

the **INVESTORS**voice

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

March 2017



ARE SMALL & MID-CAP STOCKS GOOD VALUE?



AUSTRALIAN
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TRANSITION

A WORLD IN TRANSITION – POLITICS, ECONOMICS AND INTEREST RATES
POSITIONING PORTFOLIOS FOR A NEW INVESTMENT ENVIRONMENT



EARLY BOOKING REWARD

1. Only early booking delegates are eligible to attend the Monday night Trading versus Investing debate between Alan Hull and David Chia. People booking later cannot attend.
2. Early booking delegates go into the draw to win 3 nights accommodation at the Marriott during the conference
3. Early booking rewards also go into the draw to be seated at a table with a high profile presenter

There are two ways of booking:

1. Pay a \$100 deposit by 31st May and the balance by 7th July or
2. Pay the full amount before the 31st May.

AIA ANNUAL NATIONAL CONFERENCE 2017
30 JULY - 2 AUGUST 2017
SURFERS PARADISE MARRIOTT RESORT & SPA

SPEAKERS INCLUDE:

- Hon Wayne Swan MP
- Charlie Aitken
- Marcus Padley
- Roger Montgomery
- Mark Bayley
- Ben McVicar
- Brian Herd
- Louise Biti
- Colin Nicholson
- Rob Shand

STREAMS INCLUDE:

- Income
- Growth
- Alternatives
- Superannuation & Retirement
- Strategies



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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.

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President's Message - March, 2017

By Graeme Bottrill



Presidents' Message – Mar 2017

The challenge for us investors is to come to an understanding of where the world is heading, and then decide how that will affect the investing environment. There you are – one simple sentence. So just go and do it! If only it were that simple.

In terms of interest rates, I note that the National Australia Bank is sticking to its prediction of two RBA rate cuts this year, in the expectation that GDP growth will slow in 2018, as housing construction slows, etc. They say that without further stimulus, this slow growth outlook should likely see the unemployment rate begin to rise. One wonders how any further rate cuts will have any effect. A rate of 1.5% may as well be zero.

Other commentators have the view that 2017 will see no rate movement and potentially an increase in 2018.

The latest statement from RBA Governor Lowe seems to suggest that the RBA would love to have another rate cut, but dares not risk the effect on the housing market, particularly in the major capitals.

Transition and disruption seem to be gathering pace. We have known for some time, of course, that manufacturers of fax machines had a limited future. Our local video shop closed last week, and I took my first Uber ride, and yes I know that I am behind the times!

We now have the biggest taxi company on the planet with no cars, the biggest retailer (Alibaba) with no shops, the biggest accommodation provider (Airbnb) with no property, Bitcoin making inroads into payment systems, and so on.

So what does all of this mean for equities? It is said that equity prices are a function of future earnings, and the valuation multiple (PE) that the market is prepared to pay for these earnings, and that the performance of equities is therefore a function of how these two things change over a period of time.

Whilst this is true of course, it is certainly not the only factor. 'Hope and fear' plays an equal part. In fact historically it may appear that hope and fear play the major role. The Gulf wars, '9/11' and the like, seem to have been the major impactors. I sense that many investors are becoming concerned that there could be a correction and this together with the situation in world politics generally and the South China Sea in particular, may be all that is required to tip the scales to the 'fear' side. Space does not allow me to say much about the French election in April, or the austerity measures in Europe but these are factors also.

So where is all of this leading us as investors? Interest rates lower for longer (still), and equity prices dependent on earnings. Therefore our challenge is to identify stocks with stable and increasing earnings (and not about to be impacted by disruptors). Investing 101 really. There are companies out there that meet these criteria, and if we are diligent we will find them. Note that in our conference program this year, we have a number of speakers who we have challenged with a 'stock-tipping' contest. A number of different speakers will each address this topic in their own way, and give us tradeable stock tips.

Benjamin Graham says (in The Intelligent Investor) that our rate of return is dependent on the amount of intelligent effort that we are willing and able to bring to bear on our task. So if we study and apply ourselves, we should have an expectation of success.

The 2017 Annual Conference – 'TRANSITION'

A world in transition, politics, economics and interest rates - positioning portfolios for a new investment environment

A brochure is included with this issue of Investors Voice and I encourage members to earnestly consider attending. The conference content has been planned with relevant and topical sessions which will be hugely useful to all of us in our investment journey. We will send out regular emails which will each highlight an aspect of the conference, a particular session or a speaker.

I wish you all productive investing!

ARE SMALL & MID-CAP STOCKS GOOD VALUE?

ROGER MONTGOMERY

Are small and mid-cap stocks good value?

Let me start by making something clear. The best returns will not come from the large-cap blue chips that so many baby boomers are invested in. Nor will satisfactory returns come from leveraged, over-supplied property apartments.

They will come from the stocks that have been beaten up the most in recent months. The reason I suggest the most beaten-up stocks will provide the best returns is because those stocks are the very same that we regard as some of the highest quality and those with the best long-term growth prospects.

Let's start with the large-cap blue chips.

Have you ever wondered why Telstra's share price today is lower than it was 17 years ago? Are you surprised that the National Australia Bank's share price is the same as in 1999? Are you surprised that BHP Billiton's share price is no higher than it was in January 2007 – 10 years ago? These are the so-called blue chips. How can this be?

Business economics explains the reason.

Take Telstra as an example. Since 2005, the company has been paying most of its earnings out as a dividend, retaining very little for growth. Unsurprisingly, earnings have not grown.

When we look at the data for Telstra over the past 10 years or more, it has delivered nearly flat earnings per share (EPS), averaging around 30 cents per share. FY14 was a bit better than average, with EPS hitting 37 cents, but this is only slightly more than the result achieved in 2004. On a 13-year view, Telstra's EPS growth has effectively been nil.

A hundred thousand dollars invested in Telstra in 2005 has grown to just \$105,000 at the time of writing (mid-December) and the \$5,970 of dividend income in 2005 has grown to just \$6,500. Neither has kept up with inflation, meaning your purchasing power has been reduced by this supposedly "safe" blue chip.

A company that pays most of its earnings out as a dividend might show an attractive dividend yield today, but unless the dividend income grows, owners of this asset are setting themselves up for reduced purchasing power and therefore a decline in their quality of life.

“Investing in the future will look very little like the recent past”

For the large-cap blue chips, this is an important point. It means that unless the future looks very different from the past, high-dividend-paying companies are unlikely to deliver material growth in intrinsic (true) company value.

And as the Reserve Bank of Australia reported a year ago, the most expensive stocks listed on the ASX have been those paying most of their earnings (greater than 85%) out as a dividend. The most expensive group of stocks has been those offering the lowest growth.

Those two conditions cannot co-exist for very long. Eventually, either growth needs to return (but it cannot if dividend payout ratios remain high), or prices need to decline. And if interest rates on bonds keep rising, the decline in prices for low- or no-growth companies could be harsh.

As Ben Graham once observed, "in the short run the market is a voting machine, but in the long run it is a weighing machine". In other words, the share price in the short run is just a popularity contest. In the long run, however, prices will follow the performance of the underlying business. If the underlying business performs with mediocrity, over the long run so will the share price.

What about property?

The next asset class I believe will offer mediocre returns, if not capital losses, is property, particularly apartments.

Australia's east-coast capitals are facing a tidal wave of apartment supply, and developers will not be able to sell all their inventory at current prices. Indeed, they are already trying to offer carrots to lure potential buyers. These carrots, such as millions of frequent-flyer points, holidays to Asia, or ten-year rental guarantees, are forms of discounts designed to try to preserve the ticket price.

As the supply of apartments increases, however, the discounting will become more aggressive, simply because the developers owe their lenders money and need to pay back the loans – many of which have also capitalised interest. This is also something to think about when owning bank shares.

Investors who borrowed to buy an investment apartment are at particular risk. Look at Brisbane, where in the first nine months of 2016 just 5,200 apartments were completed in the inner 5-kilometre ring from the CBD.

Investors who bought outside that inner ring – five to 15 kilometres from the CBD – have seen aggregate vacancy rates climb from 2.3% to 4.7%. And that number can only keep rising when another 13,000 apartments are completed in the next 18 months. A unit without a tenant has a yield of zero per cent, and a unit earning zero, with a mortgage attached, could put its owner in financial stress.

With record levels of mortgage and credit-card debt in Australia, we expect there will be some financial stress ahead. Want to buy some bank shares?

Are Small & Mid-Cap Stocks Good Value? *continued...*

Finding better opportunities

Finally, we turn to a group of listed companies that appears to provide the best opportunity for positive returns over the next year or two. But first a little background.

Over the last year or two, a lack of expected growth from the banks and resource companies meant large institutional fund managers migrated down the market-capitalisation spectrum, looking to boost their returns. High-quality, mid- and small-capitalised company shares with bright prospects and economics benefited.

More recently, however, the perception of prospects for the banks and resource companies improved, and those institutions found themselves underweight these sectors. Needing to "catch up", they were forced to sell down their holdings in smaller, high-quality growth companies to fund their purchases of the banks, BHP, RIO et al.

The result has been a bloodbath in the share prices of smaller high-quality, high-growth companies. ISentia has declined more than 30% in the last month, as have APN Outdoor and Vita Group. Healthscope has fallen 32% from a high of \$3.14 to a low of \$2.15, REA Group and Carsales are down 27% and 28% respectively from their highs.

Many investors ask me how high-quality companies could ever be cheap if everyone knows they are high quality. Well, occasionally, scenarios such as the one just described occur, and the market treats that which is temporary as permanent. And value emerges.

Our inability to identify good value earlier in 2016 meant Montgomery Funds had built cash levels, placing them in the enviable position of being able to take advantage of lower prices, and in some cases, the first opportunity to acquire value in a long time.

Perhaps most interestingly, the companies that score the highest on our quality matrix have been the very worst performers. This can be seen in the illustration of returns for quality deciles of the S&P/ASX300.

Being somewhat obsessed with quality, we maintain a database covering the entire ASX300, scoring every business in terms of its pricing power, barriers to entry, industry structure, switching costs, and many other factors. This allows us to calculate an aggregate quality score for every business we may be interested in and, using that, we can sort the market in order from best to worst.

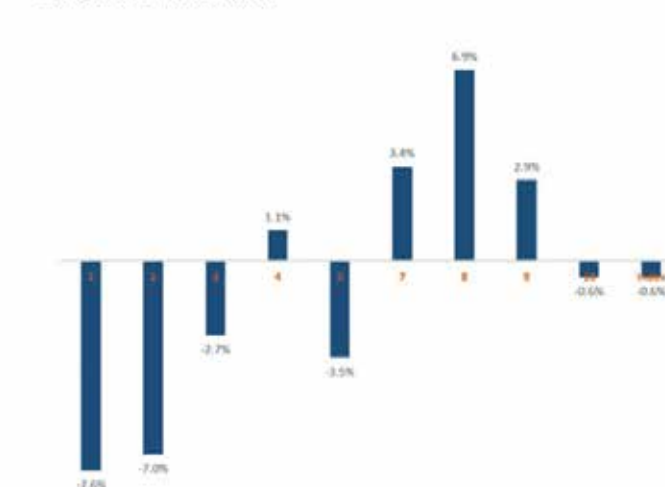
Our objective is to rank businesses by the sustainability of their propensity to create shareholder value by investing incremental capital at rates of return above the cost of capital. The underlying rationale for this is reasonably self-evident. Over long periods, a business that has the ability to create genuine value for its shareholders should be able to generate good investment returns by the accumulation of that value.

Importantly, however, this is a long-term dynamic. Value creation only reveals itself over a number of years, and as the business

reports growing shareholder equity while sustaining a high return on that growing equity.

Over shorter periods, the share prices for good businesses can decline, and the prices for inferior businesses can surge, and we believe we are currently witnessing just such a period.

Average Return by Quality Grouping 1 August to 22 November



Source: Montgomery

As shown in the above chart, the businesses with our very highest-quality scores (at the left of the chart) have delivered the worst returns since August 1, 2016. Meanwhile, the strongest returns have been found towards the low end of the quality scale (the right-hand side of the chart). The index at far right returned minus 0.6%.

Once again, this combination of circumstances does not coexist forever. In the long run, quality (the sustained ability to generate high rates of return on incremental equity) always wins.

Conclusion

Investing in the future will look very little like the recent past. Because we are so inadequately armed to pick turning points, most investors will continue to believe property and conventional blue-chip shares will be where the best returns will continue to be generated.

Our own view is founded on the basic investing tenet that the lower the price you pay, the higher your return. Combine this investing truism with quality, and the recent sell off in high-quality mid-cap company shares starts to look very attractive. Rather than appearing like a risky place to invest, a market that has just suffered a bout of volatility starts to look like the safest place to be.

An observation, famously ascribed to Jesus of Nazareth, notes: "...many who are first will be last, and many who are last will be first." This may just be true for investors in 2017 and beyond.

Roger Montgomery – Founder & CIO Montgomery Investment Management and Author



ME AND MY PORTFOLIO

Me and My Portfolio *continued...*



MIKE HOWSON

We are always looking for articles from members to publish. If you would like to submit an article for inclusion, please email Donna - dmeadows@investors.asn.au

Questions:
Are you in a wealth accumulation phase or an income producing one?

Pension income phase.

What are your investment objectives?

- 1 - A 3.8 % return (before franking) with enough growth to cover inflation.
- 2 - To always keep risk measured and survivable.
- 3 - To set up a portfolio that is easy to run as I get older.

What percentages of your investment assets are in the superannuation environment and what percentage are outside?

100% inside super

What is your current asset allocation? (Cash/AFI/property/Australian shares/international)
Shares: 30 % (4 banks)

Cash: 70 % (term deposits)

What's the reasoning behind these numbers?

I am trying to keep as much money out of the stock market as possible until interest rates make sense and the current asset bloat has settled down.

This 30:70 ratio gives me my magic 3.8 % pa. return.

Why have I chosen 3.8%?

1. After franking, the return equals the 5 % I need to withdraw as a pension each year.
 2. It meets my income needs.
 3. This figure is the average annual dividend payout for the ASX 200 over the last 30 years.
 4. The Future Fund regards over 5% return as being associated with an unacceptable risk profile for its investments. They are smart guys so I believe them. I don't think they get franking credits which allows me a 1.2 % buffer.
- 3.8 % seems to be an achievable low risk goal.

Has this allocation changed much over the years? What drove those changes?

My portfolio has had 3 incarnations so far.

The first was after I sold my business premises, which was in super, and began share investing in 2012. In the right place at the right time, shares were cheap and the AU\$ was over US\$1.00, so I chose 3 broad market index based index ETFs.

30% Australian, 30% USA, and 30 % rest of world.

The second was when I became uncomfortable with the high PE ratios due to increased share prices. I decided to give my money a break from the share market. With the AU\$ still at US\$0.95c, American dollars seem a reasonable place to park my cash.

The third transition occurred earlier this year when the AU\$ had fallen to a more traditional level. Luckily Australia has share dividend franking and its companies have a focus on dividends, so I invested 30% of my portfolio in the main banks (once they dropped to reasonable valuations) and 70 % into term deposits. This is my current position. Let's talk now about specific assets and investments, starting with Australian shares (including managed funds). Describe your shareholdings please.

30% shares (banks) and 70% term deposits is not as quite as outrageous as it looks. Firstly, most mainstream LICs, ETFs and superannuation funds have 25 -30 % of their portfolio invested in banks, so I have respected company.

Second is my take on Australian banks. Yes, I know there are headwinds, they need to be stronger, and they are in a cyclical sector.

Australian banks are, however, extraordinary beasts with incredibly high and stable dividends. They are a protected species in a very benign environment with a strict nanny (APRA) to protect them from themselves. The competition between banks is, shall we say, quite gentlemanly and unusually moderate. The only risk is if a CEO has a bright idea and decides to act on it. Stop that, and keep sharp knives away from the NAB board (they seem the most accident prone) and I reckon you have as close to perfect dividend investments as you are likely to get. When I add their dividends to the 2.5% from the term deposits, I end up with my 3.8% pa. return (5% after franking). Forgoing the extra 1.5% income achieved by whole market ETFs/LICs at present is a price I am willing to pay to keep 70% of my capital out of harm's way.

What about international investments?

Currently I feel overseas assets are more overpriced than Australian ones. All but the last two USA market crashes began when PE ratios were lower than today's levels. I am keeping my distance.

What about property?

I have done well out of property in the past. I looked again at property recently when looking for safe investment havens. Current prices and rental returns do not seem to seem to make sense as an investment. At worst a 5-10% price correction could be on the cards.

What about cash and fixed interest?

Well, what can I say? My least favorite investment, and I'm in up to my arm pits in short term deposits.

I regard long to midterm bonds with really low returns, as disasters waiting to happen. I know bank hybrids are safe, but they seem to be riddled with get out of jail clauses. I also worry that there may be even more unrecognized hand grenades hidden in the legalese.

Any other investments?

Michelle, children, grandchildren, good books, wine and food. I have stopped regarding our farm as an investment and see it now more as an enjoyable money pit.

Let's look to the future. Does your asset allocation and/or specific investment portfolio reflect anything regarding your belief about market directions in the future? Please explain.
My portfolio is based on my belief that current financial markets are crazy.

I have decided to have no expectations on where the market is going and how long it will take to get there. I have tried to design my portfolio to allow me endure the long waiting game while meeting my financial and risk goals in the meantime.

I have become rather taken with Peter Thornhill's approach to investing: boring industrial shares with sustainable, slowly increasing, and consistent dividends. Peter dislikes miners, as they introduce higher volatility into dividend earnings, and Listed Property trusts as depreciating assets offering poor long term growth prospects.

If the miners are still down and listed property trusts get pummeled, 2-3 broad market indexed ETFs or focused LICs may appeal as simpler alternatives.

The reason for this fourth incarnation: although my big brave moves have worked well in the past, the odds are that (sooner or later) one will misfire.

Do you use computer software to manage your portfolio? What software and how well does it work?

No, as it is not justified with current portfolio structure. What is the best investment advice you ever received?
From Janene at the Educated Investor bookshop: to buy a textbook "Investments" by Bodie, Kane and Marcus. It has become my bible, even though I ignore most chapters full of equations, and some of the investment advisor sections. Do you have an investment hero, and if so, who is it?
John Bogle for creating Vanguard and allowing every novice retail investor to match market benchmark performance with miniscule fees.
Hero, genius or saint. I am not sure which.

What has been your best investment decision so far?
Deciding to learn how to manage my own retirement portfolio. Just try the above strategy with 2-3% fund manager and investor advisor fees and you will see what I mean.

What has been your worst?

Buying shares on tips and newspaper headlines in the nineteen nineties with very little understanding of what investing was about.

And why was it made?

Equal doses of ignorance, peer group pressure, testosterone and hubris.
What do you know now that you wish you had known 5 years ago?

How much time it would take to get relatively competent at investing. I would have started earlier.

Do you have any other comments you would like to make?
I hesitated at first to write this article as I feel my investment approach has been quite idiosyncratic. Although it suited the times, my personality, and financial circumstances, I certainly would not recommend it to anyone else.

If my past 5 years is any guide, there is a very strong chance that I am just good at being lucky.

Having read back over my musings I apologize for sounding opinionated. Unfortunately it's just something else I am really good at.

Mike Howson, AIA member

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ALTERNATIVE TO SUPERANNUATION OVERCOMES ACCESS & INVESTMENT LIMITS

Alternative to Superannuation *continued...*

SUPERANNUATION



NEIL ROGAN

On 23 November 2016, the Government's superannuation reforms announced in the 2016/2017 Budget finally passed the Parliament. According to Treasury, the changes were designed to 'improve the fairness, sustainability, flexibility and integrity of the superannuation system.' The Government also intends to enshrine the objective of superannuation in legislation, 'to provide income in retirement to substitute or supplement the Age Pension'.

How the new rules will lead to less in superannuation

Without debating the merits of the changes, the new regulations target wealthier Australians who used the upper limits of the contribution caps to place large amounts in the tax-advantaged system. The argument is that well-off Australians are using generous tax breaks in superannuation to accumulate more wealth than they need for retirement, often with a view to transferring it to the next generation.

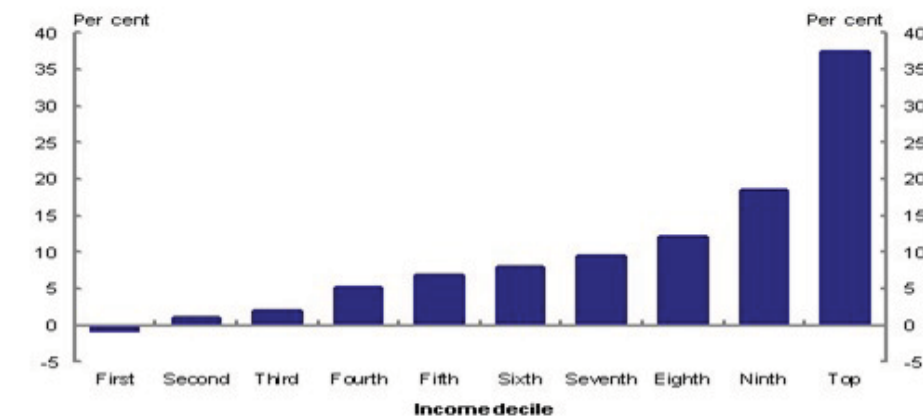
The major changes that will reduce superannuation balances, with implementation from 1 July 2017, are:

- The \$1.6 million cap on the amount of superannuation which can be transferred into a tax-free retirement account (previously no limit);
- The annual concessional (before tax) contribution limits of \$25,000 (previously up to \$35,000);
- The annual non-concessional contribution cap of \$100,000 (previously \$180,000);
- The threshold at which an extra 15% tax (total of 30%) is paid on concessional contributions is \$250,000 or more of 'income for surcharge purposes' (previously \$300,000).

Potential for further changes to superannuation

The Labor Party has other versions of how superannuation and contributions should be legislated, called its 'Fairer Super Plan'. Criticism from politicians and social equity groups such as ACOSS on the ongoing generosity of superannuation will continue. The most commonly-used table from the Murray Report is shown below, indicating about 38% of the tax advantages of super go to the top 10% of income earners. This will change under the new rules, but not significantly for a long time.

Share of total superannuation tax concessions by decile



Source: Financial System Inquiry, Final Report, page 138

Investors seeking certainty and flexibility in a tax-effective environment will increasingly consider alternatives outside of superannuation. There are various options which may assist in minimising or deferring tax, including creating a private company to hold investments, or forming a family trust. For high income earners one of the more tax-effective, flexible and cost-effective options may be an investment bond.

Tax and flexibility of an investment bond

Investment bonds are technically life-insurance policies with a nominated life insured, and a beneficiary. In investment terms, they operate like a tax-paid managed fund. Investors choose from a range of investment options, depending on their goals. These range from higher risk growth portfolios, which typically include more equities, to lower risk defensive portfolios, which usually invest in cash and fixed interest.

An investment bond is tax-paid, because the earnings from the underlying investment portfolio are taxed at the company rate of 30% within the bond structure. Investors do not receive distributions as they are re-invested, and therefore do not need to declare the earnings from the bond in their personal tax return. In the case of investment portfolios which contain equities, the tax rate may be further reduced by franking credits.

If an individual's personal taxable income is at least \$37,001 p.a., the tax paid on any additional personal income will be greater than that paid on an investment bond. At this threshold, the marginal tax rate increases from 21% to 34.5%; higher than the 30% on investment bonds.

There is no limit to the amount which can be placed in an investment bond in the first year, and additional contributions can be made each year, at up to 125% of the previous year's contribution.

Funds can be withdrawn at any time. However, if funds are left in the investment bond structure for 10 years, the entire proceeds of the bond (original investment, additional contributions and earnings) are tax paid. The investor does not need to include them in their tax return, and they can be distributed as a lump sum, or as a tax-paid income over time. Furthermore, because an investment bond is in fact an insurance policy, with a life insured (this can be the same person as the bond owner), on the death of the life insured, the beneficiary of the bond will receive all proceeds of the bond tax free, regardless of how long the bond has been held.

The proceeds fall outside of the bond owner's estate, and pass directly to the beneficiary.

This makes investment bonds ideal estate planning tools, or an effective way to transfer wealth from one generation to another. Superannuation remains the most tax-effective long-term investment structure for most Australians, but access to super money is restricted until a 'condition of release' is met. This generally means that the investor will not be able to withdraw the money until they have reached a 'preservation age' and have retired. Preservation age is 55 for an investor born before 1 July 1960, but increases up to age 60 for those born after this date. Earlier access may be allowed in exceptional circumstances, such as permanent disability.

Saving for education or estate planning purposes

In contrast, investment bonds can be used as a savings vehicle to fund education expenses or the cost of raising a child, and are often used by grandparents to finance the future needs of their grandchildren. The bonds bring simplicity in managing the tax that applies to a child's income, and may be assigned to a child in the future (subject to parental or guardian consent) without tax or legal complications. The child has the option to continue holding the investment bond without affecting the original 10-year tax period start date. An investment bond's life insurance component enables tax-effective estate planning and simple wealth transfers external to a will. It gives the life insured significant flexibility and control in determining beneficiaries of any 'death maturity' payments.

In superannuation, death benefit tax concessions apply only to dependents of the deceased member of the superannuation fund. However, an investment bond's death benefits can be directed tax-free to any nominated beneficiary, including adult family members, or the estate. How long the bond has been held does not impact the tax-free status. This flexibility may reduce the risk of disputes over estates and enable benefits to be paid more quickly.

Neil Rogan is General Manager of Centuria Life's Investment Bond Division. Suitability of investment bonds will depend on a person's circumstances, financial objectives and needs, none of which have been taken into consideration in this document. Prospective investors should obtain professional advice before making a decision to invest.

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Being an Investor

The 11 attributes of successful investors

HAMISH DOUGLASS

“
Charlie Munger encapsulates the qualities of a good investor: “Preparation. Discipline. Patience. Decisiveness”
”

The mindset in the business of “investment” is that when purchasing shares on stock markets, you are buying an entitlement to a share of the cash flows that a business will produce over time. Your job as an investor is to assess (if you can) the likely cash flows a business will generate over its lifetime, discount these cash flows back to the present value (at an appropriate discount rate), and determine whether you are likely to generate an acceptable rate of return by buying a share in the business at the prevailing share price. Speculation, on the other hand, involves trading in anticipation that a share price will move upwards or downwards over a short time horizon, typically less than 12 months.

Many esteemed practitioners have espoused key points of wisdom in successful investing. John Bogle, founder of The Vanguard Group, has spoken of the virtues of having a long term mindset. Bogle suggests that it’s all about the long term ownership of businesses focused on gradual accretion of intrinsic value. A short term focus essentially relates to a belief in appreciation of financial instruments rather than the business itself.

Warren Buffett draws a distinction between investing and speculation by stating: “Investment is an activity of forecasting the yield on assets over the life of the asset. Speculation is the activity of forecasting the psychology of the market.” Even the famous American writer, Mark Twain,

articulated the dangers of speculation, saying: “There are two times in a man’s life when he should not speculate; when he can’t afford it, and when he can.”

The principles of successful investment strategies used by Magellan are summarised below.

- 1.** Incorporate a margin of safety: “The margin of safety is the difference between a stock’s price and its intrinsic value” (Benjamin Graham). In theory, the further a stock’s price is below its intrinsic value, the greater the margin of safety against future uncertainty. The concept of margin of safety is one of the most important principles for investors.
- 2.** Invest within your circle of competence. It is worth remembering that “One of the greatest pieces of economic wisdom is to know what you do not know” (John Kenneth Galbraith), and “Real knowledge is to know the extent of one’s ignorance” (Confucius). While there are many good investment opportunities outside one’s circle of competence, there is a substantial disadvantage in attempting to become an expert in too many things.
- 3.** Be prepared to walk away. Our inbuilt biases make it difficult for investors to walk away from investment opportunities or to sell investments when something has gone wrong. If the due diligence does not support an investment case or does not demonstrate a sufficient margin of safety (adjusted for risk), then the investor must be prepared to walk away and wait patiently.
- 4.** Do not diversify excessively. “Diversification is a protection against ignorance.” (Warren Buffett). By definition, additional stocks dilute the contribution to future returns of the best investment ideas within the portfolio. Very few investors have achieved outstanding long term investment records by holding a widely diversified investment portfolio.
- 5.** Focus on the batting average rather than ‘out of the ball park’ when making investment decisions. Minimise the inevitable investment mistakes rather than trying to find the 10 times investment winners. Many investors are very happy to talk about their investment winners, but very few talk about their error rate. Charlie Munger commented: “It’s a good habit to trumpet your failures and be quiet about your successes.”
- 6.** Have a medium term investment horizon. The flawed ‘institutional imperative’ of beating the benchmark short periods (quarterly or yearly) is counter-productive and actually increases the degree of difficulty in producing superior long term returns. It is preferable to avoid being caught up with false precision on timing and being prepared to invest and wait.
- 7.** Think in terms of probabilities and not in single point estimates. In reality, there is a wide range of potential outcomes making it difficult to determine a single point estimate to correctly derive a company’s intrinsic value. It is therefore important for investors to think in terms of probability.
- 8.** Challenge your own ideas (invert the problem). Confirmation bias is one of the primary causes of investment mistakes. Investors often seek or rely on information which confirms the decisions they have made, and they become overconfident. It is much more important to ask yourself why you are wrong than why you are right.
- 9.** Do the analysis and think independently. Investment returns over time will depend on whether analysis of the economics and competitive positioning of a business is correct. As Warren Buffet says, “A public opinion poll is no substitute for thought.”

Being an Investor *continued...*



10. Investment temperament (controlling your biases). Training investors to remain unemotional in their decision-making is almost impossible. As an investor you need to remain extremely calm and rational during times of immense stress. Adrenaline is not your friend in this situation. Warren Buffett famously said: “I will tell you the secret to being rich on Wall Street. You try to be greedy when others are fearful, and try to be fearful when others are greedy.”

11. Understand opportunity cost. Opportunity Cost is the cost of an alternative foregone to pursue a course of action. An investment opportunity looked at in isolation can often look attractive. A proper assessment of opportunity cost, however, takes into account both the expected return and risk in comparison to the next best alternative. Only by properly assessing a multitude of factors is one able to assess the opportunity cost of undertaking a course of action.

In closing this discussion, a quotation from Charlie Munger encapsulates the qualities of a good investor: “Preparation. Discipline. Patience. Decisiveness”.

This article is an excerpt of an article written by Hamish Douglass titled “Being an Investor: The 11 attributes of successful investors”. The complete article may be viewed at <https://www.magellan-group.com.au/investment-insights/being-an-investor-the-11-attributes-of-successful-investors/>

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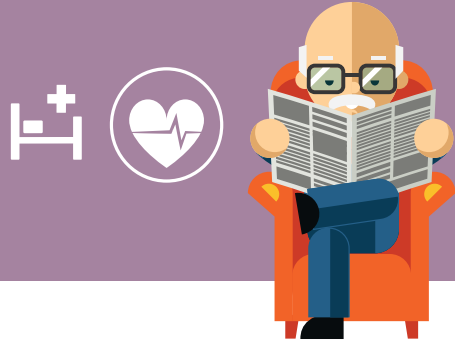
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THE TEMPTATIONS OF PRIVATE CARE

The Temptations of Private Care *continued...*



BRIAN HERD

“A riddle wrapped in a mystery inside an enigma” so said Winston Churchill when ruminat- ing about Russia’s intentions at the start of World War 2. In today’s context, he could just as easily have been describing our aged care system.

Being both a lawyer and a decision maker for a number of older people receiving care as I am, I can speak from professional and personal experience about the voyage through the murky and muddy world of caring.

The sheer volume and opaqueness of the regulation and the costs of aged care have sent me off on paths and tributaries that are just exhausting and a management challenge to say the least. I often feel like those early historical explorers embarking on their voyage of discovery across this wide brown land.

Just this week, for example, I stumbled on the Continence Aids Payment Scheme – a little known government subsidy payable (with conditions of course) to people suffering inconti- nence to assist in the purchase of incontinence aids. Needless to say it requires the completion of another set of forms and bureaucratic inquisitions.

I have been daunted by a ceaseless pursuit to understand the aged care systems (and there is more than one) and all that they have to offer not to mention the strings and stings that come with the offers. With all due respect to the My Aged Care website, I have discovered reams of words and a raft of regulation that could keep me occupied for endless hours of eye glazing research, only to determine, tentatively in many cases, that my client is not eligible (until of course they change the rules again).

It got me thinking about the cost/benefit of all the effort and frustration to find the right pidgeon hole for each client and whether, ultimately, it was worth it. With one of my clients, for example, some 50% of the government subsidy for her home care package is taken by the home care provider, not to pay for the cost of care, but in what is described as their ‘administration fee’.

PRIVATE CARE

So it was, I turned to that underworld of care – private care. Put simply, it is care provided essentially by an unregulated and unsubsidised segment of the care community. Most of the members of this group are people we are very familiar with – informal, unpaid carers – family members, friends and neighbours providing care to people at home. There are apparently over 2,000,000 of them.

But there is another developing subset of this group – the private paid carer or, as they are sometimes called, “support worker”. Best described as outriders in the care industry they are individuals who advertise themselves as just that, individuals, able and available to provide care for a fee outside the regulated environment of the traditional subsidised home care system.

By way of example, a support worker’s internet site states that she is “...only happy if you are happy” and “I believe I can give you a better care so you can stay in your own home as long as possible.” She states that she has a current police check in place, can work seven days a week between 9.30am and 9.30 pm, has a TAFE Certificate 3 in Individual Support, intermediate cooking skills and a First Aid Certificate. Her charges are \$20 per hour.

COST COMPARISON

I then compared her cost with that of a home care provider. If she were to provide 24 hour 7 days a week care, it would cost \$3,360.00 per week. If a home care provider did so, they could charge some \$7,200.00 per week. Even if we took into account any subsidy payable towards the home care providers cost, it would still well exceed that of the support worker. Question – is the significant saving in money of the private support worker value for money when compared with that of the home care provider?

“A riddle wrapped in a mystery inside an enigma”, so said Winston Churchill....He could easily have been describing our aged care system.

In pure monetary terms, the answer is obvious. Even on the measurement of what I call “form phobia”, the simplicity of the support worker compared to the bureau- cracy of the home care provider is attrac- tive. But what if we applied other criteria to the comparison? What are the risks associated with the support worker that may not apply to the home care provider and are those risks worth the savings?

RISK COMPARISON

With a home care provider, at least you have the protection of a government regulated and cost regulated system, not to mention the onerous requirements placed on home care providers in terms of the quality of care they are obliged to provide.

With a private carer, however, there are some ‘issues’:

1. They are essentially unregulated and not subject to a quality of care regime.
2. If you engage them, are you employing them or are they independent contractors?

1. This is a pregnant issue as it gives rise to questions such as, if they are your employee will you have to ensure you meet your obligations under tax law, superannuation law, workplace health and safety law and what are your insurance obligations to cover them?

3. What if they get sick?
4. What sort of insurance will they need to cover the services they provide?
5. Should you document your arrangement with them?

CONCLUSION

The world of the private carer is undoubtedly expanding, especially as it offers a significant saving in cost and bureaucracy. Adult children will subliminally be attracted to it for the savings on their inheritance. It’s all very tempting. However, it comes with both risks and uncertainties that could leave you in a legal minefield if something goes wrong. As for me, I don’t have the privilege of making the decision as if it was my care that was being decided. I have to make the decision for other people and, in that respect, I cannot afford to be a risk taker. I will stick to the system for better or worse and in sickness and in health.

As for you – it’s your choice (but, please, before you succumb to temptation, get some advice).
About the Author: Brian Herd
Recognised as one of the leading experts in Australia on elder law, aged care, retirement, estate planning and disability and a regular author, broadcaster and popular presenter on many elder law subjects and issues.

THE STEPS FOR AGED CARE

LOUISE BITI

Ideally we will all be able to stay in our homes as we grow older. But sometimes the best option is move into a residential aged care service.

This can be a confusing and stressful time for the older person and their family. If you have a family member who needs to make the move, understanding the steps and where to get help may reduce the stress and help you to make informed choices.

Step 1 – decide on strategy and preferences

Decisions may be best made as a family. Start by getting the family together to discuss options and preferences and allocate the necessary tasks. A family meeting may also provide an opportunity to explore everyone’s concerns. If you have a financial planner, he/she may be able to facilitate this meeting for you.

Step 2 – get an ACAT assessment

Before you can access the government subsidies for aged an Aged Care Assessment Team (ACAT) assessment is needed. You may need to wait several weeks for a meeting so book this in as soon as possible. Call 1800 200422 or find details at www.myagedcare.gov.au

Step 3 – choose a service provider

Before choosing a service think about what is important in deciding where to live. Make a list. This should include location, amenities and health care needs. This list will help you develop a shortlist of potential services which you might like to contact or visit. But first check what fees will be asked for accommodation and ongoing services to ensure

it is affordable. You can review and compare prices at www.myagedcare.gov.au. Once you have selected a preferred place you may wish to arrange a visit and be added to the waiting list.

Step 4 – understanding the fee structure

The costs for residential care are split into accommodation, living expenses and extra services. How much you have to pay may depend on the selected provider and assessable income and assets.

Calculating the fees and how structure finances to pay the fees can be particularly complex. A financial planner who is experi- enced in aged care advice can help with these decisions. If you don’t already have a financial planner you might want to search for a planner through the Find A Professional service at www.agedcaresteps.com.au

Step 5 – making the move

Once a place is offered you will need to sign a Resident Agree- ment and make all the arrangements for the move. This will include deciding what to do with the former home and choosing what personal items to take to the new care home.

Louise Biti
Aged Care Steps

Disclaimer: The information in this article is general and does not take into account your particular circumstances. We recommend specific tax or legal advice be sought before any action is taken and refer to the relevant Product Disclosure Statement before investing in any product.



MAX NEWNHAM

With major changes to superannuation occurring on July 1, 2017, SMSF Trustees who don't understand how the new system works could be seriously disadvantaged. If steps are not taken, trustees could find themselves paying increased tax and not maximising their super. The critical issues are the introduction of the transfer balance cap for pension accounts, and how the non-concessional limits affect the 2017 year.

At the heart of the new system is the pension transfer cap or limit of \$1.6 million that applies from July 1, 2017. This limit on the funds a member can have in all super pension accounts will also be used as a global limit on how much superannuation a person can have and still make non-concessional superannuation contributions.

Recognising that fund members required to transfer pension account balances back into accumulation would face adverse Capital Gains Tax consequences, especially when a pension account has investments with large unrealised capital gains, CGT relief has been built into the new legislation, as long as various conditions are met.

Those conditions include:

1. as at July 1, 2017 the member's pension account balance cannot exceed the new \$1.6 million limit by more than \$100,000;
2. the fund must have been a complying superannuation fund throughout the 'pre-commencement period';
3. assets must have been held/owned throughout that period; and
4. the trustees choose to receive the relief by advising the ATO in writing.

This new superannuation term 'pre-commencement period' is the period prior to the commencement of the new super system on July 1, 2017, and covers the period between November 9, 2016 and June 30, 2017.

The CGT relief will differ, depending on whether an SMSF uses the segregation method or the proportionate or unsegregated actuarial method for identifying pension assets and accumulation assets.

For super funds that segregate their pension assets from accumulation assets,

where a member rolls back the estimated excess pension account balance into accumulation before July 1, 2017, the assets reallocated to the accumulation account will effectively have their cost base re-set.

In order to benefit from resetting the cost base, the superannuation fund must have segregated current pension assets at November 9, 2016. In practical terms a fund will have been using the segregation method for the 2017 financial year. In addition, the investment asset must cease to be a segregated pension asset and become a segregated accumulation asset before July 1, 2017.

For super funds that have been using the proportionate method, the CGT relief works differently. In addition to the four conditions listed above, the proportionate method must have been used throughout the 'pre-commencement period'.

Under the CGT relief for funds using the proportionate method, the assets are deemed to be sold on June 30, 2017, and reacquired immediately afterwards at their market value. This will reset the cost base for those assets to their market value at that time.

Where the fund has a proportion of assets allocated to an accumulation account at June 30, 2017, SMSF trustees have a choice as to when the super fund pays tax on these gains. The tax can either be paid on lodgement of the 2017 return, or it can be deferred until the assets with the gain are sold.

The CGT relief will effectively mean the cost base for all pension assets which are reallocated to support an accumulation account are reset to the market value at the time of the transfer. As a result, capital gains tax will only be paid on any increase in value from July 1, 2017, upon the sale of those investments.

SMSF Trustees who don't understand the transition arrangements... could miss out on maximising super contributions.

Care needs to be taken when CGT relief is claimed for assets, because the ownership period for the one third CGT discount available to SMSFs is also reset. This means that if an SMSF member reallocates a segregated asset at March 31, 2017, and claims the CGT relief for that asset, the one third CGT discount will not be available if it is sold before April 1, 2018.

Making sure that a member's pension balance does not exceed the \$1.6 million limit by more than \$100,000 is important for other reasons. No deemed notional earnings will be calculated on the excess, which normally must be transferred back to accumulation along with the excess, and no excess transfer balance tax will be payable if the excess is rectified within six months.

Trustees also need to be aware of how the new two-tiered non-concessional contribution limits will work for the 2017 financial year.

Under the first tier, the non-concessional contribution limit will be \$100,000 (four times the concessional contribution limit that will apply from July 1, 2017). The ability to bring forward two years of non-concessional contributions will be retained under the new system.

The second tier of the new system imposes a new limit at which point no further non-concessional contributions can be made. When the value of a member's superannuation is greater than \$1.6 million, or if it will exceed this limit after a non-concessional contribution is made, no further non-concessional contributions can be made.

SMSF Trustees who don't understand how the transition arrangements work with regard to the current and the new non-concessional contribution limits, could miss out on maximising super contributions. This is especially the case where the bring forward rule is activated, but members don't maximise the contribution by June 30, 2017.

If the bring forward rule is activated, without the full amount being contributed before June 30, 2017, the maximum contribution is decreased. If activated in the 2016 year the maximum non-concessional contribution will be \$460,000, two years of \$180,000 and one year of \$100,000. If it is activated in the 2017 year, the maximum contribution will be \$380,000. If the contribution is made before July 1, 2017, the maximum contribution reverts to \$540,000. SMSF trustees under 66 at June 30, 2017, who have available funds outside of superannuation, should contribute up to the \$540,000 maximum amount before the new rules apply. If they already have more than \$1.6 million in superannuation they should also maximise their non-concessional contribution before the second-tier limit applies.

Max Newnham, Owner/ Founder Taxbiz and Author



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How to Invest in an Overvalued Market

How to Invest in an Overvalued Market *continued...*



DARYL WILSON

It seems as though investment markets have been expensive for years. But with limited exceptions, most markets have continued to track higher and higher. This brings with it a dilemma. It feels ever more uncomfortable putting money to work, but there is no guarantee markets won't keep going up. Furthermore, carrying excess cash can really impact returns.

So, what do you do when markets feel expensive? We use a combination of strategies to help navigate these difficult waters. Here are a few that might work for you as well.

Maximise returns on cash

Many investors are holding a significant portion of their portfolio in cash. One of the easiest ways to improve your investment returns is to get the best deal you can on the cash you hold. There are some great comparison sites like Finder, Mozo, Infochoice, Canstar and Rate City. All provide data from a myriad of banks and financial institutions. Check them out once in a while to see if there are any better deals out there.

Depending on the amount of cash you have, it may be a good idea to spread it over several banks. Make sure you also look at online savings accounts offered by providers such as RAMS, UBank, ING Direct, and RaboDirect. Their rates are generally better than old fashioned savings accounts and less restrictive than term deposits. In this investing climate, flexibility is key.

Take a high-level view

It's easy to get bogged down in day to day market changes, but you must regularly check how your overall portfolio is positioned. Every time we consider whether to make an investment, we ask ourselves four questions as part of the process:

- Where is the market now, compared with our assessment of fair value?
- Where is the market compared to long-term averages?
- How much cash do we have to put to work?
- How much cash do we want to retain in case we get a better opportunity?

The answers to these questions tend to dictate how much cash we have on hand at any given time. You will have your own comfort levels in this regard. Set target ranges that work for you and regularly check against them.

Accept that you can't predict the future

We often joke about how bad the weather service is at forecasting. However, they are significantly better at prediction than economists, who are right barely half the time on average. Furthermore, the best fund managers and traders get it right around 60% of the time, and over 90% of day traders lose money. Therefore, stop thinking that anybody really knows what's going to happen next. It's OK to have a view on the future and for your portfolio to reflect that view to a degree, but consider focusing more on diversification.

We apply the 80/20 rule to our portfolios. Usually over 80% of the investments are a diversified mix of great managers, and less than 20% are high conviction bets on markets we think are significantly undervalued. Of course, we try to time markets and study cycles, but we recognise we will be wrong sometimes, and we don't bet too big.

So think about your exposure to each investment asset class. Are you happy with that level? Do you want more / less?

Diversify by style

Reducing the impact of market downturns without sacrificing long-term returns is the holy grail of investing. One of the things that has surprised us most over the years is just how effective style diversification can be in reducing the volatility of returns. In the current environment it's important to us to have a percentage of our portfolios invested in styles that can make money regardless of the direction of market movements.

Strategies such as long / short and market neutral can do very well in poor market periods. An allocation to each of these investment styles can significantly improve your portfolio performance in poor markets. When we feel markets are overvalued, we usually increase allocations to managers running these types of strategies.

Low volatility investments

When we review fund managers, one of the key things we want to understand is how volatile their investment performance is likely to be. There are various ways to assess this, but one of the simplest is to compare a graph of their performance against a relevant benchmark.

We want our investments to outperform their benchmark over time and to outperform most when markets are poor. Lower volatility investments can reduce the negative impact of down markets and that's a good thing.

Don't compromise returns for diversification

Many portfolios have investments that are almost guaranteed to deliver poor returns. The rationale is almost always that it helps diversification.

If you value capital stability and are happy to accept low returns to achieve it, then that's fine. Otherwise, it's hard to justify allocations to assets like Government bonds, capital protected products and annuities. They tend to drag your portfolio down and, in some cases, can be illiquid as well.

Access smaller, more nimble managers

In theory, there are many ways to outperform markets. In our experience, nothing guarantees success. Factors that can consistently increase the chance of a manager outperforming include: managing a relatively small amount of money, investing in a specialised area, and not unnecessarily restricting how the manager can invest. If the manager has a substantial (for them) personal investment in the fund they manage, that is also a good sign.

You should consider at least some allocation to smaller funds and managers who can invest freely and differently.

Sentiment and confidence are important

One of our favourite sayings is, "Markets don't crash when half the world is expecting them to." Markets are much more likely to be making at least short term highs at times when confidence is high, momentum is strong, and the majority are feeling like nothing bad can possibly happen. The more confidence we see out there, the less confident we become.

A good example of a sentiment indicator is CNN's fear and greed index, which you can see at: <http://money.cnn.com/data/fear-and-greed/>

Finally, be ready for opportunity

Most market falls are short term blips on the road to future upside. Once markets become aware of a problem, or potential problem, its likely impact is usually overstated. Brexit, Trump election, China slowdown – they have all led to short term market corrections which have, with the benefit of hindsight, been good buying opportunities.

So be patient. Sell sparingly and build up some cash gradually as markets rise. Look to use corrections to put money to work. After a market correction of 5-10%, we might put 5% of our cash balance to work. If we're right, we've bought well. If we're wrong and markets fall further, we can always put more of our remaining cash to work.

Daryl Wilson – CEO/Portfolio Manager Affluence Funds

“Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves.” – Peter Lynch



Stock Talk: Westfield Corp

What's an Oculus?

Stock Talk: Westfield Corp *continued...*



STUART CARTLEDGE

“**Westfield broadly categorises their shopping centres into two types, flagship and regional.**”

From a delicatessen on the outskirts of Sydney in 1955, to a portfolio of “flagship” shopping centre assets across the US and Europe, Westfield is an Australian success story by any measure.

In this article we take a look at the more recent, but still dramatic activity that has helped shape Westfield’s current portfolio and share some of the company’s strategic thinking and vision for the period ahead.

Westfield's transformation

In the period from 2004 to 2016, Westfield’s UK and US portfolio of assets under management more than doubled in value, from US\$13.5 billion to US\$29.3 billion. Over the same period, the number of assets within its portfolio fell from 73 to 35, as the company divested shopping centres that it considered non-core or which operated in markets that lacked scale or growth. The proceeds from these sales were in part used to fund over US\$11 billion of development activity.

Westfield broadly categorises their shopping centres into two types, flagship and regional. While the definition of “flagship” is tenuous at best, Westfield really has the world’s premium portfolio of shopping centre assets. As the portfolio has narrowed and become more focused on key markets, the composition has moved from a portfolio comprising 35% “flagship” back in 2004 to today’s portfolio of 81% “flagship” assets.

Ultimately, the major determinant of return for any shopping centre is the willingness of tenants to sign leases and consumers to spend money. In particular, specialty tenants are the key driver of rents, and therefore inevitably the value of shopping centres. The chart below, taken from Westfield’s investor day presentation in Los Angeles in October 2016, shows the substantial improvement in shopping centre productivity, as measured by specialty store sales per square foot. By this measure the sales productivity of Westfield’s portfolio has doubled and is set for further improvement post the completion of the current development pipeline.

Another key plank in the transformation has been the use of joint venture ownership structures, such that Westfield’s ownership share of its assets under management has fallen from just under 90% to around 60% today. From a Westfield shareholder’s perspective, joint venturing has enabled an accelerated growth in assets under management without the need for fresh equity, delivering economies of scale along with the ability to collect asset management, leasing and development fees. The second chart, to the right, demonstrates asset scale, showing how the company is forecasting that nine assets will generate annual sales in excess of \$US1 billion, compared to none in 2014.



Short term earnings headwinds

Westfield’s selling of non-core assets has typically meant disposing of relatively high yielding centres and re-investing the proceeds into a development pipeline that can take years to generate a return. As a result, the company has faced earnings headwinds throughout this transformation process. A large contingent of investors tend to focus on short-term earnings; however as long-term investors, Phoenix are happy to take short term pain, for long term gain.

Development pipeline is huge

The most prominent asset in Westfield’s “flagship” portfolio is the recently opened retail component of the World Trade Center’s transportation hub, the Oculus, located in downtown New York City. The project took four years of work and required US\$1.4 billion of capital. The current pipeline includes Tower 3 at World Trade Center, and other large US projects at Century City (Los Angeles), UTC (San Diego), Valley Fair (San Jose), along with a £600 million expansion of the very successful Westfield London, in the UK. In total, this represents a total spend of approximately US\$3.7 billion, with Westfield’s share, based on ownership of the underlying assets, standing at US\$2.5 billion.

In addition, Westfield is undertaking pre-development work on a further US\$5.8 billion of projects expected to commence in 2017- 2018. This includes large scale projects in both Milan in Italy and Croydon in South London.

Whilst having a substantial development pipeline is great, the investment return on capital associated with this pipeline is the key to shareholder returns. In that regard, Westfield has a strong track record of delivering successful developments. The company’s forecast yield on cost is between 7% and 8%, which in an environment where core assets are likely to be valued on a cap rate of close to 5%, implies a valuation uplift from development of around 40%. Interestingly, this valuation uplift, if consummated, is not reflected in the company’s reported earnings, as the gain is unrealised. It is, however, fully captured in the metrics Phoenix uses to value the stock.

Online / Digital Pressures

Competition from online sales has been a significant and global influence on the demand for physical bricks and mortar shopping malls. Despite a recent slowdown in the rate of online sales growth, online sales remain the strongest part of overall retail sales growth. It is therefore imperative that the design of future shopping centre assets works in collaboration with the digital strategies of key tenants. Westfield is at the forefront of this trend, as demonstrated by the company’s investment in Westfield Labs,

a hub designed to accelerate digital experiences and strategic partnerships with retailers. Its focus on integration between digital and hard assets will be a key feature of future projects and led to Westfield Labs being selected by Fast Company magazine as one of the 50 most innovative companies globally in 2015.

Conclusion

Phoenix takes a long term view when valuing securities. As such, when you combine a high quality management team with a sound long term strategy of developing assets for the future, we believe the stock deserves a position in our portfolio. Fortunately, given the market’s focus on short term factors and with earnings growth having been temporarily held back by the disposal of higher yielding assets, we believe the current weakness in the share price presents a good opportunity for long term investors.

An oculus (plural oculi, from Latin oculus, ‘eye’) is a circular opening in the centre of a dome or in a wall. Originating in antiquity, it is a feature of Byzantine and Neoclassical architecture and has been incorporated into the design of the World Trade Center in New York.

Courtesy Cromwell Insight Magazine www.cromwell.com.au

WORKSHOP

Sunday Afternoon Conference Workshop

DATE: 30 July 2017 TIME: 12.45 – 4.30pm

The Fundamentals of Investment Portfolio Construction

In this hands on workshop, you will be challenged and educated about what you need to understand and do to accomplish your financial goals.

You do not have to be a member to attend this workshop, some members may like to invite their children or grandchildren to encourage better financial literacy.

The Workshop will cover:

- Entities: There are many different investment structures available to investors. Learn how these operate and decide which one is right for you.
- Sectors: There are also different Sectors available to investors. Learn how some of these sectors may fit your investment strategy.
- Risk Profiling: Understanding your optimal level of investment risk so you can sleep at night.
- Plan: Ensure you create your plan, map your rules and use strict guidelines in managing your portfolio.
- Portfolio: Ensure your portfolio adopts the golden rules of diversification, don't put your eggs in one basket, don't be highly geared, have sufficient diversification to different sectors and assets.
- Profit: Ensure your portfolio produces solid and growing income and your capital continues to grow.

Registration: Members can book online.
Non Members simply call 1300 555 061

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NAVIGATING SUPER LAW CHANGES WITH CONFIDENCE



Every SMSF member needs to understand what the coming superannuation changes mean for them to mitigate against any negative consequences the new laws might create. SMSF members should take action to ensure their superannuation continues to grow in the most tax-effective way.

Different applications of \$1.6 million cap

The change most people are familiar with is the \$1.6 million transfer balance cap. What you may not know is that the cap will apply in two instances.

First, it is the limit on the amount of net capital that can be placed in an SMSF member's pension account where the earnings are tax-exempt. Amounts above the cap need to be moved to the accumulation phase or taken out as a lump sum.

The second instance is where the cap will apply to a member's total superannuation balance. If a member exceeds \$1.6 million in their superannuation balance, they will be prevented from making further non-concessional contributions into their SMSF.

Exceptions and limitations

Compensation payments for personal injury received by SMSF members and contributed into their SMSFs are not counted towards either of the superannuation cap or the pension cap.

On the other hand, if a small business taxpayer transfers the proceeds from the sale of active assets up to the value of \$1,415,000, or capital gains from the sale of an active asset of up to \$500,000 into their SMSF (under the Small Business CGT concessions) the contribution will count towards their superannuation balance. If the amount exceeds \$1.6 million, then the member will be restricted from putting any more non-concessional contributions into their SMSF.

For SMSF members turning 65 during the 2016/2017 financial year, there will be a transitional non-concessional bring-forward cap of \$460,000 or \$380,000 depending on when the bring-forward cap was triggered. To take advantage of the full \$540,000 cap, members will need to make the whole bring-forward, non-concessional contribution of \$540,000 before 30 June 2017.

Knowledge is the best defence. Understanding how the changes will apply to you, and taking early action will help you to navigate these changes with more certainty.

There will also be a \$500,000 limit that stops members from being eligible for the catch-up concessional contributions, where they can use any unused concessional contributions cap, from 1 July 2018, on a rolling basis for up to five years.

Where an SMSF member exceeds their \$1.6 million pension cap by less than \$100,000 at 30 June 2017, the new law allows the member six months to remove the excess from the member's pension account. However, the member will still be recorded as having exceeded their \$1.6 transfer balance cap and will not be eligible for any indexed increases of the cap in the future, even if they reduce their pension account balance below \$1.6 million. Members need to be aware that withdrawals from their pension are recorded differently depending on the type of withdrawal. While a partial commutation reduces a member's \$1.6 million pension cap, an ordinary pension payment does not. This is an important distinction for members who want to put more money into their pension account.

Reversionary and death-benefit pensions

Reversionary pensions and death-benefit pensions are also treated slightly differently under the \$1.6 million pension cap. Although both pensions count towards a dependent recipient's pension cap, reversionary pensions are not counted towards the cap until 12 months after the deceased member's death. The amount counted towards the cap also differs. For a reversionary pension it is the amount in the deceased's account at the date of death whereas, with a death-benefit pension, it is the accumulated amount when it is paid to the dependant.

Estate planning also needs to be considered more carefully where the deceased member's children receive their superannuation entitlements. The children may not be able to take a pension of up to \$1.6 million, or may be able to take a pension in excess of \$1.6 million, depending on whether the deceased was in receipt of a pension at the time of their death. While the changes may cause concern, knowledge is the best defence. Understanding how the changes will apply to you, and taking early action will help you to navigate these changes with more certainty.

Monica Rule is an SMSF Specialist. For more information, see www.monicarule.com.au. This article is an understanding of the rules current at the time of writing. Content is provided by Cufflinks, a free financial newsletter www.cufflinks.com.au

WHAT HAPPENS WHEN BOTH MEMBERS OF AN SMSF DIE AT THE SAME TIME



It's the situation no one wants to think about, but what if a husband and wife with their own SMSF die in a car crash at the same time? What is already a difficult, emotional event for the family will become even more complicated.

Whose estate plan takes priority? And what if their respective wills differ regarding who benefits from their personal estates?

For blended families, it gets even more complex, as this example shows:

- George and Marsha are married, but this is their second marriage. George has three boys from a previous marriage, while Marsha has three girls from a previous marriage.
- George is five years older than Marsha, but Marsha has a health condition which, on the face of it, would make it likely George will survive her, other things being equal.
- Each of them wants to look after the survivor of them after they die, and super (via nominating each other as their reversionary pensioner) is the most convenient and tax-effective way to do this.
- Each of them believes this arrangement, making the other a reversionary beneficiary of their super pension, is sufficient to look after each other thereby leaving them free to decide how to use their own personal estates to look after their own respective children under their own wills.
- In the meantime, they also each have in place a non-lapsing binding death benefit nomination (BDBN) that nominates the legal personal representative of their own deceased estate, which they have not reviewed, and, on the face of it, conflicts with the reversionary pensioner nomination.

If the unthinkable happens and both of them pass away at the same time, the possibilities might include:

1. George is taken to die first as the elder of the two, so that:
 - (a) His pension is taken to revert to Marsha, giving her the balance of his pension account; and
 - (b) Marsha's BDBN operates in relation to both her own super account and the account representing the balance of George's pension, so the entire combined balance of the SMSF ends up going to Marsha's estate to be dealt with under her will for the benefit of her three girls, with none of it going to George's boys.
2. Or, if Marsha is taken to die first, it all goes the other way and the entire combined balance of the SMSF ends up going to George's estate to be dealt with under his will for the benefit of his three boys, with none of it going to Marsha's girls.
3. Or maybe their respective BDBNs take precedence, and their own respective super death benefits go to their own estates for the benefit of their own children.

Which is the correct outcome?

There are a number of considerations that can affect the outcome:

- Which nomination takes precedence – the reversionary pension nomination or the apparently conflicting BDBN – largely depends on what the trust deed for the SMSF states.
- As to which of the two members is taken to have died first in the eyes of the law, this can vary. In NSW the deaths are presumed to have occurred in order of seniority.
- The actual wording of the BDBN is also relevant. For instance, if the nomination under the BDBN is subject to the nominee surviving the member by 30 days, then if both persons have died at the same time it will be invalid.

Ultimately, the correct outcome is the one that you and your intended beneficiaries want to happen. Therefore, best practice requires that you:

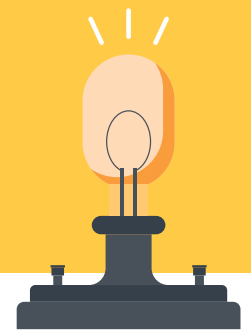
1. Talk about the issue with your adviser. Tell him or her what you want to happen to your super death benefits if you and your partner were to pass away together;
2. Have them check the SMSF trust deed to see what (if anything) it says about the issue, and the priority of a reversionary pension nomination over a BDBN or vice versa – and seek legal assistance if it doesn't say the right things; and
3. Make sure that you each have in place an up-to-date will that works in conjunction with your respective superannuation nominations.

Brian Hor - special counsel, Superannuation & Estate Planning, Townsends Business and Corporate Lawyers

Ultimately, the correct outcome is the one that you and your intended beneficiaries want to happen.

2017 & THE THIRD WAVE

2017 & The Third Wave *continued...*



ALAN HULL

In the late 1800s Charles Dow of the Wall Street Journal observed that the stock market tended to move up in a sequence of three rallies, or waves, as he called them. So at the end of the third wave it was time to sell your stocks, and then wait for the inevitable correction. In the early to mid 1900s Ralph Elliott, creator of Elliott Wave theory, attempted to quantify Dow's observation and also give an explanation as to the underlying psychology of each wave.

The first wave is driven by bargain hunters and early converters. These are the investors who are watching stock valuations rather than prices and will buy into the stockmarket when they see good companies being beaten down too far. They have little fear of negative sentiment as they rely exclusively on fundamentals. Warren Buffett is in this category.

Once this phase is over, however, the stock market will get sold back. Most investors will remain afraid of stocks because the recent correction will still be fresh in their minds. The second bullish wave will commence as the companies' fundamentals start to shine through, the economic outlook improves, fear dissipates, and the bulk of investors return to the market.

So the second wave is the most broadly prescribed and will typically be the most dominant time during a bull run. As this period is largely driven by fundamentals, it begins to weaken as prices rise to the point where said fundamentals become stretched. Value investors will start to take their leave of the market. The second bullish wave will come to an end, and the market will correct once again.

At this point we have undergone two bullish waves, tested the upper limits of the stock market's fundamentals and are collectively wondering where we go from here. Then a strange thing happens as new investors begin to catch on to the idea of rising share prices and, for no sound reason, start buying shares simply because they are going up.

This is the start of the third wave and is appropriately called the lemmings phase, where share price movements part with sound logic. Companies are valued more on future earnings than current figures, and high dividend paying stocks are priced on their yield rather than their fundamental valuations. You start to hear things like 'this time it's different' and taxi drivers will start to give stock tips. It used to be the shoe shine boys in the 1920s.

Whilst I haven't received a stock tip from a taxi driver since 2007, stock markets around the world are all trading at premium 'price to earnings' ratios at the moment, and I keep hearing that this time it is different because of record low interest rates. Higher share prices are being justified because investors are happy with any dividend that will beat fixed interest investments.

When I take a look at the charts, it's as if Charles and Ralph are right there with me, whispering, 'it's the start of the third wave'. The following chart of the SP-500 from the U.S. is a mixture of leading stocks from both the New York Stock Exchange and the NASDAQ stockmarkets. It's a monthly chart that goes all the way back to the 2008 global financial crisis.



A chart like this presents a pretty clear picture of what's happening because all the short term noise tends to disappear on monthly charts. I have drawn a red trend line identifying the current bull run and two blue lines showing the first two waves. So in my judgment, the U.S. stock markets are just beginning their third wave.

This fits pretty well with current circumstances, where the social media boom has carried the likes of Twitter and Facebook to price levels that simply aren't justified by their current fundamentals. Furthermore, I think Donald Trump's administration, supported by Republican control of the Senate, will enjoy a honeymoon period in 2017. Thus, in spite of it being the Asian century, I believe the U.S. will be the key driving force behind the global economy in 2017.

In addition there is a similar pattern in the monthly chart of the London FTSE-100 index, albeit at a more subdued level. This stock market is more conservative than the U.S. stock markets, so I am not at all surprised by this. It also appears to have begun its third wave.



“2017 will be a good year for investors”

The chart of the Shanghai Composite index doesn't show any obvious wave pattern, but then Asia does run to the beat of a slightly different drum from western stock markets. In this chart I have placed a red trendline under the most recent index activity.



As you will no doubt recall, the Shanghai stockmarket enjoyed an exponential rally across 2014 and 2015. Like all exponential rallies, it suffered a sharp correction, which is actually a polite way of saying it crashed. It has since arrested its decline and begun to rise again, albeit at a far more subdued pace than last time.

The key thing to note here is that the Shanghai Composite doesn't normally boom, then bust, and then boom again straight away. It booms, then busts, then rests, and then booms again. Note the preceding period on the chart of the Shanghai, from 2009 through to 2013, where the Shanghai Composite had a long break after the GFC.

Whilst the Shanghai may continue to slowly rise, as it is now, I wouldn't expect it to blast off again anytime soon. This echoes my earlier assessment that the U.S.A. will be the key driving force of the global economy in 2017. Nonetheless, the red trend line in the above chart denotes a period where the Shanghai rose by

over 50%, so it certainly isn't a drag on the rest of the world. Our stock market, in the guise of the All Ordinaries index, is not dissimilar to the chart of London's FTSE-100 index. It's a fairly easy task to identify the first two waves. Like the U.S. and London, the All Ordinaries appears to be in the early stages of wave three.



The common feature across all of these charts is that they have been rising since the low of March 2009. Thus we have all participated in the current bull run with the U.S.A. at its epicenter. I think this is exactly how things are going to play out to the end: with the U.S.A. leading other world markets higher through the third wave.

Consequently 2017 will be a good year for investors. I do, however, have a couple of caveats. It won't be a period where fundamentals will be a good guide, and you will do better to simply follow the crowd and buy popular rising sectors and stocks. By all means enjoy the ride, but beware of what comes after the third wave.

To enroll in one of Alan's free online courses please visit his website at www.alanhull.com



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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	EVENT	VENUE
NSW / ACT				
03-Mar-17	Friday	12.30pm	Hills District Discussion Group	Beecroft Presbyterian Church, Mary St Beecroft
13-Mar-17	Monday	7.30pm	Canberra Discussion Group	Ginninderra Labor Club
15-Mar-17	Wednesday	7.30pm	North Shore Information Meeting	The Chatswood Club, 11 Help Street Chatswood
17-Mar-17	Friday	8.30am	Investor Summit - Mining to Dining Boom	SMC Conference Centre Goulburn St Sydney
07-Apr-17	Friday	12.30pm	Hills District Discussion Group	Beecroft Presbyterian Church, Mary St Beecroft
10-Oct-17	Monday	7.30pm	Canberra Discussion Group	Ginninderra Labor Club
12-Apr-17	Wednesday	7.30pm	North Shore Information Meeting	The Chatswood Club, 11 Help Street Chatswood
05-May-17	Friday	12.30pm	Hills District Discussion Group	Beecroft Presbyterian Church, Mary St Beecroft
08-May-17	Monday	7.30pm	Canberra Discussion Group	Ginninderra Labor Club
10-May-17	Wednesday	7.30pm	North Shore Information Meeting	The Chatswood Club, 11 Help Street Chatswood
02-Jun-17	Friday	12.30pm	Hills District Discussion Group	Beecroft Presbyterian Church, Mary St Beecroft
12-Jun-17	Monday	7.30pm	Canberra Discussion Group	Ginninderra Labor Club
14-Jun-17	Wednesday	7.30pm	North Shore Information Meeting	The Chatswood Club, 11 Help Street Chatswood

VIC				
01-Mar-17	Wednesday	1.00pm	Frankston Discussion Group	Private address; contact Bill Shirley for details: bill.shirley63@bigpond.com
07-Mar-17	Tuesday	6.45pm	Geelong Discussion Group	St George Workers Club, Geelong West
28-Mar-17	Tuesday	7.00pm	Greensborough Discussion Group	Diamond Valley Library, Greensborough
29-Mar-17	Wednesday	7.00pm	Kew Discussion Group	Phyllis Hore Room, Kew Library
30-Mar-17	Thursday	4.00pm	Melbourne Bayside Discussion Group	Private address; contact Kevin Macdonald for detail: km.macdonald@bigpond.com
04-Apr-17	Tuesday	6.30pm	Melbourne Information Meeting	Telstra Conference Centre, Room 1, Level 1, 242 Exhibition Street Melbourne
05-Apr-17	Wednesday	7.30pm	Blackburn Discussion Group	Naturalist Club of Victoria, 1 Gardenia Street Blackburn
18-Apr-17	Tuesday	7.00pm	Greensborough Discussion Group	Diamond Valley Library, Greensborough
02-May-17	Tuesday	6.45pm	Geelong Discussion Group	St George Workers Club, Geelong West
03-May-17	Wednesday	1.00pm	Frankston Discussion Group	Private address; contact Bill Shirley for details: bill.shirley63@bigpond.com
25-May-17	Thursday	4.00pm	Melbourne Bayside Discussion Group	Private address; contact Kevin Macdonald for details: km.macdonald@bigpond.com
30-May-17	Tuesday	7.00pm	Greensborough Discussion Group	Diamond Valley Library, Greensborough
31-May-17	Wednesday	7.00pm	Kew Discussion Group	Phyllis Hore Room, Kew Library
06-Jun-17	Tuesday	6.30pm	Melbourne Information Meeting	Telstra Conference Centre, Room 1, Level 1, 242 Exhibition Street Melbourne
07-Jun-17	Wednesday	7.30pm	Blackburn Discussion Group	Naturalist Club of Victoria, 1 Gardenia Street Blackburn
27-Jun-17	Tuesday	7.00pm	Greensborough Discussion Group	Diamond Valley Library, Greensborough

QLD				
01-Mar-17	Wednesday	1.30pm	Brisbane Information Meeting	Wesley House, 140 Ann Street Brisbane
14-Mar-17	Tuesday	7.00pm	Brisbane Managed Investments DG	Carindale Library, Carindale Shopping Centre
15-Mar-17	Wednesday	6.30pm	Sunshine Coast Discussion Group	The Old Post Office, Buderim
15-Mar-17	Wednesday	7.00pm	Brisbane Equities Discussion Group	Carindale Library, Carindale Shopping Centre
20-Mar-17	Monday	7.00pm	Chermside Equities Discussion Group	Chermside Library, Hamilton Road Chermside
05-Apr-17	Wednesday	1.30pm	Brisbane Information Meeting	Wesley House, 140 Ann Street Brisbane
10-Apr-17	Monday	9.30am	Gold Coast Information Meeting	Helensvale Community, Centre 31 Discovery Dr Helensvale
11-Apr-17	Tuesday	7.00pm	Brisbane Managed Investments DG	Carindale Library, Carindale Shopping Centre
19-Apr-17	Wednesday	7.00pm	Brisbane Equities Discussion Group	Carindale Library, Carindale Shopping Centre
19-Apr-17	Wednesday	6.30pm	Sunshine Coast Discussion Group	The Old Post Office, Buderim
24-Apr-17	Monday	7.00pm	Chermside Equities Discussion Group	Chermside Library, Hamilton Road, Chermside
03-May-17	Wednesday	1.30pm	Brisbane Information Meeting	Wesley House, 140 Ann Street Brisbane
09-May-17	Tuesday	7.00pm	Brisbane Managed Investments DG	Carindale Library, Carindale Shopping Centre
15-May-17	Monday	7.00pm	Chermside Equities Discussion Group	Chermside Library, Hamilton Road Chermside
17-May-17	Wednesday	7.00pm	Brisbane Equities Discussion Group	Carindale Library, Carindale Shopping Centre
17-May-17	Wednesday	6.30pm	Sunshine Coast Discussion Group	The Old Post Office, Buderim
07-Jun-17	Wednesday	1.30pm	Brisbane Information Meeting	Wesley House, 140 Ann Street Brisbane
10-Jun-17	Saturday	11.30am	Annual Celebrity Lunch	Tattersalls Club 215 Queen St Brisbane
13-Jun-17	Tuesday	7.00pm	Brisbane Managed Investments DG	Carindale Library, Carindale Shopping Centre
19-Jun-17	Monday	7.00pm	Chermside Equities Discussion Group	Chermside Library, Hamilton Road Chermside
19-Jun-17	Monday	9.30am	Gold Coast Information Meeting	Helensvale Community, Centre 31 Discovery Dr Helensvale
21-Jun-17	Wednesday	7.00pm	Brisbane Equities Discussion Group	Carindale Library, Carindale Shopping Centre
21-Jun-17	Wednesday	6.30pm	Sunshine Coast Discussion Group	The Old Post Office, Buderim

SA				
14-Mar-17	Tuesday	7.00pm	Adelaide Information Meeting	Fullarton Park Community Centre, 411 Fullarton Road Fullarton
11-Apr-17	Tuesday	7.00pm	Adelaide Information Meeting	Fullarton Park Community Centre, 411 Fullarton Road Fullarton
09-May-17	Tuesday	7.00pm	Adelaide Information Meeting	Fullarton Park Community Centre, 411 Fullarton Road Fullarton
13-Jun-17	Tuesday	7.00pm	Adelaide Information Meeting	Fullarton Park Community Centre, 411 Fullarton Road Fullarton

WA				
07-Mar-17	Tuesday	7.30pm	Perth Information Meeting	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
21-Mar-17	Tuesday	7.30pm	Perth Discussion Group	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
04-Apr-17	Tuesday	7.30pm	Perth Information Meeting	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
18-Apr-17	Tuesday	7.30pm	Perth Discussion Group	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
02-May-17	Tuesday	7.30pm	Perth Information Meeting	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
16-May-17	Tuesday	7.30pm	Perth Discussion Group	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
06-Jun-17	Tuesday	7.30pm	Perth Information Meeting	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
20-Jun-17	Tuesday	7.30pm	Perth Discussion Group	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs