NEWSLETTER

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PECUNIA
PRIVATE WEALTH MANAGEMENT

Introduction

Happy spring! In this edition, we take a deep dive into the Australian share market, comparing it to the US and other global markets. We do this for one main reason: we are starting to see some separation opening up between the performance of shares on the US market and the performance of shares on the Australian market.

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The Share Market

The Australian market fell during the month of September. Here is how the month looked, as measured by the ASX 200 (and with thanks to Google and the ASX):

That said, the fall of 1.78% between the last day of August and the last day of September was smaller than the fall in the US market, further confirming our conclusion last month that the two markets have 'uncoupled' at least to some extent. Here is the how US prices performed in September, as measured by the S&P 500, this time with thanks to Google and S&P:

As you can see, the general trend in the two markets was the same, but the size of the movements was greater in the US, with their market falling an average of 4.7% for the month.

The American market was again dominated by the extreme volatility of the prices of shares in relatively few companies. One of the most dramatic performers for the month was Tesla. Having closed at $US442 on Friday, August 28, prices soared by more than 10% to close only just under $US500 on Monday, August 31. From there, prices fell by 30% over the next week, before recovering somewhat to close out the month at a tick over $US400 per share. All this in a company whose shares were trading at $US83 at the start of 2020!

What this tells us is that the markets remain very volatile and are making large reactions to any change in sentiment about a company.

Theorists will tell you that the price of a share of a company should represent the market's collective estimate of all the future profits of that company. These profits are then 'discounted' according to how far into the future they are – the theory being that a dollar of profit in 2030 is worth less than a dollar of profit in 2020. Basically, then, when you buy shares you buy a share in the future profits – and it makes sense that you would only pay what you think those future profits will be.

As we say, that is the theory. It is, of course, very difficult to predict future earnings a long way into the future. The future is always unclear. But, if such a thing is possible, the future is currently even more unclear than usual. This is why the market is moving in such large waves: the market does not know how to distinguish relevant information from irrelevant information and is reacting to everything.

This is one of the real conundrums of the market at the moment: why are people trading at such volumes when the conditions in which market participants are operating have become so unpredictable? Here, for example, is a table provided by the ASX showing trading volumes for each of the 12 months up to the end of July 2020:

Date	Equity trades
Jul 2020	32,481,895
Jun 2020	37,470,478
May 2020	32,563,167
Apr 2020	37,561,647
Mar 2020	67,395,984
Feb 2020	38,425,762
Jan 2020	32,122,975
Dec 2019	29,371,658
Nov 2019	35,084,342
Oct 2019	37,386,972
Sep 2019	36,245,224
Aug 2019	39,505,644

As you can see, the volume of trades grew enormously in March, when the pandemic's effect on the economy first started to bite. To a large extent, this would be expected, as many shareholders sold holdings in the face of market uncertainty. (Remember, prices fell markedly in that month). What is far less to be expected is the extent to which trading pretty much bounced back to normal levels from April onwards. As we know, while they have not reached pre-pandemic levels, prices have risen strongly since the 'bottoming out' in March. This means that the effect of this 'normal' trade has been to drive prices back up.

Which all begs the question: what information are these purchasers relying on? Clearly, it is not a detached and sober estimate of future profits for each of the companies in the market: for many, if not most, companies on the market the future trading conditions are simply too unclear for such estimates to be made with any conviction. This market seems very much to be being affected by simple sentiment about the market.

Whether that sentiment is borne out to have been valid is, of course, something for the future to reveal. But one thing seems clear: anyone who has deviated from a long-term investment strategy in the hope of making profits from the unusual events of 2020 is relying on hope more than sober analysis. For their sake, we hope things turn out OK.

Federal Budget 2020

Just a reminder for our readers that the Federal Budget, which is usually delivered on the first Tuesday in May, will be delivered on the first Tuesday in October this year. This will be one of the most important and interesting budgets in recent history - for all the obvious reasons.

In May 2019, Treasurer Josh Frydenberg expressed the hope and expectation that this year's federal budget would be in surplus. Obviously, that is not going to happen now. And nor should it. After all, when the Commonwealth Government's budget is in surplus, that means that the Commonwealth has removed more money from the economy than it has replaced. Everything else being equal, the economy becomes smaller than it otherwise would be. Obviously, given what happened this year, the last thing we need is for any level of government to impinge on economic activity. Appropriately, then, this year's budget will comprise a substantial deficit. This will put more money into the economy than the Commonwealth takes out and, again, all things being equal, will contribute to economic growth.

An analysis released early this week by Deloitte suggests that the underlying cash deficit of the Commonwealth government for the current financial year will approach $200 billion dollars. Obviously, that's a lot of money. Happily, unlike in previous years, we are not hearing much 'scary' conversation about debt and deficit. As we told you back on April 9 in our weekly article, debt owed by the Commonwealth government is very different to debt owed by any other participant in the economy. Have a look back at the article to see what we had to say. For now, though, when you hear the numbers being spoken about next Tuesday please just remember one thing: Australia has what is known as a fiat currency and that currency is under the control of the Reserve Bank of Australia.

If push came to shove, and there was no other source of finance, the RBA could simply create money that could be used by the Commonwealth. It has actually done a little bit of this so far in calendar 2020 – as at the end of June, the RBA had purchased approximately $40 billion worth of debt owed by the Commonwealth government. What this means is that the Commonwealth Government had initially borrowed that $40 billion from private institutions such as banks. This debt needs to have interest paid on and the whole amount then needs to be repaid at the expiry of the loan period. Because the debt was then purchased by the RBA, the Commonwealth now has to make the interest payments and ultimately repay the debt to an agency that is in fact part of the Commonwealth.

By purchasing this debt, the RBA created a situation in which the Commonwealth has effectively borrowed money from itself to finance spending. Technically, this still shows up as debt but obviously having one arm of Government owe money to another arm is not particularly risky. The big risk of this type of financing is really inflation, but there is little of that about at the moment – the most recent measure of CPI was -1.9% for the June quarter. Prices are falling, not rising.

Since June, the RBA has continued to purchase government debt. By the time the full deficit for the current financial year is known, it will be very interesting to see just how much of the 'deficit' has been financed by the Commonwealth's own bank. But one thing is for sure: the large numbers revealed by Treasurer Frydenberg next week should not strike fear in terms of how the debt will ever be repaid. Far more important is exactly what measures the Commonwealth announces to support and indeed encourage greater strength in the economy. The key driver here will be employment.

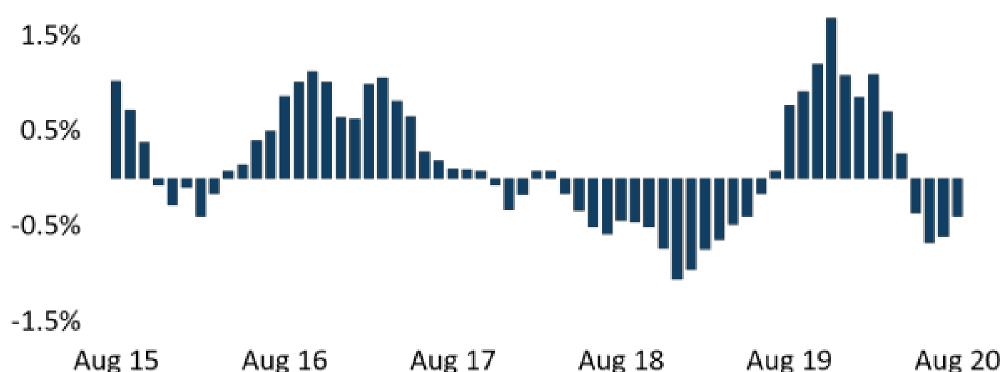
Without being political in any way, the responses of various levels of Government to the pandemic in Australia so far have actually been very encouraging. We have a stable economic system that is led by really smart men and women who have generally made really good decisions. We expect this will continue and we can hardly wait to read the Budget and then bring you a full analysis in next month's newsletter.

The Residential Property Market(s)

If the pandemic has made it tricky to analyse the sharemarket, it has made it almost impossible to analyse the residential property market (or, as we should say, the residential property markets. Unlike with shares, which mostly trade on the same national exchange, different locations give rise to different market conditions when it comes to residential property. There really are several distinct property markets in Australia).

The picture for these markets remains very unclear. So, we will still keep this amall analysis brief – but we did want to draw your attention to a couple of pieces of research that we have come across recently.

According to respected market researcher and analyst Corelogic, the month of August 2020 saw Australian average residential property prices across all of our markets fall for the fourth month in a row. Here is how monthly price changes over the past five years look graphically (with thanks to Corelogic):



One thing to note when viewing this graph: the data is for August and therefore largely reflects the sale prices for properties that were listed in June or July or even earlier. Accordingly, the full extent of the highly restrictive lockdown to which Victoria has been subject is not yet fully factored in. Because it can take some months to sell a property, there can be a lag between the time that events occur and the time that those events reveal their impact on the market.

Interestingly, none of those four months have seen prices fall to the same extent that they were falling in the second half of the 2018 calendar year. Indeed, the falls in price between May and August has been smaller than the preceding *rises* in price between January and April 2020. Expressed as a national average, prices are still higher than they were at the start of this most strange of years.

Almost certainly, this is because there has been a substantial fall in supply of residential properties for sale during the pandemic. Unsurprisingly, anyone who can hold off on selling their property has done just that. This introduces a major caveat to the numbers above: residential property is demonstrating what, in the sharemarket, would be known as 'skinny trade.' Skinny trade is where the transaction prices of a relatively low number of transactions can have the effect of misrepresenting the state of the broader market.

Across the country, in the month of August the total number of properties newly listed for sale was 21.5% lower than at the same time last year (again, thanks to Corelogic for this data). For capital cities, the total number of properties newly listed was more than 25% lower than in August 2019.

This drop in listings definitely muddies the waters when it comes to trying to gauge the impact of the pandemic on residential property prices. For now, we will continue to simply suggest that clients 'watch this space' in terms of any enduring effect for property owners and prospective purchasers. It is only when the size of the market returns to something more like 'normal' that we will be able to gauge the impact of the pandemic on prices.

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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