

NEWSLETTER
May 2018



Introduction

Welcome to our May newsletter.

In this month's newsletter, we examine the factors that underpin housing affordability and come up with some surprising findings. And we go for a leisurely walk up a nicely-graded hill. You will see what we mean when you read our share market report.

A look at history... May Day

The first of May is traditionally known as **May Day**. While the 1st of May has significance in many domains, it was selected as 'International Worker's Day' by a group of socialists and is frequently nominated as a day to remember that the eight-hour working day has not always been a reality. May Day was chosen because May was the month of the Haymarket Riot in Chicago in 1886.

As you might expect, the riot was an ugly affair. It occurred during a strike process and involved the killing of both Police and strikers. Four people were later hanged for their involvement. Nowadays, the eight-hour day just makes for really crowded public transport at 5pm.

Life really is better than the 'good' old days!

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Property Market

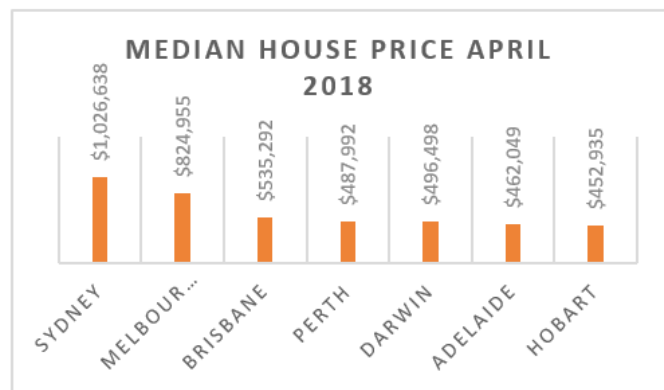
Hobart leads the way.

Data released earlier this week shows that Hobart property prices rose by more than any other state capital in April – up a whopping 1.2%. To put this in perspective, if this rate happened every month, prices would double every five years.

April was the most recent of a series of rises in Hobart, such that in the 12 months to April 2018, prices rose by 12.7%. This growth is largely being attributed to restricted supply of houses for sale and some investor and owner-occupier interest from the mainland finding its way to the Tasmanian state capital. People and money are moving to Tassie.

Elsewhere, residential property prices barely rose at all during April: in Brisbane and Adelaide prices changed by just 0.1%. Perth was completely flat. Sydney and Melbourne both fell by 0.4%.

As pretty much everybody knows, these flat conditions in places other than Hobart follow extended period of unprecedented property price growth. As the table below shows, median house prices are high all over the country, but highest in Sydney and Melbourne.

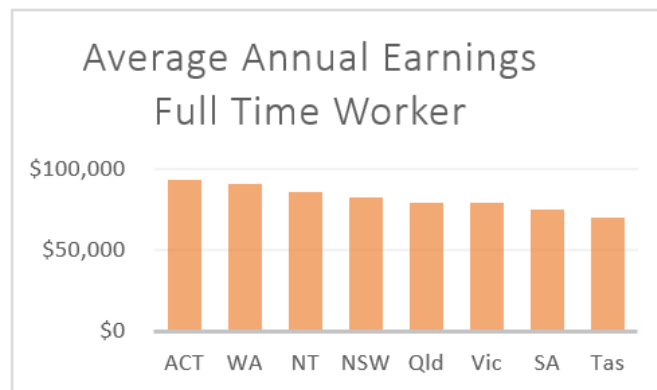


The median price is the price right in the middle of the range of all prices. It is not quite the same as an average price. 50% of properties sell for an amount equal to or greater than the median price, and 50% of properties sold for an amount equal to or less than the median price.

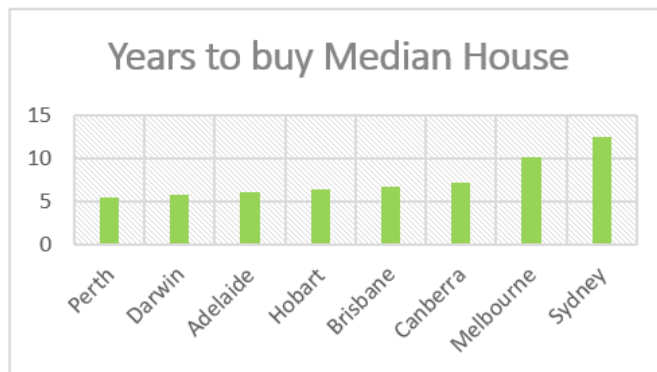
Median house prices are typically used as an indicator of the overall state of housing affordability for a particular location. In most cases, housing affordability is calculated by

dividing the median house price by average earnings.

You won't be surprised to learn that average annual earnings vary from place to place. Residents of Canberra enjoy the highest annual earnings, while residents of Tasmania have the lowest earnings for full-time employed residents.



Of course, how much you earn is not necessarily the critical element in determining how wealthy you are. More important is what you earn compared to what you need to spend. If we put together the data from the two tables above, we



can calculate a simple measure of housing affordability: how many years of average full-time employed earnings would it take to buy the median house in each place. That is how many years do you have to work to buy a mid-ranking house.

This table becomes very revealing. In terms of housing, Sydney is easily the least affordable part of Australia to live in - it would take 12 years of average gross earnings (that is, your entire earnings, including amounts you must pay as tax) to buy median property in that market. If we assume that 25% of earnings are used to pay tax, then a person would have to dedicate every dollar

they receive for at least 16 years the by the median-priced house in Sydney. Little wonder that former Reserve Bank Governor Glenn Stevens has commented that he believes that first-time buyers in the Sydney market almost invariably need the support of someone such as a parent in order to afford that first home.

Perhaps surprisingly, Perth has the most affordable housing in Australia - no doubt a function of the fact that it's market has been falling for three or four years, combined with the relatively high incomes enjoyed by full-time employed Western Australians. Indeed, if people in Sydney enjoyed the same level of average income as people in Perth, the time taken to buy a house in Sydney would fall by more than a year.

Economics suggests that such large variations in housing affordability should be corrected by the market. That is, if an essential item such as housing is unaffordable in one place, people will leave that place and moved to where housing is more affordable. This should reduce demand for housing in the expensive market, and thereby reduce prices such that affordability improves. It would also increase demand for housing in the less expensive market. Anecdotal evidence suggests that this is what is happening in Hobart: people who can are moving to that market and enjoying an improved quality of life as a result. More house for less work. Makes sense.

That said, Australia is a big country and its capital cities are a long way apart. Not everybody can or wants to move. People who have grown up in

Sydney or Melbourne (the really expensive cities) tend to want to remain there, close to family and friends. The problem is exacerbated to some extent by the fact that new arrivals to Australia are often drawn by the presence of relatives or others from their country of origin. This means that places that are already more highly populated are disproportionately the preferred point of arrival for immigrants. Migrants want to live where migrants have gone before them.

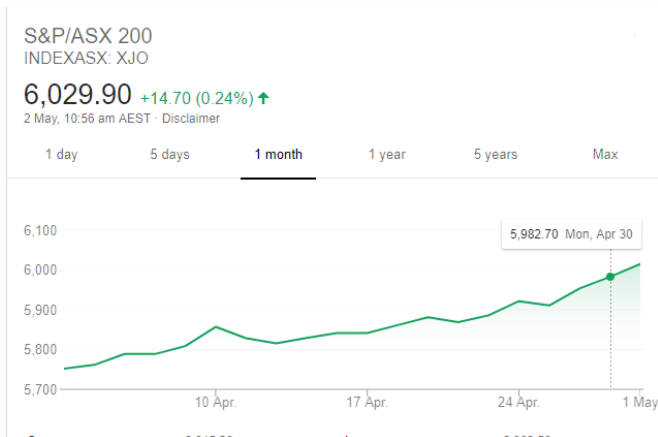
To give a simple example: it is estimated that up to 40% of people currently living in Melbourne were born in another country.

All of this is causing substantial headaches for national planning. You may be seeing the substantial debate about whether the rate of immigration to Australia should be slowed down, at least in the short term, to allow infrastructure to 'catch up' to the rate of growth in population in most of our capital cities. This necessary infrastructure includes housing, as high house prices indicate one thing above all else: demand for property is high relative to demand for that property.

When all is said and done, Australia is a wonderful country in which to live. And most people feel a particular affinity for their own city. In the long-term, the outlook for property investors remains very positive. Good quality housing will continue to be attractive. At the national level, people will continue to want to move to Australia. At the more local level, people will continue to want to live near to family and friends.

The Share Market

April was an unusual month in the Australian sharemarket. The market rose by 4% across the month. The unusual element was how smooth that rate of growth was. Here is how it looked on Yahoo Finance:



As you can see, if this was a hill, it would be a very easy one to walk up! Prices rose with almost monotonous regularity. The day-to-day changes were slight, but the cumulative effect was substantial: 4% in one month is impressive growth.

This monotony is unusual. Ordinarily, day to day prices are much more volatile. Have a look at the graph for general share prices for the 12-month period to the end of April 2018:



Anyone hiking these hills would need to be quite fit! The annual graph is much more volatile.

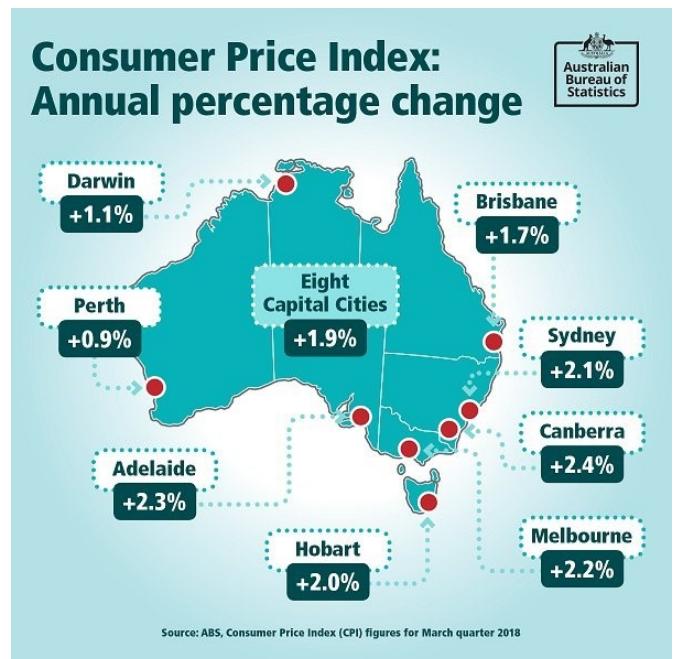
The other thing to note about the annual graph is that prices barely moved across the twelve-month period. The 4% growth in April was 'catching up' on the sharper falls earlier in 2018. On average, the rate of growth was basically 0%.

Remember, though, that investors still made money. Just because prices did not change does not mean that investors did badly. The price graphs only show changes in the market price of shares. For investors, the change in market price creates the *capital return*. The other type of return is income return, which comes to share market investors as a 'dividend.'

The average dividend yield in the Australian market is around 4.2%. So, in a year when market prices do not rise or fall, and the capital return is therefore 0%, the investor's return is still 4.2%.

4.2% is well ahead of inflation, meaning that investors still increased their purchasing power in the 12 months to the end of April 2018. The inflation rate was 1.9% for the year to the end of March. With a little bit of rounding and minor adjustment, this means that the real rate of growth in the average share investors' wealth was approximately 2.3% for the year.

As an aside, the CPI (inflation) figures for each capital city are interesting, especially in light of the analysis above regarding the property market. Not only is Perth housing the most affordable, but price rises generally are lower in Perth than



anywhere else. Here is how the ABS reported things at the end of March 2018:

What next for Perth?

The Legal Stuff

General Advice and Tax 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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