

the INVESTORSvoice

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

Sept 2017



GLOBAL POLITICAL RISKS ONE YEAR ON FROM BREXIT



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In This Issue >>

President's message	3
Global political risks one year on from Brexit	4
One of the most significant developments to date in the world	7
Hold the phone...How are the telcos?	8
Direct shares compared to managed funds	10
3 Macro-economic factors to impact your portfolio	11
Behind the LIC boom	12
Residential property...What could go wrong?	14
Has foreign capital changed the face of Australian real estate	15
Keep your spouse close but your parents closer	16
The patriotic retirement plan	17
Options trading...Covered call strategy	18
Book Review	19
Is it too late to buy Bitcoin?	20
Conference recap	22
Calendar of events	24



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President's Message

By Graeme Bottrill



There are a few things to talk about this time. The last couple of months have been interesting, both within the AIA and externally.

Reporting season is well underway again. It began well enough with a few quite positive results (the banks, etc.), but then hit a few landmines and has become disappointing. The results are generally patchy and seem to be generating an uneasiness.

For example -

- Results from companies like IAG, Healthscope and Coca-Cola Amatil were badly received. Woolworths reported a dip in net profits thanks to large losses at Big W.

- BlueScope issued a cautious forecast for the year ahead, announced that it was under regulatory investigation, and announced that its CEO was stepping down after ten years. The stock was then sold down more than 20%.

- The banks continue to gouge ever-increasing profits from their customers, including the CBA which announced its 8th consecutive record annual profit. The CBA stock price increased a couple of percent, despite the company being caught out by allegations of more than 53,000 breaches of anti-money laundering and counter-terrorism financing laws. Apparently shareholders are not too concerned.

- Telstra announced profits down 14% and investors may have at last realised that the dividend could be unsustainable. The shares have since fallen 10%. I have read one analyst who said "Those Telstra shareholders that expected a set and forget investment got a rude awakening; not only was their future income hit but so was their capital – a double whammy! How long will it take to regain that capital loss"? The general consensus appears to suggest that Telstra may have some difficult times ahead although I have seen one analyst suggest that Telstra is a buy (also, see Roger Montgomery's article on telcos in this publication).

- David Jones' profit down 25%.

Should we anticipate some volatility in the near future?

Our Annual Conference was held from Sunday 30th July to Wednesday 2nd August. This was an exceptional conference, not only due to the amazing group of speakers and topics, but also due to the incredible buzz and camaraderie that was clearly evident among the members attending, and this is one of the many factors that sets our conference apart from other investment conferences. The feedback from members, speakers and sponsors has been amazing. We recorded HD videos of the plenary sessions and these will be available on our website to conference attendees once we have done the editing.

We were also blessed by the support of our sponsors and many have already indicated their intention to support us again next year.

We truly do have an event to be proud of. If you missed this year then you really need to make a point of attending next year (otherwise you will need a note!).

This year is the 25th Anniversary of AIA and we had quite a celebration at the conference dinner. We were entertained by 'The Corporate Impostor', and we enjoyed a 25th anniversary cake.



We have produced a 25th Anniversary booklet which was given to everyone at the conference. This takes us through a brief journey of the formation of AIA by Austin Donnelly in 1992 and some snippets of the development of AIA over the years. There are reproductions of some early correspondence, and an honour roll of board members from 1992 to today. We have a few spare copies if anyone would like one. Please phone the office and we will send one out to you with a small cost for postage, etc. Be quick, as we only have a few spares.

Enjoy the journey.
Graeme Bottrill

GLOBAL POLITICAL RISKS ONE YEAR ON FROM BREXIT - What have we learned?

GLOBAL POLITICAL RISKS ONE YEAR ON FROM BREXIT - What have we learned? continued...

DR SHANE OLIVER

Key points

- Geopolitical issues create much interest, but as we saw over the last year starting with Brexit this doesn't mean they'll have a big negative impact on financial markets.
- However, a backlash against economic rationalist policies and inequality, and the declining relative power of the US globally will likely mean that geopolitical issues will continue to flare up in the years ahead.
- Key issues for investors to keep an eye on are the upcoming Italian election, the ongoing risks around President Trump and North Korea.

Introduction

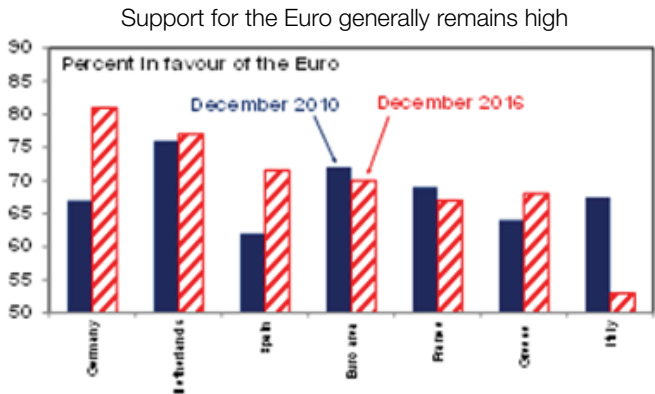
It's now 12 months since the British voted to leave the European Union, an event that some saw as setting off a domino effect of other European countries looking to do the same. This was also followed by a messy election result in Australia, Donald Trump's surprise victory in the US presidential election, increasing concern around North Korea and a steady flow of terrorist attacks. The combination of which seemed to highlight that geopolitics is now more important, and perhaps more threatening, for investors than had previously been the case. But while political developments have figured highly over the last year, the impact on markets has been benign. Since the Brexit vote, global shares are up 22% and Australian shares are up 13%. So what gives? This note looks at the main issues.

Why so little impact?

There are a number of reasons why the impact on investment markets from geopolitical events starting with Brexit has been short lived or non-existent over the last year or so:

- Europeans have refused to play along. Brexit was only going to have a significant impact globally if it triggered a domino effect of countries seeking to exit the Euro, threatening its demise. But there has been no evidence of this with post-Brexit elections in Spain, Austria, the Netherlands and France all seeing dominant support for centrist pro-Europe parties. So Brexit has turned out to be a storm in an English teacup from a global perspective. There are several reasons why European countries have gone in a different direction to the UK: continental Europeans identify far more with "Europe" than the British do; it's much harder to leave the Euro than just the European Union; people in Eurozone countries like the Euro; Europe generally does not have the same issues with inequality that have driven an anti-establishment backlash in the UK and US; and staying together makes Europeans feel stronger at a time of increased global uncertainty.

“ There are several drivers of increasing geopolitical tensions ”



Source: Eurobarometer, AMP Capital

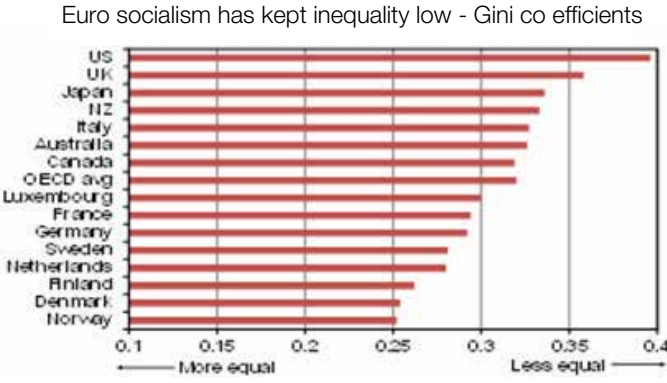
- "Trump the pragmatist" is dominating "Trump the populist". He has not withdrawn the US into isolationism, there is no trade war with China, he has appeared more focussed on pro-business policies such as deregulation and tax reform than populist policies, and he appears supportive of the Federal Reserve under Janet Yellen.
- Global growth has improved. This and rising profits have swamped geopolitical worries.
- Uncertainty over geopolitics has led to easier for longer monetary policy, notably in the US and Europe.
- And finally, in Australia the Government was returned and the difficulties in the Senate really just mean a continuation of the past, ie not great, but no disaster.

Where are we now with geopolitical risks?

While the events of the last year highlight the importance of not getting too excited about geopolitical events, they are likely to remain important for investors to keep an eye on. There are several drivers of increasing geopolitical tensions:

First, a backlash against economic rationalist policies (deregulation, privatisation and globalisation) because of the slow post global financial crisis (GFC) recovery, rising inequality in some countries and stress around immigration. The danger is that this results in re-regulation, nationalisation, increased taxes and protectionism and other populist responses, which could slow growth and share markets. However, it is worth noting that this backlash against free market policies is a messy theme. It's most acute in the US and UK as this is where inequality is greatest. See next chart, which shows Gini coefficients – a measure of income distribution - for major countries.

Politics in the UK has clearly swung to the left. But in the US while Donald Trump has tapped into popular discontent it's doubtful that his policies (e.g. cutting healthcare and corporate tax cuts) will deal with rising inequality and could just set the scene for a more left wing (Bernie Sanders-like) candidate winning the 2020 presidential election. And of course in Europe inequality has been less of an issue as it has always been more to the left anyway. In fact, France appears to be heading in a more rationalist direction.



Data is after taxes and welfare transfers.
Source: OECD, AMP Capital

Second, the relative decline of the US is shifting us away from the unipolar world that dominated after the end of the Cold War when the US was the global cop and most countries were moving to become free market democracies. Now we are seeing the rise of China, Russia's attempt to revisit its Soviet past and efforts by other countries to fill the gap left by the US in various parts of the world creating geopolitical tensions – what some have called a multi-polar world. This is evident in increasing tension between Saudi Arabia and Iran, Russia's intervention in Ukraine, and tensions in the South China Sea.

Finally, rogue states seeking to or getting access to nuclear weapons and terrorism remain an ongoing threat, notably North Korea in relation to the former and IS in relation to terrorism.

Global geopolitical issues to keep an eye on

The following looks at geopolitical issues worth watching.

German election (September 24) – Chancellor Merkel looks on track to win, but if she doesn't the centre-left Social Democrat Party under new leader Martin Schulz will, and its more pro-Europe than Merkel. Either way the result is likely to be stepped up German support (with France) for Eurozone integration.

Italian election (due by May 2018, but possibly later this year) – Italy remains a risk as support for the Euro there is weaker and it could cause a new round of break-up fears once its election date is fixed. But the waning of populist support across Europe may have a spill over in Italy. The supposedly Eurosceptic Five Star Movement seems to be wavering a bit in its Euroscepticism. Even if it does win the most seats in parliament, it won't get a majority and is unlikely to be able to form a coalition government. And even if it did and managed to move Italy towards an Itexit, a market panic would drive Italian bond yields sharply higher forcing a back down. In any case, the risk of a domino-like flow on from an Itexit to the rest of the Eurozone looks to be weak given recent European elections.

Greece – Greece seems to be creeping towards some form of debt forgiveness but this may have to wait until after the German election. In any case, there is no longer a populist Eurosceptic party for the Greeks to turn too.

More broadly, at some point investment markets will presumably tire of fearing each time an election comes up in Europe that there is the risk of some form of Euro exit. This issue has been going on since 2010 and all we have really seen is a progressive move to more Europe, not less.

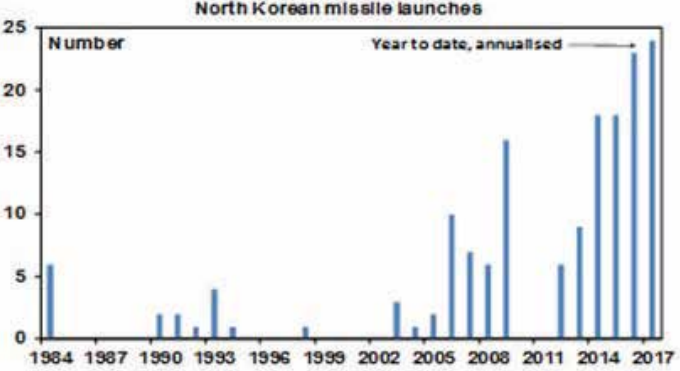
The US – impeachment risk – The main risk for investors in relation to the US is that the noise – or should that be comedy – around the Trump/FBI/Russia issue distracts the political process to such a degree that Trump's pro-business agenda stalls. Our view remains, though, that while the Democrats may find something to impeach Trump on when they get control of the House of Representatives (as seems likely after the November 2018 mid-terms) in the meantime the Republicans are unlikely to impeach Trump. Rather, anticipation of the likely loss of control of Congress after November next year will see Republicans pull together to pass their pro-business agenda. In this regard, note that the Senate is progressing on a health care reform, which is a precursor to tax reform.

The US – shutdown/debt ceiling risk – In September, funding will have to be renewed for the US Government to avoid a shutdown and by early October the debt ceiling will need to be raised again. Both are likely to happen – as 2013 showed, no side wants to be blamed for a shutdown or debt default.

Terrorism – The impact of terrorism on investment markets has been declining since the 9/11 attacks to the point where recent attacks in Europe have had little impact. While terrorist attacks are horrible from a human perspective most don't really have much economic impact and, after a while, economies and markets become desensitised to them to a degree.

Iran v Saudi Arabia – Tensions between Shia Iran and Sunni Saudi Arabia are likely to remain but are very unlikely to break out into warfare between the two.

North Korea – The risk here has risen as its missile tests have increased and within a few years it may have the capability to lob a missile with a nuclear warhead into the US (or Australia). A US missile strike is possible but would risk significant loss of life in Seoul and beyond. So a diplomatic solution aimed at containment is the most likely. Time will tell if this is successful but trying to protect an investment portfolio against the uncertain timing of North Korean risk is a bit like trying to protect it against a nuclear war in the Cold War.



Source: AMP Capital

GLOBAL POLITICAL RISKS ONE YEAR ON FROM BREXIT - What have we learned? continued...

China/US relations – Trade and the South China Sea tensions are the main issues here. So far so good with Trump looking to work through the trade issue with China and cool heads prevailing regarding the South China Sea. How the renegotiation of the North American Free Trade Agreement goes will provide some guide as how Trump is proceeding on trade. But so far it's been more rational than feared.

Implications for investors

Based on the experience of the last year around geopolitical risks, there are several implications for investors: First, turn down the noise. Geopolitical issues create much interest and are great for dinner party conversations, but as we saw over the last year this does not mean they will necessarily have a huge negative impact on investment markets. Second, it's hard to quantitatively build geopolitical risks into an investment process. You really have to understand each issue separately.

Finally, the ultra short-term impact of the Brexit and Trump election shocks – with both seeing an initial fall in share markets followed by market strength – highlights the benefit in looking for the opportunities geopolitical shocks throw up.

Dr Shane Oliver: Head of Investment Strategy & Chief Economist, AMP Capital



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ONE OF THE MOST SIGNIFICANT DEVELOPMENTS TO DATE IN THE WORLD OF INTERNATIONAL FINANCE

DREW MEREDITH

It has been hailed as 'one the most significant developments to date in the world of international finance'. No it's not the latest exchange traded fund (ETF) or research platform; it's the release of a new accounting standard for all listed business around the world. I know it's probably not the most interesting announce-ment you will see this month, but it may actually be one of the most important.

The change called AASB 16 and approved by the International Accounting Standards Board (IASB), will require every listed company to treat their property leases the same way; as 'finance' leases from 1 January 2019. What this means is that where previously a retailer like Myer or Wesfarmers could record keep their many rental agreements out of their financial statements, they will now need to include all of their future rental payments as on-balance sheet debts. As you would expect, for a company like Wesfarmers that has over 3,000 individual leases the implications are huge; early predictions expect their debt to nearly double from \$17bn to \$32bn overnight. The story for Myer isn't much better, with expectations that their debt will treble to \$2.6bn, some \$2.0bn above their current market capitalisation. **So why does this matter?**

It matters because the change will have far reaching impacts on profitability, comparability and credit ratings for the many compa-nies affected. We consider each individually below:

- **Profitability:** With all leases being moved onto the balance sheet the actual usage of the premises will be reflected in both depreci-ation and interest expenses on the balance sheet, rather than rental payments. Interest expenses come after the earnings or EBIT line, meaning margins will improve, but net profit will be lower. The result being that the balance sheet cost of each premises will be markedly different from the actual cash paid to their landlord.
- **Credit Ratings:** This is where the biggest impacts are likely to be experienced. As highlighted above, the debt levels of some businesses could double or even triple overnight. This event will see many businesses breach their debt covenants, resulting in the need for lengthy negotiations and discussions with their lenders. The size of their debt burdens may also impact on both the company's ability to raise further debt and the cost of this debt.

- **Comparability:** One of the less considered implications will be the impact these changes have on investors, both DIY and professional. Such a substantial change will mean that it will be incredibly difficult to make informed investment decisions based on historical financial statements; a key part of any fundamental analysis. The changes will impact many major financial metrics, like return on invested capital (ROIC), gearing ratios and even interest cover. Most importantly they will impact on the earnings, both EBIT and EBITDA figures, as both interest and depreciation fall outside of this calculation. The changes will make it increas-ingly difficult to compare two companies operating in the same industry but with different leasing strategies; i.e. short versus long-term.

The changes will, of course, not only impact retailers, but any company that rents premises whether as their head office, storage or agricultural property. It is yet to be seen what impact these changes could have on the banking sector and in particular their capital adequacy ratios. We expect that the businesses most impacted will progressively turn to shorter-term lease agreements or spend a great deal more time negotiating alternative clauses into their agreements in order to ensure they are gaining the full benefit of the changes.

The IISB believe that these new standards are required to finally 'bring lease accounting into the 21st century' by removing managements' ability to hide these types of commitments off their balance sheets. It will also help to compare companies that sell and leaseback properties versus those who simply borrow to fund the purchase.

Whilst this change will not be implemented for another 18 months, many newly listed businesses are already operating under these standards. For this reason, it is imperative investors get a handle on the changes before it's too late. If anything, these changes reiterate the importance all investors should place on understanding the true financial position of the businesses they are investing into.

Drew Meredith: Director, Somern Private Wealth



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HOLD THE PHONE...How are the telcos?

HOLD THE PHONE...How are the telcos? *continued...*



ROGER MONTGOMERY

“
growth in data
demand has
focused
competition
between
providers
”

The telecommunications sector endured a horrible year in 2016 with slumping share prices reflecting the uncertainty of the viability of various business models ahead of the completion of the NBN rollout. Downgrades, writedowns and capital raisings are just some of the events shareholders themselves have had to endure.

So how should investors think about a complex and extremely dynamic sector and what are some of the considerations before deciding whether valuations have become attractive since the sell off?

Fifteen years ago, life was simpler, a residence enjoyed dial-up Internet access, with speeds 100 times slower than today, shopping catalogues clogged mailboxes, CDs and DVDs clogged shelves and drawers, and teens argued about who could use the phone next. Smart phones didn't exist and the only wireless device was the TV and roller door remote control. Back then it took less time to walk to the 'video' store, come home with a DVD, watch the movie and return it than it did to download one.

The speed of change is now as fast as the connectivity we demand from our ISP and competition is ensuring prices keep falling. Meanwhile, ever faster speeds create new service categories that device manufacturers and service providers must enable access to.

This recipe of promising more data and services at ever-lower prices is not an easy menu item for operators to deliver. Combined with more than 110 companies offering access to the NBN alone, it makes navigating the future very difficult for investors and therefore valuing opportunities almost 100% guesswork.

Despite declining prices, Australian telecommunications consumers have still had to pay substantial price premiums, particularly to Telstra, over their overseas counterparts, as well as accepting slower and inferior services.

Telstra has benefited most from consumers' unwitting willingness to pay premium prices. Limited competition, for example where Telstra is the only provider of services (to 46% of fixed line services, for example), means some 3.5 million consumers are adversely affected by the market structure.

Meanwhile, it is argued the subsidisation of Telstra, through the Universal Service Obligation (the obligation placed on Telstra to ensure that telephone services, payphones and prescribed carriage services are reasonably accessible to all people in Australia on an equitable basis) entrenches its market dominance. It might be just one reason consumers are paying more. Other reasons include the disparity in spectrum ownership between operators, which acts as a barrier to competition.

Regardless, data demand is surging. Demand for data on fixed networks grew by 40% from 0.96 million terabytes (TB) to 1.3 million TB, and mobile data increased by 35% from 72,000 TB to 110,000 TB. A significant contributor to this rising appetite for data is the preponderance of audio-visual streaming services such as Netflix, Presto and Stan, while a rising number of connected devices in homes – from an average of eight in 2016 to more than 20 in the next four years – will continue to contribute to data demands. As an aside, price is also driving data demand. In just the last four years, prices for similar data plans have fallen by more than 80%.

This growth in data demand has focused competition between providers of both fixed line and mobile services resulting in increased data quotas and bundled subscriptions to streaming services.

And to top it off, the industry will change significantly as the NBN rolls out. The NBN rollout and migration of consumers to the network will raise issues for regulators, the industry and for consumers. New bottlenecks may be discovered, there'll be new pressures on battery backup arrangement, Telstra may gain a competitive advantage from access to significant information flows, while smaller service providers, will demand and require a competitive and efficient aggregation and backhaul market.

To compete against Telstra's circa 60% market share (and 51% of wholesale NBN connections compared to 24% for TPG and 8% for Vocus) either significant scale or dominance of a growing niche (e.g. VOIP) is required. The result has been a wave of land-grabbing mergers and acquisitions, such as Vocus/NextGen/M2 and TPG/PIPE/AAPT/iNet.

In 2016, total telecoms services revenues exceeded \$40 billion and grew at 2.0% for the 12 months to June 2016. Much stronger-than-aggregate growth is being generated by second-tier providers, however Telstra still dominates.

Ongoing advances in the digital economy, as well as multi-industry use of the infrastructure and the Internet of Things, will see an ongoing increase in wholesale revenues and open up opportunities in data analytics, cloud computing and services that haven't been imagined yet, while the connection of literally billions of devices puts pressure on the infrastructure.

As the future moves towards the NBN, it is believed a more level playing field will be created, but as I mentioned earlier margins will continue to be pressured. If you're thinking the telco sector in Australia is an incondite gallimaufry, you're not too far from reality.

TELSTRA (SELL/HOLD)

Telstra is Australia's largest telecommunications provider by market share and market capitalization. It offers mobile, hardline telephone and internet services to residential and business customers, as well as wholesale services to Internet Service Providers and Retail Service Providers. Subscription services (e.g. Foxtel) are provided through its subsidiaries.

Despite accusations of monopolistic behaviour, investors have not seen rising profits from Telstra for many years and a large revenue hole will emerge after consumers exit the company's copper network and are invited by all providers to join the NBN with them. Indeed, the company's forecast 2017 profit will be no bigger than 2008. This is partly because a very high proportion of the company's earnings are paid out as dividends, meaning relatively little profit is retained and reinvested for growth. Investors should probably think of Telstra shares as they might a bond. Steady dividend income can be attractive but growth is required to fend off the ravages of inflation and maintain purchasing power.

Whether we rate the shares a hold or sell/avoid depends on the price that has been paid. Investors who purchased shares when they traded below intrinsic value estimates in 2010, have generated an attractive yield and enjoyed some capital growth and can continue to hold. Be mindful that rising bond rates will render the virtually fixed dividend from Telstra less attractive.

TPG (HOLD)

Established by the reclusive David Teoh more than three decades ago, and after a steady stream of acquisitions, TPG is now Australia's second-largest provider of fixed broadband services behind Telstra, with a market capitalization of \$5 billion. That market capitalization however is significantly lower after the shares fell 53% from more than \$12.50 to the current price of \$5.81.

TPG acts as owner-operator of voice, data and internet network infrastructure, provides NBN, ADSL2+, fibre optic and ethernet broadband access, telephony services and SIM-only mobile plans to residential users as well as SMEs (small and medium enterprises) larger companies, government enterprise, and wholesale customer RSPs. Importantly, TPG owns fibre-optic networks connecting capitals and metro areas, and it owns the international PPC-1 submarine cable connecting Australia with the USA and Asia.

The company recently announced further capital expenditure of \$600 million to build its own mobile network and become the fourth mobile network operator, joining Telstra, Optus and Vodafone.

VOCUS (HOLD/AVOID)

Like TPG, Vocus Communications also went through a raft of about 20 acquisitions. The key difference however has been a recent admission that those acquisitions were poorly managed, failed to be properly integrated and therefore, by definition, were overpriced.

Vocus began life as a provider of telecommunications and network services to the business sector. After merging with Amcom and acquiring its network assets in 2015, Vocus built its own fibre and data centre network across Australia and New Zealand. In the same year it was then transformed, becoming Australia's fourth-largest residential broadband internet, through its merger with M2 Telecommunications, which owned the Dodo, Commander and iPrimus brands. Its acquisition of Nextgen also gave it a national fibre backhaul network.

The recent downgrades will be followed by a significant time delay before the company can safely say it has integrated its acquisitions, merged cultures and extracted synergies. It will be some time before the outlook for this company is devoid of disappointment risk.

Roger Montgomery: Montgomery Investment Management

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DIRECT SHARES COMPARED TO MANAGED FUNDS

Managed Funds are a way to own shares without having to select the individual shares yourself. It is a way to pool all investors in a group and share the benefits together. You buy units in the fund from the fund manager and sell these units back in the future to this fund manager.

This industry has exploded with many to choose from but for the last 40 years most managed funds have not beaten the market average. The predominant reasons are the management fees and high operating costs.

We have listed below the reasons why direct shares could be a better investment than managed funds:

- Lower Returns:** A study conducted from the SPIVA score card identified some interesting figures:
- From all Australian Equity general funds, 67.76 % underperformed against the S&P/ASX 200 on a 3 year basis.
 - From all Australian Equity mid and small cap funds , 61.86% underperformed against the S&P/ ASX mid-small index on a 3 year basis.
 - From all Australian-Equity A-REIT funds , 92.86% underperformed against the S&P/ASX 200 A-REIT Index on a 3 year basis.

From the table below, we can see that the return of direct share ownership outperforms managed funds. Even some household name stocks have done very well. If you held MQG (Macquarie Group) for 3 years you would have returned 48%, if you held NST (Northern Star) you could have returned 241 % . The average return of 8 Australian indexed managed funds only returned 6.14%.

Investment	Return Over 3 years
Average return of 8 Australian Index Managed Fund	6.14%
Mid Cap Stocks - Direct Share Investment	% Return
MQG (Macquarie Group)	
Closing price 4 Jul 2014	60.44
Closing price 4 Jul 2017	89.75
Rate of Return	48.49%
NST (Northern Star)	
Closing price 4 Jul 2014	1.36
Closing price 4 Jul 2017	4.64
Rate of Return	241.18%

Fees: There may be an upfront entry fee or an exit fee. Some funds may also have a trailing commission fee to financial planners at 0.5% per annum. All funds charge a Management Expense Ratio (MER) which is about 0.7 percent to 2 percent with active managers charging a higher fee. Managed funds also charge performance fees. This is the fee which the fund manager charges when their returns are over the benchmarked index. These fees are a whopping 10% to 20% of the outperformance.

“The return of direct share ownership outperforms managed funds”

LAUREN HUA

Redemption issues: If there is a hoard of investors wanting to withdraw their money from the managed funds, the fund manager may need to sell their liquid assets to keep up with all the withdrawals. To prevent this from happening, they may choose to freeze any redemptions. This happened recently to the UK property funds during Brexit. These funds halted withdrawals as too many people were taking money out simultaneously.

Taxation issues: With direct shares, you can use your franking credits from your dividends to reduce your tax payable. In a managed fund, there are unknown tax issues as funds do not need to disclose their potential tax liabilities. Units which you buy may inherit tax liabilities on gains which you did not benefit from. Also you cannot use the capital losses in a managed fund to offset capital losses you have outside of the fund.

Over diversification: The number of stocks required for an optimal diversified portfolio is 30. In these managed funds, the number of stocks they hold can be anywhere between 30 – 100. Diversification can reduce risk but holding more than 30 stocks does not further reduce your risk, it rather often leads to bad returns.

Flexibility: Another issue with having direct shares over managed funds is the flexibility to liquidate stocks when needed. Big fund managers such as Platinum Asset Management manage about A\$23 billion. They hold large positions in stocks so if a stock goes pear shaped, they may find it difficult to liquidate all their positions. As an individual investor with a smaller holding, it would be easier to sell your position with a simple call to your stock broker. Fund managers may also have mandates which require them to hold a certain percentage of cash in their funds. As an individual investor, you choose how much cash you want to hold in a trading account. In a bear market, you may want to hold a significant portion or the whole portfolio in cash. This choice would not be available in a managed fund.

Lauren Hua: Private Clients Adviser, Fairmont Equities
Article courtesy of Fairmont Equities, www.fairmontequities.com

3 MACRO-ECONOMIC FACTORS TO IMPACT YOUR PORTFOLIO

MATTHEW HAUPT

Since the global financial crisis (GFC), equity markets have been particularly affected by macro-economic factors. Identifying and understanding Australian and international macro-economic drivers is therefore a crucial element of investing given their potential to impact company earnings, and ultimately the performance of an investor's portfolio.

Three key macro-economic themes we are currently focused on are: the approach taken by central banks globally to monetary policy, the state of the Australian consumer and the outlook for China.

Central bank policy

Following the GFC, central bankers took unprecedented steps to support their economies, slashing official interest rates to record lows and injecting extraordinary levels of liquidity. Since 2008, the world's 50 largest central banks cut interest rates 700 times and injected \$9 trillion of liquidity into markets worldwide. Key for equity markets and investors alike will be the central banks' approach to unwinding the unprecedented monetary and quantitative easing measures adopted over the last decade, including massive bond-buying programs.

Various central banks, including the US Federal Reserve and the Bank of Canada, have recently commenced unwinding these measures, raising rates and withdrawing liquidity as conditions strengthened. With the exception of Japan, other nations are set to follow suit, signaling they too will raise rates and reduce the size of their balance sheets.

The shift in the central banks' policy approach reflects the strengthening global economic environment as the consequences of the GFC continue to recede and marks the end of easy money. It is critical that central bankers do not take an aggressive stance on this transition, and instead adjust policy settings to appropriately reflect improvements in economic conditions. In our view, as stimulus is withdrawn, draining liquidity from markets, the main issue for investors to consider will be whether company earnings growth, coupled with economic growth, will be sufficient to offset this reduction in liquidity.

Australian consumers

Australian consumers' financial position has consequences for the broader economy, as well as a range of particular sectors and companies. In the short-term, out-of-cycle interest rate increases by the banks, together with rising power prices and insurance premiums, have had a dampening effect on consumer sentiment and reduced total discretionary income. Although the fiscal health of the Australian consumer remains fragile, global economic growth, increases in full-time jobs and low unemployment provide a positive outlook for consumers.

Expectations of wage rises, rather than actual wage growth, will be key to boosting confidence and increasing spending. Currently, expectations of future income growth are low due to benign wage growth for an extended period. Lower expectations of earnings growth can lead to lower levels of consumption. Some companies, such as supermarkets, stand to benefit from these headwinds with the consumer staples segment of the retail sector largely unaffected by a reduction in discretionary spending and offering investors a defensive 'play'.

Chinese economy

As Australia's largest trading partner and the world's second largest economy, China is critical to the Australian economy and the financial viability of many ASX-listed companies. In our view, the outlook for the Chinese economy is overall positive. The economic performance of the Middle Kingdom continues to exceed expectations with fears of a sustained slow-down following the withdrawal of stimulus measures in 2015 proving to be unfounded.

Continued industry reforms, including to state-owned enterprises (SOE), to create a strong private sector will be important to China's continued economic strength and increasing the economy's long term productivity. With SOEs absorbing significant national capital and delivering low returns, the Chinese government is progressively implementing policy changes to restructure and modernise the sector, including improving governance practices.

The Communist Party of China's upcoming 19th National Congress will also be instrumental to the nation's economic outlook. Held every five years, the gathering will determine China's political future including the leadership and economic policy agenda. If President Xi Jinping tightens his grip on power, the potential to enact various reforms to the economy will increase. Ahead of the Congress, the political environment is generally risk-averse with officials up for re-election keen to ensure current growth levels are maintained and shying away from major reforms that could dent current growth levels.

Outlook positive

In our view, the overall outlook for the Australian and global economy is positive. A range of macro factors will continue to shape the operating environment for Australian listed companies and influence their share prices. Investors should continually consider and monitor big picture economic issues and trends, giving consideration to how they may impact the Australian and global economy, the share market and individual companies within their portfolios.

Matthew Haupt: Portfolio Manager, Wilson Asset Management

BEHIND THE LIC BOOM

BEHIND THE LIC BOOM *continued...*



WILL SPRAGGETT

Listed Investment Company market breaks 100 listings on ASX.

The Listed Investment Company (LIC) sector has been one of the great success stories of the Australian Securities Exchange (ASX) over the past decade.

Although LICs have been trading on ASX for nearly 100 years, it is only relatively recently that a broader range of investors has capitalised on the opportunities offered by the sector, driven by changes in regulation, demographics and market conditions.

This has unleashed a new focus from asset managers and driven an evolution in shareholder-friendly product structure that Seed Partnerships believes will drive continued strong growth.

An LIC is an ASX-listed company established to invest in a portfolio of securities, managed by a fund manager. It raises a fixed amount of capital through an initial public offering (IPO) and new capital can only be raised through a corporate issue. Shares in LICs are traded on the ASX like any other listed share.

There are three key differences between an LIC and a managed fund. An LIC is a company, its assets are held in a closed pool, and it is traded via the ASX. Generally, managed funds are held in a unit trust, are open-ended structures and accessed through platforms.

Positive investor outcomes

The LIC structure supports some positive investor outcomes:

- The payment of dividends is at the discretion of the LIC's board. This gives an LIC some leeway to control distributions of dividends through the cycle.
- There is no taxation impediment for retaining profits. This allows the board to retain profits and maintain distributions through periods of weak performance.
- The vehicle is not exposed to daily capital inflows. This ensures that dividends and performance are not continually diluted by new capital entering the vehicle.
- The structure does not support the outflow of the underlying capital. This means investor redemptions do not create a tax event for shareholders who remain in the company, impairing income.
- The vehicle is a taxable entity. This focuses the manager on after-tax outcomes, particularly the generation of fully franked dividends.

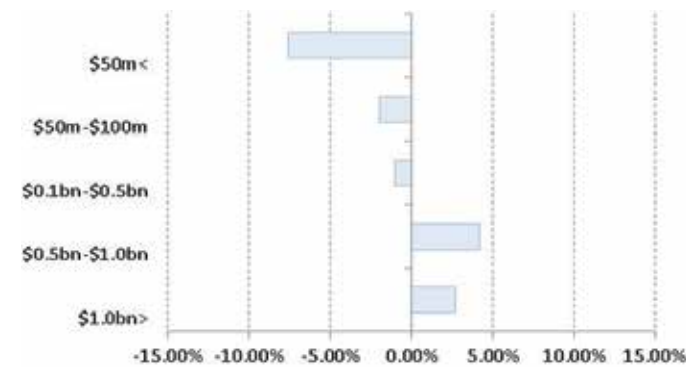
Trade is facilitated on the ASX and existing units are bought and sold, not created and redeemed. This means that an LIC may trade at a premium or a discount to its net tangible assets (NTA). How an LIC trades in the secondary market will depend on several variables, including market capitalisation, investment performance, sustainable income, market engagement, and scarcity/relevance of the mandate.

Interestingly, the market at present is trading at a 0.8 per cent premium to its NTA on a market-weighted basis. On an equally weighted basis, the premium falls to a 2.8 per cent discount,

highlighting that it is the volume of smaller LICs that are accounting for the discount, as illustrated below.

This is probably partly because of overhead costs of managing a company (largely fixed and diluted with size) excessively affecting the return, which is also a factor that an investor needs to evaluate in lower-return products.

Figure 1: LIC premium or discount to pre-tax NTA



Source: Seed Partnerships

Market capitalisation passes \$33 billion

The capitalisation of the LIC market has been trending strongly, growing at 16.4 per cent per annum over the past five years to \$33.1 billion at 30 June 2017. The number of LICs listed on ASX has also seen a strong and steady upward trend, rising from 52 in June 2012 to 102 now, and topping the century in June.

Despite this, the market capitalisation of the LIC sector is concentrated, with the bulk of funds under management (FUM) residing with the larger vehicles. There are 46 LICs with a market capitalisation above \$100 million in FUM, managing \$30.8 billion. This compares to the 56 LICs with a market capitalisation below \$100 million in FUM, managing \$2.2 billion.

The growth rate of LICs has been substantially higher than that of managed funds and there are several tangible reasons for this growth.

First, the Future of Financial Advice (FoFA) legislation in 2014 had a profound effect on the financial services market. It has driven increasing interest from financial advisers that are looking for alternative methods of accessing professionally managed portfolios. As a result, LICs have had a significant uplift in profile as investment managers, financial advisers and investors have increasingly used them.

Second, investors' search for yield has put LICs front and centre. LICs are structured as a company and therefore the company directors determine dividend policy. This structural advantage over unit trusts has allowed LICs to position themselves as an attractive value proposition to Self-Managed Superannuation Fund (SMSF) investors chasing yield. SMSFs are a valuable investor base to cater for, as they now account for 32 per cent of all superannuation assets in Australia and are growing.

Improved adviser and investor engagement

Other industry factors that have been supporting growth (LIC IPOs have raised \$4.5 billion in the past five years) are:

- the increased depth and breadth of products,
- increased quality of managers, and
- improved adviser and investor engagement.

There is also a potential evolution underway in the structure of LICs. Most notably, VGI Partners will be the first LIC to come to market that will reimburse the company for the issue costs associated with its IPO (day one NTA issued at par) and seek to absorb the vast majority of the ongoing operating costs of the company.

This type of structure is an interesting and positive development and we anticipate it is likely to drive further interest and larger capital raisings that are likely to tip through \$500 million plus.

The LIC market remains largely dominated by domestic equity focused vehicles, which account for 83 per cent of the market-place. Global equity product accounts for only 15 per cent of the LIC market, compared to the 33 per cent market share they hold in ETF products.

We anticipate growth will occur away from large-capitalisation domestic equity products and into those areas that are well under-represented. Global equity focused products are likely to be a key beneficiary and an increase in both the size and style of offering is likely. We also expect growth in more index-unaware products and those that offer a high and sustainable income.

Although it has been a strong period of growth for the LIC sector, we believe there are several drivers now in place that may see it accelerate for the next five years and beyond.

William Spraggett is a founding partner of Seed Partnerships, a specialist corporate advisory business that specialises in Listing Investment Companies.
Article courtesy ASX

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RESIDENTIAL PROPERTY WHAT COULD GO WRONG?



HAS FOREIGN CAPITAL CHANGED THE FACE OF AUSTRALIAN REAL ESTATE?

STUART CARTLEDGE

BRYAN REID

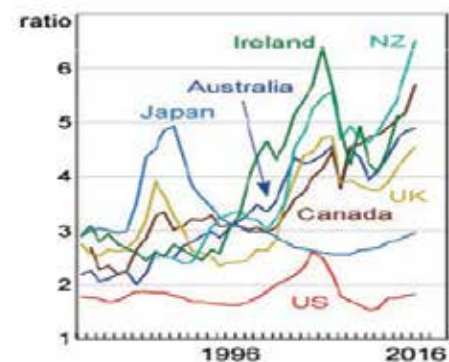
Residential property, particularly in Sydney and Melbourne, has been one of the best performing assets classes in the last few decades. What is the problem with this? We believe pricing is close to or at a cyclical peak.

Australians have rarely seen house price falls, having largely escaped the dramas in the US following the Global Financial Crisis, or the post boom meltdown that the UK delivered in the late 1980s. Furthermore, Australian housing has been the beneficiary of a taxation regime that encourages extensive use of debt to finance ever more expensive property, enabling investors to offset negatively geared losses against ordinary earned income. For owner-occupied homes, capital gains are tax-free, making home ownership an attractive investment choice for many.

In addition to favourable tax treatment, falling interest rates have driven asset prices higher both in absolute terms, but also, relative to income. This is particularly important for residential housing, given it represents such a basic human need.

Chart 1, sourced from the RBA Financial Stability Review document published in April 2017, shows how the ratio of dwelling prices to average household disposable income has moved over the last 20 years. While I appreciate there are measurement issues that sometimes obscure the data, I think we can at least conclude that for many countries, the ratio has moved strongly higher over this extended period of time.

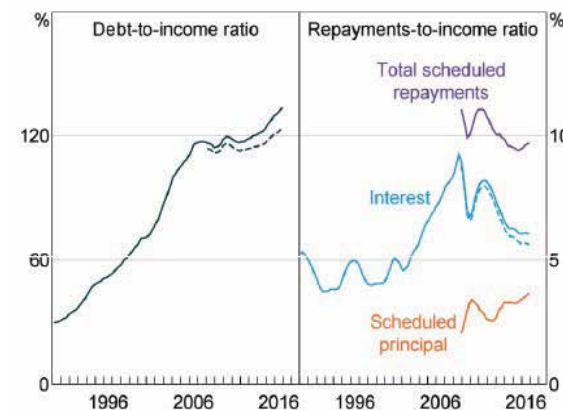
Chart 1: Dwelling prices to average household disposable income



Source: RBA Financial Stability Review, April 2017

The interaction between interest rates and house prices is partly depicted in Chart 2, which shows that while household debt to income has grown substantially, enabling higher prices, this has been made possible via lower interest rates, such that the repayments to income ratio has remained reasonably steady.

Chart 2: Housing Mortgage Debt Indicators*



Source: RBA Financial Stability Review, April 2017

* Excludes non-housing debt; dotted lines are calculations based on debt balances net of offset accounts; income is household disposable income before housing interest costs
Sources: ABS; APRA; RBA

What could go wrong?

- Government policy settings can change such that the favourable inducements to invest in residential property are reduced or removed
- Interest costs begin to rise making debt serviceability tough
- Nothing changes, the over-priced problem becomes bigger, and ultimately self corrects in a more dramatic fashion

The May 2017 budget contained some steps to assist first home buyers with a tax effective saving opportunity in superannuation, however, the \$30,000 cap on the scheme limits its effectiveness. There were also measures to encourage increases in housing supply, which should, all else being equal, put some downward pressure on prices.

Phoenix is mandated to invest in commercial property via listed Australian Real Estate Investment Trusts (A-REITs) and as a result, exposure to residential is indirect and via holdings in stocks with development exposure such as Mirvac, Stockland and Lend Lease. As such, our clients have benefitted from very strong volumes and margins from development, and given the very high level of pre-sales activity, we have reasonable clarity that strong earnings will be delivered for several years to come.

However, whether through direct or indirect investments, we must be cognisant of the risks – and right now, an investment strategy that requires prices to keep rising carries elevated risks and I would urge caution.

Stuart Cartledge: Phoenix Portfolios

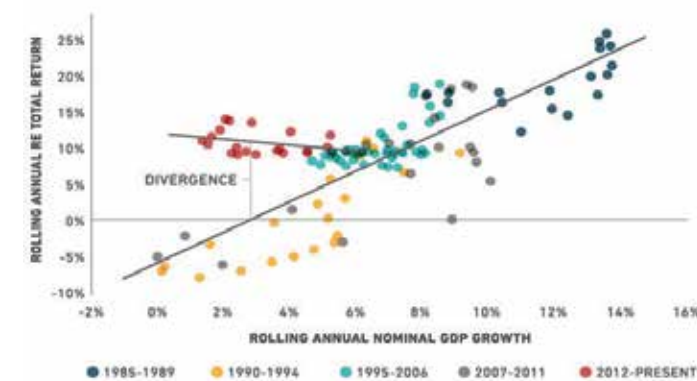
In recent years, Australian commercial real estate has attracted considerable attention from international investors, changing the dynamics of what was historically a domestically dominated market.

Private real estate often produces steady income streams and high yields that in the short term make it appear bond-like, and yet the asset class' returns historically have been linked tightly to overall economic growth. In most markets, there has long been a strong correlation between nominal Gross Domestic Product (GDP) growth and real estate returns. This correlation has been particularly evident in Australia.

In recent years, however, returns have held at long-term averages despite below-trend GDP growth.

The Property Council / IPD Australia All Property Index, with history back to 1985, shows a pronounced correlation between nominal GDP growth and total returns, across and within sub-periods, until around 2012 (see Chart 1). Since then, total returns have remained around their 10% long-term average despite tepid economic growth. Had the historical relationship held, returns would have been much lower.

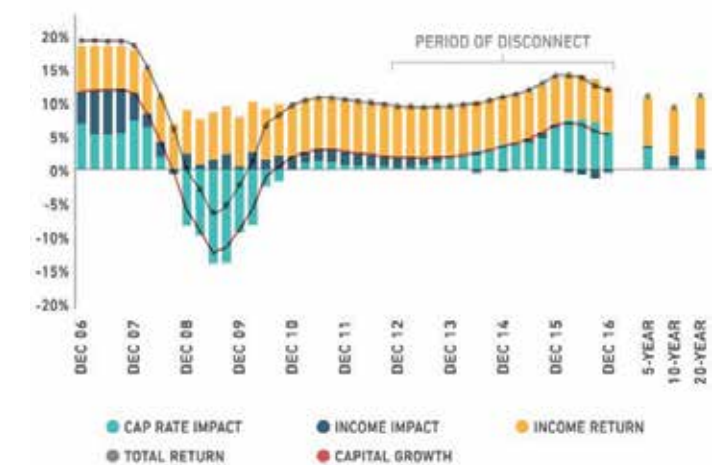
Chart 1: In Australia, the relationship between real estate returns and economic activity has diverged



Source: MSCI – Global Intel, Australian Bureau of Statistics

To explore this relationship in more depth, we have to look at capital growth, which represents the most volatile and pro-cyclical component of total return. Capital growth can be broken into a “cap rate impact” (the degree to which capital growth is driven by investor sentiment through widening or tightening yields) and an “income impact”. In Chart 2, we can see that income impact was evident even during the financial crisis, but it has all but disappeared since mid-2013, as economic growth and occupier demand weakened. Instead, tightening cap rates has become the main driver of capital growth. In other words, it is investor sentiment and capital markets which have supported returns in Australia since the end of 2013.

Chart 2: Tightening cap rates have boosted Australian real estate returns in recent years



Source: MSCI – Global Intel

What's going on? For starters, a rare confluence of circumstances, including a protracted period of globally loose monetary policy. Low interest rates have boosted asset prices through lower borrowing costs and lower discount rates on asset cash flows. In addition, domestic and foreign investors have chased higher yields available from Australian real estate, with foreign capital playing a particularly prominent role.

Even at the end of 2016, Net Operating Income (NOI) yields in Sydney and Melbourne were 5.7% and 5.8%, respectively, compared with 4.4% in Toronto, 4.2% in Amsterdam, 4.1% in New York and 3.8% in London. With these relatively high yields in the Australian market and a more globalised world of capital flows, are we experiencing a paradigm shift where Australian yield levels and total-return expectations are reset going forward?

Ultimately, it is hard to say. With signs of global growth returning and the U.S. Federal Reserve apparently on a tightening path, some of the conditions that have encouraged the foreign capital influx may be coming to an end. Counteracting that, though, Australian yields are still relatively high compared with other markets, and real estate investing has become increasingly global and shows no signs of abating. A lot will depend on investor perceptions of the Australian market, but as the recent example of Brexit highlights, changes in investor sentiment can happen quickly and have a large impact on real estate performance.

Bryan Reid: Vice President, MSCI Global Real Estate Research

“Changes in investor sentiment can happen quickly”

KEEP YOUR SPOUSE CLOSE BUT YOUR PARENTS CLOSER

BRIAN HERD

For all those baby boomers embarking on a long and sustained period of well-deserved and well-saved for later life pleasure (also known as ‘retiring’ ‘withdrawing’, ‘going away’, ‘leaving’ or ‘retreating’), – stop – think again – your parents need you!

Bernie and Bernice had only recently retired. Being newly hatched retirees, they were champing at the bit to take off and explore those 1001 things they had always wanted to do. Bernie had 3 siblings spread all over the world. Bernice had no siblings and had lost her parents many years ago.

Bernie’s surviving parent, his father Cyril, was 83 and Bernie was also his Enduring Power of Attorney. Having just come out of hospital and in fragile health, the writing was on the wall – Cyril needed high care in a residential aged care facility. Along with his other siblings, Bernie thought that Cyril’s move to aged care would be good for Cyril. It would also loosen the shackles of having to ‘be around’ and enable Bernie and Bernice to fire up that new Winnebago and explore this large brown land.

Cyril was a full age pensioner with not a lot in assets except for his now very valuable old ‘Queenslander’ in a leafy inner suburb of Brisbane. Figures of over \$1.5million were bandied about as the market value of the home.

Being the dutiful son, Bernie had found the perfect aged care facility only some 10 minutes away from his and Bernice’s home. Trouble was they wanted Cyril to pay some \$450,000 by way of an upfront refundable accommodation deposit (RAD). Cyril didn’t have that sort of money but he did own that very valuable piece of property.

Bernie and his siblings didn’t often see eye to eye but, on one issue, for once, they were determined and agreed – they didn’t want that home sold in order to meet the RAD payment. Besides, keeping it in his dad’s name would have certain benefits for Cyril as well (so Bernie’s research told him).

That Winnebago was baying for action. Bernice had set her heart on adventure and that didn’t involve tending to the physical and financial needs of her frail father-in-law. They had assiduously saved all their lives for this moment but now, enter Cyril, stage left, to squash those dreams.

As usual, they briefly regretted they had not confronted Cyril’s situation earlier and at least planned for it. They were now in crisis mode and had to do something about Cyril right now as the facility told him they needed a decision immediately and if not, they would have to offer the place to someone else.

Bernie was desperate. Cyril had about \$100,000 in cash but where was the balance of the RAD of \$350,000 to come from? While there were other options, given that time was pressing and the opportunity could be lost, Bernie decided he would provide the \$350,000 for Cyril and he would have to raid his superannuation to do that.

Bernice was none too pleased – that money was their running away money and now they would be tied down to both a financial and a ‘being around’ commitment for Cyril and, by the way, where were Bernie’s siblings to lend a hand!

By the time Bernie and Bernice got to see me, the money had been paid and Cyril had moved in to the facility. Bernie and Cyril were relatively happy. Bernice, on the other hand, wasn’t really talking to either of them.

“ The impact of the aged care needs of our ageing parents is like a multi headed hydra ”

Bernie, Bernie, Bernie were some of my first words to him as he and Bernice slid into their hot seats in our interview room. Did you know that:

1. As the Enduring Power of Attorney (EPOA) for Cyril, by advancing the \$350,000 you may have breached your duties as the EPOA , namely, entering into a conflict transaction with Cyril;
2. As you haven’t documented the basis upon which you have provided the funds for Cyril, there could be a barney with your siblings about getting it back when Cyril dies e.g., interest on the money?; and
3. The law requires that, no matter who provides the RAD payment, it must be repaid to the resident or their estate when they leave the facility (not Bernie).

Bernie’s complexion turned white and Bernice’s red – they found it difficult to look at each other – awkward.

Without boring you with the next exciting instalment in the Cyril saga, needless to say, Bernie had to expend some more hard earned retirement savings on me and my very reasonable fees. Bernice, I understand, may have also sought some separate family law advice on her situation.

The impact of the aged care needs of our ageing parents is like a multi headed hydra – it can permeate every aspect of our lives and our families. It can even affect relationships between previously long and happily married children.

Best to stop there, me thinks, assuming the message of this article is clear – get some advice before you take the plunge for your parents.

Brian Herd: Partner CRH Law

THE PATRIOTIC RETIREMENT PLAN

ANONYMOUS

Dear Mr. Prime Minister,

Please find below our suggestion for fixing Australia’s economy.

Instead of giving billions of dollars to car companies & other business that will squander the money on lavish parties and unearned bonuses, use the following plan. You can call it:

The Patriotic Retirement Plan

There are about 10 million people over 50 in the work force. Pay them \$1 million each severance for early retirement with the following stipulations:

1. They MUST retire. Ten million job openings - Unemployment fixed.
2. They MUST buy a new Australian car. Ten million cars ordered - Car Industry fixed.
3. They MUST either buy a house or pay off their mortgage - Housing crisis fixed.
4. They MUST send their kids to school/college/university - Crime rate fixed.
5. They MUST buy \$100 worth of alcohol/tobacco a week. Your money back in duty/tax etc.
6. Instead of stuffing around with the carbon emissions trading scheme that makes us pay for the major polluters, tell the greedy bastards to reduce their pollution emissions by 75% within 5 years or we shut them down.
7. Cut down on polties perks - they earn enough money to pay for their own petrol, food, drinks, airfares for their wives & families like all other hard working Aussies do. We pay big money but we still get MONKEYS.
8. No government credit cards for polties - let them get their own then they will be more careful about how they use it and pay up on time so as not to incur interest.

It can't get any easier than that!

P.S. If more money is needed, have all members of parliament pay back their falsely claimed expenses and second home allowances

Also...
Let's put the pensioners in jail and the criminals in a nursing home.

- This way the pensioners would have access to showers, hobbies and walks.
- They'd receive unlimited free prescriptions, dental and medical treatment, wheel chairs etc and they'd receive money instead of paying it out.
- They would have constant video monitoring, so they could be helped instantly, if they fell, or needed assistance.
- Bedding would be washed twice a week, and all clothing would be ironed and returned to them.
- A guard would check on them every 20 minutes and bring their meals and snacks to their cell.
- They would have family visits in a suite built for that purpose.
- They would have access to a library, weight room, spiritual counselling, pool and education.

- Simple clothing, shoes, slippers, PJ's and legal aid would be free, on request.
- Private, secure rooms for all, with an exercise outdoor yard, with gardens.
- Each senior could have a PC, a TV, radio and daily phone calls.
- There would be a board of directors to hear complaints, and the guards would have a code of conduct that would be strictly adhered to.

The criminals would get cold food, be left all alone and unsupervised.
Lights off at 8pm, and showers once a week. Live in a tiny room and pay \$600.00 per week and have no hope of ever getting out.

P.S. Think about this also:

THE AUSTRALIAN CONSTITUTION: They keep talking about drafting a Constitution for Iraq... Why don't we just give them ours? It was drawn up by a lot of really smart guys, it has worked for centuries and we're not using it anymore.

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OPTIONS TRADING

COVERED CALL STRATEGY

SIMON BRIDGLAND

It is a term that is often misunderstood by investors and one that is frequently associated with an increase in risk, but in reality, it is one that deserves a bit more attention and explanation as it often comes down to the type of options strategy that is adopted. You may consider a “covered call” options strategy.

The covered call strategy is an income-producing strategy where you sell (write) call options against stock you already own. The standard options size is 100 shares per one options contract. In exchange for selling the call options, you will receive income, known as an option premium – but the option premium comes with an obligation, that being, if the call option you sold is exercised by the buyer, you may be obligated to deliver your shares of the underlying stock.

Fortunately, you already own the underlying stock, so your potential obligation is “covered” which is where the name of the strategy derives from.

So in a nutshell, a seller of a covered call option agrees to sell a share if it is above an agreed upon price (the strike price), at the expiration date. In exchange for this, the seller receives a premium (income).

Why sell covered call options?

Selling covered call options against shares currently owned can enhance the returns from investment and they are best used when the investor is neutral to moderately bullish on the stock (i.e. they believe it is unlikely to rise sharply or fall suddenly). It can be a particularly useful strategy for investors in retirement with an SMSF looking to increase their level of income. Selling covered calls can also be considered as a risk-reducing strategy. If the share price falls, the value of your shares will also fall, however, the income received via the premium will partly offset the fall.

Working example

Let’s say an investor owns 1,000 CBA shares and they are currently trading at \$85. The outlook is neutral to moderately bullish on CBA and you wish to enhance your return on CBA in a flat market. Therefore, we elect to sell a CBA June \$87.50 call option for \$1.20 per share.

For writing the covered call, you will receive \$1,200 (1,000 x \$1.20) and your position going forward is:

- ‘Long’ 1,000 CBA shares at \$85.
- ‘Short’ 10 CBA June \$87.50 call options at \$1.20 per share.

At the expiry date (end of June in this case), the following possibilities can take place depending on CBA’s performance over the call option period:

- If CBA is trading above the strike price (\$87.50), then you must sell your shares at \$87.50 (ou keep the \$1,200 premium received).
- If CBA is unchanged (or thereabouts), the call expires worthless and you keep the shares and pocket your \$1,200 premium.
- If CBA shares fall, the option will expire at the end of the month and you keep your premium and you are \$1,200 better off having written the call than you would have been if you were simply ‘long’ CBA shares.

When you sell covered calls, you’re usually hoping that you will be able to keep the stock while generating extra income via the option premium. Therefore, you will probably want the share price to remain below the strike price. If the underlying share price is neutral-slightly down, writing covered calls on the stock can be a good strategy to enhance your income against your ‘long’ position.

The ideal scenario is a slight rise in the share price over the call period with it remaining below the strike price at the expiry date. Under this scenario, you’re not only generating extra income, but the value of your shares have also increased.

Selecting your stock, the strike price, and the expiry month

It’s important to choose a stock that you are happy to sell at some point (if you are called), so make sure it is a stock that you believe will remain within a certain price range over the call period to reduce your chances in being called. An obvious one is, don’t choose a stock that looks as though it could be a takeover target.

Selecting the strike price is akin to making a decision on what price you would like to place a limit order at which to sell the shares in the market. For example, you might set the strike price at yearly highs for the stock and would be happy to sell should it hit this level.

When it comes to selecting the expiry month for your options, it is important to remember that an obligation is assigned to you by writing options. The preference is to write calls over a 4-8 week period to reduce the amount of time that an options writer is potentially obligated.

Risks?

There are three main risks which need to be considered before adopting a covered call strategy:

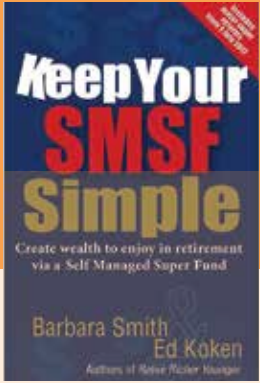
- If the share price falls heavily, the fall in the value of your underlying holding may exceed the premium received.
- If the share price rallies strongly, you have an obligation to sell stock and therefore give up any extra profits above the strike price, which is why it is important to write the calls over stock that you think is fully-valued or close to fully-valued.
- If you write an ‘American style’ call option, the call option can be exercised before the expiry date, which usually happens before a stock goes ex-dividend. Therefore, shareholders that wish to accumulate dividends should refrain from writing calls over dividend dates, or stick to writing only ‘European style’ call options which can only be exercised on the expiry day.

Getting started

If you are interested in this strategy, please contact us or another broker.

Simon Bridgland: Investment Advisor Broadbent Financial

BOOK REVIEW



BOOK REVIEW

Authors: Barbara Smith, Ed Koken
Title: Keep Your SMSF Simple
ISBN: 9780994545251 (paperback)
Publishe: Major Street Publishing Pty Ltd
Publication Date: 2017
RRP: \$34.95
Reviewer: Peter Schiff, AIA Member

The authors are well known in the financial literary world for their ability to explain what are often dense and difficult concepts to the lay person. This book is no exception. To say that its publication is timely would be an understatement. Governments of either political persuasion have seen superannuation funds as a convenient milking cow, and we have just witnessed another visit to the honey pot.

The book serves two main purposes. It brings everyone up-to-date with the new rules relating to superannuation (what you must and shouldn’t do), many of which came into effect on 1 July 2017, and it serves as a step-by-step guide for those embarking on the adventure of setting up their own self-managed superannuation fund (SMSF). Although sections of the book draw on a previous publication by the authors entitled Keep it Super Simple, they have been extensively rewritten and updated.

In recent years superannuation rules and regulations have changed many times. It is the responsibility of fund trustees to

keep up with these changes and to implement them. The book is a great help in this regard, although the authors warn that further changes are possible (likely?) and therefore we must be eternally vigilant. Where rules are referred to, they are described in some detail, and there is usually a reference in the text to either a Taxation Department ruling of a relevant Law Companion Guideline.

Whilst the title of the book contains the word Simple, and the authors point to this principle throughout, there are certain issues that are anything but. These are drawn to the reader’s attention, and we are advised to seek expert input before making decisions that could otherwise prove costly.

The set-out of the material is helpful. At the beginning of each chapter the authors enumerate, in point form, what the reader will learn. If one wishes to follow a particular theme, e.g. the tax treatment of SMSF earnings, one can cherry pick and read the relevant paragraphs without having to plough through the whole text.

I close with a quote from the book. ***“We are sad to say this, but the extensive law changes to superannuation and heavy penalties imposed if you unintentionally get it wrong are distressing people whose long-term planning is being turned on its head to the extent that some are looking for alternatives”.*** If you follow the guidelines set out, you should be on safe ground.



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IS IT TOO LATE TO BUY BITCOIN?



IS IT TOO LATE TO BUY BITCOIN? *continued...*





CARISSA PRITCHARD

Bitcoin has tripled in value this year - kicking off 2017 at \$US998 and surging to over \$US3000 today. It might be too late to be a “Bitcoin Millionaire” (one of the lucky few who bought it for a few cents five years ago), but the full value of a cryptocurrency investment is far from realised. To understand its long-term value, both the Industrial Revolutions and the future of commerce need to be considered.

From the 18th Century we evolved from agricultural, to mechanised industries, arriving in the 1980’s at the IT age. Personal computers, the internet and email were radical ideas. We never thought there’d be an evolution that would bring even greater change.

Then we witnessed the Fourth Industrial Revolution – where IT moved from supporting traditional industries to becoming the industry itself. According to McKinsey Global Institute, “Soaring flows of data and information now generate more economic value than the global goods trade”.

The Industrial Revolutions

1 st	2 nd	3 rd	4 th
18 th Century	19 th - early 20 th Century	Late 20 th Century	2015 -
			
Steam engine	Electricity, Conveyor belt	Computers, Internet	Cloud, Blockchain, IoT, AI, VR
Mechanisation	Mass Production	Information & Automation	Intelligibility

A digital economy requires a digital currency. But ultimately, what does the creation of cryptocurrency mean? Nathan van den Bosch, CEO of Bitcoin Trader, suggests, “What you’re basically asking is why cryptocurrencies exist in their blockchain format. Simply, what’s happening at the moment is we are digitising wealth. What that means is, instead of storing value in gold or fiat currency, it’s stored in a blockchain. Instead of having a bank balance and a bank ledger you have a blockchain balance and a blockchain ledger”.

Arie Levy Cohen, Banker and Entrepreneur, (CEO of Blockhaus Tokenised Ecosystems and Singular DTV) states the economic future will exist solely as “distributed, decentralised, tokenised ecosystems”. He asserts, “Paper money; cash, will go away. The connection between identity, cryptographic security and the system of credits and debits will be the future. Participating in the building blocks of something like that is one of those opportunities that doesn’t come every 100 years...this is *the* ride to be on”.

Van den Bosch recommends participating in each of the areas where blockchain is booming. His three favourites are; “Obviously, Bitcoin - the global digital currency, Ethereum - supports the Internet of Things and the apps that work with it, and Ripple - the cryptocurrency used by banks themselves”.

Fifteen of the top fifty banks have already adopted Ripple; members include Westpac, UBS, and even the US Federal Reserve has given it a vote of confidence. Ethereum smart contracts are used globally and supported by Microsoft and JP Morgan. Despite its volatility (and recent hard-fork) Bitcoin continues to boom.

The good news is – Ripple is still at 18 cents. The great news is, Paypal Director Wences Casares, projects Bitcoin will reach \$1 million in 5-10 years. That’s when it will be too late.

Carissa Pritchard: Head of Content & Communications, Bitcoin Trader



Bitcoin: the first cryptocurrency. A store of value (long-term investment) and a system of exchange (new kind of money). Fixed supply: 21 million coins released through mining; proof of work. Transactions secured by military-grade cryptography. Considered “digital gold”, the reserve for all cryptocurrency transactions which are backed out into Bitcoin. Some major digital currency exchanges don’t accept fiat at all. Predicted to reach \$1 million per Bitcoin in 5-10 years.



Ethereum: software that specifies contractual obligations, then processes them under predetermined conditions, called “Smart Contracts”. The cryptocurrency component is “Ether”. When contractual obligations are fulfilled the contract pays the other party in Ether. B2B technology is moving towards M2M (Machine to Machine) thus requires smart contracts. No fixed supply; dis-inflationary. Released through proof of work. Ethereum is the platform for commercial contracts and application of AI amidst the Fourth Industrial Revolution.



Ripple: designed as a digital currency facilitating interbank transfers. Replaces current banking software SWIFT, written in 1973. Global interbank transfers daily: 3.7 trillion. 15 of the top 50 banks already use Ripple. Amount is fixed: no mining or proof of work. The coins / tokens already exist. 80% of currency is locked away in smart contracts that only release portions of the crypto every quarter. Considered the banks own cryptocurrency and is the only one of its kind. There are no competitors to Ripple.

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25th Anniversary 1992 - 2017



CELEBRATING 25 YEARS OF INVESTORS HELPING INVESTORS



Celebrating 25 years of the AIA at the 20th Annual Conference

2017 was another successful Annual AIA Conference with over 300 delegates attending daytime sessions. We had an excellent line-up of top speakers, and there was the usual buzz and delegate interaction during breaks and at 'happy hour'. This year we had a record number of sponsors wanting to participate (in fact we had to turn some away) and most were delighted with the response they had from delegates, at what is perceived to be the best investors' conference in the country.

390 guests walked the 'red carpet' to attend the celebration dinner to mark 25 years since AIA was formed in 1992. The dinner speaker, Homer – The Corporate Imposter, had everyone in stitches with his humour, and completed his entertainment by having all the dinner guests dancing around tables to 'Zorba the Greek'. This was followed by a cake cutting ceremony by President, Graeme Botttrill, together with Past Presidents Bob Andrew, Jolyon Forsyth and Bill Shirley. The cake was then served for dessert. It was a memorable occasion and a fitting way to celebrate our 25 years.

Acknowledgement was given to several members present at the dinner, who had attended the very first AIA Investors Retreat in 1998, including Malcolm & Joan Robertson, George Keil, and Graeme Jilbert.

Thank you to all those delegates who completed our yellow evaluation forms. It is important to the AIA to get constructive feedback so we can continue to improve our offering.



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				
01-Sep-17	Friday	12.30pm	Hills District Discussion Group	Beecroft Presbyterian Church, Mary St Beecroft
11-Sep-17	Monday	7.30pm	Canberra Discussion Group	Ginninderra Labor Club
13-Sep-17	Wednesday	7.30pm	North Shore Information Meeting	The Chatswood Club, 11 Help Street Chatswood
29-Sep-17	Friday	3.00pm	Northern Beaches Discussion Group	Dee Why RSL - Aqua Café
06-Oct-17	Wednesday	7.30pm	North Shore Information Meeting	The Chatswood Club, 11 Help Street Chatswood
09-Oct-17	Monday	7.30pm	Canberra Discussion Group	Ginninderra Labor Club
11-Oct-17	Friday	12.30pm	Hills District Discussion Group	Beecroft Presbyterian Church, Mary St Beecroft
03-Nov-17	Friday	12.30pm	Hills District Discussion Group	Beecroft Presbyterian Church, Mary St Beecroft
03-Nov-17	Friday	3.00pm	Northern Beaches Discussion Group	Dee Why RSL - Aqua Café
08-Nov-17	Wednesday	7.30pm	North Shore Information Meeting	The Chatswood Club, 11 Help Street Chatswood
13-Nov-17	Monday	7.30pm	Canberra Discussion Group	Ginninderra Labor Club
01-Dec-17	Friday	12.30pm	Hills District Discussion Group	Beecroft Presbyterian Church, Mary St Beecroft
01-Dec-17	Friday	3.00pm	Northern Beaches Discussion Group	Dee Why RSL - Aqua Café
11-Dec-17	Monday	7.30pm	Canberra Discussion Group	Ginninderra Labor Club
13-Dec-17	Wednesday	7.30pm	North Shore Information Meeting	The Chatswood Club, 11 Help Street Chatswood

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

QLD				
06-Sep-17	Wednesday	1.30pm	Brisbane Information Meeting	Wesley House, 140 Ann Street Brisbane
12-Sep-17	Tuesday	7.00pm	Brisbane Managed Investments DG	Carindale Library, Carindale Shopping Centre
18-Sep-17	Monday	7.00pm	Chermside Equities Discussion Group	Chermside Library, Hamilton Road Chermside
20-Sep-17	Wednesday	7.00pm	Brisbane Equities Discussion Group	Carindale Library, Carindale Shopping Centre
20-Sep-17	Wednesday	6.30pm	Sunshine Coast Discussion Group	The Old Post Office, Buderim
04-Oct-17	Wednesday	1.30pm	Brisbane Information Meeting & AGM	Wesley House, 140 Ann Street Brisbane
10-Oct-17	Tuesday	7.00pm	Brisbane Managed Investments DG	Carindale Library, Carindale Shopping Centre
16-Oct-17	Monday	7.00pm	Chermside Equities Discussion Group	Chermside Library, Hamilton Road, Chermside
16-Oct-17	Monday	9.30am	Gold Coast Information Meeting	Helensvale Community, Centre 31 Discovery Dr Helensvale
18-Oct-17	Wednesday	7.00pm	Brisbane Equities Discussion Group	Carindale Library, Carindale Shopping Centre
18-Oct-17	Wednesday	6.30pm	Sunshine Coast Discussion Group	The Old Post Office, Buderim
01-Nov-17	Wednesday	1.30pm	Brisbane Information Meeting	Wesley House, 140 Ann Street Brisbane
14-Nov-17	Tuesday	7.00pm	Brisbane Managed Investments DG	Carindale Library, Carindale Shopping Centre
15-Nov-17	Wednesday	7.00pm	Brisbane Equities Discussion Group	Carindale Library, Carindale Shopping Centre
15-Nov-17	Wednesday	6.30pm	Sunshine Coast Discussion Group	The Old Post Office, Buderim
20-Nov-17	Monday	7.00pm	Chermside Equities Discussion Group	Chermside Library, Hamilton Road Chermside
04-Dec-17	Monday	9.30am	Gold Coast Information Meeting	Helensvale Community Centre, 31 Discovery Dr Helensvale
06-Dec-17	Wednesday	1.30pm	Brisbane Information Meeting	Wesley House, 140 Ann Street Brisbane
20-Nov-17	Wednesday	6.30pm	Sunshine Coast Discussion Group	The Old Post Office, Buderim

SA				
11-Sep-17	Tuesday	7.00pm	Adelaide Information Meeting	Fullarton Park Community Centre, 411 Fullarton Road Fullarton
10-Oct-17	Tuesday	7.00pm	Adelaide Information Meeting	Fullarton Park Community Centre, 411 Fullarton Road Fullarton
14-Nov-17	Tuesday	7.00pm	Adelaide Information Meeting	Fullarton Park Community Centre, 411 Fullarton Road Fullarton

WA				
05-Sep-17	Tuesday	7.30pm	Perth Information Meeting	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
19-Sep-17	Tuesday	7.30pm	Perth Discussion Group	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
03-Oct-17	Tuesday	7.30pm	Perth Information Meeting	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
17-Oct-17	Tuesday	7.30pm	Perth Discussion Group	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
07-Nov-17	Tuesday	7.30pm	Perth Information Meeting	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
21-Nov-17	Tuesday	7.30pm	Perth Discussion Group	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
05-Dec-17	Tuesday	7.30pm	Perth Information Meeting	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs