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Despite concerns about the US and China, 2012 turned out to be a good year for investors

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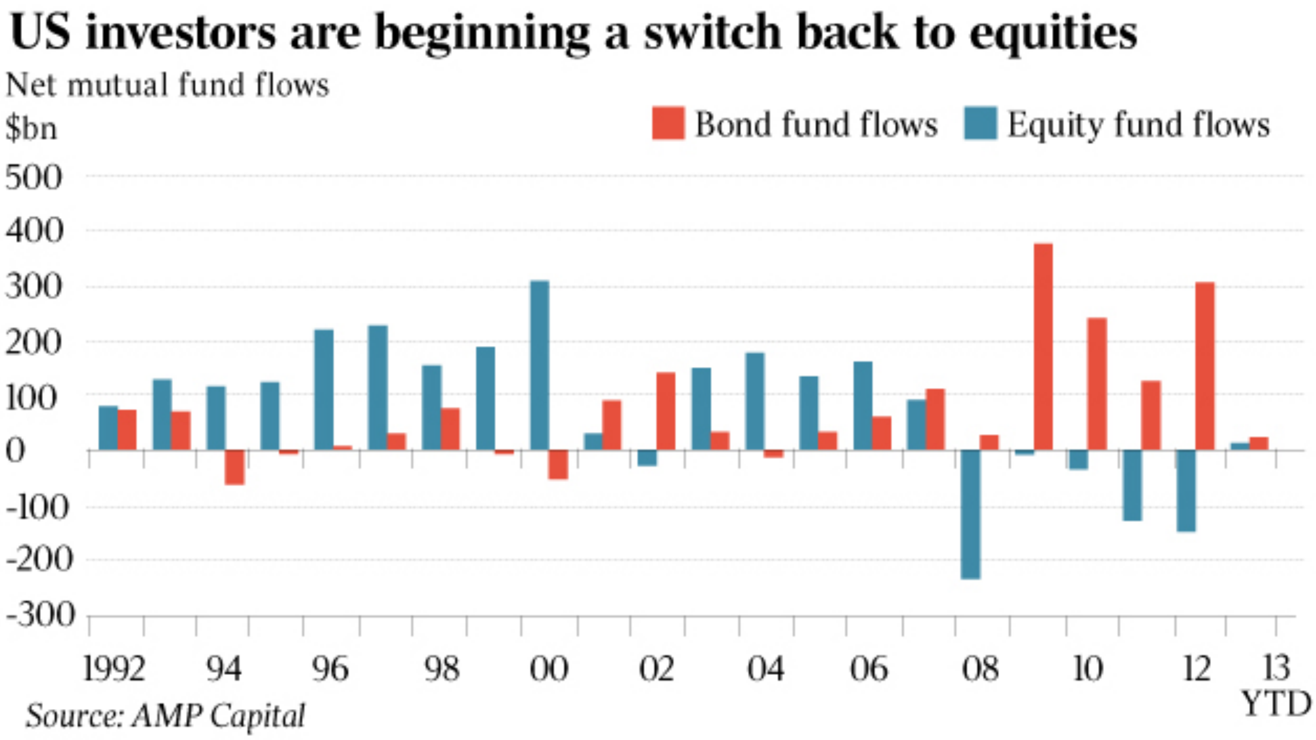

Source: The Australian

WE'VE often heard the comment that 2012 was "good" for investors. I asked Ashley Owen of Philo Capital -- who maintains exceptionally detailed records on investment history -- how the performance of asset markets over the past year looks in a longer-term context.

He responded that 2012 was only the fourth calendar year since 1900 (the others were 1904, 1993 and 1997) in which the returns of every major asset class of listed investments of interest to Australian investors produced returns that were positive, exceeded inflation, and were above their average long-term real rates of return.

Australian shares, bonds and listed property trusts delivered average returns of 20, eight and 33 per cent respectively.

International shares (unhedged to the Australian dollar) and global bonds had average returns of 15 and 10 per cent.

Globally, more than 90 per cent of sharemarkets delivered positive returns in 2012.

Two-thirds of them returned more than 10 per cent over the 12 months, and a third provided returns in excess of 20 per cent. Measured volatility in sharemarkets was unusually low.

Every bond market in the world was up. Thanks to the gloom (and resulting low prices) a year ago, the best returns came from Greek, Portuguese, Irish and Italian bonds. Also, every type of bond market -- sovereign, semi-government, corporate, high yield, emerging market, mortgage-backed, distressed and inflation-linked -- delivered strong returns.

The "worst" asset classes -- gold, term deposits and cash -- delivered positive real returns to Australian investors in 2012. Our median house price was about flat but average rent increased.

Looking back, three key themes dominated global investment markets in 2012. The first was that investors were overly concerned about the potential calamities of the euro fragmenting, the US economy double dipping and China having a hard landing. Each of these possible disruptions was avoided, in part because the second theme: the willingness of the US and European central banks to print money.

As a result, investment markets at year-end -- and continuing through early weeks of 2013 -- were dominated by the "hunt for yield" which, among other things, pushed up prices of dividend-paying shares and units in listed property and lowered interest rates on corporate bonds relative to yields on government bonds.

The recent gains in share prices mean that most sharemarkets are now priced at roughly "normal" multiples of expected corporate profits; they're no longer "cheap". However, the bullish sentiment in sharemarkets seems likely to dominate for a while: fears of a global slowdown have eased; the major central banks are willing to keep cash rates at negligible levels and to buy lots of bonds; and, as the chart illustrates, US investors have been heavily underweight in shares (experience in other countries is similar).

For global sharemarkets to be significantly higher at the end of 2013 will require that investors become more confident of growth in corporate revenues and profits in the major economies, particularly in the US. With the US suffering from below-average jobs growth but expected to make further cuts in government spending, those more optimistic expectations are unlikely to form just yet; but they could well do so in the second half of the year as the easy settings in monetary policy gain traction.

Investors need to allow that the pick-up in global growth required to drive sharemarkets sustainably higher over the year would probably mean that the major central banks would cut back on their purchases of government bonds, causing yields to rise and prices of especially long-dated bonds to fall.

The themes that could dominate global investment markets later this year are upward revisions to US and world growth, and a greater divergence in investment returns by asset class and country.

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