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December 2017 Quarter In Review

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Legislative changes

E-Zine “[Shed Connect](#)” reported on 11 December that the Parliament passed a change to the Anti-Money Laundering and Counter-Terrorism Financing Act to involve Bitcoin and other crypto currency exchanges with the “know your customer” and reporting obligations of the Act.

Markets and trend lines

The following charts show, respectively, the best fit of constant compound growth in the Australian and United States of America broad market indices together with some statistically derived probability percentiles. On this statistical basis, both markets provide reasonable value, but, on other measures, the US market, in particular, is high.

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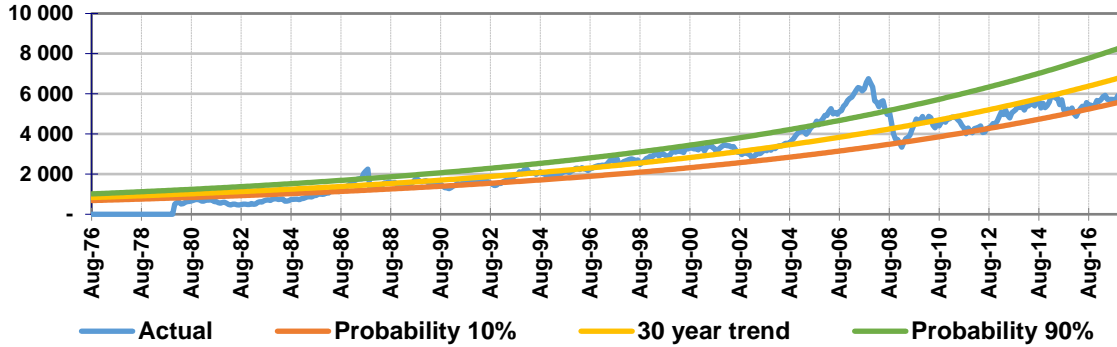
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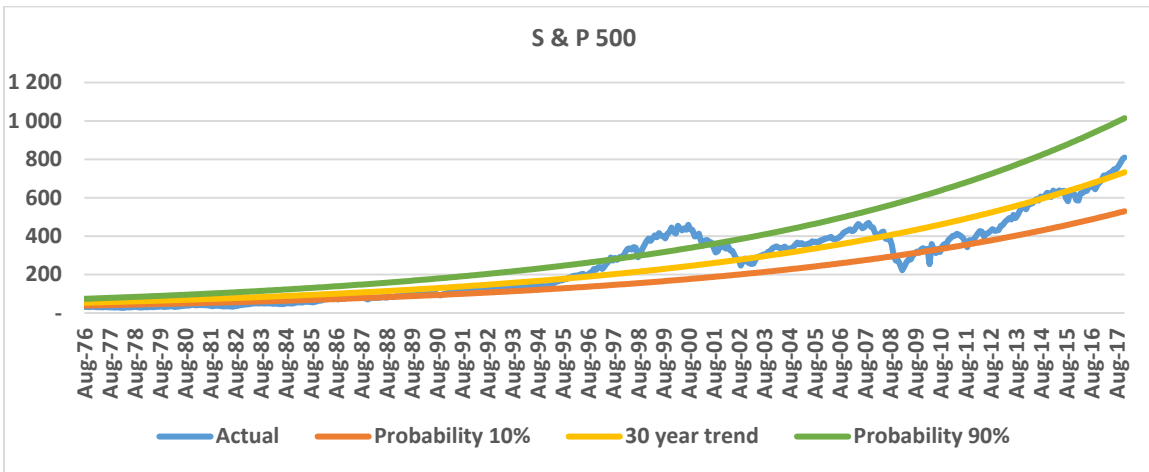


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S & P ASX 200



S & P 500



The Schiller ratio divides the price of US shares by the average of their last ten year's earnings. This ratio, charted below, currently worries commentators.



Economic milestones

On 22 December the AFR reported the passage of the USA tax cut legislation. This reduced the corporate tax rate from 35% to 21%, but reduced some deductions.

On 13 December, the AFR reported that Facebook had decided to pay local taxes, instead of passing profits through Ireland. This reflects the increasing efforts by many countries to gain their fair share of taxation applicable to revenue generated in their markets.

On 2 December the Australian Bureau of Statistics (ABS) released publication 5676.0, which showed annual growth in wages (2.5%) and company profits (20% seasonally adjusted). This may flow through to a smaller budget deficit.

On 2 November, the Bank of England raised its Interest Rate from 0.25% to 0.5% - the first increase in ten years. On 13 December, the corresponding USA rate was similarly increased with the “Fed” projecting 3 similar increases in 2018 and 2019.

On 3 November, the AFR reported that the CFMEU and Griffin Coal had agreed to a reduction of almost one third in worker’s pay stemming from the combination of a pay and hours cut.

At 12:30 on Melbourne Cup day, the stock market, as measured by the S&P/ASX200, breached 6,000 points. On a month end basis, the index last had a 4 in front of it in June 2013 and last had a 6 in front of it in December 2007. The first time the index started with

a 6 was May 2007 and it ended October 2007 at 6,754. The December value is set out below

On 3 October, the AFR reported the first monthly decline in Sydney house prices since late 2015, noting that Perth prices experienced a modest monthly increase. This was reinforced by the Domain report published in the same paper's 12 October edition of the first decline in the quarterly Sydney median house price for almost two years. "The market's just run its race" was attributed to Domain's chief economist. This statement was not disproved in the remainder of the quarter

Amid Australia's continuing energy market disarray came an announcement that China plans to launch an emissions trading scheme, joining countries such as the EU, New Zealand, Japan, India, South Korea and Kazakhstan.

Early in October, the confusions around enterprise bargaining and awards continued with the AFR reporting the Pizza Hut EBA being revoked and reinstated and the union calling for backpay. Senior Deputy President Jonathan Hamberger said "the [termination] decision was issued due to an administrative error and is hereby revoked". One wonders whether his Honour declared a conflict of interest.

An argument between the ANZ Bank and the Australian Property Institute reported in the AFR of 10 October highlights the disruption threatening the valuation profession. The article suggests valuation fees are at 1980s levels. One wonders how long banks will insist on valuations given the richness of data available from providers such as Corelogic.

The trials of the industrial relations system continued when the AFR reported on 11 October that a franchisee signed a statutory declaration that all employees under a proposed EBA met the better off overall test (BOOT) despite having no employees. The defence offered was "I was told to sign it by the IR consultant."

Economic and market statistics

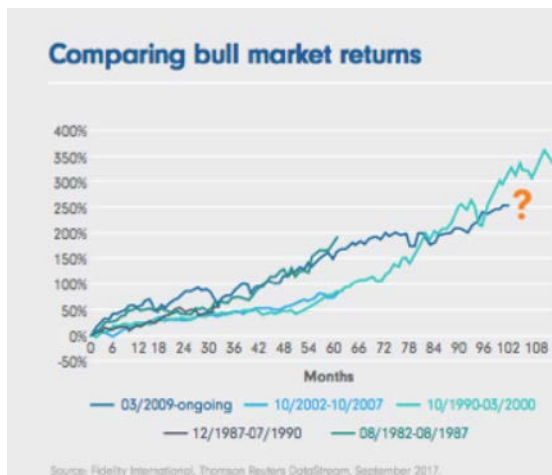
The following table shows key economic and market statistics.

	Applicable	Now	1 year ago	3 years ago	7 years ago
S&P /ASX 200- Australia	Dec 17	6,065	5,666	5,411	4,745
Annual change to latest date			7.0%	3.9%	3.6%
S&P /ASX 200 dividend yield	Dec 17	4.08%	4.13%	4.60%	4.14%

	Applicable	Now	1 year ago	3 years ago	7 years ago
S&P /ASX 200 P/E ratio	Dec 17	16.2	15.80	15.20	17.20
Topix- Japan	Dec 17	104.8	87.60	81.20	51.80
Annual change to latest date			19.6%	8.9%	10.6%
S&P 500- US	Dec 17	809.6	678.0	623.5	380.8
Annual change to latest date			19.4%	9.1%	11.4%
GDAXI- Germany	Dec 17	12898	11426	9869	7077
Annual change to latest date			12.9%	9.3%	9.0%
Average weekly earnings \$	Jun 17	1,543	1,516	1,454	1,250
Annual change to latest date			1.8%	2.0%	3.1%
Consumer price index	Sep 17	111.40	109.40	106.40	96.06
Annual change to latest date			1.8%	1.5%	2.1%
Unemployment	Aug 17	5.6%	5.70%	6.10%	5.00%
Gross domestic product \$ m per quarter	Sep 17	430,724	418,441	400,780	358,625
Annual change to latest date			2.9%	2.4%	2.7%
RBA cash rate	Dec 17	1.5%	1.50%	2.50%	4.75%
3 year Commonwealth bond	Dec 17	2.0%	1.97%	2.28%	5.19%
10 year Commonwealth bond	Dec 17	2.6%	2.79%	2.96%	5.56%
USD/AUD	Dec 17	0.8	0.72	0.82	1.02
Annual change to latest date	Dec 17		7.8%	-1.7%	-3.7%

Other peoples' views

Investment house Fidelity was quoted on the end of the stock market rises by the e-zine SMSF Adviser, on 29 November as follows



“We see two possibilities for how this ends. The first scenario is a parabolic boom and bust where loved areas of the market become more and more expensive; this would be characterised by greater complacency around valuations and more evidence of ‘fear of missing out’ behaviour among investors. The second scenario is more benign.

With two traumatic boom-bust markets in living memory, we may never see the euphoria typically associated with bull markets in this cycle. Instead, we could see a long period of consolidation — ‘sideways’ market in terms of average market levels....”

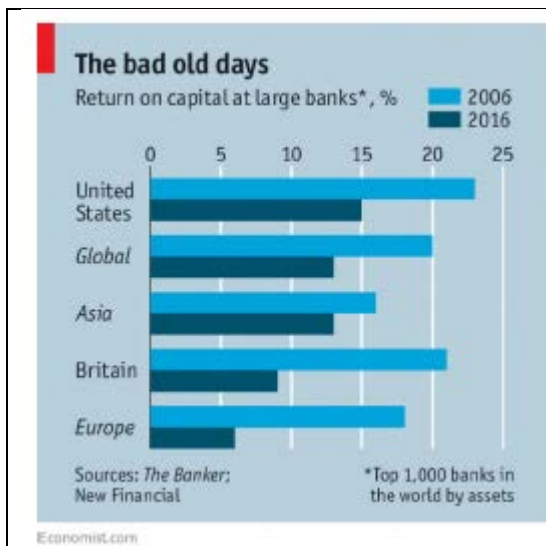
Chris Baynes, writing in the respected retirement village e-zine “The Weekly Source” on 17 October, reported on a “town hall meeting” as part of a NSW review into retirement village legislation. Of about 80 attendees he reported show of hands responses of: -

1. Did your operator act honestly? Yes 8 No 4
2. Did your operator act diligently? Yes 8 No 12
3. Did your operator act fairly? Yes 4 No 12
4. Would you join a village again? Yes 12 No 12”

Although the audience was probably somewhat self selected, there appear to be some unhappy campers.

Interestingly, “40% of attendees said they had got a solicitor to check the contract before entering the village.”

Justin Byrne of Instreet.com.au drew our attention to an article in the Economist dealing with the ten years since the Global Financial Crisis. The article showed bank profitability has fallen markedly



The article pointed out that stock markets are now a smaller proportion of GDP than ten years ago but debt / GDP is USA 434%, Eurozone 428% and UK 425%.. It concludes “*the finance industry is no less vulnerable. A sudden fall in asset prices, or a sharp rise in interest rates, would reveal the jagged rocks beneath the surface. Central banks know this; that is why they are so cautious about unwinding monetary stimuli. At the heart of the next economic crisis will be the finance business; that is something that has not changed in the past decade.*”

Respected industry commentator Greg Bright asked the question “*..does [Australian Prudential Regulatory Authority (APRA)] know what it is actually doing with its merger mania?*” in a piece published by [e-zine Shed Connect](#). He then wrote.

“Apparently, for reasons known only to themselves, APRA believes that any fund with less than about \$15 billion under management should be merged with another to obtain better scale. APRA has provided no evidence as to how and why this would be a good thing for the members of the funds. It is actually time for APRA to stand up. It may actually time that APRA may well be taken to court to prove its position. APRA is not beyond being sued.”

Interestingly, the article was triggered by a merger that failed apparently due to conflicts about who would get the top jobs in the merged entity. So much for the best interests of the members! One recalls the adage that companies exist for the aggrandisement of senior officers and directors while mutual organisations exist for the aggrandisement of directors and senior officers.

[Corelogic’s](#) Eliza Owen posed the question “is it time to get confident in Perth’s office market?” in an article published on 6 October. She concluded a tightly written factually dense article writing “Assuming the global economic environment remains stable enough to nurture private investment, the next six months could see further office demand across Perth.” Expect to hear more of Ms Owen over the coming years.

Products

The growth of ETF's continues with the announcement of BetaShares' FAIR Sustainability leaders ETF. It excludes companies "with material exposure to: fossil fuel, gambling, tobacco, armaments, uranium/nuclear energy, destruction of valuable environments, animal cruelty, chemicals of concern, mandatory detention of asylum seekers, alcohol, junk foods, pornography, recent significant fines/convictions, human rights & supply chain concerns, lack of gender diversity at the board level".

On 7 December, [e-zine Investor Daily](#) reported that the Australian Securities Exchange Ltd (ASX) will replace the Clearing House Electronic Subregister System (CHESS) which has operated since 1994 with blockchain technology developed by US company, Digital Asset. Digital Asset chief executive Blythe Masters said the announcement delivers the "first meaningful proof" that blockchain technology can live up to its potential.

The major superannuation fund for tertiary education staff has broadened its membership to include families of members and certain tertiary graduates. Membership of the attractive defined benefit fund remains closed to new members.

A succinct summary of facts about active and passive funds management emerged at a UTS and Portfolio Construction Forum Investment Management Research Conference as reported by [e-zine Shed Connect](#) on 3 October. The following table shows the proportion of active fund managers **failing** to beat their respective benchmarks in the periods ended June 2017 and the ten year average and benchmark annual returns.
ten year annual return of the average active fund and the benchmark

Asset class	1 year	3 years	5 years	10 years	Average 10 year return % pa	
					Active	Benchmark
Australian shares	61.7%	65.7%	64.7%	75.3%	3.5	3.6
Small and mid sized Australian shares	81.1%	68.8%	51.5%	36.8%	4.6	1.0
International shares	56.5%	84.1%	91.2%	90.0%	4.1	5.8
Australian fixed interest	66.0%	96.0%	78.0%	86.4%	5.6	6.3

Asset class	1 year	3 years	5 years	10 years	Average 10 year return % pa	
					Active	Benchmark
Australian property	12.5%	71.8%	76.6%	72.1%	-0.1	0.1

Without any formal statistical analysis, the table suggests active management was only worthwhile for small and mid sized shares over a long period.

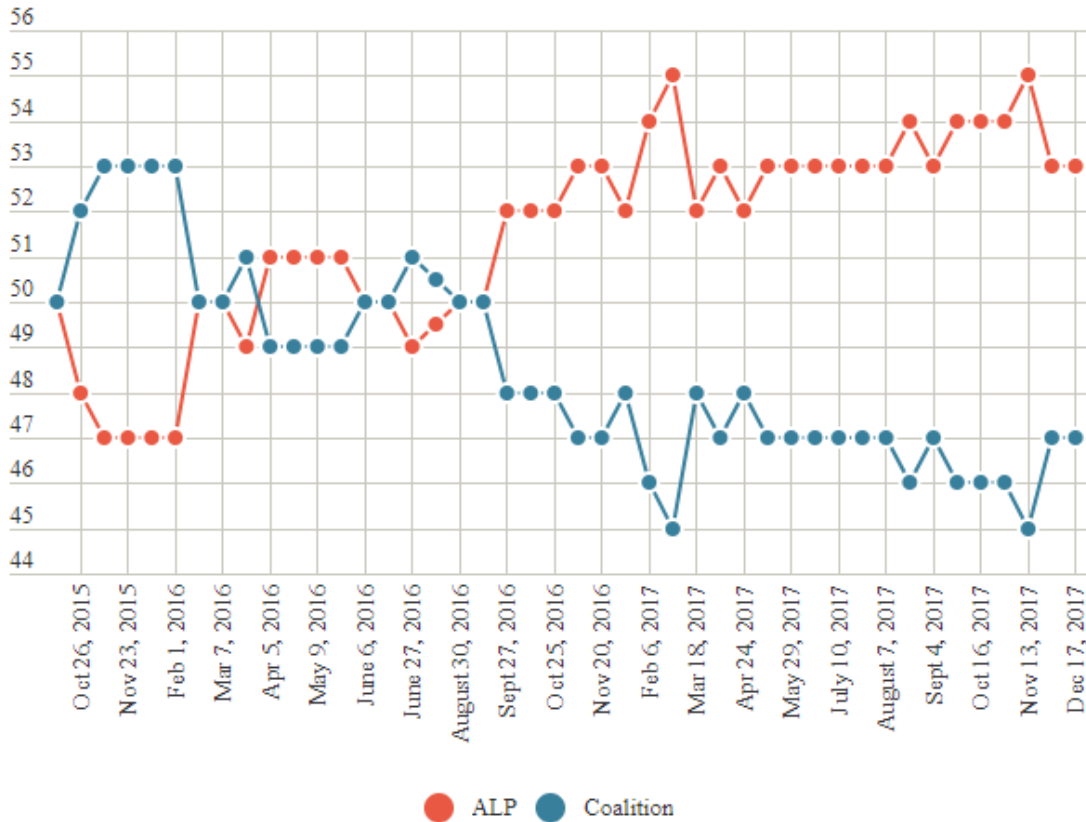
The article makes the point that the Australian EFT market has a value of \$30 billion. The total value of the Australian Stock market is around \$1.5 trillion.

Not strictly a financial product, but diversified property group Stockland Ltd, which operates retirement villages under a Deferred Management Fee model, is now marketing a “non DMF” retirement community. This may be a response to the bad publicity some other providers have received. Detail of fees and tenure are not readily apparent from the material Andep has seen.

A reverse situation was the announcement in the AFR of 1 November that retirement village operator Aveo Ltd was divesting its non retirement village operations.

Politics

The following chart, from theaustralian.com.au/national-affairs/newspoll, tracks two party preferences.



On 6 October Senator Xenophon announced he would quit the Senate in time to run for an inner north eastern metropolitan seat in the SA Legislative Assembly.

On 15 October, in Austria, the centre right People’s party overtook its centre left coalition partner, the Social Democrats and is likely to form a coalition with the far right Freedom Party, introducing the world’s youngest head of government, Chancellor Sebastian Kurz. The President, elected in January 2017 as a nominal independent, had previously been leader of the Greens Party. Meanwhile New Zealand’s coalition negotiations dragged into their fourth week.

The results of the September 2017 German election involved massive gains for right wing parties namely the Liberal Democrats and the Alternative for Germany. Although Dr Merkel’s party holds a plurality of seats it does not hold a majority. At year end, negotiations to form a Government were continuing.

Andep news

Andep has settled into its new premises and moved out of its 35th anniversary year.

Courts

Last quarter, we noted an article by Morgan Solomon of solicitors Solomon Hollett and discussions with other lawyers indicating the Courts are tightening up on challenges to wills with need prevailing over greed. Late in November, the Supreme Court ended the “secret daughter” saga reducing the previously awarded \$25 million payout to the daughter of a late mining tycoon to \$6.1 million

On 27 November, the AFR revealed that retirement village giant Aveo lodged its defence to a class action related to the way in which future changes in contracts affect refunds after current residents vacate units. Aveo’s defence seeks to suspend the laws of algebra and contrasts with previous private settlements.