Private Capital Advisers

Market Report – March 2023

Market returns

The first quarter of the year saw generally reasonable returns from markets despite significant banking failures in the US and Europe, further interest rate increases and widespread fears of a global recession. If ever there was an illustration of the value of ignoring the news and focusing on the long-term outlook this was it. Even more to that point, six months ago the conventional wisdom perceived an even more dire outlook for markets – and yet, we see the returns over the past six months (not annualised) have been excellent. Finally, and at the risk of labouring the point, the past three-years returns (which are annualised) show how strongly markets have performed since the bottom of the market panic generated by Covid. "Turn off the television" could be the best investment advice you ever get.

The other, not surprising, illustration form the Figure 1 is the value of diversification. Over three months, one year and two years, there has been quite a big dispersion of returns between the growth asset classes. Given we cannot pick these short-term dispersions, our attitude is that if we are not unhappy about at least one of our asset classes, we are not diversified enough.

Figure 1: Performance (% pa) for periods ending 31 March 2023

	3month	6 month	1 year	2 years	3 years
Australian equities[1]	3.5%	13.2%	1.7%	8.6%	18.0%
International equities[2]	9.9%	13.2%	4.1%	7.9%	13.0%
Listed property[3]	0.5%	12.1%	-13.9%	0.7%	13.6%
Bonds[4]	4.6%	0.3%	-2.6%	-2.4%	1.3%
Term deposits[5]	0.4%	0.7%	1.2%	1.2%	1.5%
Cash[5]	0.8%	1.4%	1.6%	0.9%	0.6%

1.ASX 200 inc Franking; 2. MSCI World Ex Aus Index; 3. ASX A-REIT Index; 4. Aust Comp Bond Index; 5. RBA data

Inflation and interest rates still the keys to the next year

The outlook for inflation and interest rates will still be critical for returns in 2023. As we have said before, bringing inflation under control will almost certainly require substantial economic pain, if not a recession. Central Banks are continuing to increase interest rates and in so doing are increasing the chance of hard landings around the world.

While recessions are almost always associated with equity market downturns, the size of those downturns vary dramatically both from time to time and from market to market. Furthermore, timing selling and buying based on expectations of a recession is notoriously difficult. Selling six months ago in anticipation of the world entering a recession would have been very costly so far and would set up an extremely challenging re-entry strategy.

We prefer to wait and use valuation as our key signal to make buying and selling decisions.

Silicon Valley Bank (SVB) and Credit Suisse are not the canaries in the coal mine

Silicon Valley Bank failed by investing their depositors' funds in fixed rate bonds that were safe but ignored interest rate risk. As cash rates have increased over the past year SVB needed to pay higher rates to depositors. Losing money by investing in safe assets and ignoring interest rate risks are highly unusual ways for banks to get into trouble. In all likelihood there are very few banks worldwide that will have repeated this mistake.

Similarly, the Credit Suisse failure is unlikely to be repeated in that it is one of the last remaining large banks that only just survived the GFC but never got their house back in order. For the last decade they have gone from crisis to crisis and their demise has surprised few market experts. Again, few banks share Credit Suisse' problems.

Having said that, we do expect that there will be further, isolated failures of banks overseas simply as a result of the rapid increases in interest rates. When rates are lifted as rapidly as has occurred over the past 18 months, things will break. But we do not believe problems are system wide.

Further, regulators have acted quickly and decisively. It appears that regulators have learned some important lessons from the GFC and have moved quickly to restore confidence. The end result is that Governments have effectively guaranteed all bank depositors, everywhere.

We have absolutely no concerns about the safety of the Australian Banking system.

The Long-Term Outlook for returns

The much longer term – five to ten years – is much easier to forecast than the short-term and the outlook remains positive. Lower equity prices and higher rates on fixed interest means returns going ahead are likely to be a good deal higher than our expectations a year ago as can be seen in Figure 2. In fact, the outlook for both growth and defensive assets are more attractive than they have been for some time.

Figure 2: Ten-Year Forecast Returns 31 March 2023

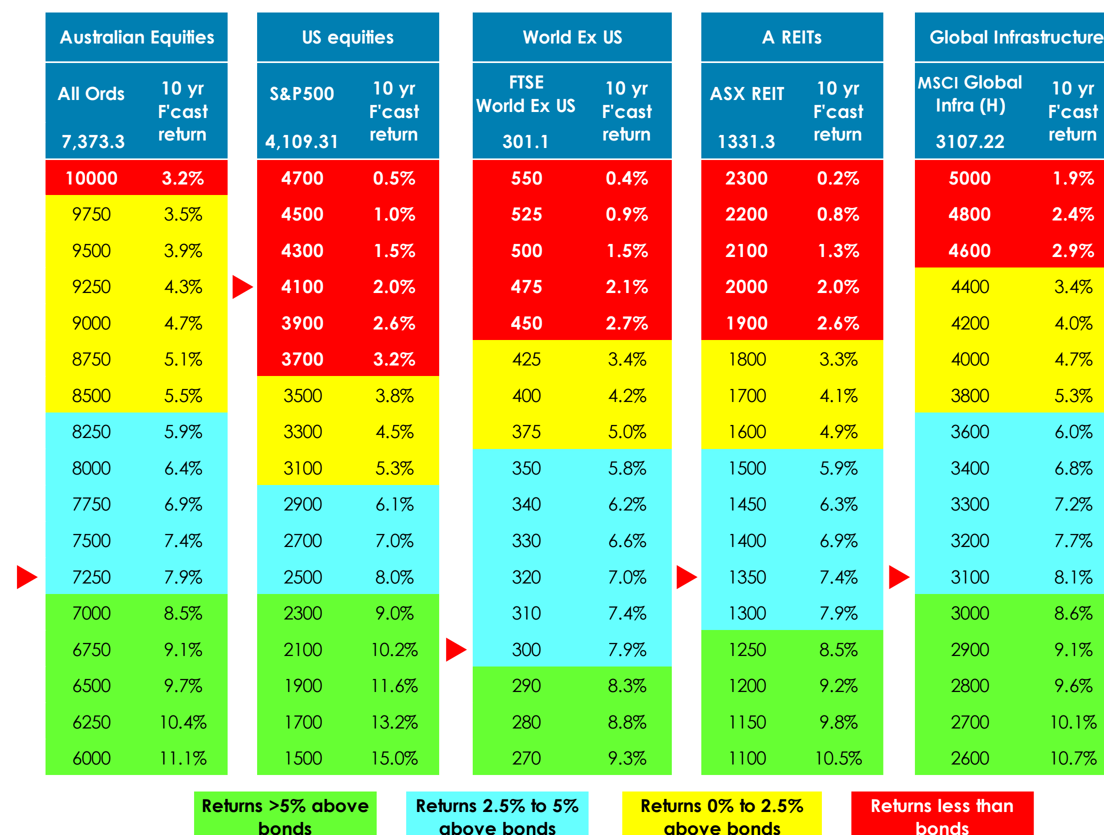
	Australian Equities[1]	Developed Markets[2]	Listed Property[3]	Infrastructure	HY Debt[4]	TDs[5]
Income	5.5%	2.1%	4.8%	4.1%	8.6%	3.3%
Currency gain/loss		-0.1%		0.2%		
Earnings growth	-0.3%	2.2%	2.3%	4.0%	0.0%	0.0%
Valuation change	2.4%	0.4%	0.5%	-0.2%	-1.2%	0.0%
Forecast 10 yr. return	**7.7%**	**4.6%**	**7.6%**	**8.1%**	**7.4%**	**3.3%**
PE Now	13.4	17.8		8.9		
PE 2033 (f)	17.0	18.5		8.7		
Yield 2033 (f)			0.0%			
Forecast (31 Mar 2022)	5.2%	4.6%	4.3%	8.2%	6.2%	3.0%

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 (Red Zone), Cheap (Green Zone) or somewhere in between.

Figure 3: The Tipping Point Tables



Australian Equities		US equities		World Ex US		A REITs		Global Infrastructure	
All Ords 7,373.3	10 yr F'cast return	S&P500 4,109.31	10 yr F'cast return	FTSE World Ex US 301.1	10 yr F'cast return	ASX REIT 1331.3	10 yr F'cast return	MSCI Global Infra (H) 3107.22	10 yr F'cast return
10000	3.2%	4700	0.5%	550	0.4%	2300	0.2%	5000	1.9%
9750	3.5%	4500	1.0%	525	0.9%	2200	0.8%	4800	2.4%
9500	3.9%	4300	1.5%	500	1.5%	2100	1.3%	4600	2.9%
9250	4.3%	4100	2.0%	475	2.1%	2000	2.0%	4400	3.4%
9000	4.7%	3900	2.6%	450	2.7%	1900	2.6%	4200	4.0%
8750	5.1%	3700	3.2%	425	3.4%	1800	3.3%	4000	4.7%
8500	5.5%	3500	3.8%	400	4.2%	1700	4.1%	3800	5.3%
8250	5.9%	3300	4.5%	375	5.0%	1600	4.9%	3600	6.0%
8000	6.4%	3100	5.3%	350	5.8%	1500	5.9%	3400	6.8%
7750	6.9%	2900	6.1%	340	6.2%	1450	6.3%	3300	7.2%
7500	7.4%	2700	7.0%	330	6.6%	1400	6.9%	3200	7.7%
7250	7.9%	2500	8.0%	320	7.0%	1350	7.4%	3100	8.1%
7000	8.5%	2300	9.0%	310	7.4%	1300	7.9%	3000	8.6%
6750	9.1%	2100	10.2%	300	7.9%	1250	8.5%	2900	9.1%
6500	9.7%	1900	11.6%	290	8.3%	1200	9.2%	2800	9.6%
6250	10.4%	1700	13.2%	280	8.8%	1150	9.8%	2700	10.1%
6000	11.1%	1500	15.0%	270	9.3%	1100	10.5%	2600	10.7%

Returns >5% above bonds | Returns 2.5% to 5% above bonds | Returns 0% to 2.5% above bonds | Returns less than bonds

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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. Other markets are at Fair Value (Blue Zone).

Portfolio moves

In the coming quarter we will be focused on ensuring that portfolios are close to fully invested in growth assets, rebalancing where necessary. And, as always, we will be carefully monitoring the long-term outlook for markets. In particular, we will still be focussing on the outlook for private credit where we see good opportunities continuing to emerge.

This report has been prepared without taking into consideration any of your objectives, financial situation or needs. Therefore, you should carefully consider the appropriateness of the information contained in this market update based on your personal circumstances, needs and objectives before acting on it. We strongly recommend you seek personal advice from Private Capital Advisers Pty Ltd and its representatives prior to acting on the information contained in this market update. Personal advice is advice that is given after having considered your relevant objectives, financial situation, and needs. If you choose to act on this information without first seeking personal advice, you risk making a decision that may result in a financial loss.