AUSTRALIAN INVESTORS ASSOCIATION

Investor Update

Monthly updates on investment issues for AIA members

DECEMBER 2013

Investor Update

A good mix this month. An article about new equities floats, some clues about advertising your rental property, a good article about high-frequency trading, and a book review. Enjoy!

In this issue

Floating your best returns

Eight Steps to value investing the floats.
Roger Montgomery

Much has been written about the rush of fourth-quarter Initial Public Offerings (IPOs). Less considered is how to spot outstanding investment opportunities in what could be the best batch of floats in at least five years – and how to avoid myriad risks when investing in new listings.

Upcoming Events

[view events schedule]

Many committees have already set their plans for their 2014 events, and these are now posted on the AIA website.

Planning for the 2014

Annual Conference

has begun

Sunday 3rd August to Wednesday 6th August 2014

Put the dates into your diary now!

We wish all of our members and families a merry and safe Christmas

Floating your best returns (Cont'd)

Make no mistake, the IPO market is on a tremendous roll. More than $10 billion could be raised from IPOs this year, which would make it the best year in almost a decade.

IPO sentiment is rapidly improving for four main reasons. First, some prominent recent floats have buoyed investors, such as In Vitro Fertilisation (IVF) provider Virtus Health (an IPO that Montgomery participated in), Brisbane-based law firm Shine Corporate and, foreign-exchange service provider OzForex Group, which have shown that outstanding gains can been made from the right IPOs – in difficult sharemarket conditions.

The second reason for renewed IPO support is relative pricing. Value is hard to find in the Australian sharemarket, so fund managers are eager for IPOs that are offered at a discount to intrinsic value.

The third reason is demand from international investors and the fourth is professional investors know better-quality businesses are typically brought to market at the start of the IPO cycle.

The result of these dynamics tends to be IPO pricing that reflects reasonably good value compared with similar listed companies, when, at a time, similar companies are trading at elevated prices. Of course there are exceptions, but as a general observation, participating in IPOs probably makes more sense for investors with a shorter investment time frame.

Several large floats are on the way. None will dominate the press more than the IPO of Nine Entertainment Co, which is expected to list on December 6 with a $1.92 billion to $2.16 billion market capitalisation, depending on the institutional book build that will determine the final price.

Other floats include Dick Smith Investments, Vocation, Redcape Hotel Group, McAleese Transport, Veda, Industria REIT, PM Capital Global Opportunities, Life Healthcare, GDI Property Group, Real Energy Corp and BIS Industries.
For investors willing to put in some legwork and properly analyse the companies coming to market, IPOs can be an opportunity to acquire high-quality businesses before others have fully appreciated their virtues. Here are eight steps that you can use to evaluate any IPO for yourself.

1. Ignore market noise
At Montgomery, we are not seduced by newspaper headlines of an "IPO boom" nor stockbroker research notes with "buy" recommendations. Equally, we aren't swayed by our fund manager peers who complain in the financial media about excessive IPO valuations or the poor performance of previous private equity-vended floats. We simply adopt a level-headed approach to assessing each IPO on its merits.

2. Buy businesses, not bits of paper
You should think like an owner when investing in an IPO. Would you happily own a piece for the right price, and hold it for several years if the sharemarket closed tomorrow? Those who buy IPOs for short-term gains or 'stag' profits take enormous risk. Never assume all floats in a rising market will rally on listing.

3. Seek a higher margin of safety
The margin of safety is the difference between the IPO's issue price and the company's intrinsic or true value, which you or your adviser has calculated. As with any shares, the goal is to buy them when they are available below intrinsic value.

A higher margin of safety is required when buying IPOs, compared with established listed companies. Companies undergoing an IPO sometimes have no commercial operating history and none as a listed company, their management can be untested in a listed environment, and often there is much less financial information and fewer forecasts to assess their merits. Becoming a listed company can divert attention and turn good managers into bad ones.

4. People
More so than for any share investment, analysis of an IPO requires careful consideration of the executive team and board. In a well-established listed company, the CEO and directors are usually known to the market. This is not always the case in IPOs, which may have first-time CEOs and small boards with only a few independent directors. Remember, bad people can quickly kill good businesses or at least put them into a coma.
Do not be swayed by glossy biographies in the prospectus. Search the internet and media databases for background stories on the CEO and chairman of a new IPO. Ask whether the board has a sufficient mix of directors to safeguard your investment, and monitor the CEO.

The best gauge of executive performance however is the company's long-term financial performance, but such data can be challenging to come by for IPOs, meaning investors often to make a value judgement on the management and the board.

5. Executive pay

Nothing tells you more about the people behind an IPO than executive pay. Excessive remuneration for executives or board, compared with its nearest listed peers, can suggest the management team sees the company as its own, and that there is little reward alignment with new shareholders.

Consider performance incentives. Is the board showering the CEO with options or other equity incentives that have low, or no, performance hurdles? Better-quality companies often base performance targets on operational goals. For example, a certain profit target has to be reached. Poor-quality companies sometimes base targets on the share price, which is all too often a poor yardstick of true performance.

The capital structure also provides important clues. Excessive options issuance to the executive team can swell the number of issued shares in coming years, and badly dilute those of existing shareholders.

6. The business

A value investor's ultimate goal is buying exceptional companies at bargain prices. Ask yourself whether the IPO is – or has the potential to be – an exceptional company.
Hallmarks of exceptional companies include a clear, sustainable competitive advantage; a well-regarded product or service that is hard to copy; a consistently high Return on Equity; little or no debt; strong surplus working capital that can fund future growth; low capital investment requirements; and recurring annuity-like revenue.

7. Alignment

No IPO indicator is more reassuring than the vendor, executive team and board having a strong alignment with new shareholders. Simply put, high shareholder alignment means the vendor (who ideally should still own a significant number of shares after the float) and executive team do well when the company does well, and poorly when it underperforms. In this way, their interests are aligned with yours.
The other trait of good IPOs is the preparedness of a vendor to "leave a little value on the table" for new shareholders.

8. Do not give up on floats after listing

Investors may believe they have missed out if they cannot secure stock in the IPO, or give up on it if the share price falls after listing. Often, the best value emerges several months after listing when IPO hype dies down and investors can judge the company's quality by its half yearly or annual economic performance. The trick is finding higher-quality IPOs at low prices – and that usually occurs when fewer people are looking at the company after the listing.

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When advertising – why tenants will want your property over the rest.

Corina Bailey

Writing rental ad copy is the best possible chance for you to be able to draw in potential & quality tenants.

Ad copy is the words you use to lure ideal tenants in to view your property. Before you begin writing your copy, do a little market research to find out who will want to rent in your specific area and why (Tip: How much rent should I charge?)

To start pulling calls and applications for your rentals, you have to first get prospective tenants interested enough to take action. It's always a good idea to make a list of all the features and benefits your property has to offer, that way you won't miss anything when writing your killer ad copy to promote your rental. Also stand out from the rest by using quality photos showing the most attractive feature or room of the house, this will capture attention.

Information like amount of rent, whether or not it includes utilities and the size and location of the property are all viable bullet points that should be added to your advertisement. Number of bedrooms, bathrooms, parking information i.e. garage, pets allowed (or not), and anything else of importance should also be added, but in a way that your potential tenants are visualizing their stay in your rental home. Include applicable pics, tenants are going to want to see proof

the property is in the condition you say it is, be sure to include a photo (where applicable) of the front & back yard, the view. They like to see the main features such as kitchen, bathroom as well as any luring enticer's like a patio, pool, spa or appliances.

To create an ad that grabs attention and compels someone to take action, you must align the facts and create an image of what their life could be like living in your property.

The Headline of your ad is a biggie, it's your first, or only possible chance to get a renter's attention. It's important that when you are writing your ads to think like a tenant in the way that they are normal, living, breathing beings who want a quiet, peaceful, or safe home to escape to and / or raise their families.

In your headlines, use adjectives like "New" and "Fresh" or "Plush" so that they immediately have an interest in reading or seeing more. An eye catching headline does not blend in with every other ad, but instead should be unique with "new paint" or "great neighbours".

Location is an important attribute that people look for when seeking a new property. Make sure you are stating in your advertisements where the house is located, what the neighbourhood is like and the quality of the schools that surround your rental.

Write out the best features of the home, if it has been newly renovated or remodelled, does it have updated bathrooms or new appliances? Make sure this information is stated at the top of your ad copy because people are likely to not read it in its entirety.

You want to get a possible tenants attention as soon as they start reading your ad.

At the end of your ad copy it is detrimental to add a call of action so the prospective tenant will know what to do next. Tell them to "Call Now!" or "Come In Today Before This Home is Gone!" be sure to include contact phone numbers and email address and more importantly, when the property is available. List any 'open home' inspection dates and times. Then, when you get a response, move fast to get them into the property while their interest is still high.

A little creativity goes a long way when writing your advertisements.

There's a lot more to renting out your property than just writing great ad copy but it is an important step that should not be ignored.

Did you know – we have access to all major websites for advertising your property for rent at affordable price, click here for more information.

Author: Landlord Guru – Corina Bailey

The future of high frequency training

Adam Maxey

Changes in technology have affected our daily lives. From the introduction of the first PC, innovation has seen computers take over from humans. Nowhere more so can this be seen than in financial markets. The use of computers makes life easier and allows for efficiency and better outcomes. One issue has divided traders – High Frequency Trading (HFT).

The last 30 years has seen trading floors, where humans traded, executed orders and where supply and demand set prices, be replaced by machines. Trading is now screen based – that is traders now sit in front of computer screens, They can do this from anywhere in the world. The transformation of markets to screen based trading has seen the development of programs to trade financial markets. Innovation and development has been rapid and has created new and intuitive ways of trading.

To better understand HFT we need to discuss how and why it has evolved. When trading first went screen based, traders did what they normally did but loaded the orders into a computer. This centralised markets and eventually made the information public, creating what is known as front running. This is where a trader looks at the depth of a market and predicts that a large buyer is in the market either by the disclosure of the order on the bid or the action the buyer is taking. By buying stock as the price rises, traders look to profit by buying and then selling the stock back to the existing buyer – whereby they have front run the order, taking stock away from the buyer and selling it back to that same buyer at a higher price.

To avoid being scalped fund managers and traders developed new ways to trade. They knew if they put their entire order, or a large proportion of the order, on the screen the front runners would push prices away from their order affecting the price they would complete their trade. To overcome this, a new price order type was created called a VWAP order. This was an advance on the traditional limit and at best or market orders investors had been using.

VWAP stands for Volume Weighted Average Price and is the standard measure on which execution is measured. It is calculated by averaging the price of all the trades over the day and is a measure that completed orders are rated against. An order that is completed outside a set deviation is considered to be a bad price.

This order type allows an order to be completed over a set period (usually a day) and the order would be split into small amounts to avoid detection by the front runners who would find it harder to determine which side to trade. Traders would enter smaller amounts of their order into the screen thereby smoothing out major changes in supply and demand. To make this process more efficient, computer programmers wrote complex strategies which are now commonly called VWAP algorithms.

The next step in the evolution was the development of complex programs written by developers to do exactly what the front runners would do but in a more effective and efficient manner - in a high frequency way. They were developed to take advantage of VWAP strategies and investors trading patterns.

The more they trade the more they are trying to make. HFT are trying to make a fraction of a cent on a high amount of turnover. They use even more complex strategies than the VWAP algorithms and try to decipher what side to trade on. They try to buy ahead of the market made up of VWAP algorithms and other market participants and sell back to the market at a higher price. When the HFT determine there are more sellers and a down trend, they do the opposite and sell ahead of the natural sellers in the market. The aim of High Frequency Traders is to predict trends in the market and push buyers higher and sellers lower.

Although HFT has been in use since at least the late 1990's, it was not until May 2010 that it became front page news. On May 6 2010 the Dow Jones fell as much as 9.2% in a matter of minutes and then recovered to finish down 3%. HFT had exaggerated this movement and a fall in the price led to a number of HFT investors selling the same securities.

The increased use of HFT and other computer based execution strategies creates patterns.
Technical analysis is the study of patterns in markets mainly through the use of charts. The aim is to determine the trend of a market to try and predict the future direction. Computer based trading strategies are generating their trades off technical information. The simplest form of technical trading is to buy support and sell resistance. The algorithms scan financial markets and look for prices that are trading near technical levels and trade their strategy using the analysis the program has done.

By analysing patterns left by computer based trading strategies, technical analysis can assist investors to reduce their execution risk and manage their entry and exit points.
Whether you trade short or long term, technical analysis is an important tool to be considered and used. The use of computers and the development of new execution techniques means investors need to keep up to date with changes to market structure and trading techniques. Investors who understand the changes to market strategies can adapt to future market trends.

HFT is considered by ASIC, the financial services regulatory, as a very high risk product. ASIC warns that those engaging in HFT should exercise extreme caution when trading in this manner.

Adam Maxey is the Developer and founder of iQuant Systems.
iQuant is the latest advance in technical analysis. Providing a picture of trends in the market, iQuant produces reports covering Daily, Weekly and Monthly time frames. iQuant works across all financial instruments including international indices, equities, commodities and currencies. It is most effective where algorithmic and high frequency trading is active.
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Imposing a Cap on Work-Related Self-Education Expenses Not to Proceed

The government announced on 6 November 2013 that it will not proceed with the previous government's announcement to introduce a $2,000 cap on the amount you can deduct for work-related self-education expenses.

Not proceeding with this measure means that these expenses will continue to be deductible according to the normal rules.

Extra 15% Superannuation Contributions Tax for High Income Earners

The Government has announced that from 1 July 2012, anyone earning more than $300,000 will pay 30% tax on concessional contributions paid into a superannuation fund, doubling the superannuation contributions tax for high income earners. The regular contributions tax is a 15%.

Concessional contributions include superannuation guarantee contributions (employer contributions), salary sacrifice contributions, and self-employed tax-deductible contributions.

The ATO recently announced that it will start issuing the first assessments in January 2014 for individuals who were above the $300,000 income threshold for the 2012/2013 financial year.

In calculating earnings for the $300,000 threshold, ‘income’ includes;

*·Taxable income
*·Concessional superannuation contributions
*·Adjusted fringe benefits
*·Total net investment losses
*·Tax-free government pensions

The excess 15% tax will be assessed to the individual, however individuals may choose to make payments from their superannuation fund using a release authority.

Possible Changes to the $6,500 Immediate Asset Write-Off and $5,000 Upfront Motor Vehicle Deduction

At this stage, the below changes have only been proposed by government, and have not been passed by Parliament. However, the changes could be introduced 1 January 2014;

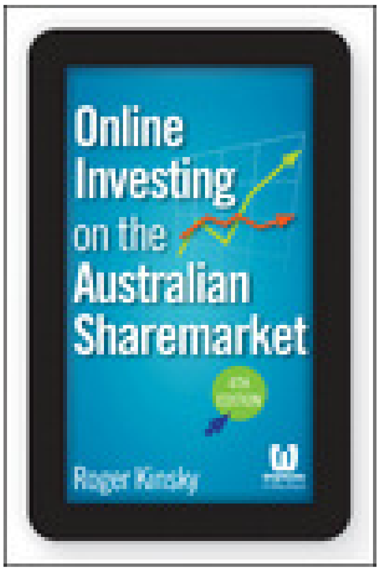
- Immediate deductions reduced for small business entities (SBEs). Currently, small business entities (generally entities with a turnover of less than $2m) can claim an immediate deduction for depreciating assets costing less than $6,500. For example, if a SBE buys a $4,000 computer, the business can claim an immediate deduction in the same financial year for the full $4,000. From 1 January 2014 however, this threshold will drop to $1,000. So, if there are assets you need for your business and cash flow allows, you have until 31 December 2013 to buy the assets you need and use them or install them ready for use.

- $5,000 deduction for motor vehicles scrapped. From 1 January 2014, the $5,000 immediate deduction for motor vehicles purchased by small business entities will be removed. Once again, if you are thinking of buying a motor vehicle for your business, you have until 31 December 2013 if you want to claim the $5,000 immediate deduction.

Book Review –
Online Investing in the Australian Sharemarket

Title:
Online Investing in the Australian Sharemarket

Author:	Roger Kinsky
ISBN:	978-1-118-60656-8
Publisher:	Wrightbooks
Publication Date:	2013 – 4th Edition
Publication Place:	Queensland
RRP:	$29.95
Reviewer:	Malcolm Andrews



Introduction
I had not heard of Roger Kinsky before receiving this book but a quick Google search indicates that he has written several books on share trading, mostly beginners' series, as well as some texts on Mechanical Engineering. This book continues in the vein as a beginner's / advanced guide to online investing. However, it must be said that the author covers the subject matter comprehensively and the online resources referenced are up to date and useful.
The book is divided into 11 Chapters, logically going from online trading and then through resources, planning, analysis methods and risks. From my point of view this order could have been reversed to give all the background, risk etc. before detailing the mechanics of trading online. Possibly there was an element of grabbing the reader's attention early in the chapter arrangement.
Two very useful attributes of the style of this book are "Tips" throughout the chapters which provide extra detail or subtlety to previous explanations and a dot-point summary at the end of each chapter highlighting the main points in the chapter. This means that if you are time poor or just want the hard hitting facts without a lot of padding then you can skim both these elements to determine whether you are conversant with the material in the chapter or need to dive in a bit deeper.

General Content of Chapters

Chapter 1 includes introductory information on the internet itself, how it is now in almost every home and the risks involved (hacking, outages etc.). It then proceeds with a general outline of the shares concept and trading process e.g. companies, boards, shares, brokers, indices and information overload, which can be a big problem for the part-time investor.

Chapter 2 introduces the types of resources available online when investors might be looking for information on an investment such as sectors and indices, company announcements, shareholder meetings. It then moves on to the trading environment with information on trading depth and volume, watchlists and margin loans.

Chapter 3 provides a very comprehensive listing and brief explanation of useful online website. The information ranges from research houses such as Morningstar and Lincoln to newsy/ information sites such as Yahoo and MSN. The author also discusses costs and the particular focus of each of these sites.

Chapter 4 deals with online brokers and discusses such things as cost, facilities (charting, watchlists, company information etc.). The author then indicates methods of assessing the suitability of a broker for your needs and lists all the online brokers in Australia.

Chapter 5 deals with the mechanics of setting up accounts and sponsorship to allow you to actually buy a share online. This chapter also spends some time on the advantages and implications of trading online within you SMSF. This information was up to date and useful.

Chapter 6 discusses planning and monitoring. Topics such as planning what to buy, what entry point, exit point and stop losses. It then goes on to explain how to monitor your performance and determine profits/losses.

Chapter 7 provides quite a lot of detail on how to trade online, e.g. bids, orders, triggers, and transparency. It also gives screen dumps from popular sites such as ComSec on how the screen looks when you are about to place an order. This is again a very informative chapter and one that can be referenced often until you become very experienced.

Chapter 8 deals with fundamental analysis and gives a good introduction to the science of assessing the fundamental financial health of a listed company.

Chapter 9 gives an in-depth explanation of technical analysis. This is often considered the opposite to fundamental analysis and many investors choose one or the other to determine their buy and sell signals.

Chapter 10 discusses the online indices and how these can be used to enhance or guide your investments.
Chapter 11 looks at the many levels of risks involved in investing in shares from sovereign risk to reduced dividend risk.

Reviewers Comment

I regard this book as a very comprehensive, accurate and useful introduction to investing generally and online share trading in particular. It is written in an easy to follow style with Tips embedded in the chapters and a dot-point summary at the end of each chapter for visual scanning and speed reading. When online resources are discussed, the URL for each website is given with a comment on its cost, advantages and usefulness. I tended to agree with the comments and didn't find any sites that were out of date or offered seemingly misleading information.
In general the book gives quite a lot of information on fundamental subjects such as how companies operate (boards, AGM, share register etc.) right through to risks and how to evaluate performance (profit/loss). In all it is a very well balanced approach to the positives as well as the risks of share trading from someone who obviously has spent a lot of time researching and using the online platform.
This book will be good for a range of investors from those taking their first steps into investing and educating themselves about how to invest their own money to those that have been trading shares for some time but are still unsure of how the big picture unfolds. It is probably not for someone with significant experience in share trading although I would consider myself experienced and still found plenty of interest.

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