

# Investors balk if interest rates hit double figures

In tough times there's a definite pattern and a rationale in equities investment gearing behaviour, explains **John Wasiliev**.

**W**hen financial services researcher Investment Trends surveyed 1600 investors with margin loans late last year, a key finding was potential resistance to equities investment gearing if interest rates crossed 10 per cent.

"We found that 78 per cent – nearly four out of five – said they would stop borrowing new money at a greater than 10 per cent interest rate," says Investment Trends principal Mark Johnston. All the suggestions were that 10 per cent was likely to be a key conceptual hurdle, he says.

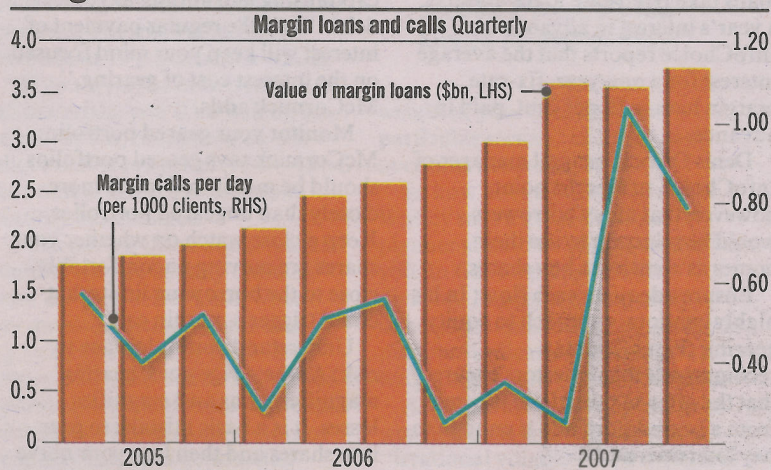
At the time investors were being questioned, margin loan interest rates were getting close to the double digit hurdle rate at between 9.5-9.7 per cent after having been about 9 per cent for most of the year. They went up each time the Reserve Bank of Australia increased the cash rate by a quarter of a percentage

point in August and November. With borrowing rates since following the two quarter of a percentage point rises in the RBA rate – one in March and one in February – they are well and truly into that zone at around 10.5 per cent.

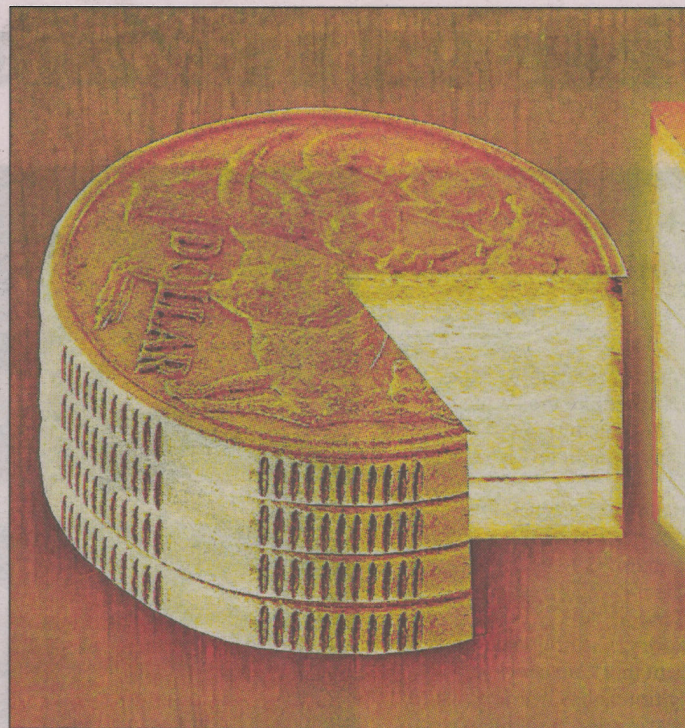
Johnston says results of the survey suggest there is an interesting psychological aspect to the interest rates question. "People seem to think in round percentage points. So 9.9 per cent is okay but crossing above 10 per cent is where people say it will affect their investing behaviour," he says.

Another broad comment from more than half of margin borrowers was that a 10 per cent interest rate will see them begin paying down their loans or reducing their level of gearing. At 11 per cent this proportion increases while at 12 per cent there are very few investors who indicate they won't be actively paying down their loans, says Johnston.

## Marginal business



SOURCE: RBA



So have investors followed up their words with action? According to Commsec's Brian Phelps, while there has certainly been a slowing in margin lending activity since interest rates rose, they haven't been in double digits long enough to assess this suggestion properly.

From Commsec's perspective, what hasn't happened as yet is any major reduction in the \$9 billion lender's loan book. Potential new clients were also still signing up for margin loans during the first quarter of calendar 2008 which certainly didn't indicate any massive concern about higher interest rates.

But while there hasn't been any reduction in the total loans that Commsec looks after, Phelps admits there also hasn't been any real growth in recent weeks. This could suggest that what is happening is that some clients are reducing their loans and they are being replaced by

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new borrowers.

But Peter van der Westhuyzen, head of margin lending sales at Macquarie Investment lending, does not agree that a greater than 10 per cent rate will deter margin investing. He doesn't think interest rates are as influential as the survey result suggest.

"The reason I believe that is

because I think serious investors make decisions not on interest rates but rather where they see value in the sharemarket," van der Westhuyzen says. Before they make any decision on whether to employ margin lending to fund any investment, investors look for investment opportunities. Where they see opportunities, the next decision they make is how much they will fund an investment.

Investment funding will be based on an assessment of the after-tax net cost of making the investment, he says.

"So if the after-tax net cost of borrowing sense they will make the investment with gearing," says van der Westhuyzen. The less influence interest rates play in margin lending, he says, is because of the fact that when the Reserve Bank's margin lending numbers for the March quarter are released, the protected lending is likely to show a significant increase in popularity over the quarter compared to the same months ago. And the interest rates on protected loans are currently between 13 and 15 per cent.

Van der Westhuyzen says that when investors can see through the market noise due to the current volatility it is likely they will continue that net after-tax costs have been coming down because the dividends on large dividend income paying companies have gone up as share prices have fallen.

Where the price reduction

To avoid slippage and other ills, deal with sat