“Research from CommSec shows SMSF trustees are fixated on Australia’s top 20 largest stocks.”
TONY KAYE, EUREKA REPORT

# Moving to mid-caps will rebalance your portfolio

TONY KAYE

New Year’s resolutions are often made with the best intentions, only to be forgotten within days or weeks.

But do yourself a favour. If you resolved to review your investment portfolio, and to take steps to rebalance it in the new year, make sure you actually do that review, and do it sooner rather than later. If you didn’t make that pledge, add it to your priority task list.

Recent research from CommSec shows SMSF trustees are fixated on Australia’s top 20 largest stocks when it comes to the share market.

While holding larger listed stocks is prudent, they have not necessarily provided the best returns over time.

Investors with wider diversification into companies outside the top 20, and even outside the top 200, have in many cases done better. Part of that reflects concentration risk, with banks dominating the top 20 ASX list.

CommSec analysis shows SMSFs were the largest net investors in the ASX top 20 during 2016, with the four biggest banks making up more than 32 per cent of SMSF holdings. That’s despite increasing concerns among analysts over the earnings sustainability of the big banks, with ratings agency Fitch also revising its outlook on the sector to negative earlier this month.

According to CommSec, banks comprise nearly a quarter of all trades by value for the SMSFs.

Separate SMSF investment data from the ATO shows Australian shares were the biggest beneficiaries of investment funds in the September quarter, with the total value of self-directed super dollars invested in stocks rising by $8.8 billion in the three months to $192.4bn.

That figure is almost matched by the huge amount of SMSF funds ($157.4bn) invested into cash — which is equal to about one-quarter of total SMSF investor assets — an alarming statistic given the dismal returns from banks accounts at current interest rate levels.

Investors would be much better served, returns wise, by redirecting more cash into assets such as shares that generate higher growth and income.

That’s where picking stocks with the best prospects is crucial.

After the big banks, research shows that investors prize the big resources stocks BHP Billiton and Rio Tinto in their portfolios (11 per cent), with materials and energy nearly another quarter of trades by value for SMSFs.

Other key holdings include telcos such as Telstra (7.8 per cent), diversified financials such as Macquarie and big insurers QBE (6.4 per cent) and Wesfarmers and Woolworths (6 per cent).

Yet, pleasingly, the CommSec research shows SMSF trustees are also moving towards the mid to small-cap market.

Marcus Evans, head of SMSF customers for Commonwealth Bank, said that while SMSFs were the net buyers of the banks and resource stocks over the past 12 months, CHESS holdings of stocks outside the ASX 100 have increased by 3 per cent.

The use of exchange-traded products, such as exchange traded funds (ETFs), listed investment companies (LICs) and exchange-traded managed funds, to diversify into international equities has remained constant at about 2 per cent of total CHESS holdings. SMSFs make up about a quarter of all ETF trades, although ETF activity was down marginally on 2015.

“One pattern emerging is the move from ETFs to direct shares when the market spikes down and specific shares become attractive from a valuation perspective,” Evans said.

There’s no time like the present to check your portfolio and it’s a relatively quick process.

There are free portfolio manager tools available online where you can easily enter all your asset details and view your current asset allocation ratio.

For investors with a lower-than-recommended allocation exposure score, the most prudent course of action is to rebalance one’s asset allocation to improve diversification, reduce risk and improve returns.

The key to successful portfolio management is having, and sticking to, defined investment objectives. Emotion should never come into play, but when circumstances dictate active investors should be ready, and prepared, to respond.

*Tony Kaye is the editor of Eureka Report, which is owned by www.investsmart.com.au*

# Avoid tax taps in super shift

## Get your house in order or face a hefty bill from the taxman

MONICA RULE

One of the biggest issues facing all advisers this year is how to guide investors through the forthcoming changes in super — importantly, there is a need here to get your house in order or you could be facing a hefty tax bill.

It is also crucial that investors understand the mechanics of capital gains tax relief if they are considering selling assets prior to the new rules coming into force.

The new $1.6 million cap, that takes effect from 1 July 2017, places a limit on pension accounts that receive tax-free investment earnings. If you have more than $1.6m in your pension account, you must either retain the excess in your accumulation account (where the investment earnings are taxed at maximum of 15 per cent) or withdraw the money from superannuation.

If the excess is not removed, you will incur an excess transfer balance tax of 15 per cent in the 2017-18 financial year and your pension will be deemed as not being in pension phase from the start of the financial year.

Crucially, this may mean your pension income is no longer tax free when you receive it. If an SMSF member moves some of their pension assets back to the accumulation phase before July 1, 2017, they can apply for capital gains tax relief so they only pay tax on the capital growth of assets from July 1, 2017.

SMSF trustees can choose which assets they provide the relief to and do not need to sell assets to apply the CGT relief. However, the CGT relief is not automatic and an SMSF will need to make an irrevocable election, in the ATO’s approved form, before it lodges its 2016-17 tax return. The relief deems an asset to be sold on June 30, 2017 for its market value and repurchased at that price. This ensures only gains from July 1, 2017 onwards will be taxed.

> The new $1.6m cap places a limit on pension accounts that receive tax-free investment earnings

If the CGT relief is applied and an SMSF asset was segregated prior to November 9, 2016, then the entire capital gain arising from the segregated assets will be disregarded. If an SMSF uses the unsegregated method (because it has assets that support both a pension account and an accumulation account) then the notional capital gain on the non-exempt portion will be included in the SMSF’s assessable income for the 2016-17 financial year. It is worth knowing, however, the SMSF can elect to defer the notional gain until the asset is sold.

SMSF members also need to be aware that by choosing the CGT relief, they must wait a further 12 months before the CGT discount can be claimed.

**Checklist for the new year**

Members affected by the new law will need to discuss their situation with their accountant or financial planner. Here’s a list of the key items to be considered:

- Members under the age of 60 with multiple pensions need to consider whether to commute the pension with the higher taxable component to minimise the tax payable on their pension income.
- Members with a pension which commenced prior to January 1, 2015 need to decide whether they wish to preserve their entitlements to the age pension and the Commonwealth Seniors Health-care Card.
- If a member is withdrawing the excess amount from their SMSF, then they need to weigh up the benefit of the $18,200 tax-free income threshold and their marginal tax rate compared to the 15 per cent superannuation tax rate.
- The new reduced contribution limits may make future contributions more difficult.
- Whether to maintain assets with unrealised capital losses at their original cost base, and reset the cost base of assets with large gains.
- If there are plans to sell assets soon, it may be more tax effective not to apply the relief due to the 12-month waiting period to claim the CGT discount.
- Whether choosing the CGT relief will produce the best tax result. It may depend on when the member retires and the expected growth of the SMSF assets. For example, if a member is within the $1.6m cap and will retire soon, it means their SMSF will wholly convert to pension mode. Applying the relief to an asset may cause the SMSF to be taxed on the deferred notional capital gain when the asset is sold. If the relief was not chosen, this tax may not arise as the pension’s earnings exemption would otherwise apply.

*Monica Rule is an SMSF specialist and author of The Self Managed Super Handbook*
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DIVIDEND DETECTIVE

# Manager offering value for investors

**Henderson Group**
**ASX CODE:** HGG
**SECURITY PRICE:** $3.71
**FYI VALUE:** $4.85
**INDUSTRY:** Funds management
**FORECAST DISTRIBUTION:** 17c per share

DAMEN KLOECKNER

Henderson Group is a leading European asset manager based in London. Despite having little remaining business in Australia, the group’s ASX listing is a vestige of its days as an AMP subsidiary.

It has historically delivered strong returns for its clients over a number of different strategies, building an inimitable reputation and brand for itself in the process. A planned merger with US peer Janus Capital would create a truly global business with enormous product diversity and geographic reach. The combined business will have more than $US350 billion ($463bn) in assets under management across a wide range of asset classes, strategies and clients. Accordingly, it is expected to generate EBITDA of SUS700 million before any post-merger synergies.

With a dividend payout ratio of 60 per cent, this translates to a healthy annual yield of 4.6 per cent, paid quarterly. Additionally, in response to Janus’s intention to pay a final quarterly dividend prior to the merger’s close, HGG will pay a corresponding special dividend to its own shareholders. Though it has not yet announced the quantum or timing of the dividend, it is likely to be in the order of 3-4c per share.

Despite its yield, Henderson is not a typical income stock. The earnings are leveraged to the performance of global stockmarkets and it is still reinvesting a large proportion of its capital to grow the business. Recent concerns over the implications of Brexit and a weakening pound have created share price volatility, but to date the underlying business has not been affected. Once it merges with Janus, these concerns should abate as Henderson’s European focus dissipates into a truly global portfolio. Henderson is also benefiting from the ongoing global shift in asset class mix from fixed interest to equities.

Henderson has risks, as it continues to be exposed to global equity markets, Anglo-European relations and key foreign exchange rates between the pound, US dollar, euro and Aussie dollar. Still, these risks are typical of the industry in general. As a result, Henderson’s sharp discount to its peers and its discount to its intrinsic value appear overdone. If the group executes on its merger and growth strategy, this discount may shrink.

*Damen Kloeckner is an associate analyst at Clime Investment Management.*

# Market favourite CSL vulnerable to US regulatory change but still an attractive buy

DAVID WALKER

Investor favourite CSL delighted faithful shareholders recently with an upgrade to its 2017 earnings guidance.

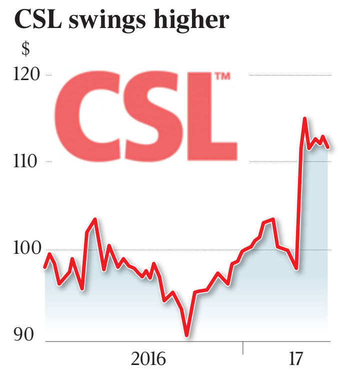
After five months of a sliding share price and earnings downgrades last year, mainly because the Sequirus influenza vaccine business acquired from Novartis would take longer to break even than initially expected, the upgrade reassured because it implies Sequirus is on track to break even in 2018 as guided by management. Previously the market had doubts about this timetable.

The main reason for the upgrade also showcases CSL’s superior execution in its core business of sourcing and fractionating blood plasma. In the December half, competitors found themselves without sufficient collection centres after underinvesting in capacity. CSL in contrast had increased collection capacity so it was able to meet growing demand for blood products for patients with compromised immune systems. So CSL has a temporary but important competitive advantage and will benefit throughout 2017.

It looks like under the leadership of CEO Paul Perreault earnings downgrades are over at this company. In fact the risks are now to the upside. After CSL’s recent lift the stock is now trading at about $111 on the ASX. But it has an upgraded intrinsic valuation of $116 allowing for the consensus earnings upgrades: I’d expect CSL’s haemophilia drugs Idelvion and Afstyla will gain traction in major markets this year. Strong sales here would see the stock push past $120.

But all this is before the new and unfathomable risk of Donald Trump’s promise to “save billions” by introducing competitive tendering for drugs. CSL is vulnerable to US regulatory change because 46 per cent of 2016 sales came from North America, so the stock sold off marginally in response to the latest rhetoric. How should value investors respond?

**CSL swings higher**




Source: Bloomberg

Although US patients undeniably pay high prices for drugs, so far there is no policy substance to Trump’s promise, which consists of a series of campaign announcements and tweets. This area of healthcare is not suited to sweeping executive orders: instead, the newly elected US congress needs to agree with the administration on the general direction of change followed by alignment on legislation both within congress and with the executive branch. This will take time. Trump’s policy must ensure patients are not denied lifesaving drugs just because the supply chain refuses to provide them at an unacceptably low price. As a result, direct pricing controls are unlikely. And some drugs are, at the discretion of prescribing doctors, superior for some patients regardless of price — which seems to rule out competitive bidding in those cases.

Furthermore, the pharmaceutical industry funds one of the most powerful lobbying machines in Washington and is particularly influential over the Republican Party.

The industry will fight hard against restrictions on profitability, not least because the vast cost, high risk and long duration of drug development and clinical trials justifies superior profitability to compensate shareholders. Trump will require determination if he really wants to change the status quo in this sector. Trump moved swiftly to introduce other policies from the campaign. Investors should prepare for some kind of action on drug prices, probably in the form of facilitating existing competitive pressures to bring down drug prices over time.

The uncertainty and any announcements will cause volatility in pharma share prices, which could create entry points.

The best way to consider CSL is to value the stock assuming no regulatory change in America but to require a larger discount to value before buying. A 10 per cent discount to our $116 valuation suggests a $104 buy price.

*David Walker is senior analyst at StocksInValue.com.au*