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# money

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## How to get decent returns in 2012

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# A decent return can be found

**John Collett** goes in search of investments that will perform better than term deposits.

Given the dreadful state of investment markets, most investors would seize any opportunity to earn 7 per cent a year.

Two years ago, all investors had to do to earn that much was put their money into term deposits.

Now the best 12-month term deposits are paying only about 5.5 per cent a year, although a bit more can be earned with longer maturity dates and larger amounts. Even so, the most you will get on a five-year term deposit is about 6 per cent, says a financial analyst with Canstar, Adam Beu.

The chief investment officer at ipac Securities, Jeff Rogers, says: "The world is no longer as generous a place for investors." Investors chasing a return of at least 7 per cent have to be prepared to take on some risk, he says.

This means people need to consider other investments, such as managed funds that invest in bonds or high-yielding shares, Rogers says.

Returns on investments with absolute capital security, such as term deposits, are likely to go even lower as investment markets struggle under the weight of Europe's debt crisis, concerns about US economic growth and Chinese inflation.

The Reserve Bank of Australia cut the official cash rate by a quarter of a percentage point twice last year – once in November and again in December.

And when the board of the RBA

meets early next month, it could cut rates again in the face of slowing global economic activity. The market is expecting the RBA to cut rates three times in the first half of this year.

Online saver accounts, which usually have daily liquidity, are paying annual interest rates of between 4.25 per cent to 5 per cent, though some have bonus and promotional rates on top of that, Beu says. To get those bonus rates, about half a percentage point, a minimum account balance may have to be maintained or a minimum amount must be deposited regularly into the account. Sometimes, the bonus rate is paid only for a limited period after the account is opened.

The interest rates paid by online saver accounts and term deposits by banks, credit unions and building societies are determined by a number of factors. They are influenced by the official cash rate, the outlook for the cash rate and the competitive positioning of the providers.

But the great attraction of cash and of term deposits is their absolute capital security because of the government's deposit guarantee. That's the trade-off for investors, as other investments do not have the guarantee. The guarantee was brought in during the height of the GFC to reassure investors their deposits would be safe; not that there was ever any danger that deposits were at risk. The guarantee came in three years ago at

\$1 million a person, per financial institution. From February 1 it will be reduced to \$250,000.

## BOND FUNDS

Rogers favours corporate bonds for investors willing to take on some risk to get a 7 per cent return.

Fixed-interest securities such as bonds do not have the government deposit guarantee. Small investors are best advised to get exposure to bonds through managed funds so as to get sufficient diversification.

Many bond funds will have an exposure to global bond markets as well as a core holding of bonds issued by Australian companies. Investors could use a combination of an Australian bond fund, which is expected to return about 6 per cent over the long term, in combination with a managed fund with a growth portfolio to produce the required 7 per cent, Rogers says.

The growth portfolio could be accessed through a managed fund with significant exposure to shares and listed property. Managed funds are well suited to small investors. Most funds have regular savings plans where investors can have money deposited into the fund regularly.

## CORPORATE BONDS

For those with larger amounts to invest, investing in corporate bonds directly



could make more sense than investing through a managed fund. For a start, investors avoid the fund managers' ongoing investment management fees.

The director of fixed-income research at FIIG Securities, Elizabeth Moran, says bonds issued by Suncorp Insurance and Downer Group Finance and an inflation-linked bond issued by Southern Cross Airports (Sydney Airport) are producing returns of more than 7 per cent.

The Suncorp Insurance bond matures in September 2014 and pays a bit more than 7 per cent a year to maturity. The Downer Group Finance bond matures in October next year and pays almost 8 per cent. Southern Cross Airports pays a variable interest rate – 4.5 percentage points more than inflation. Assuming an inflation rate of 3 per cent, the bond pays 7.5 per cent until maturity. Moran says a bond from Praeco offers a yield to maturity of more than 7 per cent.

Praeco was established to construct and operate the Department of Defence Headquarters Joint Operations Command just outside Canberra. With the construction phase now complete, the project has moved on to the low-risk operational phase that entails the upkeep and maintenance of the site, and the contract continues through to 2036, when the facilities revert back to Commonwealth ownership.

The bonds from Downer Group Finance and Praeco are "senior debt", which means that if the issuing company gets into trouble bondholders are the first in the queue to receive their money back. The Suncorp bond is "subordinated debt", which ranks behind senior debt but is still considered a low-risk investment.

You would have to think that with a company such as Suncorp Insurance, with its strong cash flows, the risk to investors' capital would be minimal.

FIIG makes its money on the trade, so the returns quoted are what the investors receive.

FIIG requires a minimum investment amount of \$50,000 for each bond. The bonds can be sold prior to maturity on the secondary market but there is the potential for a capital gain or loss.

#### **MANAGED FUNDS**

Some of the big fund managers have launched a new style of "balanced" managed funds, which targets a particular return above inflation. The Schroder Real Return Fund targets a return of 5 percentage points more than inflation, on average, over five years. Assuming inflation is 3 per cent, that is a return of 8 per cent. AMP Capital's Multi-Asset Fund aims for a return of 5.5 per cent more than inflation, on average, over five years. These funds have management fees of about 1 per cent, so they are aiming to deliver after-fee returns of between 7 per cent and 7.5 per cent with lower volatility than if the funds were invested in shares only.

They invest in a very wide spread of asset classes, including the traditional asset classes of shares, property and fixed interest. They usually have small exposures to other assets such as high-yielding bonds, commodities markets and unlisted property. The fund managers say their target-return funds are more suited to older investors looking for income, as most of the return from these funds comes from income rather than capital gains.

#### **LISTED INVESTMENT COMPANIES**

A financial planner and founder of Hewison Private Wealth, John Hewison, says the big listed investment companies, such as Argo Investments and Australian Foundation Investment Company, can be a better way to invest in shares, rather than investing in shares directly.

These listed investment companies invest in the larger, Australian-listed companies and have very low management fees. Hewison has

recommended to clients a strategy where the dividends paid by the listed investment companies are used to buy more shares in them. He has clients who have been invested this way for more than a decade. They have done exceptionally well over that time, he says. Argo and AFIC have "terrific track records over decades", Hewison says.

Though the potential returns from investing in shares is greater than other type of investments, there will also be greater volatility.

During the past four years, since the start of the GFC, shares have performed poorly. Argo and AFIC shares are paying a dividend yield of about 5 per cent, or about 7 per cent after franking credits, Hewison says.

#### **HIGH-YIELDING SHARES**

Investors seeking mostly income could invest in a spread of high-yielding stocks, Rogers says. Share prices are low and there a plenty of good companies with shares yielding, after franking credits, 7 per cent a year or more. "You are being paid to wait for the market to go up because of all of the yield you are getting with the franking credits," Rogers says.

Not many resources companies fit into the high-yielding category as the miners tend to use their cash to grow their businesses rather than pay as dividends. But the shares of the big banks can be bought on high-dividend yields and the level of their dividends is likely to be sustainable, Rogers says.

"There would have to be a big global problem that fed into Australia for these companies to cut their dividends," he says

As the table of the best-yielding stocks from among the 200 largest companies shows, stocks such as Telstra, Tabcorp Holdings and Bank of Queensland are expected to produce grossed-up yields (cash yield plus franking credits) of more than 10 per cent for the year to June 30.



**TOP 10 YIELDING STOCKS**

	CASH YIELD*	GROSSED UP YIELD*
<b>Seven West Media Ltd</b>	<b>10.82</b>	<b>15.46</b>
David Jones Ltd	9.91	14.16
<b>Myer Holdings Ltd</b>	<b>9.57</b>	<b>13.67</b>
Tatts Group Ltd	9.43	13.47
Goodman Fielder Ltd	10.42	12.43
Tabcorp Holdings Ltd	8.45	12.07
<b>Southern Cross Media Group Ltd</b>	<b>8.37</b>	<b>11.96</b>
Telstra Corporation Ltd	8.33	11.90
<b>Bank of Queensland Ltd</b>	<b>8.20</b>	<b>11.71</b>

\*Yields are based on consensus forecasts for the year ending 30/06/12.  
 SOURCE: LINCOLN INDICATORS

**BANK: TOP 10 TERM DEPOSITS**

**1-YEAR TERM DEPOSIT \$50K**

INSTITUTION	NOMINAL RATE (%)	EFFECTIVE RATE (%)
<b>Investec Bank Australia</b>	<b>5.55</b>	<b>5.55</b>
RaboDirect	5.37	5.50
<b>UBank</b>	<b>5.31</b>	<b>5.44</b>
Rural Bank ONE	5.30	5.43
<b>AMP Banking</b>	<b>5.30</b>	<b>5.37</b>
Arab Bank Australia	5.30	5.30
<b>Bendigo Bank</b>	<b>5.30</b>	<b>5.30</b>
BOQ	5.30	5.30
<b>ING DIRECT</b>	<b>5.30</b>	<b>5.30</b>
bankmecu	5.15	5.27

**3-YEAR TERM DEPOSIT \$50K**

INSTITUTION	NOMINAL RATE (%)	EFFECTIVE RATE (%)
<b>Arab Bank Australia</b>	<b>6.00</b>	<b>6.00</b>
Macquarie Bank	5.75	5.75
<b>NAB</b>	<b>5.60</b>	<b>5.72</b>
RaboDirect	5.56	5.70
<b>Bankmecu</b>	<b>5.45</b>	<b>5.59</b>
Bendigo Bank	5.50	5.50
<b>Investec Bank Australia</b>	<b>5.79</b>	<b>5.48</b>
BOQ	5.35	5.48
<b>AMP Banking</b>	<b>5.40</b>	<b>5.47</b>
Rural Bank Limited	5.20	5.30

**5-YEAR TERM DEPOSIT \$50K**

INSTITUTION	NOMINAL RATE (%)	EFFECTIVE RATE (%)
<b>Macquarie Bank</b>	<b>6.25</b>	<b>6.25</b>
RaboDirect	5.94	6.10
<b>Arab Bank Australia</b>	<b>6.00</b>	<b>6.00</b>
NAB	5.70	5.82
<b>BankSA</b>	<b>5.80</b>	<b>5.80</b>
St George Bank	5.80	5.80
<b>ANZ</b>	<b>5.68</b>	<b>5.80</b>
Westpac	5.80	5.80
<b>Bendigo Bank</b>	<b>5.70</b>	<b>5.78</b>
Bank of Cyprus Australia	5.78	5.78

Based on \$50k deposit as of 18/1/2012. SOURCE: CANSTAR.COM.AU

**Shares more tax-effective**

Cash, term deposits and bonds are not the most tax-effective way to invest (unless they are held inside a superannuation fund) because the return is income and taxed at the investor's marginal tax rate.

The government has proposed that investors only pay half the income tax on interest from cash and term deposits from July 1 this year. The measure still has to be passed by Parliament and the discount is limited to \$500 of interest income in 2012-13 and to \$1000 in following financial years.

The capital gains on shares attract a 50 per cent discount if the shares are held for a least 12 months. If Australian listed companies pay dividends with high levels of franking credits, it significantly reduces the income tax paid on the dividend income.

Australian share prices could easily grow 7 per cent this year.

The problem is a sustained recovery in Australian shares could be a long way off, even though Australia's economic fundamentals are sound and its shares are cheap. A sustained recovery in Australian shares is not likely until Europe's debt crisis has stabilised.

It may be better to consider a managed fund that has exposure to several investment asset classes.



**TOP 10 DIVERSIFIED BOND FUNDS**

FUND NAME	MIN. INV. \$	RETURN 1-YR %	RETURN 3-YR %	RETURN 5-YR %pa
Aberdeen Balanced Fixed Income	20,000	12.78	8.76	8.19
Mercer Fixed Interest	100,000	10.89	8.97	7.41
ING Wholesale Diversified Fixed Interest	50,000	10.84	7.20	5.45
Schroder Fixed Income	500,000	10.70	7.67	7.67
Aberdeen Diversified Fixed Income	20,000	10.45	14.80	8.25
Vanguard Index Diversified Bond	5000	10.18	7.15	7.44
PIMCO EQT Wholesale Diversified Fixed Interest	50,000	9.81	12.23	8.54
Macquarie Master Diversified Fixed Interest	20,000	9.62	8.89	6.45
FirstChoice Wholesale Fixed Interest	5000	9.46	9.26	6.92
MLC Wholesale Diversified Debt Class A	500,00	8.73	8.05	-

As at 31/12/11. Platform variations on existing funds removed.

SOURCE: MORNINGSTAR



**Safe havens ...  
 bond funds  
 and corporate  
 bonds can  
 deliver a solid  
 return if  
 managed  
 correctly.**

Illustration: Karl Hilzinger