1st January 2017

Woodhall's 2017 Year Ahead

Ron Bewley PhD, FASSA

2017 is likely to be another good year for equities

Trump's economic impact might not be noticed until 2018
Australian labour market in trouble unless RBA cuts quickly
Commodity prices will underpin our economic growth and dollar

---

The forecast process

The following comments on our view for the year ahead will not be altered in this document as the year progresses, no matter what happens! Otherwise they would not be our views of the year ahead but views coloured by the events that follow during 2017.

The purpose of these views is to set our (personal) asset allocations and investment strategies for 2017 – which we articulate in a companion document, 'Woodhall's 2017 Investment Strategty'.

However, comments (dated) will be added in a separate document when we deem there is sufficient evidence or reason to update our views.

We are publishing these documents to show that we believe one should be accountable for one's views – and we encourage others to be as forthcoming! We feel that the profession – especially as it is seen in the media – is too likely to reinvent disclaimers and conditions on previous forecasts; be selective in its recall of what was predicted; and, importantly not be transparent about what it did with its forecasts in terms of hard cash!

Starting point

Firstly, we produce some summary statistics of certain key variables during 2016 to provide context. The data are sourced from Thomson-Reuters Datastream.

Commodity prices (2016)

Year-to-date	VIX	Gold	Iron ore	Copper	WTI Oil	Brent Oil	$A
31-Dec-2015	18.2	1,062	42.82	4,706	37.13	36.43	0.7306
High	28.1	1,369	83.52	5,945	54.01	55.42	0.7812
Low	11.3	1,062	39.54	4,328	26.19	25.91	0.6867
30-Dec-2016	14.0	1,157	80.36	5,523	53.75	55.09	0.7236
Range	16.9	306	43.98	1,618	27.82	29.51	0.0945
Change	-4.2	95	37.54	817	16.62	18.66	-0.0070
% change	-22.9%	9.0%	87.7%	17.4%	44.8%	51.2%	-1.0%
Gain/loss							
Since low	24.6%	9.0%	103.2%	27.6%	105.2%	112.6%	5.4%
Since high	-50.1%	-15.4%	-3.8%	-7.1%	-0.5%	-0.6%	-7.4%

Stock market price indexes (2016)

Year-to-date	ASX 200	S&P 500	FTSE	DAX	Nikkei	Shanghai	Emerging	World
31-Dec-2015	5,296	2,044	6,242	10,743	19,034	3,539	44,484	1,663
High	5,699	2,272	7,143	11,481	19,495	3,539	49,624	1,774
Low	4,765	1,829	5,537	8,753	14,952	2,656	39,766	1,469
30-Dec-2016	5,666	2,239	7,143	11,481	19,114	3,104	47,651	1,751
Range	934	443	1,606	2,728	4,543	884	9,858	305
Change	370	195	901	738	81	-436	3,167	88
% change	7.0%	9.5%	14.4%	6.9%	0.4%	-12.3%	7.1%	5.3%
Gain/loss								
Since low	18.9%	22.4%	29.0%	31.2%	27.8%	16.9%	19.8%	19.2%
Since high	-0.6%	-1.4%	0.0%	0.0%	-2.0%	-12.3%	-4.0%	-1.3%

Big calls

Of course we need to make many (more) forecasts to enact our strategies. But we believe that these 12 forecasts are the main ones needed to control our allocations. New events will happen which will need to be dealt with as we go along. We imply, by omission, excluded calls are of a secondary importance (at this point in time) to the included dozen calls.

1. **The RBA will cut its rate to 1% or lower during 2017.**
    1.1. At the time or writing, the market is mixed on rates going forward. For example, HSBC says the next move is up but probably in 2018. Macquarie forecasts two cuts in 2017. We know of no one predicting a hike in 2017.
    1.2. Recently there has been an increasing call for no cuts because of what the Fed might do.
    1.3. But we think the RBA will soon be forced to acknowledge the poor state of our labour market data and act. Current fiscal policy is very unlikely to promote growth anytime soon.
    1.4. The government is too weak to build a good May budget that can control recurrent expenditure while creating a significant fiscal expansion through investing in infrastructure and the like.
    1.5. One more bad labour force number in January would pressure the RBA in its February meeting. We think they will hang on for another month before they act so March is our best estimate for the first cut. But the RBA is stubborn.

2. **The Fed will *at most* raise rates by 0.5% (i.e. two hikes) in 2017 but it is far more likely that there will be only one hike – and in December 2017.**
    2.1. The Fed pencilled in three hikes for 2017 at its December meeting. It implied only two hikes at the previous meeting in its 'dot plot' chart. The market has two hikes priced in for August and December 2017.
    2.2. We think Trump will energise the US economy – but not much before 2018. The Fed won't pre-empt (nor should it).
    2.3. Yellen (Fed Chair) cannot be dismissed and the position is not up for renewal until February 2018. Yellen has nothing to gain by raising rates but Trump might recommend someone who is prepared to rapidly raise rates post-Yellen. So 2018 is likely to be the 'hiking season'!

3. **The (Brent) price of oil will remain above $US45/barrel during 2017 except for possibly a few weeks below that rate here and there (range in 2016: $25.91 - $55.42).**
    3.1. Commodity prices bounce around from variations in basic supply and demand but also from speculation. Nothing can be ruled out for very short periods but less than $45 is unsustainable. Above $65 will bring too much shale oil back on stream. This range would be good for markets.
    3.2. The OPEC (and non OPEC!) agreement will prevent a recurrence of 2016. But, if prices rise strongly gain OPEC will move to cut prices back to a wide channel of $45 - $65 / barrel.
    3.3. But we think $60 - $65 is the main thrust for 2017. Prices will 'mean-revert' if they break out of this channel.

4. **The price of iron ore will remain above $US65/tonne during 2017 (range in 2016: $39.54 - $83.52).**
    4.1. We stood up against the China bears for years and now they are well and truly beaten. With China widely perceived as strong, demand for ore is solid.
    4.2. The current $80 or so might be due to stockpiling issues. Upside is a bit limited – but a second wave of China growth is expected in the next few years. Again – when will that surge start?
    4.3. $65+ will underpin our economy.

5. **The price of gold is heading below $1,000 before 2019. A significant part of that fall will occur during 2017 (range in 2016: $1,062 - $1,369).**
    5.1. The price of gold was always below $1,000 before the GFC. After reaching nearly $1,900, gold prices have fallen to $1,157 (2016 eoy) and we think have little support going forward.
    5.2. Depending upon when Trumponomics starts to take hold, the price of gold will fall well below $1,000. The question is when. We think before 2019 is a 'shoo in'.
    5.3. It will take a while for the price fall to gain momentum but less than $1,100 is quite probable in 2017. Less than $1,050 in 2017 is quite possible if Trump takes hold quickly!
    5.4. We first made this call in December's *$ydney Banker* (No 3 for December 2016) on November 30th 2016 when gold was $US1,174 / troy ounce. The price was $US1,157 on New Year's eve.

6. **The Australian dollar will remain above $US0.70 during 2017.**
   6.1. Although the expected interest rate differential seems to be working against us, we see the strength in commodity prices as supporting our dollar.
   6.2. When 'Trump' eventually comes in, we are off to 80 cents again because of the impact on commodities and our economy.
   6.3. This prediction was first published in *$ydney Banker* (Issue No 2, November 2016) and submitted on 11th November 2016 when our dollar was $US0.7596. We expected a dip before a retracement.
   6.4. Had we made the forecast today for the first time we would have allowed for a little more wiggle room – say 68 cents – but accountability makes us stand by our original forecast!

7. **Australia will not suffer a 'technical recession' [of two successive quarters of negative, real GDP growth] using official data published in 2017.**
   7.1. Q3 2016 was -0.5% (first estimate released in December 2016) which was a lot worse than anyone expected.
   7.2. Q4 is widely expected to be positive but we think it will be a close call. The RBA and the government have their heads in the sand over the employment data.
   7.3. There is yet no stimulus coming from the RBA or the government!
   7.4. We will be dangerously close to a technical recession but the May Budget might (or is it hope?) rescue the economy – but only just.
   7.5. The main reasons we do not think there will be a technical recession is the strength of the China and US economies and the consequent impact on commodity prices.

8. **Australian full-time employment (ABS preferred trend data) will grow at less than the estimated population growth (+1.5%) during 2017 (and, maybe, even negative!) unless the RBA cuts at least twice in early 2017.**
   8.1. It seems that nearly everyone (except us!) missed the start of the slow-down. We flagged it on April 14th 2016 – that there was a big problem looming.
   8.2. For full-time employment to kick up, we either need stimulus from home or big demand from abroad – or both.
   8.3. China is firmly back and the USA will be – but not just yet. Analysts do not seem to appreciate the necessary lead time for Trump's policies to take effect if, in fact, they do come to fruition!
   8.4. If the RBA cuts early in 2017 (as we expect), confidence might build and translate into jobs growth. But a cut could frighten those not yet with the programme. We think the net balance would be positive.

9. **China will not suffer a hard landing – or, indeed, any sort of landing – in 2017. The economy will power along.**
   9.1. All economies and (successful) product launches go through phases of growth. They increase in intensity to a peak and then glide to maturity.
   9.2. Many claim China data is unreliable. Can anyone say that our labour force data is reliable?

10. **Europe will come out of the blocks, and Brexit woes will seem a thing of the past, by the end of 2017 (just).**
   10.1. Brexit fears have not even come close to causing the damage so many predicted. EU economies are already starting to gain strength.
   10.2. A 'new normal', which is actually the 'old normal', will replace the false 'new normal' PIMCO, Westpac and others dined off following the GFC.
   10.3. Some talk of a break-up of the EU and/or the euro. We think not in 2017 even though some of the relationships are fragile. Further down the track, this disunity will be a big issue – but we only have a one year investment horizon.

11. **The ASX 200 will breach 6,000 in 2017 but more likely so in the second half of the year.**
   11.1. Our capital gains forecasts are not strong enough to predict 6,000+ in the first half of 2017. But the second half looks good.
   11.2. Our new 2017 forecasts are for an eoy of 6,000 with a high of 6,300 and a low (under normal volatility) of 5,350.

12. **The S&P 500 will breach 2,500 in mid-2017.**
   12.1. This is a relatively easy target for Q2 or Q3. We're thinking 50 points more is quite possible in a Trump world.
   12.2. Our 2017 'best estimate' is for an e-o-y of 2,680 with a low of 2,180 and a high of 2,750.