NEWSLETTER

September 2017

Edgeworth Partners

Introduction

Welcome to our September newsletter

In this newsletter we look at 'who's who' in share investing. Specifically, we talk about who you are likely to be buying from or selling to when you invest directly in shares. We also examine the Reserve Bank's recent decision on interest rates and recommend an approach that we think will suit anyone with debt.

On our website, we made August the month for business owners. So, in this newsletter, we also include two articles designed especially to help those dedicated folk who are running their own business.

We hope you enjoy this first newsletter of spring. Please do not hesitate to get in touch if there is any aspect of it that you would like to discuss.

Did You Know… the month of September

September has always been an important month in Australian history. Port Darwin was named in September 1839 when the HMS Beagle (Charles Darwin's old ship) sailed into harbour. In 1922, bush poet Henry Lawson died at the relatively young age of 55. Bush balladeer Slim Dusty went the same way 81 years later. Australia entered the Second World War in September 1939. Very importantly, television arrived in September 1956 - just in time for the Melbourne Olympics which began two months later. (Sydney's Olympics took place in September 2000). September 1983 saw Australia win the America's Cup, which is a sentence that doesn't make sense if you're not into sailing. 2008 saw Australia gain its first female governor general, Quentin Bryce. And, of course, September is the traditional month for football finals: we hope your team does well.

Peter Dugan

02 9476 6700

pdugan@edgeworthpartners.com.au

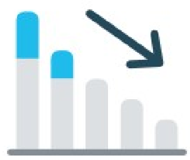
www.edgeworthpartners.com.au

MARKET REPORT

August saw many public companies report their financial performance for the 2016/2017 financial year. Reporting season is always interesting. Company reports are a closely held secret. Nobody who is privy to the contents of a company report is allowed to buy or sell shares in that company prior to the information being released to the market. Nevertheless, often the actual report of a company comes as little surprise to the market. Market surprises are what move share prices.

For example, look at the case of Commonwealth Bank. On 9 August the Commonwealth Bank announced a record profit of $9.9 billion for 2016/2017. The share price rose by only 0.5%. By the end of August, its price had actually *fallen* by around 4%. Much of this fall was due to the other big news for the month: Commonwealth Bank had been aware of some unlawful money movements by customers, but had failed to act on this information as it ought have.

So, two substantial announcements: the first, announcing a record profit, barely moved the market. The second, announcing a regulatory failure, knocked 4% of the share price. The reason? The second announcement surprised the market (in fact, it even surprised the regulator, but that's another matter altogether).



When considering why the first announcement did not shock the market, it is worth remembering that the specific information revealed on August 9 was not known to anyone buying or selling shares in the days prior to that release. Australia's insider trading laws are strict, It is unlikely that anyone who knew the specifics of the Commonwealth Bank's financial performance traded on that knowledge. So, how did the market seem to know that a was going to be announced?

The answer is simple: really smart people spend their days analysing businesses such as the Commonwealth Bank. These people work for investment managers and institutional investors. They are university trained and have decades of experience in watching companies like the Commonwealth Bank.

Why is this important for individual investors to know? Well, if you want to actively trade shares in public companies, these really smart, well-informed people form 'the other side' of the trade. If you buy shares, people like this are probably selling them. If you are selling, vice versa. When you buy and sell shares you don't typically know who you are trading with. But there is a very good chance that you are trading with an expert. Studies consistently show that about 80% of shares listed on the ASX are held by institutions and foreign investors (typically institutions). So, if you are trading, there is an 80% chance that you are trading with an institution.

So, ask yourself a simple question: do I know better than the institution to whom I'm probably selling or from whom I am probably buying? Probably not!

That said, there are two broad reasons that you might be buying shares. One is to hold over the long term, in the pursuit of a regular dividend stream and/or a capital gain. The second is to hold over a shorter term, in which case you are making a bet that the current price is low and will rise after you purchase the share.

If you're in this first boat, then it does not matter that you are probably trading with an institution. By taking a long-term timeframe, you are not trying to time the market. This is smart investing, because for you to time the market well means that the other trader (the institution) needs to be timing the market badly.

But if you're in the second boat, you need to be careful. As we say, the person that you are trading with is probably better educated and more experienced in the market than you. They spend all day every day looking at the financial performance of companies such as the one you are trading. It is no shock to them when a company such as Commonwealth Bank returns a record profit of just under $10 billion for a single financial year.

When it comes to successful sharemarket investing, it pays to 'know what you don't know.' Buying a diversified portfolio and holding it over time is a great way for most investors to proceed.

If you want to own specific shares, then taking advice from a market expert also levels the playing field. It always pays to know what you do not know.

The Property Market

This month, we going to take a quick look at the outlook for interest rates. As you may know, interest rates are heavily influenced by decisions from the board of the Reserve Bank of Australia. The board meets on the first Tuesday of each month to discuss whether it will enter the market to influence the general situation for interest rates. Any changes are announced later that day. As a general proposition, if the board decides to enter the market so as to increase interest rates, then interest rates payable on property loans tend to increase by a similar proportion.

A few days after their meeting, the board releases a summary of its thinking. It provides a quick summary of the main economic data to which it pays attention. In August, the board stated that its forecast for the Australian economy are largely unchanged. It expects the economy to grow at a rate of around 3% per year for the next two years. Current inflation is just below 2%, although the bank expects that this will grow slowly following its forecast economic growth. In particular, rising electricity prices are expected to cause an increase in the official inflation rate, although new entrants in the retail market (hello Amazon) can be expected to drag the prices down.

Interestingly, this is what the bank has to say regarding housing:

> *"Conditions in the housing market vary considerably around the country. Housing prices have been rising briskly in some markets, although there are some signs that these conditions are starting to ease. In some other markets, prices are declining. In the eastern capital cities, a considerable additional supply of apartments is scheduled to come on stream over the next couple of years. Rent increases remain low in most cities. Investors in residential property are facing higher interest rates. There has also been some tightening of credit conditions following recent supervisory measures to address the risks associated with high and rising levels of household indebtedness. Growth in housing debt has been outpacing the slow growth in household incomes."*

This last line is important. Housing debt is growing faster than household incomes, meaning that households are becoming more vulnerable to things like increased interest rates. Happily, the RBA considers that interest rates do not need to be adjusted at this time.

But this might not always be the case. Historically, current interest rates are low. Conventional wisdom holds that the thing to do at this time is to reduce net debt. You can do this by either paying down debt, or acquiring new investment assets (or both).

One thing you shouldn't do is simply spend the money you are saving. The best way to strengthen your ability to cope with increased interest rates is to assume that the increase has already happened. For example, if you are paying 4% on a $300,000 loan, then you might adjust your repayments so that you are repaying an amount that would be required if interest rates increase to 4.5%. In this way, if interest rates increase you won't experience a shock. Even better, you won't have developed a dependency on spending a higher amount of money.

Your own business should be your most important investment

First published on our website on August 11

This week, we want to talk to you about what may turn out to be the most significant investment you could ever make. It is your own business.

You may be surprised to hear that most financial planners are actually prevented from advising clients about their own business. Their licencee (the person under whose authority they provide advice) will not let them do so. Licencees typically insist that the advice be limited to managed funds, direct shares and maybe some limited forms of direct property.

All of these investments have their place, but they are not the main game when it comes to maximising wealth. For business-owning clients, the main game is just that: their business. After all, it is the business that creates the cash for investment (and servicing debt if you want to borrow to invest).

Think about two fictitious clients: Brian and Jayashri. Let's say that Brian and Jayashri both own businesses earning about $100,000 a year and they both have saved $100,000 which they are seeking to invest. Brian goes to see a 'standard' financial adviser who is only allowed to discuss managed investments. The adviser does a good job with this, and helps Brian identify an investment which makes him a 10% return each year (this is slightly higher than the long term average return for Australian shares of 8.7%. Source: ASX/Russell Long Term Investing Report 2016).

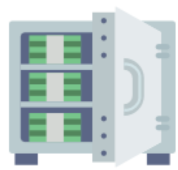
For this, Brian pays his adviser $2,000. As it relates to an investment, this fee is not tax deductible. Given his tax rate, Brian has to earn $3,174 in order to have $2,000 left to pay the tax bill. The before tax cost of the advice was, therefore, $3,174.

Jayashri saw a different adviser (Let's say she saw us!). Given our experience, the first thing we did

when we saw she owns her own business was discuss that business with her. We made a few suggestions, including changing her payment terms such that the number of days needed to collect payment is halved, purchasing a second company car for use by Jayashri's teenage daughter and using a simple system of colour-coded credit cards to automatically allocate business and private expenses, which reduces book-keeping and accounting fees.

Altogether, these suggestions increase the business profit by $10,000 a year. Every year.

Once that was done, we also looked at the $100,000 she had to invest and made the same recommendation that Brian's adviser did. So, Jayashri achieved the same return of $10,000 on her investment. Add this to the guaranteed $10,000 a year of increased revenue, and her overall return becomes $20,000.



The charge for Jayashri was $3,000. This is more than Brian, but because the bulk of the time spent on her case was business advice, which is tax deductible, she also only had to earn $3,174 in order to pay her fee.

So, you can see what has happened here. Brian and Jayashri's advice cost exactly the same in terms of pre-tax dollars (which means they worked just as hard as each other to buy the advice). They both received good advice. But Brian's advice was limited, and specifically ignored his business. Jayashri's advice made the business the focus. If nothing else, that made the advice tax deductible.

If you own a business, then that business is the main game in terms of your financial profile. Good business advice is probably the most important advice of all. So please get in touch and let us discuss how you can make your good business even better.

You and your business: time is your scarcest resource

First published on our website on August 25

Being self-employed requires an entirely different 'mindset' to being an employee.

In our own experience, and in our observations of other business owners, a number of particular attitudes need to change if we are to succeed at – and enjoy! – running our own business.

The main change in attitude is to 'let go' of the relationship between time and reward. If you are an employee, you make a basic deal with your employer. You sell them your time. They use that time to get the work done. But if the work cannot be completed in the time allotted, the employee does not have to do it. Yes, if a conscientious employee will usually be happy to work extra time, or extra hard, to get the job done. But, if the work is too much to be completed in the time available, then some of it remains incomplete. The employee can go home.

This is not what happens in your own business! Pretty much everyone who starts or buys their own business works longer hours, at least in the early days. We are sorry if that is bad news – but the business that you can run working four hours a week is elusive (and it certainly will not be the first business that you run). Most businesses need active management, especially in the early days. So, if you are a new business owner, be prepared to . No one is buying your time any more. You simply have to do what needs to be done.

The other major mental adjustment can sound a little contrary to this advice. As employees, we tend to learn to measure our output by the amount of time it took. So, if one week we find that we have worked 50 hours, not 40, we tend to think we must have done more work. And if we are being paid by the hour, that makes sense.

But in business, time is not the most important measure. Quality is much more important. A lot of new business owners spend a lot of time on things that don't need to be done. They are still using time as an indicator of performance. This can be a real trap.

Let us give you an example. A common mistake business owners make – still! – is to do their banking manually. A common method is to allow customers to pay by cash or cheque, and then drive to the bank two or three times a week, stand in the queue, fill out the deposit slip and hand over the cheques.

That's why direct debit was created! Using direct debit, or Paypal, or some other form of electronic payment, means you need merely to 'log on' to your internet banking site to confirm if customers have paid. Indeed, modern accounting software can basically do that for you, too.

Paying by direct debit is usually easier for customers too – they too can just log on to their banking site and, with a few clicks, no postage and no trip to the post office, pay their bills and create their own record of payment. That is why the Reserve Bank has just announced that paying electronically has become much more popular than using cash.

The point is that physically going to the bank does not change the quality of your money management process: the money still ends up in the same bank account.

Spending time doing anything that does not improve quality is a waste of time. If you run your own business, time is your scarcest resource. You need to manage it accordingly. So, measure your business effort by how much you get done, not by how long your spent doing it. That is the best way to make your business fly.

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.

Contact Details

Address	Suite 1, Lvl 1, 22-28 Edgeworth David Ave Hornsby NSW 2077
Phone	02 9476 6700
Website	www.edgeworthpartners.com.au
Email	partner@edgeworthpartners.com.au

Licencing Details

Peter Dugan is an authorised representative (380321) of Avana.

Avana

AFSL 516325 | ABN 67 631 329 078 | Level 1, Suite 8, 51-55 City Road, Southbank, VIC 3006