<< Return to Main Website

The Hudson Report

Thursday 19th November, 2009

*This weeks Hudson Report is brought to you by Hudson Institute **General Manager - Phillip McGann***

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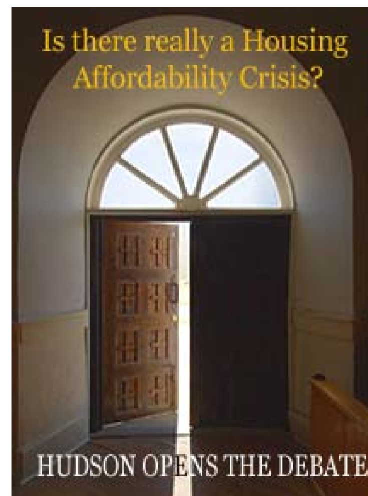


Housing affordability has been a hot button topic politically, socially and economically in Australia for over a decade. It resonates across the country because all of us are directly, or indirectly effected by the cost of housing.

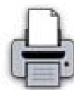
It is a complex issue, but one that too often is treated superfically by the media. This week we take a look behind the **'closed door' that is housing affordability**, and shine some light on this complex issue.

If you would like more information about any of the subjects in this week's Hudson Report, make an appointment online or speak with your Hudson Adviser on (free call) 1800 804 296.

Cheers,

Phil McGann

Hudson Institute, General Manager



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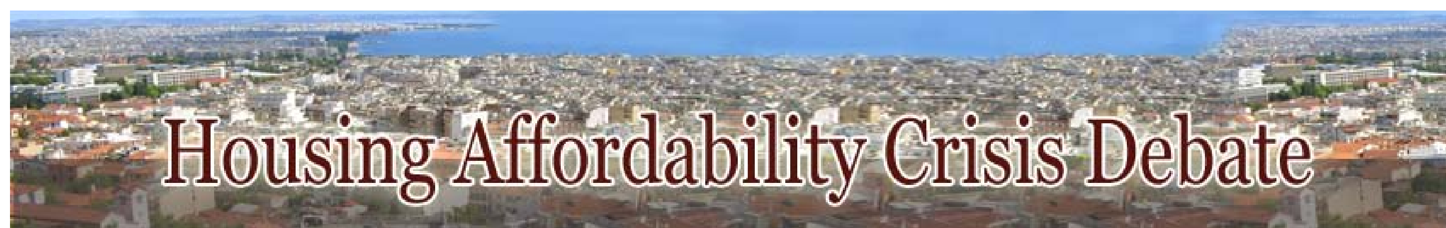
Article 1 - **Housing Affordability Crisis Debate**	From the Floor - **Bank CEO Salaries**
Hudson Selection - **CFS FC Platinum International Fund**	Share Market Update - **close of 18 November 2009**
Behind the Investment News - **What is 'Pegged Exchange Rate'?**	Whisper of the Week - **WESTFIELD GROUP**



Last week I heard a financial discussion on ABC radio about house prices in Australia.

Now housing affordability has been a hot topic for quite a few years, and it seems everyone has an opinion about it, and most offer solutions to the 'perceived' or 'real' (take your pick) problems in relation to the current price levels of housing in Australia.

Whilst most people feel that the average price in the city they live in is way "too high" to be realistic and sustainable; I feel we also secretly enjoy each report of price rises as it feeds into our own self worth equation. Most of us are genuinely sympathetic for the average first homebuyer trying to struggle into their first property purchase, but we also take heart from the fact that our "castle" is quietly increasing in value.

The radio program was a discussion between the radio announcer and the 'resident financial expert' and went along the lines of -

EXPERT:	The price of houses is too high
ANNOUNCER:	Way too high
EXPERT:	The average first homebuyer struggles to afford their first property
ANNOUNCER:	Struggles and struggles
EXPERT:	This is awful for society
ANNOUNCER:	Just awful. So, what is the government going to do about it?
EXPERT:	Well there are the grants (FHOG), and the tax advantaged savings accounts, and the state based Stamp

Duty savings, but at the end of the day, the price of property is just too high!

Then the so-called expert came out with a statement along the lines of -

"25 years ago, the median house price in the capital cities was 3 to 4 times the average wage. Today, this figure is more like 7 to 8 times the average wage. This just shows you how far out of reach property has become"

Now, at first hearing this, it sounded like a profound statement that encapsulated the crux of the issue. However on deeper reflection, it all sounded way too simplistic. In effect, it was a superficial way of looking at a deep-seated multi-faceted issue.

It also got me thinking about other things I have read and heard from the media on this issue over recent years. The media loves a simplistic solution to multi faceted problems.

If someone, (usually a politician, but more recently self appointed experts), can come up with a 'sound bite' to cover a complex situation, and at face value it "sounds good", they will get media attention every time. But, it does little to address the real problems, and consequently, doesn't offer up any solutions.

Back to the ABC 'financial expert's' statement, I contend that there are at least five things wrong with this superficial analysis that 'median house prices have risen well above average wages over the past 25 years and so house prices are unsustainably high and out of reach of the average first home buyer'

1. 25 years ago, a 1 income family made up a higher proportion of the average household than they do today. Presently a 'normal' household is more likely to have 1.5 to 2 incomes than the traditional 1 income household. This means there is more overall income in the average household to support household expenditure, including housing costs.
2. Average tax rates are a lot lower today than 25 years ago as marginal tax rates have risen up the income scale. This has meant more take home pay for the average wage earner, and hence, more household disposable income.
3. The interaction between the welfare and taxation system has grown massively in the past two decades, and this has meant more Australian households now receive at least part of their income, from the government (family tax benefits, child care rebate, etc). This means more disposable income for many households as well (whether this tax churn is a good or bad thing is a topic for another day!).
4. Lower 'real' interest rates (i.e. inflation adjusted) over the past 8 years when compared to the late 1980's and early 1990's, has meant the capacity of households to borrow more for housing has ballooned.
5. Increased competition in the finance sector over the past 2 decades has made access to housing finance that much easier to achieve. The 'margin' extracted by the banks on housing lending 2 decades ago has been greatly reduced leading to easier access to housing credit, and lower comparative costs for borrowers.

So, the 'expert's' (simplistic) comment on the interaction between wages on one hand, and house prices on the other, can be shown to be naïve at best, and superficial at worst, as overall, there is a massive interaction between many factors at play in the housing sector.

As I mentioned earlier, there have been many other (similar) instances I have come across over the past year or so, where generally held views on housing affordability can be shown to have a similar one dimensional flavour to them. For example:

GENERALISED VIEWPOINT 1

"Why in a country the size of Australian do we have a shortage of land?"

COUNTER VIEWPOINT: It is not so much the absolute size of a country's landmass that one needs to look at when considering whether there is a 'shortage' of land available for residential use, it is the 'desirable land' that is in a location which is in close proximity to the infrastructure and amenities we all like to live near, that is the real issue. We all like the idea of living close to shops, transport and our work place, but physically this cannot happen if we ALL try to live there. In a city of 3 to 4 million plus, (think Melbourne and Sydney), it's not possible for all of us to live close to the city, or the beach, near public transport, next to the park, near the best coffee shop in town, etc.

Yes, we have 'oodles' of physical land in this country, but parts of it is not inhabited at all, and the parts that are highly inhabited are because (given the choice), most people would rather (at the extreme), live on Sydney Harbour,

than in the Simpson desert. There is a problem in the availability of 'new' land at reasonable prices in the desirable areas – i.e. in the growth corridors around our capital cities. Land released and zoned by governments of all levels for residential housing, needs an overhaul in this country. There is a bottleneck between government releasing broad acre land for development into housing blocks, (and/or infill sites, and local councils zoning blocks for residential purposes, plus all of this being available at affordable prices for the market place to take it up.

An example is in Western Sydney, where it is estimated that the costs per block of vacant land that covers government charges and taxes, is now over $100K, per block! This is to cover charges for sewage, power and road works etc. All are legitimate costs, but should they all be foisted on the purchaser of the block, or in part paid by the rest of the community? This forces prices of all property up to the detriment of the community as a whole.

GENERALISED VIEWPOINT 2

"There is too much housing stress in this country"

COUNTER VIEWPOINT: This is a personal bugbear of mine; housing stress seems to be the 'new black' of the media. It seems that when it is a quite news day, editors wheel out the old 'Housing Stress' indicator, and you have a ready made 'housing crisis' that needs to be addressed.

From all the reports on this topic, the cut off point for households in 'housing stress' appears to be - if more than 30% of the household income is devoted to the provision of housing (or shelter).

Now, why 30%? Why not 35%, or 25%, or 50%? Where did this arbitrary 30% come from?

It appears that is was first brought up in an obscure government report written many years ago (1992 National Housing Strategy report), where the figure was intended to be used for low income households only. But, it doesn't stand up to reason to use this 30% as a blanket figure for all households. Surely a household with an income of $80k, and a household of $300k, have different capacity to service housing debt?

Basic living expenses vary, but a threshold is crossed in most households between needs and wants, and as your income rises (even if your lifestyle tastes gets dearer), your overall financial capacity increases with income. So why should 30% be the set figure for every household in the country as a determinate of whether you are or not in 'housing stress'? It sounds more like media short hand to make for a good headline.

GENERALISED VIEWPOINT 3

"Young people today cannot afford to get into the housing market?"

COUNTER VIEWPOINT: This may well be the most subjective issue of them all. Sure, young first homebuyers will find it tough to buy there dream home first up, but this is true of every generation. If you are in your 40's or 50's, think back to your first home. Was it a double storey, 5 bedroom, 3 bathroom, double garage with media room and pool? Or was it more likely a 3 bedroom, one bathroom with a carport?

The point I am making here is that perhaps (just perhaps), first homebuyers today want too much too soon. They are used to, and like the current quality home they have lived in with mum and dad for the past 10 years (which happens to be mum and dads third or fourth home).

If they have moved out already, perhaps they like the trendy inner city apartment they are paying a fortune in rent for, as it is close to all the things they 'need' in life like the coffee shops, work, pubs, clubs and gyms.

The problem is that this apartment costs $500 a week to rent (share with a friend), but closer to $850 a week to service a mortgage on if they were to buy it. Maybe they need to compromise a bit, buy a little further out in something a bit smaller than they're used to, and use this as their first rung on the property ladder?

They can improve this arrangement as their income rises, or when they couple up with a partner and can rely on 2 incomes instead of 1. Does this compromise mean that the market is stacked against them, and it is all a bit unfair?

No, it means that it is a **compromise**, and it is a word that many Generation Y have (perhaps) never heard before.

Summary

All this talk of housing affordability has a bearing (as well) on Hudson property investors. It goes to the need to invest in the right sort of property that will satisfy the accommodation needs of Generation Y renters now, as well as provide the right sort of property for future owner occupiers in the years ahead.

Lets face it, our cities are not getting any smaller, and with Australia's population forecast to increase to 35 million in the next 40 years, a well located property in close proximity to all the amenities all renters and owner occupiers will desire now and in the future, will be the best investment of all. You just wont hear that from the so-called experts.

SOURCE | Phil McGann :: Matusik Property Insights :: ABC Radio

CFS FC Platinum International Fund

Investment Market : International shares

Fund Style and strategy: Platinum International is a specialist international fund that is one of the star performers of the Australian Fund Management arena over the past few decades. The fund is marketed in Australia as an International Fund, but realistically, it is a hedge in all but name, and is marketed as such overseas.

The fund invests in undervalued international securities listed on stock markets around the globe. It will usually have between 100 to 200 stocks at any one time, but can also invest heavily in CASH if the funds managers believe limited undervalued opportunities exist. The fund does participate in short selling stocks it considers over valued. It does delve into the use of derivatives (futures and options etc) to limit risk and to enhance returns. Also, the fund will take active positions in currency markets to take advantage of currency movements to add returns as well.
So in effect, it is a true hedge fund, not a long only fund like most of its competitors.

Risk Profile: We would recommend that a fund such as the Platinum International fund, is suitable to investors who are comfortable exposing a part of their portfolio to higher risk investments in return for potentially higher long-term (7 years minimum) returns. The manner in which Platinum invests, is aggressive, but is also conscious to reduce risks.

Investment in such a fund may involve a higher risk than investment in more traditional 'buy and hold" funds. Careful consideration should be given to whether or not such an option is suitable and appropriate to form part of your investment portfolio. Discuss with your Hudson Advisor, if such exposure is suitable, and should constitute part of your portfolio.

Age of fund: The fund under the CFS FC platform (offered since 2003) is a mirror image of the original Platinum International fund that has been in existence for 15+ years.

MER: 2.45% pa

Time Frame: Minimum 7 years

Performance: So how has it done over time? Since offered under the CFS FC platform in January 2003, the performance has been very strong in comparison to the MSCI World benchmark. The total, 12 month return to September is 17.69%, while the index actually fell 13.41%. The comparison of the fund to the Index per annum over 3 years is 2.64%, and (-9.9%), and over 5 years is 7.17% and (-0.8%). The 'original' fund's long range performance shows this outperformance over the benchmark, has been a hallmark of the fund for over 15 years.

Comment: Platinum is a true 'one of a kind' fund that has proven to be an excellent performer over the longer term; particular in very volatile markets as we have had over the past 12 months. The fees are higher than many other international funds, but so are the returns. The venerable Kerr Nielson (who set up the Platinum funds management

business and owns a fair chunk of it, still, with majority ownership with other staff), runs the overall show at Platinum, and plays a big part in this fund as well, but he has instilled in the team a certain style of investment ethos. So it is by no means a 'one man show' with all of the risks that brings for investors. The fund should not be compared directly to a 'long only buy and hold' international fund, but instead should be considered by investors looking to add a bit of difference to their international exposure, and maybe used to compliment a traditional international fund in a portfolio.

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***free call 1800 804 296 or book online** and please read our* GENERAL ADVICE WARNING

behind the investment news...

PEGGED EXCHANGE RATE?

What is it? - A pegged exchange rate (or a fixed exchange rate) is when a currency is maintained at a certain exchange rate (or tight band) with another currency or basket of currencies.

Countries often do this to contain inflation in their own economy by maintaining a close peg to another low inflation currency; and also to ensure that the exchange rate on offer is predictable in the belief that this encourages and fosters easy trade between the two countries (or group of countries).

Many smaller countries have in recent decades, pegged their currency to the US Dollar to foster trade between the US and itself, and to foster trade elsewhere as most world trade is conducted in US dollars.

How a country keeps this currency peg is to be either actively trading in the foreign exchange market to maintain the desired fixed exchange rate, or more simply by controlling all official exchanges of the countries currency, and ensuring all exchanges are conducted at the desired level.

Currently, the Chinese government has pegged its currency (the Renminbi or Yuan) to the US dollar in a very tight band. As the US dollar has depreciated over the last 18 months against almost all the worlds leading currencies, the pegged rate with the Yuan has caused the Chinese currency to trade at levels many feel is way below where it should.

This has caused trade tensions with the US as (in normal unpegged circumstances), a falling US dollar would make Chinese goods more expensive for US consumers to buy, thus decreasing demand, whilst US goods would be relatively cheaper for Chinese consumers. Therefore, this would (likely) lead to an improvement in the trade imbalance between the two countries, which runs heavily in China's favour.

The Chinese government appears to be reluctant to allow its currency to float freely, as it would appreciate considerably (as demand is strong for Chinese goods), and this would cause Chinese goods to be more expensive all over the world causing potentially lower exports, and lead to higher unemployment at home just as the economy has surged again.

SOURCE | Phillip McGann

from the floor...

The GFC (Global Financial Crisis), has been bad for the economy and bad for companies who operate in the economy, and most of all bad, bad for banks, right?

Well, yes and no. A bank operates in the heart of the credit system that provides the lifeblood of a modern economy. Overseas banks were devastated by the GFC, and many failed, or were taken over by their national governments in an attempt to protect the whole economic edifice from collapsing on itself.

However in Australia, we ran a better show. Regulation of our financial institutions should be the envy of the developed world, as none of our banks failed or looked likely to fail, and now rank in the top 20 banks in the world by market capitalisation.

And for that, our banks have rewarded their CEO's handsomely to say "thanks". Fortune's Annual reports out this week, shows that the top four banks in Australia – ANZ, CBA, NAB and Westpac, paid their CEO's a total of over $35.97 million (including cash and equity) in 2009. Gail Kelly of Westpac on $10.62 million was edged out Mike Smith of ANZ, on $10.94 million.

Nice work if you can get it! But hey, they did save us from oblivion... so well done guys and gals, you deserve the kudos and the millions! (a little bit of sarcasm goes a long way)

SOURCE | Phil McGann :: The Australian

Share market update for the week ending Wednesday 18/11/2009

The local market has recovered well from its late October / early November correction and is on track to break new ground in coming weeks – if the momentum continues.

The All Ordinaries was marginally lower this week dropping 6 points to close at 4759 points. The big corporate play at the moment is AMP's unsolicited play for AXA Asia Pacific.

AXA has rejected the bid as underdone, but has indicated it is prepared to continue discussions (i.e. 'increase the price' and we will deal). The share market thinks AMP will eventually get its mark and will simply have to pay more, or put more cash options into the bid for shareholders to accept.

The offer at present is a mixture of cash and shares, and is valued at about 5.34 per share. AXA finished the week at $5.84 or up 15 cents for the week, so the market thinks a higher bid is coming. A month ago, AXA was trading just over $4, AMP finished 10 cents weaker at $6.30.

World indexes were mostly upbeat continuing the recent upward momentum as follows:

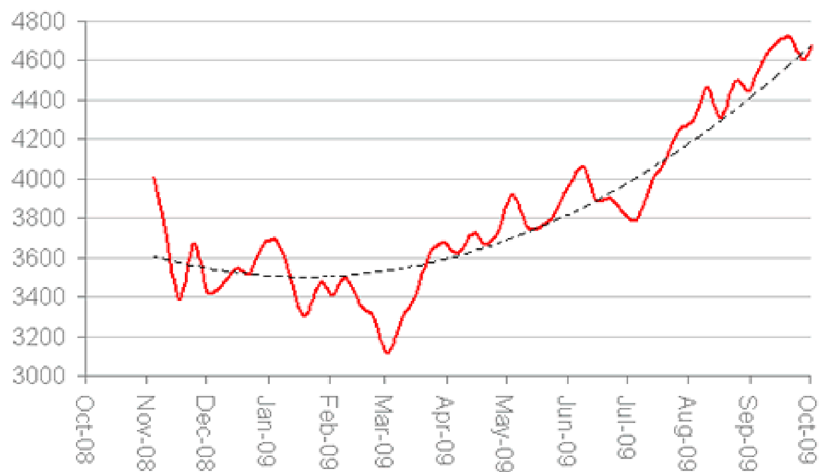
Index	Close at 18/11/09
All Ordinaries (Aus)	dropping 6 points to close at 4759 points
Dow Jones (US):	up 160 points at 10,406 points
Nikkei 225 (Japan):	losing 142 points to close at 9729 points
Hang Seng (Hong Kong):	up 287 points to close at 22914
	up 16 points to close at 1109 points

S&P 500 (US):	
FTSE 100 (UK):	up 152 points closing at 5382 points
German Dax	up 191 points to close at 5804
Australian Dollar	closed at 93.53

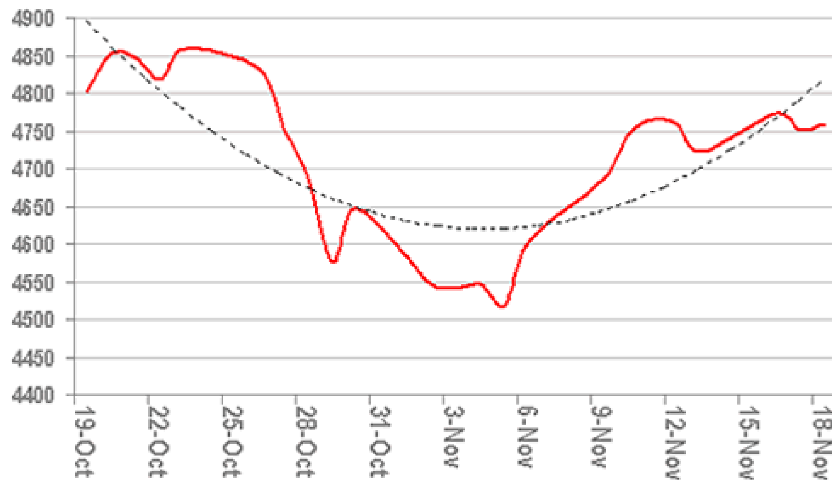
Source| Financial Review

All Ords Price History 1984 - Nov 2009 (monthly)

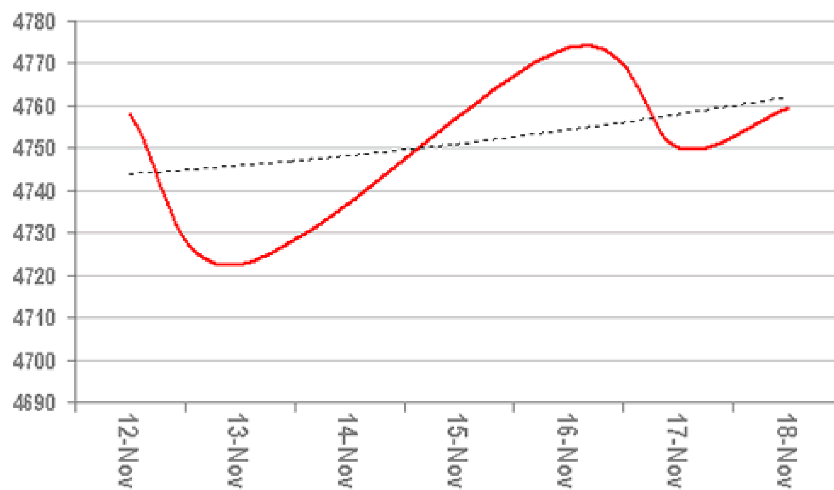
All Ords Price History Nov 08 - Nov 09 (weekly)



All Ords Price History Oct - Nov 09 (daily)



All Ords Price History in a Week 12-18 Nov09 (daily)



SOURCE | The Australian Financial Review | www.reuters.com| Graph data: Finance.yahoo.com.au

Westfield Group (WDC.AX)

Westfield is a share I own, and one I have recommended a number of times as a good long term Whisper stock.

Westfield needs little introduction, but in brief it is the largest listed shopping centre manager in the world. It is a multifaceted property investor – owning, designing, building, leasing and managing its own shopping centre assets around the globe. It has operations in Australia, New Zealand, the USA and Great Britain.

The current GFC has caused problems for its biggest asset holdings in the US market with much concern over the last 18 months about the resilience of the US consumer. The deep recession in the US, has caused increased vacancies in Westfield's malls and lower than forecast turnover.

However recent reports from Westfield show it is confident that its Australian operation will report a significantly higher turnover in 2010, and this will help alleviate softer figures in the US and UK markets, which will take longer to recover.

The Westfield share price has under performed in the general market over recent times, but the weaker share price is somewhat compensated by a stronger yield of over 7% on a forecast reduced payout next year.

Distribution per unit (historically)	106.50c	Westfield Group (WDC.AX) Long-term buy under $12.30
Distribution per unit (forecast)	95c	
Franking	NIL	
Distribution Yield (forecast 2010)	7.6%	
PER	14.6 times	
52 week high	$15.34	
52 week low	$8.68	

Source| | Graph Stats: finance.yahoo.com.au

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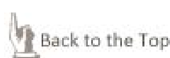

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