

Know the risks, reap the rewards

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High-risk hybrids

High-risk hybrid securities offer adventurous investors seeking income the most competitive returns.

Brad Newcombe, head of research with fixed interest broker FIIG Securities, says the distinguishing feature of most of this group of assets is the double digit yield they often offer.

The income or running yield of a hybrid is the income payment divided by the current price less any interest that has accrued and is waiting to be paid.

Two of the high-risk hybrids – Multiplex Sites Trust and Australand Assets Trust – have been on FIIG Securities' recommended list for some time.

They offer yields of 11.4 per cent and 10.5 per cent respectively. Other high-risk hybrids include offerings by timber group Gunns, property group Goodman, rural group Elders and paper merchant Paperlinx.

High-risk hybrids are a type of investment described as step-up preference shares and which pay income of 2 to 5 per cent above the rate for 90-day bank bills.

After a set period of time, say five years, they are either bought back by the company at the price they were issued – which is generally \$100 – or the income “steps up” to a higher rate to compensate investors for non-redemption.

The step-up rates are 1 to 2.5 per cent. The risk investors face with these investments is that if the company decides it won't redeem the shares they can become perpetual investments, although they can be sold through the market.

Clime Investment Management investment director John Abernethy says one aspect of hybrids is their scope to outperform shares in a recovering market.

In addition, the income on hybrids can be attractive for more adventurous retirees on pensions.

Compared with annuities that pay 5 per cent, a portfolio of hybrids with different risk profiles – including high-yielding hybrids that pay from 8 to 11 per cent – can be quite attractive.

Currency speculation

Over the past six months, encouraged by the firming Australian dollar, currency speculation has become popular among short-term traders who previously traded in contracts for difference over shares.

Surveys of traders attracted to CFDs suggest about half have added currency speculation to their activities, says Alex Douglas, general manager of online foreign exchange provider Interbank FX.

Dan Perry, Australian managing director with international forex broker FXCM, says one thing that has attracted some people is the ease with which it is possible to enter the currency trading market.

While the average aspiring trader has about \$3000, people can dabble in currency speculation for a few hundred dollars.

Currency products are mostly contracts valued at 10,000 units of the currency quoted on the left-hand side of a currency pair – for example the \$A in the case of an \$A-\$US currency pair.

There are also smaller micro or mini contracts with a value as low as \$25.

Like contracts for difference, currency traders can take positions for a fraction of the currency contract value, such as 1/200th of the value. It gives them the opportunity to test strategies with a very small outlay, says Perry.

An alternative way of trading currency is through a new exchange traded fund (ETF) that mirrors the performance of the American dollar.

The Betashares US Dollar ETF is structured to profit if the American dollar recovers against the Australian dollar, says Betashares head of investment strategy Drew Corbett.

For about \$10, investors can buy units backed by US dollars held in a bank account with JP Morgan Chase Bank.

As well as paying a modest level of income to investors, advisers suggest this ETF is a low-cost way of speculating against a potential weakening of the \$A.

For instance, if the \$US recovers 10 per cent against the \$A, which some believe is a possibility in the year ahead, the price of the ETF should mirror it, less management fees of 0.45 per cent and brokerage.

Exchange traded funds

For more adventurous ETFs, there are products that invest in emerging markets such as Indonesia, Thailand, Malaysia, Chile, Peru and Taiwan. Or you can invest in Brazil, Russia, India and China through a single product.

While some emerging markets have delivered strong local returns of 30 to 40 per cent over the past 12 months, the rising Australian dollar has worked against Australian ETF investors.

When overseas investments are converted back into Australian dollars, their value goes down.

There are also exchange traded commodities which are not funds per se but allow people to invest in gold, silver and other metals which have performed strongly in recent times.

Peter Tardent, from broker Commonwealth Securities, says there has been a surge of interest in ETFs over the past few months stimulated by advertising by a number of providers.

"They are certainly attracting attention and people are asking more about them," he says.

ETFs compete against managed funds, offering self-directed investors such as those with do-it-yourself super funds, opportunities to buy lower cost managed investments that follow strategies such as mirroring the performance of various market indexes, both local and international.

Margin lending

Borrowing money to invest in shares is great when markets are rising but needs to be scrupulously managed during uncertain times – be sure you can manage the ups and downs that inevitably occur with this strategy.

The aim of margin lending is to make gains from shares even bigger than otherwise possible and it was the hottest strategy for adventurous investors during the 2005-07 bull market.

But the subsequent market collapse highlighted a major issue with this strategy – the shares bought with a loan are held as security.

Many investors were forced to sell their shares as the values plummeted during the global financial crisis because this security shrank dramatically.

This inherent problem makes advocating margin investing a delicate topic. It is a strategy all investors should fully understand before attempting.

With margin investing there are maximum borrowing limits of 60 to 70 per cent of the value of the shares bought. But share prices fluctuate daily so a loan is constantly reassessed.

Margin is money you borrow from a bank, financial planner or broker, similar to a loan, that you then use to buy shares.

If share prices increase, so does the amount that can be borrowed. The opposite holds true – as prices fall, the value of collateral falls.

If the value declines below a predetermined minimum, investors receive a margin call from their margin lender or broker. This requires that they either sell part of their existing position or send in more money to increase the value of the account back above the predetermined level.

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