NEWSLETTER
December 2018

Introduction

The Australian sharemarket continued its fall over the past month. Pretty clearly, this fall is being driven by changing sentiment in the US market. When we look at the drivers of the US market, this does not make a lot of sense. But the old saying appears to be true: when the American market catches a cold, the rest of the world sneezes.

A look at (recent) history… betting on the Melbourne Cup

In 2018, www.finder.com looked at the way Australians spend money at Christmas. They came up with some intriguing results. For example, the average Australian spends $464 on Christmas presents. Women spend more than men - an average of $496 compared to men spending $432.

When the total spend for Christmas is added up (things like travel, food and celebrations), Australians spend around $25 billion on Christmas - $1325 per person. Gen X spend the most at $1396 per person (Gen X were born between the late 60s and the early 80s - basically, parents of today's teenagers and carers of today's elderly. No surprises that they spend the most, really). Baby Boomers spend the least, at $1234 each. (Baby Boomers were born before the 1960s. Their kids have all grown up and their parents have often left us). Perhaps Gen X can be proud, though, of the fact that they give twice as much to charity as their Baby Boomer counterparts - $76 versus $37.

And if you're thinking of giving someone a gift card? Maybe think again. In 2018, 23% of gift card recipients did not want to buy anything at the shop that issued the gift card! So, our suggestion this year? Why not just give everyone a hug instead?

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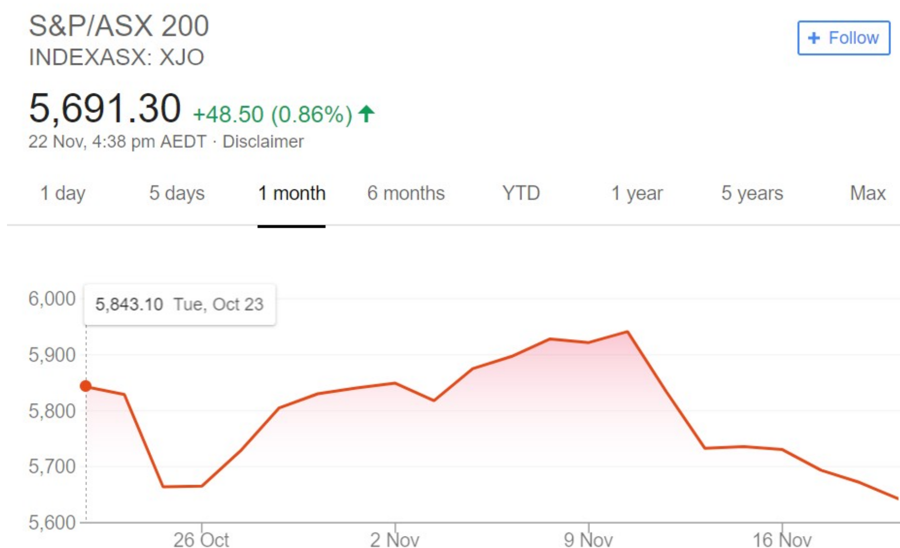
Our Share Market Report

The market giveth, and the market taketh away.

The last two months have seen substantial negative returns on the Australian market. In the month to November 22, Australia's market fell by approximately 2.6%, as measured by the ASX 200. Here is how it looks on Google:

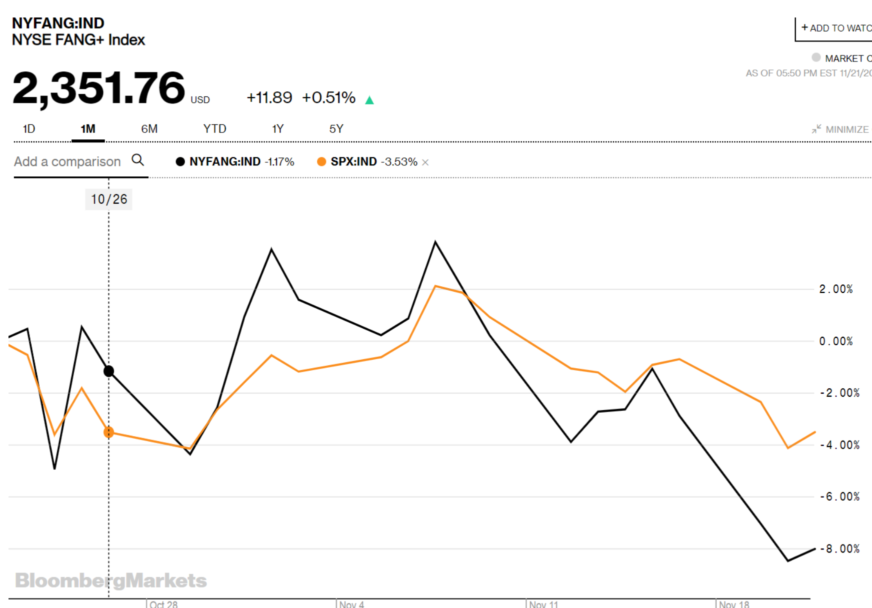


The fall in the Australian market largely mirrors what has happened on the US market. Across the same period, as measured by the S&P500, the American market fell by 3.8%. Again, here is how it looked on Google:

As we reported to you a few months ago, the American market has enjoyed extraordinary growth over the last 10 years. Much of this has come in the two years since Donald Trump was elected president, but the growth had been reasonably steady before that. As a result, a correction such as we are seeing at the moment was to be expected. Unfortunately, in the short term, when the American market catches a cold, markets in the rest of the world sneeze. For example, here is how the month leading to November 22 looked in the German market, as measured by DAX 30 index:

That is a fall across the month of 2.4% - although the market rose by 1.6% on the last day of our measuring month (November 21 in Germany). Before that, the fall was 3.9%.

For us here in Australia, perhaps the strange thing is that the falloff in the US market has been led by tech stocks. Always one for a nifty anagram, stock market analysts have identified what they call the FAANG companies - Facebook, Amazon, Apple, Netflix and Google. Of course, this anagram is pronounced 'Fang.' All these companies trade on the New York Stock Exchange. The FAANG companies now have their own index, and here is a graph that we sourced from Bloomberg that shows you the extent to which these companies are driving the American experience:



This graph shows only the movement in prices in the month to November 21, 2018. The black line is the FAANG companies. They fell by 8% for the month. The orange line is the S&P 500 index. It fell by 3.8%, as we reported above.

We must remember that the FAANG companies represent more than 30% of the S&P 500 index. So, if we remove the negative effect on that index caused by the tech companies, the negative performance of the S&P 500 becomes even less. In fact, the negative performance of the S&P 500 index minus the FAANG companies is less than 2%.

The huge impact of these tech companies on the American index can also be seen in this graph, again sourced from Bloomberg. This graph shows the performance of the FAANG companies (again indicated by the blackline) and the S&P 500 index since the start of 2018:

As you can see, in the first half of 2018, the market price of FAANG companies rose by an extraordinary amount of more than 30%. The general market was doing well enough, but nowhere near as well as these dominant five tech companies.

The market is now correcting. The news is becoming more sobering for many of these tech companies. The new iPhone has not had the success of its predecessors - perhaps indicating that people are becoming more discerning about whether they need to upgrade their phone *every* time a new version is released. Amazon is reporting flattening sales in many of its markets. Basically, business reality is catching up with exuberant share market investors. While technology stocks sell a different product, they are susceptible to the same market pressures as all companies. Basically, they need to keep selling stuff in order to keep making profits - and at some stage, the upper limit of how much stuff can be sold will be reached.

That the American experience is driven so much by a drop-off in the FAANG companies is no surprise. But it is somewhat surprising that the Australian market has followed suit so closely, because tech companies do not feature on our major indices. This should have prevented the Australian market from falling to the extent that it has. But *should* is a swear word in many walks of life, especially those where we are more interested in what *will* happen.

So, what will happen in the Australian market? Well, you would be a mug to try and predict where the sharemarket will go in the next month or two. But something that was missed in much of the news reported in November is that the Australian economy is chugging along quite nicely. The Reserve Bank reports some quite positive statistics - and put it all in a nifty little infographic which we reproduce here:

As you can see, economic growth is quite solid at 3.4% per year. Inflation is relatively low at 1.9%. Importantly, for the first time in quite a while, wage growth exceeded inflation. This means that real wages - which give us the best indicator of purchasing power - have also grown. Only by a little. But they have grown. Combined with falling property prices, this will help to reduce the level of housing unaffordability.

In the bottom right-hand square of the info graphic, the Reserve Bank provides us with the rate of GDP growth for China and the G7 countries. As it has been doing for more than a decade, China's economy is growing at a substantially faster rate than the rest of the world, including Australia. However, you can see that GDP growth in Australia is well in advance of the G7 countries. Again, this gives us pause for thought as to why the Australian sharemarket should have fallen to almost exactly the same extent as the share markets in many of these other countries. Our economy is performing more strongly than theirs.

This suggests that the long-term outlook for Australian shares remains positive. It is highly likely that the negative performance over the past few months is an overreaction in the Australian context. Of course, the trick investing is to buy low and sell high. No one knows whether the overreaction in the Australian market is now complete or whether there are more short-term falls to come. That is, we don't know when the US experience will be tempered by Australian reality. But if you take the long view - five years or more, it is highly likely that shares purchased now will enjoy positive returns over that time frame.

This is, of course, the minimum time frame that we recommend to anybody contemplating a sharemarket investment. If you have a timeline shorter than five years you are effectively guessing. But when you take a longer-term view, well, we call that *investing*.

The Legal Stuff

General Advice Warning

The above suggestions may not be suitable to you. They contain general advice which does not take into consideration any of your personal circumstances. All strategies and information provided on this website are general advice only.

We recommend you seek personal financial, legal, credit and/or taxation advice prior to acting on anything you see on this website.

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