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Private Asset Management Ltd

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THE CREDIT SUISSE GLOBAL INVESTMENT RETURNS YEARBOOK (GIRY) Part 1

In late February the 24th edition of the GIRY was published by the Credit Suisse Research Institute in collaboration with London Business School. The GIRY is acknowledged as the global authority on long run investment returns and foreign exchange performance. It has been published each year since 2000 thanks to the sterling efforts and dedication of British university professors Elroy Dimson, Paul Marsh and Mike Staunton (DMS). The yearbook covers all the main asset categories (cash, bonds, equities and currency) for 35 countries making up 98.7% of today's investable universe and 95% of the global equity market back in 1900. The core of the Yearbook is long term investment return data, including dividends, from 1900 – 2022. Most countries have a full 123 year history and the data is presented in both nominal and real terms.

One of the key attractions of the GIRY to investors, market historians and financial journalists around the world is that it aims not just to document the past, but also to interpret it, analyze it and help investors learn from it. The professors elaborate: "As William Wordsworth put it, "Let us learn from the past to profit by the present." Or, if you prefer Machiavelli to an English romantic poet, "Whoever wishes to foresee the future must consult the past." Or, switching continents, Theodore Roosevelt said, "The more you know about the past, the better prepared you are for the future."

In the summary of the latest study the authors highlight the fact that many investors evidence the performance of the US stock market as being indicative of the historic returns of the "share market" but the US sharemarket is an outlier in performance terms. "Many investors and analysts have relied solely on the financial market history of the USA to provide the basis of return projections and the expectation of what is "normal". However the GIRY's extensive database shows the USA to be the exception, not the rule, as far as historic returns are concerned. The US market has been one of the best-performing stock markets and therefore extrapolating its performance overstates the returns of a diversified global equity portfolio: since 1900 US stocks have returned, in US$ terms and after inflation, 6.4% pa versus 4.3% pa for the world excluding the USA.

The difference between US equities and the rest of the world is only 2.1% pa which doesn't sound like much however, when compounded over 123 years, it translates to a huge difference in terminal wealth. "A dollar invested in US equities in 1900 resulted in a terminal value of USD 2,024 in terms of real purchasing power. The same investment in stocks from the rest of the world gave a terminal value of USD 176, less than a tenth of the US value".

Reflecting its superior returns the US equity market's importance in the world has risen from zero when it first commenced in New York in 1792 to 58% today. The Yearbook elaborates "This reflects the superior performance of the US economy, the large volume of IPOs, and the substantial returns from US stocks. No other market can rival this long-term accomplishment. But this makes it dangerous to generalize from US asset returns since they exhibit success bias. This is why the Yearbook focuses on global returns."

Each year the Yearbook ranks the long-term performance of the markets it covers in real terms and in a common currency (US$). First equal place for best-performing stock market, 1900-2022, goes to the US and Australia with a 6.4% pa return. Although if you go to two significant figures Australia just edges out the US at 6.43% versus 6.38%. NZ takes fifth place with 5.7% pa, after Denmark at 6% pa and South Africa at 5.9% pa, and that is despite the fact that the NZ dollar has fallen by an average of 1.0% pa against the USD. Over that long history, NZ's best-ever year for shares was 1933 when the stock market soared by 138% and the worst year was 2008 when stocks fell by 49.7%

Richard Kersley of Credit Suisse, in the Executive Summary, writes "amid the wealth of historical data and analysis the Yearbook provides, we would particularly highlight three aspects in this edition for their topicality". The long run history of returns demonstrates that shares have outperformed bonds which in turn have outperformed short term deposits in every country since 1900, reflecting the basic principles of risk and return. However in the 40 years starting in the 1980s, because of the sustained decline in interest rates, bonds produced returns almost as good as shares so it was tempting to ignore the fact that bonds had duration risk i.e. if interest rates rose the longer the bond the larger it's fall in price. "However in 2022, with its inflation shock, real bond returns were the worst on record for many countries, including the US, UK, Switzerland and for developed markets overall." These losses were mainly due to duration risk which refers to the fact that if you buy a long-dated bond, say for 10 years, when interest rates are low you are locked into that interest rate for 10 years. If interest rates then go up the price of the bond will fall so that it's yield rises to the prevailing yield of the market. One of the most extreme examples of duration risk is the 100 year bond issued by the Austrian government back in 2017. A further €2bn tranche of these bonds was issued in 2020 at a yield of .88% when interest rates were very low. With the rise in interest rates the price of this bond has fallen sharply delivering a loss of more than 50% to institutions who bought at that time.

Secondly, Chapter 4 of the GIRY documents the periods of stress over time for bonds and equities and shows that whilst owning a portfolio made up of bonds and shares can mitigate downside risks the strategy doesn't always work so well in the short term. "The recent fortunes of 60/40 equity/bond strategies are a painful example of this, having trusted too heavily in the recent negative correlations between the two assets rather than properly consulting the history books. Most finance professionals are too young to remember high inflation, bond bear markets and years when stocks and bonds declined sharply together. The strength of the Yearbook is its long-term memory."

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The last issue highlighted by Mr Kersley is this year's special topic. The subject is, predictably, what history tells us about the impact of inflation on the returns from bonds and equities. The authors warn that "there is also troubling news for the growing consensus that conditions will return to normal with low inflation re-established." But that is enough "dark thoughts" for today – we will leave the professors' insights on this topic for the next instalment in two weeks time.

Brent Sheather is a Financial Advice Provider. A disclosure statement is available upon request. Brent Sheather may have an interest in the companies discussed.