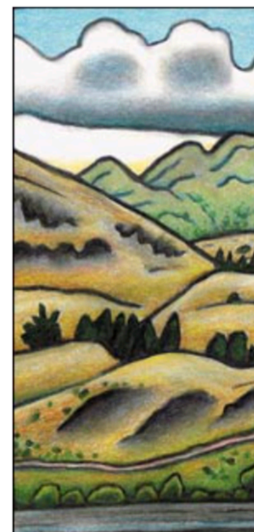
Kids and grandkids hold the key to the best investment

As Charlie Aitken said this week at the Better Manage your Wealth seminar, hosted by Market Matters, the best way to pick the next set of winners is to check out what your children and grandchildren are doing. **Bloomberg**



by **Philip Baker**

While Wall Street powers to fresh record peaks, local investors still seem to be fretting about the Australian economy and the sharemarket, which continues to lag the moves made by the Dow Jones, the S&P 500 and the Nasdaq.

In a surprise reaction to President Donald Trump's move to back out of the Paris climate agreement, global investors weren't really bothered in the end and went on a buying spree that pushed the three key benchmarks to all-time highs on Thursday night.

It comes as some experts like John Higgins from Capital Economics worry that corporate profits in the US are about to be squeezed by higher wages as the unemployment rate falls.

That hasn't been a problem for corporate America for years but as the economy improves and the Federal Reserve hikes rates, it all combines to suggest the rally in

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shares must be coming to an end.

It's a key reason why Higgins has kept his medium-term target for the S&P 500 at 2050, compared to its current level of around 2430.

It's also worth noting that in the US almost 40 per cent of the gains made so far this year can be attributed to just four stocks.

Herd mentality

Granted, they are four of the largest companies — Facebook, Apple, Amazon and Alphabet — but it shows how the herd mentality works when investors opt for passive investing and just buy an index to make their money.

The big just get bigger, but not necessarily better, as the flows dictate those stocks must be bought to match index weighting.

Shares in Apple have jumped 32 per cent so far this calender year and yet its latest earnings report showed sales and earnings came in below expectations.

That's why the forward price earnings ratio of the stock has gone from a multiple of 11 times earnings to 17 times earnings.

Investors are paying a higher price for lower earnings but if it's the biggest stock in the market, and investors want to match the index, then that means everyone justs piles on in.

So while US investors have got the French champagne out to celebrate another round of fresh highs, local investors will have to make do with the local bubbly because the sharemarket is definitely lagging.

So far this year the Dow Jones is up 7 per cent, the S&P 500 index 8.5 per cent and the Nasdaq 16 per cent. Compare these to the major S&P ASX 200 index, up just 2 per cent.

Over the past 12 months and five years it gets worse.

Offshore exposure

The Dow Jones is up 18.5 per cent and 70 per cent respectively, the S&P 500 a healthy 15.5 per cent and 84 per cent, while the Nasdaq is up 25 per cent and 199 per cent. By contrast, the local sharemarket is up 9 per cent over the past year and 40 per cent since 2012.

Little wonder then that local investors are grumpy and that there's such a push by so many experts to encourage investors to have exposure to offshore stocks.

In essence, as Charlie Aitken said this week at the Better Manage your Wealth seminar, hosted by Market Matters, the best way to pick the next set of winners is to check out what your children and grandchildren are doing.

Rather than have a portfolio of old-school stocks — the banks, Telstra, resources and

Woolworths — he thinks investors need exposure to companies that reflect how the kids shop, do their banking, entertain themselves and then pay for it all.

Little wonder then that perhaps some investors are still happy to buy Apple shares despite the hiccup in the latest set of accounts.

But there are also a few others to look at.

Like many global investors, Andrew Macken, the chief investment officer at Montgomery Global Investment Management favours Chinese internet giants Alibaba and Tencent.

Huge scale

A key reason he's investing in these stocks is China's online population.

It's three times the size of the US, and in 2016 an extra 43 million people started to use the internet in China.

"And while the US has the highest GDP per capita at over $US50,000, China's GDP per capita of $US13,000 is enough to be meaningful and is growing far more rapidly," Macken says.

Contrary to popular belief, Macken points out, the largest e-commerce market in the world is not in the United States.

Rather it is China that is already twice the size of US e-commerce and growing at a much faster pace.

"And China's adoption of mobile e-commerce far outweighs that observed in the US, by a factor of about five times," says Macken.

Alibaba (chaired by Jack Ma), which is listed on the New York Stock Exchange, has a market capitalisation of $US303 billion, a forward price earnings multiple of 30 times and earnings growth last year of almost 40 per cent.

Tencent has a market capitalisation of $US331 billion, a forward PE of 40 times but earnings growth of 32 per cent over the past five years.

Just like there's been a huge shift in the make up of top stocks in the US over the past 50 years, there's going to be another shift in the next 50.

And a fair chunk of the world's biggest companies will come from China and Asia, not the US.

Indeed, the McKinsey Global Institute thinks that in just eight years time these emerging regions will be home to more than 200 companies in the Fortune Global 500. That compares to just 85 in 2010.