# NEWSLETTER

Jun 2021

AFFINITY WEALTH PLUS

## Introduction

Welcome to our June newsletter. In this edition, we examine how home prices continue to rise and are expected to do so until at least 2023. Meanwhile, the ASX 200 has reached record levels during the month of May, and interest rates remain at an all-time low. These are breathless times for asset prices!


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# The (Residential) Property Market

Once again, the month of May saw residential property prices rise across the country. Here is how the data was presented by Australia's pre-eminent property market researcher, CoreLogic:

CoreLogic RP Data Daily Home Value Index: Monthly Values - 31 May 2021

| City | All dwellings | | | Houses | | | Units | | |
|---|---|---|---|---|---|---|---|---|---|
| | Month End Value | % Change Year on Year | % Change Month on Month | Month End Value | % Change Year on Year | % Change Month on Month | Month End Value | % Change Year on Year | % Change Month on Month |
| Sydney | 192.60 | 11.16▲ | 2.97▲ | 203.11 | 14.83▲ | 3.47▲ | 169.20 | 2.80▲ | 1.76▲ |
| Melbourne | 163.80 | 5.00▲ | 1.75▲ | 174.11 | 5.57▲ | 2.18▲ | 143.71 | 3.27▲ | 0.83▲ |
| Brisbane (inc Gold Coast) | 124.88 | 12.12▲ | 2.14▲ | 133.09 | 13.32▲ | 2.28▲ | 101.66 | 7.82▲ | 1.61▲ |
| Adelaide | 132.57 | 11.84▲ | 1.87▲ | 133.65 | 13.01▲ | 2.12▲ | 125.82 | 4.62▲ | 0.37▲ |
| Perth | 93.64 | 8.45▲ | 1.10▲ | 96.16 | 8.77▲ | 1.10▲ | 82.38 | 6.02▲ | 1.12▲ |
| 5 capital city aggregate | 157.66 | 9.10▲ | 2.29▲ | 162.77 | 11.15▲ | 2.62▲ | 144.16 | 3.27▲ | 1.35▲ |
| Brisbane | 122.18 | 10.55▲ | 2.00▲ | 129.84 | 11.93▲ | 2.16▲ | 93.46 | 4.17▲ | 1.18▲ |
| Darwin | 89.99 | 20.29▲ | 2.66▲ | 103.04 | 21.11▲ | 1.55▲ | 70.80 | 18.36▲ | 4.95▲ |
| Canberra | 147.09 | 15.56▲ | 1.75▲ | 160.72 | 17.67▲ | 2.08▲ | 107.61 | 8.02▲ | 0.49▲ |
| Hobart | 165.52 | 16.52▲ | 3.22▲ | 167.85 | 16.47▲ | 2.72▲ | 156.57 | 16.63▲ | 5.15▲ |

Note: 5 capital city aggregate includes Sydney, Melbourne, Brisbane (inc. Gold Coast), Adelaide and Perth.
Month and Year Changes are updated monthly and calculated as at the end of each calendar month respectively.

The writing in the table might be a bit small, but the fact that all the '% change' figures are all green tells you that median prices for houses and units rose in every capital city during May. The absolute largest overall change was in Hobart, where the home value index for all dwellings rose by 3.22% during the month. This was in large part due to an extraordinary one-month rise of 5.15% in the prices of units (that is, dwellings other than houses), which was easily the largest in the country.

In the section below on the stock market, we discuss the importance of weighting when you look at averages across differently-sized constituents. As it happens, the Hobart residential property market is the second- smallest of the capital city markets in Australia (Darwin is the smallest). Sydney is the largest market, and it also reported substantial price increases during May. The 'all dwelling' index rose by 2.97%, driven mostly by the growth in the value of houses, which rose by 3.47% for the month.

The changes in residential property prices show no sign of abating this year. In its most recent forecast, Westpac Bank predicted overall prices changes for the country as a whole of 15% in 2021, 5% in 2022 before tailing off to 0% in 2023. Once again, this data is somewhat 'skewed' because it combines predictions for each of the State capital cities. Here is how Westpac combines the past results and future forecast for each state capital:

## 21. Dwelling price forecasts

| | avg* | 2019 | 2020 | 2021 | 2022 | 2023 | comments |
|---|---|---|---|---|---|---|---|
| Sydney | 5.8 | 5.3 | 2.7 | 16 | 5 | -1.0 | Very strong gains centred on houses. Affordability & prudential tightening to slow. |
| Melbourne | 4.2 | 5.3 | -1.3 | 12 | 5 | -1.0 | Rising rental vacancies an issue and more exposed to affordability, weak migration. |
| Brisbane | 2.1 | 0.3 | 3.6 | 16 | 10 | 4.0 | Strong fundamentals, very tight market, less exposed to migration hit. |
| Perth | -0.6 | -6.8 | 1.9 | 14 | 8 | 4.0 | Export mix well placed, big HomeBuilder boost set to unwind. |
| Adelaide | 2.2 | -0.2 | 5.9 | 10 | 8 | 3.0 | Largely unaffected by COVID but demand susceptible to inter-state migration outflow. |
| Hobart | 4.5 | 3.9 | 6.1 | 8 | 5 | 3.0 | Tight market but affordability stretched after very strong run in recent years. |
| Australia | 4.0 | 3.1 | 1.8 | 15 | 5 | 0.0 | COVID hit milder than feared and strong, sustained upturn underway. |

All dwellings, Australia is five major capital cities combined measure; *10yr avg; Source: CoreLogic, Westpac Economics
Forecast periods cover 2020 peak to mid-2021 trough, and subsequent two years (shown in annualised growth terms).

As you can see, Westpac actually predict that Brisbane prices will rise the most strongly over the remainder of this year and through the coming two years. The Hobart market, which Corelogic tells us out-performed very strongly in May, is actually predicted to have the lowest growth for calendar year 2021.

The two largest capital cities, Sydney and Melbourne, are predicted to decline slightly – but not until 2023.

Undoubtedly, a major driver of house prices changes is the current low-interest rate environment. Which brings us neatly to our update on interest rates…

## Interest Rates

On Tuesday this week, the Board of the Reserve Bank of Australia met and decided to maintain all current policy settings regarding interest rates in Australia.

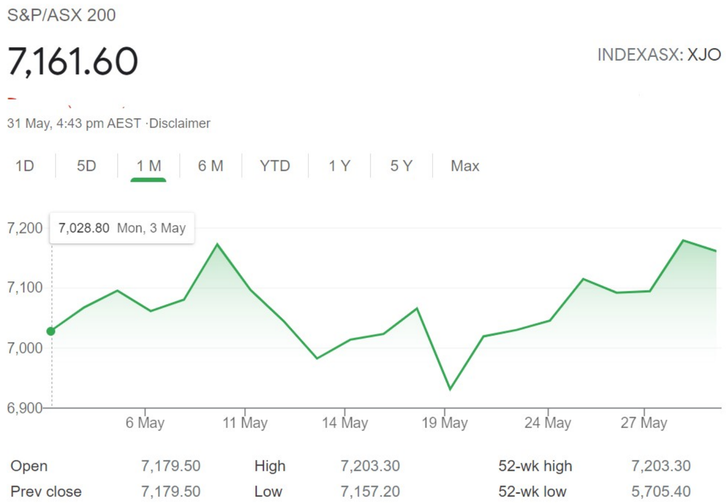
If that sentence sounds familiar, it is because we wrote it last month as well! As we have told you previously, interest rates are at an all-time low and are expected to stay there for some time to come.

In its most recent statement, on Tuesday June 1, the Board of the RBA emphasised that it "continues to place a high priority on a return to full employment." Earlier in the statement, it had observed that unemployment was around 5.5% and forecast to fall to 5% by Christmas. So, full employment is some way off still and this is likely to keep the RBA on its current course regarding interest rates.

The Board did observe in its statement that low interest rates are driving demand for housing, and perhaps signalled that it will look to aspects of loan approvals other than the interest rate to curb demand, when it states: "…the Bank will be monitoring trends in housing borrowing carefully and it is important that lending standards are maintained." This raises the prospect of a series of increasingly stringent rules around lending, known collectively as 'macroprudential policies,' potentially similar to those that affected investment borrowers in the last part of the 2010s. These policies leave the interest rate untouched, but introduce other disincentives to borrowers in a bid to reduce borrowing.

# The Share Market

May was a slow but positive month for share prices. As measured by the ASX 200, the market rose by an average of 1.8%. That included twice touching its highest ever levels during the month before finishing at 7,161 points. Here is how the month looked thanks to Google and the ASX:




Given it was such a quiet month, we thought we would take this opportunity to explain a little more what the ASX 200 index actually is. An index is a way of measuring changes in value between two or more points in time. The ASX defines the ASX 200 as "a market-capitalisation weighted and float-adjusted stocks market index of stocks listed on the ASX."

This means that the index measures changes in prices in the 'largest' 200 companies listed on the ASX. The term *largest* here refers to market capitalisation, which is the total number of shares issued by a company multiplied by the current market price for those shares. By 'weighting' market capitalisation, the index adjusts for the size of each company.

To understand this, think of the following two companies: The Commonwealth Bank of Australia (CBA) and EML Payments Limited (EML). At the time of writing, CBA had the largest market capitalisation of any company listed on the Australian Stock exchange. EML had the 200$^{th}$ largest market capitalisation, making EML the 'smallest' company (by market capitalisation) in the ASX 200.

At the time of writing (June 1 2021), CBA had a market capitalisation of $176,150,032,54. EML had a market capitalisation of 'just' $1,190,415,334. To keep the numbers simple, let's say that CBA had a market capitalisation of $176.15 billion while EML had a market capitalisation of $1.19 billion. This means that CBA was about 148 times bigger than EML.

Now let's say that the share price of CBA rises by 1% while EML's share price falls by 1%. If we try to measure the overall change using a <u>simple</u> average, we might be tempted to say that on average the market did not move: the rise in CBA was countered by the fall in EML. But, because CBA is so much larger than EML, this would be misleading. A change in the price of CBA actually has 148 times more impact on the overall market than a change of the same size in EML. The rise in the CBA share price is much more substantial than the fall in EML's.

To work out the actual average change in this example market, we need to give extra 'weight' to CBA. In our simple example, we would have to reflect the fact that CBA is 148 times larger than EML. So, we multiply the 1% rise in CBA by 148. This gives us +148. We then multiply the 1% fall in EML by 1. This gives us -1. We then add 148 and -1, to get 147. 147 is then divided by 149 and we get 0.9865. So, if CBA and EML are the only two companies in our index, then we can say that the index rose by 0.9865%.

For an index such as the ASX 200, this process is repeated for all 200 companies. This ensures that the index is reflecting that changes in the prices of larger companies have a greater impact on the overall market than changes in the prices of smaller companies.

The other thing to note about an index is that the actual number of the index is not really that important. This is because the initial value given to the index is quite arbitrary. For example, the ASX 200 'commenced' in March 2000 with an initial value of 3,133. This number was chosen because it was the same value as another index that had been used for the previous twenty years or so, the 'All Ordinaries Index.'

If you go 'right back, you usually find that market indices 'start' with a base number of 100. This means that, on the day the index commences, the value of the index is 100. If market-weighted prices then rise on average by 1%, then the index is expressed as 101. And so on.

The number of the index at any given point in time is not that important. What is important is the *relative change* in the value of the index. For example, on May 3 2021, the ASX 200 was worth 7,028 points. It is now worth 7,167 points. This is a rise of 139 'points.' But these points are meaningless on their own. So, we usually measure the change in points as a percentage. 139 is 1.98% of 7,028. So, market-weighted average prices for the largest 200 companies on the ASX have increased by an average of 1.98% during May 2021.

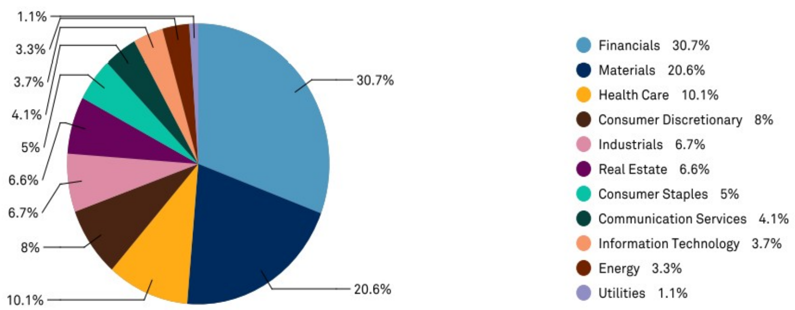
Lastly, you might be interested in the type of companies that actually make up the ASX 200. Well, the index is somewhat dominated by companies that provide financial services. As of 31 May 2021, the organisation that compiles the ASX 200 reports the following companies to be the largest ten companies in the index:

**Top 10 Constituents By Index Weight**

| CONSTITUENT | SYMBOL | SECTOR* |
|---|---|---|
| Commonwealth Bank Australia | CBA | Financials |
| BHP Group Ltd | BHP | Materials |
| CSL Ltd | CSL | Health Care |
| Westpac Banking Corp | WBC | Financials |
| National Australia Bank Ltd | NAB | Financials |
| ANZ Banking Group | ANZ | Financials |
| Wesfarmers Ltd | WES | Consumer Discretionary |
| Woolworths Group Ltd | WOW | Consumer Staples |
| Macquarie Group Ltd | MQG | Financials |
| Rio Tinto Ltd | RIO | Materials |

You can see that five of the largest ten companies are financial services providers – the 'Big 4' banks plus Macquarie Bank. This dominance of financial services firms is reflected in the 'sector breakdown' of the entire index, which is as follows (source: as above):

**Sector* Breakdown**




*Based on GICS® sectors

The weightings for each sector of the index are rounded to the nearest tenth of a percent; therefore, the aggregate weights for the index may not equal 100%.

# 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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