NEWSLETTER

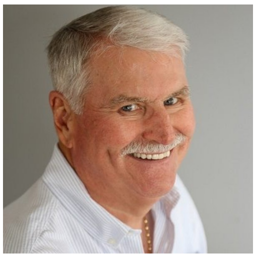
February 2023

ABL FINANCIAL ADVICE

Introduction

Happy New Year! In this month's newsletter, we look at whether there is a discernible January Effect in share markets (like there is for personal fitness and other things we promise to change!) We also examine how residential property prices fared over 2022 and think a little about inflation and interest rates. Enjoy!

Read on to find out more.



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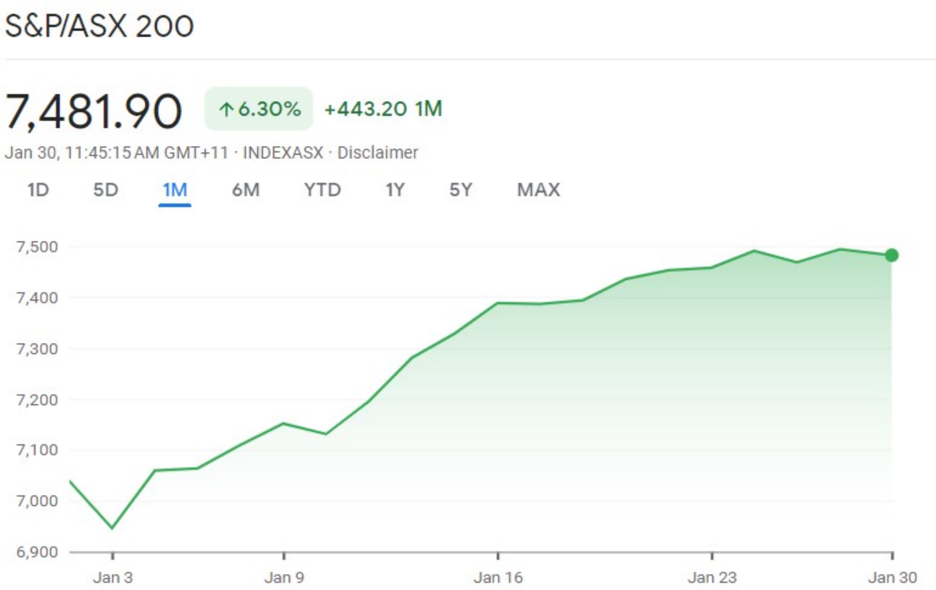
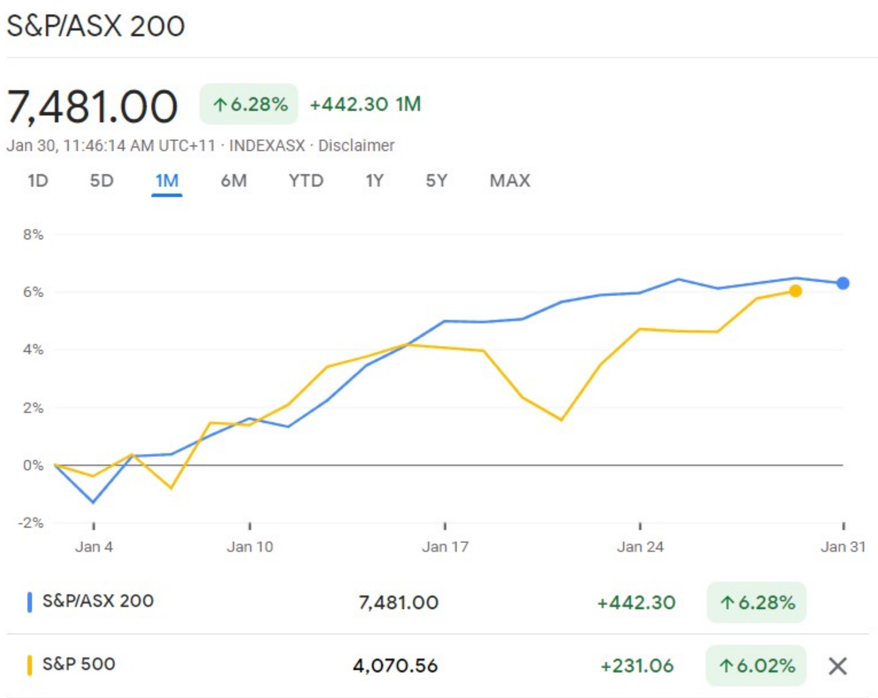
The Share Market

Can optimism fuel the share market? In 1942, US Investment banker Sydney Wachtel coined the term 'the January Effect' for a phenomenon he thought he was observing in US markets. Wachtel's idea was that markets tend to rise more in January than in any other month. He was talking about the US, but as we have discussed many times, the Australian market often moves in quite close 'synch' to the US market.

The January effect comes to mind again this year when we look at the performance of the Australian share market, as measured by the ASX 200, so far this year. Here is how the monthly performance was tracking by lunchtime on Monday the 30th, when we wrote this article (thanks to Google and the ASX):



As the graph shows, the market is up a whopping 6.30% already this year. What's more, once again, the Australian market is moving in quite close correlation to the US market:

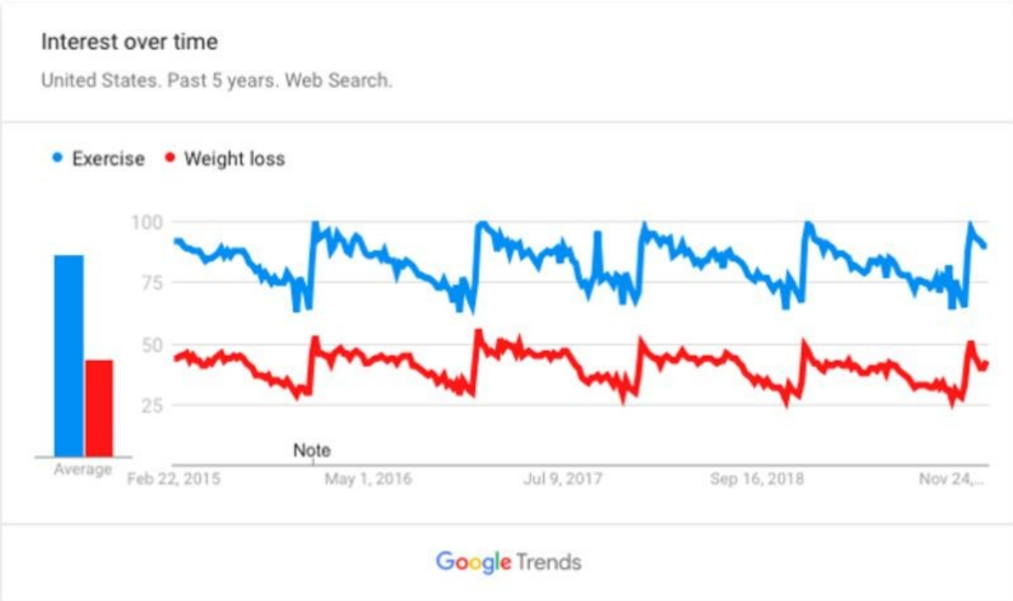


So, what drives the supposed January Effect? Most of the analysts who investigate these things are based in the US. In that market, there are a number of theories as to why markets might rise disproportionately in January.

One is that December might be a month in which there is more selling than usual, which is then followed by a month of increased buying in January. The idea here is that people are looking to 'tidy up' their portfolios to optimise their tax situation. In the US, the end of the tax year for investors is December 31 (of course, here in Australia it is June 30). Investors sell their losses to balance any capital gains they have made, which is not a very good reason to sell.

Another is that annual bonuses are paid to US workers in January, for the year just ended. This money, being 'bonus' income, often finds its way into the share market as recipients prefer to invest it rather than spend it.

A third theory is simply that people feel more optimistic in January. This then combines with New Year's resolutions to 'do better' with their money management in the year ahead. There is some really fun research into a potential January effect for things other than investing that would support this. For example, here is an image of monthly Google searches for exercise and weight loss that we found in Bloomberg:



The graphic is quite startling! Searches have an annual peak every January, and then decline pretty regularly over the remainder of the year. By December, we have all decided not to bother with fitness or weight loss until the festive season is over!

Whether the January effect on the share market is real or not, a 6% increase in a single month is a great way for existing investors to commence the year. Stay tuned to see whether the optimism of January is still there in a month's time - or whether people have canned their diet and are back on the couch eating ice cream.

The Residential Property Market

While January is historically a slow month for property sales, Australian markets have clearly continued their inflation and interest rate-fuelled falls since we last wrote about them at the start of December. According to well-regarded market researcher Corelogic, the five major capital cities declined by an average 3.3% over the three months to January 30, and 8.8% for the 12 months period to the same date. Here is the situation for each of the cities separately and in summary:

CoreLogic daily home value index

30 January 2023

CITY - ALL DWELLINGS	CHANGE DAY ON DAY	TODAY'S VALUE	% CHANGE QTR ON QTR	% CHANGE YR ON YR
Sydney	-0.04	186.2	-4%	-13.7%
Melbourne	-0.06	158.6	-3.1%	-9.2%
Brisbane*	-0.08	143.7	-4.4%	-4%
Adelaide	-0.07	166.6	-1.4%	7.1%
Perth	-0.03	109.4	-0.2%	2.6%
5 capital city aggregate	-0.05	159.3	-3.3%	-8.8%

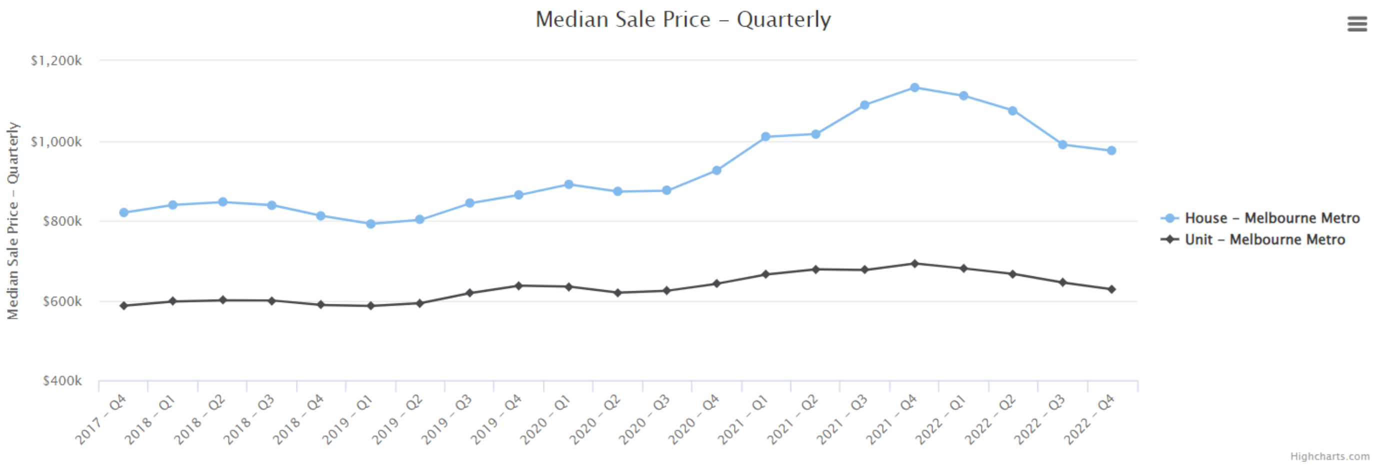
*incl Gold Coast

(While it is very difficult to measure home values on a *daily* basis, as the above graphic shows, over time trends become clearer. This is why the key figures in this graphic are the quarterly and annual change figures).

As you can see, for the 12 month period, Sydney and Melbourne have had the largest declines. As the size of their markets is greater than the other cities, the performance in these two markets – and especially Sydney – have the largest influence on the national average.

We can also see that Brisbane, Adelaide and Perth are ‘catching up’ (should that be ‘catching down’) in terms of their markets starting also to decline. The declines in price commenced later in these markets, which is why the longer-term 12 month changes for Adelaide and Perth remain positive.

The current falls are starting to erode some of the price inflation that occurred pretty much in parallel with the pandemic, as the RBA’s decision to cut interest rates to almost zero (and announce that they would likely remain low until 2024 – which is another story altogether) caused prices to soar. Each market is different, but here is the five year pattern of changes to median house and unit prices in Melbourne, thanks to the Real Estate Institute of Victoria:



This graphic tells the tale of two markets. Houses and units have performed differently, due mainly to the extent to which house prices soared over 2020 and 2021. During this period, the median house price rose from $864,000 to $1,133,000 – a rise of 31% in just 24 months. Since then, over the course of 2022, the median price fell to $975,000, a fall of 14% from the previous peak. Over the three years, then, house prices rose from $864,000 at the end of 2019 to $975,000 at the end of 2022. This equates to 12.8%.

Over the same period, unit prices are barely changed – and what change we have seen has been negative. At the end of 2019, the median unit price was $637,000. By the end of 2022, it had fallen to $628,000. This is a *fall* of 1.4%. Units are now cheaper in Melbourne than they were three years ago.

Once again, please remember that these results are for one city-wide residential market. Variation occurs, both within a city (in this case Melbourne) and between cities. But the general point is well made: median prices are declining for residential property across the country, and the declines are larger for houses than units, reflecting that the gains in house prices were greater than those for units during the low-interest rate years of 2021 and 2022.

On one level, this means that housing is becoming more affordable. The usual way of measuring housing affordability is simply to compare sale prices with changes to wages and salaries. If residential property prices fall and wages/salaries rise, then housing is more affordable. Basically, it take less time for a person to earn enough money to buy a house.

The raw figures bear this out. Between the end of 2017 and the September quarter of 2022, according to the ABS, the wage price index rose by 11.2%. If we restrict the period to between the end of 2021 and now (the period when house and unit prices have fallen), the wage-price index has risen 2.6%. So, wages/salaries rose and property prices fell in 2022. This might mean that property was more affordable at the end of 2022 than it had been at the beginning of that year.

Except…

Interest rates! Most people who buy residential property borrow money to do so. According to the ABS, in November 2022 the average loan size for an owner-occupier across the country was a tick over $600,000. (Again, there was wide disparity. The average in NSW was $752,000, while in Tassie it was $459,000). According to www.finder.com.au, the average home loan rate is currently 5.6%, meaning that the average loan of $602,000 is generating an interest expense for the borrower of $33,700 per year.

Interest rates rose on average 3 percentage points over 2022. So, the interest expense on the average loan of $602,000 rose by $18,000 during that year. Remember, for owner-occupying borrowers, this expense is after-tax. Someone paying tax at a marginal rate of 32% needs to earn $26,667 before tax in order to meet this interest expense.

As a result, it is very hard to conclude that housing is now more affordable than it was a year ago, just because prices have fallen and wages have risen. Anyone borrowing to pay even those lower prices is forking out a lot more in interest payments than they would have needed to twelve months ago.

This is another reason why most market analysts think that property prices will continue to fall, at least until the cycle of interest rate rises ends. Most agree that housing affordability was a little bit out of control by the end of 2021. It might require larger falls to bring the market back to a more realistic level.

Inflation and Interest Rates

You may have seen some headlines recently discussing Australia's current inflation rate. We urge some caution when looking at inflation, as the way it is calculated and reported can be quite confusing.

Australia's main measure of inflation is the Consumer Price Index (CPI). As the name suggests, this index measures changes in typical consumer purchases. It is calculated by the ABS, who traditionally report their findings just after the end each quarter. The December quarter figure was reported last week.

The ABS provide two figures when they release their findings. The first is the quarterly change in prices. The second is the annual change. As at December 31, the quarterly change was 1.9% and the annual change was 7.8%.

The annual figure needs to be thought about carefully. This is because it can be tempting to see the annual figure and compare it to the most recently-released annual figure – which was only three months ago. Up to the end of September, the annual change was 7.3%. Unless you are careful, you could look at the recent figure of 7.8% and think it represents another 7.8%. In reality, much of the recent 7.8% was already accounted for in the previous figure of 7.3%. After all, nine of the twelve months were the same across the two periods.

That might all seem a bit statistical. So, our advice is to look more closely at the quarterly figure, which is the figure that has new information in it. Inflation for the three months to the end of December was 1.9%.

This is higher than most pundits would like.

As a result, there is a very good chance that the RBA will continue its recent moves to increase interest rates when it reconvenes for the year on the first Tuesday in February. As you may recall, rates rose for eight straight months in 2022. The only reason they did not rise in January is that the RBA does not have a meeting in that month. But meetings recommence next week, and the changes in prices recorded in the last part of the year have led most commentators to predict another rise next month.

This can be expected to put further downward pressure on house prices, among other things. Let's see what happens.

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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