NEWSLETTER

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FINANCIAL SERVICES

Introduction

Interest rates rose again, and both the share and the property markets fell during February. What might March have in store? Read on to hear our take.

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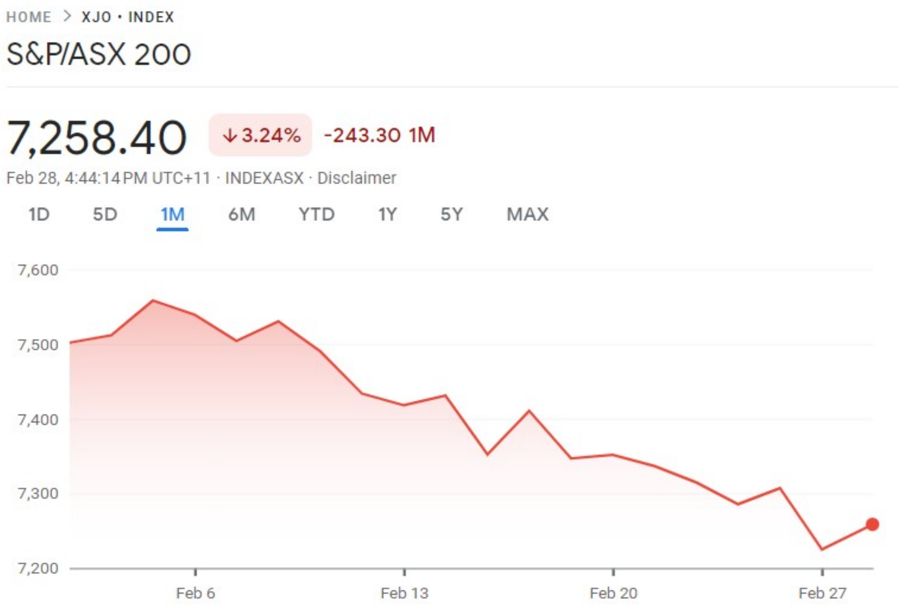
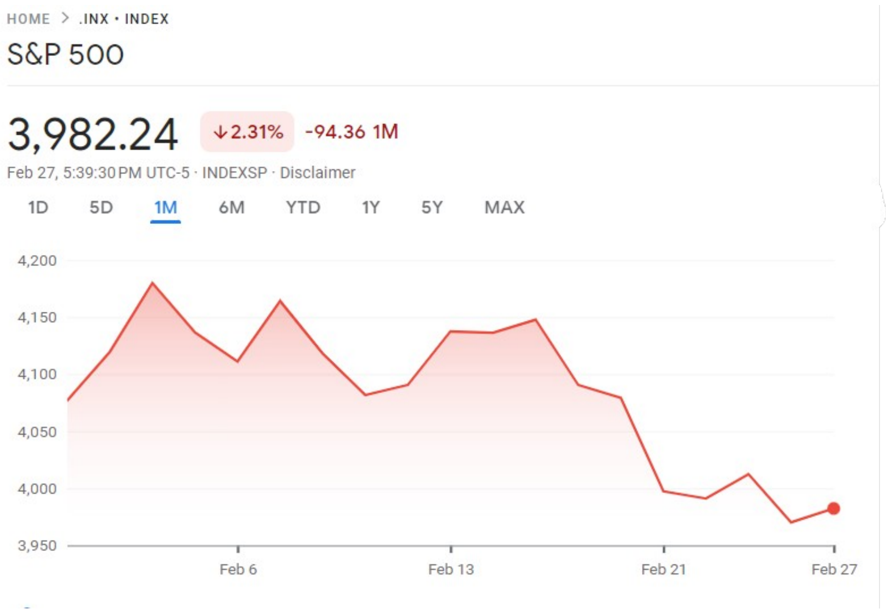
The Share Market

The Australian share market 'gave back' some of January's gains during February. As measured by the ASX 200, the market finished the month down 3.24%. Here is how it looked, thanks to Google and the ASX:



The month's movement was broadly in line with what happened in the US market, represented here by the S&P 500 index:



Nothing particularly calamitous happened during January. As the graph for the Australian market shows, the month was one of mostly small daily falls, with a few upticks, that accumulated into the monthly performance.

If anything, the February performance was probably an adjustment to the very strong performance in January. That strong performance reflected very good results from Australian companies in general towards the end of 2022.

The RBA reported this week that average company profits rose 10.6% for the December quarter 2022. This led to a 16% increase in average profits for the 2022 year. Results like this were presumably reflected in the rises in share prices that we saw in January. As markets usually do, the prices moved a little too far and corrected in February.

Suffice to say that the current higher-inflation environment is not troubling investors. 2023 is unfolding as pretty much a 'business-as-usual' sort of year.

So, what sort of investing strategy suits a year like this? In our mind, a 'business-as-usual' investment strategy is also the way to go. Usually, this means making regular investments into a diversified investment. This spreads your risk in two ways.

Firstly, the diversified investment means your money is not concentrated in too few investments. While the long-term average for the Australian share market as a whole is a good one, individual companies come and go. It has long been recognised that a diversified holding allows investors to avoid the risk of losing their entire investment, as the negative impact of a single company performing badly, or even going to the wall, is reduced by the fact that no one holding represents too much of the investment.

Secondly, regular investments over time are a type of diversification as well. As the last few months have shown, share markets can rise and fall quite substantially in the short term. As a result, there is always a risk that a single investment will be made while the market is unusually high. In recent months, that would be the end of January, as the market on average rose by more than 6% during that month. As we show above, the market then fell on average by 3% during February. So, an investor who invested all of their money at the end of January would have seen an immediate fall in value. But an investor who made one investment at the end of January and then another investment at the end of February would have enjoyed buying some of their investment at the lower price that prevailed at the end of February.

When you are a buyer, lower prices are good news.

Regular investing over time allows investors to reduce the negative impact of buying when the market is high, and to embrace the positive impact of buying more when the market is low.

In a market like the share market, the preferred holding time is a long one. Shares bought in early 2023 might be held until 2033 or beyond. When you are holding for this period of time, it does not really matter whether you bought in January or February of 2023. The key is to buy in such a way that you manage as much risk as possible. And buying smaller amounts at regular intervals is a great way to do this.

The Residential Property Market

February was another month with reduced residential property prices. The falls were smaller than they have been recently, but this time the median price fell in every capital city market other than Sydney, as well as in the regions. The largest fall was in Hobart, where prices came off 1.4%.

Sydney bucked the recent trend and actually recorded a slight uptick of 0.3%. Some commentators are citing this as evidence that the market might be nearing the low point of its cycle. We are not property experts, but we think it might be worth waiting until further in the year to call the market bottom.

It is also worth noting that January saw the introduction of changes to stamp duty arrangements in NSW, which might also have left buyers feeling they could pay more for the initial purchase of their property. This may well have given prices a temporary 'bump.'

Here is how the national markets performed, according to Corelogic:

Index results as at 28 February, 2023	Change in dwelling values				
	Month	Quarter	Annual	Total return	Median value
Sydney	0.3%	-2.4%	-13.4%	-11.2%	$1,006,923
Melbourne	-0.4%	-2.7%	-9.6%	-6.6%	$743,554
Brisbane	-0.4%	-3.2%	-6.8%	-2.8%	$694,495
Adelaide	-0.2%	-1.4%	5.1%	8.6%	$645,812
Perth	-0.1%	-0.2%	2.4%	7.0%	$561,740
Hobart	-1.4%	-4.9%	-11.8%	-8.4%	$658,470
Darwin	-0.3%	-1.0%	2.9%	9.1%	$495,712
Canberra	-0.5%	-2.7%	-6.7%	-3.2%	$833,155
Combined capitals	**-0.1%**	**-2.3%**	**-9.1%**	**-6.0%**	**$761,674**
Combined regional	**-0.3%**	**-2.1%**	**-4.2%**	**-0.3%**	**$575,916**
National	**-0.1%**	**-2.3%**	**-7.9%**	**-4.8%**	**$702,136**

One of the reasons to hold off 'calling' the bottom of the market is that approximately 800,000 home loans around the country will end their fixed rate period during 2023. These loans were set in place when interest rates were much lower, meaning that people with those loans have not been paying as much in interest as people with variable loans or who set their fixed rate loans after interest rates started to rise. As the borrowers' fixed rate period ends, they will find themselves facing higher interest payments, and it is not yet clear what impact that will have on the market. Some difficulty in making repayments should probably be expected.

Interestingly, Corelogic also report a much lower listing rate. This means that there are fewer properties being offered for sale. This reduces supply, which is potentially going some way to stop prices from falling further. Corelogic estimate that listings are down more than 11% from the same time last year, which is of course just before the RBA reversed it's position and started raising interest rates. Once again, whether the end of low interest fixed rate periods leads to increased listings remains to be seen.

All this suggests that property prices will likely fall further in 2023. Time will tell.

Inflation and Interest Rates

Well, they did it again. The RBA raised the target cash rate by 0.25% in February. And all the signs are that they will raise them again in March. (We will find out next Tuesday).

That said, we are noticing a number of good judges starting to question whether raising interest rates is the best response to this particular dose of inflation. They are saying this because of evidence that is coming out about what is causing this inflation – or, more accurately, what is not causing it.

In each of their recent announcements about interest rates, the RBA has expressed concern about what is known as a 'wage-price spiral.' This where higher prices cause workers to ask for higher wages to compensate them for the fact that things now cost more to buy. Workers' wages and salaries are a cost to business, and businesses facing higher costs might then be forced to increase the prices of their goods and services to recover the increased expense. This in turn means workers need a further pay rise to restore their purchasing power, which causes more costs to business, and so on. This is why the concept of a spiral is used.

However, during February the RBA announced that average wages, as measured by the wage price index, had only risen by 3.3% over the 2022 calendar year. This is well below the CPI inflation figure for the same period of 7.8% - in fact, it is less than half. This makes it reasonably clear that we are not currently in a wage-price spiral. Wages are lagging well behind general price rises and are quite clearly not driving price rises.

So, if the cost of labour is not pushing up prices, what is? Well, the left-leaning thinktank The Australia Institute have completed a macroanalysis and concluded that much of the current 'excess inflation' is being driven by companies putting their prices up by more than their costs have risen.

Some people call this price gouging, but there is nothing inherently wrong or shocking about this. Market economics requires that sellers in a market should always try to maximise their prices, and if shocks to prices caused by things like oil shortages give them the opportunity to increase their prices without people realising, then that is how markets usually work.

But for this to be able to happen, the companies need to have what is known as 'pricing power.' Pricing power for businesses comes about when they (i) have no or few competitors; and/or (ii) people need to buy their services anyway. That is why doctors and lawyers get paid so much: people need their services and supply is restricted so that there is not enough competition to encourage prices downwards.

It will be very interesting next month to see if, firstly, the RBA raises interest rates again and, if it does, whether it again cites wage costs as a reason for doing so.

The Legal Stuff

General Advice Warning

The above information is general in nature and does not take into account your personal situation. You should consider whether the information is appropriate to your needs, and where necessary, seek professional advice from a financial adviser.

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