

According to us

newsletter

Winter 2015



The essential focus on growth...

By Geoff Greetham, Executive Director

In the last couple of years, investing in Australian Shares, for many investors, has been predominantly about the dividend yield. This is why bank shares have been such strong performers, up until recently. The argument has been that returns on fixed income investments like term deposits have been paltry, necessitating a move by investors 'up the risk curve'. They have pursued companies offering 'bond like returns' though they are anything but this.

This trend hit its peak in the March quarter this year, precipitated by the Reserve Bank of Australia (RBA) cutting interest rates, mirroring the actions of a number of global central banks, who were doing likewise. This just added impetus to the flood of money trying to find a return.

The end result has been a re-rating of certain companies' prices, whose cash flows are deemed secure and whose primary return to the investor hinges on the dividend, hopefully with some tax benefits associated. This typically is a characteristic of companies within the banking, utilities and infrastructure sectors.

One such example is Telstra, which has doubled in price in the last four years, on this thematic. That said, we have invested in Telstra. Why? It has a terrific brand, dominates the market, has a return on equity of some 30% as well as paying a dividend underpinned by cash payments to flow from the sale of its infrastructure to the National Broadband Network.

However we do so recognising it does have an issue (but one we accept on balance) and that is its ability to grow earnings is compromised by its size and the competitive industry in which it operates.

Loading up your portfolio with higher dividend and perceived lower risk names like Telstra can (pardon the pun) pay dividends at times. But, longer term, weighting a portfolio with companies paying such high dividends often at the expense of earnings growth, is fraught with danger.

As a consequence, investments in Telstra need to be counterbalanced by other investments, where the bias to and production of earnings growth is greater thus providing a stronger fundamental base for any price rise.

This is best judged, in our investment process, by a company's Return on Equity (ROE), which is an important metric we use in determining a company's capacity to grow earnings.

Generally, a company can grow earnings by two means:

- working its assets harder to generate increasing returns; or
- investing in other assets which can generate additional returns.

When a company achieves a ROE of say 15%, it means it is delivering \$115 to shareholders for every \$100 invested. This is a company, *ceteris paribus*, which demands attention and, as a shareholder, we prefer to invest in for growth, rather than having it pay out the majority or all of its earnings to us and having to find another suitably profitable investment.

Also, with interest rates low, instead of hunting for 'fixed income' substitutes, we prefer investing in companies who can combine the above ROE with this accommodative environment for money.

Companies such as Carsales and Seek are clear examples, however that is not to say there won't be hiccups along the way because, with growth expectations comes periods of over and under performance, as growth is not always in a straight line.

The trick is to ensure the basis for that ROE (e.g. pricing power, intellectual property, first mover advantage etc.) remains and can continue to be capitalised upon.

ROE is a core pillar of our investment process and we believe paramount to a company's long term sustainable growth.

NB: For those of you who got this far and are querying why Telstra would pay out such a substantial amount in dividends and not invest, when it has a ROE of some 30%, it is a good question. It likely speaks to the difficulty the company has, because of its size, in finding meaningful opportunities to deploy its capital.



The 'Family Super Fund' question

By Jackie Cook, Financial Strategist

While most self-managed superannuation funds (SMSFs) are two member funds (i.e. husband and wife), it is possible to have up to four members within a SMSF.

There are benefits to adding children (or other family members) to an SMSF and the process is relatively straightforward, however this needs to be weighed against the potential risks that can arise when family and money are combined.

Benefits

- Greater balance within the fund to invest across a diverse range of assets;
- Cost efficiencies through consolidating all superannuation into the one structure;
- Participation assists in educating your children of the importance of planning, saving and investing;
- Provides an option to insure your children in the event of their own temporary or total and permanent disability;
- Allows you to develop a family estate planning solution; and
- Allows you to keep an eye on your children's superannuation savings (if you wish).

Risks

- Loss of control over the decision making of the fund (the result of equal voting rights per member i.e. a higher member balance does not equate to a greater level of voting rights);
- Fund becomes more complex to administer, given the different life stages and circumstances of each member;
- Paperwork needs to be signed by all members/trustees of the fund (i.e. difficulties may arise if members are not close by geographically);
- With a maximum of four members and for families with more than two children, issues may arise if two are included and others are not; and
- Your children, as trustees, will be obliged to know how much is in the fund and how much money you have available (something you may not want known).

As to the process, essentially, any family member can become a member of your SMSF provided they are not a 'disqualified person' (i.e. bankrupt or convicted of an offence for dishonest conduct).

In order to become a member of the fund, that person must also become either an individual trustee or a director of the corporate trustee of the SMSF. If a child is under 18, a parent or guardian must act as trustee/director on their behalf until they reach 18 years of age.

In all circumstances, the new trustee/director must accept their appointment in writing and complete a Trustee Declaration Form within 21 days of their appointment.



Yes or No?

It is entirely up to you whether you would like your children to join your fund, however there are many things that need to be taken into account, for example, how many children you would want to include, where they live, their age, etc.

And, whilst it might have merit now, you need to also consider the worst case scenario of a possible 'falling out' on the family SMSF. For example, maybe you do not approve of the partner your child chooses, or perhaps one of your children develops a substance abuse problem. Remember, each member has equal voting rights regardless of who holds the majority of the SMSF balance and there is a presumption that trustees act unanimously.

This last point could possibly be the most important factor in deciding whether to allow your children to join your fund, yet the one that most families quickly disregard, with the view that "that could never happen to us". But unfortunately, there have been many cases where these kinds of situations have resulted in not only heartache but also severe financial turmoil for the parents and other family members of the fund.

Given the risks highlighted above, we would suggest that you consider both the advantages and disadvantages before adding your children into your SMSF. If you would like to discuss this further, please feel free to contact our office.

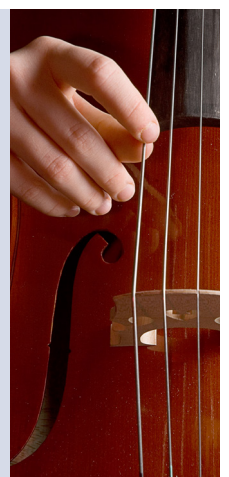
Striking A-ccord

Did you know....

The ubiquitous Apple is close to three quarters of the way towards becoming a USD trillion dollar (\$tr) company.

Apple is now so big that it is worth roughly the same amount as the 2nd and 3rd largest companies in America combined (Google and Exxon), with its increase in value over the last 12 months alone equating to the market cap of General Electric (!).

This is certainly testament to the relevance and role of technology in our lives.



Please note that the information in this publication is for general use only. We would be pleased to talk with you in regard to your particular circumstances should you wish to explore any particular aspect further. Any tax planning matters should be discussed with your accountant before proceeding.

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