David Walker offers a value investors view of the results season on Tuesday in **WEALTH**

Tony Negline finds 'something rotten' in the pension system in **WEALTH** on Tuesday

US banks supreme in global turmoil

What's driving risk off and are opportunities going begging?

STIRLING LARKIN
GLOBAL INVESTOR

The greatest fortunes have often been amassed during times of heightened concerns, periods of structural transition and especially during market structure corrections, just like the one we face today.

But as many have not seen the opportunities this presents nor recognise any clarion call that allows them to invest with reasonable confidence, Australian investment communities have transitioned to cash at one of the faster paces since the Great Recession.

Stoked by current fears over oil and China, magnified by anxiety stemming from existing European and potential (but unlikely) North American negative interest rates — coupled with the potential for systemic risks from banks globally — these fears created a surge in gold bullion that understandably rallied towards $US1300/toz at the beginning of February.

Remembering that gold is recognised as the barometer of fear or "currency of last resort", the significance of these events has deeper implications for the global investor, primarily because gold, in these circumstances, is a direct conduit for "risk off" (or risk aversion) across all asset classes.

In other words, when investors discuss gold in these ways they are really asking: Is it time to take risk out of all active market investment positions?

Australian Ultra High Net Worth investors are more attuned to the nuances of this debate (that is, those who hold more than $250 million in fungible wealth, which is the threshold between high and ultra-net wealth), and here diversification has been found across less-liquid asset classes.

Less depth of liquidity across a portfolio leads to the binary "risk on" or "risk off" decision process much quicker. Australian UHNW investors are currently focusing on the following three drivers of macroeconomic fear stemming from lower oil prices:

- The commodity capex cycle.
- Increased savings (from energy costs).
- What's referred to as the "Oil-Dollar" and "Oil-Renminbi" correlation

Recognising that each of these themes has already run their course, given the currently trendless oil market, the question becomes what's continuing to drive "risk off" and, by choosing to do so, are timely investment opportunities being missed?

On this, Goldman Sachs recently came out arguing these fears ignore the facts that systemic risks from oil, China and negative rates are very unlikely to spillover into crisis or recessionary territories.

It highlighted that OECD banks had ample liquidity to maintain funding against higher capitalisation, that the negative macroeconomic impacts from low oil prices have likely already played out and are not systemic while the spillovers from China are limited and the US is far from recession.

However, critics of these views are legion.

And that is because coming out in support of China or even the US economy at this time appears to become a poisoned-chalice position.

Australian UHNW global investors already know the following:

- An economic hard landing has already happened in the northeastern region of China.
- In that region, nominal GDP growth dropped to 1 per cent in 2015 from 5.4 per cent in 2014 and 14.9 per cent in the 10 years before that on average
- Growth of fixed-asset investment (FAI) tumbled to -11.6 per cent in 2015, compared with the 10-year average of 25.5 per cent previously seen

The significance of this region to Australian investors is that it directly accounts for about 8 per cent of total Chinese GDP, 8.1 per cent of their population, 7.2 per cent of bank loans in Greater China but, most importantly of all, is the recipient of much of Australia's exported iron ore and cooking coal since 2005. Also, the northeastern region offers a natural experiment to gauge what would happen if tail-risks across Greater China materialise.

Across northeastern China in calender year 2015, growth of household income, household consumption and retail sales slowed more than the national average, but to a much lesser extent than other indicators such as investment and imports.

There are no reports of widespread unemployment or social unrest and in these contexts the social impact appears bearable.

For investors, there are clearly some complicated undercurrents at work right now, and with multiple factors already adversely impacting US, European and Australian corporate profits and valuations it is most reasonable to expect global investors to fear China's transition.

And, for global investors, this segues directly towards an equally impactful "fear conversation" regarding Chinese Banks.

Although national-level Chinese bank dividends present as comparable to the big four Australian commercial comparisons, the state-owned Chinese banks' relationship with the government makes them more vulnerable to potential restructuring and dilution risk.

This debate has also circled around the reasons that led to the Chinese Banks' public listings in the first place:

- To subject the Chinese banks to market forces, leading to efficiencies
- To share future restructuring costs with minority shareholders, if and when the banks need to recapitalise balance sheets — akin to the current European experience with Contingent Convertible (CoCo) Bonds
- Chinese bank dividend payout ratio of 35 per cent is high compared with Chinese companies whose dividends tend to be low to nil. This approach is traditionally commensurate with fixed income, not equity positions.

With Chinese banks undercapitalised and their earnings deteriorating, the opportunity and risk question for Australian global investors is: where does that leave Australian iron ore exporters, consumer markets and the nascent but increasingly important Chinese tourism market?

Lastly, all the major Chinese offshore-listed banks are trading below their book values, however, as the denominator, being the "book value", needs to be revaluated based on more rigorously imposed loan classifications and strictly implemented Basel III, the banks would more likely be priced two to three times their net asset value.

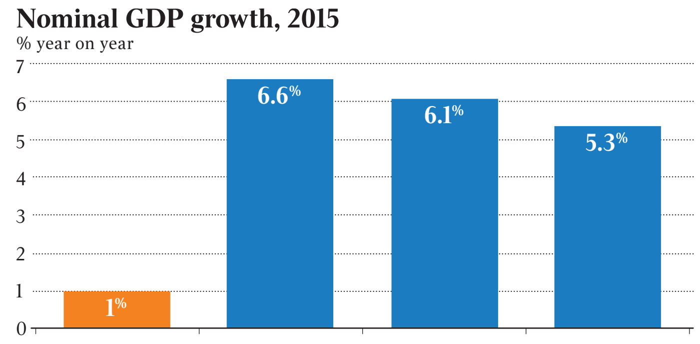
Therefore, global investors would be wiser to invest in quality money-centre banks in the US, if they came to the view that the opportunity for a turnaround story existed within this "Fear & Gold" linked to "China & Iron Ore" tryst.

Larkin Group is an Ultra High Net Worth Wealth Adviser focusing on high-yielding global investments www.larkingroup.com.au

AP

Across northeastern China household income, consumption and retail sales slowed more than the national average

Nominal GDP growth, 2015



Source: Deustsche Bank, CEIC

If you can't pay cash, you don't deserve it

ROGER MONTGOMERY

National Australia Bank head of wealth management Andrew Haggar was recently quoted sharing a disturbing statistic: half the population lives from pay cheque to pay cheque.

Meanwhile, on the same day Haggar was quoted, an article in a national publication discussing opposition Treasury spokesman Chris Bowen's concerns that 70 per cent of the benefits of negative gearing go to just 10 per cent of income earners featured a family of four earning $200,000 who have four properties in the Northern Territory with a market value of $1.95 million on which they owe $1.7m.

It strikes me that both examples demonstrate a lack of financial knowledge and an understanding of risk.

Financial education was not part of the school curriculum in the 1970s and 80s when I went to school, but if it had been I suspect there would be far fewer people able to identify with the two categories described above.

Times, however, are changing and I have been asked by my son's school to speak to his year cohort about investing and the stock market.

Encouraged by this enlightenment, a column offering the foundational elements of personal finance may not only plant the seed of future financial security for many, but also satisfy the germinating demand for financial literacy and competency.

What follows are the eight basic habits I employed from my first paper rounds through to butcher shop clean-up-kid then busboy and part-time accountant while at university.

Habit 1. Work hard and/or smart. Australia has its fair share of the lazy and idle so rising above the pack is not that difficult. All that is required is a solid work ethic. Parents of all financial persuasions need to demonstrate the benefits of hard work, even if you are financially secure. You aren't loving your kids by buying them every latest gadget. And if you've taken them on holidays with you to every country in the world by the time they're 17, please explain what they have to work hard for when they grow up?

I know of one parent of two adult kids who holds down two jobs, and who on her way home collects toys, tools and furniture dumped for council collection, cleans them and sells them at weekend flea markets. I also know of a successful young banker who sells bacon-and-egg rolls at a community market each weekend. The extra cash might not make a difference, but it's the demonstration of industriousness that will assist their kids to transition from dependency to a successful financial future.

My son looks after his bicycle more than any previous bike because he paid for it himself and he wants to sell it in the future for the highest justifiable price.

Habit 2. Pay yourself first. Whether you call it saving, wealthing or squirrelling, what matters is that from the first receipt of income your youngsters pay themselves first.

Many adults who are living from pay cheque to pay cheque are simply spending beyond their means and by the end of the week or month there's usually nothing left to save. Reversing the typical habit of spending first and saving what's left can arrest the risk of falling into this trap.

A better plan is to divert 10 per cent or more of one's income to an account with little or no access. Then spend on necessities, luxuries and philanthropy what is left. I kept such an account for many years and I would cut up the ATM cards that were sent to me every few years by the bank. An old friend destroyed his access cards and would put the cash that he was free to spend in his wallet at the start of the week so that at all times he knew how fast it was disappearing. Instead of paying everyone else from your income and keeping what is left over, pay yourself first.

Habit 3. If you can't pay cash, you don't deserve to have it. Don't apply for a credit card. I have a personal credit card, but I am told the limit is smaller than most university students'.

Habit 4. Magazines and shopping malls are soul destroying and financially ruinous.

Habit 5. Invest in businesses or start one yourself. Either learn the path to successful investing yourself or, if you don't know the difference between investing and speculating, regularly and consistently invest with those who do. Starting a business or owning equity in one won't suit everyone, but take a look at the world's rich lists and nowhere do you find: "Mr Smith. Wealth: $US5 billion. Source of Wealth: Salaried Employee.

Habit 6. Choose carefully. I am fortunate that I married a person who does not care for material possessions.

Habit 7. Be patient. Most of the adverse or permanent shocks to one's wealth stem from a lack of patience. You can become very wealthy without ever borrowing money, provided you aren't in a great rush. The accumulation of debt is more often a function of impatience and the fear of missing out.

The stockmarket in particular has a habit of transferring wealth from those that have no patience to those that do. When it comes to debt, less is always more.

Habit 8. Sacrifice. Nobody really wants to hear this, especially the young, but at the very core of financial success is the idea that choices with opportunity costs need to be made. A high school student can sacrifice a year or two of partying and instead choose to knuckle down, secure great grades and set themselves up for a life of more enjoyable choices.

A lifetime of better options awaits the person willing to defer pleasure. And don't forget: you will be older before you know it, and for longer than you think.

Mobile technology small caps face race against time in tight market

RICHARD HEMMING
UNDER THE RADAR

Buried in the torrent of information flying at me this reporting season it is some facts from a little-known small cap called Mobile Embrace (MBE) that come to mind, perhaps because they hit close to home:

- The internet is accessed more frequently by mobile phone users than from the desktop/laptop.
- Mobile phone users on average spend five hours checking their phones, or 85 times a day.
- Direct carrier billing is forecast to increase from $14.5 billion in 2014 to $24.7bn by 2019, while app downloads are predicted to climb from $102bn in 2014 to $269bn in 2019.

This should be a fertile landscape for mobile phone technology companies, but it has actually been quite hard to make big profits in the sector.

While my recommendation in the mobile products and technology company Mobile Embrace is up 25 per cent in the past nine months, it has been a rocky ride.

It is fair to say than none of the mobile-focused technology companies, such as Crowd Mobile (CM8), eServGlobal (ESV) and Mint Wireless, have fully won investors' hearts.

Mobile Embrace has the largest market cap at $120 million and all have had performed erratically on the sharemarket. The risks in this sector are high. These are all small companies trying to exist alongside gorillas such as the big banks, the big telcos and the big platform providers, namely Google, Apple and Microsoft.

Arguably the biggest challenge for a mobile technology company is working with the telcos because this may involve handing over as much as half their revenues. The other is the operating systems of the devices themselves. This is a rapidly evolving industry in which nobody knows what the structure will be in three years.

This begs the question, are these minnows worth investing in at all? Yes, one or two are for this reason: growth. Sure, such growth can be ephemeral, and you might miss it, but the big platforms of the world create opportunities for smart people to make money. The leverage is incredible. We're talking one billion mobiles on Google's Android system.

As always, backing the right management is crucial: Even if somebody finds the next hit game such as Angry Birds or Candy Crush, you can get people excited for a year, but then the consumer moves on. Management needs to be continually evolving and looking for the next opportunity.

Of course, growth and management are important, but if the company is burning cash, investors' patience will be quickly exhausted. For the six months to December 31, Mobile Embrace generated operating cashflow of $2.1m, spent $15.5m on business acquisition and $4.2m on customer acquisition; and was left with $6.5m in cash. The clock is ticking.

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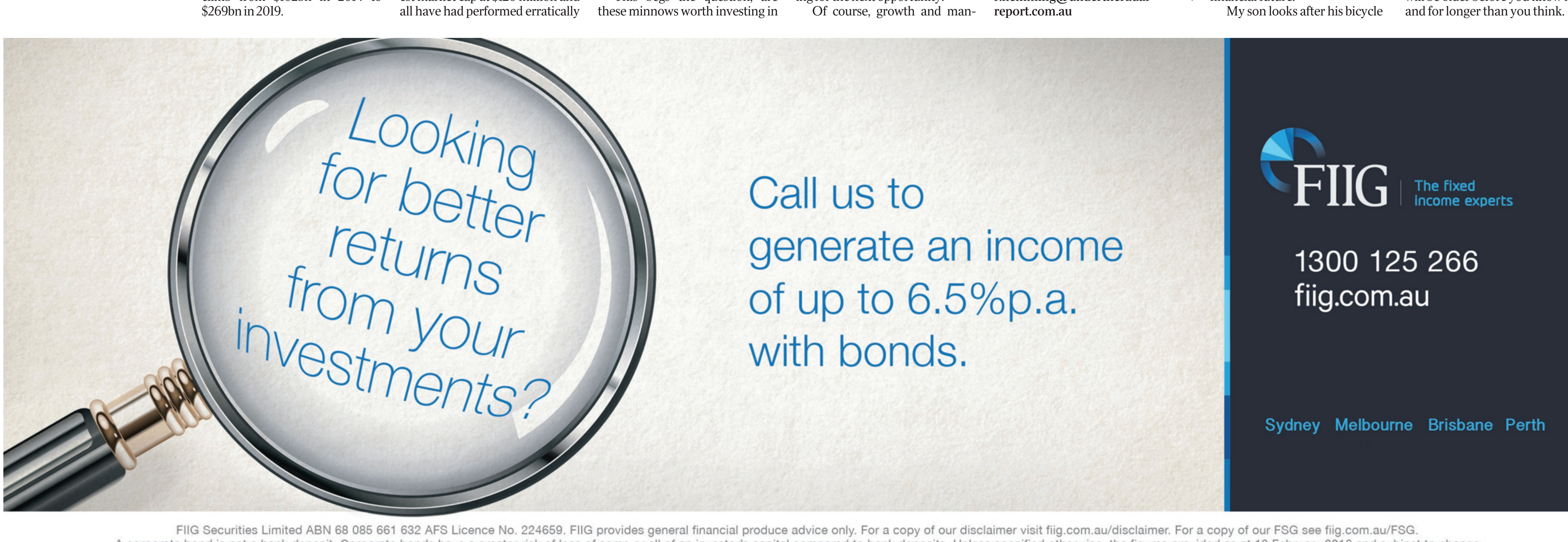

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