# Value difficult to find

by Roger Montgomery

With asset prices across all classes now reaching record highs, including and perhaps especially assets that produce no income such as the two digit New South Wales number plate that sold for $745,000 – an Australian record, and the Basqiat painting selling recently for US$110.5 million – a record for a post 1980 painting and a record for an American artist, it's not unsurprising that there's precious few assets trading at prices that represents good value.

When asset prices are high, your returns will be low. The higher asset prices go, the lower future returns will be for the buyer.  So, these are the times when a strategy that can profit from falling asset prices makes perfect sense. Consider the many industries in Australia that are being disrupted, or those are at cyclical turning points.

Starting with residential property developers, we can see that a 23% fall in residential approvals will ultimately lead to a similar fall, if not larger, in construction activity. Clearly this will have negative consequences for owners of businesses that profit from building and selling apartments and houses.

With yields pushed to record lows, note there are no Australian residential listed real estate investment trusts because there is no positive yield at all after expenses, future returns on very long duration commercial real estate assets are now unappetizing when compared to returns available on cash.

Cash however is still seen as a liability so people are emigrating in droves. In other words at the very time investors should be more cautious, they are the most enthusiastic.  This is common to the end of all booms.

An oversupply of apartments will ultimately lead to a collapse in construction activity putting many tradespeople out of work or with less work available. When less work is available tradies will have to respond by lowering prices.  So, there will be less work and lower margins on the work that is available. The construction industry employees about 9% of Australia's workforce so any change to the level of activity could have serious consequences for Australia in general.

First on the list of industries to be affected is the retail industry. Remembering also that mortgage debt household debt and credit card debt are all at record highs it does not require one to strain the imagination to see that rising construction industry underemployment Will lead to a decline in retail sales.

The collapse of fashion retailers across the country from Rhodes and Beckett Pumpkin Patch and Topshop is a sign that rising unemployment in the retail sector is just beginning. And we have not begun to address the impact of the direct decline in sales for those retailers who supply the appliances and furniture-those direct products purchased-to fit out all those shiny new apartments and houses.

A slump in housing activity always leads to a reduction in addition and alteration demand. The lag is about 10 months so at some point in the next year retailers from Bunnings through to Nick Scali could see a reduction in same-store sales growth. That will put an end to the increasing employment dreams of those retailers.

The retail industry is Australia's second largest employer and underemployment is already a problem – even without the arrival of Amazon, which will only in enhance the challenges.

If unemployment rises, already if it doesn't but the many hundreds of thousands of people with mortgages are forced to reduce their rents or lose tenants, financial stress must hurt retail sales and the appetite for the further borrowing to buy assets. That brings me to the banks.

The big four banks are already under pressure from regulators to slow the growth of investor loans. The banks have used a variety of techniques including raising deposit requirements, blacklisting entire suburbs or simply raising interest rates, to quell the insatiable demand of unwitting property speculators. Well the banks may yet be shown to have prevented a much bigger bubble and subsequent mess, they cannot avoid the fact that their growth rates Will be slower than the recent past.

From builders to retailers, car sellers to furniture sellers from electronics and white goods retailers to the banks the ground for profitable shortselling opportunities is fertile. And if the scenario I have articulated puts pressure on the Australian dollar the pressure on importers could ramp up very quickly.

Perhaps that's why at Montgomery, not unlike other managers that offer market neutral funds or funds that short sell, we have seen an increasing level of enquiry from sophisticated investors who see short selling not as a high risk alternative but as a very necessary part of their portfolio for the new post bubble era.

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