



A note from Dan

Weak US jobs data rattles global sharemarkets

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Many of the world’s sharemarkets have fallen sharply in recent days (see chart) triggered by US non-farm payrolls (employment) rising by just 114,000 in July¹. Moreover, the US Bureau of Labor also made downward revisions to the previous two months’ data².

Recent sharemarket falls

Period 15 July 2024 – 5 August 2024

Market	% fall
Global (MSCI AC World): local currency return	-8.4
Global (MSCI AC World): unhedged to \$A return	-3.7
United States (S&P 500) local currency return	-7.8
Japan (Nikkei 225): local currency return	-23.6
Australia (S&P/ASX 200) return in \$A	-4.6

With the exception of the return for the S&P/ASX 200 Index, all other returns shown in this table are net of dividend withholding tax reinvested for international investors

Source: [FactSet](#) financial data and analytics

The sobering employment data suggests the US economy is slowing faster than expected, which would be negative for company profits.

Events like these are a shock but rarely a surprise.

Global sharemarkets, driven by big gains from heavyweight US technology stocks, such as NVIDIA, Meta/Facebook, Alphabet/Google, and Microsoft, delivered strong returns for the 12 months to the end of June 2024.

However, the market’s overdependence on just a handful of US companies did leave it vulnerable to a correction, especially as those companies’ valuations have become stretched by historic measures. In scenarios like this, bad news can trigger selloffs and that’s what’s transpired.

¹ *Employment Situation Summary*. Economic News Release, Friday, August 2, 2024, U.S. Bureau of Labor Statistics, <https://www.bls.gov/news.release/empsit.nr0.htm>

² Ibid



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Long-term performance versus short-term sentiments

These events emphasise the importance of a long-term view, when investing. Over the long haul, good companies reward investors by delivering sustainable profits. In the short-term, companies can suffer setbacks because of sudden shifts in sentiments.

This is something that Benjamin Graham, one of the investment industry's great figures, noted decades ago: "In the short run, the market is a voting machine but in the long run, it is a weighing machine."

A voting machine counts votes and votes are based on people's sentiments at a given moment. Sentiments can change — and arguably are difficult to measure accurately.

By contrast, a weighing machine is much more precise and concrete — it's easy to measure weight accurately. The value doesn't change quickly but when it does change a lot there is a noticeable physical difference.

Graham's creative metaphor speaks to the proposition that short-term asset prices are driven by sentiment while long-term trends are driven by something that can be measured more concretely — financial results.

Investments and superannuation, for most members, is a multi-year, even multi-decade commitment and so setbacks do occur from time-to-time. This should not be read as a casual comment, because, understandably, nobody likes to see the value of their investments go down, even temporarily.

The past is an imperfect guide to the future, but the history of sharemarkets do provide reasons for optimism. There have been several large sharemarket falls over the past few decades including the 1987 crash, the 1999 bursting of the internet bubble, the 2007/2008 GFC, and the March 2020 COVID-crash.

In each instance, markets eventually recovered.

Japanese market hit especially hard

At the time of writing, the Japanese sharemarket, as measured by the Nikkei 225 Index, had suffered a double-digits dive, the biggest drop since the 1987 crash.

The Japanese market's plunge relate to the country's interest rates and official interest rate policy.

Official interest rates in Japan have been unusually low by global standards for much of the past three decades as the country's economy has been in a prolonged funk. Some global investors have taken advantage of this by borrowing in Yen and reinvesting in countries with higher interest rates — something described as "the carry trade."

However, the carry trade has become less attractive as the Bank of Japan (BoJ), in July, raised the cost of borrowing for only the second time in 15 years³ as it tries to normalise monetary policy in the world's fourth largest economy.

At the same time, the BoJ outlined a plan to unwind its massive bond buying program,⁴ which has contributed to keeping the country's long-term interest rates low.

The upshot is that while some advanced country central banks like the Bank of England, and Bank of Canada have recently cut official interest rates, and others like the US Federal Reserve are expected to cut interest rates later this year, the BoJ is moving in the opposite direction, and un-nerving market participants by doing so.

³ *Bank of Japan lifts rates as Fed inches towards cut*, by Leika Kihara and Takaya Yamaguchi, July 31, 2024, <https://www.reuters.com/markets/rates-bonds/bank-japan-outline-bond-taper-plan-debate-rate-hike-timing-2024-07-30/>

⁴ *Minutes of the Monetary Policy Meeting on June 13 and 14, 2024*, Bank of Japan, August 5, 2024, https://www.boj.or.jp/en/mopo/mpmsche_minu/minu_2024/g240614.pdf



Central banks to the rescue, again?

Investors have been mindful of the possibility of policy errors not just in Japan, but also in the United States. There has been a rising chorus of criticism directed at the US Federal Reserve arguing that American interest rates have been kept too high for too long and thus risk overshooting and harming the economy.

Critics will be emboldened by recent events and the clamour for cuts to official US interest rates are getting louder.

Those with different views might say that investment markets have become addicted to central bank sugar hits in the form of cuts to official interest rates whenever asset markets have become unsettled.

Furthermore, this group would point out that while global inflation has come down, it would be premature to declare victory, and interest rate cuts now, run the risk of restoking inflation.

Portfolio positioning

We manage a variety of portfolios spanning the risk/return spectrum for our clients, and thus comments made here on portfolio positioning are high level and not specific to a particular fund or product.

The strong sharemarket performance of financial year 2023/24 did alert us to the potential for a market correction and thus we strengthened defensive components of portfolios by, amongst other things, increasing the duration⁵ of our fixed income investments.

As it is, bond yields have fallen (bond prices risen) as the economic picture has become dimmer and hopes grow for US interest rate cuts. The fall in bond yields has helped to cushion our diversified portfolios from the full impact of recent sharemarket falls.

Furthermore, we believe that our sharemarket investments are likely to fare relatively well as they lean into what we believe are quality companies measured by such metrics as strong return-on-equity, histories of good profitability alongside dependable cashflows, and what we judge to be sensible valuations.

Portfolios with unlisted assets — unlisted infrastructure, real estate, private equity, and alternative assets — potentially benefit from the different risk and return characteristics provided by such investments.

Preferring industrials in unlisted real estate

There have been many headlines about the gloom over the office sector within unlisted real estate as it suffers from structural headwinds brought about by the working-from-home or at least hybrid work revolution, on the heels of COVID-related disruption.

We believe our office fund investments have fared better than the office sector en masse because of their preference for A-grade offices, rather than more under-fire B-grade offices.

At the same time, being significantly overweight to the industrials sector, where we have been leaning into companies and businesses benefiting from the e-commerce and digitisation trends, has benefited portfolios with such exposures.

Avoiding economically sensitive infrastructure

Our unlisted infrastructure investments have also been serving clients well, in our view, where its emphasis has also been on businesses related to economic digitisation, and renewable energy, both of which we believe have many years to run.

⁵ Duration is a weighted measure of how long it takes for a bond or debt investor to be repaid through cashflows. It can be used to measure the sensitivity of the price of a bond or other debt instrument to a change in interest rates. In general, the higher the duration, the more a bond's price will drop as interest rates rise. On the other hand, the higher the duration, the more a bond's price will rise as interest rates fall.



On the other hand, we have been underweight toll roads, and ports, which we deem to be much more economically sensitive sectors.

Alternative investments have their own dynamics

The pattern of returns provided by alternative investments differ from those related to sharemarket investments and thus they are valuable sources of diversification for portfolios with such exposures.

Examples include what we describe as “esoteric credit investments” backed by high quality assets and cash flows uncorrelated to the broader economy. Legal receivables and government backed receivables, are examples.

Then there are insurance related investments (IRIs), which are investments in natural catastrophe risks. In the IRIs arena, institutional investors take on the role of an insurer and receive a yield – effectively an insurance premium – for taking the risk of a natural catastrophe(s) causing losses above a certain level.

As the occurrence of natural catastrophes has no expected relationship with the economy (or with share market movements), IRIs are an attractive source of diversification.

Private equity (PE): where active management matters even more than usual

Private equity (PE), which is the epitome of an asset class where active management really matters, continues to a source of potentially strong long-term performance with lower volatility than listed equities, in our view.

A reason PE managers can produce potentially strong returns is they take a hands-on approach.

PE managers are often specialists in the industries they invest in. They take an active role in the running of companies they own through choosing directors, shaping management appointments, and the development of business plans, which gives them greater ability to influence both the operations and the management of the business.

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