NEWSLETTER

July 2018

EVEREST PARTNERS
PRIVATE WEALTH MANAGEMENT

Introduction

In this July newsletter, we have a look at the financial year that has just ended. And, when we compare residential property and the share market (Australia's two largest investment markets), we see a marked contrast: a great year for share market investors, not so great for residential property investors. Unless they invest in Hobart. Indeed, Hobartians with a decent share portfolio should be the happiest people in the country right now.

A look at history… Why is a Financial Year Different to a Calendar Year?

Financial advisers celebrate a different new year's day to the rest of the community. For us, July 1 is the start of the new financial year. This is actually mostly an Australian thing: different countries have different financial years. Many simply follow the calendar year, while others and their financial year at the end of March.

Australia uses a mid-winter change of financial year because that is the system that was used by most of the colonies prior to Federation in 1901. Each of the colonies had a treasury, and treasury would report to the colonial Parliament. The Parliaments sat in the middle of the calendar year, but not at the end. So, treasury created their reports for the 12 months ending in June each year.

There you have it: Australia uses a June-ending financial year because parliamentarians in the 1800s didn't want to work over Christmas.

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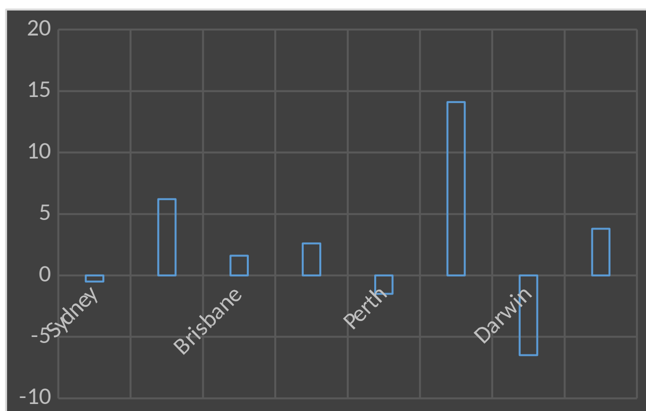
Property Market

The financial year that has just ended was a great one for people living in Hobart. This was confirmed, once again, by figures released by the Australian bureau of statistics in late June. The median price of an Australian dwelling (including land which comes with the dwelling) is now $687,700.

And how is this for a statistic: the market value of all of Australia's housing is $6.9 trillion. That is just over four times the size of Australia's GDP (which is the total of all of our economic activity in a year).

As is the way with these things, the figures released in June 2018 were current as at March 2018. The graph to the right shows the quarterly change for the three months of January, February and March 2018 (source: Australian Bureau of Statistics)



Melbourne and Canberra were the only other capital cities to do well, but as the first graph shows, Melbourne's growth all occurred earlier in the 12-month period. By March 2018, Melbourne residential property prices had actually started to fall, in line with the other major Australian market, Sydney.

Most commentators are predicting that these falls will continue, although no credible commentator is suggesting that the rate of fall will accelerate. The good judges are seeing these changes to house prices as adjustments following a very long period of price growth that reduced housing affordability almost everywhere. The recent changes in Hobart are therefore viewed as a 'catch up' as the preceding growth occurred mainly in the eastern mainland capitals – although the ABS Chief Economist Bruce Hockman also identified good economic fundamentals in that market: "Positive economic conditions in Hobart, such as solid jobs growth, rising employment and an increase in net interstate migration, are underpinning demand for property."

The ABS also identified a reduction in investor demand as the main reason for the falls in the major markets. This reinforces what we have been saying in our newsletters for some months. As Hockman put it: "Regulatory changes and tighter lending conditions have continued to affect investors, who are more active in the Sydney and Melbourne property markets."

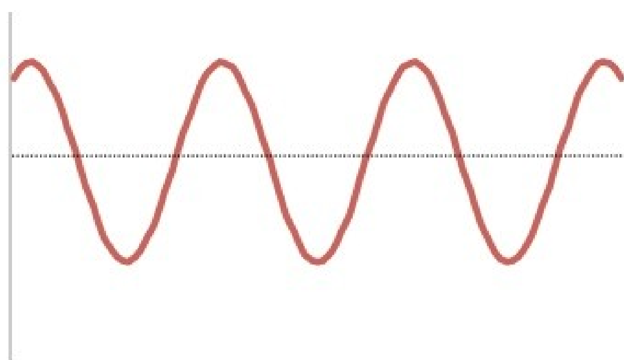
For us, this fills us with confidence about Australia's economic future. Why do we say that? Well, the policy makers with influence over the Australian economy have shown themselves to be remarkably proficient over the years. Virtually everyone agrees that residential property prices got out of hand. The policy makers took action to reduce demand from one sector of the market – investors – and that action has stopped price growth (everywhere but in Tassie) and reduced them a little in the larger markets. Here's hoping this soft landing can continue.

The Share Market

The Australian share market did much better than the residential property markets (except in Hobart) during 2017/18. Having started the financial year at 5,684 points, the market finished the year at 6,177 points. This is a capital return of 8.7%. Add in a dividend yield of around 4.1%, and the market rose by almost 13% for the year.

This will be good news for many people. It will be especially good news for people drawing pensions from their super funds. The amount of pension available each year is often a function of the closing balance as at the preceding 30 June. So, pension payments for 2018/2019 will be improved as a result of the share market performance – assuming that the super fund had a substantial amount of its asset allocation in a representative share portfolio.

Of course, the big question for share market investing is: where will the market go next? A lot of market experts will talk about something called 'reversion to the mean.' The 'mean' is a fancy word for average. The average in question is the long-term one, and the idea of reversion to the mean is that a period where things do better than the average will be offset by other periods where things do less well than the average. And vice versa. This works so that the long-term average is just that: a long term average. In the hypothetical world of theoretical statistics, here is how things might look (the dotted line is the average):



In the sharemarket, things are not this smooth. But the mathematics do tend to hold: over the longer term, performance does not stay above or below the average return for very long. Here is a graph showing just this phenomenon (source: Morningstar). The horizontal line is the average three-year return, and the blue line is the rolling three-year average return for the ten years to 2014. In broad terms, the periods above the average are matched by periods below the average:

So, what does this mean for 2018/19 and beyond? The quick response – and we saw this from some commentators who really should know better – is that the very good performance of the market in 2017/2018 will now be offset by a period of poor performance. Having gone up at a rate higher than average, the market will now compensate.

But that is way too simple a response. As the real-world graph shows, the sharemarket is not a see-saw. It does not go up one year and down the next. In fact, what is about to happen (that is, what will happen in the coming 12 months) is unrelated to what has just happened. That is because the main driver of share prices is investors' thinking about the future, and these thoughts are very vulnerable to sudden and unexpected information. Unexpected news can be 'good' or 'bad' and therefore can create optimism or pessimism. Optimism tends to drive prices higher and pessimism does the opposite.

Now, here is an interesting question: do investors prefer markets to be driven by pessimism or optimism? Be careful here: the answer depends on where the investor is in their 'lifecycle.' If the investor is still buying their investments, then they actually prefer a pessimistic market. After all, if you are buying, you want the purchase price to be lower.

If the investor has completed their buying, and is either holding or selling their investments, then they prefer an optimistic market. Higher prices are a good thing if you are selling.

One way to avoid being the 'wrong' kind of investor (a buyer when things are optimistic or a seller when things are pessimistic) is to try to avoid buying and selling all at once. We have said this many times before and we will keep on saying it forever. If you buy or sell smaller amounts at different points in time, then you go a long way towards avoiding buying or selling into a market where the 'wrong' sentiment prevails.

Happily, this often happens automatically for many people. For example, compulsory super contributions mean that employed Australians have regular amounts paid into their super funds. The portion of these funds that end up in the share market follow the 'buy over time' philosophy.

At the other end of a working life, when people start drawing down on their super, a similar thing can happen. Small amounts of shares are often cashed in at regular intervals to facilitate the gradual withdrawal of benefits through an income stream (sometimes called a superannuation pension). This system of selling needs a little more arrangement, however, so we always recommend that people see a financial planner before they commence drawing their income stream.

The other thing to remember, of course, is that the market average is healthily positive. So, even in years when the market return is below average, it is often still above zero. Years when the value of investments actually falls are relatively few – especially when we remember to factor in dividends. Most years are positive years.

So, don't worry so much about 'buying low and selling high.' Pay more attention to 'buying often and selling little.'

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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