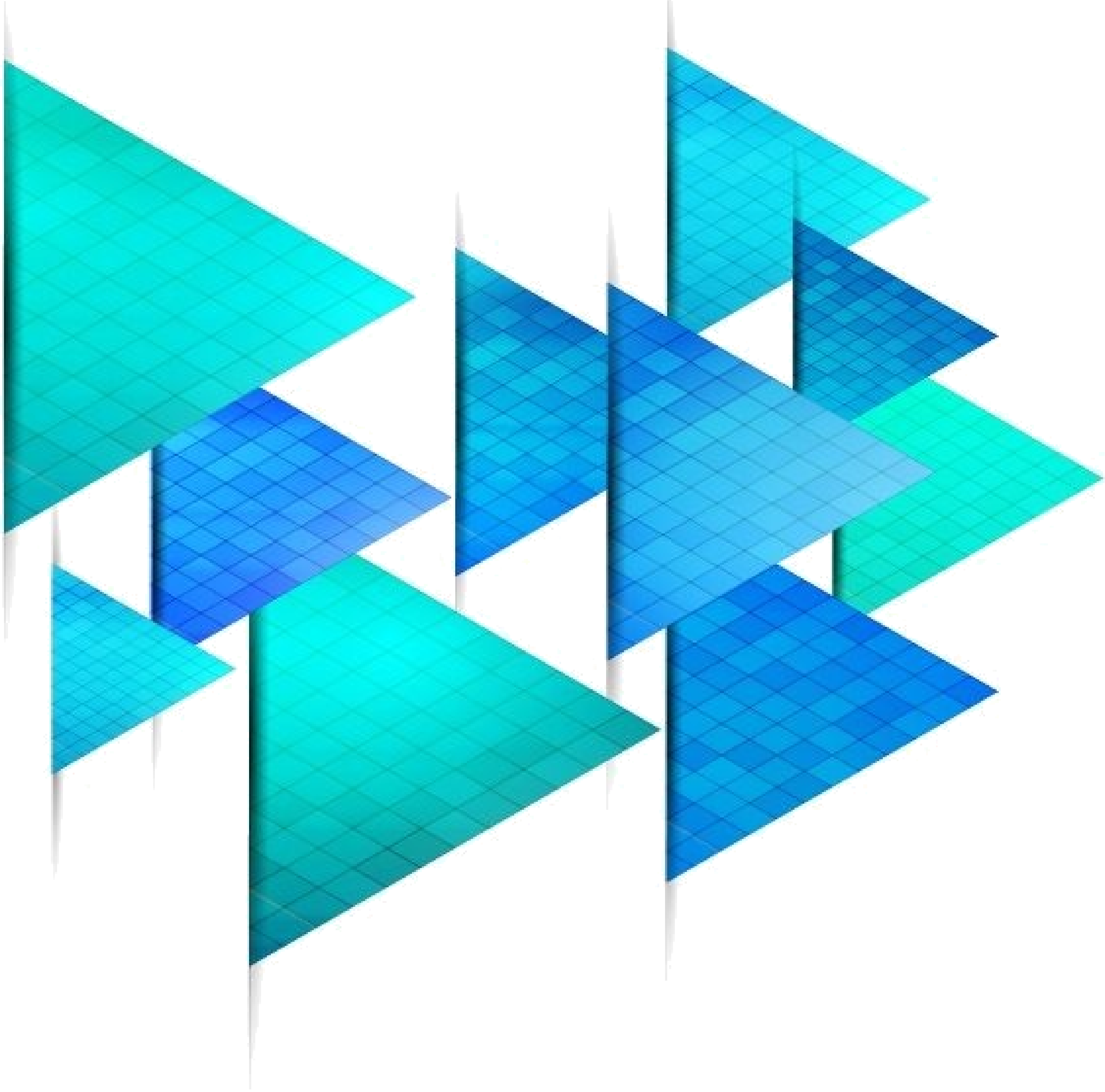

NEWSLETTER

February 2020

BRETT GEAPPEN
FINANCIAL SERVICES

Introduction

Welcome to the 20's. That's right, we find ourselves once again at the dawn of a new decade. We hope that the coming years bring peace and prosperity to you and all of yours.

This year we are doing something a bit funky with our newsletters. We like to provide regular content for all of our valued clients. So, each Friday we publish an article of interest and, on the first Friday of each month we publish a newsletter that typically focusses on the state of the two largest investment markets – shares and residential property. The newsletter comes in a PDF format so that you can download it and read it any way you like. Many people send it on to other people, which you are always welcome to do.

Many people like the PDF format. So, this year we are adapting our newsletters. They will still include the market updates and an analysis of current things that are happening (such as moves in interest rates). But we will also reproduce the previous month's 'blog' articles from our website. This means that the blog articles will also be available to you in PDF format.

We would love to know what you think of the change so, as always, feel free to drop us a line and let us know your thoughts.

Enjoy our first newsletter for the 2020s!

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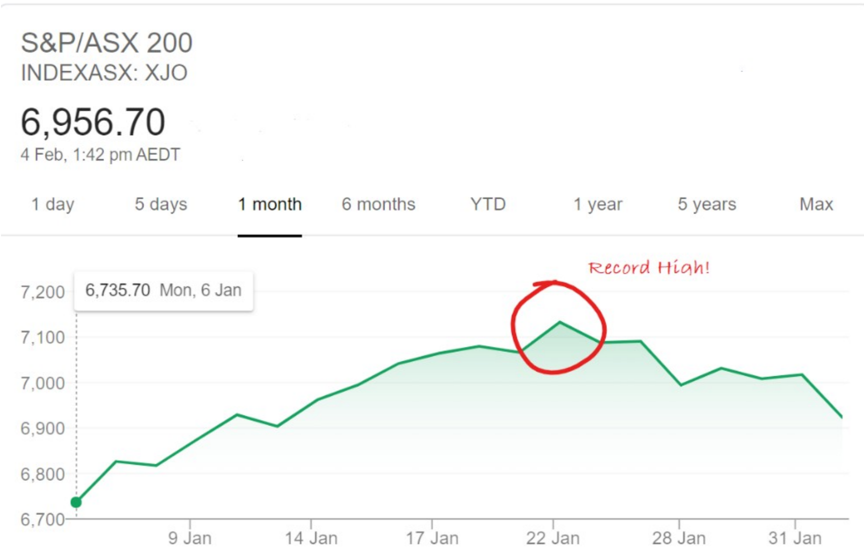
The Share Market

The Australian share market had a great summer holiday.

The market started at 6,735 points and soared to a record high of 7,132 points on January 22. It fell away a little after that, but still ended the month from January 6 with a monthly change of +3.2%.

Here is how the ASX 200 tracked for the month commencing January 6 – with thanks to Google and the ASX:



It is worth noting that this time last year the market was trading at 6005 points. So, the market has risen 15.8% since the start of February 2019. Add in dividends and it is another 20% return for the 12-month period.

One of the drivers for the share market at the moment is that rates of return on less risky investments (think cash and cash equivalent investments) are historically low. Australia's target cash rate, for example, has never been lower. This makes share investing relatively more attractive, as the rate of return available in the form of dividends becomes proportionally better.

Now, please remember that there is rarely ever one single cause of anything when it comes to economics. But the way that low interest rates can drive up the share market is as follows. Let's say that, at time A, the rate of average dividend return for shares is 4% and the rate of return for a cash-based investment is 2%. The difference is 2%. So, investors who prefer to invest in shares can expect an extra 2% return – which compensates them for the increased risk that they are prepared to take on. Looked at from the other direction, investors in cash-type investments think that the extra 2% on offer in the share market is not worth the extra risk.

Now let's say that interest rates fall to 1.5%. Company profits have not fallen, and so the average dividend return in the share market remains 4%. Now, investors who are prepared to take the extra risk of a share investment will earn 2.5% more than the more risk-averse investors. This should mean that some of the investors who thought that a 2% differential was not worth the risk re-think things: they can now get a 2.5% differential. This encourages them to buy shares.

Extra buying pressure drives the price of shares up. The average dividend yield is calculated by dividing the dividend received into the share price. So, if dividends stay the same and the share price increases, the average dividend yield falls. Economic theory would suggest that share prices will continue to rise until the dividend yield drops to 3.5% - and the difference between the two investments is again 2%.

But this is where theory can't explain the whole thing: as we say above, in economics nothing happens in a vacuum. There is always more than one factor impacting on the market. And so, during 2019, our dividend yield remained high[1]. For the dividend yield to remain high while prices rise must mean that dividends also rose to more or less the same extent. And this is what happened – company profits were generally good and the profits were paid out as dividends.

Of course, a market in which company profits are, on average, quite good will also encourage people to buy shares in that market – which also drives prices higher.

Another significant factor for the Australian market is that our average dividend is very high by world standards. Our average dividend yield tends to hover around 4.4%.[2] Other major world markets tend to offer around half of this.

Share investors can receive a mix of one or both of two types of return: dividends and capital growth. Dividends are more or less a direct function of the performance of the target company. Capital growth depends also on the sentiments of the market about a particular company. This can sometimes be completely unrelated to the actual performance of the company. Sometimes, market prices move for purely emotional reasons!

Remember, the dividend yield is the dividend divided by the share price. If the Australian average dividend is about twice the yield in other countries, then this would mean that, if the same company was operating in the overseas market, its share price would be twice as high as it is in Australia. In some ways, this is borne out by the results. If you look back at our newsletter for October 2018, you will see that we showed you how the US market – in terms of share prices - has outperformed the Australian market since the depths of the Global Financial Crisis in 2009. By some measures share prices in the US market did four times as well between 2009 and 2018. Similar profits (and dividends) saw prices rise much faster in the US.

(Before you get too excited, remember to also take a look at the newsletter for November 2018. In the October newsletter we cautioned readers to "not invest today's money in yesterday's super-performer." In the November 2018 newsletter we got to say 'We told you so!' History is a guide, not a roadmap).

Australian investors tend to prefer to receive a larger portion of their share market gains as dividends. It is worth thinking about why that is the case. Almost certainly, the relative size of our superannuation industry and its participation in the share market provides a powerful incentive towards dividends. Retirees need to receive income from their investments, and this encourages them (and their super trustees) towards companies that pay a stronger dividend. Because the strong dividend is a key incentive, the price of the company will not be bid up to a point where the dividend yield falls. As the share price rises (and the yield falls), buying pressure comes off.

So, our liking for dividends helps to stop share prices from becoming tearaways in the Australian market. Who would have thought Australian investors would be the most sober investors in the world – as if we are on a permanent Febfast when it comes to share prices!

1 Source: "ASX finally makes it back to its record high — why has it taken so long?" ABC News. July 30 2019.

2 Source: ibid.

First Home Loan Deposit Scheme

(First published January 17 2020 on our website)

Welcome to 2020! We hope that this is a great year for you and those you care about.

Normally, we would start a new year with something general about new year's resolutions or how to save. But this year, we are jumping straight in. That's because there is something we want you to know about ASAP.

As of the 1 January, the Commonwealth Government's First Home Loan Deposit Scheme comes into effect. Announced in 2019, this scheme has already seen 3,000 registrations. In fact, demand has been so strong that the next batch of registrations cannot occur until 1 February.

The scheme is being rolled out by the National Housing Finance and Investment Corporation. In order to qualify, you need to be a first home buyer. You also need to have saved at least 5% of the deposit price for a home. You can either be a single person with an income of no more than $125,000 per year, or a member of a couple (married or de facto) with a combined income of no more than $200,000 a year. And you have to live in the property – the scheme is not available to investors. The scheme can be used for both existing and new housing.

The scheme works by having the recipient take up a bank loan to purchase a first home. The NHFIC will then guarantee an amount equal to up to 15% of the value of the home. The idea is that the recipient's personal liability is capped at no more than 80% of value of the property. Usually, there is mortgage insurance to pay if you borrow more than 80% of the value of a property (this insures the lender, not the borrower. But the borrower pays the premium). This will still be the case – but the Government will pay this insurance for members of the scheme.

Being part of the scheme doesn't mean that the recipient does not have to repay the whole loan! If you borrow, say, 95% of the value of the property, then you have to pay that whole loan back yourself: the Government is not paying off your loan for you. But by providing the guarantee and paying for the insurance, the Government is allowing people to obtain a loan faster than they otherwise might.

The value of the home is also capped. There are different caps for each state and different caps for cities with more than 250,000 residents as against non-city areas within each state.

The Government will guarantee up to 10,000 loans each financial year. The good news is that we are already halfway through the current financial year, meaning that there are 10,000 guarantees available between January 1 and June 30 2020. As we say above, there have already been 3,000 registrations this month – but most of that is pent-up demand from people who knew the scheme was coming. The rate of registration will slow down – but it still pays to move quickly if this scheme is something you want to consider. There are 7,000 spots left this financial year.

The scheme is a good one – but it may not be the best way to proceed in every case. So, if you or someone you care about thinks this scheme might be worth their while, please get in touch with us ASAP. We can help you examine whether you are eligible and whether this scheme best suits your needs – and then help you register for it too.

Helping People Affected by the Bushfires

(First published January 24 2020 on our website)

Most of us have watched in horror as bushfires have burned across every state of Australia this summer. Many of us are moved to help those most affected. In this article, we thought we would let you know how you can best provide help. Getting it right can make a huge difference.

Give Cash, not Kind

The best way to provide material aid is to provide cash, not goods. While most of us have some spare 'stuff' lying around, and many bushfire-affected people have lost a lot of their own 'stuff,' the chances that our stuff is exactly what people need is low. Already, many victims of the bushfires, and their supporters, are reporting that managing actual goods that have been donated is providing a logistical headache.

After all, money was first invented because it was so much more convenient than passing stuff around. It is the best way to move wealth from one place to another. That has never been truer than today, when we transfer cash electronically. The transfer is instant, there are no transport costs and there is no need for storage. Your donation will not go off or perish and will be there ready to use when the recipient really needs it.

The other great thing about giving cash is that recipients of cash donations will tend to spend that cash locally, at least in part. These fires have come right at the height of summer, which for many areas is also the busy time of year for local businesses. This means a double whammy: people have not just lost assets; they have lost income as well. Sending cash into those communities is a way to alleviate the loss of business income and will help the local economy.

If you only have Kind…

You may not have any spare cash. If not, then look for a company that specializes in giving material aid, and work through them. As one example, Foodbank works in every state or territory. Their website also says that they prefer if you donate cash – telling us that they can purchase $6 worth of benefits for every $1 they receive. If you really want to give goods, their website has a list of things that they need and a list of locations that you can take those things to. It also has a list of things that they definitely do not need.

If the things you have are not on that 'things we need' list, but you still can't donate cash, then think about volunteering either your time or some other thing. Agency websites will tell you what sort of volunteering might be needed. For example, the RSPCA is using volunteer drivers to move family pets out of harm's way in various communities.

It might not be your time. Some people are providing a spare room, for example, or spare space in their garage. Once again, have a look at the websites of relief agencies to see if they need any of this kind of volunteering.

Look for a Reputable Agency

Sadly, these are not the first bushfires we have experienced in Australia. The only 'upside' of that is that we have developed quite some expertise in providing bushfire relief. There are experienced agencies that are very good at getting aid to the people who most need it as efficiently as possible.

Reputable agencies include:

- Foodbank;
- The Salvos;
- Red Cross;
- St Vincent de Paul;
- State-based fire services (which are typically run by volunteers).

There are plenty of others, and you may have a personal preference. That's fine – just do your homework so that you can be sure your money gets where you want it to go!

Donate Directly

On a related note, be wary of retail companies that promise to donate a portion of the cost of whatever it is that they sell to a bushfire cause. It might sound harsh, but there can even be an element of profiteering involved when companies do this. For example, a company may announce that 10% of all revenue/profits from sales of a particular item will be given to bushfire relief. This might sound generous – but they are still keeping the 90% that isn't donated, while only 10% of the money you spend ends up as relief.

And if people are moved to buy more of that product or service, then that company will be keeping 90% of increased sales. In the 10% example, if sales increase by 11% as a result of the program, the company has actually made more profit as a result of its 'donations.'

Be wary even if the company pledges to donate 100% of the purchase price. If you don't need whatever the company is selling, then you might as well just give the money directly to a charity and cut out the middleman. Even better – you get to choose the charity.

That said, if you were already going to buy that good or service anyway, then you might as well pick the one that will also put money in the hands of bushfire relief agencies. So there is no single rule.

Tax Deductibility

Think about whether you can claim a tax deduction for your gift. If you can, then you can actually donate more money to that recipient. Let's say you earn $37 per hour and you want to give $100. If you pay tax at 32.5%, then you need to first earn $148. That will take four hours. The Government then takes $48, leaving you with $100, which you give to the relief agency. So, you work four hours, the Government gets $48 and the relief agency gets $100. You are $100 worse off – because that is all you would have kept anyway.

If the organization to whom you donate is registered for tax, then you can donate $148 to them. The government will then give you a refund of the $48 tax you paid, meaning you have still only given up $100 of purchasing power – but the agency has $148. That's almost 50% more (even though the tax rate is 32.5%)

Tax deductibility turbo charges the benefits of your donation.

Don't Forget

Lastly, remember that the effect of the bushfires will last quite a while. The nature of the news cycle is that it always moves on. One day, these fires will not be on the nightly news. But it will take years for affected communities to properly recover, so it is really important that we do not forget about the people affected.

Why not make an appointment in your own diary to re-visit this issue in a few months' time? Make a simple note to think about how people might need help in April, or July. Maybe there will be a different need for assistance by then. One thing is for sure – there will still be much to recover.

Game, Set and Match

(First published January 31 2020 on our website)

Each year, the best 128 male and 128 female tennis players in the world make their way downunder to contest one of only four grand slams played around the world. Of each 128, one wins and 127 go home disappointed.

When this happens, we always think of the world's greatest investor, Warren Buffett, and his first rule of investing: don't lose money. There is, after all, one thing that all the winners of the Australian Open have in common – they are the last man or woman standing. We could re-write the rule of investment to be the first rule of tennis: don't lose a match.

Think about it: Ash Barty has always won a lot of games of tennis. But she really became a star when she stopped losing them. (Taking that beautiful baby to the press conference was pretty impressive, too). And think also of the long-time record holders: Novak Djokovic and Serena Williams have each won the Australian Open seven times. That's 49 games of tennis without losing a single one. (Novak might be about to make it 56!)

If Warren Buffett played tennis, he would use a racquet like the one in the photo. Anything to make sure he did not lose. Because the person who does not lose is the person who ends up winning.

There are millions of tennis players around the world, but only 128 places in the big Grand Slams. So tournaments like the Australian Open don't have all that much in common with you and I. Happily, investment markets are a lot easier to get into than the main draw of the Australian Open. Investment markets are not like big international tournaments that roll around once a year. Investment markets are more like the local C Grade pennant that is played every Tuesday night, rain, hail or shine. "All are welcome; no particular ability necessary. Please bring a plate for supper."

Even better, investment markets behave a lot like Tuesday night pennant, as well. That is because in Tuesday night pennant, the game is lost by the loser, not won by the winner. The 'winner' is rarely the player who serves the most aces. The winner is almost always the player who serves the fewest double faults. Tuesday night winners know that all they need to do is keep the ball in play and wait for the other player to bang it back into the net.

On Tuesday nights, if you don't lose the point you end up winning the point. As Buffett tells us, this is just how investing works: if you don't lose money, you end up making money. So, successful investors don't play too aggressively. They avoid going for the big winner down the line – and avoid the risk of the ball going wide or long. Patience is their virtue. Just like Tuesday night's champion.

Helping you keep your 'investment ball' in play is our job as advisers. Think of us as your investment coach, showing you how to play investment 'shots' that land well in the middle of the court, every time. Helping you become your very own version of Novak, or Serena – or Warren (which is even better!).

Investing is just like Tuesday night tennis: if you don't lose, you end up winning. Game, set and match.

The Legal Stuff

General Advice Warning

The above information is general in nature and does not take into account your personal situation. You should consider whether the information is appropriate to your needs, and where necessary, seek professional advice from a financial adviser.

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