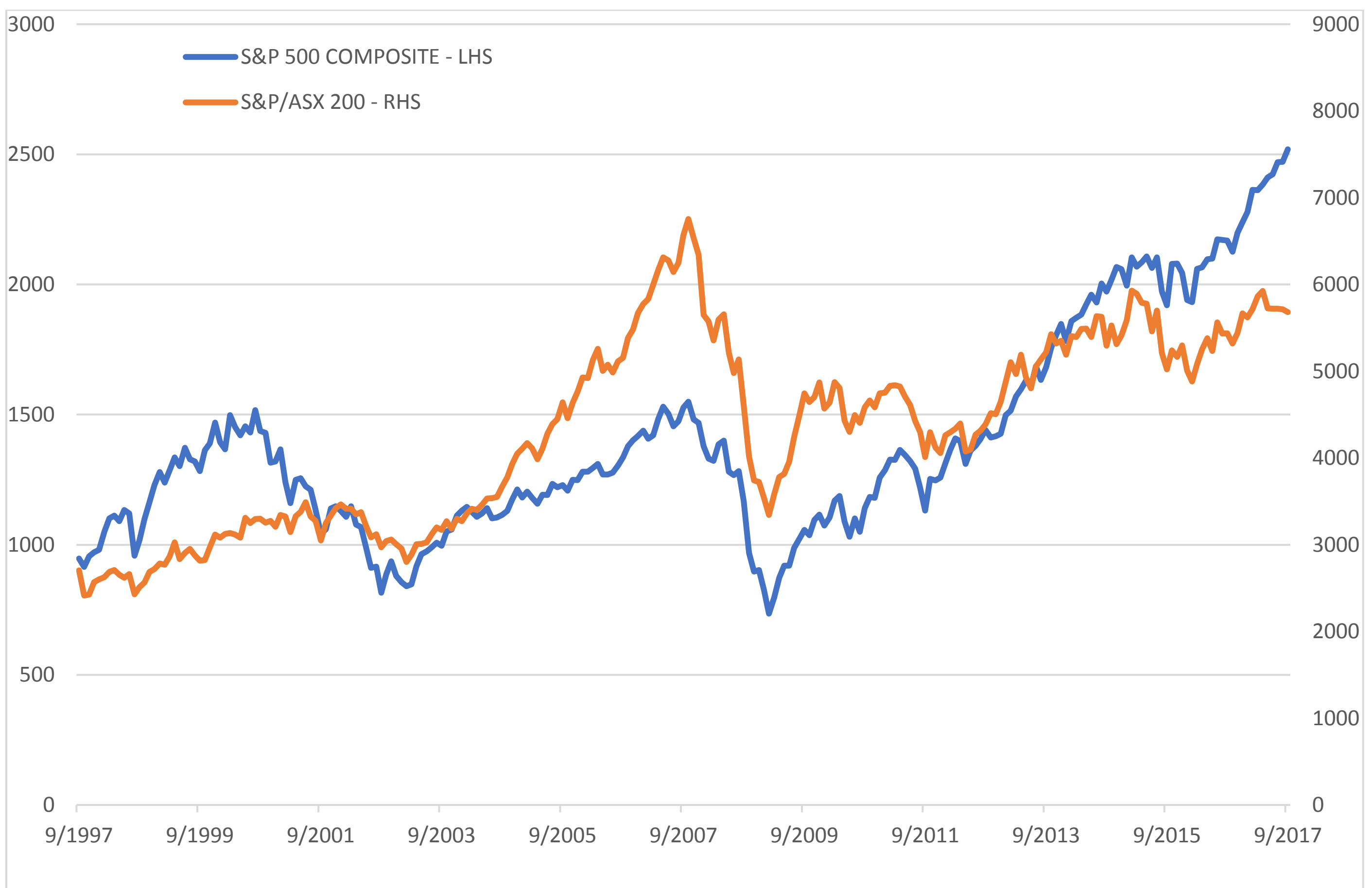
10 Years on from the GFC

It is roughly 10 years since the start of the Global Financial Crisis, and with US equity markets again setting new all-time highs over the last quarter, it is worth taking stock. The chart below shows the S&P500 (blue) and ASX 200 (orange) over the past 20 years. While US markets have clearly surpassed their previous peaks, Australia's ASX200 index still lags well below its all-time highs. There are a few reasons for this including:

- Australian stocks potentially benefiting less from central bank quantitative easing (QE) as the RBA has not chosen to go down the QE route;
- Sector differences – with the Australian market having much lower exposure to technology sectors (which have been the strongest performers post GFC) and higher exposure to banks (which have failed to regain pre-GFC peaks on the global basis); and
- Australian companies pay out higher dividends (that include franking credits) and so even if Australian and US stocks had the same returns, price growth would tend to be higher for US companies.



Source: Thompson Reuters, 2017

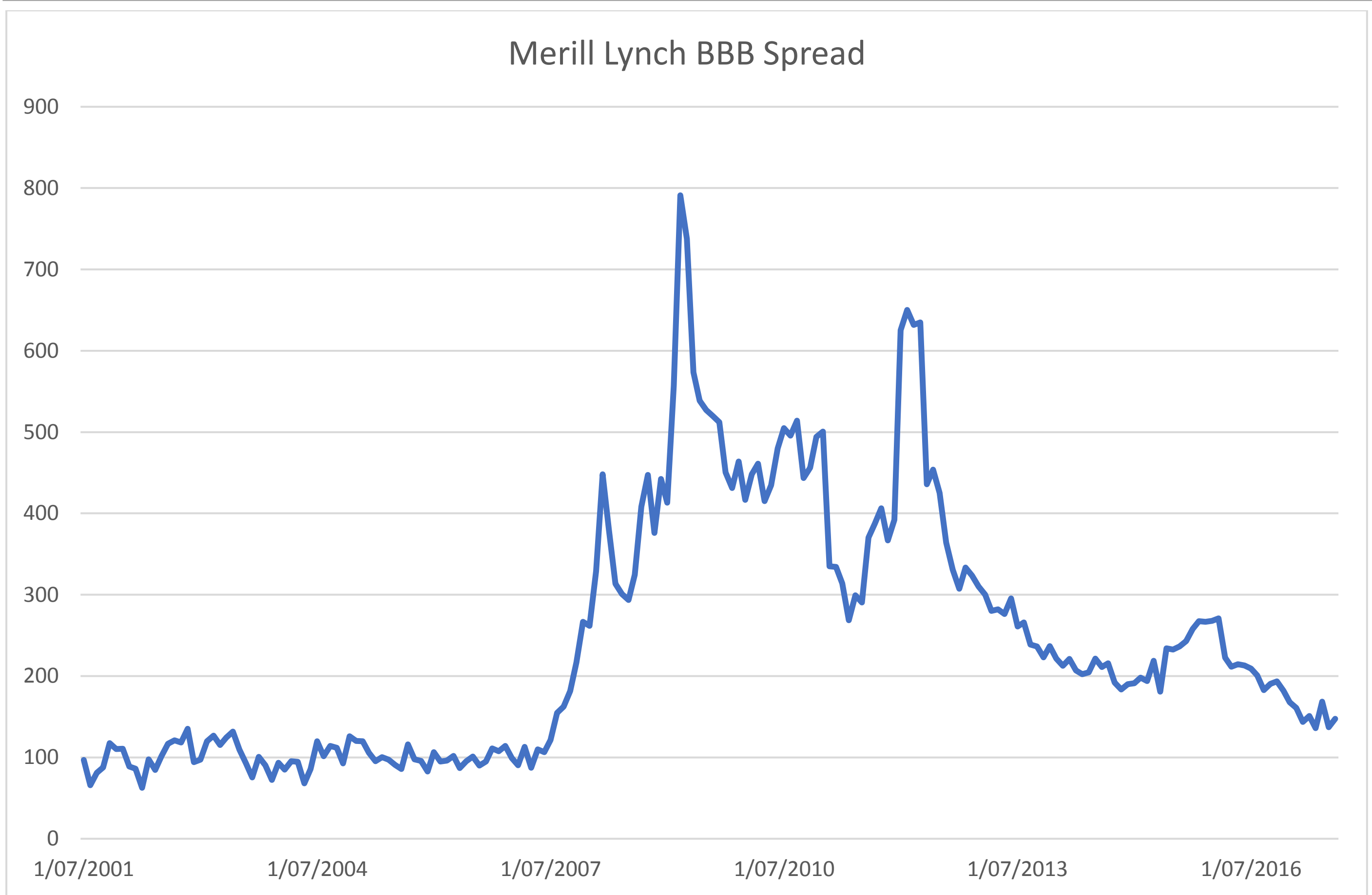
The following table summarises a range of valuation and return measures – both for the 10 years to 30/9/2007 and for the ten years to today.

		30/09/2007	30/09/2017
S&P 500	Index Level	1,526.8	2,519.4
	10 Year Return	6.5%	7.5%
	PE	17.5	22.9
ASX 200	Index Level	6,567.8	5,681.6
	10 Year Return	13.6%	3.1%
	PE	15.82	16.14
US 10 YEAR BOND RATE		4.6%	2.3%
AUSTRALIAN 10 YEAR BOND RATE		6.2%	2.8%
ML AUSTRALIAN BBB SPREAD		1.2%	1.5%
BLOOMBERG COMPOSITE BOND INDEX	10 Year Return	5.7%	6.1%
CPI	Annualised	2.9%	2.3%
SUPER RATINGS	10 Years to 30/6	8.47%	4.64%

The key points from the table are:

- US equity valuations (that is PEs) are quite high – with a significant portion of the strong performance by equities attributable to higher multiples (supported by low interest rates) rather than strong underlying economic or earnings growth.
- Interest rates have collapsed compared to 2007 levels, with both Australian and US bond rates at less than half of their pre-GFC levels.
- This collapse in bond rates has underpinned a continuation of the 30 year bull market for bonds. While equities might get the headlines – one of the shocking outcomes of the past 20 years is how close the performance of bonds has been to equities – with massively lower volatility (so far).

While credit spreads have tightened since the GFC, they remain wider than pre-GFC levels (see below for more detail). One of the outcomes of the changes in bank and financial markets regulations over the past decade is that the banking system is significantly less levered, liquidity is more expensive and a consequence of this is that credit margins are higher than in the pre-GFC period.



Source: Thompson Reuters, 2017

In conclusion – the recovery from the GFC has been reasonably unusual compared to other financial crises. A strong equity rebound is typical – but post the GFC this has been driven by lower interest rates, higher multiples rather than a particularly strong rebound in earnings. Credit spreads are a lot tighter than at the peak of GFC but are still well wide of pre-GFC tights. The biggest challenge for investors over the next 10 years will be investing in such a low interest rate/high valuation world. It is important to remember that much of the rebound has been a repricing/bring forward of future returns and, hence, achieving 3%+ post tax, fees and inflation that most Australian funds target is a real challenge.