A housing crash: Block it out

JAMES KIRBY

Timing is everything: Imagine if The Block TV show from the Nine Network was filmed as house prices were falling? Those renovating couples might not look so appealing if they were losing money. What if they were teary eyed before the cameras? Openly pondering how they were ever going to clear their mortgages.

Comedian Dave Hughes — who paid almost half a million over the reserve price for the show's top house this season — might need to double his stand up bookings next year.

Certainly, the prospect of softer house prices is upon us. This week's CoreLogic research report showed prices had fallen over the last month in Sydney creating a drop of 0.6 per cent for the three months to October 31.

But hold it! Is this a disaster? Sure, softer prices are looming but doomsday as prophesied by so many — who should know better — remains unlikely.

It's as if Sydney represents the national market ... it doesn't.

The same set of figures showed Melbourne house prices continued to rise. Perth prices continued to fall and Brisbane prices continued to drift sideways.

Few of these facts seemed to have infiltrated the Sydney-centric view of very well established institutional researchers.

UBS came out with a report that said a 55 year boom in house prices was over. "There is now a persistent and sharp slowdown unfolding" said UBS.

AAP

Caption

Credit Suisse topped the claim with a report which suggested the RBA will now have to consider a rate CUT. The Credit Suisse note returned to the highly contestable notion that money flows into Australia from China had slowed dramatically and in turn have forced house prices lower.

And of course the biggest apartment developer in the country Harry Triguboff of Meriton also felt compelled to issue more dire warnings to government agencies that he needs help at this challenging time or he will build less rental units: But if Meriton builds less apartments surely that buoys Sydney prices?

The truth — as always — is somewhere in the middle. The most likely scenario is that rates don't move up or down, house prices in some pockets fall and apartment prices on a much wider basis will see price declines.

Hey, prices can go down: it is after all ... a market.

Just to look at the issues a little more closely — the two gloomiest reports came from UBS and Credit Suisse which are both multinational institutions — global operators such as Swiss banks or international agencies such as the IMF have been calling doomsday on our house prices for years. They need to fit Australian house prices into their models, but it just does not work that way. Those models do not account for negative gearing, the endless tax advantages granted houses from first home-buyer grants or the mean test exemptions on pension access.

Sure, there is the prospect that prices will drop — but this is not Greece or Ireland for that matter. Oxford economics — a specialist in global residential housing research — put out its forecasts earlier this month on housing — it suggests that over the next three years apartment prices will fall in many areas but house prices will not fall in any city — except Sydney. : The official forecast from 2017-2020 is: Houses in Sydney are expected to fall — by 0.2 per cent Melbourne houses are expected to gain 10 per cent. In the apartment market where there is clearly oversupply the survey said Sydney units will fall 3.8 per cent and Melbourne units will fall 4.8 per cent. I would take Oxford Economics (which is the new brand name for what used to be BIS Shrapnel after a recent takeover) much more seriously than global banks.

As for making a call on rate cuts just now or for that matter making your prognostications on the most nebulous of data surrounding Chinese lenders and buyers to the Australian residential sector — it has to be taken with a pinch of salt.

Perhaps the chief economist at a major lender to the local market — Bill Evans at Westpac — would be a better guide. Evans believes there is no need for a rate move — downwards or upwards for the rest of the year and all of next year too.

Of course speculation has been present in our market. That is to be expected when you have had a long and unbroken run of steadily improving prices.

But there has also been brakes applied: Crucially, the regulator APRA has introduced macro-prudential moves which limit the lending of the banks especially to investors and to interest-only borrowers.

You don't need a rate hike to cool the market these days, that's exactly what has been happening through the macroprudential moves and you don't need to fire off reports suggest all hell will break lose because house prices fell by 0.6 per cent in one city in one quarter.

Amazon: The JB Hi-Fi opportunity

ROGER MONTGOMERY

The looming arrival of Amazon highlights the challenges faced by retailers in Australia but with $300 billion of annual sales at stake and no single player likely to dominate, there are both dangers and opportunity. Today I want to look at the opportunity.

For decades, Aussie retailers were a protected species, with new concepts homegrown, and high margins extracted from a resentful consumer who knew much cheaper prices were a Qantas flight away.

Following the advent of the internet however, and perhaps more importantly, Louis Vuitton's decision to launch in Australia under Philip Corne, which lead to an armada of international brands making the journey, retailing became a lot tougher and operators needed to be a lot smarter.

In Australia, the demolition and subsequent renovation of 'the house of retail' has some way to go, but operators can learn a great deal from those who are both flailing and prospering in the United States.

VANESSA HUNTER

Caption

One company, whose share price is now hitting five year highs, is an American big-box consumer electronics retailer headquartered in Richfield, Minnesota called Best Buy.

Yes electronics ... The same goods that JB Hi-Fi (ASX: JBH) sells. The only difference is that JBH's share price has fallen 23 per cent from its highs.

Best Buy wasn't always on a tear. Like many retailers, the growth in internet penetration increased the incidence of "showrooming" — where consumers visit a store only to touch and feel the item they ultimately buy online — producing declining sales and profits. In the case of rival RadioShack the experience saw it seek Chapter 11 bankruptcy protection.

By June 2014, Best Buy's sales had been declining for ten quarters or four years, and in 2012 the share price had fallen to under US$12 from $58 in 2006. Many analysts deemed turning around Best Buy nearly impossible.

But Best Buy has indeed turned around. Its share price has jumped from those near US$12 lows, more than fourfold, to US$55 today, and Best Buy is considered a poster-child among U.S. retailers — growing despite the ever present Amazon.

So what did Best Buy do that Aussie retailers should note? Step one was to match any rival's price — and yes that included Amazon. According to the CEO Hubert Joly, "we had no choice, we had to take price off the table and match online prices", so that in-store shoppers were saved the 'inconvenience' of shopping around and waiting for an item to ship.

Best Buy's next step may be of particular interest to JB Hi-Fi. The DVD and CD offering that was once Best Buy's hallmark were cleaned out.

In their place Best Buy embraced 'showrooming' and mimicked Apple's store concept allowing consumers to experience a product by invited electronics vendors such as Samsung and Microsoft to establish 'concessions' or stores-within-a-store.

Then Best Buy improved its delivery times, expanded its network of distribution centres and improved its website and app, giving customers the choice of delivery or click-and-collect.

Finally, Best Buy has realised that the increasing sophistication of electronics and in-home connectivity means that consumers need help installing their home-security systems, TVs, computers, and NEST thermostats. In response, the company is training its staff and has launched a free in-home advisory and installation service.

Understandably having a professionally- trained expert consultation means the consumer not only has confidence to buy but also increases their basket size with cabling and global remote controls often automatically added by the consumer under instruction from the trusted staff.

It is true that retailing is undergoing rapid change and many retailers that exist today will not be around in a few years' time. Even department stores are finding the screws tightening further with rumours that David Jones's cosmetics life-for-likes recently went backwards.

Some experts with whom I have spoken believe that Amazon will mostly hurt eBay, the online apparel retailer — the online retailer The Iconic, as well as Myer, David Jones, big box retail generally, including as Kmart and Big W and any retailer selling 'stuff' on price and range rather than a valued brand.

Some industry insiders believe Amazon will capture 20 -30 per cent of online market share in Australia — and possibly quickly. That's $8 billion of sales, which is double forecasts previously made by analysts in the stock broking community. Rumours are also swirling that Amazon will announce the acceptance of bitcoin as payment.

Sure, the coming launch of Amazon will be accompanied by great fanfare and plenty of free advertising (like this mention right here) but it's arrival does not have to mean the end.

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AFP

Jack Ma caption

CLAY CARTER

By now almost every Australian investor would know about Wall Street's tech titans also knowns as FANGs, but have you heard about the BATs?

They are of course both acronyms — among the FANGs are Facebook, Amazon, Netflix and Google (Alphabet). Not nearly as familiar to Australian investors, are the China "BATs" — Baidu, Alibaba and Tencent.

In terms of size and influence these two sets of companies have a lot in common.

Facebook, Amazon, and Alphabet are the third, fourth and seventh largest companies in the S&P 500 index (which is itself the world's largest equity index) and sport a combined market cap of some $US1.6 trillion.

The BATs are not far behind with a combined market cap of $US1 Trillion. Alibaba and Tencent make up more than 30 per cent of the MSCI China index.

Now Google and Facebook may be the global leaders in digital advertising with a combined share of 43 per cent of net digital and 51 per cent of net mobile ad revenue, but the BATs aren't doing badly either:

Baidu, Alibaba and Tencent together represent 16 per cent of the world net digital advertising revenue and 20 per cent of world net mobile internet ad revenue.

Baidu has been called the Google of China and rightly so. It attracts more than a third of China's online ad spending and operates China's largest internet search engine by both number of users and annual revenue.

Baidu will eventually de-emphasize its online-to-offline businesses in favour of longer-term bets on artificial intelligence (AI), self-driving cars and cloud services, just like Google. But for now, online advertising is its core business and is growing at a 25-30 per cent rate. Search ads accounted for 82 per cent of Baidu's second quarter 2017 revenues.

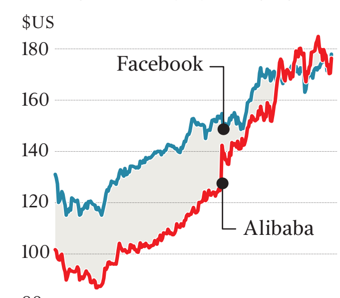
Amazon and Alibaba have some similarities (they both have a massive presence in e-commerce) but their business models are very different.

While Amazon is a giant retailer of consumer goods (a combination of its own offerings and third party resellers) and a logistics powerhouse, Alibaba is an exchange (or "middleman") that matches buyers and sellers and outsources distribution to third parties.

The major businesses at Alibaba – led by founder Jack Ma — include Taobao Marketplace (China's predominant online shopping destination), Tmall.com (a third-party platform for brands and retailers), Alibaba.com (a global wholesale platform for small businesses), Alibaba Cloud Computing (a developer of platforms for cloud computing and data management) which some have called it the Amazon Web Services of China, and Alipay (an online and mobile payment solution).

But Tencent is unlike any company in the world: mobile gaming remains it biggest business, while its messaging and payment app WeChat has almost 1 billion active users and is ubiquitous in most aspects of life in China. Essentially, it combines many of the functions of PayPal, Facebook, Uber, Amazon and more and attracts a significant amount of online advertising. It is becoming the primary means of communication in China and is disrupting the entire Chinese internet industry.

Facebook versus Alibaba



Risks and opportunties

As big and dominant as these companies are there are of course risks beyond everyday concerns such as a quarterly earnings shortfall.

Facebook, Google and Amazon, by virtue of their dominant positions, as well as the vast amounts of data they have amassed ,could well attract the attention of US regulatory bodies as they have already done in Europe. Whether this could happen during a Trump administration is open to argument.

China is a different story. Recently Beijing has expressed interest in buying a percentage of equity in the BATs thereby gaining some influence and control — perhaps a board seat. Earlier this year, it fined Tencent and Baidu for hosting banned content and in July the government controlled *People's Daily* said Tencent's popular (50 million active users) "Honor of Kings" mobile game was corrupting China's youth. Wisely, Tencent inserted a one-hour limit for younger players.

That said, a basket of BATs has significantly outperformed the FANGs.

Year to date Alibaba is up 111 per cent, Tencent 89 per cent and Baidu 49 per cent). The FANGs haven't exactly been laggards. In fact they have even been moved higher since

the graph below was put together: So far this year, Netflix has returned 60 per cent, Facebook 58 per cent, Amazon 47 per cent and Google 31 per cent .

Other than regulatory risk, there are other factors to consider. First, all these stocks have done very well, outperforming just about anything else in the market. However, with the exception of Amazon and Netflix, the forward price-to-earnings multiple of Facebook, Google and the BATs are more or less in line with recent sales and earnings growth rates.

Tencent is estimated to have grown sales over 50 per cent in 2017 and yet trades on a P/E ratio of 40 times . That's a P/E-growth ratio of only 0.8 times and still attractive for growth investors. So is Alibaba. Baba's 2017 sales are estimated to have grown 57 per cent and yet it trades on a P/E multiple of 48 times. Facebook, growing 2017 earnings and revenues in excess of 40 per cent is the bargain of the group with a P/E of only 25 times.

Given the recent proliferation of online stockbrokers in Australia that allow investors to access overseas exchanges, it's easy to invest in any or all of the FANGs and the BATs.

Alibaba trades in US dollars on the New York Stock Exchange under the symbol BABA, Baidu trades on Nasdaq under the BIDU symbol and Tencent trades in Hong Kong with 700 HK as its symbol. The FANGs of course all trade on the major US exchanges.

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Q: Is it possible to own a racehorse inside a self-managed superannuation fund (SMSF). With the success of some syndicates during the Spring Carnival, my friends and I are considering using our Super funds to acquire an interest in a horse. Thoughts?

A: This question comes up from time to time, especially around the Melbourne Cup! While technically it may be possible, you would need to make sure that you complied with some very specific legal requirements that ultimately may make very difficult.

Superannuation funds must meet the sole purpose test. Broadly, under the sole purpose test, the SIS Act prohibits trustees of a Super fund from maintaining the fund for any purpose other than providing members with funding for retirement. The ATO would likely be concerned that the investment in a racehorse or the management of the racehorse could be a way of using fund assets to pursue a "hobby or pastime".

Owning the horse within the fund may not, by itself, breach this test, but it would be a red flag to the ATO which would most likely put the fund under additional scrutiny to ensure that the fund initially complies and then continues to comply with the relevant requirements.

Any investment in a racehorse would also need to be done at arms-length. Standard commercial terms would need to be in place for stabling and management costs such as trainer, strapper and jockey. Likewise you could not acquire the racehorse from a related party.

There is nothing to specifically stop you investing in a racehorse

There is another less well known test that applies under the Superannuation Act which is the "Prudent person test". The Prudent person test compels Trustees to act with the same care, skill and diligence for their SMSF as would apply if they were investing on behalf of someone other than themselves. In other words, you can't be reckless with your assets within the fund if it would be unreasonable for a prudent person to do so.

The investments within a fund must also be aligned with the documented investment strategy of the fund. At the very least the members of the SMSF would have to agree that investing in a racehorse fits within the investment strategy of the fund.

Is it reasonable to expect that the risk and returns of investing in a racehorse will meet the objectives of providing for retirement savings for the members of the fund?

Racehorses are typically owned individually, in a partnership or as part of a syndicate. How your SMSF structured the ownership of a racehorse (for example via a trust or a company), can be a further impediment to the asset being owned by the SMSF.

So, to put it simply there is nothing to specifically stop you investing in a racehorse within a SMSF, your fund would, at the very least need to ensure the investment doesn't cause the fund to breach the sole purpose test or the prudent person test. But more importantly, your fund would need to ensure the investment is aligned to the investment strategy of the fund, and the ownership of the horse is structured in an appropriate way.

Given all of the above factors and the potentially significant penalties for getting it wrong, is it really worth the punt?

Visit the Wealth section at www.theaustralian.com.au to send your questions to Andrew Heaven, an AMP financial planner at WealthPartners Financial Solutions