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Economic Update

By Ron Bewley*. Brought to you by PATRON

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

Will the Fed trump Donald?

- The United States (US) Federal Reserve doesn't seem to be learning
- Aussies save AAA rating
- Our economic agenda at home is pointing the wrong way

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

Perhaps the biggest problem facing global markets, as we start 2017, is that people are possibly too optimistic about the 'Trump effect'. The Federal Reserve – the US Central Bank – started 2015 asking us to be patient about expecting rate hikes. We had to wait until December of 2015 to get the first hike in nine years – but they then pencilled in four hikes for 2016. But they only gave us one in December 2016.

As we start 2017, the Fed has just upped the ante for the number of 2017 hikes from two to three – and then three for each of 2018 and 2019.

Much of the Fed's (and private) optimism is about Trump cutting taxes and boosting growth through infrastructure spending, etc. He has pledged that, but there isn't yet even a 'back-of-the-envelope' policy. There isn't even yet a Cabinet sworn in. There is nothing but optimism! The US Consumer Confidence index hit a 13-year high in December!

We think Trump will deliver a much better future than the US and the rest of the world now enjoy – but such a change in attitudes and behaviour takes time. Markets anticipate growth. Perhaps they, and the Fed, are getting a little bit ahead of themselves.

If the Fed starts hiking rates in anticipation of Trump – and Trump takes a little longer to deliver – markets may not like it. The Fed should be patient as they implored us to be at the start of 2015.

We will learn a lot in the next two months. There will be two more US labour market data reports and a Fed statement. Trump will be sworn in on January 20th. But the next two months are even more critical for Australia.

Our labour force data was dismal in 2016 and the so-called MYEFO (budget update) in December did nothing to inspire. But we held on to our AAA credit rating.

Our Reserve Bank needs to act quickly but they are on holiday until February – shades of Nero playing the fiddle while Rome burnt. They don't seem to have the mindset to do anything just yet.

But is our economy in desperate straits? Part-time jobs are replacing full-time and the last economic growth figure was -0.5%. In all probability, that -0.5% was a blip but the average over the last two quarters was as close to zero as you can get without getting there. Desperate, no; weak, yes!

The problem is that the Opposition for close to a decade has acted as though it was in power and it blocks not just bills – but the construction of good ideas – with rhetoric. We need a 'Trump' in Australia to shake things up. We have had it so good for so long, the so-called leaders are living off their track records like ageing boxers going into the winter of their careers.

As long as China and the rest of the world do well – as we think they will – we won't likely do badly. But to do well at home requires a new approach. Our market posted double digit returns (including dividends) in 2017 but we are still well below our 2015 high – let alone our all-time high. Wall Street – and other markets – keep posting new all-time highs. Our investments have delivered a lot more than Canberra!

But one thing to reflect on as we make our personal New Year's resolutions is that we, as a country, are not keeping up with the new world order. The global mantra has become tax cuts and infrastructure spending to get the world economy moving again. But at home we are imposing tax hikes on super and balancing budgets at all costs. New thinking – or, at least, energy – is needed and soon.

Asset Classes

Australian Equities

The ASX 200 delivered capital gains in December of +4.1% to add to the +2.3% of November in a very nice 'Santa rally'. Over the year of 2016, the ASX 200 produced a total return (including re-invested dividends) of +11.8% but that figure masks the sharp swings in sectoral returns over the year. Materials delivered a massive total return of +42.9% while Telecommunications returned -7.1%. That is, Telcos had a capital loss which wiped out not only all of the dividends, but a further -7.1% to boot.

Stocks in the high-yield sectors lost heavily to the other sectors over 2016 by a hefty -10.7%. But over the last quarter these aggregate sectors swung in the opposite direction with high-yield sectors winning by +7.5% in only three months.

Our market has not been kind to the set-and-forget type of investor. In fact, a keen eye was needed to pick up new trends and the ends of old ones.

On top of that, there was an unusually large number of sharp sell-offs in only one day from stocks in the top 200! Indeed, 25 different stocks fell by 15% or more in a single day in a year where the broader index was up strongly.

Moderately-sized companies had their share prices pummelled on bad news or even just so-so news. On top of that, there was a knock-on effect to similar companies even though they did not report any problems.

Perhaps more than normal, do-it-yourself stock pickers might have lagged behind the index in 2016 – and they might be facing a similar experience in 2017.

We think the market is fairly priced and returns in 2017 might be around the same order of magnitude as those we got in 2016.

Foreign Equities

While our market languished at times in 2016, all four major Wall Street indexes made new highs near the end of 2016. Indeed, the Dow nearly broke through 20,000 in the last week of December.

For the year, the ASX 200 gained +7.0% (excluding dividends) while the S&P 500 recorded +9.5%. Our higher dividend payouts account for most of the difference. The London FTSE gained +14.4% despite having had 'Brexit wobbles' mid-year. The German DAX posted +6.9% but the Tokyo Nikkei was flat at +0.4%.

The Shanghai Composite went backwards with -12.3% but it might be recalled much of the angst in January was due to that market not coping with new measures to control daily market volatility.

Our modelling has the S&P facing a much brighter future than the ASX 200.

Bonds and Interest Rates

It took twelve months of waiting with baited breath but the Fed finally hiked its main rate by one quarter of one per cent in December. Our central bank did not change its rate.

After a decade of gloom surrounding rates, there is now a real push that world rates will rise on the back of economic growth promises. The trouble is, at home, we kept our rate too high for too long and we are now in the cross-fire.

Other Assets

Commodity prices are, in general, so much higher than most were predicting in the early-2016 slump. Our dollar moved around a little. Gold has been on the way down. OPEC agreed to oil supply restrictions, but will they work? They started on January 1st 2017 so we will soon know if they are working.

At this point in time our best forecast is that commodity prices are likely to be stable and possibly rise a little – but not too much. If oil prices go up much further US shale oil producers will open the floodgates. Since China does not seem likely to pump prime economic stimulus in 2017, its growth increases are more likely to be gentle with commodity price increases to match.

Regional Analysis

Australia

Our economic growth for quarter three 2016, came in at -0.5% which was much worse than the worst analyst expectations. Many suggested it was largely a blip and that the next number will be positive. While that might be the case, our labour force data is not stepping up to the plate.

We just recorded the eleventh consecutive month of falls in full-time employment using the official trend data. Part-time jobs have increased but they amount to about half of the hours worked per person on average.

Westpac's consumer confidence index slumped by a big -3.9% to a level that now shows there are more pessimists than optimists. NAB's business confidence index also fell and to levels not seen since April 2015 – but the NAB's business conditions index held.

While the world is now starting to talk about 'fiscal expansion', or government spending to promote economic growth, our government is still locked in an austerity mindset. And the Reserve Bank is doing nothing on monetary policy. So we are totally at the mercy of world growth to support commodity prices and our exports.

China

China recorded a two year high in its monthly manufacturing index on December 1st. It then backed up with double digit growth in retail sales and strong industrial output mid-month.

China's inflation jumped up +1.3% after a series of negative reads. That is very encouraging.

U.S.A.

The US is really getting behind the Trump bandwagon. He has toned down some of his outlandish rhetoric and policies. People also seem to be starting to forget they don't like him. What they do seem to like is a person with a policy to improve things and just get things done.

Consumer confidence just hit a 13-year high in December! Their labour force data came in at +178,000 new jobs for the month and that was very close to the monthly average for 2016. It was a good result but nowhere near strong enough for the Fed to act to cool things down.

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There is a danger that, in a few months, people might realise that they jumped the gun on growth expectations and a small bout of volatility could follow. But the US economy is looking really great for the year after (2018) and beyond!

Europe

The German economy is expected to finish 2016 strongly. Spain is even considering getting rid of the siesta in return for an earlier close to the working day to improve productivity. Perhaps they have installed air conditioning!

Although, sadly, terrorist attacks keep occurring across Europe, the rest of the economy is stabilising.

Christine Lagarde – the then French Finance Minister and now Managing Director of the IMF – was found guilty of negligence with regard to $400m of fraud perpetrated on her watch. However, she was not penalised because the court determined that 'she was distracted by the GFC' at the time. Some people get all of the breaks. And what happened to the old excuse, 'the dog ate my homework'?

Rest of the World

Japan's central bank made a very optimistic statement about its economy but that country is plagued by falling population levels. Prime Minister Abe made a good fist of trying to pump prime the economy, but sadly it did not do any better to stop – or slow-down – the slide. It just recorded the ninth successive month of negative inflation reads.

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Important information

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