



WHAT TO EXPECT FROM THE AUSTRALIAN PROPERTY MARKET IN 2025



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BY MICHAEL YARDNEY

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What's ahead for our housing markets in 2025?

Clearly residential real estate has defied the many doomsday forecasts made over the last few years, having moved through the bottom of its cyclical downturn in early 2023 and experiencing an overall strong recovery since.

However, national home prices fell by 0.17% over the month of December, according to the latest PropTrack Home Price Index, though they remain 4.73% higher than 12 months ago and are up 45.1% since the beginning of COVID-19 in March 2020.

BEFORE YOU GET STARTED

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PropTrack Home Price Index December 2024					
All dwellings	Monthly growth	Annual growth	Change from peak	Change since March 2020	Median value
Sydney	-0.29%	3.43%	-0.46%	37.5%	\$1,106,000
Melbourne	-0.53%	-2.49%	-5.54%	13.9%	\$780,000
Brisbane	-0.04%	11.35%	-0.04%	78.0%	\$863,000
Adelaide	-0.18%	13.53%	-0.18%	80.3%	\$793,000
Perth	0.39%	17.59%	At peak	80.3%	\$773,000
Hobart	0.03%	1.59%	-7.18%	37.3%	\$671,000
Darwin	-0.25%	-0.20%	-2.07%	26.5%	\$503,000
ACT	-0.61%	0.45%	-5.76%	35.4%	\$838,000
Capital Cities	-0.25%	4.59%	-0.35%	40.2%	\$865,000
Rest of NSW	-0.02%	3.52%	-0.02%	55.2%	\$734,000
Rest of Vic.	0.03%	-2.08%	-5.18%	38.6%	\$571,000
Rest of Qld	0.05%	10.52%	At peak	79.1%	\$705,000
Rest of SA	0.60%	13.03%	At peak	81.5%	\$467,000
Rest of WA	-0.19%	12.97%	-0.44%	75.8%	\$555,000
Rest of Tas.	0.10%	3.50%	At peak	57.8%	\$515,000
Rest of NT	-0.01%	0.84%	-4.39%	10.9%	\$408,000
Regional Areas	0.03%	5.12%	At peak	59.9%	\$653,000
National	-0.17%	4.73%	-0.17%	45.1%	\$795,000

Source: PropTrack

Moving forward, our housing markets will likely experience a year of two halves in 2025, with a slower first half and then a resurgence in both buyer and seller confidence and, therefore, activity when interest rates eventually fall - probably in the second half of this year.

The resilience of the market

Of course, property has always been a cornerstone of Australia's wealth, weathering economic turbulence with remarkable stability.

The total value of Australian residential real estate was estimated by CoreLogic to be \$11.1 trillion at the end of November 2024; however, outstanding mortgages against all residential housing are only \$2.3 trillion - resulting in a very comfortable 21% overall Loan to Value ratio.

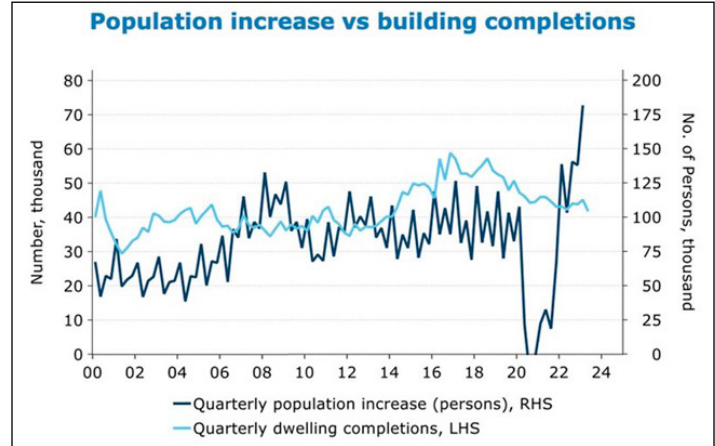
In fact, 56.3% of total Aussie household wealth is held in residential property - one of the many reasons neither the banks, the government nor the RBA wants a property crash.

As we head into 2025, our markets will remain challenged by persistent high interest rates, an affordability crisis, a cost-of-living crisis, a Federal election and ongoing geopolitical problems. But one thing that won't change any time soon is the chronic undersupply of housing, with the supply of new housing unable to keep up with demand from Australia's growing population which will continue to be fuelled by strong immigration.

And with the cost of new dwellings rising because of the ongoing challenges in construction, including labour shortages and rising material costs, this supply-demand imbalance is expected to keep upward pressure on property prices and rents in our capital city markets.

Economic and interest rate dynamics

With the Reserve Bank of Australia (RBA) tightening monetary policy since May 2022 in an effort to curb inflation, interest rates were constantly in the news in 2024. While rates have now stabilised, their higher levels compared to recent years will continue to negatively affect borrowing capacity and buyer behaviour in 2025.



Source: ANZ Bank

However, as inflation eases and the economy adjusts, the RBA is likely to start cutting interest rates in the second half of this year and I can see the market then moving to the next phase of the property cycle.

In general, when interest rates decline, the market tends to experience a surge in activity as borrowers can afford larger loans, buyers who were previously priced out of the market start to re-enter, and those who were sitting on the sidelines rush to buy before prices climb too high. This creates a snowball effect that can rapidly drive up property values.

Other forces that could influence the market include:

1. **Wage growth:** Rising wages will bolster borrowing capacity for many Australians, supporting demand in the property market.
2. **Employment stability:** Even though the unemployment rate may creep up a little, anyone who wants a job can get a job, and this security means it is likely that buyer confidence will stay strong.
3. **Consumer sentiment:** While sentiment remains cautious due to economic uncertainty, when our federal election is over and once interest rates start to fall, confidence will return, and Australians will again feel 'confident' in making big purchases like upgrading their homes.

Clearly, affordability has decreased, and property values have fallen a little in a number of our capital cities, but the housing markets are being underpinned by a number of factors:

- Wealthy buyers entering the market with higher deposits.
- Downsizers who had a lot of equity in their homes are buying debt free - in fact a third of properties last year were transacted with no mortgage at all.
- The bank of mum and dad and inheritances are helping many buyers with a deposit.
- Some buyers are buying in cheaper markets while others are buying units rather than houses.

- The property boom of 2020-21 left many homeowners with significant equity in their homes.

Migration and demographics

In the year ending 30 June 2024, overseas migration contributed a net gain of 446,000 people to Australia’s population. While this decreased from the record 536,000 people the previous year, this was a pivotal driver of rental markets as most immigrants rent for the first 3 to 5 years before putting down permanent roots. And while the government keeps talking about decreasing our migration levels, this influx of skilled migrants is not only revitalising our workforce but also fuelling demand for housing, particularly in urban centres like Sydney, Melbourne, and Brisbane, as these three cities are set to absorb the lion’s share of population growth, creating opportunities for investors targeting rental properties.

In addition to migration, demographic shifts within our domestic population will play a significant role. Younger generations, Millennials and Gen Z, are increasingly entering the housing market, either as first-home buyers or investors.

While there has been a lot of talk about the plight of first home buyers, there were a total of around 550,000 property transactions in 2024, and according to ABS finance figures, around 110,000 first home buyer transactions. In other words, around 20% of all property sales last year were to first home buyers, and it is likely that a number of investor transactions were also to first time buyers who chose to ‘rentvest’ - rent where they want to live but can’t afford to buy and then use their funds to invest where they can afford to buy.

What’s ahead for 2025?

The last few years have shown us how hard it is to forecast property trends, and as always, there will be headwinds and tailwinds buffeting our property markets.

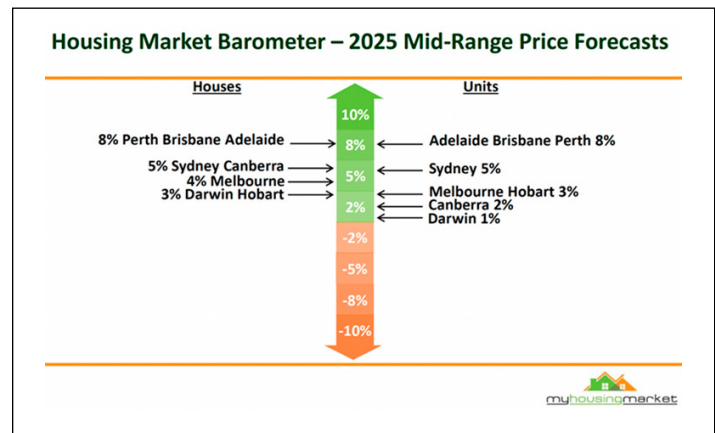
As I said, I see a year of two halves for our housing markets, which will remain fragmented with local economic factors, such as consumer sentiment, employment, and migration, predominantly driving the markets.

While the outlook is largely positive, the market will likely experience a number of hurdles:

1. **Affordability concerns:** Despite softening growth rates, housing affordability will remain a critical issue, not only for home buyers but also for renters, with rents skyrocketing over the last few years as vacancy rates hit historically low levels.

2. **Construction bottlenecks:** While the government is encouraging the construction of 1.2 million new dwellings in the next 5 years, labour shortages and rising costs will continue to delay new housing projects, which will also be more expensive, exacerbating the supply-demand imbalance.
3. **Regulatory changes:** Ongoing debates about taxation policies, such as stamp duty reforms, and potential changes to negative gearing could influence market dynamics. As will any further interference to residential tenancy regulations by state governments, which have already scared off many investors.

Dr Andrew Wilson, chief economist of My Housing Market, has made the following forecasts for 2025.



Conclusion

The Australian property markets are poised for another year of resilience and opportunity in 2025. While challenges persist, and prices may continue to fall a little in the next few months, the market’s fundamentals - robust demand from a growing population at a time of limited supply, a strong jobs market and demographic shifts - provide a solid foundation for further price growth, albeit at a slightly slower rate than last year.

While it might feel counterintuitive to buy at a time when there are so many mixed messages in the media, home buyers and investors with a long-term focus will benefit from less competition, minimal downside risk and minimal risk of oversupply.

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An investor's guide to potential U.S. policy changes in 2025

BY PAUL EITELMAN

Reprinted from russellinvestments.com

EXECUTIVE SUMMARY

U.S. policies are set for a major reshaping as full Republican control takes hold in 2025. To navigate the investment opportunities and challenges ahead, we explore how key policy changes may impact economic growth, inflation, corporate earnings, and interest rates.

Ultimately, we believe the major initiatives investors should watch closely are in areas such as tariffs, immigration, taxes, and deregulation, as these policies take center stage and shape the economic landscape.

These policies are likely to be:

- Neutral for economic growth with tailwinds and headwinds

roughly offsetting









- Modestly inflationary (+0.3 percentage-point increase for the core personal consumption expenditures price index)
- Positive for corporate earnings (+4 ppt increase for S&P 500 Index earnings-per-share, or EPS, growth in 2026)

growth in 2026)

• Mixed for U.S. Federal Reserve (Fed) policy (we expect gradual 25-basis-point cuts into the second half of 2025 to a new normal policy rate of 3.25

• Likely to lead to higher longer-term interest rates, although much of this is already priced in

This is a live document that we will update as policies and priorities become clearer in the months ahead.

Key policies	Estimated fundamental impact
 <p>Tariffs raise tariffs against China and other trading partners drag growth (0.5ppt) and earnings (1ppt), boost prices (0.3ppt)</p>	 <p>Economic growth little impact on balance tariffs & immigration (-) offset by fiscal & deregulation (+)</p>
 <p>Immigration restrict immigration to 2017-2019 levels, mass deportations? potential growth slows from 2.5% to 2%, little impact on prices</p>	 <p>Inflation modest (0.3 ppt) one-time increase in core PCE inflation more in extreme scenarios for tariffs, fiscal, immigration</p>
 <p>Fiscal policy extend TCJA cuts past 2025, cut corporate tax boost earnings (5ppt), more government debt</p>	 <p>Earnings S&P 500 earnings expected to get a 4ppt boost in 2026 corporate tax cuts (+5ppt) outweigh tariff drags (-1ppt)</p>
 <p>Deregulation Focus on financials and energy sectors</p>	 <p>Interest rates little impact on Fed near-term, long rates up on fiscal risk mix across tariffs (dovish) and fiscal (hawkish) is key</p>

Source: Russell Investments expectations as of December 2, 2024

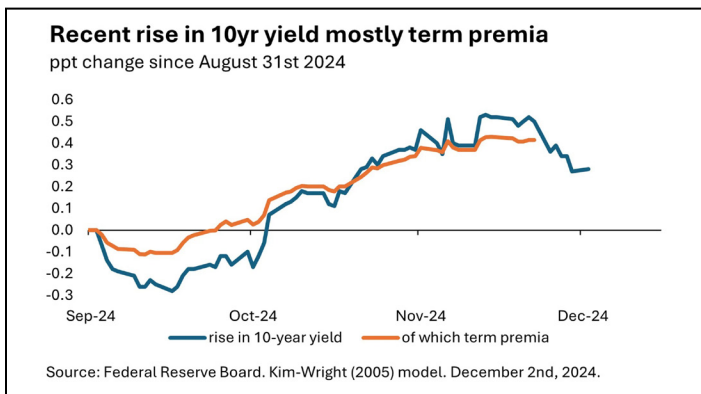
Trade policy

Key takeaways

- We assume actual tariff increases will be smaller than President-elect Donald Trump’s public statements.
- A 4-ppt increase in the effective tariff rate would likely:
 - Cause a one-time boost to core PCE inflation of roughly 0.3 ppt
 - Be a drag on real GDP growth of roughly 0.5%
 - Dent S&P 500 Index earnings growth by roughly 1 ppt
 - Not impact the Fed. If the economy slows materially the Fed would cut as it did in 2019

Tariffs: How much higher?

At times, President-elect Trump has proposed a 60% tariff rate on all imports from China and a 20% tariff rate on all other U.S. trading partners. Taken literally, these steps would lift the effective tariff rate in the United States by 15 ppt (orange dot)—a historically large increase that significantly exceeds the trade restrictions from his first term.



KEY WATCHPOINT: How aggressively President-elect Trump follows through on his tariff proposals into 2025 and beyond.

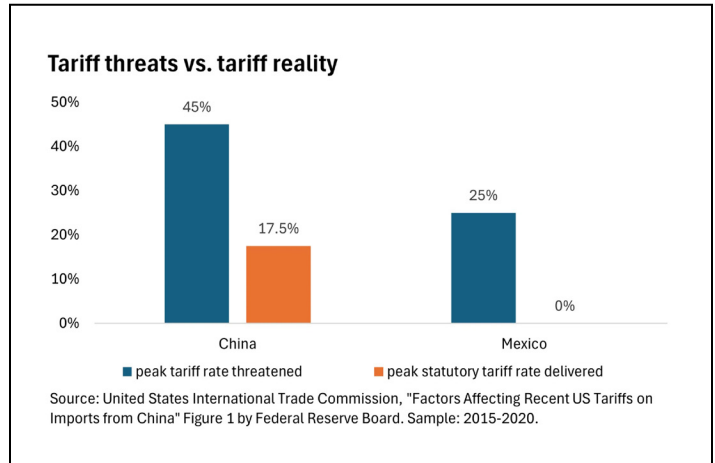
First, during Trump’s first term, the administration did not deliver the full extent of tariffs that were discussed on the campaign trail, suggesting that significant weight should be placed on the idea that tariff threats were used as a tool for negotiating trade deals, and U.S. trading partners were willing to seek deals to avoid damaging their economies.

Second, President-elect Trump championed the strength of the economy and stock market during his first term, and an aggressive trade war that risked both would conflict with some of his past priorities. As such, we expect a more measured strategy moving forward (green dot above).

Impact of tariffs on inflation

Tariffs can impact inflation through a range of channels including:

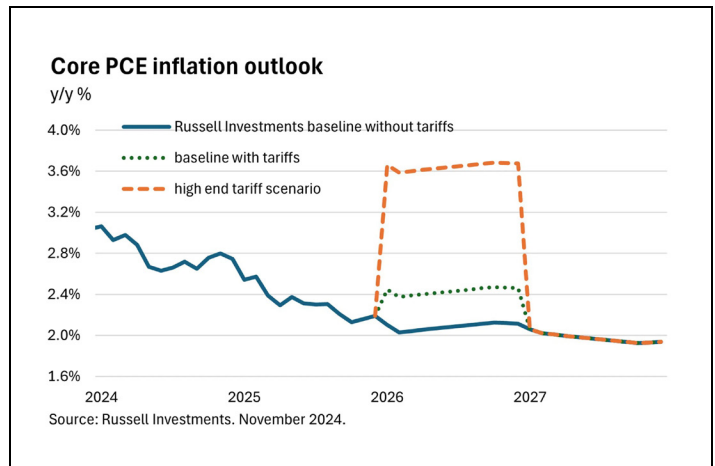
- The direct impact of higher import prices on core con-



sumer goods

- Decisions by unimpacted U.S. producers to opportunistically raise prices
- Higher production costs from tariffs on imported intermediate inputs to U.S. production
- With these factors partly offset by disinflation from weaker aggregate demand
- And disinflation from U.S. dollar (USD) strength¹

Bringing it all together, our baseline for trade policy lifts the year-ago core PCE inflation rate by roughly 0.3 ppt in 2026 (green vs. blue lines below).



Economic growth consequences of tariffs

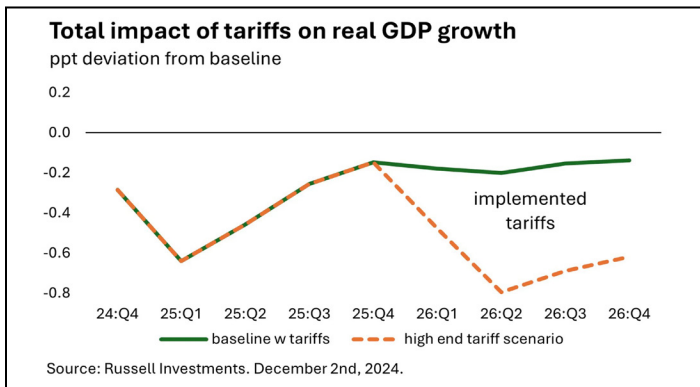
Nobel Prize-winning economist Paul Krugman famously noted “the dirty little secret of international trade economics is that moderate tariff rates don’t have huge growth effects.” This is especially relevant considering that the United States is a relatively closed economy with the import share of core personal consumption expenditures standing at only 10%.

- With that in mind, the direct and indirect effects of tariffs on economic activity can be broken down as follows: Higher import prices cause a reduction in real consumer

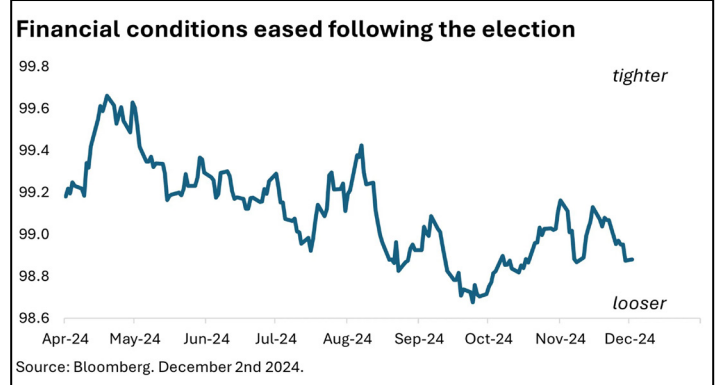
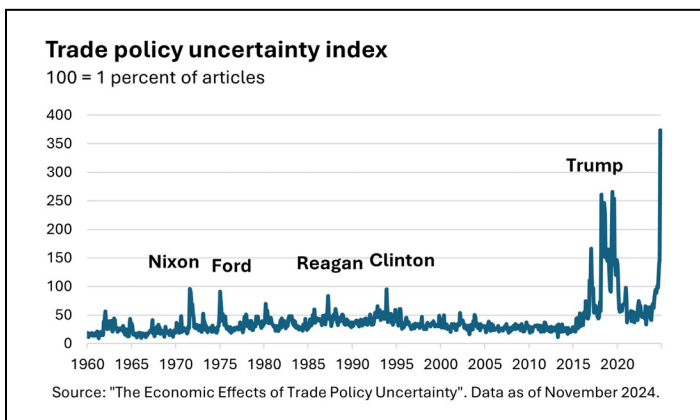
spending power (a negative for GDP)

- Higher import prices cause consumers to shift demand away from imports (a positive for GDP)
- Other countries retaliate—often 1:1—against U.S. tariffs, hurting U.S. exports (a negative for GDP)
- Higher trade policy uncertainty can dampen business confidence and capital expenditures (capex) as firms await clarity before committing to long-term investment decisions. Note: this can be a headwind for the economy even before tariffs are implemented
- Financial conditions could tighten via a stronger dollar or negative wealth effects

On balance, we estimate a modest drag of a half percentage point on real GDP growth in 2025 and 2026. Note: the high-end tariff scenario could be worse than what is shown in the chart if trade policy uncertainty increases well beyond what is currently observed in the data.



Below shows how we’re tracking trade policy uncertainty and financial conditions. Trade policy uncertainty jumped through the end of November on news of Trump’s victory. Meanwhile, financial conditions eased following the U.S. election with Fed cuts, higher equity prices, and tight credit spreads more than offsetting dollar strength. For now, the headwinds from record high trade policy uncertainty are likely to outweigh easier financial conditions for the near-term growth outlook.



How tariffs can affect earnings

Equity analysts² have estimated that every 5-ppt increase in the effective tariff rate could pose a headwind of 1 to 2 ppt to S&P 500 earnings growth. We estimate a 1-ppt hit to earnings from trade policy.

Impact on earnings	
S&P 500 Index	2026 EPS growth
IBES consensus (no tariffs)	13%
With baseline tariffs	12%
With high-end tariff threats	8%

Source: IBES Datastream, Russell Investments. December 2, 2024.

What the influence could be on Fed policy

Tariffs are a stagflationary impulse—generating both weaker growth and more inflation—and a complicated issue for central bankers. But given economists widely believe that tariffs only lead to a one-time (transitory) increase in the price level, Fed doctrine would be to focus on risks to growth and the business cycle. Put differently, tariffs are likely to create a dovish impact on policy rates.

Supporting this idea: during the last expansion, the Fed cut rates for the first time in July of 2019—with Chair Jerome Powell noting the cut was “intended to insure against downside risks from weak global growth and trade policy uncertainty.”

Watchpoints

- Concrete details on timing, magnitude, and countries facing tariffs from the U.S.
- Retaliatory actions from other countries, like China
- Trade policy uncertainty and financial conditions indices (plotted above)
- Currency markets (e.g. USD-Mexican peso) as a gauge for pricing of trade risks

Fiscal policy

Key takeaways

- TCJA (Tax Cut and Jobs Act) provisions for households are likely to be extended beyond the end of 2025.
- ...TCJA extensions have no impact on the economy as they are a continuation of current policy
- ...but would raise the CBO’s (Congress Budget Office) forecast of the debt/GDP ratio by 10 ppt in 2034.
- President-elect Trump has also talked about new tax cuts (e.g., social security, corporate, tips) and repealing the Inflation Reduction Act (IRA)
- It’s unclear which, of any, of these can pass Congress. Corporate tax cuts seem the most likely.
- Lowering the corporate rate from 21% to 15% would boost S&P 500 earnings by 5 ppt...
- ...with negligible positive effects for growth and inflation
- Term premia have risen notably on fiscal and other risks from the election results
- Our fixed income strategy team sees duration exposure attractive at 4.6-4.8% on the U.S. 10-year Treasury note

What new fiscal policies can we expect from a second Trump administration?

It’s widely expected that President-elect Trump and the Republicans will extend measures from the Tax Cut and Jobs Act that were set to expire at the end of 2025. Most of these provisions were for households, including cuts to marginal income tax rates.

PROVISION	CURRENT LAW	AFTER EXPIRATION
INCOME TAX RATES	7 brackets: 10%, 12%, 22%, 24%, 32%, 35% and 37%; several tax bracket income levels expanded in 2017	7 brackets: 10%, 15%, 25%, 28%, 33%, 35% and 39.6%; income brackets revert to lower 2017 levels (adjusted for inflation)
LONG-TERM CAPITAL GAINS AND QUALIFIED DIVIDENDS	0%, 15% and 20% Tax Rates	0%, 15%, and 20% Tax Rates
STANDARD DEDUCTION	\$14,800 for Single, \$29,200 for Married Filing Jointly (MFJ)	\$6,350 for Single, \$12,700 for MFJ (plus adjustment for inflation)
STATE AND LOCAL INCOME TAX DEDUCTION – REAL ESTATE, PERSONAL PROPERTY AND STATE INCOME TAX	\$10,000 Maximum Cap for taxpayers	Cap removed
MORTGAGE INTEREST DEDUCTION	Limited to \$750,000 of “acquisition” debt	Limited to \$1M of “acquisition” debt plus \$100k in home equity debt
CHILD TAX CREDIT	\$2000 per child, \$500 for other dependents; phaseout at \$200k/\$400k single/MFJ	\$1000 per child under 17, phaseout at \$75k/\$110k single/MFJ (plus adjustment for inflation)
ESTATE TAX	\$13.6M exemption; inflation indexed	\$5M (plus adjustment for inflation)

Source: Russell Investments, December 2024

Extending these TCJA provisions does nothing to economic growth or inflation. Households already benefit from them as current policy now. However, the moves would pressure the long-term fiscal trajectory of the United States. Most agencies—like the CBO—forecast deficits assuming policy evolves as legislated. If all TCJA provisions were instead extended, the deficit is projected to be \$7.4 trillion larger through 2034—adding roughly 10 ppt to the national debt as a share of GDP.

Beyond the TCJA, President-elect Trump has talked about using tariff revenue to pay for an expansionary fiscal program. His fiscal plan is likely to evolve but currently has three pillars:

- Ending taxation of social security benefits

- Repealing IRA energy incentives
- Cutting the corporate tax rate from 21% to 15% would provide an almost 1:1 boost to S&P 500 earnings growth.

Can these proposals pass through a Republican-controlled Congress?

- Changes to social security taxes are not allowed under the budget reconciliation process. That means the move would require 60 Senate votes (i.e. Democratic Party support) and is therefore extremely unlikely to pass.
- While Republicans might support selective changes to the IRA a full repeal seems unlikely.
- Lowering the corporate rate might be the easiest measure to pass procedurally and politically

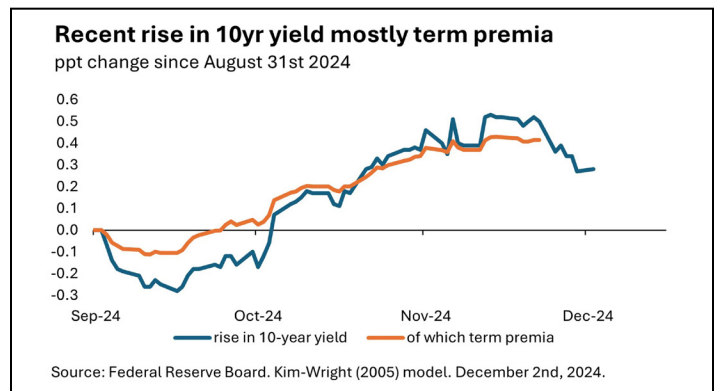
Cutting the corporate tax rate from 21% to 15% would provide an almost 1:1 boost to S&P 500 earnings growth.

Scenario	2026 EPS growth
IBES consensus (no tax cuts)	13%
Cut corporate rate from 21% to 15%	18%

Source: IBES Datastream, Russell Investments. December 2, 2024.

From an economic perspective, corporate tax cuts would have negligible, positive effects on growth and inflation.3 an expansionary fiscal policy would be hawkish for Fed policy particularly given the economy is already strong.

Longer-term interest rates increased notably in advance of the red wave outcome, with higher term premia driving most of the increase since early September.



Could bond yields and term premia rise even further if fiscal sustainability, inflation risks, or Fed independence are challenged in the years ahead? Term premia now range between 50 and 100 bps on 10-year Treasuries and are approaching their highest levels in the post-Global Financial Crisis (GFC) period. However, past periods of elevated inflation risk (the early 1980s) or challenges to Fed Independence (the early 1970s) saw investors demand even

higher risk premia for holding long bonds.

Into these risks, our fixed income strategy team judges duration exposure would look more attractive if the 10-year Treasury yield moved up to between 4.6%-4.8%.

Watchpoints:

- Tone from Republican leaders when debt ceiling reinstated on Jan. 2, 2025
- Details from President-elect Trump, Treasury Secretary, House and Senate majority leaders about fiscal plans

Immigration

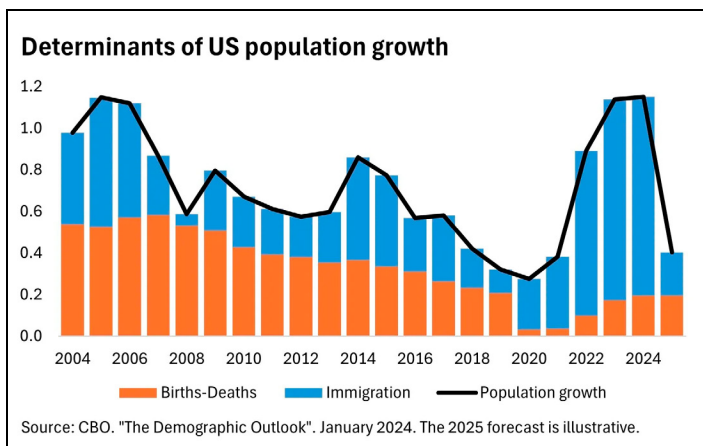
Key takeaways

- Immigration flows into the U.S. are already slowing and are likely to revert to levels from 2017-19
- Weaker demographics would slow potential economic growth from roughly 2.5% to 2%
- A hit from immigration onto potential growth was already in most economists' projections
- immigration curbs are unlikely to be inflationary with wage pressures offset by weaker demand

The immigration policy agenda

President-elect Trump is likely to take executive action to limit immigration flows. We expect the contribution from immigration to U.S. population growth to rapidly downshift to levels not seen since the first Trump administration.

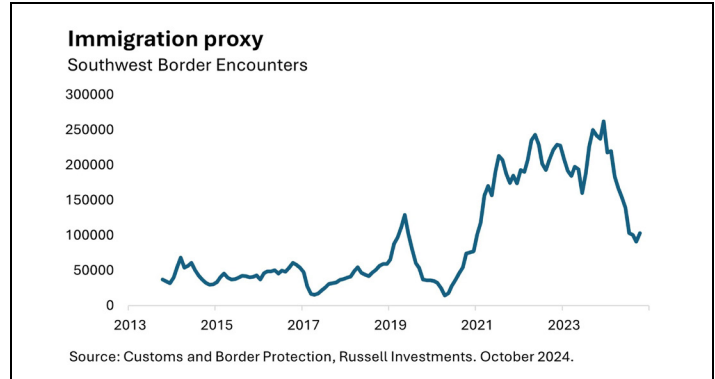
For context, during 2017-2019, immigration added 0.2% to U.S. population growth. But immigration has been 4-5 times stronger in recent years (blue bars). As immigration downshifts, the pace of potential (non-inflationary) economic growth is likely to slow from around 2.5% to 2%. Most economists already incorporated this change into their forecasts as both Democrats and Republicans proposed reforms on the campaign trail.



Less labor supply could pose upside risks to inflation. But two important points cut against this. First, the U.S. labor market is not overheated right now. Second, if aggregate

demand slows on the back of immigration restrictions, this would offset the impact of wages onto price inflation.

Interestingly, high-frequency data suggests that over half of the expected stepdown in immigration flows has already occurred.



Larger demographic impacts are possible. The second item on President-elect Trump's campaign platform⁴ calls for the U.S. "to carry out the largest deportation operation in American history". If, for example, a million individuals were deported, the direct contribution from immigration to population growth would change from +0.2 ppt (blue bar, chart above) to -0.1 ppt. And a Peterson Institute working paper found that if all of the estimated 8 million unauthorized workers in the United States were deported, it could push U.S. GDP 6 ppts below baseline into the mid-2030s.

Watchpoints

- Statements from President-elect Trump and incoming border czar Tom Homan on the likelihood and scale of mass deportations
- High-frequency data on immigration flows (above)

Deregulation

Key takeaways

- President-elect Trump has the power to appoint heads of federal agencies
- He also has the power to influence the regulatory landscape for businesses
- Deregulation and policy reforms are likely, particularly for the financials and energy sectors

The president's power to appoint heads of executive agencies is granted by Article II of the Constitution. This grants the president considerable control over the regulatory agenda and how strictly agencies enforce current law.

Two sectors have received the most attention for deregulation in a second Trump administration:

Energy:

- Reverse restrictions on greenhouse gas emissions

- Support more energy production, including for oil and gas development
- Expand U.S. liquified natural gas (LNG) exports
- EPA rulemaking to decline with implications for other sectors (e.g., relax vehicle emission targets)
- Pull the United States out of the Paris climate accord once again

Financials:

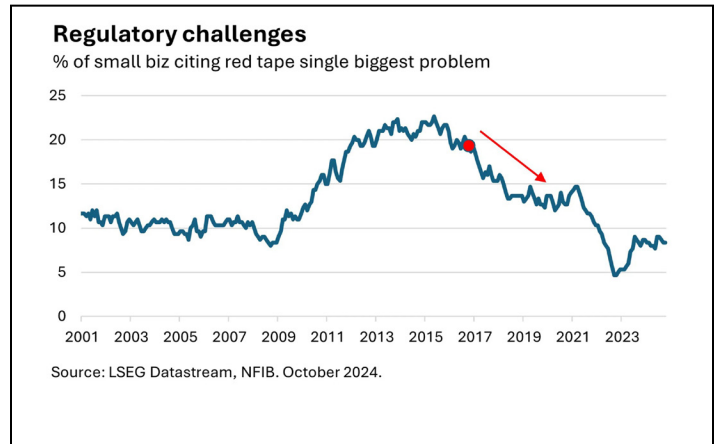
- Roll back Consumer Financial Protection Bureau (CFPB) rules and guidance⁵
- Pause the Basel III endgame proposal which would have raised capital requirements for regionals
- Allow more mergers and acquisitions, which could benefit the sector (and other sectors, like small caps)

Broadly, a more business-friendly administration is expected to support increased merger & acquisition activity going forward with tailwinds onto small cap equity and private markets.

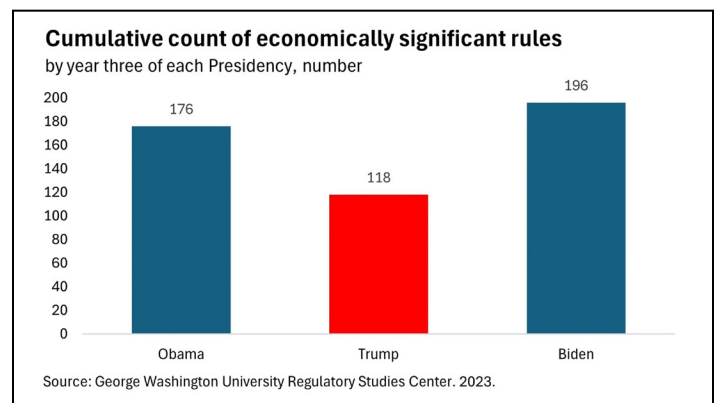
A few other observations:

- The heads of independent federal agencies—like Chair Powell at the Federal Reserve—can only be fired for cause. Powell’s term expires in May 2026.
- If he were to resign before 2026 or be replaced in 2026, investors are likely to focus on:
 - The independence of the U.S. central bank and its commitment to the 2% inflation target. Perceived threats to Fed independence could un-anchor inflation expectations and push long-term interest rates higher. Challenges to Fed independence are not unprecedented in U.S. history. Presidents Harry Truman (early 1950s), Lyndon Johnson (mid 1960s), and Richard Nixon (early 1970s) covertly and overtly pressured the central bank.⁶
 - Following SEC Chair Gensler’s announced resignation, it is expected that new SEC leadership will likely halt/pull the agency’s pending climate disclosure rules in 2025.

The percent of small businesses citing government red tape as the single most important problem declined markedly in the first Trump administration.



And, according to the George Washington University (GWU) Regulatory Studies Center, President-elect Trump put in place 40% fewer economically significant rules by year three of his first term in the White House than current U.S. President Joe Biden did.



Watchpoints:

- Challenges to Federal Reserve independence. Chair Powell’s replacement in May 2026.
- NFIB (National Federation of Independent Business) data on the impact of red tape on small business, GWU data on significant rules (above)
- Company guidance: Q4 season starting Jan. 15, 2025

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Howard Marks warns of market froth

BY JAMES GRUBER

Reprinted from firstlinks.com.au

The word ‘bubble’ is thrown around in investment circles on a regular basis, but billionaire investor Howard Marks can lay some claim to literally writing the memo on bubbles. In January 2000, exactly 25 years, he wrote what he calls a memo (ie. an investor letter) called ‘bubble.com’ and the subject was the irrational behaviour he thought was happening in tech and e-commerce stocks at that time. The memo garnered much attention because it proved right, and right quickly.

The tech-media-telecom bubble was the first of two spectacular bubbles in the 2000s. The second was the housing bubble and subsequent banking crisis of 2008.

Having been through these periods, many investors are on heightened alert for bubbles, and Marks is often asked about whether today’s market represents the third major bubble of this century.

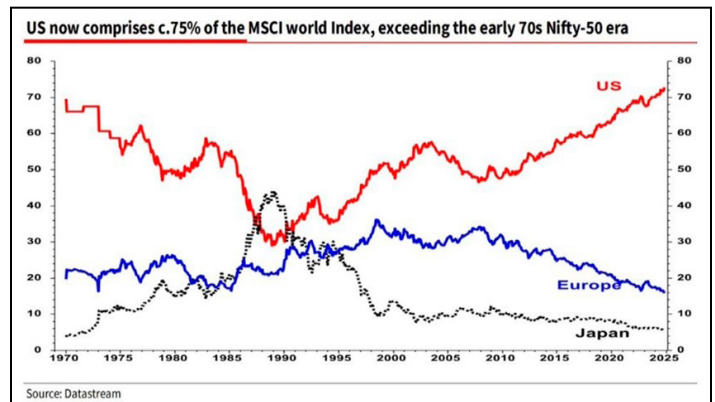
Are we in a bubble now?

First, Marks goes through some familiar facts on the ‘Magnificent Seven’ stocks (Microsoft, Nvidia, Apple, Amazon, Alphabet, Meta, and Tesla) and their impact on markets, including:

- The stocks represent around 33% of the S&P 500 Index;
- That’s roughly double their share of the index five years ago; and

- Prior to the Magnificent Seven, the highest share for the top seven stocks over the past 28 years was 22% in 2000.

The rise of the Magnificent Seven has resulted in US stocks being 75% of the MSCI World Index, the highest percentage since 1970.



The big question is: is this a bubble?

What is a bubble?

Marks initially steps back to ask what a bubble is. For him, it’s “more a state of mind than a quantitative calculation”. He says a bubble isn’t just about rising share prices, but is a temporary mania characterised by:

- Highly irrational exuberance
- Adoration of the subject companies or assets, and a belief

that they can't miss

- Massive fear that you'll miss it if you don't invest in the companies ie. FOMO
- Conviction that there's no price too high for said stocks

Mark suggests the final point is critical. Investors can't imagine any flaws in arguments to buy the stocks and are terrified they'll be left behind by those who do purchase the shares.

Therefore, Marks thinks bubbles aren't just about valuations; they have a psychological element. He quotes from Charles Kindleberger's seminal book, 'Manias, Panics and Crashes':

"... As firms or households see others making profits from speculative purchases or resales, they tend to follow. When the number of firms and households indulging in these practices grows larger, bringing in segments of the population that are normally aloof from such ventures, speculation for profit leads away from normal, rational behaviour to what have been described as "manias" or "bubbles." The word "mania" emphasizes the irrationality; "bubble" foreshadows the bursting. (Emphasis added)"

Bubbles can sometimes be recognised through anecdotal evidence, such as when J.P Morgan knew there was a problem when the person shining his shoes started giving him stock tips.

How bubbles form

The question Marks then addresses is what it is that makes investors behave irrationally. The first thing that he identifies is 'newness' or the 'this time is different' phenomenon.

Bubbles are invariably associated with new developments. Historical examples include:

- The 1630s craze in Holland over recently introduced tulips
- The 1720 South Sea Bubble in England over a trading monopoly that the Crown had awarded to the South Sea Company
- The Nifty Fifty stocks in the 1960s
- TMT/internet stocks in the late 1990s
- Subprime mortgage-backed securities in 2004-2006

Marks says that normally if a company or country's shares are at unusually high valuations, people can point to history to act as a tether to temper the enthusiasm.

However, "if something is new, meaning there is no history, then there's nothing to temper enthusiasm" and when "a whole market or group of securities is blasting off

and a specious idea is making its adherents rich, few people will risk calling it out."

The second aspect that Marks believes forms a bubble is a belief among investors that things can only get better. The attractions of a new product or way of doing business are obvious, yet the pitfalls are often hidden and are therefore ignored.

He says the trick with bubbles is that there's usually a grain of truth which underlies them; it just gets taken too far.

This can result in investors treating all contenders in a new field as likely to succeed and assigning them valuations assuming success. Though only a few may thrive, or even survive.

It can also lead to investors adopting a 'lottery ticket mentality', thinking a startup in a hot industry could return 200x, then it's worth investing in even if there's a 1% chance of success. Thinking this way, there are few limits to what investors will pay for these stocks.

"Obviously, investors can get caught up in the race to buy the new, new thing. That's where the bubble comes in," Marks says.

Valuation also comes into play

As a value investor, Marks is loath to ignore the role of valuations in a bubble. He makes a great point of a common misunderstanding when it comes to the most used valuation metric, the price to earnings (P/E) ratio. The price of the S&P 500 has averaged around 16x earnings over the past 80 years. Marks says it's typically described as, "you're paying for 16 years of earnings." He says it's more than that, because the process of discounting makes \$1 of profit in the future less than \$1 today. A 16x P/E ratio is really more than 20x (depending on the discount rate used for future earnings).

Marks says that in bubbles, stocks sell for far more than 16x earnings. For instance, Nifty Fifty companies in 1969 sold for 60 to 90 P/E ratios.

The good news is that Mark believes today's Magnificent Seven are far superior companies to those involved in past bubbles. They have huge scale, dominant market positions, and high margins.

And their valuations aren't as steep as the Nifty Fifty companies. For example, Nvidia's forward P/E ratio is in the low 30s.

The problem of remaining on top

Marks does see an issue with P/E ratios in the low 30s, though. He says it assumes that Nvidia (NYSE:NVDA) will be in business for decades to come, that its profits will grow over decades, and that it won't be overtaken by competitors. He says, "investors are assuming Nvidia will demonstrate

persistence.” In other words, that Nvidia will remain on top for a long time to come.

History demonstrates that this will be hard to achieve, according to Marks. He points out that that the following companies were in the top 20 in 2000:

Microsoft	Merck
General Electric	Coca-Cola
Cisco Systems	Procter & Gamble
Walmart	AIG
Exxon Mobil	Johnson & Johnson
Intel	Qualcomm
Citigroup	Bristol-Myers Squibb
IBM	Pfizer
Oracle	AT&T
Home Depot	Verizon

Of these, only six remained in the top 20 by the start of 2024:

Microsoft	Johnson & Johnson
Walmart	Procter & Gamble
Exxon Mobil	Home Depot

It’s worth noting that this list is now down to five companies with Johnson and Johnson (NYSE:JNJ) slipping out, while Walmart (NYSE:WMT), Home Depot (NYSE:HD), and Procter & Gamble (NYSE:PG) are just hanging on to 18th, 19th, and 20th places in the S&P 500.

It’s also worth noting that of the Magnificent Seven, only Microsoft was in the top 20 in 2000.

Marks suggests that in bubbles, “investors treat the leading companies - and pay for their stocks - as though firms are sure to remain leaders for decades. Some do and some don’t, but change seems to be more the rule than persistence.”

And in bubbles, Marks says that they initially are concentrated in a small group of stocks, though that can extend to whole markets as the fervour spreads.

Where do today’s markets stand?

With this background, Marks turns his attention to the current market. He points to the obvious: that the above average returns of the past two years can’t last forever. After

all, US corporate profits increase by an average 7% per year. For the S&P 500 to rise more than 20% as it’s done over the past two years, is unusual and can’t go on forever.

He says there are only four times in the history of the S&P 500 when it returned 20% or more, and in three of those four instances, the index declined in the subsequent two-year period. The exception was 1995-1998 when the TMT bubble formed, only to burst in 2000.

So, what about the future?

Marks lays out several cautionary signs including:

- The optimism that has prevailed in markets since late 2022
- The above average valuation of the S&P 500, and that US stocks in most sectors sell at much higher multiples to comparable stocks in the rest of the world
- The enthusiasm for a new thing in AI
- The presumption that the Magnificent Seven will continue to be successful
- The possibility that the rise of the S&P has been aided by ETFs that automatically purchase stocks, without regard to valuation
- The 465% rise in the price of Bitcoin over the past two years “doesn’t suggest an overabundance of caution.”

He also outlines the counterarguments:

- The P/E ratio of the S&P 500 is high but not insane
- The Magnificent Seven are magnificent companies and their steep valuations may be warranted
- He doesn’t hear investors saying “there’s no price too high”
- The markets, while high-priced and perhaps frothy, don’t seem nutty

(As an aside, I disagree with Marks on point three: I have heard this with the Magnificent Seven, as well as with Australian stocks such as Commonwealth Bank (ASX:CBA), Pro Medicus (ASX:PME), and WiseTech Global (ASX:WTC). In fact, I read a recent stockbroker note which essentially said that Pro Medicus was a buy, no matter what the price.)

What’s the final verdict?

Though Marks doesn’t say it, I think he believes that though the US market is expensive and exhibits some signs of irrational exuberance, it doesn’t constitute a bubble in his eyes. But it’s not to say that it won’t become a bubble in future.

Firstlinks is a publishing service providing content written by financial market professionals with experience in wealth management, superannuation, banking, academia and financial advice.

Q&A: Ask a Question

Question 1:

I've heard that when my children inherit my superannuation, they will have to pay tax on it. Is this true, and how does it work?

Yes, it's true that your children may face tax on the superannuation they inherit, especially if they are considered non-tax dependents, such as adult children. However, there may be strategies to reduce this such as choosing a different beneficiary who does not need to pay tax, or by reducing the taxable components of your super balance through a re-contribution strategy.

To use this strategy, you need to satisfy certain conditions, such as being eligible to access your super (for instance, reaching retirement age) and being eligible to make non-concessional contributions. There are also contributions caps that will apply.

There are some considerations and potential downsides. You might need to liquidate assets to make the withdrawal, which could trigger capital gains tax and transaction costs. Additionally, the funds might be out of the market during the process, which could mean missing out on potential investment returns.

It's advisable to speak to your financial adviser to ensure this strategy suits your specific circumstances and goals. They can guide you on the best approach for your situation.

Question 2:

I saw on the news that most markets are currently at all-time highs. Should I consider moving my superannuation into the "cash" option to avoid potential losses, and then reinvest once the market drops?

It's natural to feel cautious when markets are at all-time highs, as the fear of a potential downturn can tempt you to move to cash. However, timing the market is notoriously difficult, even for professional investors, as it requires correctly

predicting both when to exit and when to re-enter. History shows that markets can continue to rise after reaching new highs, and waiting for a drop may result in missing out on further gains.

Moving your superannuation into a cash option can protect against immediate losses but also means you could miss out on potential market growth. Cash investments generally offer lower returns, which may not keep pace with inflation over time, eroding the real value of your savings. A balanced strategy could involve maintaining a diversified portfolio aligned with your risk tolerance and investment timeframe, rather than reacting to short-term market movements.

Your financial adviser can help assess your current strategy and guide you on making informed decisions that align with your long-term financial goals, ensuring you stay on track for retirement while managing risk appropriately.

Question 3:

My mother is 85 years-old and we are looking to move her into aged care. I'm worried about how we are going to fund it. What are our payment options?

When moving into aged care, you can choose from several payment options based on your financial situation. The Refundable Accommodation Deposit (RAD) is a lump sum payment that is refundable when you leave the facility, minus any agreed deductions. Alternatively, the Daily Accommodation Payment (DAP) allows you to pay a daily fee instead of a lump sum, though this might cost more over time. A Combination Payment lets you split the cost between a lump sum and daily payments.

For those with fewer resources, Government Support is available if your income and assets are below certain thresholds, which can reduce or cover your accommodation and care costs. Each option has different implications for your finances and estate, so consulting your financial adviser can help you decide the best fit for your circumstances.

If you have a question that you would like to see answered in **Wealth Adviser**, please send it through to centraladvice@wtfglimited.com.