



Investors make hay while sun shines on Aussie dollar

Across the asset classes, the near-parity exchange rate is presenting more opportunities to diversify overseas

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FOR many Australian investors, the high Australian dollar is a godsend, allowing them to buy into overseas assets virtually at a one-for-one currency basis.

There is still currency risk. If the Australian dollar were to appreciate to \$1.10-\$1.15, the purchase would be worth up to 15 per cent less immediately but plenty of investors are prepared to face that risk to diversify overseas at levels that minimise the currency loading they normally pay.

"For the first time in living memory for Australians, the rest of the world is on sale," says Jim Stening, managing director of fixed-interest broker FIIG Securities.

"In terms of overseas assets, Australians have never been able to buy this much bang for their buck."

That is a common refrain around each of the major asset classes, where investors are treating near-parity exchange rates with the US dollar as an opportunity to buy overseas assets with the least currency dislocation in more than 25 years.

Shares

Interest from Australian investors in buying directly into foreign shares has increased in the past decade, says Fabiola Gibson, first vice-president at Morgan Stanley Smith Barney, but the high exchange rate has "definitely boosted" this interest.

"It has been an argument that has been becoming more compelling, that you've got to have overseas diversification, and with many of the big household-name

foreign stocks you get a really global exposure with, in many cases, very significant exposure to emerging markets, which every investor needs," she says.

"Stocks such as Nestle, Procter & Gamble, Unilever, Kraft, McDonald's, Apple, Google and [luxury goods companies] LVMH and Richemont: keep in mind that the Aussie is also strong against the euro and sterling at present.

"That was a compelling argument at US75c, compelling at 85c, and is even more compelling at 98c because the currency penalty you have to pay is very low."

Gibson says buying this kind of stock at close to US dollar parity gives investors a high likelihood of making a "double whammy" gain on both the shares and the currency.

"There is still currency risk. Most forecasts are still expecting a stronger Australian dollar for a period. We've got a potential rate rise in November and there are certainly catalysts there for the currency to strengthen further.

"But over the longer term there is an expectation that the US dollar will recover and that the Australian dollar will return to a lower trading range.

"So it's certainly a reasonable expectation that there will be a currency gain on top, but what Australian investors should be thinking about is the chance for strong equities gains on some very high-quality global stocks, bought at very favourable currency terms."

The clincher, Gibson says, is that the stocks in question are attractively priced.

"Many of these stocks look very good from a valuation standpoint as well," she says. "For example, Google, which used to trade on 25 to 30 times earnings, is currently on 18.5 times estimated 2011 earnings. Nestle is one of our strongest global stocks [and] 2011 price-earnings is 14.6 times. Australian investors have both the valuation of the stock and the exchange rate in their favour."

Brian Phelps, general manager of distribution, business and private banking at CommSec, says the broker's international desk is writing 50 per cent more international share trades than it was three months ago and the brokerage from its international desk has almost doubled in the past six months.

"We've seen a big spike in clients buying overseas shares," he says.

"Over the past few years the diversification argument was steadily lifting the interest in this part of our business, but clearly the rise of the Australian dollar has lifted it significantly of late.

"Investors are definitely seeing that they're in a position to buy at close to one-for-one and get a currency top-up on top of the equity gain as the Australian dollar declines."

Phelps says clients are mostly sticking with the blue-chip US stocks.

"It's mainly US and it mainly always has been for us, although we have access into most of the major European and Asian markets," he says.

"The US accounts for 90 per cent of our international volume."

At present, the 10 most active stocks CommSec clients are buying are Apple, Citigroup, General Electric, Bank of America, Google, Oracle, Exxon Mobil, Microsoft, Berkshire Hathaway (the investment firm run by Warren Buffett and Charlie Munger) and Caterpillar.

The attraction of foreign shares is not just the diversification aspect, he says. While that is important, it is arguably more significant that international shares give investors far greater ability to participate in global investment themes than if they confined themselves to Australia.

"For example, an investor who believed the development of the BRIC [Brazil, Russia, India and China] economies will lead to increased demand for commercial aviation might invest in Boeing,

or EADS [the parent company of Airbus]," he says.

"Or an investor convinced that electric and hybrid cars will be the next automotive revolution might buy the leaders in the field, Toyota and Tesla Motors."

Exchange-traded funds

What is working for Australian investors in buying overseas shares directly is also working for them at home in the exchange-traded fund market, where a wide variety of overseas investment exposures is suddenly much cheaper in terms of the currency loading that investors usually pay.

Of the 33 ETFs listed on the Australian Securities Exchange, each giving single-stock exposure to an index, asset portfolio or commodity, 18 are international ETFs, denominated in US dollars. ETFs are a fast-growing sector of the investment market: they are much cheaper than managed funds, with no entry and exit fees, and an annual fee that can be as low as nine basis points (0.09 per cent) a year. Also, investors pay only normal ASX brokerage when buying and selling the ETFs.

International ETFs comprise the 16 stocks in the iShares range, managed by Black Rock, and two ETFs managed by Vanguard.

The iShares track the Standard & Poor's 500 index (ASX code: IVV), the S&P Global 100 companies index (IOO), the S&P Europe 350 index (IEU), the S&P US MidCap 400 index (IJH), the S&P SmallCap 600 index (IJR), the Russell 2000 US small-cap index (IRU), the S&P Asia 50 index (IAA) the MSCI EAFE (European, Australasian and Far Eastern markets) index (IVE), the MSCI Emerging Markets Index (IEM), the MSCI BRIC Index (IBK), the MSCI Japan Index (IJP), the MSCI South Korean Index (IKO), the MSCI Singapore Index (ISG), the MSCI Taiwan (ITW), the MSCI Hong Kong Index (IHK) and the FTSE Xinhua China 25 Index (IZZ). The Vanguard pair is the Vanguard All-World ex-US Shares index (VEU) and the Vanguard US Total Market Shares index (VTS).

Each of these ETFs is denominated in US dollars and unhedged: investors are exposed to currency fluctuations. But this

means that at the present high exchange rates the international ETFs give investors the opportunity to lock in the cheapest access to overseas markets, through ETFs, they've been able to get, says Mark Holzworth, director of IndexInvest, a specialist portfolio adviser on index-based investments.

As with direct shares, Holzworth says investors buying international ETFs on the ASX must accept the Australian dollar could go higher against the US in the short term, putting them behind the currency eight-ball.

"We're finding that investors are prepared to accept that risk in the short term [to be] in the marketplace at the time that one, the US dollar recovers, and two, that US markets return to favour and particularly, the Asian and Latin American markets continue their strength," Holzworth says. "The exchange rate, where it is, simply represents a really good chance to buy cheaply into overseas exposure."

Holzworth says the beauty of ETFs is they can be highly targeted.

"For example, we've been overweight in Singapore: Singapore is on track to record economic growth of 13 to 15 per cent.

"Everyone is banging on about China having delivered 8 to 9 per cent, but Singapore shoots it down. We've also been overweight in South Korea.

"There's no active managed fund that gives you direct access into Singapore, South Korea or Taiwan: there are no funds that give you that targeted exposure, apart from ETFs.

"We've been able to build portfolios that have delivered high double-digit rates of return over the past 12 months, purely through being able to target markets where we see not only market value, but where there's still underlying growth in the economy."

While the underlying markets chosen have performed well, Holzworth says the returns have been affected by the rising Aussie dollar, but with the window of the exchange rate being close to parity with the currency in which the ETFs are denominated, he says international ETFs represent a "compelling argument".

"Near-parity is making switched-on investors think that if they didn't already have exposure to the emerging Asia story, they can use this very healthy exchange

rate to lock it in cheaply now.

"And locking it in at close to 1:1 will be worthwhile if the Australian dollar falls because you will make money on that currency exposure as well."

On the same reasoning, Holzworth says his firm's larger portfolio clients are interested in the smorgasbord of ETFs traded in US dollars on the New York Stock Exchange.

"For instance, Peru has been showing 9 per cent growth: you can buy an ETF for Peru on the NYSE. Or they might want a Russia ETF," he says. "There are a lot of opportunities that people are looking at. They were interested in the exposures before the currency rose, but it makes more sense the higher the currency goes."

Fixed-income

Fixed-income broker Jim Stening is a frustrated man. The high exchange rate of the Australian dollar is bringing plenty of interest from his clients for corporate bonds denominated in US dollars or euros, but he has none to offer them.

These bonds usually trade in wholesale parcels of \$500,000, and although Stening's firm runs a service called Direct Bonds, which breaks these wholesale parcels down into smaller minimum investment sizes of \$50,000, getting approval to cross the divide from wholesale to retail investors can prove tricky.

So far, anyone wanting to buy a foreign-currency corporate bond needs to meet the "sophisticated investor" test: they need net assets of \$2.5 million or gross income for each of the past two financial years of at least \$250,000, certified by a qualified accountant.

Direct Bonds has been able to offer Australian retail investors the chance to invest in foreign borrowers such as Swiss Re and AXA through Australian dollar-denominated bond issues, but Stening says there is increasing interest in foreign-currency bonds as a way of investing some money offshore to take advantage of the high dollar.

"High-net-worth investors are definitely more interested than ever in foreign-currency-denominated Australian bonds," he says.

"There are a number of Australian issuers that have issued bonds denominated in US dollars or euros.



“For Australian investors who are comfortable with Australian corporate names, for example the banks, and who want to take advantage of the higher dollar by putting some money into another currency, they can buy bonds issued by, say, ANZ in US dollars, euros or sterling.

“But unfortunately at the moment, in most cases, even if the parcel size is broken down to \$50,000, under the terms of the issue, you have to be a sophisticated investor. But we’re working on getting those parcels down.”

It is the same, he says, with government bonds, which still have to be offered in wholesale parcels.

“We’re working on getting these down to \$50,000 size. We think it’s going to be simpler for a lot of investors to buy the government bonds of the various countries: you don’t have to stray outside the sovereign debt to take a currency position,” says Stening.

“For example, US bonds at the moment offer very little in yield terms, but if the Aussie weakens you have an appreciating asset.”

Joe Forster, managing director of full-service (advisory) international share broker Fortrend Securities in Melbourne, says his clients are picking up healthy yield opportunities through the US ETF market, in particular the S&P Preferred Stock Index iShare ETF (PFF).

“That’s showing an indicated yield of 7 per cent. It’s an ETF that invests in preferred stock, which sits between equity and debt. It’s not debt but it’s between,” Forster says.

“You get 7 per cent yield on that, through exposure to a range of different industries, global blue-chip issuers like GE and Wells Fargo and Ford. That yield looks even better if you’re thinking that the Australian dollar is eventually going to retreat from these levels.”

Cash

At the shortest end of the fixed-income market, cash, there is a lot of activity in foreign currency deposits, says Steven Wright, head of fixed-interest at RBS Morgans.

“That’s a pure currency play,” he says. “People aren’t viewing the strength of the Aussie as something that’s sustainable.

“They’re making deposits in US dollars, euros and pounds, where the Aussie has been very strong lately. They’re expecting to see the Aussie come off from these levels over the medium term and their overseas cash to be worth more.



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JIM STENING
 FIGG SECURITIES, LEFT

“Plus they can spend some of it while they travel, which with the Aussie at 98c, most of them seem to want to do.”

Property

With an exchange rate close to 1:1, Australian property investors are increasingly looking to the US for entry-level investments, according to John Jones, marketing manager for House Buyers USA, an Australian-owned business that renovates and sells homes in the US.

Jones says House Buyers USA is doing good business in putting Australian property investors into foreclosed properties that he says have been fully renovated and are tenanted.

“People have had to bale out of houses that might have been worth \$120,000 to \$130,000, and these properties are coming on to the market at around the \$20,000 to \$40,000 range because there are only cash buyers buying them. There is entry at price levels that have gone in Australia long ago.”

As the dollar has approached parity, there has been a surge in interest, says Jones.

“It’s an exciting time at these exchange rate levels because it makes it easier. We’ve had a lot of clients who were thinking about it at 85c but decided to do it at 96c to 97c.

“When you’re only spending around \$40,000 and getting a renovated property in America that is rented out and returning you about \$100 of positive cash-flow a week, it’s attractive.”

Jones says there is also increased interest from self-managed super fund clients, some of whom have approached the Australian Taxation Office for private rulings on buying a rental property in the US.

Peter Jacob, managing director of specialist high-net-worth advisory firm

Alphington Private Investor Services, says investors should be careful about buying property in another country.

“I would be very worried that Australians, with their love of property investment, might be looking at these markets as if it is the Australian context, but these houses might well be cheap for a very good reason,” Jacob says.

“Generally speaking I think these properties are in substandard locations. Put it this way, while high-net-worth investors are certainly looking to go into US equities at these exchange rates, we don’t see much interest in US property.”

Jacob is also concerned at the prospect of investors borrowing in Australia and having their debt in Australian dollars but having their income and their asset in US dollars.

Forster says US commercial and office property real estate investment trusts are attracting a lot of investor interest.

“US commercial real estate is a great place to be,” he says. “They have very good yields, they have a tax incentive in the US that’s much like franking credits: if the REIT pays its income out it’s not taxable at corporate level.

“We’re seeing a lot of interest in commercial office REITs; stocks such as SL Green, which is focused exclusively on owning and operating office property in Manhattan, and Boston Properties, a REIT that specialises in office properties in Manhattan, Boston, Washington, DC, and San Francisco.

“Our clients have also been buying the FTSE NAREIT Industrial/Office Capped Index Fund ETF, which seeks to match the performance of the FSTE NAREIT Industrial/Office Capped Index.

“In the US banks aren’t allowing a lot of commercial property to come to market, which limits supply and keeps prices high.

“The pricing environment for the very few transactions that are actually getting done is very competitive. The REIT market in the US is the place to be because all the sovereign wealth funds are chasing that asset class. We’re pouring clients into US REITs.”



Peaks and troughs

Australian dollar against the US dollar

