

SHAREMARKET INVESTING 101 — BACK TO BASICS

continued from page 12

What the chart clearly highlights is that building wealth through equity investments has to be a long term proposition. There are always major events occurring that will impact global economic and corporate performance and investor sentiment. We literally move from one major issue to another in a relatively short space of time and this will never change given the increasing internationalisation of markets.

However, as index managers argue, the long term trend is upward and after each major setback, equity markets have always recovered and moved onward to post new highs.

For this reason, we believe investors should maximise their return potential by using periods of weakness to top-up their investment portfolio. In 2009 the sharemarket was widely regarded as being the best value in decades. Whilst it is not as cheap now, valuations do remain quite favourable. The market is currently trading at a FY11(f) Price Earnings Ratio (PE) of 11.17 times. The average market dividend yield is currently 3.49%.

To justify a long term investment, there needs to be a dividend back to investors, so we believe yield is an extremely important consideration. Diversification ameliorates risk and volatility and enables investors to combine a selection of lower yield growth oriented stocks, like Rio Tinto and CSL with the higher yielding value oriented stocks like banks, Metcash and dare we say, Telstra. This gives investors an average yield across the portfolio, whilst creating exposure to a spread of assets. More growth oriented investors with less dependence on income can weight their portfolios to growth stocks, while income dependent investors will be more biased to the higher yielding stocks.

Sticking to the basics

It is important to adhere to an asset allocation strategy both across an entire portfolio of diversified investment assets and within the share portfolio itself. That means if one stock or one asset has performed strongly and has become an overweight position, be prepared to take some profits and rebalance. If a stock has performed poorly, revisit the thesis for being invested. Situations do change. If it is no longer a quality asset, it should not be in the portfolio. There will be other alternatives that provide better opportunity.

If the fundamental reasons for being invested in a certain stock or asset have not changed, then a setback should be regarded as an opportunity. Think back to some of the excellent opportunities that were presented to investors in 2008-9 as corporates scrambled to recapitalise balance sheets and offered deeply discounted share purchase plans. Think RIO, Wesfarmers, the banks and many other stocks. Without doubt, these were uncomfortable and uncertain times for investors, but in hindsight a wonderful opportunity to invest in quality blue chip companies.

As readers will have seen on page 9, we remain in Zone 5 which we consider as an outright 'long term buy' signal on equity investments. Also, for those investors who keep an eye on technical trading methods, in mid June the Dow Jones and the S&P500 made a positive crossing of their 200 day moving averages for the first time in about a year. Australia remains below the 200 day moving average by about 100 points but is likely to follow suit. The 200 day moving average is closely monitored by the industry and a positive crossing is regarded as a sign of bullish momentum. Short term good news for equity investors has been very welcome after the last few months of uncertainty.

TELSTRA (TLS) \$3.23 — SOME GOOD NEWS AT LAST

By Lisa Baum

Over the weekend Telstra announced the signing of a long awaited Financial Heads of Agreement with NBNCo (National Broadband Network). The deal remains non-binding at this stage and is subject to enabling legislation, a shareholder vote expected in 2hFY11 and ACCC approval.



For Telstra, the agreement will have an after tax net present value of \$11 billion, of which \$9 billion will be paid by NBNCo with a further \$2 billion from the Government through policy reforms. The timeline and tax considerations are yet to be defined.

The deal involves the decommissioning of Telstra's copper and cable networks and the use of its passive infrastructure and backhaul fibre by NBNCo. It also encompasses the value of avoiding certain costs like the universal service obligation levy (USO) which will be transferred to a newly established entity, thus relieving Telstra of this obligation.

Over time Telstra will move its voice and broadband fixed line traffic to NBNCo but will continue to use the hybrid fibre-coaxial (HFC) network to deliver Foxtel. NBNCo becomes the last resort wholesale supplier of fibre connections in greenfield deployments (greenfield is a project which lacks any constraints imposed by prior networks) from January 2011.

From the Government's perspective the deal meets the definition of structural separation and avoids the threatened functional separation of Telstra. The Prime Minister has also provided written assurance that Telstra will be able to bid for future Long-term Evolution (LTE) spectrum if the deal proceeds.

Advantages for NBNCo include a substantially lower build cost (by billions of dollars) and access to Telstra's customers for take-up of the new technology, which means greater revenues.

The deal will provide the long awaited positive catalyst for Telstra. The stock will benefit from an immediate uplift in share price as uncertainty is removed and analysts rework their projections. It will take time and the devil will be in the detail.

The full positive impact however may still take a while to filter through, as it will take several months and up to a year for the deal to be sealed and delivered. However, at this early stage it would appear to be a positive deal for all stakeholders.

One point to remember with regard to Telstra is that the Future Fund's residual 11% stake is now out of escrow and the Fund has indicated it is not a long term holder of the stock. This large stock overhang is likely to be a cap on share price performance until the holding has been bedded down. This may well occur sooner than later now the NBN deal has been agreed.