NEWSLETTER

April 2018

QUAY FINANCIAL PLANNING

Introduction

Welcome to our April newsletter. March was quite a month on world share markets, with the US' introduction of trade tariffs spooking shareholders in that country and others, including Australia. Our market fell, but by nowhere near as much as the US market. What will happen next? In property, prices continue to cool in Australia's largest markets. Is this a peak or a plateau? Read on to find out.

A look at history… Money Talks

April 2018 marks the 122nd anniversary of the first Modern Olympic Games. You might be surprised to learn that the modern Olympics were initially all-amateur affairs. Initially, things were pretty strict. In 1912, American Jim Thorpe was denied gold medals in the decathlon and the pentathlon because he had once accepted money to play in a baseball game. Baseball was not one of the sports in either the pentathlon or the decathlon. In 1936 winter Olympians from Austria and Switzerland were banned from competing because they were ski instructors!

Nowadays, things are quite different. Thorpe had medals awarded to him posthumously in 1983. Since 1992 American Basketballers have been free to compete – doing things like hiring a cruise ship for accommodation in lieu of a single bed in a shared room in the athlete's village. But you might be surprised to learn that wrestling retains its amateur-only status.

This is no doubt why Hulk Hogan never carried the flag for the US.

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Property Market

The property market continues to run at different speeds throughout Australia. Recent data tells us that the Sydney market, Australia's largest, has fallen for the seventh month in a row in March 2018. Demonstrating the impact of the Sydney market on the 'national market' in general, this has kept the rate of increase for the 12 months to March 2018 to just 0.8% nationally. This is below inflation, meaning that the real price of housing fell across the period.

Falls in value in March were also seen in Melbourne and, interestingly, Adelaide. Everywhere else, including regional cities, prices rose.

Recently, Westpac Bank released an analysis where they divided the property markets in each mainland capital into three categories: the most expensive (or 'top') 25%, the 'middle' 50% and the 'bottom' 50%. When divided like this, the data is very interesting.

Only Perth has experienced falling prices across the board over the last three years. Since 2015, Perth prices have fallen by as much as 5% per year, with the falls being consistent across all categories of property.

5% is also the current rate of decrease in the value of properties in the top 25% in Sydney. Interestingly, this category is actually the only category of property in Sydney where prices have actually fallen. Prices in the middle and bottom 25% have experienced very little growth – but they have not fallen. Once again, this demonstrates why average figures (which are disproportionately affected by changes in values to properties that are already more expensive) can be unreliable. True, the rate of growth in the middle and bottom Sydney markets has fallen to near zero – but prices have not actually fallen.

In the other mainland capitals, the rates of change in prices across the three categories has been relatively consistent. One exception is Melbourne, where prices in the bottom 25% rose by more than 10% in the 12 months to March.

All this data does suggest a 'smoothing' of demand across property types. Such a smoothing is inevitable: people born since 1980 need reminding that prices tend not to rise every year forever. Demand is tempering in the major markets of Sydney and Melbourne, while Brisbane and Adelaide continue to show annual growth more or less in line with inflation, perhaps plus 1 or 2 percent. Perth has seen prices fall for three years, while Hobart has bucked this trend and risen over the same period, seemingly as demand from the mainland 'spills over' and people move to Hobart for lifestyle reasons.

The other significant market news in recent days has been the Reserve Bank's 18th consecutive decision not to make a decision. That is, the RBA has not altered its target cash rate for 18 months. The rate is at a record low, as are retail interest rates being paid by property buyers. That prices are not rising in this low interest rate environment (albeit with some restrictions being applied to property *investment* loans) suggests that the market really has peaked.

Having reached a peak, the question now becomes how 'spiky' that peak will be. A spiky peak is one that is followed by a fall. The alternative is a plateau-peak, where prices rise to a peak and then stay at that level, without any substantial fall.

The low interest rate and generally positive economic news, coupled with high rates of migration, especially to Melbourne and Sydney, will probably prevail against the current prices becoming a spiky peak. While the next 12 months might see some minor falls, especially in Melbourne as it's prices follow Sydney in settling, in the absence of some 'black swan' event that disrupts the world economy, we would expect more of a plateau than a peak. Things just don't look grim.

In recent years, wage growth has not kept up with property price growth. Put simply, this means that people have needed to work longer to buy property, especially in Melbourne and Sydney, the two most populous states. Indeed, the time taken for someone on average earnings to earn enough gross income to buy a house has more than doubled in those major markets (and risen everywhere else, as well).

Ideally, a period of flat property prices will be accompanied by wages and salaries playing 'catch up,' allowing property to become more affordable (and in turn increasing the likelihood of a plateau in prices). After all, owning your own home remains a substantial element of the Australian dream.

The Share Market

The Trump effect raised its head on world share markets during March. The ASX 200 brushed 6,000 points on March 12, before falling to 5,750 on the first day of trade for April. This was a fall of 4.1%. The fall in the Australian market reflected a larger fall in the US, where the S&P 500 fell from 2,786 points on March 9 to 2,581 on the first day of trade for April. This represented a fall of more than 7.3%.

So, what did the Donald do? On March 7, he imposed stiff tariffs on imported steel and aluminium into the US. Talk soon turned to the prospect of a 'tariff war.'

You might be wondering what a tariff is and why they are used (or, over the last thirty years or so, increasingly dis-used). A tariff is a tax imposed on imported goods. The aim is to discourage the importation of those goods, by making them more expensive to domestic (in this case, US) purchasers. This makes locally-produced goods more cost-competitive. Trump's hope is that imposing tariffs on steel and aluminium will encourage domestic production of those things, which will lead to increased employment in that industry.

This can sound like a good idea. So, why did the share market react so pessimistically? Why did people decide that they would be better off not owning shares (which is what must be happening when prices fall so dramatically)? And why did the Australian market have a softer fall than the US?

To take the last question first, Australian shareholders seem to have become less pessimistic because Donald Trump singled out Australia as a 'friend' of the US whose products would not be subject to tariffs. This appears – really – to be at least partly due to the lobbying efforts of Greg Norman. Trump is a golf enthusiast. All we can say is that we are glad he is not a cricket lover.

Tariffs have been 'on the nose' for several decades. They are seen as a distortion to the efficient allocation of productive resources in a global economy. If steel can be produced more cheaply in one country, then it makes sense for that country to produce more of the world's steel. Workers in the other countries, who import that steel, can then be dedicated to other purposes. This allocation of employment resources, in a theoretically 'pure' market, should maximise total output. Basically, if everybody does the thing that they can do most efficiently, total economic output is maximised.

As with most things, countries like China enjoy a competitive price advantage when it comes to manufacturing steel and aluminium. This advantage comes from lower wages in those countries – meaning anything that is labour-intensive can typically be made more cheaply. The world's economic leaders have long held the idea that allowing countries like China to take the lead in manufacturing means more things get made on a global scale. The more things that are made, the cheaper they are and the 'better' the purchaser's quality of living.

As a look into any middle-class teenager's bedroom will tell you, we certainly have a lot more things today than we had thirty years ago. So, the reality seems to fit the theory.

The concern now is that China, faced with lowered demand for its steel and aluminium, will reciprocate by imposing tariffs on things that they import. In turn, this invites another reciprocation from the US. This 'tit-for-tat' effect then becomes a 'trade war.' One effect of this is that the world economy is no longer making as many things as it could if its resources were allocated more efficiently.

And if businesses become less efficient, then fewer people want to own them. Which is why more people wanted to sell their shares in March than there were people wanting to buy them.

Where will it all end? Who knows. This is the first time that markets have not liked what Trump has been promising. Before this, the trajectory of markets has been up since his election. The S&P 500 was just 2.085 on November 4 2016 (Trump was elected on November 8). The rise to 2,786 points represented a 33% increase. Add in dividends and the market return since Trump's election is almost 40%. In the wake of the tariff announcement, the market 'took back' a lot of this increase. What the market does next will have a lot to do with what Trump does next.

The Legal Stuff

General Advice and Tax 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.

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