super fund.

Your fund trustee then assesses you according to your trust deed. At the same time, it would seek to claim from the insurance policy. Both assessment processes must be run independently of each other.

Your insurer might ask for medical and other information that your super fund doesn't need or want and vice versa.

Another disadvantage with insurance inside super involving death insurance involves the payment of that benefit and your survivors working their way through the fund's trust deed, any benefit nominations you have completed and dealing with any conflicts. This is an area of increasing litigation. The only way to avoid this is with very careful planning.

5 other issues to consider

1. **Stepped or level premium** – most life insurers offer two types of premiums – stepped, which increase each year based on your age, and level, which remains unchanged for the life of the policy. Initially, level premiums will be more expensive but, over time, will become cheaper.
2. **Underwriting** – medical and occupational underwriting can be a pain in the neck. Most industry super funds offer cheaper insurance than other market offerings and also allow you to increase your insurance amount without underwriting when you first join the fund. That said, because the insurance is cheap, it doesn't mean it will suit your purposes or needs.
3. **Insurance for business purposes** – insuring against business succession and key employee risk are complex issues and many of the issues that need to be considered haven't been canvassed here – perhaps a piece for another article!
4. **Insurance is a contract** – remember that all insurances are a contract and, by definition, the wording of that contract is very important; you need to make sure that the contract will pay you a benefit when you expect it.
5. **Don't buy solely on price** – value is important but a lower price is often an indication of greater restrictions on paying you a benefit

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Professional's Pick – Gateway Lifestyle Group (GTY)

by Andrew Smith

What do you like about the stock?

We are attracted to GTY for several reasons, however, the primary reason is the strong tailwinds from the ageing population in Australia. The population of over 65 year olds is set to double between 2005 and 2021.

Given this backdrop, we have long been attracted to the retirement sector and have already had several successful investments in the last seven years (AOG, INA, LIC and AVE – bought by Stockland).

Amongst the listed peers, GTY stands out as it offers an affordable mobile home retirement product with the weekly rental providing investors with strong and predictable annuity revenues. In this sense, it is most like Lifestyle Communities (LIC). However, with GTY, you are not restricted to greenfield developments (as you are with a LIC).

Gateway is aggressively consolidating the sector, providing strong earnings accretion in the process. Given this focus on acquisitions, you need a quality management team, who not only stay disciplined when assessing acquisitions but can also manage an expanding portfolio.

We believe the team led by chief executive Trent Ottawa provides this as well as the strong board led by chairman Andrew Love overseeing major decisions.

Finally, the valuation at the initial public offering (IPO) was very attractive, priced at 11.8 times forward earnings, a large discount to both peers and the market.

We also liked the fact that Ottawa (which holds 5% of the company) did not sell any stock in the float and has not since.

How is it better than its competitors?

Location is everything in this business and GTY has many villages in attractive coastal locations close to major population centres.

This attracts residents and boosts returns to shareholders, given the high occupancy levels typically experienced. Many of these quality sites are hard to replicate so the restricted supply provides a natural competitive advantage. For example, there is very little chance of similar retirement parks being built near Gateway's Sydney or Brisbane locations, given tight planning laws and high land values.

What do you like about its management?

The management team is experienced, having been involved in the retirement park sector since 2007. It also brings strong financial discipline to all acquisitions, given its background in accounting.

This is important, given that the management team is focused on consolidating the industry and acquisitions will be continuing for many years. Yet the team manages to combine this with an ability to manage the parks in the friendly and hands on manner needed to keep the residents happy.

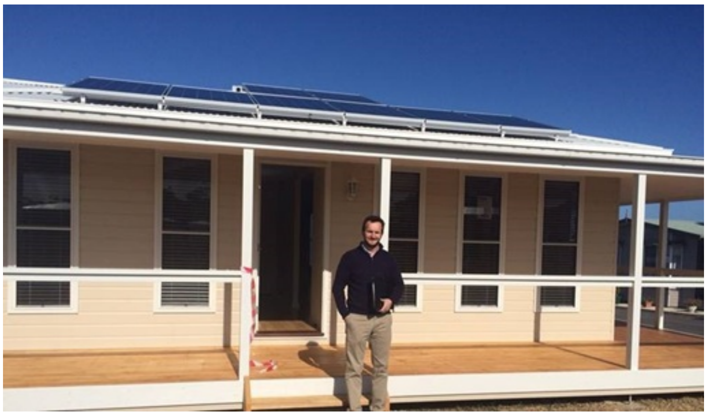
Importantly, I have visited several parks without head office management present and have found a consistently high quality of management at the park level. In this sense, the management style runs from the chief executive down throughout the company.

Where do you see the value?

The value in Gateway is in the growing rental annuity.

Underpinning this is the quality of the land on which the homes are located. As a result, we continue to undertake extensive site visits of both Gateway and competing villages to ensure the quality and exclusivity of each location. I have included an example of a site visit I made to the Valhalla retirement village, which is owned and operated by Gateway.

The village is one of the highest quality that I have seen and well located near Lake Macquarie on the Central Coast. Importantly, the quality of the new stock being delivered to incoming residents (example in the photo) is also amongst the best I have seen.



How long have you held the stock?

After several months of due diligence and site tours, we acquired the stock in the IPO at $2.00, with the listing occurring in June 2015. We have held the stock ever since and bought more shares on market, lifting our stake to 7.7% of the company.

What is your target price on the stock?

We tend to look at valuation relative to the market and on this basis we think it approaches fair value around $3.00, where investors will be getting close to a 5% dividend yield. However, this valuation does not take into account future acquisitions or approval for more developments on the existing land bank – on our conservative numbers this lifts the valuation to $3.30. As these opportunities are announced, we will adjust our valuation accordingly and therefore I can see a situation where more accretive acquisitions continue to push the valuation higher and all the time the annuity revenues continue to grow.

At what point would you sell it?

We typically look to sell stocks when they move well past what we see as fair value, based on the information we have at the time.

The other development that would cause us to sell would be any signs management is overpaying for acquisitions or if strategy differs materially from what we think is a very sensible strategy, as outlined at the IPO.

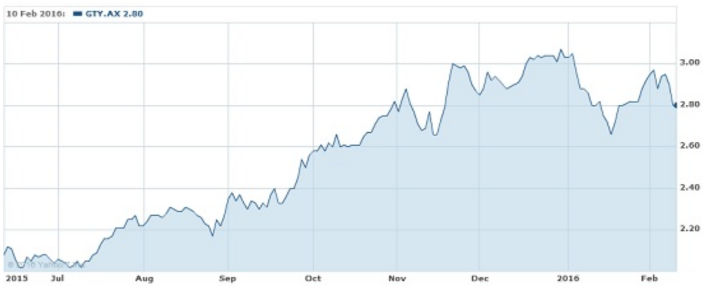
How much has it added (subtracted) to your overall portfolio over the last 12 months?

Our fund, the Perennial Value Smaller Companies Trust, was up 13.5% net of fees in 2015, 3.3% above the ASX/ S&P Small Ordinaries Index. Gateway contributed to about a third of this excess return, despite only being listed mid-way through the year.

Is it a liquid stock?

The pleasing thing about Gateway Lifestyle Group is that with a market cap of $700 million, there is plenty of liquidity versus other small cap investment opportunities. This liquidity was enhanced when the stock was introduced to both the S&P 200 and 300 index in September 2015.

Gateway Lifestyle Group (GTY)



***Source**: Yahoo!7 Finance, 11 February 2016*

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Retirement goals and decent returns

by Questions of the Week

Question: I've read your article, *How much do I need to retire?* Let's say I have the $1 million you say I need in my super fund. How do I generate the $60,000 a year I would like to live on?

Answer (By Melanie Dunn):

Thank you for writing in to the *Switzer Super Report* about my article.

If I pick up our example, a 65-year old couple requires just under $1 million in savings to support a spend of $70,000 p.a. for life – assuming spending reduces in real terms at older ages. We consider a household invested in a broadly balanced asset mix during retirement.

This $1 million is assumed to comprise of all of the households investments, not just super, but excludes the family home. The $70,000 p.a. in spending is assumed to be met from income produced by the household's assets, age pension entitlements, and, as these vary year to year, also from spending capital when required.

In practice, how income in excess of the age pension and SMSF minimum pension drawings is generated to fund each year's spending will come down to your personal decisions about where to draw your spending from. This is where it is useful to be able to revisit your situation each year to ensure you remain on track to meet your retirement goals.

Question: I have sold a large portion of shares in my super portfolio and now hold cash. What is a good place to hold it and get a decent return, until such times as the market improves? I keep hearing about bonds, but have no experience of them.

Answer (by Paul Rickard): I think "a decent return" is a bit in the eye of the beholder. If you were bearish on the stock market and thought the market might drop 15%, then a return of 2.5% to 3.0% from term deposits might look pretty decent.

Working on the assumption that protection of capital is pretty important, here are some suggestions:

1. Term deposits. Have a look at the second or third tier banks for a higher rate – remember that the government guarantee applies up to $250,000 per institution;
2. You can purchase bonds directly. Brokers like FIIG Securities can help;
3. You can purchase government bonds directly – they trade on the ASX. See link here;
4. Have a look at some bond funds. Consider duration (average maturity of the bond), credit risk and management fees. Consider funds like the AMP Corporate Bond Fund – see here.
5. Hybrid securities; and
6. Potentially, some lower risk property assets – perhaps a well-diversified property trust.

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