PATRON Financial Advice
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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.

Economic growth improves in key countries

- China economy shows strong signs of strengthening

- Australian employment data continues strength

- Rates on hold in Australia and the United States (US)

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

There were some notable economic growth numbers released in July. After a few years of declining (but still stellar) growth numbers in China, the latest statistic was back up to 6.9%. The new China leadership team is about to be ushered in and the Chinese know how to throw a party. On top of that, the China Purchasing Managers Index (PMI) came in at 51.4 for manufacturing and 54.5 for services – both in the sweet spot. Throw in 11.0% for Retail Sales and 7.6% for Industrial Output and you have what Keating might call, 'a beautiful set of numbers'.

Turning to the US, the anaemic growth in Q1 was overshadowed by the June quarter coming in at 2.6%. True it's not the 3% that the Fed is aiming for or the 4% that Trump was dreaming of. But 2.6% is really solid. Unemployment is low at 4.4% and 222,000 jobs were created in June when only 180,000 new jobs were expected. It is true that wage growth was low at just 0.2% but you can't have everything all at once can you?

Even Australia was looking good. We had some very nice jobs and unemployment data – against the trend of 2016. For whatever reason, the labour force data are looking better. But the RBA chimed in at the start of July saying that 3.5% is our 'neutral' interest rate. That is, rates should be at 3.5% when things are chugging along. Since we are sitting on only 1.5%, there are a lot of hikes in the pipeline!

It was a bit silly to advertise that opinion just now and an Assistant Governor had to come out and hose things down. Retail sales did come in at a biggish 0.6% for the month. We're not cooking on gas but at least we are cookin' again.

As we go around the world the United Kingdom (UK) is starting to struggle a little with its latest growth of only 0.3% for the quarter and Brexit looming large. Prime Minister Abe in Japan has gone from rock star status to a meagre approval rating of 29.9% in a few years. The Royal Bank of Canada bumped up rates to 0.75% from 0.5%.

So the dice are still rolling. Fortunes are rising and falling but there seems to be no basket cases anymore and there is lots of good news.

We became aware of a new expression this week. It's been out but under the radar for a few years. It's still worth sharing. On asking why stock markets – particularly in the US – remain strong – the new catch phrase is that it is a TINA market. Not as in Turner or Arena, but it is the acronym for 'There Is No Alternative'. Money has to be invested somewhere when cash rates are so low.

TINA puts a safety net under markets for a while but we must be vigilant for when Tina starts singing.

So where to from her? Trump is floundering but his economy is doing well. The Australian economy seems to have stabilised. To us, it looks like a smooth ride ahead – until we see otherwise.

The current US reporting season has been unusually strong meaning that increases in earnings are supporting recent stock price strength. Can it go on? In a word, yes!

The big Tech Companies are having mixed results but they are looking strong. We should never be complacent but the second half of 2017 doesn't look too bad at all. Perhaps we all deserve a break after the trials and tribulations of 2008 – 2015.

Asset Classes

Australian Equities

The ASX 200 was flat for the month of July. The Materials sector was the strongest on the back of some very strong commodity price movements. Healthcare took a beating at -7.5% with Utilities (-5.3%), Telcos (-4.3%) and Industrials (-3.2%) not far behind. Financials (+1.2%) put in a creditable performance. A big sector rotation just took place.

Our August reporting season is just getting underway. As always, the companies' outlook statements will be crucial for the future of our market. We have found some recent softening in broker forecasts of company earnings and dividends. At least that downgrade has resulted in our forecasts for capital gains to be only a tad under the long-run average.

Foreign Equities

The S&P 500 fared a bit better than us in July posting a solid +1.9% capital gain. The London FTSE also did well at +0.8%. Emerging Markets were particularly strong at +4.1% on the rising tide of commodity prices.

Our expectations for Wall Street are for a good finish for the year despite the strong first seven months of +10.3%.

Bonds and Interest Rates

With the "Fed" (US Federal Reserve) on hold again in July, the next chance for a hike is at the September meeting. But most forecasters are not expecting another hike this year. The odds of a rate hike by December are priced in at a little under 50%.

The Fed is widely expected to start its balance sheet repair in September. This amounts to gradually lowering the $4.5 trillion bond debt down to $2.5 trillion over a number of years. Since this policy will gradually raise long rates on its own, there is no reason for the Fed to also raise the underlying Federal Funds rate at the short end.

The RBA kept rates on hold again in July and August. The majority of pundits are expecting the next move to be up but not until at least the middle of 2018 – and possibly 2019.

Our view of needing a cut at home is on the back burner for the moment. We need a little more data to change our call. It all depends upon the next GDP growth number to be posted on September 6.

Other Assets

Commodity prices were on a flier in July. Iron ore was up +15.2%, Brent Oil up +9.8% and Copper up +6.2%. Our dollar was up +3.8% against the greenback.

The volatility index called the VIX was down -3.7% in July. This fear index is around all-time lows.

Since we are a commodity producing and exporting country, the restoration of solid commodity prices bodes well for our total exports and GDP growth.

However, not everyone wins from this sectoral rotation. Healthcare and a number of Industrials names are finding stronger headwinds after a good first half to 2017.

For example, our Healthcare sector is up +13.0% for the year-to-date including the poor -7.5% for July.

Regional Analysis

Australia

Our headline CPI inflation came in at only +0.2% for the quarter or +1.9% for the year. Since the RBA's target range is 2% to 3%, this read gives the RBA no motive to raise rates anytime soon.

With total employment up around 170,000 in the first half of 2017 – with nearly all of them full-time jobs – we are back on track. During that period, the unemployment rate has been stuck at around 5.6% and wage growth is non-existent.

Europe

The focus in Europe is on what the implications of Brexit are for employment and trade. It will be nearly two years before we find out the full story so we cannot expect much good news from that region in the medium term.

However, the underlying economies are so much stronger than in recent times. We don't have to waste much energy worrying about Greece and the other 'PIGS' countries anymore. Can you remember what PIGS stands for? Those days are gone!

China

The China data have been on a roll for quite a while. Without taking sides, it is hard to conclude after recent data that China is not undoubtedly doing well at the moment. Yes, there are political problems with the US and who would want North Korea as a neighbour – let alone an ally.

But what seems to be forming is a view that China has regained its role as a lead player in the world – as solid and dependable – at least in an economic sense.

US

Trump is hiring and firing quicker than he did on "The Apprentice" – but the West Wing is for real.

The US is facing a number of problems in a month or so but these 'episodes' on TV have not stopped US jobs and growth.

We don't think anyone can reliably predict how this scenario will play out but, as annoying as the tweets and press releases are, the economy is marching on!

Rest of the World

With sanctions on Russia being on the front burner, and the woes of the Venezuelan leadership also up there on many news wires, some instability in oil pricing is likely. Both countries are big exporters.

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