What? Me worry?

The US and China are making a comeback and the Dow is around 280 points from its all-time high. With all this great news about economies around the world, in today's note I ask, what can go wrong?

Also, Tony Negline looks at the effectiveness of the catch-all provision and Paul Rickard reveals where SMSFs are investing right now. Brokers have upgraded their predictions for the ASX 200, believing it will beat 5000. Plus, Lance Lai explains why stock market watchers need to be patient.

Sincerely,

Peter Switzer

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I’m positive! What can go wrong?

by Peter Switzer

In one of my daily blogs on www.switzer.com.au, I proposed the idea that 2013 would be the year of living dangerously. Regular readers would know I’ve been tipping for some time that the US and China are on the comeback trail — economic growth-wise — and these two economies, the two biggest in the world, will underpin stock price improvements.

Adding to the better economic outlook ahead, Japan is now prepared to spend its way out of decades of economic stagnation, and even Europe is showing signs of a quicker return to growth than the experts thought some months ago.

In fact, the recent fall in the Oz dollar to 104 US cents has been linked to “growing evidence of an emerging economic recovery”, Dow Jones Newswires reported. Our currency has copped it because, to put it simply, we look like we’ll be growing slower than expected and Europe could be faster than tipped.

That’s good news for the global economy, commodity prices and material stocks.

Six things that could go wrong

Anyway, with all this good news about, and more commentators jumping on my optimistic bandwagon, what could go wrong?

Here’s my list:

1. The ticking debt time bomb worldwide. This problem is not a 2013 issue but will come back to bite us down the track. Hopefully, over the next two to three years, we’ll see solid economic growth to help pay down some of the debt.

2. The inflation genie gets out of the bottle. This threat is also likely to be a problem in two or three years’ time, as economies grow and governments have to step up to the plate with responsible policy responses.

3. Gutless governments that won’t address the problem. The inflation genie mentioned above links to concerns about gutless governments or paralysed parliaments, such as the US Congress.

4. The inability of the US Congress to reach agreement on deficits and debt. There will be another flashpoint in May over raising the debt ceiling, however, Congress still has to battle over automatic spending cuts, which are set to take place in March, and this debate could unsettle market confidence. I expect the Yanks will play their games but another holding exercise will develop to ensure Congress doesn’t kill the nice recovery of the US economy.

5. A Middle East left-field event. You can’t rule out an X-factor rocking markets but the whole mess over there seems to be manageable at the moment.

6. The explosive personalities of the European leaders and their people. The biggest risk lies in Europe, where the latest comments from Germany’s Angela Merkel and the European Central Bank (ECB) have implied a better than expected economic performance from the eurozone. I believe the impact of lower bond yields will help not only turn around public finances, but also confidence.

The best indicator I have that shows a positive contagion is developing, as the ECB boss Mario Draghi put it, was this — the German Dax, which measures stock price movements like our S&P/ASX 200 index, is up 31% since June 4. The stock market is driven by what investors think lies out there, and this is an enormous sign of positivity from the riskiest region in the world economy.
Sure, I expect some stupidity akin to France’s 75% tax on earnings over 1 million euro, which has seen Gerard Depardieu chase Russian citizenship and France’s richest person, Bernard Arnaut, seek to become a Belgian.

All this said and done, Europe still worries me a little. Bankers are still concerned about Europe, though the consensus is the euro has stabilised, but unemployment in Europe is a high 11.7% and isn’t expected to fall much this year.

The good news

On the plus side, the Davos meeting in Switzerland of the world’s heavyweights of government and business has a more relaxed mood this year compared to last year, when the euro looked in real trouble.

Another good sign Reuters reported was, “a larger-than-expected early repayment of cheap three-year loans by some eurozone banks to the [ECB].”

Some 130 billion euro worth of crisis loans are expected to be repaid to the ECB this week, which reinforces my positive views for 2013.

It’s the uncertainty of how the banks in Europe are going that keeps me from declaring a boom is here, as the crisis loans handed out by the ECB were over a trillion Euro. The best thing for repayment is economic growth, and sitting here right now, that looks like a reasonable chance for 2013.

I remain positive for the year ahead — now that’s a surprise!

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Trust the law – where your power as a trustee comes from
by Tony Negline

As I mentioned last week, a trust, such as a super fund, isn’t a legal entity – the trustee is the legal entity. A trustee’s powers don’t arise as a matter of course (unlike natural persons or companies, which are given the powers of a natural person at law). Rather, the trustee’s powers may only be derived through several sources: the Courts; by legislation; and by the trust deed. If the trustee undertakes an action that isn’t permitted by one of those sources of power, the trustee is in breach of trust.

In reality, it’s impractical for a court to continually confer powers on a trustee.

Also, while the relevant State and Territory trustee legislation certainly confers powers on a trustee, many superannuation powers aren’t within their scope.

The SIS Act doesn’t give trustees extensive powers. These provisions are generally either prohibitive (i.e. you can’t do something, such as lending money to a fund member) or, they are permissive (i.e. allows you to do something but doesn’t actually authorise the action).

In reality, the predominant source of power for a trustee to act is the trust deed.

This is where the argument as to the effectiveness of catch-all provisions arises.

Some SMSF industry people will say that a trustee’s powers must be set out expressly and shouldn’t be implied from a catch-all provision because there’s no standard set of trustee’s powers. In other words, a trustee’s powers must be set out expressly in the deed.

Other SMSF industry people argue that a catch-all provision is sufficient – it’s a positive formulation of the trustee’s powers and that power doesn’t need to be expressed.

The problem with this argument is that even if we accept that a well drafted catch-all provision can give you sufficient power to act, it won’t set out the mechanics or parameters of using that power.

In many situations this is extremely important. Let’s take Binding Death Benefit Nominations as an example. The super laws don’t allow a member to make a BDBN and they don’t give a trustee any power to accept these nominations.

The SIS Act simply states that if the trust deed allows a third party (a member) to give directions to the trustee, the trustee won’t be in breach of its duty not to delegate its decision making responsibilities.

As discussed above, the powers that a trustee needs have to come from the trust deed.

Let’s assume your catch-all provision gives you the power to accept a binding nomination. That is all that the catch-all provision will do – give power to the trustee to accept the binding nomination. It doesn’t compel you to act in accordance with the nomination. The trustee could follow the nomination if it wanted to, but wouldn’t have to under the deed.

Another example is account-based pensions. The SIS laws say that if a benefit is cashed out, it can be paid as either a pension or lump sum. This means that the terms of a pension and its ability to provide for any estate planning objectives depend entirely on the terms of the trust deed.

You can’t get around this by simply saying that a fund can provide whatever benefits are permitted by the SIS laws. The SIS Act provides that the trustee can pay an account-based pension but the definition...
of account-based pensions in the SIS Regulations isn’t complete. For example, the SIS regulations provide that a pension is only transferable on the death of the pensioner. This is no help in working out if a reversionary pensioner can be and has been nominated. Whether the pension is reversionary, and also the identity of that beneficiary, can only be determined by the terms of the pension.

What should you do if you’ve relied on an ineffective catch-all provision? This depends on the particular action undertaken.

If a member has given a “binding nomination” to the trustee on the basis of a catch-all provision, then the deed should be amended to expressly provide for binding nominations. The member should then make another nomination in accordance with the terms of the amended deed.

For other actions, perhaps the trust deed can be amended retrospectively and signed by the members to ratify the trustee action. It would really depend on the action that the trustee has taken and even then needs to be thought about on a case-by-case basis.

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The broker wrap: Coca-Cola, Newcrest and Fortescue upgraded, BHP downgraded by Rudi Filapek-Vandyck

Equity market strategists at stockbrokers and investment banks have been busy updating their expectations for the Australian share market this year. Without exception, and in-line with renewed market optimism, targets for the ASX200 have been lifted to 5000, or higher.

While this could act as yet more support for the present rally, investors should also keep in mind major indices are rapidly approaching 4900, and it isn’t even February just yet.

As far as ratings for individual stocks are concerned, the week past saw seven stocks receiving upgrades and eight others downgrades.

Upgrades

The ASX (ASX) was upgraded to Buy from Neutral by analysts at Citi, after the broker (also) turned more bullish on market returns for 2013. Citi is expecting retail money to start flowing back into equity markets and funds, which, in turn, could lift cash market velocity out of its current slump, while otherwise seeing solid support coming from the yield on offer.

However, the upgrade is far from enough to lift the stock currently into positive sentiment territory, with four Holds, three Sells and just one Buy on record in the FN Arena Database.

Macquarie took a kinder view of shipbuilder Austal (ASB), lifting the stock to Buy from Neutral on news the company has effectively lowered its debt levels, after selling a luxury stock boat for an undisclosed sum. While not out of the woods, the company is in a substantially improved position, says the broker.

Coca-Cola Amatil (CCL) received an upgrade from Citi, to Buy from Neutral, on the back of accelerating volume growth in both Australia and Indonesia. The upgrade lifts the stock to Neutral, sentiment wise, on four Holds, two Sells and two Buys. Citi also boosted Henderson Group (HGG) up to Buy from Neutral, on the expectation that fund flows will turn positive in FY13 on better performing investment markets. The broker also noted that Henderson is trading at a discount to UK peers.

JP Morgan jumped back on board the Lynas Corp (LYC) train, upgrading from Neutral to Buy, citing strong leverage to recovering economies. Despite weak rare earth prices, valuation upside remains compelling and is compensating for the protest actions the company still courts. The stock enjoys positive sentiment in the FN Arena Database, with two Buys and two Holds and 28% upside to the consensus share price on display.

The last two upgrades are miners, with Credit Suisse lifting both Newcrest (NCM) and Fortescue (FMG) to Buy from Neutral last week.

While the broker was expecting some fairly weak December quarter numbers from Newcrest, it still thinks that, given the recent underperformance of the share price and the weak start to FY13 production,
investors may be factoring in a larger than likely risk to current FY13 production prospects. A couple days after the upgrade, analysts from CS confirmed the slightly disappointing December quarter production report, but nonetheless remain confident Newcrest can deliver on full year guidance. That confidence seems to be based on the fact that Lihir and Cadia East will ramp up in the second half, while other projects are expected to return to normal grades and tonnage.

Credit Suisse upgraded Fortescue on the fairly straightforward grounds of recent share price weakness. Conversely, Deutsche Bank downgraded its call to Sell from Neutral after December quarter production fell short of the broker on both the sales and costs lines. CS also remains concerned about the balance sheet and increasing costs. The stock maintains a positive sentiment bias in the database, with five Buys, two Sells and two Holds on display.

Downgrades

BHP Billiton (BHP) wore two downgrades last week, with both CIMB and Citi dropping to Neutral from Buy, despite the company putting out a fairly well received December quarter production report. CIMB makes its call, citing a 23% rise in the share price from July 2012 lows, while Citi is also concerned about current valuation multiples and a soft near-term outlook for commodities. The revision has taken some shine off overall sentiment, with shares now barely in positive territory on two Buys, five Holds and a Sell.

Mirabela Nickel (MBN) was also the recipient of two downgrades, with Macquarie and Citi both lowering their calls to Neutral from Buy. A rather subdued outlook for the price of nickel has Macquarie thinking that the stock will find it difficult to outperform in the quarters ahead. Citi’s move is simpler, with the broker noting little upside to its downwardly revised price target. The downgrades leave the stock at flat Neutral, sentiment wise, with three Holds recorded in the database.

Insurance Australia Group (IAG) was cut to Sell from Neutral by UBS, the broker citing an increasingly stretched valuation and its view material upside beyond FY13 will prove elusive. The downgrade also moves the stock from Neutral to Negative in terms of the sentiment read, with one Buy fighting off two Sells and five Holds. Suncorp (SUN) was also downgraded by UBS, the recommendation dropping to Neutral on a similarly pessimistic view of near-term upside. UBS’s last “limited upside from here” victim was Transurban (TCL), which also slips from Buy to Neutral after the broker took a more conservative approach to modelling upside from growth projects.

The last two downgrades are miners cut by Citi. Both Kingsgate Consolidated (KCN) and PanAust (PNA) were trimmed to Neutral from Buy. Citi’s move on Kingsgate was a simple valuation call, while PanAust was a bit more complicated. Citi thought it was a pretty good quarterly result, however FY13 guidance came in well short of consensus, which the broker thinks could well spark a run of downgrades.

Sentiment remains positive, with PNA showing five Buys, two Holds and a Sell. KCN is a different story, enjoying three Holds and a Sell.

There were also a couple of price targets that increased by 10% or more last week and four that fell by 10% or more. Boral’s (BLD) price target jumped almost 30% after the company pushed through a big guidance increase for 1H profit. Henderson Group’s consensus target was up by 12.4% over the week,
with much of it coming as part of Citi’s upgrade.

Conversely, Lynas’ price target moved 17% lower as part of JP Morgan’s update. Grange Resources (GRR) found its consensus target 15.7% lower on a fairly neutral quarterly update and growing concerns about costs. Gindalbie Metals’ (GBG) consensus price target was trimmed by 12% and Perseus Mining (PRU) saw its target slip by 10.3%.

There were a number of significant earnings forecasts changes over the course of last week. Consensus earnings for Gindalbie were lifted significantly off a low base despite the lower price target, while forecasts for Sydney Airport (SYD) jumped 22.75%. On the downside, average earnings forecasts for Macquarie Atlas Roads (MQA) are down 115% on soft traffic on the APRR in France and on the Dulles Greenway in the US. Lynas’ forecast earnings are down 80% and Transurban down nearly 38%.

Note: FN Arena monitors eight leading stockbrokers on a daily basis and the tables below are based on data analysis from the week past concerning these eight equity market experts. The eight experts in casu are: BA-Merrill Lynch, Citi, Credit Suisse, Deutsche Bank, JP Morgan, Macquarie, CIMB (former RBS) and UBS.

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Investing in property gains traction, size really does matter!

by Paul Rickard

New figures from the ATO show that investing in residential property is finally starting to gain favour with SMSF trustees. Investing in residential property was made more attractive when the ATO issued a ruling that allows improvements, such as a kitchen renovation, to be made to a property funded through a limited recourse borrowing arrangement, provided that the funds for the improvement come from other monies.

Over the year to 30 September 2012, investments by SMSFs in residential property rose from $14.8 billion to $16.3 billion, an increase of around 10%. Admittedly, this growth comes off a very low base, with residential property only representing a tiny proportion of total SMSF assets at around 3.5%.

Where are SMSFs investing?

Shares and cash/term deposits continue to account for the bulk of SMSF investments – just over 60% at the end of September. On paper, there has been a material shift into shares by trustees, with investments growing over the year to September from $118.3 billion to $141.5 billion – an increase of almost 20%. Adjusting for the increase in the S&P/ASX 200 over this period of 9.4%, the increase is a little more measured – however, still significant.

Size, Fees and Performance

Size matters! Bigger funds do better – and pay less!
So, if there is any take out of this data (the exact pattern is also the case for the 2008, 2009 and 2010 years), see what you can do to lower the fixed costs of your fund (and potentially transaction or investment management costs). If you can’t make additional non-concessional contributions, can you bring in other members – family or friends?

**Where do Trustees fall foul of the rules?**

The ATO says that the Number 1 type of breech reported to it by approved auditors is ‘loans or financial assistance to members’, followed by breech of the 5% cap on ‘in-house’ assets. The top contraventions reported to the ATO from 2005 to 30 June 2012 are:

<table>
<thead>
<tr>
<th>Contravention</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan or financial assistance to member</td>
<td>20.9%</td>
</tr>
<tr>
<td>In-house assets</td>
<td>18.3%</td>
</tr>
<tr>
<td>Separation of assets</td>
<td>12.9%</td>
</tr>
<tr>
<td>Administrative</td>
<td>12.0%</td>
</tr>
<tr>
<td>Operating standard contravention</td>
<td>8.3%</td>
</tr>
<tr>
<td>Borrowings</td>
<td>8.0%</td>
</tr>
<tr>
<td>Sole purpose</td>
<td>7.8%</td>
</tr>
<tr>
<td>Investment at arm’s length</td>
<td>7.5%</td>
</tr>
<tr>
<td>Other</td>
<td>2.8%</td>
</tr>
<tr>
<td>Acquisition of Assets from related parties</td>
<td>1.5%</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

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Good news as S&P 500 passes test and continues to rise. Next stop 1,552?

by Lance Lai

The last time I spoke of this most important Index was on Switzer on 29 November 2012.

At that time, the market in my opinion was well balanced at 1,410 with two levels identified, G = Good at 1,448 and B = Bad at 1,354.

The premise was that if G was breached, then this was Good and the markets would run up.

On the other hand, if B was breached, this would be Bad and the markets would fall.

G was breached on 2 January 2013, and the market has run steadily up 3.6% in the past month without looking back.

The questions now on everyone’s mind are: “Where to next?” and “Do we buy now?”

The positives on the chart below number six points, while the negatives number seven.

While this might seem confusing, the news is good.

The charts have cleared the way for a healthy medium-term outlook. This timeframe ought to last several months, say from three to eight months.

In the shorter term though, in clearing the important level of 1,448, it has “shown us the way” and risen nicely, but arguably too much in less than a month. The difficulty at the time of writing is that the market has shown no sign of slowing, but is expected to reverse either here and now with strong resistance at 1,502 and if not, then at or around 1,552, or 3.4% more.

1,552 is shown as “L” on the chart and it is possible, but not necessary, as a level to hit in the short term before a retracement is seen.

This analysis conforms with the analysis last week of the Shanghai index, namely patience for now is the safer option on a short-term basis. A better entry level ought to present.

If your time frame is longer term, then there is also the argument to simply buy some more now, if you haven’t already done so.

Positives

1. The 200-day moving average is pointing upwards now.
2. Weekly time frames indicate more upward momentum to be expected.
3. The “G” standing for “Good” level of 1,448 was tested, rejected, and then broken on 2 January 2013. It has been on an upward steady run since. Up 3.6% from 2 January. This is very strong and steady.
4. 2013 for the next 12 months ought to be positive.
5. An extension of this current bullishness another 3.4% to 1,552 is not out of the question, though not ideal. Last year the 14 September, represented a height of bullish sentiment, where the Index was 9.3% above
the moving average.

6. None of the downside risks of the “B” level was seen. Trading has been positive to the upside, removing the doubt that had existed.

Negatives

1. Indicators are topping out on daily time frames.
2. Strong resistance is at 1,528, or 1.9% higher.
3. Strong level is at 1,502, which is where we were end of last week, expect selling pressures right here and now.
4. Next levels on upside are:
   a) 1,552 or 3.4% higher
   b) 1,593 or 6% higher
   Both these levels seem a stretch at this point without a pull back.
5. A stretch towards higher levels of 4a) and 4b) above without a pull back firstly would be negative for the market and implies an irrational exuberance mindset change. For the long run, this is not desirable.
6. The run up now from the last major low of 1,343 on 16 November 2012 is 11.7% to date. In 2.5 months, this is substantial and arguably too much in such a short time.

The Index is 7% above the 200 day moving average. This is again a significant amount and reveals a risk of a retracement in the wings.

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The week ahead

**Australia**
January 31: Trade price indexes (December)
January 31: New home sales (December)
January 31: Private sector credit (December)
February 1: Performance of Manufacturing (January)
February 1: Producer prices (December)
February 1: RP Data-Rismark home prices (January)

**Overseas**
January 28: US Durable goods orders (December)
January 29: US Cash Schiller home prices (November)
January 29: US Consumer confidence (January)
January 30: US ADP employment (January)
January 29, 30: US FOMC meeting
January 31: US Personal income (December)
February 1: US Non-farm payrolls (January)
February 1: US ISM manufacturing (January)