Your Wealth Bulletin

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Hi,

Welcome to the July issue of Your Wealth bulletin.

"We could all use a little coaching. When you're playing the game, it's hard to think of everything." (Jim Rohn)

Property outlook

Where to next for investment property?

A combination of record low interest rates, tight rental markets and generous grants to first home buyers continues to buffer residential property from the falls experienced in many developed economies.

CBA's Commsec Research report on 30th June pointed to the increase demand for housing due to the fastest population growth in 40 years, improved affordability and weak returns on other asset classes. Over the last 6 months, 87,000 homes have been bought by first home buyers.

You may recall a couple of years ago a University research paper that i commented upon. It examined the variety of factors that influence prices of residential real estate. They found the dominant factor to be interest rates. Obviously, the super low interest rate environment we are in is greatly assisting to bolster housing market prices.

This same article also highlights their research that property price movements take time. It can be a period of 12 months after interest rates fall before house prices trend upwards. If you would like a free copy of this Research paper, just email me david@reedfinancial.com.auand I will email it to you.

On the 10th June, Commsec Research had this to say about the prospects of residential real estate:

"Investors should think long and hard about property investments. Rents are rising at double-digit rates, construction is not yet keeping pace with population (although latest signs are encouraging), interest rates are low and home prices are rising."

Bullish sentiments indeed.

However, there are two key points that are short term risks for this asset class:

- Higher unemployment
- Existing high unaffordability base

Unemployment is an area that receives constant publicity. The figures have been trending upwards with a recent seasonally adjusted 5.8% in June (ABS).

While these figures are comparatively low to other Western countries, any future sharp increase would likely result in a faltering in housing prices. Low interest rates or not, it's extremely difficult to afford a home loan if you don't have a job and house prices are obviously impacted by how many have constant employment.

The aspect that does not receive as much publicity is the high unaffordability levels. While the general softening of median house prices has assisted, Australian capital cities remain some of the most unaffordable in the world.

The International Housing Survey for 2009 that was recently released has Sydney as the 5th most unaffordable and Melbourne as the 12th. The Sunshine Coast is the most unaffordable while the Gold Coast is 3rd.

The benchmarks for the study is that anything over 5.1 times the suburb's median annual income as a median house price is severely unaffordable.

Sydney has a multiple of 8.3 median salary for it's median home price. The Sunshine Coast is a world record 9.6. Melbourne is 7.1 which is above both New York (7.0) and London (6.9) to give some perspective to these numbers. We'll endeavour to examine this research more in a future issue.

In summary, there are fundamental factors developing

so as to boost the fortunes of residential property. However unemployment is a short term risk that may dampen any sharp surge. The already high salary multiples required to buy a property should also be considered if examining certain locations.

Property and Share Market Similarities?

Value versus Growth Locale Properties

By now, most readers and clients will be aware for our preference towards an academic investment philosophy for equity markets.

In brief, historical evidence has shown that Value Companies have outperformed Growth Companies over the long term. While this is historical (and not a prediction of future movements), it has been a significant market anomaly for a long period of time.

Value Companies are technically referred to as having a High Book Value to Market Price. In layman's terms, it's saying that the market price is lower than the potential future earnings of the business.

Growth Company traits are generally based around a prediction of being the 'next big thing'. Think along the lines of Bio-tech, Internet companies and you're on the right track.

The historical markets have shown that generally investors overprice Growth Companies and in the long term, Value Companies have collectively outperformed by reasonable margin. This could be attributable to the expectations being higher (and thus priced in) to Growth companies.

So for some time, I have been researching this philosophy and it's potential applications in other markets, in particular real estate.

Unfortunately, it would appear that it's an area without significant research by the academic world. From my correspondence, it would seem that reliable data and mixed use of value methodologies has made it nigh on impossible.

Nevertheless, Shares and Properties are assets that are traded on markets every day. They have inherent values and prices that are judged by market

participants every day.

The opportunity to expand the Value versus Growth methodology from businesses to real estate assets may have some elements worth considering.

Which brought me to a very interesting research paper written by respected real estate analyst, Terry Ryder. Terry publishes researches on a website called www.hotspotting.com.au and regularly appears on Channel 7.

His recent 'Iconomics' article examined many myths of property investing such as capital growth being better near the CBD.

Ryder researched the past 10 years data to highlight that these myths were not exhibited in actual returns. He highlights the example of an investor achieving a far better return in Branxton (Hunter Valley) than the Gold Coast. He refers to these areas as 'hill-change' and many were shown to outperform 'seachange' locations.

The regional areas were then compared to inner city locations. Again, it was shown that a number of regional areas outperformed considerably the inner CBD locations.

All in all, some very thought provoking research.

It goes against the grain of the typical publicity for real estate investing and what we are generally led to believe. The research also contains elements of the Value versus Growth principles that are academically proven in equity markets. Hopefully we can see more of this type of factual research in the future.

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