NEWSLETTER

November 2019

EVEREST PARTNERS
PRIVATE WEALTH MANAGEMENT

Introduction

We hope that 2019 continues to treat you well. In this month's newsletter, we look at the state of the share and residential property markets, and the way in which interest rates (amongst other things) are affecting our main property markets. It looks awfully like the property market has bottomed out, at least in the larger capital city markets.

Famous People in Finance – Blaise Pascal

Blaise Pascal was a 17th century Frenchman who founded a form of mathematics – calculus – that underpins most modern financial management. He also invented the first mechanical calculator – basically as a favour to his overworked dad, who was a tax collector in the French city of Rouen.

Pascal developed a theory of calculus and probability by observing the fall of dice in an underground casino. Amongst other things, he is also remembered for a religious theory known as "Pascal's Wager" – which basically says that people should make decisions based on the consequences of getting their decision wrong. The worse the consequences, the more important they are in the 'decision matrix.' This thinking underpins all modern risk management.

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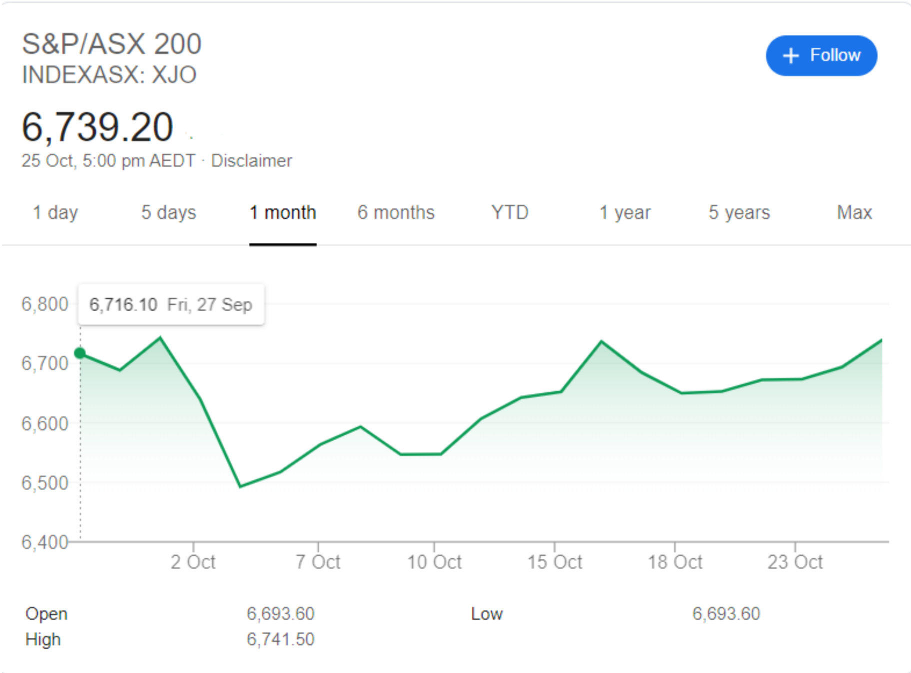
The Share Market

Nothing happened at all in the share market during October.

OK. That is not quite right. But if you look at the following graph, showing the changes in prices in the ASX 200 between September 27 and October 25, you can see why we would make that statement (as ever, thanks to Google and the ASX for the data and the graph):



The market rose by just 0.3% for the month leading up to October 25 (when we go to press). In July, the ABC reported that the average Australian dividend yield for a company within the ASX 200 is 4.4%. On a monthly basis, we can 'average this out' to say that investors receive about 0.36% per month in dividends. Add this to the 0.3% capital growth for the market, and for the month investors were about 0.66% better off.

So, October was not a bad month. It was just not a very interesting month either. So, let's leave the share market and turn our attention to the property market, where the news is more interesting.

Property – Perceptions and Reality

We won't go so far as to say we told you so. But the property data released over the last month suggests that our recent observations that the residential property market may have 'bottomed out' may well be true. As a national average, residential property prices rose substantially in the September quarter 2019 – although there was substantial variation between capital cities.

The Domain House Price Report

Each quarter, the Domain group publish their research into the state of the Australian residential property market. According to the Domain House Price Report, published last week, here is what happened to house and unit prices in each of the nation's capitals in July, August and September:

City	Median House Price	% Change
Sydney	$1,079,000	4.8%
Melbourne	$855,428	4.1%
Brisbane	$562,847	-1.0%
Adelaide	$538,550	-0.6%
Perth	$527,107	-1.0%
Hobart	$482,960	1.3%
Canberra	$738,864	-0.7%
Darwin	$521,651	1.0%

Table 1: Changes in House Prices, September Quarter, 2019. *Source: Domain.*

As you can see, the strongest price rises occurred in Sydney and Melbourne, which are Australia's largest residential property markets. Rises in our two largest markets meant that the national average also rose. But house prices fell in four cities: Brisbane, Adelaide, Perth and Canberra.

The Domain research emphasises the continuing effect of population growth in Sydney and Melbourne. It points out, for example, that while Queensland has the highest rate of interstate migration (note that it is the highest rate, not the highest number), it attracts relatively few international arrivals. Thus, property prices in Brisbane have not increased to the extent that they have elsewhere.

Adelaide is similar, although in that state the relatively high unemployment rate is seen as a main driver in the quarterly drop in prices. We also need to note that Adelaide prices rose in the previous quarter, so they have only dropped a little off what was the highest ever recorded level.

Perth has now experienced five years of negative house price growth. Prices have fallen by more than 14% from the mining-boom led highs of 2014. There are good signs starting to emerge, however. Rents are rising, suggesting that demand for housing is picking up, and the affordability of Perth housing (prices compared to average incomes) is one of the strongest in Australia. The research suggests that Perth may not be far off starting to recover.

The modest fall in Canberra can almost be attributed to seasonal variation. Prices in Canberra remain the third highest of all of Australia's capital cities – albeit that Canberra is a smaller market than almost all of the other capitals,

The changes in house prices were also observed in the changes in unit prices. Once again, price growth was strong in Sydney and especially Melbourne, driving the national average higher. Prices fell in Brisbane, Adelaide, Canberra and Darwin. Unit prices rose in Perth, again suggesting that Perth's residential property market may have bottomed.

Here is how unit prices changed over the September quarter.

City	Median Unit Price	% Change
Sydney	$694,840	2.6%
Melbourne	$520,940	3.7%
Brisbane	$375,179	-3.4%
Adelaide	$302,756	-5.2%
Perth	$344,672	2.8%
Hobart	$395,715	1.7%
Canberra	$432,252	-4.4%
Darwin	$294,951	-3.3%

Table 2: Changes in Unit Prices, September Quarter, 2019. *Source: Domain.*

A little more on housing affordability

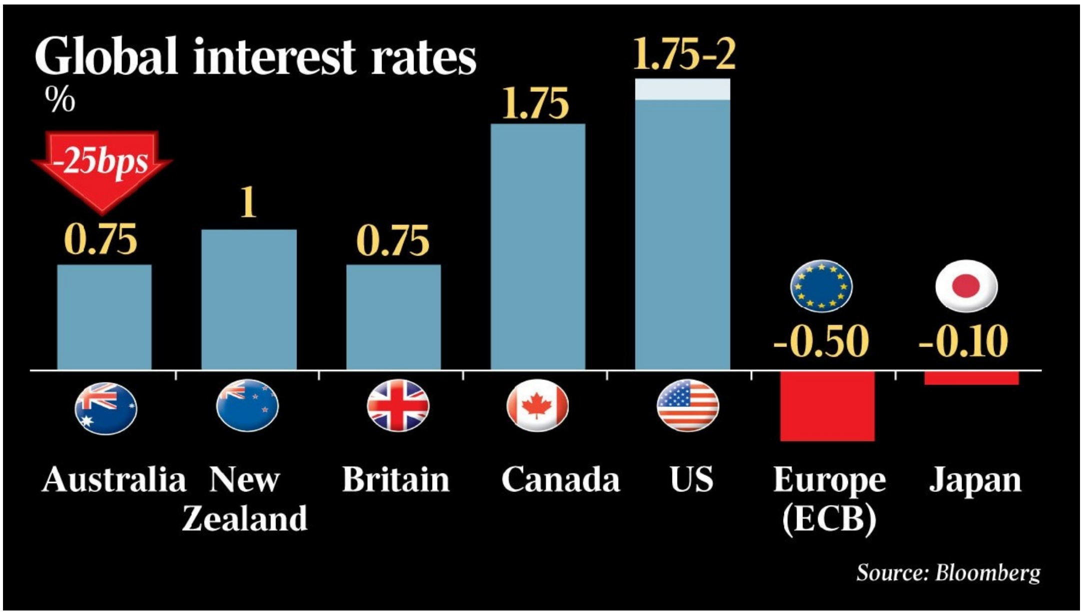
We have written previously about housing affordability – refer back through our catalogue of newsletters to catch yourself up. Generally, the term 'housing affordability' refers to the interplay of property prices and wages. When property prices rise and/or wages do not rise to the same extent (perhaps even falling), then affordability falls. If property prices fall, and/or wages grow, then affordability rises.

The most recent data on wage growth in Australia was released by the Australian Bureau of Statistics in August. The for the 12 months that ended in June 2019, wages rose by 2.3%. This means that wages were rising (albeit modestly) while property prices were not rising (the rises shown in the tables above happened after June 2019). So, up to June 2019, housing affordability was 'getting better.'

Unfortunately, in the larger markets, the rises in house and unit prices since June 2019 mean that affordability has fallen back again. While wage data has not been released, it is clear that wages have not grown to the extent that property prices have risen. The one 'shining light' in terms of affordability is that interest rates continue to fall. We discuss these in the next section.

Interest Rates

Interest rates were cut again last month. Australia's interest rates are now lower than those in most non-Eurpoean markets, as this graph from the Australian Newspaper/Bloomberg makes clear:



(While we won't go into it here, you are reading that graph correctly when it comes to Europe: official interest rates there are negative, meaning that depositors often do pay the bank for keeping money in a bank account).

The decision by the RBA Board to cut interest rates in October represented the third cut in five months – all following a period of more than two years during which the target interest rate did not change. As described above, this seems to be having a positive effect on property prices, especially in the larger markets, which are also experiencing substantial demand due to immigration. Because most people borrow to purchase property, a reduction in interest rates makes servicing that debt easier. This encourages more borrowing, which allows people to offer more as a purchase price. Prices rise accordingly.

The RBA did not raise interest rates to 'prop up' the property market, however. In a statement following the most recent reduction, the RBA Governor Philip Lowe observed that employment growth was sluggish. The interest rate reduction is intended to boost economic activity generally, thereby increasing economic activity and growing the economy. Lowe was pretty confident that this will happen. He was quoted as saying: "the low level of interest rates, recent tax cuts, ongoing spending on infrastructure, signs of stabilisation in some established housing markets and a brighter outlook for the resources sector should all support growth…"

That is, the RBA sees its moves on interest rates as part of a group of factors that it expects will stimulate economic activity in coming months. Interestingly, Lowe also made the following observation: "[it is] reasonable to expect that an extended period of low interest rates will be required." That is, he thinks interest rates will stay at their record low levels for a long time to come. And given he is 'the Governor,' he is probably right.

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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