WEALTH

WEEKEND EDITION | Edited by Andrew Main

PRODUCT WATCH

State Street Hedged ETF

WHAT IT IS: An Australian dollar-hedged international equity exchange-traded fund, WXHG, built by State StreetGlobal Advisers, the largest local ETF provider. It's designed for Australian investors and hedged into Australian dollars. It began trading on the ASX on July 9.
WHAT IT DOES: It gives investors access to a portfolio of international shares while minimising the impact any movement in the dollar has on the value of the shares. Its performance will correspond to the performance of a basket of physical shares included in a market index and hedged into Australian dollars. In this case, WXHG will track the S&P Developed ex-Australia Large MidCap AUD Hedged Index, consisting of shares listed on 25 developed stock exchanges excluding the ASX. The ETF will provide access to about 350 international equities including Google, Adidas, Louis Vuitton and Toyota.
WHAT IT COSTS: It is 0.48 per cent or $48 for every $10,000 invested. This one is the only international equity ETF hedged to the Australian dollar. It is uniquely domiciled in Australia and follows a locally created benchmark index.
WHAT WE LIKE: There's a lot of logic in using this low-cost way to invest more globally without having to worry about what changes in the dollar will do to the performance of the overseas shares.
WHAT WE DON'T LIKE: If our dollar keeps dropping, you'll lose performance. But the State Street brigade have thought of that and also offer an unhedged version, carrying the code WXOZ. Note also that these products are strictly a developed market play, with no emerging market exposure.

ANDREW MAIN

THE COACH

QUESTION: I have been told by my accountant that I need to have an insurance strategy for my SMSF. I already have a documented investment strategy — is this the same thing?

ANSWER: There is now a requirement that the trustees of a SMSF must consider holding insurance for fund members when creating or reviewing the investment strategy of their fund.

It is not compulsory for a trustee to have insurance but consideration of the insurance needs of the members must be documented when formulating the fund strategy.

It is recommended that trustees take into consideration the following to determine if there is a need for insurance to be established.

If the fund has borrowed money, how would the debt be discharged and how would a benefit be paid out to a beneficiary in the event of the fund holding illiquid assets like property?

Consider the personal needs of the members and what insurance cover is currently in place.

What type of insurance is required, based on the members' needs?

Death, total and permanent disability, income protection.

Trauma cover is not recommended.

In most circumstances, if there is a need for insurance, there are very good reasons to hold it within a SMSF; insurance premiums are tax-deductible to the superannuation fund. Premiums are taken out of the superannuation fund balance as opposed to requiring funding from the members' personal cashflow.

ANDREW HEAVEN

ONLINE Visit the wealth section at www.theaustralian.com.au to send your questions, which will be answered by Andrew Heaven, an AMP financial planner at WealthPartners Financial Solutions.
Follow Andrew on Twitter: @andrewheavenFP

Gold still a golden opportunity

Graham Tuckwell says the precious metal will spike

ANDREW MAIN

"DO one thing only, but hopefully do it well," says Graham Tuckwell, the man who effectively invented the idea of trading gold on a stock exchange.

Based in London but originally from Canberra, Mr Tuckwell was spreading the word to the gold faithful in Sydney this week despite the yellow metal's recent travails, which he sees as the dip before the spike.

He set up the first gold exchange traded fund in Australia exactly 10 years ago and within months the idea spread to the London Stock Exchange. His highly successful ETF Securities business now offers about 30 commodity products.

Meanwhile, he says, gold exchange traded products saw their global assets under management reach $US147 billion at the end of last year.

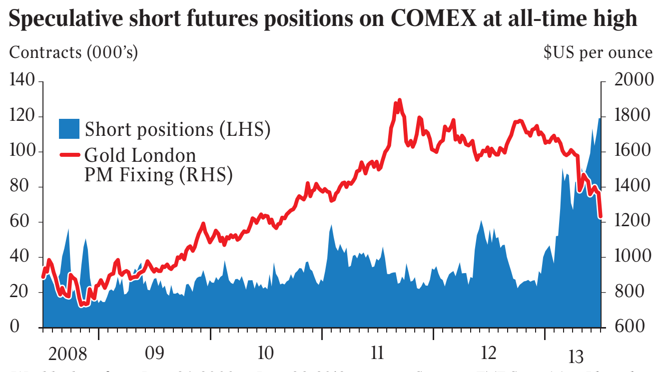
While gold's down 32.4 per cent from its US dollar high set in September 2011, the price of an ounce of bullion is not quite so dire in local dollar terms because of our dropping currency. But it's still down 29 per cent in our money over the same period.

That's not how Mr Tuckwell sees the glass being filled: like most serious investors he sees gold as a highly reliable inflation hedge and he pointed out that the COMEX exchange in the US is reporting record short positions in gold. In simple terms that means most investors are expecting gold to keep going down but, if sentiment turns, the price could shoot up sharply and short sellers scramble to buy gold to cover their positions.

JAMES CROUCHER

ETF Securities chairman Graham Tuckwell sees gold as a highly reliable inflation hedge

Speculative short futures positions on COMEX at all-time high



Weekly data, from June 24, 2008 to June 26, 2013 *Sources: ETF Securities, Bloomberg*

And he sees ETFs as much the safest way to play gold. Most particularly, he believes investors are far better off owning a gold ETF than gold shares, for instance.

"If you give us a 100 ounce gold bar, in five years' time we'll give you back 98 ounces of gold: all we'll have taken is a management fee of 0.4 per cent a year," he says. "But if you'd given that bar to a goldminer, in terms of converting the gold to cash and investing it, the company would on average have taken around 60 per cent of your bullion. Over 10 years, that deficit would climb to 64 ounces . . . or 64 per cent.

"Most goldmining companies destroy value: all they ever seem to do is lower the cutoff grade to increase production, which invariably means that their cost of production goes up."

He said while goldminers quoted their marginal cost of production at, say, $700 an ounce, that did not include exploration, drilling and amortisation. "If those costs were included, their overall cost would be closer to $1500 an ounce, which means that most of them are not making any money."

His gold forecast? "I'm sticking to previous statements of $3000 an ounce but I'm not putting a timeframe on it except to say it would be 'reasonably short'."

And nobody's accusing Mr Tuckwell of being a dreamer. He and his wife Louise have just conducted interviews at the Australian National University in Canberra to select 25 high-achieving university students for planned scholarship programs worth $100,000 each, which comes out of the couple's $50 million endowment.

Financial engineers need to build a transparent vehicle

GREG TANZER
COMMENT

FOR people with mortgages, our 2.75 per cent official interest rates have been great news.

But for those looking for investments, I think this low-interest rate environment may be tempting some to chase complex products offering higher returns. Likewise, this environment creates fertile ground for financial engineers to concoct these complex products and spruik them to investors.

This search for yield worries me and is something the Australian Securities & Investments Commission does not want to see get out of control, where unsuspecting consumers invest in products that seem to be one thing but are actually another, and then lose money. As always, I'd remind investors that diversification of investments is important and placing too much of your personal wealth in risky products can be disastrous.

I am particularly concerned about hybrid securities, or what I call capital notes. These complex products blend some features of debt and equity and are generally traded on a secondary market such as the Australian Securities Exchange.

Many of the companies issuing these notes are household names whose products are trusted brands. I urge investors to be cautious — these products may not be suitable for everyone, especially if an investor needs steady returns or capital security.

Some have terms and conditions that allow the issuer to exit the deal or suspend interest payments when they choose. Some are very long-term investments; for example, more than 60 years.

Other risks ASIC has identified include:

- There is no guarantee of a dividend or even getting your money back.
- The price of capital notes can drop below what investors originally paid, making it hard for them to get out of the investment.
- Despite the advertised high interest rates, some companies will stop paying interest if their financial position deteriorates.
- They are usually unsecured.

Investors should read and understand the prospectus, especially the section on significant risks. If they are still in doubt, they should get independent financial advice. But this is a two-way street and those issuing these products need to ensure their disclosure documents are clear, concise and effective. They should communicate the product's key features and risks, including highlighting the final maturity date, so investors can make an informed decision.

More broadly, one of ASIC's priorities is ensuring investors can be confident and informed. This is about helping people take responsibility for their investment decisions. And the best way to take responsibility is to think hard before you invest, weigh up the risks of the particular product against its returns, and spread the risk by diversifying.

An investor should understand clearly the product they are investing in, and comprehend the risk-reward pay-off and the concept of diversification.

Product manufacturers and issuers have a role. It's not a sustainable business model if their customers are losing money. Those selling complex products to unsuspecting investors need to do the right thing. They may get away with it for a while but, as we've seen since the global financial crisis, governments and courts inevitably rule in favour of investors that have been mis-sold these complex products.

ASIC has a working group on complex products that is exploring regulation methods. This includes assessing product development processes, introducing conventions around naming and making recommendations to government on whether ASIC should have wider powers.

ASIC is committed to addressing the very real risk complex products present. Investor education is critical while those pushing these products need also to do the right thing.

Greg Tanzer is a commissioner with the Australian Securities & Investments Commission.

Marge's nutmeg a pinch of salt

ROGER MONTGOMERY

IN an episode of *The Simpsons*, Marge visits not Walmart but Monstromart, exclaiming, "Ooh, that's a good price for 12lb of nutmeg" as she places the giant box in her trolley. It's ambitious to think that anyone would need that much nutmeg in a lifetime. And yet because Marge believes the price is cheap she buys it. I call it "going broke saving money". It's a popular strategy in the stockmarket.

While price is important, it doesn't make sense to buy groceries that are unusable or unwanted. You need to know whether you are getting precisely what you want. Unfortunately, a lot of share investors sometimes behave like Marge, choosing investments simply because they're cheap.

To illustrate, let's look at BHP Billiton. The share price has fallen from $39 in February to about $32 today, and many analysts consider that cheap. We don't. It's far more useful to first determine whether we'd be comfortable owning the business regardless of what the sharemarket or the economy does. It is better to buy an extraordinary company at a fair price than a fair company at an extraordinary price.

It helps to determine whether a company provides a service or product that is in some way unique. If a product is difficult to replicate or costly for customers to stop using then this provides the discretion to set the price. Pricing power allows a business to increase revenues without having to increase volumes, but also insulates earnings if industry conditions deteriorate.

Companies that produce generic products or services do not have this luxury and must accept whatever price is being offered in the market. BHP is one such price taker producing commodities such as iron ore and petroleum. In the face of excess supply, BHP has no ability to raise prices.

If the best business is one that can employ large amounts of capital at high rates of return then the worst is one that must, by necessity, do the opposite. Despite the benefit of an additional $30 billion in equity, BHP's profits remain unchanged from six years ago. Moreover, the iron ore price arguably has an unfavourable outlook, given expanding production amid moderating demand from China.

A company may be providing a world-class product, but for it to prosper impressively over the long term it must be able to produce its products or services at a high margin on both sales and equity sustainably. It is therefore important to understand two elements of a business's expenditure: how much capital is required to build and maintain production facilities (capital expenditure) and how much it costs to produce each additional unit (operational expenditure).

BHP requires a high level of expenditure to sell iron ore: it must spend considerable capital on exploration, build the infrastructure, take the iron ore out of the ground, process it and transport it to buyers. BHP does have the ability to produce iron ore at a relatively low cost compared to its peers, due to the high quality of its assets and the scale of its operations, but since significant capital is required to develop a mine it has had to shelve projects because of the deteriorating outlook for commodity prices. This will constrain long-term production.

BHP's share price may ultimately fall to such a level that would justify taking a position in the company. However, just as Marge Simpson doesn't actually need 12lb of nutmeg, I wonder whether you need to own a giant mining company.

Roger Montgomery is the founder of Montgomery Investment Management and the author of Value.able: How to Value the Best Stocks and Buy Them for Less Than They're Worth, available at www.rogermontgomery.com.