Analytical advice since 1982.

March 2018 Quarter In Review

Contents (Alphabetic)

Legislative changes

Acknowledging many a slip twixt cup and lip and the devil in the detail, the March 13 ALP proposal to prohibit franking credit refunds could deal a huge blow to self managed superannuation funds in the pension phase as well as public offer funds' individually directed pension offerings (i.e Wrap accounts). While the opposition has modified the proposal for age pensioners, the initial conclusion remains valid.

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, the Australian market provides reasonable value and the USA is a little elevated. On other measures, however, the US market, in particular, remains high. One commentator describes it as "astonishingly high".

The 30 year trends now exclude the 1987 stock market crash and encompass a period of steadily falling interest rates, which is at or near its end. These make conclusions from the trend charts optimistic.

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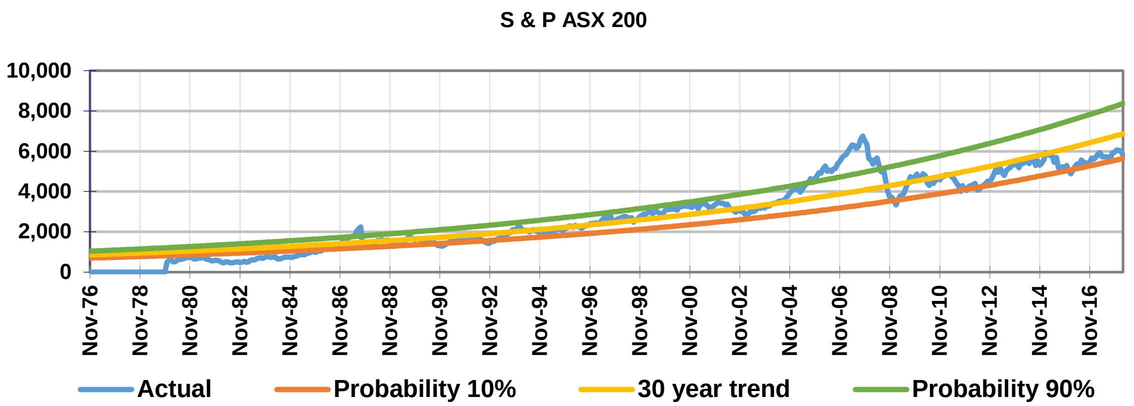
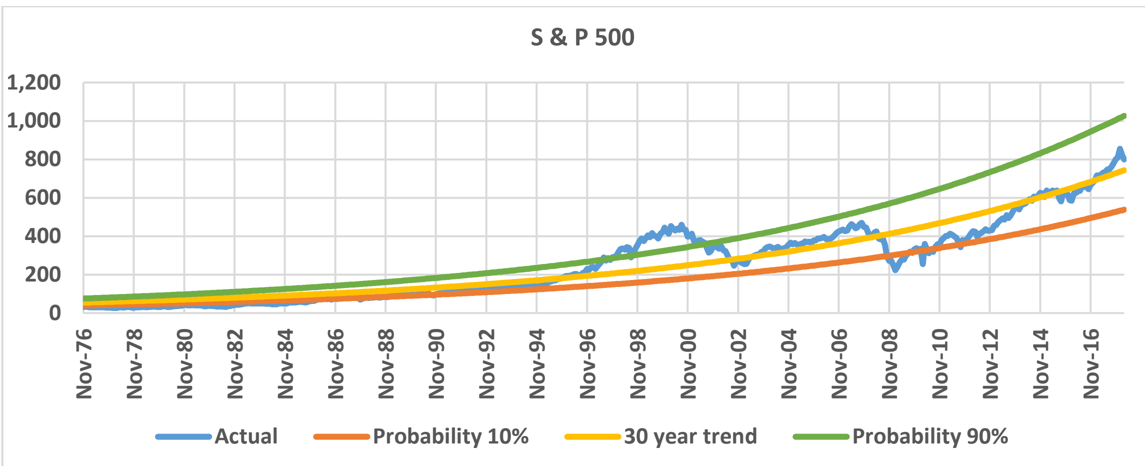
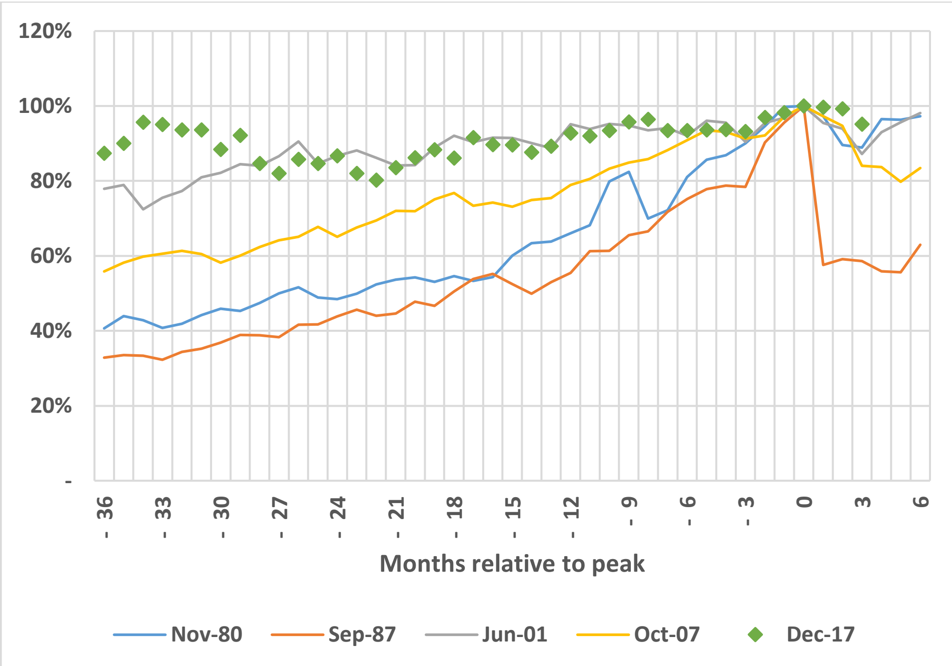


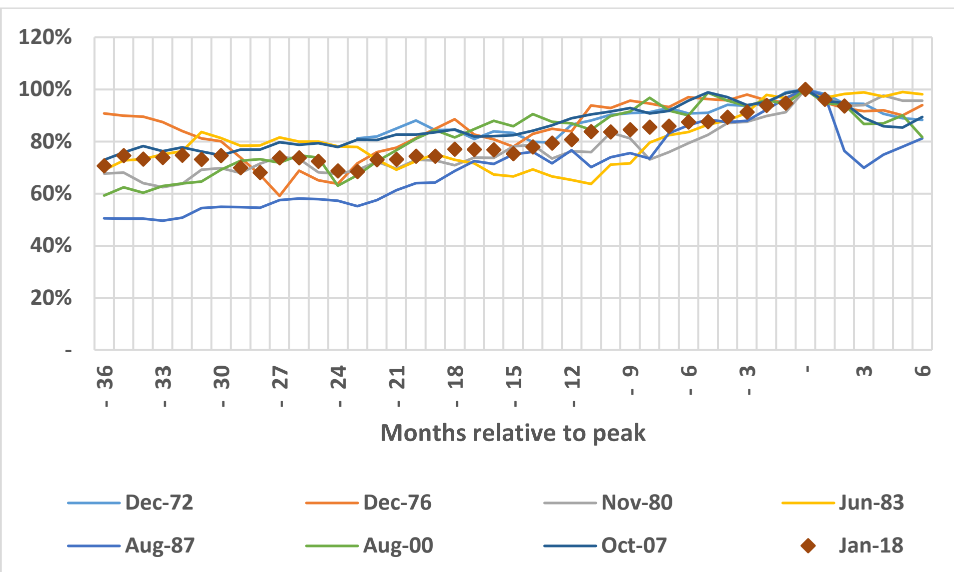


Another graphical view of the markets is a comparison of the movement in the three years leading up to the most recent peak and the three years before and six months after significant peaks.

The following chart relates to Australia and the diamonds of recent progress are almost exclusively above the lines representing the lead up to other peaks. Australia has not recently seen the rapid increases that preceded earlier peaks.



One can be less sanguine about the USA market, depicted in the following chart. The recent rise to the January peak was in the mid range of earlier rises preceding major peaks.



While the USA market has grown at 8.5% per annum over the past three years, the Japanese market has grown at less than half that rate (3.6%) and the UK and German market are relatively steady.

While many Australian based international fund managers have reduced their exposure to the USA, that market is vulnerable to rising interest rates and a trade spat. The risk is that a USA fall could flow on to other markets. Andep's view is that now is the time to gently lighten off one's share market exposure, perhaps reducing it by 5%.

Economic milestones

On 21 February respected E-zine Renew Economy reported the then South Australian premier's intention to impose a "75% renewable 25% storage" target by 2025. While not understanding what 25% storage means, this is a very bold step. This was picked up by equally respected commentator Jennifer Hewett in the AFR of 23 February. The same AFR issue reported the world's largest home battery maker was setting up in Adelaide. Interestingly, the sites examined by the company included disused car plants at Elizabeth and Tonsley Park. Is this to be SA's future? The change of government renders this question irrelevant.

On 19 January, the AFR reported the Bank of Canada raised its target overnight interest rate to 1.25% per annum.

On 23 January, the Federal government announced the agreement for a revised Trans Pacific Partnership. This follows the decision of the USA not to participate in the previously negotiated deal. The announcement coincided with USA announcing additional trade restrictions.

The debate about corporate tax cuts continued with two front page articles in the AFR of 26 February. Miner Rio Tito indicated it would make fewer investments in Australia if the tax rate were unchanged. The paper reported talk of successful investment bank Macquarie shifting overseas away from the Australian bank tax and to a country with a lower tax rate. Later in the quarter, large businesses talked of more investment and more jobs if the cuts became law. Talk is not action, but the debate aimed (ultimately unsuccessfully) to pressure the Senate to pass the government's proposed cuts.

On 15 February, the ABS reported further additions to employment, making 18 consecutive monthly increases, the longest since 1978.

On 2 March the USA announced a 25% tariff on steel imports to near universal condemnation. Time will tell whether this is the start of the feared trade war. Less than a week later the revised Trans Pacific Partnership excluding the USA treaty was formally signed by representatives of 11 nations.

On 8 March, the AFR reported that the UNSW team trying to build a quantum computer had achieved a significant success.

On 20 March the US Federal Reserve Board raised its benchmark interest rate range from 1.5% to 1.75% and signalled two more increases this year. Interestingly, the US rate is now higher than the corresponding Australian rate.

Economic and market statistics

The following table shows key economic and market statistics.

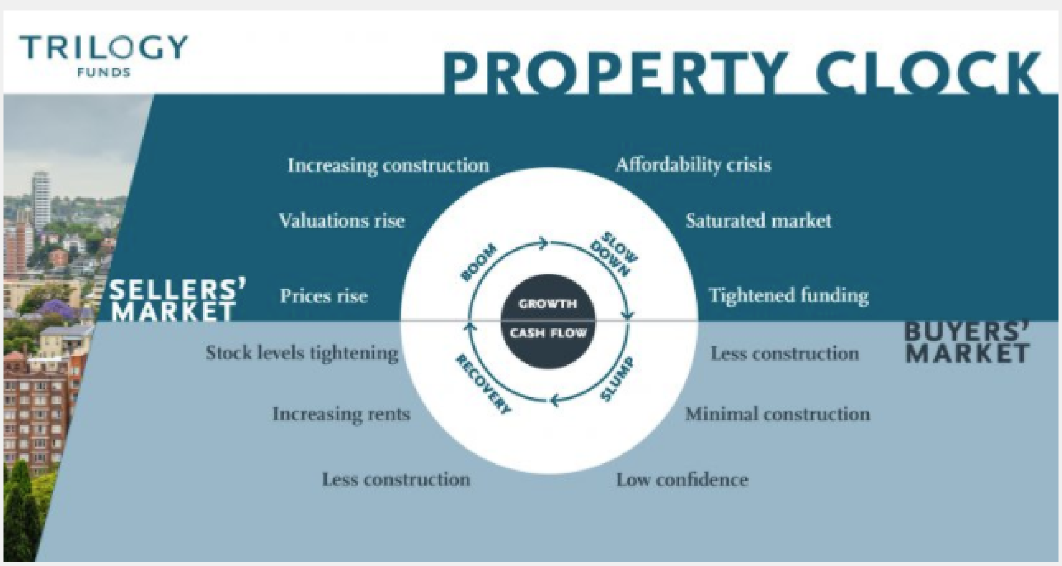
	Latest date	Now	1 year ago	3 years ago	7 years ago
S&P /ASX 200- Australia	Mar 18	5,791	5,865	5,892	4,838
Annual change to latest date			-1.3%	-0.6%	2.6%
S&P /ASX 200 dividend yield	Feb 18	4.20%	4.23%	4.28%	4.05%
S&P /ASX 200 P/E ratio	Feb 18	15.5	15.90	16.40	17.60
Topix- Japan	Mar 18	99.0	87.20	89.00	50.10
Annual change to latest date			13.5%	3.6%	10.2%
S&P 500- US	Mar 18	799.7	715.5	626.2	401.5
Annual change to latest date			11.8%	8.5%	10.3%
GDAXI- Germany	Mar 18	12133	12369	11903	7514
Annual change to latest date			-1.9%	0.6%	7.1%
Average weekly earnings $	Dec 17	1,568	1,533	1,477	1,275
Annual change to latest date			2.2%	2.0%	3.0%
Consumer price index	Dec 17	112.10	110.00	106.60	96.45
Annual change to latest date			1.9%	1.7%	2.2%
Unemployment	Feb 18	5.6%	5.90%	6.15%	5.00%
Gross domestic product $ m per quarter	Dec 17	432,685	423,034	402,517	362,342
Annual change to latest date			2.3%	2.4%	2.6%
RBA cash rate	Mar 18	1.5%	1.50%	2.25%	4.75%
3 year Commonwealth bond	Feb 18	2.1%	1.94%	1.88%	5.20%
10 year Commonwealth bond	Feb 18	2.9%	2.75%	2.50%	5.61%
USD/AUD	Feb 18	0.78	0.77	0.78	1.02
Annual change to latest date	Feb 18		1.4%	0.0%	-3.7%

Other peoples' views

The AFR of 23 February reported Jeremy Grantham, a doyen of the funds management industry, taking as very positive view of "emerging markets". The article noted that beyond the well known recent removal of leaders in southern Africa and South Korea, corrupt and / or inefficient governments have been replaced in Peru, Argentina and Brazil.

A post in the e-zine Nestegg.com.au promoted by property syndicator Trilogy Funds described the cycle of the property market.

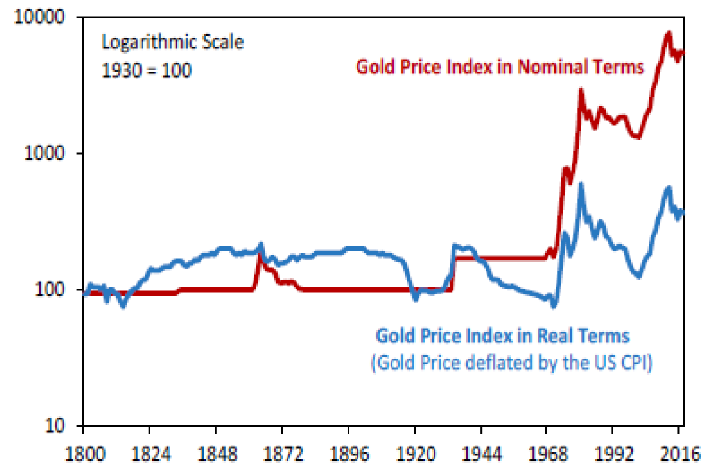
> The property-cycle has four phases – the value stage (slump), the growth phase (recovery), the peak (boom), and the correction (slow down). The whole cycle typically takes seven to ten years. Typically, you'll see two to three years of robust growth followed by seven to eight years of slow to moderate growth. However, there are many factors to consider which drive the property cycle – most of which are recurring – such as liquidity, economic growth, consumer confidence, investment returns, scarcity of supply and rising demand.
>
> At the bottom of the market, rental yields are strong, and the confidence in the market is quite low. These characteristics provide investors with five to seven-year investment goals and the opportunity to take advantage of strong yields, while waiting for the property increase in capital value. At the peak – also known as the "seller's market" – rental yields are weak and confidence is high. This commonly results in more buyers than sellers, providing those investors who purchased at the bottom of the cycle a healthy market in which to sell.



[Read more.]

Fund manager Pyrford International published an interesting chart in its December quarter review. The chart was in the context of the bitcoin debate and the problem of devaluation of national currencies. It noted that the US dollar has lost 95% of its purchasing power since the Federal Reserve Board was established in 1913. The chart, which is muted by its logarithmic scale, shows gold to have been an excellent store of value over more than 200 years, but that it has been a disaster for several generation long periods.

Gold Price Indices – Data for the United States: 1800-2017
The Price of Gold and the Purchasing Power of Gold based on Consumer Prices



Source: 'The Golden Constant' by Roy W Jastram 1560-2007; Updated by Jill Leyland and Pyrford International

Market researcher Roy Morgan Research issued a release on its survey of superannuation satisfaction on 12 January. A key feature is that self managed funds generate the most satisfaction and retail funds the least. Satisfaction is greater for those with larger balances with this particularly evident for self managed funds. Of the fifteen largest funds, satisfaction scores ranged from just under 50% to just over 70%. Funds recommended by Andep were not stellar performers in the survey, but they are recommended for their products and fees, not popularity.

On 9 February, the AFR quoted the Executive Director of the Finance Brokers Association of Australia as arguing for the retention of trailing commissions (monthly commission paid to mortgage brokers for the life of the loan in addition to the initial commission) because, were they not paid, brokers would "churn" clients to obtain their income. The ED said it was unnecessary to attach a "best interests of clients" duty to mortgage brokers.

Two interesting comments on the corporate tax debate emerged early in March. The founder of Magellan fund management group, Hamish Douglass, suggested companies could renounce the opportunity for their investors to use dividend imputation and suffer 15% rather than 30% tax. This would be attractive to "start-ups'. BetaShares economist, David Bassanese, went a step further in e–zine Switzer Daily , re visiting a three year old article in which he argued for a small electronic transfer tax instead of the GST. He argues now that this could be extended to allow abolition of corporate taxes

Products

On 24 January SBS News reported that the Australian Securities and Investments Commission (ASIC) had found that advisers licensed by the big banks who had guided a client to an in-house product had, in 75% of cases, failed to act in the best interests of the client.
In 10% of those cases, the advice given was likely to have left the customer in a significantly worse financial position. The article can be accessed here.

Late in March, Exchange Traded Fund provider BetaShares announced the removal of Facebook from the index used for its Global Sustainability Leaders Fund, reflecting its privacy problems.

Exchange Traded Fund provider BetaShares announced two “active” exchange traded funds on 21 February. Previously, all of BetaShares products had been “passive” in that they sought to follow an index. Of late, the indices followed have become increasingly specialised, in that they require companies to meet certain criteria to be include in the index.
Specification of the index required investor judgement, but, once defined, the process became automatic. Under the “active” model, the selection of investee companies requires human judgement.

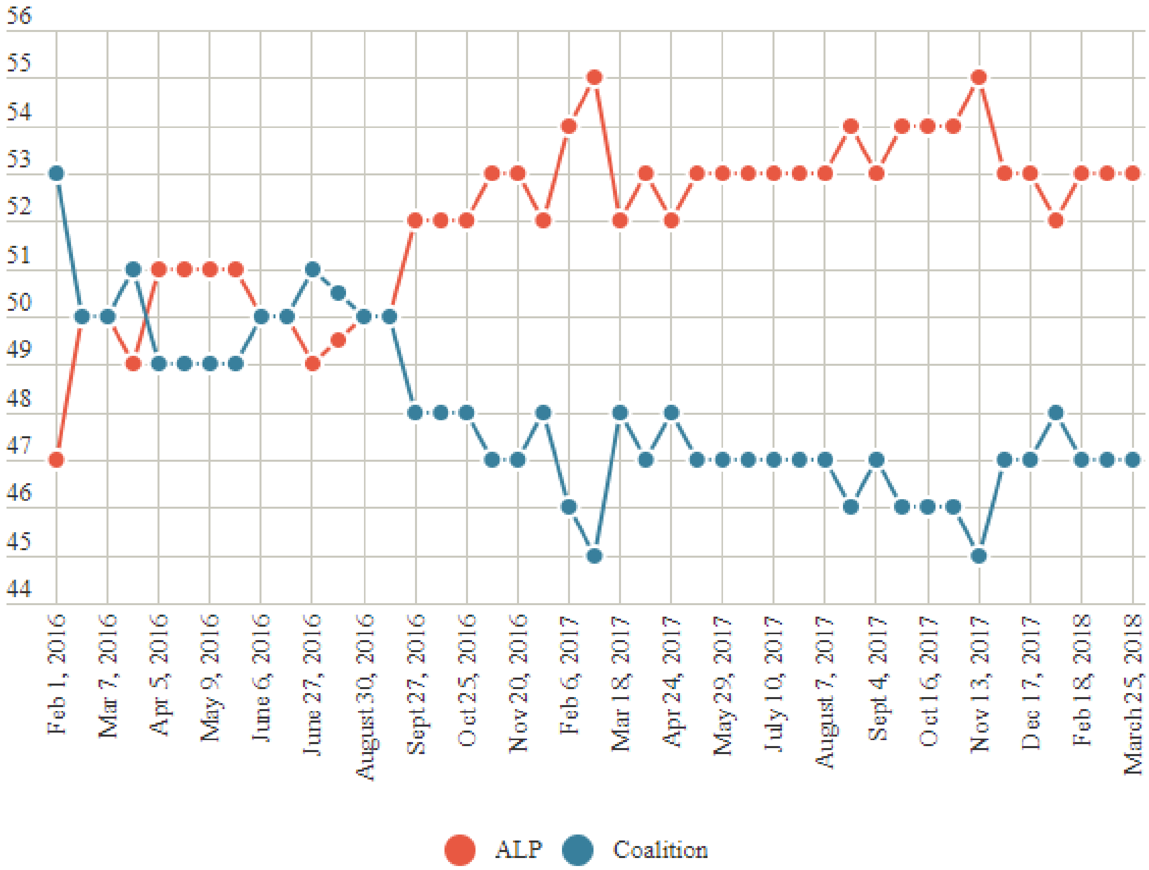
The new funds invest in Australian shares expected to produce high after tax dividend income and Australian companies and trusts invested in property and infrastructure.

Information provider Morningstar has added fox to its gamekeeper role. The company currently offers a comprehensive data service and portfolio administration service as well as publishing the Huntley’s “Your Money Weekly”. It is now offering three managed funds, “growth”, “balanced” and “cautious” to the public. These new products can be accessed entirely online. They add to the multiplicity of similar funds available and are noteworthy only because of the fox / gamekeeper situation.

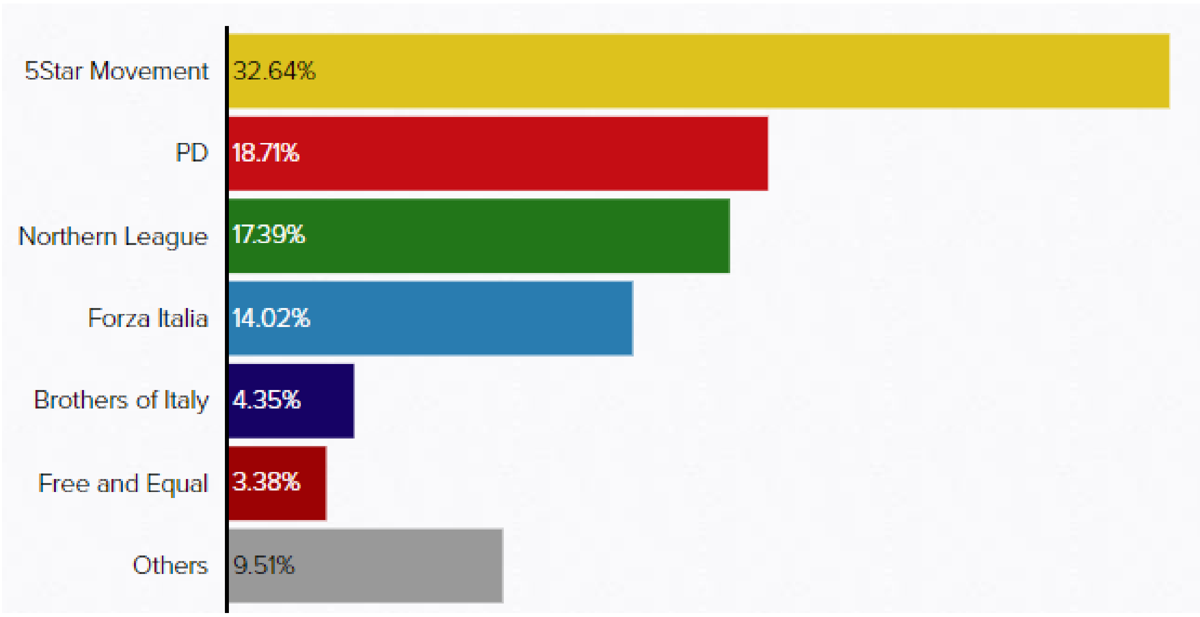
Politics

Four months after the German election, a coalition of the same two parties which were in power before the election was agreed.

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



Early results of the Italian election held on 4 March indicated populist parties had secured more than half the vote. The largest number of votes went to the five star movement, a movement started by a comedian. Early vote shares are charted below.



On 11 March, Chinese President Xi Jinping secured National People's Congress approval of a proposal to remove the limit of two five year terms on the presidency. Russian President Putin had a comfortable (77%) win in the 18 March election.

In Australia, Tasmanians re elected the liberal government despite a 1% decline in it is vote and a loss of two seats. The ALP improved by 5% of the vote and three seats, largely at the expense of the Greens who lost 4% and one seat. In South Australia, the Liberal Party ended 16 years of ALP government in an election notable for the failure of Nick Xenophon's SA Best party to secure a lower house seat.

Courts

We have taken the liberty of defining the Hayne Royal Commission into Banking as a Court and note that it has observed that mortgage brokers earn(?) an average gross trailing commission of $57k. This suggests a conflict between the Commission and the industry view expressed above.

So far, counsel assisting the commission, Rowena Orr, has helped the banks paint themselves as greedy, uncaring and slow to react. Evidence of customer stupidity has attracted much less public and press criticism.

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