NEWSLETTER

October 2019

alpha ADVISERS GROUP

Introduction

William Shakespeare and the psychologist Carl Rogers are not often quoted in the financial press. More's the pity. In this month's newsletter, we look at the way people's perceptions about financial markets can lag those markets by several years, and offer a simple solution that builds on Rogers' insistence that "the facts are always friendly." Read on to find out more.

Famous People in Finance – Hetty Green

"I buy when things are low and nobody wants them. I keep them until they go up and people are crazy to get them. That is, I believe, the secret of all successful business."

So goes the forerunner to the modern phrase 'buy low, sell high.' These words were spoken by Hetty Green, a financial wizard from the second half of the 19th century. Using family wealth derived from whaling, Green leveraged her start in the family business as a bookkeeper at the age of 13 to eventually earn the title 'Queen of Wall Street.' Famously, she insisted that her husband (and later her son-in-law) sign a pre-nuptial agreement giving up any right to her wealth. She was a woman before her time. Upon death in 1916 she was thought to be the world's wealthiest woman.

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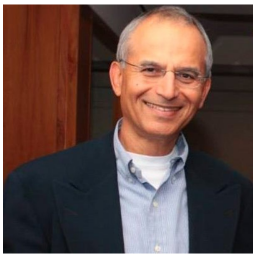

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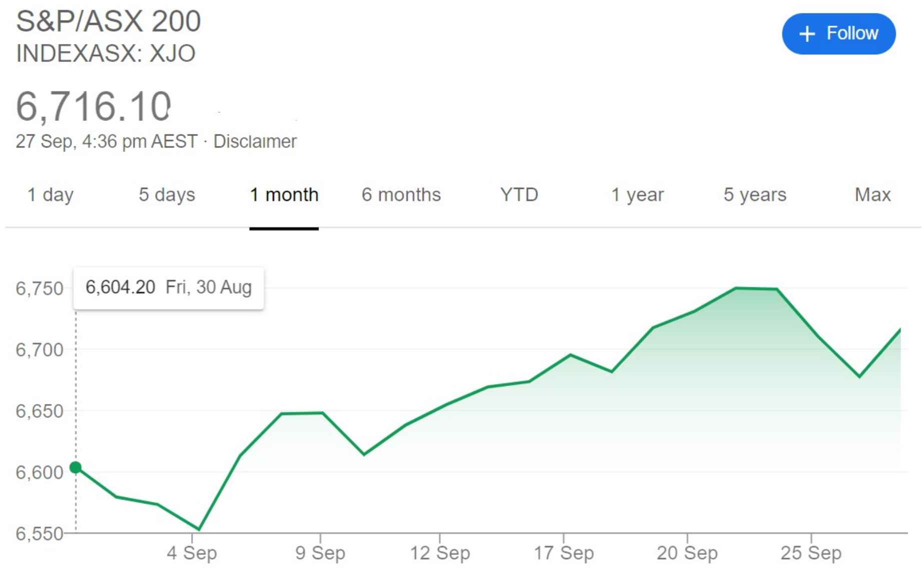
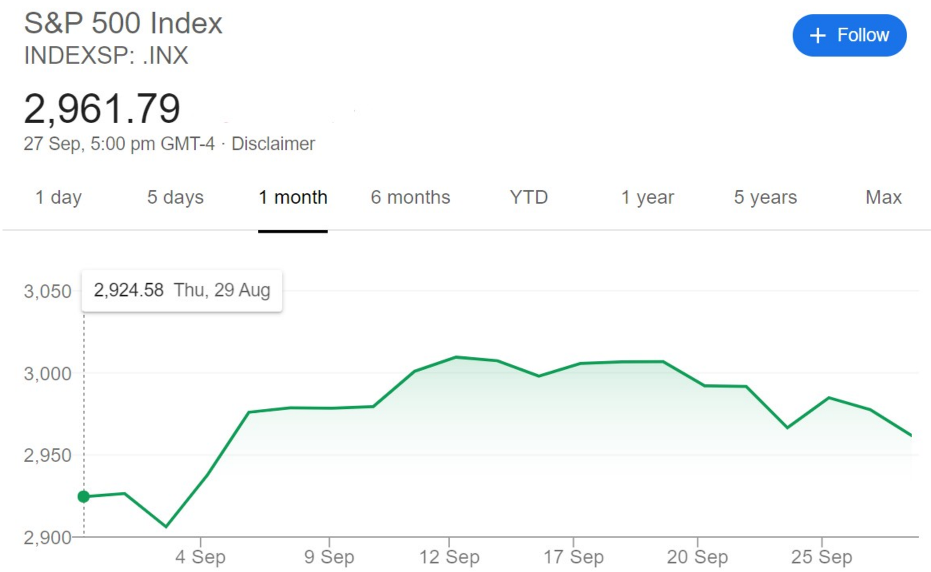
The Share Market

Having closed the month of August at 6604 points, the S&P/ASX 200 index had risen 1.7% when the market closed on Friday, September 27. The S&P/ASX 200 index is probably the best indicator of the market as a whole. So we can see that the month of September was a relatively good one for market prices. Here is how it all looks graphically, with thanks to Google and the ASX:



As you can see, the market experienced a month of steady and unspectacular increases in price. Prices did not change by more than 1% on any day during the month of September. Essentially, the month consisted of a lot of small increases interspersed with relatively few small decreases in market prices.

Basically, Australia's market kept track with the US market. As measured by the S&P 500 index, the US market rose by 1.3% between the start of September and Friday the 27th. If you look at the graph for the US market, you can see that it also shows a series of small increases interspersed with the occasional decrease in market prices. Here is the graph, again thanks to Google and Standard and Poor's:



Put simply, Australia's sharemarket did the most boring of things during September: it followed the US market in providing gentle positive growth. But, as we have said many times, boring is usually good when it comes to investing!

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Property – Perceptions and Reality

"There is nothing either good or bad, but thinking makes it so."

Hamlet, Shakespeare. 1599.

The quote above comes to mind whenever we think about the state of Australia's property market. Indeed, the quote is a useful one when considering the state of *any* market. Rising prices are great if you're selling but terrible if you're buying - so a change in price is itself neutral. What the change means to you is what dictates whether the change is a good or bad thing.

The quote came to mind for us again this week, as we examined a report from Australia's leading property researcher Corelogic. The report is titled "Perceptions of Housing Affordability 2019." The operative word is **perceptions**. Basically, the researchers were keen to identify what people *thought* about the residential property market rather than their usual focus – what prices are actually doing in that market. This makes really good sense: after all, people's thoughts are what drive their decisions.

Corelogic is Australia's Leading property researcher

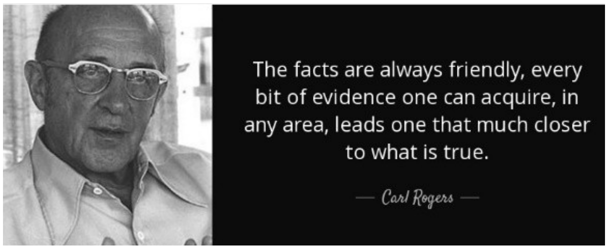
The researchers identified some really interesting perceptions. For example, in 2017 the proportion of Australians who expected not to leave home before they reached the age of 30 was 20%. In 2019, that proportion had risen to 34%. This change tells us that people aged under 30 have become much less optimistic about being able to buy their own home than they were two years ago. But here is the really interesting aspect of that finding: over the last two years, actual median property prices have fallen, meaning that housing has become more affordable, not less. Based on the actual data, young people should be more optimistic about the property market than they were in 2017.

According to figures provided by the Domain group and the website www.realestate.com.au, the last two years have actually been really good ones for first home buyers. In July 2019, the median house price in Australia's largest market (Sydney) was $900,000. This was a 7.7% decrease from the figure in July 2018 and a whopping 18.5% decrease from the median house price reported in June 2017 (where median house prices reached an almost overwhelming $1.17m).

So, property prices fell by 18.5% over the two-year period. Over the same two-year period, perceptions of affordability also fell. The proportion of people aged under 30 who think they are unable to afford to leave home was 70% higher in 2019. Potential buyers were becoming more pessimistic even while the properties they want to buy were becoming less expensive.

Taken together, this tells us that perceptions lag actual data. In 2019, people's perceptions are still being informed by the state of the market two years ago. It takes people some time to update their thinking.

For the sensible young first home buyer, **this represents a really useful opportunity**. While there is evidence that markets have perhaps bottomed out, first-time homebuyers who are able to purchase a home today may find they face less competition from other buyers. Those other buyers have not yet caught on to the reality the prices have fallen by almost 20% since their peak in June 2017. Those competitors' perceptions are locked in 2017.



As the famous psychologist Carl Rogers once said, "the facts are always friendly." Accurate information is always useful. When it comes to purchasing property, first home buyers who find the most up-to-date information gain a substantial advantage over other potential purchasers, who rely more on the general media to gather information about the state of the property market. This is why we periodically publish the most up-to-date information we can find about the property market. We really want our readers - and especially our young readers and/or young people associated with our valued clients - to understand what is happening right now in the most important financial market in Australia: that of residential property.

Our most recent comprehensive analysis of the residential property market was two months ago. Please feel free to flick back through our newsletters to see what we had to say in August. We are aiming to provide another analysis next month when the data for the September quarter has been released. So, watch this space!

Land, Labour and Capital

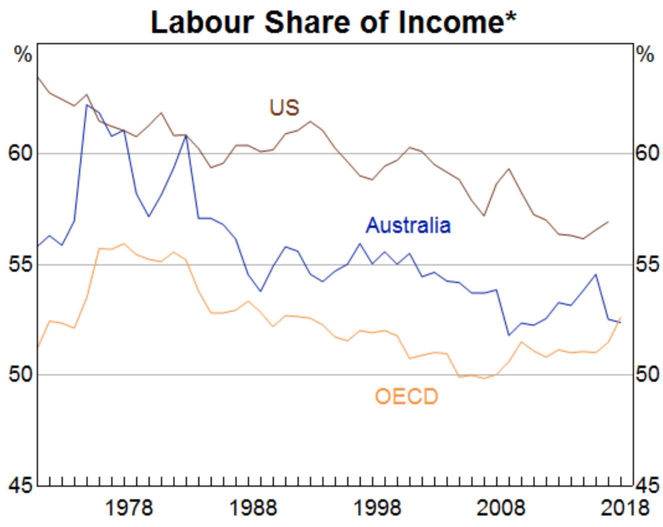
In our monthly newsletters, we try always to marry some standard economic theory with things that are 'in the news' at any particular point in time. Our role as advisers is not just to tell you what's happening - it is also to explain what is happening and therefore assist you to make better decisions when it comes to your own financial management.

Recently, we read an article in the Fairfax press about some enterprising young people making the most of their property purchases. Basically, people who have purchased property within walking distance of Australia's CBDs are increasingly renting out one or more parking spaces that attach to that property. The extra cash that this generates can be extremely useful for the property owner.

The article suggests that a single car parking space can add up to $100,000 to the value of a property. With interest rates currently at or below 4%, this means that a property owner can achieve positive cash flow on their car parking space if they rent the for more than $4000 per year. That is less than $80 a week, or $16 a day. Depending on the location (of course), $16 a day would be very cheap for guaranteed secure parking close to any of Australia's CBDs. Most people using this option are generating a benefit greater than the cost that they have incurred.

Reading this article reminded us of something taught in high school economics: in a modern capitalist economy, income is generated in one or more of three general ways. Basically, individuals can generate income by offering one or more of **land, labour** or **capital** to the economy. That income takes the form of rent (the income generated from land), salary or wages (labour) and interest or dividends (capital). Each of these types of income has advantages and disadvantages.

People new to financial management tend to focus on labour income such as salary or wages. Certainly, this is where the school system focuses its training of our young people – "study hard to qualify yourself to earn high salary or wage income" is the mantra there. Obviously, earning higher levels of wages or salary is a good thing. But earning nothing other than wages or salary is also quite risky. For example, the share of total Australian income derived from labour has fallen from almost 65% in the early 1970s to around 52% today (source: RBA). This tells us that almost half of Australian income (48%) comes from the non-labour sources of land and capital. If you rely only on income, you are fishing in less plentiful waters. Have a look at changes in labour as a share of income over the past 50 years (again, source: RBA):



The changes are not just happening here in Australia. They are a phenomenon all around the developed world. Labour is less significant as a source of income. This trend is unlikely to change any time soon.

Anyone serious about financial independence must consider land and capital as additional or alternative sources of income. After all, our ability to generate labour income is inherently limited. If, for example, we are paid an hourly wage then our income is capped by the number of hours that we can dedicate to paid work. If we receive a salary, that salary depends on the balance of demand for our skills and qualifications and the supply of those skills and qualifications in the economy. To give a simple example: Australia now employs relatively fewer journalists than it did in the pre-Internet age. Journalism is still seen as a prestigious occupation, however, and so Australia has a relatively high number of people who are qualified to work as journalists. As a result, the price paid to journalists in the form of salaries is relatively less than was the case back in the days before social media. Remember, high supply and low demand means low prices (and a salary is the price of labour).

Generating income from land or capital has a number of other advantages. Firstly, if the income is high enough, then a person's need to also generate income from their labour is reduced or removed altogether. This frees a person's time up to spend however they like - surely the best definition of freedom that there is! Secondly, if you can add income from land or capital to your income-generating portfolio, then you achieve something very similar to diversification. You become much less vulnerable to changes in the economy like the ones experienced by journalists over the last 20 years.

In the same way that investing in multiple companies reduces the damage of any one company failing, so developing multiple income streams reduces the impact of damage to any single stream. Multiple income streams means less risk.

Helping people develop income streams from land and/or capital is our stock in trade. So, if you would like to become more like those enterprising young property owners renting out their car parking spaces, please do not hesitate to come to talk to us. Helping people achieve greater financial freedom is the work that we are most proud of.

Finally, we should also point out that the above article does not discuss the tax implications of doing things such as renting out car parking spaces. Australia's tax law is too complicated to discuss all of its permutations here. Basically, we encourage you to get in touch with us whenever you are contemplating adding a second or subsequent income stream to your portfolio. Good taxation planning can provide outstanding benefits in the medium to long-term.

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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