Newsletter

November 2016

Introduction

Welcome to our newsletter for November 2016. This newsletter combines the articles that we have published on our site since we last published a discrete newsletter. We provide the newsletter in this format so that you have a single, portable document that you can read at your leisure.

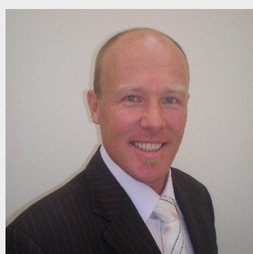
In this newsletter, we continue our new column – our monthly review of the state of the market. We also offer a couple of cautionary tales that remind us that simply listing on the share market does not mean anything when it comes to profitability. We then take an educative bent – and discuss why median house prices may or may not be helpful, before taking this time before the Christmas rush to show you a good way to say thanks to your staff for their hard work this year.

Please feel free to share this newsletter with anyone you think would find it helpful. And please also free to get in touch with us if there is anything that you would like to discuss about its contents.

Did You Know… the month of November

November has been in important month in Australian history. In a harbinger of what was to come, bushranger Ned Kelly was hanged on November 11 1880 (this day became 'Remembrance Day' after the end of the First World War, on 11 November 1918. The first Tuesday in November means a public holiday for Melbourne and a pretty casual day at work for everywhere else as the Melbourne Cup is run – Phar Lap won his one and only Cup in November 1930. November 1956 saw the commencement of the Melbourne Olympic Games in 1956, and in 1975 the Whitlam Government was dismissed by the then Governor-General, Sir John Kerr.

1850, Australia's first University (Sydney) was founded. Fast forward to 1973 and Australia's first weirdly-shaped Opera House was also opened – also in Sydney. It remains the only one.



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Market Summary November 2016

A bad month for sellers is a good month for buyers. But you would never know from the headlines.

October was a horrible month in the share market – but only if you wanted to sell shares.

But, as is the way with these things, it was a good month if you were buying.

The ASX 200 opened the month at 5,435 points, and then closed at 5,317, a fall of 2.2%. Here is how it looked on Google:

The trend has continued in the early days of November. As of Thursday November 3, the market has fallen another 2%.

If you wanted or needed to sell shares in October, this was bad news. How bad depends on what the market does next: if it rises again, then selling in October simply manifested the bad month. Selling locked in the loss.

But if it keeps falling, then selling in October will have been the way to go.

As financial advisers, we are often asked what the market is about to do. Here is a little secret: most of the time, no one knows what the market is about to do. Very occasionally, recent moves in the market are obviously driven by something that will need to be corrected. And longer term trends tend to 'fall back to the mean,' which is a fancy way of saying that things tend not to stay above or below average for very long. Periods of strong growth in prices are followed by periods of low or negative growth, and vice versa.

If only people could tell you when these changes will take place. By the way: Economists call these times the 'points of inflection.' That is, the point when an upward rising line on a graph turns down, or vice versa.

The best most investors can do – and it is effective and well worth doing – is aim to manage the timing risk inherent in a volatile market like the stock market. Timing risk is the risk that you will buy when prices are temporarily high (that is, share prices fall after you buy) and/or sell when prices are temporarily low (that is, share prices rise after you sell).

In strict economics, the term 'risk' is a neutral one. The chances that prices rise after you buy is also known as risk – sometimes called 'upside risk.' But that is not the risk we are worried about. The risk we are worried about is 'downside' risk. The risk that you will either lose money or miss out on making money. The risk of being poorer than you would have been otherwise.

To minimise the impact of this risk, it pays to spread buying and selling out over time. The logic is that if you do this over a long enough period, then the volatility in the market will be smoothed out. You will sometimes buy when prices are high. That's bad. But you will also buy when prices are low, which is good. The same happens with selling: sometimes you will sell when prices are about to rise. D'oh! But other times you will sell when prices are about to fall. Bravo!

When you approach buying and selling with this mindset, you can also start to think separately to the crowd. If you are buying, then falling prices are good news (for the same amount of money, you get more shares. October was a good month for buyers). If you are selling, then rising prices are good news.

This is quite different to the 'mood' that we see described in the media. In the media, rising prices are always seen as good news and falling prices are always seen as bad news. It is as if everyone is a seller, all the time. Maybe buyers don't read the news.

Consider these recent headlines:

- ANZ Shines Amid the Gloom;
- Australian Share Market Follows Wall Street Plunge;
- Nine news sports presenter announces retirement.

OK: that last one was not so dire. But you see the point. The media will never announce a fall in share market values with a headline such as 'Market Offers Great Time to Buy.' And a rise in the share market will never be headlined with something like 'You Should Have Bought Yesterday.'

But we can all translate the headlines in our own minds, depending on whether the state of the market is good or bad news for us.

Listed but not tested

Companies don't need to be profitable to list on the stock market. So, don't be fooled into thinking that every share market listing is a sure thing.

It has been an interesting week, and we do not just mean with the American election. The election's impact on the share markets has been confusing: on Wednesday afternoon prices fell by as much as 4.66%. But by Thursday night, market prices had bounced back and the market was up 2.9% for the whole week. Odd.

Anyway, you are probably sick of hearing about the election, so we want to talk about something else.

Our eye was drawn to some activity on the Australian share market this week. Something that highlights why the share market needs to be seen as a place where money can be lost, as well as made. Consider this a cautionary tale.

When a company's shares are first traded on the share market, this is known as a 'float' or 'going public.' Companies generally float because they want to raise money from the public. The company might want to use public money to finance its activities. Or, the current owners of the company (the people who own shares before the float) may wish to find someone to buy some or all of their shares. These are both ways of raising money – albeit for quite different purposes.

Unfortunately, there is no rule that requires that a company must be a good investment before it lists on the share market. So, be careful about judging a company as a 'good thing' just because it is going public.

Consider a company called Yellow Brick Road. You might have seen the chairman of this company, Mark Bouris, on television hosting the Celebrity Apprentice (there you go – a link to the US election!). Bouris started Wizard Home Loans in 1996 and it was an enormous success. He sold it in in 2004 for a substantial profit.

He then founded Yellow Brick Road in 2007, and it went public in 2009. Unfortunately, it has not been a success. According to media reports, in the seven years since floating, the company has not made a profit, and the accumulated losses now total $37 million. This is reflected in the share market, where the market price has acted as you would expect for a company that is not making a profit. Here is Google's graph:

As you can see, the company's shares opened at $1.10 in February 2008. Since then the moves have mostly been down, with the shares currently trading at 16 cents. They have been as low as 5 cents per share in mid-2009.

Admittedly, some investors have made money on YBR. Those who bought for 5 cents in July 2009 saw the shares reach 60 cents in December 2010, and then go even higher to 72 cents by late 2014. But this rate of return (1200% in 18 months) meant buying shares in a company that had fallen more than 95% since it had floated and was yet to make a profit. Brave 'investors' indeed.

But the story for most investors over the years is one of losses. What's more, the company has never paid a dividend. It is not allowed to because dividends can only be paid out of profits. If you do not make a profit, there is no chance of paying a dividend.

The story of YBR came to mind for us this week as we watched another company float. This company has links with Channel Nine as well. The company's name is Domacom and you may have seen it trying to raise money to buy one of the Block Apartments. Yep. We know.

Like YBR, Domacom listed on the share market offering nothing more than its potential. It has not yet made a profit, and has actually raised very little revenue since it first commenced as a private company a few years ago.

Domacom floated on Monday. Before the float, shares were offered at 75 cents per share. They started trading on the ASX at 70 cents. By mid-morning Wednesday their market price had dropped to 31 cents, before 'bouncing' on Thursday to 35 cents (in very thin trade – just the one, by the looks of it). That is a fall of 50% from the initial market price (and more than that from the price at which people took up the offer before the float).

Like YBR, Domacom is run by people who did well with previous businesses. But the 'new' company being floated is not the old one. The new one has not made a profit. All investors were buying was potential. This is a surefire way to lose money.

When companies float, there is often a lot of hype. This hype means a lot of people see the company and assume, wrongly, that it must be doing well. Maybe people watching the Block will be among them. We hope not. Doing well and going public are nowhere near the same thing.

What is a Median House Price?

You hear a lot of commentary about median house prices. But what is the median, exactly?

If you watch the financial news, you will often see reference to the median house price. But what is the median house price?

Statisticians refer to the median as a 'measure of central tendency.' Sounds serious, doesn't it? But the median is actually a really simple concept.

The median house price is the middle price in a range of houses. So, if 5 houses were sold in a particular period, then the median price is the third highest price. This is also the third lowest price. Here is an example:

House 1	$400,000
House 2	$450,000
House 3	$500,000
House 4	$550,000
House 5	$600,000

The third price in this range (counting from either end) is $500,000. And that is the point of a median price: it is the same regardless of which end you start counting from. It is the middle price. We should call it the "middlian".

Once the list of prices gets large enough, then 50% of prices will be equal to or higher than the median, and 50% will be equal to or lower than the median.

A lot of people confuse the median with the average. But they are not the same thing. Consider the following five house prices:

House 1	$400,000
House 2	$400,000
House 3	$400,000
House 4	$400,000
House 5	$900,000

In this group, the median price is $400,000 – it is the third price when counting from either end. But the average price is $500,000. This is because the total of the prices is $2,500,000, and there are five prices. $2,500,000 divided by five is $500,000.

This is called skewing the results. One unusual price tends to muck up the average. We see this in many different ways. Let's say we took Frank Lowy (the head of the Westfield group) and you and three friends. That is a group of five people. Lowy alone is worth $5billion. So, the average wealth in your group is going to be just a little over $1 billion.

Sounds great. But Frank is not known for sharing.

This skewing is the reason why house prices tend to use the median rather than the average price. One rogue price in either direction and the average becomes meaningless.

That's not to say that the median price cannot be compromised as well. It can, because using the median only makes sense if there are a lot of houses being bought and sold. Let's say you live in a suburb where only three houses were sold last month. Two of the houses were from the worst street in the suburb, and one of them was a pull-down job. The other was from the best street in the suburb. Here is how the prices looked:

House 1 (pull-down job)	$450,000
House 2	$500,000
House 3	$800,000

The median price is $500,000. But if you own a home in a better part of the suburb, then this price does not tell you much about what your home is worth. And if you want to buy a home in the nicer part of the suburb, then looking at the median price will just get your hopes up!

So, whenever you hear that the median price has risen or fallen, think for a second what that might actually mean for you. It may not be as obvious as you think.

Tax-Free gifts for Christmas

The end of the year is coming and you might be thinking of a way to say thanks to your staff for their efforts this year.

If you want to give your staff a gift, then think about the rules that apply. Generally, if you give something to your staff it is classed as a 'fringe benefit' and you may be taxed on it. But low dollar-value and irregular gifts can be provided to employees without an FBT (fringe benefits tax) charge for the employer or an income tax charge for the employee. This is known as a 'materiality' rule. The ATO, or at least the legislature, recognizes the reality of day to day business life and employment relationships, and is basically saying "we are not concerned with irregular low dollar value gifts and will not seek to tax them in any way".

Gifts are a great way to lift employee morale and show appreciation of effort. Employees respond more to empathy and appreciation than just money. A $299 shopping voucher for each employee at Christmas, with a nice note, and some public recognition is a nice way to say "thanks, we appreciate you".

And its tax free for your staff (but tax deductible for you), which makes it even nicer.

Other ideas include a bottle of spirits, perfume, a food hamper, a CD, a book or a clothes or toy shop voucher. The gift does not have to be consumed at work, and there is no reason why the employee cannot "re-gift" the gift to someone else who may appreciate it even more. **Read here** for some practical tips on re-gifting unwanted presents.

Shopping vouchers are a great idea. A voucher to a widely available retailer (think supermarket or department store) is almost as good as cash. Your staff can spend the voucher on a wide variety of products or services – perhaps even on filling the Santa sack for their own kids. This takes away the risk of getting it wrong (say, giving alcohol to someone overcoming a drinking problem) and is appreciated more by your staff.

What does the ATO say?

We asked our licencee, Dover Financial Advisers, what the tax office thinks. Dover is a registered tax adviser, so they are allowed to tell us their opinion.

The ATO says any one gift must be "modest in value", valued under $300 per gift, and must not specifically relate to the employee's work performance. So, you can't just give the gifts to staff who met sales targets, or something like that. The gift is just that: a gift. There should be no more than four special occasions (ie gifts) per employee per year.

This means if you have, say, three staff you could provide say three gifts with a market value/cost of about $900 each and a total market value/cost of $2,700 a year. This is a great way to show your staff you care and you appreciate their good efforts. Birthdays and the Christmas and Easter breaks work well, but it's never a bad time to show your appreciation.

You can read the ATO's views on minor benefits here: **ATO view on the minor benefits exemption**.

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.

We recommend you seek personal financial and/or taxation advice prior to acting on anything you see on this website.

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