Alternative strategies: a short story

ROGER MONTGOMERY

Buy low. Sell high. That's all there is to investing, right? Well, not quite. You see, there is an alternative strategy that not enough investors are taking advantage of. You could sell first and buy later at a lower price. As long as the selling is at a higher price than the buying, it doesn't matter which comes first, you'll still make a profit. Selling at a high price first is called "short selling" and it's becoming a more prominent part of the portfolios of wealthy investors and their advisers.

Unsurprisingly, inquiries from financial planning groups for new long/short and market neutral funds is increasing simply because the incumbent funds are fast filling up and closing their doors to new investors.

So why are these strategies moving from the alternative investment background into the mainstream? The answer is simply high asset prices.

Low and negative interest rates have resigned many investors to the reality of very low returns. In a world of annual returns of just a couple of per cent, unsophisticated investors' fears of missing out is fuelling bubbles in everything from so-called "stable" stocks on the sharemarket to art, to low-digit licence plates to property. People believe low interest rates are here to stay.

Mark Twain's quote here is apt: "When you find yourself on the side of the majority, it's time to pause and reflect".

Another band of investors are observing the merit of pursuing strategies that not only have the ability to generate returns that aren't dependent on the direction of markets but also offer the added protection that comes from an ability to generate profits in declining markets.

Lessons from Enron

When Enron fell to zero, Jim Chanos from short fund Kynikos made billions. David Einhorn's Greenlight Capital made billions for investors by "shorting" Lehman Brothers. Andrew Left at Citron Research won plaudits when he predicted Valeant Pharmaceuticals would fall, ultimately by more than 70 per cent and Carson Block from Muddy Waters made his investors a fortune when he unearthed and shorted a major business fraud at Sino-Forest.

Investors are wedded to the idea that there are signals and the idea that people can correctly predict when the markets are about to crash. In pursuing such holy grails investors hope to be able to jump in and out of the market at the right times. But you don't need to.

History shows that many investors tend to do the exact opposite of what works in investing; They tend to sell at the lows and buy at the highs.

Instead of an "all-in" or "all-out" approach, it is sensible to build a portfolio that includes investments that sidestep the need to make prescient entry and exit decisions. By adding investments that profit from falling asset prices, you can ride through the inevitable storms and emerge protected as well as positioned to take advantage of the lower prices.

A "fat tail" is an event or risk that is infrequent but will have a significant impact on returns. By allocating a small proportion of a portfolio to strategies that gain value through such events, the investor protects a portfolio.

How it works

Most investors know little about these strategies because most managers that run these funds, aren't offering them through the most widely adopted platforms, wraps and approved product lists. It tends to be the very high net worth investor that benefits.

I have invested in our global long/short fund and our market neutral fund. I have also opened an account that allows me to hold short positions in global bonds, believing that if global long-bond rates rise, I will make a profit to at least partially offset the losses such an event will have on the market value of my portfolio.

A market-neutral fund buys a portfolio of quality companies the fund manager believes will outperform and an equally-sized portfolio of short-sold, poorer-quality stocks.

If we assume the market falls 10 per cent, the bought portfolio falls 9 per cent and the short-sold portfolio of poorer quality stocks falls 11 per cent, the investor would have lost 9 per cent on the bought portfolio but would have made a profit of 11 per cent on the short-sold. As a result, the investor makes 2 per cent even though the market falls 10 per cent.

It could go the other way. If the market falls 10 per cent, the bought stocks fall 11 per cent and the short-sold portfolio falls 9 per cent, the investor would have lost 2 per cent. But remember, even though a 2 per cent loss is not ideal, the market fell 10 per cent.

It doesn't matter if the market rises, falls or trades sideways. As long as the fund manager's choice of purchased stocks beats the portfolio of short stocks, the investor in a market neutral fund will profit.

In a world of high asset prices, low or negative returns are likely to follow. Having some exposure to alternative funds makes a lot of sense. Unfortunately unless you pressure your adviser to investigate, most investors will miss out. And after 30 years of declining interest rates, now is the time to be thinking alternatively.

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Australia's top 10 most shorted stocks (% held short)

WOR	WORLEYPARSONS LTD ORDINARY	15.94
MYR	MYER HOLDINGS LTD ORDINARY	15.52
MTS	METCASH LTD ORDINARY	12.39
WSA	WESTERN AREAS LTD ORDINARY	11.77
MND	MONADELPHOUS GROUP ORDINARY	10.95
FLT	FLIGHT CENTRE TRAVEL ORDINARY	10.32
BAL	BELLAMY'S AUSTRALIA ORDINARY	10.28
CVO	COVER-MORE GROUP LTD ORDINARY	10.06
AWC	ALUMINA LTD ORDINARY	9.46
WOW	WOOLWORTHS LTD ORDINARY	9.16

Source: www.shortman.com.au

There's mortar brick play than meets the eye

MICHAEL RODDAN

As new investment models emerge from internet technology and crowd-funding techniques, one significant attempt to allow investors into the residential housing market has captured wide attention

BRICKX, Australia's first "stock exchange" for residential property, launched earlier this week by Markus Kahlbetzer, the son of one of the country's richest men, targets younger investors with the opportunity to buy fractions, or "bricks", of a property for less than $100 a parcel.

But people familiar with the business model have questioned the company' pricing structure.

Mr Kahlbetzer, the son of $800 million agribusiness mogul John Dieter Kahlbetzer, has plunged $3.5m into getting BRICKX up and running.

It works like this: the company buys a house, splits it up into 10,000 "bricks" and offers investors the ability to buy a stake in the property without having to see the house or attend an auction.

No single investor may buy more than 5 per cent, meaning that each house will have a minimum of 20 part-owners.

Who is responsible for the house? Each property is underwritten by BridgeLane but owned and managed by the trustee, Theta Asset Management, which distributes the net income on properties to investors monthly.

While the business has approval from the Australian Securities & Investments Commission, the development is likely to be unsettling the Australian Prudential Regulation Authority, which is already confronted by the possibility of a price crunch in apartment prices as an oversupply looms.

BRICKX, which advertises the level of gearing of its properties, told *The Weekend Australian* house valuations were conducted twice a year, but the market value of the house was detached from the prices or trading conditions of the "bricks".

The valuation, which is advertised, is meant to be a guide for investors, who can chose to list their bricks at a higher or lower price than the market value.

A BRICKX spokesman said if the prices of bricks dropped dramatically, or if the valuation on the house was written down, it didn't necessarily mean people would lose money. "If people choose not to sell at that price, they may not potentially lose money," the spokesman said.

The BRICKX product it is largely ungeared at the moment, meaning the investors may not be saddled with debt attached to the house.

The company also does not want to negatively gear properties, due to the bureaucratic nightmare that would present.

However, despite BRICKX being hailed as an innovative way for investors to avoid large upfront payments on property, the fee structure is worth examining more closely:

- BRICKX makes a 1.75 per cent commission for every brick transaction. Buying a 5 per cent stake in a $500,000 house would attract fees of $8750. To sell out at the same price would then add a further $8750, assuming prices were steady.

> 'The idea is we grow our investor base and liquidity grows with that'
>
> BRICKX SPOKESMAN

- One seasoned investor who examined the business model told *The Weekend Australian* that it wasn't so simple. "There's a secondary market, but it doesn't appear to be that liquid," the investor said. There's a market price decided by the number of bricks available to be bought or sold at any time. If there's no market and an investor wants to sell into an unreceptive market, prices could fall sharply.

Bricks were usually selling at a 2-3 per cent discount to the market price of the property, the investor said.

The BRICKX spokesman said: "Liquidity is an inherent risk. Obviously we don't have as much liquidity as we would like at the moment but the idea is we grow our investor base and liquidity grows with that."

BRICKX said it now had thousands of members and more investors were approaching the company every day.

- There is a 6 per cent management fee, not including GST, deducted from the gross rental income of each BRICKX trust before distributions are send out to brick holders, along with a flat monthly fee of $75 per property per month.
- At the end of every five years, all the investors in the property vote to decide whether to continue, or discontinue, with the investments and at any time, 50 per cent of each property's investors can vote to wind up the investment.

Only time will tell if a new product can deliver on its promises. For the moment though, some models raise as many questions as answers.

Markus Kahlbetzer launched BRICKX this week

Breaking into commercial property with just $100,000

JAMES GERRARD
INVESTMENTS

This week's confirmation the government will tighten the rules on superannuation combined with falling returns on cash is forcing self-funded retirees to reassess the best way to generate income in retirement.

If we look back to 2008, investors were getting 8 per cent on term deposits without breaking a sweat whereas today, term deposit rates are sitting at a measly 3 per cent, which is barely enough to keep up with inflation.

Many investors are now looking to residential property, especially houses, as oversupply remains a constant threat in the apartment market.

But what about commercial property? Though it has often been seen as the preserve of very wealthy investors, it might surprise you but it is possible to get into commercial property for less than residential in any city.

So how can one get started in commercial property with as little as $100,000?

Car spaces

Strata car park investment is a commonly queried commercial property asset given its low entry cost. Car parks are probably the easiest way into directly owning commercial property.

For less than $100,000 you can purchase a strata car spot in most capital cities on a guaranteed lease basis by the car park operator. Ramon Mitchell, director of acquisitions at Performance Property Advisory, says although the entry price is attractive, "after the car park operator fees are taking out, net income from these investments tend to only be around 5 per cent per year".

Office, cafe and industrial units

For most people, it might be more realistic to see the $100,000 cash as a base which could be geared up to, say, $335,000 at a 70 per cent borrowing level. This opens up the options for direct investment into a small office space, shopping strip cafes or industrial unit such as lockups that can be bought at relatively modest prices.

Endre Kollo, director at property advisory firm KS investments, says "commercial property income returns can vary from 5 per cent to 10 per cent depending on many factors". Not only are price points and location variables in determining the income return, the type of commercial property purchased is also important.

Medical centres are a standout

Kollo says "analysing data over the past five years, the clear winner in the commercial property sector for income has been medical centres.

"Rental income in medical centres has averaged 8-10 per cent, leases are generally five years with a five-year extension option and tenancy turnover is low". It makes sense. Doctors generally do not like to relocate medical centres as they lose patients in the process.

With cash rates unlikely to head north in the foreseeable future, for the income-focused investor unlocking investment in commercial property does not require millions of dollars and should be considered.

The question that needs to be asked is the same for everyone, but the answer will be different for each. Is it worth the gamble to move money from the security of cash and invest in commercial property on the basis of trying to target income returns in excess of 8 per cent a year? If it makes sense for you, then it's time to do some homework.

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