Financial Focus

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Welcome to Financial Focus.

Is it better to invest in property or shares? What is an investment property? Should you save or invest your money? If you're an investor, a saver or thinking about finding ways to capitalise on these changing times, then it's a good idea to do your research first.

Successful investing, whether in shares or property, can be difficult in times like the present with immense uncertainty around the impact of coronavirus on the outlook. This makes it more important to stay focussed on the basic principles of successful investing, attitudes to things like risk, debt and involvements with your investment.

When it comes to your money, learning how conservative or how willing you are to take risks could reveal the limitations and advantages of your investing style. Understanding the type of investing you're comfortable with and your investment objectives could guide you to the right investments for you.

Things are changing all the time, so in this edition of Financial Focus we've pulled together information to help you understand certain investment types and get a better understanding of investment options and how to manage risk.

It's important that you always align your investment options to your financial goals. Before deciding what type of investment you would like to go for, we recommend you speak with your financial adviser.

Share in the excitement or bank on the house?

There are some great debates in Australian society that seem to never end. Aussies Rules vs Rugby League. The eternal Sydney vs Melbourne stoush. And of course the age-old conundrum of whether to invest in shares or property.

Key points

- Broadly speaking, returns on shares and property are in the range of 7-8.5%.[1] That's significantly better than the returns from cash in the bank and that's after inflation.
- Many people invest in property because it's perceived to be less risky than shares. However, investors should remember that all assets have risks. During the GFC, for example, sophisticated economies like the US, the UK, Ireland and Spain all recorded significant residential property losses.
- Whilst residential property in some areas has been negatively impacted by COVID-19, the share market has not been left untouched. High unemployment, low consumer confidence and a low growth economy are hardly the recipe for a booming stock market.
- However, some companies are prospering in the current economic conditions – no matter how uncertain they appear. Tech stocks have generally boomed since COVID-19 began as many investors seem to have taken a view that we've become so used to the conveniences of 'on-demand' life – think of everything from food delivery services to streamed entertainment and Zoom conference calls – that we'll be using these services even more in the years ahead.
- The property vs shares stoush isn't new. Perhaps the decision between property and shares seems to be less about returns and more about attitudes to things like risk, debt, and involvement with your investment.

Historic returns

The obvious place to start is returns. The US National Bureau of Economic Research has published a fascinating paper called The rate of return on everything.[2] According to their long-term figures, the real (after-inflation) return on Australian shares beats residential property by around 1%.[2]

Since 1980, that margin has increased to 1.5% but, broadly speaking, returns on shares and property are in the range of 7-8.5%.[2] That's significantly better than the returns from cash and that's after inflation. So, there's no need to die in a ditch over which side is best when looking at past returns.

Future returns

Long-term returns are valuable data, but you're not investing in the past. Let's think about the likely returns from these two major asset classes into the future.

Property – where have all the people gone?

There are two big forces affecting property for the foreseeable future, due to the current impacts of COVID-19 on Australia and the rest of the world.

- Unemployment has gone up, which means fewer new buyers pushing up prices and more people selling under mortgage pressure – thus pushing prices down.
- Immigration has crashed. In June, the Government suggested immigration could fall by 85% this financial year. That's over 200,000[3] fewer people looking for a home.

Shares – you win some, you lose some

Whilst residential property in some areas has been negatively impacted by COVID-19, the share market has not been left untouched. High unemployment, low consumer confidence and a low growth economy are hardly the recipe for a booming stock market. There are whole sectors of the market likely to be in the doldrums for months, maybe years. The prospects for tourism, travel, entertainment and international education appear downbeat.

However, there are companies who are prospering in the current economic conditions – no matter how uncertain they appear. Tech stocks have generally been strong since COVID-19. For instance, between 1 February 2020 and 28 September 2020, Amazon's share price was up around 78.9%.[4]

Amazon isn't an outlier.

The share prices of a number of other tech stocks including Google, Facebook, Microsoft and Netflix have also boomed since COVID-19 began as many investors seem to have taken a view that we've become so used to the conveniences of 'on-demand' life that we'll be using these companies' services even more in the years ahead.

Still, there's no clear winner on historical returns from property vs shares and it's equally hard to predict which of the two major growth asset classes will outperform in a COVID-19 world. Again, the point to stress is that both are likely to do better than cash (interest rates are low – and staying low in Australia, judging by Reserve Bank of Australia comments).[5]

We should not forget that COVID-19 is unlikely to be with us forever. A successful vaccine or more effective treatment should enable societies and economies to gradually return to normal life, and that ought to translate to better outlooks for businesses, including those listed on stock markets.

Volatility

Many people invest in property because it's perceived to be less risky. The key word here is "perceived." Unlike shares, which are priced second-by-second on stock exchanges, residential property generally only gets priced in two ways.

Firstly, by a valuer, including a bank when you apply for a mortgage. Secondly, when a property goes on the market for sale. The absence of constant pricing creates the impression of less risk compared to shares.

However, investors should remember that all assets have risks. During the GFC, for example, sophisticated economies like the US, the UK, Ireland and Spain all recorded significant residential property losses.

Debt – a borrower be

One of the keys to success in the Australian property markets is debt. Indeed, some commentators believe the reason many Australians profit from the sale of their property is due to purchasing the property with a large amount of debt, the investment discipline of paying a regular mortgage and a growing population, meaning, there has been increasing demand.

Many share investors use debt too – often via margin lending. But banks will typically underwrite a much larger percentage of your investment when you're buying property rather than shares. That's great from a return point of view – but it is an added risk.

Housework

One other difference between shares and property investing is the amount of effort involved. By choosing to invest in managed funds, you can invest in shares using a very hands-off approach.

To successfully invest in residential property, you must manage:

- tenants
- maintenance and renovations
- mortgages, leases, buying and selling.

All this work requires skills not all investors have (or creates costs if outsourced to property managers or real estate agents). In short – unless you're a trader, as opposed to a buy-and-hold investor – property investing requires more work than long-term equity-investing.

Conclusion

The historical returns on shares and residential property are both attractive and broadly similar so returns are probably not the deciding factor. While property has more risk than many believe, shares are more volatile. Property investment typically requires more debt than equity investing and is more admin heavy. This needs to be considered when calculating the real cost of the investment and when seeking to maximise returns.

The decision to buy property or shares seems to be less about returns and more about individual attitudes to things like risk, debt and involvement with your investment. Those are very personal decisions and a chat to a financial adviser about your lifestyle goals will probably improve your decision-making when it comes to shares vs property.

[1] www.nber.org/papers/w24112.pdf
[2] Ibid
[3] www.afr.com/policy/economy/later-migration-plunge-to-hurt-economy-and-housing-20200501-p54p2g
[4] www.barchart.com/stocks/quotes/AMZN/performance
[5] www.abc.net.au/news/2019-11-26/interest-rates-to-stay-low-but-unlikely-to-go-negative-says-rba/11739728

Which are you – a saver or investor? Or both?

Whether you are a saver or investor is an interesting and important question because in the long run it could make a major difference to your lifestyle. To determine if you are a saver or investor let's look at the characteristics of the two categories.

Key points

- Saving is usually associated with money you have in the bank. Savings also tend to be accessible – you can get your money out pretty much immediately
- Returns from savings tend to be low, especially in the current low interest rate environment where interest payable on bank and Fixed Term deposits are less than 2%.
- Investing is more typically a long-term pursuit. It can last for decades – think superannuation (super) or investing in shares or residential property.
- Invested money is less accessible. Lots of investment choices either lock your money away for the long term (such as super) or take months or even years to turn into a profit (such as a house).
- Historically, returns from investments have been higher. In general terms, longer-term investments like shares and property generate better returns than cash savings.

What does a saver look like?

- Almost by definition the money you put in bank accounts, Cash Management Trusts or Term Deposits are short-term savings. You may use these to save for a short-term goal like a holiday or home deposit. It's not targeted at a long-term goal, like using superannuation to save for your retirement, for instance.
- Your savings are accessible. You can go to the bank (or your laptop) and get your money back pretty much immediately.
- The returns are low. Back in the day (well actually, a long way back in the day), you could get nice returns on your cash. But low interest rates and low deposit rates have become the order of the day, and it doesn't seem as though things are going to change any time soon.
  In fact, the Reserve Bank of Australia Governor Philip Lowe has said that interest rates are likely to stay low for an extended period.[1]

A quick search of the latest 12-month Fixed Term deposits shows you'll struggle to get more than 1% on your money.[2]

Outside of special short-term offers, your average savings account return would be even lower, especially after you take inflation into account.

Why be a saver?

As you can see from the above, there are a range of reasons we save. Sometimes it's to accumulate cash towards a bigger purchase (like a holiday). That's often a sensible alternative to credit card borrowing.

Sometimes it's for security. Financial experts suggest having a rainy-day fund equivalent to around six months of your salary.[3] Coincidentally, that's the time it can take to find a new job. Given the current unemployment rate, there's a lot of smart savers who'll be glad they put money away for the day when the Covid-19 virus rained down on our heads.

So, what does an investor look like?

- Investing is more typically a long-term pursuit. It can last for decades – think superannuation or investing in shares or residential property. Most financial planners wouldn't recommend the average investor buy shares or managed funds if their timeframe was less than five years.[4]
- Invested money is less accessible. Lots of investment choices either lock your money away (such as super) or take months or even years to turn into a profit (such as a house). While you can almost always sell shares and managed funds instantly, the volatility of the stock market means 'parking' cash in shares is usually a bad idea.

  If you're looking for your share investments to pay for a large, unexpected bill, you could find you have less to take out than you thought. A good rule of thumb with shares is: don't rely on them for short-term cash, they're for long-term growth.
- Historically, returns have been higher. In general terms, longer-term investments like shares and property generate better returns than cash savings. As MLC's Financial Year Summary highlights, local and international shares outperformed cash by over 5% a year over the past ten years.
- Sometimes but not always, investment assets can be more tax effective, depending on your tax circumstances. Based on your tax circumstances as well as how your investments may be structured, your investment property can offer tax deductions and depreciation allowances. Many companies listed on the Australian Stock Exchange offer "franked dividends," which means investors/shareholders receive a tax credit that can be offset against other income. And super has a whole range of tax concessions. But the return on money in your poor old cash account is taxed just like the income you earn from your job.

The good news – you're already an investor

As you can see, saving is important for security and to start you towards being an investor.

Investing – putting money into potentially higher-returning, long-term investment products – is what could eventually enable you to replace your work income with investment income.

The good news is you're already doing it. Almost all working Australians are investors thanks to compulsory super. A recent paper from the Association of Superannuation Funds of Australia (ASFA) points out that as a country we invest over $70 billion dollars in super each year,[5] and that with balances at around $200,000 per family,[6] superannuation is easily the average family's second biggest financial asset (after the home).[7]

So, you're already an investor. That's good news and a great start. But remember that our retirement system is made up of three components – super, investments outside super, and the means tested age pension for those who don't have enough in super and outside super.

If you'd like to explore the investment options within your super, or explore other options, like shares and managed funds outside super, please feel free to contact me.

[1] www.abc.net.au/news/2019-11-26/interest-rates-to-stay-low-but-unlikely-to-go-negative-says-rba/11739728
[2] www.finder.com.au/term-deposits/12-months#start_comparing
[3] www.finder.com.au/how-to-protect-your-rainy-day-fund-when-it-rains-a-lot
[4] https://moneysmart.gov.au/how-to-invest/choose-your-investments
[5] www.superannuation.asn.au/ArticleDocuments/359/2006-The-benefits-of-Australias-compulsory-superannuation-system.pdf.aspx?Embed=Y
[6] www.abs.gov.au/statistics/economy/finance/household-income-and-wealth-australia/latest-release
[7] www.superannuation.asn.au/ArticleDocuments/359/2006-The-benefits-of-Australias-compulsory-superannuation-system.pdf.aspx?Embed=Y

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