Clay Carter finds two offshore mobile technology stocks ready to roar in **WEALTH on Tuesday**

How does the bank crackdown on residential investment lending work? **Andrew Main** finds out in **WEALTH on TUESDAY**

Picking Wall Street's next phase

A smart investor will look towards the future and not the present or the past

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Advising ultra high net worth clients means you must always remain focused upon the foreseeable future and do so while maintaining firm strategic positions today.

At the same time, you must operate a fluid tactical allocation in anticipation of tomorrow's ever changing realities.

Such guidance seeks to provide a lens through which to interpret what is going on.

Running commentaries on Greece, China "wins and woes" and iron ore spot price levels make for important and equally interesting reading but should never be confused for the Tortoise when they are, in fact, really, the Hare.

With this longer-term pace in mind, the 58th presidential elections in the US, the world's most important economy, on November 8, 2016 becomes a very timely conversation and an investment horizon we now need to think about heading towards 2017 and beyond.

US politics do matter and have real material impacts on global investment markets both in the short and longer terms.

Traditionally, Republican victories during such elections are more welcome on Wall Street, but given the current levels at which the US stock, greenback (US dollar) and bond markets sit, the more important question this time around becomes who can resolve the current gridlock in the US congress.

Such impasses have placed a hex on future fiscal capital expenditure, desperately needed corporate taxation reform and other important legislation that impacts the US real economy and respective investable markets.

The resurgence of the US dollar, as seen in the graph today, talks more to the historical "price reversion" of the greenback than its recently subdued valuations, which were primarily caused by the now finished unconventional monetary programs, which included US quantitative easing.

In terms of our "reflective" Australian dollar, the greenback is, at this time, reverting to its fair valuation and is no longer suppressed by unconventional stimuli, colloquially referred to as "money printing".

These are all important conversations to have framing our post-2016 presidential election thoughts, surrounding the future of the US economy. This future US economy, in 2017, will be stewarded by a fresh fiscal government mandate, a real economy at the tail-end of a seven-year business cycle and one which will be half a year out from a potentially new custodianship of the monetary arm of US government, with US Federal Reserve chair Janet Yellen's four-year term up for renewal on February 3, 2018.

One of the decisions the global investor needs to decide at today's fork in the road is whether current S&P 500 stockmarket valuations are reasonable or excessively stretched?

As of this week, the S&P 500's averaged P/E ratio is 20.34 and this is estimated from the indices' respective constituents' latest reported earnings and current market pricing.

Additionally, during an epoch when pricing remains distorted thanks in a large part to the formerly mentioned QE programs, reviewing what is referred to as the CAPE ratio — cyclically adjusted price earnings, which are based on average inflation-adjusted earnings from the previous decade — can be a particularly insightful aid during this timely decision process.

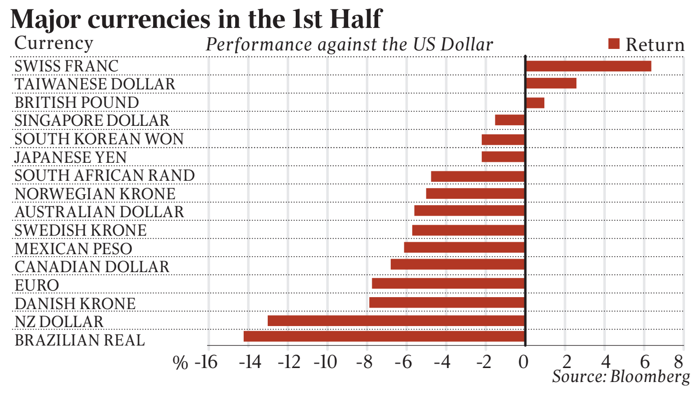
This week's S&P 500 CAPE ratio averaged in at 26.72.

Dr Robert Shiller, the Nobel Laureate, lionised for establishing this particular valuation metric, poignantly said last year that a CAPE score above 25 was "a level that has been surpassed since 1881 in only three previous periods: the years clustered around 1929, 1999 and 2007. Major market drops followed those peaks."

AFP

US Federal Reserve chair Janet Yellen, whose four-year term will come up for renewal on February 3, 2018

Major currencies in the 1st Half



Source: Bloomberg

The difficulty faced by the global investor today is deciding which becomes a more important gauge for our decision making — the fact that the underlying US real economy continues to naturally expand due to genuine growth through an organic business cycle expansion, or whether valuation metrics that currently are flashing red lights should be prioritised, even if we know that fundamentals since QE have become unavoidably distorted (referred to as the "Great Distortion")?

As discussed previously in this column, this is where ultra high net worth wealth advisory becomes more art than science as, objectively speaking, the above decision branches both hold true.

Knowing that S&P 500 currently trades at a historically high multiple of 17 times forward EPS, the following three investment pathways balance both of these options without having to miss out on future "market action".

- The first is to own US stocks with high domestic US sales and avoid those with higher International revenues.

Examples to keep an eye on include the US Consumer Staples, CVS Health Corporation (CVS) and Tyson Foods (TVN)

It is important to remember that the information technology, materials and US energy sectors face the higher sales exposures to foreign revenue sources.

The only exception within the S&P 500 energy sector subset is US domestic "frackers" who currently continue to face some prohibitions on international sales of US energy.

- The second is to prioritise those which return excess cash to shareholders via buybacks, dividends and other on-market distributions but yet still maintain fair growth metrics heading into 2016, such as the US Healthcare sector darling, HCA Holdings (HCA).

Remembering that the 2016 US presidential elections will, in part, be a proxy battle for the support or repeal of the US Affordable Care Act, dubbed Obamacare, taking tactical positions today in such entities as CVS Health would be framed through a strategic lens, which accounts for geopolitical fallout if Republicans win the executive branch of US government.

- And the third, which directly addresses downside risks, is selecting S&P 500 constituents which enjoy a high risk-adjusted prospect return — measured by the Sharpe Ratio (a risk adjusted investment performance measure) — given elevated historical market valuations.

Both CVS Health and Tyson Foods satisfy these dual parameters.

The global investor can only establish firm strategic positions and maintain fluid tactical allocations when guidance is sought through a lens that looks towards the future and not the present or the past.

Larkin Group is a wholesale wealth adviser focusing on high yielding global investments.

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Why I won't invest in China's stockmarket

ROGER MONTGOMERY

The year to June witnessed enormous variation in sharemarket returns.

The Australian All Ordinaries Index recorded a miserly 1.3 per cent return, excluding dividends. The Shanghai Composite Index was easily the best performing major market with a return of 108.8 per cent.

That excitement, which saw the Chinese market up 152 per cent at its peak, was driven by a lot of leverage (that is, investors borrowing to finance their share investments).

I previously have pointed out individual names selling on nose-bleeding multiples.

The 30 per cent decline in the past month has seen $US3.2 trillion ($4.3 trillion) of value, or more than two times the total value of the Australian sharemarket, wiped out.

Given most small Chinese investors who undertake margin lending joined the market near its peak, there is a fear this decline will transmit into the real economy.

Making matters worse, about one-quarter of the companies, representing one-third of the market capitalisation, listed on the main exchanges in Shanghai and Shenzhen have had their stock suspended, something usually reserved for significant imminent announcements.

The "risk off" bet (the decision of many Chinese investors to sell at the same time) has translated into a recent sharp decline in iron ore, down 26 per cent to about $US45/tonne; oil, down 12 per cent to $US52/bbl and copper, down 7 per cent to $US2.44/lb.

Investors lucky or insightful enough to get their money offshore have just witnessed the Australian dollar hitting six-year lows at sub US74c.

On the downside, that trip to Aspen just got a bit more expensive.

The objective of the recently launched Montgomery Global Fund is to purchase a portfolio of 15 to 30 high-quality companies, with good prospects at a discount to their estimated intrinsic value, and if there are insufficient companies that appeal, then allow the cash component of the portfolio to build.

To run such a fund you need to be absolutely sure of the numbers that you work with. Excess volatility also does not make the job any easier. Some investors will take heart at the 'rebound' we saw at the end of the week in the Chinese share market with a 6 per cent jump in a single session.

But does not and is unlikely ever to own any Chinese listed companies.

The issue I have is one of transparency and that has a lot to do with the audit process and the hurdles foreign auditors face when trying to assess Chinese companies.

Such financial and business information has been categorised by the Chinese government as state secrets, so cannot be turned over to foreigners.

The "big four" auditing firms do not operate in mainland China. Instead, they essentially license their brand name to local affiliates.

Under US law, all major auditors must undergo regular inspections by the Public Company Accounting Oversight Board.

Yet the PCAOB is not allowed by the Chinese government to inspect the local Chinese affiliates of the big four auditing firms.

It cites national security reasons. Therefore, all US-listed Chinese firms appear to be in breach of the Securities Exchange Act.

The Securities and Exchange Commission, however, basically has caved in to Beijing's refusal to turn over such corporate information to US regulators. The SEC had the right to delist all Chinese companies from US exchanges for being in breach of the Securities Exchange Act. It chose not to.

About one-quarter of the companies, representing one-third of the market capitalisation, listed on the main exchanges in Shanghai and Shenzhen have had their stock suspended.

Chinese accounting expert Paul Gillis, from the Guanghua School of Management at Peking University, sums up the situation nicely: "Today we have different rules for Chinese companies that list in the US than we have for others. Not only is the SEC dependent on Chinese regulators to decide what documents they can see, the PCAOB remains unable to conduct inspections of auditors."

In Australia, we have the Corporations Act 2001, which sets out the laws dealing with companies in Australia. Section 310 of the act states: "The auditor: (a) has a right of access at all reasonable times to the books of the company, registered scheme or disclosing entity; and (b) may require any officer to give the auditor information, explanations or other assistance for the purposes of the audit or review."

So what would an Australian auditor do if it were faced with the task of auditing a Chinese company?

Of course there are always opportunities in China, but there are safer ways of playing the growing middle class — and you don't need to suffer the knee-trembling volatility or poor transparency of investing directly into a Chinese listed company.

Roger Montgomery is founder and chief information officer of the Montgomery Fund.

High Fidelity as Bryce Courtenay's Yowie delivers the chocolates

RICHARD HEMMING
UNDER THE RADAR

Spotting stocks that are under the radar and that don't have institutions on the register puts you in the running for big returns when those big investors climb on board.

But even we were surprised when funds management giant Fidelity popped up as a substantial holder of listed chocolate manufacturer Yowie, which in the first half clocked up just over $500,000 in sales and with a share price of a $1 now has a market cap of more than $140 million.

Fidelity has done well so far, announcing late last month that it has a stake in the minnow of 5.77 per cent, purchased at an average of close to 73c a share. It has invested just as Yowie starts rolling out its chocolate-encased themed Yowie figures (think Kinder Surprise) throughout Walmart and Safeway stores in the US. It has a patent on its "encapsulated" chocolate in the US that expires in 2018. The clock is ticking ...

This is a challenging investment in the sense that it is a one-product company and has largely unproven management in which a great deal of hope is invested.

It is, however, a good story. The Yowie characters were created by none other than bestselling author Bryce Courtenay and his friend Geoff Pike and launched by Cadbury in 1995, whereupon it achieved annual sales of $100m a year. Then there were unwanted dramas as the popular brand was pulled from the shelves by Cadbury because it didn't own the intellectual property — the brand was later resuscitated by the unlikely figure of mining engineer Wayne Loxton, who spotted the opportunity.

What is really gaining the interest of the likes of Fidelity is the traction Yowie is getting at the big end of retail with the product's rollout by Walmart. In mid-June it announced that the retailer had agreed to a full-scale rollout of Yowie to all 4300 of its US-based stores because of a successful trial in just over 1500 stores.

Yowie also has secured in-store trials with other big grocery and convenience store chains in the US, including Safeway, CFS, 7-Eleven, Walgreens, Worldmarket and Valero. Collectively they account for almost 40,000 store locations in a market estimated to have more than 300,000 target stores. A number have moved from trial to second-stage rollouts and more full-scale rollouts are expected in the next 12 months.

Obviously, the valuations you can get on this stock are astronomical, with Canaccord coming up with a base-case valuation of $2.76, which assumes "the successful ramp-up of production capacity and a reasonable ramp-up of retail store count".

I'm less optimistic in the short term. Assuming that the Yowie chocolates make US30c profit a pop and they sell 50 units a store per week, a valuation of 70c to 80c is justified from 5000 stores selling at this rate.

Nonetheless, if you are finding the whole implosion of China's stockmarket and the potential for Grexit too much, you may combat depression the traditional way and munch on some chocolate. Those who aren't sated by this may take a punt on Yowie. After all, you've got Fidelity to hold your hand on the share register.

Richard Hemming is an independent analyst who edits undertheradarreport.com.au. Under the Radar Report is licenced to give general financial advice only (AFSL: 409518). The author does not own shares in any of the stocks mentioned.