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Woodhall's Wrap

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Brexit fears cast aside

UK consumer confidence bounces back
US Federal Reserve claims economy strengthening
Japan ready to add more stimulus

The Big Picture

It is just a year since some reports on the China stock market sell-off last August predicted doom and gloom. As we suggested t the time, it wasn't a major problem because that market was and is in its infancy. The market stabilised and it is now comfortably above those 2015 lows.

At the end of 2015, some nerves were rattled about the prospects of Federal Reserve rate hikes in the US. While occasional bouts of uncertainty continue to cloud market movements, the successive Fed meetings have gone reasonably smoothly.

In January 2016, the Royal Bank of Scotland told us to 'Sell everything' and some other big houses made similar dire predictions. Markets are comfortably up and selling wasn't the answer.

Oil and iron ore prices dived into February 2016. Iron ore prices dipped below $40 but later climbed to $70. Oil was predicted by some to get down to $20 or even $10 when it was $26. Instead prices have since more or less doubled. Another 'crisis' averted!

And then there was 'Brexit' and the dire predictions that went with it. The leave vote won but consumer confidence jumped 3% in the UK in the first month following the referendum. Markets are stable and the pundits got it wrong again.

Of course, at some point, an event will come along that will have a medium-term adverse impact on our investments but most of these stories are simply overblown in quiet news periods. At this point we feel that all of those scare stories are fading into oblivion and there are no new major known issues brewing.

At home, our labour force data isn't great but the mid-year fall in full-time employment seems to have been turned around. Unemployment is stable at 5.7%. Our Reserve Bank is expected to cut rates again – from 1.75% to 1.50% sometime this year – but that is more to align our rate with the rest of the world rather than a reaction to avert major issues at home.

News in August was dominated by the Olympics. Australia was disappointed but 'Team GB' beat all expectations. There are big lessons for economic management to be learnt from these results.

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Australian Olympic success was at a low in Seoul, 1988. Government funding was pumped in with increasing success to match – until, that is, at Beijing and after.

GB hit its nadir in 1996 at Atlanta with only one gold medal being won. The national lottery was born with substantial taxes going to sports' funding.

In both cases it took time for athletes to respond but pumping money into a venture alone is not an investment. Just like with migrants, the expression "The first generation makes it, the second builds on it, and the third loses it" might apply to economies and sports alike. But our athletes might now be doing as well – it's just that others are rapidly improving.

Importantly, Australia was reported to have concentrated funding on our traditional sports. GB, on the other hand, looked for opportunities in sports they had not previously been good at. GB's plan seems to have thrown up many unexpected successes.

The reaction to the GFC was for governments to cut back on fiscal spending around the world. Now we need well-tailored programmes to start the next phases of growth. Not pink batts but spending on considered infrastructure projects and the like could be what we need now. But with our government system living on minority leadership for too many years, it is difficult to see from where such a programme will come.

In the meantime, growth might be a little below par but good enough. A shot in the arm for infrastructure could well be the start for a return to our desired long-run growth path.

Asset Classes

Australian Equities

The ASX 200 did lose -2.3% in August but that followed a massive +6.3% gain in July. Virtually all sectors lost ground in August but market volatility remains reasonably low.

After reporting season in August, our view of the fundamentals remains strong. We expect the 2016/17 financial year to be strong. The calendar year-to-date for 2016 posted a gain of +5.6% including dividends.

The high-yield sectors of Financials, Property, Telcos and Utilities continued to seriously lag behind the other sectors in 2016 y-t-d including dividends. Indeed, capital losses in high-yield have more than wiped out dividend payouts. The total returns of the 'other' sectors have exceeded +14% y-t-d.

Foreign Equities

Wall Street hit some new all-time highs in August. The VIX fear index reached quite low levels suggesting markets are quite settled even if August was not a strong month for markets.

With a rate hike in the US unlikely before December only the Presidential election seems likely to interfere with a smooth finish into the end of 2016.

Bonds and Interest Rates

The RBA kept rates on hold again in Australia. The Fed Reserve's second-in-command caused some volatility with his comments shortly after Chair Yellen made her views known. While Yellen saw the chance of a hike strengthening with good economic data, Fischer went further putting September back on the table. December is still our call for the first hike.

Other Assets

Oil prices have seemingly stabilised on talks between OPEC and Russia. At current prices, oil is too cheap to warrant shale oil to come back on stream in the US and too high to cause major concerns going forward.

The VIX volatility – or fear – index reached a low for 2016 during August. Our dollar did vary somewhat over the month but the change on the month was relatively small.

Regional Analysis

Australia

On the face of it, our employment data grew strongly but full-time employment fell while part-time employment did the work. The unemployment rate was steady at 5.7%.

Trend full-time employment – the official preferred method – has started to pick up – possibly because of the earlier rate cut.

China

The month started reasonably with a Purchasing Managers Index (PMI) at 49.5 for manufacturing – which is just below the break-even 50 level. The services version of the PMI continues to be well above 50 as the domestic economy takes over from infrastructure expenditure.

Mid-month retail sales and industrial production did miss forecasts by a fraction but not by enough to worry markets.

USA

Janet Yellen talked up the strengthening US economy at the annual Central Bankers' conference in Jackson Hole. There is no doubt that employment data have bounced back strongly from the earlier mini-slump. But two good numbers are not enough to eradicate all discomfort.

Europe

The Brexit vote won at the end of July. August Retail Sales surged at +1.4% against an expected +0.1%. UK confidence also surged from a three year low to 109.8 from 106.6. With Olympic success as well it seems the UK has side-stepped the issues that some worried about earlier in the year.

The Bank of England did cut its rate at the start of August and also pumped in some unexpected monetary stimulus.

Germany's GDP came in at +0.4% for the quarter smashing expectations. There are also other pockets of mild success. Brexit will happen slowly so trade deals can be renegotiated far before trade becomes an issue.

Rest of the World

Japan can't win a trick. They just recorded another month of deflation but Japan is pledging to continue to stimulate the economy as required.

Japan's problem is its falling population. Many countries, such as ours, would also look a little glum if their populations were not growing!