Private Capital Advisers

Market Update – March 2025

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A note on current market volatility

High levels of volatility have returned to markets in the past few months in response to market sentiment around the likely impact of President Trump's tariff policies on the both the US and the global economy. While we recognise that the short-term impact of these policies is unquestionably negative, we have learned that changing portfolios in response to developments such as these is, more often than not, costly to investors.

The events of the last four months have, if anything, strengthened that conviction. When Donald Trump was elected in November, the widespread belief was that his business-friendly policies would be good for corporate America and good for the sharemarket. Prices rose strongly post-election. That positivity has turned to fear as markets have begun to contemplate the real risk that the tariffs and large lay-offs of public sector staff may lead to a recession.

Whether these fears are grounded, we don't know. Further, we don't know how the much further markets may fall in the event that the US does indeed fall into recession. We don't know when or how quickly the market may turn around when it eventually senses that the economy has bottomed. Finally, we don't know whether or not there will be policy U-turns in response to a deterioration in economic conditions. Actively trying to position portfolios for all of these twists and turns ultimately is most likely to lead to high transaction costs and lower returns.

Accordingly, we stick with our strategy of making investment decisions on the basis of long-term return expectations about which we feel we can have a much higher level of conviction.

Market returns

Despite the volatility in the March quarter, the returns for the quarter were remarkably benign as we see in Figure 1 below. As it turned out, the falls in the second half of the quarter only just exceeded the gains from the early part of the quarter. More importantly, returns over one, two and three years remain solid.

Figure 1: Performance (%pa) for periods ending 31 March 2025

	3mo	1 year	2 years	3 years	5 years
Australian equities[1]	-2.8%	4.1%	10.0%	7.2%	14.7%
ASX Small Ords[2]	-1.7%	-0.5%	6.8%	-0.1%	11.0%
International equities (UH) [3]	-2.7%	11.9%	19.9%	14.4%	15.7%
International equities(H)	-1.8%	7.2%	15.9%	7.7%	16.2%
Listed property[4]	-6.8%	-5.4%	13.7%	3.6%	13.6%
Global Infrastucture[5]	3.4%	19.4%	11.3%	6.8%	13.0%
High Yield Bonds [6]	0.1%	6.8%	8.4%	4.0%	6.7%
Bonds[7]	1.3%	3.2%	2.3%	1.7%	-0.5%
Term deposits[8]	1.0%	3.7%	3.0%	2.3%	2.1%
Cash	1.1%	4.4%	4.3%	3.4%	2.1%

1.ASX 200 inc Franking; 2. ASX Small Ordinaries Index; 3. MSCI World Ex Aus Index (Hedged & Unhedged); 4. ASX A-REIT Index; 5. S&P Global Infra (Hedged); 6. BofA US HY index (Hedged); 7. Aust Comp Bond Index; 8. RBA data (Rolling 3 yr TDs)

Australian equities

The past quarter's returns were slightly negative with small negative returns in most sectors. No sectors stood out.

International equities

International equities experienced small falls for the quarter. Pleasingly, returns from non-US equities proved to be much more resilient with European and Asian equities (to which we are over-weight) being the best performing sectors.

Real Assets: Real Estate Investment Trusts (Listed Property) and Infrastructure.

Most real assets have had a solid quarter and a very strong year with Infrastructure up 19% as we see in the table and Global REITS up by around 17% over the year.

On the other hand, Australian-REITs have given back some of the strong gains of the previous two years. As we have remarked on in the past, Australian REITs returns have been driven largely by the performance of the Goodman Group (GMG) which recently made up about 38% of the A-REIT index. In 2024 that led to outsized returns by the index but over the last quarter that reversed with a fall in GMG of around -27% leading to a fall in the A-REIT index of -6.8% for the quarter and -5.4% for the year.

As we have flagged previously, we believe Global REITs, which are essentially involved in traditional real estate investment, are a better indicator of REIT performance and both G-REITs and Infrastructure had positive returns over the quarter. Pleasingly, Real Assets are providing the some of the diversification benefits we have expected from this asset class with infrastructure in particular performing strongly over the year.

Bonds

Bond returns were in line with long-term expectations. Over the year bonds have produced a modest 3.2% return, largely in line with expectations.

Cash

The RBA begun the long-awaited easing cycle reducing cash rates to 3.85%. We continue to expect that we will see a further two to three cuts this year and that cash rates will settle in the 2.5% to 3.5% range when this easing cycle is over.

Australian inflation improving if not yet under control

From a US perspective, there are concerns that tariffs will result in higher prices for US goods and that cuts to immigration and possible deportation of illegal immigrants will create a shortage of workers driving up labour costs increasing US services inflation as well.

Nonetheless, the outlook for Australian inflation continues to improve regardless of the direction of US inflation. Australia imports very little from the US hence there will be very little impact here if US prices rise. It is even possible that non-US manufacturers may redirect goods that cannot be sold in the US to other markets at lower prices. If so, this may provide a small reduction in Australian inflationary pressures – but with a strong emphasis on small.

Australian domestic inflation is the more important number for Australian investors as that is what drives RBA interest rate decisions.

The Long-Term outlook for returns

While the short-term outlook remains highly uncertain, the much longer term – five to ten years – can be more reliably forecast. As can be seen in Figure 3, the outlook going ahead is reasonable, even though returns are expected to be lower than the stellar experience of recent years.

Figure 3: Ten-Year Forecast Returns (%pa) as at 31 March 2025

	Australian Equities[1]	Developed Markets[2]	Listed Property[3]	Infrastructure	HY Debt[4]	TDs[5]
Income	5.2%	1.6%	3.9%	3.8%	8.8%	4.4%
Currency gain/loss		-0.1%		0.6%		
Earnings growth	3.4%	3.2%	3.7%	3.7%	0.0%	0.0%
Valuation change	-2.0%	-1.6%	-0.1%	-0.5%	-1.2%	0.0%
Forecast 10 yr return	**6.6%**	**3.1%**	**7.5%**	**7.6%**	**7.6%**	**4.4%**
PE Now	20.1	22.3		9.5		
PE 2035(f)	16.5	18.9		9.0		
Yield 2035 (f)			4.0%			

1. All Ordinaries Index; 2. MSCI World Index; 3. Global REITs; 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.

The Tipping Point Tables

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

Figure 3: The Tipping Point Tables

Australian Equities		US equities		World Ex US		G REITs		Global Infrastructure		Hi Yield Debt	
All Ords 7,655.0	10 yr F'cast return	S&P500 5,062.25	10 yr F'cast return	FTSE World Ex US 319.8	10 yr F'cast return	NAREIT Eq REIT 704.38	10 yr F'cast return	MSCI Global Infra (H) 3405.0	10 yr F'cast return	Bof A HY Spread 4.45%	10 yr F'cast return
10000	3.3%	6250	-0.1%	550	0.6%	1000	4.7%	5000	2.7%	0.5%	4.1%
9750	3.7%	6000	0.3%	525	1.1%	975	5.0%	4800	3.2%	1.0%	4.6%
9500	4.0%	5750	0.8%	500	1.6%	950	5.3%	4600	3.7%	1.5%	5.1%
9250	4.4%	5500	1.3%	475	2.2%	925	5.7%	4400	4.3%	2.0%	5.6%
9000	4.8%	5250	1.8%	450	2.9%	900	6.1%	4200	4.9%	2.5%	6.1%
8750	5.2%	5000	2.3%	425	3.6%	875	6.4%	4000	5.5%	2.8%	6.4%
8500	5.6%	4750	2.9%	400	4.3%	850	6.8%	3800	6.2%	3.0%	6.6%
8250	6.0%	4500	3.5%	375	5.1%	825	7.2%	3600	6.9%	3.3%	6.9%
8000	6.5%	4250	4.2%	350	6.0%	800	7.7%	3400	7.7%	3.5%	7.1%
7750	7.0%	4000	4.9%	340	6.4%	775	8.1%	3300	8.1%	3.8%	7.4%
7500	7.5%	3750	5.6%	330	6.7%	750	8.6%	3200	8.6%	4.0%	7.6%
7250	8.0%	3500	6.4%	320	7.2%	725	9.1%	3100	9.0%	4.3%	7.9%
7000	8.5%	3250	7.3%	310	7.6%	700	9.6%	3000	9.5%	4.5%	8.1%
6750	9.1%	3000	8.3%	300	8.0%	675	10.1%	2900	10.0%	5.0%	8.6%
6500	9.7%	2750	9.4%	290	8.5%	650	10.7%	2800	10.5%	6.0%	9.6%
6250	10.4%	2500	10.6%	280	9.0%	625	11.2%	2700	11.1%	7.0%	10.6%
6000	11.1%	2250	12.0%	270	9.5%	600	11.9%	2600	11.6%	8.0%	11.6%

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

We will continue to closely monitor portfolios with the three key themes being the amount of equity exposure against that of real assets, whether a small reduction in the overall level of risk is prudent and the level of currency hedging for international assets.