NEWSLETTER
May 2021

Introduction

Welcome to our May newsletter. There will be a much awaited Budget presented next Tuesday evening, and so we will keep this newsletter relatively brief – there will be a lot to let you know about in coming weeks!

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The (Residential) Property Market

The average price of residential property rose again in April – and the rises were again quite strong. That said, rises were a little lower than they had been in previous months. Thank goodness!

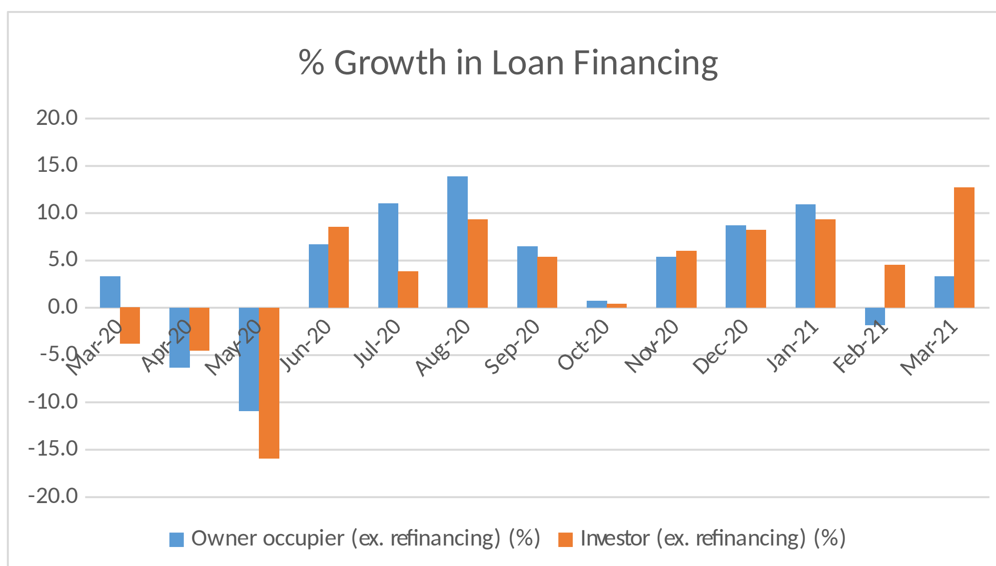
The rises are shown in this table, sourced from Domain and Corelogic:

Index results as at April 30, 2021

	Change in dwelling values				
	Month	Quarter	Annual	Total return	Median value
Sydney	2.4%	8.8%	7.5%	10.1%	$950,457
Melbourne	1.3%	5.8%	2.2%	5.3%	$744,679
Brisbane	1.7%	5.6%	8.3%	12.8%	$558,295
Adelaide	2.0%	4.3%	10.3%	14.9%	$492,285
Perth	0.8%	4.2%	6.7%	11.5%	$513,598
Hobart	1.0%	7.0%	13.8%	19.2%	$561,254
Darwin	2.7%	5.8%	15.3%	21.4%	$465,976
Canberra	1.9%	6.7%	14.2%	18.7%	$734,107
Combined capitals	1.8%	6.8%	6.4%	9.8%	$705,375
Combined regional	1.9%	6.6%	13.0%	18.2%	$457,938
National	1.8%	6.8%	7.8%	11.4%	$624,997

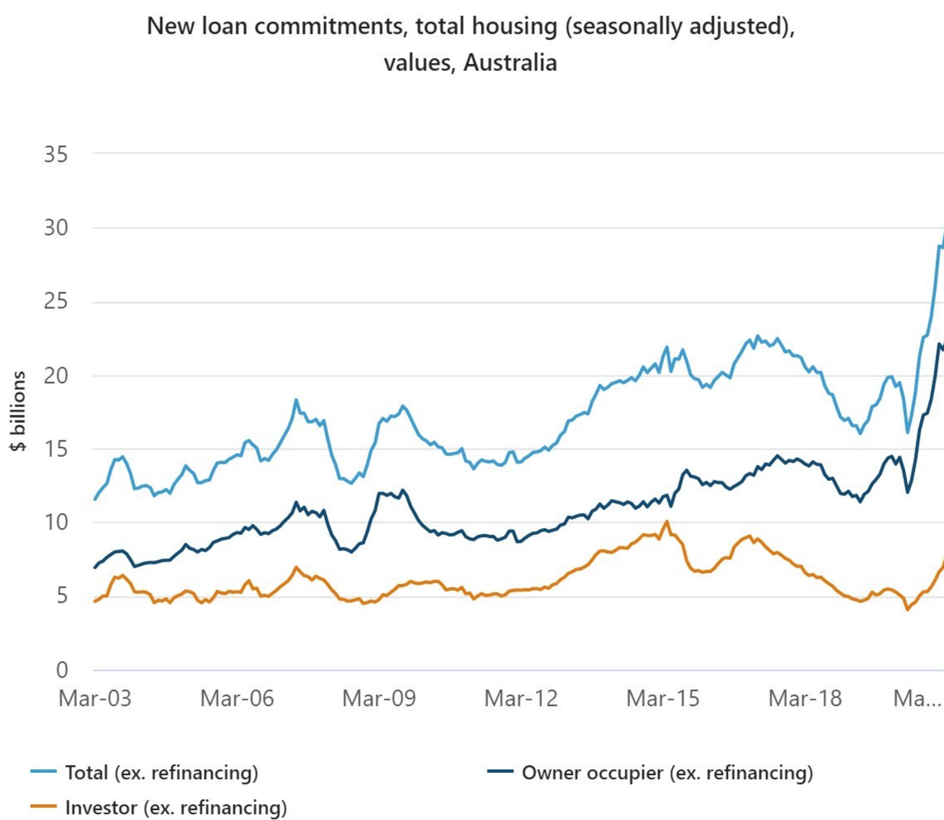
These things are, of course, all relative. Ordinarily, monthly growth of 1.8% would constitute an extraordinary month. However, average prices rose by 5% across the country in the two months prior to April, meaning that 1.8% was the lowest rate of growth over the last three months. 1.8% almost looks like things are slowing down.

Last month we reported that the increase to date in house prices was consolidating into a broad-based boom. Further evidence of that was released recently by the Australian Bureau of Statistics. Each month, the ABS compiles the total amount being lent to investors and owner occupier, which is a pretty accurate proxy for how much is being spent on housing, and by whom. While the growth has been a bit lumpy, as the following chart demonstrates, there has been a substantial increase in the amount of loans being taken out by investors. (We have compiled the chart using data sourced from the ABS).



The re-entry of investors into the residential property market is an indicator that the market generally expects that the recent price rises represent a permanent increase in the value of property. This expectation of a permanent increase (or, put another way, this prediction that market prices are unlikely to fall in the future) attracts people whose interest in the residential property market is simply to build wealth. As the graph shows, this sector of the buying market has tended to be more subdued than the owner occupier segment over the last 12 months.

Unsurprisingly, the same ABS data also indicates that the amounts being borrowed over the last few months to buy residential property are the highest that they have ever been. Total new loan commitments in March 2021 topped out at more than $30 billion. Interestingly, notwithstanding that investors are returning to the property market, owner occupiers are still the main drivers of this huge increase in the amounts being borrowed to purchase housing. In fact, the amount borrowed by owner occupiers in the month of March 2021 was higher than had been seen for total borrowing (owner occupiers *and* investors) in any previous month.



There is no secret behind why this is happening. Interest rates are low, personal savings are relatively high and the price of housing has never been higher. As this evidence shows, the current boom in property prices is very much a product of our low interest rate environment - something that, as we discuss in the next article, shows no sign of ending.

Interest Rates

On Tuesday this week, the Board of the Reserve Bank of Australia met and decided to maintain all current policy settings regarding interest rates in Australia. In summary, interest rates will remain at their record low levels. Graphically, here is how the RBA's cash rate target has looked over the last 30 years (source: Reserve Bank of Australia). That horizontal line at the bottom will get longer and longer:

Graph of the Cash Rate Target

Source: RBA

The RBA announcement also mentioned two very important economic variables: unemployment and inflation. Happily, official unemployment in Australia has fallen back to 5.6%. The total number of people employed in Australia is now higher than it was prior to the pandemic.

Historically, economists observe that unemployment and inflation have an inverse relationship. That is, inflation will rise when unemployment falls. However, this relationship only really holds when unemployment is relatively close to 0. In Australia at the moment the unemployment rate of 5.6% is still too high for inflation to become an issue. Accordingly, underlying inflation is not increasing, even as unemployment falls.

Strange as it may seem, the current low rate of inflation is actually less than the RBA would like. The RBA tends to aim for an inflation rate between 2 and 3%. In the recent release, the RBA tells us that it expects inflation to be no more than 1.5% in the current year.

As unemployment falls further, the RBA is hoping that competition for staff will increase pressure on wages and salaries. These increases will be inflationary, but not to a worrying extent. The RBA thinks that our economy can absorb an increase in the inflation rate. An increase in wages would have other positive effects for the economy.

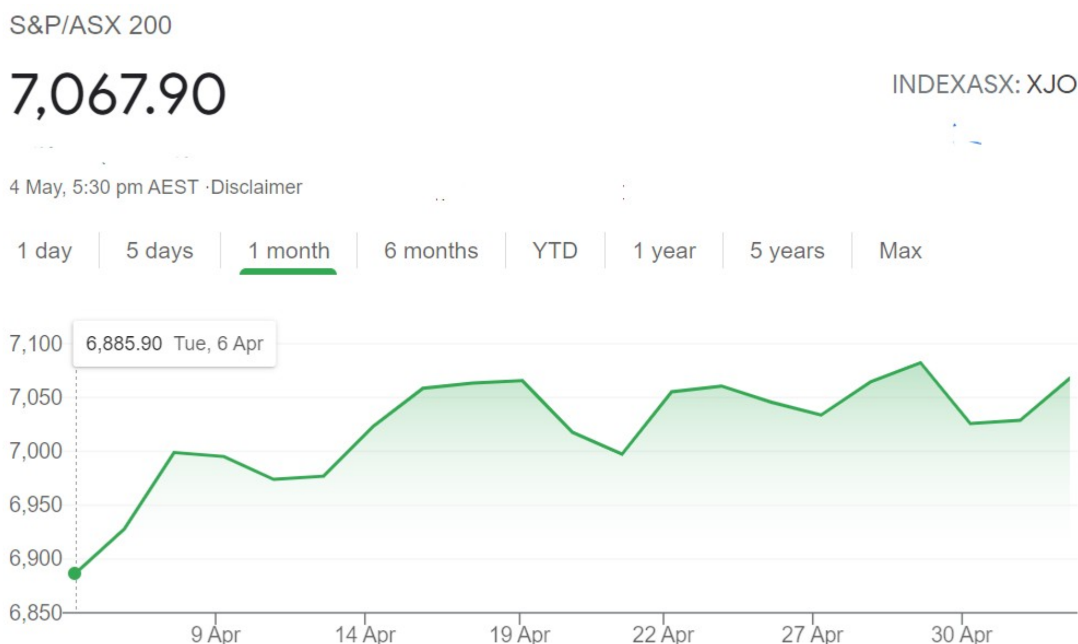
One effect of inflation is to make debt repayment easier. Inflation erodes the real value of debt. For example, if inflation averages 3%, then the real value of debt will halve every 24 years. Currently, and particularly as a result of the pandemic, governments across Australia are borrowing large amounts of money. Inflation is one way in which the RBA expects this government debt to be managed.

The benefit of inflation for borrowers is not limited to governments. All borrowers, including private households, benefit from the way in which inflation reduces the real value of their debt.

So, if you are worried about the prospect of inflation returning any time soon, please remember that inflation is actually good news for borrowers.

The Share Market

The Australian share market beat the residential property market during the month of April. As you can see in the graph below, as measured by the ASX 200, the market rose by 2.6% between 6 April and 4 May. (Source: Google and the ASX).



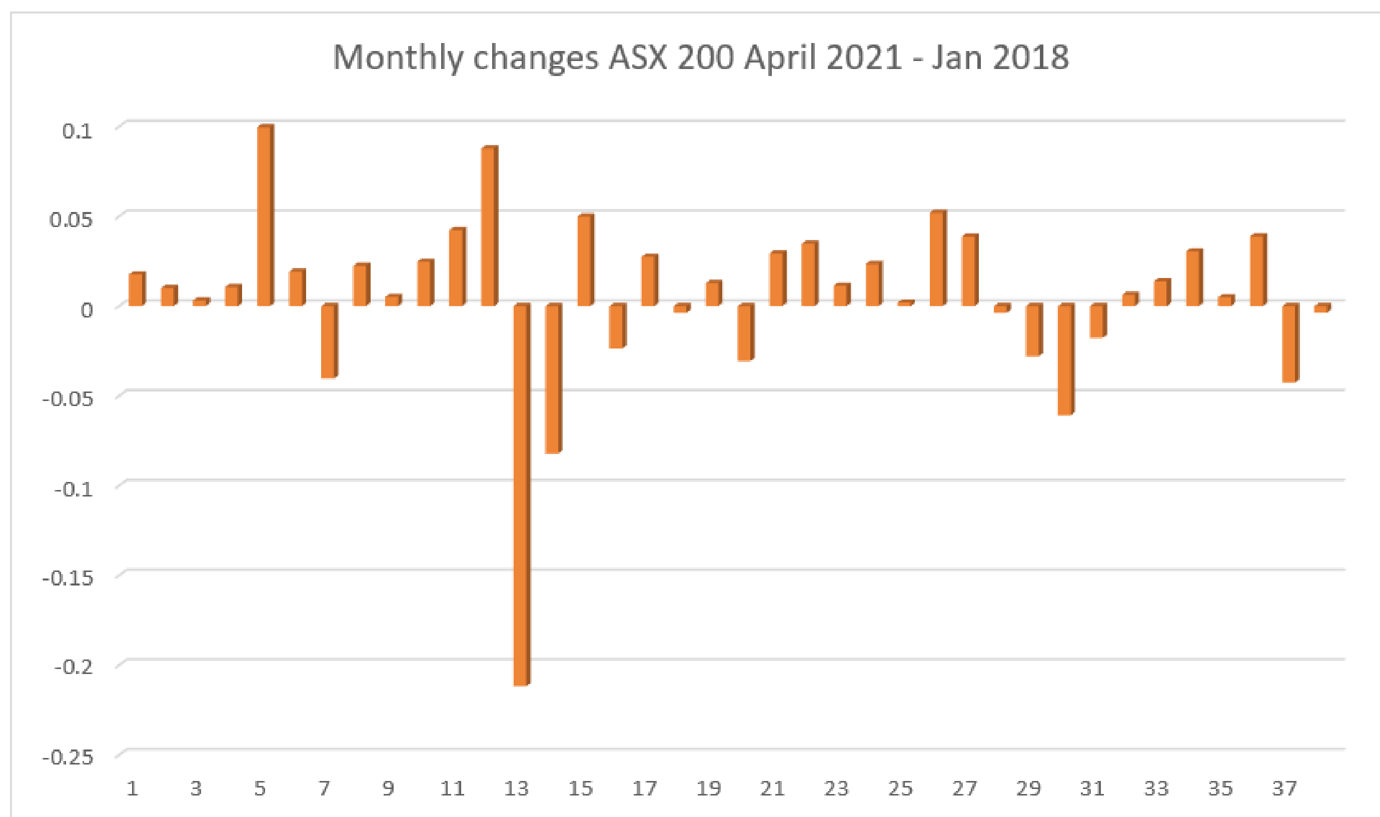
Significantly, as also displayed by the graph, daily moves were relatively lower than they have been in recent months. In addition, the market fell on only six days within the month, while rising on 12 days.

These simple facts are worth considering when it comes to the sharemarket. Of the 18 trading days between April 6 and May 4, prices rose on exactly 2/3 of the days. The rise were gentle: the market did not rise by more than 1% on any of these days. There was no particularly 'strong' day in terms of price growth. Nevertheless, an overall increase of 2.6% for the month is a very good one for shareholders. In fact, if we go back to the start of the year 2018, there have only been 11 months (out of 39) in which the market has increased by more than 2.6%.

The relative calmness of the market during April gives us a chance to look at some broad habits of the market over the last several years. As we stated above, during April the market rose on 12 days and fell on six - a general 'split' of 2/3s upwards and 1/3 downwards in terms of price movements.

If we look back to the start of the 2018 year, then we see that market has fallen, on a monthly basis, in 12 of the 39 months - once again, very close to a ratio of 2/3s upwards and 1/3 downwards. It is almost as if the market likes to take two steps forward and then one step back. Unfortunately, it does not do so in such a neat order!

In fact, rather than follow a set order, the rises and falls tend to clump together, as shown in this graph of the monthly changes in the value of the ASX 200 over the last 39 months. The graph uses the value of the ASX 200 on the last trading day of the particular month. The most recent month, March 2020, is shown as month 1 on the graph. January 2018 is shown as month 38. (Source: ASX. Remember, a rise of 10% means 0.1).



Of the 12 negative months, only four months occurred in isolation. There were two occasions when the market fell for two consecutive months, and one when the market fell for four consecutive months. The really large monthly fall was March 2020, the first full month after the pandemic arrived and marked as month 13 on the above graph. The share market impact of the pandemic had already commenced the previous month (month 14 on the above graph).

This haphazard nature of negative returns is one of the reasons why people say that trying to time the market is extremely difficult. Timing the market means buying when the market is low and/or selling when the market is high. It is a difficult thing to do. Since 2018, for example, there have seven occasions when a negative month followed a positive month. Of these, the market went up again the following month on four occasions. On two occasions, the market fell again the next month. On one occasion, the market fell again for the next three months.

This means that, at least since January 2018, anyone trying to 'buy low' has needed to be very quick. When prices have fallen, they have started rising again within a month more than half of the time.

The alternative to trying to time the market is to invest smaller amounts more often. It is interesting to see that, since 2021, people who have bought representative shares each month have seen their investment improve within that month more times than they haven't. Regular investing over time has worked. That is, of course, why we almost always recommend it as the best way to invest.

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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