PRESS RELEASE

Invest in equity or invest in debt

On 29 August 2018, the ASX200 peaked for the year at 6352. Today, it closed at 5580 for a loss 12% in a little over three months – a curt reminder of equity market volatility.

But if you thought 2018 was a bumpy ride for equities, the portents for 2019 are far from promising. Why? Despite the G20 summit in Buenos Aires, trade wars (especially between China and US) remain an issue, the US economy is slowing down as interest rates rise and the stimulatory effect of Trump's tax cuts are wearing off.

Locally, the September accounts showed the economy slowing with quarterly growth of 0.3% (economists were tipping 0.6%). Both household and business spending are cooling, and construction might be peaking. And upcoming federal and NSW elections are likely to dampen economic activity as business awaits the voters' verdicts.

So, should investors, particularly SMSF trustees, reassess their investment strategies and take the opportunity to be more heavily weighted towards commercial property?

Supply and demand factors rank high in Thinktank's market analysis, and its positive impact is evident in the office and industrial sectors. Office space in some capital cities enjoys near record low vacancy rates and demand in the industrial warehouse sector is being driven by investors and owner/occupiers with access to low-cost debt to fund relatively high-yielding assets.

But the fundamentals for the retail sector tell a different story. Retail sales are weak and consumer buying patterns are changing, impacting both large department stores and smaller specialty shops. But it's sub-regional shopping centres that are really feeling the squeeze in terms of transaction prices with capitalisation rates rising after years of tightening. The one notable exception is neighbourhood centres where grocery store anchors remain well priced due to their mainstay – non-discretionary spending.

Aside from the fundamentals, one of the great attractions of commercial property in terms of asset allocation is income returns that are generally significantly higher than residential rental returns and dividend yields on equities. [Note, too, the slump in the residential market is likely to be longer than many expect due to a tighter supply of credit that appears structural, suggesting the market will take longer to adjust.]

And although equity dividends have been supplemented by dividend imputation, this is now under threat by the Labor Party and its franking credits policy. Many investors will rightly rethink how they should respond.

Looking ahead, the MSCI index provides good comparisons of investment returns in a variety of sectors on a semi-annual basis and the results for the second half of 2018 will be very interesting when released in February 2019.

The major corrections in equity markets will feature prominently, but if we look at the results to June 2018 some observations can be made about longer-term trends. For the 12 months to 30 June

2018, Real Property provided total returns of 11.7%, split evenly between capital growth and income.

While equities had a total return of 13.9%, 9.1% was in capital growth and the income return was a little more than 1% less than Direct property. The five-year returns for direct property were the same at 11.7% and, interestingly, the very long-term results calculated since December 1984 were still in double digits at 10.1%.

In a recent report from BIS Oxford, Dr Frank Gelber said: "Returns will be significantly lower over the next five years than the last five – not just for property, but across asset markets". Specifically, the report forecasts the following: For investors with a five-year horizon, BIS Oxford notes that the best investment returns in the next few years will be offered by office markets in Sydney, with a 9.2% internal rate of return, with Melbourne at 7.7% and Canberra at 6.1%.

It's an assessment Thinktank concurs with, ranking both the Sydney and Melbourne Office markets as "strong" with "improving trends". Adelaide, Perth and Brisbane are all rated "weak" but "stable". Once again, Sydney and Melbourne rate highly for Industrial with both rated "good" with "improving trends". Our concerns about Retail are reflected by only "fair" ratings for each capital except Adelaide {"weak) and across the board a "stable" trend.

It's often been said that timing the market is the impossible art, so any predictions about how asset classes will perform are fraught with danger. That said the fundamentals for Office and Industrial property, when coupled with attractive yields, do make for a compelling investment argument as 2019 looms. At the very least it's worth considering.

About Thinktank:

Thinktank

Leading Commercial Finance

Thinktank is an originator, credit underwriter and trust manager of small ticket (sub $3m) commercial mortgages targeting the SME market. Thinktank was founded in 2006 by experienced banking & financial services professionals in commercial property & SME lending.

Property types include retail, industrial, office, as well as other types of commercial property such as child care centres, student accommodation, and boarding houses.

Thinktank is Sydney based and privately owned with 14 private shareholders [until April 2018, when ASX: AFG acquired a 30% interest] .

All senior staff have greater than 25 years in their respective fields of financial services expertise, at the core of this experience is a deep knowledge of the market segment that Thinktank specialises in.

https://www.thinktank.net.au/

Media Contact:

Trish Nicklin

Senior Consultant

Ph – 02 9247 8533 / 0413 992 909

Trish.Nicklin@shedconnect.com

www.shedconnect.com