“Investors are generally poor at timing their selling and even poorer at timing their re-entries.”
ROGER MONTGOMERY

WEALTH

Facing a compulsory acquisition

A government buyout of your house can be a real hassle

JAMES GERRARD
HOW TO DO IT

While we all love new train lines and roads, what if your home is in the way of a nation-building project, is this necessarily bad news? Is it a disaster or maybe a lottery win?

Compulsory land acquisition is happening all across the country as state and federal governments pour billions of dollars into new infrastructure projects. NSW is spending $12.5 billion on the Sydney Metro project, Victoria is spending $11bn on their Melbourne Metro while in Queensland, $8.5bn is being spent upgrading the Bruce Highway.

So what happens if the roads department comes knocking on your door to make a compulsory acquisition?

PHILLIP ROGERS

Some may see buying a new home as a decision for life but compulsory acquisition could change all that

1. Valuation

Paul Colagiuri, director and principal lawyer at PC Law, which specialises in compulsory land acquisition law, says, “If your property is going to be acquired it is a real hassle. You have to go through a valuation process with the government to assess the value of your property which is time consuming and costly”. Registered valuers are engaged by both property owner and government, which is then followed by a round of negotiations between the parties.

2. Appeal

But If you cannot agree, Colagiuri says “the matter is then referred to the Valuer-General who will assess the value and set the sales price.

3. Prospect of court action

If you still don’t agree then you can take the matter to court. However, all this is time consuming and costly and there is no guarantee that you will get a satisfactory outcome. There have been instances where owners get less compensation than their property may be worth and instances where they get more”.

In general property owners are usually contacted well in advance sometime during the planning stage of the project by the relevant state department.

Once the project is approved and the acquisition becomes likely, the time varies depending on how urgently the government requires the land but an average time might be six to nine months.

Colagiuri says, “If the project is very urgent, the time period could be as short as a few months because the government has the power to expedite the process, however this is rare”.

State to state

One of the most notable aspects of this issue is that the laws differ from state to state and you can be entitled to more dollars in compensation depending on where you live. If you receive correspondence which mentions the word “solatium”, it’s worth knowing this is the legal term for the provision for relocation costs and compensation for the inconvenience of moving.

In NSW, solatium, which is a payment for the inconvenience of being forced to move, is capped at a maximum of $27,235, whereas in Victoria, solatium is capped at 10 per cent of the property value.

In terms of property ownership rights, Daniel Corbett, director of Full Property Advice, says don’t overestimate your chances of taking on a state government, even if you have been inspired by local heroes who have hit the headlines.

Corbett references the 1997 Australian movie *The Castle* where Michael Caton’s character successfully challenged a compulsory acquisition of his property.

“Although one’s home is one’s castle, *The Castle* was a fictional movie but the story of having your home compulsorily acquired can be an unpleasant reality” says Corbett.

“Property owners do not have the right to decline an approach by government to acquire their property. Instead, they have the right to be paid just compensation under their state’s legislation. They also have the right to get legal and valuation representation and be reimbursed reasonable fees for those” say Colagiuri. In NSW they have the right to remain on the land until they are paid at least 90 per cent of their compensation and if it is their principal place of residence, have the right to remain living there for three months after the compulsory acquisition has occurred.

To minimise the chances of having your property sold under compulsory acquisition rules, Trevor Chan, licenced real estate agent from Northshore Property Sales in Sydney, says that prospective property buyers should “check the zoning of the land they intend to buy as set out in the planning certificate.

In NSW, this on the section 149 certificate attached to the contract for sale and in Victoria it is found in the section 32 Vendors Statement of the contract for sale”.

Colagiuri adds “if the land is in part or wholly zoned for a public purpose such as a railway or road, then it means the land has been earmarked for this use and it is likely that it will be acquired at some point in the future for this purpose.

Ordinarily your solicitor should point out if this is the case upon reviewing the contract”. Chan suggests property buyers “check council, state and federal planning websites for proposed projects that may affect the property”.

If your property does end up being subject to government compulsory acquisition, the most important thing is to get good legal and valuation experts on your side, as it is a very difficult and technical process.

Having the right team on your side will allow you to navigate the process and help to maximise your chances of receiving achieving full compensation.

James Gerrard is the principal and director of independently owned Sydney financial planning firm FinancialAdvisor.com.au

Short selling isn’t a dirty word: investors can profit from falling stars

TIM BOREHAM
CRITERION

It’s a sobering reflection on Myer Holdings’ perceived prospects that short sellers account for 16 per cent of the retailer’s share register. It’s the single most shorted stock on the market.

Over at contractor Worley Parsons, 15 per cent of the shares are held by parties betting the strife-prone contractor’s fortunes will continue to be, well, strife prone.

Other stocks with large shorted positions comprise an intriguing selection such as nickel producer with a lively history, Western Areas (13 per cent), retailer — controller of the IGA supermarket brand — Metcash (12 per cent) and China-focused infant formula producer, Bellamy’s (11 per cent).

Shorters have also targeted three of the big four banks (CBA excluded) ahead of their full-year results, with the shorted component of the registers ranging from 1.9 per cent for Westpac to 1 per cent for NAB.

Overall, though short selling accounts for only about 1 per cent of the market and is deployed far less here than in the US. During the GFC the practice also gained a “shorting and distorting image” and was blamed for everything from individual stocks going bust to the global recession.

Critics of short selling often argue that shorters delight in spreading negative rumours about a stock, and there’s probably a kernel of truth in this.

These days, though, short selling is becoming a more accepted tool to preserve capital, especially among older investors scared of losing their duds a la GFC just ahead of retiring.

“There’s also an improving knowledge of strategies at both the individual and adviser level,” says Mark Burgess, a portfolio manager with absolute return fund manager Kardinia Capital.

‘Easier picking losers’

Montgomery Fund founder and Wealth columnist Roger Montgomery says share investors have enjoyed 30 years of asset growth with low interest rates — but the times are a changin’.

“With disruption affecting every industry from energy to television it is often easier to pick the losers than the winners,” he says.

“Investors can profit from the inevitable decline of some industries as they are replaced by automation, substitution, or faster rivals.”

Top Ten Most Shorted Stocks

MYR	MYER HOLDINGS LTD	16.17%
WOR	WORLEYPARSONS LTD	15.36%
WSA	WESTERN AREAS LTD	13.10%
MTS	METCASH LIMITED	11.66%
BAL	BELLAMY’S AUSTRALIA	11.49%
MND	MONADELPHOUS GROUP	11.35%
CVO	COVER-MORE GRP LTD	11.19%
FLT	FLIGHT CENTRE TRAVEL	10.37%
AWC	ALUMINA LIMITED	9.07%
TFC	TFS CORPORATION LTD	8.94%

Source: Theshortman.com.au

Short selling entails borrowing and then selling stock from an institutional holder, usually an index manager who are holding rather than trading the shares.

This is done via a so-called prime broker, which accesses the requested stock via a pool of shares. In the case of big companies there’s usually more than enough stock to cover requests for both the borrower and a lender fund wishing to redeem the shares.

Index fund managers — who passively sit on their holdings — are willing participants. Offshore institutions are popular as lenders, because they can’t use their franking credits and thus don’t need to be compensated for the loss.

The borrowing fee is surprisingly low: usually 0.4-0.5 per cent of the face value of the shares. But as with the heavily shorted Fortescue Metals Group a few years ago, this can rise to as high as 10-15 per cent if there is scarce stock available. While half a per cent or so seems derisory, it makes a big difference to the returns of a low-fee index manager.

“The end of story is that hopefully the share price tanks to a level that reflects all our information and is fairly valued,” Burgess says.

“We look to buy back in, lock in a profit and return the stock to the prime broker.”

If the stock defies expectations and rises in price, a squeeze occurs as shorters scramble to buy stock to square off their positions (typically, they set a 15 per cent share appreciation as a stop-level at which they buy back in).

Because of this, the likes of Myer and Worley Parsons are candidates for sharp share spikes on any unexpected good fortune.

Montgomery dubs short selling as a foil against earnings manipulation (boards will be found out) and the buy recommendations of conflicted brokers.

“A band of researchers happily lifting the hood of companies to find flaws is a necessary counterweight,” he says.

Of course, individual investors can’t lob up to a prime broker (most investment banks have this function) to bot a handful of shares.

But they can access managed funds that employ “long-short” strategies, although the choice of products is far more limited than in the ‘long-only’ sector.

Tall stories

Like Tim Tams, long-short funds come in different flavours.

The market-neutral funds will have an equal short and long component, with performance dependent on the manager’s stock tipping ability.

An “active extension” variant, known as a 130/30 fund, short sells 30 per cent of the value of the portfolio but then reinvests the amount in a long position. This way, the fund is 100 per cent exposed to the market’s movement (beta).

As its name suggests, a variable long-short adjusts its market exposure according to the prevailing conditions.

According to research house Zenith Investment Partners, the Bennelong long-short equity fund (market neutral) has returned 16.75 per cent over the last ten years, compared with the ASX 300 accumulation index’s 4.76 per cent increment.

Other stars are the Regal Tasman market-neutral fund (16.74 per cent), the Bennelong Kardinia absolute return fund (11 per cent) and the Smallco Investment Fund (10.5 per cent).

Another way of “shorting” a stock is to take out a contract for difference, which compels a buyer and a seller to pay the difference between the current value of a share and its worth at an agreed date.

In a sense, CFDs are the purest way for investors to take a position, but they are also a winner-takes-all device akin to plonking it all on the black at Monte Carlo.

As the corporate watchdog intones: “The complex structure of CFDs and the risks associated with them mean that they are unlikely to meet the investment needs and objectives of most retail investors.”

***The Australian* accepts no responsibility for stock recommendations. Readers should contact a licensed financial adviser. The author holds bank shares.**

How much are you really paying for shares?

ROGER MONTGOMERY

There is a lot of conjecture about whether equity markets are cheap or expensive. The answer you get depends on who you ask. Some market commentators, experts and other “helpers” use the PE ratio as their measure of fair value (the price/earnings ratio which is the share price divided by the earnings per share).

Some others will use charts to show support and resistance levels and some just make an “educated” guess. It is easy to see why many investors become confused and lose confidence.

Recently, my colleague Daniel Wu questioned the veracity of PE ratios and related valuation techniques such as Schiller Cyclically Adjusted PE ratio (CAPE).

The problem with the PE may simply be that it is not a valuation of a business. If price is what you pay, and value what you receive, then a valuation cannot have price as an input because it must stand separate from prices to determine whether value is present or absent.

So the PE ratio may be high but it tells us little about whether the market is expensive or cheap and little about what returns are likely to be in the future.

The holy grail

The holy grail of course would be an indicator that could tell us when to buy and when to sell, but in the absence of such a device it is arguably important to stop thinking in terms of “all in” or “all out”.

Before considering an alternative and much more sensible approach, it is probably worth discussing briefly my own thoughts on where the market is at. In short, I believe the chance of a correction between now and 2020 is almost certain.

The “income recession” in term deposits has triggered an investor migration up the risk spectrum and into company shares with lower perceived earnings and dividend volatility. The problem, of course, is they tend to be the large cap conventionally-described blue-chips or the infrastructure and utility companies.

Here’s the problem with each of these share categories:

- In the case of the big blue chips, the ASX 200 dividend payout ratio has increased from 55 per cent in 2011 to 80 per cent today. As a result, these companies, in aggregate, are retaining less of their profit for growth. In other words, investors are buying bond-like returns but taking on equity market risk.
- In the case of infrastructure and utility companies, the valuations are high because interest rates are low. When analysis and investors discount back future cash flows to arrive at a valuation they often use the weighted average cost of capital.

The WACC is simply the cost of debt multiplied by the proportion of debt plus the cost of equity multiplied by the proportion of equity. Most of these companies have little or no net equity on their balance sheet so valuations are boosted by them having a high proportion of debt.

Low interest rates

So think about that for a moment. The most expensive companies are those with little growth or a lot of debt, or both. That’s what low interest rates have done but as the mathematician Herbert Stein, once observed: “If something cannot go on forever, it will stop.”

Low interest rates have had some strange consequences, including the corruption of the assessment of risk.

The way the PE ratio does work is in terms of explaining how share prices might react if long-term interest rates rise. When interest rates rise, the ‘P’ for price in the PE must fall. If the ‘E’ for earnings grows one might compensate for the other and the investor could be relatively safe. If however the ‘E’ is not growing then the ‘P’ falls and the share price declines.

Elsewhere, art, vintage cars, low-numeral licence plates and wine are making record prices in auction rooms characterised by standing room only and frenetic bidding. Sometimes we don’t need share market data to tell us of market excesses and an impending turning point.

Legendary bond fund manager Jeffrey Gundlach, speaking with Business Insider, observed: “The artist Christopher Wool has a word painting: ‘Sell the house, sell the car, sell the kids.’ That’s exactly how I feel — sell everything. Nothing here looks good.”

Investors are generally poor at timing their selling and even poorer at timing their re-entries. Buying and selling requires two prescient decisions, the probability of which is very small.

An alternative approach to “selling out” is to adopt an approach that involves realising there is a small probability of an event that could have significant impact on your portfolio. We call these fat tails and their risk can be mitigated.

The answer is not selling something but instead buying something else.

That “something else” is generally an alternative investment — what some commentators call a hedge fund.

Now I can hear you screaming “that’s high risk and they’ve had such lousy returns”.

Neither is true. A fund with the ability to profit from falling share prices lowers the risk of your portfolio.

Roger Montgomery is founder and chief investment officer of the Montgomery Fund. www.montinvest.com

Price-to-earnings ratios roll higher

Source: ASX

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