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Edition 214, 11 August 2017

This Week's Top Articles

Seven checks for choosing the best LIC

Nathan Umapathy

In the last five years, there has been an impressive array of new Listed Investment Company (LIC) issuance. The number of LICs listed on the ASX has seen a dramatic surge from 52 in June 2012 to 102 listed presently.

Here are seven tips for choosing a good LIC:

1. Compare against historical premium and discount

LICs are market-listed, closed-ended funds, which leaves the security exposed to the vagaries of supply and demand in the market. A LIC can trade away from its underlying pre-tax Net Tangible Assets (NTA), with the discount contracting (or premium expanding) when demand exceeds supply and discount expanding (or premium contracting) when supply exceeds demand.

Trading at a premium or a discount is a fundamental part of the LIC structure, and investors can benefit by understanding this premium and discount behaviour.

The table below shows the underlying NTA of the individual LICs in our coverage. This is calculated by modelling the percentage movements of the underlying disclosed holdings. Where holdings are not disclosed, the weekly or monthly NTA figures released on the ASX are used. This report is most effective for LICs with a high percentage penetration of investments in the Top 20, lower turnover of investments and regular disclosure of cash position. We also calculate the average premium/discount over one, three, five and 10 years.

For instance, Platinum Capital (ASX:PMC) is currently trading at a 6.0% premium to NTA (column 3), however, it has traded at an average 11.4% premium over the last 10 years (last column). This may indicate potential value, given it is trading at a lower premium than normal. However, we would argue that this premium is likely no longer sustainable noting a number of new and credible global LICs have recently entered the ASX and created viable alternatives.

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Indicative premium/discount to Pre-Tax NTA (as at 01/08/17)

ASX Code	Company Name	Share Price	Fully Diluted Ind. Pre-Tax NTA"	Indicative Prem/Disc"	Average Premium/Discount+ 1 year	3 years	5 years	10 years
AFI	AFIC"	$ 6.11	$ 5.95	2.7%	0.2%	2.4%	2.5%	1.8%
ARG	Argo Investments	$ 7.98	$ 7.78	2.6%	-1.0%	3.2%	1.3%	1.1%
DJW	Djerriwarrh Investments	$ 3.83	$ 3.30	15.9%	14.9%	25.2%	23.2%	16.7%
AUI	Australian United Investments	$ 8.49	$ 8.47	0.3%	-6.8%	-4.9%	-6.0%	-5.6%
MLT	Milton Corporation	$ 4.62	$ 4.52	2.2%	-1.8%	0.9%	-0.6%	-2.0%
BKI	BKI Investment	$ 1.70	$ 1.62	4.9%	0.8%	1.5%	-1.0%	-7.2%
CIN	Carlton Investments	$ 32.30	$ 36.28	-11.0%	-13.1%	-11.4%	-12.9%	-15.3%
DUI	Diversified United Investments	$ 3.83	$ 4.06	-5.6%	-7.3%	-6.2%	-6.8%	-6.4%
WHF	Whitefield	$ 4.54	$ 4.92	-7.7%	-9.7%	-7.8%	-7.6%	-8.6%
AMH	AMCIL	$ 0.93	$ 0.95	-2.9%	0.3%	-1.0%	-3.9%	-9.7%
WLE	WAM Leaders	$ 1.12	$ 1.14	-1.4%	-0.1%	0.1%	0.1%	0.1%
FSI	Flagship Investments	$ 1.57	$ 1.83 ^	-14.2%	-14.0%	-7.7%	-6.9%	-6.1%
WAM	WAM Capital	$ 2.47	$ 1.94	27.2%	19.7%	13.1%	8.2%	-4.7%
MIR	Mirrabooka Investments	$ 2.68	$ 2.37	12.9%	19.3%	14.8%	11.0%	1.5%
WIC	WestOz Investment Co.	$ 0.99	$ 1.08 #	-8.7%	-13.8%	-11.3%	-13.6%	-17.9%
WAX	WAM Research"	$ 1.58	$ 1.22	29.8%	22.2%	12.6%	7.8%	-8.4%
OZG	OzGrowth	$ 0.16	$ 0.19 #	-14.9%	-20.1%	-16.1%	-18.3%	n/a
WAA	WAM Active	$ 1.13	$ 1.05	7.1%	6.9%	4.1%	2.5%	n/a
CTN	Contango Microcap	$ 0.94	$ 1.00 ^	-6.6%	-6.7%	-8.5%	-10.5%	-18.6%
ACQ	Acorn Capital Invst Fund"	$ 0.97	$ 1.08 ^	-10.9%	-12.5%	n/a	n/a	n/a
ALF	Australian Leaders Fund"	$ 1.28	$ 1.27 ^	0.4%	6.9%	-2.9%	-9.0%	-13.8%
CDM	Cadence Capital"	$ 1.30	$ 1.16 ^	11.3%	0.4%	-3.3%	-13.5%	n/a
NCC	NAOS Emerging Opp"	$ 1.40	$ 1.29 ^	8.1%	-0.2%	-7.8%	n/a	n/a
FGX	Future Generation Investment Company	$ 1.10	$ 1.15 ^	-4.7%	-1.3%	n/a	n/a	n/a
AEG	Absolute Equity Performance Fund	$ 1.12	$ 1.11 #	0.8%	3.9%	n/a	n/a	n/a
WMK	Watermark Market Neutral"	$ 1.00	$ 0.99 ^	1.0%	1.2%	n/a	n/a	n/a
SNC	Sandon Capital"	$ 0.98	$ 0.99 ^	-0.7%	-5.9%	n/a	n/a	n/a
MFF	MFF Capital Investments"	$ 1.97	$ 2.17 #	-9.5%	2.6%	-6.1%	-9.9%	n/a
PMC	Platinum Capital	$ 1.76	$ 1.66 #	6.0%	0.6%	-4.3%	2.5%	11.4%
TGG	Templeton Global Growth	$ 1.37	$ 1.49 #	-7.9%	-11.1%	-9.4%	-10.7%	-15.4%
HHV	Hunter Hall Global Value	$ 1.18	$ 1.19 #	-0.9%	-5.0%	-9.4%	-11.8%	-13.0%
PGF	PM Capital Global Opp"	$ 1.11	$ 1.24 #	-10.6%	-14.6%	n/a	n/a	n/a
APL	Antipodes Global Investment Company	$ 1.21	$ 1.15 ^	5.1%	n/a	n/a	n/a	n/a
EGI	Ellerston Global Investments	$ 1.02	$ 1.10 ^	-7.4%	-11.8%	n/a	n/a	n/a
ALI	Argo Global Listed Infrastructure	$ 1.79	$ 2.04 #	-12.3%	-11.0%	n/a	n/a	n/a
GVF	Global Value Fund	$ 1.15	$ 1.10 ^	4.5%	0.9%	n/a	n/a	n/a
FGG	Future Generation Global Invest Company	$ 1.11	$ 1.13 ^	-2.0%	n/a	n/a	n/a	n/a
EAI	Ellerston Asian Investments	$ 0.94	$ 1.06 #	-11.2%	-12.2%	n/a	n/a	n/a
PAF	PM Capital Asia	$ 1.14	$ 1.22 #	-7.2%	-13.5%	n/a	n/a	n/a

" The Fully Diluted Indicative NTA has been adjusted for options dilution (100% excercise) and dividends. Dividends are removed from the NTA once the security goes ex-date and until the receipt of the new ex-dividend NTA . # The Indicative NTA is the actual reported weekly pre-tax NTA as we have been unable to calculate the Indicative NTA within a reasonable level of accuracy. ^ The Indicative NTA is the actual reported monthly pre-tax NTA as we have been unable to calculate the Indicative NTA within a reasonable level of accuracy.* Average premium/discounts as at end of the previous month. +Prem/Disc does not adjust for the dilution of unexcercised options.

Source: Company data, IRESS and Bell Potter

Purchasing a LIC at a lower discount or premium to the long-term discount or premium to pre-tax NTA will not guarantee outperformance. However, in our view it does suggest that if, at the time of investment, the LIC looks expensive versus historical norms, perhaps an alternative LIC should be considered.

2. Familiarise with share price normalisation

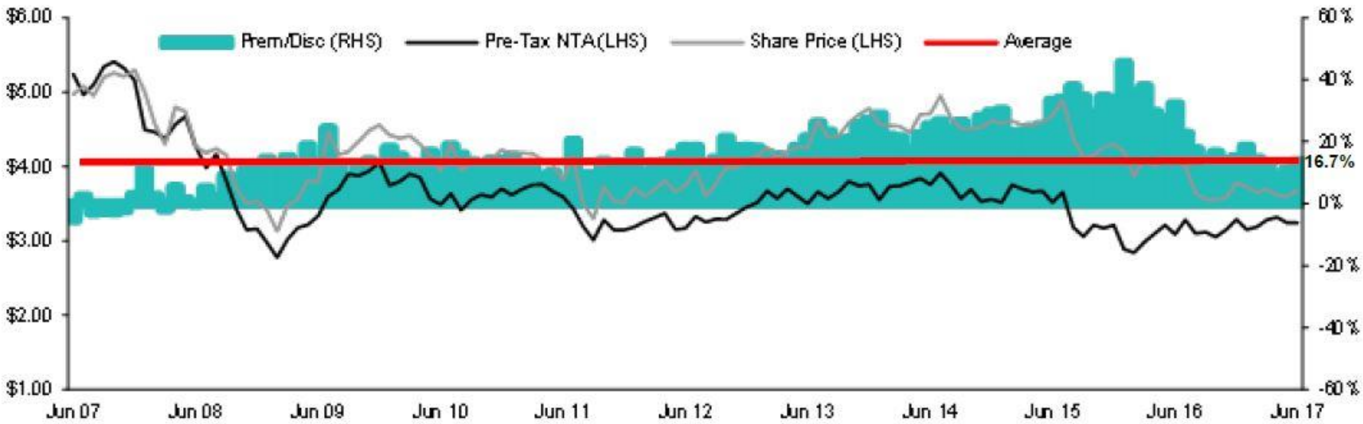
There is a tendency for LICs to revert to their mean premium or discount throughout the cycle. It is important that investors understand the implications this will have on the share price.

Essentially, if an investor buys a LIC at a 20% premium to its pre-tax NTA and it ordinarily trades in line, the investor is increasing the risk of a capital loss should we see normalisation back towards the mean.

Similar for a LIC that trades at a narrow discount compared to its historical average of a much wider discount. Investors should be aware of the capital upside or downside when purchasing LICs, and avoid purchasing LICs simply because they are at a discount.

Djerriwarrah Investments (ASX:DJW) is a good case study. DJW invests in Australian equities and writes call options over individual positions, enabling an enhanced level of dividends.

DJW's share price and NTA



Source: Company reports, IRESS and Bell Potter

Demand for DJW has historically been strong with a lack of alternatives, resulting in DJW trading at a nearly 50% premium to its pre-tax NTA in early 2016. However, in recent times, both DJW's share price and premium have fallen. This was likely due to a dividend cut and an influx of alternative products, but the heightened premium was unrealistic. As at 1 August 2017**,** DJW traded at a 15.9% premium, more in line with its 10-year average premium of 16.7%.

3. Understand each LIC's investment strategy

The LIC universe can be divided into three main categories, and the results can vary significantly between the groups:

1. Domestic mandates offer exposure to the Australian market. Subsets include Large, Large to Medium, Medium to Small, and Small to Microcap companies, Long/Short/Market Neutral, Specialist and Tech.
2. International mandates offering offshore exposure, with subsets of Global and Asian.
3. Specialist mandates offering other choices.

It is essential investors pick the right exposure to fit its investment portfolio. Within these three categories, an investor will find different styles of investments. For example, an Australia equity LIC might be long only with full market exposure, or long/short with a market neutral bias.

4. Watch the fees

Fees play a big part in any investment vehicle. A small difference in fees and expenses can have a substantial impact on the investor's long-term performance given the compounding nature of returns.

Some investment mandates by their very nature are more cost intensive to execute than others. For instance, funds focused on small companies where external or broker research is limited may incur higher costs given the necessity to bridge the information gap through in-house research.

Lower fees will not guarantee superior performance, but they are clearly less of an impediment on returns. For instance, if one fund is charging a management fee of 0.2% and another charges 2.0%, it will be more difficult for the latter to deliver outperformance on a consistent basis given a requirement to recover the additional 1.8% management fee prior to delivering a positive return to the investor.

Average Indirect Cost Ratio across each LIC's investment mandate

Mandate	Average ICR (w/out perf. Fees)	Average ICR (with perf. Fees)
Large Caps	0.22%	0.22%
Large to Medium Caps	0.86%	1.17%
Medium to Small Caps	1.19%	2.72%
Small to Micro	2.67%	3.87%
Long Short/Market Neutral	1.70%	3.60%
International	1.50%	1.52%
Specialist	0.98%	1.53%

5. Look for medium to long-term outperformance

Historical performance is not a guarantee of future performance but it is a guide. The key consideration is whether this performance is replicable.

The performance of a LIC can be measured using either the NTA or security price. The NTA performance seeks to measure the performance of the underlying investments of the manager. The security price performance seeks to measure the performance of the security as it trades on the ASX.

The benchmark defined by the manager is used to measure relative pre-tax NTA performance. This allows the investor to gain an understanding of whether the manager has added value through its active investment. While there may be reasons to expect improved performance in the future, a LIC that has materially under-performed its benchmark over the medium-to-long term should be approached with caution.

6. Be careful of options overhang

Most of the LICs that have listed on the ASX in recent years have come to market with a bonus option to compensate the initial investor for the issue costs reflected in the NTA. The option holder thereafter receives a right, but not an obligation, to purchase additional shares in the LIC at a fixed price (strike price) until a specified date (expiry date). The bonus option is usually listed and can be sold on the ASX.

Investors that seek to purchase LICs in the secondary market need to watch the potential dilutionary impact on the NTA of in-the-money options. The person who exercises the option is not diluted as they have received the benefit of the lower exercise price. In fact, if less than 100% of options are exercised (which is generally the case unless options are underwritten), they are actually accretive to those who exercise and dilutive to those who don't.

There has been a recent evolution in the LIC industry with two LICs, VGI Partners Global Investment (ASX:VG1) and MCP Master Income Trust (ASX:MXT) coming to market without the attached option and with a proforma NAV in line with the issue price. For example, the manager will pay the issue costs for VG1 out of the fees it receives, to give shareholders access to the product at NAV at initial issue.

7. Value the dividends

A final consideration for investors is distributions. These can vary markedly from manager to manager, largely dependent on its mandate. Investors should also be particularly aware of franking as this can provide additional upside. The table below lists the top yielding LICs over the past 12 months across each investment mandate.

Highest distributions for LIC across each investment mandate

Distribution					
30-Jun-17	Large	Lrg/Medium	Med/Small	Alternative	Intl
(%)	AUI	CAM	WIC	HHV	SNC
Net Yield	4.2	5.5	6.3	6.3	6.9
Franking	100.0	100.0	100.0	100.0	100.0
Gross Yield	6.0	7.9	8.9	9.0	9.9

Source: company data, IRESS & Bell Potter

Conclusion

Investing in a LIC is essentially an investment in a listed fund manager. The key proviso here is selecting a manager that has the ability to consistently beat the market and provide strong after-tax performance. Quantitative measures can assist investors with picking the right LIC, which can be used as 'building blocks' to complement a robust investment portfolio from a risk and return perspective.

Nathan Umapathy is Research Analyst at Bell Potter Securities. This document has been prepared without consideration of any specific client's investment objectives and there is no responsibility to inform of any matter that subsequently may affect any of this information. For the latest Bell Potter Quarterly Report, click here, and for the Weekly NTA update, click here.

Is there an ideal minimum investment in a portfolio?

Chris Stott

Investors can be overwhelmed with decisions when constructing their investment portfolios, such as international versus domestic equity exposure, correlation with the overall market, sector exposure, the underlying investments' quality and holding size, to name a few.

There are many views on the appropriate exposure to an individual company in a share portfolio. Most commentary focuses on the **maximum** exposure to a company, with many institutional mandates dictating holdings equate to no more than 5-10% of the fund. Less often discussed is the ideal **minimum** investment size.

Diversified versus concentrated

Determining the optimal investment size is essentially informed by the investor's preferred investment style, especially if the portfolio is diversified or concentrated, and how risk is managed.

A diversified investment style favours numerous, small holdings. A more diversified portfolio is a favourite with investors giving a high priority to managing risk and preserving capital. As diversification within a portfolio increases, generally volatility decreases.

In contrast, a concentrated approach to portfolio construction favours fewer stocks, with larger positions as a proportion of the overall portfolio. As a result, the performance (good or bad) of an investment is amplified by price movements in one or two stocks, increasing the risk and volatility of the portfolio.

Individual investors and investment managers sit at various points along a scale between the concentrated and diversified approaches.

With holdings in 60-100 companies on average at any one time, Wilson Asset Management is at the diversified end of the spectrum with our bias towards having many, smaller holdings in our investment portfolio.

A question of risk

Essentially, an investor's preference for a diversified or concentrated approach hinges on the management of risk. Another way we manage risk is by maintaining above-average cash holdings. For example, our first listed investment company (LIC), WAM Capital, has held an average of 34% cash since its inception in 1999.

We apply our rigorous rating process to assess if a company represents a worthwhile investment proposition and we identify a catalyst we believe will re-rate its share price. Then, a range of factors inform our level of investment in that business. Our holdings in investee companies generally represent less than 3% of our investment portfolios (and can be as small as 0.25% of a portfolio) depending on our level of conviction and factors including liquidity and potential upside to our valuation.

Liquidity is key

The more liquid a company's shares, the more flexibility the investor has to increase or decrease their exposure. We assess a company's liquidity by measuring the number of days required to exit our position based on current selling volumes. More broadly, we also consider the liquidity of all our holdings, routinely analysing the likely timeframe to convert our entire investment portfolio to cash.

Often, a company's liquidity can fluctuate and sometimes it can only truly be measured in tougher trading conditions. This is particularly the case in the micro-cap end of the share market.

Transaction, labour and opportunity costs

There are other factors for an investor to weigh up when considering holding size as a proportion of their portfolio. In particular, there are costs involved in maintaining any investment and, as the number of positions increases, these costs also rise.

Transaction fees such as brokerage are an important cost to control. Time and energy is also required to manage a portfolio, including the administration. The greater the number of holdings in a portfolio, the greater the effort required to monitor and assess those investments. As a result, highly diversified, actively-managed portfolios are very labour intensive.

Opportunity costs arise because capital deployed in one investment is made to the exclusion of an investment in another stock or stocks. We continually re-assess all investee companies to ensure they represent a worthwhile investment proposition. We assess whether they still warrant a place in our portfolio or if that capital could generate a better return invested elsewhere.

Considerations for investors

Investors should adjust their weightings based on their investment approach and the management of risk in their portfolio. There is no universal or agreed ideal maximum or minimum level of exposure but rather a best fit with an investment style and approach to risk.

Wilson Asset Management believes diversification provides access to liquidity ensuring we can be nimble and flexible in deploying our shareholders' capital. However, most institutional funds have mandates that restrict how the manager invests capital in terms of sector weightings, maximum holding sizes, cash holdings and deviations above and below an index.

Chris Stott is Chief Investment Officer of Wilson Asset Management *(WAM). This article is general information and does not consider the needs of any individual. Subscribe to regular investment insights at* wilsonassetmanagement.com.au

Five things to know before you invest in ETFs

Aditi Grover

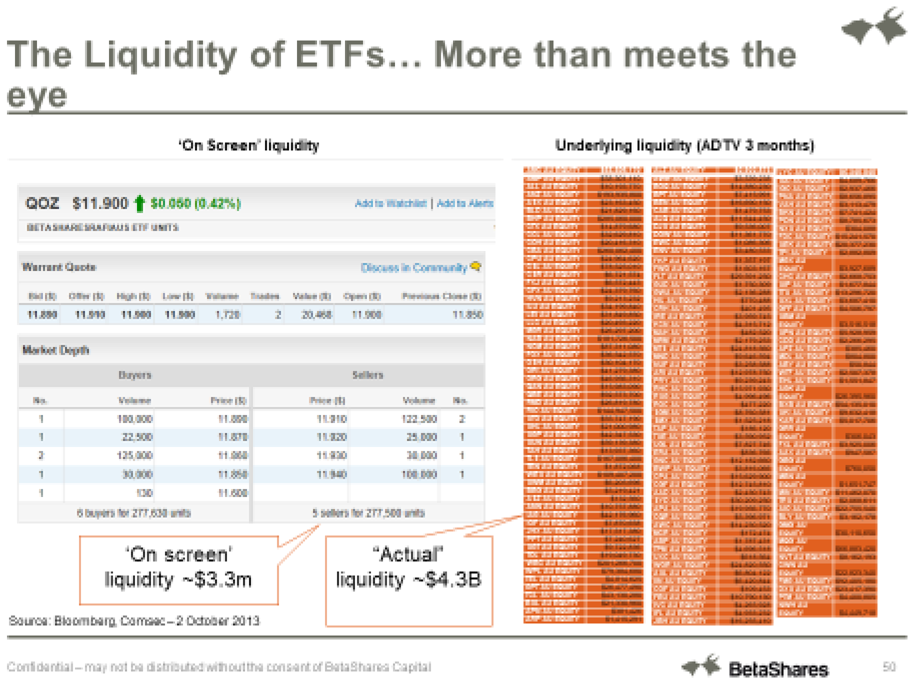
With the Australian Exchange Traded Fund (ETF) industry just shy of $30 billion in assets and ETFs more actively traded than stocks in the US, investors are increasingly adopting ETFs as core building blocks of their portfolios. This trend is set to continue as exchange traded products have evolved from being only index-tracking strategies, and they now also provide a simple way to add exposure to particular asset classes such as gold. They can be used as a tool in a specific strategy, such as taking sharemarket exposure but with reduced market volatility. ETFs are low-cost, offer instant diversification and investment transparency.

The below five tips may help beginner ETF investors.

1. Understand the basic structure and liquidity

Unlike shares, the size of the ETF in terms of assets under management, the daily volume traded and the volume of units quoted 'on screen' is **not** indicative of an ETF's liquidity.

An ETF's open-ended structure means units of an ETF can be created or redeemed by market makers, in contrast to company shares which have a fixed amount of stock outstanding on any given day. The supply on offer for an ETF can be adjusted to cater to the demand. Therefore, the ETF fund size, daily volume traded and 'on screen' liquidity are not meaningful when assessing the liquidity of an ETF. An ETF's liquidity is mainly determined by the liquidity of the underlying holdings of the fund. This is demonstrated in the example below, in which the daily liquidity is reflected by the daily average volume of the underlying holdings for BetaShares FTSE RAFI Australia 200 ETF (QOZ):



2. Use the indicative Net Asset Value (iNAV) to determine the price to trade

To help determine a fair price to buy or sell an ETF, investors should refer to its indicative net asset value or 'iNAV' (if available). The iNAV is the estimated intra-day 'fair value' of the ETF (which is the price per unit of the basket of underlying securities held by that particular ETF less any liabilities such as management fees), which updates regularly. INAVs bring intra-day pricing transparency to ETFs in contrast to unlisted managed funds, for which net asset values are determined daily (or sometimes less frequently) once the trading day ends.

INAVs can be found on the website or on the respective product page of the issuer.

3. Understanding bid and offer spreads

All exchange traded and unlisted investment funds are subject to bid and offer spreads (known as buy/sell spreads for unlisted funds). In the case of ETFs, a bid/offer spread is the difference between the NAV of the ETF and the price at which the ETF can be bought or sold on the ASX. A 'spread' is a market maker's compensation for the time and financial risk they bear to make markets and enhance liquidity i.e. acting as a buyer and seller of ETF units on the exchange and creating and redeeming units based on investor demand.

Spreads for each ETF vary as they are largely dependent on liquidity of the underlying securities. In general, the more liquid the security, the tighter the spread. Market makers also seek to maintain tight spreads to ensure they do not give their competition the potential to arbitrage profits.

4. Know the difference between 'market orders' and 'limit orders'

When placing an order through a broker, whether it is for a share or an ETF, there is the choice to place the trade as a 'market order', agreeing to buy or sell at whatever price the market demands, or a 'limit order' at a specific price.

The risk with the market order is that there may be many orders placed at the same time relative to the demand on offer. For example, a previous investor may have placed a large order which momentarily depletes the volume offered at the current market price. The trade runs the risk of being filled with the next best market bid and this may be worse than the best price possible. A volatile market may also cause the iNAV of the ETF to fluctuate and spreads to widen, which also may lead to bids being filled at undesirable prices.

Placing a 'limit order' will avoid this risk. Although the order may not be filled immediately, there is no risk of getting worse than your desired price for the ETF.

5. Time when you buy or sell

Investors may also wish to avoid trading near the market open and close. This is because market makers can experience higher risk at these times, which may result in wider than normal spreads. At the market open, market makers look to determine the accurate pricing of the ETF's underlying securities, taking into account the fact that only some, but not all, of the securities, have commenced trading and therefore have current prices available. This occurs as companies commence trading on the exchange in tranches on a staggered basis, as shown in the diagram below:

Time (AEST)	Market Status
10am	**Open** Opening starts at 10:00 a.m. (Sydney) and lasts for approximately 10 minutes. **Group 1** – 10:00:00 a.m. Letters A-B (e.g. ANZ) **Group 2** – 10:02:15 a.m. Letters C-F (e.g. CBA) **Group 3** – 10:04:30 a.m. Letters G-M (e.g. GNC) **Group 4** – 10:06:45 a.m. Letters N-R (e.g. NAB) **Group 5** – 10:09:00 a.m. Letters S-Z (e.g. SEK) The opening time is randomly generated and occurs up to 15 seconds either side of the times shown above. E.g. Group 1 may open at any time between 9:59:45 a.m. and 10:00:15 a.m.

Source: MarketIndex.com.au – how to buy shares

Market makers experience higher risk when markets open and near market closing time, as prices of securities tend to fluctuate more. This volatility occurs especially around the market close as the 'matching period' approaches. That is, all trades that take place on the close transact at a price determined by the market. The higher risk in pricing at this point may lead to wider than normal spreads.

Buying and selling ETFs on market is straightforward and an application form is not required. ETFs can be simply bought and sold through a broker as with any share on the ASX.

Aditi Grover is a Business Development Associate at BetaShares, a sponsor of Cuffelinks. This article is general information and does not address the needs of any individual.

Silver's shine versus gold's glitter

Jordan Eliseo

Gold is the preeminent monetary metal, and throughout history to this day, it has projected the most enduring images of wealth. Consider how often gold bars are used to depict glamour and riches. Silver is in its shadows, but as an asset, it contains similar wealth-protecting qualities, perhaps with even greater return potential.

Unlike physical gold, which is used very little in industry, physical silver is an input in a wide range of industries including photography, medicine, defence and electronics. Silver is the best conductor of electricity and heat and is a highly reflective metal.

Modern medicine has recently rediscovered silver's anti-bacterial qualities, with its germ-fighting properties leading to an explosion in products containing silver. From silver-impregnated sportswear (to kill the germs which cause body odour), fabrics for public transport and airline seats to prevent the spread of infections, coatings for fridges and washing machines and even in antiperspirant sprays and band-aids.

As the best conductor of electricity, silver is used in solar panels to increase efficiency and in wiring, switches and soldering contacts. Silver oxide batteries (probably like the one in your watch) are increasingly used to power larger devices as they store the most power relative to size of any battery.

Silver is also used in iPhones, iPads, cell phones and flat screen televisions, with over 10,000 known industrial applications.

Silver prices are currently relatively low, making recycling largely uneconomic and therefore, much of the silver used in products is lost to landfill. This may change if the price rises substantially, but for now, it's a bullish factor underpinning the silver market.

Silver as monetary metal

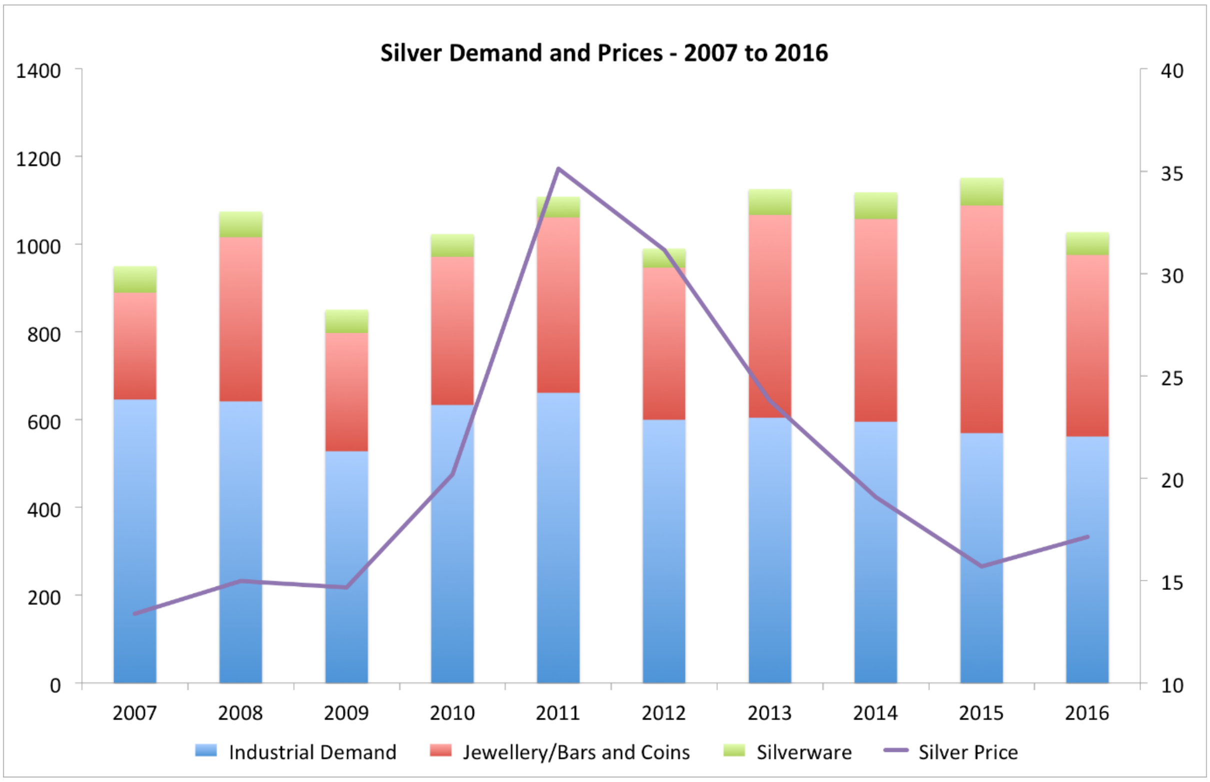
Whilst silver is heavily used in industry, it has an incredible history as a monetary metal. Known as Argentum in Latin, the Ancient Egyptians, Lydians, the Greeks, and the British all valued and used silver as a monetary asset.

There is a reason why British money is referred to as Pound Sterling. Indeed, the term dollar can be traced back to the 1530s, and a legendary Bohemian silver mine near Joachimsthal, which at its peak produced over three million ounces of silver a year.

The coins produced from this mine were called Joachimsthaler, or 'thaler' for short, and these silver coins formed the basis of the Dutch 'daalder'. The 'daalder' became the most popular trading currency in the Dutch founded town of New Amsterdam, known today as New York, where they were known as dollars.

Current demand and supply

The chart below shows the breakdown of silver demand over the last 10 years, as well as the move in the US$ silver price over this time. Approximately half of the demand comes from industrial applications, with jewellery and implied net investment, predominantly bars and coins, comprising the majority of the rest. Investment demand has increased markedly over this period, with bar and coins sales tripling between 2007 and 2016.



Source: GFMS via Thomson Reuters, ABC Bullion

The majority of the current supply comes direct from mine production, with about 20% of total supply across the last 10 years coming from silver scrap. A significant portion is mined as a by-product, meaning that the mine the silver is coming from is predominantly in place to produce other metals, like gold, copper, or zinc and lead, with more than half of the silver coming from Latin America.

The fact that silver is so often a by-product adds a degree of inelasticity to supply, in that a copper miner isn't going to increase production if the price of copper is falling or stagnant, just because the silver price is rising. The miners are often not overly interested in the silver, as it probably only consists of a small portion of the miners' overall revenue.

Net government sales were a source of supply to the market until recently, but have effectively stopped, as national silver bullion reserves the world over are all but completely depleted.

The gold/silver ratio and the future of silver

Whilst we expect silver to be the more volatile of the two monetary metals, the gold/silver ratio (GSR), which measures how many ounces of silver one needs to buy one ounce of gold highlights why we believe silver prices may rise by more, in percentage terms, than gold in the coming years.

The GSR is currently about 78, with gold at US$1,260 an ounce and silver at about US$16.20 an ounce. This is nearly 20% above the average of the last 30 years, a timeframe in which the GSR has averaged just over 66. Indeed, as per the chart below, the GSR is currently at a level that has only been exceeded once in the past 30 years.

Going forward, there are a handful of reasons why the GSR should be lower than the current reading of 78.

Firstly, as per the chart above, since the turn of the century, the GSR has approached current readings three times, back in early 2003, again in late 2008, and toward the end of 2015. Each proved good buying points for precious metals, with silver in particular rallying from these levels in the subsequent year, with average gains of nearly 20%.

Geology and mine production are factors too. Gold occurs in the earth at a rate of 4 parts per billion (PPB), whilst silver occurs at 75 PPB. This ratio of about 19:1 indicates that there is roughly 19 times more silver in the ground compared to gold. Given gold production has averaged around 2,800 tonnes per annum over the last decade, one might expect (based on a silver/gold PPB ratio of 19:1), that about 53,000 tonnes of silver would be mined each. In reality, primary mine supply is barely half that, with the latest data from the Silver Institute suggesting annual silver mine production is just 27,500 tonnes.

Industrial demand, should global growth accelerate from here could also propel silver prices in the years ahead. Industrial demand is essentially a non-factor in the gold market, but a major factor in the silver market. As such, silver stands to benefit if governments get their wish of higher global demand and a pick-up in inflation, which they almost certainly will should they unleash fresh bouts of fiscal stimulus.

Finally, it's worth looking at the size of the gold and silver markets from an investor's perspective. Gold demand in 2016 was just over 4,300 tonnes, worth over US$170 billion at an average price of US$1250/oz. Silver demand on the other hand came to just shy of US$18 billion, meaning gold demand was nearly ten times higher than silver demand.

As such, it takes less dollars to move the silver market, a factor that may prove decisive if more investors seek to hedge their portfolios with a precious metals exposure. There are portfolio benefits of including precious metals in a diversified mix of assets.

Add all these factors together, and silver, a quasi-industrial metal with a rich monetary history, may be about to step out of gold's shadow, and shine brightest in the years ahead.

Jordan Eliseo is Chief Economist at ABC Bullion*. This article is general information and does not consider the circumstances of any individual.*

Risks of dropping personal insurance when most needed

Roy Agranat

People often take out personal insurance early in their working career, but if it is done without adequate advice and knowledge, a significant proportion will then drop their coverage later in life at the very time they are most likely to need it.

When paying off debt, funding lifestyle needs and saving for retirement are competing with the cost of holding personal insurance, the former are generally treated as a priority, particularly as the cost of some personal insurance premiums rises substantially in later years.

Many only realise in hindsight that different personal insurance planning decisions made earlier in life would have made a significant financial difference.

Long-term understanding of premiums

In the early years of a working life, understanding how best to fund personal insurance can significantly affect the ability to retain cover while still being able to save for a quality retirement, or meet other expenses.

The two most common premium-funding options are level premiums and stepped premiums.

With a **level premium**, the cost of the cover remains the same of over the lifetime of the policy except for CPI increases in cover.

With a **stepped premium,** the cost of cover starts lower than level premium, however the rates increase each year based on the insured person's age plus CPI increases in cover.

Under either funding option, the insurer can also increase the rate charged over and above the annual rate change.

While a level premium seems more expensive than a stepped premium when first starting out, a long-term view shows a significant difference over the life of a policy.

For instance, as the table below shows, the year-on-year increase in a stepped premium policy in the early years is not as steep as in later years.

Average year-on-year increases for stepped insurance premiums, nil indexation

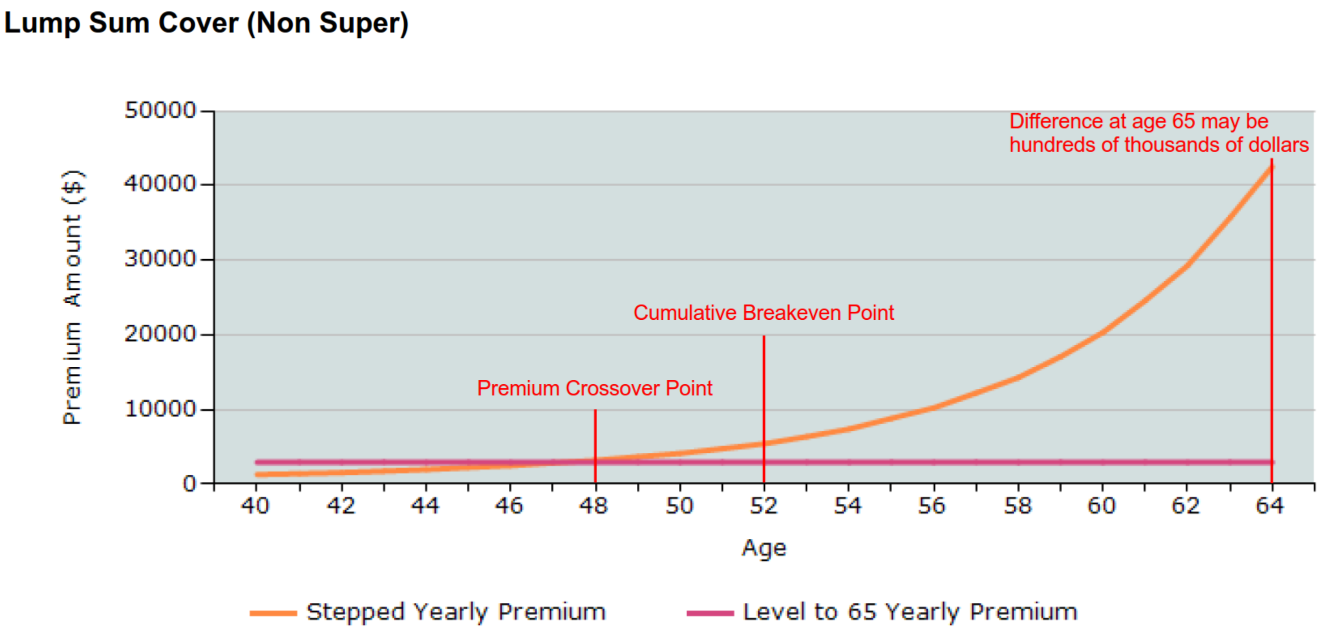
Age Band	Life Cover	TPD Cover	Trauma Cover	IP Cover
30-39	4.4%	5.5%	7.8%	6.2%
40-49	13.4%	14.9%	15.5%	10.7%
50-59	17.5%	20.6%	15.6%	12.5%
60's	18.3%	20.8%	15.2%	11.0%

(TPD = Total and Permanent Disability, IP = Income Protection)

In addition, the percentage increases will have more of an impact at an older age when the premiums are higher. For example, a 5% increase on a $100 per month premium is $5, which is more palatable than a 15% increase on $600 per month, or $90. What's more, with a 15% year-on-year increase, the premiums will double every five years.

The total stepped premiums for a 40-year-old male taking out $1,000,000 Life and TPD cover (with nil CPI increases) until age 65 will cost $266,249 while level premiums will cost only $74,461.

The following chart illustrates graphically the difference in cost between stepped and level premiums over the lifetime of the policy. After age 52, the age when people are most likely to need cover, the cost of the stepped premium rises dramatically.



As a general rule, for a 40-year-old with Life and TPD cover for $1,000,000, not indexed to inflation, it will take eight years for stepped premiums to catch up to level premiums, and another five years on top of that to reach the break-even cumulative point.

For example, a specific insurer provides this table although the general principles apply.

Lump Sum Cover (Non Super)

Year	Age	Life Cover	TPD linked to Life Cover	Stepped Yearly Premium	Level to 65 Yearly Premium	Cumulative Stepped Yearly Premium	Cumulative Level to 65 Yearly Premium
1	40	$1,000,000	$1,000,000	$1,325.71	$2,962.64	$1,325.71	$2,962.64
2	41	$1,000,000	$1,000,000	$1,449.75	$2,995.56	$2,775.46	$5,958.20
3	42	$1,000,000	$1,000,000	$1,580.73	$2,962.64	$4,356.19	$8,920.84
4	43	$1,000,000	$1,000,000	$1,785.74	$2,995.56	$6,141.93	$11,916.40
5	44	$1,000,000	$1,000,000	$1,997.23	$2,962.64	$8,139.16	$14,879.04
6	45	$1,000,000	$1,000,000	$2,268.87	$2,995.56	$10,408.03	$17,874.60
7	46	$1,000,000	$1,000,000	$2,523.91	$2,962.64	$12,931.94	$20,837.24
8	47	$1,000,000	$1,000,000	$2,885.49	$2,995.56	$15,817.43	$23,832.80
9	48	$1,000,000	$1,000,000	$3,230.42	$2,962.64	$19,047.85	$26,795.44
10	49	$1,000,000	$1,000,000	$3,700.40	$2,995.56	$22,748.25	$29,791.00
11	50	$1,000,000	$1,000,000	$4,152.46	$2,962.64	$26,900.71	$32,753.64
12	51	$1,000,000	$1,000,000	$4,789.98	$2,995.56	$31,690.69	$35,749.20
13	52	$1,000,000	$1,000,000	$5,453.91	$2,962.64	$37,144.60	$38,711.84
14	53	$1,000,000	$1,000,000	$6,406.15	$2,995.56	$43,550.75	$41,707.40
15	54	$1,000,000	$1,000,000	$7,414.06	$2,962.64	$50,964.81	$44,670.04
16	55	$1,000,000	$1,000,000	$8,847.04	$2,995.56	$59,811.85	$47,665.60
17	56	$1,000,000	$1,000,000	$10,256.05	$2,962.64	$70,067.90	$50,628.24
18	57	$1,000,000	$1,000,000	$12,249.99	$2,995.56	$82,317.89	$53,623.80
19	58	$1,000,000	$1,000,000	$14,318.42	$2,962.64	$96,636.31	$56,586.44
20	59	$1,000,000	$1,000,000	$17,116.00	$2,995.56	$113,752.31	$59,582.00
21	60	$1,000,000	$1,000,000	$20,354.45	$2,962.64	$134,106.76	$62,544.64
22	61	$1,000,000	$1,000,000	$24,621.90	$2,995.56	$158,728.66	$65,540.20
23	62	$1,000,000	$1,000,000	$29,308.01	$2,962.64	$188,036.67	$68,502.84
24	63	$1,000,000	$1,000,000	$35,685.60	$2,995.56	$223,722.27	$71,498.40
25	64	$1,000,000	$1,000,000	$42,526.99	$2,962.64	$266,249.26	$74,461.04

If all cover is held to age 65, the savings on a level premium can be hundreds of thousands of dollars.

Minimising the burden of insurance policies

Steps can be taken to ensure insurances are retained that might otherwise become such a financial burden that the cover is reduced or given up entirely when most needed. They include:

- **Life cover and TPD** – in early years with a young family, ongoing income and mortgage debt is higher than it is as children get older and debt is paid down.

  Solution: place a portion of cover on stepped premiums and maintain for 15–20 years, with the remainder on a level premium ensuring this cover remains affordable in later years.

- **Income protection** – generally the cover will be required across an entire working life.

  Solution: maintain a level premium until policy expiry at either age 65 or 70.

- **Trauma cover** - in the early years of greater family financial commitments, cover may need to be higher than in later years.

  Solution: place a portion of the cover on stepped premiums to manage cash flow with some cover on level premiums for the longer term.

Risks with level premiums

Level premiums offer long-term financial benefits but other factors must be considered:

- Product may become obsolete: the insured person is locked in with a single insurer and product series and could be left in an old or closed product. Medical definitions and premium rates for the policy may not be up to date with the current market.
- Rates are not guaranteed: Insurers always reserve the right to increase base premium rates at any time (this is applicable under both stepped and level options).
- Inflation cover can change the original premium rate: If inflation-proof cover is chosen with CPI increases in cover each year, some insurers will charge the original level premium rate when the policy commenced but a new level premium rate for each age range for the increased portion of cover.

Nevertheless, forward planning of insurances and a sensible approach of using a blend of stepped and level premiums could have good financial outcomes.

When obtaining advice it is important to be furnished with the complete illustration of the stepped and levels options of the insurer to enable an understanding of the long-term overall cost.

Insurance discussions with adult working children

As people grow older and their children make their own way in life, they do not give much thought to the impact as a parent if the child became disabled due to sickness or accident. What often happens is the parent steps in to support the child. The financial burden could be huge and impact significantly on retirement savings.

Increasingly, we are seeing parents step in and fund the personal insurances for their adult children, at least in the early years. If a 25-year-old is earning $50,000 a year, the income could be insured for as little as $40 per month. In the event of a disability, if the benefit period was to age 65, they could receive $2,800,000 with claims indexation of 3%. This is a small price to pay to ensure retirement assets are protected, and the child can take over the premium payments at a later stage.

Roy Agranat is a specialist risk adviser with [Fairbridge Financial Services](). *This article is general information and does not consider the circumstances of any individual, and the rates quoted are indicative only.*

Australian shares: what happened to the miracle economy?

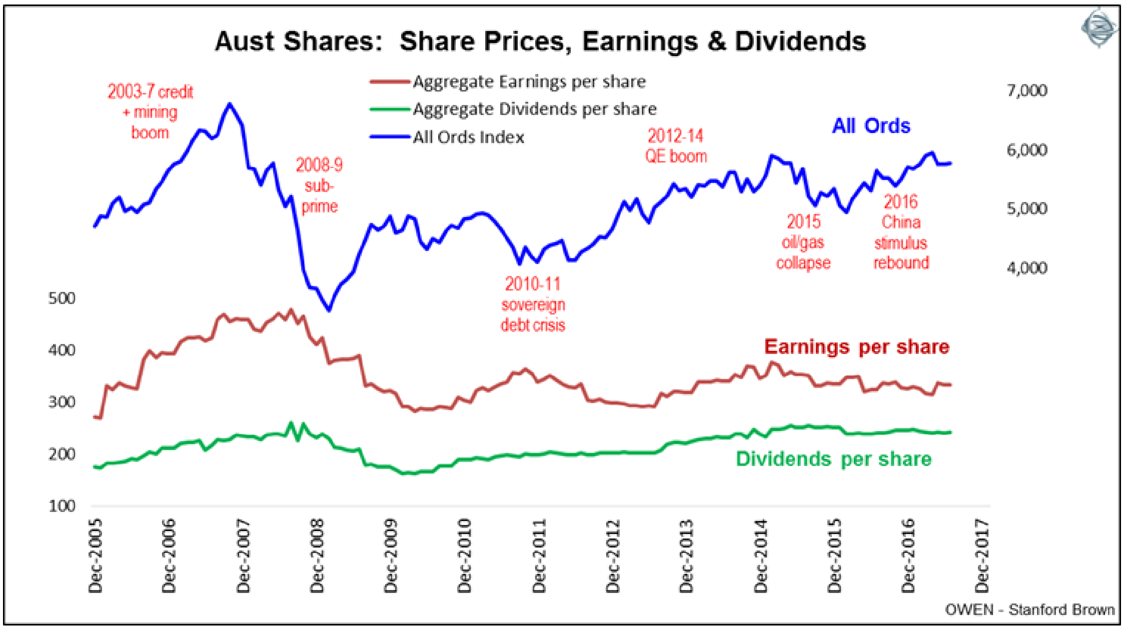
Ashley Owen

As we head into year-end profit reporting season in Australia (most companies have their financial years ending in June) it is worth checking where we are in the earnings and dividend cycle.

Company earnings tend to rise after economic booms and then decline after economic slowdowns. There is a lag between when activity affects a company and the time it reports it to the market, often many months later. Share prices lead earnings. Ironically, share price crashes generally occur while earnings are strong (because reporting lags activity) and share rebounds generally happen when earnings are weakest. Dividends lag even further behind. Dividends cuts are the last resort for boards.

Earnings and share market cycles

The chart shows the All Ordinaries Index (blue), the aggregate company earnings per share (orange) and aggregate dividends per share (green) since 2005.



2008 was a great year for profits (although much of it was accounting fiddles, revaluations of already over-valued assets, and straight out fraud, as it is in all booms) but share prices crashed. Then in mid-late 2009 to 2010 earnings were falling and dividends were being cut savagely but share prices rebounded strongly.

The problem at the moment is on the right side of the chart. Aggregate earnings per share fell in 2015 and 2016, mainly due to losses in the big miners, oil and gas, and other write-offs on bad acquisitions such as by NAB and Woolworths. Dividends are also weak, again mainly due to mining but also ANZ last year and probably Telstra soon.

Company earnings and dividends struggling

Despite Australia's so-called 'miracle economy' that has not had a 'recession' in 25 years, company earnings are still some 30% below where they were 10 years ago, and dividends are still 7% lower - and that's before inflation. The actual dollar amount of dividends has risen, but the per-share figures are lower because of all the dilutive capital raisings imposed on investors in the GFC. Investors have had to put their hands in their pockets due to the mistakes of managements and boards and to pay more for the same dollar amount of dividends.

In the up-coming August reporting season, we are expecting modest growth in earnings and dividends. The big cartel-like banks are reaping windfall profits from their co-ordinated rate hikes on housing loans while they keep loss provisions at wafer-thin levels, and the miners are restoring profits and dividends as they put prior losses behind them thanks to the commodities price rebound in 2016.

What lies ahead?

This calendar year thus far has been kind to investors who hold sensibly diversified portfolios. Share prices are rising in most markets around the world, interest rates remain low everywhere, oil prices are benign, and market volatility is at record lows. There are even early signs of much hoped-for price inflation in Europe and Japan. Only faint, but enough to prompt central bankers to start talking about scaling back asset buying programs and maybe even raising interest rates. Probably too soon, but the prospect has kept bond yields low after their spike late last year.

Europe seems to have settled down a little following Emmanuel Macron's stunning election win in France, but a much larger test will be at the Italian elections later this year. Italy has probably the largest general anti-Europe vote and it may be a repeat of Brexit. Chinese growth numbers are being propped up leading up to November's convention when Xi Jinping will seek (and receive) glowing endorsement of his glorious reign. In Australia, the government seems to glide along not doing much, getting diverted into endless dead ends and distractions. The local economy bounces along lurching from one source of good fortune to the next. This time it is the purely fortuitous rise in commodities prices and the resulted unexpected gains in mining tax revenues taking the pressure off doing anything about the budget deficit and mounting debt pile.

In the US President Trump remains completely incomprehensible and unpredictable. Months ago, I gave up trying to remember the names of all the various characters he hires and fires each week. So far Trump has run into difficulty getting his legislation through Congress and his executive orders through the Courts. Where he has freer rein is in foreign policy, but in the past week another major check to his power was added when Congress effectively blocked his ability to lift sanctions on Russia. Trump is certainly inventing new ways to be unconventional, but the rest of the system (and increasingly his own Republican Party) is also inventing new ways to make sure he doesn't do too much damage. The bigger picture is that Trump is probably removing America from its dominant place in the world, exemplified by the recent G-20 meeting in Hamburg which effectively became the G19 without Trump.

When an incumbent power is removed or vacates its central role, the resulting vacuum rarely resolves itself neatly. There will be big challenges ahead where real leadership is required, such as dealing with China's North Korea.

Ashley Owen is Chief Investment Officer at privately-owned advisory firm Stanford Brown and The Lunar Group. He is also a Director of Third Link Investment Managers, a fund that supports Australian charities. This article is general information that does not consider the circumstances of any individual.

Summary of LIC performance over a solid financial year

Peter Rae

In the 12 months to 30 June 2017, the S&P/ASX 200 Accumulation Index was up 14.1% driven by a good performance from large caps and strong gains in the resources sector with the S&P/ASX 200 Materials Index up 25.8%. Small caps underperformed over the financial year with the index up 7.0%. There appears to be some value in the small cap sector, with a number of small cap managers viewing the market as slightly undervalued relative to large caps.

Best 5-year portfolio returns - % p.a.*#

Australian Large Cap Focus					Small/Mid Cap Focus & Others				
Company	3M	1Yr	3Yr	5Yr	Company	3M	1Yr	3Yr	5Yr
WHF	-1.7	10.8	7.9	15.3	FOR	2.9	25.2	18.4	21.7
DUI	-0.7	17.6	6.8	13.0	GFL	1.0	11.2	11.3	16.8
AMH	1.1	6.0	6.5	12.1	WAX	-0.4	6.9	12.1	15.6
FSI	1.3	4.6	6.0	11.5	MIR	2.1	6.9	7.6	13.2
ARG	-1.7	12.9	5.8	11.4	HHV	-5.6	-13.6	6.9	13.0

Discounts & Premiums to pre-tax NTA - %

Largest discounts		Largest premiums	
Company	Discount	Company	Premium
BTI	-15.9	WAM	22.6
BST	-15.8	WAX	22.4
FSI	-15.5	FOR	17.0
CTN	-11.4	DJW	13.6
GC1	-8.6	MIR	13.0

*Data to 30 June 2017. Only includes LICs covered by IIR
#Portfolio return = Pre-tax NTA + dividends per share

Some value amongst the large cap LICs

The Australian large cap LICs benefited from the solid market performance over the 12 months to 30 June with the five largest LICs delivering an average portfolio return (pre-tax NTA plus dividends) of 11.5%. This was below the S&P/ASX 200 Accumulation Index return of 14.1% and largely reflects underweight positions in resources. Over the medium to long-term we expect the Australian large cap share focused LICs to perform broadly in line with the market.

For investors seeking exposure to the Australian large cap market sector, the three largest LICs, Australian Foundation Investment Company (ASX:AFI) Milton Corporation (ASX:MLT and Argo Investments (ASX:ARG) offer reasonable value trading at or slightly below pre-tax NTA at 30 June 2017 compared to their three-year average premiums to pre-tax NTA. The shares are currently offering fully franked dividend yields of 4% or better. We have a Highly Recommended rating on all three LICs.

Australian United Investments (ASX:AUI) and Diversified United Investments (ASX:DUI) were the top two performing LICs in our coverage over the year delivering portfolio returns of 18.0% and 17.6% respectively. These two LICs have benefited from overweight positions in some of the major banks, CSL and RIO. DUI has also been one of the best performing large cap LICs over the past five years as shown in the above table.

Historically, AUI and DUI have traded at a discount to pre-tax NTA. However, at 30 June 2017 their discounts of 5.6% and 7.0% were slightly higher than their three-year average discounts. Our rating for AUI is Recommended Plus and our rating for DUI is Recommended. Investors should be aware that DUI also has some exposure to international equities with up to 10% able to be invested in international markets via ETFs.

Aberdeen Leaders (ASX:ALR) also performed strongly over the 12 months to 30 June 2017 outperforming the broader market with a portfolio return of 14.9%. The portfolio benefited from overweight positions in CSL, RIO and AGL. Over the longer-term ALR has underperformed the S&P/ASX 200 Accumulation Index. At the end of June, ALR was trading at a 7.9% discount to pre-tax NTA in line with its three-year average. Our rating for ALR is Recommended.

Small caps underperform the broader market

Excluding two outliers that delivered significant negative returns, the average return for small cap focused LICs for the 12 months to 30 June 2017 was 7.6%, slightly above the ASX Small Ordinaries Accumulation Index return of 7.0%. Forager Australian Shares Fund (ASX:FOR) was the best performing small cap focused entity in our coverage with the company benefiting from a strong weighting to the recovering mining and mining services sectors.

As the table above shows, FOR has also been the best small/micro-cap focused performer over the past five years (including pre-listing data) delivering an outstanding portfolio return of 21.7% p.a. Since inception, the high conviction strategy and concentrated portfolio approach has delivered strong returns, with the portfolio outperforming the S&P/ASX All Ordinaries Accumulation Index by 7.5% p.a. Our rating for FOR is Recommended Plus however, as the above table shows the units were trading at a 17% premium to NTA at 30 June 2017.

We would prefer to buy the units closer to NTA. Westoz Investment Company (WIC) was another small-cap focused entity to benefit from the strong resources sector, delivering a portfolio return of 13.5% for the 12 months to 30 June 2017. Whether it can continue to perform well depends on the outlook for resources and the resources based West Australian economy. Over the past five years WIC has delivered a portfolio return of just 2.2% p.a. despite the strong returns of the past 12 months. Our rating for WIC is Recommended.

WAM Capital (ASX:WAM) delivered a portfolio return of 9.6% for the 12 months, above the small cap index return of 7.0% but below its benchmark ASX All Ordinaries Accumulation benchmark return of 13.1%. As the table above shows, WAM Research remains the best of the Wilson Asset Management LICs over a five-year period although over the past 12 months its portfolio return of 6.9% was below both the small cap index and the ASX All Ordinaries Accumulation Index returns. These LICs continue to trade at significant premiums to NTA. Whilst our recommendation for WAX is Highly Recommended and WAM is Recommended Plus, we would rather be patient acquirers of the shares at levels much closer to pre-tax NTA.

Strong performance from international shares

Returns from the international focused LICs were positive over the 12 months to 30 June 2017 with international markets performing well. This sector delivered an average portfolio return of 17.1% compared to the MSCI World Index (AUD) return of 14.7%. Emerging market focused LICs delivered a return of 14.5% against the MSCI Emerging Market return of 20.1%. With a number of market commentators suggesting that emerging markets look better value than a fully priced U.S. market, we could see further outperformance of emerging market shares in coming months. IIR covers two emerging market focused LICs/ LITs, Emerging Markets Masters Fund (ASX:EMF) which invests in a portfolio of emerging market funds and Asian Masters Fund (ASX:AUF) which invests in a portfolio of Asian Equity Funds. AUF has the ability to indirectly invest in China A-Shares through its manager selection. At the end of June EMF and AUF were trading at small premiums to NTA of 1.6% and 0.8% respectively. We have a Recommended Plus rating on both entities.

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