Private Capital Advisers

Market Report – April 2024

Market returns

The first quarter of 2024 produced strong gains in growth assets with markets continuing from where they left off in the last quarter of 2023. The main driver appears to be improving sentiment around the prospect of inflation being brought under control without an accompanying recession - the so-called soft landing. As we see in Figure 1, the last two quarters returns have significantly contributed to a very strong 12 months. So much so that we now have had excellent overall returns from growth assets over three years and five years - in fact, much higher than we expect to see going ahead.

Figure 1: Performance (% pa) for periods ending 31 March 2024

	3mo	6 mo	1 year	2 years	3 years	5 years
Australian equities[1]	5.3%	14.2%	16.2%	8.7%	11.1%	10.7%
International equities[2]	13.9%	19.8%	28.5%	15.7%	14.4%	14.1%
Listed property[3]	16.8%	36.1%	36.6%	8.4%	11.4%	6.4%
Global Infrastucture[4]	2.8%	11.1%	3.7%	1.0%	6.4%	4.3%
Bonds[5]	1.0%	4.9%	1.5%	0.9%	-1.3%	0.2%
Term deposits[6]	0.7%	1.3%	2.2%	1.7%	1.5%	1.8%
Cash[6]	1.1%	2.1%	4.1%	2.8%	1.9%	1.4%

1.ASX 200 inc Franking; 2. MSCI World Ex Aus Index; 3. ASX A-REIT Index; S&P Global Infra (hedged); 5. Aust Comp Bond Index; 6. RBA data

Australian equities

The strong first quarter returns were broad based with most sectors joining in other than resources. The financials were particularly strong on the back of increased expectations around a soft landing for the Australian economy.

International equities

Similarly, the international equities rally was also broad based if led by the US and Japanese equities which were particularly strong. Returns were further improved by a 4% fall in the Australian dollar which has the impact of increasing international returns because a falling Australian dollar increases the Australian dollar value of international shares.

Listed Property and Infrastructure

We saw a major departure between the returns of A-REITs and Infrastructure over the quarter with A-REITs producing outstanding returns on the back of a 35% increase in the price of the Goodman Group (which now makes up 34% of the A-REIT index). Over the next decade we now expect substantially higher returns from Infrastructure as compared with A-REITs.

Bonds

Bond returns were in line with their underlying yield of 4% pa.

Cash

The RBA maintained cash rates at 4.35%. We expect that this is close to the peak in cash rates with the main uncertainties being how long cash rates will need to remain at these levels to bring inflation under control and how far the RBA will reduce rates when they believe it prudent to do so. Our expectation remains that cash rates will settle in the 2% to 3% range at some point over the coming three years.

Inflation and interest rates remain the key

Investors' perceptions of the likely outlooks for inflation and interest rates will continue to drive market returns over the next few years with the most recent quarter being no exception. From a longer-term perspective, tight labour markets remain the main worry for Central Banks. While the possibility of a wages breakout and accompanying wage-price spiral remains, we expect that Central Banks will be loath to cut interest rates prematurely. Hence our expectation that it may be three years before cash rates returns to more normal levels.

The Long-Term outlook for returns

As always, the short-term remains highly uncertain however, the much longer term – five to ten years – can be more reliably forecast. As can be seen in Figure 2, the outlook going ahead is reasonable, if much lower than the experience of recent years.

As markets have risen over the past six months, our expectations for long-term returns have reduced somewhat because, paying more for the same future cash flows, means lower expected returns than previously were the case.

Figure 2: Ten-Year Forecast Returns (% pa) as at 31 March 2024

	Australian Equities[1]	Developed Markets[2]	Listed Property[3]	Infrastructure	HY Debt[4]	TDs[5]
Income	5.2%	1.6%	3.7%	4.5%	8.1%	4.0%
Currency gain/loss		0.1%		0.3%		
Earnings growth	3.4%	3.1%	2.9%	3.2%	0.0%	0.0%
Valuation change	-2.0%	-1.3%	-2.0%	0.6%	-1.2%	0.0%
Forecast 10 yr return	**6.6%**	**3.6%**	**4.6%**	**8.6%**	**6.9%**	**4.0%**
PE Now	20.2	20.8		8.2		
PE 2033(f)	16.5	18.3		8.7		
Yield 2033 (f)			4.5%			

1. All Ordinaries Index; 2. MSCI World Index; 3. ASX A-REIT Index; 4. Non-investment grade credit; 5. Forecast return on Bank TDs over the next decade.

These forecasts for the next ten years are built up from assessing what we earn from dividends, how fast we expect company profits and property rents to grow and how much we expect future investors will pay for those profits and rents. While they are obviously based on estimates and are far from perfect, they generally come out within a few percent of the original estimate.

Another way of looking at these forecasts is via the Tipping Point Tables which shows whether different markets are Overpriced, Cheap or somewhere in between.

Figure 3: The Tipping Point Tables

Australian Equities		US equities		World Ex US		A REITs		Global Infrastructure		Hi Yield Debt	
All Ords 8,153.8	10 yr F'cast return	S&P500 5,254.35	10 yr F'cast return	FTSE World Ex US 342.4	10 yr F'cast return	ASX REIT 1743.6	10 yr F'cast return	MSCI Global Infra (H) 3092.28	10 yr F'cast return	Bof A HY Spread 3.15%	10 yr F'cast return
10000	3.6%	5000	2.0%	550	1.3%	2300	1.0%	5000	2.2%	0.5%	3.7%
9750	4.0%	4800	2.4%	525	1.8%	2200	1.6%	4800	2.7%	1.0%	4.2%
9500	4.4%	4600	2.9%	500	2.4%	2100	2.2%	4600	3.2%	1.5%	4.7%
9250	4.7%	4400	3.4%	475	3.0%	2000	2.8%	4400	3.8%	2.0%	5.2%
9000	5.1%	4200	3.9%	450	3.7%	1900	3.5%	4200	4.4%	2.5%	5.7%
8750	5.5%	4000	4.5%	425	4.3%	1800	4.2%	4000	5.0%	2.8%	6.0%
8500	6.0%	3800	5.0%	400	5.1%	1700	4.9%	3800	5.7%	3.0%	6.2%
8250	6.4%	3600	5.7%	375	5.9%	1600	5.8%	3600	6.4%	3.3%	6.5%
8000	6.9%	3400	6.4%	350	6.8%	1500	6.7%	3400	7.2%	3.5%	6.7%
7750	7.3%	3200	7.1%	340	7.2%	1450	7.2%	3300	7.6%	3.8%	7.0%
7500	7.8%	3000	7.9%	330	7.6%	1400	7.7%	3200	8.1%	4.0%	7.2%
7250	8.4%	2800	8.7%	320	8.0%	1350	8.2%	3100	8.5%	4.3%	7.5%
7000	8.9%	2600	9.7%	310	8.4%	1300	8.8%	3000	9.0%	4.5%	7.7%
6750	9.5%	2400	10.7%	300	8.9%	1250	9.4%	2900	9.5%	5.0%	8.2%
6500	10.1%	2200	11.8%	290	9.3%	1200	10.0%	2800	10.0%	6.0%	9.2%
6250	10.8%	2000	13.1%	280	9.8%	1150	10.7%	2700	10.6%	7.0%	10.2%
6000	11.5%	1800	14.6%	270	10.3%	1100	11.4%	2600	11.2%	8.0%	11.2%

CHEAP :Returns >5% above bonds	FAIR VALUE : Returns 2.5% to 5% above bonds	FULLY PRICED : Returns 0% to 2.5% above bonds	OVERPRICED : Returns less than bonds

In the Red Zone of the Tipping Point Table the expected returns are less than those from fixed interest and it is time to start heading for the exits. Only the US market is currently rated as Overpriced. Most other markets are close to the border between Fair Value and being Fully Priced. The Fully Priced zone is where we begin to consider taking some modest cautionary action.

Potential portfolio moves

In the coming quarter we will be looking at ways of reducing the risk of portfolios somewhat now that markets are beginning to move into the Fully Priced zones. However, any moves over coming months are likely to be slow and incremental. If markets move further into the Yellow Zone, and remain there for some time, the overall effect of these moves will become significant but, for now, we remain close to being fully invested.

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