WATERHOUSE
WEALTH MANAGEMENT PTY LIMITED

Quarterly

SPRING 2020

DNR investment review

By Jamie Nicol

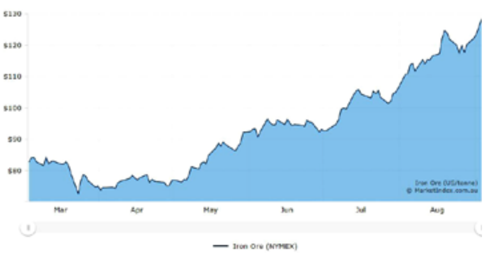
The market continues to enjoy a strong run despite lockdowns in Melbourne, uncertainty regarding the outcome of the US elections and ongoing trade disputes with China. This month we review the reporting season and the key issues overhanging the market.

Reporting season overview

The reporting season surprised to the upside. Companies are generally careful to guide the market ahead of results and consequently most disappointments occur ahead of reporting season. Nonetheless, important insights emerged.

1. Earnings per share (EPS) growth was down 16 % due to COVID-19.
2. Consumer-related companies (like retailers) enjoyed the fiscal stimulus and super withdrawals. Bunnings Warehouse, JB Hi-Fi and others were major beneficiaries. With consumers unable to travel and spend their money on other experiences they are back to spending their money on hard goods. How long can this continue? We have been inclined to sell into this rally as we do not see it as sustainable.
3. Mining companies benefited from strong commodity prices, particularly iron ore as China began stimulating its economy.

Iron ore price



Source: Marketindex.com.au

4. Software companies are benefiting from a move in activity to the cloud as employees stay home.
5. US housing activity has picked up and this benefited aligned companies. This appears to be a response to improved affordability, a lack of supply and movement out of the major cities.

Housing sales and starts growth show a V-shaped rebound through July

Source: Goldman Sachs Global Investment Research

6. Banks continue to struggle as low interest rates place pressure on margins, bad debts are elevated and expenses remain high as they deal with legacy issues.
7. While companies exposed to COVID-19 (travel, education) remain under pressure, some of the results were better than feared (IDP Education (IEL), Corporate Travel Management (CTD)) and reflected good flexibility displayed by management teams.
8. Uncertainty overhangs physical assets like office property and regional retail property.

Major investment considerations

COVID-19 vaccine and reopening of the economy

The lockdown in Victoria triggered anxiety for the Australian economy. Do we have a plan to reopen the economy if there is no vaccine? Are we going to go back into lockdown with an increase in cases? This is not a good environment for business confidence. Consequently, progress on the vaccine becomes important for those companies tied to the health of the economy or dependent on the economy reopening. We expect to hear more on this front over the next month.

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Coping with market volatility

By Robin Bowerman

Recent volatility in investment markets can be frightening when you're saving for retirement, but one of the key lessons from history is that volatility is a normal and necessary part of investing.

Markets are made up of individuals making buying and selling decisions based largely on their view of the future. Given the future is uncertain, those individual views differ. From time to time, events that increase uncertainty about the future or lift the chance of a weaker economy can prompt sell-offs in the markets.

The daily market moves reported in the media can make things seem worse than they are. A 1000 point move in the Dow Jones Industrial Average sounds big but it represents less than 4 % of the index in 2020. Contrast that with October 1987, when the Dow fell 500 points in a day – but it was a full 22 % of the index's value.

Investors have certainly had to cope with severe volatility and uncertainty in recent years (and especially in 2020), from the worldwide spread of COVID-19, to US-China trade tensions, to fears of impending recession and worries about inflation taking off.

So how can investors remain focused and cope with market fluctuations?

The first step is to accept that volatility is normal and that it should be expected.

The second step is to have a financial plan. It does not need to be War and Peace just capture the essence of why you are investing in the first place, the goals you are hoping to achieve and a realistic stock take of where you are today.

The third step is to stay diversified, be disciplined to avoid impulsive decisions and stay focused on your long-term goals.

Sometimes, investors can be tempted to sell during downturns, getting out of the market to avoid the potential for further losses. The problem with this strategy is it locks in losses and provides no exposure to the eventual recovery in prices.

Global markets experience eye-catching downturns on average about every two years. In fact since 1980 (and even not including recent market events sparked by COVID-19), global stock prices have fallen more than 10 % (called a 'correction') on 11 occasions. On eight occasions they fell more than 20 %, the very definition of a bear market.

Remaining in the market is a better strategy than selling.

Some investors might also be tempted to try to pick up a bargain during a downturn, buying stocks that have fallen heavily in the hope they will make outsized gains as sentiment recovers.

But the odds of picking the winners are small and the odds of timing market up days and down days are even slimmer, particularly as days of big moves (in either direction) tend to cluster together.

So remaining diversified is the superior strategy.

Diversification is a proven approach to managing investment risks, reducing the risk of damaging losses from the performance of a single asset or sector.

Not all markets perform badly at the same time and a diversified portfolio ensures that exposure to the worst performing markets is mitigated while delivering at least some exposure to the better performing markets.

Article source: Vanguard Investments

DNR investment review

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US election

The outcome of the US election will have implications for the market. Trump offers lower taxes and regulation (which the market likes) but greater geopolitical uncertainty and a higher risk premium (for his chaotic policy development). Biden is more of an unknown. How far will he be dragged to the left on economic policies, and who will lead the Treasury, are key unknowns. It increases the likelihood of a large infrastructure spend and progress towards modern monetary theory, which could well be inflationary.

Inflation versus deflation

The COVID-19 pandemic has been a major deflationary event. Federal Reserve Chair Powell has flagged it will keep interest rates low and lift inflation targets as a signal to the market that efforts to inflate the economy will continue. It is one thing to change a target, it is another thing to develop the policies to change inflation amid a pandemic that has created a hole in demand. The level of fiscal stimulus continues to increase, but so does national debt. Therefore, there are significant challenges to change the current inflation outlook, but a change would create significant investment implications.

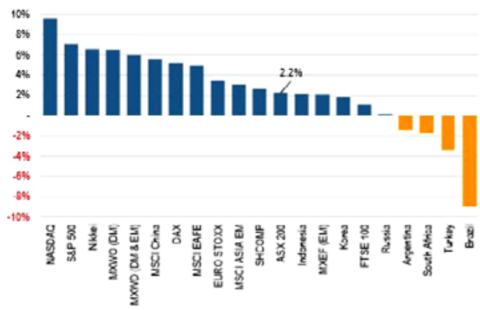
Inflation during each Fed chair's team

Source: Federal Reserve Bank of St. Louis

Value versus growth

The momentum in growth stocks continues with the technology sector doing particularly well. COVID-19 has been supportive of this trend with a lack of cyclical growth, a trend towards use of cloud software and acceleration of online sales causing interest in the NASDAQ to remain at high levels. We note the value of the NASDAQ is now worth more than the entire European market. While the earnings outlook appears robust, market interest has become a little speculative, which raises risks in these names. Support for a rotation to value rests on the outlook for the cycle improving, which remains a little uncertain.

NASDAQ outperforms in August



Source: J.P. Morgan estimates, Bloomberg. Past results are not an indicator of future performance.

Article source: DNR Capital

Starting the investment journey late

By **Robin Bowerman**

The power of compound returns is startling and the mathematics in favour of starting to save early in life is undeniable.

At a 4 % annual return, $100,000 invested today will grow to around $580,000 over the course of a regular 45-year working life.

Vanguard's retirement planning team has a worked example online. A person starting at age 20 and saving $4,500 a year has a good chance of having $1 million in retirement. At 30, they would need to save $9,000 a year. And if they wait until 40, they need to save $18,000 a year to hit the same goal.

That's all very well for the young, but what of us that didn't hear that lesson in our 20s and find ourselves mid-career starting to think about putting something away for retirement?

And as the old radio ad said, the best time to start might well have been 20 years ago, but the second-best time is now, even with the challenges being thrown up by the COVID-19 pandemic. Not surprisingly, the global health emergency has people much more focussed on short-term, particularly if employment or business income has been affected.

But with more people working from home, there may be a good opportunity to devote some of that time by getting back to basics.

First things first – starting late means making a genuine effort to understand your financial plan. How much do you really need to retire? And how long do you have?

The answer to this important question will set the scene for how much you need to save. Saving for retirement is effectively a balance between your quality of life today and quality of life tomorrow.

Only once you have a plan, can you work out how much you need to save each year.

The clearest path to a comfortable retirement is to step up the amount saved each year which can only be achieved by earning more, spending less or both.

Big ticket ways to spend less include renegotiating mortgage rates lower, paying down credit card debts and personal loans and avoiding replacing things like vehicles and home appliances where possible.

Whatever path taken, the extra savings can be used to prepare for retirement in two ways – paying down debt and investing for growth.

So how to decide between those two? It is almost always best to pay down personal debts with high interest rates first. That means getting rid of those credit card and personal debts. Retiring debt free is the holy grail. Any debt repayments you need to make in retirement directly reduce the amount of money you have to spend.

The next question is asset allocation.

With a shorter timeframe a key decision is in setting realistic goals for when you retire. If higher returns will be required that generally means taking on higher risk.

A key strategy here is shifting asset allocation away from assets like cash and fixed interest towards growth assets like equities. Understanding your risk tolerance as an investor is key in this step. You will need to understand the various types of risk that each asset brings. This could be a good time to consult a financial adviser.

Historically, equity investments like stocks have provided higher returns than fixed interest investments like bonds. This higher return comes with higher risk and so a diversified approach is critical. Setting realistic goals is also where a financial adviser can add real value.

You could choose to use an index funds-only investment strategy, which aim to replicate the performance of the market or, use an active investment strategy through the use of actively managed funds that seek to beat market performance. Or, you could choose to use a blend of both.

The important thing to note about the use of actively managed funds is that they typically have higher fees than funds which seek to track the index. And higher costs will always eat away at returns.

Even if you've waited a long time to begin your investment journey, it is always better late than never to start planning for your retirement.

Article source: Vanguard Investments

Estate planning and wealth

By **Robin Bowerman**

Ensuring you have an up-to-date and valid will is a central tenet of good financial planning, so it's a little surprising that almost half of Australians don't have one. But how many of those without a will know what actually happens to their investments after they pass away?

When you die without a will you are said to have died 'intestate', a legal term that simply means without a will. The situation where a person has died without a will is called 'intestacy'. It's even possible to die 'partially' intestate, meaning you have a will that only deals with part of your estate. In that case, the bits left over after your will has been dealt with come under intestacy laws.

Unfortunately, despite the fact our federation is more than a century old, the rules surrounding intestacy differ from state to state. But at their core, their intent has remained unchanged since ancient times – to pass on assets to successors based on an agreed hierarchy of family relationships.

Generally, the closest family relationship is the spouse and that's where the intestacy rules look first. If the deceased has no spouse, the children inherit the assets.

If you die without a spouse or children to inherit your assets, a series of rules are followed until an heir is found. First, the administrator looks for parents, then siblings, then grandparents and then various aunts and uncles depending on the state. Finally, if no-one can be found, your assets will go to the government.

Things get complicated when there are children from multiple relationships or more than one spouse – which is possible if the deceased is in a de facto relationship while married. In those cases, assets start getting split up according to fixed formulas.

It's tempting to think that with one spouse and children from that relationship only, your family will get your assets when you die anyway, so why go to the trouble of making a will?

One problem is the trouble and expense of administering the estate. Leaving your spouse and children with the uncertainty of having to follow fixed statutory formulas can take time and become emotionally taxing on the family.

In more complicated families or families with adult children and grandchildren, leaving no will can lead to conflict and even fallouts between relatives. And in some cases, you may want to leave a bequest to charity or a friend. This cannot normally be done under the intestacy rules.

Remember that while a will deals with your home, your investments and the other assets you own, it cannot deal with your superannuation, which is held in trust for your retirement and must be passed on after death in very specific ways under the law.

There is some good news amid all this complexity: unlike many countries, there are no taxes on inheritance or estates in Australia. There can be tax implications in passing on super, and capital gains tax applies as usual when an asset is sold, but Australia abolished death duties in 1979. Under Australian tax law, the people who receive your assets when you're gone generally receive them without an immediate tax bill.

And there are some clever things that a good estate plan can achieve, including the establishment of a testamentary trust, which is a trust that can look after your assets for you after you die. A testamentary trust lets you hold off children getting access to assets until they are a certain age or reach a life stage like getting married or completing university. It can also protect beneficiaries that might not be capable of making good financial decisions and stop your assets being caught up in a divorce or a bankruptcy among your beneficiaries.

Going through the process of creating a valid will and keeping it up to date ensures the investment wealth you spent your life accumulating passes on to the people and charities you want to have it. The process is not difficult although it's best done with professional advice. But it's a small price to pay for peace of mind

Article source: Vanguard Investments

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