What they want, not what they will get

ANDREW MAIN

NOW the dust has settled from the budget and Tony Abbott's speech in reply, what's actually going to happen with all these various proposed measures for superannuation?

Let's start with the certainties and work down from there, because both Labor and the Coalition are facing a gap between what they've said they want and what the political process means they'll get.

First up is the fact that the legislation to start the lift in compulsory super contributions from 9 to 12 per cent by 2019 has already been passed. Most of us missed it, but it received royal assent on March 29 last year.

So what was the Opposition Leader doing talking about how he and an incoming Coalition government would delay the whole process by two years?

Assuming he and his colleagues win on September 14, he will have the right to put up all manner of legislation, but he may not have a full majority in the Senate. It's only a half-Senate election and our office political gurus say he may find himself dealing with DLP senator John Madigan, plus a senator from Bob Katter's Australian Party, both of whom play hard on their blue-collar connections.

That means it may not be easy to unwind the lift to 12 per cent — a measure that has its critics on the conservative side.

There are some, such as putative superannuation minister Mathias Cormann, who really don't like 9-12 on any timeframe, because they are concerned about its damaging the economy. Stand by for a lot of grumbling, but it's unlikely that the process will be derailed.

And employers should note they will need to increase the compulsory super payments they make on behalf of all their eligible employees to 9.25 per cent from July 1. It's a certainty, as is the encouraging news for working oldies that as of July 1 the upper limit of 70 for compulsory super is being removed. No matter how old you are, if you are working and eligible, you can have your employer contribute.

So why did Abbott say he would delay the lift to 12 per cent? For the same reason that Superannuation Minister Bill Shorten said in April there would be a tax on pension phase earnings above $100,000 per year per person. To get their budget numbers to line up.

That Shorten measure hasn't been tabled yet and probably won't be, given the few sitting weeks before parliament is prorogued, so you can conclude that both the Coalition and Labor have put up measures that probably won't happen.

So what else will? Shorten has tabled the lift in concessional contributions cap for the over-60s from $25,000 a year to $35,000, with a view to getting it through before the election, and plans to do the same soon with the measure to reduce penalties on excess contributions. The $35,000 cap, by the way, should also be extended to the over-50s from July 1 next year. Those will all be popular measures and unlikely to be held up. All else is a maybe at best.

As a matter of interest, a long view on short odds

JAMES CROUCHER

Toby Lewis, in Sydney this week, doesn't see all industrial equities in Australia as expensive, but is not keen on resources stocks that have 'some way to go down'

Beware property, and do your research, says Citibank's Toby Lewis

ANDREW MAIN

THE Reserve Bank's policy of lower interest rates looks likely to provide the best short-term chance of improved corporate earnings to justify the high prices among some of our industrial stocks, according to Toby Lewis, investment strategist at Citibank Private Wealth.

"Cuts in interest rates should produce increased earnings in interest-rate-sensitive stocks with high borrowings and high depreciation," he said, qualifying that by noting the impact would be lessened once interest rates started to turn, quite possibly later this year.

He noted that the S&P/ASX 200 index had already hit Citi's target for the year of 5200, but that the house would be in no mood to ratchet that target up. "We could of course move the target, but we'd need to see more of those much-talked-about productivity gains," he said.

He noted that "the profitability per dollar invested in Australian corporations is lower than in any other major market except Japan. On a globally relative basis, our market is expensive".

He added that the average price-to-earnings ratio of the top 200 stocks in Australia was running at 15.74 per cent against, for instance, 11.01 times for Morgan Stanley Capital International's Emerging Market index.

We're more expensive than the US market, too, which is at 14.73 times.

But, meanwhile, he was quick to admit that if you looked at Australian equities on a comparative value basis to government bonds, there's not much of a contest.

"Equities are still cheap relative to government bonds because they pay a higher income," he said, noting that the dividend yield for the year of the Australian sharemarket was likely to come out about 4.48 per cent compared with 3.10 per cent for 10-year government bonds.

So it comes back to Australian equities being expensive if you compare them with other markets, and cheap if you look at the traditional local alternative, the bond market.

So, hasn't the lower dollar helped and won't it have a very positive effect in the months to come?

Not as much as lower interest rates, he said, although he agreed that the drop below parity with the US dollar was partly caused by the Reserve Bank's drop in official interest rates on May 7 to an historic low of 2.75 per cent.

He said if interest rates fell by a small amount again this year, as has been widely flagged, that would be a positive development for our sharemarket.

"Bond yields and equity dividend yields and earnings yields have tended to fall in line with interest rate expectations since the beginning of the year," he said, which "largely explains the increase in prices of both bonds and equities in Australia in the 2013 year to date".

"Yields on short-dated fixed-interest issues have suddenly broken out on the downside."

Since peaking on March 14 at 3.074 per cent, yields on Australian two-year government bonds have dropped steadily to just above 2.5 per cent.

So what's his investment tip for Australian investors nervous of high local PEs, but unwilling to buy into what's very much regarded as an expensive bond market with low yields and correspondingly high prices?

He doesn't see all industrial equities in Australia as expensive, although he is not keen on resources stocks that he says have "some way to go down further" until they represent certain value.

"An appropriate response is to spend more time on research.

"The best longer-term strategies, once interest rates start to turn up again, will be to look for asset classes that are less sensitive to interest rates, being companies with strong balance sheets."

There's one asset class he's not that excited about, and that is Australian property.

It was "looking precarious", based on the fact that we are now getting close to the bottom of the interest rate cycle and, as borrowing rates rise, affordability reduces and buyers accordingly become rarer.

Any other thoughts?

"Use the higher Australian dollar, even at these sub-parity levels, to buy cheaper assets overseas," he said.

And, two, "get into long-short funds that can go short assets such as US Treasurys".

Long-short funds are also known as absolute return funds or hedge funds that are usually closed to retail investors, but can often be accessed via wealth management platforms.

On the evidence, Wesfarmers likely to lead trend south

MICHAEL GABLE

A CHARTIST'S VIEW

WHILE the mining and engineering services sector is seeing plenty of downgrades, the next sector likely to experience some pain is the retailers.

I looked at Myer earlier this month and said why I felt the share price would come under pressure. The stock has clearly trended down since then.

In my opinion, the next company that will start trending down is Wesfarmers (WES). As the chart shows, on May 16 we saw a breakout in the WES share price where it gapped up and ran strongly all day. (Note that the top of the thick part of the white candles is where the stock closed above the open, whereas the black candles show where the close is lower than the opening price.)

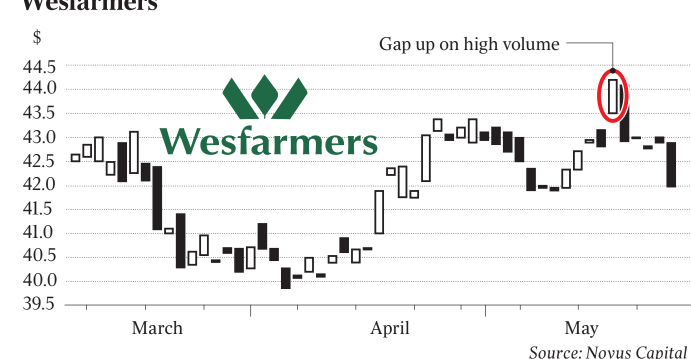
However, what made me cautious at the time was the fact that it gapped up on high volume after having trended strongly for such a long time. That sounds a bullish sign, but that's not the case: it is actually a sign of exhaustion.

This usually occurs when you have frustrated retail investors tired of sitting on the sidelines while the stock runs away from them. They tend to rush at the stock at the worst possible time due to a fear of missing out, pushing it well over its valuation.

Often that is the signal for the professional investor to start selling their shares and move on to something else.

If you were to look at a daily chart of BHP, you will notice that the price action on WES during the last several weeks is almost identical to that of BHP earlier this year. The resemblance is uncanny. Remember, that led to a 20 per cent drop in the BHP share price.

Wesfarmers



Source: Novus Capital

With WES we are seeing a similar situation play out. After a seemingly bullish move up on May 16, the company announced a downgrade the next day. The effect was a 5 per cent decline over the next week.

If the share price cannot quickly recover now, then we will probably see a period of weakness for WES. There is support at $40 but if that cannot hold, then $36-$37 is a possibility.

As it has rallied 50 per cent in the past 12 months, you really shouldn't be thinking about how much more profit you could make, but how much you can now lose, if indeed we see it fall to $36.

Winds of change are roaring in from west

ROGER MONTGOMERY

IN just the five months since December 31, 2012, the Australian sharemarket has delivered investors a 10 per cent capital return. But indices hide facts. What I would like to draw your attention to is that the companies that service Australia's resource sector have entered a deep recession.

The Monadelphous Group (ASX: MND) is one of Australia's most successful project management, construction, asset management and maintenance service companies focused on the resource, energy, and infrastructure sectors. Revenue, over the five years to June is expected to jump from $1 billion to $2.6bn. Mona's interim result for the six months to December 2012, released on February 19, was also pleasing.

However, their outlook commentary was very sobering and incredibly insightful. Here are some of the highlights:

"After two consecutive years of extraordinary revenue growth, the year to 30 June, 2014, is currently anticipated to be a period of consolidation in which the achievement of any revenue growth will be challenging.

"Uncertainty remains regarding the rate of new project approvals in the resource and energy sector as customers reassess their capital expenditure plans and focus their attention on high-return options. Project delays and a slowdown in near-term new major project approvals are likely to reduce the pipeline of opportunities in the medium term."

Fast-forward only three months to May 2013. Woodside Petroleum announced the cancellation of its proposed onshore $45bn development for the 12 million tonne-a-year Browse liquid natural gas project at James Price Point near Broome in Western Australia. The new chief executive of BHP Billiton, Andrew Mackenzie, announced a 35 per cent reduction in the company's annual capital and exploration expenditure, from the current amount of $22bn to a targeted $15bn over the medium term.

Meanwhile, Sam Walsh, Rio Tinto's chief executive, announced Rio will be targeting $5bn in cost savings over the next two years. Commentators are now asking: is the resource super-cycle over?

There are much more important questions Australians need answers to than that.

Over recent weeks, many companies servicing Australia's resource sector have announced severe declines in their outlooks. The extent of this downturn seems to have caught the management of these companies by surprise. You would know that we were not surprised; indeed, we sold all of our mining services exposure in The Montgomery (Private) Fund in April 2012, a year ago.

A casual look at 10 of these companies reveals the average share price decline so far this calendar year is 50 per cent. That's a capital loss of 10 per cent a month! Many of these companies have provided trading updates that should be ringing alarm bells such as: "Worse trading conditions than we saw during the GFC."

"Further delays of major projects impacting revenues in the engineering business."

"Ongoing uncertainty in commodity markets is resulting in the delay to and deferment of a range of resources and infrastructure projects."

And, perhaps most worryingly, "What we are seeing are significant project delays or cancellations that are broader than simply mining."

We believe that the average share price decline of 50 per cent will usher in further severe earnings reductions for resource service companies in the year to June 2014.

> There are much more important questions that Australians need answers to

Job losses in Western Australia, where anecdotal reports of consumer confidence recall the lows of the GFC, are likely to gain media attention along with the inevitable stalling of the property market there.

A possible but logical progression would then be that this pessimism is spread by the media, across the Nullarbor to the currently indifferent eastern seaboard of Australia's economy at precisely the same time as many stocks look a bit stretched from a valuation perspective.

How investors in somewhat overpriced bank shares respond to the possibility that nascent credit growth is delayed or fails to emerge at all could be interesting to watch.

Sharemarket investors may want to consider their portfolio carefully and pay particular attention to consumer confidence numbers and the valuations of banks and retail stocks.

Successful value investing involves waiting for value to appear and at present there doesn't appear to be any. The winds of change, however, appear to be roaring in from the west, so it may be worth keeping an eye on what Mona is saying.

Roger Montgomery is the chief investment officer of Montgomery Investment Management. Montgomery Investment Management does not own shares in any of the above-mentioned companies.
www.montinvest.com

Hard times hit mining services

ASX code	Company	Price 31/12/12	Price 22/5/13	% change
ASL	Ausdrill	$2.83	$1.13	-60
BLY	Boart Longyear	$1.88	$0.69	-73
CGH	Calibre Group	$1.22	$0.30	-75
COF	Coffey International	$0.33	$0.16	-52
FWD	Fleetwood Corporation	$9.79	$5.26	-46
MND	Monadelphous Group	$24.42	$16.06	-34
SDM	Sedgman	$1.23	$0.56	-54
TSE	Transfield Services	$1.95	$0.92	-53
UGL	UGL	$10.88	$7.13	-34
WOR	Worley Parsons	$23.36	$19.72	-16
	AVERAGE			-50

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