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Woodhall's Wrap

Ron Bewley PhD, FASSA

The Big Picture

Can anyone seriously wish for more from the Australian macro-economy? Kick the lights out jobs, profits and GDP must make other countries look on in wonderment.

But let's not put this success down to any recent domestic developments. As we argued two years ago at the India meetings, when you have had 15 years or more of great results, low unemployment and China on your side, it would have taken a nuclear bullet to knock Australia off its tracks.

The US is still in pain – but a glimmer of optimism is starting to shine through. Things are getting better – but not quickly enough. Germany is strong again. Even the UK is looking OK. Obama might play a trump card after the November mid-term elections.

So with strength at home, when do our interest rates start to climb again? After a couple of months of passive rate-watching, we are all now asking when and not if. November seems to be the consensus view but don't write off October. And with no RBA meeting in January, two hits before Christmas is a possibility! More likely though one before and one shortly after Christmas. Australia is definitely back to normal. Of course there is pressure on the banks through funding to do an out-of-cycle rate hike.

And what of the election? Rob what's-his-name got a perfect 10 for artistic interpretation but zero for technical merit. Keep your day job going, Rob. I can't see this happy bunch lasting to Christmas without major divisions. Indeed, cracks started appear in day 1.

To the markets. Equities look reasonably priced after brokers cut their forecasts based on a lacklustre vision for the future during reporting season. This down-in-the-mouth attitude does mean that it will be easier for companies to surprise on the upside between now and next February's reporting season.

Bond markets are looking a bit toppy but gold, oil and the dollar do not seem to be going anywhere soon.

So what is the bottom line? Patience is a virtue – or so they say – and investing life in Australia is getting much better. We just need 'healing time' to lick our wounds and get that cash off the sidelines and into the market.

Woodhall Investment Research Pty Ltd (ABN 17 141 486 160)

Contact: ron.bewley@woodhall.com.au

Australian Equities

We started the year with a forecast of about 16% (including dividends) for the Australian market. In each reporting season (February and August) broker forecasts glided downwards. At 11% for the next 12 months, we are looking forward to an average year. More importantly, the lower expectations for company profits next year is great. After a year of meeting expectations, the erosion of expectations leaves plenty of room for upside surprises.

Resources (Energy and Materials) are looking much stronger than the other sectors. Forecast dividends for the market as a whole are around 4.5% - with franking credits that is about as good as cash but with the prospect of capital gains – albeit modest – are likely. One good ‘reason to believe’ in the US or Europe and we could bounce up.

The downside risk is the ‘very new’ Labor. Mining taxes, not-so-independents, and back room shuffling may stifle growth. Fortunately, volatility, market fear and other indicators seem well contained. A bit more of a crab (sideways) market and then off to the races – it’s just a question of whether it is the Spring or Autumn Carnivals.

Foreign Equities

Amazingly, they (overseas) are doing better than us. It has to be the RSPT or MRRT or whatever Bob Brown and the Independents can concoct. The mood of analysts on Bloomberg TV and Sky Business seems to be getting a little better. The double-dippers are getting less coverage. As I argue in my next column for *Professional Planner* double dippers are just making a probability statement – like a 30% chance – are just taking an each-way bet. Of course the ‘Celebrity Economists’ like Roubini, Stiglitz, Ferguson and Krugman are strutting their stuff but not really adding any insights – great media. Entrenched opinions are just that. Make your statement and move on.

Bonds

There is a lot of money in bonds earning very little. It seemed safe but in time earning nothing will tilt investors to earning something – and that is equities. There is talk now of a bond bubble bursting. Watch this space.

Interest Rates

All has been quiet on the Western front for some time but with many being surprised in the (massive) strength of the Australian economy, inflation worries will re-emerge and then the men from the RBA will again wield their big stick. One more increase before Christmas is very likely. Two is possible but either way a 5% headline is likely before the Easter Bunny arrives.

Currency

Some of the ‘parity’ parrots have re-appeared but there is nothing special about parity and the dollar ‘belongs’ with a 7 or 8 in front of it. No one can predict exchange rates. Just watch with interest.

Oil

Seems to be contained with a 7 in front. We need real US growth (or the opposite) to change that.

Gold

Gold reached a new high this month but that is likely to be it – in a ballpark sense. All the bad news is factored in and the taxi drivers are competing with the hedge funds.

Other ...

The Baltic Dry index – which many of us use as an indicator of shipping iron ore to China – has improved massively over the month. As new ships come on board, who knows what the real relationship should be – but just getting back in the right direction is OK.