



US Direct-Share Portfolio Service

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Palmer Portfolios Pty Ltd (ABN 41 533 933 417) is a Corporate Authorised Representative (No. 301761) of Palmer Portfolios Group Pty Ltd (AFSL:376719 / ACL: 376719 / ABN 78 145 431 107)

Snapshot: US portfolio service

Our US direct share portfolio service is a fully-managed 40-stock portfolio of direct US equities.

Target return & Strategy

- 15-20% p.a. long-term return (5-10%p.a. above benchmark S&P500)
- Overall strategy and stock selection based on well-proven quantitative research methodology
- For Australian clients, presents an opportunity to buy \$US investments while Australian dollar is historically high

Account structure

- Accounts are held direct with Interactive Brokers Inc (discount US broker). Palmer Portfolios as licensed adviser
- Accounts can be held by Australian Individuals, Companies, Trusts or Self Managed Super Funds
- Minimum investment \$200,000

Fees

- Interactive Brokers – Very low brokerage (US 0.5cents per share bought/sold)
- Palmer Portfolios – 0.4pc (+GST) per quarter + performance fee (if benchmark outperformance achieved)

Introduction

Palmer Portfolios is one of the few licensed advisers in Australia to offer its clients the option of investing directly into US-listed companies.

Our superior research, low cost-of-service and track record of results, make our US portfolio service a sensible long-term option for investors.

The Australian share market represents just 2% of the world share market. Within our Australian market, there is a strong bias towards banking and mining stocks, with the big four banks alone making up 24% of the total share market by market capitalisation. Traditionally, for Australian investors to gain exposure to a diverse range of foreign companies they have had to buy units in international managed funds. This typically results in an extra layer of fees for Australian investors and little transparency as to the underlying investments held in a client's portfolio.

With the Australian dollar close to an all-time high against the US dollar, diversifying into US investments is also a way to potentially capitalise on the strength of our local currency.

This document provides information on:

- Why you might consider a US equities portfolio
- Our US investment strategy and target rate of return
- Choice of broker and account set-up procedures
- Compliance and regulatory protections
- An overview of fees and other costs
- Risks and exchange rate considerations
- Taxation considerations
- Further information and reading

Why US equities?

Diversification

A key consideration for investing in US equities is diversification.

The Australian share market is heavily weighted towards banks and mining companies, which limits investors choices for constructing a diversified portfolio of companies from a varied range of industries.

By contrast, in the US you can invest in IT leaders Google (Nasdaq:GOOG) and Apple (Nasdaq:AAPL), right down to quirky little growth companies like Build-A-Bear Workshop (NYSE:BBW) and 99 Cents Stores (NYSE:NDN). Increasingly, companies from Europe, Asia and other emerging markets are also “dual-listing” on the US share market, which opens the door to an even greater diversity of investment opportunities.

Apart from the greater variety of companies, the US share market is also significantly larger than Australia's market. The Australian share market has just 880 companies with a market size greater than \$50 million, while the USA has about 4,750 listed companies greater than \$50 million in size. Immediately, your “universe” of investment opportunities for a competent investment adviser is increased.

The issue of diversification can also be extended to look at an Australian investor's typical household balance sheet. The average Australian is primarily invested in three asset classes – Australian property, Australian shares and Australian cash (and most often with a heavy tilt towards property). While Australian property has historically been a sound performer, our nation's “over-weight” position in real estate can be seen as a diversification risk.

Historically high Australian dollar

Another key reason why most Australian investors are open to the idea of investing overseas, is that the Australian dollar is unusually high. In a nutshell, your \$A buys a lot more than it did before. Ten years ago one Australian dollar bought 53 US cents, while today (March 2012) it buys twice as much at about \$US1.06.

While we cannot predict the future of currency movements with any great accuracy, historically there has never been a better time to convert \$A to \$US. (See more information on currency considerations and risks on page 9)

Very low trading costs

Australian investors have typically been over-charged for share brokerage, both for buying local Australian companies and for buying US or other foreign stocks through so-called discount brokers like Commsec. Australian online brokers will typically charge a minimum of \$20-\$30 for an average share transaction (buy or sell) in Australia, and up to \$100 per trade to buy or sell US shares. However, Australian investors holding an account *direct* with a US broker can easily buy or sell US shares for as low as \$5 per trade.

With Palmer Portfolios' US share portfolio service, we have partnered with what we believe is the best value-for-money online broking service. The lower transaction costs also gives investors scope to buy smaller parcels of shares thereby increasing the total number of companies held in an investor's portfolio, increasing diversification and lowering the barriers to starting a US portfolio.

Investment Strategy & Target Return

This section outlines the investment strategy and stock selection process for our client's US portfolios. The overall strategy is a blend of two distinct styles of investing – Value and Growth. In simple terms:

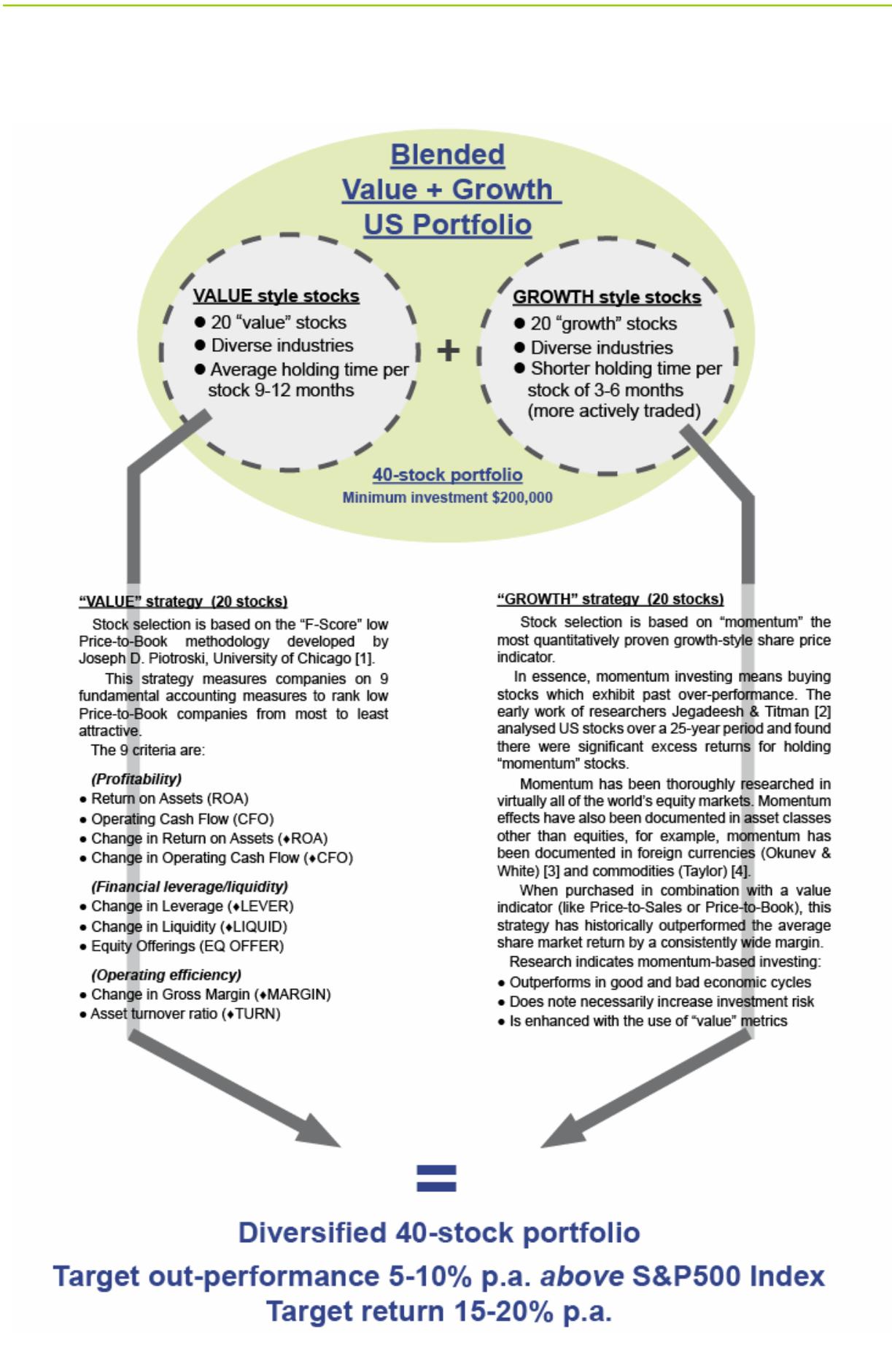
1. Half of your portfolio will be invested in 20 different stocks, chosen according to a strictly followed VALUE-based quantitative strategy.
2. Half of your portfolio will be invested in 20 different stocks, chosen according to a strictly followed GROWTH (momentum) based quantitative strategy.

In total, your portfolio will be spread across 40 different stocks, sourced from two different, but complementary, investment styles.

It is widely acknowledged that share markets go through cycles where "Value"-style investing outperforms (usually in an overall "bear" market), and periods where "Growth"-style investing outperforms (usually in a "bull" market).

Palmer Portfolios overall strategy is to have client's portfolios split between the two main investment styles, in two well-researched and tested individual strategies. Having two independent strategies working within your portfolio is designed to smooth some of the volatility associated with normal market cycles, and improve your portfolio's overall risk-adjusted return.

The following page highlights the structure and overall strategy of our US portfolio service:



Choice of broker & account set-up

Interactive Brokers

Client portfolios are held through a trading facility with Interactive Brokers (www.interactivebrokers.com) a US-based online share broker. Interactive Brokers Group Inc provides direct access ("online") trade execution and clearing services to retail and institutional stock investors.

Interactive Brokers Group Inc has consolidated equity capital of more than \$US 4 billion and is regulated by US Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), the New York Stock Exchange (NYSE), the Securities and Futures Authority (SFA) and other regulatory agencies around the world.

In March 2012, Barron's rated Interactive Brokers "Best Overall Online Broker". It was ranked "best" in seven categories, including "Best for International Traders". Interactive Brokers was rated ahead of 26 other US online brokers.

Interactive Brokers has an office in Sydney, Australia, to assist with account setup for Australian clients.

Account set-up

Clients can open their US portfolio accounts as either:

- Individuals (or joint individuals)
- Companies
- Trusts
- Self Managed Super Funds

Palmer Portfolios will co-ordinate the account set-up process with Interactive Brokers and also the identification needed to comply with both Interactive Brokers' requirements and also Australia's Anti-Money Laundering and Counter-Terrorism Financing (AML/CTF) Act.

The minimum initial investment is \$200,000.

Compliance & Regulatory protections

There are several compliance protection mechanisms in place to safeguard the integrity of your investments and cash. Please note these protections do NOT cover you against investment loss as a result of fluctuations in individual share prices, your overall portfolio value or currency movements.

Your Interactive Brokers account

Interactive Brokers is regulated by the SEC, FINRA, NYSE, SFA and other international regulators. Customers' share accounts at Interactive Brokers are protected by the US Securities Investor Protection Corporation ("SIPC") for a maximum coverage of \$US500,000 (with a cash sublimit of \$US250,000) and under Interactive Brokers' excess SIPC policy with certain underwriters at Lloyd's of London for up to an additional \$US30 million (with a cash sublimit of \$US900,000) subject to an aggregate limit of \$US150 million. As with all securities firms, this coverage provides protection against failure of a broker-dealer, not against loss of market value of securities.

Palmer Portfolios Group Pty Ltd

Palmer Portfolios Group Pty Ltd holds an Australian Financial Services Licence (AFS Licence: 376719), which authorises our representatives to provide investment advice on a wide range of investments, including Australian, foreign and US equity investments. Details of our AFS Licence are contained in the current version of our Financial Services Guide. You can also visit the Australian Securities and Investments Commission's website and search for our details in the AFS Licensees register (www.asic.gov.au).

Palmer Portfolios Group Pty Ltd does not hold any client funds, or at any time accept any deposits from clients. All client investments (both in Australia and overseas) are held direct with third-party regulated custodians, with Palmer Portfolios Group Pty Ltd as the appointed investment adviser.

As per ASIC requirements, Palmer Portfolios Group Pty Ltd also holds Professional Indemnity (PI) insurance, details of which are also contained in our Financial Services Guide.

Fees and costs

The cost to you of having a professionally managed portfolio of US stocks, can be broadly broken down into two categories:

- 1) Our fee (Palmer Portfolios) for management of your portfolio strategy, execution of trades and to provide an annual summary of your capital gains, dividends and interest income.
- 2) Transaction costs charged by Interactive Brokers for share brokerage and currency conversions

Palmer Portfolios

- Portfolio Management fee: 0.4% (+ GST) per quarter
- Performance fee: 10% (+GST) of any benchmark outperformance
(charged only when your portfolio outperforms, and calculated only on the "outperformance" component)

Palmer Portfolios charges a portfolio management fee of 0.4% (+GST) per quarter. This fee is calculated on the average daily value of your shares and cash held in your Interactive Brokers account over each quarterly period. This fee covers

- The underlying ongoing research, investment selection and strategy implementation decisions
- Execution of trades in your portfolio (typically conducted between midnight and 6am AEDT)
- Annual summary of capital gains, dividend and interest income information for tax purposes

Palmer Portfolios also charges a performance fee which is equal to 10% (+GST) of any benchmark outperformance. The benchmark for calculating outperformance is the S&P500 Index. Each quarter, the return of your portfolio will be calculated and compared to the return achieved by the benchmark S&P500 Index. When your portfolio "outperforms" over the quarter, Palmer Portfolios will calculate and charge a performance fee equal to 10% (+GST) of your outperformance component only.

Interactive Brokers

Brokerage (the transaction fee charged by an online broker to buy or sell shares) is generally cheaper for US stocks than it is for Australian shares. The brokerage through Interactive Brokers is based on the *quantity* of shares bought and sold in each company, not the dollar value of each trade. IB's brokerage is \$US0.005 *per share* bought or sold. For example on a \$US20,000 transaction (1,000 shares at a share price of \$US20), the brokerage would be \$US5 (1,000 x \$US0.005)

There is no custodian or ongoing annual or monthly administration fee charged by Interactive Brokers

Converting funds between different currencies (i.e. at account setup time, or when processing withdrawals back to Australian dollars or other currencies) can also result in a small transaction cost (buy-sell spread). For transfers of at least \$25,000 this is estimated to be less than 0.1% through the Interactive Brokers platform, which is highly competitive compared to the buy-sell typically charged by Australian banks.

(Please be aware there are NO commissions, or any other inducements, paid to Palmer Portfolios by Interactive Brokers. We have selected Interactive Brokers as our preferred US broker purely based on our independent research of their services, fees and online functionality. Brokerage and fees paid by clients to Interactive Brokers are identical to that paid by Palmer Portfolios advisers in their own personal US portfolios.)

Risks & Exchange Rate considerations

While owning shares in US companies is very similar to owning shares in Australian companies, there are a few specific considerations, particularly for Australian investors.

For Australian investors (and other non-US investors)

Australian investors will typically value their personal wealth in Australian dollars. Similarly, an investor who lives in the UK is likely to value their wealth in pounds sterling. By investing in US shares you will be exposed to the normal risks associated with share ownership (outlined below), plus the risk that currency movements could also either decrease or increase the value of your portfolio, if measured in your "home" currency.

For Australian investors, while the \$A is historically high against the \$US, investors should note that if they buy US shares and the value of the \$A continues to rise, this will devalue the value of a US share portfolio in \$A terms. Conversely, if the \$A were to fall in value, this will inflate the value of a US share portfolio in \$A terms.

It is important to understand this foreign exchange relationship and how it relates to your "home" currency.

For all investors (Australian or overseas-based)

Investing in shares is inherently more risky than other asset classes, like cash or bonds. The trade-off for this extra "risk" is potentially higher long-term returns. If you invest in shares, your portfolio value will rise and fall in value and can potentially suffer prolonged periods of negative returns.

Before investing in shares (in any market) you should understand this "risk-return trade-off" and that your portfolio will inevitably undergo periods of both positive and negative returns.

(While most of Palmer Portfolios clients are Australian residents, we do have a number of overseas-based client earning income and holding investments and property in US dollars. The \$A-\$US exchange rate considerations outlined above are therefore less (and in some situations completely) irrelevant for these clients. Non-Australian residents should also seek independent advice in their country of domicile as to the tax implications of holding direct US investments.)

Taxation considerations

Anyone considering holding US investments should seek out qualified tax advice before making any investment decision. Palmer Portfolios is not authorised to provide taxation advice and no part of this document should be relied upon for tax purposes.

For clients who are Australian residents for tax purposes, capital gains tax rules and other considerations are generally the same for investments whether they are held in Australia or overseas. If you are an Australian resident for tax purposes, any income you earn from dividends, cash or other sources overseas is generally taxed the same as income earned in Australia.

Please note, dividend yields on US shares are generally lower than on Australian shares.

Further information

Please contact Joel Palmer for further information about Palmer Portfolios US portfolio service.

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Further reading

PDF copies of the following research articles are available by emailing joel@palmerportfolios.com.au

- [1] Piotroski, Joseph D, *Value Investing: The Use of Historical Financial Statement Information to Separate Winners from losers*. Selected Paper, University of Chicago Graduate School of Business
- [2] Jegadeesh, N. and S. Titman, *Returns to buying winners and selling losers: Implications for stock market efficiency*. Journal of Finance, 1993. 48(1): p. 65-91.
- [3] Okunev, J. and D. White, *Do momentum-based strategies still work in foreign currency markets?* Journal of Financial and Quantitative Analysis, 2003. 38.
- [4] Taylor, S.J., *Forecasting Market Prices*. International Journal of Forecasting, 1998. 4: p. 421-426.

Further reading on momentum growth strategies

Rouwenhorst, K.G., *International Momentum Strategies*. Journal of Finance, 1998. 53(1): p. 267-284.

Griffin, J.M., S. Ji, and J.S. Martin, *Global Momentum Strategies: A Portfolio Perspective*. Available at: SSRN: <http://ssrn.com/abstract=492804>, 2004.

Demir, I., J. Muthuswamy, and T. Walter, *Momentum returns in Australian Equities: The influences of size, risk, liquidity and return computation*. Pacific-Basic Finance Journal, 2004. 12(2): p. 143-160

Disclaimer

This content is general in nature and has been prepared for information purposes only and does not constitute any specific recommendations. It has not taken into account your objectives, financial situation or needs and you must therefore assess whether it is appropriate in the light of your own individual objectives, financial situation or needs, to act upon this content. We recommend that you obtain financial, legal and taxation advice before making any financial investment decision. You should refer to the Palmer Portfolios Group Pty Ltd/Palmer Portfolios Pty Ltd Financial Services Guide in relation to any financial services provided to you.

This information is given in good faith and has been derived from a source believed to be reliable and accurate. This document is produced by Joel Palmer and any views expressed are those of the individual sender, and do not necessarily express the views or opinions of Palmer Portfolios Group Pty Ltd.

Any performance figures or targets mentioned in this article are not a guarantee of future returns. Any companies mentioned are not necessarily stocks that would meet our research and selection process.

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