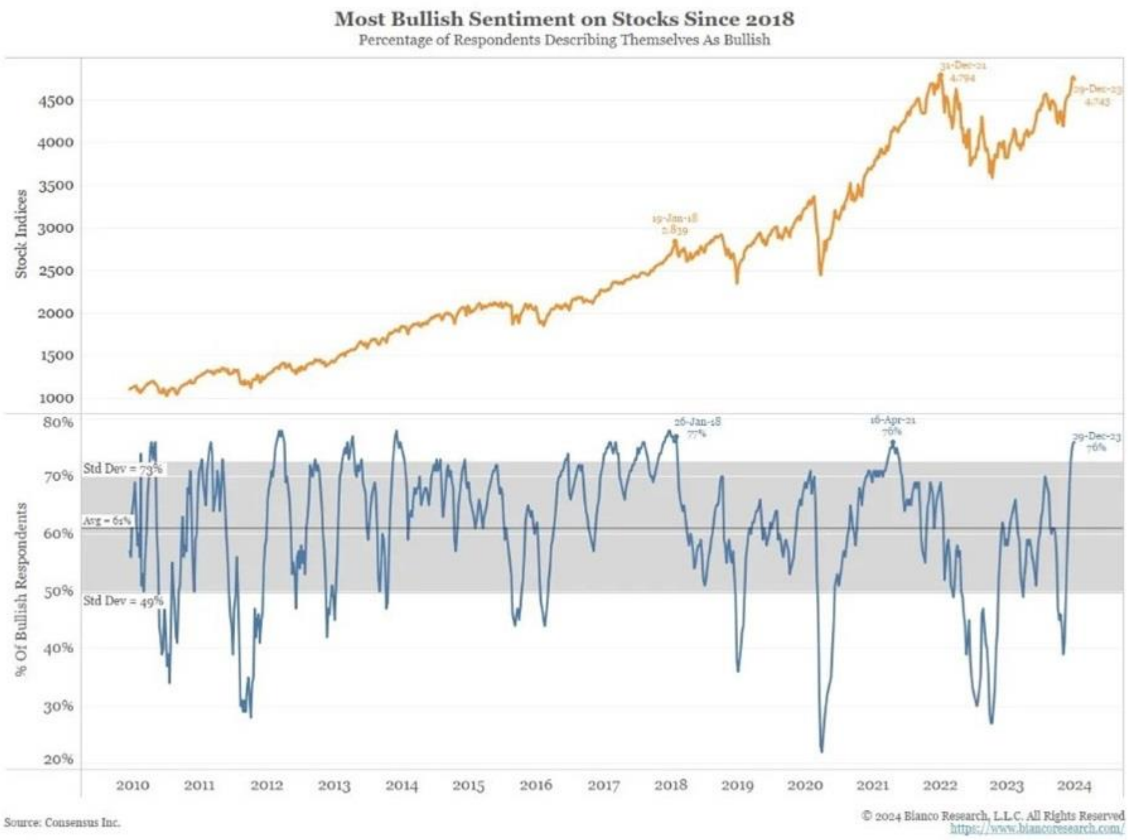
Edition 543, 19 January 2024

Contents

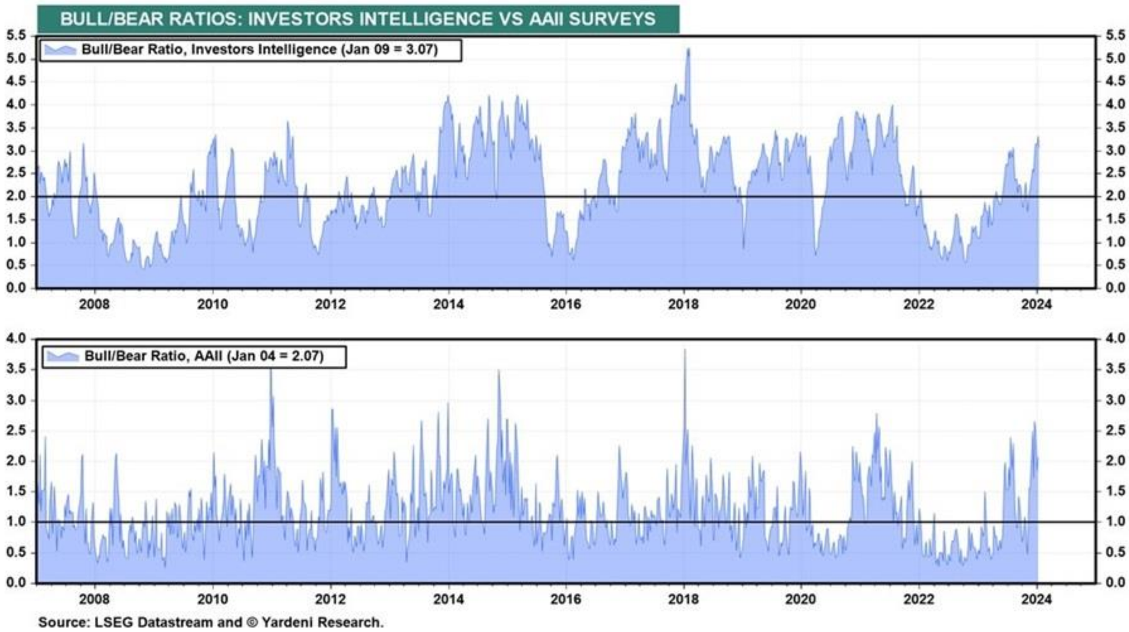
Editorial

Everyone from brokers to strategists to fund managers seems to be bullish on the prospects for stocks this year. For the contrarians among us, this near-universal optimism is a red flag, or at least an amber one. Is caution warranted, though?

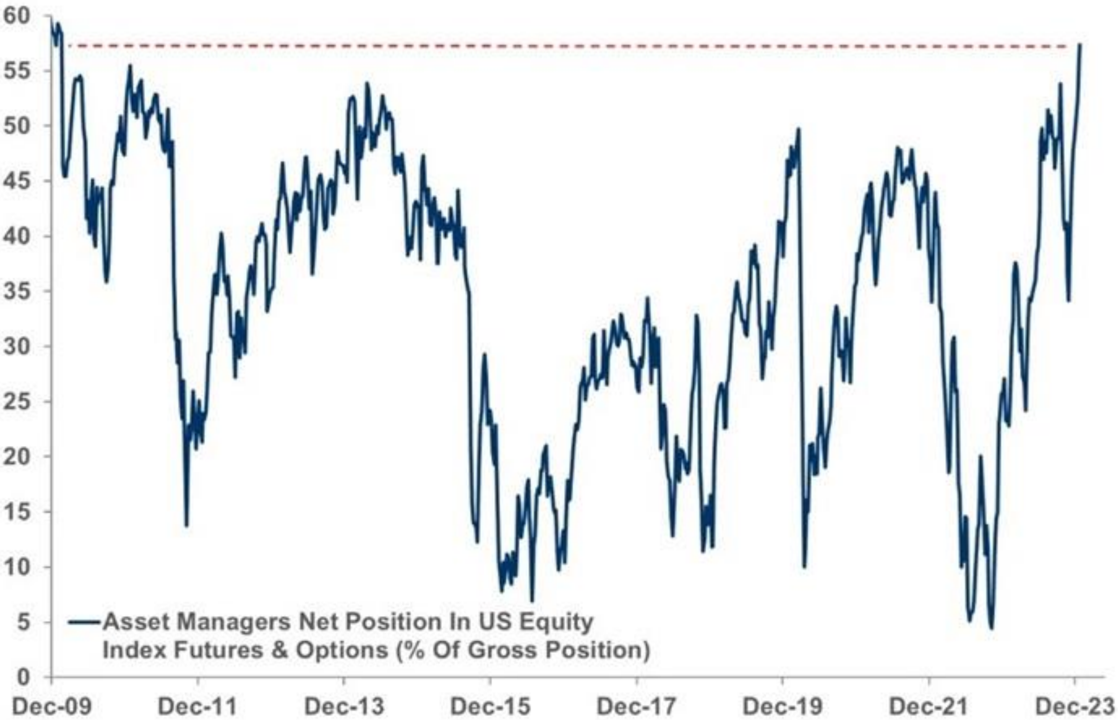
Let's first take a closer look at investor sentiment. Consensus Inc tracks futures market newsletters and brokerage reports, and aggregates the percentage that is bullish. This stock market series is the most bullish since 2018.



The sentiment of individual investors in the US echoes that of newsletters and brokerage reports.



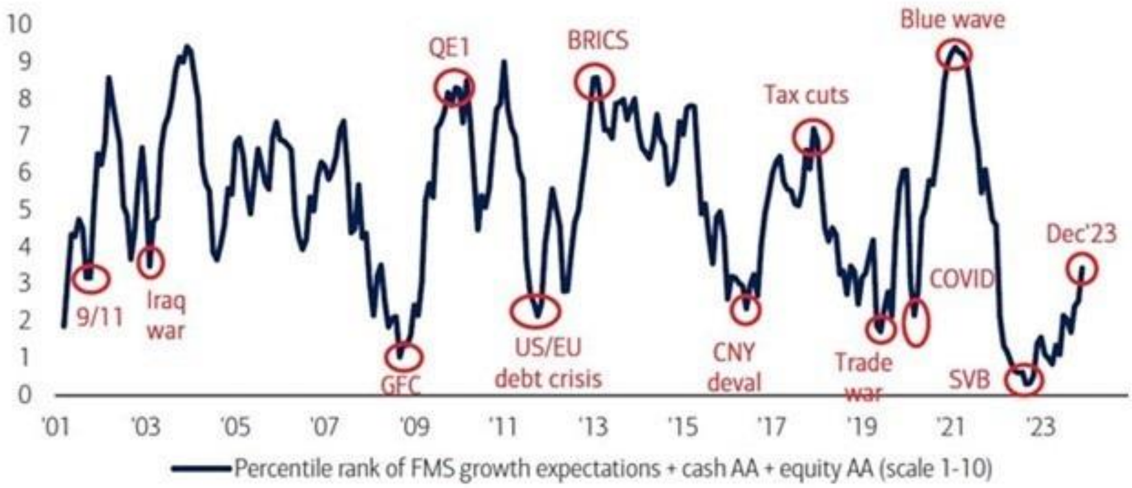
Asset managers are also optimistic. They have the largest net long position in stock index futures since 2009.



Fund managers aren’t quite as positive though sentiment is on the way up.

Chart 2: FMS sentiment improved to highest since Jan'22

Percentile rank of FMS growth expectations + cash level + equity allocation (scale 0-10)



Source: BofA Global Fund Manager Survey; (0=bearish, 10 = bullish)

BofA GLOBAL RESEARCH

Most investor surveys then support anecdotal observations that there is widespread optimism on the prospects for markets.

The positives

The bulls point to several factors that will lead to higher stock markets high this year, including:

- Inflation in the West has peaked and is likely to head towards central bank targets.
- With inflation falling, interest rates are too restrictive and will soon be cut.
- Lower rates reduce the cost of capital and thereby increases the value of assets.
- That should lead to higher prices for assets, including stocks.
- Markets and sectors outside of US tech aren't expensive and should benefit most.

Clime Investment Management's John Abernethy has an excellent article in Firstlinks this week, outlining these arguments and more, for why he thinks 2024 and beyond will be fruitful for investors.

The risks

What could spoil the party? Here are some risks for markets this year:

- Inflation doesn't fall as fast as expected and perhaps even bounces back up.
- Interest rates don't fall or don't fall as fast as investors expect.
- A recession brought about by the lag effect from higher rates and their impact on consumer spending and the economy.
- Private assets finally get properly valued and that reduces the capital of private equity and venture capital to finance deals and drive markets.
- Donald Trump gets re-elected as US President, inflaming internal divisions and consumer sentiment.
- Donald Trump doesn't get elected US President and internal tensions boil to breaking point.
- China doesn't recover and continues to deflate after one of the largest credit bubbles in history.
- Wars in the Middle East and Ukraine don't stay contained.

There are always risks and reasons to worry. My experience is that markets can usually handle one or two concerns and manage them with equanimity. But when multiple concerns hit all at once, that's when things get rocky. And it's the risks that markets can't see now that are the ones to most worry about – the 'unknown unknowns' in the words of Donald Rumsfeld.

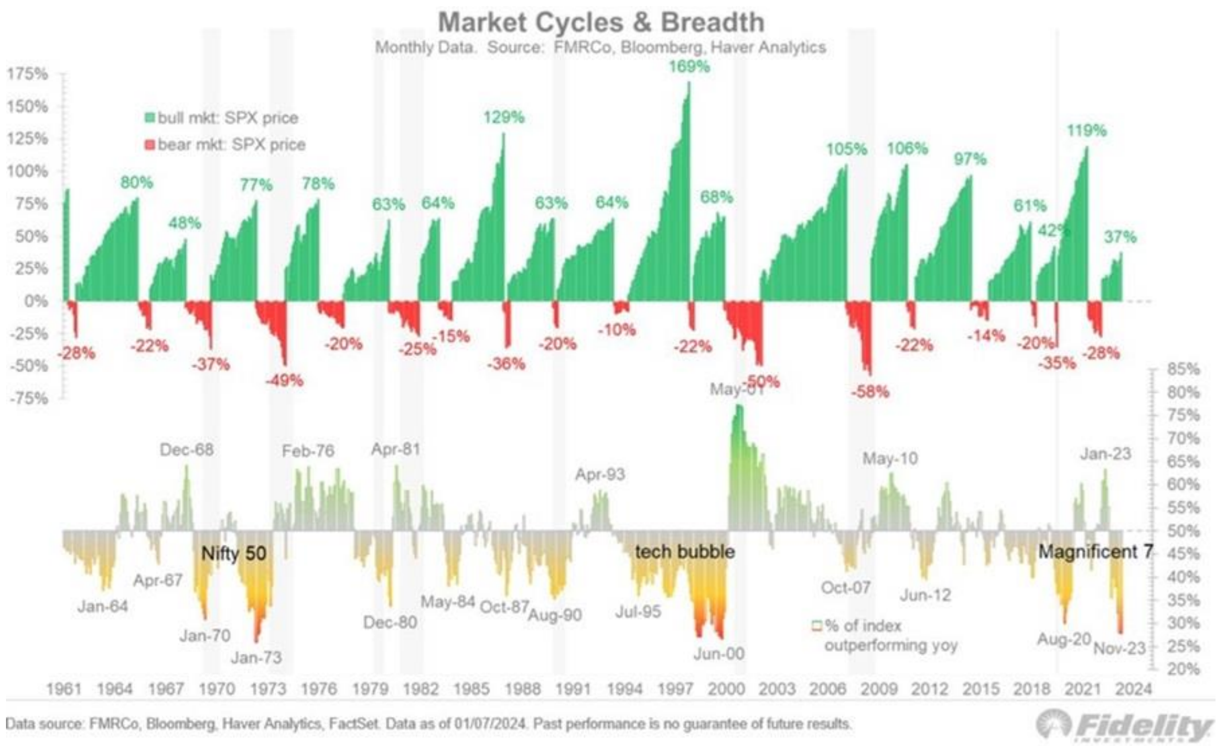
Possible opportunities

What should investors do, then? First, zoom out. Since 1900, the Australian share market has ended the year in the black 72% of the time. For global markets, that figure is 78%. And world stocks have had positive returns 99% of the time over 7-year periods.

That means the default for investors should be optimism. Not blind optimism mind you, as there are times when markets swing to be wildly overvalued or undervalued. Though today doesn't seem to be one of these periods.

In fact, history suggests that the current upturn in markets may have a way to go.

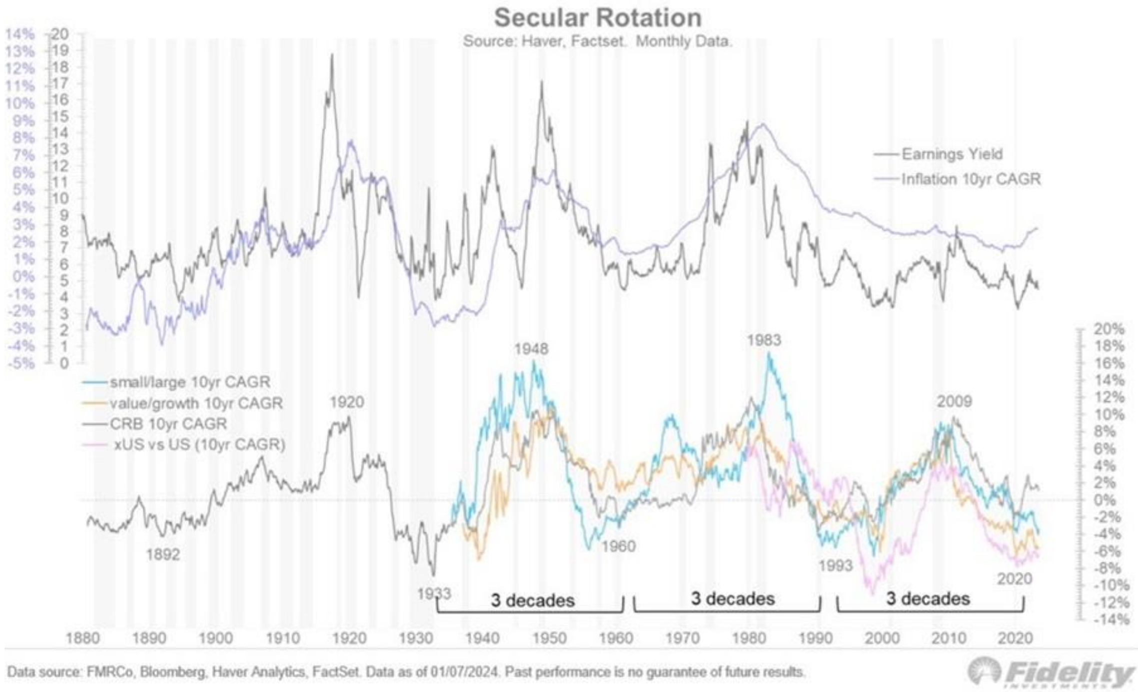
Source: Firetrail



Famed investor Howard Marks also thinks market valuations don't look out of whack. Yes, the US market appears mildly overvalued and US tech looks stretched, but there are large pockets of opportunity outside of that.

Where are these pockets? I don't think you need to look far to find them. Tech and large cap stocks, especially in the US, have sucked an extraordinary amount of money over the past decade. The reasons for this include the rise of software-as-a-service, artificial intelligence, inflows into passive ETFs that automatically flow to larger stocks, phenomenal earnings growth especially among the 'Magnificent Seven' and great returns which in turn attracts even more capital.

Yet the love for large caps and tech has meant that other sectors have been left behind and forgotten. The following chart illustrates four areas where returns have lagged.



1. Small caps

Small caps stocks, including in Australia and the US, have trailed large caps for the past 15 years and now look cheap.

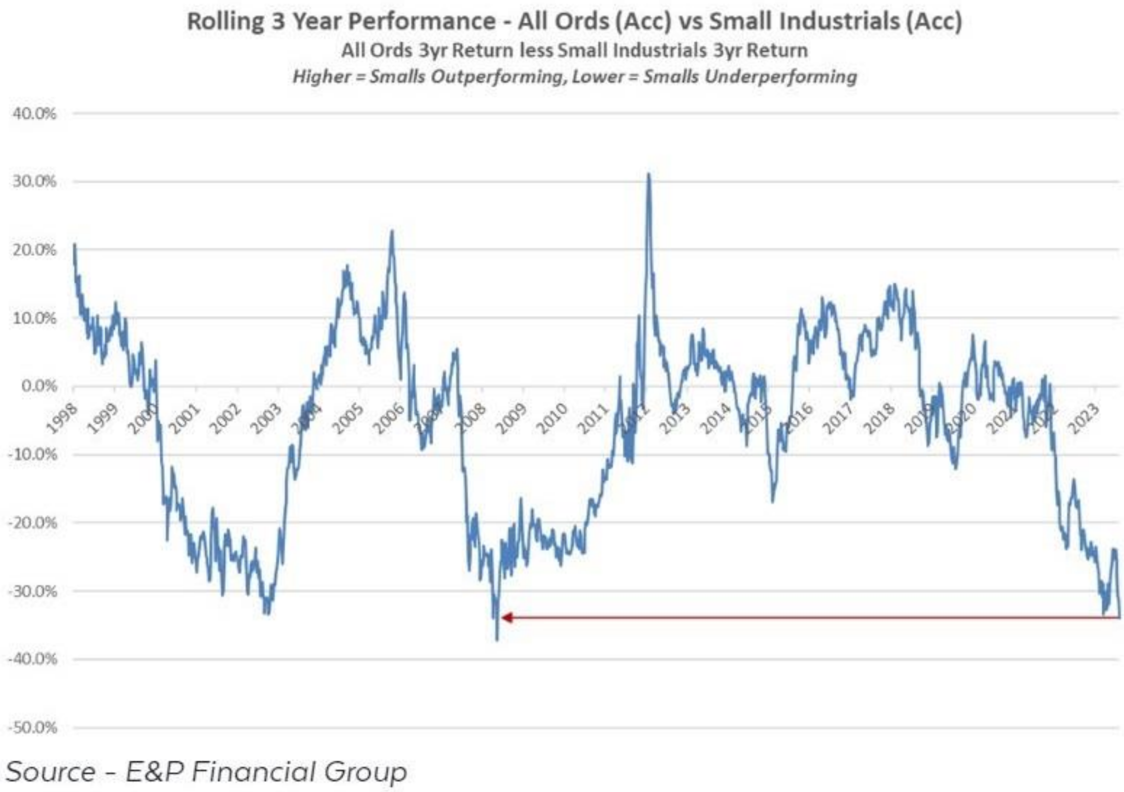
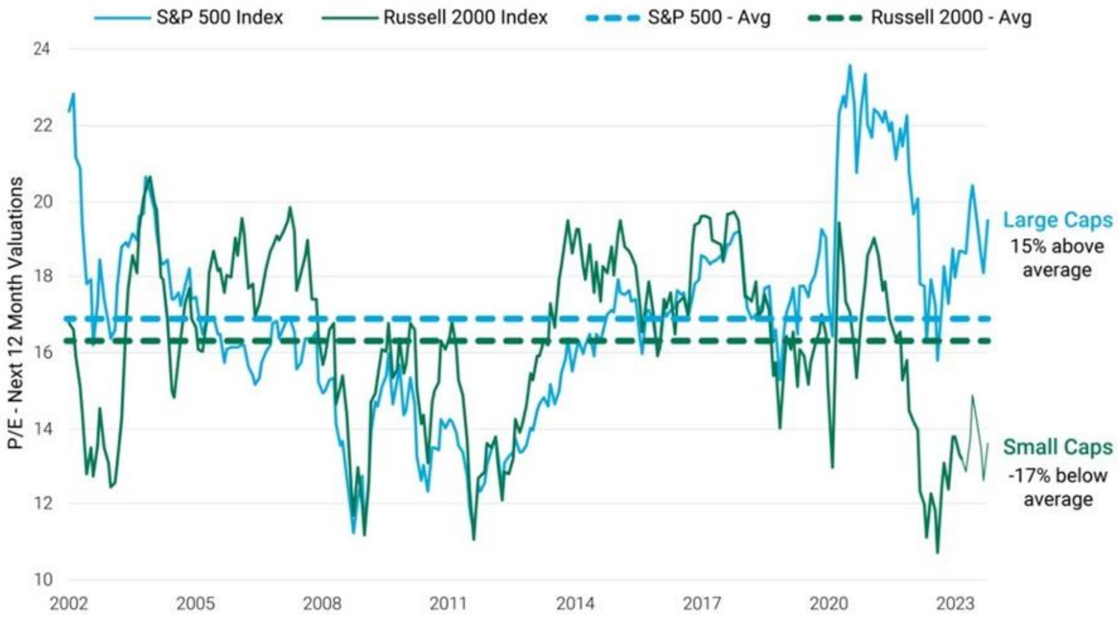


Figure 1 | Value Disparities Between Large- and Small-Cap Stocks

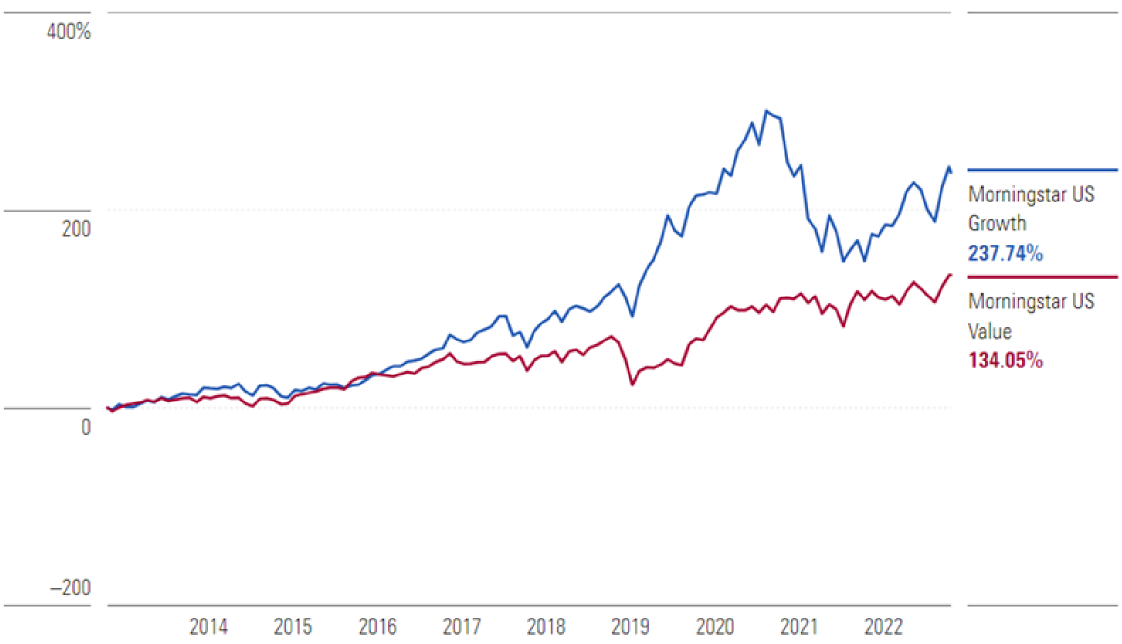


Data from 2/28/2002 – 11/30/2023. Source: FactSet. **Past performance is no guarantee of future results.** Price to Earnings Ratio (P/E) is defined here.

2. Value stocks

Growth stocks have obliterated value stocks since 2008. After value outperformed during the downturn of 2022, growth again got its measure last year. Value again looks cheap.

Stock Performance: Value vs Growth

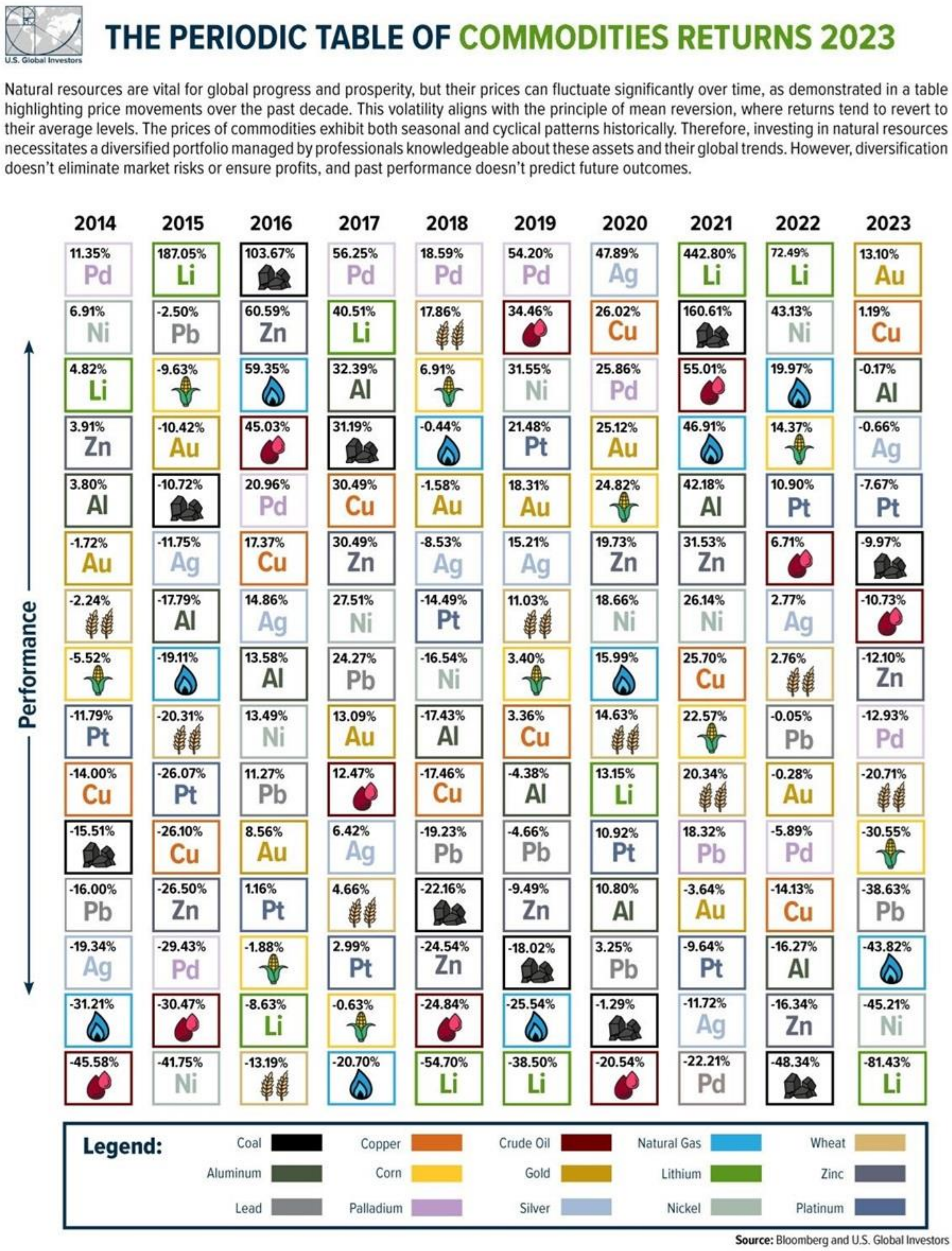


Data as of Jan 9, 2024. Morningstar Direct

3. Commodities

Commodities have lagged, dragged down by the prolonged economic slowdown in China. It's been a mixed bag though. Last year, iron ore ripped, and gold prices increased 13% while at the other extreme, nickel and lithium plummeted by 45% and 81% respectively.

Could the energy transition and increased infrastructure spend globally lead to a rebound in this sector over the next year and beyond?



4. World ex-US

There's plenty of value outside of the US. Markets such as the UK, China, and broader emerging markets look especially cheap.

The ASX 200 is trading close to its long-term average price-to-earnings ratio, though that disguises the huge disparities in valuations for industrials versus miners and the banks.

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In my article this week, I look at nine investing lessons that I've learned from owning a small business. In 2016, I took a large bet and bought a motel on the outskirts of Sydney. Since then, I've ridden the highs of a motel on the rise, to the lows of Covid, and back again. Along the way, owning a business has made me a better investor, and being an investor has made me a better businessperson.

James Gruber

Also in this week's edition...

The Australian stock market performed reasonably well in 2023 but how did its performance compare to history? **Ashley Owen** does a deep dive into the data back to 1900 and shows where last year sits, as well as what to possibly expect from the ASX this year.

Most of us want to age at home where we can remain close to our communities and neighbourhoods. But some of us don't always get that choice, especially renters. As more older Australians are forced into the rental market given the exorbitant prices for purchasing homes, **Christopher Phelps** and colleagues suggest the issue is becoming an important one for both individuals and governments.

Japan had one of the best performing stock markets in the developed world last year. The resurgence comes after long overdue corporate governance changes, which are lifting returns on equity. **Platinum Asset Management's Charles Brooks** asks whether this is a new dawn for Japan or a false start?

Jeremy Siegel's book, *Stocks for the Long Run*, became an instant classic in the 1990s by popularising the view that stocks outperform bonds in the long-term, and that it isn't even close. Yet a new academic study raises questions about Siegel's data and conclusions, with potentially radical implications. **Morningstar's John Rekenthaler** assesses the new claims.

Just when you thought that China's stock market couldn't go much lower, 2023 delivered another poor year, dragged down by a deflationary bust in the property market and slowing economic growth. Could this year be different? **Dr Joseph Lai** thinks so as he believes the country's problems are manageable and many blue chips are at bargain basement levels.

Lastly, in this week's whitepaper, **VanEck** thinks markets are prematurely pricing in rate cuts this year, and investors need to be selective in where they put their cash.

9 investing lessons I've learned from owning a business

James Gruber

In 2016, I took the plunge: buying a 51-room motel in south-west Sydney. It was a big bet, using most of my family's savings (not the bank of mum and dad) to fund the purchase.

Since then, we've ridden the highs of initially owning a motel on the rise, to the lows of Covid where the accommodation sector suffered the equivalent of a Great Depression, and back again to slowly recover as domestic travel rebounded following the pandemic.

Through it all, owning a business has made me a better investor, and being an investor has made me a better businessman.

Here, I'd like to share the lessons from being at the coal face of a business.

The search

First, some context. I didn't purchase the motel on a whim. I'd previously covered larger hotels as an equities analyst and portfolio manager. I'd visited hotels both in Australia and Asia, had spoken with management of listed hotel companies, and had thoroughly studied the financials of various accommodation businesses. Also, my wife had moved to Australia and entered the hotel industry, overseeing a portfolio of hotels. Combined, we felt we had a decent handle on the industry.

But we still moved cautiously. After all, hotels are different from motels. Analysing them from the outside is different to owning and running them. And spending your own money to buy one is different from spending other people's money.

I remember going to a motel seminar in 2011 where a broker had various speakers present to an audience of prospective buyers. What struck me then was that most of the audience were want-to-be retirees. They weren't in the industry yet were looking to buy a regional motel as a 'lifestyle' business – where they'd work and settle down into quasi retirement.

I sensed a potential opportunity as these weren't sophisticated businesspeople and prices for motels at the time were reasonable.

Our plan was to buy a leasehold motel as a freehold one was outside of our budget. It would most likely be in a regional area because metropolitan ones weren't often for sale. We wouldn't operate it day-to-day and would have managers to do that. Invariably, that meant it couldn't be a small motel because it needed to be large enough to pay these managers. Lastly, we preferred a motel closer to Sydney so we could regularly visit it and oversee the business.

I'd like to say that it was a quick process though it was anything but. We inspected about 25 motels over the next four years. We went everywhere from Eden, 6.5 hours drive south of Sydney, to Coffs Harbour, around the same drive time north of Sydney, and everywhere in between, from Orange to Goulburn to the Central Coast, and Sydney itself.

Early in 2015, we visited a motel on the outskirts of Sydney. It was quite large at 51 rooms. We were impressed, though the price was a little high. Soon, it was under contract with another buyer and the opportunity seemed to have passed.

Maybe six months later, the broker came back to us. The previous deal had fallen through and were we still interested? Yes, we were.

Buying a business isn't a straightforward process. It took us nine months to complete the purchase. We learned a lot about dealing with finance brokers, motel brokers, banks, accountants, valuers, lawyers, and others who are needed to get a deal done.

For instance, our lawyer refused to insert a clause that we needed in the contract, and to this day, we don't know why. We ended up having to do it ourselves! Suffice to say, getting the right lawyer is crucial.

Day one to year eight

Taking over an established business is never easy. The motel had 15 employees, including two managers who lived on site. The rest of the employees were mostly housekeepers or reception staff. My first job was to get to know these managers and to convince them to stay on to ensure continuity of the business.

I promised them a lot of autonomy as they were far more experienced than I was in the hotel industry (they'd both been working in it for 25 years). They expressed some scepticism as they had to run all the decisions through an HR consultant under the previous owners. It seemed an odd arrangement. And, therefore, one of my first acts before we officially took ownership of the business was to tell the HR consultant that we wouldn't be continuing with her employment. A few months later, we also had to let go of another employer that we'd inherited. They were tough, albeit necessary decisions to make sure the motel was well run.

The previous owners were good operators and we hit the ground running. The motel catered primarily to tradies, who worked on residential and commercial projects in the area. It also had sporting groups, movie and television production crews (nearby has a large house and surrounds where many well-known local films and shows are shot), travellers, and others.

The first few years were positive. I recall the exhilaration of seeing the financial figures being sent to us in the evening and knowing that we were earning money while we slept that night. I know that when you own stocks and other assets that you also earn money while sleeping, but this felt different given we were sole owners of the business.

Then, there was Covid-19. Business dropped quickly by 95%. We were losing money fast. I'll never forget the day when our motel had 2 occupied rooms out of the 51 available. We were close to closing the motel for a period. That was the low point.

Luckily, the initial Federal Government package for businesses was generous. Without it, we would have been lucky to survive.

Running the business was also challenging given the pandemic. We had to overhaul our procedures, change the way we cleaned rooms, and deal with employees and customers on edge. There was one time when one of our housekeepers heard a family say how they'd come off a plane from England, that they all had Covid, and were laying low in one of our rooms. The housekeeper freaked, and I had to politely inform the family that they needed to immediately depart. It was a strange time.

The second Federal Government package for businesses wasn't nearly as generous. That resulted in 2021 being a real struggle. It was difficult to get employees motivated again after they'd been paid to effectively stay at home for a year. And people still were restricted from travel, which meant business was still poor.

It took the best part of three years for the business to get anywhere near back to what it was prior to the pandemic.

At the start of 2022, things slowly opened up. Then, Australians couldn't get enough of domestic travel. City motels like us didn't benefit as much as regional areas from this initially. Later, people started to forego the regions to head to the capital cities. And we also benefited from a local area with a lot of development, both residential and commercial.

Eight years after buying the motel, we still have the same managers and the longest serving housekeeper has also stayed with us. We have a lot of new faces – casual employment offered by a motel like ours invariably means there is turnover of staff.

We still own the motel, and it has been quite a ride.

Key takeaways

Here are nine investing lessons that I've learned from owning the motel business:

1. Businesses are more than just numbers.

As a former portfolio manager, I was familiar with the numbers of accommodation businesses, and when I first took over the motel, I was therefore very numbers driven. What I quickly realised is that numbers are the result of numerous business decisions.

Yes, numbers matter. But the secret sauce is the decision making which drives the numbers that end up in the profit and loss and balance sheet statements.

I've met many sell-side analysts and fund managers, and my view is that a lot of them don't pay enough attention to the qualitative factors that determine whether a business succeeds or fails.

2. The price you pay for a business matters … a lot.

The price that you pay for a business determines your future returns. The reason that we've made adequate returns from our business is because we negotiated a good price for it.

In the share market, negotiating a good price means waiting for the right price before buying a stock.

3. Customers first, employees second, shareholders third.

A business needs to have priorities and if customers aren't at the top of the list, then something is wrong. Customer purchasing decisions and feedback are often the best ways for a business to know whether a strategy is succeeding or not.

Employees are obviously critical too. They are the ones that should put the customers first. To do that, they need to have a clear understanding of their roles and how to execute them.

Shareholders come last. Now I know there are many past and present ASX-listed companies that put shareholders first. But it's best to be wary of companies over-emphasizing shareholder returns.

The world's best companies, like Costco for example, get their priorities right.

4. Leaders need to know the nitty-gritty of their businesses.

There are businesses which hire leaders who've never worked in their industry. I think this can be an error.

I came from the finance sector to own our motel, and it would have helped immeasurably if I'd had hands-on experience working in the accommodation industry before the purchase.

Knowing the ins and outs of different jobs in a business and how they contribute to the whole operation is crucial to being an effective leader.

So, cast a sceptical eye on companies which hire leaders who have no experience in their industry.

5. Debt makes businesses fragile.

During Covid, the accommodation businesses that didn't survive were mostly those which took on too much debt.

Now you might say that Covid was an extraordinary event, and these businesses were just unlucky. But unforeseen events happen often, and businesses need to be prepared.

In stock markets, leverage also magnifies the returns of companies, both on the upside and downside. It's prudent to opt for businesses with sound balance sheets.

Investors burned by Star Entertainment over the past few years have learned this lesson.

6. Only the paranoid survive.

This phrase comes from a book by former Intel CEO, Andy Grove. There's a lot of truth to it.

A business needs to be paranoid about competitors, employee turnover, known risks, unforeseen events, and the list goes on. Paranoia leads to businesses constantly innovating to improve themselves.

Invest in businesses where there's paranoia and an emphasis on continual improvement.

7. Owners/leaders need wise counsel.

Businesses are team operations. Leaders will have certain skills and lack others. They need to hire people or get outside help with expertise in the skills that they don't have. To do that isn't a sign of weakness but strength.

A 'star' leader of a business who may be taking on too much should be a red flag.

8. Good leaders make fair deals that are win-wins for both sides.

I used to read books that told me that a good deal is one where both sides win, and I scoffed at that. I thought that there'd be winners and losers, and I'd want to be on the winning side!

Only with more experience did I see the merit in the cliché of a win-win. And that when negotiating a deal, it's important to always think about what the other side wants from it.

Give a wide berth to leaders who boast of getting the better of a supplier or another business in a deal.

9. Quality businesses make tough decisions early.

Crises tend to separate good businesses from bad ones. I regret not moving quickly enough with a few decisions at the start of Covid. That cost us time and money.

I remember working at an Asian stock brokerage during the 2008 financial crisis. Very early, this firm cut the pay of all managers by 25%. It said that it did this to avoid firing people. Then, when things went further south, it used the same reason to propose a 20% pay cut for the remaining employees. That's leadership.

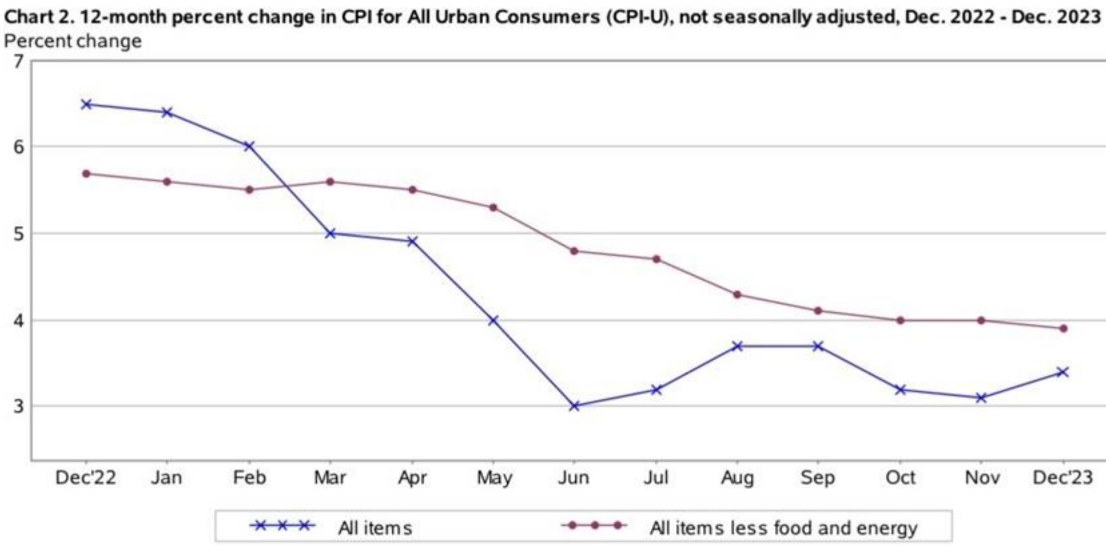
In tough times, good companies make tough decisions and move quickly.

James Gruber is an assistant editor at Firstlinks and Morningstar.com.au

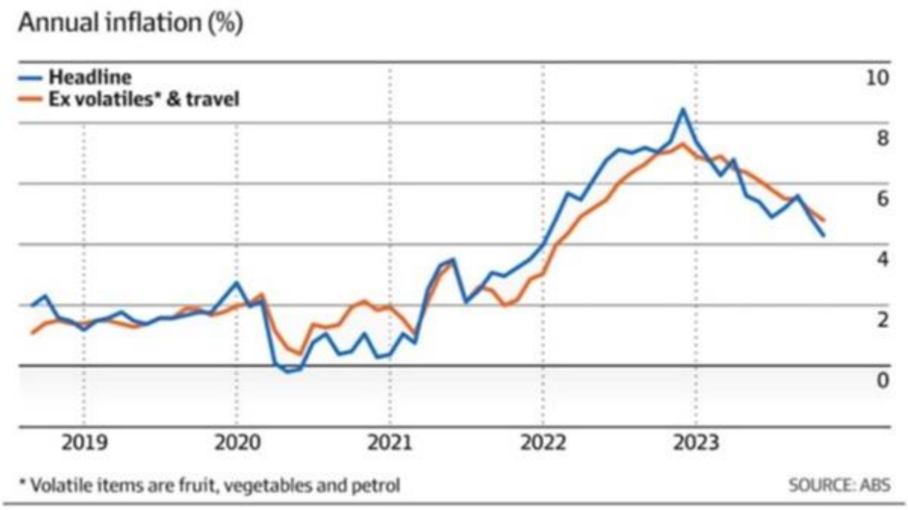
Clime time: Tailwinds for asset prices in 2024 and beyond

John Abernethy

In the final quarter of 2023, it became increasingly obvious that investment markets had excessively discounted both the risk of a US recession and continuing high inflation. After a sharp pullback during October, equity and bond markets across the world rallied hard through November and December as US inflation readings plummeted. In calendar 2023, US CPI was recorded at 3.4%, half the rate of 2022 and 2% below the level of US cash rates.



Source: [Bureau of Labor Statistics]



In Australia, annualised inflation readings have been retreating rapidly from the near 9% recorded in November 2022. Indeed, the recent rate (for year to November 2023) of 4.3% takes inflation back towards the cash rates. I expect annual inflation to fall towards 3% before June 2024, and cash rates will then be set well above inflation, so that "real" yields reappear.

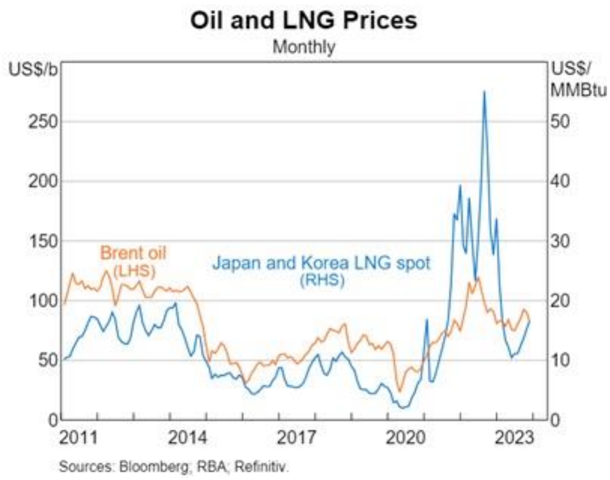
However, as 2024 opens, is it possible that markets have already factored in much of the good news? If that is so, should self-managed investors be cautious?

My answer is simple. Investors should *always* be cautious, and more so as they move deeper into retirement years and into higher pension requirements. Further, investors should also be sceptical of groupthink or consensus.

The best protection for an investor is to maintain a strong qualitative overlay that focuses on high quality, cash generating investments – whether they be equities, fixed income or property investments. Sticking to quality and value, plus an appropriate asset allocation, is the best way to invest with suitable caution.

Markets have fittingly repriced and recovered as inflation readings across the world have fallen. Further, given that interest rates – whether they be cash or long dated bonds – did not excessively rise against inflation, the bounce in asset prices is justified. As the world economy (including Australia) moves through a low growth period (first half of 2024), it will become increasingly obvious that stronger growth is assured in 2025 and risk assets will be rewarded.

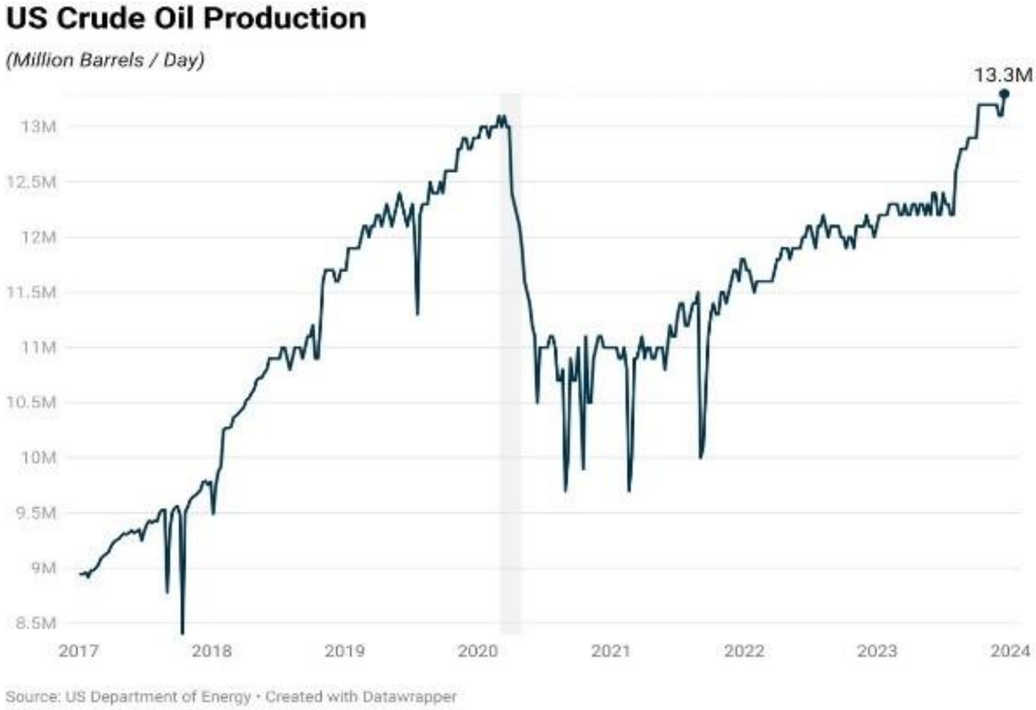
Macro charts show why markets have quickly recovered



The key driver in moving inflation from "transitory" (coming out of Covid) to "intransigent" was the war in Ukraine and the effect on energy prices (oil, natural gas and coal). This was primarily because Europe (in particular, Germany) had embedded itself in Russian gas supply and because OPEC+ was seemingly sympathetic to Russia's needs, by restricting oil supply to maintain oil revenues.

The opening chart plots oil and LNG prices and shows the price surges that flowed following the invasion of Ukraine. It is interesting to note the substantial price declines that occurred in 2023, now flowing into inflation readings.

Contrary to widespread opinion, the decline in oil and energy prices did not occur because world demand faltered, but rather because the US brought back its oil production. This is important because it shows the power of the US to mobilize its economy to meet economic issues. In particular, it shows that the US will defend itself against economic attack. The creation of "intransigent" inflation caused by OPEC+ was swiftly met by rising oil production, on the surface in complete contrast to US goals of reducing its carbon footprint consistent with world agreements.

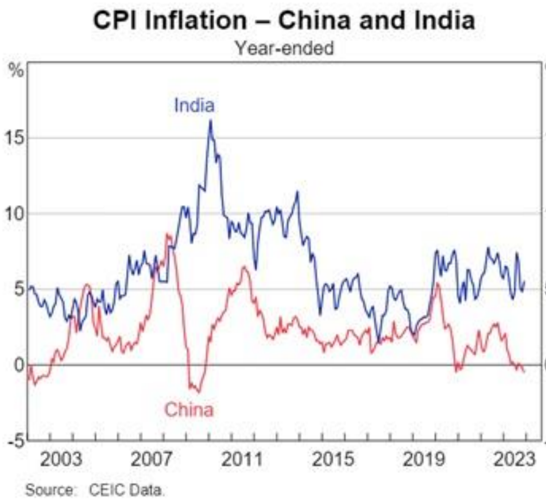


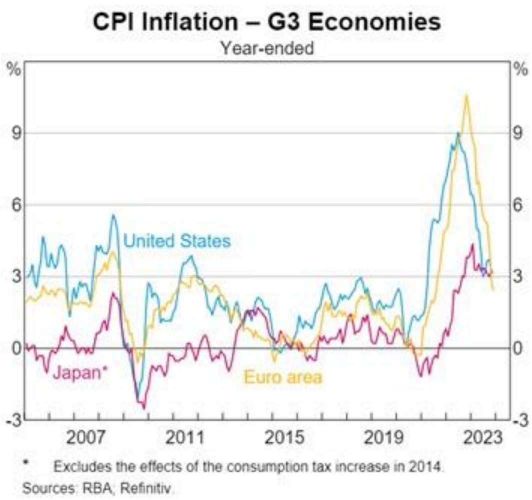
Just this week, it was reported that the US has become the world's biggest exporter of liquefied natural gas for the first time, with 2023 shipments overtaking leading suppliers Australia and Qatar. The US exported 91.2 million tonnes of LNG in 2023, a record, according to data through December 31 compiled by Bloomberg.

This is remarkable because surging US oil and LNG production was kept well away from the mainstream press, which remains fixated on clean energy developments across the world.

The US production record is important for Australia to observe and understand. Managing 'inflation outcomes', 'the cost of living' and 'the cost of doing business' requires responsive and thoughtful leadership. As one of the largest exporters of energy in the world (LNG and coal), Australia should understand the economic risks of not having proactive inflation-fighting policies that flow from our abundant energy resources. Our current policy settings that drive energy prices higher are nonsensical. Why feed inflation when we could have held prices and costs down by more aggressively utilising the budget surplus? The legacy of poor long term energy planning for the Australian economy has become obvious and no more so than since the Ukraine war.

The recovery of US oil production has shifted both the supply and demand curves of oil markets. As the US increases its supply, it withdraws from buying on international markets and this has led to a scramble by OPEC+ to reduce production. At the same time, Russia is providing discounted oil to China and India, the result being that inflation is under control in India and has plummeted in China.

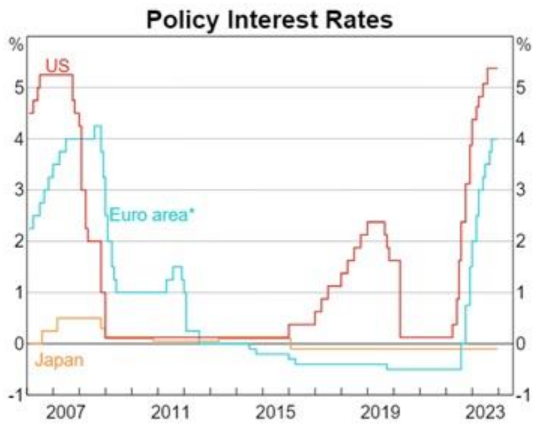




Inflation is dropping dramatically across the US, Europe and Japan. This was an appropriate trigger to stir asset prices higher as it became clear that lower inflation meant that bond yields (risk free rates) had peaked.

What flows from the above is that interest rate settings in the US (in particular) are too high. As noted, US bond yields have already been bid lower in the open market, even though the Federal Reserve has been reticent to admit that inflation appears beaten by energy price compression.

There is no doubt that US cash rates must come down (and by at least 1%) through 2024, but with the question being, "When?" - given the US Presidential election is in November.

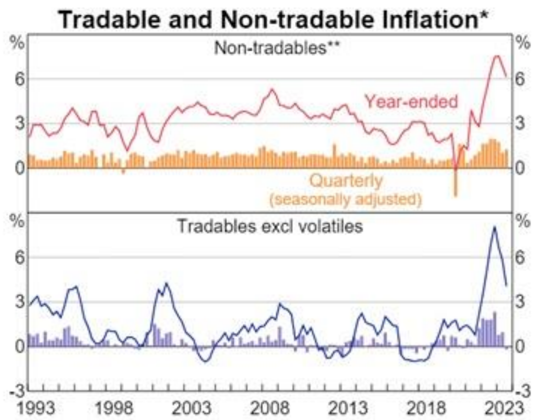


* Main refinancing rate until the introduction of 3-year LTROs in December 2011; deposit facility rate thereafter.
Source: Central banks.

What about Australia?

In Australia, the FY24 outlook for inflation is good but more so in FY25, albeit delayed by politically motivated policy decisions driven by an eye on the election cycle. This is shown by our inflation chart below where "transitory" inflation (driven by "tradeables" or imported inflation) has been replaced by elements of "intransigent" factors ("non-tradeables" mainly the costs of services pushed by wage increases).

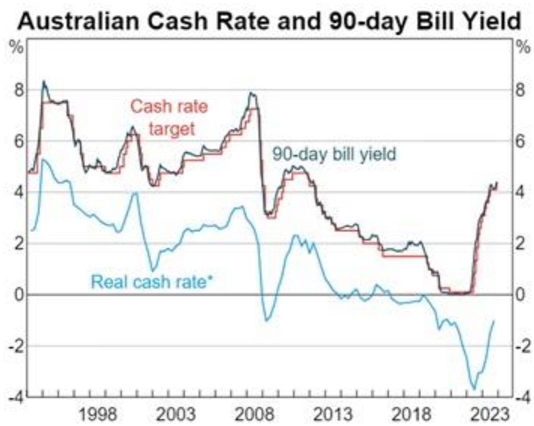
Whilst tradeable inflation flowed from pandemic lockdown effects on supply and a weak AUD, more recent inflation has been caused by cost pressures within the economy. Importantly, both of these overlapping inflation cycles have predominantly been "cost" rather than "demand" driven.



* Adjusted for the tax changes of 1999–2000.
** Excludes interest charges and indirect deposit & loan facilities.
Sources: ABS; RBA.

That is why inflation is now falling and will continue to fall over the next 9 months. Lower petrol prices, lower electricity and gas prices (from July 2024), a rising AUD (as cash rates move above inflation) and zero inflation in China, all point to a rapid decline in inflation in Australia. Cash rates have peaked with no need for the RBA to adjust them higher. Therefore, the cost of debt that also feeds "cost" inflation will now be tempered.

The chart (right), which compares cash rates to inflation, suggests that the blue line (the "real" cash rate) will become positive by about 1%, creating a sustainable positive real interest rate for the first time in a decade. Over the last 80 years it is more normal to have positive real interest rates than negative real interest rates – so investors need not be alarmed by this return to normal.



* Calculated using average of year-ended weighted median inflation and year-ended trimmed mean inflation.
Sources: ABS; AFMA; ASX; RBA.

What will hold up Australian inflation in the meantime?

The nonsensical delay in reducing energy prices (until July), the indexing of consumption taxes (eg. excise duties), road tolls and other essentials for young households (like health insurance and education) will all contribute. Further, the lack of initiative by the Government to bring forward tax cuts in an attempt to hold down wage increases, will keep inflation higher than it should or could be. Lack of taxation initiative has effectively increased the cost of doing business which then leads to expense recovery by increases in the costs of goods and services.

If markets have factored in the good news, is this a risk for investing?

My answer to this is a resounding "No". The economic growth of Australia seems assured in 2025, with stable and lower inflation (sub 3%), and the prospects for economic growth that will feed the earnings and cash flows of both growth and risk asset valuations.

My positive outlook is driven by these observations:

First, 2025 will see the lingering consumption demand growth from immigration, with a return of education exports (students) and travellers.

Second, Stage 3 tax cuts will flow through the economy in 2025, contributing to growth.

Third, the continuing need for infrastructure investment will be added to by significant rebuilds flowing from floods in Nth QLD and Victoria. Rebuilds are a constant for growth that are often overlooked by economists.

Finally, the recovery of China and compounding growth of India mean our export earnings will continue to be strong. Australia borders with over 4 billion people across Asia and as their standard of living improves, our growth is assured.

John Abernethy is Founder and Chairman of Clime Investment Management Limited, a sponsor of Firstlinks. The information contained in this article is of a general nature only. The author has not taken into account the goals, objectives, or personal circumstances of any person (and is current as at the date of publishing).

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Breaking down 2023 returns for the ASX

Ashley Owen

2023 was a good year for the Australian share market, but where does it sit in historical terms?

The past five years were actually rather boring and ho-hum for the share market – despite a host of extreme events like the Covid lockdowns, steep recessions, inflation spikes, aggressive rate hikes, wars, rising military tensions, bank collapses, etc.

Here are our Annual Return Pyramids for the Australian share market.

This first chart shows total returns (ie capital gains plus dividends) from the broad Australian share market per calendar year since 1900. The returns are organised in 5% bands – from the worst years at the left through to the best years to the right.

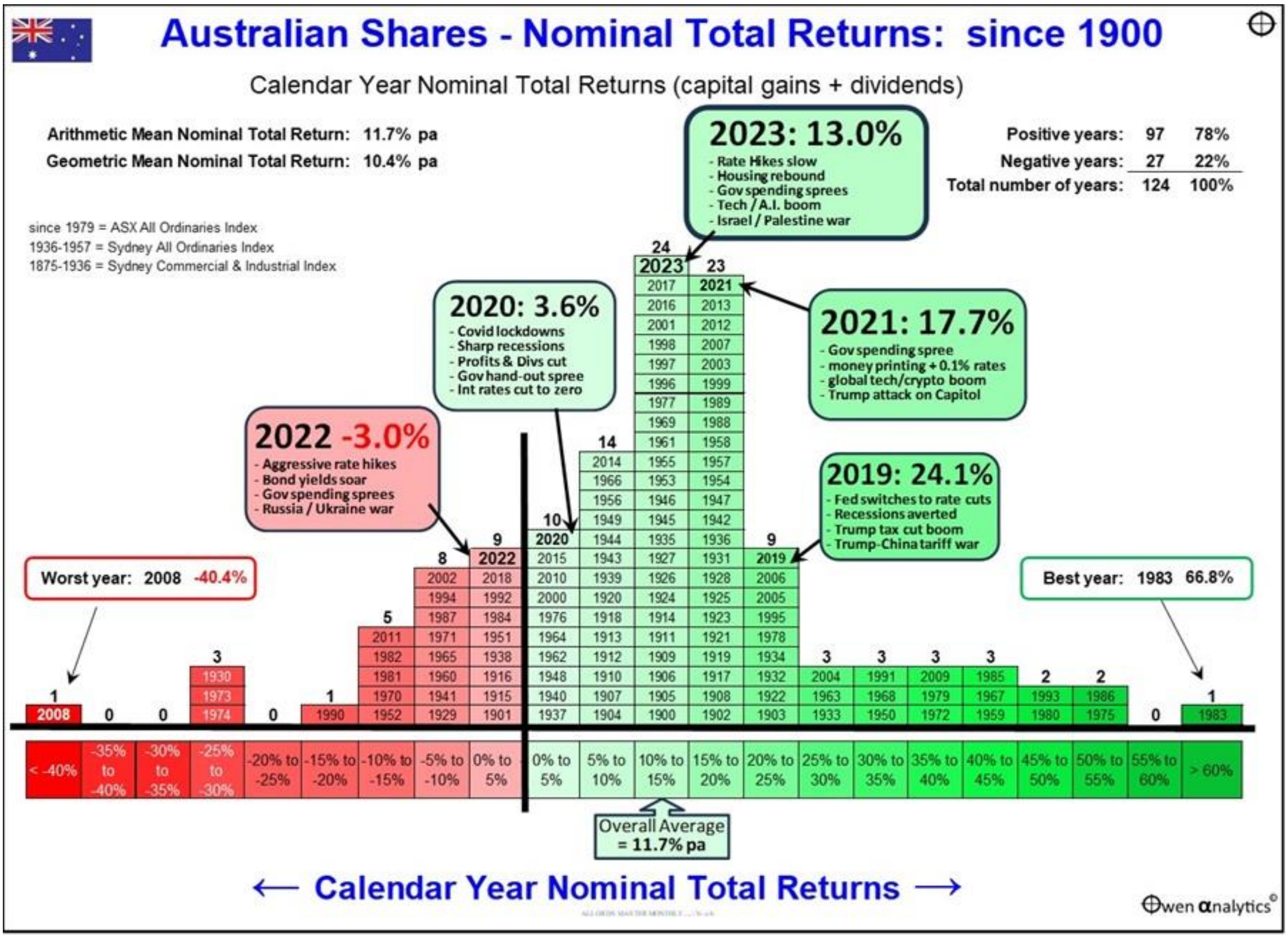
Although the market has returned an average of more than 11% per year overall, the returns each year have ranged from very deep negative years to very large positive years.

The worst year was 2008, with a return of minus 40%, in the depths of the 2008-9 'Global Financial Crisis' triggered by the US sub-prime collapse. The 2008 negative year came after five consecutive years of strong gains in the 2003-7 China/credit boom.

The best single year was 1983, with a return of +67% in the tremendous rebound out of the 1981-3 recession, which had caused negative years in 1981 and 1982.

Very high positive returns and very low negative returns are relatively rare.

Most of the years are bunched in the 'boring' middle third of the chart. 39% of all years were between 10% to 20% range.



One thing that stands out is that the great majority of years have been positive for the overall share market.

- 78% of years were positive
- 70% of years were above 5%
- 59% of years were above 10%
- 40% of years were above 15%
- 21% of years were above 20%
- Only 22% of years were negative, 15% were worse than -5%, and only 8% of years were worse than -10%.

Past five years

The chart highlights returns for the past five calendar years.

- Four out of the past five years were positive, including 2020 with the Covid lockdown recessions
- 2022 was the only negative year in the past five years, and it was very mild at just -3%.
- Three out of the past five years were well above average

'Volatility!' – what Volatility?

The other notable stand-out from this chart is the fact that these past five years fall into the 'boring', ho-hum middle third of the chart, but look what happened during those five years:

- Governments locked entire populations in their homes for months on end for the first time in history
- the sharpest and deepest economic recessions since the 1930s Great Depression
- soaring inflation everywhere
- savage interest rate hikes
- extraordinary new monetary policies and policy errors
- the first major war in Europe since WW2
- new wars and flare-ups in the Middle East

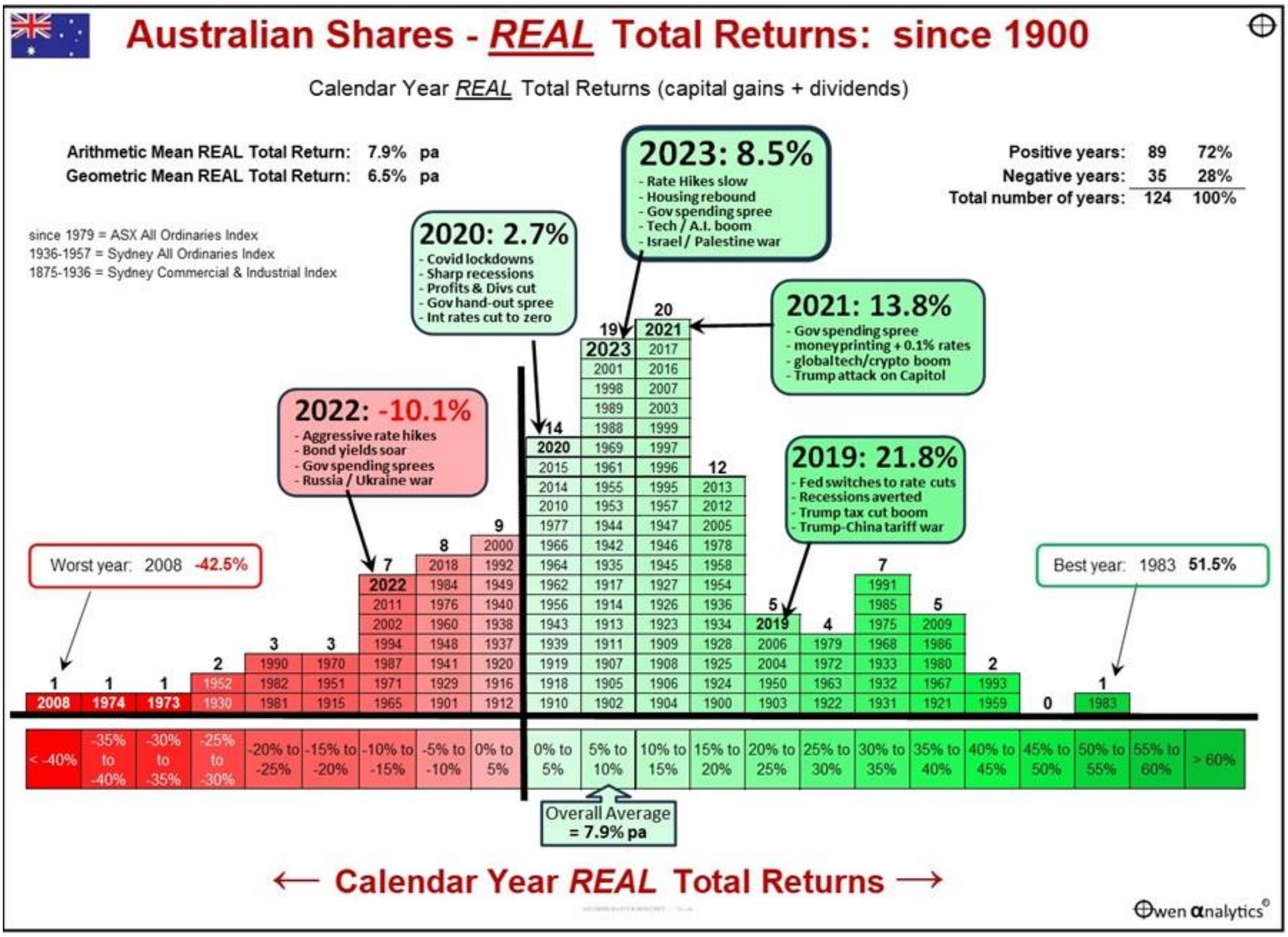
- a new 'cold' war between China and the US
- trade wars, tech wars
- commodities booms and busts
- tech booms and busts
- bank collapses in the US and Europe
- our main export buyer, China, ground to a halt with the collapse of its main driver of growth - construction

Despite all of this so-called 'volatility' and 'uncertainty', the local share market sailed through it, staying in the middle section of the chart, avoiding extreme highs and lows on the left and right of the chart.

Real returns after inflation

The above section relates to 'total returns' that include price changes plus dividends, but they do not take into account the wealth-destroying effects of inflation. We adjust returns for inflation in the next chart.

Like the previous chart, the returns are organised in bands – from worst years at the left through to the best years to the right.



< -40%	-35% to -40%	-30% to -35%	-25% to -30%	-20% to -25%	-15% to -20%	-10% to -15%	-5% to -10%	0% to 5%	0% to 5%	5% to 10%	10% to 15%	15% to 20%	20% to 25%	25% to 30%	30% to 35%	35% to 40%	40% to 45%	45% to 50%	50% to 55%	55% to 60%	> 60%
1	1	1	2	3	3	7	8	9	14	19	20	12	5	4	7	5	2	0	1		
2008	1974	1973	1952	1990	1970	2022	2018	2000	2020	2023	2021	2013	2019	1979	1991	2009	1993		1983		
			1930	1982	1951	2011	1984	1992	2015	2001	2017	2012	2006	1972	1985	1986	1959				
				1981	1915	2002	1976	1949	2014	1998	2016	2005	2004	1963	1975	1980					
						1994	1960	1940	2010	1989	2007	1978	1950	1922	1968	1967					
						1987	1948	1938	1977	1988	2003	1958	1903		1933	1921					
						1971	1941	1937	1966	1969	1999	1954			1932						
						1965	1929	1920	1964	1961	1997	1936			1931						
							1901	1916	1962	1955	1996	1934									
								1912	1956	1953	1995	1928									
									1943	1944	1957	1925									
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										1905	1908										
										1902	1906										
											1904										

A quick comparison of the two charts shows that the real returns for most years are shifted a little to the left on the scale of return bands (ie lower real returns) compared to the previous 'nominal' return chart.

However, there were some years with negative CPI inflation, so 'real' returns were higher than 'nominal' returns. The years of negative inflation were 1900, 1903, 1904, 1921, 1922, 1924, 1927, 1930, 1931, 1932, 1933, 1944, 1962, and 1997.

Real total returns from the market averaged nearly 8% per year after inflation, compared to more than 11% per year before inflation, because inflation averaged 3.7% per year over the period. Like the previous chart, real returns each year have ranged from very deep negative years to very large positive years.

The worst year for real returns was still 2008, in the GFC.

The best single year after inflation was also still 1983, despite inflation was running at 10.1% for that year.

Good CPI+ returns

Even after the effects of inflation, the majority (72%) of all years were positive for shares, and 60% of years were better than CPI+5%, ie more than 5% above inflation.

This is a great outcome for investors, and a good reminder that broad share markets are one of the best hedges against inflation.

Ashley Owen, CFA is Founder and Principal of OwenAnalytics. Ashley is a well-known Australian market commentator with over 40 years' experience. This article is for general information purposes only and does not consider the circumstances of any individual. You can subscribe to OwenAnalytics Newsletter here. Original article is here: 'Australian Share Market Annual Returns Pyramid

Most older Australians want to retire where they are

Christopher Phelps, Rachel Ong ViforJ, William Clark

As Australia's population gets older, more people are confronted with a choice: retire where they are or seek new horizons elsewhere.

Choosing to grow old in your existing home or neighbourhood is known as 'ageing in place'. It enables older people to stay connected to their community and maintain familiarity with their surroundings.

For many, the decision to 'age in place' will be tied to their connection to the family home. But for many, secure and affordable housing is increasingly beyond reach. This choice may then be impeded by a lack of suitable accommodation in their current or desired neighbourhoods.

Our recently published study asks what motivates older homeowners and renters to age in place or relocate, and what factors disrupt these preferences. It suggests older renters are often not given a fair choice.

Most older Australians want to age in place

Having the option to age in place enables older people to retain autonomy over their lifestyles and identity, promoting emotional wellbeing.

Using 20 years of data from the government-funded Household, Income and Labour Dynamics in Australia (HILDA) survey, we tracked the preferences of Australians aged 55 and over.

Encouragingly, most older Australians are already where they want to be.

Two-thirds (67%) of respondents strongly preferred to stay in their current neighbourhood, and an additional one-fifth (19%) had a moderate preference to stay.

Only 6% showed a moderate or strong desire to leave. Ageing in place is then the natural choice for a vast majority of older Australians.

Our study highlights several motivations for people to stay put as they retire.

For homeowners, family ties matter. Owners with children residing nearby were around one and a half times more likely to have a higher preference to stay.

Older owners might then have a reason to call on their substantial housing wealth and keep their children nearby via the "bank of mum and dad".

For renters, how long they stay is important. Those renting their home for 10 years or more were 1.7 times more likely to have a higher preference to stay than short-term renters.

Renters face the most disruption

The survey enabled us to follow where older people lived a year after they provided their preferences. This helped us gauge how often they turned their desires into reality.

The chart below indicates that private renters face greater obstacles to ageing in place.

Around one in 10 private renters that desired to age in place were disrupted – they wanted to stay in their neighbourhood but didn't. This suggests they moved out of their neighbourhood involuntarily.

Only 2% of homeowners and social renters experienced the same disruption. However, for those in these tenures that did not desire to age in place, involuntary immobility was a greater concern. Only 15% of those that wanted to leave succeeded, leaving the vast majority "stuck in place".

The private rental market is the least secure of tenures, and so private tenants are often exposed to involuntary moves. Australia's private rental system is lightly regulated compared to many other countries, creating tenure insecurity concerns.

On the other hand, social renters were particularly susceptible to involuntary immobility. Social housing is scarce in Australia and subject to lengthy waiting lists. A neighbourhood move often requires transferring to the less affordable and less secure private rental housing.

Even after considering financial status, social renters were four times as likely to be stuck as compared to private renters. Social tenants are strongly deterred from moving in the current system.

How can we support older Australians' preferences?

Our study exposes some barriers in the housing system that hinder people from being able to age in place, or move when they want to. Clearly, older renters enjoy fewer protections against disruptions to their preferences to age in place than older owners.

For private renters, tenure insecurity in the private rental sector is a key reform priority. This can be achieved through stronger regulation that improves tenants' rights. For example, more states could adopt recent regulatory rental reforms that support the rights of pet owners and protect against no-grounds evictions.

While social housing can provide older Australians with more security, it can also be hard to move.

Large numbers of older private renters also face severe rental stress, which may force them to move from their preferred neighbourhood. Commonwealth rent assistance reform would alleviate some of this stress through an increase in rates and better targeting.

An increase in the supply of social housing would play an important role in improving both tenure security and housing affordability. Older social renters enjoy fewer obstacles to ageing in place than older private renters.

However, if social renters want to move into the private rental market to relocate, they face difficulty securing accommodation. This will likely discourage moves as it would require sacrificing the tenure security offered by social housing. However, policy initiatives that improve the quality of the public housing stock can reduce feelings of being stuck.

As homeownership rates decline both among young people and those nearing retirement, we can expect the population of older renters to grow.

Overall, our findings support a strong case for policy reform in the rental sectors to address the needs and preferences of older renters.

Christopher Phelps, Research Fellow, School of Accounting, Economics and Finance, *Curtin University*; Rachel Ong ViforJ, ARC Future Fellow & Professor of Economics, *Curtin University*, and William Clark, Research Professor of Geography, *University of California, Los Angeles*

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Japan: New dawn or same old story?

Charles Brooks

Over the past three months, Japan has been the number one talking point with my clients throughout the US, Europe and Asia. The Nikkei225 was up 28% in 2023, with corporate governance reform a key catalyst. So there's a lot more interest in the Japanese market, yet there's also scepticism.

Previous attempts at reforming governance in Japan have stalled or disappointed and it shows in the trading valuations of Japanese stocks and their profitability metrics:

- Some 40% of Japanese companies in major indices are trading on Price-to-Book (PBR) ratios of less than one. On the S&P500 it's just 5% and in Europe (STOXX600) it's 24%.[1]
- Similarly, some 40% of major Japanese stocks have a Return on Equity (ROE) of under 8%. By comparison, only 14% of the S&P500 can't beat that mark.[2]

So, while we are sure reform is taking hold (some of our recent Japanese stock picks reflect its influence), we wanted to retest the thesis. To take just one angle, we wanted to assess whether the various institutions involved in corporate governance reform were aligned in their aims and ambitions. An integrated approach is much more likely to drive change that's broad, deep and sustainable.

Talking to the people who set the rules

On a recent research trip to Japan, our Japan strategy co-Portfolio Managers Jamie Halse and Leon Rapp, plus co-CIO Andrew Clifford, met with the Ministry of Economy, Trade and Industry and Japan's Financial Services Agency.

More recently, Leon and I, plus Tim Maher (UK Managing Director) met with Mr Yamaji, the President of the Tokyo Stock Exchange (TSE). These were fascinating meetings.

Mr Yamaji was keen to stress the continuity of the Japanese approach (see the chart below). "People see the reforms as a set of individual initiatives", he said, "but they're not. They're part of corporate governance process rolled out for 20 years."

In our meeting, Mr Yamaji stressed just how seriously Japanese authorities take reform. He sees the health of Japanese companies as vital for the overall economy and the country's prosperity.

Mr Yamaji's expectations go beyond share buybacks and cutting excess capital accumulation. He wants Japanese companies to "understand how they can improve across a whole range of factors. How they can invest in R&D, improve working practices, invest in business growth."

He also spoke about the importance of broadening the talent pool. "We want to see diversity of boards, a mix of males and females, more diversity of backgrounds, local and overseas directors. We now have good case studies showing the benefits of these changes. Ten years ago we had nothing."

Top policy-makers and regulators in Japan believe many of the building blocks are now in place. They argue it's now the job of investors – and others - to bring the weight of money to bear on Japanese corporates to drive these reforms even further.

I'm inclined to agree.

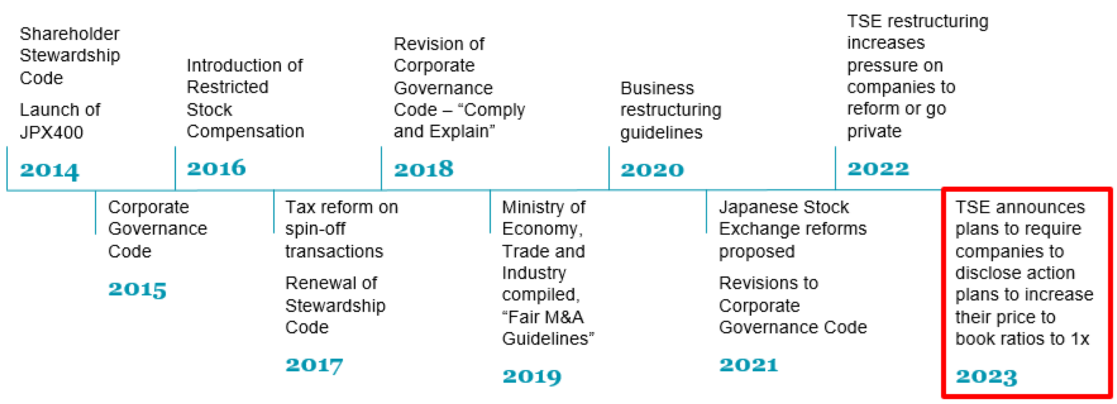
Pressure the corporates

We asked Mr Yamaji what he expects from global investors like Platinum.

He is looking for global investors to engage with companies about improved governance and capital management and to demand changes that drive sustainable growth. Our Japan strategies are putting money to work on this theme, with significant holdings in Toyo Seikan (packaging), Nittetsu Mining and confectionary-maker Ezaki Glico. All three have overcapitalised balance sheets – but improving corporate governance.

The story so far

As the graphic below shows there *has* been a decade of corporate governance reform in Japan, culminating in the latest efforts by the TSE.



Source: Platinum

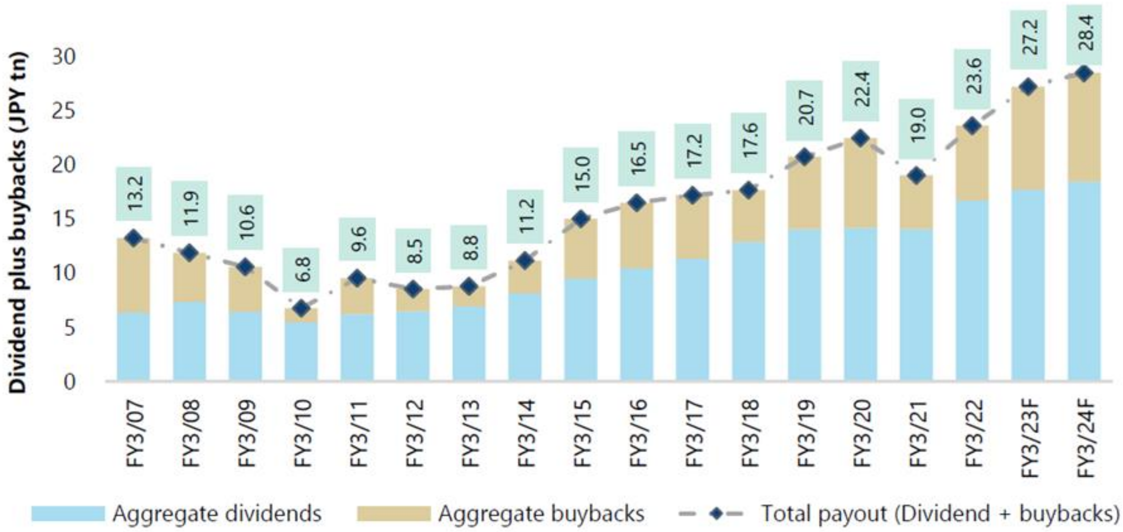
The efforts in the early years were focused on getting corporates to be more shareholder friendly. More recently the TSE has sought to change behaviour by forcing public demonstrations of a company's reform efforts. The TSE now expect companies to publish a plan for improvement. The response has been encouraging. By July 2023, only a few months after the TSE initiatives were announced, nearly 40% of Prime Index companies had published those plans.[3]

The overall sweep of reforms have been a mix of encouragement and regulation. The final push now asks Japanese companies to make a public display of their effectiveness. A 'name and shame' approach can be an effective motivator in a country like Japan.

Evidence of change

The chart below highlights how Japanese firms have been increasing cash returns to shareholders since 2007.

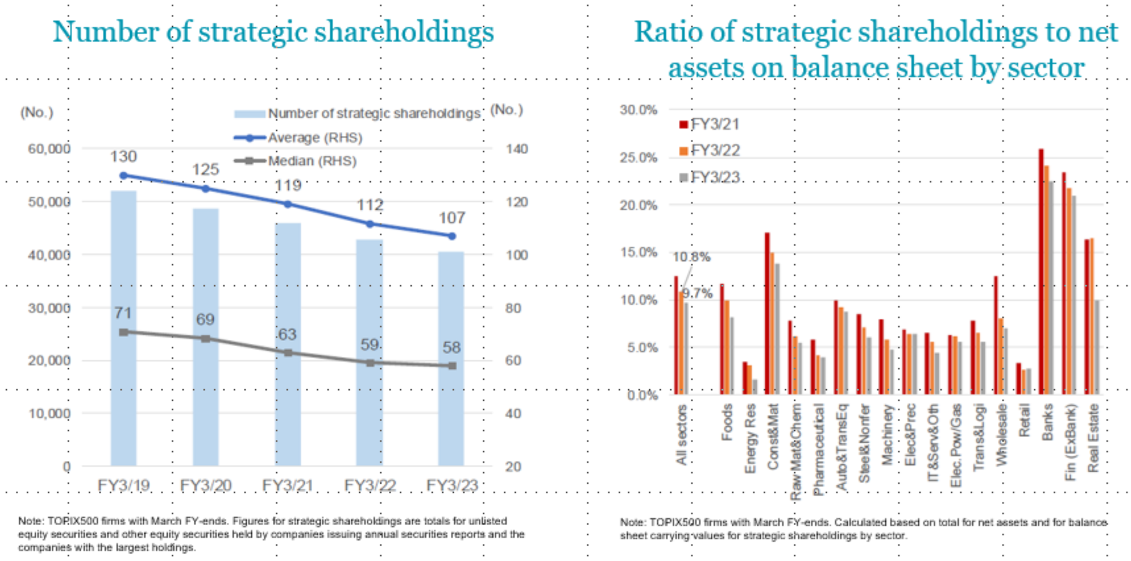
Chart 1: Topix – Aggregate Dividend and Buybacks Trend



Source: FactSet Research Systems, Bloomberg, Jefferies

For too long, the Keiretsu style cross-shareholdings in Japanese companies protected management and boards from demands for shareholder-friendly change. Now, as the charts below show, the effective free float of shares is widening. That means big new (and global) investors can take a position in a company and demand a change or angle for a takeover. That builds the pressure for strategic, operational and financial innovation that moribund boards have resisted in the past.

Charts 2&3: Fewer aligned shareholders



Source: Mitsubishi UFJ Morgan Stanley Equity Research Report, 28 July 2023

The leaders are moving

While the economy-wide numbers are positive, in the Japanese market it's always good to see what the giants are doing. Our Japan strategy Co-Portfolio Manager, Jamie Halse, says Toyota is an example of what's changing: "Their web of cross shareholdings between "group" companies is legendary for its scale, complexity and circularity".

Toyota has already sold US$1.8bn of KDDI shares and now the Group is selling US$4.7bn worth of major parts supplier Denso. Group company Aisin has announced it will sell off US$700m of cross-shareholdings, with plans to reduce the remainder of its holdings to zero over time.[4]

"With a leader like Toyota now pushing these changes we expect to see more of the Japanese market undertake similar measures," says Jamie. "That could be positive for returns on equity and stock prices."

Where from here?

Understandably, many investors have been sceptical about the reality of Japan's corporate reform efforts. However, after talking to the regulators and to the corporates we believe the forces of change – political, regulatory and commercial - are now aligned. In a consensus society like Japan that momentum can be hard to stop. That's good news for investors.

[1] Source TSE
[2] Source: TSE
[3] Source: TSE
[4] Source: Toyota website

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Stocks don't always beat bonds

John Rekenthaler

Until recently, the expected long-term total return for equities seemed obvious. Since 1871, U.S. stocks had outgained inflation by an annualized 6.9%. When Wharton professor Jeremy Siegel extended that analysis to 1802, the result barely altered, registering 6.7%. That figure closely resembled the average stock market gain of 20 non-U.S. countries during the 20th century.

Thus, equities figured to earn 6% to 7% per year, after inflation. The evidence urged the conclusion. While stocks are of course highly risky in the short term, over time their returns were, to cite Siegel's phrase, "remarkably durable."

That premise of persistent 6%-plus stock market returns, when measured over long periods, has since been threatened. Additional work from the international-stock investigators trimmed their estimate to an annualized 4.3%. And in "Stocks for the Long Run? Sometimes Yes, Sometimes No," which scrubbed and updated the U.S. equities database, Edward McQuarrie of Santa Clara University cut the pre-World War II estimate for real equity performance to 5.4%. That essentially matched what bonds had delivered.

As detailed in McQuarrie's paper—and summarized in my article—the combination of lower stock market returns and somewhat higher bond market totals (which have also been revised because of further research) scotched the assumption that equities invariably outgain fixed-income securities. Before World War II, stocks managed that feat on only about half the rolling 30-year periods.

McQuarrie's objection

Should you care? McQuarrie believes so. As he points out, the advice to hold stocks for the long run, as popularized by Professor Siegel, relies heavily on the "stationarity" of equity returns. The logic supporting that advice was:

1. It is true that the future will not repeat the past.
2. It is also true that investment conditions evolve. Industries come and go, as do government policies, interest rates, and corporate profitability.
3. However, knowing that things will be different in the future is not particularly helpful, because profiting from that realization requires that one predict *how* things will differ. Good luck with that.
4. Consequently, the best forecast for future events is what already occurred. The more stable the historical results, the more reliable that estimate.
5. Because long-term real stock market returns, across both time and countries, have been extremely stable, the expectation that over several decades they will earn a real return of at least 6% annualized, while also beating bonds, is quite sensible.

McQuarrie's paper undermines that argument by challenging the stationarity presumption. When examining both the full U.S. record and the experience of other countries, he maintains, equities do not outperform so consistently. The apparent norm is, in fact, a case of modern American exceptionalism.

The revised history

For McQuarrie, U.S. investment history consists of three stages:

Three investment cycles (U.S. Markets, McQuarrie's Formulation)

Period	Length	Winner
Pre-World War II	148 Years	Draw
From World War II to Reagan	40 Years	Stocks
Present	42 Years	Draw

Source. Edward McQuarrie.

Initially, equities and bonds traded wins. Equities then triumphed spectacularly and unprecedentedly for four decades, before the horse race once again resumed. (Strictly speaking, equities have also outdone bonds during the third period, but the contest has been much closer than during the previous decades.)

The counterargument

The rebuttal to this interpretation comes naturally. The affairs of other nations are only moderately relevant to *this* country. What happened when buggy whips were popular, even less so. A reader amusingly phrases the latter contention:

"New data reveals that mortality rates for leg amputations from 1793 to 1920 far exceed what was previously reported. Therefore, we should adjust the expected mortality rate for leg amputations going forward. Some may ask, 'Have not advancements in medical knowledge, equipment, medicines, and hygiene greatly reduced the risk of dying after surgery?'" Not, however, the data collectors.

Obviously, his contention is technically incorrect. McQuarrie certainly has contemplated such issues—but has been unconvinced. After all, some aspects of human existence have changed less than others. Modern medicine, transportation, and communications far exceed Alexander Hamilton's experience. On the other hand, Mr. Hamilton would immediately almost understand today's courtrooms and political discussions.

Which side Is correct?

The debate about the utility of the additional investment data is therefore practical rather than theoretical. Some 19th-century experiences remain pertinent, while others have become outdated by either technology or custom. What about stock and bond market performances? Where do they rate in that framework?

On that issue, the academic community and investment professionals tend to diverge. When projecting future investment returns, both parties extrapolate from the past. In that, they are alike. Where they differ is with data selection and adjustments. For most finance professors, forecasts are best conducted with as much data as possible and as little tinkering. In contrast, investment professionals tend to pick their spots. When sifting through the history, judgment is required.

My sympathies land somewhere in the middle. On the one hand, American investment markets have indeed hugely changed. The 19th century was a cesspool of stock price manipulation, fraudulent offerings, and investment panics. What's more, the Federal Reserve system had not yet been created. Consequently, bad times all too frequently became worse owing to the lack of a lender of last resort.

That said, as even the dissenting reader granted, McQuarrie's evidence is wonderfully useful for challenging complacency. By historical standards, modern American equity returns *have* been exceptional. They are unmatched within this country's history, and with few equals outside it as well. There are many reasons for their success, and many intelligent and thoughtful observers who believe that such prosperity—give or take—can continue. (Warren Buffett, for one.)

But the optimists could be wrong. The case for the ongoing dominance of stock is less overwhelming than we once believed. That observation bears consideration, especially for retirees tempted by advice that they invest heavily in equities. Such counsel is not necessarily wrong, depending upon individual circumstances (in particular, wealth levels), but it often is coupled with the implicit assumption that stocks will inevitably beat bonds over the long term.

Maybe. If not, though, retirees do not get a second bite at the financial apple. That lesson is very much worth pondering.

Note: When I sent Professor McQuarrie the reader's comment, he forwarded me the following response:

"My take is in the article's title. Sometimes stock returns will soar far above bond returns, as after the war. That outperformance can be sustained for decades. Other times stocks will lag bonds, for decades. There's no rhyme or reason to it, and in all likelihood, no predictability **over the individual investor's limited time horizon of several decades**.

"As for your reader's clever riposte, here is my redo: 'The rate of death from disease and epidemics stayed at a relatively high and constant level from 1793 to 1920. Then advances in modern medicine fundamentally and permanently altered the trajectory ... or so it seemed until COVID-19 hit in February 2020.'"

John Rekenthaler has been researching the fund industry since 1988. He is a columnist for Morningstar.com and a member of Morningstar's Investment Research Department. The views of the Rekenthaler Report are his own. This article is general information and does not consider the circumstances of any investor. Originally published by Morningstar and edited slightly to suit an Australian audience.

China is primed for a comeback

Dr Joseph Lai

Our investment philosophy is to buy champion businesses of the future when valuations are depressed. Typically, reasons for the negativity are obvious. Our job as long-term investors is to look past short-term disruptions, and determine if the businesses possess strong economic moat which enable them to become champion companies in the future.

From this perspective, Chinese equities are exciting for us. After a three-year bear market, Chinese equites are well-and-truly out of favour. While the Chinese economy is facing multiple headwinds, quality businesses will continue to grow and become champion businesses in coming years. Right now is an opportunity to invest and take advantage of the attractive valuations.

The challenges

The economic headwinds for China are well-understood. The economy is reducing its reliance on the property sector for growth. It also has to cope with heightened geopolitical pressure and has spent the last few years purposefully reforming the economy.

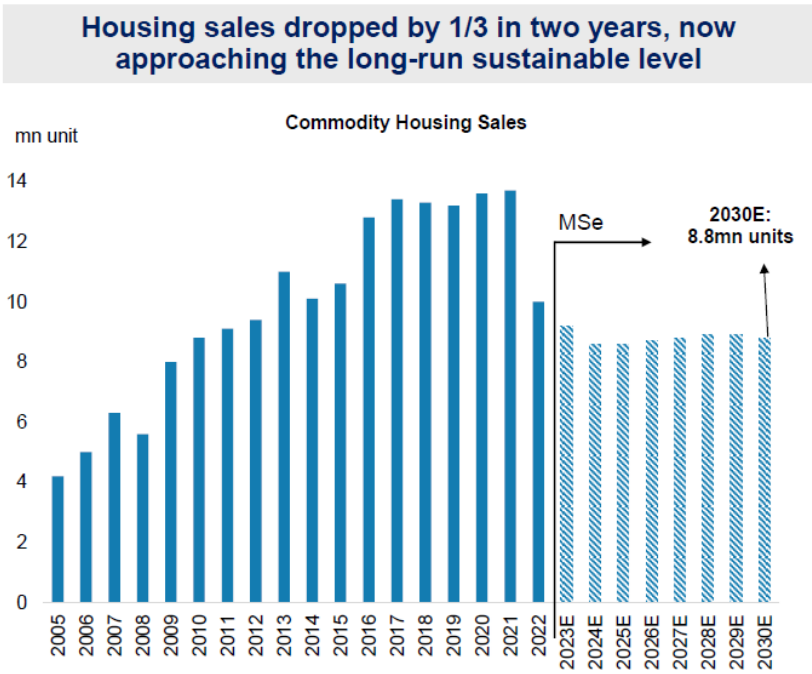
All these negative factors are reversing to a certain extent for the better. However, it will take time for these measures to take hold and for the various sectors of the economy to heal. We believe that a muddling-through outlook is unfolding, with a generally stable and improving growth environment.

In the meantime, we are focussed on strong businesses with solid positions within the country that are still enjoying long term growth. Businesses like Tencent, Tencent Music or Kuaishou, all of which have an abundance of levers to pull by virtue of their dominance in the internet to maintain decent growth rates even in a slower economy.

Let's go through a few of the issues that has worried investors.

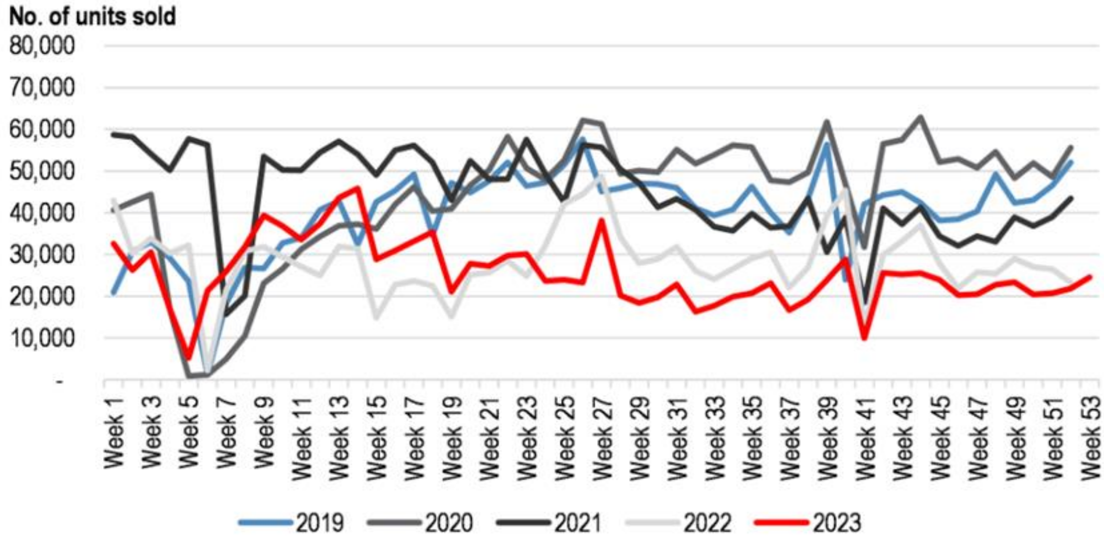
1. The property sector

The much talked about property downturn is in fact quite advanced. Sales volumes of new residential properties are down 35-40% from peak sales a few years ago. With loosening of property policies, sales volumes are stabilising. Going forward, given the current backdrop, further decline in volumes is going to have smaller incremental impact on economic activities. According to Morgan Stanley Research, given the significant decline in activities, property investment in China as a percentage of GDP is already lower than that of Korea, Germany and Japan.



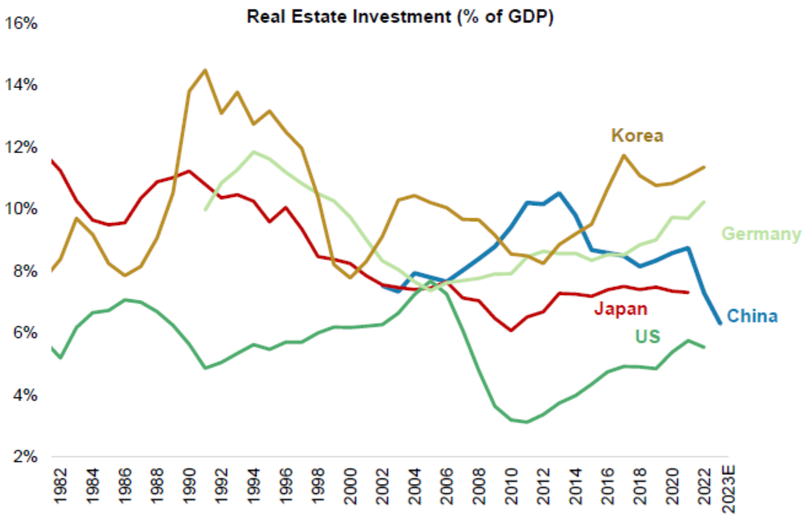
Source: NBS, Morgan Stanley Estimates

Figure 7: 60-city weekly primary sales (excluding outliers) – compared with 2019 / 2020 / 2021/ 2022



Source: CREIS

China's real estate investment/GDP ratio is one of the lowest among major economies



Source: NBS, Morgan Stanley estimates.

2. Hidden local Government debt

Another risk to the economy is the 'hidden debt' of the local Governments (also known as local government funding vehicles). Estimates have it totalling US$7 trillion (around 50% of China's economy). While not a small sum, it is manageable, and the magnitude is well-understood by investors and regulators. The regulators are pursuing a combination of austerity, debt restructuring, assumption of debt by the central government and potentially money printing to tackle the problem. These initiatives should gradually work down the problem over time.

3. Government crackdowns on certain private sectors

Well-known examples of crackdown were on the after-school tuition sector and the internet sector. Firm rules were implemented to curb some of the activities that were deemed dysfunctional by the authorities.

The vibrant private sector has to shoulder the burden of economic growth under guardrails, and the Central Government has little appetite to introduce more tightening measures. The most recent episode involved a

Government department official having to step down after releasing a consultation paper on additional tightening measures for the video gaming industry.

VIDEO GAMING

Key mainland official 'steps down' after market rout

Staff Reporter

A key mainland official involved in oversight of the country's video gaming industry has stepped down after proposed regulation last month wiped out billions of dollars of value from Chinese gaming stocks, according to people familiar with the situation.

Feng Shixin, a long-serving official, had left his official role as the publication bureau chief at the Communist Party's Central Propaganda Department, one person told the Post, asking not to be identified due to the sensitivity of the matter.

A second person, who also asked for anonymity, said Feng's departure was a sign that China might walk back some of last month's proposed restrictions on consumer spending in video games, which surprised the market due to their severity.

The National Press and Publication Administration (NPPA), the agency that answers directly to the propaganda authority in overseeing the country's video gaming industry, did not immediately respond to a request for comment.

Feng's departure comes as Beijing attempts to limit the damage from the NPPA's disclosure on December 23 of draft rules aimed at reining back spending on video games, which triggered a global sell-off of China gaming stocks, including leading players such as Tencent Holdings and NetEase.

According to the published proposals, which are open to public feedback until January 22, video game developers would have to implement measures to cap user spending, with bans on "excessive" rewards for activity such as daily logins and top-ups for fresh spending by consumers.

The timing and severity of the proposed rule changes dealt a fresh blow to already-fragile investor confidence in mainland stocks. NetEase, the country's No 2 gaming operator, fell by nearly a quarter in a single trading day, with Tencent dropping over 12 per cent.

The new rules appeared to be at odds with a recent change in Beijing's tone towards the video gaming industry – previously subject to a harsh crackdown – and broad efforts by the government to stabilise stock market sentiment and support the country's private sector.

In an attempt at damage control, the NPPA subsequently said the proposed regulation changes were aimed at "healthy development" of the gaming industry and that it would "revise and improve" the rules.

Meanwhile, the regulator approved 105 new video games for sale in China for December, the most in 17 months, in a supportive gesture to an industry with combined annual sales of 300 billion yuan (HK$330.4 billion) in 2023.

Feng is a veteran regulator. He delivered keynote speeches at the China Gaming Industry Annual Conference, the yearly gathering of officials and executives, for three consecutive years in 2018, 2019 and 2020 as a deputy publication bureau chief. In December 2020, Feng urged China's gaming companies to be vigilant about gaming content and not to "provide channels for any harmful content".

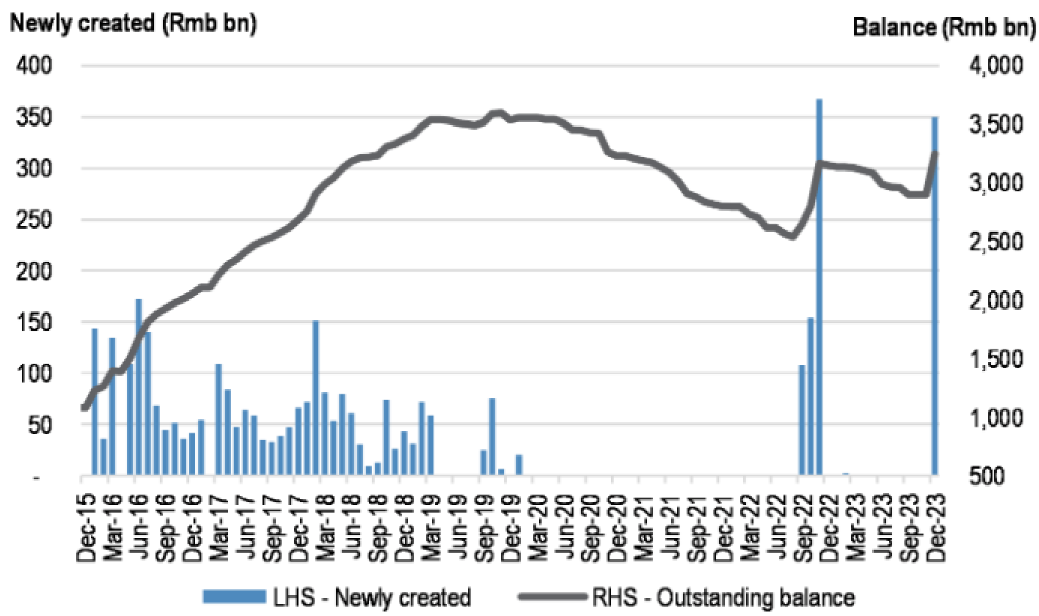
At the latest annual conference last month, Yang Fang, an official from the NPPA, delivered the keynote speech after Feng delegated the task to her.

Source: SCMP

4. Money printing?

China's version of "money printing" is called pledged supplementary lending (PSL). If the magnitude is eventually bigger than investors' expectations, this will be a meaningful impetus for economic growth and cleaning up of the banking system.

Figure 1: China PSL outstanding balance

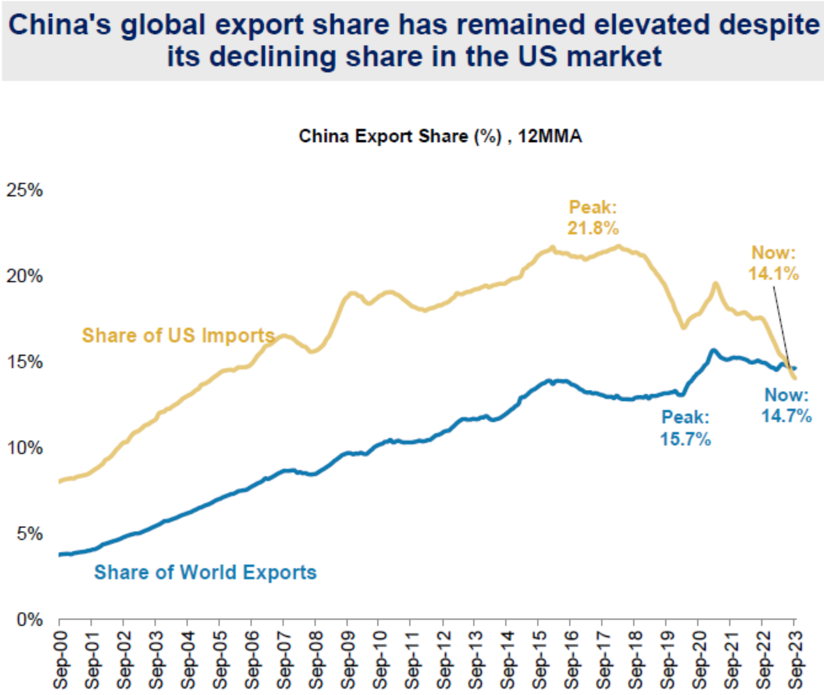


Source: Bloomberg Finance L.P., J.P. Morgan

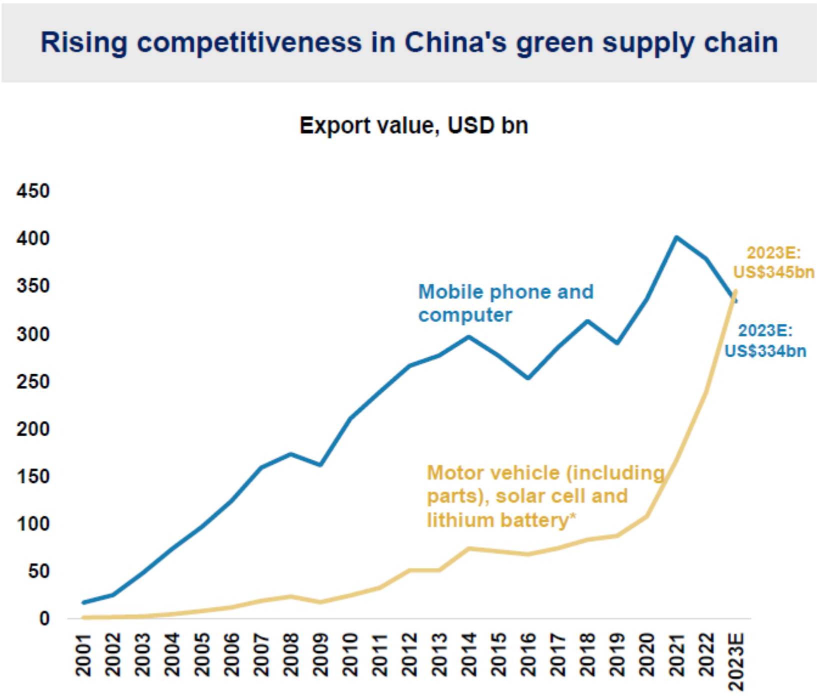
5. Geopolitical Tension

Geopolitics tension is thawing. The meeting between President Biden and Xi shows the intention from both sides to restore bilateral relations and reducing near-term risk of escalatory confrontation. With the economy a top priority, China is adopting a pragmatic approach to dealing with geopolitical questions.

It is likely that continued technological competition will remain. Nevertheless, its manufacturing base remains second-to-none and cost-competitive, China will remain a key part of the global supply chain. New industries such as electric vehicles, renewable energy and automobile have become new drivers for export. China is diversifying exports towards the BRICS countries of the global south and remains the biggest exporter in the world.



Source: NBS, Morgan Stanley Estimates



Source: NBS, Morgan Stanley Estimates

Negatives seem priced in

The problems facing the Chinese economy are manageable. The bright spots are the huge domestic market that continues to grow. Indeed, real income for the consumers is growing, but with the weakness of consumer confidence, excess savings have built up. Improvement in confidence can quickly re-ignite consumer spending. Valuations have come down and are cheap on a historical and global basis.

Source: Bloomberg

Dr Joseph Lai is Founder and Chief Investment Officer of [Ox Capital Management](#) (ABN 60 648 887 914, AFSL 533828). This document does not relate to any financial or investment product or service and does not constitute or form part of any offer to sell, or any solicitation of any offer to subscribe for interests, and the information provided is intended to be general in nature only. It has been prepared without taking into account any person's objectives, financial situation or needs.

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