FULL FINANCIAL ADVICE

PATRON Financial Advice

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Economic Update

By Ron Bewley*. Brought to you by PATRON and Full Financial Advice

Within this month's update, we share with you a snapshot of economic occurrences nationally and from around the globe.

The US Fed destabilises market expectations:

- The Fed fails to hike its interest rate
- Optimism surges in Australia
- Japan is still trying

We hope you find this month's Economic Update as informative as always. If you have any feedback or would like to discuss any aspect of this report, please contact your Financial Adviser.

The Big Picture

August was terrible for stock markets around the world. While September may not have felt great, markets were volatile but mainly moving sideways – at least until the last few days of the month.

By far the biggest news from last month was the United States (US) Federal Reserve indecision on interest rates. This central bank flagged late in 2014 that its first rate hike in eight years from the emergency low setting of 0.0% - 0.25% would be "data dependent" but most analysts pencilled in mid-2015 for the event.

June came and went and September seemed to be the new date in economists' minds – but not in market pricing by the people, who trade rather than talk. Although jobs creation has been quite strong in the US for a couple of years and inflation has been subdued, there was no need for a hike. But it is now seen to be embarrassing for the US to have rates so low for so long.

In the end, the Fed didn't hike last month but it was the accompanying statement released at the press conference that spooked markets. In essence, the Fed argued that global growth looked like a bit of a problem and recent volatility made it a good idea to wait. It was that latent Fed fear that put markets into a spin.

Dr Yellen, the chair of the Fed, gave what would normally have been a low-key speech a week after the press conference at a university but everyone was waiting and listening for a signal. Yellen's voice uncharacteristically faltered during her speech and she wasn't able to finish the speech or answer questions as planned – and she needed medical attention when she left the podium.

The official statement said that she was suffering from 'dehydration' which seems a bit like a 'drunk' politician on TV claiming to have been 'tired and emotional'. The stress for Yellen must have been immense in her bid to quell market uncertainty. We certainly empathise with her. She said what we wanted to hear – rates will likely go up this year.

Most of the Fed members have now joined forces to say that rates will go up this year but there are only two meetings to go in 2015 and one of those has no scheduled press conference to follow. A quarter of a per cent rise (or less!) would have no impact on the real economy and inflation is too low to worry about. It is a case of getting a rate hike out of the way so we can all move forward.

But just "carrying on" isn't what is happening in Australia. Malcolm Turnbull swept into the Prime Ministership and had an immediate big positive impact on consumers. The first consumer confidence index report after the spill came in at +8.7% which is the biggest improvement since the index was created about seven years ago. Unsurprisingly, the index did pull back a little in the following week.

Jobs data at home were again strong. Rates were also kept on hold but a cut soon is quite possible. A hike is out of the question.

So we are all waiting for the Fed to pull the trigger to set our minds at rest. Until then, it is quite likely that market volatility will continue. However, the long-run prospects for us look just as strong as they were a few months ago. It is just so hard waiting!

Asset Classes

Australian Equities

The market moves in the last few days of the month were crazy. No human knows why the daily changes were so large.

Even though only two days in September saw the ASX 200 finish below 5,000, the sinking feeling pervaded most investors' thinking. The market lost -3.6% on the month. We have estimated that the market has a fair value of 5,700 so the market was very cheap by our reckoning at the end of September by -12.0%.

The current volatility is unlikely to be a long-run problem – or so we think – it is the price for staying in the market. In a month or two the volatility could well subside and we can be headed on a 'normal' path upwards. If Turnbull injects that innate quality Australians have to win into our political decision-making – everything could change for the better sooner rather than later.

Foreign Equities

No market was spared from the down draught that hit markets in September. Markets go up and down. Confusion creates volatility but we see the long-run future as solid.

The S&P 500 was down -2.6% on the month; the German DAX was down -5.8%; and the London FTSE was down -3.0%.

Energy, Materials and Healthcare were the sectors worst hit around the globe.

Bonds and Interest Rates

We thought – and still think – that the US Fed does not need to hike rates for the first time this year to control the economy. But it made such a mess of its communications after the September meeting that it needs to act quickly – so that it can signal that it believes the economy can sustain a little hike – even if it doesn't need one!

The Reserve Bank of Australia (RBA) also kept rates on hold again in September. It would probably be wise for the RBA to wait and see what impact, if any, the new Prime Minister and Treasurer will have on business and consumer confidence. A rate cut is still possible this year, but it is now much less likely than it seemed last month.

The New Zealand Reserve Bank cuts its interest rate for the third time this year.

Other Assets

Iron ore prices have stabilised at just under $60 / tonne. The Brent oil – world – price is also stable but the US oil price (WTI) did fall a little over September.

Regional Analysis

Australia

Australian employment improved yet again – by +17,400 new jobs in August. Unemployment came in at 6.2%, which is down from 6.3% the month before. GDP growth for the economy was weak at +0.2% for the quarter ending in June but +2.0% for the year.

The main problem we have been facing in growing our economy is getting business to start investing. Lower rates alone are not enough to induce confidence – it is the political backdrop that shapes business conditions.

Turnbull has started off as an assured leader who will not be badgered by questions from the media trying to force him to make policy decisions on the run. While nothing is certain in this world, we now have a good chance to get things going again.

In his 'previous life' Turnbull was a journalist, a highly successful barrister and an investment banker. Possibly more than most in parliament he has the experience to communicate with big and small business. And since he seemingly uses public transport whenever reasonable in his work he might well shake off the arrogant tag he had when he was previously the Coalition leader.

China

The China Shanghai Composite stock market index has seemingly settled down after a -30%+ fall from its peak in the middle of the year.

Retail Sales and Industrial Output are still growing at double-digit rates but Industrial Profits did fall significantly last week. The problem in China is similar to the one that is affecting most countries in the world. Oil (and other commodities) prices have fallen significantly over the last year or two and that impacts on measuring inflation and balancing costs and revenues for profits.

China's General Secretary Xi Jinping visited President Obama in the US to strengthen its role in the world. China is transitioning its economy into one that is no longer just dependent on infrastructure spending and exports. It needs to get its currency accepted as being traded in a mature market. It is a long road but China – like all major countries before – will do all that it can to perform well. It is capable of more stimulus to maintain strong growth if needed and probably will do so.

The 1st of October official measure of manufacturing output exceeded expectations and last month's number, it was only just shy of the 'sweet spot'. That's why markets rallied hard on the news and again the 'perma-China-bears' ducked for cover.

U.S.A.

US economic growth was revised upwards for the second and final time for Q2 to +3.9% over the year. The nonfarm payrolls (jobs increase) were a little on the low side at +173,000 but one number does not make a trend. And these numbers also often get revised.

The US unemployment rate now stands at 5.1% but the problem is that, as manufacturing languishes in the US, people are moving into the services industries for work. The average rates of pay in many services' roles are less than those in manufacturing so wage growth is not accompanying jobs growth – a bit like here in Australia.

Europe

European news is still dominated by how the European Union (EU) can deal with the immigration/refugee issue. Putin is now involved in Syria, but no one is quite sure which targets his air force is bombing! This ISIL problem is exceptionally difficult to solve.

The Greek Prime Minister, Alexis Tsipras, was re-elected in his snap election by forming a coalition with a small number of right-leaning independents. This solution means that it is more likely that Greece will co-operate with the rest of Europe to control Greece's debt problems.

In due course – if it bites the bullet – debt forgiveness will probably follow so that Greece can rebuild its future.

In spite of strength of its economy, the United Kingdom (UK) has seemingly postponed the mooted rate hike until next year. Jeremy Corbyn was elected leader of the (opposition) Labour party that was decimated when the Scottish National Party took all but one seat from Labour in in this year's general Scottish election. Since Corbyn is from the extreme left, it looks like Labour will be in the wilderness for many years to come. Tony Blair was arguably such a successful Labour leader because he – like Hawke and Keating – took a far more 'centrist' approach.

Rest of the World

Japan has been struggling for a couple of so-called 'lost' decades in a low-inflation environment. Prime Minister Abe brought in three new policies this September in a hope to turn the latest negative inflation read around. But Abe's main problem is stemming the predicted fall in population. He is claiming he will be able to stop the current population of 127 million from falling below 100 million in the foreseeable future! That is, natural attrition will remove more than the population of Australia from the Japan total in short order!

Iran is getting ready to get its oil exporting up to normal levels after its successful negotiations over its nuclear presence – possibly producing as much as a billion barrels per day. Since oil prices are already depressed, this extra supply is likely to keep a cap on oil prices in the medium term. That's very good for consumers but not so good for producers.

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