Torrens Title

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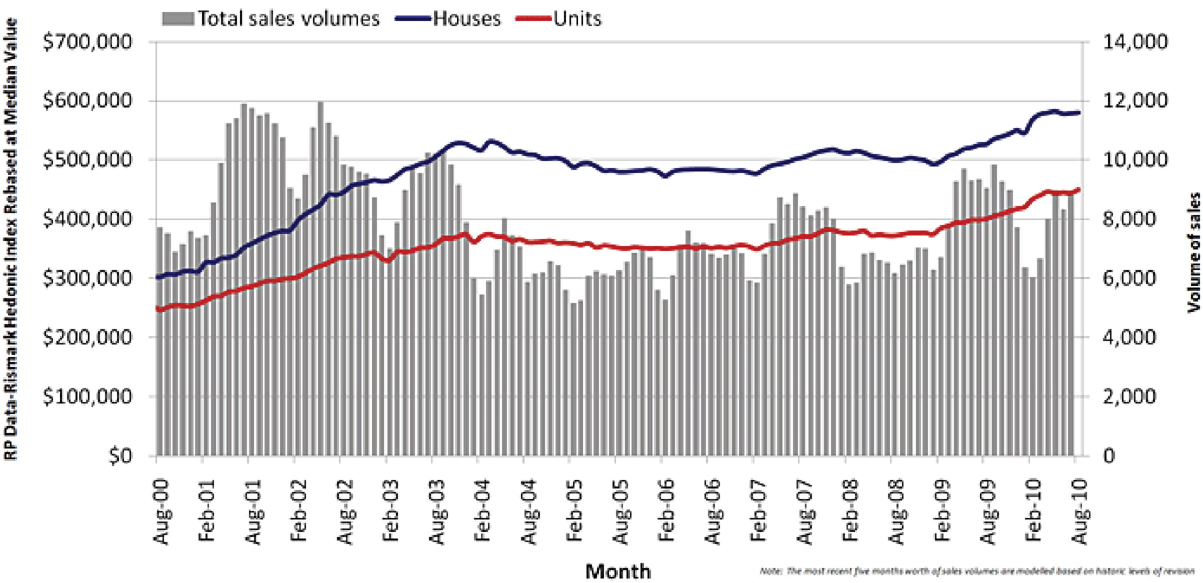
I am always interested in hearing people's differing views on the residential property market. There are a range of reasons why we Australians like to invest in bricks and mortar. I think one of the most notable reasons that retail investors prefer this asset class over others such as shares is that it is tangible. Being able to touch and feel the investment makes it feel real and valuable; much like holding a brick of gold. But as house prices hit record highs there is speculation brewing about whether or not a bubble has formed. The IMF annouced last week that it believes our housing market is mildly over-valued, and the media has since embraced the bubble theory like a long-lost friend.

Given my geographical location, I am most familiar with the Sydney housing market. On the weekend I had a discussion with my brother, Brett Whiteley who happens to be a real estate agent for LJ Hooker. After our discussions, we concluded that in our experience, the Sydney market appears to follow a trend. There is usually a two to three year period of rapid price growth followed by a mild correction (as momentum in rallies often causes assets prices to overshoot) and then five to seven years of flat prices before the cycle starts again. If you look at the chart below, which is the RP Data-Rismark Hedonic Index that measures change in Sydney property prices over the past decade, you will see the cycle in action.



Source – http://www.myrp.com.au/sydney_house_prices.do

Residential property rallies are often triggered by an event that drives demand. While the 1990s were kind to sharemarkets, the turn of the millenium brought a number of events – including the tech wreck, 9-11 and Iraq – which sent investors searching elsewhere for investments that would provide a better reward for the amount of risk they were taking with their hard-earned dollars. The grey vertical bars in the chart show the volume of sales and you can see that there were extremely high sales volumes during that rally at the start of the noughties. As with any asset, property price is determined by the market forces of supply and demand, and demand had never shown more depth. As sharemarkets entered the foothills of the next bull market, property sales volumes fell and prices stagnated until 2007/08 as investors were again lured back to shares; well, until the GFC hit that is, and then…BAM! Volumes are up and prices are again rising.

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It looks to me like we are two years into a residential property rally which I think will come to an end during the next 12 months as global share markets enter their next bull market. We heard this week from Luci Ellis of the Reserve Bank that house prices are easing. I would say it is too early to call the end of the property rally as it still has some steam left in it yet. And let's face it, there are some supply-side constraints.

This takes me to my next point. Shares are looking very attractive right now; well, probably a little less than they did before September added 10% gains to sharemarkets. But there is certainly a lot more upside over the next three to four years in which we might even be lucky enough to see sharemarkets double. No that was not a typo. We are coming from a very low base! I am quite confident regarding this theory for the following reasons:

Firstly, history shows us that sharemarket recoveries in low inflation environments have produced (on average) returns of around 160% (see my July article 'It's a Long Way to the Top' for more on this).

Secondly, the alternative investment classes are losing their lustre. I have covered Sydney residential property above. In other parts of Australia the picture varies. With global interest rates as low as zero in some countries and close to zero in a lot of others, government bonds are not looking particularly attractive. This is because there is an inverse relationship between interest rates and the price of bonds. This means that when interest rates rise, bonds will suffer a fall in capital value. Global fund manager, GMO recently published their seven-year forecast for International Sovereign (Government) Bonds as being -1.3% and US Sovereign Bonds at -0.3%, both with a variance of +4.0%.

Lastly, we are currently seeing positive global growth. Sure there are words like anaemic being used to describe it, but it is growth all the same. It is normal for recoveries to progress in stages or cycles. Be patient, structure your portfolio with adequate diversification to help manage your portfolio risk and the rewards will come.

It's worth keeping an eye on the US corporate reporting season which starts this week. If corporate earnings in the US report strong results over the next couple of weeks we should expect September's rally to continue; otherwise, there will likely be a retreat to some degree. A good gauge of the direction of the US economy is very diversified companies such as General Electric.

Financial advice

For any further information or to discuss your financial situation, please don't hesitate to contact me on **0413 244 733** or email **simon.whiteley@eqtsuper.com**. I look forward to hearing from you.