# NEWSLETTER

September 2018

EVEREST PARTNERS
PRIVATE WEALTH MANAGEMENT

# Introduction

In this newsletter, we are taking a slightly different tack. Traditionally, we include a residential property market report and a share market report in our newsletters. However, there are only so many ways you can discuss the gradual softening in the residential property market, so in this edition we combine our share market report with some interesting takes on prominent events in the world of finance. We hope you enjoy!

## A look at history… who or what was Tesla?

In this edition, we discuss entrepreneur Elon Musk and his company, Tesla. Many readers may not be aware that Tesla is named after a man named Nikola Tesla, the Serbian inventor who moved to the US via Paris in 1884, at the age of 28. Amongst many other things, Nikola specialised in the emerging electricity industry, involved particularly with machinery that used the alternating current (AC) technology. (The alternative was – and remains – direct current, or DC. So, without Tesla, we may never have enjoyed the music of Australia's own AC/DC).

Recent commentary has Musk struggling with inadequate sleep – something that did not seem to hamper Tesla, even though it is reported that he only slept for two hours per night. He was also said to walk 8 to 10 miles every day – obviously electric cars had yet to be invented - and do 100 toe curls each night. That might explain how a man who stood 188 centimetres tall weighed just 64 kilograms.

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# In the News

## Tesla Tweets

You may have seen some recent commentary about Elon Musk and his twitter account. It seems that this account continues to get him into trouble.

On 7 August, Musk sent out the following tweet: "Am considering taking Tesla private at $[US]420. Funding secured." Later the same day, Musk tweeted: "investor support is confirmed. Only reason why this is not certain is that it is contingent on a shareholder vote."

'Taking Tesla private' means buying enough of its shares, in this case at a price of $US420, to ensure a majority of shareholders vote to no longer be a public company whose shares are traded on a public stock exchange.

But here's the thing: on the 6 August, Tesla shares *were* being traded on a public stock exchange, called the NASDAQ. The shares closed that day at $US342. So, the tweet suggested that share holders would be offered an extra $US78 per share – more than 20% more than the current share price.

Now, if you know that the future price of a share is going to rise, what do you do? You will probably buy some of those shares. And when a bunch of people decide to buy shares, what happens to the price? That's right: it goes up. Which is exactly what happened to Tesla on the NASDAQ. By the end of the day on August 7, during which trading had been temporarily halted, the price of shares had jumped to almost $US380. That's an 11% jump in one day!

Since then, though, the price has been downward, as investors become very worried about Tesla. In fact, the price has now fallen below the price on August 6.

One of the main problems – apart from the apparent fact that Musk made the tweets while driving himself to the airport - is that there are complex laws surrounding announcements of things like takeover plans. This is especially so when those announcements nominate a 'target' price 20% higher than the current market valuation. The rules exist to stop people manipulating prices via their announcements. And so the US Securities and Exchange Commission (SEC) have started to investigate. In particular, it seems they will focus on the comment that funding is *secured*. Usually, to make an announcement like this, the regulator would be looking for a signed agreement to that effect.

The SEC regulators are not the only people investigating. Within a week and a half of the tweets, Musk was sued by two separate groups of 'short-sellers.' Short sellers are share traders who identify a company that they believe is over-valued. Very simply, they essentially borrow shares in that company – and then sell them. The plan is that, when the price falls in the future, they can purchase the same number of shares at a lower price. They then returned the 'borrowed' assets and keep the profit. Of course, the system only works if the price falls – and so people who had 'shorted' Tesla stocks did rather badly when the price suddenly rose by more than 10%.

Musk has long been critical of the short-selling of Tesla stocks. On one level, short selling is seen as pessimism about a stock: after all, it only makes sense if the price is about to fall. So, a lot of people 'shorting' your stock means there are a lot of people who think its price will fall. Those people then sell their 'borrowed' shares, which can actually induce a fall in price. That is why conspiracy theories have arisen regarding Musk's announcement.

One unfortunate irony here is that, given the fall in price since the announcement, short sellers have actually made more money than they otherwise may have. In soccer, they call that an 'own goal.'

## Could you survive a minor financial crisis?

We came across some interesting market research from the US recently. When asked how they would pay for an unexpected expense of $US1,000, only 39% of households (click for more info) nominated savings as their source of payment. 19% said they would use a credit card, 12% said they would borrow from family or friends and 5% said they would take out a personal loan. Taken together, this indicates that 34% of respondents would have to borrow the thousand dollars they need to meet the unexpected expense.

This is an American finding, but it does echo Australian research that found that as many as 22% (click for more info) of Australian households made use of 'payday lending' at some point within a three-year time period. Payday lending is name given to a form of short-term loan typically taken out by somebody who finds that they have run out of spending money before their next income payment. What this research is telling us, then, is that almost 22% of households ran out of money during at least one pay period in the previous three years. More than one in five households are living from pay packet to pay packet - and occasionally not getting there.

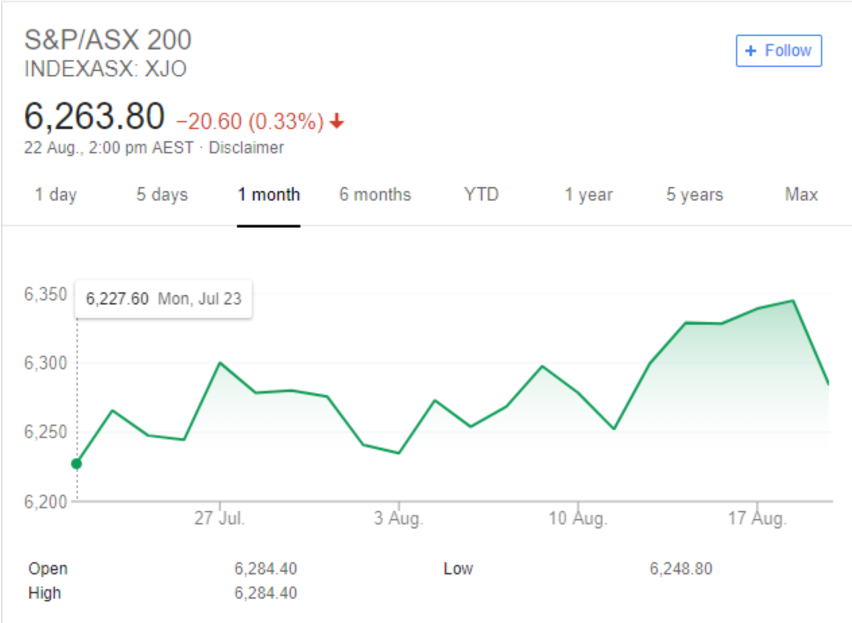
One of the things about unexpected expenses is that, in the long run, they are often not that unexpected. They are simply unpredictable. For example, a burst hot water service is a rare event. But no hot water service can last forever, and so if you have a hot water service you should remember that replacing that service is inevitable.

Because of this, it makes sense to keep at least a small amount of savings aside for 'irregular expenses.' Things like repairs, medical expenses, cost of travel if we need to case somewhere at short notice, et cetera. Ideally, you would be able to learn a little bit of interest on these savings - something that is particularly achievable if you also have debt such as a home loan.

If you or someone you know would struggle to meet an irregular expense, it is time to come and talk to us. We can assist you to establish and maintain savings specifically intended to cover you in the event of one of these expected unexpected expenses arising.

# The Share Market

In the four weeks to Wednesday, August 22, the ASX 200 barely moved. The index rose from 6227 points on Monday, July 23 to 6264 points one month later. This is a rise of 0.5%. Here is how it looks according to Google:




Each month, we give you a report about the performance of the ASX 200. You might be interested to know exactly what the ASX 200 actually is. So this month we thought we would explain.

The ASX 200 is an index which indicates movement in the market prices of shares in 200 companies listed on the Australian Stock Exchange (the ASX). These 200 companies are the largest 200 companies in terms of market capitalisation. Market capitalisation is the total 'value' of a company's shares at a given market price. So, if company A has issued 1000 shares, and those shares are trading at $10 each, the market capitalisation is $10,000.

Because of their size, these largest 200 companies constitute most of the trading in shares across the market. Therefore, creating an index of price movements within these companies gives a good indication of general movements in prices across the entire market.

ASX
AUSTRALIAN SECURITIES EXCHANGE

The index gives different weight to each constituent company, depending on its market capitalisation. This weight is essentially calculated by adding up the market capitalisation of each of the 200 companies, and then dividing each individual company's market capitalisation into that total number. BHP Billiton, for example, constitutes 6.15% of total market capitalisation. It is the second-largest company by market capitalisation traded on the ASX, with an approximate market capitalisation of $112 billion. Wesfarmers is the seventh largest company traded on the exchange, with an approximate market capitalisation of around $56 billion. Accordingly, BHP Billiton is almost twice as large as Wesfarmers. So, within the index, movements in BHP's share price are given twice the weight as movements in Wesfarmers' share price.

So, if BHP shares rise by 1% and Wesfarmers shares fall by 2%, these two movements effectively cancel each other out and the ASX 200 would remain unchanged (assuming, for the sake of this illustration, that the share prices of the other 198 companies have not changed. This is, of course, an unrealistic assumption, but we make it to illustrate the point).

Looked at another way, any change in the share price of a larger company, such as BHP, will have a bigger impact on the index than the same sized change in the share price of a smaller company.

Australia's market is actually dominated by relatively few companies. Approximately 42% of total market capitalisation is held in just 10 companies (source: ASX):

| Company | Sector | Market Cap | Weight(%) |
|---|---|---|---|
| **Commonwealth Bank** | Financials | $131,619,000,000 | 7.23 |
| **BHP Billiton Limited** | Materials | $111,960,000,000 | 6.15 |
| **Westpac Banking Corp** | Financials | $101,189,000,000 | 5.56 |
| **CSL Limited*** | Health Care | $88,946,500,000 | 4.89 |
| **ANZ Banking Group Limited** | Financials | $84,531,900,000 | 4.65 |
| **National Aust. Bank** | Financials | $77,453,700,000 | 4.26 |
| **Wesfarmers Limited** | Consumer Staples | $56,079,700,000 | 3.08 |
| **Macquarie Group Limited** | Financials | $41,805,800,000 | 2.3 |
| **Woolworths Group Limited** | Consumer Staples | $39,517,900,000 | 2.17 |
| **Telstra Corporation** | Telecommunications | $33,777,000,000 | 1.86 |

* Since this article was written, CSL has grown in market capitalisation to become the third largest company by market cap on the ASX.

What's more, financial companies dominate to the extent that and 31% of total market capitalisation comes from that sector. A further 18% of total market capitalisation comes from the materials sector (including the mining sector and capturing companies such as BHP). So, the Australian share market is dominated by relatively few companies drawn from relatively few industries.

As a result, things that might affect these larger sectors, such as interest rate changes or changes in demand for minerals on global markets, will often have a pronounced effect on the ASX 200.

## 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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