the INVESTORS voice

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LOW INTEREST RATE ENVIRONMENT

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What does a low interest rate environment mean for markets?

Michael Kodari

From the US to Europe, Canada to Peru, countries around the world have embarked almost simultaneously on a series of monetary policy easing decisions. At the February Reserve Bank Australia meeting the central bank followed suit. The RBA Board entered into unchartered territory with a 0.25 basis point cut taking the official cash rate to a record low 2.25%.

A drop off in mining investment, non-mining sector weakness, and a tight fiscal environment have all contributed to the below average GDP growth and a deteriorating employment landscape. The weakening domestic outlook has been further compounded by a moderating global economy which looks set to continue into 2015. Although the US economy has performed strongly in recent times, the Japanese economy remains in recession, while the Eurozone's chronic weakness persists in spite of the ECB announcing broad scale economic stimulus.

With that economic backdrop in mind, the RBA deemed a cut in the interest rate appropriate, no doubt designed to work in tandem with lower oil prices and a lower Australian dollar to support aggregate demand and consumer spending.

As a result of the recent cuts, individuals and businesses alike have never before been able to borrow and service their loans so cheaply. As demonstrated in the chart of household finances below, interest paid as a ratio of household disposable income has fallen, at least theoretically, giving the consumer greater capacity to extend themselves financially. In addition, as illustrated in the chart of the three year swaps rate below, a recent rally in the Australian Bond market, and more particular the Swaps Market, has enabled banks to fund themselves and convert rates from floating to fixed (and vice versa), at the cheapest levels in history. This is important because these are the mechanisms used by the banks to price their mortgage offerings, in the process enabling lenders to offer mortgages at all-time low rates without necessarily being prompted by a further RBA rate cut.

Lower mortgage rates are great for home owners, but bear in mind only one in three Australians actually have a housing loan. Spare a thought for the retirees who depend on the interest rates for income.

These retirees are essentially earning nothing in real terms and will struggle to fund their retirement with deposit rates and bonds yielding at best 4 per cent. You also have a situation arising where many Australians are being ushered into lower risk profiles as they approach retirement, effectively meaning these people will hold a larger weighting of cash and bonds, potentially putting at risk their ability to sustain themselves deep into retirement.

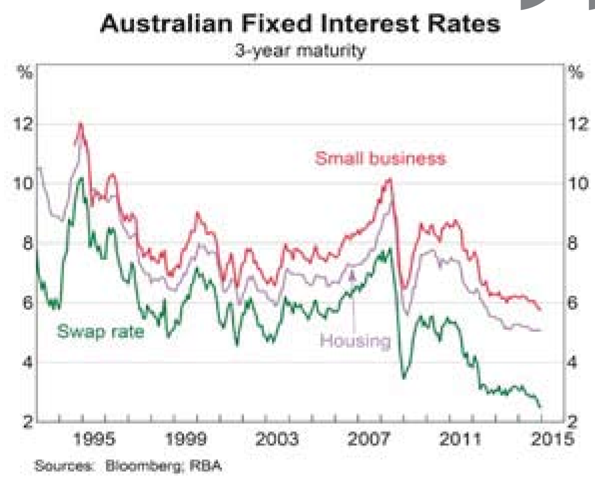
Naturally, if retirees are earning less on their retirement funds annually, the chance of those funds running out increases markedly. This is a situation that leads to more aged pensions claims and subsequently adds to the welfare burden incurred by an already stressed government purse, where expenditures equate to 25% of GDP and revenues only 22%. Currently the government already pays $149 billion in social security, a whopping 33% of government expenditure, and 25% higher per person than our New Zealand cousins. As it stands, the government last year already contributed negatively to growth for the first time since 1959. So should such a sequence of events transpire, one could foresee further pressure on any intended government expenditures, and in turn the government's contribution to growth.

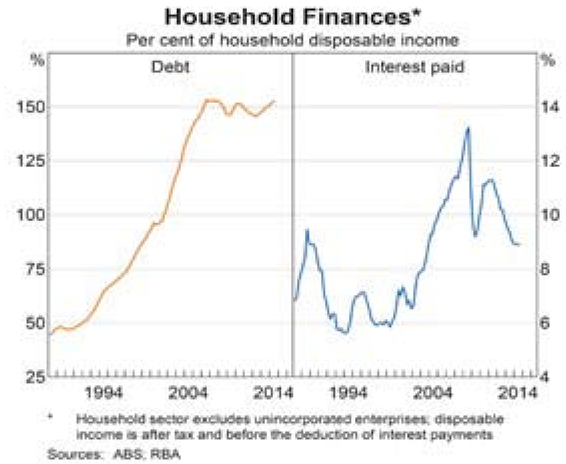
On the flipside, equity owners should fare better at least in the medium term. A low interest rates environment has the capacity to help bring forward the riches of the equity market. Mathematically, by discounting future profit streams by record low interest rates, company P/E ratios inflate. You only have to look at the US markets for a case in point. However, there is a notable warning to be made. If yields and rates can't go much lower, then expected ROEs fall, and capital gains become harder to attain into the future. It's especially the case if corporate management resort to paying higher dividends to quench investors' thirst for yield, at the expense of investing in future growth.

In economics, most things tend to revolve in cycles. After a period of P/E expansion, should markets reach a point where prospects for capital growth are poor, then investors may begin to take profits off the table, instead sitting on the sidelines in preparation for an end to easy money and the end to asset price inflation. Domestically, this situation is a way off and we should be buoyed by the outlook for markets. Nevertheless, investors should keep in the back of their mind that the good times won't roll on forever.

When it comes to the broader economy the situation is similar. After all, investors must remember that low interest rates aren't a cause for celebration, rather a symptom of weak aggregate demand and systemic issues within the economy.

"individuals and businesses alike have never before been able to borrow and service their loans so cheaply"





There's a suggestion that after the initial sugar hit of an interest rate cut, as rates inevitably approach zero they in fact detract from consumption and growth. Corporations sensing a drop off in mining investment, non-mining sector weakness, domestic demand weakness and a tight fiscal environment, choose to defer any investment. They deem the risk incommensurate with the return potential offered in a low ROI environment where structural demographic shifts and high government debts come together to create a challenging outlook.

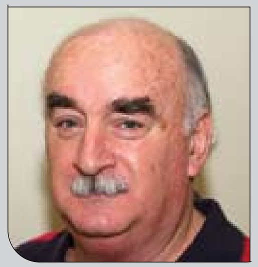
Borrowing cheaply is one thing, however, if invested poorly the debt incurred can easily become unmanageable once rates inevitably rise, whether it be five or ten years down the track. As the esteemed founder of PIMCO, and Janus Capital's Bill Gross points out "it is becoming obvious that as yields move closer and closer to zero, credit increasingly behaves like cash and loses its multiplicative power of monetary expansion for which the fractional reserve system was designed."

Domestically, in the low interest rate environment about to confront investors, high quality businesses with steady earnings profiles, minimal leverage, attractive dividend yield, dividend growth, and globally diversified revenues give investors the best chance of navigating the period with desirable returns

Michael Kodari is CEO of KOSEC – Kodari Securities www.kosec.com.au.

President's Message

By Bill Shirley



While reviewing various articles looking for data to disseminate to you our members, I came across several articles that may be of interest to you and your future investing strategies.

The first one is that we in the "land downunder" are not doing too badly in the per capita wealth game. At the end of June 2014 we had the highest ranking in the world for the fifth year in a row, based on figures tabulated by an overseas institution.

The main points are that the median wealth per Australian adult was US$ 225,000 (A$256,211). This was a rise of 4.9% on the previous year of US$219,505, and well ahead of the second placed country at US$173,000.

The report also shows that the top1% of wealthy people in Australia owned 21% of all assets, while the top 5% owned around 39% of all assets. The world average shows 1% owning about 50% of private wealth.

I believe the above spread shows that we in Australia are following a better economic process that allows a better spread of wealth across the population, when compared to other developed countries.

We are also still in love with property, as Australians hold about 60% of their holdings in this sector, while the world average is 46%. Another figure of interest is the USA property holding of 30%.

Thus, I hope the above figures outline some data that may assist you when considering your structural asset allocation by sectors.

The second subject to consider could be some economic figures in conjunction with the above property data.

In recent times, a half yearly report has been produced which reviews up to 26 indicators, by 25 leading panellists. The estimate for each indicator by each panellist is tabulated, including a low and high score, plus an overall average.

I have picked five indicators as a sample to give you an idea of some of the figures listed, these being, Australian GDP Growth, China GDP, Australian CPI, Australian cash rate, as well ASX 200 figures. These are all for year-end December 2015, and are estimates.

Australian GDP: Average 2.60%, Low 0.50%, High 3.60%
China GDP: Average 6.90%, Low 6.00%, High 7.70%
Australian CPI: Average 2.40%Low 2.40%, High 3.00%
Australian Cash Rate: Average 2.37%, Low 2.00%, High 2.50%,
ASX 200: Average 5449, Low 4800, High 6100, Current 5880.

The last figure is somewhat disturbing, as the end result is down around 7.40% for the year. I put forward this figure for you to ponder and consider!

The 2015 National Conference at the Gold Coast is well down the planning path. We will have four sectors, and the theme will be "The Search For Returns. The Challenges Ahead." The dates are 2 - 5 August.

Finally the Board and I would like to offer all our members and our volunteers, a successful year.

Warm Regards – Bill Shirley.

Honey, I lost the DEED!

KRISHNA SKANDAKUMAR

Introduction

The question seems simple enough - what should you do when the trust deed for a self managed superannuation fund (SMSF) is lost? The answer to this question is becoming increasingly important as more and more trust deeds are being misplaced or lost.

This article offers a solution that may be appropriate for some SMSF trustees who lose their trust deed. However, it begins by examining the preliminary question of why a trust deed is even important in the first place.

Does a SMSF require a deed?

Broadly, a SMSF is a type of trust that, like all trusts, is 'run' by its trustee. One of the most fundamental responsibilities incumbent on a trustee of a trust is that they obey the terms of that trust. Ordinarily, the trust deed is the document that sets out the rules and terms of that trust (and is also sometimes referred to as the governing rules).

Therefore, without a trust deed, a SMSF trustee cannot say that they are abiding by the terms of the trust, as they cannot know what those rules or terms are. Additionally, other parties who may want to rely on specific powers in the deed (for example, banks) may not be able to do so.

Find it!

If a trust deed cannot be found, this does not necessarily mean that the trust deed has been lost forever. Accordingly, SMSF trustees should exhaust all avenues to locate it, including:

- contacting all accountants, auditors, financial planners and financial institutions who may have seen, or have a copy of, the trust deed;
- contacting the deed supplier to determine whether they retained the original trust deed or even an unexecuted copy; and
- checking the place where all other financial documents end up (this may be with an advisor or in a safe deposit box or a cupboard/drawer).

But what if it is still lost? Unfortunately, there is little guidance on what seems to be a common problem.

Theory versus practice

In a perfect world, an approach should be made to the relevant Supreme Court seeking an order regarding the administration of the SMSF. However, in practice, many SMSF trustees are reluctant to spend the time or money required to approach the court.

Accordingly, many trustees make a commercial decision to bear some risk and either wind up the SMSF or continue without the deed. This is especially likely for lower value SMSFs or SMSFs where the risk of dispute is believed to be relatively low.

However, a better solution may exist.

> *"without a trust deed, a SMSF trustee cannot say that they are abiding by the terms of the trust,"*

The solution

The Supreme Court of New South Wales may have provided a better solution in the 2004 case of Re Bowmil Nominees Pty Ltd [2004] NSWSC 161 ('Bowmil').

The decision suggests that irrespective of what the existing or lost deed requires, if all of the members and beneficiaries of the SMSF are adults of sound mind and execute a deed varying the rules of the SMSF, that variation will be effective. However, several questions remain unanswered.

> *Losing a SMSF trust deed can cause significant problems. Accordingly, a SMSF trustee should make every attempt possible to find the deed.*

Facts of the decision

The facts of Bowmil are as follows:

- the Williamson Superannuation Fund ('Fund') was a sole member superannuation fund;
- the sole member of the Fund died;
- the governing rules of the Fund required that any Fund member's death benefits be paid by way of lump sum (or more particularly the governing rules did not allow death benefits to be paid by way of pension);
- the beneficiaries of the deceased member of the Fund wished to receive the deceased member's benefits by way of multiple pensions and sought to vary the governing rules of the Fund;
- in order to implement the above variation, the existing governing rules of the Fund required the approval of a party defined as the 'principal employer';
- the principal employer refused to approve such a variation of the trust deed; and
- accordingly, the trustee of the Fund applied to the court to vary the trust deed by deleting the provision requiring the principal employer's approval.

The decision

In Bowmil, Justice Hamilton accepted that the court did have an inherent power to vary the governing rules of the Fund. However, he chose not to exercise the power.

Instead, he noted that where the beneficiaries, who are all ascertained and sui juris (of sound mind), agree to a variation, there is no need for the court to interfere. The judge considered this to be the corollary of the rule from Saunders v Vautier which - at the risk of oversimplifying - requires a trustee to vest (or transfer) all of the assets of a trust if all of the beneficiaries call on them to do so. Accordingly, the trustee of the Fund presented a new set of governing rules to Justice Hamilton, to which the judge stated: As the new trustees will be the beneficiaries and they are all sui juris, this is entirely appropriate … furthermore, it has now been made plain that the ongoing beneficiaries (and proposed trustees) have received the … amending deed and had it explained to them. It also shows that they have had advice concerning it and consent to the amendment of the existing provisions governing the trust into that form. I am now prepared to give relief.

Issues with the decision in Bowmil

However, care must be taken before relying on the decision in Bowmil.

Firstly, Justice Hamilton noted that all of the beneficiaries must be ascertained and sui juris. While this may seem like the simple exercise of listing the members and their dependants, the reality is that the potential recipients of a deceased member's benefits can include a vast list of beneficiaries, including grandchildren and other extended relatives of fund members. The next and more technical problem with the decision from Bowmil is that the judge accepted that all beneficiaries of a trust could vary its terms as a necessary corollary of the rule from Saunders v Vautier. However, this assertion may not be as certain as Justice Hamilton stated.

Finally, many SMSF trust deeds generally contain certain conditions that prevent a beneficiary from having absolute, vested and indefeasible interest in the fund. This issue was not expressly canvassed in Bowmil, which presents some uncertainty for an application of Bowmil to a lost SMSF trust deed.

Practical solution

Despite the issues with the decision in Bowmil, it still provides a potential solution. If a client is happy to accept a degree of risk, relying on this decision can form part of a practical course of action.

Under the Bowmil approach, a carefully drafted deed of variation could implement new governing rules. The parties to the variation should include as many of the beneficiaries to the fund members as possible. Beneficiaries should include everyone who could theoretically one day receive a benefit under the SMSF, not just the members. Naturally, this potential solution does not resolve all of the issues discussed in this article (and some others that have not been discussed). However, it does provide a better basis than proceeding without a trust deed at all!

Conclusion

Losing a SMSF trust deed can cause significant problems. Accordingly, a SMSF trustee should make every attempt possible to find the deed. Ideally, if the trust deed cannot be found, an approach should be made to the court. However, such an approach will involve significant costs and efforts, which many SMSF trustees are unwilling to accept.

A practical solution from Bowmil is for the SMSF trustee to arrange for a carefully drafted deed of variation to be executed with as many beneficiaries as practical added as parties to the deed. This approach is typically the most practical option available, especially where there is a low likelihood of dispute. However, it must be noted that this is not a perfect solution and trustees utilising this solution must be aware that they are assuming some risk.

Krishna Skandakumar, Lawyer, DBA Lawyers

This article is for general information only and should not be relied upon without first seeking advice from an appropriately qualified professional.

GLOBAL EQUITIES
THE NEW FRONTIER

IAN IRVINE

Australian investors are increasingly looking offshore in their search for returns. This article explores the growing range of opportunities.

The Australian sharemarket may be small by global standards but its performance has been hard to miss. While the S&P/ASX 200 comprises just 1.8% of the $US66.9 trillion global equity market, no other major asset class outperformed the local sharemarket over the 10 years to the end of 2013.

Even accounting for the impact of the global financial crisis, Australian shares delivered an impressive annualised average return of 9.2% – so why look anywhere else? The answer is diversification. When Australian shares 'zig', global equities can 'zag', while long-term global equity returns (hedged for currency) still delivered a healthy 8.2% a year over that same decade to 2013.

However, many self-directed investors still display a home bias even as large superannuation and pension funds located in the Asia-Pacific, North America and Europe have been increasingly investing offshore since the late 1980s as globalisation and de-regulation has opened up new investment opportunities.

Other investors are now also beginning to consider the opportunities including self-managed super fund trustees. In the past, Australian investors have turned their backs on the sector, investing less than 1% of assets in global equities compared to 32% in Australian shares, according to ATO data.

However, of those SMSFs considering further diversification of their portfolios, the highest proportion (15%) were considering global equities, according to a survey last year by the Financial Services Council.

Meanwhile, a recent survey by research house Investment Trends found that one-third of financial planners had placed new client investments in international assets over the past year – the highest level recorded since the survey was first conducted in 2008. But the type of international equity fund they are considering has changed substantially after the US S&P 500 surged 13.69% in 2014. Just 28% of planners said they intended to invest in US-specific equity funds, down from the six-year high of 40% last year.

The US economy is recovering faster than many other regions and is expected to increase interest rates later this year. The recent devaluation of the Australian dollar has also supercharged unhedged US equity returns. While there is no shortage of marketplace commentary about whether those trends will continue to bolster the US equity market, financial planners are instead turning to multi-region global equity funds in an attempt to further diversify their clients' portfolios and smooth out returns.

Approximately 70% of planners said they were favouring multi-region global equity funds in the next 12 months, up from 62% in 2013 and just 49% in 2012, according to the Investment Trends report. For example, a long-term investor who remains bullish about China's long-term growth story could invest in a China fund or defray some of that country-specific volatility by instead investing in an emerging markets fund. China still comprises about one-fifth of the index, which also includes exposures to a range of other countries such as South Korea, South Africa, India and Russia.

While investors are increasingly considering global equity investments, they are being presented with a wider choice of structures to access global markets. There are already a significant number of exchange-traded funds which offer index returns covering specific countries, regions and investment styles. ASX also recently launched the mFund Settlement Service which offers investors unlisted actively managed funds, which can be bought and sold using the same infrastructure (CHESS) as shares.

> ***"The global equity market is vast and an investor faces many choices."***

Both ETFs and mFunds offer a diversified portfolio of global shares – an important risk management tool given it is more difficult to assess an individual company's prospects from offshore. Active managers have greater flexibility to blend quantitative and qualitative data when compared with ETFs. Their investment strategies are not just defined by region, but also by investment style, which is more flexible than index-based funds.

Two of the more popular investment styles are value and growth. Value managers tend to buy companies at relatively low valuations on an absolute basis (using metrics such as price-to-earnings or price-to-book ratios). By way of contrast, growth managers are willing to pay slightly higher multiples for stocks if, in their judgment, they are also expected to grow earnings at a superior rate than the broader market.

Growth at a reasonable price (or GARP) managers blend the two strategies, often investing in stocks which are trading at a discount but are expected to grow faster than the market or stocks with a price-earnings ratio below the long-term projected growth of the company.

The global equity market is vast and an investor faces many choices. But the potential rewards can be substantial.

The median overseas active equity fund manager delivered an annualized 13.1% return each year, outpacing the MSCI World ex-Australia Index's 12.7%, over the five years ended November 2014, according to Mercer Investment Consulting, while the top quartile active global equity fund manager posted average gains of 14.4% over the same period.

Ian Irvine is ASX Head of Customer and Business Development

> ***"The answer is diversification."***

Commodities, energy Australian Dollar & interest rates are down WHERE DO I INVEST NOW?

BRENTON TONG

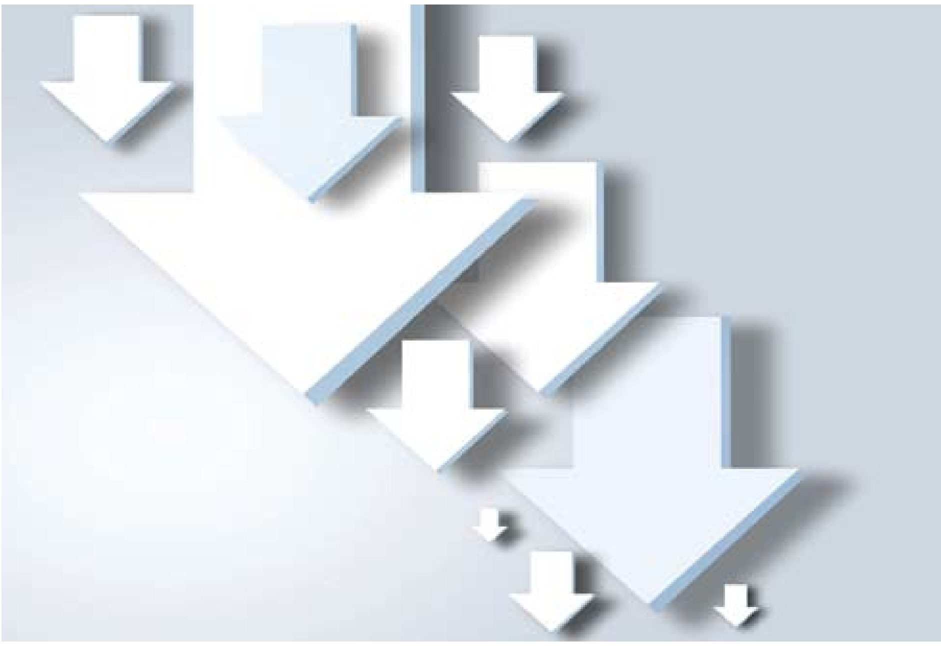
The current economic environment is one of the most contrasting and challenging scenarios that we've seen in a long time. Where there have typically been at least some "go to" investment areas, we're faced at the moment with a stable but not strong economy, high property prices, a dollar that has fallen significantly, record low interest rates and falling commodity prices. For those investing, especially retirees, no matter which way you look the returns just aren't appealing.

Typically, if you can't find something to invest into, you keep your funds in cash which is safe and will give you a modest return. This would typically give you protection until you find the right investment, however, at the moment, interest rate returns on term deposits and cash are running at or lower than inflation – you're barely keeping up and possibly falling behind.

Now more than ever, it is important to keep a close eye on the strategic elements of your investment plan. In a rising market, most decisions lead to some sort of profit, however, nothing could be further from the truth at the moment. Rather than being desperate to invest into something, consider your time frame for investing.

Advice for us is not about investing, but doing the right thing at the right time. While cash may not be the best returning asset class at the moment, if you're struggling to find value in the current market, be patient and wait. If you're earning cash rates for three, six or 12 months until you can see value in your target markets, so be it. Earning 2-4% on cash will not help you to achieve many goals, but it could be better than rushing out and trying to invest into the first thing you think that has a chance of making a return. Everyone has opinions, and if yours are negative, just be patient and wait. If you have a 10 year plus time frame, six months will not make much difference.

If you're being more aggressive and gearing into the markets, make sure you've got the right time frame and a solid risk mitigation plan in place. Given the current jobs market, we would suggest that you avoid too much negative gearing and maintain a healthy cash buffer. Long term players will do fine in the current market, but speculators could get quite badly hurt.



Keep in mind the total cost of gearing – investment property loans are now under 5% so you've got a much better chance of having a neutral investment property. If you're borrowing for shares, keep in mind that we're in a low return environment, so if your cost of borrowing is too high, it's going to be hard to get significant returns that will justify the risk of a geared portfolio.

If you are looking to invest now because you're a bit more upbeat on the investment markets, the key things to think about for 2015 and the current environment are as follows.

- International shares are widely predicted to outperform the local share market this year. While this is an element of crystal balling, keep in mind that with the currency having fallen recently, your Australian Dollars are not buying as much of the overseas investments and this is going to have an impact on your returns.

- Property is always polarising. Commercial property appears to be faring better, however, there are some economic headwinds with retail as well as office leasing. There is better liquidity in the market and much was learned from the catastrophes of the GFC. Residential property is interesting with such low interest rates, however, given that it's typically a very lumpy and illiquid asset, be cautious around your asset allocations so you're not forced to sell.

- Australian shares are well priced and solid yields are still available, however, you certainly have to ensure that you've got long term investing on your mind. Don't be expecting to sell to get capital gains to fund any lifestyle needs in the shorter term.

- Term deposits are falling, but could fall further, so if you know you're locking your money away, take a medium term view on. Rates will go back up, however, looking at the economy there are not many triggers that most economists feel are going to push rates up to levels we saw a few years ago.

Finally, when looking at your overall portfolio, it's always vital to look at the efficiency of what you're doing. It's more important now more than ever. Given that

> "*Everyone has opinions, and if yours are negative, just be patient and wait*"

Commodities, energy Australian Dollar & interest rates are down WHERE DO I INVEST NOW? *continued...*

yields and overall returns have been falling, the money that you're paying out is even more important than it was before. These are the four keys things that you should be looking at.

- Tax – do you have the right tax structures in place? It doesn't hurt to look and take a proactive approach to this. A modest tax saving could boost your returns a great deal – every dollar you don't have to pay in tax is additional returns you get to keep.

- Fees – everyone hates paying them, but they're usually a fact of life. But, with a little bit of effort, you may be able to drop the amount of fees that you're paying. Similar to taxes, if you can save 0.5% in fees, that's 0.5% return that you're keeping. If you're not sure about the fees that you're paying, check in with family and friends, or get professional advice from an independent financial planner.

- Interest rates – the banks are always looking for new business, however, they're not as good at looking after old business. It's often quite easy to approach a different bank and get a better rate and loan package than you already have. While changing banks can be a bit of work, it's often worth the hassle. If you don't want to do it yourself, visit a mortgage broker, but try to find one that has exceptional customer service.

- Cash rates – similar to mortgages, it can be more work than you'd want to do to shift banks to earn more interest – but it comes down to value for money. Is the $1,000 extra you'll earn by moving banks worth the one hour you'll spending setting it up?

Brenton Tong is Head of Strategy, Financial Spectrum
http://financialspectrum.com.au

> "*Now more than ever, it is important to keep a close eye on the strategic elements of your investment plan.*"

CHEAP STOCKS
how to buy (and sell) them

KARL SIEGLING

People often refer to themselves as either 'fundamental' or 'technical' investors and feel so strongly about one style of investing compared to another that they engage in heated debates. We believe investors should use whatever tools are at their disposal to try to beat the market, and that fundamental analysis combined with technical analysis has a greater probability of achieving this than one style alone.

Understanding fundamental analysis
When we refer to fundamental analysis we mean the process of determining accounting profits, operating cash flows, free cash flows, balance sheet debt, cash and overall balance sheet strength, as well as estimating these metrics two years into the future.

There are about 2,180 stocks listed in Australia (2.5% of the world's listed market capitalisation) and in any given year 600 to 700 of these companies actually make a profit – so about 75% of Australia's listed companies do not. We are unable to analyse companies that do not make a profit.

Of the profitable companies, 5% are usually cheap and 5% are really expensive in any given year. This equates to a 'sweet spot' of about 70 companies that meet our fundamental criteria. We hope to construct a portfolio of between 30 and 40 core positions in any given year.

This approach is outlined in Diagram 1 below. Importantly, we need an open mandate to implement this investment strategy (that is, few restrictions on the fund's investment style). Investing with an open mandate is unusual in Australia and particularly in the superannuation investment industry, although this is changing. We estimate that around 85% of all super money invested is invested on a restricted mandate, effectively reducing the number of really good opportunities available to a portfolio manager.

Diagram 1. Identifying good and bad stocks from the listed universe

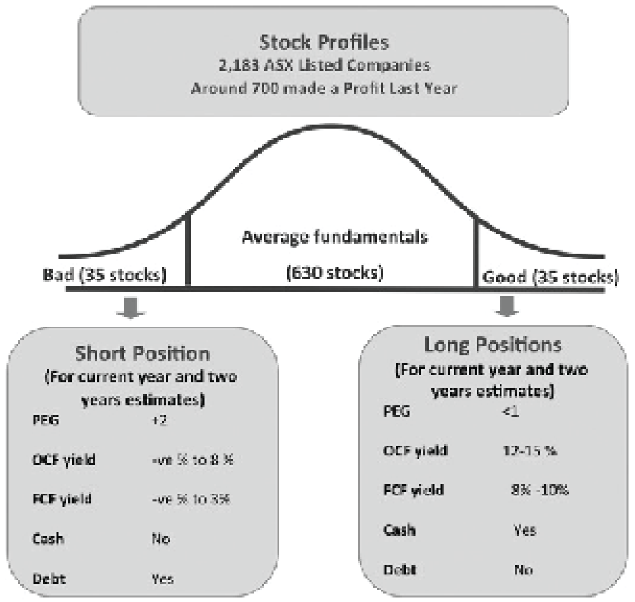


Diagram 1 shows that a typically cheap stock may have:
- earnings growth of around 20% per annum;
- price-to-earnings (PE) multiple of around 10 times;
- 12 to 15% operating cash flow (OCF) yield;
- 8 to 10% free cash flow (FCF) yield;
- minimal debt on the balance sheet;
- (a 'long position' means the fund will buy that stock).

Conversely, an expensive stock may have or be:
- growing at 10% per annum;
- trading on a PE multiple of 20 times;
- negative to 3% operating cash flow;
- negative to 3% free cash flow yield;
- lots of debt on the balance sheet;
- no cash;
- (a 'short position' means the fund will sell that stock).

The process of trying to identify cheap and expensive stocks is ongoing, and just as individual stocks exhibit cyclical earnings and valuations, so too does the overall share market.
At the time of writing, several sectors in the market are showing high valuations, and a smaller, more discrete, group of stocks are presenting as fundamentally cheap. This is often the case.

Using technical analysis
Diagram 2 shows how we buy and sell stocks. No matter how cheap we think a stock is, we are not allowed to buy if it is falling in price or in a downward trend. Conversely, no matter how expensive a stock, we do not sell or short-sell if it is in a price uptrend.

Diagram 2: Do not buy a falling stock, do not sell a rising stock
Buying stocks that are falling and selling stocks that are going up are probably the two biggest mistakes that investors make.
There are deeply engrained reasons for this and many psychological barriers within investors' psyche that often prevent them from buying stocks that are going up and selling stocks that are going down. In fact, investors are often compelled to do exactly the opposite.

An entry strategy to buy cheap stocks
Diagram 3, below, shows the process that we undertake once it has identified a stock to be cheap. We wait for the falling share price trend to finish (this is how a stock becomes cheap – people sell it). Once the price starts to recover we initiate a 1% (of our portfolio) position. At this point conditions are ideal to generate good risk-adjusted returns. We then add 1% and another 1% as the price rises, up to a maximum of 5% of our portfolio at cost into any one position.

Our core positions start as 1% positions initially so we do not have too much capital invested in any one new idea. Starting with a small position is another way of mitigating risk.

Diagram 3: Staged entry and exit points

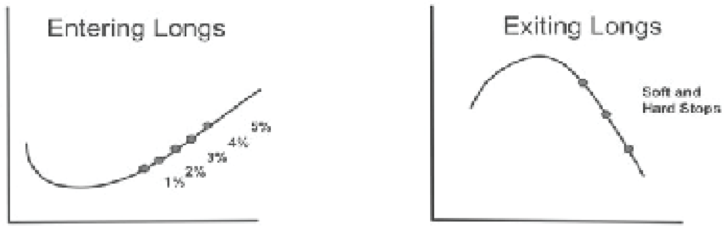


Diagram 3 also shows how we exit our positions once the long-term trend has ended and the stock becomes expensive. We sell a third of the position initially then another third and eventually the final third. In this way we are not making decisions about an entire position on a day-to-day basis.

The fundamental and technical processes in practice
Diagram 4, below, shows the combination of fundamental and technical analysis operating together using Macquarie Group as an example.

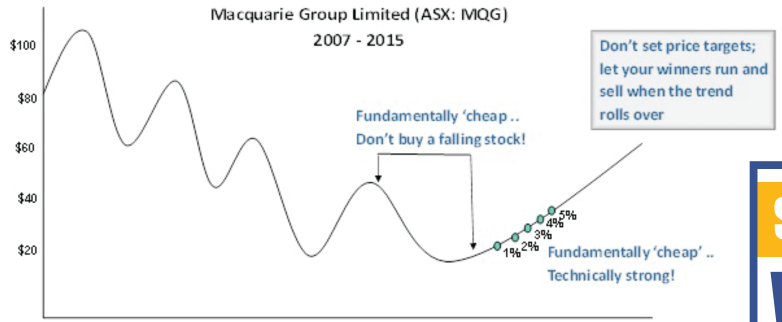


Diagram 4: Combining technical and fundamental analysis
Source: Bloomberg, Cadence Capital, January 2015

Shortly after reaching a peak of nearly $100 (on our fundamental analysis at the time, reasonably expensive), the GFC brought havoc and Macquarie's earnings fell substantially, along with its share price. It continued falling and at around $40 started to look reasonably cheap from a fundamental perspective. However, as outlined, we don't buy a stock that is cheap but still falling in price.

Macquarie subsequently traded from a low around $17 and has recovered to its current price of around $63 ($68 if you include the spin-off of Sydney Airports). Once the fundamental and technical picture for Macquarie lined up (that is, the stock was fundamentally cheap and technically going up), our approach was to buy with an initial 1% position at $23, then add to it again around $26, $28, $35 and $41, accumulating a 5% position at cost over time. Macquarie is now the largest position in our fund accounting for 9.0% of the overall portfolio (as at 31 January 2015).

With a profit upgrade announced to the market in January 2015, we expect the share price to continue in an upward trend. Following the exit rule in Diagram 3, when the trend rolls over we would sell the position one third at a time.

We believe, in this example, had we started buying when we identified Macquarie as fundamentally cheap when the share price was still falling, we would have been taking unnecessary risk and incurring large losses before the stock price had finished falling and started to rise.

From a fundamental perspective, it does not matter how cheap or expensive investors may think a stock is, should the share price still be falling it is not a good time to buy technically, and should the share price still be rising, it is not a good time to sell technically.
Karl Siegling is a Portfolio Manager at Cadence Capital Limited (ASX Code: CDM).

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INTERNATIONAL OUTLOOK 2015 REMAINING POSITIVE

NICK GRIFFIN, JEFF THOMSON, JAMES TSINIDIS & KIERAN MOORE

K2 Asset Management is positive on global equities heading into 2015. This will be the sixth consecutive year we have favoured equities over cash, having turned bullish in March 2009. In 2015 we are forecasting positive returns from global equities as well as further tailwinds from a falling Australian dollar. Nevertheless, the equity bull market is now almost six years old, and US equities in particular have already enjoyed a significant re-rating, so returns are likely to be relatively muted compared to the earlier years of the bull market. Furthermore, a difficult and potentially hazardous process of "policy normalization" by the Fed is also likely to mean that volatility will continue to rise. A marked divergence with the rest of the world, where growth is generally mixed and monetary policy is still easy, means that the US dollar is likely to continue to strengthen.

Despite the backdrop of higher volatility and potential US interest rate rises, global equities still look reasonable value versus history and also good value versus other investment alternatives such as bonds and property. The table below flags the key metrics for a selection of global equity markets. Headline valuation measures show little in the way of over exuberance, particularly outside the US.

Table 1: Key Global Equity Valuations

	P/E			Dividend Yield (%)		
	FY14	FY15E	FY16E	FY14	FY15E	FY16E
S&P 500 Index	18.2	16.6	14.8	2.0	2.1	2.2
Eurostoxx 600 Index	21.2	14.2	12.8	3.7	3.7	4.0
FTSE 100 Index	18.7	13.8	12.4	4.7	4.2	4.4
Hang Seng Index	10.1	10.7	9.7	3.8	3.7	4.0
Hang Seng China Enterprises Index	8.6	8.0	7.3	3.5	4.0	4.4
Shanghai Composite Index	15.5	13.7	12.2	2.0	2.2	2.4
Nikkei 225 Index	21.4	19.0	16.7	1.5	1.5	1.7
S&P ASX 200 Index	18.9	15.3	14.1	4.5	4.7	5.0

Source: Bloomberg 5/1/15

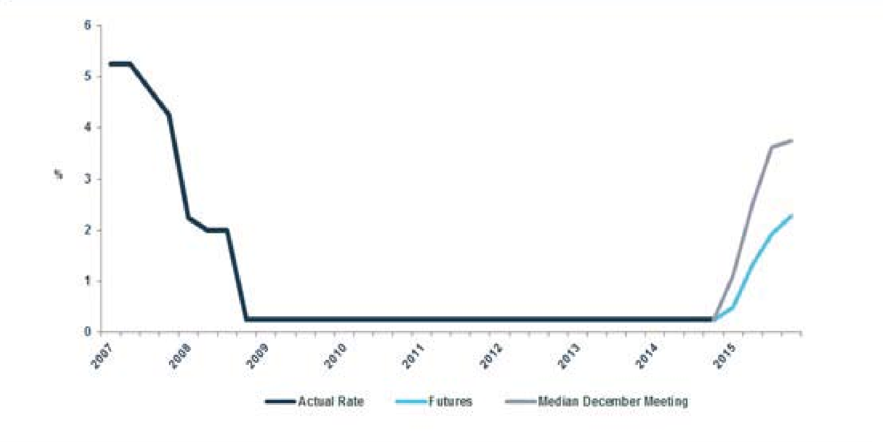
> "global equities still look reasonable value"

Key risks to our outlook will likely come from a changing interest rate outlook in the US versus other developed economies and the associated currency volatility. In addition, political disruption in Europe continues to occur, specifically problems in Greece, France and Russia. Finally, the re-emergence of deflationary forces in struggling regions such as Europe and Japan could put pressure on equity multiples in those economies. Below we highlight some investment insights for 2015 and how their evolution will affect the way we invest.

• The Fed will raise interest rates in 2015

The US economy continues to recover. US third quarter GDP growth was revised up to an annualized rate of 5%, the strongest period of growth since 2003. Nonfarm payrolls have grown by an average of 258,000 over the last six months, and the unemployment rate has fallen to 5.8% and appears to be headed lower. All of this means that US rate hikes now loom large on the horizon. While the Fed remains "patient", there is a clear intention to raise rates in 2015. The significance of this cannot be underestimated. This will be the first rate hike in over eight years and the journey back from historically unprecedented levels of monetary stimulus towards some kind of normalcy will be difficult and uncertain. What does seem certain is that this will not be a smooth process and higher levels of volatility appear inevitable. There already appears to be a growing disparity between financial market expectations and current Fed intentions.

Figure 1: Fed Funds Rate: Median FOMC Projections vs Fed Futures



Source: Bloomberg & US Federal Reserve 5/1/15

Nevertheless, we see no reason why equity markets cannot ultimately continue to perform well as any rate increases will be associated with higher economic growth. Most crucially of course we expect the Fed to proceed in a measured and cautious manner. Bull markets traditionally don't end with the first rate hike They end with the last rate hike and ultimately if the Fed can successfully raise rates without derailing the recovery, then this is long term positive for US equities.

• It's a strong USD world

While clearly it's a consensus view, it is hard not to argue for continued strength in the USD over 2015. The US economy continues to exhibit strong growth and there is no reason why US interest rates should not rise in 2015, diverging significantly from both Europe and Japan, that look set to embark on further quantitative easing. Stronger growth, higher rates and potentially an improving fiscal deficit outlook all point to a stronger USD versus most regional currencies. While the AUD has already weakened significantly to date versus the USD, a diverging growth outlook suggests this tailwind can continue in 2015. Consequently we remain unhedged on our international investments as we enter 2015. Hedging aside, it is also worth flagging that such large currency moves will provide a source of market and corporate earnings volatility in 2015, with those earning US dollars in various global markets the key winners. Conversely, non-USD earners will have a harder time as falling currencies reduce earnings power and credit problems grow in emerging markets.

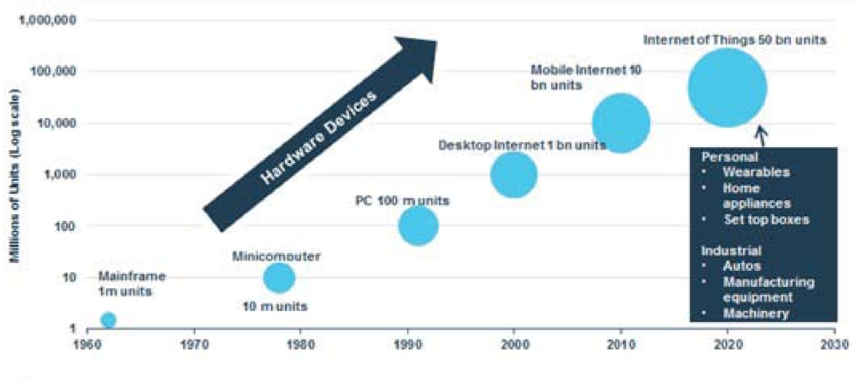
Figure 2: Global Currencies: USD at the start of a long period of relative strength

Source: Bloomberg 5/1/15

• The Internet of Things has arrived

What started with one mainframe computer in 1960, has grown to one connected device per person with personal computers, to two with mobile telephones, to three with iPads and laptops and is now rapidly on its way to 10-12 connected devices per person with the onset of connected cars, homes, TV's and other appliances. Do the maths on 7 billion people and from a connected device stand point 2015 is the year the numbers start to get really, really big. Three things have contributed significantly to the proliferation of connected devices; the internet, cloud computing and Moore's Law, whereby the power of computing hardware roughly doubles every two years (or the cost for the same hardware roughly halves). These factors have allowed the proliferation of low cost connected devices that provide real time updates to their users across all aspects of daily life and commercial operations. This has in turn led to the rise of social media, mobile apps and data analytics. As we move towards 50 billion connected devices we see strong structural growth for those involved in the semiconductor industry and a collection of big winners who can unite platforms for cloud computing and social media.

Figure 5 : The Internet of Things drives device proliferation ... good for semiconductor players



Source: Cisco, Credit Suisse estimates

> "The US economy continues to exhibit strong growth"

Nick Griffin, Jeff Thomson, James Tsinidis & Kieran Moore, K2 Asset Management

K2 Asset Management is a Melbourne based, boutique fund manager.

CAN AN ADULT CHILD BE A *TAX DEPENDANT* *ATO ID 2014/22 says yes!*

DANIEL BUTLER, DBA LAWYERS

ATO Interpretive Decision 2014/22 addresses the question: 'Can an adult child be a 'death benefits dependant' of his or her deceased parent for the purposes of section 302-195 of the Income Tax Assessment Act 1997 (Cth)?'
The adult child was considered to be a death benefits dependant for the purposes of this section.

Tax definition

Section 302-195 provides:
(a) (1) A death benefits dependant, of a person who has died, is:
(a) the deceased person's *spouse or former spouse; or
(b) the deceased person's *child, aged less than 18; or
(c) any other person with whom the deceased person had an interdependency relationship under section 302-200 just before he or she died; or
(d) any other person who was a dependant of the deceased person just before he or she died. [Emphasis added.]

As you can see from the definition above, an adult child is not covered by paragraphs (a) or (b) of s 302-195(1). Indeed, paragraph (b) only expressly recognises a child aged less than 18 years as a death benefits dependant. Therefore, it is usually understood that an adult child does not qualify as a death benefits dependant for tax purposes unless they fall within paragraphs (c) and/or (d) above.

The ATO confirmed in ATO ID 2014/22 that the definition of death benefits dependant in s 302-195(1)(d) does not stipulate the nature or degree of dependency, but it is generally accepted that this refers to financial dependence and it is a condition that must exist in relation to the taxpayer at the time of the deceased's death.

SIS definition

Note that we are focusing on the tax definition here as the Superannuation Industry (Supervision) Act 1993 (Cth) ('SISA') definition of dependant is:
dependant, in relation to a person, includes the spouse of the person, any child of the person and any person with whom the person has an interdependency relationship. [Emphasis added.]

Thus, an adult child is always a dependant for SISA purposes who can be paid a superannuation lump sum death benefit directly from a deceased parent's superannuation fund. However, an adult child does not obtain a tax free death benefit unless he or she is a dependant for tax purposes (ie, a death benefits dependant under s 302-195).

The facts in ATO ID 2014/22

Returning now to the facts of ATO ID 2014/22, the adult child had given up work to care for the terminally ill parent and received no financial support from anyone, other than the parent, during that time.
The ATO confirmed by way of a note at the end of ATO ID 2014/22 (after confirming the main point that the adult child was financially dependent on the parent) that the child and parent also satisfied the interdependency relationship.
What is an interdependency relationship?
Under s 302-200(1) two persons have an 'interdependency relationship' if:
(b) they have a close personal relationship; and
(c) they live together; and
(d) one or each of them provides the other with financial support; and
(e) one or each of them provides the other with domestic support and personal care.
Regulation 302-200.01 of the Income Tax Assessment Regulations 1997 (Cth) requires that certain further matters be taken into account in determining whether two persons had an interdependency relationship before one of them died. Those circumstances include:
(a) the duration of the relationship;
(b) whether or not a sexual relationship exists;
(c) the ownership, use and acquisition of property; and
(d) the degree of mutual commitment to a shared life; …

> "*the ATO* ***is now comfortable accepting an*** *interdependency relationship*"

ATO ID 2014/22 — interdependency relationship

The ATO confirmed in ATO ID 2014/22 that the adult child and parent had a close relationship; they lived together; the parent provided financial support for the child; and the child was providing significant care for the parent. Thus, the adult child satisfied the interdependency relationship limb of the definition of 'death benefits dependant'. In particular, the requirements under s 302-195(1)(c) and as described in paragraphs 302-200(1)(a),(b),(c) and (d) above were satisfied.

Thus, the adult child could be paid the deceased parent's lump sum superannuation death benefit and since the adult child was a 'death benefits dependant', the payment was entirely tax free. The ATO's finding that the adult child was financially dependent on the parent at the time of the parent's death is not surprising. However, it is interesting to note that the explanatory statement to the legislative instrument that introduced the additional factors in an 'interdependency relationship' under both the SISA and tax regulations (Select Legislative Instrument 2005 No.262) stated that:

Each of the matters listed is to be given the appropriate weighting under the circumstances. The degree to which any matter is met or is present or not, as the case may be, does not necessarily of its own accord, confirm or preclude the existence of an interdependency relationship.
(f) Generally speaking, it is not expected that children will be in an interdependency relationship with their parents. [Emphasis added.]

CAN AN ADULT CHILD BE A *TAX DEPENDANT* *ATO ID 2014/22 says yes!*

This is believed to be why there has been some uncertainty that the ATO may not accept an interdependency relationship in respect of an adult child and his or her parent in prior years. However, the above extract from the explanatory statement was followed by an example where a 23 year old child named Daniel had died with $30,000 in super and was given in the context that this child's parents and a younger brother would not generally be in an interdependency relationship. The facts in ATO ID 2014/22 can be distinguished from Daniel's example in the explanatory statement as in the adult child in ATO ID 2014/22 was, among other things, providing significant care to the parent.

Conclusions — the strategic news

Thus, this ATO ID is an extremely important clarification as it confirms that the ATO is now comfortable accepting an 'interdependency relationship' being satisfied in respect of an adult child and a parent. Moreover, often this criteria is generally more readily satisfied, as compared to financial dependency, as an increasing number of adult children are spending more time looking after and caring for their elderly parents who have a limited time to live.

This article is for general information only and should not be relied upon without first seeking advice from an appropriately qualified professional.

BORROWING TO INVEST DETOX

Julie McKay is Senior Manager Technical Research, Leveraged Equities

When making financial decisions, many people are held back by fear and bias. Boosting the amount available to invest by borrowing can be an effective strategy if you have medium to long term financial goals, reasonable prospects of reliable income and a view that investment markets will trend upwards.

It's time to detox some misguided ideas that may be preventing you from borrowing to invest, by looking at five common investment mistakes.

1. Value not amount

We have an innate bias to think about money in terms of amount not value. If you have $100 today and $100 in six months, it's tempting to think you haven't lost money. If filling the petrol tank costs $100 today but $120 in six months time, then you have lost value.

Your savings need to do more than just earn enough to replace erosion by inflation. Some essential life goals, such as health care and education, typically experience higher than average inflation. You only have to look at health insurance premiums to get a sense of how fast your savings are being eroded.

By avoiding certain financial strategies, are you at risk of having life's goals drift out of reach?

2. Dragging an anchor

Among the many tricks our minds play is anchoring. We latch onto a point and unconsciously accept only information that validates that point. Such as, after buying a red car you notice more red cars. We usually anchor on events that had a strong emotional impact on our lives.

The first reaction for many people when talking about borrowing to invest in shares or managed funds is margin call phobia. Their minds may be anchored on the global financial crisis which caused fear in many and financial hardship for some. This dose of fear can impair your ability to make rational decisions based on more up-to-date information.

Many people borrow no more than half of the amount they invest. For such people, the chances of experiencing a margin call are similar to being struck by lightning. But margin calls can happen. Just as many people safely stay indoors during a lightning storm, there are steps you can take to manage the risks of a margin call.

A strategy of borrowing to invest can drift away from your goals because of changes in your circumstances, market expectations or, more commonly, the value of the portfolio changes.

As share markets rise, the ratio of the amount borrowed to portfolio value falls. Conversely, as markets fall, the ratio of the amount borrowed to portfolio value rises. The relationship between amount borrowed and portfolio value is a way to define risk.

A higher ratio means a market fall has more potential to eat into your capital. A higher ratio also puts you closer to the maximum a bank will lend for investment purposes. Prudent risk management means taking action to keep the ratio of amount borrowed to portfolio value within your 'goldilocks' zone – not too high or too low given your goals, circumstances and market expectations.

Is it time to check the anchors slowing down your financial progress?

4. About birds and trees

We all know a bird in the hand is worth two in the bush. In other words, we prefer a smaller certain gain over a larger uncertain gain. A funny change happens when we consider losses.

If forced, would you choose the certainty of losing $100 or flipping a coin; heads you lose $20, tails you lose $200? Many people opt for the coin toss, becoming risk takers to avoid a loss. Being risk seeking loss avoiders means we'll hang onto a losing investment well past its usefulness date. When borrowing to invest, staying in your 'goldilocks' zone means being prepared to sell at a loss in a falling market.

The immediate response from those who don't recognise they are seeking risk to avoid loss is to not sell in a falling market. The argument is that you might contribute to the rout. Firstly, if you typically buy widely held investments you are unlikely to be holding so much that your sell order will be enough to significantly move the market. Secondly, you are opting for the coin toss. The market might bounce back, but it might also continue to fall. You won't know for certain until after the event which is the very definition of risk.
Are you avoiding risk in pursuit of gains and pursuing risk to avoid losses?

5. Apples and oranges

Stories about improbably successful investments often fail to count all the costs - repairs to a rental property for example. A seemingly foolish decision may have been a wise investment if returns are tallied up correctly.

Measuring the success of a term deposit by looking at the starting and ending balance is easy. Measuring the success of a borrowing strategy is not as straight forward because of ongoing cash flows, buying and selling activities and potential tax deductions.

Some people who borrow to invest have dividends paid into a general cash account and use that money for various day-to-day expenses. Dividends leak out, don't earn compound returns and are forgotten when it comes time to assess the investment. To better capture all the returns, dividends can reduce the loan or be reinvested.

Are you rationally assessing financial outcomes or comparing apples and oranges?

6. Beware the herd

Following the herd is often not the best strategy. The more the herd moves toward one investment the more you should be looking for crocodiles. It's hard to break away from the herd but there are two techniques to keep in mind.

Diversification is the art of mixing your investments so one capricious event cannot wipe out everything. Also you'll be less likely to get caught by a fad. Investors with a clear eye on their goals and a plan to achieve those goals are more likely to avoid many investment pitfalls.
Do you have an investment plan that gives you the confidence to step away from the herd?

ALL EYES *on the Fed...*

Lee M. Spano,

Perhaps the single most important macro-economic issue for 2015 is the raising of US central interest rates by the Federal Reserve. This will likely have significant impacts not just on the US economy but also the broader global economy. In this article we give investors important insights and tools to better conduct their own independent analysis.

Background

The ending of Quantitative Easing (QE) in the US towards the end of 2014 was a watershed in the global economy. This cleared the way for rises in US interest rates by the Fed. The ending of QE and the rising of US interest rates from its current 0.25% are based on a key condition precedent - the nature and extent of an improving US economy since the GFC in 2008.

Investors need to be mindful that an improving US economy does not automatically mean interest rates will rise. The condition precedent of an improving US economy and the key indicators used by the Fed in its decision making are not necessarily straight forward.

The question of interest rate rises has three important sub-issues:
a) when will interest rates rise, if at all?
b) how quickly will they rise?
c) how will relevant markets react - beforehand and afterwards?

> "Investors need to be mindful that an improving US economy does not automatically mean interest rates will rise."

Investors will need to think carefully about these three sub-issues during 2015 and beyond. The tools below will assist you to conduct your own independent analysis. Naturally, this will vary depending on your portfolio, chosen markets and strategies.

The media and even economists are all currently trying to second guess the Fed, and opinion varies markedly. For example, I have read one commentator quite firmly predicting an interest rate increase by June 2015, and another not until 2016 or beyond. Investors should not fall into the trap of predicting anything, let alone central bank decision-making. There is no one agreed over-arching rational framework, and economic factors are inter-laced with political and broader considerations. The situation is complex, and market reaction may appear random at times. However, remember as investors we should never predict, rather we anticipate and react. We should always think in terms of probabilities and evidence.

Strength of the US Economy

Gauging the strength of the US economy through key economic indicators will assist in the evidence building process. The indicators below are tools to assist your fundamental analysis. They are not exhaustive and the space of this article merely permits broad-brush comments. Investors can source quality data readily now on the internet. Two sites you might like to consider are: Trading Economics - www.tradingeconomics.com and Forex Factory Economic Calendar - www.forexfactory.com/calendar.php

The key economic indicators include the following.

1. Sovereign Debt
Currently in 2014 Gross Debt /GDP Ratio is 101.53%. Trend was rising since GFC in 2008/9, then 64.8%, but some evidence it is plateauing since 2012.

2. Inflation
CPI currently 0.8%. Ranging to falling trend since 2011, peaked then at 3.9%.

3. Unemployment Rate
Currently 5.6%. Falling trend since 2010, then 9.7%.

4. Non-Farm Employment Change (NFP)
January 2015 monthly change was 252,000. Trend steadily positive since 2009, then peak low -718,000 (April 2009).

5. Gross Domestic Confidence (GDP)
Currently 16,800b. Rising trend since 2008, then 14,480b.

6. CB Consumer Confidence
Currently 102.9. Trend rising since 2009, then a low of 20.5.

7. Philly Fed Manufacturing Index
Currently 6.3. Since 2008, trend unclear, mixed results above and below 0.0 baseline.

8. CB Building Permits
Currently 1.03m (annualised monthly). Trend steadily rising since 2009, then peak low of 0.39m (February 2009).

The general conclusion from this data is there is clear evidence of a strengthening US economy. The ongoing issue is whether this can continue, particularly in a rising interest rate climate in future years.

A few things to particularly note about the US economy. First, it is a demand driven economy. So indicators such as Consumer Sentiment play a more important role, say when compared to Australia which is an export driven economy. Second, as a consequence, and for other reasons, particularly political, unemployment is perhaps the most watched indicator by institutions, government, investors and other market participants. Third, the emerging issue of US shale oil and gas, and the continued fall in global oil prices generate significant uncertainties. The war with OPEC may or may not see US companies succeed long term, and a rising US dollar will not help. This will impact the usual indicators including GDP and unemployment. Investors will need to watch this issue very carefully in 2015 and beyond.

Technical Analysis of Key Markets

Particularly for longer term investors, it is always good to combine sound fundamental analysis with technical analysis. The charts of the key markets we should watch closely in 2015 are listed below. Again space only permits broad comments. Investors can readily access basic charts from Stock Charts - www.stockcharts.com - their codes are used below. All comments made on the weekly (W1) chart:

1. S&P500 ($SPX)
The main equities index now in the US ahead of the Dow. Broad steady uptrend continues, although recent volatility in significant retracements.

2. NASDAQ ($COMPQ)
Similarly to S&P500.

3. Russell 3000 ($RUA)
A small and mid cap index, also similarly to the S&P.

4. US Dollar Index ($USD)
Ranging until about April 2014, extreme uptrend since then.

5. Gold USD (@GOLD)
Gold spot price in US dollars. Downtrend in doubt, current strong bullish retracement.

6. Volatility Index – US Stocks ($VIX)
Trend unclear. Currently 20.44 and above the important 20.0 threshold.

7. US Treasury Bond 10 year ($UST)
Trend unclear. Previously ranging, currently clearly bullish.

Naturally, you should conduct your own more detailed technical analysis. However, in broad terms equities have been continuing their bullish run since the GFC, and this is despite the winding up of QE towards the end of 2014. However, there is some evidence of a movement towards defensives, such as Gold and US bonds. The US Dollar is also a traditional defensive, and it is showing evidence of an anticipation of a rise in US interest rates.

Conclusion

It should be clear from our brief discussion that the rise of central interest rates in the US is a complex issue. It is mixed with investor, economic and political factors at several levels. Hopefully the tools we have provided will help you conduct your own independent analysis based on evidence and probability. Seasoned investors should never rely on idle opinion or hopeful predictions.

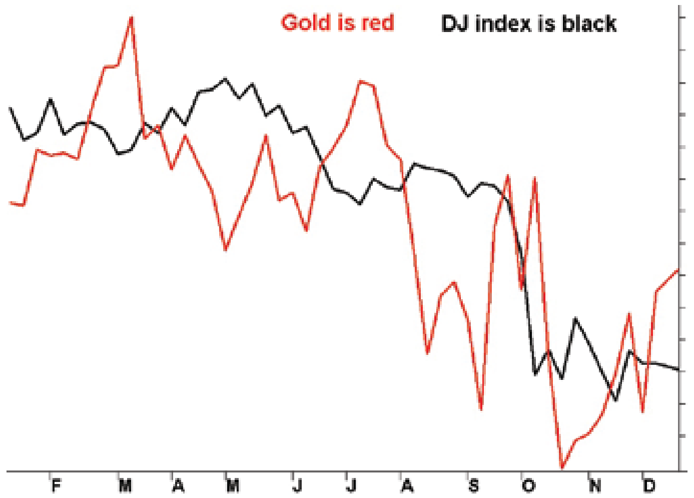
Lee M. Spano, Investor & Creatness International CEO

GOLD, GOLD DERIVATIVES & GOLD STOCKS

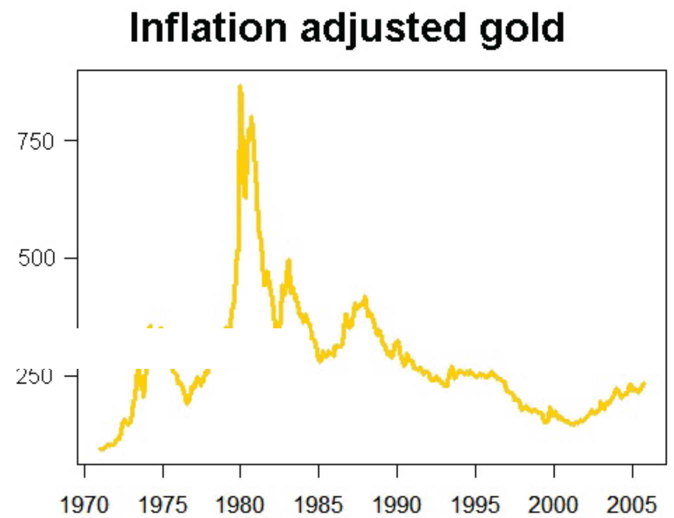
ALAN HULL

This discussion looks at gold as a defensive play in the event of a collapse in capital markets, namely equities. This is a question I get a lot from investors. I think most of them don't understand the dual nature of gold. It is both a commodity and an alternate form of money.

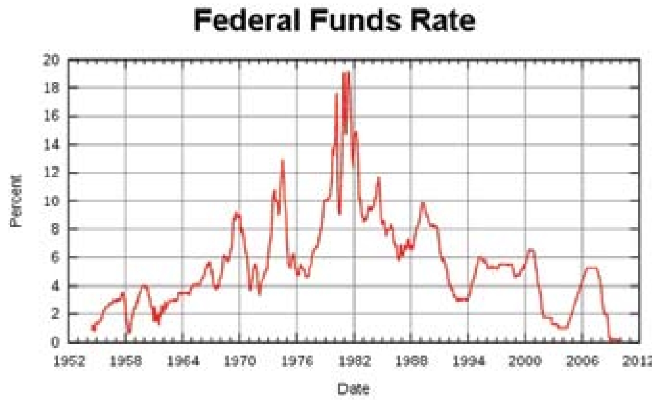
As a commodity, the price of gold generally goes up and down just like other commodities. However, given its reputation as a safe haven it does tend to fall less precipitously and it also tends to recover more quickly, but at the end of the day it will behave cyclically with other assets and commodities. The following chart compares gold to the Dow Jones in 2008.



I use this chart quite often and for good reason. It is irrefutable evidence that gold is not a safe place to hide when equity markets are in trouble. However, it is a great place to hide when there's a loss of confidence in the monetary system as occurred in the late 1970s, early 1980s.



The following chart shows the US Federal Reserve interest rates all the way back to the early 1950s. Note how this rate spiked up in direct correlation with the spike in the gold Chart. This is because interest rates were dramatically increased to fight inflation and restore faith in the dollar. Would you put your savings in cash if you could get 19% pa risk free? I certainly would.



What happened was a loss of faith in the US dollar which was the global standard at the time. So much so that during President Carter's administration the government raised funds in Swiss Francs by issuing a special Bond series. These were known as Carter Bonds and it's a pretty sad indictment of the US dollar if the government itself wanted to raise funds in another currency.

So at that time investors fled the US dollar in favour of an alterna-tive … ergo gold. At times like these, gold does an accounting for the monetary system via the open market where the limited amount of gold available will supposedly replace the entire money supply. Hence the price of gold spiked up from $35 per ounce in 1967 to $850 per ounce by 1980.

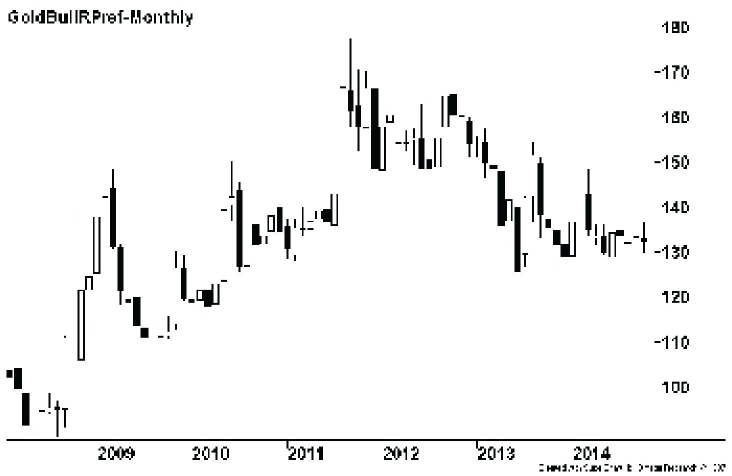
So gold is an alternative form of money and, therefore, it is a safe place to hide in the event of a monetary system collapse. And then there's the related question of using shares in gold producers rather than buying gold itself. This is a good question but there's also the issue of using derivative products such as the Gold Exchange Traded Fund (ETF) which trades under the code GOLD on the ASX.

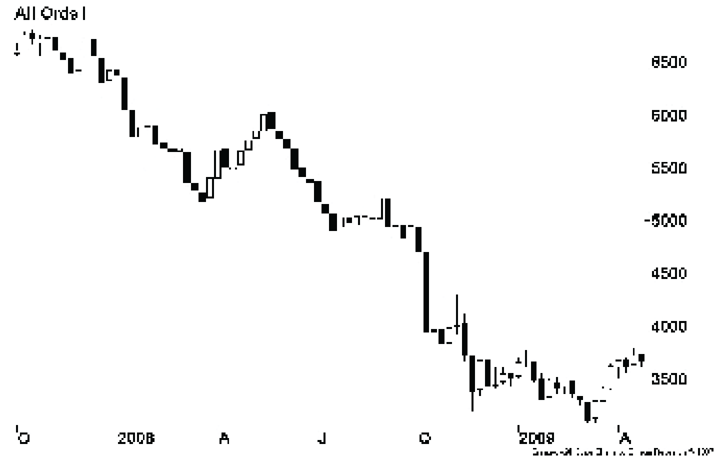
This instrument is supposedly equal to one tenth of an ounce of gold in Australian dollars. The following long term charts give a direct comparison of the Gold ETF (first chart) with the spot price of Gold in US dollars (second chart).

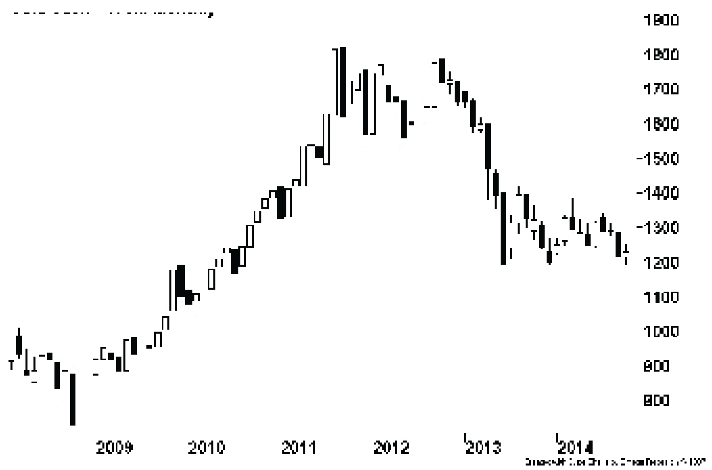
These charts are very similar but not exactly the same. The reason is the currency exchange rate, as one is measured in Australian dollars and the other in US dollars. Now given that our purpose for buying gold is to protect against a collapse of the monetary system, movements in the exchange rate will most likely be an unwanted complication.

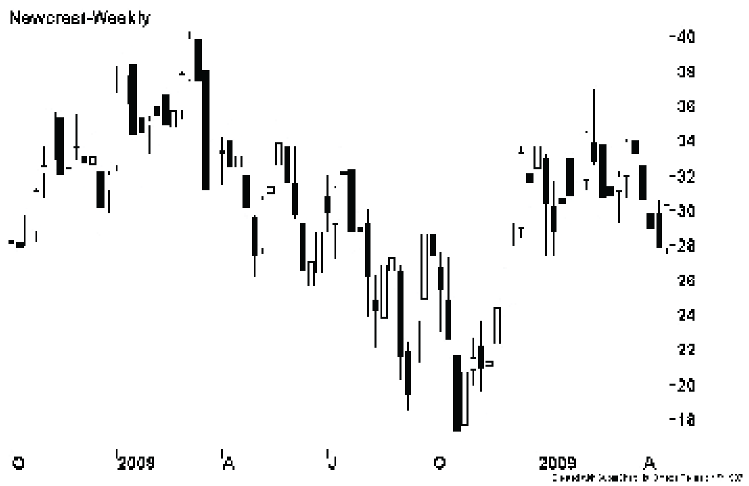
The other complications with using gold derivatives is that the issuers of these instruments can do cute things like buy gold on forward contracts etc. And another problem is that derivatives are inevitably subject to issuer and underwriter risk. Now you might say that the chances of a default occurring are remote and many of these products have a proven track record. But I want gold as a form of protection in the event of a collapse of the global monetary system.

> "As a commodity, the price of gold generally goes up and down just like other commodities."









And such an event will not be pretty where catastrophic failures in the banking and financial system will undoubtedly occur, along with panic gold buying and a corresponding shortage of gold. In this circumstance I will want to be sitting on physical gold, not a gold derivative. So now to the question of buying shares in listed gold producers in place of physical gold itself.

And unlike gold derivatives I think this approach has some merit. The following charts give a direct comparison of the All Ordinaries and Newcrest Ltd, Australia's largest gold producer during the global financial crisis. Note how Newcrest did go down but recov-ered quickly.

So on the tail end of an equity market correction gold producers look like the place to be. And monetary system failures usually occur on the back of capital market failures. Furthermore, gold producers get their hands on the shiny stuff at the price that it costs to dig it out of the ground, although there are potential issues with management, currency hedging, etc. So when the time comes, I will create a gold portfolio with physical gold and gold stocks.

And I guess that lends itself to yet another question. Is there a danger of the monetary system collapsing? This is a question I will leave to Jim Rickards, author of 'The Death of Money'. I recom-mend reading Jim's book and you can also search 'Jim Rickards' on YouTube.

Alan Hull

Seven Year Cycles in the Market Place

Jody Ellis, Investor Centre

Traditionally we have a saying in the market place: “Down in January down for the Year. Up in January up for the year.”

Certainly 2015 has started in the right direction with our market moving back towards the 5660 post GFC high from a low in December of 5200. This initially gives a green light to investment in the market and is further backed by international sentiment moving to “bullish” in the Australian market with our dividend stocks deemed to be of value when the Australian dollar is below $0.80 USD.

A few concerns have entered the market that are taking the edge off the potential bull run for 2015. These factors need to be considered.

1. Energy sector is low on rock bottom oil, gas, and coal prices and they are not looking like rising in at least the first two quarters. The US has said it is on track for energy self-sufficiency by 2018 and is prepared to tolerate $30 billion for oil prices for an extended period.

2. Commodities across the board, with the exception of gold, are having a tough time and demand has decreased putting pressure on small producers and also infrastructure companies in the mining sector.

3. Bank yield is struggling to keep pace with share price increase and banks like CBA are quickly falling to 4% yield on current price escalation. This is still a good yield for the international market on discounted $AUD but puts pressure on the Australian market.

A further consideration is the “Seven Year Cycles”. These cycles can be traced back to the early twenties and have a bizarre oscillating pattern that lends itself to interpretation. The following chart is of the US DOW 30 stocks from 1960. It shows the oscillating pattern that seems to permeate the market place.

We seem to have a basic cycle that says we have three years of choppy market and then four years of good market or four years of choppy market and then three years of good market before a market correction and then we do the whole thing again. 2015 is regarded as a 1 year – which is known also as a RESET year. Reset years are marked with a significant high and then a volatile recorrection that resets the 7 count.

We can have a look at recent 1 years: March 1966, October 1973, March 1980, October 1987, March 1994, September 2001 (October), March 2008.

We can have a look at recent 1 years: March 1966, October 1973, March 1980, October 1987, March 1994, September 2001 (October), March 2008.

With the exception of 2001, re-correction points oscillate between March and October. There is a fair bit of evidence to suggest we would likely have recorrected in October if we had not had the September 11 incident in 2001.

That leaves us with October 2015 as a reset point for the next seven years. Whilst we are left wondering if the mythical seven year cycle can strike this year, we start to wonder who is heavily investing in the Australian market at this time and what happens if they suddenly stop.

Enjoy the bull run but be prepared to go defensive this year. Failure to listen to the market could result in substantial loss of capital value. It may take quite a bit of time for the market to come back from any re-correction. The FTSE 100 has significant resistance at 6880 and if this market does not penetrate this level soon, it will be on the back foot for some time.

Jody Elliss is the CEO, Investor Centre

> **Reset years are marked with a significant high and then a volatile recorrection**

Calendar of Events

Please Note:
As AIA events are confirmed, details are posted to the AIA website **www.investors.asn.au**
Please note topic is subject to change.

MARCH 2015

03/03/15	Canberra Discussion Group	7.30pm	Southern Cross Club, 92-96 Corina Street, Woden ACT
04/03/15	Geelong Discussion Group	7.00pm	St George Workers Club, 212 Pakington Street, Geelong West VIC
04/03/15	Perth Information Meeting	7.00pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs
05/03/15	Brisbane Information Meeting	1.00pm	Broncos Leagues Club, Fulcher Rd, Red Hill
12/03/15	Sydney North Shore Information Meeting	7.00pm	The Chatswood Club, 11 Help St, Chatswood
18/03/15	Brisbane Investment Management Discussion Group	6.30pm	Carindale Library, Carindale Shopping Centre, 1161 Creek Road, Carindale QLD
18/03/15	Perth Equities Discussion Group	7.30pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs
19/03/15	Brisbane Share Investments Discussion Group	6.30pm	Carindale Library, Carindale Shopping Centre, 1161 Creek Road, Carindale QLD
25/03/15	Kew Discussion Group	7.00pm	Phyllis Hore Room, Kew Library, Corner Cotham & Civic Drive, Kew VIC
27/03/15	Bayside Discussion Group	4.00pm	Hampton Community Centre, Willis Street, Hampton VIC
28/03/15	Brisbane Special Event - Lunch with Peter Thornhill	11.30am	Tattersalls Club, 215 Queen Street, Brisbane QLD BOOKINGS ESSENTIAL

APRIL 2015

01/04/15	Blackburn Discussion Group	7.15pm	Naturalist Club of Victoria, 1 Gardenia Street, Blackburn VIC
01/04/15	Sydney Hills District Discussion Group	7.00pm	B Davis & Associates, Suite 17, 35 Old Northern Road, Baulkham Hills NSW
01/04/15	Brisbane Information Meeting	1.00pm	Broncos Leagues Club, Fulcher Rd, Red Hill QLD
07/04/15	Perth Information Meeting	6.00pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs WA
07/04/15	Adelaide Information Group	7.00pm	German Club, 223 Flinders St, Adelaide (Senatorum Room) SA
07/04/15	Melbourne Information Meeting	6.30pm	Telstra Conference Centre, Room 1, Level 1, 242 Exhibition St, Melbourne
08/04/15	Sydney North Shore Information Meeting	7.30pm	The Chatswood Club, 11 Help St, Chatswood NSW
13/04/15	Canberra Discussion Group	7.30pm	Southern Cross Club, 92-96 Corina Street, Woden ACT
15/04/15	Brisbane Share Investments Discussion Group	6.30pm	Carindale Library, Carindale Shopping Centre, 1161 Creek Road, Carindale QLD
20/04/15	Chermside Equities Discussion Group	7.00pm	Chermside Library, Hamilton Road, Chermside QLD
21/04/15	Brisbane Investment Management Discussion Group	6.30pm	Carindale Library, Carindale Shopping Centre, 1161 Creek Road, Carindale QLD
21/04/15	Gold Coast Information Meeting	9.30am	Robina Community Centre, Robina Town Centre Drive, Robina QLD
21/04/15	Perth Equities Discussion Group	7.30pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs WA

MAY 2015

05/05/15	Geelong Discussion Group	7.00pm	St George Workers Club, 212 Pakington Street, Geelong West VIC
05/05/15	Perth Information Group	7.00pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs WA
05/05/15	Adelaide Information Group	7.00pm	German Club, 223 Flinders St, Adelaide (Wolf Blass Weinkeller Room) SA
06/05/15	Brisbane Information Meeting	1.00pm	Broncos Leagues Club, Fulcher Rd, Red Hill QLD
06/05/15	Frankston South Discussion Group	1.00pm	Private address. Please contact Bill Shirley 03 9787 3045
11/05/15	Canberra Discussion Group	7.30pm	Southern Cross Club, 92-96 Corina Street, Woden ACT
13/05/15	Sydney North Shore Information Meeting	7.00pm	The Chatswood Club, 11 Help St, Chatswood NSW
18/05/15	Chermside Equities Discussion Group	7.00pm	Chermside Library, Hamilton Road, Chermside QLD
19/05/15	Perth Equities Discussion Group	7.30pm	Wembley Downs Tennis Club, Cnr Morden & Ednah St, Wembley Downs WA
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