# December 2021 — Over the Horizon Market Commentary by David Offer

Calendar 2021 was a reasonable year for the Australian share market, with the All-Ordinaries index returning 13.5% for the year. Most of these gains were achieved in the first half, with the market up 10.7% in the 6 months to June.

As to what 2022 will bring, inflation and its impact on interest rates will likely be the overriding theme that will dominate investment markets globally. Central banks including Australia's own Reserve Bank (RBA) appear to have miscalculated the re-emergence of inflation. An increasing number of market commentators are at odds with the RBA outlook with a notable example being former Treasurer Peter Costello labelling the RBA "irresponsible" for stating it would keep interest rates where they are until 2024.

Should Central Banks choose to start to proactively deal with inflation, as well as the standard measure of increasing the official cash rate, Central Banks are also likely to reduce quantitative easing. That is, to reduce the amount of money printing to buy government debt to artificially depress the interest rate paid on longer duration debt. In this scenario, with government induced demand for government debt reducing, interest rates would likely rise to more sustainable levels. As a base case, one would think that this would be where investors are actually getting a return on their money that is at least equal to the inflation rate so that purchasing power is maintained.

With the base case being interest rates will start to normalise in 2022, and hence the discount rates used to price all assets to go up, this could easily take the wind out of the sails of highly priced growth assets. Indeed, this process is already starting to occur. Former market darling Afterpay is a prime example, having already halved in value over calendar 2021. Afterpay made it into the ASX20 index at the start of 2021 and as such was forced to be purchased by index funds *after* it had appreciated in value. With its share price falling, should Afterpay subsequently exit our major indexes, these same index fund managers will then be forced to sell Afterpay at materially lower prices and this will likely add further to its share price woes.

In addition to growth shares, rising interest rates are also bad for venture capital, private equity, property, fixed rate bonds and assets where there is excessive speculation. Speculative sectors of note include the US$2 trillion crypto currency sector, which has already dropped almost one third in value in the last two months having nudged almost US$3 trillion in November, and Special Purpose Acquisition Companies (SPACs), which are American based cash boxes used to acquire businesses with a view to listing on the American share market in the future. In the US, 602 SPAC IPOs occurred in 2021 to raise a record US$160 billion. In the SPAC space, more money was raised last year than in the years 2003 to 2020 combined.

The expectation of upcoming interest rate rises does appear to be starting to provide some gravity to begin the process of bringing back to earth some of the more excessively priced investments. We may just be at the beginning of this process and suspect that 2022 may be the year that excess speculation starts to subside and, as such, investment markets start to act more in keeping with the past.

We view the best hedge to deal with a more difficult investing environment going forward is to ensure optionality by holding a decent cash balance within portfolios that predominately comprise of value orientated share investments. We define such companies as those that are undemandingly priced and comprise of real businesses that generate strong cashflow and profit over the economic cycle. In particular, we favour companies that stand to benefit once the Covid pandemic eventually passes.

Thankfully, this seems to be occurring with the severity of the Omicron appearing to be substantially less than earlier strains of the virus. Omicron appears to be rapidly infiltrating the East Coast (and in particular NSW) with no meaningful increase in hospitalisations. Of the few presently hospitalised by Covid, more than 80% are not vaccinated. As such, there is clear evidence that, other than for those people with severe ongoing medical conditions, vaccinations will ultimately enable life to return to normal with the current strains of Covid circulating within the community.

Western Australians will need to prepare for Covid becoming part of life within the community as soon as travel restrictions ease. Pleasingly, of West Australians over the age of 12 years, 86 per cent are now double-vaccinated against COVID-19, suggesting that the virus will have a relatively low impact within our State once it begins to circulate.

Examples of shares that we are enthusiastic to buy at the current time include **Seven Group**, **Westpac**, **Qantas**, **Tassal**, **Unibailrodwestfield**, **Ansell** and **Lend Lease**.

Seven Group is a relatively new addition to investment portfolios. The Company is a conglomerate of businesses that comprises of Westrac, Coates Hire, Boral (70% ownership), Beach (30% ownership) and Seven West Media (40% ownership). All businesses have the potential to grow strongly over the next few years which makes Seven's current PE ratio of 12 times (a 25% discount to the broader market) very undemanding. Macquarie's valuation of between $25 and $30 suggests there is scope for material upside to the current share price at $21.50. We have had considerable success in investing in conglomerates to date, with Wesfarmers, Soul Paterson and Brickworks to name some earlier successes, and hope this tradition will continue with Seven Group.

Within our office we have some exciting news to share with two new staff members, Nicola Hynes and Ricki Brown, set to join at the end of the month. As you may be aware, the financial planning industry is going through tremendous change at the current time, with increased regulation forcing approximately one third of industry participants out. To replace these people, new entrants must have completed a 'Relevant Degree'. In Western Australia, the only university offering this course is Curtin University and this year they had 22 graduates. Having presented to this student cohort several times last year and having had the opportunity to get to know each other a little, I am delighted that both Nicola and Ricki have elected to join our business as New Financial Advisors. Both are interested in learning more about offering investment advice and this is their principal reason for joining Horizon. I will look forward to introducing Nicola and Ricki to you in due course and likewise increasing the amount of communication and investment suggestions with you in the months ahead.

Finally, I thought it appropriate to share with you a positive article from Firstlinks newsletter service; **the three all-time best tables for every investor**. While we all tend to get caught up in looking at share market investment on a short-term basis, this article reminds us that bringing a long-term view towards share investment will ensure success as evidenced by share market data going back 146 years to 1875. Over that period, there have been no negative periods when share investments (representing the index) have been held for a minimum duration of 8 years, with the average return for every 8-year period being 120%. With negative real returns from 'investing' cash in the bank, these are pleasant statistics to be reminded of.

Our office wishes you a happy and successful 2022.

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# Three all-time best tables for investors by Romano Sala Tenna

I have read countless books on investing, met an enormous number of financial experts and fund managers, and made pretty much every investing mistake possible!

If I could distil my learnings into one statement, it would be this: **the short term is unknowable, but the long term is inevitable**.

Let me share my three all-time favourite tables from 30 years of investing.

**The long term is inevitable**

Firstly, the stock market has good years and bad, but over the long term there is only one trend and it is up. Despite this being obvious, I continue to be astounded at how investors behave during 'bad' years.
We are now into our 146th year on Australian stock exchanges (under various names). That enormous amount of data provides the clearest guide to anyone willing to learn. During this period, the market (dividends plus share prices) has risen 117 years and declined 29 years (returns used in this article are nominal, not real adjusted for inflation). So 80.1% of the time, the market rises. One in five years on average, the market declines.

| SINCE 1875 | NEGATIVE RETURNS | POSITIVE RETURNS | TOTAL |
|---|---|---|---|
| # of Years | 29 | 117 | 146 |
| % of Years | 19.9% | 80.1% | 100.0% |
| Average Return | -10.4% | 16.1% | **10.8%** |
| **SINCE 1979** | | | |
| # of Years | 11 | 31 | 42 |
| % of Years | 26.2% | 73.8% | 100.0% |
| Average Return | -11.8% | 21.8% | **13.0%** |

*Source: Katana Asset Management*

When the market rises, it does so by an average of 16.1%, and when it declines the average is minus 10.4%. When combined, we see that over the past 146 years, the market has averaged a return of 10.8% per annum.

Since Australia has become more sophisticated and introduced the Accumulation Index in 1979, the data points to an even stronger outcome. Over the 42 years since 1979, the market has risen by an average of **13.0%** per annum. And this is despite some seriously scary episodes, including the 1987 stockmarket crash, the 1997 Asian financial crisis, the GFC and the fastest crash on record, Covid-19.

**If there is a better table than this, send it to me …**
To better understand how the market behaves over different time frames, we can break the data into rolling periods. For example, a rolling five-year period, is the average return over every five-year period since 1875.

What this table demonstrates is extraordinary.

| Timeframe (Rolling Average) | Average Return Since 1875 | Number of Negative Periods |
|---|---|---|
| 5 Years | 65.1% | 7 |
| 7 Years | 100.7% | 2 |
| 8 Years | 120.4% | 0 |

*Source: Katana Asset Management*

If you were to invest your money in the ASX (index), turn off your screen, go away and comeback in five years' time, then on average you would have a 65.1% return, and there would have been only seven occasions out of the 142 rolling five-year periods where you would have a negative return.

If you were to invest your money in the ASX (index), turn off your screen, go away and comeback in seven years' time, then on average you would have a 100.7% return, and there would have been only two occasions where you would have a negative return.

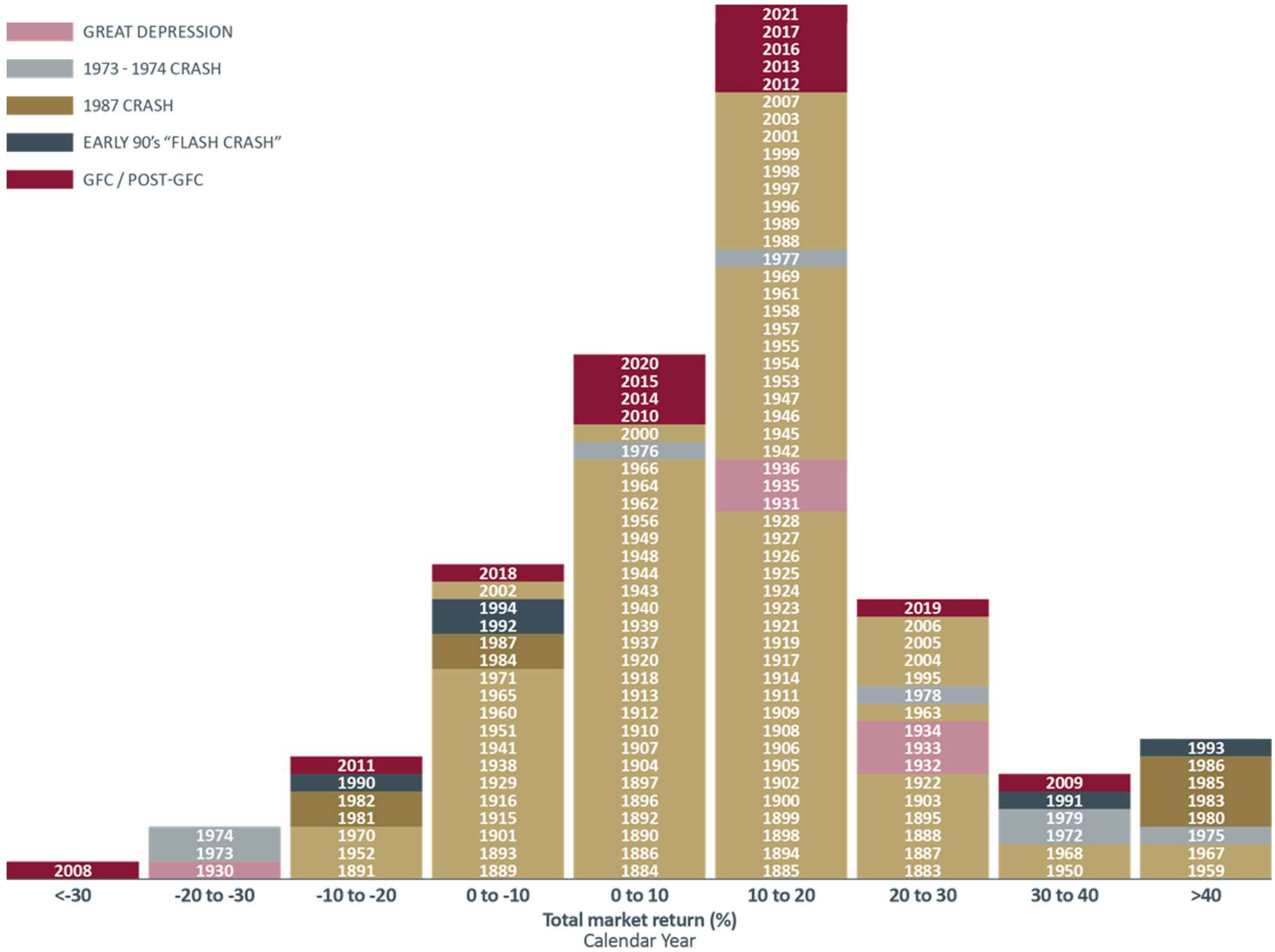
But even more remarkably, if you were to invest your money in the ASX (index), turn off your screen, go away and comeback in eight years' time, then on average you would have a 120.4% return, and there would have been **NO** occasions on record where the dividends and capital growth would have been negative.

There is only one long-term trend, and it is up.

**Volatility is the price you pay for a seat at the table**

But of course, in the short term – from year to year – markets are volatile.

We've all seen this distribution curve below, but I suspect many investors have failed to grasp the most important aspect.




*Source: Katana Asset Management (click image to enlarge)*

Crashes are inevitable. Be ready and don't panic at the bottom. In fact, the best time to panic is at the top.

Case in point. There has only been one (calendar) year in the 146-year history where the market fell by 30% or more, in 2008. But if you panicked and sold during that crash, you would have missed an extraordinary recovery. In 2009 the market was up by 39.6% and rose in 11 of the 13 years following the crash, including by 18.8% in 2012, 19.7% in 2013 and 24% in 2019.

Know thyself. If you are prone to doing the wrong thing at the wrong time, stay out of the stock market. Or work with a trusted financial adviser who can coach you through such periods.

**Timeframe, timeframe, timeframe**

If the short term is unknowable and the long term inevitable, an investor really does need to focus on the long term.

If through age or financial circumstance an investor does not have the luxury of a long-term horizon, then they should understand the extra risk that they are taking on. Remember in the stock market, volatility really is the price you pay for a seat at the table. There will be another crash. Guaranteed.

If your time horizon is not beyond the next crash, or you panic and do the wrong thing at the wrong time, then discretion may be the better part of valour.