

Pick your targets properly

Analysts are divided on what the new financial year will bring but everyone is agreed a cautious approach to investing is best, reports **Barbara Drury**.

When asked what he liked best, Pooh Bear was about to say honey before he thought again and answered it was the anticipation of eating honey. That's where investors find themselves at the moment; economic recovery is still out of reach but experienced investors can almost taste it.

The question is, do you dip a paw in the market and risk disappointment or wait for all the other bears to come out of hibernation and risk losing some of the best profits in the rush?

Australian shares have recovered almost 28 per cent since March. The All Ordinaries Index fell from a peak of 6800 in late 2007 to a low of 3100 in March this year but bounced back to 3960 last week.

Residential property is also showing early signs of recovery, as low interest rates and the Federal Government's first-home owner grant put a rocket under the lower end of the market. Investors are hoping the sharemarket has

bottomed and is in the early phase of recovery, but there is still a niggling fear that prices could fall sharply again or drift sideways for years.

What sets successful investors apart is not forecasting skills, but an ability to assess the present and act on it. Despite the uncertainty, experienced investors are selectively buying well-priced assets with good prospects of growth in the current economic environment.

SHARES

Share investor and educator Colin Nicholson says we are in the last phase of a bear market and that the recent jump in share prices is a short-term rally, rather than the start of a new bull market. He points to the 1974 market crash, which was followed by an extraordinary rally after which prices moved sideways for years.

"That's what we need to keep an eye on," he says.

He says a common trap at this point in the investment cycle, after a severe downturn, is to disbelieve the signs of recovery. To protect against the possibility that his view of the market is wrong, he is cautiously phasing his way back into the market.

"Don't try to be a perfectionist," he says. "Make money from a few investments that work brilliantly but quickly sell those that don't."

Nicholson is one of the few investors to survive last year's market bloodbath. In early 2007, he was invested fully in shares. By early last year, he had shifted 100 per cent of his investment funds into cash. In recent months he has begun to cautiously rebuild his portfolio.

The president of the Australian Investors' Association, Jolyon Forsyth, has been investing since the 1960s and is now semi-retired. He is not interested in market timing and, in fact, rarely sells a share.

His aim is to build a portfolio of quality stocks that will provide a comfortable retirement income for him and his wife. "I didn't sell anything over the past two years," he says. As a result, the value of Forsyth's substantial share portfolio has halved since 2007 but his dividend income has declined by only 20 per cent.

"My philosophy is if I can buy shares with increased distributions year by year above the rate of inflation, then I'm happy. I haven't done that recently but I'm earning enough [dividend] income to cover our needs, so I'm happy," he says.

"My feeling is that the market has bottomed. If it falls again, I don't think it will fall that far. I think investors should look at getting back into the market. There are a number of good shares that still pay good dividends," he says.



Targeted investments are the best way to deal with the recovering economy.

Nicholson outlines his investment strategy, honed over 40 years of investing, in his latest book *Building Wealth In The Stock Market*. He uses a combination of technical and fundamental analysis to select shares but he also uses simple market and economic indicators to determine how much money to leave in the market during each phase of the bull and bear cycle.

While some indicators, such as the low market price-earnings ratio and high dividend yield, point to a recovery, others, such as a peak in unemployment, are not yet in place.

Since the market low in March, Nicholson has bought two stocks doing well in the difficult economic climate IMF (Australia), which funds legal claims, has doubled in price this year and Cash Converters, a second-hand dealer and pay-day lender, has jumped by 60 per cent. He is watching a third stock a very small, high-risk and low-liquidity stock but won't put

more than 20 per cent of his total investment funds into the market until he is convinced the first phase of the next bull market is under way.

"Active investors should be getting into the market early but there's no need for haste," he says. "Move in gradually, be choosy and buy up-trending shares in sound businesses with low debt-to-equity ratios, low price-earnings ratios and high dividend yields for a margin of safety."

However, Nicholson says passive investors with a portfolio of sound investments should aim to ride out bear markets and avoid realising capital losses, with one proviso. "If you've got some really rotten shares, the present rally is your first real opportunity to get out and into something better," he says.

PROPERTY

Property investor and financial adviser Margaret Lomas says the first thing people need to understand is that there's no single property market in Australia but a host of markets that have been impacted differently by the global financial crisis.

"I have 32 properties and in the last two years I've had growth in values and rental returns in all the properties I own because they are in areas that are always in demand," she says. She gets consistent rental yields of 6 per cent at present and real (after tax) yields of 8 per cent.

The chairman of property specialist accounting firm Chan & Naylor, Ed Chan, has also emerged from the financial crisis unscathed because he has structured his finances to see him through the ups and downs of the property cycle.

He has about 40 residential properties, mostly in the eastern states. "There are two groups of property investors," he says. "Opportunists who look for a bargain then jump in and out [and] the other group has a plan and sticks to it."

Chan's own plan involves having a line of credit in place to cover the costs of owning a property. "If you think that property doubles in price every seven to 10 years then, to be safe, you need to be able to service your loan for 10 years to weather the storms," he says.

Hence, if you are negatively geared with a \$10,000 annual shortfall, then you need a \$100,000 line of credit to fund the shortfall

for 10 years. Chan says property investors who end up as forced sellers in a downturn generally fail to have a financial buffer in place.

"Over 10 years, the ups and downs of the economy and the property market won't affect you," he says.

While high-end residential property has suffered because of the mass retrenchments and loss of bonuses at the big end of town, more affordable property is holding out.

Lomas says she looks for lower-priced properties in locations where locals might not want to live but where enthusiastic councils are addressing infrastructure planning and people are moving because it's affordable.

She is currently on the road, talking to mayors of regional areas close to major cities.

Lomas recently encouraged her daughter to buy a new townhouse on the freeway between Sydney and Melbourne, in an area targeted for infrastructure spending. It cost \$200,000 and rents for \$270 a week.

Chan's 20-year-old daughter has also just bought her first property in Sydney, for \$400,000. "Property investing is about identifying a property that will deliver strong tenant demand with a yield that will cover your [investment] costs," Lomas says.

"Then you can afford to sit for the long term so you end up with a property worth more than it cost you."

BIS Shrapnel is forecasting that recovery in housing demand will broaden and deepen once unemployment peaks, and predicts double-digit returns over the next three years. Median house prices in Sydney and Melbourne are tipped to grow by 19 per cent, Brisbane by 16 per cent and Newcastle and Wollongong by 22 per cent.

Chan believes this is a good time for selective buying of affordable properties up to the \$600,000 mark because rates are likely to climb.

Speaking before last week's bank rate increases, he suggested investors should factor in rates closer to 6.5 per cent.

■ *Building Wealth In The Stock Market: A Proven Investment Plan For Finding The Best Stocks And Managing Risk.* (Wiley, \$65).