NEWSLETTER
December 2021

Edgeworth Partners

Introduction

Welcome to our December newsletter, our final piece for 2021. We reflect on the year we have just had and look forward to what can be expected in 2022. Safe to say investors in shares and/or property had a very good 2021. We wish all our readers a safe and happy year end and look forward to seeing you early in the New Year.

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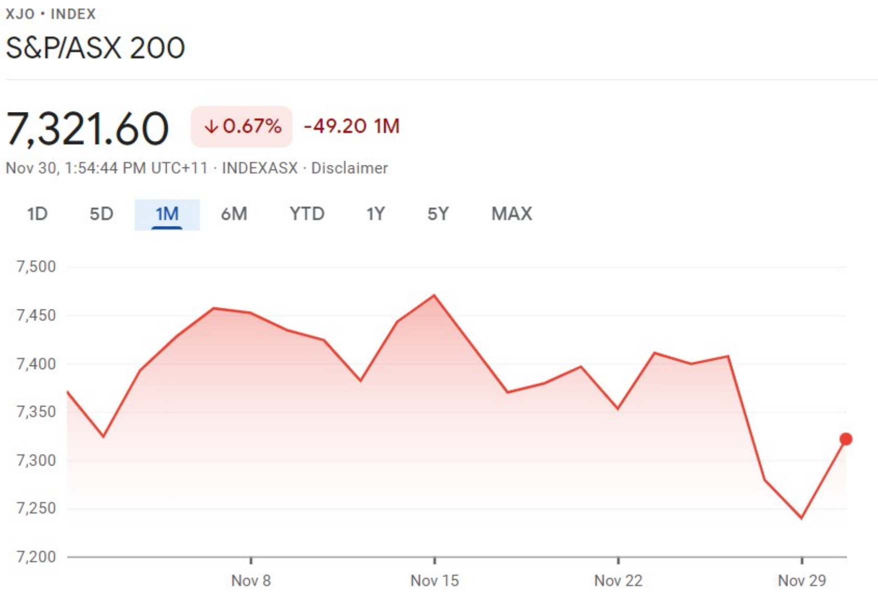
The Share Market

The Australian share market, as measured by the ASX 200, tracked largely sideways during the month of November. The following graph shows the daily movements (thanks to Google for the graphs):

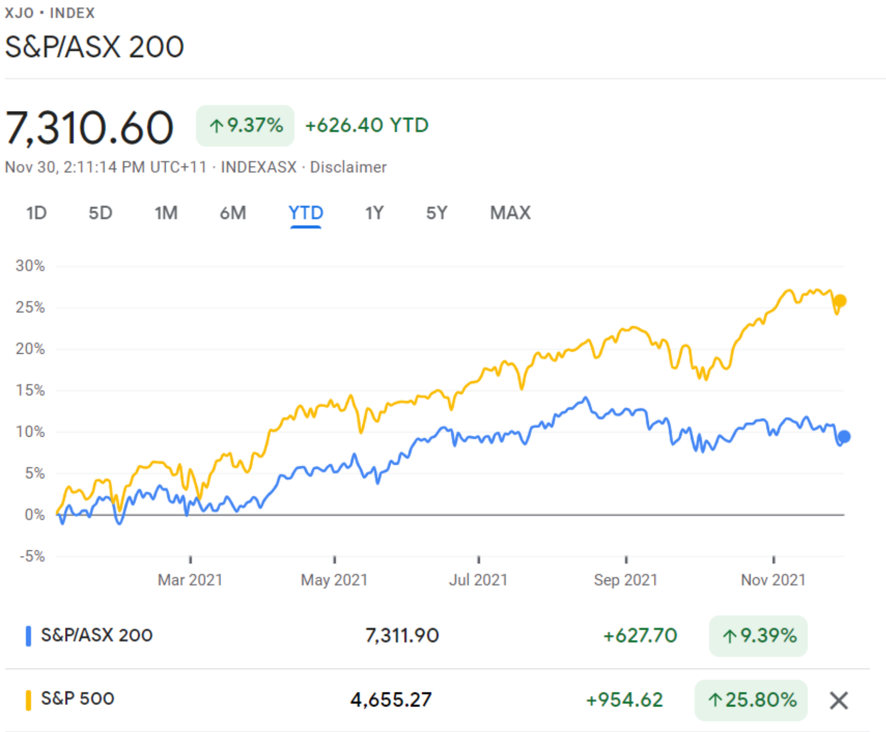


The fall towards the end of the month was due to the emerging news of a new Covid variant, Omicron, which saw the market lose some confidence about the future. Prices fell by about 2%. On the last day of the month, however, world leaders such as US President Biden appeared to express calm about the new variant and this gave markets some of their courage back.

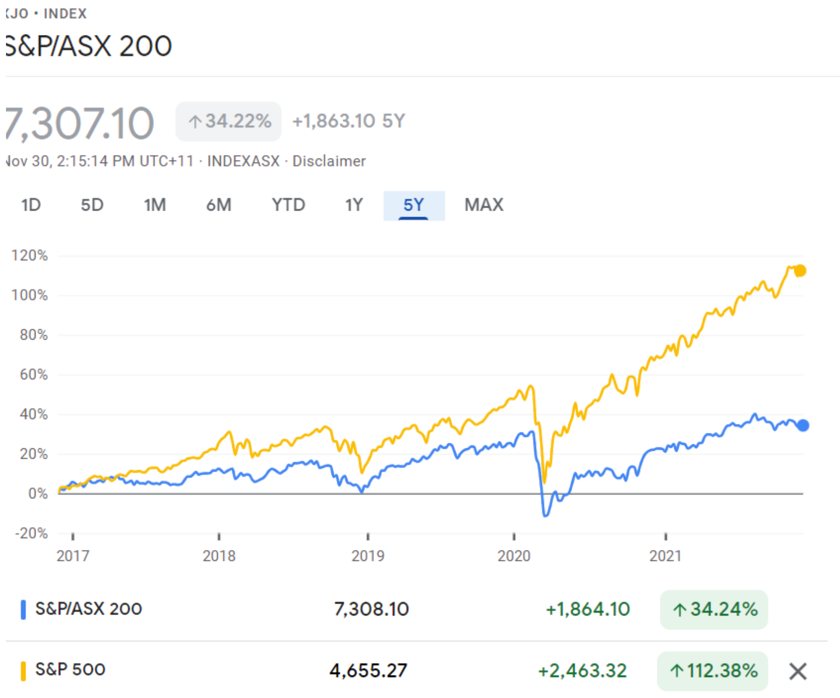
As this is our last newsletter for 2021, it is a good time to look back on the market so far in the year 2021. It has been a relatively strong one for Australoan investors, with average rises of around 9.5% for the eleven months to the end of November:

As you can see, the bulk of the growth occurred in the first eight months, after which much of the eastern seaboard was in some form of lockdown, which suppressed economic activity and thus company profits.

While returns approaching 10% are nothing to sneeze at, interestingly the Australian market did not rise to anything like the same extent as the US market. Here is the performance of Australia's ASX 200 index compared to that of the US' S&P 500 index, since January 1 2021:



The outperformance of the US market continued a longer-term trend, as shown in this graph showing the relative performances over the last five years of the two markets:



So, given this divergence, is the Australian market underperforming or is the US market overperforming? We do not really know (very few people do, which is why the next move for the stock market is almost impossible to predict), but we were intrigued to come across the following graph showing the relative price of US stocks at different times in history using what is known as the *Shiller PE* ratio (source: www.multpl.com):

You may remember that a standard PE ratio is the ratio between the most recent annual earnings for a company (its profits) and its current share price. A high PE ratio means that the price of a share is high relative to its actual profits – the price of the share is expensive. The Shiller PE ratio uses a different measure of earnings – it takes the earnings figure over the previous ten years, and adjusts them for inflation. This is thought to remove temporary or one-off rises or dips in company profits caused by events such as the Covid pandemic.

As the graph shows, the current Shiller PE ratio for the US market is almost at an all time high. It has also risen very rapidly, from a point at the start of 2020 that was also high by historical standards.

The obvious limit to graphs like this is that they are historical. They simply do not tell us what is about to happen. Have a look at the value of the Shiller PE in about 1997. It was passing through 30, which at that time was the highest it had ever been. It has also run up substantially in the previous five years or so. Many people would have looked at this type of situation and decided that the market was about to fall. Taking a long-term view, they were right – by the end of the next decade, the ratio had fallen to 15. But in between times, of course, prices kept rising and the index rose to almost 45 just before the dot.com boom went bust. So, selling out at 30 meant profits were missed.

Knowing this history, we can say two things with some confidence: the US market is historically high, and the immediate next move for prices is still unknown. But, for us here in Australia, we can perhaps take some reassurance that the strong but not outstanding returns for 2021 might make for a more stable 2022 than our US counterparts should be expecting.

Residential Property Markets

What can we say about residential property prices for 2021 that we have not already said? They have gone up. Pretty much everywhere. And by a lot. Much more than most people expected.

The big question now, of course, is what will happen to prices next. Recently we read a report from Westpac Bank arguing that they expect more modest price growth in 2022 before prices correct somewhat in 2023. Here is what Westpac predicts in each of the major markets, along with the actual data for the last three years:

DWELLING PRICE FORECASTS

	2018	2019	2020	2021f	2022f	2023f
Sydney	-8.9	5.3	2.7	27	6	-6
Melbourne	-7	5.3	-1.3	18	8	-6
Brisbane	0.2	0.3	3.6	22	10	-1
Perth	-4	-2.8	7.3	15	8	-1
Adelaide	1.3	-0.2	5.9	18	8	-2
Hobart	8.7	3.9	6.1	25	6	-2
Australia	-6.4	3.1	1.8	22	8	-5

All dwellings, Australia is five major capital cities combined measure.

Source: CoreLogic, Westpac Economics

As you can see, Westpac expects average growth across Australia of 8% in 2022, before prices fall by around 5% on average in 2023. If these predictions come true, then prices will rise by around 2.6% for the two year period. This is likely to be less than inflation, which means that for people whose wealth and income can keep track with inflation, prices will be slightly lower.

Of course, it is impossible to predict with absolute accuracy what is about to happen. But the general direction of the predictions may give some comfort to anyone thinking of buying or selling in the next few years: there is no need to rush your decision. Prices are not expected to change much in the next period, allowing people to take their time to either (i) find the right place to buy or (ii) sell at a time that really suits them.

The levelling off of price growth is expected to come via various restrictions that will be brought to bear on new loans. These will include things like raising the 'buffer' interest rate that lenders need to use to calculate whether a borrower could repay their loan if interest rates rise. Changes such as these are known as *macroprudential* measures and, as we have previously written, they have worked to dampen rising demand in the past. We would also expect any rise in interest rates to reduce demand for housing and (at least) stop prices from rising so fast. That said, the Governor of the RBA recently used a lot of words to essentially say that the RBA does not expect interest rates to rise before the end of 2023. So, interest rates will likely stay low but other factors will reduce demand for housing.

After the year we have just had, this will still be a welcome relief.

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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