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Investment advice from the experts

Simon Letch

by Sally Patten

What are the burning questions that investors want answered as they ponder the S&P/ASX 200 above 6000, bitcoin shooting through the $USD16,000 mark, the possibility of war on the Korean peninsula, low interest rates, a recovering global economy and the Trump presidency in the United States? This week *Smart Investor Weekend* spoke to four market experts who conduct investor roadshows around the country and asked them which questions they field most from their audiences.

What is the economy going to do?

This question comes up time and again, says Roger Montgomery.

The chief investment officer of Montgomery Investment Management is positive. Globally, economic growth is accelerating, including in Australia and interest rates are expected to remain low on the back of a benign inflation outlook. It is the classic Goldilocks combination. At the same time, corporate earnings growth is accelerating and there are no nasty surprises on the horizon, either financial or geopolitical.

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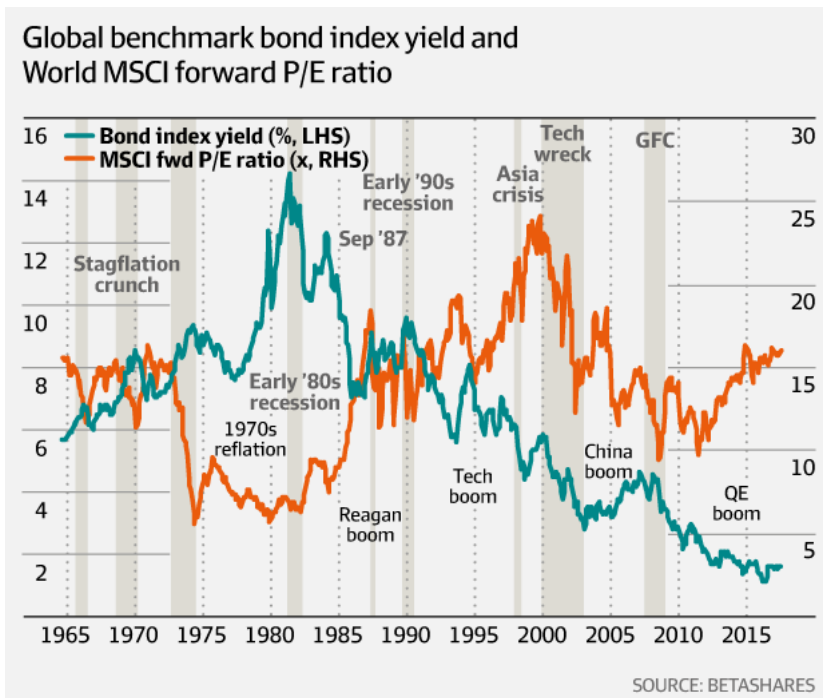

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Are shares expensive?

The economy may be chugging along nicely, but when it comes to the stockmarket, there are red flags everywhere, says Montgomery.

"Across the board, on a number of measures, the market is very expensive," he notes. Montgomery points to the cyclically adjusted price/earnings ratio (CAPE) measure that uses real earnings per share over a 10-year period to smooth out fluctuations in corporate profits. The current reading is 32.24. Since the 1870s, the only time it has been higher was just before the tech wreck of 2000. Disconcertingly, the current conditions look quite similar to those that have preceded nasty market crashes throughout history. The CAPE index is high, corporate earnings growth is strong and market volatility is low.

This is not to say that Montgomery is expecting a crash, but returns are likely to be low.

It is a question that Chris Stott, chief investment officer of Wilson Asset Management, fields a lot too. Stott points out that we are in the third-longest bull market of all time.

Andrew Clifford: higher Australian dollar. **Anna Chen**

"We are entering the final stages of this bull market that is eight years young," says Stott.

Montgomery Investment Management is long cash in three of its key funds. The Montgomery Private Fund is more than 30 per cent invested in cash, while the flagship Montgomery Fund and the Montgomery Global Fund are both more than 24 per cent invested in cash. Those cash levels are at record highs, notes the firm's founder.

Montgomery warns his audiences not to get overly confident that the bull market will continue unabated. "When interest rates have been so low for so long, people start recycling profits into risky things," he says, adding that investors who buy at high

prices are locking in low returns over the long term.

Don't dismiss cash, Montgomery says. "Today cash is a liability because the return is punitive. But cash offers a better adjusted-risk return [than many risky asset classes]." The yield from residential property is lower than cash, but the risk is much higher.

Chris Stott: stay clear of bitcoin. **Jessica Hromas**

David Bassanese, chief economist at exchange traded funds provider BetaShares, is far more sanguine on markets."I'm still bullish," he says. Bassanese concedes that price earnings ratios are above average, but he says that is justified by low interest rates. Indeed, global shares are trading at fair value relative to bond yields, argues Bassanese. "We are at the early stages of an [interest rate] tightening cycle. Bear markets don't start until the latter stages," he adds.

Meanwhile, corporate earnings are rising. Investors, he says, can expect total annual gains of between 9 per cent and 10 per cent from shares.

What do you think of Bitcoin?

Bitcoin and cryptocurrencies are the hot topics *du jour*.

Roger Montgomery: positive about the economy **Michel O'Sullivan**

Stott warns his audiences to steer clear of bitcoin. The cryptocurrency, which surpassed $USD16,000 for the first time on Thursday, "appears to be an asset bubble". Stott says he is concerned about the lack of regulatory oversight and the involvement of illegal activity. "When we see stories of how much money people have made over a short period of time, we are generally sceptical.".

Andrew Clifford, chief investment officer at Platinum Asset Management, is no bitcoin fan either.

"We can't find any rational explanation why we would want to own it. It makes no sense. It is more of a tulip bubble than [the original[tulip bubble, and at least they had something to look at," quips the expert stockpicker.

That said, Clifford is wary of the downside of group think and group proclamations when it comes to investing. "We all need to be careful of our intuitive response. It is often wrong," he says. "The goal is to try to understand Bitcoin. Until we understand why, it is hard to predict where it will go."

David Bassanese: still bullish on markets.

What's your view of Telstra?

Unsurprisingly perhaps, Stott fields this question a lot. Many retail investors are still overweight Telstra shares, which have plunged to about $3.60 from $5.30 since January. In August the telecoms behemoth said it would slash its total dividend in the current financial year to 22¢, down from 31¢ in 2016-17. Stott doesn't own them and hasn't for years. For starters, he is worried by the uncertainty around the rollout of the national broadband network.

In late November, NBN announced it would halt the rollout of hybrid fibre coaxial technology, the network which is owned by Telstra and being progressively sold to NBN, due to mounting issues with users experiencing dropouts in their connection. Telstra promptly slashed its full-year earnings guidance by $600 million. Further uncertainty could be created by a Labor government. Then there is the problem that like many companies, Telstra has been guilty of under-investing over the past couple of years, partly to meet insatiable investor demand for dividend income in a low interest environment.

"Telstra is now having to re-invest which could suppress shareholder returns in the shorter term" says Stott. Other headwinds include the termination of NBN-related payments from the government, the potential for lower margins over NBN connections, as opposed to ADSL connections, and increased competition from the likes of TPG, which will launch a mobile service in Australia next year.

"Mobile has been one of Telstra's best-performing divisions over the medium term," adds Stott. "In our view, TPG are well positioned to take market share off Telstra in the coming years."

Where is the Australian dollar headed?

Clifford gets asked this often. In the short term the Platinum executive expects the local currency will head north because of the strength of commodity prices and Australia's high interest rates compared to elsewhere in the world. Longer term, however, the picture is quite different. "Longer term our view is tempered by deep concerns about household debt in Australia."

Clifford is cautious that thanks to high household debt levels, Australia could yet suffer a housing crisis, similar to that experienced in countries such as the US and Spain in the wake of the global financial crisis.

When it will happen is the big unknown. It would take a sharp move in unemployment or household income to trigger, neither of which are on the immediate horizon. But if Australia did face a credit crisis, the local dollar would fall.

In which sectors are dangers lurking?

Top of Montgomery's list is retail, for two main reasons. Margins in the sector will take a hit from Amazon's entry into the Australian market and sales could be impacted by a rise in unemployment. Montgomery keeps a close eye on building approvals, where there has been a 40 per cent drop in applications or approvals for multi-storey apartment blocks since the peak. The construction sector is Australia's third-biggest employer and if all those engineers, electricians and labourers can't find work on infrastructure projects – and they are carrying lots of debt – consumer spending across the board could be hit.

In late November family-controlled retailer OrotonGroup fell into administration. "We will see many more. If you are focused on price and range and don't have a strong brand, you will struggle," says Montgomery.

He is also wary of residential construction. "We are keeping an eye on the pipeline of sales and pre-sales of apartments. There could be some settlement failures."

Where are interest rates headed?

In Bassanese's view, interest rates will be on hold next year because wages are unlikely to rise.

"I don't think the Reserve Bank of Australia's growth or inflation targets will be achieved," the BetaShares executive says. "If you look at the US, where unemployment is lower than Australia, there has been no pick up in wage growth. Weak wages is a phenomenon around the world," he says.

From 2019, however, Bassanese thinks interest rates could start to rise. "I think the next move will be up."

What is the outlook for property prices?

Bassanese notes that there is no such thing as a national property market, where movements in one area could affect prices in another. In Sydney, he argues, prices have reached their peak and will probably fall between 5 per cent and 10 per cent over the next one or two years from their high. Melbourne, he argues, is six months behind Sydney, with prices being held up by strong population growth.

"As the steam comes out of Sydney, we will see a pick-up of interest in other markets," Bassanese says.

What do you think of Brexit?

In Clifford's experience, while investors are not asking as much about the impact of a Donald Trump presidency in the US, they are still interested in the impact of Brexit. He tells audiences that there will be long-term ramifications for the British economy from Brexit, perhaps particularly for the financial services sector which has benefited from London's position as a financial centre. The difficulty is in predicting exactly what the ramifications will be. In any case, any erosion of activity will be felt over a long period of time.

As an aside, on the question of Trump, Clifford tells private investors that he does not expect the 45th president of the US to influence his stock-picking.

"Reform is extremely difficult because there is always someone losing out and they are typically good at influencing. Trump is likely to be relatively ineffective, but will cause a lot of angst along the way," says Clifford. In any case, it is not something that he spends much time on, as such external factors are typically not the main drivers of sharemarket returns. The main drivers are the performance of the business and the price an investor pays. "Other things that come into play are peripheral to the questions we are asking," Clifford says.

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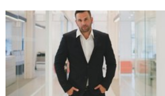

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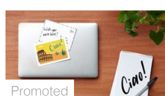

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