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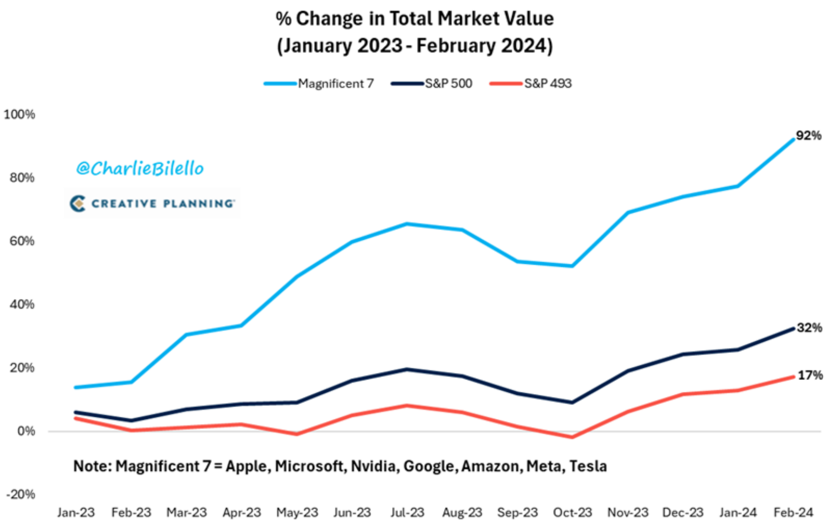
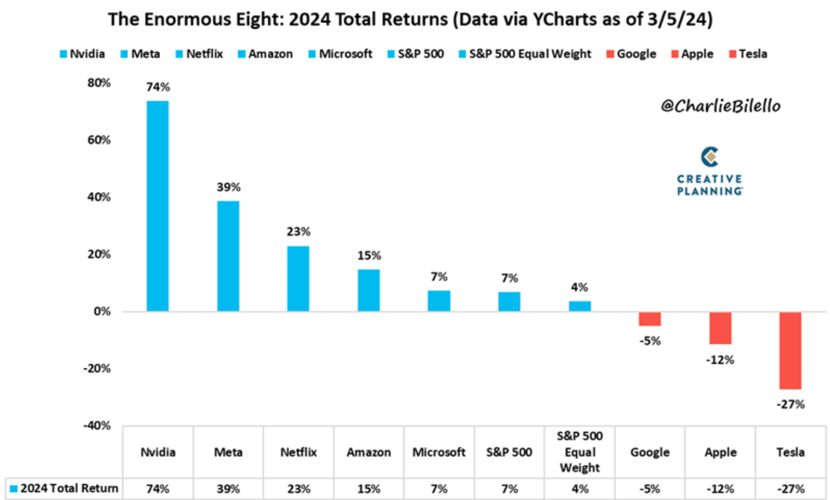
## Editorial

Equity markets are booming. The S&P 500 is up 7% year-to-date and has risen 16 of the past 18 weeks, something that hasn't been seen since 1971. The so-called Magnificent Seven are the talk of the town, as key drivers to the upwards move. These stocks are up 92% since the start of last year, versus the rest of the S&P 500, which has increased by 17%.



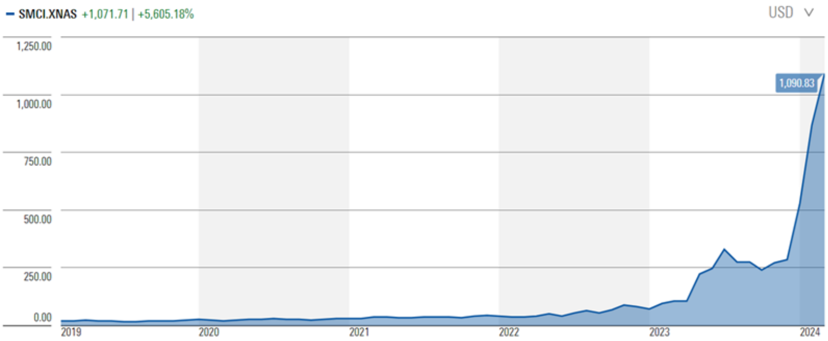

Yet, the Magnificent Seven may soon turn into the Magnificent Four, as the performance of the companies start to diverge. Three stocks, in Alphabet, Apple, and Tesla, have fallen this year. Tesla is the worst performer in the S&P 500 this year.




Apple and Tesla are being hurt by slowing China sales, a combination of a teetering economy there as well as both losing market share to local competitors. Meanwhile, Alphabet is being seen as behind the ball on AI compared to the likes of Microsoft and Amazon.

Frothiness is reaching other areas of market, with artificial intelligence server maker, Super Micro Computer, becoming the latest meme stock, rising 278% this year, surpassing its climb of 223% in 2023. The meteoric jump has led to the stock being included in the S&P 500 index. Who said indexes are passive?

Super Micro Computer now sports a market capitalization of US$61 billion, and it's valued at a cool 84x earnings and on an EV/Ebitda multiple of 66x.




*Source: Morningstar*

And the optimism is reaching other markets too. This week, Japan's Nikkei 225 crossed 40,000 for the first time ever, after breaching its 1989 record high in late February.

**Nikkei 225**


*Source: Trading Economics*

Outside of equities, other markets are feeling the love too. Bitcoin has jumped 61% this year, after a 156% gain in 2023.

Even the proverbial 'pet rock', gold is scaling all-time highs. It's surged 5% this month and 17% over the past year in US dollar terms.


*Source: Trading Economics*

| Bitcoin Returns: 2010 - 2024 | | | |
|---|---|---|---|
| Year | Year Start | Year End | % Change |
| 2010 | 0.003 | 0.30 | 9900% |
| 2011 | 0.30 | 4.72 | 1473% |
| 2012 | 4.72 | 13.51 | 186% |
| 2013 | 13.5 | 758 | 5507% |
| 2014 | 758 | 320 | -58% |
| 2015 | 320 | 430 | 35% |
| 2016 | 430 | 968 | 125% |
| 2017 | 968 | 13,860 | 1331% |
| 2018 | 13,860 | 3,689 | -73% |
| 2019 | 3,689 | 7,184 | 95% |
| 2020 | 7,184 | 28,775 | 301% |
| 2021 | 28,775 | 47,902 | 66% |
| 2022 | 47,902 | 16,531 | -65% |
| 2023 | 16,531 | 42,280 | 156% |
| 2024 YTD | 42,280 | 68,000 | 61% |
| @CharlieBilello | | Data as of 3/5/24 | |

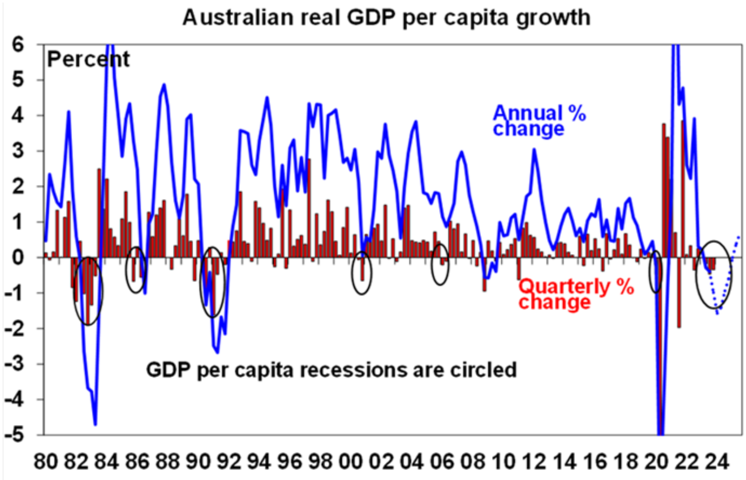
**Optimism doesn't stretch to economies**

Much of the positivity in markets isn't filtering down to economies. The world's third largest economy, Japan, is already in recession. The fourth largest, Germany, will almost certainly join it when first quarter GDP statistics are released. Meanwhile, the second biggest economy, China, remains in the sick bay as its credit-fuelled property bubble deflates.

The UK has also recently joined the list of those in recession, along with Sweden, Ireland, and Finland. France, Spain, Italy, New Zealand, and Israel are expected to join them soon too.

Meanwhile, Australia isn't in great shape either. GDP data released this week shows the economy here expanded by 0.2% during the December quarter. Meanwhile, annual GDP growth slowed to 1.5%, the lowest in 23 years.

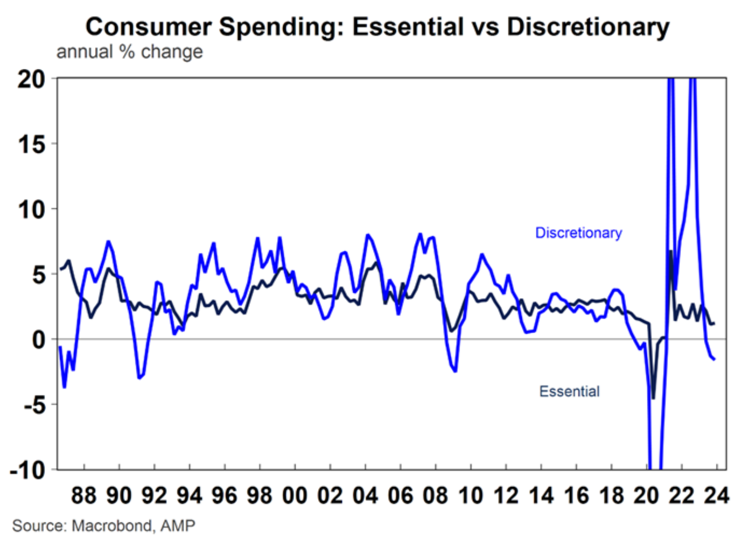
GDP was only in the black thanks to strong population growth. Per capita (or per person) GDP fell 0.3% during the quarter and was 1% down on the year. It's the third consecutive quarterly decline in per capita GDP. So, we're officially in a per capita recession.




*Source: Shane Oliver, AMP*

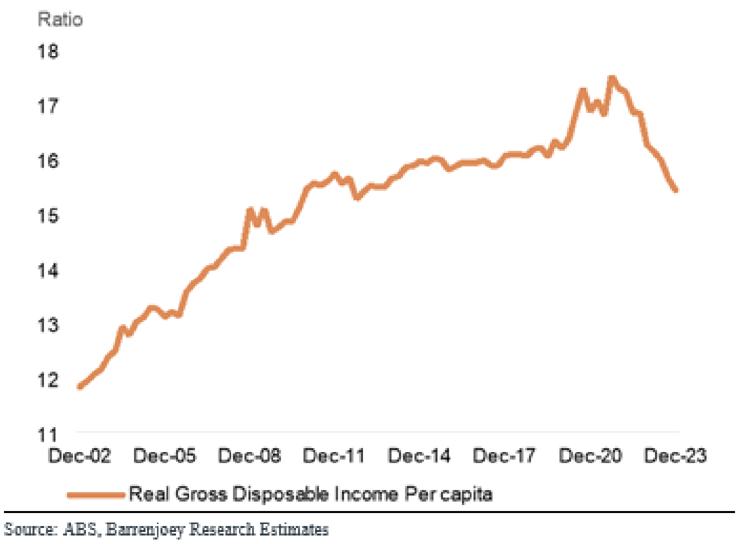
The big culprit for the poor economic data is a struggling consumer. CBA has this to say on the matter:

> *"Growth in real consumer spending over the past year has been incredibly weak given the squeeze in real household disposable income … Real household consumption grew by just 0.1%/qtr in Q4 24 [ed: this should read Q4 23] and is up by the same amount over the year. In other words aggregate consumer spend has essentially been flat for a year.*
>
> *On a per capita basis real consumer spending is down by a very large 2.4% over the year. Such an outcome would normally be associated with a large negative shock or recession. The weakness in the consumer lies at the heart of the soft GDP outcomes. And it is the primary reason why the unemployment rate is on a firm upward trend (albeit from an incredibly low level)."*




Spending on essentials increased 0.7% during the December quarter, but this was largely offset by discretionary spending declining by 0.9%. The data shows that people are cutting back on dining out, recreation and clothing.

It appears that savings built up from the pandemic period have been exhausted and people are reducing their spend on non-essentials to pay for essentials such rents, food, health, and electricity.

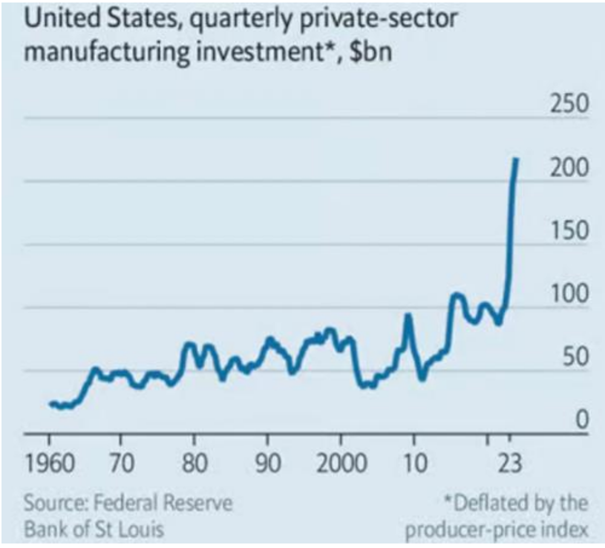



One curiosity is the extreme divergence between the data on consumer spending and the positive results and outlooks reported by consumer discretionary companies during the recent reporting season. **Hugh Dive** looks at this and all the earnings results in his article this week.

The other question that comes out of this GDP print is what it means for the RBA and rates moving forward. Could it be that the RBA is forced to cut rates before the Fed in the US? It's an intriguing possibility, though time will tell.

**Why are markets soaring, while economies are flailing?**

The one major economy that's firing on all cylinders is the US. Buoyant consumer spending from Millennials, exploding industrial construction as domestic manufacturing moves onshore from China, and strong government spending, are driving an acceleration in economic growth.




The outlook for the US economy looks reasonable as well, given positive demographics, further onshoring of manufacturing, relatively cheap energy sources, and it being the world's major technology innovation hub.

That contrasts with economies in Europe, North Asia, and China where populations are quickly ageing, domestic demand is stalling, energy prices are high, and innovation underwhelms versus America.

This perhaps explains why the US stock market has trounced most others over the past decade and continues to lead the way.

And even Donald Trump may not be enough to spoil that positive outlook…

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What are the best ASX dividend stocks for the next decade? In my article this week, I look at [11 companies that may fit the bill].

**James Gruber**

**Also in this week's edition...**

For decades, governments have told people to save for retirement, and then hold onto their nest eggs at all costs. However, they're now concerned that retirees aren't spending enough. **Kaye Fallick** isn't happy with the way that the current government is handling the issue and she offers some alternative solutions to encourage reasonable spending patterns in retirement.

Meantime, retirement planning tends to focus on money. Yet a new study from **Professor Joanne Earl** and colleagues shows that other matters such as health and career are important too, and a more holistic planning approach can better equip people as they prepare for retirement.

Countless reports have told of how Australia is unprepared to meet the needs of its ageing population. **Anne-Marie Elias and Dr. Abby Bloom** say it's now crunch time and we urgently need to help older people to get work if needed, access community care, and connect with others.

It's International Women's Day this week, and to commemorate the occasion we have **Dr. Tracey West** exploring the issue of financial literacy among women. Unfortunately, the evidence shows that being a woman increases the likelihood of lower financial literacy scores, and that this gender gap widens over time. Dr. West says that by rethinking traditional approaches, we can find new ways to bridge the gap.

In Eastern cultures, the Year of the Dragon is a cause for optimism. **Eric Souders** from **Payden and Rygel** asks whether 2024 will be similarly auspicious for markets. He thinks strong labor markets and a loosening in financial conditions should help in the first half, though they may sow the seeds for a rockier end to the year.

Lastly, in this week's whitepaper, **Vanguard** outlines how Australian ETFs, especially bond-focused ones, attracted huge inflows in the December quarter.

## 11 ASX dividend stocks for the next decade

James Gruber

Last week, I wrote an article on [ASX stocks that you could buy and hold forever](). A subscriber suggested a follow-up article on stocks for people who want dividends which can see them through retirement. Here is my attempt to deliver on that.

I'm going to focus on stocks that can provide sustainable, growing dividends over a 10-year period. This way, it's not just applicable to retirees but for anyone who needs a reliable income stream over the long-term.

This article has a different emphasis to the previous one. Last week's article was about stocks that you could own forever, while this week is adopting a shorter timeframe of 10 years. That matters because owning a stock indefinitely means you must be confident that a company will be around forever, and that they can continue to grow earnings too. That criterion is loosened considerably when applying a shorter timeframe, as per this week.

Also, last week was a wish list of companies that you could buy at some point in the future. This week has a list of stocks that could possibly be bought now. I figure that people who need regular income need it right away. Because of this, unlike last week, I have taken valuation into consideration when choosing the stocks for this list.

**The criteria**

My goal for the dividend stocks is that each of them should provide resilient annual income and perform better than the ASX 300 index including franking credits over a 10-year period. The index has historically returned about 10% per annum including franking credits. However, this has been helped by considerable tailwinds for the biggest index weights, including a 40-year credit growth boom for banks and, more recently, an iron ore surge for the major miners. Consequently, index returns are likely to be lower going forwards.

Therefore, the objective for each of our dividend stocks is to produce steadier annual income than the index and provide +8.5% total returns per annum including franking credits over the next decade.

Here are the criteria for the list of stocks to achieve that goal:

1. **In the ASX 300.** Ideally, you want to own well-established firms that have some history of success. The smallest company in the ASX 300 has a market capitalization of under $600 million. This criterion then excludes small caps and includes mid and large caps.

2. **Durable earnings and dividends.** If you want regular income from stocks, you need reliable dividend payments. A stock that pays out $1 of dividends in one year, and then 25 cents the next, won't meet this goal.

3. **Growing earnings and dividends.** Ideally, you want a company to turn their dividend of $1 in year one into $2 or more by year 10. To do this, a stock needs to be able to grow earnings over time, as dividends ultimately come from profits.

4. **Sustainable dividend payout ratio.** The payout ratio refers to the percentage of earnings that are paid out in dividends. If a company is paying out 120% of profits in dividends, that's not sustainable through time.

5. **Economic moats.** For companies to grow earnings and dividends, it helps if they have economic moats. Moats are sustainable competitive advantages. They help companies defy the laws of capitalism which suggest that businesses which have high returns of capital will have these returns competed away. Competitive edges can come from many things including network effects, intangible assets, cost advantages, switching costs, or efficient scale. You can find out more about moats [here]().

6. **Sound balance sheets.** It's good to own companies that don't rely on too much debt to generate returns. Excessive debt makes companies fragile, which can ultimately impact earnings and dividends.

7. **Reasonable/undervalued price.** It's unwise to ignore valuations when buying stocks, even for dividend purposes. For instance, if you buy a stock on a 50x price-to-earnings ratio and that ratio goes down to 15x over a decade, you'll nurse a large potential capital loss, which is likely to more than offset any dividends paid throughout the period.

One thing to note is that we're not just looking for high dividend yielding companies here. Yields can be deceptive if dividends are cut in future. Ideally, the dividends need to be sustainable, and growing.

**What doesn't make the list?**

Mining stocks are notable absentees from the list. This may seem odd given many of these stocks currently sport high dividend yields. The problem is that these dividends aren't reliable and therefore most of these companies don't pass the second criterion.

Mining companies are highly dependent on commodity prices, which are notoriously volatile. That makes the earnings and dividends from these companies volatile too.

Even giants such as BHP don't pass the second criterion. For instance, the company paid total dividends per share of $4.64 in 2022. A year later, that dividend had been cut 43% to $2.61 a share. It's certainly not the first time that's happened with BHP and won't be the last.

The other notable absentees are great companies that could strongly grow future dividends yet are too expensive at current prices. The likes of Cochlear, The Lottery Corporation, and Transurban fall into this category.

**The list**

Here is my list of the best 11 ASX stocks to hold for income over the next 10 years:

| Company | Code | Market cap (bn) | Sector | Dividend yield (%, trailing) | Franking |
|---|---|---|---|---|---|
| Ampol | ALD | 8.89 | Energy | 6.70 | 100% |
| Argo Investments | ARG | 6.68 | Financial services | 3.92 | 100% |
| Aurizon | AZJ | 6.97 | Industrials | 4.65 | 60% |
| Charter Hall Retail REIT | CQR | 2.08 | Real estate | 7.01 | 0% |
| HomeCo Daily Needs REIT | HDN | 2.56 | Real estate | 6.73 | 0% |
| Medibank Private | MPL | 10.16 | Financial services | 3.96 | 100% |
| National Australia Bank | NAB | 106.24 | Financial services | 4.89 | 100% |
| SkyCity Entertainment | SKC | 1.38 | Consumer cyclical | 6.11 | 0% |
| Suncorp | SUN | 19.52 | Financial services | 3.97 | 100% |
| Telstra | TLS | 44.02 | Communications services | 4.59 | 100% |
| Wesfarmers | WES | 74.56 | Consumer cyclical | 2.93 | 100% |

Let's go through the companies one by one:

**Ampol (ASX:ALD)**

The company is a fuel refiner and petrol station owner. Most investors see it operating in a sunset industry, yet the beauty of sunset industries is they discourage competition and often encourage consolidation. That is what's happened here, and it's likely to result in growing margins on both the retail and commercial/wholesale sides of their business. The stock has had a good run but still looks reasonable value, with a healthy 6.7% dividend yield.

**Argo Investments (ASX:ARG)**

A listed investment company with a long history of decent performance, shareholder friendly policies, and growing dividends. The beauty of LICs is that they can retain some of their profits to smooth out dividend payments through time.

**Aurizon (ASX:AZJ)**

This company has had its ups and downs though it may finally be getting its act together and its rail assets remain attractive. Rail has an enduring cost advantage over road transport for bulk commodities. The downside of Aurizon is that it is over-reliant on coal. However, this reliance will reduce over time, and should hopefully be less of a concern. I expect its earnings and dividends to grow nicely from here.

**Charter Hall Retail REIT (ASX:CQR)**

The property sector has been in the dumps but this one stands out for being resilient through different cycles. CQR owns $4 billion in neighbourhood retail assets, and some petrol stations. The retail assets are principally local supermarkets, with 5-10 tenancies around them, such as pharmacies, butchers, newsagents etc. Dating back 20 years, the occupancy for its portfolio has been remarkably resilient, between 97.5% and 98.5% the entire time. This is due to the quality of the anchor tenants - including Woolworths, Coles, Aldi, Ampol and BP – who account for 60% of rents. The stock remains at a steep discount to its net asset value and offers a 7% dividend yield, albeit unfranked.

**HomeCo Daily Needs REIT (ASX:HDN)**

This is the other REIT that I like. It's headed by David Di Pilla, the canny former investment banker who recently put together the Sigma and Chemist Warehouse deal. HomeCo comprises a national portfolio of 51 properties, including neighbour retail assets, large format retail (think household goods) and health and services. The portfolio is 99% leased, and the largest tenants are Wesfarmers, Coles, and Woolworths. The stock should benefit from strong population and ecommerce growth, and significant potential upside comes from future development of its unused landbank.

**Medibank Private (ASX:MPL)**

With an ageing population, higher demand for healthcare will put pressure on the public health system. That makes private health insurers such as Medibank an attractive opportunity. Yes, Medibank operates in a heavily regulated industry where premium increases must be approved by government, but steady, growing profits seem assured, and dividends along with it.

**National Australia Bank (ASX:NAB)**

The best days for Australian banking may be behind it, but that doesn't mean well run banks can't deliver strong dividends going forward. NAB is my pick of the bunch to provide steady income and total returns that at least match the indices. It's well managed, inexpensive, and offers a 4.9% net yield, fully franked.

**SkyCity Entertainment (ASX:SKC)**

This one may surprise people as casino stocks remain in the sin bin. Yet, SkyCity's earnings and dividends will soon recover after being depressed by Covid and regulatory issues. Its economic moat comes long dated and exclusive casino licences in Auckland and Adelaide. The stock is really cheap, and I expect strong total returns, as well as dividend growth, going forward.

**Suncorp Group (ASX:SUN)**

With the imminent sale of Suncorp Bank to ANZ, SUN will become an insurance pureplay. Insurance is currently attractive with healthy pricing and growing investment earnings from higher bond yields, among other things. With the sale, there are also expectations of future capital returns.

**Telstra (ASX:TLS)**

Telstra is a market leader, with a strong competitive advantage, recurring earnings, good dividends, sound management, and is resilient to economic downturns. Importantly, it's an industry that's inproving and becoming more rational. The company has started to grow its dividend again, and I think it's a keeper.

**Wesfarmers (ASX:WES)**

Retailers don't usually make good dividend stocks as theri earnings and dividends are vulnerable to economic downturns. Wesfarmers is different as the bulk of its earnings comes from Bunnings. Bunnings has scale, an economic moat, and some growth to power Wesfarmers long into the future. The key risk with this stock is if the management uses the cash from Bunnings to diversify into lower returning industries. I am closely watching the Lithium push on this front. While Wesfarmers doesn't have a high dividend yield, I expect a growing income stream over time.

**A final word**

Obviously, the list doesn't consider your personal circumstances and portfolios. Seek advice if you need it.

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

## Time to smash the retirement nest egg - but how?

Kaye Fallick

Remember Easter 2022 when passengers were in long queues at capital city airports, waiting hours for flights, some of which were cancelled? And the reward for their inconvenience and patience? They were slammed as not 'match fit' by then Qantas CEO, Alan Joyce.

Well, we know how that ended, don't we? Those passengers *were* match fit, but the airlines had quite a few issues that needed sorting. The service that passengers were paying for just wasn't up to scratch.

This analogy comes to mind during the current 'super wars'. The current debates have been further heightened by a call for submissions to the Treasury Discussion Paper, *Retirement phase of superannuation*. Many submissions have found their way into media releases which have been duly reported across our media. The statements vary, but underneath many of the claims, is a subtext that retirees are somehow … again … at fault.

This time it's for underspending. It seems, like airline passengers, retirees just aren't match fit. Which must make the average retiree's blood boil!

That's because, for the past 30 or so years (since compulsory super was introduced), they have been told by the banks and super funds to save, save, save their money in super. They were led to believe that a 'comfortable' couple's retirement required a fully paid-off home and about a million dollars in savings. And that socking money into their 'nest egg', then preserving it at all costs was their primary mission.

Evidence suggests that many retirees have responded to this exhortation by making minimum withdrawals from their super accounts, leaving large balances for their families to enjoy after they've departed. But now we see industry exhorting retirees to get over their so-called 'frugality' and start to spend, spend, spend. No wonder many retirees are so 'disengaged' as industry politely terms it. That's an understatement.

**How did we get here?**

How can we reframe the discussion in a way that supports retirees? Here's a brief backgrounder and some starting thoughts on how we can help retirees to smooth their income across their two- or three-decade long retirements.

**The rise of the 'nest egg'**

Back in the early days of super in the 1990s, the advice within the retirement income industry was largely driven by major insurance companies: NRMA, AMP, MLC and AXA to name a few. Their advertising campaigns sold retirees on a goal of super large nest eggs – literally – with images of golden eggs in golden baskets. The industry then had a robust army of financial planners who took commissions and managed these 'nest eggs'.

The heyday of commissioned planners did not last, and the Royal Commission into banking and finance, which reported in 2019, largely shut the door on this planning and saving model.

But somehow these persistent images of nest eggs and piggy banks became code for retirement savings. Sitting beneath this was a strong message based on fear and guilt:

- You won't have enough
- You need to save harder
- If you don't reach the $1 million target, you'll have a miserable retirement

And these subliminal messages die hard. To be fair, a quiet revolution has taken place since the early days of compulsory super.

Many planner conflicts have now been removed or modified. Industry funds have gained strength (some might say too much). Today they are behemoths, but their core proposition that 'From little things big things grow' is a much more realistic strategy for most retirees when compared to forceful suggestions that you'll need a million to live a decent retirement.

The question is, how could an entire industry push ordinary Australians to save, save, save, without an eye on the day when this clearly discernible demographic spike of baby boomers would quickly reach Preservation Age?

And how could the financial services industry be seemingly unaware that the constant 'save for your nest egg' refrain would become so ingrained and self-defeating?

And that retirees with modest means can't simply flip a switch at age 60, 65 or 70 and embrace a spending mode?

**How to turn on the tap**

What are the answers to encouraging reasonable spending patterns in retirement? In short, how does government now ask retirees to turn on the tap of spending their super?

There are a few issues to tackle here but the first has to be to agree on the facts. Until now there seemed to be general agreement that retirees were underspending. But in more recent times we've been told retirees spend all they have!

The first important fact is that compulsory super did not start until 1992, and then it was at 3% of income, not increasing to 9% until 2007. As a consequence, retiring Australians will not have received the benefit of a meaningful super contribution over the 40 years of their working life until the mid-2040s. So for most older Australians and current retirees super savings tend to be modest, if they have any at all. As the Productivity Commission found in 2019 around 20% of workers have no super at Preservation Age and then only around 40% still have super when eligible for the Age Pension. Those with smaller balances will often take a lump sum to pay off debts, undertake a renovation or purchase a new car or white goods in preparation for retirement. So it's unsurprising that many current retirees have no super when they die.

This view of super spending, that retirees are inclined to spend themselves out, is reflected in recent reports from Association of Super Funds Australia (ASFA) and the newly convened Super Members Council (SMC).

However, as the RIR found in 2020 those fortunate enough to have enjoyed a more substantial rate of super savings over their working lives tend to die with most of their savings intact. By adhering to minimum drawdown levels, superannuants tend to underspend in retirement – spending the income rather than the capital they have put aside all their working lives to provide a good standard of living in retirement, Consequently, they are leaving what is often an unintended bequest to future generations.

Apart from moderating language about saving, there are other ways to encourage retirees to more efficiently access their savings.

Providing support to better understand key triggers and decision-making points in their retirement journeys makes a lot of sense. This means financial literacy support through basic explainers of key rules including Age Pension entitlements, preservation age, retirement income streams, account-based pensions, even MySuper options. When you are in an industry long enough you start to accept jargon that is confusing and meaningless to the broader population. But everyday retirees need more help here. This is a big shout out to the Federal Government in particular which has been missing in action on the need for retirement financial literacy support across the 30+ years of mandated super.

Understanding that your savings continue to grow while you draw a retirement income stream also helps. If a single female has, say, the median amount in super (female, $204,000) and withdraws a pension top up of $1200 a month, then the balance at the end of her first year will be $204,000 - $14,400 = $189,600. But when we apply a conservative 7% earnings to the balance (last year balanced funds delivered 9.6% according to SuperRatings) then the balance at the end of the period would be at least $202,872, so the withdrawals are largely mitigated. If this retiree wanted more money for renovations or lifestyle requirements, she might have confidence to access her funds, knowing that she is not in danger of running out.

**It's not just what we say, it's also how we say it**

Much of the old school retirement saving/spending discourse has had a hectoring tone. You must save more. You'll run out. Here's an impossible target for savings, but you're on your own when it comes to getting there.

This tone persists in the chiding of retirees for being too frugal. 'They' are not spending enough, the headlines admonish. 'They' are passing on wealth to the next generation instead. 'They' haven't put enough aside for aged care. And then there's the suggested rainy day money target of three months' salary…

These are impossible targets for many retirees. For most, in fact.

They have led to a predictable response, 'Don't keep telling me what to do, show me my potential strategies instead…'

**Stepping through the options**

Is it time to give retirees a break from jargon and step them through their options in a more positive manner? One suggestion is for funds to give individual members a retirement income projection from *day one* so that they anticipate getting the super back in terms of an income. Not just a bundle of savings.

There are many other ways of helping retirees to help themselves without berating them, for starters, by providing relevant and timely information and guidance. So as older Australians join the queue for the long-haul journey of retirement income management, let's stop telling them that they're not match fit for not spending quickly enough. Instead let's scrutinise what industry and government are doing to support them to get on board in the most effective way.

*Kaye Fallick is Founder of [STAYINGconnected](STAYINGconnected) website and SuperConnected enews. She has been a commentator on retirement income and ageing demographics since 1999. This article is general information and does not consider the circumstances of any person.*

## The standout winners from February reporting season

### Hugh Dive

During February and August every year, most Australian listed companies reveal their profit results and guide how they expect their businesses to perform in the upcoming year. Whilst we regularly meet with companies between reporting periods to gauge how their businesses are performing, reporting season offers investors a detailed and externally audited look at the company's financials.

The February 2024 company reporting period that concluded last week displayed stronger-than-expected results despite the higher inflationary and interest rate environment. The February reporting season's dominant themes have been a resilient consumer, strong cost management, moderation in inflation and a positive economic outlook. While many companies performed very well against the headwinds of higher inflation and interest rates, not all performed well. In this article, we look at the key themes from the reporting season that fared last week, as well as the best and worst results.

"Daddy doesn't know any magic tricks. Daddy knows accounting tricks."

**Better than expected**

Going into the February reporting season, the market was expecting the themes that didn't occur in August 2023, including cost inflation, higher interest costs, and slowing retail sales. However, once again, the reporting season demonstrated that many companies have managed a higher inflation and interest rate environment much better than many expected, with around 40% of companies beating market expectations. ASX companies that exceeded expectations were in the IT, Consumer Discretionary and Real Estate sectors. Conversely, disappointments were clustered in the Energy, Materials, and Healthcare sectors, primarily related to falling commodity prices and rising costs.

**Resilient consumer**

The first dominant theme for the February reporting season was the strength of the domestic consumer. In November 2022, Westpac's economists forecasted a grim year for 2023, the much-feared fixed interest rate cliff was expected to see unemployment rise to 4.5%, an 8% fall in house prices, bad debts to spike and retail sales grinding to a halt.

However, February 2024 showed continued consumer demand for technology and electronic products, with sales growing across the **JB Hi-Fi** brand. Similarly, with **Wesfarmers**, Kmart increased profits by 27% as consumers looked to trade down to lower price point options and the success of its Anko brand, which is now stocked in Canadian department stores. Consumers were also willing to treat themselves to fashionable jewellery from **Lovisa** and 4WD accessories from **ARB**.

Conversely, with the cost of living increasing, the wagering environment has had a downturn, which saw **Tabcorp** revenues and active users decreasing across both digital and cash wagering. Similarly, consumers weren't as willing to spend on bedding and furniture at **Harvey Norman**, with sales falling by 9% in Australia.

**Inflation moderation**

Across the major supermarkets, a theme that stood out was that food inflation had moderated throughout the first half and into the first six weeks of the next half. During the half, **Woolworths** saw average prices for fruit and vegetables decline by 6% and average prices for meat fall by 7%, driven by lower livestock prices and an increased supply of fruit. Ironically, reporting expanding profit margins in February was a case of poor timing for Woolworths, as it will see the company appear before the Senate Select Committee into Grocery Prices; consequently, its share price declined by 8% over the month.

In contrast, companies with revenues linked to inflation continue to benefit. The best example is toll road operators **Transurban** and **Atlas Arteria**, which saw increased revenues from higher traffic volumes and inflation-linked tolls. For a toll road, the most significant cost is interest, with the ongoing costs of operating a toll road once built being minimal. Both toll road companies were very active in extending their loan book from 2020 to 2022, during a period of the lowest recorded interest rates in 5,000 years. For example, in mid-2021, Atlas Arteria sold €500 million of 7-year bonds priced at a coupon rate of a mere 0.17%. While this looks low, in early 2020, the company managed to sell €500 million of bonds, paying no coupons with a negative yield of -0.077%! Effectively, bondholders were paying the company to hold their money, a situation that economists such as Adam Smith or John Maynard Keynes would have never foreseen. Since January 2023, tolls have increased by +7.6% on Atlas Arteria's French toll roads, resulting in profit margin expansion from higher revenues and minimal change in expenses.

**Cost management**

During reporting season, a dominant theme that continued through was cost control and cost cutting, with over a third of companies reporting that cost pressures have now passed their peak. **JB Hi-Fi** cost management surprised markets, with costs only increasing by 5% despite the retailer facing wage and rent growth pressures. JB Hi-Fi benefitted from staff operating more efficiently and more online sales, with online sales in the last half of 2023 increasing to $736 million, up from $170 million in the same period pre-COVID-19.

On the flip side, **Ramsay Healthcare** saw its costs increase by over 11% and its profits fall by 40%, driven by labour costs and occupancy costs. Similarly, the miners saw cost pressures and weakening commodity prices, which squeezed margins. Diversified miner **South32** had a particularly rough month, with reported profits falling 92% due to higher costs, production issues and falling nickel, aluminium and manganese prices.

**Positive economic outlook**

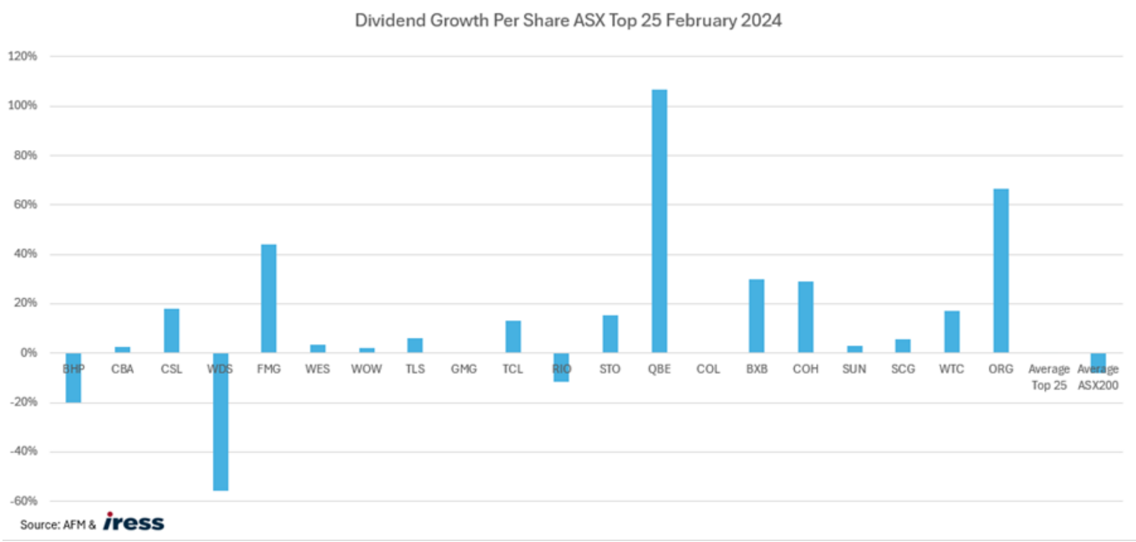
**Commonwealth Bank** provides a good look through the economy during reporting season, with Australia's largest bank holding 16 million customer accounts. Consequently, the banks' financial results and accompanying 231-page reporting suite give investors an insight into the health of the various sectors of the economy. CBA showed minimal bad debts and rising dividends but also that higher interest rates had differing impacts across their customer base. While discretionary spending had been cut back along with savings for customers aged between 20 and 54, older customers aged above 55 had increased spending and savings.

Insurers had their best results season since the GFC as they enjoyed higher premiums, lower claims inflation, lower adverse weather events, and sound investment returns. **Suncorp** expects gross written premiums to increase by low-mid double digits and for margins to rise as cost inflation subsides. Similarly, **QBE** expects its gross written premium to increase by mid-single digits over the coming year and for margins to expand.

**Show me the money**

Looking across the top 20 stocks (that reported – the other banks have a different financial year-end), the weighted average dividend increase was 0%. The three companies that reduced their dividends, **BHP**, **Rio**, and **Woodside**, saw weaker commodity pricing.

On the positive side of the ledger, **QBE**, **Origin**, and **Fortescue** offset the cuts, posting solid increases in cash flows to their shareholders. Across the wider ASX 200, dividends declined by -8% in February.




**Best and worst**

Over the month, **Lovisa Holdings**, **Wisetech Global**, **Reliance Worldwide**, **NextDC**, and **ARB Corporation** delivered the best results. Despite the uncertain economic environment, especially around the softening of consumers, these companies were able to grow sales and expand gross margins along with providing optimistic outlooks.

Looking on the negative side of the ledger, **South32**, **Corporate Travel Management**, **Healius**, and **Whitehaven Coal** reported poorly received results by the markets. The common themes amongst this group were lower commodity prices (South32 and Whitehaven) and slowing sales with high PEs (Healius and Corporate Travel Management).

**Result of the season**

Before the February 2024 reporting season, conglomerate **Wesfarmers** would not have been near the top of any investor's picks after a stellar performance in the August 2023 reporting season. Many in the market predicted Wesfarmers' profits would go backwards following a softer economic outlook for domestic consumers and weaker lithium prices. However, the opposite happened with their flagship business, Bunnings, maintaining its earnings and Kmart increasing their profits by +27%, driven by its lowest price position and consumers moving to their Anko brand. Anko has been so successful in Australia that Kmart now offers its Anko product in Canada through the Hudson Bay Company (Canada's Myer). Wesfarmers was up +16% for February 2024.

*Hugh Dive is Chief Investment Officer of Atlas Funds Management. This article is for general information only and does not consider the circumstances of any investor.*

## Australia needs to transform how it cares for older people

### Anne-Marie Elias, Dr. Abby Bloom

*[This is an edited extract from a recently released report, Longevity 2030: A Global Crisis and Opportunity]*

The World Health Organization predicts that by 2050, the global population aged 60 and over will double to 2.1 billion people, with those aged over 80 tripling to 426 million. Similarly, in Australia, 20% of the population will be aged 65 or older by 2030. By 2050 this group will represent 25% of the population (Intergenerational Report 2020), challenging the adequacy of pension systems, healthcare, and the workforce. This is the beginning of powerful and world-changing demographic trend that will continue beyond 2030 until at least 2050. The time to prepare our society and economy is now.

The World Economic Forum's Longevity Economy Principles, unveiled in January 2024, underscore the economic significance of longevity. These six principles, ranging from ensuring financial resilience to addressing longevity inequalities, establish a comprehensive framework for navigating the intricate web of challenges and opportunities presented by longevity.

Australia is at a critical juncture: in 2030, the ABS says we will have more people aged 65 and older than those aged under 18, a surge in retirement across generations, and a declining workforce on the horizon. Despite the alarm sounded by six Intergenerational Reports produced by the Australian Treasury since 2002, Australia is unprepared to meet the fundamental needs of its ageing population.

**Living longer does not necessarily mean living better**

The support older Australians need as they age under the burden of chronic illness is already exerting severe and increasing pressure on carers. For many years Australia's focus of funding and attention has been on residential aged care - nursing homes - yet over 90% of people aged 65+ are living in the community, according to the Australian Institute of Health and Welfare. The fundamental premise underlying care and living support and funding for Australia's ageing population is - at best - incompatible with the desires and needs of Boomers and Gen X. At worst, this approach is fundamentally outdated and misguided.

Confronting as it is, we need to accept that residential aged care is end of life care - whether that be 6 months or 6 years. The average age of residents is 85 and average stay 2.5 years with exit due to death.

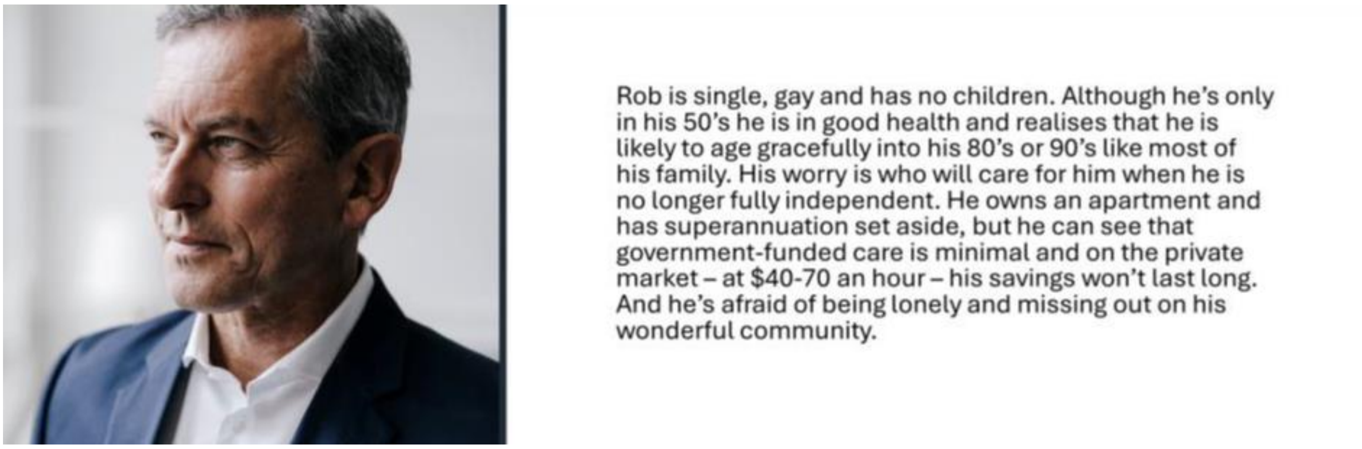
Residential aged care absorbs most of the funding and attention aimed today at longevity, but it only meets the needs of a very small slice of Australia's older population.

With such a high proportion of older Australians choosing to age in the community, not in aged care, we need a fundamentally different system of support and funding. Ageing successfully in the community takes a multi-generational village, anchored in strong connections within community and family. The opportunities and benefits have been widely viewed on the ABC in Old Peoples Home for Teenagers which pairs teens with older people in retirement villages for an intergenerational experiment.

For family carers who are still working and have infants, toddlers, school, or university-aged children still at home, the pressure is immense, whether their parents are in aged care or in the community. Care responsibilities are a leading factor in the decision of mid- and high-level working women to reduce their working hours or leave the workforce entirely.

**Technology can help**

In the home, the 'Internet-of-Things' can connect devices to set medication and other reminders, turn on lights and many other functions that become difficult for less mobile older people. Wristbands can track health status and send instantaneous messages to paid and family carers. Voice-activated devices can assist less mobile people to live independently longer. The availability of inexpensive, over-the-counter hearing aids - costing a fraction of the price of high-end devices - can expand accessibility and use to restore a functional level of hearing and delay physical and psychological decline associated with hearing loss in old age. In practice, hearing aids reduce social isolation, falls and potentially slow the rate of cognitive decline. Older tech like personal alarms will soon be superseded by technology in accelerator- and IoT-enabled mobile and wearable devices that are already here and more like the 'Apple' watches so many younger Boomers and Gen X already rely on.



For now, we have a generation of older people ageing in the community with some tech skills. Most have mobile phones which keep them connected to family and the wider community. Around 30% of seniors are not tech savvy, but their children and grandchildren are, and with their help seniors can use and benefit from devices and apps like iPad, Alexa, and FaceTime to stay connected and monitor wellbeing.

Younger Baby Boomers (those born from 1955-1964) are much more technologically fluent than outworn stereotypes lead many to believe. Many people approaching 65 or 67 are still in the workforce, utterly self-reliant with technology, and curious and eager to keep learning.

**Working and ageing**

Australia's pension age increased from 65 to 67 for those born after 1957, leading to the implicit expectation that Australians will generally remain in the workforce until then. In theory, working even longer will presumably be encouraged. In practice, however, working longer is not well accommodated.

While the focus is on creating productive intergenerational workforces, the reality is that people over the age of 50 face overt and unconscious bias in employment. As a result of the decline in births over several decades and the barriers to employment of older workers there will be a 6% shortfall in Australia's workforce by 2030 according to Australia 2030: Prosperity through innovation – A plan for Australia to thrive in the global innovation race.

Without policy and practical interventions, the gap is likely to increase. Experts predict a greater likelihood of a shortage of workers than a shortage of jobs. For this reason, policies and initiatives to accommodate older workers may well be decisive for Australia's future economy. Bunnings has already tapped into mature aged workers, and startups like Maturious are pioneers in improving the employment outlook for mature age workers, benefiting organisations desperately seeking experience as well as talent.

**Dealing with social issues**

Australians are lonelier than ever: the Australian Institute of Health and Welfare in a report on Social isolation and loneliness (2023) found loneliness across all ages, young and old. We understand the causative link between loneliness and physical and mental wellbeing. Transport is a powerful enabler or inhibitor of people's independence and ability to participate in community activities as they age. Those who lose their ability to drive need access to affordable and community transport to remain connected and mobile in the community. Tackling loneliness requires a vibrant multi-generational local community that works to keep seniors active and engaged. Local government has a crucial role to play in supporting older people in the community by providing transport and opportunities for engaging in social and cultural events and physical activity through community facilities including libraries, parks, arts and cultural and community centres.

Initiatives like social prescribing are gaining momentum in Canada, the UK and more recently Australia. Social prescribing involves providing non-medical support to boost a person's wellbeing and can include exercise, meditation, social clubs, art or pet adoption. Social prescribing has been found to be effective in the treatment of older people with chronic illness, depression and dementia. There is a movement in Australia led by Dr JR Baker Chair of ASPIRE the Australian Social Prescribing Institute of Research and Education is leading the way to promote understanding of the benefits of social prescribing.

A 2020 report by the Royal Australian College of GPs and the Consumer Health Forum recommended that social prescribing be included in routine healthcare (incorporated in the Federal Government's 10 Year Primary Health Care Plan) and that Primary Health Networks expand pathways to include social prescribing pathways for patients.

*Anne-Marie Elias and Dr. Abby Bloom are founders of PrimeLife Partners, an Australian company aimed at transforming how we live, age, care and retire. Further information on PrimeLife Partners services, events, and papers can be found at: https://primelifepartners.com/news/.*

## Improving financial literacy for women is a necessity

Dr. Tracey West

Many Australians struggle to manage their money, and one in three people find dealing with money stressful and overwhelming. Increasingly complex financial choices and products require people to have ever greater knowledge about financial matters and understand the consequences of their financial decisions. But what exactly do we need to know to achieve this threshold of knowledge, and who do we learn from?

One way to better understand where the threshold might lie is to rank people's level of financial literacy by responses to a series of five questions (see below) on compound interest, inflation, and risk diversification. Not surprisingly, researchers using these questions have found that people with higher financial literacy scores save regularly, engage in long-term planning, are willing to take appropriate financial risks and ensure they have emergency savings.

Unfortunately, evidence consistently shows that being a woman increases the likelihood of lower financial literacy scores. This gender gap widens over time, painting a concerning picture for aging single women. Addressing this gap is a matter of equality and a critical step towards empowering women to take control of their financial futures.

Closing the gender gap in financial literacy is not just a moral imperative; it's an economic necessity. Financial literacy equips women with the knowledge and confidence to build wealth and achieve long-term financial goals. By rethinking traditional approaches to learning about financial concepts at school, providing financial education resources in the workplace, and harnessing the expertise of experienced investors, we can find new ways to close the gender gap in financial literacy. Delivered alongside structural change to equal pay and childcare affordability, women's full potential can be reached as investors, savers and contributors to economic growth.

**Understanding the gender gap**

The gender gap in financial literacy is a multifaceted issue influenced by various societal, cultural and economic factors. Historically, women have been less involved in financial decision-making, leading to less exposure and experience in managing money and investments. This disparity is further exacerbated by differences in educational opportunities, workplace dynamics, and cultural norms surrounding money and finance.

The significant impact of the ability to generate income on an individual's financial well-being should not be underestimated. Participation in adequately paid work makes it easier to cover expenses, acquire assets and accumulate emergency savings. It is also associated with a greater sense of personal satisfaction, choice, and control over their financial situations.

It is well-documented that women, on average, earn less than men for the same work. Several factors, including gender stereotypes, lower wages for female-dominated industries, inflexible working conditions, time out of the workforce due to caring roles, and gender discrimination, contribute to this difference. Having lower incomes and experiencing barriers to workforce participation, such as childcare costs and availability, significantly impact women's current and future financial circumstances.

Another issue is that gender stereotyping regarding work and pay can start surprisingly early. In the home, boys are paid more pocket money while girls are expected to do more inside chores without pay. Research also shows parents starting money conversations with boys at a younger age is important because more frequent parent-child discussions correlate to more favourable financial attitudes. Moreover, men are more likely to be the primary decision-makers on saving, investing, and borrowing. Watching their fathers take a more dominant role in financial decisions, and mothers take a lesser role reinforces and perpetuates gendered roles in households and has consequences for girls as they mature and enter romantic partnerships.

Another distinctly inherent female trait is to avoid risk-taking. For financial decisions, this means that women may not participate in share investing and benefit from potentially higher returns. Taking calculated financial risks increases the probability of achieving greater wealth, but people perceive the risk differently. Risk perceptions may be linked to a person's status and control over their circumstances. Emerging research shows that people with high incomes, high levels of education, and high levels of trust in authorities have the lowest perceptions of risk, and these people are more likely to be white males. Accordingly, reducing women's discomfort with taking financial risks is an important undertaking, and good solutions are likely found in socialising stock investing with other women and female mentors.

Finally, critiques of the financial knowledge questions outlined above include issues like reliance on self-assessment, potential for random guessing, and misunderstanding due to question framing. Research indicates that gender differences in decision-making under uncertainty exist, and as such, multiple-choice questions favour men. The questions also include numerical components, as numeracy skills are essential for financial decision-making.

However, studies show women have higher math anxiety, leading to more skipped questions or choosing the non-response 'Do not know' answer options. Therefore, the question framing may be disadvantageous for women, and unfortunately, the findings perpetuate the stereotyping that women lack financial knowledge. However, it also highlights that women lack confidence in answering these questions and need further support. Whether that is in deconstructing the question, understanding the context, or disentangling the knowledge from mathematics is yet to be well understood. Researchers have raised concerns that the reliance on mathematics for teaching financial concepts in school may disengage many girls.

**Bridging the gap: Strategies for improvement**

Closing the gender gap in financial literacy requires a concerted effort.

Firstly, there is a need to improve current approaches to building financial knowledge at school. The gold standard would be to mandate a standalone personal finance course in high school, as now occurs in 25 American states. In the absence of a standalone course, a change in approach to the delivery of financial literacy within mathematics would be effective. The exclusive focus on formulae to derive a correct answer does not represent real-world problem-solving. Using stories to help deliver content and assessment that elaborates context would help girls seek the support needed to complete the task and build confidence.

Secondly, experienced investors can share their knowledge and expertise by taking up or creating mentorship opportunities, which may include facilitating discussions at schools, workplaces or with community groups. Fostering peer learning and support networks where women can share experiences, knowledge and best practices related to personal finance and investing is beneficial. Initiatives that target women in under-served communities are also vital to addressing the gap and the intergenerational transmission of low financial literacy.

Third, workplaces can extend their existing employee assistance programs to include financial well-being objectives and provide members with financial education resources, seminars, and access to financial advisors. Furthermore, workplaces can promote equal pay and career advancement opportunities for women.

Finally, raising mothers' financial literacy and economic empowerment will significantly benefit daughters. Achieving this requires a collective effort to remove structural barriers and shift social norms and stereotypes.

*Dr Tracey West manages Talk Money, a school financial education program. Talk Money is funded by Ecstra Foundation, an independent charitable foundation committed to building the financial well-being of Australians within a fair financial system.*

**The five financial literacy questions**

1. Suppose you had $100 in a savings account, and the interest rate was 2% per year. After 5 years, how much do you think you would have in the account if you left the money to grow?

More than $102 | Exactly $102 | Less than $102 | Do not know | Refuse to answer

2. Imagine that the interest rate on your savings account was 1% per year and inflation was 2% per year. After 1 year, how much would you be able to buy with the money in this account?

More than today | Exactly the same | Less than today | Do not know | Refuse to answer

3. Please tell me whether this statement is true or false. "Buying a single company's stock usually provides a safer return than a stock mutual fund".

True | False | Do not know | Refuse to answer

4. If interest rates rise, what will typically happen to bond prices?

They will rise | They will fall | They will stay the same | There is no relationship between bond prices and the interest rate | Don't know | Prefer not to say

5. A 15-year mortgage typically requires higher monthly payments than a 30-year mortgage, but the total interest paid over the life of the loan will be less.

True | False | Don't know | Prefer not to say

*Notes: These questions were included in Lusardi, A. and Mitchell, O.S. (2011) Financial literacy around the world: an overview, Journal of Pension Economics & Finance, 10(4), 497-508; correct response below.*

1.More than $102
2.Less than today
3.False
4.They will fall
5.True

## Retirement planning is about more than just money

### Professor Joanne Earl

Most of you reading *Firstlinks* already understand the need to plan and the value of advice. It's not always the same in the general community. Some people will say "advice is too expensive, I can get most of what I need online", while others believe "there's no use planning, you never know what's ahead".

Nine months ago, I came to understand the latter personally as my husband of five years was diagnosed with bowel cancer, which has since spread to his liver. He has just turned 61.

It has made me appreciate the value of advice and getting our finances in order well in advance of retirement. We had income protection, knew exactly where our super was, and how to access funds when we needed – I made the call to my financial adviser as soon as I got my head around my husband's diagnosis and treatment plan. We are living proof that planning helps and advice matters.

My own research has been tracking the benefits of retirement planning over the past 17 years with a special emphasis on holistic models over the past 12 years. After the results came back from our latest project, I am more convinced than ever of the importance of planning that goes beyond just the financial aspects of retirement.

In this study, we developed three online modules (career, health, and finance) combined with individual consultations that aimed to help older workers to make more considered decisions about retirement.

**Background to the study**

As people approach retirement, money matters. But there are broader considerations, including when and how they want to leave work, do they want to leave the workforce permanently or do they want to continue to work part-time? If they plan never to retire, will their health help them to go the distance? These are not questions that a financial advisor can necessarily answer for any individual but having clients consider them ahead of time can help to crystallise thinking about what the best options are.

So, the key questions in the study focused on whether a holistic model that includes career, health, and finance could work better than finance alone? Can an online intervention help shift some of those retirement planning behaviours? Or is advice needed in addition to the online tools to really make a difference?

The study monitored several different metrics such as retirement planning behaviours, workplace exit perceptions, financial decision making, and goal setting.

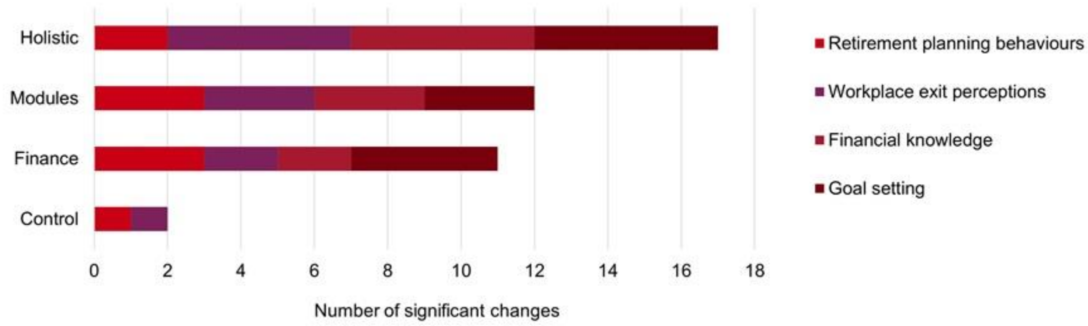
| Groups | Tasks completed by each group | | | | | | |
|---|---|---|---|---|---|---|---|
| | Modules | | | Consultations | | | Surveys |
| | Career | Health | Finance | Career | Health check-up | Finance | Pre/Post |
| 1. Modules | ✓ | ✓ | ✓ | ✗ | ✗ | ✗ | ✓ |
| 2. Holistic | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| 3. Finance | ✗ | ✗ | ✓ | ✗ | ✗ | ✓ | ✓ |
| 4. Control | ✗ | ✗ | ✗ | ✗ | ✗ | ✗ | ✓ |

Study duration 6 weeks


The study compared four different groups of people: one group acted as a control and there were three experimental groups: online modules, online modules plus advice; finance only. The control simply completed before and after measures to see whether or not any of their behaviours had shifted over the passage of time. The online group completed three one-hour modules over a 3-week period: one on careers, one on health and the other on finances – this is referred to as the holistic group. The holistic plus advice group also completed the online modules but they attended advice sessions soon after completing the online modules too. The third experimental group completed the online finance module followed by seeing a registered financial adviser.

**The results**

All three interventions made a difference on some of the metrics compared to the control group. In terms of improvements to the metrics that were monitored, the greatest number of changes were seen in the holistic + advice group, then the online modules followed by financial advice group. Whilst all three experimental groups showed improvements in some of the metrics including financial literacy and estimates of net income, as well as striving to meet career and financial goals, it was the holistic group combining online training with advice that was most different to the control group. Differences were found on financial self-efficacy, estimated retirement spending, health goals, retirement age confidence and preparation for exit.




Put simply, older workers who completed the retirement planning course reduced their expected retirement age by an average of just over a year, felt more confident in making financial decisions and felt better prepared to leave the workforce.

The implications of the research are clear: as more Australians investigate retirement, there is an opportunity to expand advice models to include careers and health considerations alongside financial ones.

Questions remain about who is best placed to provide this advice. Should future advice models look to expand the expertise of financial advisers, or should we be aiming to develop multidisciplinary teams that include health and career practitioners? We will leave you to ponder that old chestnut.

*Joanne Earl is a Professor of Psychology at Macquarie University.*

*Professor Earl and colleagues' academic study can be accessed here. An 8-minute video on the study details is also available.*

*The online modules mentioned are now being offered publicly at a small cost and all the funds go back into research to keep the modules updated over the coming year.*

## Will the Year of the Dragon be good for markets?

### Eric Souders

The Year of the Dragon holds particular significance in Chinese culture. As the only mythical creature in the Chinese zodiac, it symbolises light, authority, and prosperity, promising good fortune.

While revered in China, Western folklore often associate dragons with darkness and destruction. The contrast between these interpretations underscores the uncertainty surrounding the year ahead and its potential implications for financial markets.

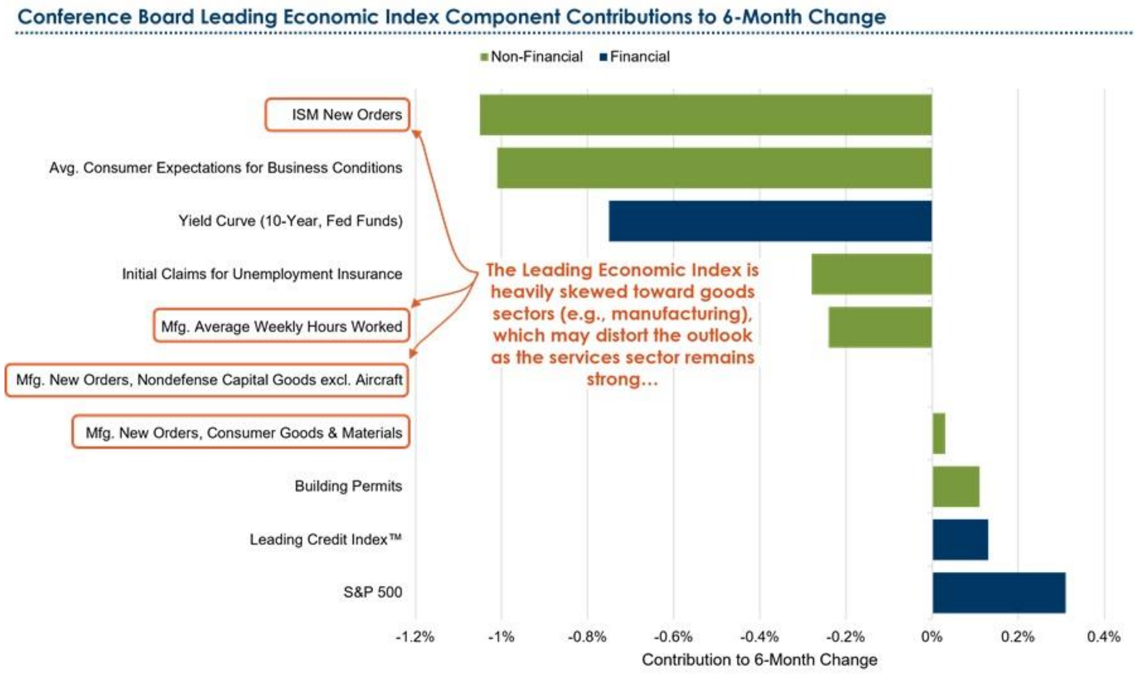
**Western dragon**

In financial market terms, the Western dragon symbolises a recession, casting darkness over the labour market and corporate profits, and wreaking havoc on valuations in risk assets such as equities and high-yield corporate bonds. Since the beginning of 2022, market consensus has repeatedly anticipated the emergence of the Western dragon from its hiding place. Poor leading economic indicators, contraction in bank lending, and elevated interest rates: something must surely break. Let's examine these factors individually.

**Poor leading economic indicators**

The Leading Economic Indicator (LEI) index is comprised of various inputs that typically precede changes in overall economic activity, including economic measures like employment and business activity. Since 1990, the LEI has turned negative on average 12 months prior to a recession. However, lead time varied to as short as six months (2020 recession) and as long as 19 months (2007 recession). Despite the LEI in negative territory for the past 20 months, a recession has not materialized. Why?

**Figure 1:** The leading economic index is heavily dependent on the manufacturing cycle




*Source: Conference Board, Payden Calculations*

The composition of the LEI index changes over time, with modifications to both inputs and weights based on past experiences involving the economic landscape. This makes sense as models should be adjusted to conform to changing environments. For example, the aggregated economic output (gross domestic product) in the US today is comprised of 80% services and only 9% manufacturing, a material change from nearly 30% of output deriving from manufacturing 40 years ago. In contrast, the LEI index currently includes ten measures in total, with four of those measures related to manufacturing. This discrepancy skews the LEI towards manufacturing, diverging from the actual composition of economic output.

**Elevated real rates**

Global interest rates have been rising for nearly four years, most notably in developed markets, at a pace unseen since the 1970s.

The natural response to such a rate hike is concern that it may be too restrictive and unsustainable, leading to an eventual breakdown. Undoubtedly, a few things have broken along the way: the cryptocurrency market in 2022, the regional banking episode in 2023, and the broader office sector within commercial real estate. This raises the question: Are interest rates too restrictive? The answer likely depends on your timeframe.

Using 10-year real rates in the US as an example, from 1990 to 2002, they averaged 3.8%. From 2002 to 2023, the average dropped to 0.9%. Since the beginning of 2023, they have averaged 1.7%, with current rates at 2.02%. Are these rates restrictive? When put in the context of the 2000s and 2010s, the answer is yes. However, in the context of longer- term history, the answer is no.

**Eastern dragon**

While the Western dragon has made several attempts to emerge from hiding, the Eastern dragon has been occupying the skies for multiple quarters, largely shining light and prosperity on financial markets. Global growth has remained robust, particularly in the US, as the Eastern dragon has been fuelled by a combination of fiscal stimulus, abating inflation, and a more balanced posture from global central banks. However, as the benefits from these factors diminish, the Eastern dragon must seek new sources of strength to continue its ascent in 2024. Let’s examine these sources.

**Strong labour market**

The global labour market has enjoyed robust health for several years, fuelled by the reopening of economies and the corresponding demand surge post-Covid. However, signs of labour divergence are emerging, particularly in developed markets.

When assessing the labour market wages should also be considered. Nominal wage growth remains elevated in most developed countries, with real wages rising as inflation declines. The result is more money in the pockets of consumers, providing a tailwind for consumption. This trend is particularly noteworthy in the US, where fiscal stimulus has been substantial and household leverage lower compared to other developed countries.

With all that said, the Eastern dragon should remain vigilant. Preliminary signs of labour market softening include a downward trend in overtime hours and a shorter aggregate workweek over the last few years.

**Financial conditions**

How should the Eastern dragon interpret current financial conditions? First, recent readings of real-time measures like the Goldman Sachs (GS) Financial Conditions Index remain below 30-year averages, indicating an environment favouring easing over restriction. Second, November and December 2023 witnessed the largest two-month easing in the GS Financial Conditions Index for several decades. Third, global monetary policy has shifted from a hawkish and hiking stance to one of leniency and easing (see chart below). This shift in policy should help mitigate disruptions in financial conditions associated with growth concerns or turbulence in the financial system's workings. Finally, while varied in magnitude, global fiscal policies continue to be accommodative, especially in developed countries where austerity measures are deemed undesirable.

**Figure 2:** The global monetary tide shifts from policy tightening to easing


*Source: Bank for International Settlements, Bloomberg*

**Implications for markets**

The synergy of a robust labour market and a collective easing of financial conditions is poised to keep the Eastern dragon airborne for the first part of 2024, but we suspect a strong interconnection between the two dragons. The Eastern dragon's growing strength heightens the chances of the Western dragon stirring from its slumber, as a stronger for longer market, coupled with favourable financial conditions and rising asset prices, increases the probability of economic growth, and by extension, inflation. This may curb expectations of continued loose monetary policy, leading to higher interest rates, diminished asset values, and tighter financial conditions. The resulting negative wealth effect could dampen consumption, weaken the labour market, and ultimately trigger a recession, awakening the Western dragon.

The current environment differs from the last 20 years given elevated yields in liquid public markets and an inverted yield curve. Credit spreads in most sectors are deemed fair at best and expensive at worst. Hence, investors may capitalise on market conditions by shortening maturity profiles, upgrading credit quality and transitioning from less liquid private markets to more liquid public markets.

**Figure 3:** Correlation Between Rates and Risk Assets: Inflation Matters

**Correlations Across Inflation Regimes**

| Inflation Regime | S&P 500 vs US Treasuries | US HY Corp vs US Treasuries |
|---|---|---|
| <0% | -0.67 | -0.60 |
| 0-2% | -0.32 | -0.18 |
| 2-4% | 0.14 | 0.21 |
| 4-6% | 0.25 | 0.41 |
| 6+% | 0.25 | 0.84 |

**Correlations Across Decades**

| Decade | Average CPI | S&P 500 vs US Treasuries | US HY Corp vs US Treasuries |
|---|---|---|---|
| 2020s | 4.6 | 0.58 | 0.63 |
| 2010s | 1.8 | -0.45 | -0.11 |
| 2000s | 2.6 | -0.23 | -0.15 |
| 1990s | 3.0 | 0.35 | 0.23 |
| 1980s | 5.6 | 0.23 | 0.76 |
| 1970s | 7.8 | 0.41 | |

*Data Sources: S&P 500 Index, Ice BAML US Treasury 7-10yr Index, Ice BAML US HY Corp 100 Index, BLS US Core CPI (YoY), Bloomberg
**Correlations utilizing monthly total returns, start month 12/31/1975 for S&P 500 and US Treasuries, and 1/31/1980 for HY Corp

*Source: Payden & Rygel, Bloomberg*

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