Australian shares long-term star performer but active diversification the key ahead

Investors must respond to dramatically different market dynamics to achieve long-term investing success in next 10-20 years

SYDNEY, 24 July 2013 – Australian shares have outperformed other asset classes over the past 10 and 20 years, according to the latest Russell Investments/ASX Long-Term Investing Report, but Russell warns investors need to be truly diversified and take a more active approach to deal with an increasingly changing market environment for the next 10-20 years.

The 15th edition of the annual report, commissioned by the Australian Securities Exchange (ASX) and prepared by Russell Investments, found the two key themes dominating investment returns for the past 10 and 20 year periods were falling bond yields in Australia and globally, as well as strong domestic economic growth driven by the resources sector – two major factors that look to change going forward.

“This report offers investors some practical guidance on the performance of different asset classes and in particular the benefits of ASX-listed investments over the longer term,’’ said ASX Business Development Manager Jonathan Morgan.

The report demonstrates the benefits to be gained from diversifying across multiple assets. Comparing the results for the 10 year period in this year’s update to last year’s report, the ranking of asset classes has changed significantly. Last year’s winner – hedged global bonds slipped to third place this year with a return of 7.9% p.a. while last year’s runner-up – Australian residential property slipped to fifth place at 6.5% p.a.

Instead, Australian shares and hedged global shares took first and second prizes this year at 8.9% and 8.2% respectively, thanks to the very strong risk rally in 2012. In contrast, cash remained unchanged at 3.8% p.a. while unhedged global shares was back in the black at 1.4% p.a., but still suffering from the very strong appreciation in the Australian dollar over the last 10 years to 31 December 2012. All these returns were against an inflation rate of 2.8% p.a.

The report also considers the impact of tax, costs and borrowing on ultimate investment returns. The aim is to provide investors with insight into how different investments have performed over the medium to long-term, after-tax and expenses. The difference in after-tax returns between types of investors in the same asset class highlights opportunities to choose the right investment structure. For example, the value of investing in Australian equities via a superannuation vehicle rather than directly was an additional 2.4% in returns to high marginal tax rate investors over 10 years.

Triple treat investment returns a rarity

Over the past 10 years investors exposed to a number of Australian assets enjoyed a ‘triple treat’ of investment returns. This came from Australian shares, Australian currency and Australian residential investment property.

Scott Fletcher, Director Client Investment Strategies, Asia Pacific, at Russell Investments said “Australia has experienced less extreme market fluctuations during and recovering from the global financial crisis – compared to those in the Northern Hemisphere – as the strong resource sector activity offset weaker domestic growth,” he said.

The Australian dollar has doubled in the last 10 years starting from around US$0.50 off the back of phenomenal commodity prices.

Australians’ love affair with bricks and mortar, supported by relatively low unemployment, solid growth in disposable incomes and falling borrowing costs, has also seen housing prices increase persistently over most of the past two decades.

Forward looking glasses: the next 10-20 years

Going forward, Mr Fletcher said investors needed to substantially adjust their expectations and revisit the traditional approach to investment and asset class diversification going forward. In a supplement to the report, Russell explored how likely the historical returns would be repeated over the next 10-20 years.

“There are a number of aspects investors need to consider with forward looking glasses, rather than looking in the rear view mirror,” Mr Fletcher said. The conditions that produced the ‘triple treat’ returns from domestic shares, currency movements and residential property were unlikely to be sustained.

“The two speed domestic economy driven by mining activities has slowed to a single pedestrian-speed growth outlook and this will impact returns from multiple domestic assets in the future.” Mr Fletcher said.

“Although the AUD has fallen more than 12% in Q2 2013, it is still overvalued relative to history. Looking to the next 10-20 years it is unlikely that the currency will appreciate much further, and boost hedged returns by the same amount as in the past.

Another trend that is very unlikely to continue is the multi-decade trend of falling government bond yields. While these have contributed to very strong performance in domestic and global bond markets for the last 20 years, especially providing investors with safe havens in volatile times, more realistic expectations for bond market returns for the next 10-20 years are in order.

With yields off historical lows and returns harder to come by, Russell Chief Executive Asia Pacific, Alan Schoenheimer, said that investors who have been heavily reliant on bonds in the past really need to move to other sources of returns outside traditional government bonds to generate sufficient returns going forward. ”We know these investors need exposure to growth assets, but may not be able to stomach the volatility from equity markets. This is why an active strategy that relies on truly diversified sources of returns from a range of assets makes sense.”

“In addition, innovative bond strategies that move away from conventional developed market exposures to include emerging market bonds and other strategies (such as currency, credit and long/short) that are less sensitive to interest rates will help,” he said.

“Russell is seeing a new breed of investment solutions being developed to meet the needs of these investors. Actively managed, multi-asset approaches are one way to long-term investing for the changing landscape.” Mr Schoenheimer concluded.

A copy of the historical report and supplementary commentary is available from the russell website link here. Please contact Honner Media if you would like any more information.

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