Are you over-exposed to residential property?

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This probably won't surprise you but at APN Property Group we're big fans of property. Real estate is the largest asset class in the world with many attractive attributes, especially in regards to a retirement portfolio. Rental returns usually deliver a higher income than cash or term deposit at typically lower risk than an investment in equities.

The problem is that many property investors are pushing a sound case too far and are more exposed to the residential property market than they should be as a result. The residential home dominates household wealth. Around 70% of Australians either own their home or are in the process of doing so. A Legg Mason global survey (link here) found that Australians invest 10% more in property than the global average and allocate more to property than any other income-producing investment. For many of us, real estate remains a central means to financing our retirements. This mentality deeply resonates with APN's 'property for income' philosophy but is also a source of concern.

No doubt you've read about the booming Sydney and Melbourne residential property markets and how first-home buyers are being shut out. The issue has become so mainstream it's become an election issue.

Less discussed is the fact that the next biggest piece of a typical investor's pie is an allocation to the big banks. The big four banks account for around a third of total sharemarket capitalisation in Australia, which represent one of the highest percentage shares in the world. And their history of profit growth and attractive dividends means many investors allocate even more to the sector than a 'balanced' allocation might indicate.

Banks may look like well-diversified businesses but their loan books are heavily dependent on residential mortgages. According to banking regulator APRA, nearly two-thirds of bank balance sheets are exposed to housing loans.

For retirees with a mortgage, a residential property investment and a share portfolio, this is a potential triple whammy. A residential property price collapse could hurt these investors, hitting their share portfolios, pushing down property prices and potentially driving up interest margins as banks squeeze borrowers to boost their cash flows. In 2009, US property investors learned how painful this can be.

Could it happen here? It's possible. Australia has enjoyed 23 years without a recession and many residential property investors have no experience of a declining market. With interest rates continuing to fall, too many portfolios are dominated by their exposure to domestic residential property with little attention paid to the risks. We're not one to predict the next recession but we do feel that property investors should be better prepared for the possibility of trouble.

The founding father of modern portfolio theory, American economist Harry Markowitz, suggested that the key to high, risk-adjusted returns was diversification. This doesn't guarantee gains or protect against losses but it does help to manage the risk/reward trade off. A suitable mix of investments can help deliver more consistent returns over time.

How might this theory work in practice? If you like the regularity of returns that property offers but want some diversification away from the Australian market, the APN Asian REIT Fund deserves consideration. Offering commercial real estate exposure primarily to three key, developed Asian markets, it has delivered total returns of 17.27% per annum since inception on 19 July 2011 and currently offers a running yield of 6.09% per annum (as at 31 May 2016)[1].

The Fund invests primarily in Singapore, Hong Kong and Japan because they're global gateway cities where land is scarce. Office rents are considerably higher than in Sydney and Melbourne and demand is also much stronger. Much the same argument applies to the retail market. These cities feature some of the most attractive shopping centres you're likely to find, where per capita incomes and education levels are amongst the highest in the world.

If you abide by the old real estate mantra of 'location, location, location', we believe there are few better places to invest in commercial real estate than these global financial hubs. Against the backdrop of record-low interest rates, that running yield makes the argument a little stronger.

Best of all, allocating a portion of your portfolio to the APN Asian REIT Fund adds geographic diversification to your property investment portfolio. In return for accepting some risk through exchange rate movements and exposure to different currencies, investing in overseas markets offers greater investment opportunities and reduces your overall exposure to Australia. Eventually, Australia will have a recession, which may well bring the domestic residential property market's stunning growth to an end. We hope that doesn't occur but 'hope' is not a strategy.

Investors should be prepared for that possibility by ensuring they're not overly-exposed to Australia's property market. The APN Asian REIT Fund is a way of doing just that. And with a management fee discount of 50% offered to investors in the Fund until June 30, now's a great time to reduce your reliance on Australia's property market.

1 Returns after all fees and expenses. Assumes distributions are reinvested. Investors' tax rates are not taken into account when calculating returns. Running yield is calculated by current monthly distributions (annualised) divided by the latest entry unit price. Distributions may include a capital gains component. Past performance is not an indicator of future performance.

This article has been prepared for general information only and without taking your objectives, financial situation or needs into account. You should consider these matters and read the product disclosure statement for the APN Asian AREIT Fund (PDS) in its entirety before you make an investment decision. The PDS is issued by APN Funds Management Limited ABN 60 080 674 479 (AFSL No. 237500) and contains important information about risks, costs and fees associated with an investment in the Fund. For a copy of the PDS and more details about the APN Asian AREIT Fund and its performance, visit our website at www.apngroup.com.au.

APN Property Group
A specialist real estate investment manager

We actively invest in, develop and manage real estate and real estate securities on behalf of institutional and retail investors. APN's approach to real estate investment is based on a 'property for income' philosophy.

Established in 1996, APN's listed on the ASX and manages $2.4 billion (as at 31 December 2015) of real estate and real estate securities. APN trades on the ASX under the code 'APD'.

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