

PORTFOLIO MANAGEMENT IN THE CURRENT GROWTH ENVIRONMENT

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DISCLAIMER

This presentation is extremely general in nature and must be seen as a broad background briefing only.

Investors need to discuss investment choice, strategy and decisions with their adviser or advisers who understand their particular needs.

The theme of this presentation

- **From mid-2016 to January 2018, global growth was strong and largely synchronised across countries**
- **Now there are many investors and commentators claiming the good times are about to end**
- **My theme: the “wow” factor from global synchronised growth has dissipated; a lot of good news is now priced into markets; sentiment in investment markets will swing widely; an early global recession is unlikely**
- **allow for the wide swings in sentiment and markets - and benefit from them**

What I've learnt (and re-learnt) on investing since 1962?

- **Be a patient investor**
- **Benefit from the magic of compounding**
- **Allow for cycles in the economy and investment markets**
- **Maintain a sensible diversification**
- **Limit your borrowing; and distinguish good" from "bad" debt**
- **Recognise the many shades of grey. Don't follow the "crowd"**
- **Allow for the powerful influences from abroad – but watch out for fake crises – such as in early 2016, 2011, 1994**

And what is the mistake that investors most-frequently make?

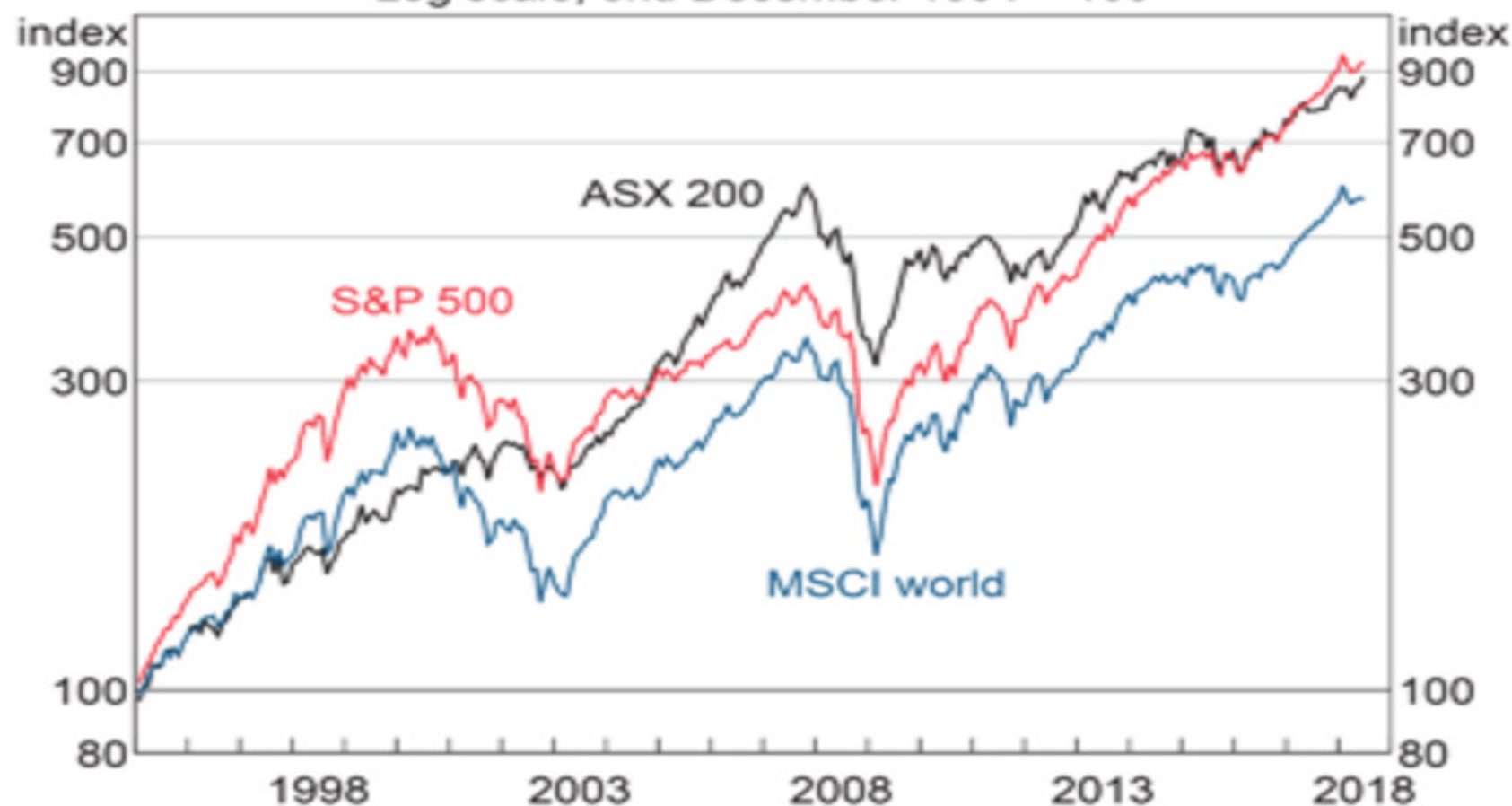
- **Believing future investment returns will be a simple extrapolation of recent experience**

Increasingly, our economy and markets are affected by global influences – but it's complex

- **Our economy: main influences are China and US**
- **Our shares: main influence is usually US shares**
- **The A\$: affected a lot by China, US\$ and US interest rates**
- **Our bond yields: influenced by US yields, German yields and inflation**
- **Our cash rate: determined mainly by local influences**
- **Our house prices: determined mainly by local influences**

Share Price Accumulation Indices

Log scale, end December 1994 = 100



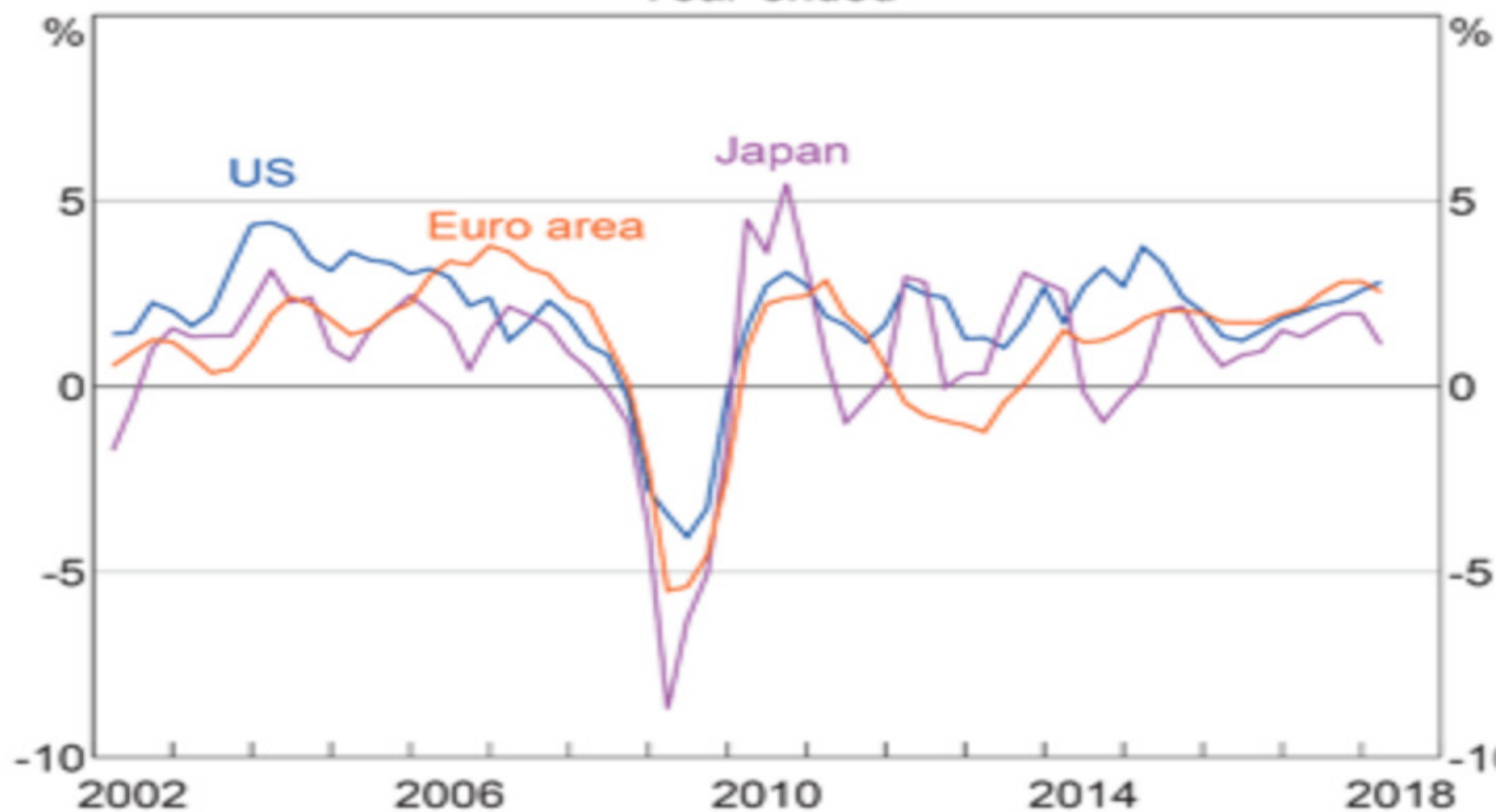
Sources: MSCI; RBA; Thomson Reuters

The past 30 months for the world economy

- **Early 2016: fears of a hard landing for China and a US double dip**
- **Mid 2016: quickening in US growth; China avoids hard landing**
- **Late 2016: zig-zag in market views on Trump**
- **2017: global growth was stronger-than-expected and synchronised**
- **2017: positive returns from all major asset classes AND low volatility**
- **2018: some slowing in global growth, choppy markets, higher volatility**
- **Now, increasing concerns that strong and synchronised growth is coming to end**

GDP Growth – Advanced Economies

Year-ended



Source: Thomson Reuters

What explains the better-than-expected good times since mid-2016?

- **Expectations were still low after the global financial crisis**
- **The long period of highly accommodative monetary policy in major economies – low cash rates and quantitative expansion**
- **Strong growth in employment in the US**
- **Trump's cut in company tax rate and write-off for capital spending**
- **Low inflation**
- **Geo-political concerns have not been seen as hurting as much as was feared (at least while global economy is strong)**

Why are fears now returning of choppy times?

- **Concerns US monetary policy will be tightened too quickly**
- **Concerns Europe could tighten too quickly next year**
- **US upswing is becoming “very old” and “will soon have passed on”**
- **Flattening of US yield curve**
- **Stretched valuations in share markets**
- **Concerns of a marked slowing in the Chinese economy**
- **Worries about effects of the escalating trade war**
- **Worries about geo-politics**
- **Concerns about US budget deficit (soon 5% of gdp)**

US: Recession probability inferred from the term rate spread

Source: Fed of Cleveland



US monetary policy

- **Seven increases in the cash rate since December 2015**
- **Many investors expect 5 to 6 further increases by end-2019 to “normalise” cash rate and contain inflation**
- **But what if US inflation doesn’t increase all that much, even allowing for some months being like February 2018?**
- **US quantitative easing is on the way out**
- **Fed’s Powell is one of best appointments by Trump ad Congress**

Euro-zone monetary policy

- **Has been super-easy: negative cash rate, quantitative easing**
- **Quantitative easing now being phased out – but at a snail pace (currently ECB purchases of bonds > new issue of bonds by all euro-zone governments)**
- **Slow and gradual increases in cash rate from mid-2019???**
- **Many political problems of maintaining the coalition government in Germany and working with populist government in Italy**
- **Growth of 1.5 to 2 per cent over next 12 months?**

China

- **Big changes since Deng Xiaoping**
- **Must expect a fall in trend rate of growth given big increase in gdp**
- **Re-orientation of economy towards services and consumer spending**
- **Big growth of borrowing by regional governments and for property**
- **“Fake” crisis in early 2016 based on “ghost cities” and “capital flight”**
- **Risk of another fake crisis building up**
- **Nationalist policies and response to Trump on trade war**

Trade wars

- **Trump sees others countries trade surpluses with US as a sign of unfair trade**
- **No awareness of history (Smoot-Hawley), of multi-lateral trade, or of what causes the US to run its over-all trade deficit (low saving)**
- **Trump's concerns on IP and investment have some validity**
- **Escalation in trade wars could take gloss of global growth in the short term and reduce real incomes over the longer term**

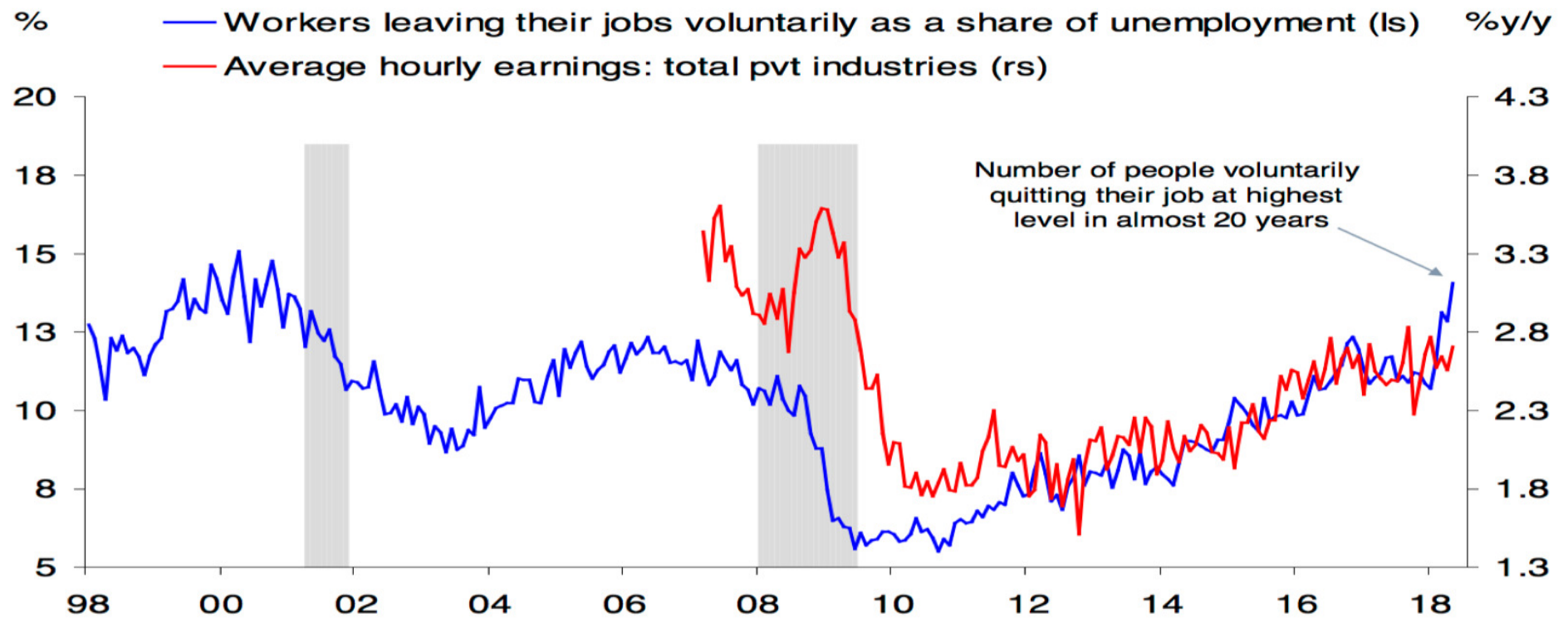
Major economic blocs: a summary

- **US: upswing is old – but upswings don't die just from old age**
- **US: Huge cut in rate of company tax. Generous tax deduction for capital spending are contributing to growth. Big budget deficit???**
- **US: watch: credit, inflation, wages, inventories, shape of yield curve**
- **EUROPE and JAPAN: growth at or a little above trend rates**
- **CHINA: trend growth is slowing; fears of a slump are building-up**
- **EMERGING ECONOMIES: hurt by stronger US dollar; some country-specific problems**

Global inflation

- **Not much inflation around the world, despite stronger employment and quickening + synchronised growth in GDP**
- **Why? Memories of GFC. Moderate pace of global recovery. Globalisation. Technology. Weaker unions. Low rates of wage increases. At times, low energy prices.**
- **Short-term shock in February with jump in US wages and inflation**
- **US inflation is creeping higher but expectations in bond market are for sustained low inflation**
- **Inflation will return – especially if synchronised growth continues**

The US: More people leaving their jobs indicates upward pressure on wages



10-year Government Bond Yields



Source: Thomson Reuters

Australia

- **Gdp growth a bit above 2.5%**
- **Boost from: infrastructure: growth in volume of exports of goods and services; reasonably good commodity prices**
- **Soft sectors: housing construction; retail sales**
- **Inflation: low**
- **Politics: like a lot of other countries, populism and weak**
- **Cash rate: unchanged since 8/2016; may stay put for another year?**

Summary

- **Strong and synchronised growth was important from mid-2016 to early 2018**
- **Now, it's losing “wow” feeling; and there are worries the good times will soon end**
- **Expect – a lot of volatility in investment markets**
- **In particular, at times expect a lot of gloom**
- **In fact, there'll be better growth - and more synchronised growth – than is expected unless trade wars keep escalating**