How big super funds are fighting back against the DIY brigade.
Tony Negline in TUESDAY on WEALTH

What market insiders expect' from the earnings season? **Rudi Filapek-Vandyck** explains in **WEALTH on Tuesday**

Gearing up for 'market moments'

You could benefit from knowing the global market shifts

STIRLING LARKIN
GLOBAL INVESTOR

The steps taken by the global investor over the next three months are going to be some of the most important this decade.

For Australian ultra-high-net-worth investors in particular, the changes to global markets that are developing in the US, China and Europe will have additional significance.

This is simply because this community of investors seek allocations across a wider dispersion of asset classes, all of which will be affected by changes in benchmark interest rates, volatility levels and yield dispersions.

In approximately five weeks from now, the US Federal Reserve Open Markets Committee, the dubbed FOMC, is expected to announce the lifting of US interest rates from its current nil base.

Knowing this does not help anticipate how best to tactically position for this outcome today, but in combination with a better understanding of the other "market moments" foreseeable in the coming months, the global investor can indeed prepare.

Further to this, Australian UHNW investors can also decide whether their Australian-focused investments are expected to grow or contract, given regional parameters and domestic conditions.

Actionable intelligence can be found by extrapolating the near-future ramifications of the above graph for the Australian investor.

A developed market economy heavily linked to the immediate fate of the Chinese real economy cannot ignore consumption of copper, gold, iron ore and energy — which include LNG, oil, coking and thermal coals.

The contraction seen across these "commodity buckets" has obvious and undeniable knock-on effects for listed Australian markets, mining sectors and services industries.

Significantly, the recent announcement that Canada, a somewhat comparative economy, rolled into a "technical recession" — two conservative quarters of negative GDP — has been taken very seriously by the Australian UHNW investment community, who know that there is a great likelihood of more challenging conditions ahead Down Under.

The September FOMC "lift off" of US rates, for the first time in over a decade, leaves much unknown for the global investor post September 17 when chairwoman Janet Yellen reports at the "Summary of Economic Projections" press conference.

FOMC "forward guidance", asset purchases and even macro-prudential tools cannot prepare any of us for what will happen in Australia and New Zealand — the two markets which will first open globally following this conference — on Friday, September 18.

For the Australian-domiciled global investor, this time will be extremely sensitive, given that our Reserve Bank is sitting on the thin edge of the wedge with developments in China, Canada, eurozone and of course, the US.

Further compounding these sensitivities is the announcement this week that the Australian credit cycle is peaking in terms of growth momentum.

Total Australian domestic credit is now expanding at its slowest rate since December last year in terms of its annual growth rate and the slowest since December 2013, on a three month annualised basis.

This is important given that our economy has not faced a cyclical recession since 1991 — waning credit cycle expansion is a quintessential example of conditions leading to a recession.

The sell-off in Australian-heavy commodities may also reasonably be expected to continue following the Chinese Communist Party's fifth plenary session of its 18th Central Committee session in October.

This is because it is no secret that the CCP will announce further steps toward a consumption-led economic model within China, and such models require far less raw heavier commodities.

With a foreseeable quantum shift in US rates, Chinese consumption and Australian asset prices, Australian UHNW investors are bracing for increased volatility across broader geographies and, in particular, emerging markets such as India where many harbour investment exposures via private equity, hedge fund and other similar "alternative" asset allocations.

One does not need to be a sage to pre-empt this rise in volatility expectations — when the FOMC ended Quantitative Easing during the US summer of 2013, markets globally went into a "taper tantrum", which saw emerging market economies suffer seismic volatility spikes and friction across portfolio distributions.

Comparable to the Greece crisis of 2012, this time around global markets are better placed for this foreseeable shift, notwithstanding the fact the US "lift off" in combination with the abovementioned events will inadvertently have big ramifications.

Remembering that US unconventional monetary stimuli has now ended and European and Swiss equivalents remain in early stage and somewhat nascent, it should not be forgot that Japan remains in full flight in terms of stimulus. This is important and it should continually be remembered that "frictionless markets" do not exist. Year to date, the Japanese bourses remain some of the best performing on a currency unhedged basis, yielding 20.29 per cent year to date on the "Nikkei 400".

According to Sam Manchanda, head of Passive Investments for Southeast Asia, Deutsche Bank, "The JPX-Nikkei 400 Index is a sophisticated strategic beta index that aims to provide investors with exposure to quality Japanese stocks. The index is much in demand because it offers another choice to institutional investors."

This particular index provides an interesting strategic exposure to Japanese equities because it has a bias towards the more bottom-up underlying Japanese securities, which are not solely influenced by the Bank of Japan's QE stimulus program and Prime Minister Shinzo Abe's reform program.

As a result, while capital management initiatives and corporate governance move to the fore, the index filters the Tokyo Stock Exchange for quality picks with a focus on profitability — for example return on equity and operating profits — plus liquidity.

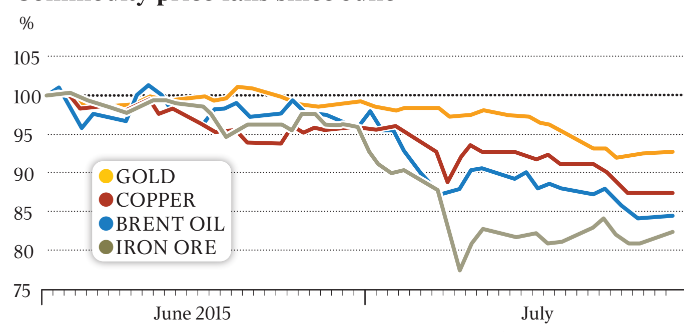
Australian UHNW global investors know too well that they have no allies but just common interests and identifying where those interests lie allows them to find that extra dimension that will remain elusive to most.

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

www.larkingroup.com.au

AFP

Japan's PM Shinzo Abe's efforts to revive the economy has fired up the Japanese markets



The numbers stack up: Seigling's high-conviction fund returns 18pc

RICHARD HEMMING
UNDER THE RADAR

One of the trends in funds management is for its operators to run what they call "high conviction" funds. Instead of investing in 40 or more companies, these managers invest in much fewer, taking much bigger bets.

It can either work really well, or one position can blow you up. Such is the lot of a modern-day fund manager seeking to set themselves apart from the pack. One who has done this successfully is Karl Siegling, the founder of the listed investment company Cadence Capital, which has returned more than 18 per cent a year, before fees, since it kicked off just under 10 years ago. This compares to the ASX All Ordinaries return of close to 6 per cent.

"You've got to let your winners run and cut your losses," he always tells me. "I can't emphasise this enough."

The major contributor to the return over many of those years is Cadence's high-profile investment in RHG, the renamed Rams Home Loan Book. In late 2011 it represented a third of his fund, and returned something like tenfold on the fund's initial purchase before it was taken over in late 2013 by the mortgage lender Resimac. (This was before Cadence withdrew its joint bid with another non-bank lender and recent ASX listing, Pepper Group.)

These days Siegling's big bets (though as a fund manager he would never call them bets, rather he would describe them as "positions") continue to be in financial service stocks, which represent 10 of his fund's top 20 holdings and follow his view that interest rates will remain low.

Cadence's biggest holding is in Macquarie, which he started buying in early 2013, when it was $24 a share. Now it's $81 and he thinks it will go to $100, which he says emphasises the correctness of his philosophy:

"Most people would buy Mac Bank at $24 and sell at $34 and be pleased. But this strategy means you leave 300 per cent (of potential profits) on the table!"

His macro views have worked on the resources side, having been underweight since 2011.

As if emboldened by this, Siegling is taking more and bigger positions based on his views of the world.

"On the thematic side, I'm always talking about the Australian dollar going to US51c (it's now US73c), iron ore to $US31 a tonne (it's about $US56) and oil $US41 a barrel (WTI is $US45).

"These things are getting closer and closer."

Cadence's second biggest holding is in the Italian-based manufacturer of sunglasses Luxottica. Cadence holds global financial services giants Mastercard, Visa and Citigroup. But it is definitely his team's activities in the resources space that raise eyebrows, where his fund is selling short Fortescue Metals and Rio Tinto, in the hope of buying them back at a lower price to lock in profits.

Back on the stock-picking front, Cadence, with an 11.4 per cent stake, is the largest shareholder in one of Under the Radar's favourites, the IT services group Melbourne IT. "The company is currently undergoing a turnaround.

If the numbers stack up and the turnaround goes to plan, you're looking at 100 per cent growth in normalised earnings and it's trading on a forward PE of only 9 times!"

When you are a high-conviction operator like Karl Siegling, enthusiasm is a job requirement.

Richard Hemming is an independent analyst who edits www.undertheradarreport.com.au, which provides investment opportunities in Small Caps that you won't get anywhere else. (r.hemming@undertheradarreport.com.au)

Why I got out of coal: prices to remain soft

ROGER MONTGOMERY

Those who say you glorify the past when the future has dried up may be surprised to hear that you can profit from a dried-up future.

In the past decade China's steel production has jumped from 350 million tonnes to about 840 million tonnes, representing annual average growth of 9 per cent.

For context, China produces as much steel as the rest of the world combined and more than four times the peak of US production in the 1970s.

China's well-documented residential property slowdown has seen its demand growth tapering off, with apparent steel consumption running at about 730 million tonnes, or 45 per cent of global consumption.

That means China is producing more than 110 million tonnes a year that it doesn't need.

It is safe to expect China's steel exports to exceed 100 million tonnes.

Indeed, the world's largest integrated steel producer, ArcelorMittal, believes China's exports this year could be closer to 130 million tonnes.

With a negligible growth rate in global steel production expected across the balance of this decade, the implications for the iron ore and coking coal markets, as well as the Australian dollar, are only just being felt. (For more on iron ore see Richard Hemming's Under The Radar column today.)

I have discussed the iron ore bear case on numerous occasions since 2010 — it is the reason I never purchased RIO or BHP, and there is further to go — so I thought this article should instead focus on coking or metallurgical coal, the ramifications of the overcapacity, and how to profit from the inevitable destruction.

As an aside, as I write this column, the collapsing US coal industry received more bad news as Alpha Natural Resources filed for Chapter 11 bankruptcy protection.

Plagued by plummeting coal prices and high debt, the collapse of another company needs to be read with the collapsing iron ore price, and negative free cashflows and high debt of Fortescue Metals and Vale.

Back to coal: the seaborne supply of metallurgical coal (coal used for making steel) peaked in 2013 and 2014 towards 300 million tonnes and China's imports had reached 60 million to 70 million tonnes.

With production of 500 million to 550 million tonnes, China's imports accounted for only 12 to 15 per cent of its needs.

The outlook for China's steel production combined with its protectionist policy means global prices for seaborne metallurgical coal will remain, at best, under some pressure for the balance of this decade.

And it's no great surprise to see the price of metallurgical coal fall by 75 per cent in recent years from $US330/tonne to under $US90/tonne.

US metallurgical coal producers have been the hardest hit. Alpha Natural Resources, the biggest US producer, traded down from $US67 a share and a market capitalisation of $US8 billion in 2011.

We expect other companies will follow Alpha into Chapter 11 bankruptcy including Walter Energy ($US141 to US4c) and Arch Coal ($US36 to US18c).

Closer to home, last week Brazilian Vale and Japan's Sumitomo sold the Isaac Plains coking coal mine based in the Bowen Basin, Queensland, to Stanmore Coal Limited for $1. Sumitomo had bought its half stake in 2012 for $430m ... talk about destruction of capital!

Add a dash of operating leverage combined with financial leverage and suddenly the equity value — the part of the company shareholders own — can quickly become significantly less valuable than a company's indebtedness.

China produces as much steel as the rest of the world combined and more than four times the peak of US production in the 1970s

As one well-known commentator says in describing this destruction phase: "Equity is a fine sliver of hope between assets and liabilities."

Many investors are greatly influenced by fashion and are tempted to buy whatever is going up.

They also have a tendency to try to pick low points.

But there are opportunities to profit from deteriorating industry dynamics and they can be relatively easy to uncover. At Montgomery funds, our Montaka Global Fund (a wholesale only fund) previously identified the deteriorating economics of coal as a theme or structural shift it could profit from by selling shares of companies most exposed to the overcapacity and demand destruction.

Some of these positions are still held today.

And it's not just the dynamics of iron ore or coking coal that you may like to focus on.

From the Cobb & Cos, Ansetts and Babcock & Browns of the past, to the classifieds and print advertising business models of today, there are many businesses globally that, despite being run by the most talented managers, are simply destined to repeat their historical cycles or, worse, offer a dried-up future — albeit a dried-up future from which profit and the protection of capital is available.

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

Boost your investing IQ

Discover smarter investing - earn from **4% to 7%** p.a. and protect your capital with corporate bonds.

Register today for a free Smart Income seminar in Adelaide, Brisbane, Canberra, Melbourne, Perth or Sydney and receive your complimentary copy of our 2015 Smart Income Report. Call 1800 01 01 81 or visit *www.fiig.com.au/seminars*

Winner Fixed Income, CoreData SMSF Service Provider Awards 2013 and 2014

The fixed income experts

FIIG-IQ-JUL2015-AUS-3

fiig.com.au | 1800 01 01 81

FIIG Securities Limited ABN 68 085 661 632 AFS Licence No. 224659 FIIG provides general financial product advice only. For a copy of our disclaimer please refer to *fiig.com.au/disclaimer*. A corporate bond is not a bank deposit. Corporate bonds have a greater risk of loss of some or all of an investor's capital compared to bank deposits. Unless specified otherwise, the figures provided as at 25 May 2015 and subject to change.