FINANCIAL REVIEW

Five things SMSF investors need to watch in the correction

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The 4.1 per cent fall in the S&P 500 on Monday needs to be put in perspective, says Anton Tagliaferro. Fona Morris

BY SALLY PATTEN

A 3.2 per cent decline in a benchmark index in a single day, preceded by an even bigger downturn in offshore markets the night before, may seem shocking, but it hardly comes as a surprise, experts say.

The 4.1 per cent fall in the S&P 500 on Monday needs to be put in perspective, says Anton Tagliaferro, investment director at Investors Mutual, pointing out that the broad United States index climbed 20 per cent in 2017.
"The correction is overdue. I don't think the shake-up is too much of a surprise," says the veteran stockpicker.

Liam Shorte, principal at Verante Financial Planning, adds: "Markets got way ahead of themselves. There was always going to be a reality check."

Expected or not, sharp falls in equity markets create huge uncertainty and should prompt investors to think carefully about the signs they should be looking at to help guide investment decisions.

This, of course, includes looking for signs it is time to buy in an effort to capitalise on cheap asset prices. Here are five things to watch out for.

1. Australian share prices

Many investment experts are looking at this week's share price falls with the intention of – eventually – adding to their portfolios.

As Roger Montgomery of Montgomery Investment Management says: "This is good news because at least we will start to see some rational prices. It's a welcome relief."

Adds Shorte: "If you have cash, look for weaknesses in decent stocks."

Investors who haven't already identified which stocks they want to buy at a cheaper price should create such a list, including the purchase price. Montgomery has done just that.

On his list are biotechnology group CSL, medical device company Cochlear, Macquarie Group, retailers Harvey Norman and JB HiFi, Reece, the plumbing and supplies group, and ARB, the motor vehicle accessories manufacturer and distributor.
Tony Davison, senior financial adviser at Henderson Maxwell, has a ready-made wishlist too, taking in mining behemoth BHP, CSL, data centre company NEXTDC, gaming machine manufacturer Aristocrat Leisure, online recruiter Seek and REA Group, the online real estate company.

Shorte is focused on income-yielding shares for clients who are 55 years and over on the grounds that if he can pick up shares on a yield of more than 6 per cent it takes the pressure off the stocks having to generate capital growth as well.

Shorte has his eye on SCA Property Group, the real estate investment trust, Spark Infrastructure and the major banks.

If these stocks fall 10 per cent from their highs, they will offer attractive value when yields and franking credits are taken into account, Shorte says.

Montgomery doesn't expect the opportunity will arise in the next couple of days but could well do over the next few months. After all, he quips, markets are a transfer mechanism from the impatient to the patient.

Davison suggests individual shareholders look for signs that the bond market is settling down, that abrupt intra-day moves in the US market have stopped and the return of institutional investors before dipping their toes into the market.

Shorte recommends investors, particularly those aged 50 and above, drip feed money back into the market on a gradual basis.

"We are not expecting to time the market perfectly. "Don't put in a big lump sum. Volatility will continue throughout the year. There will be more opportunities. It is a case of taking advantage [of market falls] when you can," Shorte argues.

"This correction could be short-lived and markets will rally again. If that is the case, we will be sitting on our hands again," Montgomery says.

2. US share prices

Despite the overnight fall in the US on Monday night, the S&P500 is still 10 per cent overvalued, argues Davison. Shorte, who often uses exchange traded funds to get access to offshore markets, says he would like to see the US market decline 10 per cent or more before buying.

Davison is not so sure that the opportunity will ever arise, however. He argues that the US is highly attractive because of the impact tax cuts will have on corporate earnings, the strong sales growth being achieved by US corporates and the prevalence of the technology and healthcare sectors in the index.

Those factors, he says, should insulate the S&P500 from armageddon. "The price earnings ratios are demanding, but they can be justified," Davison says.

3. Bond yields

The yield on the 10-year US Treasury fell overnight, but that is not to suggest that the 30-year bull run in US bonds has further to go.

The yield needs to be watched closely, says Montgomery. Shares are partly priced on the value of future earnings in today's prices.

If yields rise, those future earnings are worth less and investors will take fright. The problem is that identifying the point at which investors switch to worrying about the impact of higher bond yields is tricky.

"No one knows when sentiment will switch," says Montgomery.

4. Anecdotal evidence

In addition to tangible indicators, investors should also keep an eye on anecdotal evidence that might point to markets reaching bubble territory.

Montgomery suggests that such signs are already evident, suggesting that it is a time to be cautious, rather than buying aggressively.

The evidence includes the 500 per cent share price rise in December in a US micro called Long Island Iced Tea Corp after rebranding itself Long Blockchain Corp.

Earlier this month the shares of Kodak surged after the 100-year-old company announced the launch of KodakCoin, an encrypted, digital ledger of rights ownership for photographers.
"When companies add 'blockchain' to their name and their shares surge, it's a warning sign that investors need to be more cautious. Enthusiasm has turned to irrational exuberance," says Montgomery.

5. Interest rates

Investors can't afford to take their eyes off local interest rates. One rate rise from the Reserve Bank might do nothing more than put a lid on property market enthusiasm and make investors pause about the prices they are prepared to pay for an investment apartment.
But two rate rises could have a far more significant impact on residential property prices. A hike in the cash rate will also force investors to review the value of infrastructure and commercial real estate investments, says Davison.

In the meantime, recommends Shorte, investors should be using the current low interest rate environment to pay down debt.

"Make the most of low interest rates. If you get a decent buffer into your mortgage offset account, you will be in better shape when interest rates rise. You will sail through that," Shorte says.

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