A 2019 prediction; stocks will fluctuate, rents will be stable

Reading the financial press about the outlook for 2019? If so, you've probably got another reason to stay on holiday for as long as possible. According to some, an outlook as wintry as the GFC is upon us. Less concerned types are predicting an 'extremely tough year'. Great.

Financial markets are complex, which is just one reason why forecasters get it wrong. Nevertheless, these annual tablets of wisdom hit our summer reading list as if divine prophecy.

Being based in Melbourne, we know better. If weather forecasters can't get it right for the next three hours, what hope do market forecasters over the next 12 months? It might be interesting to read these opinions but don't expect them to be right. There are better, more useful things you can do with your time.

Here are four simple tips to prepare your portfolio for the year ahead, whatever the weather:

- **Check your asset allocation**
  Research suggests a portfolio's composition plays a big role in overall performance. In Australia, many investors are typically over-exposed to property, Australian shares in general and banks in particular. It's when assets come under pressure, as is currently the case with residential property and bank shares, that investors realise why diversification and sensible levels of exposure to each asset class make sense.

  Tip 1: It's a cliché but only because it's true. Check your asset allocation and don't put all your eggs in one basket.

- **Look for connections between your assets**
  Banks, for example, derive a large component of their profits from lending to the residential sector. These are considered separate assets classes but are highly correlated. Indeed, the recent fall in residential property prices can partly be explained by tighter bank lending standards. If you own your house, an investment property and bank stocks your overall exposure to residential property is probably higher than you realise, great when things are going up but…

  Tip 2: Look for what the professionals call correlated risks by understanding what your underlying or look-through exposure to each asset class is.

- **Ask whether your portfolio is truly diversified**
  A resilient portfolio needs to be diversified by asset type. It may also have an allocation to assets with different attributes, like a preference for capital growth over income for example. Most investors are aware that residential property is primarily a capital growth investment but some may not realise their equity investments have a similar focus on growth, providing them with minimal or no dividends. An exposure to income investments is an important feature for many investors but one often overlooked.

  Tip 3: If you want income, understand which investments you hold to achieve this objective and be clear on how regular and sustainable the income is.

- **Remember that all property is not created equal**
  Whilst it's true that a house, office block and shopping centre are all property assets, from an investment perspective they're worlds apart. Unlike capital growth-focused residential property, the majority of an Australian Real Estate Investment's (AREITs) return comes from income generated from rents from commercial property. This makes them less risky than other equities and less volatile. Because income is based on long term leases (3, 5, or 10 years versus 1 year for residential) financial market and business cycle volatility has less of an impact on earnings. The message is that commercial property investments are income-driven and more predictable than residential property. That kind of understanding should support your asset allocation decisions.

  Tip 4: If you want a higher level of income security in your portfolio, consider AREITs.

When John D Rockefeller was asked what Standard Oil stocks would do, after ponderous deliberation he replied, "Young man, I think they will fluctuate."

We'll know what will happen in 2019 in just over 11 months time. In the meantime, undertake a simple portfolio review using these four tips to ensure it can meet your investment objectives for the year ahead and beyond.

Happy New Year.

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