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Woodhall's Wrap

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2018 shaping up as another good year for investors

Global growth co-ordinated
US tax reform
Strong jobs growth in Australia

The Big Picture

After almost a decade of economic woes around the world, all the major economies are starting to come good together.

China, as we expected, not only stayed strong, it also gathered a little pace towards the end of 2017. The US certainly gathered momentum finishing the year at a rate of 3.2% pa. Even Europe is looking strong but the big surprise is the way that the third largest economy, Japan, has at last put five strong quarters back to back.

When growth is co-ordinated like this it is much harder for any individual country to fall into recession anytime soon.

But the prospects for 2018 became even better after Trump got his tax reform through at the eleventh hour. It is doubtful if analysts have yet fully digested the consequences. It may well be that macro and market forecasts will be revised upwards in the next few months.

Citi produces a 'surprise index' for many major countries. It is based on how often analysts' forecasts are beaten by the actual events. The US index stands at a reading of +73 which is a six year high. The Australian index stands at -10.9! We keep thinking things are better than they really are.

Global growth is likely to keep us well out of recession but we are likely to continue to underperform. Our jobs creation has been strong all year – largely because of immigration. Our unemployment rate stubbornly stands at a moderately high 5.4%

The Westpac consumer sentiment index stands at just above 100 but that is only for the second month this year. NAB's business conditions and confidence indexes, however, remain consistently strong.

Major share markets did well around the world with Wall Street being the stand-out performer. But Australia didn't do too badly after a bad reaction to various bank inquiries. The ASX 200 posted growth of over 13% over 2017 when dividends and franking credits are factored in.

There are a number of things to watch out for in 2018. The Brexit negotiations between Britain and Europe are progressing without any major problems so far. The new US Federal Reserve chairman looks set to make two or three rate hikes while our RBA is not expected to move in 2018.

Our Royal Commission into Financial Services might cause some angst depending how any press releases are handled.

The more difficult possibility to assess is Trump's wish to commence a big infrastructure programme. In the election campaign he was talking about a trillion dollar deal but that has since been scaled back to 200-300 billion dollars. With tax reform behind him, we should see some movement on this front in January.

The ASX 200 closed at the highest level since December 2007 on the penultimate trading day of 2017 and we see growth of about 5% in 2018 – but that means that the November 2007 peak is not likely to be surpassed this coming year.

We see strong growth continuing on Wall Street in 2018. But, if analysts revise earnings forecasts upwards in January based on company tax cuts, we might see very strong growth in the first half of the year.

On the commodities front, copper, gold and oil prices did well in 2017. It would be sufficient for our resources sector to have a good 2018 if these prices just hold over 2018.

In conclusion, we see it unnecessary to take on extra risks in 2018 to chase returns. Volatility on share markets was unusually low in 2017 and that is expected to continue for the foreseeable future.

We wish you all a safe and prosperous New Year.

Asset Classes

Australian Equities

Our market was seemingly stuck in a tight range from mid 2017 but then it blasted through 6,000 at last – and it even finished 2017 above that psychological barrier.

The resources sectors led the charge in December to give the broader index a boost of 1.6% for the month.

The Financials sector was down slightly for the year but there were outstanding double digit returns to be had in all other sectors except for Property, Telcos and Utilities.

The February reporting season is only just around the corner so this is the time for companies to 'confess' if they are likely to miss their guidance for earnings. We found analysts started revising their forecasts in an upwards direction for the last month or two. Therefore, we are expecting a good "report card" in February.

Foreign Equities

The S&P 500 index recorded another positive month in December making it 12 in a row for 2017 and the first time on record! We do not, however, think the market is over-priced by more than two or three percent.

2017 market growth has been dominated by the big tech companies. Some are looking to Amazon to become 'master of the universe' by establishing a major presence across a broad array of industries.

The strong Japan economy has supported its Nikkei index to record near 20% growth in 2017.

Bonds and Interest Rates

The RBA was on hold again and is unlikely to raise rates before the end of 2018. Indeed, another cut is quite possible before the next hike.

The Fed hiked rates in December making it three for the year. Their so-called 'dot plots' show that they collectively expect three more hikes in 2018 but the market has only priced in two. The Fed is unlikely to want to risk too much so two is much more likely than four. US inflation is still below target.

Other Assets

Oil and copper prices were firmly higher in 2017. Iron ore prices were down on the year but staged a very strong comeback of 36% from the lows of the year.

Regional Analysis

Australia

Over 60,000 new jobs were created in November – the latest published data point – and two-thirds of them were full-time. However, the unemployment rate was stuck at 5.4%.

Around 1,000 jobs were created on each day of the year (on average) but it seems, much of this was matched by immigration flows. Price and wage inflation are also stuck at below target rates. However, we at last got a better than expected growth in retail sales (+0.5% against 0.3%).

The government presented its mid-year report card ("MYEFO") in December which argues the deficit is better than had been previously expected.

China

China has reportedly been spotted exporting oil to North Korea which got Trump's hackles up. But, other than that, there is less reported bad news about China's economy. Of course, any developing economy starts to slow gradually as it reaches economic maturity.

We do not see China's economy being a problem for us in 2018.

US

After a bumpy ride, a tax reform bill passed through Congress giving Trump one victory for 2017.

The infrastructure programme could be even more tricky to get through because the size of it will require a public/private joint venture. That means the private sector will have a big say on which projects start first. That will put the Democrats off-side as they always want to lead with the public interest.

If the bill makes some progress in 2018, the US economy looks set for continued growth for a few years to come.

Europe

Greece finally came out of recession in December! While the European Union as a whole still has some problems to work through – notably Brexit – the general mood appears to be positive.

Rest of the World

Japan's Q3 growth figure was revised upwards to 2.5% from 1.4%.