NEWSLETTER

June 2019

EVEREST PARTNERS
PRIVATE WEALTH MANAGEMENT

Introduction

Welcome to our newsletter for June 2019 – the first since the Federal election in May. In this newsletter, we examine whether the election influenced the share market, as was claimed by some sections of the media. We also re-visit some of the Coalition's promises, so you can see how you fare from the election result.

Famous People in Finance – Simon Kuznets

OK, so Simon Kuznets may not be famous. But perhaps he should be. Born in Russia in 1901, Kuznets emigrated to the US in 1922. In 1933, following a US Senate inquiry into the state of the US economy, Kuznets was commissioned to come up with a way to calculate total national income. (Source: The Great Invention, Ehsan Masood).

His response was to create the forerunner of what we now call "Gross Domestic Product", or GDP. GDP – and in particular its rate of growth or decline – is now the primary measure of how well an economy is or isn't doing. Despite the fact that sometimes bad things cause GDP to rise (think car accidents, sickness and environmental disasters) and many good things are not included in GDP (think volunteering, housework and caring for relatives), most people like an economy whose GDP is growing steadily. Like Australia's has, for the past 28 years.

Vera Gu

+61 2 8051 3119

veragu@eppwm.com

eppwm.com

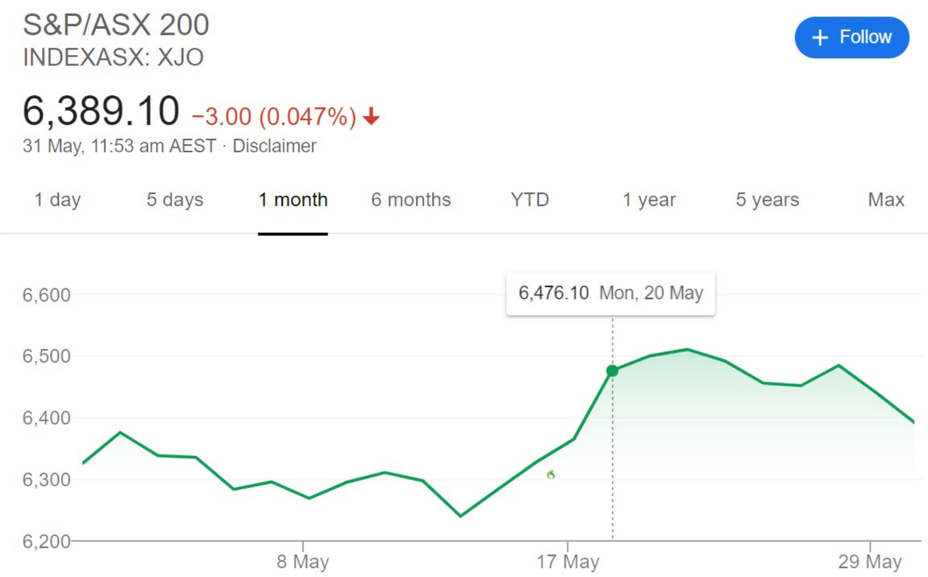
Robert Castro

+61 404 873 367

rob@eppwm.com

The Share Market

Overall, May was a gently positive month for share prices. As measured by the ASX 200 index, the market rose by around 1%. Here is how prices changed over the month, according to Google (the negative figure in red refers only to changes in the index on the last day of the month):

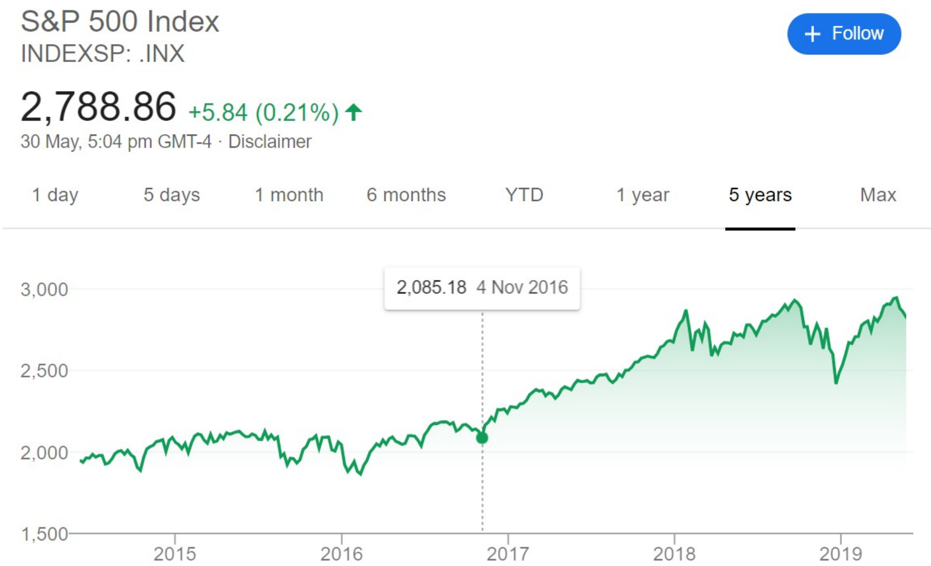


For the month, prices rose by approximately 1%. As the graph shows, the first two weeks of May saw the market dip to a low of 6239 points on Tuesday, 14 May. From there, prices started to rise. We have highlighted the largest single day rise in prices, which was 20 May. On this day alone, prices rose by 1.75%.

Monday, 20 May was, of course, the first trading day after the Federal election. This suggests that investors saw the re-election of the Coalition Government as good news. We will come back to that, but the fact that prices actually started to rise from Wednesday, May 15 is interesting. As anyone with even a passing interest in politics would have known, the Federal election result contradicted what pretty much everyone had predicted during the campaign. But over the three days between Wednesday, May 15 and Friday, May 17, when the whole world thought that Labor would win, the market rose by 2%.

These figures could be interpreted in a number of ways. Some might argue that, had the Labor opposition won the election, the boost to share prices on the morning of May 20 may have been even larger. This is something that we will never know. More intriguing is the potential notion that investors really do prefer Coalition governments - which could imply that the investment markets were predicting the election result in the days immediately before the official election. That is, the markets knew something that the rest of us didn't.

Plenty of market analysts would like us to think that they have this much foresight. But, unfortunately, there isn't much evidence that investors have this much political savvy. Have a look at the following graph, for example, which is also sourced from Google. It shows the S&P 500 index for American markets over the past five years.



We have highlighted the value of the index for the week ending November 4, 2016. This was the week immediately before Donald Trump was elected president. While it is a little difficult to see, the data shows that the American sharemarket *fell* by almost 2% during that week. In the week that immediately followed, the market *rose* by 3.8% - something that at the time was referred to as the 'Trump Bump.' There is no doubt that US investors feel positive since the 2016 election: market prices have risen by 34% in just 2½ years. Combined with an average dividend yield of approximately 2% (source: S&P), this implies total returns of just under 40% since Donald Trump was elected president.

It has to be noted, however, that in the US the markets did <u>not</u> predict Trump's election. Prices were falling immediately before Americans went to the polls in 2016, before rising immediately after. The election results surprised US markets.

Investing is not the only way for people to 'put their money where their mouth is.' Here in Australia, there is a common argument that betting markets are good at predicting things like election results. While we don't condone betting, it is worth examining this theory. The idea is a basic one: what people say is one thing, but if you really want to know what they think, look at how they spend (or bet) their money.

Guess what? The 2018 election completely smashes this theory as well. According to the Canberra Times, punters were spectacularly bad at predicting the results of our most recent election. Several bookmakers reported 70% of all bets being placed in the expectation of a Labor victory. This impacted on the odds being offered: in one spectacular case, one national bookmaker was offering $1.08 for a Labor victory. In case you're not a gambler, this means that for every $1 that a punter bet on a Labor victory, they stood to receive a profit of just eight cents. A coalition victory was offering odds of $11 - meaning that for every $1 that a punter bet on a coalition victory, they made a profit of $10. Depending on how you look at it, a statistician would argue that this meant that punters thought that a Labor victory was more than 100 times more likely than a victory by the Coalition.

So, with all due respect, punters had no idea who was going to win the Australian election. Which brings us back to our initial observation: investors became more positive about the Australian sharemarket in the days immediately before the May 18 election. Does this mean anything? In particular, does it mean that investors were accurately predicting the election result? Well, no. If investors had this power, we would see it in other elections. And if people generally had this power, we would also see it in the performance of punters.

In all likelihood, the Australian market was going to rise anyway on May 20. It was almost certainly simply a coincidence that the Federal election took place right in the middle of a small but significant 4% surge in share market prices, starting on May 15.

So, what was driving the increase?

Well, the main driver of sharemarket prices is the performance of the company whose shares are being traded. Profits lead to higher share prices, as owning shares in profitable companies is obviously more attractive than owning shares in companies that make losses. But things are not always that rational. There are lots of different factors that influence decisions about buying and selling shares – and some of them have no real basis in logic.

In 2015, some American academics published a fun piece of research in a journal titled "Review of Economic Analysis." The research was conducted by Gary Smith and Michael Zurhellen, both of Pomona College in California. The name of their paper gives away their findings: "Sunny Upside? The Relationship between Sunshine and Stock Market Returns." What did they find? You guessed it. Price movements on the New York Stock Exchange were affected by whether or not the sun was shining in New York on a particular trading day. The effect was not large but it was discernible. When the sun was shining, investors felt more optimistic and this optimism spilled over to stronger beliefs that companies were likely to make future profits. This led investors to buy more shares and drove prices higher. Sunshine meant higher share prices.

This research repeated findings that had been found over several previous decades. Interestingly, the authors found that the impact of New York's weather on share prices is actually weakening: sunny days used to have an even bigger impact than the one they were observing. They attributed this to the fact that, in this age of Internet connectivity, fewer investors actually live in New York. Presumably, when it is sunny in New York but cloudy somewhere else, investors in that other place don't share the optimism of the sunburned New Yorkers.

Could this explain what happened in the Australian market around the time of the election? Well… The days before and after the Federal election were unseasonably warm and sunny in Australia's two major population centres, where the majority of investors and investment managers live. Sydney had an extremely pleasant week of 22° plus days, culminating in a peak of 27° the day after the election. Melbourne also had a week of sunny weather that culminated in a peak of 22° on Sunday, May 19.

It did not rain all week in either city.

The lesson in all this probably one of humility. Unfortunately, humility does not sell newspapers. Early in the week following the election, the Australian Financial Review ran a headline "Morrison Makes Markets Great Again." The article attributed the May 20 bump in share prices to the market's perception of the Coalition victory. Unfortunately, this ignored the fact that markets started rising *before* the election, when everybody except Scott Morrison's mum was predicting a Labor victory. Maybe our elected leaders (and professional investment managers) have less effect on markets than they think.

But if a politician could figure out a way to make the sun shine more often…

Recap: What this Election Result Will Mean

Two months ago Treasurer Josh Frydenberg delivered his first Budget. Our April newsletter contains a summary of the year's Budget (which had been brought forward by a month to accommodate the election slated for May. In this newsletter, we decided to revisit some of that edition to see what promises we can expect will now become law.

Here are some of the more relevant elements. Direct quotes from the April edition are shown in italics.

Taxation

*For most **individual taxpayers**, the Budget contains good news when it comes to personal tax, although much of the effect of this good news is deferred until later years. For example, in 2024/25, the 32.5% tax bracket will be lowered to 30%. What's more, by this time, there will only be three tax brackets. The 30% bracket will include people earning between $45,000 and $200,000. This is estimated to represent 94% of all taxpayers by that time.*

… people earning between $18,201 and $37,000 a year will receive 'tax relief' of $255 (people earning less than $18,201 do not pay tax on this income at all). People earning between $37,000 and $48,000 will effectively pay somewhere between $255 and $1,080 less tax (within this bracket, the more you earn the greater the tax benefit). Those on $48,000 to $90,000 a year will receive tax relief of $1080. Once your income exceeds $90,000, the amount of the tax cut starts to fall. People earning $126,000 or more will not receive any tax relief at all.

These reduced taxes will be delivered in the form of a combination of tax offsets, basically meaning that you get the benefit through a larger tax refund when you lodge your first tax return after the end of the current financial year.

Note: there is some speculation that the tax cuts will not be able to take effect for the current financial year, which ends on June 30. This is because the cuts require Parliament's assent, and Parliament may not have recommenced sitting in time for the cuts to be passed. However, on May 20, the Australian Tax Office told the ABC that the cuts may be used retrospectively to amend 2018/2019 tax returns if Parliament does not sit before June 30, so this is likely only to be a delay in the benefits of the cuts flowing to taxpayers, rather than a permanent 'missing out.'

Franking Credits and Negative Gearing

Neither of these will be affected now that the Coalition have won the election. Labor had proposed changes to both of these things.

Infrastructure Spending

As is probably appropriate given the surplus, a substantial amount of infrastructure spending has been announced. Infrastructure spending always has the effect of boosting economic activity, as the government becomes a large purchaser of goods and services from various parts of the community. Over the coming 10 years, the government proposes an additional $100 billion on infrastructure. $42 billion would be spent in the first four years of that period.

Targeted projects include $500 million for commuter car parks around the country, as part of a $4 billion package to relieve road traffic congestion in our major cities. There will also be rail links for the corridors of fast population growth to the west of Sydney and Melbourne. (Interestingly, while not strictly a budget measure, the government has also announced it will reduce the target rate of permanent migration down from 190,000 people per year to 160,000 people. As we have written elsewhere, population increases have been a major driver in Australia's economic growth over the last 10 years or so. However, the rate of infrastructure development has not kept up with the rate of population growth, leading to the congestion that these budget measures are designed to address).

As a general proposition, Victoria and New South Wales both do well. Victoria will receive an additional $6.2 billion and New South Wales will receive an additional $7.3 billion.

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.

Contact Details

Address	L 36, Gateway Tower, 1 Macquarie Pl. Sydney NSW 2000
Phone	02 8051 3119
Website	eppwm.com
Email	admin@eppwm.com

Licencing Details

Everest Partners Private Wealth Management Pty Ltd ABN 21 635 916 755 is a corporate authorised representative (no. 1278026) of Alliance Wealth Pty Ltd ABN 93 161 647 007 (Australian Financial Service Licence no. 449221).