AMP CAPITAL

MARKET WATCH

Are we in another 1990s tech bubble?

A quick look at the valuations of the so called FAANMG group of stocks – Facebook, Apple, Amazon, Netflix, Microsoft and Google – and it certainly feels like it we're in a tech stocks bubble a-la the late 1990s.

However, if we compare valuations of this group to historical valuations during the major global asset bubbles over the last 40 years, it's possible FAANMG and tech generally might not be as overvalued they might seem.

The average price/earnings multiple of this group might be high at around 40-times, but this level is not overly onerous for a group of technology stocks, says Dr Shane Oliver, AMP Capital's Head of Investment Strategy and Chief Economist.

"Yes, you've seen a rise in these stocks and that is a concern; at some point tech stocks will take a back seat as the US starts to withdraw from Quantitative Easing and focus on Quantitative Tightening and we will start to see cyclical stocks like materials performing better," Oliver says.

But does that mean we're going to see another tech-stock crash?

"I'd have to say at this point, probably not," Oliver says

"Bear in mind these companies are earning profits whereas they weren't in the late 1990s," Oliver points out.

There's no doubt, though, quantitative easing and accommodative monetary policy has been good for the stock prices of technology companies in the United States, pushing valuations up to eye-watering PE multiples in some cases.

Dr Shane Oliver
Head of Investment Strategy and Economics and Chief Economist, AMP Capital

The tech bubble in the late 1990s ended in a dramatic 80 per cent fall in the NASDAQ high tech index in the US in early 2000. Valuations of listed technology companies.

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4 steps to help protect portfolios against political risk

We face troubling political and geopolitical risk across the world: Trump, Brexit and, above all, the risk of nuclear confrontation with North Korea. Yet some investors, used to QE-fuelled rises, have simply forgotten about political risk and are maintaining highly concentrated portfolios, which exposes them to the fallout from political shocks.

To protect against heightened risk to portfolios, advisers and investors need to begin assessing political risk objectively from a multi-dimensional perspective. This involves four key steps. If they can grasp those steps, they will not only get better portfolio protection, but also gain a broader insight into the field of managing risk and uncertainty as investors.

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1. Put some odds on it

The first step is to put some probability on the risk of the event happening. Financial markets were pricing in the prevailing view in London and ignoring the rest of the country. The market, therefore, hadn't priced in the risk of Brexit, especially in the pound. We took advantage of that gap and took a short position in the pound as a hedge.

2. Assess likely impact

The second step is to determine the impact of the political event. If the impact is likely to be extremely high, then it may make sense to move to help protect your portfolio. A North Korean nuclear attack might be unlikely, but the impact would obviously be horrific.

3. Ask how much of that bad scenario is priced into the market.

The third step is to analyse how much the political risk is priced into the market. Broadly, if everyone is talking about a political risk, it's usually priced in and it's too late for us to do anything.

Nader Naeimi
Head of Dynamic Markets

4. Construct a portfolio that accounts for risk

The final step is to construct your portfolio to account for the risk. That may involve using put options, shorting an asset class, or using currencies to hedge.

Less fearful investment

The recent events surrounding Barnaby Joyce's eligibility, as well as the history of markets shows that political risk surrounds us, and that political events can rock markets and severely damage portfolios. Yet when political risks hit markets, investors are often caught by surprise. They then panic, as they did back in 2008, and often sell at exactly the wrong time.

I well remember back in October 2008 when the House of Representatives rejected a $700 billion financial rescue package, triggering one of the biggest stock sell-offs in history. The market had been expecting the bill to pass.

By firstly being aware of political risks, then objectively assessing those risks, investors can remove that emotional element and better prepare their portfolios to weather those risks.

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Could our mortgage monster become the Christmas Grinch?

Dermot Ryan
Co-Portfolio Manager,
Equity Income Generator

The disappointing retail sales figures from the last quarter could be just the tip of the iceberg for those watching the retail sector heading into Christmas, reckons Dermot Ryan, AMP Capital's Portfolio Manager – Australian Equities.

But it's not likely to be the so called "Amazon effect" of internet shopping, nor competition from fast fashion retailers, or even unfavourable currency swings Ryan is factoring in when he's calling out the possibility we're heading for a flat Christmas in terms of spending and economic growth – although all three of these factors could prove to be head winds for retailers but a boon for shoppers.

It's the debt overhang from the housing boom that could end up casting the longest and coldest shadow over Australia's Christmas cheer, Ryan says, pointing out he's reading the data and not himself the Christmas Grinch.

"We're at the mature stage of a housing cycle where a lot of mortgagees have large debts and some groups have overextended themselves buying property. Even before the RBA (Reserve Bank of Australia) thinks about raising interest rates this year, stresses are appearing as banks raise the cost of interest only and investor loans and I'm guessing it will seriously curtail their ability to spend this festive season," Ryan explains.

"It does seem like the increased mortgage payments are starting to make an initial dent into retail sales. This has further to play out given the mortgage rate hikes and ongoing push to switch mortgages to P&I (principal and interest) loans from interest only loans," Ryan notes.

Cutting spending is the first thing households worried about mortgage repayments will do, Ryan says, highlighting the findings of a recent UBS study which surveyed Australians who had recently taken out a mortgage to buy a residential property.

Half of those surveyed who said they were feeling anxious about repayments said they'd cut spending while others surveyed said they'd likely opt to switch to principle and interest loans.

"Looking at the data it's clear this trend to P&I is still in play which points to a difficult Christmas ahead," Ryan notes.

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Rising energy costs are eroding retirees' financial well-being

Jeff Rogers
ipac CIO

Regardless of whether you think climate change exists or not, the flux when it comes to energy policies is having unintended consequences beyond high energy prices. Self-funded retirees are bearing the brunt of this as they are being crunched three ways.

Their cost of living is rising, which means retirees are drawing more cash flow from their superannuation investments to support their spending including paying energy bills. According to the Association of Superannuation Funds of Australia Retirement Standard, this figure is typically about 10 percent of retirees' total consumption.

Secondly, when we manage retirement income portfolios to fund these essential spending goals, we look for Australian companies with high and sustainable dividends. But because many of these companies face higher energy input costs, their cash flows and dividend paying power are under threat. There is a secondary impact of this on retirees as many of them directly invest in these companies for dividends that supplement their income.

The federal government's latest policy – the National Energy Guarantee – may not garner the bipartisan support it needs without significant changes to emissions reductions targets, in part because there remain very wide-ranging opinions about climate change policy within the major parties.

They are also impacted by fund managers' inability to effectively hedge energy on their behalf because of the frequent government policy changes during the past decade. If we could reallocate 5 percent of the retiree's portfolio from fixed income and invest it in new sustainable sources of electricity production, there would be an improvement in the stability of inflation-hedging cashflows from both parts of the portfolio as well as improved societal outcomes as a result.

Risk adjusted portfolio returns might improve by 10 – 20 basis points, according to our own analysis, which corresponds to $500 - $1000 per annum for the retiree.

But we can't make this hedge.

From a risk management perspective, there are too many unknowns and some of these are significant such as a company's right to operate, new taxes, access to research and development funds, and social pressures.

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Without a broadly agreed plan, the cost of capital in the energy sector will remain unnecessarily high.

Under such conditions, super funds will not broadly support significant new investment in electricity production. While this will affect the whole community, retirees are the cohort facing the most evident blow to their financial well-being.