How to protect your portfolio from a property market crash

Special Report

DECEMBER 2018

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Letter from the Editor

Dear Investor,

The last few years have been instructive for anyone seeking a lesson on how the media influences popular thought.

In the five years to mid-2017, house prices in Sydney and Melbourne rose by 75% and 55% respectively. You may remember the breathlessly reported stories from the period. ***Auction frenzy continues as reserves are smashed across Sydney***, wrote *The Daily Telegraph* in March, 2015.

Stories like this made casual conversations in both cities, and to a lesser extent other capitals, painstakingly dull. Needless to say, a good proportion of the population, spurred on by reports of easy gains, wanted a slice of the action and the banks weren't about to let them down.

In September 2009, annual growth in investor credit stood at about 2.5% a year, by March 2015 it had burst past 10%. *Business Insider* termed a quadrupling in investor credit growth 'nuts'. In December 2014, APRA nudged the banks towards a 10% limit on growth in investor home loans but, with the market hooked on cheap money, it took a while to have the desired effect. By mid-2017, credit growth had slowed and Mr (property) Market's unbridled optimism had lapsed into despondency. Market highs, both very much focused on Sydney and Melbourne, came in the middle of last year.

Then came the falls and some breathless reporting. **Australian property prices facing 'longest downturn in decades'**, claimed UBS in Fairfax papers. **Housing 'powder keg' could blow as 'gravity catches up with stupidity'** claimed the ABC.

Extracting an exaggerated emotional response from readers, whether it be greed on the way up or fear on the way down, has become a mainstream media business model. It is not the job of this special report to pick a point and settle somewhere between these two extremes. There is nothing to be gained except embarrassment from forecasting where things will go from here.

Few people predicted where Australian property prices would head after the biggest financial crisis in 80 years. We're not about to add our name to the list of prognosticators forecasting doom that will be subsequently proved wrong. What we can say is that debt-financed property accumulation leaves many Australians with a portfolio heavily exposed to the residential property market and Australian shares, many of which are exposed to the Australian property market.

This report shows you some practical steps to manage that exposure and to prepare for the possibility of lower property prices.

Yours sincerely,

John Addis
Editor-in-Chief
InvestSMART

“AUSTRALIA’S MAJOR CITIES ARE ALREADY A SPRAWLING MESS. AND YET THE POLICIES ADOPTED BY ALL LEVELS OF GOVERNMENT HAVE MEANT RELEASING LAND ON CITY FRINGES, OR CONVERTING LAND CLOSE TO THE INNER RING TO HIGHER DENSITY LIVING, HAS NOT HAPPENED TO THE EXTENT IT MIGHT.”

Why Australian property prices have risen

Over the past decade, value investors have shown their hand in regards to the Australian residential property market. With an inbuilt bias to look down rather than up, finding one enthusiastic about Australian property has been rare.

Indeed, famous money managers have come to these shores and been agog at how house prices have climbed since the last recession of 1991. 'Tell a European you think there's a housing bubble and you'll have a reasonable discussion,' **wrote famed investor Jeremy Grantham** in May 2011. 'Tell an Australian and you'll have World War III.'

Let's try and make the bull case for property, beginning with a caveat rather than the assassination of an Archduke.

As should be the case with any investment, the bull case for property is based on a long-term view and the interplay of supply and demand.

The supply of land is fixed, particularly for many large Australian cities, which sit on the coast and are bordered by national parks.

Australia has a huge land mass and a small, highly urbanised population. We love our cities and we want to be close to the economic and cultural opportunities they offer. For most people, the likes of Lithgow, Moe and Toowoomba are close, but not close enough.

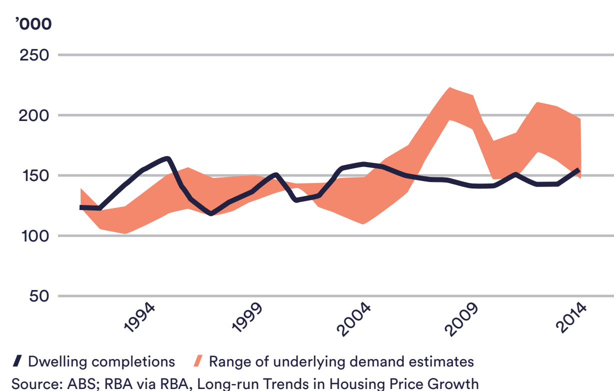
This poses a problem: Australia's major cities are already a sprawling mess. And yet the policies adopted by all levels of government have meant releasing land on city fringes, or converting land close to the inner ring to higher density living, has not happened to the extent it might.

Fortunate residents of outer city suburbs are connected by slow, grotty trains while the unfortunate face a daunting trip on a clogged, expensive toll road. Regional city residents are hardly better off. Those living, for example, in Geelong, Gold Coast and Wollongong face marriage-ending commutes. A 2012 report from Infrastructure NSW noted that today's CityRail express service from Newcastle to Sydney is slower than the pre-war steam train.

Nimbyism and planning regulations hardly help to make affordable housing accessible. Over the past 15 years our politicians and bureaucrats have barely pulled the levers that might increase housing supply to meet demand.

Chart 1: Underlying demand and supply

Additions per financial year



Source: ABS; RBA via RBA, Long-run Trends in Housing Price Growth

Chart 1 is from a Reserve Bank paper on ***Long-run Trends in Housing Price Growth***. It shows the number of dwellings completed each year (the blue line) while the shaded (orange) area represents the range of estimates of underlying demand.

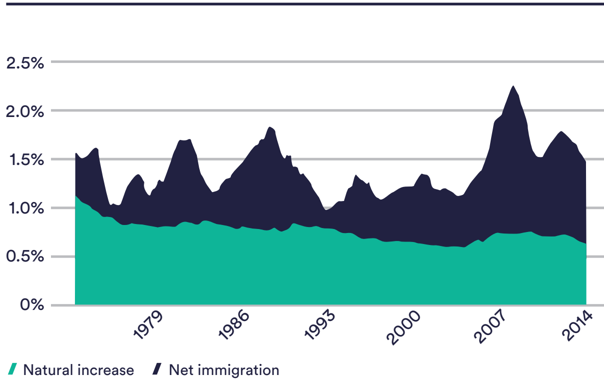
That huge increase in demand from around 2005, unmatched by an increase in dwelling completions, may well explain the property price growth we've seen over the past decade.

On the demand side, the factors are more varied. Looking at the components of rising demand, population growth since around 2005 has really taken off.

Naturally, there are nuances to this argument. Most immigrants head to Sydney and Melbourne. These places are also considered 'global' cities, where overseas investors and global businesses prefer to locate.

Chart 2: Population growth*

Year-ended contributions



Natural increase / Net immigration

*Total population growth is the sum of the components
Source: ABS; RBA via RBA, Long-run Trends in Housing Price Growth

This makes Australia's two biggest cities fundamentally different to the rest of the country. But with one of the fastest growing populations in the western world, demand for Australian property has been increasing across the board.

The bull case for property is predicated on the factors that have led to an increase in demand over the past 20 years remaining in place, whilst supply is similarly constrained.

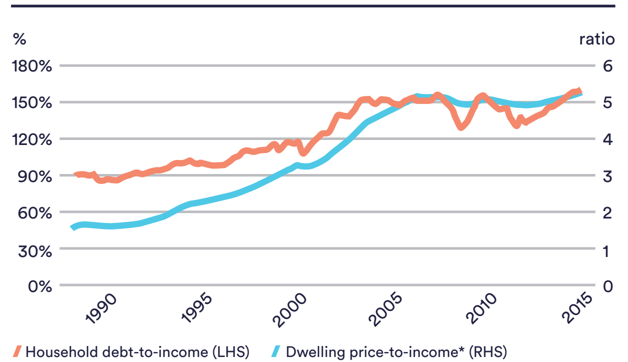
Think about it like this. When you add an investment property yield of, say, 2.5% to GDP growth of 4–5% that's not so bad, especially when the investment case is predicated on governments continuing to avoid sensible policies whilst maintaining bipartisan support for high levels of immigration.

How they may have gone too far

But there are two more important factors that have driven Australian property prices higher and they might be less reliable.

Financial deregulation began in the mid-1980s and ended in 1996 with the privatisation of Commonwealth Bank. This has made mortgage credit more readily obtainable. According to the RBA report: 'Over time, financial deregulation, together with increased competition, has increased borrowers' access to credit and reduced its cost.'

Chart 3: Debt-and price-to-income ratios



Household debt-to-income (LHS) / Dwelling price-to-income* (RHS)

*Mean dwelling price
Source: RBA, Long-run Trends in Housing Price Growth Via ABS; CoreLogic RP Data; RBA

That naturally led to an increase in demand, right at a time when interest rates were falling. 'Previously credit constrained households were increasingly able to borrow more for a given level of income and pay higher prices,' said the RBA. But without 'a corresponding increase in supply in the most desirable locations, this was likely to have led to a pick-up in housing price growth, and household debt, for a protracted period.'

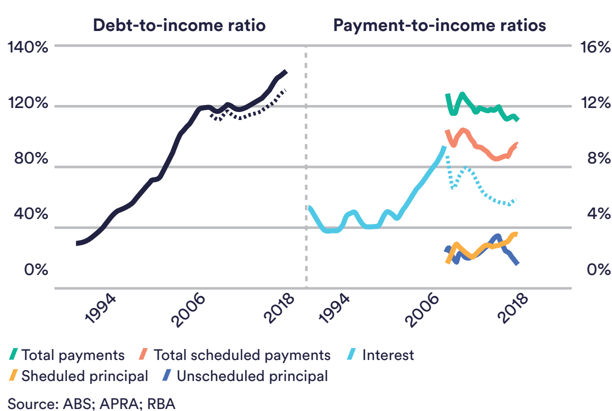
The result was a long-running increase in the ratio of household debt to income and dwelling price-to-

income ratio. Thirty years ago Australia's household debt was about 70% of GDP. It is now over 120%.

Over the past decade, the debt ratios have stabilised at their new higher levels as interest rates have stabilised at lower levels. Indeed mortgage serviceability has actually improved over the past decade as payment-to-income ratios have fallen. That's why the RBA recently claimed that a household debt crisis was 'not imminent'.

But the high debt levels – described as 'extremely elevated' by **UBS** and a 'ticking time bomb' by **Macrobusiness** – mean that households and property prices remain highly exposed to any increases in interest rates.

Chart 4: Household mortgage debt indicators



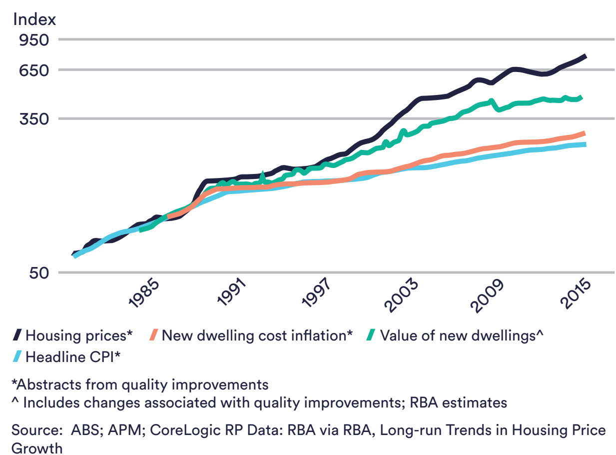
Source: ABS; APRA; RBA

There's one more point worthy of note: we have a taxation system hand-crafted to encourage property market speculation, in the form of capital gains tax discounts and the tax deductibility of interest ('negative gearing'). We won't rehearse the arguments for or against these tax breaks, but the rising cost of housing have brought both into the political firing line in recent years and it's increasingly likely they'll be watered down or removed.

So, where does this leave us? With a housing market where prices have risen well ahead of the cost of building new homes. This is what that looks like over the long term:

Chart 5: Inflation, housing prices and quality

June quarter 1986 = 100, log scale



*Abstracts from quality improvements
^ Includes changes associated with quality improvements; RBA estimates

Source: ABS; APM; CoreLogic RP Data: RBA via RBA, Long-run Trends in Housing Price Growth

Over the very long term, we'd expect property prices to track economic growth – which typically runs at a per cent or two above inflation – but in recent years they've comfortably exceeded that.

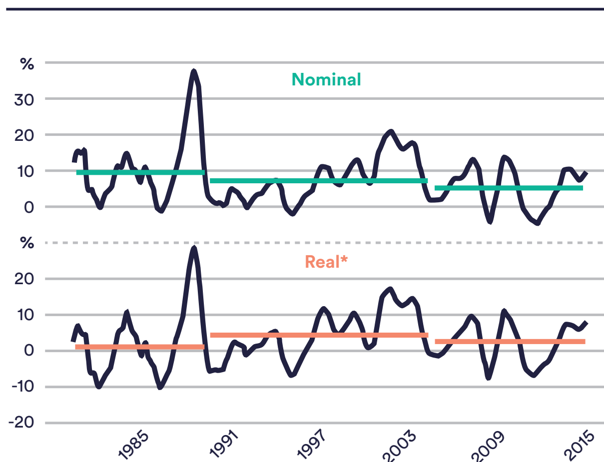
Property prices can go down

In most consumer markets companies can respond to increasing demand quite quickly. If a retailer finds a new range of clothing is flying off the shelves, more can be ordered and delivered in a matter of weeks. Zara's vertical integration, for example, means even new designs can be in-store within a month of conception.

Housing isn't like that. Land acquisition, planning approvals and construction can take years. That means supply doesn't respond to changes in demand quickly. The result is a housing market more volatile than many people might imagine.

Chart 6: Housing price growth

Year-ended



*Deflated by healding CPI

Sources: ABS; APM; CoreLogic RP Data; RBA via RBA, Long-run Trends in Housing Price Growth

Chart 6, again from the RBA report mentioned previously, shows changes in housing price growth over the last 35 years in nominal and real terms.

Over the past 30 years, house prices have risen by 7.25% a year on average, although, as the red horizontal lines show, there have been periods when this figure has been substantially higher and lower than that. In real terms, after accounting for inflation, house price growth averaged 1.4% a year in the 1980s, 4.5% in the 15 years from 1990 and 2.5% in the decade after 2005. That's quite a variation.

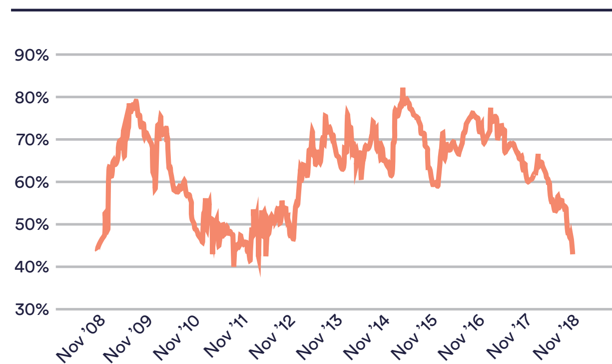
But the swings in house price growth over shorter periods are even greater. Over the past few decades there have been many occasions when real house price growth has gone from more than 10% a year to less than minus 5% in the space of a year or two, most recently following the global financial crisis.

Because we buy and sell property infrequently, we tend not to see the volatility in the same way we do shares. But it's there alright.

That's the background to the current environment, in which news reporting could lead one to believe house prices have never fallen before, when in fact they do so all the time. So, what's the most logical explanation for the current falls?

This goes directly to the heart of the demand and supply issue. At a time when access to mortgage credit is falling to record lows, mortgage interest rates are rising and wages growth is barely keeping pace with inflation, cranes dot the skylines of our cities. The result is a fall in auction clearance rates from over 70% two years ago to around 45% now.

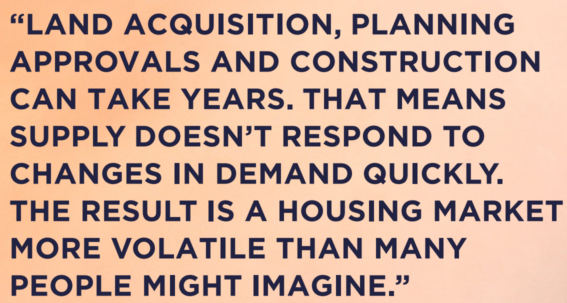
Chart 7: Weekly clearance rate, combined capital cities



Source: CoreLogic via Business Insider

'This is indicative of a housing market that has weakened and one where there is a mismatch between the expectations of buyers and sellers,' Gareth Aird, CBA Senior Economist **told Business Insider**. 'As such, prices are adjusting downwards.'

Sydney's auction clearance rate is now at **decade lows** while Melbourne's is **reported** to be even lower, at 41%. The result of lower demand and burgeoning



“LAND ACQUISITION, PLANNING APPROVALS AND CONSTRUCTION CAN TAKE YEARS. THAT MEANS SUPPLY DOESN’T RESPOND TO CHANGES IN DEMAND QUICKLY. THE RESULT IS A HOUSING MARKET MORE VOLATILE THAN MANY PEOPLE MIGHT IMAGINE.”

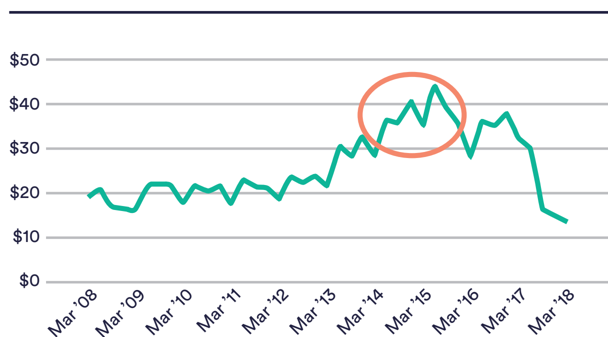
supply is lower prices. According to CoreLogic, Melbourne home price falls have fallen 4.7% over the past year while Sydney prices have tumbled 7.4%.

This shouldn't be a surprise. Price falls of this magnitude are commonplace over recent decades. One might also argue modest price falls are exactly what the Reserve Bank and other regulators have been trying to provoke.

The RBA has noted the 'build-up of risks associated with the housing market' while APRA now demands that banks limit interest-only lending to just 30% of new residential mortgages. Foreign investors also face tighter controls whilst banks are conditioning us to accept out-of-cycle rate rises.

The result is a substantial decline in the rate of growth of housing related debt, primarily through a fall in interest-only loan approvals.

Chart 8: Value of new interest-only loans approved per quarter



Source: Finder.com, RBA via The New Daily

The question on many people's minds is how far prices will drop. Here's **Shane Oliver of AMP Capital** on the matter:

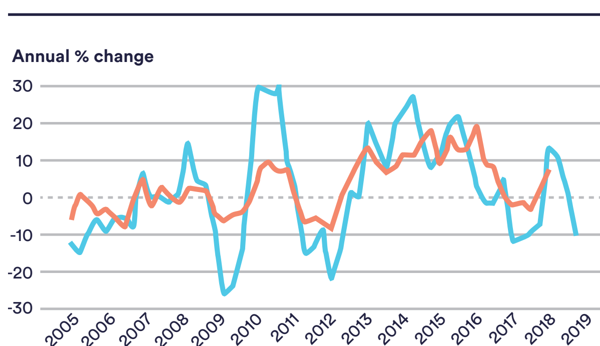
'With prices now falling naturally the calls for a property crash are getting a lot of airing. But these have been wheeled out endlessly over the last 15 years or so. Our assessment remains that a crash (say a 20% or more fall in national average prices) is unlikely unless we see much higher interest rates or unemployment (neither of which are expected) or a continuation of recent high construction for several years (which is unlikely as approvals are falling) and a collapse in immigration.'

The possibility of a crash, just as the reasons for the rise, again come back to supply and demand. Unfortunately, the question as to how far prices might fall won't be answered correctly until history has had its way. As Howard Marks says: 'Ignoring cycles and extrapolating trends is one of the most dangerous things an investor can do' but it happens all the time.

At some point psychology takes over. The panic induced by a small fall in house prices can lead to bigger falls, although with building approvals declining, supply might be tightening.

Whether house prices fall further or not shouldn't prevent an examination of the risks of things getting worse. If, in the face of additional price falls, banks further tighten credit availability and consumers, worried about meeting their mortgage repayments, reduce their discretionary spending, the economic impact would be more widely felt. Were Australia to enter a recession those risks would increase.

Chart 9: Building approvals are pointing to a fall in home building



Source: ABS, AMP Capital via AMP Capital

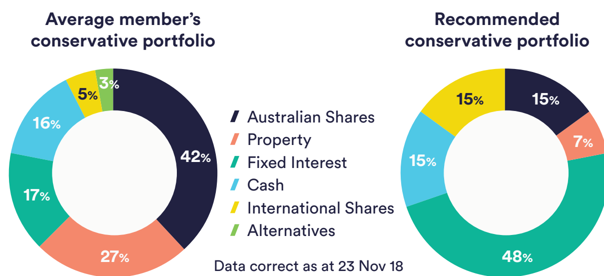
The issue, then, is not one of predicting whether house prices might crash but in managing the risk that they might. It is here that many investors are exposed, perhaps dangerously so.

Your biggest risk: over-exposure to property

In a column titled ***The warning signs you should heed***, written in August last year, I noted how this was 'an odd world in which we're trying to invest; one where record low interest rates have pushed investors out of cash and bonds and into property and shares'.

At the time, Australian stocks were priced at a multiple about 20 per cent above their long-term historical average (in the US it was almost twice that) and households were more indebted than ever. That didn't seem to worry investors. The market absorbed shocks like Brexit, Trump, ballooning sovereign debt and record low interest rates, sending volatility to record lows. The result was a typical investor's asset allocation looking something like this:

Chart 10: Recommended asset allocation



The figures in Chart 10 are from InvestSMART's free portfolio manager. It maintains the portfolios of over 100,000 investors, about 10,000 of whom class themselves as 'conservative'. The chart on the left shows their average asset allocation; on the right is InvestSMART's recommended asset allocation.

The differences are eye-popping. As of November 2018, the average member had a 27% asset allocation to property (excluding the family home) whilst the recommended weighting was just 6.9%. The recommended weighting to Australian shares was 14.7%, as it was for international shares. The actual weightings were 42% and 5% respectively.

You can argue with the recommended numbers but there aren't many scenarios under which having a quarter of one's investment portfolio allocated to property, with most of the rest in Aussie equities, is a good idea.

After 28 recession-free years, Australians have steadily climbed up the risk curve, underweight cash, fixed interest and international equities and overweight property and Aussie equities. For investors classing themselves as growth-orientated, at an average 34% exposure to property, it was even worse.

These figures almost certainly understate the true nature of the average investor's over-exposure to property because in most cases these figures exclude the value of the family home. Shares in Australian Real Estate Investment Trusts (AREITs), bank hybrids and other stocks related to property, construction and development are also excluded, despite the property market having a direct bearing on their performance.

The conclusion is obvious: too many Australian investors are overexposed to the property market through direct and indirect investments. But it's not too late to do something about it.

OVER 60% OF ALL BANK ASSETS ARE
ASSOCIATED WITH HOME LENDING.
IF YOU OWN MORTGAGED INVESTMENT
PROPERTIES AND BANK SHARES YOU
ARE DOUBLY EXPOSED TO A PROPERTY
DOWNTURN.

How to reduce your property exposure

Over the years, we've made repeated warnings about over-exposure to property. If your situation is similar to the one described above, it may be worth taking action.

Before describing what you *might* do, let's first recognise the unique position of the family home. Although it may be worth a great deal, everyone needs somewhere to live and that should be the primary reason for owning it. We have therefore excluded it from our thinking. What follows relates only to your investments, not your place of residence.

There's a second caveat. If you own a good number of investment properties and want to reduce your risk to the sector, the only way of effectively doing so may be to sell one or more of them. But if you own only one or two the matter might not be so pressing. Property transaction costs are significant and investment properties are best viewed as long-term investments.

This means living with the risk of a downturn, suffering the consequences if one occurs and holding on for the recovery. If you're not prepared or unable to do that, again, you may have no choice other than to sell.

We're going to assume that for most people this is not the case, which is why our focus is on reducing your over-exposure to property through your share rather than your property portfolio. There are three ways to do this:

1. Reduce your exposure to the big banks

The major banks have their fingers in every financial pie but don't be fooled: their profitability is heavily dependent on mortgages. Over 60% of all bank assets are associated with home lending. If you own mortgaged investment properties and bank shares you are doubly exposed to a property downturn.

There are few sectors that elicit such strong feelings as the banks. It's easy to point to the dangers – tightening credit, increasing interest rates, high systemic debt, a property downturn, and high leverage of the banks themselves. And yet despite ever-present risks, they've performed well over the long term.

So well, in fact, that for many investors the big banks form the centrepiece of their portfolio. At seminars and through emails, comments and Q&As, we know that many members have large weightings to the sector.

One of the key planks of our advice over the years has therefore been to explain the risks and encourage members to keep their bank weightings in check. We're going to take this opportunity to make that point again.

On top of economic risks, the Royal Commission is likely to lead to tighter regulation and lending standards (thereby restricting credit growth and perhaps exacerbating property price falls) and a slew of remediation, fines and litigation. There's also the threat of technological disruption and the potential for increased competition.

TABLE 1: RECOMMENDED BANKING SECTOR WEIGHTING LIMITS

Company (ASX Code)	Price at 5 Dec 2018	Latest Recommendation	Max. Portfolio Weighting
Commonwealth Bank (CBA)	$70.00	14 Nov 18 (Hold - 69.47)	8%
Westpac Bank (WBC)	$25.59	9 Nov 18 (Buy - $27.70)	8%
ANZ Bank (ANZ)	$26.17	2 Nov 18 (Hold - $25.52)	8%
NAB (NAB)	$24.18	6 Nov 18 (Hold - $25.39)	8%
Maximum sector weighting			20%
Maximum sector weighting (conservative investors, or members with existing significant exposure to property)			10%

The acknowledgment of at least some of these threats is now being expressed through share prices. In October, Westpac joined our **Buy List** and the other major banks are close to following suit. But it is one thing to buy a stock and quite another to have too much of it.

Over the years we've stressed that members should have a maximum of 20% of their portfolios exposed to the banking sector, or closer to 10% for more conservative investors or those with significant other exposure to the property sector.

At times we've considered reducing these limits, but we've chosen instead to emphasise that we think **most members should probably be using a limit closer to 10%** – and to stress that it's a maximum rather than a recommended weighting.

Individually, the four major banks have maximum portfolio weightings of 8%, as you can see from Table 1. We don't cover the regional banks but, if you own them, then these should also be added to your sector weighting. We also don't cover bank 'hybrid' securities, but since these are typically subject to conversion into ordinary shares in times of stress, they should also be included in weightings.

AMP and Macquarie Group also own banks, but these are relatively small parts of the group, so we wouldn't include them within your major bank exposure. However, if you do own them, then it would be further reason to keep your banking sector weightings in check.

How the maximum sector weighting of 10% for conservative investors breaks down within your own portfolio is really a matter for you. The important thing is to keep within the overall and individual weighting limits.

2. Sell down stocks with direct property exposure

It isn't just banks that have direct exposure to the property market. Real estate is a huge sector of the economy, covering everything from agents to home builders and building material companies.

Some Australian property trusts (AREITs), including **Stockland** and **Mirvac**, have direct exposure to residential property through development activity, but it's safest to assume that all AREITs would be directly affected by a sharp residential property downturn.

In addition to banks and AREITs, stocks in Table 2 will be directly affected by a property downturn. This isn't

TABLE 2: STOCKS INDIRECTLY EXPOSED TO PROPERTY

Company (ASX Code)	Price at 5 Dec 2018	Latest Recommendation	Max. Portfolio Weighting
Domain Holdings (DHG)	$2.40	20 Nov 18 (Buy – $2.44)	4%
REA Group (REA)	$76.67	13 Aug 18 (Hold – $87.49)	6%
News Corp (NWS)	$17.97	9 Oct 18 (Buy – $19.15)	5%
Genworth	$2.21	Not covered	NA
Brickworks (BKW)	$17.00	24 Sep 18 (Hold – $16.18)	6%
James Hardie (JHX)	$15.73	24 May 18 (Hold – $22.16)	5%
Fletcher Building (FBU)	$4.51	Not covered	NA
McGrath (MEA)	$0.31	Not covered	NA
Reece (REH)	$10.07	23 Nov 18 (Hold – $9.97)	5%
DuluxGroup (DLX)	$6.76	21 May 18 (Hold – $7.81)	6%
Adelaide Brighton (ABC)	$5.10	6 Mar 18 (Hold – $6.90)	4%

TABLE 3: STOCKS DIRECTLY EXPOSED TO PROPERTY			
Company (ASX Code)	**Price at 5 Dec 2018**	**Latest Recommendation**	**Max. Portfolio Weighting**
Village Roadshow (VRL)	$2.50	Not covered	NA
Flight Centre (FLT)	$46.50	**26 Sep 18** (Hold – $52.58)	6%
Carsales.com (CAR)	$11.81	**14 Nov 18** (Buy – $11.61)	6%
AP Eagers (APE)	$6.63	Not covered	NA
Automotive Holdings (AHG)	$1.57	Not covered	NA
JB Hi-Fi (JBH)	$22.62	**15 Aug 18** (Hold – $25.49)	4%
Harvey Norman (HVN)	$3.24	Not covered	NA
Crown Resorts (CWN)	$11.55	**14 Aug 18** (Hold – $14.36)	5%

a recommendation to sell them altogether, merely to watch your portfolio weightings for each stock and establish your overall direct exposure to the property sector by adding your weightings together and adjusting accordingly.

The aim is to get an overall picture of your exposure, including the banks, AREITs and any stocks with direct property exposure (examples of which are given in the table below), and adjust accordingly.

3. Sell down stocks with indirect property exposure

It is said that Australians will do almost anything to avoid missing a mortgage repayment and there is some truth to that. Despite **reports of mortgage stress** there's little evidence of default. **ANZ Bank's recent result**, for example, showed provisions for bad debts at 0.12% of gross loans. In the words of our banking analyst Rakesh Tummala, this might be the 'lowest in many decades, if not ever'. Figures for the other major banks are equally low.

That, of course, doesn't mean it will stay that way. But if interest rates were to rise – and there's little sign of that just yet – homeowners are likely to cut back on discretionary spending in order to meet their monthly mortgage repayments.

This sort of thing can lead to recessions and there aren't many stocks that will escape one of those, but you have to draw the line somewhere, so we'd recommend including any stocks that are highly exposed to discretionary consumer spending.

You can see the type of stock you might include in Table 3. Again, it's not an exhaustive list, but we'd suggest these would be among the first to feel the tightening of homeowners' belts.

Now, what should you do with all this information? The end point is to establish your overall portfolio exposure to property by adding your overall bank holdings to your direct and indirect exposures to the sector.

We recommend that figure does not exceed 30% for conservative investors (assuming a 10% weighting to the banks) or 40–50% for more aggressive investors, depending on how broadly you define your exposures.

The main thing is to spend some time thinking about your holdings and assessing how they'd be affected by a property downturn.

After conducting this exercise, you may find you need to sell down some of your holdings. When you do you'll reduce the asset allocation risk in your portfolio and have a nicer problem to address.

"THE BEST DEFENCE AGAINST A LOCAL PROPERTY DOWNTURN IS TO INCREASE ONE'S INTERNATIONAL EXPOSURE, WHICH IS NOW MUCH EASIER THAN IT ONCE WAS."

What to buy with the proceeds

Recent market falls have made the issue of investing in new opportunities a little easier. At one stage this calendar year our **Buy List** had just seven stocks on it; now it has more than double that.

That is not to say the cash released from stock sales should burn a hole in your pocket. We have no idea whether stock prices will continue to fall from here or recover. Instead, we prefer to make our decisions based on the value on offer in each particular situation.

There is, however, one big issue that remains unaddressed. According to InvestSMART portfolio manager data, the average Australian investor has over 40% of their portfolio allocated to Australian shares. Loading up on locally listed stocks isn't necessarily sensible.

And the corollary of most investors being over-exposed to Australia's economy through ASX-listed stocks is that they're under-exposed to everywhere else.

Here are two options to reduce your exposure to Australia's economy and a mini-portfolio of attractively-price ASX-listed stocks where profitability isn't heavily dependent on discretionary expenditure. Both offer protection against a local downturn.

1. Increase your overseas exposure

According to figures from **InvestSMART's portfolio manager**, only 5% of the average conservative investor's portfolio is allocated to international exposure. The InvestSMART recommended weighting is almost three times that. The best defence against a local property downturn is to increase one's international exposure, which is now much easier than it once was.

Not only are there listed international fund managers like **Platinum Asset Management** and PM Capital, which, like Platinum, runs a **global** and an **Asian fund**, the flood of exchange traded funds now makes obtaining international exposure as simple as buying a locally-listed entity. A special report from 2016 – ***Investing overseas without leaving home*** – is well worth a read, especially the introduction, for those wanting to know more.

Pushing our own barrow, the **InvestSMART International Equities Portfolio**, built around a portfolio of ETFs, is one of the easiest and cheapest ways to improve your international diversification. With a capped fee of $451 a year, regardless of the amount invested (and even cheaper for small amounts), plus ETF fees of about 0.19% (based on an indirect cost ratio) it's a cost effective way to reduce your dependence on Australian shares.

TABLE 4: STOCKS WITH OVERSEAS EXPOSURE

Company (ASX code)	Price at 5 Dec 2018	Latest Recommendation	% above/(below) Buy price	Max. Portfolio Weighting (%)
News Corp (NWS)	$17.97	9 Oct 18 (Buy – $19.15)	(10.20%)	5%
Trade Me (TME)	$5.90	21 Nov 18 (Hold – $5.65)	18.00%	6%
Hansen (HSN)	$3.56	20 Aug 18 (Hold – $3.51)	18.70%	5%
CSL (CSL)	$179.75	26 Nov 18 (Hold – $182.32)	19.80%	7%
Ansell (ANN)	$22.76	21 Aug 18 (Hold – $25.53)	26.40%	7%
Computershare (CPU)	$17.41	28 Nov 18 (Hold – $18.89)	36.20%	7%
ResMed (RMD)	$15.22	7 Nov 18 (Hold – $14.47)	45.00%	7%
Cochlear (COH)	$170.71	15 Aug 18 (Hold – $195.58)	77.80%	7%

TABLE 5: PROPERTY PROTECTION MINI PORTFOLIO			
Company (ASX Code)	**Price at 5 Dec 2018**	**Latest Recommendation**	**Max. Portfolio Weighting**
Coles (COL)	$11.82	22 Nov 18 (Buy – $12.87)	7%
Unibail-Rodamco-Westfield (URW)	$11.24	12 Nov 18 (Buy – $12.59)	6%
Sonic Healthcare (SHL)	$22.55	14 Nov 18 (Buy – $21.80)	5%
Ramsay Health Care (RHC)	$55.89	30 Oct 18 (Buy – $55.20)	7%

2. Buy local stocks with overseas earnings

The second way to increase your international exposure is to buy ASX-listed stocks that generate a high percentage of earnings from overseas.

Whilst we have only one Buy recommendation among these stocks it may still make sense to buy stocks we rate as Hold. You can see a list of suggestions in Table 4.

If we regard a stock as overvalued, then we'll recommend selling, so a Hold recommendation indicates we see a stock as slightly undervalued, but not enough to provide sufficient margin of safety for an outright Buy. But it may still make sense to buy a Hold recommendation if it improves your portfolio balance, particularly if the current price is relatively close to our Buy price.

3. Follow our property protection mini-portfolio

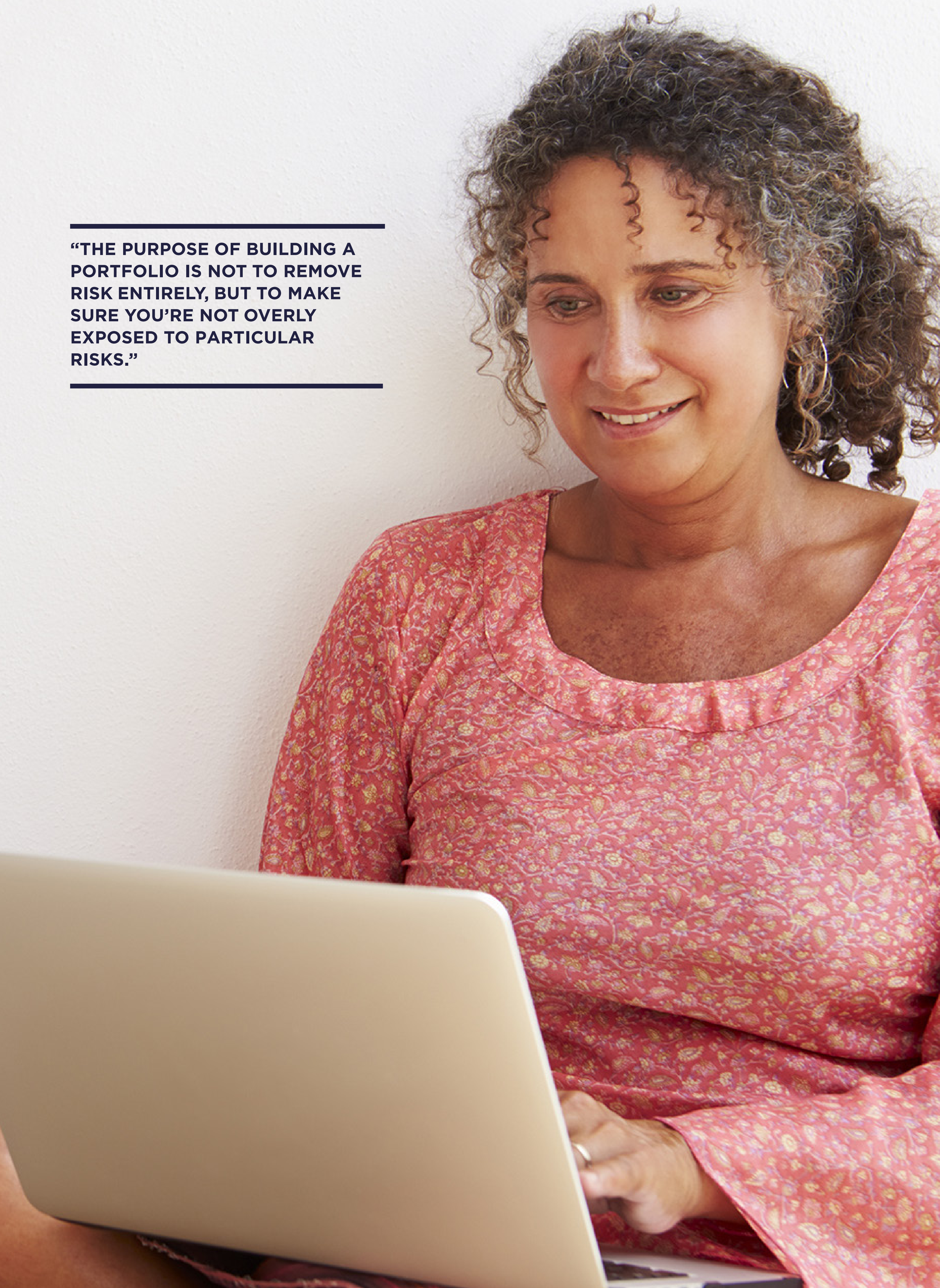
Finally, Table 5 provides a mini-portfolio of four attractively priced stocks that could help insulate your portfolio against a property crash.

All of these stocks are buy recommendations at the time of writing, and between them they have a maximum portfolio weighting of 31%, although bear in mind that with most of them we wouldn't advocate going to the full maximum weighting at current prices.

Of course, even if these stocks aren't exposed to Australian residential property, they each have their own risks: Unibail-Rodamco-Westfield is threatened by the rise of online retail; Ramsay Health Care is struggling against weak admissions in the UK and France; Sonic Healthcare is threatened by the Government's new health records database; and even Coles is struggling for sales growth against a resurgent Woolworths.

But in each case we think the risks are more than offset by an attractive price – and the purpose of building a portfolio is not to remove risk entirely, but to make sure you're not overly exposed to particular risks. We hope this report will help you protect your portfolio from the threat of a major property downturn.

Note: The original version of this report included IOOF as one of the Buy recommendations in our 'property protection mini-portfolio', but after proceedings were issued against it by APRA, it was downgraded to Hold and it has therefore been removed.


"THE PURPOSE OF BUILDING A PORTFOLIO IS NOT TO REMOVE RISK ENTIRELY, BUT TO MAKE SURE YOU'RE NOT OVERLY EXPOSED TO PARTICULAR RISKS."

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