Private Capital Advisers

Market Report – September 2024

Market returns

Markets roared ahead in the September quarter at least in part due to the improving inflation data globally and the large interest rate cut in the United States raising the possibility of Central Banks pulling off a rare soft landing. Returns from growth assets have been outstanding over one, two, three and five years.

Figure 1: Performance (%pa) for periods ending 30 September 2024

	3mo	6 mo	1 year	2 years	3 years	5 years
Australian equities[1]	9.1%	8.0%	23.3%	19.2%	10.0%	9.8%
International equities[2]	2.8%	3.1%	23.6%	22.5%	10.8%	12.6%
Listed property[3]	14.5%	8.0%	47.0%	28.6%	9.1%	7.0%
Global Infrastucture[4]	11.3%	14.2%	26.9%	13.8%	9.4%	5.6%
Bonds[5]	3.0%	2.2%	7.1%	4.3%	-1.2%	-0.4%
Term deposits[6]	0.9%	1.7%	2.9%	2.3%	1.8%	1.9%
Cash[6]	1.1%	2.2%	4.4%	3.8%	2.6%	1.7%

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 (3 yr rolling TDs)

Australian equities

The September quarter returns were excellent with the strong performances in virtually all sectors other than energy which has had a dismal year. Over the full year banks, real estate and Information Technology have been the standout sectors.

International equities

International equities returns were more modest largely impacted by a 3.9% rise in the Australian dollar over the quarter. (An increase in the value of the Australian dollar which has the impact of decreasing international returns because a rising Australian dollar represents a fall in the value of other currencies.)

For the full year, international equities have enjoyed excellent returns pretty much in line with those of Australian equities. Most global markets have done well with the US again leading the pack.

Listed Property (Real Estate Investment Trusts) and Infrastructure

Australian-REITs and global Infrastructure were the best performing assets for both the quarter and the year. To a large extent, these returns have been driven by a re-rating following the large cut in US cash rates over the quarter. Australian REITs still have been further boosted by the stellar performance of the Goodman Group which now makes up about 38% of the A-REIT index.

The weight of Goodman in the A-REIT index is a cause for concern. We use REITs as a separate asset class because we believe that their essentially passive rent collecting status makes them a source of predictable income streams and more stable long-term returns than other growth assets (noting that REITs can be quite volatile in the short-term). Goodman changes all of that, it is an outstanding company but far from a passive rent collector.

From here on we will expand our definition of REITs to include Global REITs which have small exposures to entities such as Goodman and as a result are essentially involved in traditional real estate investment.

Bonds

Bond returns were positive as bond interest rates fell in expectation that the RBA will begin cutting cash rates before too long (if not nearly soon enough for those households battling very high mortgage payments. Over the year bonds have produced a 7.3% return – well above their long-term expected returns of 4.0%pa.

Cash

The RBA maintained cash rates at 4.35%. We continue to expect that this is close to the peak in cash rates with the main uncertainties being whether one rate rise will be necessary, and after that, how long cash rates will need to remain at these levels in order to bring inflation under control. Our expectation remains that cash rates will settle in the 2% to 3% range at some point over the coming three to four years.

Inflation and interest rates remain the key

As we have repeatedly stated, investors' perceptions of the likely outlooks for inflation and interest rates have and will continue to drive market returns over the next few years. From a longer-term perspective, the tight labour markets remain the main worry for Central Banks. Encouragingly for the inflation outlook, labour markets continue to ease with job vacancies falling and unemployment creeping up – but progress remains slow. The RBA in particular will be loath to cut interest rates prematurely, hence our expectation that it may be two to 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 only reasonable, and returns are expected to be much lower than the experience of recent years.

As markets have continued to rise over the past year, our expectations for long-term returns have reduced - 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 30 September 2024

	Australian Equities[1]	Developed Markets[2]	Listed Property[3]	Infrastructure	HY Debt[4]	TDs[5]
Income	5.0%	1.6%	3.7%	3.9%	7.9%	4.1%
Currency gain/loss		0.1%		0.6%		
Earnings growth	3.3%	3.6%	2.5%	3.7%	0.0%	0.0%
Valuation change	-2.2%	-2.3%	-0.9%	-0.2%	-1.2%	0.0%
Forecast 10 yr return	**6.0%**	**3.0%**	**5.3%**	**8.0%**	**6.7%**	**4.1%**
PE Now	20.6	23.1		8.9		
PE 2034(f)	16.5	18.3		8.7		
Yield 2034 (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 8,416.6	10 yr F'cast return	S&P500 5,751.07	10 yr F'cast return	FTSE World Ex US 359.6	10 yr F'cast return	NAREIT Eq REIT 821.52	10 yr F'cast return	MSCI Global Infra (H) 3477.4	10 yr F'cast return	Bof A HY Spread 2.89%	10 yr F'cast return
10000	3.6%	5800	0.0%	550	1.1%	1000	2.8%	5000	3.3%	0.5%	3.8%
9750	3.9%	5600	0.4%	525	1.7%	975	3.2%	4800	3.8%	1.0%	4.3%
9500	4.3%	5400	0.8%	500	2.2%	950	3.5%	4600	4.3%	1.5%	4.8%
9250	4.7%	5200	1.2%	475	2.8%	925	3.9%	4400	4.9%	2.0%	5.3%
9000	5.1%	5000	1.6%	450	3.5%	900	4.2%	4200	5.5%	2.5%	5.8%
8750	5.5%	4800	2.1%	425	4.2%	875	4.6%	4000	6.1%	2.8%	6.1%
8500	5.9%	4600	2.5%	400	4.9%	850	5.0%	3800	6.8%	3.0%	6.3%
8250	6.3%	4400	3.0%	375	5.7%	825	5.4%	3600	7.6%	3.3%	6.6%
8000	6.8%	4200	3.5%	350	6.6%	800	5.8%	3400	8.3%	3.5%	6.8%
7750	7.3%	4000	4.1%	340	6.9%	775	6.2%	3300	8.8%	3.8%	7.1%
7500	7.8%	3800	4.7%	330	7.3%	750	6.7%	3200	9.2%	4.0%	7.3%
7250	8.3%	3600	5.3%	320	7.7%	725	7.2%	3100	9.7%	4.3%	7.6%
7000	8.9%	3400	6.0%	310	8.1%	700	7.7%	3000	10.1%	4.5%	7.8%
6750	9.4%	3200	6.7%	300	8.6%	675	8.2%	2900	10.6%	5.0%	8.3%
6500	10.1%	3000	7.5%	290	9.0%	650	8.7%	2800	11.2%	6.0%	9.3%
6250	10.7%	2800	8.3%	280	9.5%	625	9.3%	2700	11.7%	7.0%	10.3%
6000	11.4%	2600	9.2%	270	10.0%	600	9.9%	2600	12.3%	8.0%	11.3%

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 addition to any changes occurring due to a change in the assessment of Listed property, in the coming quarter we will continue to look at ways of reducing the risk of portfolios somewhat now that markets are beginning to move into the Fully Priced zones. However, any moves 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.

This market update has been prepared in conjunction with farrelly's Investment Strategy 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.