Financial advice sector set for rise of machines

JAMES KIRBY
WEALTH EDITOR

"We got $50,000 after Bill's mum died and we have no idea how to invest it." That line, or something very like it, has long been the rainmaker for the investment advice industry.

Bill's lucky relatives were herded into a fund, charged fees and most of those funds did not beat the market — many did not even equal conventional market returns.

Post-Hayne royal commission, this structure is collapsing.

The awful truth is nobody really wants to deal with you any more if you're at this level — you will be not be worth the trouble.

The advice sector is changing substantially for two reasons.

First, the big institutions such as banks, life insurers and industry funds are facing a legal exclusion from offering you general or casual "advice".

After a shock loss in the full federal court this week where Westpac lost a case taken by the Australian Securities & Investments Commission, it now looks like casual advice from a bank teller or a team member in a call centre will be illegal.

> Typically, your money is moved substantially into exchange traded funds or index funds where no manager is being paid to try to beat the market

In brief, the Australian Securities & Investments Commission went to court to challenge Westpac on the very issue of herding customers into bank products and sidestepping personal advice regulations: Westpac lost.

The implications are serious not just for banks, but for every big organisation where anyone asks you "can I help you with anything else".

From here, either you get full-scale personal advice — that will cost at least $3000 to start — or none whatsoever.

Long before the court loss, Westpac boss Brian Hartzer had made the point that banks and financial advice were very hard to separate — even as they sell off wealth advice units.

As the incumbents that dominated the market, they would often remain the first port of call when people received a lump sum such as an inheritance or a redundancy payment.

Hartzer put it this way: if a customer walked into a bank with money to invest, and if the bank could not offer financial advice as they had in the past, the money would end up in a term deposit getting less than inflation.

You might say at least the money is safe and the chances of being dudded by salespeople is off the table.

Fair enough, but you would hardly call it a full solution.

What a hopeless outcome. This new system will now protect you from a big organisation nudging you into one of their products, which is good, but it leaves the majority of people high and dry.

Nonetheless, the message must surely be getting through that financial advice from a bank or an industry fund that finishes with a decision in which you put money in another wing of the same organisation is not "advice", it is sales.

Similarly, many people are beginning to understand the hard reality that you can't get good financial advice cheaply — that's an abiding law of economics.

Robotic benefits

But there is, perhaps, a silver lining: it's called roboadvice. Thanks to this landmark legal win at ASIC, it is inevitable that this low-risk option will now accelerate its move into the mainstream, as it has done in the US.

The roboadvice model is generic and simple.

You fill out a form, you tell them if you are one of those people who want risk or not, you tell them what age you are, when you want to retire and they come back with a set menu choice.

It's a McDonald's menu of limited options, not an a la carte range that takes in the specific details of your situation.

Typically, your money is then moved substantially into exchange traded funds or index funds, where no manager is being paid to try to beat the market for you.

Rather, you will get the market return, whatever that is, and your fees will be tiny compared to the raft of fees you would get from a big organisation where there are ticket clippers dotted along the long road to a final investment destination.

Ted Richards, business development manager at the roboadvice operation Six Park group, says the automated advice model is gaining new clients through dealer groups, which were the traditional networks used by banks. (Six Park is backed by Brian Watson, ex-JPMorgan Australia chairman, and Lindsay Tanner, ex-ALP finance minister.

As Richards explains, the average amount of money that is managed by SixPark is less than $100,000.

At the same time, rival robo-adviser Stockspot released a performance update this week with the eye-popping claim its investment portfolio range beat 97.5 per cent of other multi-sector funds over a five-year period.

Roboadvice is not for everyone.

It's not rocket science and you will never beat the market, but neither will you be sold something that is second rate by someone who barely understands what they are doing.

The next time I am asked, "What will we do with uncle Bill's mum's money?", I'll have a better answer ready.

Reality check for housing rebound

The slump in approvals hasn't ended just yet

ROGER MONTGOMERY

Listening to some of the mainstream media, you'd think we're back to the races. The media is replete with reports of a strong recovery in house prices that portend a surge in confidence and therefore economic conditions. With the exception of a bounce in house prices, however, not much has changed.

The Australian Bureau of Statistics, Australian Property Monitors, CoreLogic and Residex, say year-on-year price change trends show prices are falling less. In other words, in recent months, prices have indeed recovered. The data also reflects the latest RBA information about a housing loan approval uptick.

The recovery that began immediately after the Liberal election victory is the first sustained increase for almost two years, but are we witnessing a return to boom times? My view is probably not, or not yet.

Looking at the combination of house price and loan approval increases suggests monetary policy is having a positive impact. But the decline in property prices that began in 2017 and which we warned about through 2016 is partly due to an oversupply of property, particularly apartments. Another major contributor is changes to credit availability.

If oversupply is an issue, we would see a recovery in prices, but little or no recovery in building activity. And that is precisely what is happening. Our channel checks indicate the pipeline of residential building work is declining. That means less work ahead for builders and independent contractors, from bricklayers and concreters to electricians, carpenters and roofers.

The combination of higher auction clearance rates and a continuing decline in the residential building pipeline suggests that lower interest rates are driving demand for existing properties rather than new properties. It will be some time before the excess stock is soaked up, ensuring a sustained recovery in house prices.

I don't expect a sharp V-shaped bottom for property, but nor do I expect the recent lows to be plumbed again. A drift across at these levels for another year or two might instead be a reasonable expectation. Keep in mind, of course, it is the marginal buyers and sellers this weekend who determine prices for everyone else.

However, the same "drifting at these levels" cannot be said for the residential construction industry. What we know and have reported previously is that residential building approvals have declined by 40 per cent from the peak level of an annualised 250,000 dwellings.

The pipeline of residential building work is declining, which means less work ahead for builders and contractors

> If building approvals are going to fall further before they recover, then building activity, which is led by approvals, has a long way to fall before it recovers

At a run rate of 150,000 dwellings today, there is simply a 40 per cent lower intention to build. Residential approvals are a leading indicator for construction activity and so the slump in approvals must be followed by a plunging "pipeline" for builders who might be completing properties that were ordered and commissioned a year or two ago.

The question I have been asking is where does the slump in approvals end? Sadly, the answer might be not yet. That's because one likely leading indicator for approvals is land sales. And land sales are plunging, too.

UBS says that, at their peak, land sales in Sydney, Melbourne, southeast Queensland and Perth were running at an annualised 58,000 transactions. Today that number sits at just under 25,000 transactions. That's a decline of 57 per cent, suggesting further declines in building approvals are imminent. If building approvals, which are led by land sales, are going to fall further before they recover, then building activity, which is led by approvals, has a long way to fall before it recovers. It looks like things may just get a little worse before they get better.

One wonders if the 3.5 per cent of the Australian workforce (375,000 people) directly employed in residential construction can see the pipeline drying up and are responsible for directing earnings into paying off the mortgage rather than spending it at the shops. Indeed, Treasury secretary Steven Kennedy suggested as much to a Senate estimates committee a week or two ago — that households would "initially use the tax cuts to pay down debt faster".

I am not sure to what extent the very real and serious slowdown in forthcoming construction activity affects the aggregate economic growth rate, and I am unwilling to suggest we're heading for a recession — there are simply still too many levers the RBA and the government might pull to help prevent that. What I will suggest is that declining incomes — an income recession, if you will — is a very real possibility for a growing number of Australians.

That the economy is slowing in Australia seems beyond doubt and during the AGM season several companies have highlighted weakening conditions.

At Cleanaway's AGM the company highlighted sensitivity to the economic cycle, particularly weaker economic activity, surprising the market and causing the share price to slide. While Cleanaway still expects earnings growth this financial year, there is now a skew to the second half, concerning investors who have downgraded earnings.

Meanwhile, Viva Energy is the exclusive licensee of Shell fuels and the distributor of Shell lubricants in Australia. Additionally, Viva manufactures and distributes bitumen and industrial chemicals. In its September quarter update, the company noted industry margins and trading conditions remained weak across the sector, while emphasising weaker economic conditions and intensified competition.

If 380,000 builders and building contractors see their income fall by up to half over the next 12 months, the reverberation will be felt by retailers, many of whom are already struggling. And if we add to the builders and retail staff experiencing weaker incomes, the employees of start-ups whose time might soon be up, we do have the ingredients for many Australians to batten down the hatches and tighten their belts rather than head "off to the races" again.

Roger Montgomery is founder and chief investment officer of the Montgomery Fund.

www.montinvest.com

Domacom beats ATO and gets its ducks in a row as it looks to grow

TIM BOREHAM

With Australia facing housing problems at both ends of the demographic scale now that prices are recovering, alternative providers are eyeing the opportunities.

At the more youthful end, hordes of first-time buyers remain locked out of the market because of ongoing affordability issues and lack of access to credit as the banks pull back on high loan-to-valuation lending.

As for the elderly cohort, plenty of retirees have a decent asset — their house — but not enough income to live "comfortably".

Domacom (DCL, 8c) has been a vehicle for frustrated homeowners to start climbing the property ladder with a fractional investment (a minimum $2000) in one or more of the properties held by the fund.

After a seven-year struggle to win regulatory approval, Domacom is girding to launch an equity release product that enables cash-strapped retirees to sell a portion of their home to one or more investors.

The offering, Senior Equity Release, is pitched at self-managed super funds via financial advisers.

As well as convincing the Australian Securities & Investments Commission the scheme was kosher, Domacom prevailed in court over the Australian Taxation Office, which argued Domacom's products could breach the "single purpose test" that decrees a super fund's investment must serve members and nothing else.

Last year's Federal Court win — which the ATO has not appealed — enshrined the ability of an SMSF to co-invest in a property and then rent it to a related party. The decision is a "game changer", Domacom CEO Arthur Naoumidis told the recent annual Australian Microcaps Investment Conference in Melbourne.

"You can use your SMSF to co-invest in a property and you or a relative can rent it," he said.

The terms and conditions are somewhat laborious, but as with reverse-mortgage schemes, the owner continues to reside in the property and can never be turfed out.

The resident also continues to benefit from capital gains on their remaining share of the property.

Nothing is ever free and the homeowner incurs a 4.4 per cent "service fee" paid five years in advance. After five years, an additional portion of the home is sold to fund the fees.

Investors benefit from any capital gains (or risk capital losses) on their share of the investment.

On the other side of the deal, the investor receives a set 3 per cent of this fee, with the balance used to fund the co-investor's proportionate share of costs such as property management and insurance.

Domacom's fractional investing products are approved by 44 dealer groups, representing 1200 planners, or about 5 per cent of the planning market. But so far planners have been unwilling to recommend it, partly because Domacom lacked a funding source to gear up its property investments.

This impediment melted away after Domacom recently won the support of a $50m facility from Latrobe Financial, owned by global giant Blackstone.

Domacom this month placed $3m of shares to Halo Investments, which gives the advisory and funds management group a 19.9 per cent stake in the company. Halo also underwrote a further $3m rights issue at 7c a share.

Domacom shares have sagged dramatically since listing at 75c apiece in November 2016 and the company is now valued at only $17m.

Apart from making losses — $5.7m in the 2018-19 year — Domacom's problem is scale, or lack thereof. The company has funds under management of $60m, which Naoumidis describes as "not great but not zero".

The company forecasts $600m-$700m of funds under management would be needed to reach a break-even position.

The founder of listed administration outfit Praemium, Naoumidis says funds under management can grow quickly once a platform business gains traction.

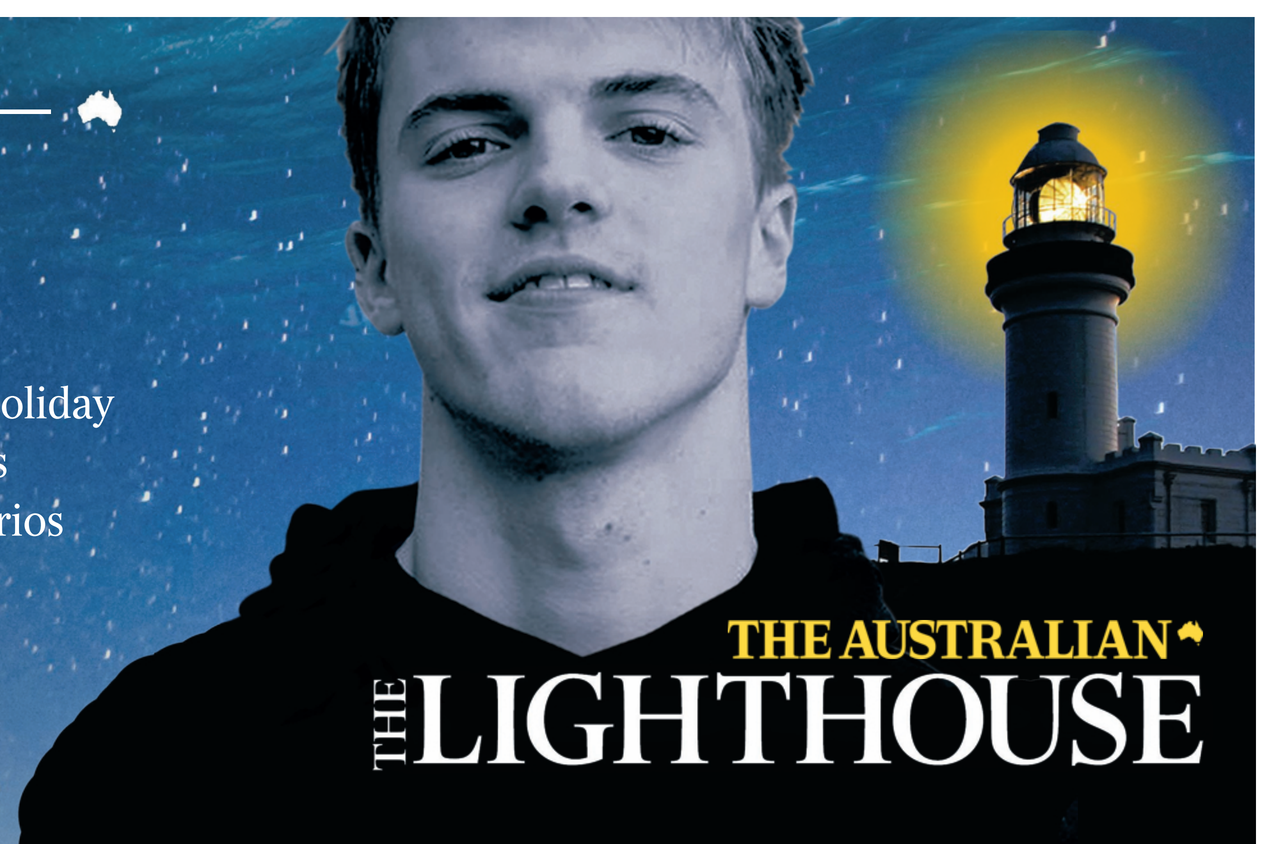
"It took us five years to get to $40m under management in January and only six months to grow that by 50 per cent," he says.

"We have all of our ducks in a row now."

Tim Boreham edits The New Criterion.

tim@independentresearch.com.au

Introducing the latest podcast from *The Australian*



A missing tourist. A celebrity town. A search like no other.

Theo Hayez is missing in Byron Bay. He vanished while on a backpacking holiday and hasn't been seen since May this year. In *The Lighthouse*, *The Australian's* national crime correspondent, David Murray, investigates all possible scenarios and takes you inside the extraordinary search for answers.

Listen now: theaustralian.com.au/thelighthouse