My 2018 checklist for investors

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Looking out 12 months is never easy, but most investors would agree conditions are as promising as we have seen them in many years. As an active investor the summer break is a good time to review what you have been doing in the last 12 months and, importantly, make some key decisions for the year ahead.

Here's my checklist for 2018.

Explore borrowing at low rates

Official rates remain at 1.5 per cent. In order to reach levels that central bankers regard as "normal" they would have to double to 3 per cent. In reality banks have tried everything to push the actual rates borrowers pay in the market higher. Home mortgage rates are close to 4 per cent or higher if you are an investor or interested in interest-only loans. Nonetheless, this extended era of low rates means that many investors can remain comfortable with borrowing to leverage their performance in any investment class, and that includes shares. (Remember negative gearing is not just for property).

ETFs remain market darlings

With the majority of brokers forecasting strongly positive returns on the ASX for 2018, it is a year which may very well suit index funds, or exchange traded funds. Brokers are looking at stock price increases across the market of 9 per cent with an additional 4 per cent from dividends. If the market is going to offer on average 13 per cent or anything near it, then there is a very compelling argument for ETFs, which simply reflect the performance of the index. Certainly, there are flaws in nondiscerning approach of ETFs, but for the year ahead they would seem to answer a lot of questions.

Don't miss a mining a rebound

It's been a while since the miners were front and centre of the investment scene — last year the mining index outpaced the wider market: The mining index returned close to 17 per cent against around 10 per cent for the wider market. What's more, there is every reason to believe the miners can do it again in 2018 with synchronised 3 per cent-plus global growth expected to push all resources higher.

Under this scenario household names such BHP and Rio are perfectly placed. On top of that there is the dramatic requirements that EVs (electric cars) are expected to place on selected resources: nickel, lithium, cobalt and graphite. Junior miners that supply into the EV battery market such as Syrah, Orocobre, Iluka and Galaxy are expected to benefit as electric cars move towards representing one in five cars by 2020.

Stick with residential property

Is it a soft patch or the long-anticipated disaster gloom merchants would have us believe? It looks for all the world like a soft patch engineered by the macroprudential restrictions regulators imposed on the banks this year. Yes, house prices are expected to be flat in 2018, but that is not a signal to sell property, rather it is a signal to hold on.

There is undoubtedly weakness in Sydney market and risks of further weakening in Melbourne. At the same time there are convincing signs that Perth will have a better year in 2018 than it did in 2017. There will be problems in inner city apartment projects and second-grade properties across all cities, particularly Brisbane. But with low interest rates and unemployment levels at less than 5.5 per cent, it does not represent a threat to mortgage servicing patterns ... that's the heart of the housing market.

Know your retirement sweet spot

Earlier this year the government announced major changes to superannuation which included new contribution caps coupled with subtle but severe restrictions on pension access. These changes have changed the dynamics of retirement savings. The system is absurd and now so poorly structured that you can quite literally get more income by saving less. Put simply in terms of annual income don't be in the middle zone! Wealth writer James Gerrard has estimated that the annual income of a couple who own their home with $400,000 get an income $52,395 a year thanks to Centrelink, a couple in the same position with $800,000 get $42,251.

Yes, of course it is better to have your own savings, but it is surely galling to know you can have a higher income if you save less.

Find your non-correlated assets

This is a bull market — know it when you see it. US and Australian shares are expected to return 10 per cent-plus in the year ahead. Tech stocks are selling at remarkable prices and then there is the unprecedented excitement around bitcoin. Sooner or later we will get a correction and eventually we will get a sharemarket crash. Non-correlated assets are assets that are expected to "perform well" when this happens. The last time the markets crashed in 2008 we found out the hard way that many of the newer breed non-correlated assets did not work — this would include hedge funds and a variety of products which are exposed to weakness in securities markets. There are two enduring non-correlated assets which have proved themselves in all weather: cash and gold.

• Cash: In Australia cash deposits have the exceptional advantage that they are guaranteed by the government at up to $250,000 (per person, per bank). Moreover, cash rates though historically low are inching higher.

• Gold now has a rival in bitcoin but it would be a brave investor who would depend on cryptocurrency when the RBA deputy governor Guy Debelle just this week blasted the cryptocurrency craze warning it was "a speculative mania".

Gold — the bullion not gold shares — proved to be a very effective non-correlated asset after the GFC and it will no doubt do it again in the future.

Should you buy some bitcoin for Christmas?

It's fine if you like to speculate, but not as a store of value

ROGER MONTGOMERY

As investors, what do we do about the cryptocurrency craze? Bitcoin and its peers, such as Ether, Litecoin, Zcash, Monero and perhaps even Filecoin are referred to, rightly or wrongly, as decentralised currencies. There is no central bank or entity that is involved in creating or transacting them. Instead, all that is required is a peer-to-peer network of hosts that agree on aspects of how the protocol is implemented and employed.

The way I look at it, bitcoin currency transactions are simply entries on a peer-networked ledger — called the blockchain — that is simultaneously agreed by multiple hosts. And because my identity in the system is really just a series of numbers that don't have to be tied to my physical identity, there is a level of privacy available — and taken advantage of.

It's this anonymity that is of particular interest to the European Union law enforcement agency, Europol, which has examined the growing role of Zcash and Monero on the so-called dark net, and observed: "Transactions cannot be attributed to any particular user/address, all coins used in a transaction are 'hidden' by default, and transaction histories are kept private." (To read how bitcoin actually works see The Coach column).

While cryptocurrencies are being used for exchange, they aren't yet generally accepted. Therefore, a significant proportion of transactions occurring in cryptocurrencies are not transfers for the purchase of a goods or service, but for speculation. And thanks also to limited supply, the resultant volatility brings into question their acceptance as a store of value.

Fiat currencies, like the Australian dollar, unbacked by gold and declared to be legal tender, have no secondary use. So in that regard, cryptocurrencies are the same — their acceptance as a conduit for payment stems from a belief that others will continue to use them to exchange goods and services in future.

And that future could be very large. Money supply multiplied by its velocity equals the price multiplied by the quantity of goods and services. In other words, the velocity of a monetary base is used to sustain an economy.

If you consider the size of an economy that can be sustained by cryptocurrency transactions, and if you keep in mind that there are less than 500,000 wallets worldwide with more than $US10,000 of bitcoin, the potential for much higher bitcoin prices is large.

On the other side of the fence sit some people who are at the very centre of this digital revolution. Olaf Carlson-Wee, the first employee at Coinbase — arguably the most reputable company through which digital wallets for cryptocurrencies are created, suggests bitcoin will never be a substitute for the US dollar. "It was a big mistake that any of this was ever compared to currency," he says.

Paying for goods and services with dollars is already seamless thanks to debit cards and the internet, and the advent of smartphone services will make transacting even more streamlined. So, according to Carlson-Wee, the world will not adopt cryptocurrencies because they and their supposed benefit of not relying on a central agency to prevent double spending aren't needed. There are also too many legal, regulatory and cultural hurdles on the way to mainstream adoption.

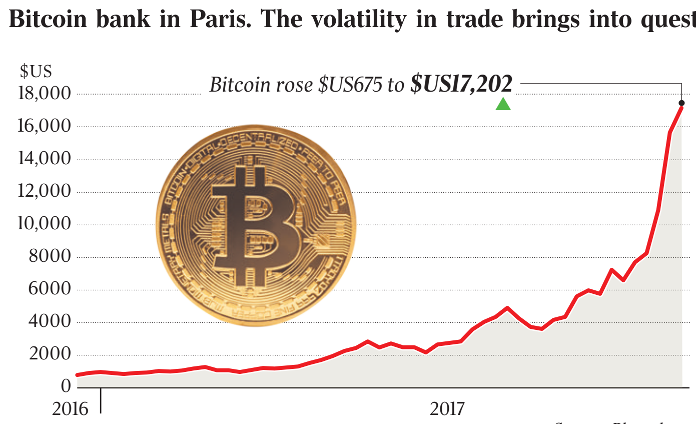
BLOOMBERG

A display at the La Maison du Bitcoin bank in Paris. The volatility in trade brings into question bitcoin's acceptance as a store of value

That leaves just the current trading of them as an investment — like gold — as a hedge against some changing of the guard. But given the drivers of the currency's underlying moves are unknowable, beyond the possibility of widespread adoption, precious metal-style speculation is why bitcoin's price is on the rise.

The price is going up because people *think* the price will keep going up. And that is speculation, pure and simple.

Others believe the future of bitcoin will be similar to MySpace — ultimately a failure but an early version of something much more successful and sustainable. Already alternative uses for decentralised networks are emerging.



Source: Bloomberg

The Ethereum platform's digital "tokens" function as digital versions of anything that holds value — not just money. Ethereum, for example, runs "smart contracts" — software programs that, in their simplest form, can send tokens to a friend at a future date, but could soon potentially drive entire decentralised autonomous companies.

Then, there's the Golem Project, an attempt to decentralise the world wide web. With the internet still run by central authorities like ICANN, the world wide web still has central points of failure. Golem is an effort to create an alternative system that's completely distributed with no single person, company or government controlling it.

If it all sounds like too much to take in, leave the speculating to those who think they can predict each parabolic rise and precipitous fall. Alternatively, if you are prepared to speculate on gold, bitcoin may turn out to be no different — providing a very similar return, which is hardly very promising.

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

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Can you please explain what bitcoin is and how it works?

Bitcoin is a form of digital currency. Created in 2009, it is the first example of a category of money or store of value referred to as cryptocurrency.

A software developer using the name Satoshi Takemoto devised bitcoin as an electronic payment system. The idea was to create a currency independent of any central authority. Unlike conventional currencies, bitcoin is unique in that it is decentralised. No government or central banks controls the bitcoin network.

There are only 21 million bitcoins in existence. However, these coins can be divided into smaller units. The smallest unit is one hundred millionth of a bitcoin and this is referred to as a "satoshi". You buy bitcoins either through cryptocurrency exchanges or directly from others via bitcoin marketplaces. Coinbase is regarded as the world's best known exchange. Be aware the exchanges do not offer the same capital protection as banks.

Bitcoin works on a peer-to-peer system. Transactions can take place between users directly, without an intermediary. These transactions are verified by computer network nodes and recorded in a public distributed ledger called a "blockchain". The transactions are verified and recorded by a network of nodes (or databases) on the internet. Because each node stores its own copy, there is no need for a trusted central authority (bank).

Designed to work as a currency, bitcoin is touted as a low-cost medium of exchange with international currency transfers costing a fraction of what, say, a bank may charge.

To buy bitcoins — or units of bitcoin you do not need to buy a "whole coin" — you must first establish a bitcoin "wallet". As there is no physical currency, the value is stored electronically. The process of establishing a wallet in Australia is akin to opening a bank account and subject to conventional banking requirements verifying identity and the source of funds. The ATO has stated that profits derived from bitcoin transactions are taxable.

Over the last five years, the price of bitcoin has soared from $US12 to over $US14000. Since I last wrote on this subject in July 2017, valuations have surged six times. Bitcoin enthusiasts see it as the currency of the future. An alternative view is that it is just another example of a bubble in an investment market.

The recent volatility in the value of cryptocurrencies is a warning. Here are a few reasons you should be very wary of bitcoin and cryptocurrencies. The primary function of any currency, crypto or otherwise, is to be a reliable store of value to execute trade. Cryptocurrencies are far from being a reliable store of value. The market has had numerous 20 per cent-plus setbacks in value, meaning huge losses if someone transfers funds into bitcoin for a transaction, say to trade an asset, but it collapses in value before the transaction is completed.

Bitcoin produces no income or yield, it's impossible to value and, unlike gold, it's intangible. The price could go to $100,000 but could fall to $10. China has already moved quickly on this front.

I admit I personally struggle to fully understand how it works and one important lesson from the "dotcom" era and the global financial crisis is, if you don't understand what you are investing in, you shouldn't invest.

Even if you do understand how bitcoin works, the cryptocurrency market exhibits all the hallmarks of a classic speculative bubble. I seriously doubt most investors are buying bitcoin for it's primary function, currency exchange, but rather to speculate.

Visit the Wealth section at www.theaustralian.com.au to send your questions to Andrew Heaven, an AMP financial planner at WealthPartners Financial Solutions.

Tech stocks a big draw as more Australians look offshore for diversification

JAMES GERRARD

We hear Australian investors are more ready these days to invest overseas, but what shares do they actually buy?

Yes, ETFs and conventional managed funds are high on the agenda as Australians take their first steps into the international markets, but a new survey from Class — the SMSF software group — offers a useful insight into the names and numbers behind the gradual diversification of Australian investors into direct overseas shares.

US technology companies make up 57 per cent of direct international share investments with the top three holdings being Apple, Google and Microsoft.

In fact, Apple is easily the biggest commitment made by Australian investors overseas, representing 11.4 per cent of all international share investments among SMSFs, that's almost twice as much as nearest rival Google (Alphabet) — Class A shares. The strong ties to Apple reflect the strong brand name of the company in our market, not to mention the very strong returns the group has delivered.

The top 10 offshore shares favoured by Australians

RANK	DESCRIPTION	% of funds with international shares that hold this security	% of total SMSFs with international share investments
1	Apple	11.4	4.7
2	Google – Class A shares	6.5	1.3
3	Microsoft	5.9	1.2
4	Google – Class C shares	5.7	11
5	Visa	5.0	0.9
6	PayPal	4.4	0.8
7	Amazon.com	4.1	0.8
8	IGas Energy	3.8	0.1
9	Lloyds Banking Group	3.7	0.8
10	Johnson & Johnson	3.6	0.8

While tech titans Google and Microsoft are also firm favourites, Australians are increasingly showing strong interest in the fast-moving world of payments technology with Visa and PayPal strongly represented. Online retailer Amazon is also a favourite with local investors able to offset possible weakness in our local retail sector by investing in the US-based group.

Amazon moved from 12th place to seventh over the last year while Facebook moved from outside the top 20 holdings to 11th place.

The first non-US stocks to appear in the lists are IGas Energy and Lloyds Bank, both listed on the London stock exchange.

In terms of what opportunities SMSF investors are favouring abroad, the trend is towards multinational companies that affect our day to day lives — there is little obvious interest in the traditional blue chips that have dominated Wall Street for generations.

To illustrate the point, although JPMorgan and Bank of America are two of the top 10 biggest companies in America, they are shunned by Australian SMSF investors and don't feature at all within the top 20 holdings.

As local investors build holdings in direct shares they are also accumulating ETFs and managed funds. The most popular ETFs are the iShares S&P 500, iShares Global 100 and Vanguard All World Ex-US Shares fund. The top three managed funds for overseas markets are Magellan Global Fund, Platinum International Fund and Platinum Asia fund.

AP

Apple makes up 11.4pc of all global investments by SMSFs

Alex Zaika, director at BlackRock's iShares business in Australia, says "the ETF market is growing for SMSFs. They like the diversification, ease of use and accessibility that ETFs bring to portfolios". SMSF trustees are also slowly becoming more comfortable investing beyond our shores says Zaika. He says the idea of SMSFs being overloaded with bank and mining stocks does not hold up.

"The simplistic view of Australia from overseas investors is that we are a bank next to a hole in the ground. It does, however, go to the point that many opportunities can be found outside Australia".

Analysing the Class super report, SMSF trustees have an evolving international share strategy. They still hold exposures to managed funds with the incumbents Magellan and Platinum being the two most widely held SMSF investments, but are gradually moving down a new path.

Other funds to feature on the lists include the Winton Global Alpha Fund, the Fidelity Australian Equity Fund and specialist funds such as the Macquarie Income Opportunities Fund and the RARE Infrastructure Value Fund.

SMSF trustees are realising that they can take more control of their international share investment activities by using a two pronged approach — ETFs and direct shares.

The exchange-traded fund is used to gain broad market exposure at a low cost and then overlaid with individual stock picks to outperform. An ETF such as the iShares S&P 500 fund has a low management fee of 0.04 per cent.

Traditionally, SMSFs would invest in overseas sharemarkets by using the investment expertise of a fund manager.

Today, clearly the pattern is changing and though fund managers are not off the radar, they are expected to offer a distinct way to add value or to offer a specialist approach such as finding offshore infrastructure opportunities not available in Australia.

From a trend perspective, however, the most interesting aspect of the report is clearly the willingness of retail and SMSF investors to directly enter offshore markets such as the US and Britain, where sectors such as technology and pharmaceuticals can offer share portfolio diversification, which is simply impossible on the ASX.

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