

the **INVESTORS**voice

Magazine of the Australian Investors Association - *Investors helping Investors*

Dec2015



INVESTING IN SOUND BUSINESSES

MORTGAGES GEARING MICROCAPS



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1300 276 693

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Investors Helping Investors

The Australian Investors Association (AIA) is a national, non-profit, independent association of investors dedicated to helping other investors achieve their goals through education and advocacy.

CONTACT DETAILS

Australian Investors Association
PO Box 1208
Oxenford Qld 4210
Phone 1300 555 061
Fascimile 07 5573 7319
Email aia@investors.asn.au
Website www.investors.asn.au

NATIONAL COUNCIL

President Graeme Bottrill
Vice President Jon Kalkman
Treasurer & Company Secretary
Jolyon Forsyth

Directors

Graeme Bottrill
Jon Kalkman
Jolyon Forsyth
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EDITORIAL

Editor Jackey Coyle
Office Administrator Chris Kesting
Events and Member Services Coordinator
Donna Meadows

Advertising Enquiries

Phone 1300 555 061

Lifetime Members

Bob Andrew
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President's Message By Graeme Bottrill



Dear Members.

This is my first message as president, and I tossed up whether to talk about the association and our future plans, or to restrict my comments to investing matters. So, I decided to do both!

My vision for the association is to progressively improve our offering to members and make us more relevant. We have just three major contact points with our members, and those are, (1) our functions - discussion groups, information meetings, seminars and the annual conference; (2) our publications – Investors Voice, Investor Update, and a revamped webinar program, and (3) our website. Each of these three contact points will be improved and updated in the coming months.

We will work on our functions by planning topics which are relevant to the self-directed investors' needs in the current circumstances; we will work on our publications to source higher quality articles; and we need to work on our website to improve our google ranking by updating the site to make it mobile responsive. We also need to update our administration systems such as our member database, event booking system and our email system.

We are working on several fronts to convey a more progressive and professional image. One such improvement is a new office phone system, one benefit of which is to ensure that our phones are answered personally during full business hours.

Some of these improvements involve some small costs, and in order to proceed we need an increase in revenue (by attracting new members) to balance these costs. Later in this issue there is a note about a member referral program, and I encourage all members to consider how each may assist in this regard.

Our 2016 conference "Volatility, Risk and Reward - Strategies for an uncertain world" will be held from the 7th to 10th of August 2016 at the Gold Coast Marriott Resort. The title seems very appropriate. Planning is well underway, and we have some interesting new aspects to the program for next year.

Now to turn to the most important subject of our investing.

The ASX has wandered sideways for several years. Alan Kohler published some charts in September*, which show that the ASX200 has been in a downtrend. Alan says "The compound annual return since 2007 has been minus 1 per cent pa. That's a bear market." Alan then excluded the banks and showed that the index is now lower than the March 2009 low. Alan's comment was that we have had a bear market since November 2007.

Many of us may not be concerned about a fall in equity prices, because we believe that we will still receive substantial franked dividends. I believe that the issue for us is – will those dividends continue unabated?

I refer to stocks such as Woolworths, which has recently warned of a likely fall in dividends. Surprising, as many would have believed that the profits generated from food and grog would continue to increase. Looking below the surface reveals other headwinds such as price competition from Coles and Aldi, together with the Masters and BigW issues. There are no doubt other 'blue-chip' stocks which we all hold in our portfolios, which may face short to medium term difficulties and therefore potential dividend reductions. Most will survive of course, but we may suffer reduced income in the meantime. We need to critically examine our portfolios without bias, and consider the specific circumstances and risks related to each company. Make any adjustments that you deem necessary and prepare your portfolio.

In times like these, I retreat to Benjamin Graham's "The Intelligent Investor" for insights into managing one's portfolio during difficult times.

As we approach the Christmas period, all of us at the AIA wish all our members and their families and friends a happy and safe Christmas.

Kind Regards – Graeme Bottrill

Investing in Sound Businesses

COLIN NICHOLSON

When the last big bear market hit us in 2008-09, many investors in Australian stocks lost heavily. Those who were invested in sound businesses and held their nerve came though alright and by late 2013 the market as measured by the S&P/ASX All Ordinaries Total Return (Accumulation) index had recovered the losses.

Another group also came through fine – those who follow the market timing approach that I teach of being in bull markets and out of bear markets.

Unfortunately, there were other investors who were not so fortunate. Many panicked and sold their part ownership of sound companies in the grim days of late 2008 and early 2009. Then they compounded the error by watching frozen as the market roared back in mid-2009. Even worse hit were those who were part owners of unsoundly financed companies, which went belly up, or who were gambling in the speculative end of the market. In general terms there are two kinds of private investors in the stock market:

Investors: They buy a part ownership of a business which will yield them an income stream in the form of dividends and franking credits and, if the business prospers over time, an increase in the market value of their investment.

Speculators: They buy and sell shares with the aim of making a capital from favourable changes in the price of the stocks. Typically, they are investing with an eye to the spectacular gains that are occasionally made when the company finds or develops something. While speculators will be prepared to buy and sell anything that moves in price, investors should know that there are two basic types of businesses that are listed on the stock market:

Investment grade stocks, which can be defined quite easily; they are stocks that have a history of making profits and paying dividends. If possible, investors should seek out the history of earnings and dividends over at least ten years. This is not always possible because the business may not have been listed on the stock market that long. In that case investors should seek to read the prospectus on the ASX website in the section on company announcements. This may provide information on these metrics for the time before the stock was listed. Failing that, and in all cases, the best investments will be in companies that have

shown consistency and growth in earnings and dividends with little debt.

The necessity to look at a decade of earnings and dividend history is especially important if the business is cyclical (grows and declines with the business cycle) or is tied to commodity markets, which are notoriously cyclical.

Speculation, which can also be defined quite easily; they are stocks that have not yet been able to make consistent profits and pay dividends. This group will be avoided by investors, but hold out the temptation for the speculators that one or two may hit the jackpot and spectacular capital gains will be made, hopefully offsetting the many others that failed and lost most of the speculator’s capital that was punted on them. These speculative stocks come in many forms including:

- New businesses that have raised seed money to try to prove up a business plan
- Resources explorers that have raised money to search for an economic mineral or energy deposit
- Biotech developers that have raised money to try to discover and develop new treatments
- Internet/technology start-ups that have raised money to implement a new and unproven business idea or to make a new scientific discovery

The key thing to remember is that, if an investor buys speculative grade stocks, they are not really investing, but speculating. If they hold these stocks and the management does not make the business work, or they do not discover something, before the money runs out then these stocks will end up worthless and no income stream will have been enjoyed during the process.

Assuming that we want to focus our investing on sound businesses, how might we find them among the over 2,000 securities listed on the Australian Securities Exchange? The first step is to winnow the list down to only those stocks that both made a profit and paid a dividend in the last year. As of Friday 6 November 2015 there were only 431 listed companies that made the grade. However, some were not very large businesses. If we were to filter that list further by requiring that the market capitalisation was \$1 billion or more, there were only 150 companies left to consider. This list can be quickly reduced well below 100 companies by crossing out those that are in cyclical industries, businesses tied to the commodity cycles, businesses that you do not understand and especially those with high debt. Once the easy work has been done, the list needs to be worked over, looking for those companies that meet these easily found or calculated metrics:

- Grossed-up dividend yield better than the market average*
 - Price earnings ratio less than the market average*
 - Return on equity greater than 10%
 - Profit growth over 5 & 10 years that is greater than sales growth over those periods
 - Likewise earnings per share
 - Likewise, dividend growth
 - Likewise, free cash flow growth
- * The market average is used because it represents the opportunity cost versus investing in an index fund.

Above all, we must be sure that we understand the business and its growth prospects. Here we want to see a business that has a level competitive advantage, with pricing power with respect to suppliers and customers. Some of this analysis is relatively simple in that it is a matter of accessing and processing readily available data in company accounts. The difficult part is the work needed to understand the business, level of competitive advantage and its growth prospects through wide reading and study. Colin Nicholson is an AIA member, author and educator who has been investing in Australian stocks for over 50 years. His primary vehicle for investment education is his website www.bwts.com.au.

FINANCING A LONG & *HAPPY RETIREMENT*

PATRICK BROCK

One of Australia’s foremost superannuation experts, Jeremy Cooper – author of the Federal Government’s Super System Review – sent a shiver through many investors recently when he claimed that \$1 million in super may not be enough to retire comfortably.

ASFA Retirement Standard	Annual Living Costs	Weekly Living Costs
Couple - Modest	\$33,766	\$648
Couple - Comfortable	\$58,364	\$1,119
Single - Modest	\$23,469	\$450
Single - Comfortable	\$42,604	\$817

Source: ASFA

Cooper was quoted in the Australian Financial Review stating: ‘Assumptions and assertions that \$500,000, or even \$1 million, in super, in the current environment, will guarantee a comfortable retirement are suspect.

‘The brutal reality is that a fair price for an age pension in today’s interest rate environment is around \$1 million. For that amount, a couple will get \$33,717 of income a year. A comfortable retirement would cost more.’

Cooper’s comments highlighted the fact that with interest rates at record lows, the lump sum required to generate a sustainable living income is at a record high.

With interest rates at record lows, the lump sum required to generate a sustainable living income is at a record high

To reach this conclusion Cooper made a number of assumptions, including that retirees put all their capital into low-interest bonds and that they live only off the interest earned, never dipping into their capital.

In practice, most retirees choose higher-yielding investments and don’t just live off interest. They estimate their life expectancy and then supplement their income by drawing down capital accordingly.

Nonetheless, balancing life expectancy and the rate at which capital is drawn down is increasingly important. It is also especially relevant for SMSF trustees who take a greater role in self-managing their retirement income.

The risk of getting the balance wrong is called longevity risk. An ever-increasing number of trustees need to actively consider their longevity risk if their funds are in, or approaching, retirement phase.

The lifestyle question

To manage longevity risk you first need to determine how big your nest egg needs to be by working out how much income you need for your desired standard of living.

A number of different organisations have sought to quantify this, but the most widely used figures are from Association of Superannuation Funds of Australia (‘ASFA’) Benchmarks. The table above will give you a rough idea of how much income you would need to support a modest or comfortable retirement today.

Another rule of thumb often used to estimate how much money you will need in retirement is to assume you need 67% (two-thirds) of your income before you retire in order to maintain the same standard of living in retirement. This estimate is more suitable for high-income earners.

So the next question is how much of a nest egg you need in order to generate your chosen income for your lifetime.

ASFA estimates the lump sum needed to support a comfortable lifestyle for a couple is \$510,000 (or \$430,000 for a single person) assuming a partial age pension and an average life expectancy. However, to ensure against the risk that you may live beyond 85, more money may be needed.

Underestimating longevity

Of course, it would be easier to calculate the lump sum required if you knew exactly how long you are going to live. The issue is that many people assume they will live for less than they are actually statistically likely to. This underestimation can be by more than seven years for somebody in their early 50s.

How can you protect against longevity risk?

Aside from living modestly in retirement, there are few good answers to longevity risk protection, a fact highlighted by a number of recent reports including the Henry Tax Review, the 2015 Intergenerational Report and David Murray’s Financial System Inquiry.

However, understanding all these important considerations will help you achieve a comfortable lifestyle in retirement:

- your actual life expectancy
- your income requirements in retirement
- how to balance investment risk, return and capital draw-down strategies.

Age Group	Average estimation of own life expectancy	Intergenerational Report	Underestimation
50 to 54	81.4	88.5	-7.1
55 to 59	82.8	88.2	-5.4
60 to 64	83.5	88	-4.5
65 to 69	84	88	-4
70 to 74	85.4	88.3	-2.9
75 to 79	86.9	88.9	-2

Source: National Seniors Australia

How long will people live in the future?

- In 2015, life expectancy for males is 91.5 years and for females it is 93.6 years
- By 2055, male life expectancy is projected to increase to 95.1 years
- Female life expectancy is projected to increase to 96.6 years
- The number of people aged 65 and over is projected to more than double
- Those over age 85 is expected to represent 4.9% of the population versus 2% today

Patrick Brock, Relationship Manager Cromwell Property Group

The YIELD FIELD is still in play

TIM LINCOLN

For Australia's growing number of retirees and those nearing retirement, creating a reliable income stream that can last for many years – if not indefinitely – is imperative.

As well as being able to meet one's living expenses and keep ahead of inflation, a good income stream translates to a better quality of life. For those with a self-managed super fund, or any DIY investor, really, the Australian share market is a perfect place to achieve that goal.

That's certainly come into sharper focus in recent times especially following the GFC, with Australia's official interest rates still holding at record lows. Those with large amounts of capital held in bank accounts or fixed-interest products have suffered, with some returns below the rate of inflation. In effect, their real returns have been negative.

On the other hand, savvy investors – even those with a low-risk appetite – have wisely chosen to invest their capital on the share market into high-quality, financially healthy companies that have been paying consistently high, fully franked dividends. The market average yield has risen consistently, and is tracking above 6%.



Our view is that the strong yield attraction from the Australian share market will likely continue into 2016, with official rates likely to remain at historical lows and returns from other asset classes, including direct property, expected to decline in most capital cities.

THE GREAT HUNT FOR YIELD

In Australia, the chase for better income returns from the share market has primarily centred on large-capitalisation companies.

These companies have included the big four banks – ANZ Bank, Commonwealth Bank, National Australia Bank and Westpac – Telstra, and other strong, financially healthy companies with high dividend yields (a company's dividend expressed as a percentage of its share price). The major banks, and other listed financial institutions, are currently yielding upwards of 5.5% on a net basis, and more than 8% on a pre-tax (fully franked) basis.

And the hunt for yield has had an added benefit. Because of the strong investor demand for certain income stocks, those holding them have enjoyed good capital gains over the last few years in the process. The best income stocks have, in effect, become strong quasi growth stocks as well.

“While high-yield returns and growth are always great, the artificial hunt for yield created by low official interest rates won't last forever.”

Yet, while high-yield returns and growth are always great, the artificial hunt for yield created by low official interest rates won't last forever. Some stocks may not be able to stay the dividend distance, and sometimes if a dividend yield sounds too good to be true it probably is. That's because a company's yield return can look good on paper if its share price has dropped and it hasn't adjusted its dividend per share amount. A sharp fall in a company's share price often signals trouble.

So what companies should you be looking for? How do you, as a dividend maximiser investor, know whether you are buying into a quality stock or multiple stocks that will be able to maintain a reliable income stream for you over the longer term?

The answer, as always, is about doing fundamental analysis and assessing key financial ratios to identify the best share market investments – that is, the best stocks to buy.

THE THREE GOLDEN RULES FOR INCOME STOCK SELECTION

We define a quality income stock using three very important rules:

1. Financial health

A company must be exposed to manageable levels of financial risk. Having a strong or satisfactory financial health rating is a must.

2. Management assessment

A company must have a consistent history of paying dividends per share and increasing them, and needs to have been supported by a history of earnings per share rises.

3. Outlook & forecasts

For income opportunities, we also want to ensure that their future earnings profile is stable, not only to sustain an above-market yield but to increase dividends into the future.

The best place to start in order to achieve a rock-solid income portfolio is with what we call a Stock Doctor Star Income Stocks –

a financially healthy company that has delivered consistent dividends, often with an annual grossed-up (including franking credits) dividend yield above the market average.

These companies also have been analysed by our in-house research team to ensure that their future earnings profile is stable, not only to sustain its above-market yield, but also increasing the likelihood of dividend rises into the future.

STUDY THE DIVIDENDS FORM GUIDE

It's important to look over a company's dividend record over time such as its dividend per share payout ratios, while other things to consider include the diversity of its revenue streams, principal activities and past company announcements.

It's also worth noting that, often prized for their perceived stability, sometimes companies pay 'special' dividends as one-off rewards for shareholders if they have excess cash. Quite often, companies in this position will flag this to their shareholders beforehand.

One such example recently was Suncorp Group Limited (SUN), a Stock Doctor Star Income Stock that, in its latest full-year results for the 12 months to 30 June 2015, declared a fully-franked final dividend of 38 cents per share and also provided a special dividend of 12 cents per share. This represented a payout ratio of around 100% of reported earnings for the year.

IN A NUTSHELL

Generating a reliable income stream from the share market is a key investment objective for many investors, and easily

achievable. Most importantly, as an ASX investor it's worth remembering that buying into a company should not be about picking the highest short-term yield.

It's really about studying a company's longer-term form to ascertain whether it is likely to be able to sustain a strong yield over time, and that means focusing on its financial health fundamentals, its earnings stability, its dividends track record, and its prospects for increasing payouts over time.

The strongest stocks paying reliable dividends will always gravitate to the top of the pile, and those attracting high investment demand are also likely to enjoy good capital appreciation. Good dividends and good growth – it's a win-win scenario and the formula behind share-market success.

Information current at 30 October 2015
Tim Lincoln
Managing Director Lincoln Indicators

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MORTGAGES:

Older than Dickens but still a potentially profitable investment



PHILLIP RYAN

The term ‘mort-gage’ is French derived and originally meant ‘death pledge’.

These days the term is not used in such a drastic fashion, but still means that on default of a borrower’s obligations under a mortgage agreement, the lender or ‘mortgagee’ generally has a right to sell the security property in order to recoup their loan. For a ‘first mortgage’, that means that the lender generally has the right to recoup their loan in priority to the interests of the borrower and other parties (such as other lenders).

“In a mortgage trust, private lending occurs with the benefit of a mortgage over real property so that if a default occurs, the mortgage trust can take possession of the property and sell it.”

We are all familiar with lending carried on by traditional institutions such as banks, building societies and credit unions. Private lending is also a centuries-old concept and has historical references in both Shakespeare and Dickens.

In a mortgage trust environment, private lending occurs with the benefit of a mortgage over real property so that if a default occurs, the mortgage trust can take possession of the property and sell it to recoup the money lent to the borrower.

PRIVATE LENDING

You can, of course, engage in your own private lending. To do so, you would have to find a suitable borrower, negotiate terms, identify and value your security, and have a solicitor draw up appropriate mortgage security documents. In doing so, you would be able to negotiate your own interest rate and sit back and watch the money flow into your account – except it is not that easy.

For a start, how do you find a ‘suitable borrower’? Borrowers come in all shapes and sizes, but you would have to find one willing to offer real estate security you are happy to take security over.

Often, borrowers want to develop or construct on land to add to its value. In that case, you would need the skills to assess the feasibility of the project. You would also want to assess the borrower and their contractors to ascertain they have the ability to complete the project. You would also engage the services of a quantity surveyor and valuer to help you along the way.

Having made the loan, how do you monitor the borrower’s performance? When should you advance funds to construct the project? Should you withhold advances at any stage? These are complex issues and vary from case to case. Again, it is useful to engage industry professionals to assist and give their ‘sign off’ where appropriate.

Of course, if the borrower fails in their obligations, you need to have the skills to be able to enter into possession of the property, preserve it and sell it to recoup your loan. Naturally this area is heavily regulated, requiring special notices and time constraints. It is not a matter of simply taking possession and putting a ‘For

sale’ sign on the property.

So if this area of investing is so complicated, then why do people do it? Well, they can negotiate their own interest rate, which is important in this historically low interest-rate environment. But there is a simpler way.

MORTGAGE TRUSTS

Mortgage trusts act in the same way as a private lender, except that your investment monies are pooled with other investors and advanced to borrowers under the professional supervision of a fund manager or responsible entity. In that way, you typically receive the interest payable under a mortgage, less management fees payable to the fund manager. The fund manager would also receive certain fees payable by the borrower in that instance also. In this situation, you really can sit back and watch money come into your account.

At this stage you are probably wondering why a borrower would come to a private lender and not a bank or other traditional lender for finance.

TRADITIONAL LENDERS

There are many possible reasons. For example, it may be that a bank does not want to proceed with a loan because it believes that it already has enough exposure in its loan portfolio to that market sector.

It could be that the bank would want to proceed with a loan, but the conditions imposed are considered too onerous by the borrower. An instance of that would be where a bank insists on a certain level of presale contracts be entered into by a borrower, which may not be desirable if the borrower believes they will achieve better prices when the project is finished.

It also could be a simple matter of convenience. A credit department in a bank may be located interstate, so it could take some time for it to understand the project enough to approve it. For some borrowers, this could represent lost opportunity.

RISKS TO BE AWARE OF

Of course, as with all investments, investors should be cognisant of risks, which could involve a loss of income and/or capital. One point to consider with mortgages is the Loan-to-Valuation ratio (LVR) adopted by the lender. The LVR reflects the amount of the loan to be advanced by the lender as compared to the valuation of the security property.

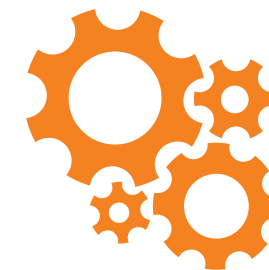
For example, on a development project with an ‘as if complete’ valuation assessed at \$1 million, a 70% LVR implies that the maximum loan offered is \$700,000. To put it another way, the project would have to realise net proceeds of less than \$700,000 before the lender would suffer a loss.

Investors should note there are various risks to be aware of and that the risks section of the relevant Product Disclosure Statement should be read in full before proceeding with any investment.

Philip Ryan is Managing Director, Trilogy Funds

GEARING:

The hardest lesson



JULIE MCKAY

When borrowing to invest (gearing), the message we’re consistently given is to mix (diversify) and monitor investments. But diversifying and monitoring are not sufficient; adjustments are occasionally necessary. This can be the hardest lesson for novice and professional investors alike.

1. Only change is constant

Take \$100 invested – \$60 in shares and \$40 in cash. This highly simplified example of a mix is expected to achieve a return that suits the investor’s circumstances, given the risks. The shares rise in value to \$67 while the cash remains at \$40 (ignoring interest, for simplicity). With the portfolio now worth \$107, 63% is invested in shares and 37% in cash. This mix no longer matches the desired diversification and thus potentially changes the expected returns and risks, possibly in a way that is no longer suitable.

2. Decision to revert

Many investors faced with this scenario maintain the investments as is. Markets favour steadfastness over the long term and fewer transactions mean lower costs. Some investors may be aware of the ‘buy-on-the-dip’ mantra. Take the initial \$100 invested as above – this time the shares fall in value to \$54 while the cash remains at \$40 (a 57:43 percentage mix).

The investor might use some cash to buy shares, bringing the portfolio back to the desired 60:40 mix. Conversely, the investor should sell some shares if they rise in value, but they usually resist this, often because of ingrained behavioural biases.

Diversifying and monitoring alone are not sufficient when gearing; adjustments are occasionally necessary. This can be the hardest lesson for both novices and professionals.

Another way to manage the investment mix over time is to set a minimum threshold for the portfolio’s value. Generally, as shares rise in value the distance (or cushion) between threshold and portfolio value widens, meaning the investor can buy more shares. As the distance narrows (the shares fall in value), the investor sells some shares, moving into the relative safety of cash.

No strategy is best in all circumstances. Buy-and-hold is usually best if investments rise constantly but modestly. Investments rarely behave so perfectly. Aiming for a constant mix (buy on a fall, sell on a rise) tends to do best when markets are choppy but relatively flat. Maintaining a cushion above a threshold (sell on a fall, buy on a rise) seems counterintuitive, but tends to be best when markets are trending up without too many dramatic reversals.

3. Cushions & gearing

For an investor to even consider gearing, they must expect reasonably strong upward-trending markets with relatively moderate interest rates. Generally, if markets perform as expected the strategy of maintaining a cushion will tend to give better results over the long term.

More importantly, maintaining a cushion is somewhat similar to self-insuring a desired minimum of investor capital; remember that markets can move faster than investors can react so it is not a guarantee. Given the risks of gearing – it magnifies losses as well

as gains – investors should at least consider any strategy that aims to mitigate the downside. Adopting any proactive rebalancing strategy can be as much art as science. Buying or selling too often can result in excessive costs, which can quickly erode the benefits. On the other hand, too little reaction to changes in portfolio mix can mean additional risks or lost opportunities.

4. Essential tools for gearing

Diversification, monitoring and rules for responding to changes are together the minimum essential tools for successful gearing. Each investor will adopt a different approach to diversification.

Only a margin loan gives geared investors a consolidated view for monitoring their loan and investments. Also, the links between a margin loan and brokers make it easier to do the transactions needed to maintain the desired investment mix. This can be only a brief introduction to some possible strategies for managing changes in portfolio mix when gearing.

When used appropriately and when using the right tools, gearing can be an effective way to build financial strength. Julie McKay is Senior Manager Technical Research, Leveraged Equities, a subsidiary of Bendigo and Adelaide Bank Limited www.leveraged.com.au



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GUARANTEEING MEDIocre RETURNS

ROGER MONTGOMERY



The US Dow Jones Total Return Index, which includes dividends reinvested, has returned 120.7 per cent in the ten years since November 2005. The S&P500 has produced an almost-as-impressive rise of 75 per cent. Meanwhile the local bourse, as measured by the ASX/S&P200 Accumulation index has produced a relatively paltry 31.7 per cent – that equates to just 2.79 per cent per annum over a decade, and that's growth and dividends combined.

Many investors wonder why the Australian share market index has done so poorly. The reason is simple; it is invested mostly in large businesses that trade a lot. It is not solely invested in great businesses that increase in value.

The local index is also dominated by the banks, resource companies - like BHP and RIO, and Telstra. Together their weighting amounts to nearly half of the Australian index. This is not the case in the US where more satisfactory diversification exists in the indices.

So why then is index investing so popular among Australian investors?

The answer lies partly in a pithy marketing one-liner: 'Most active fund managers underperform the index'. That one-liner – whether its true or not – along with the promise of diversification and a low cost are the top three reasons for the popularity of index funds and ETFs in Australia.

Their growth and popularity however belies the fact that broadly diversified cap-weighted equity index funds guarantee 'average' returns for a generation of investors.

As passive index investing becomes ever more popular, the arguments that justify the switch from active to passive management weaken and then completely break down. Retail investors are none-the-wiser, and trust those recommending the lazy approach because it's cheap.

Tellingly, they are cheap

Index investing, in particular when it is directed to cap-weighted equity indices, is dumb investing.

In fact when Warren Buffett recommended index investing to the masses, he made the point that it suits the "know-nothing investor". That is, the investor who has no interest in understanding a business or valuing it.

If you are reading this issue of Investor's Voice, you aren't a know-nothing investor. Index investing should therefore make no sense for you. And if you are an advisor, it should make no sense for your clients either – they are relying on you and paying you to be a 'know-something' investor.

There are plenty of reasons to avoid index investing and the ETF structures used to promote them, but those reasons haven't hampered their growth.

ASX-traded ETF funds under management are at a record high of over \$17 billion and according to a January 2015 'Australian ETF Review' report, ETF trading activity also broke the record for the largest month-on-month gain in funds under management as growth reached \$955 million. Meanwhile, the number of exchange-traded products trading on the ASX exceeds 100 and the number of ETF investors in Australia grew by 46% in the 12 months to October 2014, to 146,000. More than 180,000 investors are expected to have adopted the structures by the end of calendar 2015. Meanwhile the number of financial advisers employing ETFs has reached the record level of 7,000.

Of course strong market performance is having a significant impact on index investing's popularity. The adoption rate can reasonably be expected to be highest when the market is at a crest and lowest when the market is on its knees – precisely the opposite of a successful investment strategy.

While exchange-traded and index funds have been heralded as one of the most important financial innovations during the last decade, promoters fail to warn investors of their limitations.

Dangers of popularity

As ETFs and index investing grow in popularity, so does the blind purchase and sale of large baskets of shares with no regard for their underlying fundamentals. How such an approach to equity investing can be recommended to an investor requires careful examination. Most dangerously, as index investing grows in popularity so too does the divergence between stock prices and fundamental values.

Three risks for index investors increase –the risk of permanent capital impairment, volatility, and the certainty of average and mediocre performance.

Index investing is justified on the basis that the market is efficient and stock prices always reflect fair values. Therefore index investors ride the coat-tails of analysts who have done the work to determine values and disseminate that information. As the number of index investors increases however, so does the amount of blind buying and selling. This 'squeezes out' sensible value-based investing and reduces the influence of the narrowing pool of analysts required to establish the valuations the efficient-market-index-investing proponents rely on.

More frequent periods of greater divergence between price and fundamental value will occur, and in those periods, active managers, like The Montgomery Fund and The Montgomery Global Fund, have the opportunity to make much larger returns for their clients.

In other words as index investing grows in size so does the ability for marginalised active managers to outperform. The argument that passive beats active – the reason for the migration to passive forms of investing – weakens.

In the long run, sensible investing beats blind investing

I have frequently used the following example to argue a number of positions and this allegory also makes the case for smart active investing.

In 1919 Coca Cola listed on the NYSE at US\$40 per share. A year later the stock was trading at \$19.50, the result of rising sugar prices and a perpetual contract Coca-Cola had with its bottlers to supply syrup for \$1 per gallon. What would have happened if a single share of Coca-Cola was purchased in 1919 at \$40 and held through all of the frightening subsequent economic and financial developments, including the subsequent decline to \$19.50 in 1920, then through the great crash of 1929, the subsequent depression of the 1930s, World War II, a baby boom, dozens of other wars and skirmishes, an oil crisis, assassinations, the fall of the Berlin Wall,

innumerable recessions, booms, busts and scandals, as well as a war in Vietnam, two in Iraq and the market crashes of 1974, 1987, 2000 and the Global Financial Crisis?

Holding that single share, accepting all of the subsequent stock splits and reinvesting all dividends, would now equate to over 252,000 shares and the investment would have a market value, at \$US40 per share, of over US\$10 million.

It goes without saying that there would have been many periods and windows where the S&P500, the Russell 2000 and the Dow Jones indices outperformed the share price of Coca Cola. Indeed over the last two years the S&P500 has returned 35%, while Coca Cola has returned negative 5%. And over the last five years, the S&P500 has returned more than 72%, while Coca Cola has returned 50%.

But over the very long run - the period over which investing in a slice of a business makes perfect sense - sensible value investing in quality businesses cannot help but beat an index. The index is forced to be in both high and low quality companies. A \$40 investment in the S&P500 index in 1919, is now worth just \$540,000, compared to the \$10 million for Coca Cola.

Australia is replete with businesses generating poor returns

Some commentators despair that the S&P/ASX 200 price index remains below its all time high, eight years later. And yet, without thinking about why this is the case, they advocate index investing.

The reason the index remains below its high despite an unprecedented amount of artificial, and temporary, support from low

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Index investing, in particular when it is directed to cap-weighted equity indices is dumb investing
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GUARANTEEING MEDIocre RETURNS *continued...*

interest rates, is that the index is dominated by businesses generating poor returns on shareholders' equity capital. Mediocre businesses, generate mediocre returns on shareholders' equity, and over time, share prices reflect this, ensuring small minority shareholders receive a return similar to that of a 100% owner of the business. Mediocre.

As an example, I have previously explained the terrible performance of Virgin Australia over the last decade. It has required massive capital injections, holds \$2 billion of debt and the share price is a quarter of its level ten years ago. An investor in Virgin shares would have experienced a proportional economic calamity, over a decade, to the individual who owned the entire business. Every index with a weighting to Virgin has paid the consequences of this poor investment, as has any index fund invested in that index.

But airlines aren't the exception. A cursory examination of share price performances for many so-called 'blue chips' reveals many equally disappointing performances. Companies like AMP, NAB, Boral, Leighton, Lend Lease, BHP, Rio and Telstra might have paid dividends but their capital return has been disappointingly flat to negative over a number of years, even over a decade or more in some cases.

These blue chips make up the major cap-weighted stock indices and it is the blind buying of these diversified and cheap indices through index funds and ETFs that will ensure their investors receive similarly mediocre returns.

Indices were originally designed as a way to measure the performance of the market, a single number to help determine whether the market was rising or falling, and to make comparisons over time. An index is designed to offer a device for traders that reflects [market trading] activity. A cap-weighted index is not designed nor constructed with the intention of producing a solid long-term return for investors.

And that's the thing to remember when 'investing' in an index. Perhaps you aren't investing at all.

Roger Montgomery is the CIO of The Montgomery Fund and the founder of Montgomery Investment Management.

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[^] Performance figures are for the period 1st October 2014 – 30th September 2015 and are after all applicable fees and taxes. Inception Date: Wholesale Units: 4 March 2014.

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I'm an Enduring Power of Attorney for someone. Now what do I do?

BRIAN HERD

When someone appoints you the executor of their Will, there is nothing much for you to do for a while, at least – you hibernate.

Then one day, when the person who appointed you goes to sleep permanently, you awake from your slumber. Suddenly, you may find out that firstly, you've got the job and secondly, that job has just begun.

But when someone appoints you their Enduring Power of Attorney, you may go to sleep for a while but you may be awoken by a rude shock – the person who appointed you has lost their capacity; is still alive but now needs you to do things and make decisions for them, potentially for the rest of their life.

The beauty of a Will is that it gives the Executor a menu or agenda for what they have to do. The problem with an EPA is that it is not that helpful. You are left having to use your judgement and, in many cases, having to make serious and far-reaching decisions for the person without the benefit of a script.

With an EPA you are left having to use your judgement and often make serious and far-reaching decisions for the person without the benefit of a script.

Many of us tend to dumb down the role and believe that that all we have to do is pay the bills for the person. Let me tell you, being an EPA myself for a few people, it is a job that comes with many strands and responsibilities, not to mention calls on your time.

Your role can include making fundamental decisions about a person's:

- health care
- residence
- finances and assets
- aged care
- relationships with their family
- life

From my experience, however, it is amazing how few people appreciate how important it is to understand everything you can about that person's life in order to make good and informed decisions. When I am appointed as an EPA, I go on a fossicking exercise to find out about the person, their family, their finances, their bank accounts (including

online ones), their tax and Centrelink status, their health, their wishes and much more, including who's going to feed the cat.

In doing your job properly, there are some basic investigations in particular, that need to be made to ensure the person's interests are protected and that you don't get sued sometime in the future for making the wrong or an ill-informed decision or, even worse, for doing nothing. These include the following:

Questions you need to ask

- 1. Does the person have a Will?**

 - a. You need to look for it.**
 - b. If you find it, you need to read it.**
 - c. You then need to consider and get advice on whether it needs to be changed.**
 - d. If you can't find a Will – what should you do bearing in mind that you can apply to a court for it to make, change or revoke a person's Will who is unable to do so themselves?**
- 2. What is the state of the person's finances?**

 - a. Do they have a financial adviser**
 - b. Who are they and where are they**
 - c. Arrange a meeting with them to review the finances**
 - d. Get advice from them in relation to the person's changed situation**
 - e. Are all the person's assets insured?**
- 3. Has the person lodged all their tax returns and paid their tax?**

 - a. Does the person have an accountant who prepared the tax returns?**
 - b. If not, should I be making contact with the ATO to find out?**
 - c. If the person's tax situation is in disarray, should I engage an accountant to fix things?**
- 4. What is the person's Centrelink status and have they advised (or should I advise) Centrelink when required of any change in circumstances?**

I cannot emphasise too highly that your responsibility to 'get to know' and 'take control' of the person's affairs is a legal duty, not just a good idea. If you don't there can be adverse consequences for you personally, including financially, as we see so often in our practice.

Here's some free advice: if you are the EPA for someone and your role has been activated and, particularly if it is your first time, contact a specialist law firm to get some helpful riding instructions on how to do it well – the person who appointed you did so because they trusted you and that's what they would want and expect you to do.

Remember as well: the cost of getting good advice as an EPA is a cost that you won't have to bear – it is the person for whom you are the EPA who will pay and, if they could, they would probably thank you for spending their money so wisely.

Brian Herd is a Partner at Elder Law Services, CRH Law

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The beauty of a Will is that it gives the Executor a menu or agenda for what they have to do

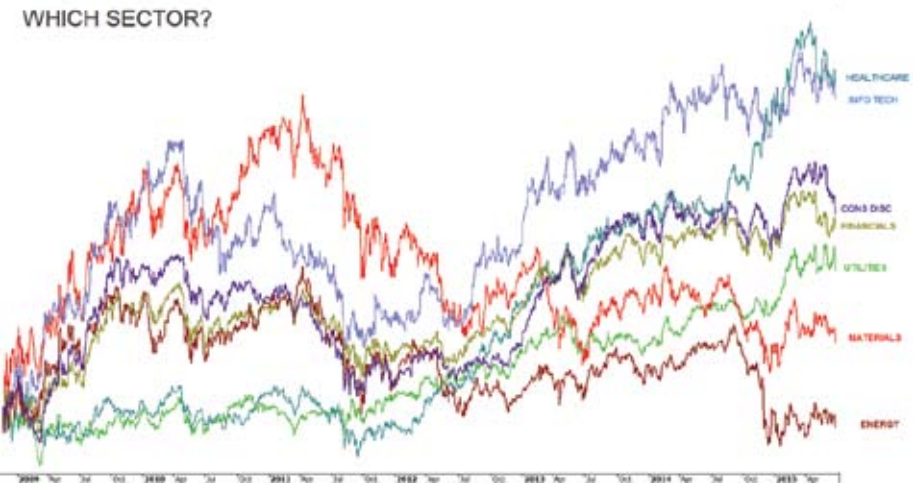
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13

A step-by-step approach to recognising potential in a chart

DON ODGERS AND DAVID BARNES

WHICH SECTOR?



If you are using technical analysis to help in your decision-making, you may find yourself reviewing many charts on a single day – charts that you need to quickly evaluate and either act upon, or move on. How can you quickly and accurately review each one and seize on the one or two that really matter – the ones that show genuine opportunity?

This is a conundrum we may face as we look for buying and selling opportunities. Some could be stocks you have identified from a scan, which could offer a trading opportunity if certain conditions are met. Others may be positions you currently hold and you need to protect your capital. Others could be on your watchlist.

The ability to make a decision with a quick glance at a chart is an acquired skill – however, it is a simple process if you establish a disciplined evaluation system. The system we use is one that works for us. It is basic and uncomplicated. Having a clear, disciplined procedure that you work to religiously will greatly reduce your workload and it is guaranteed to improve your ‘hit rate’.

There are just five steps to follow and if you use this simple system it will quickly become embedded into your DNA.

Step 1

Where is the stock in relation to the current trend? Is the downtrend or uptrend about to break?

Effective trend management techniques are among the simplest and easiest ways to understand changes in market sentiment. The old adage ‘let the trend be your friend’ encapsulates the concept.

Generally speaking, if a trend has broken for between two and five periods you can be sure that the market sentiment has changed on that particular stock.

From a practical point of view, we believe that a one-period break is too tight and a five-period break is too loose a setting.

Accordingly, we would suggest that a break of either two or three periods provides a generally accepted safety margin.

Having a disciplined approach to trend management is the most basic of all of the techniques of technical analysis. And, of course, you should always check the longer-term trends on a weekly, or even monthly, chart.

“Chartists recognise that buyer support and buyer resistance – along with trend management – are some of the most fundamental forces at play in the market.”

Step 2

Where is the stock now in relation to significant buyer support or buyer resistance?

The market is totally controlled by the buyers. Chartists recognise that buyer support and buyer resistance – along with trend management – are some of the most fundamental forces at play in the market.

Chartists recognise that buyer support and buyer resistance – along with trend management – are some of the most fundamental forces at play in the market.

The stock may retrace to a level that has provided consistent support in the past – where buyers recognise it as value. This is where they will enter the stock and the price will rise. Or indeed it may have run up to a level where the buyers believe it is overvalued, and without their buying support the stock price falls away. The level could also be a Fibonacci or Gann retracement level. Again, remember to flick over to a weekly, or even monthly, chart as well. Longer-term charts can identify previous levels where buyer support and buyer resistance have occurred, providing signposts that are often overlooked.

Step 3

Is there a significant top or bottom that the stock is testing or approaching? A move through this level could signal a buying or selling opportunity as the forces of support and resistance come into play.

It also pays to check the weekly chart so that you can see the bigger picture. Often a historic high or low may have occurred some time ago – beyond the confines of the daily chart.

Step 4

Is there divergence (or convergence) visible? Many indicators provide strong divergent/convergent signals and these can provide a leading indication that a change in market sentiment may be about to occur.

Divergence is present when the stock and the underlying indicator are moving in different directions. For example, where the indicator is making higher lows at the same time the stock is making lower lows, and vice versa. This is particularly relevant when the indicator is moving from oversold (or overbought) back into the mid range.

The indicators we find that provide reliable divergent or convergent signals are the RSI, MACD, Price Oscillator and the Stochastic. Each of these indicators is calculated differently. However, the signals they generate can be extremely effective in identifying the moment that buying energy is entering or exiting a particular stock.

Step 5

Can you see any patterns? As you know, some patterns can indicate reversal of the trend. Others indicate that the current trend is likely to continue.

Reversal patterns can prove extremely useful in setting targets for trade planning purposes and include:

- Head and Shoulders Tops and Bottoms
- Double/Triple Tops and Bottoms
- Triangles.

Continuation patterns on the other hand indicate that the current trend is likely to continue and so you can enter the trade with some confidence on that basis.

Continuation patterns include Flags and Pennants and usually occur as the analysts digest a recent announcement that may have caused a price spike, either upwards or downwards. Once the continuation pattern is complete you can enter the trade (short or long) on the understanding that the traders and investors have digested the announcement that caused the spike and judge it to be soundly based.

Go where the money is & go there often!
The five steps we have identified are not intended to encapsulate a complete understanding of technical analysis.

They are simply a discipline to follow that will enable you to quickly assess whether a particular chart has any potential for further examination and analysis.

Don Odgers and David Barnes are from Chartwise Academy

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FIVE UNDERVALUED, QUALITY YIELD STOCKS ON THE ASX

DAVID WALKER

Inadequate yields on fixed interest products, produced by ultra-low bond yields globally, continue to drive income investors into the equity market. There is an ocean of demand for yield which will only grow as the proportion of citizens in pension mode rises with the ageing of the population.

But indiscriminate buying of equities for high dividend yields can be dangerous. Ultra-high dividend yields often predict the dividend will be cut or omitted, or the company will downgrade its earnings guidance or fail.

To earn more income from equities and preserve capital, investors should buy stocks only at a discount to a robust estimate of what a company is intrinsically worth away from the sharemarket. This ensures the investor does not overpay for a stock which happens to be popular in the market but is at risk of falling due to overvaluation.

Investing against a sensible intrinsic valuation also protects the investor against the volatility currently afflicting the equity market. When the latest global macro disappointment strikes, investors holding overvalued stocks are vulnerable while those with stocks trading at or below value are better protected. Ranking stocks by dividend yield alone is not safe investing.

To help preserve capital in the volatile equity market, income investors should prefer stocks which pay attractive yields and are undervalued. There are such opportunities in the market if you know where to look. We used StocksInValue's filter search functions to find five stocks with above-average dividend yields and discounts to value investors could/should consider. The stocks are ranked below in descending order of dividend yield.

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indiscriminate **buying of equities** for **high dividend yields** can be **dangerous**”

National Australia Bank (NAB)
Forecast dividend yield:
6.9% fully franked
Share price: \$28.56 (5/11/15)
Forward valuation: \$32.89

NAB is the best-placed major bank in the increasingly challenging Australian banking environment. After the demerger and IPO of Clydesdale, the sale of 80% of the Australian life insurance operations, the Great Western bank divestment, an increase in reinsurance of the life book and the sale of commercial real estate loan books in the UK, NAB will be a simpler business focused on the more profitable Australian and New Zealand traditional banking markets. The strategy should boost group return on equity by at least two percentage points – an invaluable support at a time of increasing regulatory capital requirements, slowing economic growth, peaking residential mortgage lending and competitive pressure on interest margins.

We also like NAB's sector-leading exposure to business lending, which we forecast to accelerate.

On 30 September the common equity tier 1 ratio was 10.2%, above the bank's target range of 8.75% - 9.25%.

While declining bad debts expense has supported earnings since the global financial crisis, we expect no more than a modest normalisation of loan impairment charges across the banking sector over the year ahead. Credit quality is supported by improved debt-servicing capacity from lower lending rates, low corporate gearing and support for asset prices from global liquidity.

In our view NAB is oversold. We recently topped up our position in our model portfolio.

Commonwealth Bank of Australia (CBA)
Forecast dividend yield:
5.7% fully franked
Share price: \$75.85 (5/11/15)
Forward valuation: \$81.25

CBA is our second-favourite large ASX bank for its long record of superior profitability and growth, which are the product of consistent focus on the profitable Australian banking market (not failed offshore jaunts), technological leadership and conservative management of costs, capital, loan book diversification and loan risk underwriting. Like NAB, CBA raised capital early and does not need another large equity raising. CBA does not have WBC's excessive exposure to Sydney and Melbourne investor loans, nor ANZ's exposure to impaired loans in the mining and agricultural sectors.

The stock is fluctuating with general sentiment on ASX equities. In the September quarter, revenue growth was steady, underlying interest margins were flat and credit quality improved. CBA should also benefit from an acceleration in business lending. We built a weighting in our model portfolio during the August-September correction and would further increase the weighting on another pullback to the low \$70s.

Retail Food Group (RFG)
Forecast dividend yield:
5.7% fully franked
Share price: \$4.52 (5/11/15)
Forward valuation: \$5.78

RFG is Australia's largest multi-food franchiser as the licensor of 12 well-known brand systems including café/bakery shops Donut King, bb's cafe, Brumby's and Michel's Patisserie; Quick Service Restaurants including Pizza Capers and Crust Gourmet Pizza; coffee brands Gloria Jeans, Esquires Coffee, It's a Grind Coffee House, and Di Bella Coffee; and mobile coffee brands The Coffee Guy and Café 2 U. The firm makes money from upfront franchise fees and a percentage of franchise revenue.

David Walker
Head of Australian Equities Research,
Stocks in Value

RFG is a global business, with 1,000+ outlets in 40 countries in addition to ~1,500 outlets in Australia. The firm is on track to open ~250 new stores in 2015 as part of a plan to have 3,500 outlets in three years' time, up from ~2,500 currently. The company has a solid record of brand system management and sensible acquisitions in a sector where consumption (of coffee, snack foods and staples) is steadily growing. Return on equity averaged 23% over the last five years.

Credit Corp Group (CCP)
Forecast dividend yield: 4.9% fully franked
Share price: \$9.35 (5/11/15)
Forward valuation: \$13.89

CCP's core business is purchasing and collecting on debt ledgers. CCP purchases this debt from banks, telcos and car dealerships at a fraction of the total value of the debt on the ledger based on its estimate of the proportion of debt likely to be recovered. Revenue is then earned from debt collection and fees for related services. CCP benefits from its economies of scale and analytical superiority and hence is able to achieve greater profitability than its peers.

As the core domestic business is now mature, CCP is pursuing growth in consumer lending in Australia and debt collection in the US. The consumer lending segment has just reached critical mass and as the loan book grows, gross margins will expand and drive profitability higher. CCP is able to leverage its extensive credit database to grow the consumer lending operations. This is a unique aspect of CCP's business, which does not do payday lending.

Recent share price weakness reflected concern about increased competition from the entry of Encore Capital into the market, via its acquisition of a controlling stake in Baycorp, and the exit of Westpac from funding payday lenders. We viewed these concerns as overblown, continued to see CCP as a deep value investment and topped up in our model portfolio. After the earnings upgrade at the 5 November AGM we increased the model weighting because the stock was still undervalued by dollars, this time with confirmed earnings momentum.

JB Hi-Fi (JBH)
Forecast dividend yield: 5.4% fully franked
Share price: \$17.63 (5/11/15)
Forward valuation: \$21.25

The retail environment is challenging, with consumers cautious about discretionary spending, but JBH's business model of high turnover and a low cost base is compensating. The FY15 result beat the top end of company guidance. The major theme of the result was JBH's transition away from structurally declining software sales to appliance categories like homewares, which are benefiting from the strength in the building cycle.

FIVE UNDERVALUED, QUALITY YIELD STOCKS ON THE ASX
continued...

Consumers see JBH as a price leader and are attracted to its after-sales service and online support, which is available across its nationwide store network. Store locations are carefully chosen in areas with high foot traffic to maximise sales and convenience for shoppers.

The store-roll out and category expansion underpin a solid outlook. JBH ended FY15 with 187 stores, including 43 in the Home format. Six new stores are planned for FY16. JBH's category expansion through JB Hi Fi Home leverages trust in the JB Hi Fi brand into appliances categories.

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ADRIAN HARRINGTON

Not a day goes by without residential property consuming our headlines. And why not, when you consider Australia's love of this asset class?

However, just how far does the love go?

According to the latest research from Rice Warner, quite far. It seems, as our wealth grows, so too does the proportion of property we hold within our investment portfolios.

As at 30 June 2014, the Australian superannuation market was worth \$1,839 billion.

A big number by all accounts; however, considerably below the \$2,490 billion of total assets held in the private investment market (i.e. assets outside superannuation excluding the family home).

Rice Warner estimates that almost half (48%) of this private investment market (\$1,188 billion) was represented by directly held property net of debt. To put this into perspective, the value of directly held property investments (outside superannuation) is equivalent to approximately 65% of the total pool of Australia's superannuation assets.

Directly held property investments outside superannuation are equivalent to about 65% of the total pool of Australia's superannuation assets.

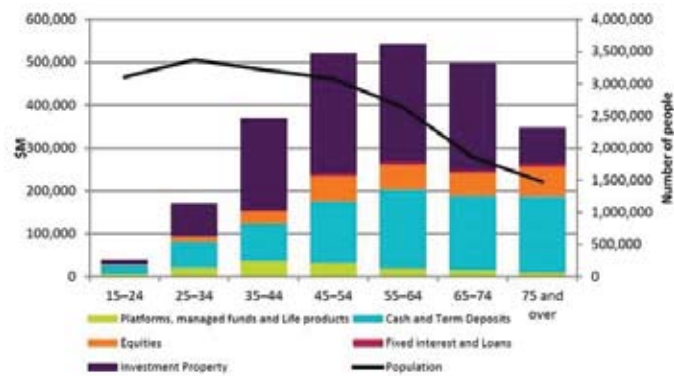
As Rice Warner points out, in strategic terms Australia's wealth management and superannuation sectors are a significant and vital part of the broader economy. Yet, in real terms, the dollar value of superannuation assets is in fact challenged markedly by the importance of property when it comes to the wealth of Australians.

So who holds this private wealth?

Figure 1 shows the distribution of private non-housing wealth by age. The solid line shows the population in each of these groups. The total volume of private assets is greatest for those aged 55 to 65. However, on a per capita basis, the wealthiest group is those aged 65 to 74. Not surprisingly, the total value of assets diminishes for those above the age of 75, due to a declining population and their need to draw on existing assets in the later years of retirement.

Once Australians move into their retirement phase, their asset allocation changes. The importance of owning direct property diminishes, and while exposure to cash and term deposits remains high, equities become increasingly popular. Put simply, retirees increasingly transfer out of illiquid assets and move into more liquid assets (Australian large cap stocks with high franking credits, such as the banks and Telstra, are high on the list), as they seek to finance their retirement.

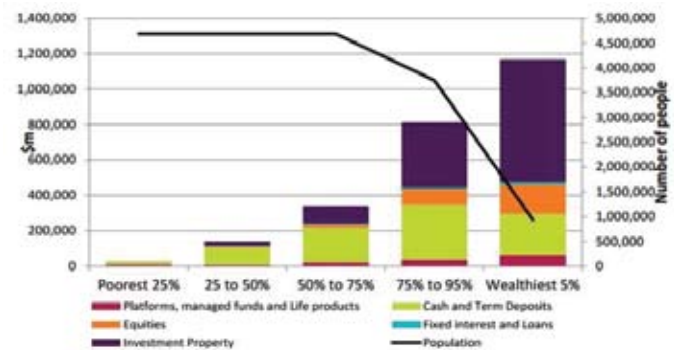
Figure 1: Total investment and asset allocations by age cohort



Source: Rice Warner

Chart 2 shows the distribution of private wealth by wealth groups. Not surprisingly, the wealthiest groups hold the majority of private wealth. The proportion representing property also rises with one's wealth. Rice Warner concludes that this concentration of wealth in property will be exacerbated if property within the SMSF segment continues to grow.

Figure 2: Total investment and asset allocations by wealth groupss



Source: Rice Warner

The latest figures from the ATO show that self-managed super funds (SMSFs) invested \$21.8 billion in residential property in March 2015 – a 100% increase over seven years (Chart 3).

Chart 3: Residential SMSF assets: June 2008 – March 2015



Source: ATO

BRICKS & MORTAR

underpin Australia's concentrated private wealth continued...

However, it is worth pointing out that despite this massive growth, it is off a low base, and the actual allocation to residential property has hovered between 3.3% and 3.9% over the past seven years. At March 2015, the allocation stood at 3.8% – hardly a massive overinvestment in residential property. Some SMSFs, though, have invested far more than the average in residential property and are clearly not abiding by the mantra of diversification, diversification, diversification.

Adrian Harrington - Head of Funds Management, Folkstone



BOOK REVIEW

“Retire Well, Retire Happy - Practical tools and tips that every retiree should know”

Author	Ann Nelson
ISBN	978-1-922118-39-7
Publisher	Global Publishing Group
Publication date	2014
Publication place	Victoria, Australia
RRP	\$25.00
Reviewed by	Malcom Andrews

This memoir details how the author navigated through the retirement maze after losing her husband at age 60. During some health issues soon after, she reflected on her loss and the need to become self-reliant and plan for her future.

Set on the Gold Coast, Queensland, the book reveals the strategies and advice that worked for the author when she was learning how to manage the money she had available to support her in retirement.

The book is divided into three sections.

1. In the beginning it is all about the money

The book begins with five key financial questions:

1. How will you cope after the regular pay cheques stop?
2. Do you have a financial plan?
3. Do you have a savings plan?
4. What is a safe withdrawal rate?
5. What effect does inflation have on your money?

Nelson had little idea of the importance of these questions, let alone any answers, at the beginning of her journey. She explains how these answers are important in building a happy retirement with a sound financial foundation.

The average person needs a team of people to help them manage their affairs in retirement. The author describes the team of 14 people and organisations she has used, including banks, brokers, insurance companies and government agencies.

This book reveals the strategies and advice that worked for the author in learning how to manage the money to support her in retirement.

Unusually for a retiree's reference book, Nelson describes ways to supplement your income online. In particular she looks at selling items on eBay and using 'covered calls and trading options' to enhance share income. While she gives a brief description, I

suspect that not many retirees would choose this option.

A relatively lengthy chapter gets back into more usual territory for a book of this nature, with hints and tips from experts in their field. Covering a range of investments including shares, property and fixed income, this chapter is a useful introduction to investing for someone who has not had a hands-on approach to their superannuation, perhaps relying on an employer-selected fund before retirement.

2. Retirement brings fresh lifestyle choices

In 'The empty nest', Nelson describes the possibilities after the children have left home – what to do with your life, what to do with your house and where else in the world you might like to live. This is a short chapter with little detail.

Other short chapters give brief descriptions of the over-50s lifestyle village scenario, an introduction to volunteer work and a short interview with the Chairperson of Lionesses Australia.

As travel is arguably the most popular activity in retirement, Chapter 8 gives some examples of travel organisations that cater particularly for older people.

3. Looking after our personal state

This section begins by giving some background on what attitude we need to remain happy in retirement. That is, how to value the things that count rather than comparing ourselves to advertisements or other misleading information.

The following chapter gives information on health and wellbeing, again with reference to the author's personal contacts; as such they are more targeted to her situation than a general approach.

Lastly, major events will happen to us all in later years. These include ageing parents, inheritance and estate planning (especially to minimise tax).

In a nutshell

Overall, I found reading the book was like a chat over some scones and a cup of tea – the advice is heartfelt and genuine and is centred on the particular story of the author. Many contact names and organisations are included, specific to the South East Queensland region.

MICROCAPS

MARCUS PADLEY

I attended the annual Australian Microcap Investment Conference in Melbourne last week, which included 25 companies speaking over two days. The average market capitalisation was \$80 million, although if you took out the five companies with a market capitalisation of more than \$100 million, that would leave 20 companies with an average market cap of \$40 million.



The microcap space unofficially encompasses stocks with a market capitalisation of less than around \$300 million. This encompasses 1816 companies, or 83 per cent of all listed stocks, although notably these stocks account for just 3.04 per cent of the total stock market's capitalisation.

The conference is in its sixth year and while it is targeted more at brokers, fund manager analysts and professional investors, there is hardly an engaged equity investor out there that wouldn't benefit from the experience. Ten years ago smaller company investment was still in its infancy and the microcap space didn't even have a name, but it is now much more widely recognised although still not universally understood.

There are all sorts of arguments for microcaps but the most compelling is that they represent tremendous opportunity that you simply don't get in the plain vanilla stockmarket. The Australian market is essentially very narrow, with 50 per cent of self-managed super money that is invested in equities invested in just 10 stocks. That may seem out of balance but it's simply an index reality that in a small country like ours, small by population, the top 10 stocks account for 41.3 per cent of the stockmarket by value, the top 20 stocks account for 55.32 per cent, the top 50 stocks account for 72.1 per cent and the top 100 stocks account for 84.5 per cent of total market value.

Because of that, any institution or individual that benchmarks itself to the All Ordinaries index or the ASX 200 index and is concerned about their performance relative to their competition really only needs to bother about getting the top 100 or 200 stocks right. Microcaps take a lot more effort (read time and expense) to research properly as a fund manager, so you won't find that many managers in the space because, generally speaking, only the big fund managers can afford to resource a microcap effort. Being a niche product the interest is less and the professionally run funds tend to be small so the fees are smaller. The end result is that for all the extra effort and perceived risk, a microcap fund manager, who is arguably much better at research and stock picking, is more skilled but works harder for less money.

Another reason the sector is overlooked is the Australian compliance regime, which requires anyone giving advice on stocks to have a reasonable basis for every recommendation.

At any one point in time most brokers could give you 10 reasons to buy or sell the CBA or BHP, but when you start straying outside of those well-known stocks as an advisor you run a much higher risk of getting it badly wrong, having clients complain about you and attracting the attention of the authorities. So it is far easier and more commercial to advise on and deal in the big stocks and leave this end of the market to people who don't have to answer to ASIC.

So while most of the industry spends their time, especially on the buy side, focused on the big end of the market, where the most money is invested and the bulk of the commission and fees are generated, there is a small end of the market that is largely ignored and under researched and offering much more opportunity.

I have always said that if you do one hour's work on a company you end up in the top 1 per cent of people who know anything about it and if you do 10 hours' work you end up in the top 0.1 per cent. In the microcap space, if you spend one hour researching a company you end up in the top 0.000001 per cent of people who know anything about it. That's a huge advantage. I also ask you who you would put your money with. The chief executive of one of the big four banks who is chauffeured to work and has never actually bought a share in his life beyond his company options or the CEO of AMA group who owns 19.6 per cent of the company, is consolidating the crash repair business in Australia and simply loves what he is doing.

The 25 companies that presented at the Australian Microcap Investment Conference this week have averaged a 61 per cent return before dividends in the past year. The ASX 200 is down 2.6 per cent over the same period. Three of the stocks are up more than 100 per cent in a year and one of them is up more than 1000 per cent in a year. Over the past five years, one of the microcap companies presenting is up 8898 per cent and another is up 2226 per cent. Or you can buy Telstra. Your call.

Marcus Padley - Founder, Marcus Today



Tribute to Bob Hartley

Robert (Bob) Hartley, together with his wife Ruth, died in a tragic car accident outside Warwick, Queensland on Saturday, 31 October 2015 whilst returning from a bush walking holiday in northern NSW. They are survived by their two daughters and their families, one of whom resides in Perth and the other in Zurich.

Bob held qualifications in metallurgical engineering and project management. During his professional working life he worked on major resource projects for companies which included Iluka Resources Ltd, Comalco Ltd, New Zealand Aluminium Smelters and Tomago Aluminium Smelters in locations which included Capel (WA), Brisbane (Qld), Invercargill (New Zealand) and Newcastle (NSW). In later years, he also had his own project management consulting business, Bob Hartley & Associates Pty. Ltd.

He joined the AIA in 2003 and actively participated in the Brisbane Investment Management Group under the capable leadership of AIA Life Member, Scott McKenzie, who passed away in 2012 after a long illness. Bob took over the leadership of the group in 2010 as coordinator and continued in this role up until his death. He was greatly respected and appreciated for his "inclusive" leadership style and his passion to assist with the education of self-directed investors navigating through the investment jungle.

He made a major contribution to the Australian Investors Association (AIA), serving in various capacities over the period of his membership including AIA board member (2012 /13), national conference organizing committee (2014), Queensland management committee as well as co-hosting and speaking at investor seminars and workshops.

One of Bob's greatest achievements for the AIA membership was the production for 9 years of the Best Performed Managed Investment Report which provides members with comprehensive information to benchmark the performance of their portfolios. This year, Bob commenced trialing with a small group of interested members in the Brisbane group, the first modules of his "Living Well in Retirement" investor education package.

Bob was a structured thinker who always provided a balanced perspective and his involvement in any activity always ensured a better outcome. His intellectual and leadership contributions to the Association will be sadly missed.

Prepared by Mike Tidbold
Mb 0412 270 058

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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.

DATE	DAY	TIME	TOPIC	VENUE
NSW / ACT				
09-Dec-15	Wednesday	7.30pm	Christmas special, Q&A, etc.	The Chatswood Club, 11 Help Street, Chatswood
14-Dec-15	Monday	7.30pm		Ginninderra Labor Club
03-Feb-16	Wednesday	7.00pm		B Davis & Associates, Suite 17, 35 Old Northern Rd, Baulkham Hills
08-Feb-16	Monday	7.30pm		Ginninderra Labor Club
10-Feb-16	Wednesday	7.30pm		The Chatswood Club, 11 Help Street, Chatswood
04-Mar-16	Friday	9.00am	Are Australian Banks Competitive? Investing on a Global World – Nathan Bell (Peters MacGregor)	SMC Conference and Function Centre, 66 Goulburn St Sydney
09-Mar-16	Wednesday	7.30pm	Riding the stock market roller coaster	The Chatswood Club, 11 Help Street, Chatswood
14-Mar-16	Monday	7.30pm	Bullet-proof your investment strategy for your SMSF- Peter Hogan (NAB)	Ginninderra Labor Club
VIC				
01-Dec-15	Tuesday	6.30pm	Nathan Bell and Ashley O'Connor	Telstra Conference Centre, Room 1, Level 1, 242 Exhibition St, Melbourne
02-Dec-15	Wednesday	7.15pm		Naturalist Club of Victoria, 1 Gardenia Street, Blackburn VIC
02-Dec-15	Wednesday	1.00pm		Private address, please contact Bill Shirley, E: wshirley@hotmail.net.au
28-Jan-16	Thursday	9.30am		Private address, please contact Kevin Macdonald for details E: km.macdonald@bigpond.com
03-Feb-16	Wednesday	7.15pm		Naturalist Club of Victoria, 1 Gardenia Street, Blackburn VIC
09-Feb-16	Tuesday	6.30pm		Telstra Conference Centre, Room 1, Level 1, 242 Exhibition St, Melbourne
QLD				
02-Dec-15	Wednesday	1.00pm	Christmas Special, Everyone Welcome	Broncos Leagues Club, Fulcher Rd, Red Hill QLD
20-Jan-16	Wednesday	6.30pm		The Old Post Office, Buderim QLD
03-Feb-16	Wednesday	1.00pm	Economic Outlook, Chris Caton	Wesley House, 140 Ann Street, Brisbane QLD
15-Feb-16	Monday	7.00pm		Chermside Library, Hamilton Road, Chermside
15-Feb-16	Monday	9.30am	Economic Outlook, Chris Caton	Helensvale Community Centre, 31 Discovery Drive, Helensvale QLD
16-Feb-16	Tuesday	7.00pm		Carindale Library in Carindale Shopping Centre
17-Feb-16	Wednesday	6.30pm		Carindale Library in Carindale Shopping Centre
17-Feb-16	Wednesday	6.30pm		The Old Post Office, Buderim QLD
02-Mar-16	Wednesday	1.30pm		BT 260 Queen St Brisbane
15-Mar-16	Tuesday	7.00pm		Carindale Library in Carindale Shopping Centre
16-Mar-16	Wednesday	6.30pm		Carindale Library in Carindale Shopping Centre
16-Mar-16	Wednesday	6.30pm		The Old Post Office, Buderim QLD
21-Mar-16	Monday	7.00pm		Chermside Library, Hamilton Road, Chermside
SA				
09-Feb-16	Tuesday	7.00pm	The Outlook for the Australian Stockmarket 2016, Tony Catt	German Club, 223 Flinders St, Adelaide, (SENATOREM Room)
08-Mar-16	Tuesday	7.00pm	David White	German Club, 223 Flinders St, Adelaide, (SENATOREM Room)
WA				
01-Dec-15	Tuesday	6.00pm	Christmas Special and Economic Update by John Abernethy	Wembley Downs Tennis Club, Cnr Morden & Ednah Street, Wembley Downs
02-Feb-16	Tuesday	7.30pm		Wembley Downs Tennis Club, Cnr Morden & Ednah Street, Wembley Downs
16-Feb-16	Tuesday	7.30pm		Wembley Downs Tennis Club, Cnr Morden & Ednah Street, Wembley Downs
01-Mar-16	Tuesday	7.30pm		Wembley Downs Tennis Club, Cnr Morden & Ednah Street, Wembley Downs
15-Mar-16	Tuesday	7.30pm		Wembley Downs Tennis Club, Cnr Morden & Ednah Street, Wembley Downs

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We have analysed the feedback from the 2015 conference and are tailoring the 2016 conference to suit the different audiences we are now attracting. There will be sessions for those new to the investing world, those who are highly knowledgeable and everyone in between. The streams that we will put focus on in 2016 are:

- **Risk Off** – all defensive assets like cash, bonds, hybrids, fixed interest
- **Risk On** – all growth assets like shares, property and international
- **Alternatives** – all non-core assets like infrastructure, hedge funds, collectables, ETF's and LICs.
- **Super** – all topics related to Super, SMSF and Pensions
- **Strategies** – wealth creation, wealth preservation, insurance, longevity, estate planning, aged care and Gen Y/X investors

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