NAB on way to resolving UK woes

DIVIDEND DETECTIVE

ASX CODE: NAB
SECURITY PRICE: $34.77
INDUSTRY: Banking
FORECAST DISTRIBUTION: $2.01 per share fully franked

DARREN KATZ

THE major bank stocks are some of the biggest sources of dividends for Australian investors.

But with bank shares near record highs after being bid up by investors seeking yield in a low-interest rate environment, many are asking if they're too expensive to buy.

We believe National Australia Bank, while the fourth-ranked of the major banks and a relative share-price laggard, is a solid option given it is resolving issues at its offshore operations, its share price is actually reflecting some value, and the bank is paying a strong dividend yield.

One of NAB's biggest problems has been its British operation, which has weighed down the share price.

Before the global financial crisis NAB expanded in Britain through lending to commercial property. But when the GFC hit and property tumbled, NAB was left with about $11 billion of impaired assets, marring financial performance in recent years. However, NAB is moving to clean up the mess.

It's being helped by improvements in the British economy and increased demand for British commercial property, which will allow it to offload underperforming loan portfolios.

On July 28 the bank announced the sale of £625 million ($1.13bn) of non-performing loans from its British Commercial Real Estate portfolio to an affiliate of New York-based private equity firm Cerberus Global Investors.

The British problems are not entirely resolved.

Incoming chief executive Andrew Thorburn warned that NAB's broader British operations still face some challenges, but he says the bank will continue to look for opportunities to sell non-core assets.

Meanwhile, the bank's local operations have been benefiting from a strong housing market and falling bad debts.

NAB in the first half, the last to be handed down by outgoing CEO Cameron Clyne, reported a 15.8 per cent increase in net profit after tax to $2.86bn; cash NPAT was up 8.5 per cent to $3.15bn.

The result was driven by a 52 per cent fall in the charge to provide for bad and doubtful debts on the back of lower loan losses at its Australian banking and British businesses.

Revenue growth, however, was relatively subdued at 2.6 per cent — that's weaker than its peers such as ANZ (6 per cent) and Westpac (5 per cent).

NAB declared an interim fully franked dividend of 99c per share, a 6.5 per cent increase, and the bank is forecast to pay out a total fully franked dividend of $2.01 per share, which gives a solid dividend yield of 5.7 per cent.

Along with ANZ, NAB is trading below our valuation of $35.42. So while NAB is the fourth-ranked bank in terms of performance, there are signs the millstone of its British operations is resolving, and the stock is trading slightly below value and offers a strong dividend yield for investors.

Darren Katz is head of product development at Clime Asset Management.

The big game's in Africa if you want to make a killing

The super-rich have a new investment destination of choice

ANDREW INWOOD

ACCORDING to the latest CoreData research, the number of Australians who have more than $1 million to spend outside their house and their superannuation grew by just under 9 per cent in the year to June, pushing it through the 400,000 mark for the first time.

The growth, which in the main came from exposure to the sharemarket, has however started to slow as the push into equities starts to fall and once again the high-net-worth investors start to build up cash as they wait for the earnings reports to wash through the system.

The Australian growth numbers are, however, relatively poor. The growth in the number of new HNWIs in Europe, Africa and the US all reached double figures, with the African data showing an extraordinary 40 per cent-plus jump. The figures seem to show it's our love affair with cash and our fear of direct investing which is keeping our numbers down.

If you start to unpick the numbers of ultra-high-net-worth individuals, those with more than $30m to invest, then you start to see a radically different type of investing behaviour at play.

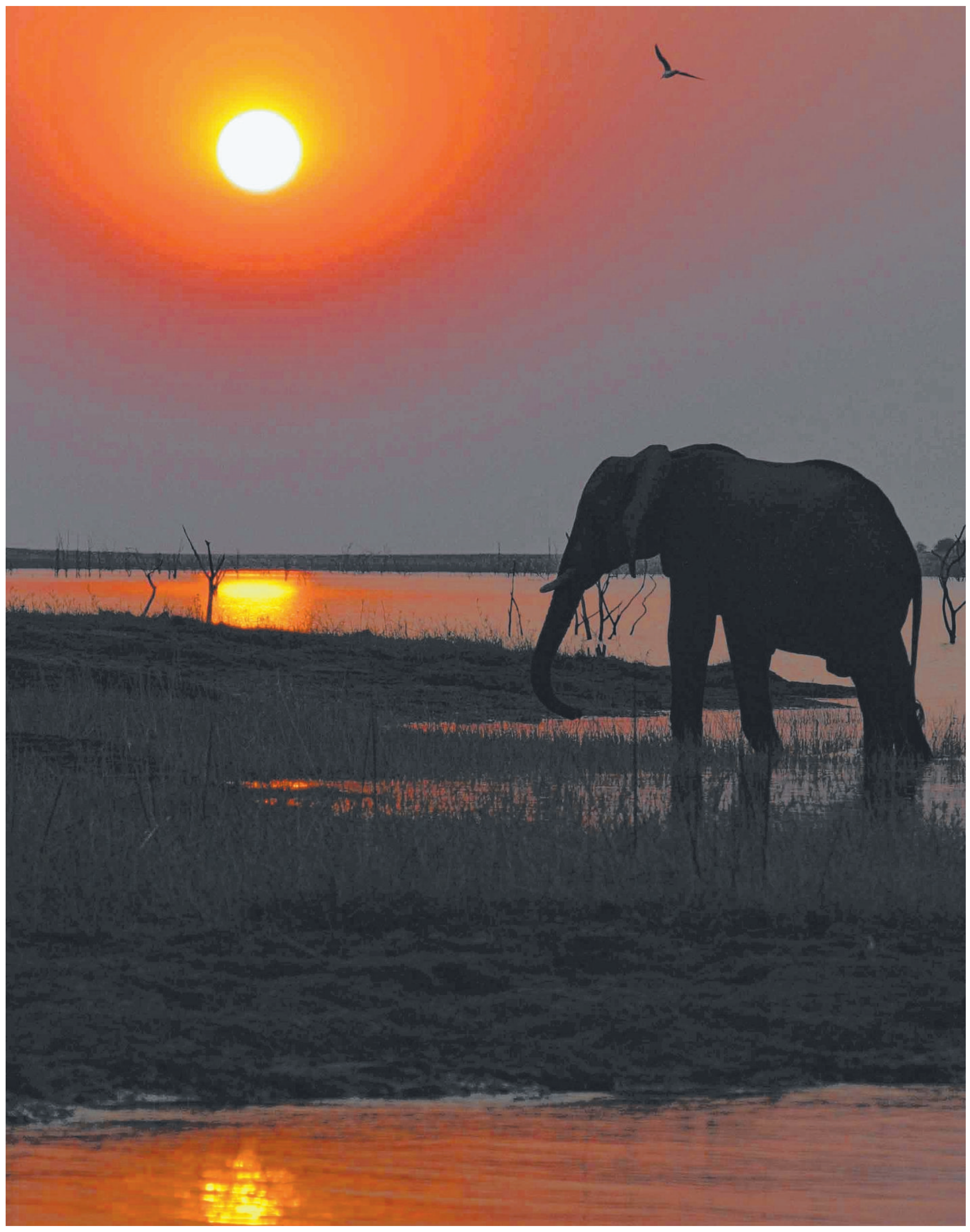
For a start, they tend to have made their money by owning all of — or part of — a business and they tend to focus on investing in businesses and themes rather than products or markets.

In recent research into UHNWIs we asked respondents a series of specific questions about service providers, asset classes and business and were surprised by the detailed understanding of global themes, investment preferences and what they saw as a lack of investment talent.

Our figures show that there are just over 3500 people in this country with more than $30m to invest and 21 billionaires, and that all of them are developing fixed views about what's happening in our economy and what's happening across the world.

To get the obvious out of the way — Australia's UHNWIs love two industries in Australia, banking and mining, and not much else. They are not hopeful for manufacturing, agriculture and, in particular, are expecting big things from CBA this reporting season.

What's worth pointing out in these figures is where global wealth is going and where the expectations of growth are.



TONY PARK

Australian tycoons have turned their backs on the local market in the hope of 50 per cent returns from Africa

By and large the UHNWIs think that mainland Europe and the US are a better bet for investment than Australia, in particular for new business opportunities — but what is most surprising is that the new bet being made is Africa.

The research revealed that it's not just the obvious industries in Africa — mining and oil and gas — that are going through a revolution, though those are attractive, but manufacturing and agriculture that are booming there as well.

This seems to be backed up by our UHNWI forecasting which shows the rich expect growth in Australia to hover in the high single digits (between 8 per cent and 9 per cent) but they are expecting as much as a 50 per cent upside from the investments they are making in Africa.

In a blow for Australian investment houses, it seems, at least in the minds of Australia's rich investors, that local investment companies haven't yet plugged into the African growth story. They believe it's being driven by individuals, leaving the banks and investment managers lagging behind. In a recent round of UHNWI deep-dive interviews with 10 Perth-based Australians, eight said they had all but abandoned their Australian-based investments and had started pushing hard into Africa.

What was interesting about this was that not only were they doing everything directly, in businesses ranging from building concrete bridges to leasing mining equipment, but that they were seeking more opportunities.

One of the UHNWIs, who is in the business of oil pipeline manufacturing and is seeking to get greater exposure to the market there, noted that it's now almost impossible to find opportunities in Australia.

At the moment the upswing in Africa is just enormous and it looks like it's going to run for a decade.

It's a lot like Russia was a few years back so there is some serious wealth going to be created. But to get in, investors are having to go in via opportunities coming out of London.

Australia just isn't in the mix.

Andrew Inwood is the founder of CoreData Research.

All eyes on Fed to get the rates ball moving

DON STAMMER

SINCE the global financial crisis hit in late 2008 interest rates have been unusually low. Many rates have declined again recently. Understandably, investors hunting for yield ask why are interest rates are so low, and when are they likely to start rising again.

Low interest rates are not the only standout feature in investment markets.

Interest spreads — including the gaps between yields on government bonds and those on corporate bonds — have narrowed a lot. Sharemarkets and property are strong. And volatility has just about disappeared in each of bond, share and foreign exchange markets. Any explanation of why interest rates are so low has also to bring out what's been happening to interest rate spreads, shares, property and volatility.

The dominant cause of these several outcomes is, in my view, the ultra-easy settings in the monetary policies of the major central banks. And the impact on investor behaviour has been magnified by market expectations that the US will leave its near-zero cash rate unchanged until the second half of next year.

That's mainly because, as the chart shows, US inflation has risen only a little; also, the Fed is of the view that there's more slack in the US economy than is suggested by the measured unemployment rate of 6.1 per cent.

There's also the thought that Europe's low inflation could morph into deflation — and further boost European investors' appetite for bonds.

The consensus forecast for global growth this year has been progressively cut back in recent months and now stands at a modest 3 per cent — low enough to encourage bond investors to stay put but not so low as would cause share investors to rush to the exits.

The global excess of saving and huge differences in saving rates country by country are causing big flows of funds across national boundaries — helping to keep interest rates low in countries such as the US and Australia. So far, China has maintained its tight regulation on private capital outflow — though these controls have increasingly been described as "porous", even while liberalising capital inflow.

As a result, China's overall balance of payments has tripped into larger surplus and official holdings of international reserves have risen to $US4 trillion ($4.3 trillion).

China has been buying US bonds, especially on days when stronger economic numbers are released in the US and US bond yields have drifted up. If, as seems likely, controls on private capital outflow are relaxed, China's holdings of international reserves and its demand for US bonds seem likely to decline.

Australia's AAA rating has attracted offshore investors, particularly central banks and sovereign funds, to our government bonds.

We've also seen strong demand for Australian interest-bearing investments from Japan and other countries — helping to bring down interest rates here and to keep the Australian dollar relatively strong.

The US has held its cash rate at close to zero for almost six years — and that's despite the economic recovery, US banks having re-capitalised, share prices (as measured by the S&P 500 index) almost tripling since March 2009, and average house prices rising by 10 per cent in the past year.

Ten-year US bonds recently traded yields of 2.5 per cent — only half a percentage point more than inflation.

In my view, the most likely trigger event to cause the general level of interest rates in the US and here to be moving up again will be expectations forming that, with the US economy stronger and inflation picking up, the cash rate in the US will be raised earlier than either the Fed's forward guidance has been suggesting or investors generally have been anticipating.

Such a re-assessment could well lead to investors taking a sustained negative attitude towards bonds, particularly long-dated ones, and a more cautious view towards shares.

Don Stammer chairs QVE, is a director of IPE, and is an adviser to the Third Link Growth Fund, Altius Asset Management, Philo Capital and Centric Wealth. The views expressed are his alone.

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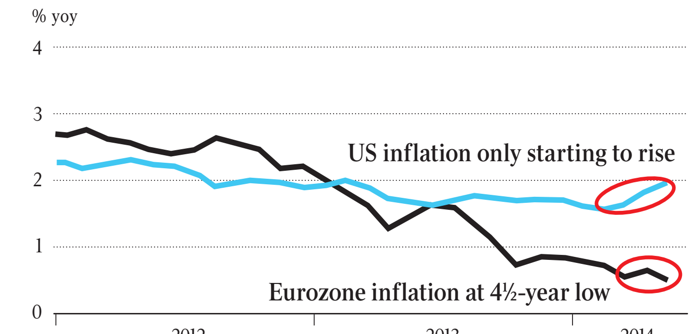
US inflation risk increasing



Fundamental tenets the key to successfully navigating retirement risk zone

JASON ANDRIESSEN

IF you are now entering the retirement risk zone, please fasten your seatbelt. This period is broadly defined as the decade either side of retirement — and the stakes are considerably higher than anywhere else.

Poor decisions at this time can have far-reaching consequences, which older investors simply don't have the time to recover from.

When it comes to regulation, change feels like it is coming thick and fast. The recent federal budget highlighted that changes to super are again very much on the cards. The pension age will be raised again, which may mean the preservation age will be raised as well.

Our money already spends a long time in superannuation, so if the preservation age is lifted, the question arises of whether investors will embrace the longer time horizon, which will have consequences for portfolio structure.

Of course, there are tax advantages to favouring super over other investment options, and there is no talk of changing these concessions significantly in the near term.

The introduction of a debt levy for higher income earners and changes to concessional contribution caps may mean parallel investment strategies are the best option for some. Clearly, the overarching risk for retirees is longevity, or running out of money prematurely. But the big question is how investors should look to mitigate this risk in the structure of their portfolio.

Making the best decisions in the retirement risk zone depends on accepting a number of fundamental tenets.

These include that income certainty is a primary goal of retirees, returns matter most in the decade either side of retirement, and losses in retirement hurt more than gains feel good.

In addition, it's important not to forget that inflation is still the No 1 cause of retirement ruin, so some growth assets are necessary to mitigate this.

Needless to say, no "one size fits all" portfolio structure will suit every investor. On the other hand, there are key variables that affect every investor and need to be considered. These are the magnitude of returns, the order of returns, the level of drawdowns and life expectancy. But as every person is different, it is crucial to seek financial advice as early as possible.

The investment adage that time in the market brings greater success than timing the market no longer holds true as investors head into the retirement risk zone. For investors close to retirement, timing matters a great deal.

For younger people, in the accumulation stage, a tilt to growth assets, such as equities, makes sense, because there is time to make up for sudden losses.

For those in the retirement risk zone, several years of negative returns may leave them unable to recover. Price fluctuations, and more specifically returns, both positive and negative, matter a lot.

> The investment adage that time in the market brings greater success than timing the market no longer holds true

As retirees must be able to meet lifestyle expenses from investments, and they are drawing down from their capital base, any losses will reduce the size of their portfolio, meaning they will not participate to the same extent in any market recovery, as their portfolio is now smaller.

So what does this mean in terms of their portfolio?

Is the so-called glide-path investment formula, which defines the asset allocation mix based on a target end date, the best option?

Under this structure, the portfolio becomes more conservative — moving from equities to fixed interest — as the fund gets closer to the end date, thereby providing some protection from unexpected falls in the market.

Unfortunately, it isn't that simple. Keeping up with inflation means retirees must keep some growth assets to compensate for the potential loss of purchasing power at a time when maintaining income levels is vital.

One option is to underpin a portfolio with a secure income, thereby diversifying the core of the portfolio and reducing the need to sell down growth style assets at depressed prices.

This option, combined with judicious rebalancing over time, permits the inclusion of growth assets without forgoing all income.

To this end, there are a number of products available designed to provide secure income.

For example, a short-term annuity with a fixed-term element, or a fixed-term investment within an allocated pension.

Ultimately, planning for retirement can be a complex process because financial needs change during retirement.

For this reason therefore, different plans for different retirement stages need to be considered.

Jason Andriessen is general manager of marketing, product and advice, for State Super Financial Services (SSFS).

Be alive to the call of a binding death benefit nomination on your self-managed super

MONICA RULE

THERE have been many articles in the media on court cases involving disputes between Self-Managed Superannuation Fund trustees who are family members.

Judging by the outcomes, you should take care to put arrangements in place if you want your wishes to be respected in the event of your death.

Most trustees believe their will should take care of how their assets will be distributed. That may be true for assets outside their SMSF, but if they want superannuation savings to be distributed as part of their estate they will need to check the wording of their trust deed and put a binding death benefit nomination (BDBN) in place, because super does not automatically form part of a person's estate.

The way your super savings will be paid from your SMSF is based on your SMSF's Trust Deed. The trust deed should state not only how your benefits can be received by you while you're alive, it should also spell out how it will be distributed when you die.

The problem with SMSFs is that under the superannuation law an SMSF does not have to have a BDBN. This means, on your death, surviving members in your SMSF will determine who your benefit is paid to.

This may not be a problem if there is only you and your spouse in your SMSF and you both want each other to have the other's superannuation entitlements.

But what if you want some or all of your superannuation savings to go to your children or children from a previous marriage?

Although the superannuation law does not require SMSFs to have a BDBN, it does allow for one if it is permitted by your SMSF's Trust Deed. Because SMSFs do not need to have BDBN, there are no restrictions on what needs to be in one. Normally, a BDBN needs to be witnessed by two individuals who are not beneficiaries to the estate. It also needs to be updated every three years for it to be valid.

Your SMSF Trust Deed can spell out under what terms a BDBN will be accepted.

For example, it can offer a BDBN that does not have to be updated on a regular basis or does not need to be witnessed by two people. A non-lapsing nomination remains valid until the member changes it or revokes it.

Please talk to a lawyer about what you should put in your Trust Deed as well as in a BDBN. You want to make sure it reflects your wishes after you pass.

Monica Rule is the author of The Self-Managed Super Handbook. www.monicarule.com.au.