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Woodhall's Wrap

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Markets hit record highs

US strong economic data
China data impress
Australian jobs hold up

The Big Picture

In March, Wall Street's S&P 500 reached all-time highs and our ASX 200 reached an 11-year high. To keep these results in perspective, both indexes are only just ahead of the 2018 September highs. We see no indication that these indexes are due for any pull-back based only on this assessment.

Of course, pull-backs can occur at any time but exiting a market too early can also cause underperformance in our investments.

The US reported some great economic data in March. In particular, economic growth came in at 3.2% when trend growth is only about 2%. The market was only expecting 2.3%. Given the longest government shutdown occurred during this quarter one (Q1) – and the weather was quite bad – this result is one in the face for the recession merchants!

In mid last year a significant number of commentators were calling for a recession starting with negative growth in Q1. In spite of the 'unexpected' economic strength, the Fed's preferred inflation measure – the so-called core PCE – came in at 1.6% which is comfortably below the Fed's target of 2%.

The US jobs data were also stronger than expected with 196,000 new jobs and the unemployment rate is at 3.8%. Wage growth was a creditable 3.2% which is well above price inflation. If that wasn't enough, US retail sales came in at a big 1.6%.

China too beat market forecasts for economic growth. GDP came in at 6.4% and retail sales, industrial output and fixed asset investment also beat expectations. Exports came in at +14.2% growth over the year.

With the US and China firing on all cylinders, global growth is not under threat – even if Europe isn't doing well.

At home, the Reserve Bank of Australia (RBA) signalled that it will cut rates if the unemployment rate starts to trend upwards. The latest rate was 5.0% and it has been steady for some months.

A fair haul of new jobs was created; 25,700 in total and full-time jobs were at +48,300 swamping the part-time loss of -22,600.

So why are we all now worried about the Australian economy? The official data do not distinguish between food-delivery cyclists (and the like) seemingly growing exponentially and traditional jobs

– and this switch also has an impact for average wage growth.

Moreover, our strong immigration numbers inflate job gains and economic growth. When per capita data are analysed our situation is more problematical.

The recent Federal Budget – if it all gets passed in parliament – is mildly stimulatory – and two RBA cuts will provide a back-up monetary policy easing. Both parties are offering reasonably stimulatory policies going into the May 18th election.

In short, at last our economy may be getting the policy support it needs. That support can help our stock market especially as resources demand is backed by a strong China. There is also every chance of a compromise trade deal between China and the US being nutted out in May and presented in early June.

But the recent CPI data at home caused a stark reminder of what might happen if economic policies do not get through parliament and the RBA sits on its hands. Our latest inflation read was actually zero! When highly variable components are extracted to get the RBA-preferred number, inflation jumps only to 0.3%, or 1.6% for the year. That growth is well below the 2% to 3% target rate which keeps being missed by the RBA.

But, on a lighter note, maybe we should follow the Ukraine in voting in a TV comedian as the new president with a landslide victory. We doubt if anyone thinks he can do well but it is confirmation that people right across the globe are fed up with the current style of politics on all sides in all countries.

Asset Classes

Australian Equities

The ASX 200 posted a fourth straight month (+2.3%) of positive gains in April making a gain of +12.0% over 2019 to date. There was great disparity among the gains across sectors. Consumer Staples (+7.3%) and IT (+7.3%) were the very big winners with Materials (-2.1%), Property (-2.6%) and Utilities (-0.5%) going backwards.

By our own measurements, we see the e-o-y results for this market to be stronger than we did at the beginning of the year. We have the market only mildly overpriced and so that does not seem to be a headwind for markets.

While there maybe heightened market volatility around the May 18th election, we see volatility returning to average levels not long afterwards.

Foreign Equities

Many suggested there would be an 'earnings recession' in the US – a recently thought-up concept to suggest two negative quarters of earnings growth. The current Q1 earnings are well below the bumper Q4 results but Q1 earnings growth is strongly positive which no doubt played a large part in propelling the market to new highs.

In spite of global doubts by some and the strong run-up in markets since the start of the year, there have been some amazing gains on international markets.

The S&P 500 posted +3.9% for April but Japan's Nikkei came in at 5.0% and the German Dax at +7.1%!

Bonds and Interest Rates

The CME Fedwatch tool for pricing possible rate changes by the Fed this year keeps changing on the slightest news. There is little or no credence being given to a rate hike this year and the probability of no change is varying between 30% and 40%. The real movements are in the possible number of rate cuts this year. The latest strong GDP data brought one cut to be a little more dominant than in recent times. Indeed, one cut currently has a much higher probability than no changes this year.

At home there is a 50% chance being priced in for a cut in May by the RBA. Given the proximity of the Federal election, May seems unlikely to us as that might be used to signal an unwelcome comment on past economic management. But two cuts this year seems almost a certainty. The chance of one cut by June is about 80%.

The talk earlier in the year about US 'inverted yield curves' we reported on and their prediction of possible recessions has all blown over – so all those who missed it (or didn't understand it) can carry on oblivious to the myriad of false signals of recession that some commentators have been coming up with.

Other Assets

Oil prices were the biggest movers of the major commodities. They were up over 5% in April. Part of this move is due to Trump's sanctions on Iran but Trump has also encouraged the Saudis to play their part in stabilising prices.

Regional Analysis

Australia

The general election is rapidly approaching and both sides are offering the usual sweeteners to voters. Either way, there is likely to be some stimulus coming our way soon. However, as with previous elections, there is unlikely to be a majority for one party in both houses so deal making will have to happen to get the bills through.

With inflation remaining well below the target range there is every chance of rate cuts that might help stabilise the housing markets.

Jobs data remains quite strong but we believe the basic statistics mask some of the changes that are going on within this – and other – economies. Technology improvements and home delivery services are changing the balances. It is difficult to assess what the real situation is. The weak wages growth supports the notion that all is not well in the labour market. Nevertheless, the latest monthly data shows that 48,300 new full-time jobs were created in March.

China

The latest economic growth data did not disappoint the People's Republic forecasts made in the previous month. A 6.4% outcome for Q1 against an expectation of 6.3% supports the notion that China's stimulus policies are working.

All of the other major partial economic indicators beat expectations – except for the latest manufacturing index that came in at 50.1 when 50.5 had been expected. Nevertheless, 50.1 is above the 50 level that divides expected growth from expected contraction.

US

A bumper economic growth figure of 3.2% boosted Trump's economic management message. The negative commentators whose expectations were blasted out of court are now looking for reasons why the next number will be lower. The Boeing crisis is now being estimated to take 0.1% to 0.4% off Q2 growth.

With trend economic growth at about 2% there is a lot of wiggle room before published data suggest a real slowdown.

It is hard to watch any of the overseas business TV channels without being inundated with claims and policies from a long list of would-be Democratic nominees for the 2020 election.

The problem when so many candidates are in the running is that policies have to become wilder and wilder to get the attention of the media. Hopefully, candidates will start to drop off soon due to lack of funding so that a sensible debate about how the US should be run can emerge,

Europe

The Brexit deadline seems to have been moved back to Halloween (with a hurdle or two before) so that Brexit is less of a distraction for markets.

In further moves to political instability around the globe, Spain just voted back in a socialist government but 'with a far-right breakthrough'.

Economic conditions in Germany are far from great and the car industry is suffering from US trade policy.

Rest of the World

It is difficult to 'top' the report that The Ukraine voted in a comedian to be its president (he actually plays the part of a comedian who becomes president in his new series). But, after the recent failure of the Trump-Kim nuclear talks, it is interesting to see Putin and Kim are getting their knees together under the table.