COSTLY: The Australian housing market is one of the world's most overvalued.

Boom or bust, it's still a case of buyer beware

Australia's current economic state can be blamed on the GFC.

NOEL WHITTAKER

AUSTRALIA is facing challenging times. Household debt levels are a record high and still rising, and inflation is running at the top of the Reserve Bank's target range. Yet, interest rates are at historic lows with no increase in sight.

It's all a hangover from the global financial crisis. In a way, the GFC was as much an economic catastrophe as World War II was – the main difference is the building boom that followed the end of hostilities in 1945. Now, there are no buildings to repair, just balance sheets.

After World War II, governments all around the world dropped interest rates to stimulate activity, yet restricted the supply of credit to prevent unwelcome booms from occurring. In Australia the control of credit was one of the main ways the government kept a check on the economy. Older readers can remember the dreaded headline "credit squeeze".

Of course, human nature being what it is, people will usually find a way around government restrictions, which is why there was a boom in lending by building societies in the 1950s and why the short-term money market was formed in 1959 as another tool to regulate credit.

This is history, but it does highlight the challenges facing our Reserve Bank now, as it tries to cool off an overheated property market. Governor Glenn Stevens has already pointed out that there is no point in making any further rate cuts as rates have become so low that any further reductions are now ineffective as a stimulatory tool.

Cutting rates has lost effectiveness in both Europe and the US. The European Central Bank has now reduced rates to an unheard of 0.05 per cent – last month they even started charging banks negative interest rates on deposits to encourage them to lend. This has had little effect to date, and even Germany, the engine room of Europe, is experiencing very low levels of business confidence and investment.

The US is doing better than Europe, with its economy recovering and inflation low but rising. Whether the recovery will be sustained is anybody's guess, but I do feel sorry for American retirees. Their sharemarket is at a record high, interest rates are at a record low, and bond markets look extremely risky.

The Australian housing market is one of the most overvalued in the world, but you can't put a brake on it by raising rates by a small amount.

Think about it – if you came across an undervalued asset now, even an extra 1 per cent interest wouldn't stop you buying it. You could stop the property market dead in its tracks with a large rate rise, but the outcome would be unthinkable. There would be a string of repossessions as first home buyers lost their homes.

Even though the Reserve Bank is concerned about the number of low deposit loans written, it is not practicable to insist that property buyers have a larger equity. It would simply force first-home buyers out of the market, leaving the space to investors who would simply increase their equity by mortgaging other investment properties they own.

So our Reserve Bank remains stuck between a rock and a hard place. It could go back to the old days and restrict the amount of money the banks could lend for housing, but this could be easily circumvented by the use of non-bank lenders and offshore borrowings.

At the end of the day, it's buyer beware – anyone who buys into a boom must have an exit strategy when the music stops.

Noel Whittaker is the author of *Making Money Made Simple* and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before making any financial decisions. Email: noelwhit@gmail.com.

Q I am 34 and my wife is 32. I earn $85,000 gross plus super, and my wife raises our two young children. We own our home outright, have no other debt, and would appreciate your advice on the next step to growing our wealth. Would an investment property or shares provide the best investment returns?

A The bulk of your assets are in the residential property basket now, so it makes sense to diversify into shares. A major benefit of shares is that you can simply buy the index, or use a fund where the decisions are made by a full-time professional fund manager. As your home is paid off, I suggest you take advice about borrowing, say $100,000 against your home to invest in a quality share trust. The interest would be a tax-deductible $6000 a year, which would be almost offset by the dividends from the shares. If possible, re-invest the dividends to maximise the compounding effect.

Q I am 85 and know I can gift cash to my children. Can I do the same with shares, and if so what is value that I can give?

A You can give away as much as you like in whatever form you like but for Centrelink purposes any gifts, including shares, of more than $10,000 a year or $30,000 over five years would be treated as a deprived asset and would be subject to deeming.

Weight pros and cons of Medibank offer in a volatile market

By **DAVID POTTS**

HOLD your horses if you're thinking about the Medibank Private float.

There's no rush because it doesn't officially close until November 14, and governments never pull the plug early on privatisations.

It looks unseemly, somehow.

By waiting you'll also have a better idea of how much the shares are going to cost. And better still, where the market is going.

The government has set an "indicative price range" of $1.55 to $2, although it's admitted it won't go any higher, at least for mum and dad investors.

Trouble is, it isn't offering a carrot to them either, unless the final price does go over $2.

Otherwise there's no discount, unlike previous privatisations. And the only benefit for policyholders is they can buy more shares if they want to.

Using the suggested price range the dividend will yield 3.5 to 4.5 per cent, or 5 to 6.4 per cent after the 30 per cent franking credit. Remember, the true price won't be revealed until a week after you've posted your cheque.

With what we have, Medibank is priced about 17 times its earnings. This compares with, say, a bank stock of about 13 times, with a bigger dividend: it's not cheap.

You've probably noticed the market is going through a, shall we say, sensitive phase, which has made a lot of other stocks more attractive.

The way things are going the only listed rival to Medibank Private, NIB Holdings might offer the better value as its price falls as sellers raise funds for the float.

And don't be fooled by any claims that the bottom end of the projected price range might be a bit steep.

If fund managers can bluff the government into a better deal, as well as put everybody else off, why wouldn't they?

Mind you, the Medibank side is spruiking the huge number of requests for a prospectus. That might be so, but in the end it is meaningless.

No, you need to judge it on its merits and whether you can cope with an increasingly volatile and erratic market.

The biggest things Medibank Private has going for it are its brand and market dominance. Oh, and the fact it's not carrying any debt, though that might change if it goes on the acquisition trail, something newly floated outfits freed of their government chains are always itching to do.

The record is mixed. Telstra botched its acquisitions while CBA proved to be street smart.

But perhaps the most unlikely selling point for Medibank is its inefficiency. It makes a decent quid all right, but profitability is relative to what you pay for a stock. Others, notably its listed rival, do better. It's estimated that Medibank makes only 3.6¢ on every dollar it gets in premiums, compared with NIB's 5¢. And I don't think the missing 1.4¢ goes into better benefits either. So, with some slash and burn, Medibank can lower its costs.

Whether health insurance is an attractive industry for investors is the question. The experience of NIB in consistently rewarding its shareholders suggests it is.

Sure the market will test your nerves, but if you're patient and don't put everything in one stock, your money will grow.