NEWSLETTER
June 2020

AFFINITY WEALTH PLUS

Introduction

In this edition of our newsletter, we look at the continuing rise of the share market and ask, why? We also look at the early ‘Corona-impact’ on residential property prices and remind everyone that, if you want your child to have the best chance of being a number 1 draft pick in the American National Basketball Association, you should move to Melbourne before you give birth. Read on to see what we mean.

As always, we hope that you and your loved ones stay safe and well in these unprecedented times.

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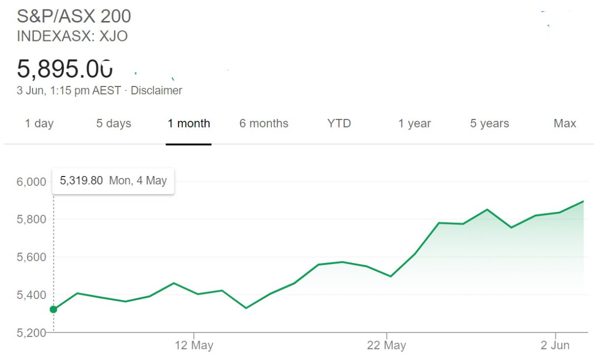
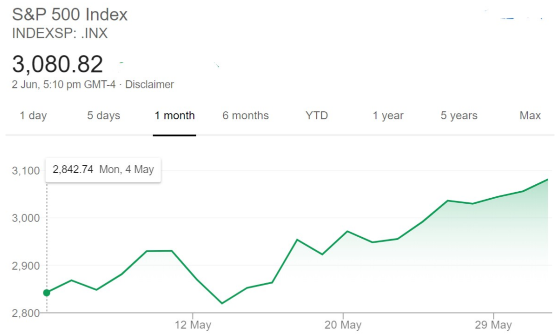
The Share Market

Australia's share market continues to perform as if it had never heard of Coronavirus. In the month of May, the market rose again. Having closed the month of April at 5,522 points, the ASX 200 index closed the month of May at 5,755 points. This is a rise of 233 points, or 4.2%. 5,755 points means that, by the end of May, the economic effects of the Coronavirus had 'only' removed 1,384 points, or 19%, from the all-time high reached on February 20 2020.

In many ways, the Australian experience is again tracking the US experience. Here are the two major indices for the two share markets (the Australian stock Exchange and the New York Stock Exchange) for the month of May 2020 (the 'snapshots' were taken at 1.15 pm AEST on Wednesday June 3. Thanks to Google, the ASX and the NYSE):



The Australian Share Market in May



The US Share Market in May

These markets could be twins. And this correlation means that, to understand why prices are rising in Australia, we really need to look to why prices are rising in the US.

The problem is, it is hard to know why prices are rising. The continuing rise of US prices has many commentators and analysts confounded. Here is what columnist Stephen Bartholomeusz had to say about the US market in the Fairfax Press on May 28:

> *As the death toll from the coronavirus in the US topped 100,000, Wall Street's S&P 500 index broke through 3000 points on Wednesday. It's now more than 35 per cent off its March lows and only 10 per cent off the record levels of February.*
>
> *That's despite soaring unemployment, plummeting corporate profitability, the biggest fall in consumer spending for more than 60 years, the lowest levels of consumer confidence since the global financial crisis, swelling spreads for high-yield bonds and very large slabs of the world's largest economy still in lockdown.*

Bartholomeusz is one of Australia's most trusted finance journalists. He sounds flummoxed. He went on to point out that the US market has a Price to (historical) Earnings ratio of 22.2. This 'PE ratio' is almost 50% higher than the long-term average of 15.7. What's more, the most conservative estimates of corporate earnings for the current financial year expect a fall in 20%. So, the earnings part of the PE ratio is likely to go lower. If everything else stays the same, at current prices this implies a PE ratio of 27.

And this was all *before* the riots that have recently broken out across America started to happen. Anyone looking at the economic data alone would be profoundly pessimistic. But anyone looking just at the market prices would conclude that people are overwhelmingly optimistic.

You can see why we think trying to pick which direction a share market will move next is a mug's game!

GDP in Australia

On Wednesday of this week, the Australian Bureau of Statistics confirmed what pretty much everyone knew - Australia's economy is in recession. This is our first one since 1992. To put that into perspective, Australian-born US basketball star Kyrie Irving was born in 1992 and, like anyone his age, has never seen an Australian economic recession.

(That said, Kyrie is probably OK. He signed a four-year contract in 2019 for $US142 million. That is about $A200 million. Perhaps we could lure him home to spend a bit of it. As a further aside: did you know that there have been more 21st century number 1 NBA draft picks born in Melbourne than in any other city of the world – including all the US ones? Andrew Bogut was the first, Kyrie Irving the second and Ben Simmons the third. Sure, Kyrie was only here until he turned 2, when his American folks returned home after a few years playing basketball in Melbourne, but we will claim him as 'Aussie Kyrie' nonetheless).

A recession has a 'real world' meaning and a technical meaning. The technical meaning is that the official change in Gross Domestic Product (GDP) is negative for two consecutive quarters. For the March quarter, Australian GDP fell by 0.3%. Australia really only went into lockdown in the last two weeks of March, which is why the fall was so small.

The fall will be much greater in the June quarter and will mean that Australia experiences the required two consecutive quarters of negative growth.

You hear it mentioned all the time, but you might be wondering: what is GDP exactly? Another term for GPD is 'national income.' Very simply, GDP is calculated as the following:

GDP = Consumption + Investment + Government Spending + (Exports – Imports)

Consumption is spending by private households. **Investment** is (mostly) business spending on new assets. **Government** spending is spending on things like salaries for public servants. It does not include 'transfer payments' such as Centrelink benefits (which tend already to be measured when they are spent as private consumption). **Exports** are included because they are things that Australia makes and sells and therefore represent economic activity here. **Imports** are excluded because they are made somewhere else.

As you can imagine, measuring all of these things is difficult and the ABS has to use data from various sources, as well as a series of estimates for many of the GDP components. According to the World Bank, as of October 2018, Australia enjoyed the 13th highest GDP in the world. The US is the world's largest economy as measured by GDP (accounting for almost a quarter of world GDP). China is the second largest and is about 66% the size of the US GDP. Australia accounts for approximately 1.6% of world GDP. On a *per capita* basis, however, the World Bank records Australia as having the 19th highest level. Qatar is the wealthiest country in the world on a per capita GDP basis. The average Qatari enjoys access to more than twice as much GDP as the average Australian.

In our last newsletter, we discussed how, in times of economic contraction, there is usually a role for the Government to play by increasing it's own spending as a means of stimulating economic growth. The formula above shows you how direct Government spending impacts directly on GDP. In recent decades, much Government stimulus has tended to be 'indirect' with the Commonwealth giving money to other people to spend in the economy rather than spending it themselves – for example, the Jobseeker payments are paid to workers through their employers. They are 'counted' in the GDP figure when they are spent as private consumption.

GDP has its critics. For example, GDP only measures *paid* activity within a community. Volunteer work is not counted. So, if a retired grandparent provides childcare, this is not counted in GDP as no money changes hands. If a child attends a childcare centre, however, the price of that care is counted in GDP.

For our purposes, though, whether GDP measures the 'right things' is not so much the issue. The issue is the rate of change in measured GDP. That rate, in almost all developed countries, is currently negative. For the first time since Mr and Mrs Irving welcomed young Kyrie into the world, the list of countries in a technical recession includes ours.

Residential Property Market

Residential property makes up the largest portion of wealth for Australian households. In July 2019, the Australian Bureau of Statistics (ABS) provided the most recent update as to the composition of household wealth in Australia. This most recent analysis looks at data from June 2018. At that time, the first time in Australian history, average household net worth (that is, household assets minus household debts) was more than $1 million. The specific figure was $1,022,200. The figures were as follows:

Mean financial assets	$427,700
Mean non-financial assets	$778,800
Total assets	$1,205,800
Mean total liabilities	$183,900
Mean household net assets	$1,022,200

The assets being assessed are household assets. Financial assets include things like bank accounts, shares and super and balances. Non-financial assets include things like cars, household contents and property interests. Chief among these, of course, are residential properties.

Given the importance of residential property to the wealth of Australian households, the impact of the Coronavirus on residential property markets is one of the most important impacts of all. It is still only two months since most Australian households went into lockdown. So, clear data about the economic impact of the lockdown is not yet available. That said, it is clear that the Australian economy will go into recession. This will necessarily have an impact on the residential property market. While it is early days yet, we are starting to see some of this impact.

One impact is that people are holding off selling homes. Between the first week of April 2019 and the first week of April 2020, the Real Estate Institute of Victoria reported that the number of residential properties going to auction fell from 795 to 280. This is a 65% reduction in the number of properties being offered for sale by that method. Similar falls have occurred in all Australian markets.

For the month of April, the reduction in supply of houses being offered for sale seemed to offset the reduction in demand. In early May, research house Corelogic reported that national house prices actually rose on average by 0.3% in April 2020. May 2020 told a slightly different story. This time, Corelogic reported that, across the country, residential property prices fell by 0.4%. The smaller markets of Canberra and Hobart went against this trend, both rising (although both by less than 1%). Prices in all other capitals fell. Perth and Darwin, which have been reporting the weakest growth in property prices for quite some time now, fell by the most.

Basically, the data suggest that prices at the end of May are about where they were at the end of March 2020. We will have to wait a little longer to see the impact of the Coronavirus on residential property.

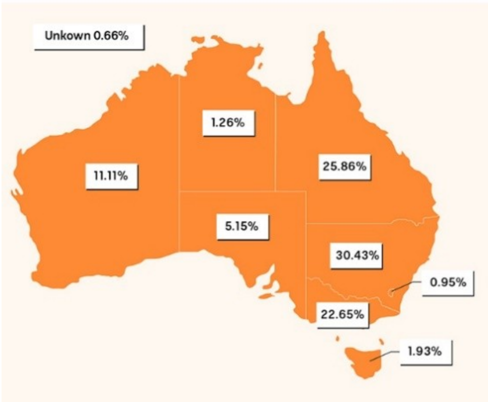
Early Release of Super

One of the more contentious stimulus measures introduced in response to the economic impacts of the Coronavirus shutdown has been the opportunity for people negatively affected by the shutdown to access a tax-free lump sum from their superannuation. Ordinarily, of course, superannuation must remain within an appropriate fund until a person retires. But people who have suffered a sharp reduction in their income have been allowed to access up to $10,000 in the current financial year and will be allowed to access up to a further $10,000 in the first three months of the next financial year.

Whether it is a good move to withdraw your super early is an extremely personal decision and, in a newsletter like this, we specifically state that we are not recommending either withdrawing or preserving your super. In this article, we simply thought we would discuss some very interesting data about who is withdrawing super and what they intend to do with it – and then introduce a touch of 'realism' into those plans.

Firstly, the research shows that younger people are more likely to access their super early. As of 11 May, the Australian Tax Office reported that 33% of the 1,354,200 people who had accessed their super early were aged 30 or under. Interestingly, their withdrawals only accounted for 27% of the total amount withdrawn. This tells us that younger people musty have been withdrawing less than the full $10,000 (the average for the under 31s was in fact $6,576). There can be some combination of two reasons for this. Young people either (i) had less to withdraw; or (ii) needed to withdraw less. This second reason is quite a valid one as people aged under 31 are less likely to have financial commitments such as a mortgage. They are also, of course, likely to have lower super balances to start with.

Intriguingly, the ATO reported that 200 people aged 71 or older requested 'early' access to their super. If that is early access, we wonder what normal access will look like! Across the country, as of 11 May, the average withdrawal was $8,211. 440,500 people aged 31-40 had withdrawn an average of $8,751 each. 282,400 people in the 41-50 age range withdrew an average of $9,313 each. 159,000 people in the 51-60 age range withdrew just on $9,400 each (on average). This age group had the highest average withdrawal.



The geographical data is interesting. ABC news provided this map of where people who accessed their super early live. There is no surprise that NSW, the most populous state, showed the highest rate of early access. But the data does not follow the actual population spread of the country. According to the ABS, in September 2019 there were 25,464,000 people living in Australia. They were spread out as follows among the states:

State	Population	% of Total
NSW	8,118,000	31.9%
Victoria	6,629,000	26.0%
Queensland	5,115,000	20.0%
Western Australia	2,630,000	10.3%

State	Population	% of Total
South Australia	1,756,000	6.9%
Tasmania	535,000	2.1%
ACT	428,100	1.6%
Northern Territory	245,600	0.9%

When we look at the early access data, we see that three areas accounted for a disproportionately large number of requests. These are Queensland (20% of the population but 25.86% of the requests for early release), Western Australia (10.3% of the population and 11.11% of requests) and the Northern Territory (0.9% of the population and 1.26% of the requests).

There are certain criteria that must be met before a person can apply for early release. These basically amount to losing income. This national data suggests that more people have lost income in Queensland, on a proportional basis, than in other states. This would be very consistent with the significant role that tourism plays in the Queensland economy – Queensland's borders have been closed for some months now. The economic effects of the Coronavirus will not be the same everywhere.

Fruit Salad or Chocolate Mousse?

On 29 May, the ABS reported the results of a survey that they conducted into early release. They found that about 5% of Australians had applied for early access to their super. The survey was conducted in mid-May, and people who did not have a job were three times more likely to have applied for early access than were people who did have a job. 9% of unemployed people had applied for early access. (People with a job could still apply for early access if income from that job had fallen by a particular amount). The survey asked people how they had used or planned to use the money that they had withdrawn. 57% said that they had or planned to use the money to pay household bills such as mortgage loan repayments, rent or other debts. 36% said that they had or planned simply to add the money to their savings.

That all sounds very prudent: most people who have accessed their super say they will either save it or use it to pay necessary expenses. Given their economic circumstances, these expenses would otherwise either not be paid or need to be paid using some form of debt. Bills might be paid using a credit card, or a personal loan, for example.

As a result, using super to pay necessary expenses should mean less personal debt for these people. The avoidance or reduction of debt should balance the reduction in their superannuation assets - the fall in assets is matched by a fall in debts. Overall, the 'net wealth' position should be the same. It is the same if people add the withdrawn super to their savings. If people have withdrawn super (which is a form of saving) and simply saved the money outside of super, the level of their overall assets should not have changed. They have simply 're-balanced' their portfolio between their super and their non-super assets.

There is a potential problem here: the ABS survey asked what people were *planning* to do with the money! Sometimes, the best of intentions can come a cropper. The ABS survey reminds us of a well-known and intriguing piece of research in behavioural finance. (Behavioural finance is the psychology of money management). We are simplifying things here, but the researchers used a simple research method to show that people do not always act as sensibly as they plan to.

Specifically, the researchers compared people's attitudes towards a healthy food option (fruit salad) and an unhealthy food option (chocolate mousse). People were told that they would be going out for dinner in a week's time. For catering purposes, they were asked to choose between two options for dessert: chocolate mousse and fruit salad.

When the meal was some time away, people were more likely to nominate the fruit salad than the chocolate mousse. They planned to have the healthier option.

The same people were then presented with an actual fruit salad and an actual chocolate mousse and invited to choose one to eat immediately. You guessed it: more people chose - and ate - the less healthy chocolate mousse than the fruit salad.

The researchers concluded that while people's plans were often well intended, their actual behaviours do not always meet such a high standard. This might be important for the way people use their super: the money might be withdrawn with the best of intentions, but once people have the money in their hands they will need to resist the temptation to spend it all on the economic equivalent of chocolate mousse.

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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