



Don Stammer has a warning for all sharemarket investors. Read him on **TUESDAY** in **WEALTH**

New Alternatives To Cash. Elizabeth Redman has some smart suggestions on **TUESDAY** in **WEALTH**

Goodbye to a market luminary

Michael McKenzie brought a practical approach to investing

STIRLING LARKIN
GLOBAL INVESTOR



In a world where incremental market and economic insights shared by the likes of Warren Buffett, John Maynard Keynes and Milton Friedman inspired millions, one Australian financial luminary remained relatively un-hailed and yet his work shone a light as bright as arguably anyone else before him.

Michael McKenzie was unique and peerless — an Australian finance academic who not only held mastery of both the classic and also contemporary economic theories of our times but also combined these with a brutally practical approach to markets and investing, particularly for Australian investors.

Within Australian Ultra High Net Worth investing in particular, the quintessential question of our time became how do you level out a broadly dispersed portfolio of risky and conservatively positioned assets along what is referred to as the “efficient frontier” — a curve representing the combined best possible expected levels of returns for given levels of risk — when such a curve is clearly distorted due to the unconventional global government interventions of our modern era.

In addressing and ultimately answering this, McKenzie found an elegantly simple path forward.

Clever enough not to try and solve with one solution or explanation, McKenzie, a pragmatist until the end, argued that Australian investors needed to separate and thereby subdivide their allocations and by so doing, allow the forces over each to work through their natural steps.

For investors, this meant acknowledging that the asset price movements seen in their real estate investments should not be

compared to those seen within their ASX 200 stockmarket allocations nor any or all other asset classes domiciled abroad; such as private equity, alternatives or commodities.

Believing in many ways that US and global quantitative easing was “madness”, McKenzie argued that in such an era when the classic paradigms of Hayekian and Austrian economics were disobeyed, Australian and global investors had to adjust and accept the new realities faced.

On this, written in English far clearer and more profound than anything I could ever write, McKenzie once told me that “the main tip is to have a very clear vision of what it is your portfolio is trying to achieve before you start to invest. Further, try to then break it down into sections to make a huge task seem more achievable”.

For all Australian investment communities this meant appreciating that listed shares in the top ASX 50 would behave quite differently than those seen either off-market or at the bottom of the market capitalisation spectrum.

This was simply because global quantitative easing had a natural disproportionate impact on larger, more institutionally supported investments than those seen with more broadly supportive retail participation, that is, small cap stocks.

But far more than simply finding a road map for Australian investors to follow, McKenzie then went to work on addressing the practicalities of markets, investor behavioural heuristics (in other words, how people actually behave in reality given circumstance) and why the supposed laws of the jungle in 2015 no longer make sense to ordinary and sophisticated investors alike.

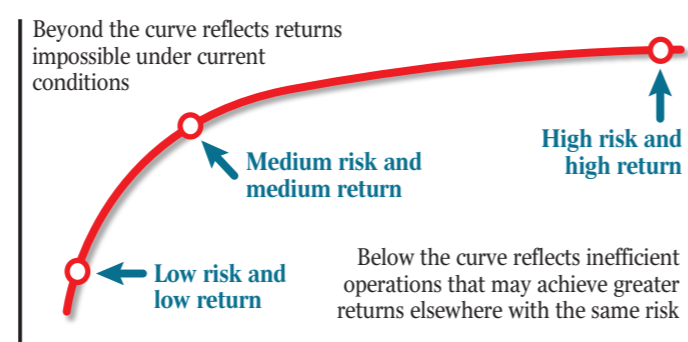
Far smarter than many recently lauded Nobel Economic laureates, McKenzie dispelled the notion that “animal spirits” explained such market behaviours.

Knowing that the answer did not lie in any one explanation or solution, McKenzie, following the GFC years, dedicated his professional and personal focus on tackling each difficult conundrum, one by one. Always disciplined, always stoic in his pursuit of the truth, McKenzie employed the best empirical tools available



Michael McKenzie, who was well known for his work on naked short selling, died in an accident in Britain

The efficient frontier



to us here in Australia and he allowed the data to drive him towards his objective ends.

This hard work shed valuable light on areas such as the “flight-to-quality” phenomenon and why asymmetric volatility responses were being seen in US Treasuries — an asset class subset that affects all fixed income yields around the world, including Australia’s

bonds, fixed income and term deposit investments.

McKenzie was recognised as leading the world in research and the understanding of the impact of naked short selling (i.e. the selling of borrowed shares without collateral) to profit from downward price movement), on the securities lending and equity markets, here on the ASX and globally.

Such work has directly led the British government to undertake a review and seriously consider changing its short selling rules with similar considerations being seen here in Australia and the US.

On China too, McKenzie argued strongly that Australian investors needed to accept that the mining boom was well and truly over but that new and more exciting investment and trade opportunities would present themselves but not in such explicitly visible ways, as before.

Professor McKenzie, ProDean at RMIT, the University of Sydney and most recently the University of Liverpool (Britain), taught literally hundreds of thousands of aspiring finance students over 20 years. He was admired, greatly liked and highly respected by literally all who met him.

To everyone’s loss, Michael died earlier this week in a sporting accident in Britain. He is survived

by his wife and a newborn daughter whom he loved more than life itself. He was the backbone of the Larkin Group Advisory Board, he was my mentor and my best friend.

There are no words to be found that convey Australia’s great loss.

But rather than mourn, please allow us this week to share with you the pearls of wisdom and acumen that Michael generously shared with us.

His contribution has been phenomenal and his insights profound and if there was ever a time to be proud of being an Australian and the impressive talents that we harbour, allow today to be one of those days. Goodbye my friend and thank you.

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Six top picks to help nail your investing needs

ROGER MONTGOMERY



There is no doubt monetary policy — influencing economic activity through the manipulation of interest rates — is a blunt tool. Keep in mind, to anyone with a hammer the problem always looks like a nail.

Low rates in Australia are intended to force people out of savings and into consumption, which fuels revenue, profits and employment.

But baby boomers, who are most reliant on income from their savings, are not of a mind to spend their life savings on the latest handbag.

Instead, low rates are fuelling asset inflation.

Meanwhile, the economy lingers along, hostage to China and the butt of jokes from our Kiwi neighbours, who are lining up to hold “parity” parties.

(The present exchange rate is about one Australian dollar to NZ98c.)

It is time to be more selective in your investing. In the sharemarket, that means, by definition, ruling out index investing.

Keep in mind the index is always invested in the worst companies, too. The index is another hammer used to solve everyone’s investing nails/problems.

No matter what the economic outlook or the forecast for the sharemarket, one should focus attention on extraordinary businesses and their valuations.

Allow me to repeat the amazing story of the US initial public offering of Coca-Cola in 1919 at \$US40 a share.

The following year the shares had plummeted and the stock traded at \$US19.50.

Coca-Cola had perpetual fixed price contracts for the supply of syrup to its bottlers for \$US1 a gallon (3.8 litres). Unfortunately sugar prices were surging.

Ignoring that decline and holding on to their single share, what would your grandparents or great-grandparents have created if they also held the shares through the great crash of 1929, the subsequent depression of the 1930s, World War II, a baby boom, dozens of other wars and skirmishes, an oil crisis, presidential assassinations, the fall of the Berlin Wall, innumerable recessions, booms, busts and scandals, a war in Vietnam, two in Iraq and a global financial crisis?

If they kept this share in the family, accepted all the share splits and reinvested all their dividends, they would have more than 250,000 shares and their investment would have a market value of more than \$12 million.

The point is there are always predictions, both false and present, to frighten any “investor”.

Yet through it all, sound companies with powerful competitive advantages keep

growing net worth and throwing off rising levels of income.

So where could you now focus your investigations? Are there any companies that meet my criteria for quality and value? You would, of course, only want me to mention those sufficiently attractive to invest the funds we steward, so let me remind you Montgomery funds own these stocks. Also keep in mind the number of candidates has halved in just two weeks. Here’s my outstanding list of six.

Challenger (CGF): Challenger operates as an issuer of annuities and a provider of listed and unlisted investment products and services to institutional and retail clients.

ANZ Bank (ANZ): Through its subsidiaries, the group provides banking and financial products and services to retail, small business, corporate, and institutional customers in Australia, New Zealand, the Asia-Pacific region, the Middle East, Europe, and the US.

Henderson Group (HGG): The group is an asset management holding entity, providing services to institutional, retail and high net worth clients. It manages equity, fixed income, and balanced mutual funds.

Henderson Group was founded in 1934 and is based in London.

McMillan Shakespeare (MMS): The group operates in two segments: remuneration services and asset management. The remuneration services segment provides salary-packaging services, remuneration policy design, fringe benefits tax, goods and services tax, BAS reporting, and motor vehicle lease management services. The asset management segment offers financing and ancillary management services associated with motor vehicles, commercial vehicles, and equipment.

iSentia (ISD): This is a “software as a service” business, providing media intelligence solutions in Australia, New Zealand, and Asia. It’s the old Media Monitors business and now a whole lot more, including a social media listening platform, which provides industry monitoring, reporting, workshops and insights.

Medibank Private (MPL): The company provides private health insurance and health solutions in Australia and New Zealand. Its health insurance services include hospital insurance for private patients, ancillary or extras cover, and private health insurance for international students and visitors to Australia. It also provides life, travel, and pet insurance services.

If you are looking at your portfolio and worried about the prices of stocks generally, and your stocks are not on the list above, it means they are possibly expensive, or poor quality — or both.

That doesn’t mean they are just about to crash.

It does mean you might want either to dance close to the door or commit to behaving like the Coca-Cola share investor of 1919.

Roger Montgomery is founder and CIO of the Montgomery Fund.

Oil prices are likely to remain low, but it’s not all doom and gloom

DAVID SOKULSKY



Oil’s 50 per cent fall from a peak price of \$US110 a barrel in September has had a significant impact on global economic growth, geopolitical risks and consumption patterns in many countries, depending on their reliance on the commodity and whether they are an importer or exporter.

There has been much speculation about why the price has fallen so sharply.

Among the most popular suggestions are: OPEC is trying to damage US shale producers; the US is trying to economically suffocate Russia; and the world is trying to reduce the price Islamic State can sell oil for on the black market.

There is probably some truth in all these suggestions. But arguably the key reasons are the dramatic

increase in supply by US shale gas producers, a stronger US dollar — due to its inverse relationship with commodities in general — and momentum in financial markets.

The question now is whether the price will rise or fall going forward. While most people will want a definitive answer, it is difficult to predict because of the multifaceted drivers at work.

What we do know is “supply” — as opposed to “demand” — will be the key driver of oil. This is primarily because oil demand has held relatively consistent irrespective of the price or macroeconomic outlook — it is an inelastic good.

This is evidenced by global demand hardly fluctuating during the global financial crisis or when oil was priced at more than

\$US100 a barrel. Knowing the key driver makes the analysis a little less complex, but there are still a number of factors that will determine supply, including OPEC production levels, US shale production, the Iran nuclear deal, Saudi bombing activity in Yemen, US energy policy and Russia’s external relationships.

Over the longer term, what matters most is OPEC’s production quota and US shale production. It looks as if OPEC will maintain its production quota of 30 million barrels a day indefinitely, as the Saudis have shown no inclination to deviate from this level and they do not want to lose market share to rivals. The next OPEC meeting is on June 5.

There has been much talk

about the US rig count declining from more than 1800 at the start of the year to about 988 in April.

This 45 per cent decline has supported prices and led to West Texas intermediary (WTI) crude trading in a range between \$US45 and \$US55 for most of the year.

Interestingly output has been very sticky and has only just started to fall, as a result of the rig closures, due to a lag between activity and oil production.

As such, if US shale production is now starting to decline, we have probably seen the lows in oil, unless risk markets generally are “shocked” by an unforeseen macro event.

But this does not mean the price is going to rally back up to \$US80 a barrel, as some commen-

tators have speculated. WTI is now trading at six-month highs, but the upside is likely to be limited as the producers that have cut production can easily ramp it back up should prices sharply recover.

For investors, this means the price of oil will likely remain low for the foreseeable future, but not at the extreme levels we have recently witnessed.

This should be a favourable environment for investors as the world will still experience considerable economic benefits compared with a year ago.

David Sokulsky is executive director and head of investment strategy at UBS Wealth Management Australia.

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