NEWSLETTER

March 2019

Introduction

Welcome to our newsletter for March 2019. In this edition, we take a deeper look at the Australian share market – which has 'roared back' since our last newsletter. Once again, we see the Australian market acting in concert with the US market. But we also include a discussion of dividends and the impact they have on overall returns for share market investors. We hope you enjoy the newsletter and that the month of March is a good one for you.

Famous People in Investing – Charlie Munger

Many people have heard of Warren Buffett. Not as many people have heard of his offsider, Charlie Munger. Currently aged 95, Munger initially studied mathematics at university. The Second World War interrupted his studies. He enlisted in the U.S. Air Force and trained as a meteorologist. After the war he returned to university, this time studying law. From there he morphed into professional money management.

Munger has a wonderful turn of phrase. Books have been written analysing various quotes attributed to him. He is what we used to call a 'polymath' – someone with a deep interest in and knowledge of several different areas. One of his key areas of interest is psychology. We will leave you today with one of our favourite Mungerisms, that combines most of his interests: "To get what you want, you must deserve what you want."

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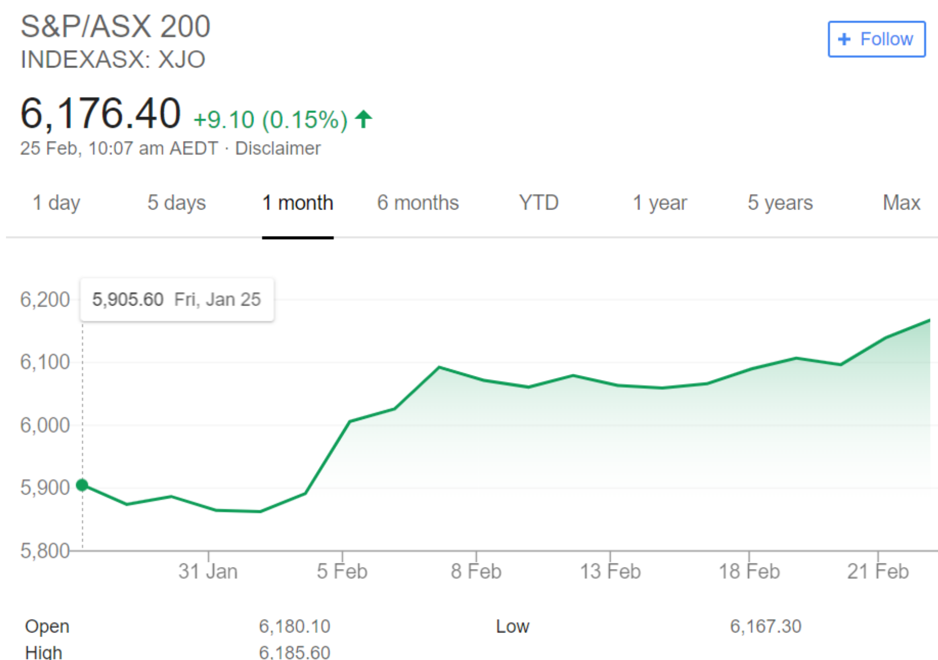
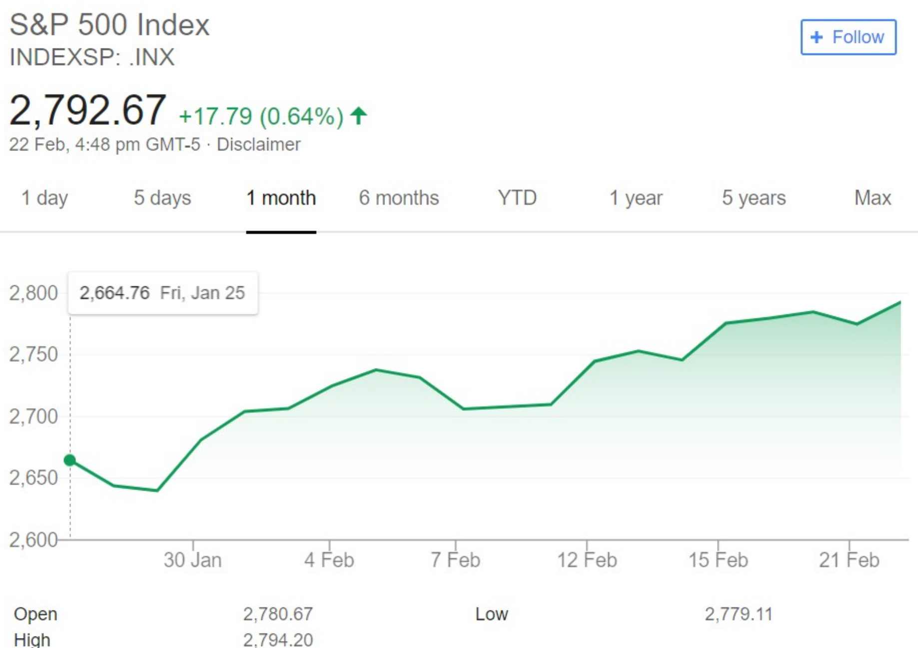
The Share Market

After several months of negative returns, the Australian share market bounced back with a vengeance in the month of February. The Australian market rose 4.6% over the month to February 25. Here is how it looked on Google:

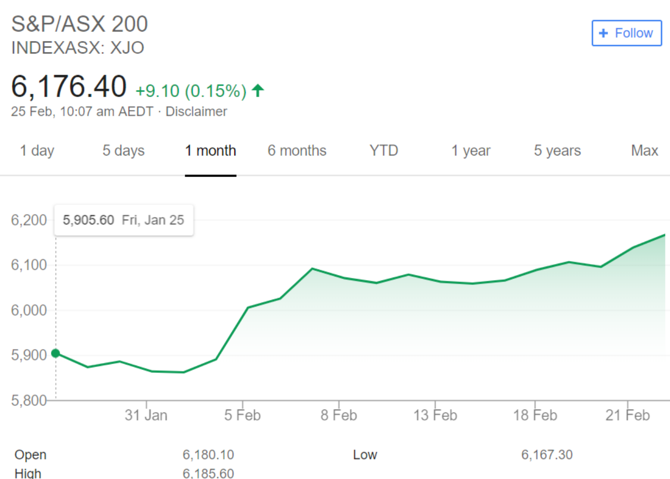


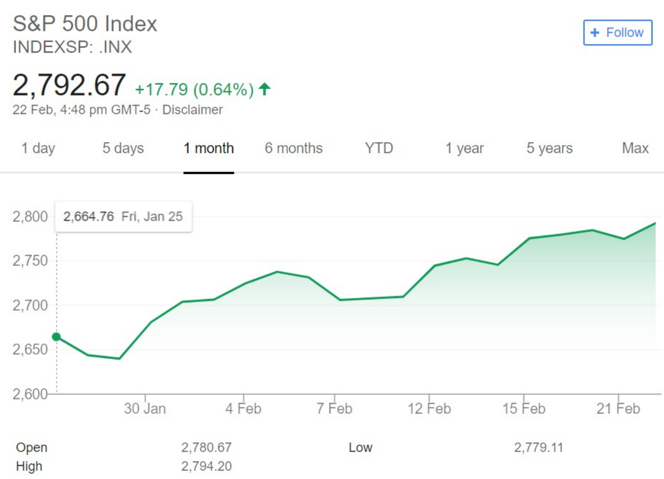
Indeed, the month of February was so positive that the market, as measured by the ASX 200, has almost returned to its recent highs of August 2018:

Once again, the Australian experience is almost an exact replica of the US experience. Here is how the US market fared in the month to the close of business on February 22, as measured by the S&P 500 index:

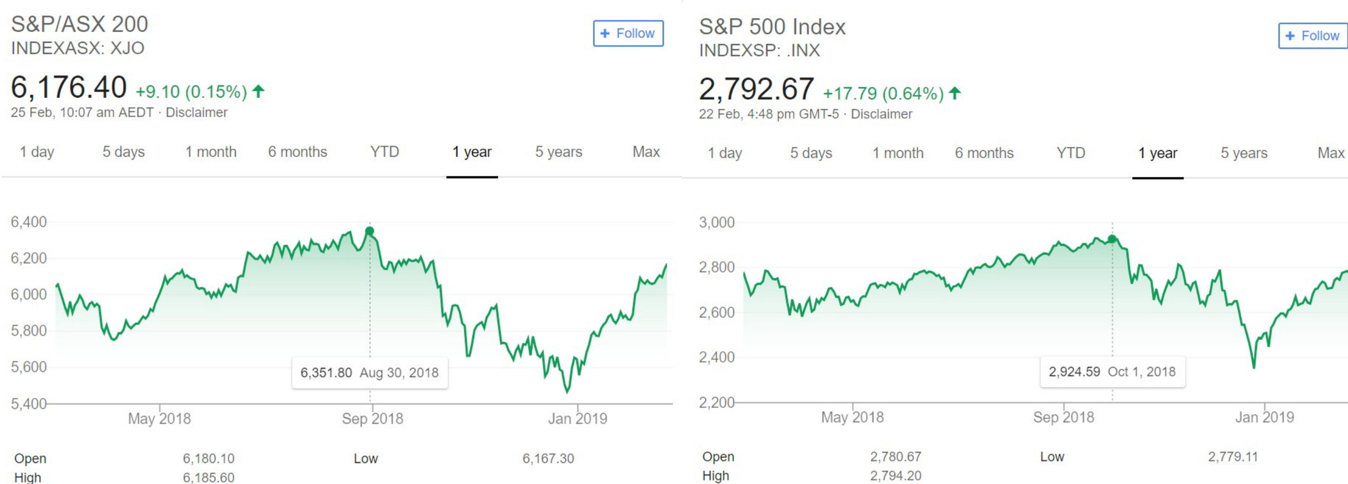


The US market rose from 2664 points to 2792 points - a rise of 4.8%. This is almost exactly the same as the rise in the Australian market of 4.6%. Let's look at the two graphs side-by-side to get a clearer picture of just how much the markets are moving in lock step:





The Australian market is on the left, the US market on the right. The US market had started to rise by the end of January, with the Australian market taking a few days to 'catch up.' After that, the markets track extremely closely. When we take the longer view, we see the same phenomenon. Here is the relative share market performance over the last 12 months for the US and Australian markets:



Once again, the Australian market is on the left, the US market on the right. The Australian market started falling sooner than the US market, but the performances have been very similar. One thing to note about the two graphs being shown side-by-side is that they have different scales. Basically, the same percentage movement on the Australian market looks twice as big because the Australian index is using larger numbers. For example, because the Australian market is currently at 6176 points, a 1% increase equates to an increase of 61.76 points. The US market is currently at 2792 points. So, the same 1% increase equates to an increase of just 27.92 points.

This is a feature of indexes (or indices). In many ways, especially in the short term, the nominal value of an index is not important. So, the fact that the Australian index, as measured by the ASX 200, is currently trading at 6176 points doesn't mean much in and of itself. An index only has meaning when it's compared to something else. Usually, this is the value of the same index at some previous point in time. In our analysis above, we are comparing the index on for February 25 2019 with the value of the same index on January 25, 2019. This lets us see the extent to which general prices changed over that one-month period.

Most indices start with a value of 100. So, on the day on which the index is first measured, it is given a value of 100. The S&P 500 index, used in the American market, started in 1982 with a value of 100. Today, in 2019, the index is almost 2800 points. This tells us that, in general, share prices on the US market are 28 times higher per share today than they were 37 years ago. It should be noted that the general S&P 500 index, like the Australian ASX 200, only reflects prices on the sharemarket. It does not reflect dividends that are paid on the shares used to construct the index.

The interplay of market prices and dividends is interesting. Dividends that have not yet been paid are generally included in the current market price of a share. Once the dividend is paid, in theory the market price of the share should fall by pretty much exactly the amount of the dividend. You can understand this with reference to an example:

> Let's say that shares in company A are trading at $102.50 per share. The company has announced that it will pay a dividend of $2.50 per share. When this dividend is paid, <u>everything else being equal</u>, we would expect the market price for these shares to fall to $100. This is because the initial price of $102.50 included a right to receive $2.50 in dividends. Once the dividends have been received, this right to receive them no longer exists. Theoretically, once the dividend has been paid, the future benefit of holding shares in that company reduces by the amount of the dividend.

When a share price changes due to the payment of a dividend, the shares are referred to as going *ex* dividend. Prior to the payment of a dividend, but after the dividend has been announced, the shares are referred to as *cum* dividend. *Ex* and *cum* are Latin terms meaning 'without' or 'with' respectively. So, an *ex*-dividend price is the market price without the dividend.

The interplay of dividends and market prices is such that every time a dividend is paid, the market price is adjusted downwards from where it would otherwise be. Over time, therefore, using a basic index to measure changes in price will not include the dividends paid on a share, because these dividends are periodically removed from the market price of that company's shares. To get around this, some index providers calculate what they call a total return index. Put simply, this index retains the value of dividends to show the total benefit to shareholders over a period of time.

The current value of the S&P 500 total return index is 5569 points. This is roughly double the 2769 points for the simple index. This suggests, therefore, that roughly half the benefit of holding shares in companies that constitute the S&P 500 index comes in the form of dividends.

In the Australian context, this is an important point to note. According to the ASX, the long-term average dividend yield on the Australian market is approximately 4.2%. When we look back on the performance of the Australian market over the last 12 months we see a slightly positive return in terms of share market prices:

Between February 26, 2018 and 11:07am on the morning of February 25, 2019, the market rose by 145 points. This is a 2.4% increase. But this is only for the share market prices. Assuming the market achieved its long-term average dividend yield of 4.2%, then the total return across this 12-month period becomes 6.6%. Not bad in a year when many people describe the market as having simply gone 'sideways.'

The Legal Stuff

General Advice Warning

The above suggestions may not be suitable to you. They contain general advice which does not take into consideration any of your personal circumstances. All strategies and information provided on this website are general advice only.

Please arrange an appointment to seek personal financial, legal, credit and/or taxation advice prior to acting on anything you see on this website.

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