ASX forecasts pruned as favoured stocks thin out

RUDI FILAPEK-VANDYCK

As we head towards the end of the financial year, it is a good time to review where the wider ASX is meant to be heading and what stocks the leading brokers are backing ... or backing away from.

Comparing Australia's stockmarket to Wall Street it is clear the underlying dynamics have not been as supportive. In fact, stockbroking analysts have been reducing wider market forecasts since April and it has started to appear on investors' radars.

Just a few days ago, Shaw and Partners chief investment officer Martin Crabb highlighted the profit growth picture in Australia is deteriorating ... fast.

Crabb's report titled "Earnings Picture Deteriorating Fast", shows how rapidly forecast EPS for the ASX 200 index recovered in the second half of 2016 to above the prior peak registered in late 2014. But now the trend is faltering. Moreover, the underlying trend seems to be pointing firmly to the downside.

If we take a more positive view than Crabb, who seems to suggest a larger correction is likely to follow on the back of this negative trend in earnings estimates, then we can point out a large contribution to the negative trend comes from downgrades to forecasts for retailers and other companies exposed to discretionary spending domestically.

So what has been holding the market up? The positive offset has come from companies such as a2 Milk (A2M), Aristocrat Leisure (ALL), Amcor (AMC), CSL (CSL) and Qantas (QAN), whose upgrades, alas, cannot make up for the reductions elsewhere, though they do explain why these share prices have performed strongly.

As things stand, the outlook for reporting season in August (only six weeks away) remains strong, despite the negative trend, but this is largely on the back of much higher commodity prices, which have since reverted towards lower levels. Worrywarts like Crabb rightfully point out current profit projections for FY18 and FY19 seem rather light, and they are falling.

This will be the crucial factor to watch over the two months or so ahead of us. Though investors whose portfolios are stacked up with banks and resources stocks can always hope the global reflation trade, so fierce in the second half of 2016, might resume in the months ahead.

Recent analysis by Goldman Sachs generated some interesting insights into buying "cheap" stocks, so to say the least.

The research points out so-called "value" investing has had a much tougher execution post-GFC. In other words: value investing has become a lot tougher than it used to be.

Not that any of this will ever stop investors' attention to be reignited whenever a sudden dive announces itself.

Shrinking list

Looking broadly across the market, stockbroker Morgans' recent update on its selected list of Conviction Buys revealed the removal of two stocks: Macquarie Atlas Roads (MQA) and Beacon Lighting (BLX).

With no new additions, the stockbroker's list has thus reduced to six remaining stocks: ResMed (RMD), Orora (ORA), Westpac (WBC), Oil Search (OSH), Speedcast (SDA) and Bapcor (BAP).

Over at Macquarie, portfolio strategists are of the view that offshore earnings will remain a dominant theme in the Australian share market (obviously supported by a view that the only way is down for the Aussie dollar).

Macquarie's portfolio thus remains Overweight Aristocrat Leisure (ALL), Corporate Travel (CTD), Orora (ORA) and Wesfarmers (WES). They have now added Boral (BLD) and Brambles (BXB) to increase the exposure.

On the other hand, Macquarie's portfolio no longer includes JB Hi-Fi (JBH), Fortescue Metals (FMG), or Smartgroup (SIQ) while exposure to Sydney Airport (SYD) has been reduced.

Equity strategists at Deutsche Bank also suggest investors may want to consider adding extra exposure to offshore profits. Their most preferred candidates

> 'Value' investing has had a much tougher execution post global financial crisis

are Amcor (AMC), Aristocrat Leisure and James Hardie (JHX).

Recent model portfolios updates by Morgans revealed the stockbroker has dumped Macquarie Atlas (MQA), Tatts Group (TTS) and Ingham's (ING). In particular the latter was eye-catching: "Our earlier comfort in ING has been dented by the difficulties facing other IPOs recently listed out of private equity ownership, where small misses can be disproportionately sold-off in this unforgiving market. We prefer to see a longer listed track record of ING and prefer to reduce our exposure to unknowns in this market."

The difficult decision to (finally) exit Vita Group (VTG) was also made at Morgans. The shares were trading around $5 last September. They are hovering around $1. Morgans' portfolio loss is reportedly circa 42 per cent and the strategists have no qualms in admitting they got this one badly wrong.

In case you hadn't noticed, share prices in local producers of lithium and graphite have had a rough ride recently. But stockbroking analysts are increasingly jumping to the rescue, so to speak. The common view is that fast-moving money has abandoned the sector on expectations that rising supplies through Direct Shipping Lithium Ore (DSO) will place the global market in dramatic over-supply, but it appears such fears are unwarranted.

How to avoid paying too much for your aged care

Here are five ways you can reduce the residential costs

RODNEY HORIN

TARA CROSER

Queensland Premier Annastacia Palaszczuk with Aveo Group CEO Geoff Grady at the opening of Aveo Springfield

The professional standards and pricing structures of retirement communities are back in the news once again for the wrong reasons.

It is certainly the case most Australians pay way too much for residential aged care. In fact, some pay hundreds of thousands of dollars too much, particularly if they rush into signing a contract without looking at the options available.

The major sharemarket-listed companies are the biggest offenders because of the pressures they have from shareholders. The latest listed group to hit the headlines is Aveo. The retirement group was sold off sharply this week after media investigation into poor practice at the company.

People often feel they have to make quick decisions about very large sums of money. This is often the case when a parent, for example, has a fall, ends up in hospital and the doctor advises the children that the parent can no longer live at home but must move into residential aged care.

All of a sudden, the adult children find themselves in a maze of refundable accommodation deposits, daily fees, extra-services fees and means-tested fees.

Worse still, there is the dreaded Centrelink form, which must be downloaded and filled in in order to determine the means-tested fee — it is 28 pages long and includes 145 questions.

If the wrong decisions are made at this time, families will pay more than they need to, particularly if the person, generally a parent, lives in aged care for several years.

Here are five ways to dramatically reduce the cost of residential aged care:

- Negotiate on the Refundable Accommodation Deposit. The RAD (formerly known as the bond) to secure a room at an aged-care facility can be as high as $2 million. In many cases these RADs are negotiable, and at times can be as much as halved.

The willingness of an aged-care facility to negotiate on RADs depends very much on the demand and supply of rooms at their facility. It is possible to negotiate to pay some or all of the daily fees from the RAD to minimise the impact on a person's cash flow. This means, of course, that less of the RAD will be returned at the end of the care period.

- Look at potentially part-paying the RAD. Although aged-care facilities prefer people to pay a RAD in full at the time of entry into aged-care, it is possible to choose to pay interest payments only or pay with a combination of lump sum and interest payments. This frees up capital for other expenses.

- Structure finances so that a parent can keep the full pension. The full pension, currently $888.30 per fortnight (or $23,095.80 per annum), can be lost if the family home is sold and the cash from the sale is added to the person's assessable assets. Sometimes it is better to keep the family home and pay aged-care fees from the rental income generated.

- Lower the daily means-tested fee. The means-tested fee is based upon the income and assets of the aged-care resident, so it increases as the resident's assessable assets and income increase. A resident on a part age pension with assets totalling $200,000 and deemed to be earning $28,109 per year will pay $2.07 per day ($756 per year), while a resident with assets totalling $1.2m and deemed to be earning $38,262 per year will pay $67.48 per day ($24,629 per year).

One option to reduce the means-tested fee is to buy an aged-care annuity, if appropriate. Other options include making gifts to children ($10,000 per year allowable, maximum $30,000 over rolling five-year period) or prepaying a funeral ($12,500 maximum).

- Look closely at the extra-services fee. Premium extra-services fee packages can cost as much as $120 a day and provide for additional services like a choice of meals, alcohol at meals, expanded activities program, cable television etc. Look closely at the extra-services fee and ask what services are being delivered and assess whether they represent value for money.

As Australians live longer, more and more will end up in residential aged-care. The number of people in permanent aged care in Australia is expected to triple in the next 35 years, from 225,000 today to 700,000 in 2050. Adult children may consider a parent to be many years away from aged-care, but circumstances can change very quickly.

Rodney Horin is a partner at aged-care specialists Joseph Palmer & Sons.

Take it to the limit one more time — but follow the rules

MONICA RULE
SUPERANNUATION

The $1.6 million limit on superannuation has caused a great deal of confusion. This concerns me because this confusion has the potential to stop people from putting more money into their superannuation savings (when they still can); cost people more in tax (if they exceed the limit); and have people claiming incorrect tax exemptions (by using an incorrect calculation method).

Some people think the $1.6m limit is the maximum amount they can have in their self-managed superannuation fund. This is not the case. There is no limit on the amount an SMSF can have in its accumulation account, but the amount a member can have in a retirement pension account is limited to the general transfer balance cap, which is $1.6m for the 2017-18 financial year.

Now I would point out that the $1.6m limit applies in three areas of the superannuation law, so this has probably added to the confusion.

> The $1.6 million limit applies in three separate areas of the superannuation law, so this has probably added to the confusion

I've briefly touched on the retirement pension account, but I've outlined this and the other two areas in a bit more detail:

1. Transfer balance cap. This is the maximum net assets value ($1.6m) that an SMSF member can have in their retirement pension account.

If a member's pension account is represented by a property with a market value of $2m but it has a $500,000 loan attached to it, then the net asset value of the property is $1.5m. If a member has more than $1.6m in their retirement pension account as of July 1 this year, they will incur a 15 per cent excess transfer balance tax calculated on the notional earnings of the excess amount.

The notional earnings are calculated using the 90 day bank accepted bill rate, plus 7 per cent. This is applied from the date the excess occurs to the date the excess is rectified or the date the Australian Taxation Office issues a determination.

However, any excess amount of less than $100,000 at June 30 this year will be disregarded by the ATO provided the excess is removed from the member's retirement account by December 31, 2017.

2. Total superannuation balance. This is the total amount of a member's accumulation account, plus their retirement pension account, plus any amount rolled over that has not been allocated to either of these accounts, minus any personal injury payment received by their SMSF for the member.

The total amount is then used to determine whether the member can make any non-concessional contributions into their SMSF. If their total superannuation balance is $1.6m or more at June 30 this year, then they cannot make any non-concessional contributions in the 2017-18 financial year. However, an SMSF member can still make concessional contributions of up to $25,000 each financial year regardless of their total superannuation balance.

3. Tax exemption on pension assets earnings. If an SMSF is paying a retirement pension, then the way it calculates the tax exemption on the investment earnings of assets supporting the pension is based on whether an SMSF member accessing a retirement pension from their SMSF has a total superannuation balance of more than $1.6m in total across all of their superannuation funds at the start of the financial year. If they do, then the tax exemption must be calculated using the unsegregated assets method.

The $1.6m limit applies to three areas but it doesn't stop you from accumulating more than the limit in your SMSF. Being aware of how the limit applies to these three areas will assist you to manage your SMSF more effectively and limit your tax bill.

Monica Rule is an SMSF Specialist and author of The Self Managed Super Handbook — Superannuation Law for SMSFs in plain English
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DIVIDEND DETECTIVE

Price and volume growth on way

STOCKLAND
ASX code: SGP
Security price: $4.72
Industry: Real estate
Forecast FY2018 distribution: 27c per security

ADRIAN EZQUERRO

With origins dating back to the 1950s, Stockland has grown to become one of the best known and largest diversified property groups in Australia.

Stockland owns, manages and develops a broad spectrum of real estate assets encompassing shopping centres, logistics centres, business parks, office assets, residential communities and retirement living villages.

It has long attracted investor interest due to its solid mix of passive income-producing properties held within its trust, coupled with the more active earnings drivers held within its corporation.

As it stands, about 70 per cent of the group's asset base is allocated to the trust, which itself comprises retail, office, logistics and business park assets. The 30 per cent balance is allocated to the large-scale development of residential and retirement living property.

Recent results have been sound, building further on the solid operational momentum generated over the previous few years. In its recent third quarter update, SGP maintained its 2017 financial year guidance for earnings per share growth of 6-7 per cent.

Though there is understandable caution among investors in relation to the apartment market, Stockland has for many years focused its activity on the development of affordable detached housing. Given a much larger focus on the first homebuyer and owner-occupier market, this portion of the residential market should be more resilient in the face of a slowing housing and broader economic cycle.

Stockland recently held its annual investor day in Queensland, a state that represents about one quarter of the group's asset base and a significant portion of its residential pipeline. Management said the group had achieved strong recent sales results, which when coupled with a record pipeline, suggests that both price and volume growth are likely to continue for at least the near term.

Over many years, SGP has proved to be a consistent performer that has provided an attractive stream of biannual distributions. At current prices, SGP offers a yield of about 5.7 per cent. Also notable is the fact that the stock goes ex dividend (12.9c) later this week. Investors are therefore likely to receive income totalling about 40c per security over the coming 14 months.

With Stockland trading at a marginal discount to our valuation of about $4.85, it offers a mix of incremental growth and regular income.

Adrian Ezquerro is a senior analyst for the Clime Australian Income Fund.

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The new super rules are coming ...in the post!

JAMES GERRARD

You may have recently received a letter from the Australian Tax Office warning you to check your superannuation transfer balance cap. And if you haven't, a letter may be on its way.

With the new super rules just around the corner, talk is coming to an end and the rubber is about to hit the road. So what is this new transfer balance cap and are you affected?

Though we have covered these issues in WEALTH regularly it is clear to me as an adviser the education process is just beginning – so here is a recap of what happened and how it may affect you.

In a budgeting measure to limit the amount of taxation benefits given to those in retirement, the Federal Government is implementing new rules to cap the amount of money people can hold in the tax free superannuation 'retirement phase' accounts (also known as account based pensions or super pensions). Currently, unlimited amounts of super money can be held in tax free pension accounts at retirement however from 1 July 2017, if you have more than $1.6M in super pensions, you will need to take action otherwise face unpleasant tax penalties.

Sounds simple enough, but when you scratch beneath the surface, it gets quite complicated. From 1 July 2017, every superannuation member will have a 'transfer balance cap' which starts at $1.6M and is indexed with inflation overtime in $100,000 increments.

Everyone will also have a 'transfer balance account' which tracks how much of the transfer balance cap has been used. If your transfer balance account exceeds the transfer balance cap (which starts at $1.6M on 1 July), you will be issued with an 'excess transfer balance determination' and a process will start for you to unwind the money in super pensions above the allowed cap.

Here's my call on how it all works:

1 - If you use the full 1.6M cap or exceed it, you are not eligible for future 100k increases in the cap, which would have allowed you to move more money into tax free pensions at a later stage.

2 – If you start a pension with $1.59M but due to market movements the account increases over $1.6M, this does not put you over the cap. Your cap is calculated on the initial capital transferred across to a super pension. Income and growth is disregarded for the purposes of your cap threshold.

3 – The cap is per person, so a married couple could have up to $3.2M in super pensions tax free

4 – People with transition to retirement pensions are included in the $1.6M cap rules

Xxxx

The tax penalties are steep and I have not seen much coverage of this issue to date: If you exceed the cap however transitional arrangements are in place. If you have an existing super pension prior to 1 July 2017 and you exceed the $1.6 million cap by less than $100,000, you can remove this excess before 31 December 2017 without penalty. However, if you start a new pension after 1 July 2017 and exceed the $1.6M cap, you will have to pay 'excess transfer balance tax'. The amount by which you exceed the cap is deemed to earn income and is taxed monthly. The Government deems earnings as follows:

- 90 day bank accepted bill yield (currently ~1.7%) + 7 percentage points

If you have $2M in a super pension and thus exceed the cap by $400,000, each month you will have deemed earnings of $2,900 on the excess above the cap. The penalty tax rate is 15 per cent for the next financial year, meaning $435 per month tax penalty would be payable until the excess $400,000 is removed. However, from 1 July 2018, the penalty tax changes to 15 per cent for the first time you breach the cap and then 30 per cent for second and subsequent cap breache

Here's what you need to know based on your age bracket: .

Under 55

If you are under retirement age (previously 55 but sliding up to 60 for those born after 30 June 1964) then you don't need to take any immediate action with regard to the transfer balance caps. The best you can do is implement an equalisation strategy so that both spouse super account balances are similar to give yourselves the best shot of staying under the transfer balance cap in the future. Contribution splitting and maximising contribution caps for the spouse with the lower super balance are two popular strategies.

Retired but no super pension

If you've retired and reached preservation age but have not started a super pension, you need to be aware of the $1.6M pension transfer cap starting from 1 July 2017 and make sure that you start a super pension below this amount.

Retired with a super pension

If you've retired and already have a super pension, act quick prior to 30 June to reduce your super pension below the $1.6M cap otherwise face potential taxes penalties. To reduce your super pension, you can either commute part of it back to the accumulation account otherwise withdraw it out of super completely as a pension payment.

James Gerrard is the principal and director of independently owned Sydney financial planning firm FinancialAdvisor.com.au