WATERHOUSE
WEALTH MANAGEMENT PTY LIMITED

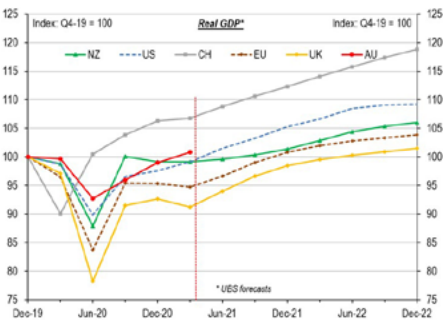
Quarterly

EDITION 2, 2021

DNR investment review

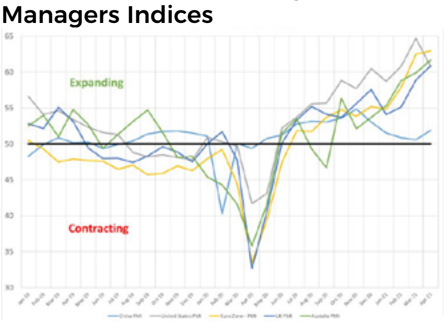
As the world emerges from the coronavirus pandemic, Australia has fared relatively well. The recession was not as deep as that of other developed economies, and is emerging from the crisis ahead of most.

Real GDP*



Source: UBS Research

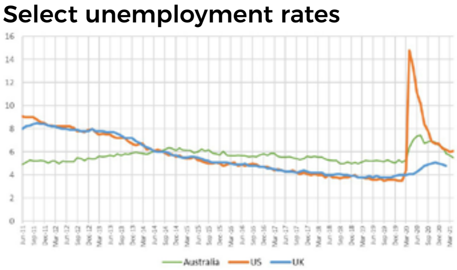
Select Global Purchasing Managers Indices



Source: FactSet, DNR Capital

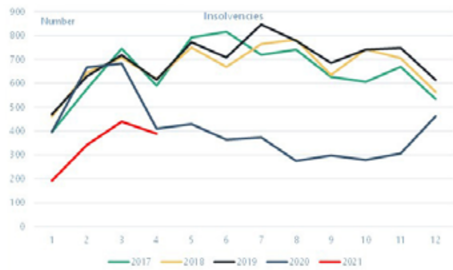
Employment has also returned to pre-pandemic levels, and perhaps most surprisingly, insolvencies are at record low levels.

Select unemployment rates



Source: FactSet, DNR Capital

Insolvencies



Source: Jarden, ASIC

Anxiety over the end of JobKeeper and broader government support has so far proven unfounded, as the population continues to spend well in excess of pre-pandemic levels.

Select global retail sales growth (YoY)

Source: FactSet, DNR Capital

The national accounts indicate this increased consumption is being funded from savings accumulated over 2020 under the unusual scenario where spending fell but incomes increased, mostly as a result of government support.

Inside:

The risks in hunting for higher returns

How much investment risk are you willing to take?

If you've ever used a financial adviser, it's one of the first questions you'll be asked when establishing your overall investment strategy.

Because your tolerance for risk will ultimately determine the types of assets an adviser will recommend for you to invest in.

It's a question all investors should be considering right now, at a time when some are taking on more investment risk than ever before, both on global share markets and bond markets.

In essence, what's occurring is being driven by a combination of forces.

Record low interest rates are spurring some investors to take on more risk by buying into riskier securities and other types of investment products offering higher returns. Economic factors, including the massive government stimulus programs underway linked to COVID-19, are also playing a hand in the activity.

And, at the same time, there has been an escalation in share market trading activity based around speculation.

HOW SPECULATORS ARE DRIVING MARKETS

In recent weeks there has been a noticeable spike in speculative investment activity on share markets.

This is primarily being driven by smaller investors (operating in unison within large groups) buying into companies on the basis of rumours gleaned from online investment forums and social media channels.

In some cases, frenzied buying activity by these speculators has seen some company share prices soar and then fall back sharply, and very quickly, after heavy selling. In many cases, investors who have rushed in blindly have been left wearing large losses when share prices have dropped suddenly.

Companies in the U.S. technology sector have been the prime targets of this type of speculation, as have companies involved in biotechnology.

Although not as pronounced in Australia, there has also been a rush of investor capital into buy-now, pay-later technology companies and into miners associated with the production of battery metals.

The sudden spike in first-time online broking account openings here following last year's sharp COVID-induced market correction spurred the Australian Securities and Investment Commission to issue a warning around the risks of trying to time markets.

The same applies to investors speculating on companies without doing proper research.

A HIGH-YIELD BONDS SURGE

Bonds are generally considered to be less risky than shares, but recent heavy buying activity in what's known as the "high yield" sector of the bond market has also drawn attention to potential investment risks.

High-yield bonds are bonds issued by companies with credit ratings below what credit ratings agencies regard as investment grade.

For a bond issue to be regarded as investment grade, it needs to be rated between AAA (the highest rating) and BBB-minus. Issues classified as high yield are rated between BB-plus and C-minus, with companies at the lower end of the spectrum carrying a higher risk of credit default.

Companies with low credit ratings may use the bond market to raise capital from investors, because they're unlikely to secure funding from lenders such as banks.

For investors willing to take on the risk of lending their money, the bond issuing companies typically pay a higher income return than the investment grade bonds largely issued by governments and companies with better credit ratings.

Which is where current economic events are coming to the fore. The combination of record low interest rates and government financial support measures have made it extremely attractive for companies to refinance their borrowings, even those with low credit ratings.

In effect, borrowing money has never been cheaper. At the same time, investors wanting higher income returns than they've been able to get by buying into lower-risk government bonds and investment-grade credit have been willing to buy into high-yield bond issues.

That's largely because low interest rates mean companies have a much better chance of servicing their debt payments, and because government stimulus programs have reduced the risk of many companies going into financial default – at least for now.

But the latest twist for investors has come because of the surge in demand for high-yield bonds. This has driven up their prices, which in turn has resulted in their investment yields falling to the lowest levels ever seen.

Basically, when market prices rise yields decline. Yields are falling, so investors are effectively getting less return for taking on higher risk. And the inherent risks in holding high-yield bonds, if a company does go into default, remains.

It's another example of potential investment risks.

RISKS VERSUS REWARD

Taking risk is part and parcel of investing, because wherever you invest there are always factors that can lead to potential financial losses.

There are a wide range of potential investment risks, including market risk, credit risk, inflation risk, liquidity risk and geopolitical risk (generally risks associated with specific countries and regions).

Understanding risks, why some assets are lower risk than others, and determining your own risk tolerance, are all fundamental aspects in mapping out your investment goals and strategy.

In basic terms, the higher the potential reward, the higher the risk of losing money. The lower the risk, the lower the potential reward.

Diversification within asset classes, and across different asset classes, remains the most powerful strategy for managing traditional risks.

Article source: www.vanguard.com.au

Weighing up the property boom

Across Australia residential property prices are booming, thanks to pent-up demand, record low interest rates and ready access to mortgage finance.

Median house prices in metropolitan and regional areas have surged, and that trend is set to continue as owner occupiers and investors compete for limited stock.

National dwelling values rose by an average 2.8 per cent in March, the fastest monthly gain since October 1988, according to CoreLogic. This followed price rises in every capital city.

But what's happening in the property market here is actually being replicated right around the world, for precisely the same reasons.

Data from the Organization for Economic Cooperation and Development shows housing prices in 37 developed countries have risen at their fastest pace in almost 20 years.

The United States, China, Canada, New Zealand, South Korea, and much of Europe, are all heading into new territory in terms of property prices.

Parts of the Chinese property market have risen around 16 per cent over the last year, while prices in New Zealand have jumped more than 20 per cent since the start of 2020.

And it's a situation that central banks and financial regulators are monitoring very closely. Although any rises in official interest rates are almost certainly off the cards for some time, some regulators may impose tighter controls on lending.

While they're unlikely to intervene in any way at this stage and disrupt the pace of economic recovery, a general concern is that if property markets become too overheated that could create stronger inflationary pressures.

This would ultimately lead to higher rates, which is behind the market sentiment that's currently driving longer-term government bond yields higher.

In its March monetary policy minutes, the Reserve Bank of Australia noted its board members had noted that housing market conditions warranted close monitoring in the period ahead.

"In particular, it was important that lending standards remain sound in an environment of rising housing prices and low interest rates."

The Australian Prudential Regulation Authority (APRA) is also monitoring the market, but says there is no cause for immediate alarm.

THE VIEW FOR PROPERTY INVESTORS

Australian economists and other property market forecasters are predicting that house prices will continue to gain ground over 2021.

The same may not be the case for apartment prices, particularly in Melbourne and Sydney where there is an oversupply of existing properties and more new apartments are under construction.

For property investors, there are a wide range of factors to consider.

Although residential prices are gaining broadly, property price growth is never uniform and capital returns vary considerably across cities and regions, by location, by property type, and an individual property's physical condition.

On a rental income level, current market conditions remain fickle.

The impacts of COVID-19 during 2020, including a rise in unemployment levels, resulted in governments enacting legislation enabling severely affected tenants to seek rent reductions and payment deferrals.

As a result, many property owners are still contending with lower rental income and, in some cases, have needed to seek mortgage payment relief from their lenders.

Rental demand also has weakened due to the departure of temporary residents as a result of COVID-19, most notably foreign university students. This will be further exacerbated with net overseas migration to Australia expected to remain negative into 2022.

THE OUTLOOK FOR RATES

On a monetary policy level, the RBA has made it clear that, like most of other central banks, it is not likely to be raising official interest rates for several years.

That's because neither wages, or inflation are rising fast enough to warrant a rate rise to dampen consumer sentiment at this stage, and especially with unemployment rates still elevated.

Yet, investing into property should generally be considered a long-term strategy. So, even though rates are at record lows now, there's every likelihood they will rise over the medium term.

This should be factored into your future capacity to service borrowings.

ASSESSING YOUR INVESTMENT GOALS

Whether you already own investment property or are considering an investment into direct property for the first time, it's vital to see how property fits in with your overall investment goals.

What is your overall strategy with owning property and your investment time frame?

It's also important to understand that property is an illiquid asset. Unlike assets that are highly liquid and can be readily sold on financial markets, either as a whole or in smaller quantities, generally the only way to realise capital growth from an investment property is to sell it.

The only exception is when it's possible to sub-divide land and sell off part of a property.

Furthermore, like other investments, owning property is not an instant pathway to gains. There are substantial entry, holding and exit costs.

And, as past episodes have shown, such as during the Global Financial Crisis, there will be periods when property prices decline, and sometimes quite sharply.

So, it's vital to weigh up both the pros and cons of buying residential property purely on an investment basis.

Article source: www.vanguard.com.au

The benefits of regular investing

Making regular investments of smaller sums of money is one of the best ways to achieve an ambitious financial goal without feeling daunted by the task ahead. It can also help keep you on track so you can reach your goal faster.

SET AND FORGET

Setting up automatic investments on your brokerage or fund platform is an easy way to ensure you contribute regularly whilst removing the pressure of deciding when to make each investment.

Not only do automatic investments simplify the process, it also discourages risky investment behaviour such as market timing or following the crowd.

DOLLAR-COST AVERAGING

Automatic investments of the same amount of money each time is also a great way to implement the 'dollar-cost averaging' strategy and in many ways simply replicate what your workplace super contributions are doing but with the advantage that the money can be accessed for personal goals – house deposit, holiday, education expenses – compared with super which is locked away till retirement.

The price of ETFs and shares will fluctuate as markets rise and fall, which means the investments you have will have been purchased at different prices because they were bought at different times.

This is a good thing because when prices are up, you'll buy fewer of them. When they're down, you'll buy more. Overall, this strategy will lower the average entry cost into specific assets over time.

While lowering the cost of investing is certainly a positive, the most powerful reason to practice dollar-cost averaging is that it encourages discipline and removes any behavioural biases or emotional factors when it comes to investing.

Investing based on emotional instinct, be that greed or fear, is dangerous. It can be easy to fall victim to market cycles – particularly during periods of volatility – and either panic-sell when markets dip or become overweight in particular asset classes when markets boom. Such actions can be detrimental to your long-term investment goals.

DOLLAR-COST AVERAGING IN PRACTICE

Below is an example of how dollar-cost averaging can build up investment balances over time, assuming you have $5000 to start with, set weekly contributions over a ten-year period and achieve a six per cent average annual return including distributions.

Weekly contributions amount	Balance after ten years
$25	$26,089
$30	$29,516
$35	$32,943
$40	$36,370
$45	$39,797
$50	$43,224

As illustrated above, regularly investing smaller amounts can go a long way in accumulating wealth without you having to be overly concerned by what the market is doing.

For those wishing to invest over the long-term or need a strategy that is low-touch and low-fuss, dollar-cost averaging may be the answer. Just be mindful of brokerage platform fees as some may charge a fee for every investment.

Article source: www.vanguard.com.au

With compliments from Waterhouse Wealth Management Pty Ltd

Head Office
Suite 12 Level 3, Gateway Building
1 Mona Vale Road
Mona Vale NSW 2103

T 02 8973 2222
F 02 8078 4040
E wwmadmin@waterhouseca.com.au
W www.waterhousewealth.com.au

Waterhouse Wealth Management ABN 41 059 645 126 is a Corporate Authorised Representative of The Advice Exchange Pty Ltd ABN 55 107 629 194 Australian Financial Services Licence No 278937. Registered Office: G2, 10 Yarra Street, South Yarra, VIC 3141.