FINANCIAL REVIEW

SE Portfolio

HD **Winkle out the winners**

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WC 2,189 words
PD 26 November 2014
SN The Australian Financial Review
SC AFNR
ED First
PG 21
LA English

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Assets Certainty is a rare commodity in uncertain times, but diligent sifting by experts offers investors a variety of **firm** pointers across a range of classes, from stocks to the art showroom.

At any time in any market there are investments that are underappreciated, overlooked and cheap. Smart Investor took a tour of the asset classes – mainstream and esoteric – and asked the experts for their best buys.

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Global stocks are appearing on the radar of Australian investors and it's about time. But there's a lot to sift through and expert advice is needed.

Joe Forster, managing director of full-service global broker Fortrend Securities, says United States banks – hammered by GFC fallout and the compliance crackdown – are screaming buys. In a classic contrarian viewpoint, Forster says the banks that have just been forced to pay the largest amounts to settle lawsuits – $US16 **billion** ($19 **billion**) in the case of Bank of America and $US13 **billion** in the case of JPMorgan – are the best buys.

"It doesn't matter what the price-earnings ratios are. What you're buying in the banks is the recovery, after a long time, in the creative, positive mindset of the banks, to develop new products and **business**," he says. "On the back of that, financial services will grow and it has huge room to recover in terms of its weighting in the S&P 500."

The big software companies – Oracle, Microsoft and SAP – stand out as overlooked, he says, on very undemanding P/Es of 12.5 to 15 times.

The US market is also undervaluing the major progress being made in therapeutics. "For a **company** that is knocking hepatitis C out of the **park**, Gilead Sciences shouldn't be trading at 10 times [forward] earnings," says Forster. "Gilead is dirt-cheap."

David Walker, a senior analyst at StocksInValue.com, nominates a surprising name as one of the most overlooked stocks he can find in the Australian sharemarket: Queensland **coal** producer New Hope. After all, New Hope has been pounded on the back of the slump in thermal **coal** prices, and has lost 25 per cent this year.

But Walker sees this as a sentiment downturn that has gone too far. "Our fund partners, Clime Asset Management, value New Hope at $3, but it is trading at $2.47."

New Hope faces "multiple sentiment headwinds", says Walker: a strong Australian dollar, low **coal** prices, a slowing **Chinese** economy and mounting anti-**coal** sentiment on the back of climate change concerns. But the thermal **coal** investment story is "simply not over at this point in time", he says.

"Yes, the use of renewable **energy** will increase in time, and **coal**'s share of the **energy** mix will fall, but at the moment, **China** needs **coal** – and it is precisely New Hope's high-quality, low-sulphur, low-ash, low-moisture **coal** that it most needs to help solve its pollution problems.

"Until the price recovers, New Hope has a very strong balance sheet and can continue to ride out this downturn."

Consumer sentiment is behind his view of global travel agency operatorFlight Centre as under-valued. "We value the stock at $45.30, against a share price of $39.69. It's well-managed and it has a very good organic growth plan, and it is well leveraged to a recovery in sentiment.

At around $38.50 you could **buy** this stock on a fairly comfortable margin of safety," says Walker.

ANZ Banking **Group** is another undervalued stock, he says: it is "the cheapest of the major banks, without the risks of NAB". Clime values ANZ at $37, making the share price, at $31.86, an implied discount of 13.9 per cent.

Louis Christopher, managing director of **property** research **firm** SQM Research, has one word for **residential property** investors: "Hobart." Christopher says the southern capital stands out for cheapness on a house prices-to-income basis.

Christopher likes to look at the asking prices – the advertised prices, or what sellers want for their houses – and compiles a weekly asking price index.

"We think it is more timely data than **transactions**, and there is a very strong correlation between the asking price index and ABS House Prices." In Hobart, he says, the median house asking price is $388,000, while for units it is $253,000. That compares to an average capital-city median of $725,000 for houses and $480,000 for units.

"Hobart is significantly cheaper, and it also has some of the highest rental yields in Australia: a two-bedroom unit is showing an average yield of 5.5 per cent, while a three-bedroom house is showing an average yield of 4.8 per cent – both well above the national average. Vacancy rates – which were running at 3 per cent back in July 2012 – have come down to 1.3 per cent, which represents a landlord's market," says Christopher.

He also likes the stock-on-market statistic. "There is plenty of stock, but it is being absorbed at a quicker rate. Back in December 2012 there were 4800 properties on the market in Hobart: there are now about 3400. When listings go to low levels there are more buyers than sellers – which means upward pressure on prices. Hobart may be Australia's true south – but its **residential property** market is going north."

With most big overseas and domestic investors in Australian **property** targeting "core" **property** – meaning prime office, the best regional shopping centres and the top industrial properties – and "still wanting to be conservative", investors looking for more value are looking at "secondary and metro assets", says Nerida Conisbee, national director of research at Colliers International. At that level, secondary industrial "stands out as good value with generous yields", she says.

By secondary, Conisbee means "older-style" properties, not new facilities, and with weighted average lease expiries (WALEs) profiles that are under five years.

"Secondary properties with long leases are very hard to find. In Sydney and Melbourne, areas such as South Sydney, Port Melbourne and Richmond respectively, are providing investors with some good income-generating and development change-of-use opportunities. However, local market knowledge is paramount to developing successfully. **Residential** conversions have been popular with offshore developers catering to the demand for apartments."

The most affordable, secondary industrial market is Adelaide – but the flipside of that is that "leasing demand is fairly weak", she says.

Conisbee also likes large-format retailing – bulky goods, furniture, bedding – big-box retailers, put together in a mini-shopping-centre. "After the GFC, investors avoided bulky goods retail, driving down their price but the investors are now back, increasing values, but value still remains for investors looking for assets in well-serviced locations close to growing **residential** areas," she says.

Justin McCarthy, director financial institutions and corporate research at specialist fixed-income broker FIIG Securities, says the "best-value bond in the Australian market-place" is Sydney Airport's inflation-linked bond, maturity date 2030, which is showing a return of 3.8 per cent over inflation. McCarthy estimates that represents a yield to maturity of 6.3 per cent, using an inflation assumption of 2.5 per cent. "That's a pretty good return in the current environment. This compares to the 2030 Commonwealth Government Inflation Linked Bond, which is trading at just 1.20 per cent over inflation."

Second-best value, he says, is Qantas's fixed-rate bond maturing in 2022, which is showing a yield to maturity of 6.7 per cent, or 3.25 per cent over the bank-bill swap rate.

"That security has a credit rating of BB+, which is sub-investment-grade, but first-quarter guidance was for a return to profitability, and the risk-return trade-off is OK," he says.

"We like the fact that Sydney Airport has a very diversified portfolio of income streams," says McCarthy. Aeronautical revenue represented 49 per cent of the airport's revenue at the June 2014 half-year), followed by retail (22 per cent), **property** leasing (17 per cent) and car parking (12 per cent).

Sydney Airport has an investment-grade (BBB/Baa2) credit rating.

While there is no expectation for a rate rise until at least end of 2015, at some point the yield curve will steepen in anticipation of tighter monetary policy, says Steven Wright, director of fixed interest and wealth products at Morgans. This means that investors should be looking at floating-rate securities in anticipation of higher bank bill rates over time.

With banks continuing to try to claw back margin on term-deposit pricing, Wright says yield-oriented investors continue to look to the ASX-listed interest bearing securities market, and shares, for yield.

Good value for a diversified portfolio can be found, he says, in Tatts **Group**'s listed senior bond TTSHA, maturing in July 2019, which offers a margin of 3.1 per cent over the 90-day bank bill rate – which Wright says represents a yield to maturity of 5.33 per cent.

"That's attractive for a senior-ranking security. It's a good diversifier when combined with lower-ranking subordinated portfolio holdings."

The Origin **Energy** subordinated debt note (ORGHA), with a call date in December 2016, offers a margin of 4 per cent over the 90-day bank bill rate, or a yield-to-call of 5.98 per cent. "It is extremely likely that Origin will call this security," says Wright. "In the meantime it represents a pretty attractive short-term yield."

The art investment market is "almost back to pre-GFC clearance rates and dollar values," says Ralph Hobbs, director of art at Sydney-based art investment advisory **firm** Art **Equity**, but there is still plenty of value to be found.

Hobbs says senior artists such as Rick Amor and George Gittoes have become very important culturally, with many major exhibitions to their credit, but are still "yet to set the secondary market on fire", and represent great upside potential. Hobbs says you can pick up a Rick Amor **oil** for in the range $10,000 to $150,000, while a Gittoes **oil** will set you back $10,000 to $120,000.

"For the collector and the investor looking at exciting future great artists, names such as Robert Doble, James Drinkwater and Giles Alexander are artists that have gained curatorial and **commercial** success and are keenly sought after, and over the longer term should do well in the **sale** rooms." He says price ranges are $5,000–$25,000 for a major Doble **oil**, $1,000–$7,000 for a Drinkwater and $5,000–$49,000 for an Alexander. The much-maligned indigenous art market "still has some gems by the greats", he says, including the late Bill Whiskey, where availability of stock is limited, but "his importance will undoubtedly keep prices solid into the future.". Buyers can expect to pay between $20,000 to $200,000 for a Whiskey acrylic.

Precious metals are cheap – but they can "get a whole lot cheaper," says Mark van der Sluys, bullion dealer and adviser at BullionMark. He says there was a huge upswing of investment into precious metals from 2011, and the overallocation that ensued is being "systematically unwound" .

"Palladium incurs GST in Australia, platinum is not well-understood, so people go to **gold**. Silver is loved or hated because of volatility, which leaves **gold**. **Gold** went from $US400 an ounce to $US1900 an ounce and has come back to $US1200 an ounce. **Gold** is cheaper than it was, but we think that is a natural backswing from 2011. We think **gold** is cheap, but we would recommend dollar-cost averaging into it, because it can get cheaper …" says van der Sluys.

British fund manager Ben Davies, CEO of Hinde Capital, says risk and reward factors are more favourable for **gold** than for any other investment. "**Gold** is the only asset class in the world where the risk of a 10 per cent loss is probably all you can see, and at the same time the upside is staggering,"

Luke Campbell, **wine** consultant, personal sommelier and director of Vinified **Wine** Services, actually tries to dissuade his clientele – high-net-worth investors and self-managed super funds – from investing in **wine**. He says the right fine **wine** can achieve a non-correlated return of 10 per cent – but clients must have realistic expectations, and invest in something they ultimately want to drink. Much **wine** investment revolves around clarets, burgundy and bordeaux, but Campbell says there are good Australian wines that can be expected to increase in value over the next decade.

He nominates: the 2012 Bass Phillip 'Premium' Pinot Noir from Gippsland, Victoria ($190+); the 2010 & 2012 Bindi Block 5 Pinot Noir from Macedon, Victoria ($120+); the 2006, 2009 & 2010 Torbreck Descendant Shiraz Viognier from the Barossa Valley, South Australia ($125+); the 2010 & 2012 Wild Duck Creek Reserve Shiraz from Heathcote, Victoria ($125+); and the 2000 & 2010 Howard **Park** Abercrombie Cabernet Sauvignon from Margaret River, Western Australia ($85+).

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