informed investor

RESERVE
Financial Consulting

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In this issue:

Economic Update

Australia

- The Reserve Bank of Australia lowered interest rates in June by 25 basis points to 1.25 per cent, and again in July by a further 25 basis points - moving the official cash rate to 1.00%.
- In a July speech, the Governor of the Reserve Bank suggested it would be imprudent to lower Australia's inflation target (2% to 3%/yr) and affirmed that policy makers are willing to ease policy settings further, if required.
- Australia's Composite PMI – a reasonable barometer of activity levels in the manufacturing and services sectors – deteriorated slightly in July, but remained in 'expansionary' territory.
- Unemployment was unchanged at 5.2%. While new job adverts increased markedly in June, it is too early to suggest this is indicative of a meaningful improvement in the labour market.
- The residential property market appeared to stabilise. National home prices rose 0.1% in July; only a modest gain, but significant in that it followed 20 consecutive months of declines.

United States

- At the end of July, the Federal Reserve lowered US interest rates by 0.25 percentage points.
- Consensus expectations suggest US interest rates could be lowered further in the months ahead. Markets have already factored in a 60% probability of another cut after the Federal Reserve Board's next meeting in September.
- Economic growth in the US slowed in the June quarter, to an annual pace of 2.1%. Whilst below the 3.1%/yr rate seen in the March quarter, the reading was ahead of forecasts. A marked improvement in consumer spending supported growth; rising employment and a reasonable level of wage growth appear to have contributed to buoyant discretionary expenditure.

Welcome

Welcome to our latest edition of the Informed Investor newsletter.

As always, should you have any questions or would like some further information, please get in touch and we'll be happy to help.

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Europe

- The Eurozone economy expanded just 0.2% in the June quarter, down from 0.4% growth in the first three months of the year.
- There was no growth at all over the quarter in Italy, while the pace of growth decelerated in both France and Spain.
- These releases increased the probability that the European Central Bank will announce a new phase of Quantitative Easing; most likely in September.
- Core inflation dipped back below 1%/yr in July, which is likely to be another concern for policy makers.
- In the UK, Boris Johnson won the Conservative Party leadership contest and has been sworn in as the new Prime Minister.
- Johnson has talked openly about his willingness to pursue a 'no deal' Brexit in October if terms cannot be agreed with European officials. The increased probability of this potentially destabilising event resulted in sterling weakness and a sharp move lower in UK government bond yields following his election.

New Zealand

- Business confidence deteriorated in July, to its lowest level in a year. This does not augur well for growth.
- Inflation remained below target in the June quarter, but picked up to an annual pace of 1.7%. Some suggested this might result in the Reserve Bank of New Zealand leaving monetary policy settings unchanged when it meets on 6 August.
- That said, markets continue to suggest one or two rate cuts remain likely before the end of 2019.

Asia

- Economic growth in China fell to a 30-year low of 6.2%/yr in the June quarter. The slowdown appeared primarily due to trade tensions with the US, which are reducing export demand and affecting the manufacturing sector.
- A slowdown in Chinese imports is a separate concern, indicating weakness in the domestic economy.
- Export demand has also tailed off in Japan. June data indicated exports were 6.7% lower than the corresponding period a year ago.
- Consumer confidence levels in Japan have deteriorated to their lowest levels in more than five years. With demand weak, Core inflation remained anchored at 0.7%/yr, well below the Bank of Japan's 2.0%/yr target.

Australian dollar

The release of mixed economic indicators in Australia and stronger-than-expected GDP data in the US saw the 'Aussie' dollar depreciate against the US dollar. By the end of July, the Australian dollar had fallen back below the US$0.70 level, closing below US$0.69.

Commodities

Iron ore prices closed the month of July at around US$115 per tonne. There was a notable increase in stockpiles at Chinese ports, indicating demand could tail off in the near term.

Continued weakness in China's manufacturing activity saw a sharp decline in premium coking coal prices during the month. Oil prices weakened for much of the month and closed July around -2.0% lower. The demand outlook in a slowing global growth environment offset potential supply concerns as geopolitical tensions between the US, UK and Iran intensified. Disruptions in the Persian Gulf could affect a significant proportion of global oil supply.

The gold price climbed a further 1.1%, adding to recent strength. The nickel price rose a further 17.8%, adding to gains earlier in the year. In fact, nickel has been the best performing industrial metal in 2019, benefiting from increased demand for electric cars.

Australian equities

Australian equities followed global equity markets higher as prospects of more stimulatory monetary policies both here and in the US drove Australian shares to all-time highs during the month of July.

Sector performance was dominated by Consumer Staples, which rose an impressive 10.2%. The Health Care sector (+6.2%) also fared well, supported by Resmed (+10.7%). The sleep disorder mask and medical device manufacturer announced a 13% increase in revenue in the June quarter and set an ambitious target for its user base to jump to 250 million by 2025. Materials (+0.4%) lagged in spite of rising iron ore prices.

Australian small caps bounced back from the longer-term underperformance of their large cap counterparts. The S&P/ASX Small Ordinaries Accumulation Index rose 4.5%, driven by small gold stocks.

Listed property

Global listed property posted moderate gains for the month. The FTSE EPRA/NAREIT Developed Index returned 0.4% in USD terms and 2.2% in AUD terms.

Europe (ex UK) was the best performing market (+2.5%), while Hong Kong was the worst performer (-5.1%) amid ongoing civil unrest in the territory.

In Australia, the S&P/ASX 200 A-REIT Index returned 2.6%. Diversified A-REITs was the best performing sub-sector (+4.2%), followed by Retail A-REITs (+4.1%), which bounced back after three consecutive months of negative returns. The worst performing sub-sector was industrial A-REITs, driven by the underperformance of Goodman Group.

Global equities

Global equity markets continued to establish new highs in July. The MSCI World Index edged up only 1.2% in local currency terms, but the weaker AUD helped to bolster returns in AUD terms to 2.3%. While momentum in US markets helped, the UK bourse was the strongest performer, with the FTSE 100 Index up 2.2% in local currency terms. UK stocks were up as much as 3.6% as sterling fell to two-year lows. German stocks struggled, with the Dax falling -1.7% in euro terms.

Emerging markets have now underperformed their developed counterparts for six straight months as the MSCI Emerging Markets Index only rose 0.7% in AUD. MSCI EM Asia was the weakest regional index in AUD terms, rising only 0.3%. Both MSCI India (-5.5%) and MSCI South Korea (-3.9%) fell particularly heavily in local currency terms.

The US/China trade conflict is hitting many Asian companies hard, but there is also an escalating trade disagreement between South Korea and Japan. Indian stocks fell sharply on market unfriendly budget proposals announced earlier in July.

Global and Australian Fixed Interest

Fixed income markets remained dominated by expectations of interest rate cuts and other potential forms of monetary policy easing.

Australian 10-year government bond yields closed the month 14 bps lower, for example, at 1.19% as Reserve Bank of Australia officials indicated that borrowing costs could be lowered further. Investors are speculating that Australian interest rates could fall as low as 0.50% in this cycle, effectively pricing in two further 0.25 percentage point cuts.

Yields plunged even further into negative territory in Europe, with 10-year German bund yields closing July at a new record low of -0.44%. In the UK 10-year gilt yields declined 22 bps, to 0.61%, as markets factored in the prospect of a potentially disorderly withdrawal from the European Union.

Bond markets were little changed in the US and Japan, with 10-year yields up a single basis point in both countries in the month as a whole.

Global credit

Anticipation of interest rate cuts worldwide helped support sentiment towards global credit markets. All else being equal, lower borrowing costs make it easier for companies to service their debt repayment obligations by reducing the cost of new issuance.

Around two thirds of US companies also released their quarterly earnings during July. Collectively, earnings increased by nearly 3.0% during the period, which was well ahead of consensus expectations.

These positive factors saw spreads narrow in both the investment grade and high yield areas of the market in July, resulting in another month of positive returns from global credit portfolios.

Source: Colonial First State

Six cognitive biases that influence how we save, spend and invest money

We like to think we're rational beings. But the reality is that a lot of our daily behaviour is influenced by our subconscious.

Behavioural scientists have looked at the way human beings are wired and discovered some 'cognitive biases' that influence our everyday behaviour. So if you find yourself clicking on that Amazon special or buying lunch at the same expensive cafe near work every day, they could explain why it's so difficult to stick to your spending limits or saving plan.

Here are a few of their insights into how our minds work.

We tend to discount the future

We value immediate rewards over rewards in the distant future. This tendency to want instant gratification is hard wired from birth. Studies have shown that children find it hard to stop themselves eating a treat even when a bigger and better treat is offered for those who wait for a few minutes. And 'discounting the future' doesn't stop when you reach adulthood. It could explain why it's hard to get too excited about saving for your retirement in your 20s. But the earlier you start planning, the more you'll be able to put away.

We tend to feel the pain of a loss more than the pleasure of a gain

You can see an extreme example of this sort of behaviour at the casino when gamblers chase their losses. This 'loss aversion' can also manifest itself in continuing to commit to a poor investment because you've already put a lot of money into it. It can help to think long term and avoid focusing on short-term fluctuations in the value of your investments.

We tend to follow the herd

Much as we like to think of ourselves as independent human beings, we tend to look to others for affirmation. Think about the rush to secure seats for the concert when you know that everyone else is using the online booking system. It's all about FOMO. This sort of 'herd mentality' can work in a positive way. Just a generation or two ago it was socially acceptable to smoke in restaurants or to drive without a seatbelt. Now it's unthinkable.

When it comes to money, this 'herd mentality' can manifest itself after stock market downturns, when investors start panicking and selling up, even though rationally this will crystallise their losses. It can help to shut out daily market noise and focus on long-term goals.

We tend to think things are more likely to happen than they are

You can see this in the popularity of lotteries around the world. While the chances of winning are infinitesimal, the winners get a lot of publicity, which makes us think it's more likely to happen. But at least the lottery is relatively harmless. Thanks to the global mass media, this 'availability bias' often focuses on bad events like kidnapping, plane crashes or stock market downturns.

Investors who experience a market crash like the GFC over-estimate the chances of the same thing happening again, even though statistically it's unlikely. It can lead to people saving for retirement changing their investment preferences to lower risk investments, even though this may not be in their best interests as their long-term returns struggle to keep pace with inflation.

We tend to favour recent reference points when making decisions

This 'anchoring bias' can make it easy to overspend in shopping malls. When you first see a pair of shoes for $200 and then a similar pair for $150 it's easy to anchor on the first amount and perceive $150 as a great bargain. And these days it doesn't stop when you leave the mall—online shopping means plenty more opportunities for that anchor to embed itself and end up in an unwanted purchase.

To counter this, try setting your own 'base price' before you set out shopping and stick to it. You can also see anchoring in practice when investors rush in to buy stocks that have just plunged in value without looking at the underlying performance of the company. They have made the mistake of anchoring the recent high point in their mind.

We tend to be a bit lazy

We tend to stick with current plans rather than change if it's too much hassle. This is probably why so many of us stay with our utility providers rather than shopping around for a better deal. If you find yourself suffering from 'status quo bias', try making a start with one area of the household finances—say, your electricity bill—to make it more manageable, rather than trying to tackle everything at once.

Source: AMP

How do Managed Funds work?

If you want to diversify your investment portfolio to spread your risk across different asset classes, sectors or geographic markets, you may be limited by the amount of money you have available to invest.

Managed funds are popular with investors looking to build their wealth over the long-term. By pooling your money with a group of investors, you can tap into much wider opportunities (such as infrastructure or overseas markets) that would be out of reach as an individual investor.

Want to invest in Brazil's economy, or agribusiness ventures? You're likely to find a managed fund that will give you access to that investment opportunity.

What is a managed fund?

A managed fund pools multiple investors' money into a fund, which is professionally managed by specialist investment managers. You can buy into the fund by purchasing units, or 'shares'. The unit's value is calculated daily, and changes as the market value of the assets in the fund rises and falls.

Each managed fund has a specific investment objective, typically focused on different asset classes and a specific investment management philosophy to provide a defined risk/return outcome.

For example, the investment objective of a fixed interest managed fund may be to provide income returns that exceed the return available from other cash investments over the medium term.

Why invest in a managed fund?

There are three key advantages a managed fund brings to your investment portfolio:

1. Diversify to reduce risk

By investing across different assets classes – and within different types of shares within asset classes – you can spread the risk of your investments falling due to market volatility. You can also balance different investment timeframes and income returns.

For example, investing $1,000 in a managed fund could give you exposure to 50 different company shares in an Australian equities managed fund. But to invest that amount in 50 companies as an individual would limit you to companies with low share prices (and cost a significant amount in brokerage fees).

2. Expert fund managers

Selecting individual stocks is also time consuming, and requires a certain level of market knowledge. Professional fund managers have access to information and research, and have the processes and platform access to manage your money effectively.

3. Reinvesting brings compound benefits

You can invest regular amounts into your fund, just like a savings account. And by reinvesting your fund's distributions you could 'compound' your investment returns. Effectively, any future interest payments will be a percentage of a growing amount.

Are managed funds good for income or growth?

You usually get two types of returns from a managed fund:

- Income is paid to you as a 'distribution', which you can easily reinvest back into the fund
- Capital growth if the unit price of your investment grows over time

If you're more interested in capital growth, you'll need a longer timeframe for investing – and these funds usually carry a higher risk.

Types of managed funds

When you're comparing managed funds, look at the asset allocation to understand its risk profile and potential performance.

- Income funds – low risk of capital loss, focus on defensive, income generating investments such as cash and fixed interest.
- Growth funds – longer-term (5+ years) investments, focused on capital growth rather than income and weighted towards securities and equities.
- Single sector funds – specialise in just one asset class, and sometimes a sector within that class (such as Australian small companies).
- Multi-sector funds – diversified across a range of asset classes, with varied risk levels.
- Index funds – aim to achieve performance returns in line with a market index, such as the ASX 200. Also known as exchange traded funds (ETFs) or passive funds.
- Active funds – an actively managed index fund that aims to outperform that index.

There are also multi-manager funds, which invest in a selection of other managed funds to spread your investments across different fund managers.

Who should I talk to about managed funds?

To find out more about managed funds, please contact us.

Source: Colonial First State

What are the best investments for your retirement?

In the simplest terms, investing your money means buying an asset with the expectation of earning returns from ownership of that asset. If you own an investment property, for example, you can expect to receive rent as income. But if you then sell the property for a higher price than you paid, you've increased your returns from your asset even more. This is known as a capital gain – the growth in value of an asset over time.

Different types of investments are grouped together into asset classes – a group of investments with similar characteristics, such as term deposits, bonds, property or shares/equities. When it comes to choosing between different investment options, they generally fall into two broad categories, defensive and growth assets.

Defensive assets offer less opportunity for growth, but more stability and security for your original investment. A term deposit is an example of a defensive asset – the interest you'll earn is fixed but you're guaranteed to get your original deposit back at the end of the term. Growth assets, such as shares, carry more risk but offer more potential to grow your wealth over time.

Why diversification is important

When choosing growth assets and defensive assets to invest in you're looking at how much you can expect to earn compared with the risk of losing some of the original sum invested. Diversifying your investments can be a good way to strike a balance between risk and reward. Because different asset classes behave differently at different times, spreading your money across a number of assets can help you earn more stable investment returns overall.

Investing costs

Every type of investment comes with costs. For buying and selling shares, you'll pay brokerage fees for each transaction. When you buy and own property, there are upfront and ongoing costs such as stamp duty, agency fees and maintenance costs. Plus, you'll be liable for tax on the income from your investments and on any capital gain you earn when you sell assets. These are all things you need to take into account when looking at different investment options.

Should you invest in a super fund?

You can invest in all sorts of assets outside of super, either directly or through managed funds. Most super funds will also offer a wide range of choices for investing your money, including their own blended investment options, such as growth, conservative (defensive) or balanced. So should you be investing your retirement savings in super or look elsewhere?

A key benefit of investing through your super fund is the potential savings on the tax on your investment income. Any investment earnings in your super fund are taxed at a maximum rate of 15%, regardless of the marginal tax rate on the rest of your income. The main drawback of investing in super is the money you invest and the investment earnings are locked away until you reach your preservation age and/or meet a condition of release. If you need access to the money you're investing in the short or medium term, then your super fund isn't the right place for it.

What about SMSFs?

If you're looking for more flexibility in your choice of investments than you can expect from a super fund, a Self Managed Super Fund (SMSF) could be the answer. However, there are significant costs involved in setting up and managing an SMSF so your freedom to invest super savings in property or collectibles, for example, comes at a price.

Your superannuation investment strategy

There's no one-size fits all when it comes to investing. Whether it's your investment strategy for retirement or another purpose, there are lots of personal circumstances and preferences to think about. Some of these include your investment timeframe, your appetite for risk and how much you already know about different types of investments. To find out more please contact us.

Source: FPA Money & Life

The impact of falling house prices

Housing is the most important asset owned by the majority of Australian households, according to the Reserve Bank of Australia (RBA).

A house not only serves as a place to live, but as a long-term investment, a measure of household wealth and a source of consumer spending. Therefore, a change in house prices can have a knock-on effect on a number of variables, such as wealth perception, consumer spending, interest rates and the overall health of the economy. Existing and potential homeowners and investors alike are keeping a close eye on the current downturn in house prices.

The impact of falling house prices

National house prices fell by 7.8 per cent over the year to March 2019. This compares to two consecutive years of growth, an increase of 2.3 per cent over the year to March 2018 and of 10.2 per cent in the year before that.

This most recent decline has had a negative impact on the 'Wealth Effect', which is the relationship between household wealth, (measured as the household's assets minus liabilities), and consumption. When house prices rise, homeowners tend to spend more and save less of their disposable income, or they may even remortgage to release equity from their homes to fund a new car or holiday. Remortgages account for about 30 per cent of the housing market in terms of value.

However, ABS figures show that household net worth decreased by 2.1 per cent in the December 2018, predominantly driven by losses on property and financial assets. Consumer spending has also suffered a corresponding fall - car sales are down by 8.1 per cent for the year to April 2019 and although the March retail report indicated a slight increase in spending, from 3.2 per cent to 3.5 per cent, the gain was predominantly due to a rise in prices rather than an increase in sales, which were materially weaker.

Financial Health Confidence

While falling international demand and tighter lending criteria may have shaken the housing market and initiated a slowdown in economic spending, the good news is that the downturn is easing up and the rate of decline in house prices has started to slow.

"The improvement in the rate of decline is attributable to an easing in the market downturn across Sydney and Melbourne where values were previously falling much faster," says Tim Lawless, CoreLogic Head of Research.

Despite the fall in house prices, Australians actually report a four-point increase in positive financial health sentiment between January and May 2019, according to BT's Financial Health Index.

Australians remain as positive about their financial health in May 2019 as they did in March 2018, with overall responses remaining unchanged, while the index reveals a two-point increase in positivity since the June quarter last year.

Furthermore, when asked how confident they feel about being able to afford their desired lifestyle in the future, Australians also report a four-point increase in positivity between January and May, with males and females feeling equally confident.

Interestingly, those aged 54 to 75 have seen a seven-point increase in confidence. This group may feel buffered from falling house prices because on average this group has lower overall mortgage balances and more assets elsewhere. Interestingly, this group are also likely to be impacted by lower property values when downsizing but this is not necessarily playing out in sentiment for this age group.

Similarly, the GenY/Z, 18 to 35-year olds, who are potentially first-time buyers looking at a more affordable housing market, are also more positive about their financial health, with a six-point increase in positivity between January and May of this year.

Driving the improved sense of financial wellbeing over the longer term has been a fall in the concern about house prices, which has fallen from 6.1 points to 5.6 points in the March 2019 quarter, measured on a scale where 0 is 'not at all concerned' and 10 is 'extremely concerned'.

Overall, it's important to remember to take a step back and consider a long-term view when there's any price correction in the housing market. For example, according to the RBA, over the 30 years to September 2015, house prices increased by an average 7.25 per cent a year.

This could mean that short-term fluctuations are of less concern when approached with a longer investment horizon.

Source: BT

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