DO WE HANG UP ON TELSTRA?

QANTAS HYBRIDS TECHNOLOGY INVESTMENT LIC DISCOUNT DILEMMA PROTECT YOUR SMSF
19 OCT 2018 Melbourne One Day Seminar

PORTFOLIO CONSTRUCTION

Date: Friday 19th October 2018
Venue: Batman’s Hill on Collins
Address: 623 Collins Street, Melbourne
Time: 8.30am - 4.30pm

The topic is Portfolio Construction and will have the following sessions around asset classes and big picture macro.

- Opening - Macro - Big picture economic / global
- Fixed interest & Cash
- Alternatives
- Property
- Putting it all together

More details will follow shortly so put it in your diary!

Please feel welcome to tell family and friends that you believe would be interested to hear one of Australia’s most successful investors.

03 NOV 2018 Brisbane Annual Celebrity Lunch

BRISBANE ANNUAL CELEBRITY LUNCH 2018

Date: Saturday 3rd November 2018
Venue: The Sebel Brisbane
Address: 121 Charlotte Street, Brisbane
Time: Midday for 12.30 – 3.30pm
Cost: $80pp for AIA & AIR Members and Guests –

Report: Blockchain event at Tamim Global Equity Investment Team

RUDI FILAPEK-VANDYCK

The inaugural AIA stock picking contest

Timmar Global Equity Investment Team

20 Trade wars - What's been going on?

Graeme Bottrill

22 Report: Blockchain event at Sydney’s North Shore

Michael Tan

23 Calender of events

This December is made for the purposes of discussion only.

The AIA, its officers, agents, representatives, and employees are for its accuracy or reliability. All views and information expressed by do not hold an AFSL and does not purport to give advice or operate in any way in contravention of the Acts. The AIA, its officers, agents, representatives, and employees exclude all liability whatsoever. In any event, the AIA is not liable for any loss or damage which may arise from any publication to the full extent permitted by law. The AIA has a policy that does not permit the endorsement or recommendation of any product or service regulated by the Acts.

November 2018

2018 National Investors Conference

Graeme Bottrill

Where next for Qantas?

Arnie Selvarajah

How SMSFs are investing

Brian Hor

Addressing Enquiries

Phone 1300 555 061

Lifemembers

Bob Andrew

Bruce McIlroy

BY ELECTIONS

The recent By-Elections seemed to indicate that the prospect of a future Labor Government is now more likely. As I write this today, we have just had the second Liberal Party leadership challenge in a week and Scott Morrison is now PM. Most now think that a Labor victory at next year’s election is assured. I have heard from many people that they are concerned with how others who have they have thought about returning to the board after a short absence, and will represent us on the Alliance and lead our work in connection with the whole retirement incomes and franking credits matter.

The last couple of months have been an interesting time. We have seen that the federal Labor opposition has maintained its stand on the policy of withholding franking credit refunds. Despite consistent criticism from many and varied organisations representing different sections of the retiree cohort, they remain unmoved. This policy has incensed the vast majority of retirees who rely heavily on their franking credits for a significant portion of their retirement income. The Alliance is quickly gaining some exposure and meetings have been held with politicians and others to spread the word and build understanding of the issues. There is a Summit scheduled for 6th September in Sydney to gain media exposure, etc. I will keep members informed of progress.

The 2018 Russell Investments/ASX Long Term Investing Report was released recently and shows that Australian Residential Property outperformed all asset classes for the 10 and 20 years to 31 December 2017. I guess that is no surprise to most of us, especially those living in the eastern capital cities where residential real estate prices have escalated enormously. Residential real estate is said to have grown by 10.2% p.a. for the past 20 years to December 2017, Australian shares were in second place with 8.8% for the same 20 year period. The results were no doubt bolstered by the somewhat meteoric rise in real estate in the last few years.

Australian fixed income was ahead of Australian shares with 6.2% vs 4.0-4.5% respectively for the past 10 years, but over 20 years, the reverse is true (shares beat fixed income). The report states “For the 10 years on a gross of fees and tax basis, residential property was the top performing asset class, followed by global shares (hedged) and global fixed income (hedged), while Australian listed property, cash and Australian shares were the bottom three asset classes”. Food for thought! You may download the report here -


I wrote last time about the Labor franking credits proposal and I mentioned that we had joined the Alliance for Future Retirement. Jon Kilkunen has accepted our invitation to return to the board after a short absence, and will represent us on the Alliance and lead our work in connection with the whole retirement incomes and franking credits matter.

Please feel welcome to tell family and friends that you believe would be interested to hear one of Australia’s most successful investors.

SPEAKERS TBA

ABN 75 052 411 909

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
Chesterfield QLD 4120
Phone 1300 555 061
Fax 07 5573 7319
Email aia@investors.asn.au
Website www.investors.asn.au

NATIONAL COUNCIL

President Graeme Bottrill
Vice President Russell Leo
Treasurer & Company Secretary Robert Wootsmann

Directors

Graeme Bottrill
Russell Leo
Jon Kilkunen
Chris Souther
Bhavan Spies
John Vorn
Robert Wootsmann

EDITORIAL

Editor Dianne Bottrill
Office Administrator Chris Kasting
Events and Member Services Coordinator Donna Macleod

www.investors.asn.au

The Australian Investors Association Ltd ABN 75 052 411 999

The opinions expressed in this publication are those of the authors and do not necessarily reflect the views of the AIA. All views and information expressed by do not permit the endorsement or recommendation of any product or service regulated by the Acts. The AIA believes that the material contained in the publication is based on the information from sources that are considered reliable and is accurate when posted. The AIA does not warrant its accuracy or reliability. All views and information expressed by do not grant any licence to reproduce, adapt, distribute, transmit or reproduce in any other way material contained in the publication without the prior written consent of the authors and do not necessarily reflect the views of the AIA.
DO WE HANG UP ON TELSTRA?

Telstra has been a core portfolio holding for many investors after being privatised at $3.30 per share in 1997. Today the stock is trading at $2.73, well below its initial public offering price 21 years ago. The difficult performance of Telstra since listing is because its dominant market position has gradually been eroded by the natural forces of competition and technological change.

In this note we highlight the risks around Telstra’s earnings and dividend from a further decay in Telstra’s core business of mobile phone subscriptions. Our research suggests investors should be prepared for lower future earnings from Telstra and a substantial cut in the dividend and potentially a much lower Telstra ‘dividend yield’.

The market does not appreciate the decline in Telstra’s mobile earnings. The impact of the NBN on Telstra’s profitability is well understood as data moves from Telstra’s copper wires to the government’s fibre optic network. What is less appreciated is the decline in Telstra’s mobile earnings now underway (mobile earnings represent 50% of TLS’ operating profit). Perhaps this is not surprising, as even Telstra has been late to acknowledge the deterioration in mobile profitability. Telstra was still targeting mobile earnings growth as recently as May 2018...

Background: The mobile phone industry
Telstra has dominant market share in Australia’s mobile sector, with almost 50% of mobile phone subscriptions and circa 60% of mobile industry profits (EBITDA). Optus is the other major player with a 30% mobile customer growth over the last two years. This has caused Optus’ market share to increase by +2.1% since 2016, while Telstra’s market share has declined -1%.

Optus capitalised on its significant mobile phone price discount to drive market leading mobile customer growth over the last two years. This has caused Optus’ market share to increase by +2.1% since 2016, while Telstra’s market share has declined -1%.

Who is leading the charge on mobile competition?
We see Optus as the key source of competitive pressure on Telstra’s mobile business. After substantial investment in recent years, Optus is now widely regarded as having comparable mobile network quality to Telstra, which is substantiated by a recent independent study ranking Optus as Australia’s top mobile network.

Despite Optus closing the gap on network quality, Telstra’s pricing premium has expanded in recent years. We calculate Telstra charge an average premium of 30% above Optus, up from an average 20% premium over 2010-16.

What is Optus trying to achieve by aggressively chasing market share?
Optus is the second largest mobile phone player but has a market share significantly lower than Telstra. Their best strategy is to remain aggressive on price to produce material growth in customer numbers, grow market share and leverage the significant investment they have made in improving their network quality. This appears to be what they are doing. Our work on the US mobile industry suggests Optus could be pursuing a similar strategy to challenger network T-Mobile in the USA.

In 2014, T-Mobile was the number four mobile competitor in the USA. It priced its mobile offering ~20% below its competitors. In just four years T-Mobile delivered customer growth of 11% per annum, versus peers at just 2% per annum. T-Mobile’s operating profits almost doubled over the same period.

Telstra mobile pricing premium to Optus has continued to rise...

Refers to post-paid mobile market share. Source: Company data; Newgate estimates

Telstra mobile pricing premium to Optus

Despite Optus closing the gap on network quality, Telstra’s pricing premium has expanded in recent years. We calculate Telstra charge an average premium of 30% above Optus, up from an average 20% premium over 2010-16.

Refers to Telstra’s post-paid ARPU premium to Optus. Source: Company data

Optus has capitalised on its significant mobile phone price discount to drive market leading mobile customer growth over the last two years. This has caused Optus’ market share to increase by +2.1% since 2016, while Telstra’s market share has declined -1%.

Telstra mobile pricing premium to Optus has continued to rise...

Refers to Telstra’s post-paid ARPU premium to Optus. Source: Company data

Despite Optus closing the gap on network quality, Telstra’s pricing premium has expanded in recent years. We calculate Telstra charge an average premium of 30% above Optus, up from an average 20% premium over 2010-16.

Refers to Telstra’s post-paid ARPU premium to Optus. Source: Company data

Telstra mobile pricing premium to Optus has continued to rise...

Refers to Telstra’s post-paid ARPU premium to Optus. Source: Company data

Optus has capitalised on its significant mobile phone price discount to drive market leading mobile customer growth over the last two years. This has caused Optus’ market share to increase by +2.1% since 2016, while Telstra’s market share has declined -1%.

Telstra competitive response is not enough
We believe intensifying competition in the face of Telstra’s high pricing premiums has created pressure for Telstra to cut mobile prices to preserve its customer base. We are starting to see this unfold, with Telstra announcing at its June Investor Day that it will release lower priced mobile plans from July 2018.

Our work on the US mobile industry suggests Optus could be pursuing a similar strategy to challenger network T-Mobile in the USA.

In 2014, T-Mobile was the number four mobile competitor in the USA. It priced its mobile offering ~20% below its competitors. In just four years T-Mobile delivered customer growth of 11% per annum, versus peers at just 2% per annum. T-Mobile’s operating profits almost doubled over the same period.

Telstra earnings and free cash flow implications
We expect mobile industry profits to continue declining as competition intensifies. We expect Telstra’s unsustainably high mobile phone charges compared to Optus to narrow as Telstra seeks to stem market share leakage to them. If we factor in Telstra cutting its mobile phone charges by 20% over the next three years, we estimate a 30% decline in free cash flow over this same time period. This would see free cash flow per share decline from 20 cents to 14 cents per share1, and the dividend declining to circa 12 cents per share2. If we assume that Telstra trades on a 6% fully franked yield then it would trade at approximately $2.00 per share, representing 25% downside from current levels. We expect to see continued downside pressure to Telstra’s share price over the 12 months ahead.

Andrew Lewandowski, Senior Investment Analyst, Newgate Capital Partners Pty Ltd

1. Telstra has guided for NBN to have a $3.00 per annum negative impact on Telstra’s EBITDA by the end of the roll-out
2. Telstra presentation to Macquarie Investor Day, 2 May 2018
3. A postpaid mobile phone is a mobile phone service provided under a prior arrangement with a mobile network operator. The user in this situation is billed according to their use of mobile services at the end of each month
4. Dec 2017 P3 Connect Mobile Benchmark Australian test: Optus scored 887/1000 vs Telstra 884/1000
5. A postpaid mobile phone is a mobile phone service provided under a prior arrangement with a mobile network operator. The user in this situation is billed according to their use of mobile services at the end of each month
6. Telstra has guided for NBN to have a $3.00 per annum negative impact on Telstra’s EBITDA by the end of the roll-out
7. Telstra presentation to Macquarie Investor Day, 2 May 2018

More information on the AIM Global High Conviction Fund www.aimfunds.com.au
WHERE NEXT FOR QANTAS?

Roger Montgomery

The Qantas share price has soared 600 per cent since January 2014. This has surprised many long-term investors, who view airlines as a bit like the Bermuda Triangle — a place where money is lost and never seen again. So, what’s happened? Are airlines now a great place to invest?

Over the years, airlines have generally produced poor returns on incremental equity. In addition, accounting standards allow large diversions to persist between reported profits and ‘economic’ profits. For those reasons we have chastised those who even entertain purchasing shares in airlines.

You might think we’d be applauded for protecting investors. Qantas shares are trading where they were about 11 years ago and Virgin’s shares are 90 per cent lower than where they were 11 years ago.

Of course, stock markets have short memories and investors instead look to the six-fold jump in Qantas’s shares since January 2014 as reason to think airlines have changed their spots.

One of the inescapable issues for airlines is the need to fund new aircraft to remain fresh, efficient and competitive. The problem is that airline accounting doesn’t do a great job of reflecting the true cost of running the airline and replacing the planes.

The depreciation expense in the profit & loss statement is based on the historical cost of an aircraft that could be more than 15 years old and if the depreciation change was instead replaced with an equally creative ‘provision-for-replacement of aircraft’ charge, the expense on the profit & loss statement would be much larger and the accounting profit could quickly turn into a loss.

Of course, another way to test whether any real money is being made is to look past the reported accounting profits to the cash flows. But in Qantas’s case, the company has also been reporting strong cash flows in recent years.

Back in 2014, the year the company wrote down the value of its international fleet by $2.6 billion, Qantas reported a $5.8 billion headline loss and a $640 million underlying loss; however, the operating cashflow amounted to just over $1 billion. Fast forward to 2017, and while reported profit had grown to $852 million, cash flow from operations grew to $2.7 billion. And since 2014, the share price is up over six-fold.

So, what gives? Have airlines suddenly become high quality businesses that we should hope to own for the long term? Or is there something the strong cash flow isn’t reflecting?

As an aside, Warren Buffett has previously been on the record pointing out that had he been at Kitty Hawk in 1903 when Orville Wright took off for his maiden voyage, he hoped that he would have had the presence of mind, for the benefit of all future capitalists, to have shot him down. This is due to the tremendous aggregate losses airlines have accumulated over decades.

Those losses are a function of being incredibly capital and labour intensive, and there’s the small matter of some competitors having access to much cheaper fuel thanks to ties with royal families or supportive governments.

Yet only back in January, Berkshire Hathaway’s share portfolio, which is arguably managed by Ted Weschler and Todd Combs, owned an US$11 billion stake in United Airlines, Delta Airlines, Southwest and American Airlines (all are lower since the beginning of calendar 2018).

So back to the original question – have airlines become compelling investment opportunities?

We think not and here’s why.

First, while the company’s cash flows look great, they have benefitted in recent years from generally declining oil prices. In July 2008 West Texas Intermediate crude oil traded at US$147/bbl. By February 2016, the oil price had fallen to less than US$26.00/bbl. But since then oil has almost tripled to over US$70/bbl and analysts at UBS now believe Qantas could be hit with a $700 million negative shift in fuel costs from FY2018 levels to the current spot price. And while the impact might be offset by an expected 10 per cent increase in domestic revenue, there’s the small matter of $400 million per annum in cash tax payments starting in FY2019.

In addition to benefitting from cheaper fuel, cash flows have also been boosted by a strategy that has allowed the fleet to age.

The most expensive part of running an airline is replacing old cheap planes with newer and more expensive models. Airlines cannot escape this capital expenditure lest passengers jump to competing airlines with fancier entertainment offerings and more comfortable seats, bars and beds.

You can call it a disciplined approach to capital spending or you could say the board might prefer to see the share price go up now, maximise share price related incentives for current management and leave the reality of replacing planes to the next guy. Whichever way you spin it, the investment bank UBS notes Qantas’s ‘fleet age’ has increased from 7.7 years in 2015 to a current 10.2 years. They also note that the fleet is now older than the last peak of 9 years in 2007.

According to the same report, Qantas has introduced just nine new aircraft, or 3.7 per cent of group seat capacity, over the last three years and so a minimum of $1.4 billion per annum will be required to maintain a constant fleet age, with an additional $600 million spend on the non-aircraft asset base making $1.7 billion. That matches depreciation, but depreciation is based on historical costs so it is still probably undercooking how much is needed to keep the fleet fresh, new and competitive.

And that means future cash flows might not look as good as recent numbers suggest – airlines cannot escape having to eventually replace their planes.

As a final comment, it seems Buffett’s airlines investments are not going so well this year.

Roger Montgomery, Montgomery Investment Management

WHERE NEXT FOR QANTAS? continued...

One of the inescapable issues for airlines is the need to fund new aircraft to remain fresh, efficient and competitive.

We think not and here’s why.

First, while the company’s cash flows look great, they have benefitted in recent years from generally declining oil prices. In July 2008 West Texas Intermediate crude oil traded at US$147/bbl. By February 2016, the oil price had fallen to less than US$26.00/bbl. But since then oil has almost tripled to over US$70/bbl and analysts at UBS now believe Qantas could be hit with a $700 million negative shift in fuel costs from FY2018 levels to the current spot price. And while the impact might be offset by an expected 10 per cent increase in domestic revenue, there’s the small matter of $400 million per annum in cash tax payments starting in FY2019.

In addition to benefitting from cheaper fuel, cash flows have also been boosted by a strategy that has allowed the fleet to age.

The most expensive part of running an airline is replacing old cheap planes with newer and more expensive models. Airlines cannot escape this capital expenditure lest passengers jump to competing airlines with fancier entertainment offerings and more comfortable seats, bars and beds.

You can call it a disciplined approach to capital spending or you could say the board might prefer to see the share price go up now, maximise share price related incentives for current management and leave the reality of replacing planes to the next guy. Whichever way you spin it, the investment bank UBS notes Qantas’s ‘fleet age’ has increased from 7.7 years in 2015 to a current 10.2 years. They also note that the fleet is now older than the last peak of 9 years in 2007.

According to the same report, Qantas has introduced just nine new aircraft, or 3.7 per cent of group seat capacity, over the last three years and so a minimum of $1.4 billion per annum will be required to maintain a constant fleet age, with an additional $600 million spend on the non-aircraft asset base making $1.7 billion. That matches depreciation, but depreciation is based on historical costs so it is still probably undercooking how much is needed to keep the fleet fresh, new and competitive.

And that means future cash flows might not look as good as recent numbers suggest – airlines cannot escape having to eventually replace their planes.

As a final comment, it seems Buffett’s airlines investments are not going so well this year.

Roger Montgomery, Montgomery Investment Management

Quality & Value Investing for 20 Years

1998-2018

To mark IML’s 20th anniversary we have compiled:

20 ‘lessons’ from 20 years of investing

To learn more visit: iml.com.au/20-lessons

This information is general in nature and does not take into account your personal circumstances. Investors Mutual Limited (ABN 61, 226684) is the issuer of the product. Please refer to the Product Disclosure Statement dated 25 September 2017 or speak to your financial adviser for more information.
20 STOCK MARKET TRUTHS

1. Don’t buy a portfolio, buy stocks, and one day your portfolio will miraculously reappear. Focus on stocks not financial marketing about diversification. The only reason professionals tell you to diversify is so that you can’t sue them.

2. Index returns are heavily marketed as an expectation, but they are a fantasy and the accumulation indices that compound dividends are even more fantastic. No index under your fund management performs. The index perfectly compounds dividends, costlessly replenishes the bad stocks with good stocks, pays no dealing costs, has no rent, no staff, water coolers, or management fees, and is not therefore a reality. I am amazed we all allow ourselves to be benchmarked to it. It is hard to beat. And the relentless snipping from the sidelines that fund managers are idiots because they all underperform the market is not a reflection of the fund manager’s incompetence but the speaker’s ignorance.

3. Don’t bother predicting anything – Bear markets start and bull markets end and when the market says so and it will only become obvious in hindsight. Best you go with the trend until it changes and doesn’t do that, predict the beginnings and ends of the market. It will cost you. Warren Buffet is not. Warren Buffet is a marketing tool for people that can’t sell their own products on their own merits.

4. The market never crashes up – The market never crashes up. It is driven by fear. Fear is a bigger driver than confidence and “It takes five minutes to be fearful, but you can’t get a ride home faster than confidence”.

5. So why does diversification cost so much? Because it is diversification. The market never crashes up, it is driven by fear. Fear is a bigger driver than confidence and “It takes five minutes to be fearful, but you can’t get a ride home faster than confidence.”

6. Watch the crowd, feed the crowd, manipulate the crowd, but don’t be the crowd – If the market tells you to diversify, do the opposite. If the market tells you to buy, sell. If the market tells you to sell, buy.

7. Don’t sell a stock because you think it will go down – Don’t sell a stock because you think it will go down. If you sold a stock you thought was going to go up and it didn’t, you paid to lose money. If you sold a stock you thought was going to go down and it didn’t, you paid to make money.

8. A diversified portfolio is a diversification in name only – A diversified portfolio is a diversification in name only. It only looks like diversification. The market never crashes up, it is driven by fear and “It takes five minutes to be fearful, but you can’t get a ride home faster than confidence.”

9. The market’s emotional impact is much greater than its financial impact – The market’s emotional impact is much greater than its financial impact. “It takes five minutes to be fearful, but you can’t get a ride home faster than confidence.”

10. The second-best way to get rich is to become rich – The second-best way to get rich is to become rich. The best advice I give is to sell the one stock that is the most attractive. The best advice is to sell the one stock that is the most attractive.

11. The market never crashes up – The market never crashes up. It is driven by fear. Fear is a bigger driver than confidence and “It takes five minutes to be fearful, but you can’t get a ride home faster than confidence.”

12. Don’t sell a stock because you think it will go down – Don’t sell a stock because you think it will go down. If you sold a stock you thought was going to go up and it didn’t, you paid to lose money. If you sold a stock you thought was going to go down and it didn’t, you paid to make money.

13. Don’t sell a stock because you think it will go down – Don’t sell a stock because you think it will go down. If you sold a stock you thought was going to go up and it didn’t, you paid to lose money. If you sold a stock you thought was going to go down and it didn’t, you paid to make money.

14. The only effortless way to get rich is to become rich – The only effortless way to get rich is to become rich. The best advice I give is to sell the one stock that is the most attractive. The best advice is to sell the one stock that is the most attractive.

15. The only effortless way to get rich is to become rich – The only effortless way to get rich is to become rich. The best advice I give is to sell the one stock that is the most attractive. The best advice is to sell the one stock that is the most attractive.

16. The market never crashes up – The market never crashes up. It is driven by fear. Fear is a bigger driver than confidence and “It takes five minutes to be fearful, but you can’t get a ride home faster than confidence.”

17. The other weaknesses of the market are emotional – The other weaknesses of the market are emotional. “It takes five minutes to be fearful, but you can’t get a ride home faster than confidence.”

18. The second-best way to get rich is to become rich – The second-best way to get rich is to become rich. The best advice I give is to sell the one stock that is the most attractive. The best advice is to sell the one stock that is the most attractive.

19. The second-best way to get rich is to become rich – The second-best way to get rich is to become rich. The best advice I give is to sell the one stock that is the most attractive. The best advice is to sell the one stock that is the most attractive.

20. The second-best way to get rich is to become rich – The second-best way to get rich is to become rich. The best advice I give is to sell the one stock that is the most attractive. The best advice is to sell the one stock that is the most attractive.

The fund’s assets & operations could be frozen

If you have a self-managed superannuation fund (SMSF), you may need to put ahead to ensure that you can still keep the cash you lost. If you lose your capacity due to dementia (or other reasons such as surviving a stroke), otherwise the fund’s assets and operations could be frozen, resulting in losses from being unable to bail out self-investments at the right time. Control of the fund falling into the wrong hands or into the hands of total strangers, even the loss of complying and fund status with catastrophic consequences.

So, before the unthinkable happens to you, here are 10 things you can do to protect your SMSF from your incapacity:

1. Talk to your financial adviser about what you want to see happen with your fund if you lost mental capacity, in terms of things such as who should be in control, what should happen in terms of investment strategy and ongoing management of the fund, whether the fund should be wound up and your member benefits rolled out into an ARPA fund, what should happen in terms of your death benefits, and so forth. Your adviser can give you advice and coordinate getting further assistance from an accountant and/or a lawyer where necessary.

2. Put into place an Enduring Power of Attorney, to appoint someone who you trust to be able to handle your financial affairs and to be able to appoint in your place as a trustee of the fund (or as a director of the corporate trustee).

3. Check the trust deed for the SMSF to ensure that it allows for your Enduring Attorney to be appointed in your place as a trustee of the fund or as a director of the corporate trustee (and if it doesn’t, then have it updated accordingly).

4. Put into place written instructions to your appointed Enduring Attorney and the other trustees or directors of the corporate trustee as to what you want your Enduring Attorney to be appointed in your place, and what their roles and responsibilities will be and what specific instructions you may wish to give to them regarding things such as dealing with particular fund investments, etc.

5. Appoint one or more substitute or “back up” Enduring Attorneys – especially if you appoint your spouse as first choice, as they may be the same age as you and therefore also at risk of developing dementia at the same time as you do, in which case the substitute attorney should be younger than you (such as one or more trusted children of yours).

6. To help prevent the investment strategy of the fund going off the rails after you lose capacity, put into place an investment strategy that clearly sets out what should happen and how it should be implemented, both before and after one or more members of the fund lose capacity, and ensure that it binds all the fund trustees.

7. Put into place a corporate trustee rather than individual trustees, as this will make things much easier if you lose capacity. For instance, if you lose capacity there is no need to change the ownership of the fund assets (which can be a costly and time-consuming exercise) as they will be in the name of the corporate trustee, so that all that needs to happen is that you are replaced as a director.

8. If you are a director and shareholder in a corporate trustee of the fund, check the constitution of the company to make sure that your Enduring Attorney can exercise the voting power on your shares so that they can be appointed as director in your place.

9. Put into place a Non-lapsing Binding Death Benefit Nomination (and if necessary update the trust deed for your SMSF to allow you to do this). Otherwise if you lose capacity and your nomination lapses, you will not be able to renew it and the trustee of the fund will have the discretion to pay your death benefit – perhaps to someone you did not intend to receive it.

10. Make sure your Will is properly updated, because once you lose capacity you can no longer make or change your Will. This can be critical in the context of your SMSF, as the only way you can give your super to persons who are not eligible to receive benefits directly from your SMSF is via your Will. For instance, unless you were in an interdependency relationship with them or they were your financial dependants, you cannot nominate grandchildren to receive a death benefit directly from your fund – instead you have to direct the death benefit to your deceased estate and then make a gift of the death benefit to your grandchildren under your Will.

MARCUS PADLEY

BRIAN HOR
A SMART WAY TO ADD TECHNOLOGY INVESTMENT TO YOUR PORTFOLIO

PAUL WILSON

WHAT do Uber, Airbnb, Twitter, Workday, and Dropbox have in common?

All these companies are valued at more than $10 billion, but were all formed in the last decade.

Technology companies can get very big, very quickly, reflecting the size of the global markets they are addressing and their ability to scale rapidly.

Australian technology companies too have had rapid rises in fortunes with names such as Atlassian, WiseTech, and Appen providing stellar historical returns. Emerging Australian names such as SiteMinder are already world leaders. These companies are all addressing very large opportunities by utilising technology as an asset class. But with a number of boom and bust stories emerging, what is a smart way to add some technology exposure to a portfolio?

Solid Foundations

The underlying foundations for the growth in the technology sector have been progressively laid over some time. Key elements include:

- digitisation of information
- increased computing power
- broadband proliferation
- widespread use of smart devices
- the development of cloud computing services

These elements are driving structural shifts in the way business is being conducted in almost every industry. Some companies are failing to adapt quickly enough, and are at risk of value erosion.

This however provides an opportunity for tremendous value creation for those companies nimble enough to embrace the change and allow it to drive their own growth.

Technology companies are not restricted to addressing the Australian market. They can address a global market by the very nature of their products and services, and grow to be very large enterprises.”

Mark Burns, TMT Partners

Naturally, Australian investors want the opportunity of participating in such businesses that have the potential to achieve such phenomenal growth and global reach. Some investors want to diversify their investment portfolios to include technology as an asset class. But with a number of boom and bust stories emerging, what is a smart way to add some technology exposure to a portfolio?

The Technology Sector is well established as a portfolio allocation

In larger markets such as the US, technology is very well established. Did you know that the Information Technology sector now comprises 25% of the S&P500 index, and is a larger sector than financials or healthcare?

<table>
<thead>
<tr>
<th>Sector</th>
<th>Schwab Sector View</th>
<th>Share of the S&amp;P500 Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information technology</td>
<td>Outperform</td>
<td>25%</td>
</tr>
<tr>
<td>Financials</td>
<td>Outperform</td>
<td>15%</td>
</tr>
<tr>
<td>Health care</td>
<td>Outperform</td>
<td>14%</td>
</tr>
<tr>
<td>Consumer discretionary</td>
<td>Market perform</td>
<td>13%</td>
</tr>
<tr>
<td>Industrials</td>
<td>Market perform</td>
<td>10%</td>
</tr>
<tr>
<td>Consumer staples</td>
<td>Market perform</td>
<td>7%</td>
</tr>
<tr>
<td>Energy</td>
<td>Market perform</td>
<td>5%</td>
</tr>
<tr>
<td>Materials</td>
<td>Market perform</td>
<td>3%</td>
</tr>
<tr>
<td>Utilities</td>
<td>Underperform</td>
<td>3%</td>
</tr>
<tr>
<td>Real Estate</td>
<td>Underperform</td>
<td>3%</td>
</tr>
<tr>
<td>Telecom</td>
<td>Underperform</td>
<td>2%</td>
</tr>
</tbody>
</table>

Source: Schwab Centre for Financial Research and Standard and Poor’s as of 31/5/2018

The NASDAQ Internet Index has returned 22% pa over the last 4 years, and Information Technology is one of only three sectors rated as ‘Outperform’ by Schwab.

The overseas experience is that technology is well and truly established as a credible asset allocation, but also that the sector can be an important hedge against disruption to legacy businesses in an investment portfolio.

Technology Investment opportunities in Australia

The market capitalization of companies in the information technology sector listed on the ASX/NZX has risen strongly over the last five years, but still represents only 2.2% of the ASX2001. This compares to Financials comprising 32.7% of the ASX2001.

1. Specialist technology sector expertise

A manager who focuses only on the technology sector will have the experience of reviewing hundreds of potential opportunities of a similar nature. This means experience and a deep understanding of relevant technologies, business models, management teams and appropriate valuations.

2. The appropriate stage of company development

Companies that are past the start up or early stage will have a dramatically greater chance of success. This means several million dollars of annual revenue, repeating customers, proven globally competitive technology, proven business model, and a seasoned management team. This is referred to as the expansion stage, where businesses are looking to accelerate growth of a proven model.

3. An actively involved manager and board

A manager who is prepared to get involved in the management and governance of an expansion stage technology business can add much needed discipline as these companies grow. A seasoned board who have personal involvement can ensure a steadier growth path, without taking undue risks.

4. Diversification through a portfolio of investments

Having exposure to a number of investments in this space is a sensible diversification of risk, a well-established principle.

Many investors in Australia are looking to gain some exposure to the technology sector, recognizing that the industry balance in Australia is likely to trend towards other developed markets over time. Some portfolio allocation to Information Technology is a way to obtain exposure to potentially high return investments while providing some industry balance to their portfolio.

Recently there have been several technology companies listing on the ASX. Some of these companies have had stellar performance, and others less so. A number simply do not yet have the level of predictability to be properly ready for the public markets. There is no question that investment in the technology sector can produce exceptional returns, but can also come with a level of risk.

How to reduce risk?

A number of measures can be taken to reduce risk in technology investing, including:

1. Specialist technology sector expertise

A manager who focuses only on the technology sector will have the experience of reviewing hundreds of potential opportunities of a similar nature. This means experience and a deep understanding of relevant technologies, business models, management teams and appropriate valuations.

2. The appropriate stage of company development

Companies that are past the start up or early stage will have a dramatically greater chance of success. This means several million dollars of annual revenue, repeating customers, proven globally competitive technology, proven business model, and a seasoned management team. This is referred to as the expansion stage, where businesses are looking to accelerate growth of a proven model.

3. An actively involved manager and board

A manager who is prepared to get involved in the management and governance of an expansion stage technology business can add much needed discipline as these companies grow. A seasoned board who have personal involvement can ensure a steadier growth path, without taking undue risks.

4. Diversification through a portfolio of investments

Having exposure to a number of investments in this space is a sensible diversification of risk, a well-established principle.
HYBRIDS

Hybrids deserving of a place in a balanced portfolio?

Due to their attractive franked income returns, relatively low capital volatility, and ready availability through the Australian Securities Exchange (ASX), hybrid securities have been a popular choice with Australian retail investors over recent years.

As this article will demonstrate, hybrid securities are best considered a distinct investment class in their own right as they blend both bond and equity characteristics to varying degrees. As such they have a unique and valid place along the risk-return spectrum of investment choices available to investors.

That said, due to their inherent complexity and the general inefficiency of the market in which they trade, we believe a strong case can also be made for gaining exposure to hybrids securities through a diversified and professionally run managed fund.

The unique risk/return characteristics of hybrid securities

Hybrid securities are neither traditional bond investments nor equities. As the name implies, they share the risk and return features of both to varying degrees, depending on the specific terms and conditions attached to the hybrid security in question. As such, and as evident in the diagram below, hybrids can be expected to produce risk and return characteristics above those of traditional fixed-income securities like bonds but below those of ordinary shares.

In exchange for these particular characteristics, however, hybrids securities due to their attractive income returns, usually offer only moderate levels of credit risk or return volatility. Note hybrid income returns also include franking credits which are not available via bond and cash investments.

As at end-June 2018, for example, the gross running yield on the BetaShares Active Australian Hybrids Fund (managed fund) (ASX Code: HBRO) was 5.4% p.a., compared with 3.8% p.a. for the Bloomberg AusBond Composite Index, which is the most commonly used bond benchmark for local fund managers and Australian Bond ETFs. The Bloomberg AusBond Credit Index (comprising mainly corporate bonds) had a running yield of 4.1% p.a.

Illustrative only. Source: Bloomberg, BetaShares. Past performance is not an indicator of future performance. You cannot invest directly in an index. The benefit of franking credits will vary depending on an investor’s tax situation.

HBRO’s prospective income return as at end-June was also broadly comparable with that of the Australian equity market, with the gross dividend yield for the S&P/ASX 200 Index at that time running at 5.5% p.a.

Compared to shares, moreover, hybrids tend to offer considerably less return volatility.

As seen in the chart below, while hybrid valuations did experience a decline during the GFC-induced panic regarding bank solvency, these declines were still much less than that for bank shares and losses were recovered relatively more quickly. What’s more, hybrid values were hardly affected during more recent period of bank share price weakness. This suggests that during normal periods of share market volatility – when the ultimate solvency of major hybrid issuers such as banks is not seriously in question – the volatility of hybrids returns might be expected to be relatively low, even approaching that of traditional bonds higher up the capital structure.

PETER HARPER

While retail investors are reliant on making trades through the exchange, moreover, professional fund managers can additionally source other hybrids opportunities - and often deeper liquidity - through direct trades with other financial institutions in over-the-counter (“OTC”) transactions.

All up, given the complexity of hybrid securities, the relative inefficiency of the hybrids market and associated opportunity to take advantage of mispricing, and generally lower levels of exchange liquidity, we believe there are advantages in gaining exposure to these investments through a diversified, professionally run managed fund.

Peter Harper, BetaShares

HYBRIDS continued...

Illustrative only. Source: Bloomberg, BetaShares. Past performance is not an indicator of future performance. You cannot invest directly in an index.

What’s more, one feature of hybrids that should help mitigate return volatility over time – especially compared to traditional fixed-rate government and corporate bonds – is that their interest rates tend to be floating, or adjust to the general level of interest rates over time. Due to this feature, the price or capital value of hybrids tends to be much less sensitive over time to changes in the general level of interest rates than is the case for fixed-rate bonds. This is particularly noteworthy in the present climate (at the time of writing), given interest rates globally remain quite low but are generally expected to start rising over the next year or so.

The case for active hybrid management

Although they offer the potential for attractive income returns, hybrids are complex securities which can differ greatly in terms of their bond and equity characteristics - and hence their ultimate risk to investors.

Failure to properly understand each hybrid security’s specific terms and conditions can result in some investors taking on unintended risks, or at least potentially forgoing better returns available on other hybrids with similar risk. In addition, the relative inefficiency and make-up of the hybrids market allows experts to potentially take regular advantage of mispricing.

Compared to the share market, moreover, the hybrids market is relatively liquid. As seen in the chart below, for example, the bid-offer spreads (i.e. the difference between the market price at which hybrids are able to be bought and sold) for Commonwealth Bank hybrid securities tend to be notably higher than that for its shares.

What’s more, these spreads can vary greatly on a day-to-day basis – suggesting they can be highly influenced by the number of buyers and sellers on any given day. While it’s possible for retail investors to get into and out of hybrids securities on the exchange, it can often come at a cost!

Easy access to high quality global equity and global listed infrastructure companies

www.magellangroup.com.au
info@magellangroup.com.au
The format of Listed Investment Companies (LICs) has not changed meaningfully since they first appeared on the ASX. The LIC, Whitefield, was formed in 1923 and the Australian Foundation Investment Company (AFIC) in 1927. Argo was established in 1946. Many LICs have a long and proud history of providing capital growth and dividends. In recent years there has been a proliferation of LICs; the number and market capitalisation of listed investment companies doubled in the five years to June 2018.

In very brief terms, LICs are closed-ended investment vehicles, meaning that investors cannot apply for new shares (that is grow the size of the fund) or redeem them (that is, shrink the size of the fund) on a daily basis. For the investor, using traditional LICs:

• Gives access to the underlying investment manager and the associated investment performance
• Gives simplicity of being able to trade the LIC’s securities daily on the ASX
• Gives access to franked dividends where franked dividends are available

For the investment manager, using an LIC structure means they can invest for the long term without the distraction of daily applications and redemptions. Further, arguably, LIC investment managers have less motivation to hug an index relative to when managing a fund in which investors can redeem daily, as the manager does not need be concerned about redemptions if they are underperforming the index in the short term.

However, the traditional LIC structure poses a number of issues for investors, including:

• Even strongly-performing LICs can and do trade away from their underlying net tangible asset (NTA) value, cycling between discounts and premiums. This creates uncertainty for investors as to whether they can obtain the underlying value of their securities

The discount/premium cycle dilemma - an industry wide experience

Discounts and premiums are not an isolated case among LICs. It affects the LICs we manage, including the PM Capital Global Opportunities Fund (ASX: PGF), and a wide range of well-known managers investing in different market segments. They can have significant effects on what returns the investor receives in the hand, notwithstanding the performance of the underlying manager.

History has clearly demonstrated that LIC share prices cycle between premiums and discounts to NTA, with both situations being problematic. For incoming shareholders, it is illogical to pay a premium to the underlying assets, and for selling shareholders, discounts represent the inability to obtain the ‘in-loco’ value of their investment. The charts below show what looks similar to a “discount to premium to discount” sine wave pattern of a sample of well-known Australian large cap, small/mid cap and international LICs since December 1999.

Discounts and premiums can have a very real effect on investor returns. However, in our opinion LICs’ benefits to investors mean that the issues of share price variances around NTAs and the effect on investment returns should not be a total deal breaker. We therefore have attempted to combine the LIC principle with a new option that we think investors should demand becomes a mandatory part of the LIC investment landscape going forward: PTrackERS, a Portfolio Tracking Exchangeable Redeemable Securities (Converting Security) are economically redeemable LIC equity exposure, but give investors more options to realise their investments than is currently the case. Apart from selling on the ASX, they can be redeemed in the future based on NTA; meaning even if PTrackERS are trading at a discount to NTA, investors can still obtain NTA. They can also convert into fully paid ordinary shares of the PM Capital Global Opportunities Fund (PGF) without triggering a CGT event.

When it comes to disposal of LIC interests, only the first choice – selling on market - is available to LIC investors currently, where they are subject to the vagaries of sentiment affecting the broader market as well as the performance of the individual LIC. The idea of PTrackERS is to insulate investors from these sentiment shifts – a redemption “safety net”.

Almost every portfolio manager, including our own at PM Capital, has a return target for their investments. LICs are no different. However, our opinion LICs’ benefits to investors mean that the issues of share price variances around NTAs and the effect on investment returns should not be a total deal breaker. We therefore have attempted to combine the LIC principle with a new option that we think investors should demand becomes a mandatory part of the LIC investment landscape going forward: PTrackERS, a Portfolio Tracking Exchangeable Redeemable Securities (Converting Security) are economically redeemable LIC equity exposure, but give investors more options to realise their investments than is currently the case. Apart from selling on the ASX, they can be redeemed in the future based on NTA; meaning even if PTrackERS are trading at a discount to NTA, investors can still obtain NTA. They can also convert into fully paid ordinary shares of the PM Capital Global Opportunities Fund (PGF) without triggering a CGT event.

When it comes to disposal of LIC interests, only the first choice – selling on market - is available to LIC investors currently, where they are subject to the vagaries of sentiment affecting the broader market as well as the performance of the individual LIC. The idea of PTrackERS is to insulate investors from these sentiment shifts – a redemption “safety net”.
HOW SMSFs ARE INVESTING

Move toward global equities in portfolios, via ASX, gathers pace.

For global investors, 2017 was a top-performing year, with most of the major world indices posting double-digit gains. The Dow Jones Industrial Average was up 25.2 per cent and the S&P 500 19.7 per cent.

With global sharemarket capitalisation steadily heading towards $100 trillion, many self-managed super fund (SMSF) investors are sitting up and taking notice of offshore performance, seeking opportunities to diversify outside the Australian market by investing in exchange-traded funds (ETFs), listed investment companies (LICs) and mFunds.

Advised SMSFs are more diversified

Trading analysis of data across the Bell Direct platforms shows some marked differences between the investment preferences of advised versus self-directed SMSFs.

The Bell Direct Investment Barometer shows that advised SMSF portfolios continue to be more diverse than self-directed SMSFs and are shifting some of their allocation from direct equities at a faster rate.

The table below provides a quick snapshot:

![Table showing investment preferences between advised and self-directed SMSFs](image)

* Includes warrants, floating rate notes, convertible preference securities, convertible notes

Source: Bell Direct

The shift is from Australian-domicile direct equities to products that provide access to a wider range of locations and assets, namely ETFs. There are some obvious reasons for this. Although the Australian sharemarket has performed well in recent decades and offers attractive income-generation features such as franking credits, it is relatively small on a global scale, accounting for just over 2 per cent in December 2017.

Also, ASX is dominated by a small number of large companies in the financials (32.7 per cent) and materials (18.8 per cent) sectors, with the top 20 stocks comprising almost half the market capitalisation.

By comparison, the MSCI World Index offers access to 23 developed markets (see chart below) and a much broader range of sectors, the largest being information technology (19.47 per cent), financials (17.11 per cent), consumer discretionary (12.8 per cent) and healthcare (11.89 per cent).

As such, many SMSFs have acted to shift portfolios towards a more globally minded and diversified portfolio (often using ASX-listed products for global equities exposure).

The growing number of ETFs, LICs and mFunds on ASX enable investors to increase their portfolio diversification by tapping into new markets and less-traditional high-growth sectors such as robotics, aerospace and IT.

Some of the best-performing global stocks in 2017 were in these sectors. Tesla, for instance, was up 47 per cent, Facebook posted gains of more than 50 per cent and flash storage provider Micron delivered an impressive 101 per cent.

A weakening Australian dollar has also provided impetus for many advisers to look offshore to maximise investment gains.

Many self-managed super fund (SMSF) investors are sitting up and taking notice of offshore performance.

Self-directed SMSFs slower to respond

The figures show that self-directed SMSFs have been slower to respond to the constant calls for portfolio diversification, even increasing their allocation to Australian-domiciled direct equities to 84.39 per cent as of April this year.

Of this, 40.25 per cent was allocated to financials, 14.8 per cent to materials, 9.0 per cent to healthcare and 6.9 per cent to consumer staples.

With more than 70 per cent of the direct equity allocation reliant on just four sectors, self-directed SMSF portfolios are exposing themselves to significant portfolio risk.

A reason for this increasing lack of diversification could be the time it takes to effectively run an SMSF. According to Investment Trends in March, SMSF trustees spent about 6.4 hours a month managing their fund, up from 6.3 hours in 2014. With so much time being consumed by fund administration, it is easy to see why so many SMSFs are exposed to portfolio concentration risk.

It is often said that strategic asset allocation is responsible for 80 per cent of overall portfolio performance. Ultimately, this is the key driver behind the retirement outcomes an SMSF can derive over its lifetime.

As a rule of thumb, SMSF trustees should spend most of their investing time researching and managing overall performance. For most, this is where the value add is and the rationale for setting up an SMSF in the first place.

Lifting the net performance of a median-size SMSF of $630,000 $3,150 a year – before compounded interest. This is more than double the cost of an average digital administration solution.

Learnings for all SMSF investors

The Bell Direct Investment Barometer should serve as a base for self-directed and advised SMSF trustees to review and compare their current asset allocation.

In our view, a well-diversified SMSF portfolio should strike a balance between direct equities, passive low-cost index funds and professionally managed active funds (which can be easily accessed and managed through mFunds). The key is to balance the performance of the SMSF portfolio with the risk profile of the members, while minimising the underlying total cost of running the portfolio.

A key component of these choices is also the transition from an SMSF from accumulation to pension phase. As it moves closer to pension phase, it is easy to see why so many SMSFs are exposed to portfolio concentration risk.

Self-directed SMSFs still slower to respond

The figures indicate that self-directed SMSFs have been slower to respond to the constant calls for portfolio diversification, even increasing their allocation to Australian-domiciled direct equities to 84.39 per cent as of April this year.

Of this, 40.25 per cent was allocated to financials, 14.8 per cent to materials, 9.0 per cent to healthcare and 6.9 per cent to consumer staples.

With more than 70 per cent of the direct equity allocation reliant on just four sectors, self-directed SMSF portfolios are exposing themselves to significant portfolio risk.

A reason for this increasing lack of diversification could be the time it takes to effectively run an SMSF. According to Investment Trends in March, SMSF trustees spent about 6.4 hours a month managing their fund, up from 6.3 hours in 2014. With so much time being consumed by fund administration, it is easy to see why so many SMSFs are exposed to portfolio concentration risk.

It is often said that strategic asset allocation is responsible for 80 per cent of overall portfolio performance. Ultimately, this is the key driver behind the retirement outcomes an SMSF can derive over its lifetime.

As a rule of thumb, SMSF trustees should spend most of their investing time researching and managing overall performance. For most, this is where the value add is and the rationale for setting up an SMSF in the first place.

Lifting the net performance of a median-size SMSF of $630,000 even by half a per cent can provide investors with an extra $3,150 a year – before compounded interest. This is more than double the cost of an average digital administration solution.

Learnings for all SMSF investors

The Bell Direct Investment Barometer should serve as a base for self-directed and advised SMSF trustees to review and compare their current asset allocation.

In our view, a well-diversified SMSF portfolio should strike a balance between direct equities, passive low-cost index funds and professionally managed active funds (which can be easily accessed and managed through mFunds). The key is to balance the performance of the SMSF portfolio with the risk profile of the members, while minimising the underlying total cost of running the portfolio.

A key component of these choices is also the transition from an SMSF from accumulation to pension phase. As it moves closer to pension phase, it is easy to see why so many SMSFs are exposed to portfolio concentration risk.

Self-directed SMSFs still slower to respond

The figures indicate that self-directed SMSFs have been slower to respond to the constant calls for portfolio diversification, even increasing their allocation to Australian-domiciled direct equities to 84.39 per cent as of April this year.

Of this, 40.25 per cent was allocated to financials, 14.8 per cent to materials, 9.0 per cent to healthcare and 6.9 per cent to consumer staples.

With more than 70 per cent of the direct equity allocation reliant on just four sectors, self-directed SMSF portfolios are exposing themselves to significant portfolio risk.

A reason for this increasing lack of diversification could be the time it takes to effectively run an SMSF. According to Investment Trends in March, SMSF trustees spent about 6.4 hours a month managing their fund, up from 6.3 hours in 2014. With so much time being consumed by fund administration, it is easy to see why so many SMSFs are exposed to portfolio concentration risk.

It is often said that strategic asset allocation is responsible for 80 per cent of overall portfolio performance. Ultimately, this is the key driver behind the retirement outcomes an SMSF can derive over its lifetime.

As a rule of thumb, SMSF trustees should spend most of their investing time researching and managing overall performance. For most, this is where the value add is and the rationale for setting up an SMSF in the first place.

Lifting the net performance of a median-size SMSF of $630,000 even by half a per cent can provide investors with an extra $3,150 a year – before compounded interest. This is more than double the cost of an average digital administration solution.

Learnings for all SMSF investors

The Bell Direct Investment Barometer should serve as a base for self-directed and advised SMSF trustees to review and compare their current asset allocation.

In our view, a well-diversified SMSF portfolio should strike a balance between direct equities, passive low-cost index funds and professionally managed active funds (which can be easily accessed and managed through mFunds). The key is to balance the performance of the SMSF portfolio with the risk profile of the members, while minimising the underlying total cost of running the portfolio.

A key component of these choices is also the transition from an SMSF from accumulation to pension phase. As it moves closer to pension phase, it is easy to see why so many SMSFs are exposed to portfolio concentration risk.

Self-directed SMSFs still slower to respond

The figures indicate that self-directed SMSFs have been slower to respond to the constant calls for portfolio diversification, even increasing their allocation to Australian-domiciled direct equities to 84.39 per cent as of April this year.

Of this, 40.25 per cent was allocated to financials, 14.8 per cent to materials, 9.0 per cent to healthcare and 6.9 per cent to consumer staples.

With more than 70 per cent of the direct equity allocation reliant on just four sectors, self-directed SMSF portfolios are exposing themselves to significant portfolio risk.

A reason for this increasing lack of diversification could be the time it takes to effectively run an SMSF. According to Investment Trends in March, SMSF trustees spent about 6.4 hours a month managing their fund, up from 6.3 hours in 2014. With so much time being consumed by fund administration, it is easy to see why so many SMSFs are exposed to portfolio concentration risk.

It is often said that strategic asset allocation is responsible for 80 per cent of overall portfolio performance. Ultimately, this is the key driver behind the retirement outcomes an SMSF can derive over its lifetime.

As a rule of thumb, SMSF trustees should spend most of their investing time researching and managing overall performance. For most, this is where the value add is and the rationale for setting up an SMSF in the first place.

Lifting the net performance of a median-size SMSF of $630,000 even by half a per cent can provide investors with an extra $3,150 a year – before compounded interest. This is more than double the cost of an average digital administration solution.

Learnings for all SMSF investors

The Bell Direct Investment Barometer should serve as a base for self-directed and advised SMSF trustees to review and compare their current asset allocation.

In our view, a well-diversified SMSF portfolio should strike a balance between direct equities, passive low-cost index funds and professionally managed active funds (which can be easily accessed and managed through mFunds). The key is to balance the performance of the SMSF portfolio with the risk profile of the members, while minimising the underlying total cost of running the portfolio.

A key component of these choices is also the transition from an SMSF from accumulation to pension phase. As it moves closer to pension phase, it is easy to see why so many SMSFs are exposed to portfolio concentration risk.
Our annual conference was held from 31st July to 1st August and this year continued the pattern of the last twenty years of great AIA investment conferences.

The theme of the conference – “Synchronicity” – referred to the fact that the 45 countries tracked by the OECD are all experiencing growth this year. We arranged various sessions to explore the effects of this synchronised growth on our own investment strategies.

Stephen Koukoulas opened the Monday morning and told us that the China economy may be softer than official figures show. There were tentative hints that 2019 growth will be less. He also said that the Australian economy was underperforming marginally, with growth now 2.75% against a forecast of 3.25% which was looking unlikely.

He went on to speak about housing construction, capital investment, infrastructure spending, unemployment and interest rates. We were given a very clear picture of the factors currently affecting our investment landscape.

I wanted to avoid singling-out individual speakers, but I have to comment on Saul Eslake. Saul spoke after lunch on the final day, and very effectively provided a summary and a reminder of the current scene. He mentioned that our potential growth rate is less, and that growth in the workforce is about to turn negative.

We also heard from Peter Switzer who suggested that the bull market can go on and interest rates are not currently a threat. Other speakers of course covered the range of portfolio construction, asset allocation, estate planning, fixed income, etc. Roger Montgomery spoke in the final session, and told us that mortgage delinquencies are increasing and we have record household debt to GDP and record household debt to incomes. Roger said ‘be cautious and discerning’, and to expect more volatility.

In a new innovation this year, we had a live Skype interview with fund manager Paul Black, who is Co-CEO and portfolio manager at WCM Investment Management based in Laguna Beach USA. This opened our minds to the ideas and strategies of a successful fund manager from the other side of the world, and shook us out of our tunnel-vision and gave us some insight into how the majors do things. I think that the committee may well use this technology again in the future. We often think of inviting top overseas experts to speak at our conference, but the tyranny of distance (and time) makes this impossible. With this technology we can enjoy these speakers without them being physically present.

For the second year, we held “the Great Debate”, this time the topic was “That men make better investors than women”. Henry Jennings and Charlie Aitken were the affirmative team, and Felicity Cooper and Holly Grofski were the negative team, all ably chaired by Marcus Padley with Alan Hull as timekeeper. The women won (again) and it was a very amusing and entertaining performance by all. Lots of light-hearted fun to finish the day.

At the 2017 National Conference in August last year, we asked a number of speakers to give us their stock picks. This was intended to be a serious contest but with a light-hearted edge to it. We said that we would award a prize to the winning stock-picker. The stock picks were not published to the general membership, so you had to attend the conference to be ‘in the know’. We allocated a notional $20,000 to each stock, and we tracked the total return from the Friday of the conference week, up to the 30th June this year.

The winner was announced at the 2018 Conference last month, and the results are shown below. The top prize goes to Paul Rickard who achieved a 51.8% return, and in equal second place are Henry Jennings and Charlie Aitken with a 49.1% return. We think you will agree that these are very fine results. Interestingly, if you were to invest an equal amount in all of the picks, you would have achieved 22% for the period. So, even with the not-so-good picks, you would have achieved a result nearly double the increase in the ASX200 index.

We ran the contest again at the Conference this year, and we will award a prize again next year.

### 2017 AIA Conference - Stock Picks

<table>
<thead>
<tr>
<th>Tipper, and TIp</th>
<th>Price on 4th Aug 2017</th>
<th>% of $20K investment</th>
<th>Price on 25th June 2018</th>
<th>Value on 25th June 2018</th>
<th>Profit (Loss)</th>
<th>Dividends Received</th>
<th>Total Return</th>
<th>Percent Return</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paul Rickard CSL Limited</td>
<td>128.14</td>
<td>156</td>
<td>23.62</td>
<td>30.063.99</td>
<td>10,063.99</td>
<td>299.71</td>
<td>10,363.70</td>
<td>51.82</td>
<td>1</td>
</tr>
<tr>
<td>John Addis Trade Me Group Limited</td>
<td>4.01</td>
<td>415</td>
<td>4.27</td>
<td>17,754.68</td>
<td>-2,245.32</td>
<td>728.56</td>
<td>-1,516.77</td>
<td>-7.58</td>
<td>7</td>
</tr>
<tr>
<td>Chris Stott Southern Cross Media Group</td>
<td>1.16</td>
<td>471</td>
<td>1.51</td>
<td>19,364.71</td>
<td>-715.29</td>
<td>1,189.71</td>
<td>404.41</td>
<td>2.02</td>
<td>6</td>
</tr>
<tr>
<td>Henry Jennings Aristocrat leisure Limited</td>
<td>20.95</td>
<td>955</td>
<td>30.90</td>
<td>29,988.81</td>
<td>9,498.81</td>
<td>324.58</td>
<td>9,823.39</td>
<td>49.12</td>
<td>2</td>
</tr>
<tr>
<td>Steve Johnson Macmahon Holdings Limited</td>
<td>0.175</td>
<td>232</td>
<td>0.22</td>
<td>24,571.83</td>
<td>4,571.83</td>
<td>0.00</td>
<td>4,571.83</td>
<td>22.86</td>
<td>5</td>
</tr>
<tr>
<td>Ansgus Geddes Fairfax Media Limited</td>
<td>1.04</td>
<td>1932</td>
<td>0.75</td>
<td>14,092.75</td>
<td>-5,507.25</td>
<td>599.03</td>
<td>-4,908.21</td>
<td>-24.54</td>
<td>8</td>
</tr>
<tr>
<td>Charlie Aitken Aristocrat leisure Limited</td>
<td>20.95</td>
<td>955</td>
<td>30.90</td>
<td>29,988.81</td>
<td>9,498.81</td>
<td>324.58</td>
<td>9,823.39</td>
<td>49.12</td>
<td>2</td>
</tr>
<tr>
<td>Roger Montgomery REA Group Limited</td>
<td>68.74</td>
<td>231</td>
<td>90.87</td>
<td>25,405.75</td>
<td>6,545.75</td>
<td>225.13</td>
<td>6,770.89</td>
<td>53.62</td>
<td>4</td>
</tr>
<tr>
<td><strong>Total and Average</strong></td>
<td><strong>160,906.00</strong></td>
<td><strong>191,583.93</strong></td>
<td><strong>31,583.93</strong></td>
<td><strong>3,703.30</strong></td>
<td><strong>35,285.23</strong></td>
<td><strong>22.05</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
TRADE WARS - WHAT’S BEEN GOING ON?

Increased globalisation and the industrial development of China, Korea, Brazil, etc has created winners and losers. Economic theory states that increased trade, with low or no tariffs benefits all parties, as those with a comparative advantage (costs, know how, etc) in particular goods and services, produce more of those goods and service, etc. At the broad macroeconomic level this has largely been borne out as standards of living have broadly risen for those countries that have taken part in global trade.

However broad macroeconomic statistics don’t tell the whole story, as we know. Workers and regions in the West that have relied on old traditional industries – steel, shipbuilding, mining, car production – have clearly lost out in globalisation as these jobs have moved East – either eastern Europe, or Asia where labour and material costs have been lower. Increased migration has also pushed down relative wages for those in less skilled work categories in many parts of the West too.

Donald Trump clearly identified this understandable loss and anger felt in America’s Rustbelt states and promised to bring back jobs to these hard hit areas. This clearly helped him win the Presidency in key States like Ohio, Pennsylvania, Iowa and Illinois.

Now Trump clearly believes this has a lot to do with unfair trade terms between China, Europe and wherever else is exporting goods in certain categories – steel, aluminium, engineering products, etc. The key questions are: Is this a purely political gesture to his voter base to make them feel better, or will it have a material positive economic impact on these areas? Who will be the winners and losers? How far could it escalate? What will be the wider economic and political impact of such a trade war? How much will it affect markets?

The recent tariffs imposed by the USA on EU steel and aluminium products only fall on $12.5bn of goods traded (0.6% of EU exports to USA); while EU imposition on US agricultural and steel products only amount to $7.5bn of goods traded (2.5% of EU imports from USA).

The size of trade affected by tariffs between China and the USA is altogether more substantial. The US has already announced a total value of $250bn of imports from China with extra levies of 10% (total of 25%) covering over half the value that the US currently imports from China ($462.5bn). These cover a very wide range of goods, covering 28 pages from the US trade’s representation office from aircraft parts, lithium batteries, ICT, robotics, printers & copiers, machinery, autos, cranes and oil & gas parts. Notably it excludes TVs, and mobile phones, but most manufactured goods are on the list. Of the companies our portfolio hold, the mostly likely impacted from the Chinese tariffs on the USA would be Caterpillar, with the Japanese rival, Komatsu benefiting at its expense.

 TRADE WARS - WHAT’S BEEN GOING ON? continued...

When investors hear “Trade Wars” they invariably think of the 1930s

World stock markets are understandably worried about escalation risks. Tariffs raise prices across the world and reduce consumption. Further escalation with Europe would likely see a significant sell off in markets. If the tariffs are broadly confined between USA and China, markets could probably live with that. If these tariffs stick and there is negotiated settlement between the USA and China it will be interesting to see how Chinese companies cope with the increased price and whether they can absorb some of it through reduced pricing, or even moving some of its production offshore. To put it in to context, if China lost 30% of its exports to the USA that would reduce Chinese GDP by 1.2%; if they lost every single sale to the USA it would be 4.0% of GDP.

Corporate bonds may provide the solution to your portfolio imbalance.

Preserve capital and create a known income
Active, liquid markets
NO custody fees
Diverse range, offering 6-12%pa
Self-directed or managed account options

www.mintpartners.com.au

Fixed income solutions

bdc

Lazy cash barely keeping pace with inflation?

Overweight equities and concerned about a correction?

BGC

Cameron Window • Ph: 0421 829 760 • E: cameron.window@mintpartners.com

Fixed income solutions

Proud partners of the AIA
There was an impressive 99 people present at our last Chatswood Information evening on 19 August 2018. The keynote speaker, Dr. Ken Macdonald from the CSIRO, shared his thoughts on Blockchain technology, and the implications for our investing activities.

Mark showed us how Blockchain could potentially remove the ‘middle-man’ in financial opportunities (e.g. peer-to-peer transactions, resulting in lowering costs) and risks (e.g. lack of confidentiality in transactions as well as the risk of losing the ‘security key’ to our account) for our investing activities.

I found Mark’s presentation to be insightful and balanced, raising many questions for me such as “How do we keep information confidential when Blockchain allows everyone to see what everybody else is doing?”. Responding to these questions will be part of the educational process for us as self-directed investors. In this regard, Mark certainly succeeded in raising many interesting questions for the audience.

I would like to thank the NSW State Committee, especially Marina, for their work in putting on a very successful evening. It truly was an evening of Investors helping Investors!

I would like to thank the NSW State Committee, especially Marina, for their work in putting on a very successful evening. It truly was an evening of Investors helping Investors!

**What happens when the CIO of your SMSF passes away?**

- Women outlive their partners by at least 5 years;
- Yet, men make the majority of SMSF and investment decisions;
- Most families don’t have a Plan B for their investment strategy.

Ask how we can tailor a solution for you

**CONTACT WATTLE PARTNERS** 03 8414 2901

---

**REPORT: BLOCKCHAIN EVENT AT SYDNEY’S NORTH SHORE**

**MICHAEI TAN, AIA NSW Committee**
Your specialist in **modern** investment products with wealth preservation, diversification and growth

Global Merces Funds Management Ltd is Australia’s hub for new and interesting managed funds not found anywhere else.

We act on behalf of retail and wholesale managed investment schemes focussed on fractional property, property development, media and equity derivatives.

If you would like to learn more about investing in the funds we licence, visit [www.globalmerces.com.au](http://www.globalmerces.com.au)