Select Wealth Management

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Investment Update – November 2016

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After a two-year slowdown, the global economy's growth rate is starting to lift again. Commentators expect global GDP to rise to 2.8% in 2017, after 2.4% growth this year.

Global growth has fluctuated in a narrow range for the past five years and this recent acceleration marks a shift from the bottom to the top of that range. This movement should be relatively supportive for risk assets. The strengthening is largely due to the terms of trade shock from the strong US dollar and the fall in commodity prices on several economies and sectors starting to abate in the latest numbers.

US

The September decision of the US Federal Reserve Committee to hold interest rates unchanged was a "close call": some policymakers thought a move could be merited relatively soon. On the other hand, others preferred to wait for more convincing evidence that inflation was moving toward the Committee's 2% objective.

After the decision, Janet Yellen, the Fed chair, stressed that there was scope for further improvement in the labour market before the central bank needed to lift rates since its December 2015 increase. Jobs numbers released after that meeting have supported that argument, as the unemployment rate inched up amid signs Americans are being drawn off the side lines and into the labour force.

Non-farm payrolls for September rose by 156,000 new jobs, which was slightly below market expectations, while the unemployment rate lifted from 4.9% to 5%. September retail sales were slightly soft at only +0.6% too.

Japan

The Japanese parliament passed an extra spending package in mid-October to help to get Prime Minister Shinzo Abe's economic-revival plan back on track, but the Japanese leader is already facing calls to do even more than this, as he is fully committed to a reflationary strategy for the country. Some economists say the Bank of Japan is essentially offering unlimited funds to the government interest-free and he should not let this opportunity pass.

China

Mining shares have risen in recent weeks as Chinese factory data adds to signs of an improving economy for the largest consumer of raw materials. Reports from China show a gauge of manufacturing held near a two-year high for a second month in September, and services increased too.

However, Goldman Sachs Group Inc. has sounded a warning about the outlook for China's property market, saying it sees growing risks across the industry and that any downturn will pose a challenge for metals, especially iron ore and steel. They cited factors such as possible overbuilding, concern some people now cannot afford homes and rising speculation to support their view.

September CPI inflation in China was above expectations at +1.9% pa.

Europe

In recent months, the European Central Bank has been caught on the horns of a dilemma — between a lacklustre economic recovery it fears cannot stand on its own two feet and German hostility to any attempt to extend the ECB's ultra-loose monetary policy. Up to now, the ECB has been able to sidestep the controversy. Britain's decision to leave the EU has caused less fallout in the Eurozone economy than some had feared, relieving the central bank of the need to carry out any emergency measures.

The call for governments to increase spending in support of monetary policy is growing louder in Europe as well as Japan. Increased fiscal spending would stimulate these economies and bond yields would likely move higher in anticipation of higher inflation.

Australia

The economy grew by 0.5% in the third quarter with year-on-year growth picking up to a respectable 3.3% from 3.0%. However, without a strong contribution from government spending growth, GDP would have been negative in the quarter. Domestic demand remains quite sluggish.

Housing remains the key for the interest rate outlook. For now, the RBA seems happy with the apparent stability in the housing market: auction clearance rates remain around the 80% mark.

New Zealand

GDP data released for the June quarter showed growth momentum continuing to build further above its long-run trend. In particular, the pace of activity increased to a robust 3.6% year-on-year in June, strengthening from the 3.0% year-on-year growth rate recorded in the March quarter. Relative to most other developed market economies, the NZ growth rate continues to remain favourable. Moreover, recently released leading activity indicators suggest that the annual rate of GDP growth is likely to continue to remain in a 3.0-3.5% range over the second half of 2016.

Underpinning this positive growth performance has been activity concentrated in the construction and services sectors, which have also benefited from strong tourism growth. In addition, net immigration which posted a historic high over August has also been an important contributor to the strengthening in domestic demand. House price inflation continues to remain robust, although there are initial signs that the RBNZ's recently introduced macro-prudential measures and some tightening in credit conditions may be having a dampening effect.

September CPI inflation was in line with expectations at 0.2% for the quarter and the year. These figures take the economy dangerously close to deflation, a phenomenon where falling price expectations start to suppress economic growth.

Summary

Overall, we find that markets are still pricing in a world of low growth, low interest rates and low inflation without any visible road blocks to "more of the same" in markets. Even after the strong rise in equity values over the last 7 years and a correction in October, we are cautious but not bearish on equities as there is no sign of recession and financial authorities appear prepared to do whatever is required to ensure that the financial markets are well supported.