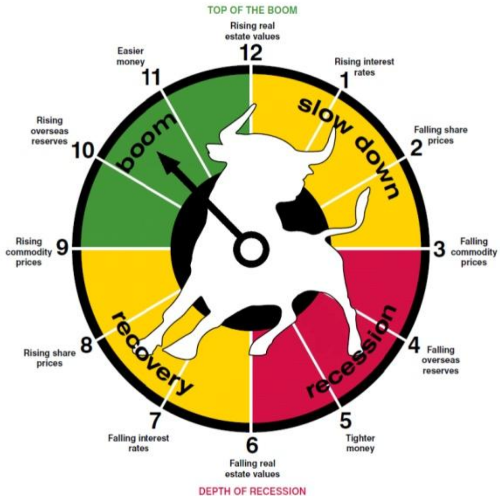
eureka report

Has the clock struck midnight?

Alan Kohler
Editor-in-Chief
7 Aug 2019

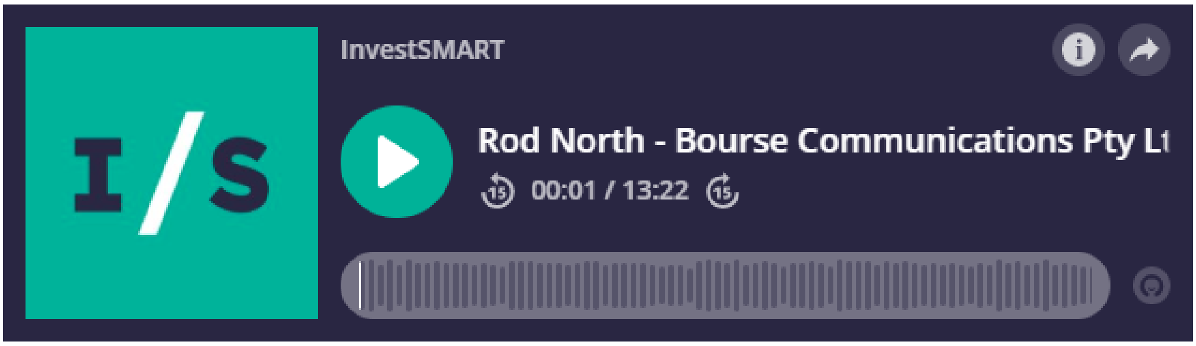


This week's fund manager interview is with Rod North, Managing Director at Bourse Communications and author of 'Understanding the Investment Clock', about when the investment clock will finally strike midnight on the markets.

Alan Kohler here and for today's interview I thought it would be a good idea to catch up with Rod North who has written a book called Understanding the Investment Clock. Rod is a public relations guy who is the founder and managing director of Bourse Communications. I have known him for a long time, he wheels up a lot of interviews to us and now we're going to interview Rod. The reason for doing that is simply that the market [last week] passed its 2007 peak, Rod is a student of peaks and troughs in the market, the cycles of the market which he puts into that book called the Investment Clock. I thought it would be good to get some perspective on the history of the market and what we could possibly expect from here.

The other reason for talking to him is because I thought it'd be good to get something optimistic because he reckons it's going to keep going for a while, there's another 20% to 25% left in the market he reckons going by history. Who knows if that's correct but he says midnight isn't until the end of next year, midnight is when the rising part of the investment clock, the book section of the investment clock, is finished. Let's see what Rod has got to say. Here is Rod North, the founder and

managing director of Bourse Communications and also of *Understanding the Investment Clock.*



Rod, it's taken 12 years for the market to get back to its previous high. You're a student of history, is that a long time? It seems like a long time.

Yes, it is an awfully long time because if you go back over share market history back to sort of 1900s, so 119 years, the sort of average it took for the market to reach and then surpass its high from top to bottom was generally somewhere between four to six years. In this particular cycle from the market peaking in November 2007 at an intra-day high of 6,873.2 we then bottomed in March 2009 at around 3,109 so it's virtually taken nearly 12 years to get back just recently to its all-time high. The interesting thing in the history of the share market in Australia; in every cycle it has reached and then surpassed its previous high and it had me very intrigued as to why it hasn't happened this time.

There's probably some very good reasons for that, none the least of which are we've probably had six Prime Ministers since John Howard departed back in 2007 when he was the last Prime Minister to serve a full term so that probably didn't help and also obviously against the performance of the economy in the world context and so forth.

What's the normal or average time from peak to peak?

Normally anywhere between four to six years. For example, if you go back to the market when the All Ordinaries was set at 500 it then reached 1,000 back in January 1980. Then it took from 1980 to 1987 to reach 2,247 so it roughly gained 1,700 points.

After it peaked – I am assuming, I don't know for sure, but did it peak at 1,000 in 1980 then have a bear market?

Yes.

The question is how long did it take to get back to 1,000?

In that particular instance it took about 3.5 years to get back to 1,000. In the case of the most recent time being 2007 peak to bottom and then to rise back it has taken nearly 12 years so this is way out of cycle for the history of the share market in Australia in terms of booms and busts.

What does that tell you? What conclusions do you draw from that?

I think what's happened is a lot of things have changed, we're in a much more dynamic digital world. Probably Australia in the context of the rest of the world is still a very small country and our market is a very small market. It also tells us, I think, that the index and its composition particularly at the top end, if those stocks in the top 50 or top 100 aren't performing that's not going to help get the index up to the sort of level that it perhaps should get to so I think there is a whole lot of factors like that. I think the state of the economy, the government of the country.

I think all those factors mitigate as well because we have seen in that context the Dow rise when we thought, Alan and I'm sure you too, 10,000 seemed like a high Dow and then it's recently been surpassing 27,000 which is quite phenomenal so the growth there has been enormous and for a long period of time over history we used to follow the Dow, there seems to have been a bit of a disconnect with that in sort of the last six months or so. I think obviously one of the key things that's driving the Australian share market at the moment is the fact that we have a cash rate at the lowest rate we have ever seen ever at 1% with expectation that that rate may drop a little bit further which of course means investors have very few avenues where they can get a return on the investment in terms of a significant yield.

I think that's driven a lot of money back into the market and may well continue to do over the course of the coming months if we do get a cash rate of 0.751% which many people are suggesting.

In history what does the market typically do having regained its previous peak after a bear market?

Well we, in some instances see that market go up an average of an additional 25% to 30% so where we are at the moment if we say we're in a boom phase we have the potential to gain potentially another 20% to 30% but it's always difficult to know whether we'll achieve that or not because no one ever rings the bell and tells us we're at the top of the market because certainly in 2007 we didn't know that because the market declined from top to bottom there, it took from November 2007 until March 2009 so that was a longer period to reach the bottom whereas in 1987 the market pretty much dropped 40% to 50% over the course of a few days.

If we are in the boom cycle of the market at the moment on the investment clock we're probably at about 10:30 and moving towards midnight but we just don’t know when midnight is going to be, it could be six months away or 12 months away and I guess for my own context I sort of look at what is going to happen in a geopolitical sense. With the US elections being held in November 2020 I think if the economy in the US continues to remain as robust as it is at the moment you’d have to argue that the US market is probably going to go higher so therefore our market potentially will follow against the backdrop of low interest rates and probably few avenues available to investors to get yield unless they invest in shares but the biggest issue that needs to be taken into context is that your capital invested in the share market can be at risk even if you’re chasing yields of 4% to 6%, you don’t want to be losing the capital value if we do get a market correction at some point or we then reverse over the course of the next 12 months or so into a bear market because we could see the market drop 30% or 40% because history tells us that’s what will happen.

You’ve written a book called Understanding the Investment Clock.

Yes.

Give us a bit of a burst on that, help us understand the investment clock.

Yes, I looked at the investment clock which appeared, would you believe, in the Evening Standard in London in 1937 and when I was working in share broking in the late Seventies and early Eighties I came across it and thought this was interesting and putting things in the context of cycles to give you a bit of an idea because no one ever rings a bell at the top or the bottom of the market to tell you. But interestingly enough, and everyone has their own views as to where you are but I certainly think we move through a couple of different phases, the slowdown phase, the recession phase, the recovery phase and the boom phase. I think we have been in a recovery phase in Australia and we’re now moving into a boom phase which is showing things like higher commodity prices, lower interest rates, rising real estate values.

It’s that phase of the investment clock which needs to be viewed in the context of taking a fair bit of caution because there is a tendency for that cycle to also be known as the greed cycle and we do see share prices often rise well above probably their real value or the context of the sort of PE that they might end up being on, a massive PE and often valuations are thrown out the door, people get a bit carried away with it. I think we’re probably in the throws of moving into that phase where you really need to obviously look very closely at companies and analyse their balance sheet much more closely, look at their earnings and the sustainability of those earnings as well because there’s many companies receiving lots of revenue from other parts of the world and if say, for example, that’s China, well you’ve got to say, well, if that changed and you’ve got 90% of your revenue coming from China, is that going to affect your earnings going forward if the tap got turned off.

We're in that phase, I think, at the moment and it's still got a bit of time to run but we're ticking ever closer to midnight which of course is the top of the boom and then inevitably after the top of the boom is reached we then move into a slowdown phase where we will ultimately see real estate prices fall and interest rates rise and the context of that is we've got to try and work out when that's going to be. My view is we've probably still got a good 12 months of rising markets ahead of us but towards the end of 2020 to 2021 I think we probably have to look very closely at our investment portfolio and say we need to be a bit more careful.

You reckon midnight on the investment clock is the end of next year, this is your best guess? If that's true, Rod, then what happens after midnight?

After midnight we could be seeing the market reverse anywhere between 20%, 30% to 40% if those values that companies are at are unsustainable because their earnings are not able to be sustained. I think there's lots of companies perhaps that have ended up on very high share prices without earnings to support it and what happens in that cycle is fear starts to come into it. People start to look at the overall economy and the fact that it's not as robust as it should be and it becomes a bit of a self-fulfilling prophecy. History has shown us this for well over 100 years now.

Basically, you're saying that history shows that the investment clock really is just the ebbing and flowing of the tide of fear and greed?

Yes, I think largely it is around that and we're in the greed cycle at the moment and we're in a cycle too where I'm getting lots of people, and I'm sure you are, talking about the share market for the first time that perhaps haven't got the context of the fact that the low point was 2009 and ten years later we're at the highest point of the market that it's been since 2007. You've got to seriously think about being very careful at entering the market at this level and look at the companies that you're investing in or the funds you're investing in that those companies have sustainable growing earnings because if they don't at some point in the cycle they're the stocks that often get pounded the most in the reverse cycle.

Good to talk to you, Rod, I appreciate it. Thanks.

Thanks very much, Alan.

That was Rod North, the founder and managing director of Bourse Communications and author of the Investment Clock.

https://www.investsmart.com.au/investment-news/has-the-clock-struck-midnight/145953?v=988017