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MARKET	1.72	SUN	+1.70%	14.35	FMG	+1.84%	2.21	BHP	+1.77%	29.36	STO	+5.53%
S&P/ASX 200	AUD/USD		TOP GAINER LNG		TOP LOSER ARI							
+1.30%	+0.16%		+8.68%		-4.55%							
5490.2000	\$0.80		\$2.63		\$0.21							

Coca-Cola shows bubbles barely matter for seasoned investor

ROGER MONTGOMERY THE AUSTRALIAN NOVEMBER 22, 2014 12:00AM

I'LL wager you never thought Coca-Cola had anything to do with property investing. Well, kick back and read on as I demonstrate how Coke can make you a more sensible property investor.

The story of an owner of Coca-Cola shares at the time of its IPO in 1919 is a useful allegory for thinking about how to invest successfully in any asset class. In 1919 Coca-Cola came to the stockmarket at \$US40 per share. A year later Coca-Cola shares were trading at \$US19.50 — the result of losses stemming from rising sugar prices and a perpetual contract Coca-Cola had with its bottlers to supply syrup for a fixed \$US1 a gallon. The only reason the shares traded at \$US19 was because investors were selling from the fear of losing even more money.

But what would have happened if your grandparents or great-grandparents had bought a single share in Coca-Cola in 1919 at \$US40 and held on through the subsequent decline to \$US19.50 in 1920, then on through the great crash of 1929, the subsequent depression of the 1930s, World War II, a baby boom, dozens of other wars, skirmishes and nuclear missile crises, an oil crisis. Not to mention the Cold War assassinations, the fall of the Berlin Wall, yuppies, innumerable recessions, booms, busts and scandals, as well as a war in Vietnam, two in Iraq and then ... the global financial crisis?

Think of all the newspaper articles advising you about what to do with your shares through all of this! If, however, your relatives had kept that single share in the family, taken the splits and reinvested all their dividends, they would have accumulated 126,321 shares on January 8, 2010, and their investment would have a market value of \$US6,966,603.15.

And in the nearly five years since, there have been another 14 dividends paid and another two-for-one split. As of August 2014, that original \$US40 investment is now worth \$US11.7 million — a compounded return of just over 14 per cent a year.

So how does this relate to property? Well there's a lot of concern about prices being in a bubble just now (which they might be). Low interest rates have propelled demand for investment property loans to 10 per cent higher annual rate in the most recent quarter, suggesting prices could head even higher in the near term.

Eventually there will be a rate rise and this will first hit those crazy people who have borrowed significant amounts of money on “interest only” and with high loan-to-value ratios. These loans could be Australia’s answer to the US subprime loans of the GFC. And how far could prices fall?

It may surprise many that prices for Australian homes have previously fallen 10 per cent or more three times in the past 35 years. Those living in Mosman, on Sydney’s north shore, and other hard-hit suburbs around the nation will know that prices fell a great deal more than that during the GFC.

Rates will eventually rise and if they rise sufficiently, it won’t be necessary for people to lose their jobs for prices to fall. The marginal buyer will simply pull their bid and anyone on the brink may be forced by their bank to exit while keeping their job to pay the bank back.

US Federal Reserve officials are already warning investors and foreign central bankers to brace for market turbulence as the Fed prepares to raise short-term interest rates.

But should you be worried? Perhaps, yes, if you are heavily leveraged. But think about this: In the next 40 years our population will be 20 million greater than it is today. In 2006 there were 2.6 people per household, which means in the next 40 years we might need 7.7 million new homes. Australia is on track to build just 143,800 homes this year. That’s down significantly from 2003, when we built 168,580 homes. Recessions, higher interest rates and a slowing China will produce lumpy new housing volume, while the population steadily rises. Think about the Coca-Cola story and you will have some insights into how and when to buy property.

Roger Montgomery is the founder of Montgomery Asset Management.

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