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Woodhall's Wrap

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Changes in interest rate policies

Markets bounce back strongly
Elections change likely course of interest rate moves
Australia economy still doing fine

The Big Picture

If you feel confused by recent events in financial markets, you are certainly not alone. But, as we tried to convey in recent Economic Updates, some people deliberately put out bad news to grab headlines; some are manipulating markets behind the scenes in short-selling and the like; and calm, informed analysts and commentators get crowded out by the other two groups.

Now that the Quarter One (Q1) 'volatility cluster' is behind us we can say we saw what happened. At the time, we could not be certain but – as they say in courts of law – for us it was beyond reasonable doubt.

Whatever was the catalyst – probably the US Fed rate hike in December or it was just 'the time was right for a correction' – commodity prices nose-dived to unsustainable levels in Q1.

When the price of oil got down to the mid 20's some big houses were calling for $10 and $20 oil. But prices jumped to around $40 and stabilised. Iron ore prices also plummeted and bounced back as hard. In fact, on March 8th, the price of iron ore had its best day ever – up +19% in one day!

The calls for a hard landing in China and a recession in the US have come and gone. They will come back again one day and someone will listen – but not us unless there are sound reasons for such calls.

The moral of the story is simple. Events like these happen from time to time so long-term investors should be positioned their portfolios *before* such events and then sit tight. The whole point of these 'squeezes' is what we call 'shaking the tree' in the industry. You shake the tree so some fruit falls and someone picks it up to their benefit. In finance – some force prices down to get people to sell in fear and panic so that they can buy cheaply.

So where is the world heading? It's fine but not great – just as it was late last year. We discuss the details in the 'Regional Section' below. Let's just focus on the big game in town here.

The Prime Minister got the new Senate voting procedures through both Houses and then flagged a possible election and double dissolution for July 2nd. As we wrote about in 2013 the voting procedures needed to change and now they have. People will now get the people they vote for and not those that did backroom deals with almost no first preferences. It was never to Australia's advantage (whoever won majority) that a clutch of micro parties had to be placated to get any business done in parliament. We are back on track.

But the budget is now to be on May 3rd and the election looks like July 2nd. That means the Reserve Bank is unlikely to change rates at those times. In fact, it now looks like there can be no rate cut until around August/September.

On top of that the US Fed's talk and US data have pushed back previously expected rate hikes probably to December if not later. These interest rate scenarios amount to a massive change in policy just since last month's Economic Update! We think this means that the Australia economy will be a little more sluggish than we previously expected to be.

In summation it is important to understand your investments in good times so that you don't have to sell in bad. Unless you are a trader it is best to be calm when headlines get gloomy.

Asset Classes

Australian Equities

The ASX 200 had a bumper month as it gained +4.1% in March. But that was not enough to put the market in the black for the year-to-date. We are still down -4.0% while Wall Street is up.

Despite the big sell-off near the end of the month for the big banks, that sector led performance over the whole month at +6.3%. The resource sectors also did well with +5.3% for Energy and +5.5% for Materials. At the other end of the spectrum the normally robust Healthcare sector fell by -0.5%.

Importantly, volatility has subsided to normal levels. Given that we estimate that the market fundamentals strengthened over March but that we have the market a little underpriced, April could also be good for investors.

Foreign Equities

The S&P 500 gained an impressive +6.6% over March but the Shanghai Composite (China) index led the way with a gain of +11.8%.

The VIX 'fear' index for Wall Street has fallen to below average levels suggesting that investors are quite relaxed about the future direction of that market.

Bonds and Interest Rates

The Reserve Bank of New Zealand cut rates again by 0.25% in March. But, at 2.25%, New Zealand still has the highest rate in the developed world. We are next at 2%!

At home, the chance of a rate cut by June has been priced down by the markets. The market now has a cut at 30% compared to 60% a month ago. Political considerations make the next move unlikely before the mooted July election.

The US Federal Reserve changed its rate outlook at the March meeting. Last December, when it first hiked in nearly a decade, its 'dot plot' representation to the media suggested four hikes this year totalling 1.0%. The March version now has only two hikes for 2016 but again the market thinks that optimistic. The market consensus has just one hike in December if any at all this year.

Other Assets

Iron ore prices are up +12% over the month and seemingly stable. The power play by the big miners to squeeze out smaller miners seems largely over.

Oil prices too have stabilised and Brent oil is up +12.5% on the month. OPEC is scheduled to meet again on April 17th with Iran to thrash out deals to stabilise prices further.

The price of gold was flat but our dollar appreciated +7.2% against the US dollar in March.

Regional Analysis

Australia

Trend unemployment continues to improve but at a very slow rate and trend employment growth has been strong and steady. But here, as around the world, improving labour markets are not resulting in wage or price inflation.

Our overall economic growth – measured by the growth in Gross Domestic Product – came in unexpectedly high at 3.0% for 2015. But digging deeper, the headline number was a little above trend but some of the components were less robust.

Our score card is the same as it has been for months. A rate cut or two would help. A budget that paves the way for solving the long-run problems we face would also really help. There is no impending cliff from which to fall – nor is there a simple solution to our current situation. We will probably jog along at this pace for the rest of the year.

China

It seems that the China doomsayers have retreated into the shadows but they can easily return unless data get really strong. So far China is much stronger than most thought a month or two ago. Indeed the March Purchasing Managers' Index (PMI) came in at 50.2, or expansionary territory easily beating expectations of 49.3 and following February's read of 49.0.

The China policy makers have set a range of 6.5% to 7.0% for growth over the next five years. China is also making overtures in the form of stimulus. China says there is no hard landing and we can't find any evidence of one. At last, the China economy looks pretty safe.

USA

The US jobs data reported in March were very strong. There were 242,000 new jobs when only 19,000-195,000 were expected. But, importantly, 242,000 jobs were not big enough to make an interest rate hike likely any time soon.

The Fed Chair, Dr Janet Yellen, has taken two of the four mooted rate hikes from last December off the table. And then she may have even taken another off in a speech later in March.

Europe

Obviously the Brussels' bombings dominated March news in Europe and around the world. Sadly these incidents will not go away any time soon but, fortunately, they do not seem to dent market performance and economic conditions.

The so-called 'Brexit' referendum slated for June 23rd looks line ball when the UK will determine whether or not it should stay in the EU. Migration issues are front and centre – as we wrote about last year when Germany's Chancellor, Angela Merkel, wanted to embrace all immigrants. Now countries are reportedly planning to send back 80% of immigrants because they are not 'proper' refugees. There is a lot to sort out in that part of the world.

The UK sugar tax caused some interest. In their recent budget they stated they are to tax sugar content in drinks and food in a bid to help health. They just happen to get a nice tax haul as a bonus!

Rest of the World

After a very poor run for nine months into the end of January Emerging Markets have bounced back strongly. Indeed, the markets' index grew +8.2% in March.

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