STANFORD BROWN
Financial Advisers

Stanford Brown Monthly Top 5

December 2019

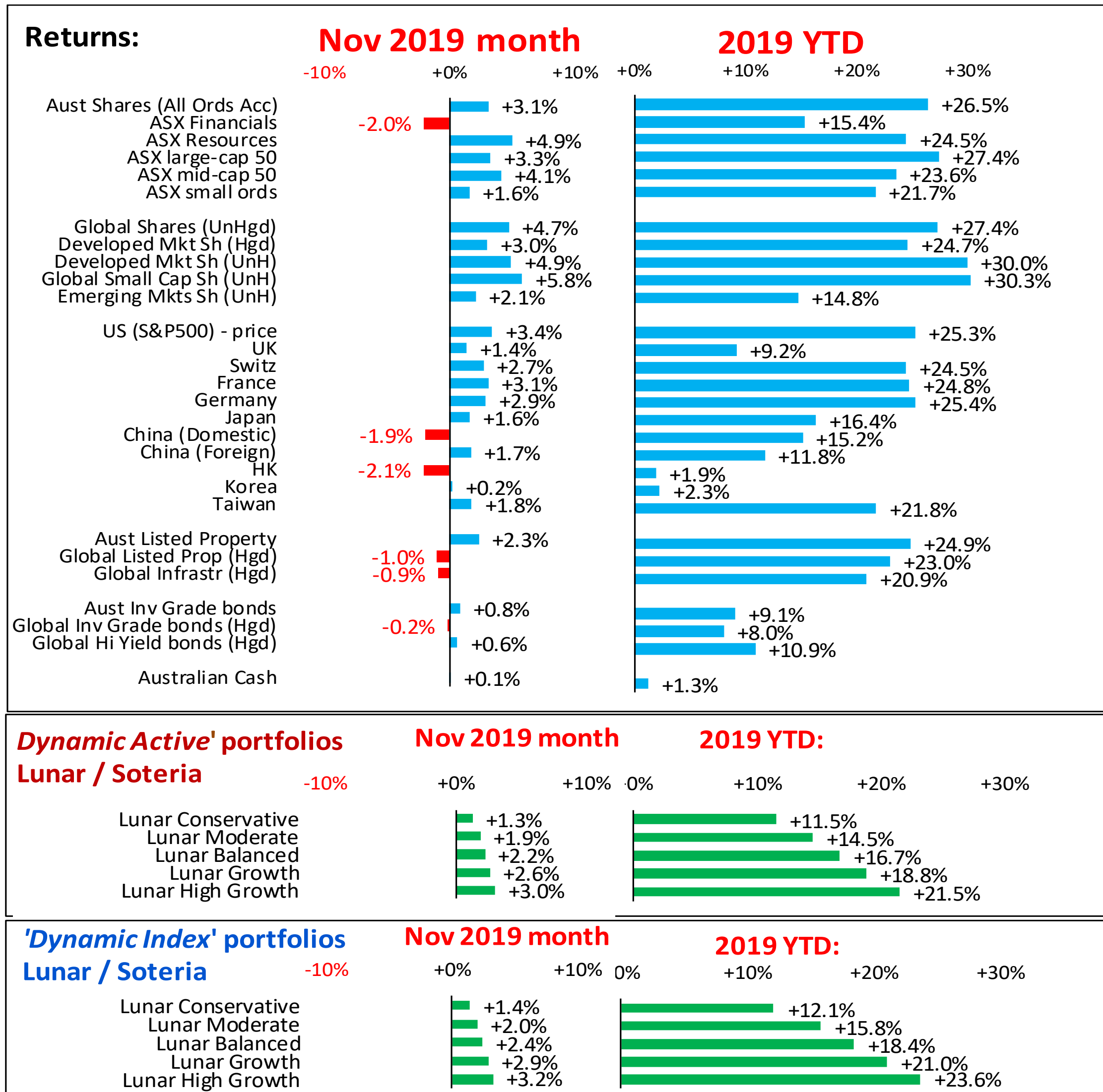
Stanford Brown's Top 5 key factors in Australia and around the world that are affecting investment markets. We aim to help investors cut through all the media noise and hype and understand what is really driving investment markets and portfolio returns.

1 Portfolios heading for stellar year

November was another good month for our investors – with all portfolios gaining between 1.3% and 3% for the month, and up between 12% and 23% (including distributions) across the risk/return spectrum for the calendar year so far.

Shares returned 3% in Australia and around the world for the month. In Australia the miners rode rebounds in iron ore and oil prices, but the big banks were a drag on the market, especially Westpac (down -13%), NAB down -9.5% and ANZ -7.1%. Only CBA was up +2.7%. More on the banks later. Local tech stocks also rode the global tech boom and Telstra continued to rally as local bond yields fell back further.

Most international share markets were also strong, led by the US in turn led by gains by Apple, Microsoft, Facebook, Alphabet (Google) and Netflix. Healthcare, banks and industrial stocks were also up strongly in the US and around the world.



In portfolios – what added value was being over-weight Australian shares and under-weight 'large-cap' shares (the large cap sector is dominated by the big banks). Being over-weight global shares also added value, and also by avoiding emerging markets, which continue to lag developed markets this year. Our low 'hedge ratio' on international shares also added value as the Australian dollar fell a further 2% against the USD, -2.5% against the RMB, -1.6% against the Yen and -1% against the Euro.

Portfolios also benefited from being under-weight global bonds, as bond returns were hurt by government bond yields rising in all major global markets. The exception was in Australia where bond yields fell back heavily as the RBA talked up the possibility of another two rate cuts and then experimenting with 'quantitative easing'. The market interpreted this as a very bearish sign that the RBA fears a deep recession is on the way. However our bias toward corporate bonds and under-weighting of government bonds also added value as corporate bonds posted positive returns as credit spreads receded further in Australia and around the world.

Our holdings of infrastructure funds detracted from returns a little due to the rising global bond yields in November. However infrastructure provides a great buffer against broad share sell-offs - as it did in late 2018, when they helped shield investors from much of the sell-off.
All portfolios remain well ahead of their long term goals and ahead of their peer multi-sector funds on risk-adjusted returns.

2 Eleven year rally since the GFC - Are we living on borrowed time?

It is nearing eleven years since the Australian share market hit its low point at the bottom of the GFC on 6th March 2009. The All Ordinaries index has risen by +123% so far in the long post-GFC rally. It has been a good rally for those who bought (or at least didn't panic sell) at or near the bottom, but has it now lasted too long or rallied too high? Are we living on borrowed time?

If one defines a 'correction' as a fall of more than 20% across the broad market, then the local share market has had fifteen 20%+ corrections in the past hundred years. The most recent was a 20.3% fall in the 2011 Greece 2 / US downgrade crisis.

Some of these 20%+ falls rebounded relatively quickly (like the 2011 fall). If we look past these short term corrections and define a major correction as a fall of 20% or more that is not recovered quickly (say within a year), then we have had 10 major falls in the past 100 years – about one per decade. The chart shows these 10 major booms and busts from a common base.

100 years of Share Booms & Busts in Australia

+450%
+400%
+350%
+300%
+250%
+200%
+150%
+100%
+50%
+0%
-50%

1 251 501 751 1,001 1,251 1,501 1,751 2,001 2,251 2,501 2,751 3,001 3,251 3,501 3,751 4,001

Days

9
7-8
2
10-13
4
3
5
14
6
1

Current boom (cycles 15-16)

Cycles: Bottom -> Top -> Bottom

1: 28-Feb-1921 -> 4-Sep-1929 -> 17-Sep-1931
2: 17-Sep-1931 -> 11-Mar-1937 -> 31-Mar-1942
3: 31-Mar-1942 -> 7-May-1951 -> 29-Sep-1952
4: 29-Sep-1952 -> 16-Sep-1960 -> 16-Nov-1960
5: 16-Nov-1960 -> 27-Feb-1964 -> 29-Jun-1965
6: 29-Jun-1965 -> 6-Jan-1970 -> 30-Sep-1974
7 & 8: 30-Sep-1974 -> 6-Apr-1981 -> 8-Jul-1982
9: 8-Jul-1982 -> 21-Sep-1987 -> 11-Nov-1987
10 - 13: 11-Nov-1987 -> 7-Mar-2002 -> 13-Mar-2003
14: 13-Mar-2003 -> 1-Nov-2007 -> 6-Mar-2009
15 & 16: 6-Mar-2009 -> CURRENT BOOM

A 'cycle' is a rally that is ended by a correction of more than 20%

A 'boom' can consist of more than one cycle where a correction is recovered within a year

Aust All Ordinaries since 1979

Sydney Ordinaries before 1979

ALL ORDS Daily - cycles

OWEN

The first thing to note is the 2003-7 boom that ended with the 2008-9 GFC crash – this is cycle 14 in the chart (it is cycle 14 as it is the 14th 20%+ fall but only the 10th major or sustained 20%+ fall). Contrary to the media hype at the time and ever since, the GFC crash was not a 'once in a century' nor even a 'once in a lifetime' collapse in share prices - in Australia, the US nor anywhere else. It was neither the deepest, the steepest nor the longest fall. There have been several prior falls for our local market that were deeper, steeper and longer than the GFC – but that headline doesn't sell papers. (The above chart shows the length of each boom/bust cycle in trading days which prior to the end of WW2 included Saturdays – yes, Saturday share trading!)

<u>Now to the first question - has the current boom run for longer than usual?</u> The answer is - longer than most.

As the most recent 20%+ fall (2011) was recovered quickly, we can connect cycle 15 (before the 2011 fall) and cycle 16 (since the 2011 fall) into one long post-GFC rally (red line). Aside from 2011 correction, this post-GFC boom also had some near misses: the 'Greece 1 / flash crash' crisis in 2010 (-15%), the 2015-6 oil/gas/steel crisis (-18%), and the late-2018 global growth scare (-13%). Each recovered quickly.

We reduced the weighting of Australian and global shares in client portfolios before the 2018 sell-off, but we increased weights in early 2019 for the rebound because our models indicated the sell-off was probably not going to be a major collapse and that the boom still had further to run.

The post-GFC rally has been longer than most. The only boom to run for longer before a major correction was the boom that covered cycles 10-13 from after the 1987 crash to early 2002. But that long boom was actually four rallies interrupted briefly by three 20%+ falls along the way which rebounded quickly: a 32% fall from Aug 1990 to Jan 1991 (dozens of major corporate bankruptcies in the 1990-1 recession); a 20% fall from Nov 1991 to Nov 1992 (Westpac & ANZ near fatal losses); and then a 22.1% fall from Feb 1994 to Feb 1995 (bond market crisis).

The current boom has only seen one 20%+ fall along the way (2011) and so it has been a smoother ride than the long 1988-2002 boom.

3 Why the long slow rally?

The current cycle has been unusually long because consumer and business spending in Australia and around the world have taken an unusually long time to recover from the GFC. Even after ten years of unprecedented monetary stimulus by central banks (ultra-low, zero and even negative interest rates, plus asset-buying programs to increase prices and reduce yields), and also fiscal stimulus (government deficit spending sprees), economic activity everywhere is still sluggish with no sign of runaway inflation that would require major policy tightening. Whenever central banks have tried to tighten policy – like Japan in 2014, Europe in 20011 and 2018, and the US in 2017-8 – they have had to quickly abandon it and revert to stimulus. Even though central banks and governments have stepped up their stimulus efforts again over the past year, we are likely to see sluggish growth rates and therefore continued stimulus measures for some time yet.

For Australia it has been nearly 30 years since our last recession, and the US had 'enjoyed' its longest ever period of expansion since the GFC – but still both economies are running below par and on life support. (Europe and Japan have flat-lined and are drifting in and out of recession).

Although activity in the 'real economy' has been sluggish, the enormous breadth and depth of monetary and fiscal stimulus has created debt-fuelled asset price bubbles everywhere – just about every type of asset in the world is over-priced on just about every measure. But central banks and governments are blind to this and are likely to keep pouring petrol onto the fire until eventually the global bubble bursts – again.

<u>To the second question - has the current boom run up higher than usual?</u> No. Although it has been long, it has not been high or steep.

The chart also shows the current rally has been rather modest compared to our previous booms. Most prior booms saw share prices rise much further and more steeply before they collapsed: +420% in cycle 9 (1982-7), +325% in cycle 7-8 (1974-81), +247% in cycle 2 (1931-7), +156% in cycle 14 (2003-7), +152% in cycle 1 (1921-29), +146% in cycle 3 (1942-51). Only cycles 5 & 6 (both in the 1960s) were lower than the current boom before they fell back.

The current post-GFC boom in Australian shares is also modest compared to other countries. Since their GFC lows the US broad market is up +360%, NASDAQ +570%, Japan +230%, Germany +255%, Switzerland +141%, France +135%. Even New Zealand is up +197%. The Australian market index has only just climbed back to its pre-GFG high – one of the last major countries to do so.

One reason for the slow recovery in the Australian market is our resources 'curse'. BHP (once known as the 'Big Australian') was the largest company on the ASX in the GFC but has been the biggest drag on the overall market in the recovery. Its share price is up just 40% since the bottom of the GFC nearly 11 years ago. CBA (2nd largest behind BHP at the time) has been the best of the big old dinosaur banks: up +230%, leapfrogging BHP into top spot. The other big-4 banks have lagged.

This has also held back other global laggards burdened by banks and resources shares: UK +110%, Canada +120% - the same as Australia.

The stars in Australia's post-GFC rally have been tech stocks REA (realestate.com), Seek.com and Flight Centre, plus Goodman Group (industrial property riding the Amazon boom) and Aristocrat (poker machines) - each up more than +1,000% since the GFC low. Healthcare stocks CSL, Ramsay and Fisher & Paykel Health are each up more than 800%, and so too are Macquarie Bank (the only truly competitive bank), Challenger and James Hardie (asbestos fame). CSL is about to leapfrog ahead of CBA as the most valuable company on the ASX, but it was just one seventh of CBA's value in 2009.

At the other extreme, some company share prices are lower today than their GFC lows. The main culprits are resources and financials. Oil/gas stocks Origin Energy -31%, Santos -35%, Karoon Gas -57%, Sims Metal -23%, No Hope (sorry, New Hope) -23%, AMP -44%, and QBE -19%. Others are still barely above their GFC lows, like BHP: – including Telstra, Newcrest (gold mining), AGL (gas), Worley (oil/gas engineering), and Amatil (drinks). Also dragging the overall market lower have been those that disappeared worthless (like the Babcock & Brown companies, the Allco companies, Rubicon trusts, Record Realty, ABC Learning, Ventracor, Octaviar/MFS, Great Southern, Timbercorp, and many others.

<u>Third - Is the current boom over-priced?</u> Yes but not significantly - yet.

Share prices have risen by 140% since the bottom of the GFC but aggregate company earnings per share are still *<u>lower</u>* than they were in 2009, and dividends per share have risen by just 17%. (The total dollar amount of profits and dividends is much higher than they were in 2009, but profits and dividends per share have been watered down severely by massive share raisings over the period).

Because share prices have doubled but profits and dividends have stalled, price/earnings ratios across the market have more than doubled, and dividend yields have nearly halved. The market was very cheap relative to profits and dividends at the bottom of the GFC, and has risen to being moderately expensive now.

The problem is that over-pricing is not the main cause of crashes. Our market does not crash because, or when, it is over-priced. The overall market was not significantly over-priced relative to profits or dividends before any of the ten major crashes over the past century – not even in 1929 or 1987. Our market almost always rises and falls with the US market, regardless of local conditions. Most of our crashes (all except cycle 3 – the 1951-2 Korean war inflation crisis) were triggered by external events – mainly emanating from the US.

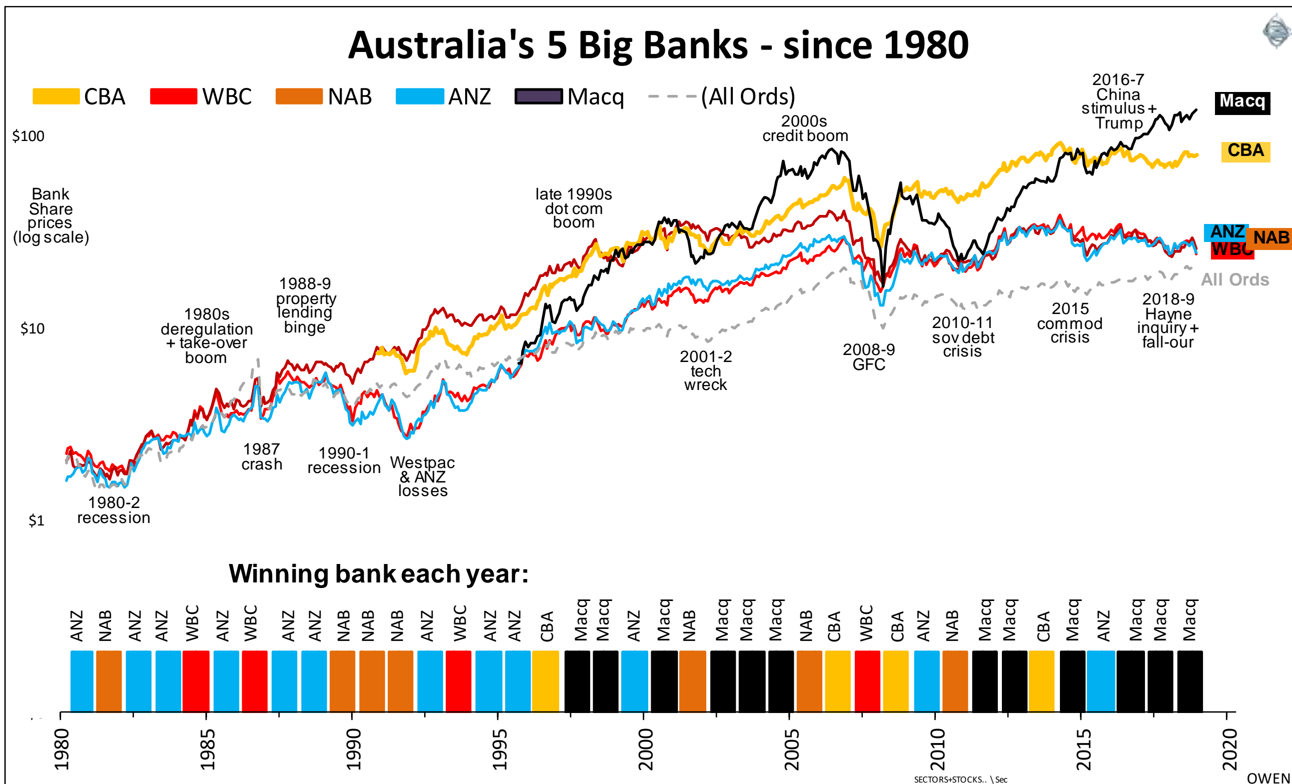
4 Banking woes – temporary or terminal?

2019 has been another bad year for Australia's big dinosaur banks. While the broad share market index is up by 22% this year, CBA, the best of the big-4 banks ('best' in share price terms only) is up by just +12%, NAB +8%, ANZ +2% and Westpac is down -2%. The banks have been going backwards for nearly five years since they peaked in early 2015. They have been hit by declining margins and profits, rising costs, rapidly ballooning regulatory penalties and customer remediation costs, flat or declining dividends with flat or declining franking credits. The sheer scale of institutionalised greed, fraud, fee gouging, mis-selling of inappropriate conflicted internal products, predatory lending, document forging, market rigging, lying to regulators, facilitating money laundering that financed everything from terrorist groups to paedophile rings, and a host of other dishonest and unsavoury practices – is breathtaking. One wonders why anyone would want to be a part owner in these dens of thieves – except of course if the part-owners have been showered with some of the proceeds for the past three decades.

The big banks are probably not entirely dens of thieves, just incompetent. (I am being kind here – it is more than naive incompetence because of the obscene amounts of pocket-lining that has gone on at all levels). But incompetence from board level down has enabled dens of thieves to thrive at various levels inside each bank. The CEOs and/or Chairpersons at three of the big-4 (plus AMP) have been fired (officially they stepped down 'to pursue other interests' or similar nonsense) over the past two years, and there are probably more to come. What we haven't seen yet are serious fines (the US SEC has no qualms handing out fines of up to $10b to US and European banks). Nor have we seen multi-billion dollar class action law suits yet in Australia. Both are likely to start hitting bank profits in the next year or so.

The chart shows share prices of the big banks since 1980. Westpac, ANZ and NAB have been listed on stock exchanges since the 1800s Westpac (originally called Bank of NSW) was Australia's first company and first bank, formed in 1817. It has a long history of being rescued by governments and shareholders from various crises, starting from 1821 after its head cashier stole customer deposits totalling 1/6th of the bank's assets (equivalent to staff theft of $150b in today's terms). In the most recent rescue it required emergency funding from the Fed (yes the US Fed) on 20 December 2007 and again on 9 Oct 2008 to keep the doors open. (NAB also required three bouts of emergency Fed funding).

CBA was listed on the ASX when it was sold off by the federal government in 1991 in the depths of the 1990-1 recession in which Westpac had another near-death crisis due to bad debts from incompetent lending in the wild late 1980s lending spree. Also on the chart is Macquarie (listed 1996) for comparison. It has held a banking licence since 1985 but is not really a traditional bank. It is more of a deal-based asset-shuffler and ticket-clipper that is nimble, cunning, and always seems to stay one step ahead of the law. Macquarie is Australia's only truly competitive and globally relevant bank, and I have included it here to illustrate what the others could do if they had the skill and talent.



I have also included the All Ordinaries Index (grey dashes) from a common starting point to show how the banks as a group have beaten the broad market over the past 40 years, even after the lag since 2015. This out-performance has been largely because of their cartel gouging of margins and fees, and also the fortuitous tailwinds that have benefited them until recently. More on this below.

For shareholders of the old dinosaur banks - Westpac has been the worst over the past 40 years – but only a fraction ahead of ANZ and NAB. CBA leads the big-4, mainly because it did not blow up billions in the orgy of bad lending in the late 1980s (like Westpac and ANZ), and it also did not blow up billions in failed overseas ventures in the 1980s, 1990s and 2000s (like the other three).

The coloured bars in the lower section of the chart show the bank with the best share price gains in each calendar year. Westpac (red) has been the worst performer here as well – winning in only in 4 years out of the past 40, and only one year in the past 20 (that was in 2008). Macquarie has been the winner in more than half of all years since it has been a listed company (12 out of 23 years). Macquarie is the only bank with share price gains in the past five years, while the big-4 have each gone backwards.

Will the rout continue? Or will the big banks get their mojo back?

The main supporters of the banks (aside from politicians duped or bought by the powerful bank lobby) are small investors, especially those who bought into CBA's three-phase float in the 1990s. Regular readers of this report would know that I have been bearish on the big-4 banks over the past three years. Most long term holders are reluctant to sell because they have become accustomed to the windfall gains in the good times – three decades double digit growth in profits and dividends – and they believe these golden years will magically return and then last forever.

The answer depends on whether you believe the banking woes are temporary (cyclical) or more long-lasting (structural). Some of the recent challenges are cyclical and will probably ease in the next few years. One is the current margin squeeze due to ultra-low interest rates – this is bound to ease as rates rise in the next economic upswing when it eventually arrives. Another is the housing construction slowdown – this too is merely a short term cyclical factor that will improve in the next cycle. Likewise, the ballooning costs of customer remediation are unlikely to be on-going at the same levels – although they are likely to get a lot worse in the short term before they reduce in the medium term.

However, there are longer lasting structural shifts that will affect bank profitability for many years. The tailwinds that boosted profits and shareholder returns in the past three decades – deregulation, loose capital rules, demographics and lack of real competitors - have now turned into headwinds.

Deregulation (including allowing unabated buying up of competitors) is now reverting to crippling and costly re-regulation. This is likely to get progressively worse in the coming years as more mis-deeds are bound to surface. Likewise, the loose capital rules of the past three decades are now tightening – requiring much more equity capital behind each loan. More equity backing reduces returns on equity.

The demographic dividend is also wearing off. The banking cartel's windfall gains from dominating a market with high population growth rates and baby boomers in their peak borrowing and spending years – are fading. Population growth rates are falling (both natural growth and immigration) and the boomers are now retiring, reducing spending, downsizing and paying off debt. This is a multi-decade structural shift that will take decades to turn again. We had a baby boom and a corresponding lending and spending boom after WW1, and we had another after WW2. The next one is probably many years away yet, and when it starts it takes a decade to build.

On the competition front, the banks bought up almost all of their competitors in the 1990s and 2000s – small banks, building societies, finance companies, mortgage originators, mortgage brokers, etc – and they profited handsomely from the resultant cartel club. Executives and staff lined their pockets and even shared some of the spoils with shareholders. Neither Royal Commissioner Hayne nor the Morrison government were brave enough to break up the cartel or remove their cosy government guarantees.

However the banks have been forced to get rid of many of the activities that have brought them as much pain as profits – including insurances, financial advice, and wealth (mis-)management. They are retreating to their traditional functions (deposits, lending and payments). The problem is they face completely new types of competitors – including global giants like Google, Apple, Facebook, and a host of new ways of gathering savings, lending to individuals and businesses, and making payments. In the future who will need a bank?

How cheap is cheap?

As the banking woes continue, at some point the banks will become cheap – but how low do share prices need to be (or how much do they need to lag the broad share market) in order to be considered cheap?

The problem is that all of the big banks are still trading at levels that are well above their book values. This only makes sense if they are earning returns on equity that are well above their cost of equity capital. (One of the most fundamental rules of corporate finance is that if a company can't earn more on its equity than the cost of its equity capital, it should close up shop, give the money back to the owners and go back to driving cabs or Deliveroo, or whatever else the directors and execs are good for).

If the shifts described above are structural and long-lasting and the market finally becomes truly competitive, the big-4 will only be able to achieve returns on equity of around 10-12% per year at best. This is around their cost of equity capital, and so their share prices should be no higher than their book value per share – like every other big commercial bank in the rest of the world.

CBA is trading at twice its book value per share and the other three are at 1.3 to 1.6 times their book values. Given CBA's return on equity is already down to around 12% and the others are around 10% at best, this means their prices are all still about 50% too high relative to their earning capacity. In other words they are all still significantly over-valued given their likely future performance. Even if the share prices of the big-4 banks fell by 30% tomorrow they would still not be 'cheap' unless they magically solved the structural headwinds and immediately returned to the glory days of double digit growth in profits and dividends. This is highly unlikely.

Macquarie on the other hand is trading at more than twice its book value per share (similar to CBA), but this is more justifiable because it is still generating returns on equity of 15% and more, and its business model and structure are more attuned to innovation and adaption to changing conditions than the big dinosaur banks.

This of course is not advice to buy or sell any particular bank shares, but simply provides some factors to think about when talking to your adviser. (Disclosure: I am a long term holder of ANZ and Macquarie. I only retain ANZ because the average cost base is so low (below $5) and I have a great aversion to paying so much capital gains tax if I sold!)

5 Another decade almost done!

The end of another decade is almost upon us! Each decade tends to have its dominant themes and lasting memories. The 1970s was the era of flared pants, disco, Nixon/Watergate and the Whitlam dismissal, oil price spikes, US dollar collapse, high inflation and unemployment. The 1980s was big hair & shoulder-pads, Reagan/Thatcher inflation-busting recessions, Hawke/Keating reforms, the 'greed is good' boom, then the 1987 crash and fall of the Berlin Wall. The 1990s saw the collapse of the Soviet bloc, re-unification of Germany, Asian currency crisis & Russian default, and the 1990s 'irrational exuberance' dot-com boom. The 2000s had the 'tech wreck', 9/11 attacks and the 'war on terror', the global credit/China boom then the sub-prime crash and GFC. Nobody could have predicted any of these at the start of each decade.

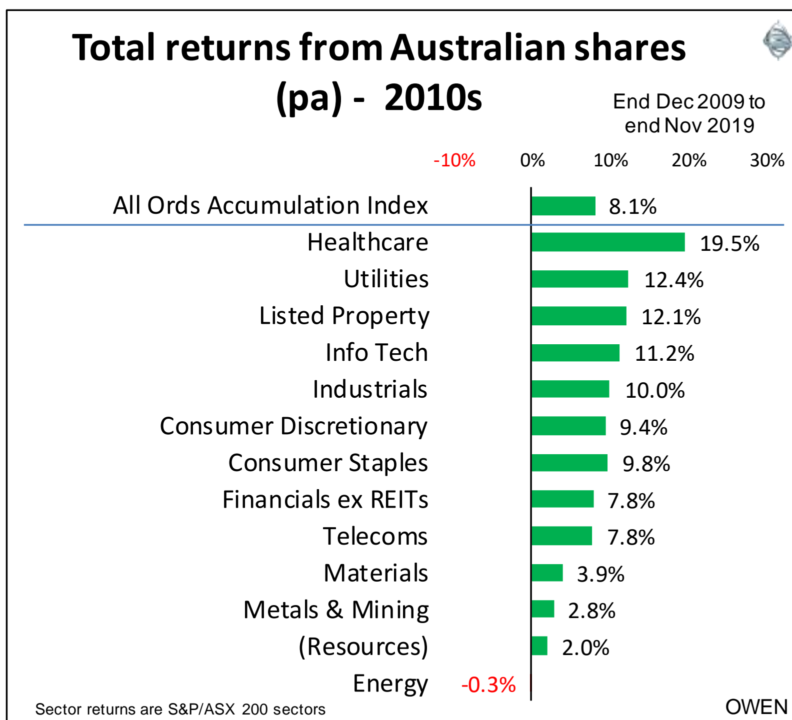
The 2010s has certainly been a decade of change and unpredictable events. Many things we now take for granted were unthinkable at the start of the decade. Instagram, 'Instagram influencers' and YouTube channels as lucrative 'careers', Snapchat, Pinterest, WhatsApp, Uber, Deliveroo, Airbnb, Spotify, iPads, tablets, Kindle, bitcoin, Square, pay-wave, smart watches, fitness trackers, Bluetooth, USB flash drives, GPS on smartphones, 4G, streaming, self-driving cars, drones, and even test cricket played at night with a pink ball! We have Trump in the White House, Britain in 'Brexit' chaos, combat warfare on the streets of Hong Kong, rising nationalistic fervour and extreme right and left-wing politics across the world, the US withdrawing from the multi-lateral world and China expanding militarily and economically far beyond its borders.

For investors it has also been a decade of surprises. At the start of the 2010s decade the world looked like it was on the way to recovering from the US sub-prime crisis and global banking crisis. Ten years later the US, Europe and Japan are still on life support in the form of unprecedented monetary and fiscal stimulus. Much of the world still has near zero or negative interest rates, negative bank deposit rates, negative bond yields, and even negative rates on mortgages in some places. In Australia we have cash rates and bond yields below 1% for the first time in history, and at the level as Greece even though Greece has had its debt restructured three times over the decade.

These were unthinkable ten years ago. All of this monetary and fiscal stimulus has done little to stimulate economic growth or inflation. All it has done is fuel asset price bubbles and mountains of debt everywhere. The winners have been asset owners, lenders and emerging country wage earners, while the losers have been savers, renters, traditional retailers and developed country wage earners.

In next month's report we will take a look at asset class returns for investors over the decade, but this month we start with Australian shares.

The chart shows annualised total returns (including dividends) from the different sectors of the Australian share market since the end of 2009 to the end of November 2019 (almost a decade). There are two unusual features. The first is that the 8% total returns per year from the overall market has been well below its long term average of around 10% per year. What is surprising is that the poor results were achieved in an era of very low interest rates and inflation. The second unusual feature is the wide dispersion of results between different sectors.



(The numbers expressed below for individual companies are total share price gains over the decade, *not* annualised, so they should be compared to the broad market share price gain of +42% for the decade. Yes, just 42% growth (or 3.6% per year) for the decade!).

Healthcare has been the star sector for the decade. CSL is up +773% and is about to take the lead from CBA as the most valuable company on the ASX. ResMed is up +274%, Cochlear +239%, Ramsay +570%, Ansell +171%, and Sonic +99%. Despite these success the healthcare

/ biotech sector is notoriously speculative and accident-prone, with many more losers than winners. Some companies had their brief time in the sun – like Mesoblast and Primary Health care (now 'Healius'), but most of the nearly 200 healthcare stocks that were on the ASX at the start of the decade have gone nowhere (still waiting or their big breakthrough) or have run out of money and disappeared.

Utilities stocks have also done well over the decade. Their relatively stable, regulated cash flows have benefited enormously from the great collapse in bond yields over the past decade. APA is up +214%, AusNet +90%, Spark +57%, but AGL is up only +41%.

The tech sector has had a good decade. Carsales is up +207%, Altium + 14,000%, Technology One +1,003%, Infomedia +563%, Praemium +256%, and Seek (classified as an 'industrial') is up +236%. The tech sector is like healthcare in having a lot more losers than winners. At the other extreme is Silex Systems down -90%, but most of the other 110 tech stocks that were listed 10 years ago have remained dormant or disappeared. Computershare, a survivor from the last tech boom in the 1990s, is up just +55% this past decade.

The listed property sector is in the winners list for the decade but it suffered very badly in the GFC, and so even the best property trusts are still well behind the rest of the market if measured at starting point before the GFC hit. Industrial property specialist Goodman has been the star +368% - benefiting from the 'Amazoning' of retailing – ie the shift from physical shops to online shopping, while the others have lagged the broad share market. Bunnings +129% has been a rare exception of retail thriving despite the Amazon effect. The smartest operator in retail property is Frank Lowy (Westfield) and he sold out of the retail trust of Westfield in 2014 and out of the development arm this year.

In the industrial share sector - transport has done well: Qantas +144%, Transurban +177%, Brambles +85%, as well as building products: Amcor +145%, James Hardie +241%.

That's the good news. The problem has been that the two largest sectors – banks and miners – have dragged on the market over the decade.

In the case of the banks - CBA is up just 47% in 10 years, but the rest of the big-4 have done nothing – dead flat. AMP is down -71%, Bank of Qld down -32%. The star has been Macquarie – our only home-grown globally relevant bank. After a near-death experience in the GFC it is up +185% for the decade. Among the insurers, IAG +99% and Suncorp +54% have easily beaten the perennially accident-prone QBE -50%, which was once a top-10 stock.

As for the miners – it is all driven by commodities cycles. The 2000s China boom peaked in 2008, then had a brief revival in 2010-11 thanks to China's enormous GFC stimulus boost, but that ended in 2011 when commodities prices peaked. Iron ore prices are down -18% for the decade and down -54% from their peak. Coal prices are the same as they were 10 years ago but down -37% from their peak. Almost all other industrial commodities prices are well down from their 2011 peaks and also well down over the decade: Copper -20%, Nickel -28%, Aluminium -18%, Lead -20%, Tin -2%, Zinc -12% for the decade.

BHP's share price is down 11% for the decade (or down -5% including the free shares in spin off South 32), but RIO is up just 29%. Fortescue is a genuinely new star +119%. Gold mining heavyweight Newcrest is down -13%. The gold price is up 30% over the decade but down -23% from its 2011 peak.

Energy stocks (mainly oil & gas) are driven mainly by oil prices, which are down 60% since the 2008 peak and down 30% since the start of the decade. Natural gas prices are also down 59% for the decade. So it is no surprise then that oil/gas share prices are down - Origin -48%, Woodside -27%, Santos -42%, Worley (oil/gas engineering) is down -48%. Only Oil Search is ahead +21%.

Australia enjoys a mining boom about once every three decades, and they take many years to develop – with steadily rising demand and diminishing supply - like the steady rise of Chinese industrialisation and urbanisation in the late 1990s and early 2000s accompanied by supply constraints from lack of exploration and development due to the commodities price collapse in the 1980s and 1990s. There is little sign of the start of the lead-up to the next big mining boom. An exploration drought and mass mine closures caused by a sustained commodities price collapse would be a good start, but it would also require a source of steady demand growth – perhaps an industrialisation boom in Africa or more likely a rapid military build-up by China and the US. I was lucky enough to get in early on the last mining boom, and I'll make sure my kids get in on the next one! Meanwhile it will be slim pickings.

Also struggling over the past decade were the retailers. Myer is barely surviving after being worked over by private equity (it will probably suffer the same fate as Dick Smith), and DJs has been taken over by South African Woolworths and is also on its last legs. Harvey Norman, the star of decades past, is dead flat over the 2010s decade. Even JB – arguably the best of the retailers – is up just +66% in 10 years. Woolworths is up +42%, and Metcash down -21%. The winners have been the online players – like Domino's Pizza up +878%.

Rounding out the laggards is Telstra – up just 32% in the last 10 years, but still 60% below its peak 20 years ago.

Who will be the winners and losers over the next decade? The miners and banks are driven by macro shifts. For miners it is the big picture commodities cycles, and for the banks it is demographic cycles, regulatory cycles, competitive regimes and interest rate/credit cycles.

In the other sectors – each industry has its own big picture trends - like the 'Amazoning' of retailing, but what determines the winners and losers is the same in every era in every sector – the quality of management. This includes the ability to capitalise on opportunities, but often it is a simple as not doing dumb things – like undertaking huge ego-boosting acquisitions and expansion projects at the tops of booms, and then selling or closing them and writing off billions in the busts. It's not just miners, it's a disease that afflicts most companies in all industries.

The winners in the next decade will be the companies run by visionaries who are supported by highly skilled directors with real experience in running companies themselves and who add real value rather than just tick compliance boxes.

What lies ahead?

This year has seen economic slowdowns in Australia and just about everywhere else, but it has been tremendous for returns from just about every investment asset class except cash. There have been two dominant themes – central bank stimulus and trade wars – and the US has led both. In 2018 the US Fed raised interest rates four times and scaled back its balance sheet, the European Central Bank also wound back its 'QE' asset buying programs, the Bank of Japan waivered on more rate cuts and QE, and Trump started his trade wars. As a result, shares sold off heavily late last year but we reduced exposures to shares significantly in portfolios prior to the sell-off. In Australia we had the housing construction slowdown and the Hayne enquiry – and shares sold off here, mirroring the US.

Then from early 2019 we increased exposures to shares and returned to a moderately bullish stance for the rebound. This year shares have done well because the stimulus effect has out-weighed the trade war effect. The US Fed resumed rate cuts and asset buying, and this has been echoed in Europe, Japan, China and even Australia. This year Trump's trade wars have been reduced to a slow grind as he keeps his eye on the 2020 election, knowing that his tariffs are hurting his voter base. As a result, share prices soared here and around the world.

Last year's sell-off was sharp but it was short-lived. There are three major possible triggers for a deeper and more sustained sell-off like the GFC crash. The first would be a major escalation in Trump's trade wars that dramatically reduced production and jobs across the world (like the GFC); the second would be a sudden sharp tightening of monetary policy in response to a serious inflation scare; and the third would be a sudden loss of faith in the US government – for example if Trump repudiated US foreign debt (one of the few election promises he has not acted on).

The first scenario – a sudden escalation in the trade war with China - is possible, but more likely after the 2020 election if Trump wins. In an election year Trump is probably more likely to refrain from rapid head-on escalation with China, and instead create a few side diversions and skirmishes with other countries.

On the inflation scenario - the world is probably many years away yet from a major inflation spike (say 5%+) that would require a major policy tightening that might send share prices lower for a year or so. Central banks have a long history of going too late and too hard, so it is highly unlikely they would manage a smooth landing without a major crisis or crash. The US is the most likely candidate for inflation but a serious and sustained inflation spike is still probably years away – even with a return to zero or negative rates and trillion dollar government deficits. The most likely cause of inflation would be a sustained military build-up – like the late 1960s Vietnam War build-up. This is the base case.

On the US default risk – just the fear of this is enough to create volatility (like the 2011 US downgrade crisis) and keep the gold price simmering along. Probably unlikely in an election year.

Meanwhile, economies in the US, Australia, China, Europe, Japan and just about everywhere else have been slowing – but that is not the major driver of share prices. What drives share prices is changes in investor perception about possible policy responses to signs of economic slowdowns (or booms for that matter). As long as inflation and wages growth remain slow, monetary and fiscal stimulus efforts are likely to remain very supportive of asset prices over the coming months – subject to the usual frequent short, sharp shocks along the way.

Ten years after the GFC - which was a crisis about debt together with the complexity and interconnectedness of banks – the major economies are still stagnant on life support and burdened with more debt than ever before, and the banking system is more complex and interconnected than ever before. This makes for a fascinating year ahead!

As always we remain on the look-out for possible sources of risk and we are ready, willing and able to make adjustments to protect investors and to capitalise on opportunities where warranted.

'Till next time, happy investing!

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