Woodhall's Wrap

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The Big Picture

One out of three ain't good. Mid-month, Westpac went out on a limb and predicted 4 rate cuts by September 2012. Attention grabbing - yes. Correct - doubtful. The end-of-month print on inflation put an end to hope of a cut any time soon, but most money is on an RBA-do-nothing for a few months - at least.

Markets struggled with the political infighting over the debt ceiling in the US Congress. At the first hint of a slight compromise (mid July), our market shot up 150 points in a few days. Of course that fizzled out when we all realised hope is different to action. The August 2nd deadline looms large but weekend scurrying in Washington DC might yet avert a disaster. If the latest proposal of a bipartisan shift of the problem until after the 2012 Presidential elections comes off today (or this week), expect a 'happy little surge' in all markets. Whether this is the start of a big rally is not clear. That will depend a lot on how the ratings agencies interpret the move.

The US reporting season was pretty good and, apart from a few rats and mice, our companies haven't downgraded profits as many had expected before our season starts. It's off to the races with our reporting season this week. A good season here, and a partial debt-ceiling solution in the US would be brilliant - but old wounds take a long time to heal. Expect a few dips along the way - even if it is good news today or this week.

The one reasonable piece of news was that the European debt situation has been firmly pushed away for some time. Germany and France got together and ring-fenced Italy and Spain - so they are now safe - if they weren't already. It now matters less what happens to Greece (except for the Greeks) as the contagion effect has been all but eliminated. So it is only one out of three for the month, but rates and debt-ceilings should be better understood this week.

Of course the big news of the month was News. How did that guy get past security with a custard pie - and right up to Rupert Murdoch without an army of 'helpers' in the hearing room. But wasn't the Mike-Tyson-like response from his wife, Wendi, wonderful. Perhaps if we can clone her and put one in Canberra, one in the RBA, and one in Washington, we could all sleep peacefully.

Finally, if the debt ceiling, Europe and interest rates are off the table - for the moment - what will the media types find to try and spread their version of gloom? Could they actually be positive for a change?

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Asset Classes

Australian Equities

There were two optimistic signs last month amid the otherwise nervous times. Our market reacted really well to the slightest hint of a resolution to the debt ceiling crisis. And we didn't get much in the way of downgrades in the 'month of confession' - the month preceding the August reporting season. Our modelling of broker forecasts is still very solid and we are very under-priced - by about 10%.

The retail sector (in Consumer Discretionary) did take a bit of a beating but that was hardly unexpected. The question for that sector is less to do with consumer's feeling wobbly but more to do with a structural change within the industry. After nearly three years of continuous discounting, why would anyone pay full price anymore?

Foreign Equities

Despite all of the troubles in Washington, the Dow Jones finished the month only down about 250 points - but the Dow futures this morning (1 August) suggest most of that will be erased tonight providing, of course, the debt ceiling is hiked sufficiently.

But it was not all gloom in the USA. The last job claims figure was quite good - easily beating expectations. Companies like IBM and Apple smashed expectations in their reporting season - and there seem to have been more 'beats' than usual.

Obama didn't seem to come out well in the debt ceiling negotiations. In April he went for no spending cuts and a tax hike. He is due to speak today (Sunday in the US) and may announce spending cuts and no tax hike! The positive is that the debt ceiling could be lifted enough for him to get on with his election campaign unfettered by this problem.

Bonds

July wasn't the month to be optimistic about bonds - in Greece or the US but we, in Australia, march on. There does seem to be some talk about the importance of bonds in a portfolio but I suspect that will vanish as soon as the dust settles on the US solution.

Interest Rates

Westpac pulled one out of the bag with a massive call for a full !% cut in rates by September 2012. That never seemed on the cards. Rates aren't high compared to the historical normal range. A firm 'no increase' from the RBA this week would restore a lot of consumer confidence. One cut this year would start smiles spreading from ear to ear. Four cuts would have property prices going through the roof - and the need for hikes. We did get to see a lot of the Westpac logo though. We're they going for public sympathy after their double hike two years ago?

The inflation print at the end of July (for Q1) was 0.9%, 0.2% above the consensus estimates. The main cause was a massive increase in the price of fruit and veggies and petrol. While an interest rate hike would not have, and will not cause those types of price increases to vanish, the print was all that was needed for speculation of a rate rise to return. Almost no chance of a rise tomorrow but one by the end of 2011 seems a distinct possibility.

Currency

The dollar firmly got set above \$1.10 but flirted with a sub \$1.06 along the way. It is too early to call a fall in our dollar but I still think one is likely as soon as the US looks sorted. That could be days, months or much longer - but significantly higher is now much less likely.

Oil

Oil has tried to get above \$100 again but failed to breach that level in its few runs during July. Again, if the US looks sorted, more stability will come in all commodity prices. For the moment, volatility will remain.

Gold

Gold broke through \$1,600 in July on the back of the US debacle. It might take some time for investors to get used to fewer financial problems around the globe. It could go either way in August but down thereafter is much more likely than up.

Regional Analysis

Australia

The carbon tax seems to have morphed into a redistribution of income. It is hard to see how that will change behaviours but it sounds good. Time to move on. The retail crunch is deservedly getting a lot of attention. There seems to be a major structural change forming. Lots of little bits - like exchange rates, internet shopping, GST-free on-line purchases and nearly three years of sales discounts - have joined forces to make consumers aware that we pay a lot more for stuff in our shops than foreigners do in their countries for similar products. It does not seem possible to reverse this trend.

The labour market data showed a little stutter but, by and large, this level of unemployment is about as good as it gets - if history is anything to go by. It is confusion by domestic and global issues that has knocked the confidence out of us. The money is in our pockets (or bank accounts) but it is wise to have a little hoarding when we don't know what will happen next! When that vision is clearer, I think we will spend again.

China

China seems to have been unusually quiet this last month. I guess complaining about their economy running too fast or too slow gets a bit tedious. We deserve a month off from that flip-flopping.

U.S.A.

The real problem with the US deficit doesn't really get going for a few years. When the baby boomers start retiring and expecting pensions and health care, the action really starts. The Republicans seemed to be avoiding the question of social responsibility when it calls for spending cuts. Of course there is always room for savings in government programs but cuts to pensions doesn't seem the way to go. After all, if some Greeks can still retire at 50, it isn't reasonable for Americans to work until they drop - especially given their high unemployment.

Obama has struggled to retain control which doesn't bode well for his chances of re-election. If the US citizens share the confusion that seems to abound in politics, it makes it harder for them to get back on their feet. Double dips still seem unlikely but slow grinding growth may be with them for some time to come. But we have China.

Europe

At long last there was positive news from Europe on their debt management. By looking after Italy and Spain - who were not really in trouble but could have become collateral damage following any Greek default - the world seems a somewhat safer place. It matters little to us now if the ratings' agencies call the Greek debt restructuring a default of not.

Rest of World

With the passage of time since the Japan disasters, the supply chain must be getting back closer to normal. The second half growth for 2011 might finish up more like a Q4 start - but we can hold out that long.

The London Olympics is now less than a year off. The last time they staged it, it was 3 years after the Second World War - to boost spirits. It worked then and 3 years after the GFC it might even help do the trick again. They even seem to be getting the sporting sites ready on time!