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Woodhall's Wrap

US trade deals

US strikes a deal with Mexico over trade
Global growth under control
Australia gets yet another PM!

The Big Picture

The US reported progress on trade talks with the EU. Then the US struck a trade deal near the end of August with Mexico – and markets loved it. But then Trump talked of leaving the World Trade Organization (WTO) and the market pulled back a fraction. Big US tariffs on China imports are due to be imposed by September 6th if a deal isn't struck before.

Such is the Trump style of negotiating – big threats followed by deals. All this trade talk means short term volatility and long term growth. The US quarter two economic growth statistic was just revised up to 4.2% from 4.1% and recent China trade data were robust to the trade chatter.

The US Fed's preferred measure of inflation just came in at 2% - in the sweet spot. Chairman Jay Powell stated that the US economy is not overheating but the Fed is expected to raise rates a notch in September and possibly once more in December. All this hiking does is to get the rate back to the so-called 'neutral rate'. Monetary tightening only occurs if the rate is pushed up above the neutral level and that's not expected until at least mid 2019.

In spite of the S&P 500 reaching new highs at the end of August we see no reason to start reducing US equity exposure. But, of course, we monitor the situation.

The Bank of England raised its rate for the first time since the GFC. The economy was looking in a bit of trouble until last week when hope of a Brexit deal was heightened by favourable comments from Europe.

On the other hand, the Reserve Bank of New Zealand pushed back its forecast for its next rate hike until quarter three, 2020. We read all of these signals as showing that central banks are reacting in measured steps that can support continued synchronised global growth.

There are some difficulties in emerging markets. The Venezuelan and Turkish economies are still struggling and Argentina just raised its interest rate from 45% to 60%! We do not expect these emerging market issues to impact on global growth. China is ready to act when needed and President Xi was admonished for being too aggressive over US trade talks.

At home our jobs' report was very solid. The unemployment rate at last fell and full-time employment growth started to improve.

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Perhaps a better sign for our economy has come from the listed companies' reporting season that just concluded. There have been many 'beats' where companies have improved earnings over expectations and their share prices have been justly rewarded. Of course some companies underperformed and some of these share prices were savaged.

August was a positive month for the ASX 200 index but fund managers and investors could easily have found themselves well above or below the index depending upon the positions they took – such was the dispersion of stock returns.

While the Reserve Bank of Australia (RBA) has been on hold for two years and expected to do so for many more months, Westpac just raised its flagship home loan rates by 0.14% points. Because banks do not borrow funds from the RBA to disperse to home loans, they must refer to their actual costs of funding. Much of this funding comes from overseas and those rates have been drifting higher.

After a number of surprise moves in Canberra, Australia now has a new prime minister in Scott Morrison. Unlike one of the contenders, Peter Dutton, Morrison is expected to continue the current thrust of policy but with a more elector-friendly spin.

Asset Classes

Australian Equities

Our ASX 200 just completed its fifth successive month of capital gains – putting such slogans as “sell in May and go away” in the place they deserve to be. Indeed, three sectors (Health, IT and Telecommunications) produced double digit returns in August alone. The Materials sector was the biggest loser.

With the August reporting season all but complete, and recent earnings strong, the index looks set to continue modest rises into at least the end of the current financial year. There have not yet been any signs of material changes for earnings' prospects as summarised by consensus forecasts.

Foreign Equities

The US' S&P 500 has also enjoyed five successive months of capital gains and its bull run – now the longest in recorded history – looks set to continue. The new all time high of just above 2,900 is well

short of the 3,030 'sell signal' we are using as a guide until the end of 2018.

Bonds and Interest Rates

The US Fed is widely expected to increase the funding rate at its September meeting. But what will be more important is the so-called 'dot plot' that shows the individual committee members' expected rates over the next couple of years. The Fed is independent but Trump has been attempting to lean on the institution saying that he thinks rates are already too high.

Germany has withdrawn its support for a German to replace Mario Draghi, President of the European Central Bank, next year when Draghi's term expires. Since the German was thought to be hawkish – meaning that he would increase rates faster than currently being considered – there is now less chance of emerging economic problems in Europe. Germany has, instead, put its weight behind electing a German for President of the European Union.

With Westpac being the first of the big four banks to raise its home lending rates, the others are expected to follow in short order. If this pattern is indeed established, Australia will have had a de facto rate hike without intervention by the RBA. Not only does this situation push back forecasts for the timing of the next RBA rate hike, it increases the chances of a rate cut.

Other Assets

Prices of gold, copper and iron ore slipped over August but oil prices firmed.

Regional Analysis

Australia

The RBA's Statement of Monetary Policy revealed the bank is not expecting the unemployment rate to dip to 5.0% until December 2010. Given that the latest read was 5.3%, the bank is clearly not expecting much in the way of economic activity for some time. Indeed, if it were not for strong immigration-fuelled population growth, our rate of economic growth would look very poor indeed.

The new prime minister will have his work cut out to restore growth prospects in the few months left before the next election. Josh Frydenberg, the new treasurer, has a strong background in resources and energy. With electricity prices a major problem

across Australia, the new Energy Minister, Angus Taylor, has come out on the front foot in the debate.

China

China imports grew at a stunning 27% while exports grew at 12% against an expected rise of 10%. China trade is holding up in spite of all of the trade threats and negotiations.

On the other hand some of the domestic statistics were a bit softer than expected: retail sales; industrial production; and fixed investment. China is reportedly poised to act if and when necessary.

The end-of-month Purchasing Managers' Indexes (PMI) for both manufacturing and services beat expectations and the previous month's numbers.

With the US set to place significant tariffs on \$600bn China imports by September 6th, China will have to negotiate quickly or increase its stimulus for its economy.

US

Two people close to President Trump's campaign have been found guilty of some serious charges but these charges do not relate to any possible Russian involvement. While the situation reflects poorly on Trump it seems highly unlikely that he, himself, will be drawn into the legal fray.

That Trump negotiated a new 'better' trade deal with Mexico should be emphasised. Trump has many detractors and they must feel overwhelmed by this clean end to the Mexican trade dispute. So much so that Canada immediately stated that it was now close to a new deal with the US which means the long-standing NAFTA arrangement has been improved upon for the whole region.

With the mid-term elections approaching, these deals could help Trump keep control of the House of Representatives. If he loses control, he would find it very hard to continue his policy agenda in the following two years of his presidency – a so-called lame duck presidency.

Europe

At last the UK has found some support from Europe for its Brexit trade deal to replace that with the European Union after March next year.

Germany reported its latest economic growth statistic to be 2% which is reasonable but not great. There is a growing movement of right-wing sympathisers in Germany who apparently feel that they are being marginalised by Berlin compared to

the government assistance for the new large refugee population.

It is seven years since the onset of the 'European crisis' involving mainly Portugal, Italy, Greece and Spain financial institutions. There was then much talk of a 'Grexit' that was concerned with the implications of Greece leaving the common euro currency. The major ratings' agency, Fitch, just upgraded their national debt which is a good step towards a stable Europe. Greece's austerity programme has at last produced economic stability

Rest of the World

Turkey started to repair its damaged reputation for economic management and its lira stabilised. However, some volatility remains but it has not spilt over into other emerging markets to the extent that some feared.

However, Argentina's separate woes are escalating. Its central bank just raised its official rate to 60% from 45%.