> When a genius value investor throws in the towel and joins the bullish bandwagon eight years after it commenced, it's worth being cautious.
> ROGER MONTGOMERY, MONTGOMERY FUND

What Morrison's moves could mean for investors

WILL HAMILTON

BUDGET 2017-18

Federal budgets have two elements: first, political discussion; and second, how does this affect me as an investor?

Let's look chiefly at the actual measures that affect investors — keeping in mind at this stage they are proposals only and individual measures may or may not be passed by parliament.

Superannuation

After last year's dramatic changes few measures were announced that further affect superannuation.

But it is important to note last year's changes take effect in just a few weeks on July 1, 2017, and it is imperative that if there is any lack of clarity investors should take advice from their taxation adviser. The only significant change to super rules announced in the budget is the action on "assisted downsizing".

Those aged 65 and over will be able to make a non-concessional contribution of up to $300,000, in addition to their existing caps, from the proceeds of selling their home.

Contribution eligibility requirements, such as the work test and restrictions on contributions from 75 will not apply to these contributions. The requirement to have a total super balance of less than $1.6 million to be eligible to contribute will also not apply.

Features associated with this measure include:

- The property must have been the principal place of residence for a minimum of 10 years;
- Both members of a couple will be able to take advantage of this measure for the same home, meaning $600,000 a couple can be contributed to super through the downsizing cap;
- Amounts will count towards the transfer balance cap when used to start an income stream;
- Contributions will be subject to social security means testing when added to a super account.

The government also announced it would reduce opportunities for members to use related-party transactions on non-commercial terms to increase super savings.

First-home super saver scheme

The government is proposing that individuals may make voluntary contributions to super of up to $15,000 a year capped at $30,000 in total, for buying a first home. Both voluntary concessional and non-concessional contributions will qualify. Contributions along with deemed earnings can be withdrawn for a deposit from July 1, 2018, with the taxable portion being included in assessable income, which will receive a 30 per cent offset.

Higher Education Loan Program (HELP)

The repayment criteria will be changed through revised repayment rates of between 1 per cent and 10 per cent. A new minimum repayment threshold of $42,000 and a maximum of $119,882 (indexed) will apply.

Medicare Levy

This will increase 0.5 per cent, from 2 per cent to 2.5 per cent from July 1, 2019.

Temporary budget repair levy

This is due to expire on June 30. The top marginal tax rate will effectively fall for taxpayers whose income exceeds $180,000, including the Medicare Levy, from 49 to 47 per cent from July 1, but increase to 47.5 per cent from July 1, 2019, when adjusting for the Medicare Levy increase.

Residential property

A number of deductions for residential rental property have been disallowed.

- Travel expenses — deductions for inspecting, maintaining or collecting rent for a residential rental property will be disallowed for properties held interstate and internationally.
- Plant and equipment depreciation deductions will be limited to outlays incurred by investors in residential real estate properties, while acquisitions of existing plant and equipment will be reflected in the cost base for capital gains tax for subsequent investors.
- Foreign and temporary tax residents will not be eligible for the CGT main residence exemption. Those who already own a qualifying property as at May 9 will have the exemption only until June 30, 2019. We are still trying to clarify the status for expatriates.
- The existing 10 per cent CGT withholding rate for foreign tax residents who sell a property will rise to 12.5 per cent from July 1.
- The CGT withholding threshold will also fall to $750,000 (now $2m) from July 1.

Small business

The small businesses asset write-off for assets under the $20,000 threshold has been extended to June 30, 2018. Measures that are yet to be fully determined will be introduced to ensure taxpayers do not arrange their affairs in a way that means ownership interests in larger businesses do not count towards the small business taxation tests. This is to ensure the small business concessions are available to the appropriate group of taxpayers.

Affordable housing

The CGT discount rises from 50 to 60 per cent for resident individuals who elect to invest in qualifying affordable housing.

Managed investment trusts

Affordable housing will now be an eligible investment within the flow-through tax environment of a managed investment trust. The affordable housing must be available to rent for 10 years, with the trust deriving at least 80 per cent of assessable income from affordable housing.

The government will not proceed with a number of unlegislated components of previous Coalition budgets, often called "zombie measures".

It's not important to go into these as they were unlegislated. What is important is that what I have detailed are proposals only and, as mentioned earlier, are subject to being passed not just by the House of Representatives but by the Senate where the government does not hold a majority. Given the noise out of Canberra since the budget, some of what I have discussed could become another set of zombie measures.

Will Hamilton is managing partner at Hamilton Wealth Management.

Guru turns his back on tribe

Opinion is split on whether the market will correct or not

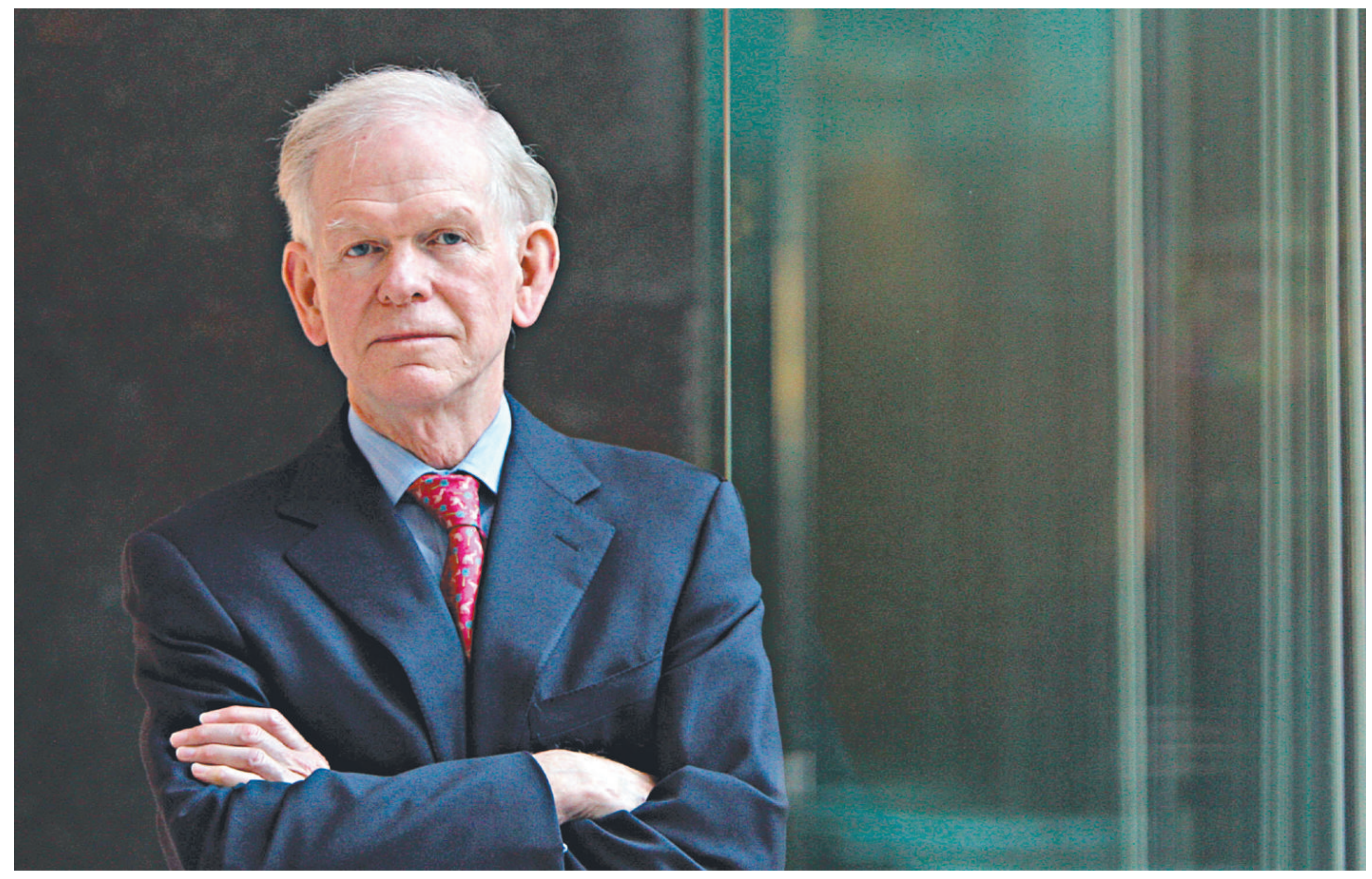
ROGER MONTGOMERY

Perhaps the four most dangerous words in investing are; this time is different. History shows, however, that it is never different, and the belief that today we are more educated, experienced or advanced than "last time", or that conditions have permanently changed, perpetuates the behaviour that is causing the problem.

A sign that we might be near the end is the preponderance of dyed-in-the-wool value investors who simply give up plying their trade and join the momentum. One case in particular — Jeremy Grantham — has concerned me because Grantham is one of the greatest. A regular visitor to Australia, the head of GMO investments has always been worth listening to.

As I read the latest GMO quarterly letter, I felt it demanded a response: how you respond will also determine your returns for the next decade, so a lot is riding on the answer.

Grantham argues against the background of interest rate settings that the most important inputs in equity markets have changed — they are prices and profit margins



JAMES CROUCHER

Jeremy Grantham is the co-founder and chief investment strategist at GMO, a high-profile US fund player

On prices

Grantham plots a "trend" P/E ratio for the S&P 500 and defines a trend as "a level below which half the time is spent". You might recognise this definition as simply the average.

Grantham then explains that since 1997 the highest P/E ratio achieved (during the tech boom) and the lows achieved shortly afterwards were both much higher than previously recorded booms and busts. He notes "the failure of the market in 2002 to go below 'trend' even for a minute should have whispered that something was different." Grantham then observes that even in 2009 — the depths of the GFC — the market P/E "went below trend for only six months". Therefore in the past 25 years the market P/E has only been below trend for six months.

This time is therefore different, and Grantham believes the market now oscillates normally enough but around a much higher P/E.

In 1927, John Maynard Keynes pronounced, "We will not have any more crashes in our time". In 1929, the year of the greatest stockmarket crash of all economist Irving Fisher, posthumously declared by Harvard economist Milton Friedman as "the greatest economist the United States has ever produced", said: "Stock prices have reached what looks like a permanently high plateau. I do not feel there will be soon if ever a 50 or 60-point break from present levels, such as (bears) have predicted. I expect to see the stockmarket a good deal higher within a few months."

The great crash began days later and plunged the world into the Great Depression. I couldn't help but compare Grantham's new, higher trend P/E to Fisher's permanently high plateau.

On profit margins

Grantham examines corporate profit as a share of GDP. This is the ratio that in 1999, Warren Buffett declared, "In my opinion, you have to be wildly optimistic to believe that corporate profits as a per cent of GDP can, for any sustained period, hold much above 6 per cent.

"One thing keeping the percentage down will be competition, which is alive and well. In addition, there's a public-policy point: If corporate investors, in aggregate, are going to eat an ever-growing portion of the American economic pie, some other group will have to settle for a smaller portion.

"That would justifiably raise political problems — and in my view a major reslicing of the pie just isn't going to happen."

I would argue corporate profits, in particular profitability as measured by returns in incremental equity is the most important factor in determining an equity investor's long-term return.

Grantham, who used to call profit margins "the most dependable mean reverting series in finance" makes the observation that between 1970 and 1997 the average or trend profit/GDP ratio was 3.8 per cent but since 1996 the average has been 4.5 per cent. He then asks the question "why did they stop mean reverting around the old trend?"

Here Grantham perhaps unwittingly declares another permanently high plateau.

Split the difference between these two numbers and you get 4.15 per cent. What is so significant about 1997? Why should the new average be calculated from that date onwards? Don't get me wrong, I hope he's right but I dare say he, like many other forecasters, won't be.

More directly Grantham points out that globalisation, which has made brands more valuable, steadily increasing corporate power and influence — consummated through the Supreme Court's Citizens United decision, Justice Department inertia with respect to anti trust matters, a decline in capital spending as a percentage of GDP, and cheap money failing to spur competition, suggests profit margins will remain elevated.

I cannot say whether the market will correct anytime soon but I do know when a genius value investor throws in the towel and joins the bullish bandwagon eight years after it commenced, it's worth being cautious.

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

www.montinvest.com

Bespoke portfolios give Cult the pick of buyers and cellars

DANIEL SHANE

Tom Gearing had a nose for fine wine from a young age. At just 13, he upstaged other bidders at a Christie's auction to secure a rare case of Domaine de la Romanee-Conti — one of the world's finest burgundies — at a knockdown price. Today, that same case is worth 800 per cent more.

Almost two decades later and the London-based wine investor is now sniffing out opportunities in Asia.

His company, Cult Wines — which he runs with his former Goldman Sachs banker father Philip — recently opened its first Asian office in Hong Kong. Globally, Cult Wines manages more than $40 million in investments ranging from ultra-rare vintages to more garden variety Bordeaux, which are benefiting from rising wine consumption in Asia.

Wine investment funds aren't really anything new, but Gearing — a former runner-up on Britain's edition of *The Apprentice* — says Cult Wines takes a more made-to-measure approach.

The firm doesn't offer any one-size-fits-all funds. Each investment portfolio is tailored to a client's specific needs, including their risk-profile, liquidity requirements and investment horizon.

Gearing says two people can walk through his door with $100,000 to invest each, and end up with two completely different portfolios. He calls it "a private bank approach to investing in wine".

The clients range from high-net-worth individuals to wine connoisseurs whose private cellars have become too unwieldy and need a professional touch.

Cult Wines uses its clients' money to buy both physical cases of wine and wine futures contracts. Cases of wine are stored in a government-bonded warehouse on investors' behalf, either in London or Hong Kong.

A portfolio depends on an investors' thirst for risk, but Gearing says up to 60 per cent in various Bordeaux is a good "bread and butter" position.

"World War III could happen but I can almost guarantee in the next 10-15 years people would still be consuming these wines because they've got such a great heritage and longevity," he says.

You could follow that up with 20 per cent in "up-and-coming producers" from the Burgundy region which enjoy "tight supply and ever-increasing demand".

That could be rounded off with Tuscan wines ("great value for money") or New World wines, such as those from California's Napa Valley. The latter are less liquid as these producers typically don't have great distribution outside the US, but the "long-term potential from a value perspective is very strong".

Many happy returns

Investing in wine can uncork big returns. The Liv-ex Fine Wine 1000 index tracks a portfolio of 1000 wines from across the world. It's up almost 25 per cent in the last year, beating stock gauges like the MSCI World index.

Of course, you do sacrifice liquidity for that. According to Gearing, fully divesting from a £100,000 ($174,000) portfolio can take weeks as buyers need to be found. It goes without saying that bottles of wine don't pay dividends, either. Still, he says, investors can look forward to capital appreciation of between 12 per cent and 15 per cent annually, which "a lot of people are immediately sceptical" of. In terms of fees he says Cult's portfolio managers are competitive. New clients can pay up to 15 per cent of their investment immediately, which will cover five years' worth of fees, or pay 5 per cent initially and 2 per cent a year thereafter.

Most of the money flowing to wine is from small, private investors. The wine market can also perform in rain or shine compared with other asset classes: For example, when stockmarkets are doing well people have more disposable income to spend on wine.

Long-term prospects from wine investing seem pretty good. Gearing says emerging markets are increasingly consuming and investing in wine. China is a prime example: while the world's second-biggest economy is now one of the largest consumers of wine, guzzling about $2 billion worth a year, its potential is still largely untapped, Gearing argues. Chinese, on average, drink 2.5 litres of wine a year. Compare that with Italians, who get through about 55 bottles of vino annually. Last year, wine imports into the Middle Kingdom jumped 20 per cent.

The one preconception he's keen to change is that wine is just for snobby connoisseurs. Not true, Gearing insists. "You don't need to be scared off by the fact wine's a huge subject. We break it down and make it very easy for people to invest."

In that case, bottom's up.

BARRONS

FLOAT WATCH

Miner's location key to fortunes

Macarthur Australia

ASX CODE: MMM
SHARES ON OFFER: 50 million
LISTING PRICE: 20c
MARKET CAPITALISATION: $37.7m
LISTING DATE: June 2

SIMON HERRMANN

An increasing number of small and mid-cap mining companies are listing on the ASX this year as the outlook for the metals and mining sector continues to brighten driven by price stability in commodities.

However, the deals so far this year have been average at best. The increase in IPOs is predominantly sentiment driven and the performance of these companies will largely depend on whether the recovery in commodities is sustainable. By the end of the year, the number of mining IPOs could exceed 30 or 40, but how many can actually survive?

The coming listing of Macarthur Australia is interesting due to its strategically located assets as well as existing lithium and iron ore projects. Macarthur Australia seeks to raise up to $10 million to fund exploration of its lithium projects and the development of its advanced iron ore assets, the Ularring Hematite Project. The lithium assets are at an early stage and could attract some interest, although the "lithium boom" could be at a mature stage.

The main catalyst, however, is the potential of a corporate transaction. Macarthur's iron ore assets are adjacent to the Koolyanobbing mine of Cliffs Natural Resources, a major iron ore miner, though one financially strained at this time.

Cliffs is a $US1.7 billion ($2.3bn) company listed in New York where the stock has fallen from near $US100 in 2011 to less than $US7 a share. Cliff is fully geared with debt matching its current market cap and, given the company's balance sheet pressure, there is impetus to "play ball" with neighbouring companies holding synergistic assets. In Macarthur's instance, we anticipate its Ularring Hematite Project could benefit from the ageing nature of Cliffs' Koolyanobbing Mine.

In 2015, junior miner Champion Iron agreed to buy the Bloom Lake mine in Quebec from Cliffs for $C10.5m at a low point in the cycle. The deal only presented itself due to the downturn in prices and Cliffs' financial struggles. Champion Iron's share price has increased fivefold since the acquisition.

The listing of Macarthur is possibly not suitable for risk-averse investors as a speculative appetite is required. However, as a joint venture or any other corporate transaction offers the potential for upside, we believe this IPO is worth another look.

Simon Herrmann is an analyst at wise-owl.com.