After the 2009 *hurricane*

Snapshot

What a difference a year makes! This time last year, the world was in the grip of the Global Financial Crisis (GFC) and Australians, like everyone else, feared the worst after the biggest share market collapse since 1930. Twelve months later, the Australian market is not just recovering, it is tap dancing. The All Ordinaries Index finished 2009 up 33 per cent, its strongest performance in 16 years.

2009 Shares (% increase)	
Australia	33.4
US	23.5
Japan	19.0
UK	22.1
Germany	23.8

Source: Commonwealth Securities

The Grip of Panic

Despite the rebound, investors are still feeling cautious and with good reason. Even the experts over-estimated the extent of the financial crisis in Australia. Who can forget the bold predictions of Associate Professor Steve Keen of the University of Western Sydney? In late 2008, in the eye of the financial storm, Keen made a string of media appearances declaring that Australian house prices would collapse by 40 per cent and unemployment would shoot through the roof to “depressionary levels”. So confident was he of this Armageddon scenario that he sold his own house in inner Sydney — at a loss. By mid-2009 the good professor was eating his words.

People who panicked at the height of the crisis and moved out of shares and property into government-backed cash investments and then stood on the sidelines as the market rebounded, may be kicking themselves now. Buy in gloom and sell in boom is a strategy that has stood the test of time, but it’s easy to be wise in hindsight.

While none of us can forecast the future with accuracy, as 2010 gets underway there is one thing we do know for sure — the investment outlook for the year ahead is far more positive than the outlook this time last year.

The Year of the GFC

In hindsight, 2009 was the best and the worst of times. Europe and the United States bore the brunt of the GFC, which turned out to be more of a US and European crisis than a global one. Despite an unprecedented bailout of the financial sector, the US and Europe plunged into the worst recession since the 1930s and only began to show signs of recovery towards Christmas. This was despite interest rates of close to zero in the US and Japan, 0.5 per cent in the UK, and 1 per cent in Europe.

Cash Rates, Dec 2009 (%)	
Australia	3.75
Europe	1.00
Japan	0.10
UK	0.50
US	0.25

Source: Bloomberg

Unemployment also remained stubbornly high at 10 per cent in the US and Europe and 7.8 per cent in the UK and will continue to be a drag on economic recovery for months to come.

It was a different story on global share markets. In early March investors switched to a different channel, shaking off the panic that had gripped markets since late 2007. Share markets tend to predict economic recovery and there was an almost audible sigh of relief once investors were confident the US Government and the US Federal Reserve were determined to clean up the financial sector and deal with bad debts.

Even so, the speed and strength of the market rebound took most observers by surprise. The MSCI World Index finished the year up 27 per cent, after falling by more than 42 per cent in 2008. The US S&P 500 was up 24 per cent, the UK FTSE was up 22 per cent, and the Japanese Nikkei rose 19 per cent.

The top performers were emerging markets in Eastern Europe, Asia and South America, led by Russia with a cork-popping gain of 129 per cent. The HSBC Emerging Market Index for fourth quarter 2009 revealed the largest gain in emerging market manufacturing exports in five years. This prompted HSBC chief economist, Stephen King, to comment that global recovery is likely to be led by emerging markets, particularly China.

Australia – Dodging the Recession

According to Commonwealth Securities, Australia finished halfway down the equity market leader board, but ahead of all the leading developed markets. The All Ordinaries Index rose 33 per cent after a fall of 43 per cent in 2008. While the annual figure is impressive, the rebound from the March 6 low was a staggering 57 per cent.

The best performing market sector was retailing, up 88 per cent as Australians spent their stimulus dollars on consumer electronics, fashion and accessories. The banks came in second with a 54 per cent rise as local and foreign investors responded to the relative strength of Australia's banking system. The wooden spoon went to the telecommunications sector, down 9 per cent.

As confidence, and money, flowed back into equities the returns on Australian government bonds eased 2.2 per cent, following returns of 18.8 per cent in 2008 when investors flocked to the safety of government-backed securities.

Here in Australia, the economic picture was also far brighter than elsewhere. Australia was the only developed economy to escape recession. While economic growth slowed to 0.6 per cent, this was cause for celebration when compared with falls of 5.1 per cent in the UK and Japan and 2.5 per cent in the US.

Snapshot

Economic Resilience

The Rudd Government and the Reserve Bank of Australia moved swiftly to stimulate the economy while our banking sector proved better managed and regulated than its overseas counterparts.

The resilience of the local economy renewed inflation fears and prompted the Reserve Bank to lift rates three times in late 2009, bringing the cash rate to 3.75 per cent and widening the interest rate gap between us and the rest of the world.

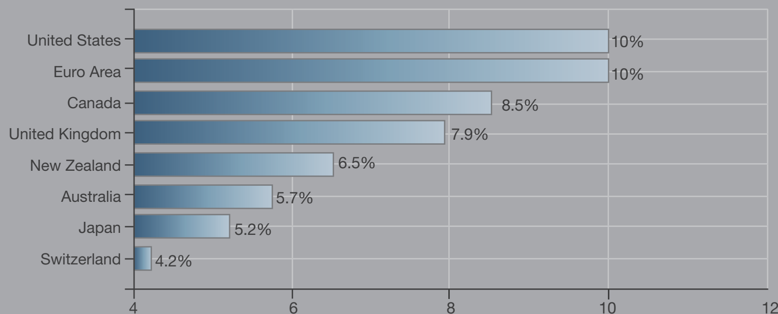
But economic growth had positive spin-off effects on the labour market. Unemployment peaked below 6 per cent, confounding official estimates earlier in the year, thanks to the willingness of employers to cut back hours rather than retrenching staff en masse.

2009 Commodities (% increase)	
Gold	26.1
Oil	75.0
Sugar	92.2
Zinc	106.5
Copper	135.8

Source: Bloomberg

Bricks and Mortar

But the thing that really separated Australia from the rest of the world was the continued strength of our housing sector, partly due to the Federal Government's First Home Owners' Boost, high levels of immigration, and a baby boom. Despite some gloomy predictions of a crash in property prices similar to those in the US, Europe and parts of Asia, Australian residential property recorded double digit returns last year.



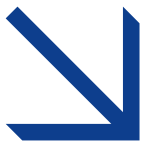
Resource Riches

Just as important, Australia benefited from being a resource-rich nation within easy reach of China, India and other rapidly developing Asian neighbours. The Chinese manufacturing sector rebounded quickly from the GFC, injecting renewed life into our resources sector.

Commodity prices soared, with copper, zinc and sugar all up by more than 100 per cent in the year to December 2009 while oil rose 75 per cent. Gold finished the year up 26 per cent to around US$1100 an ounce. At these levels gold is still well below its inflation-adjusted high of US$850 in the 1980s, giving the optimists grounds for believing it has further to run.

According to RP Data-Rismark, total returns from residential property were up by 11.3 per cent in the 11 months to November.

Snapshot



The ABC of 2010

If 2009 was the Year of the GFC, then the focus in 2010 is likely to be on the speed and shape of the recovery. It is already apparent that some countries, such as China, and Asia generally, are recovering quicker than anticipated, exhibiting signs of what economists like to call V-shaped recoveries.

The Chinese economy continues to expand rapidly and is set to overtake the US to be the biggest global economy within a decade, according to the International Monetary Fund. While this bodes well for the Australian resources sector, there is a risk of a bubble in commodity prices and upward pressure on the Aussie dollar if this expansion is too rapid.

The big question mark for 2010 hangs over the US recovery. With an oversupply of housing, 10 per cent unemployment and a US$1.4 trillion budget deficit, some economists are warning that the US could slip back into recession. This is what is referred to as a W-shaped recovery.

Recovery in Australia has been more convincing than the US and Europe but less emphatic than China. In the alphabet-speak popular with economists, recovery here has been U-shaped.

Back to Business as Usual?

Now the Government is winding back its stimulus spending, and measures such as the First Home Owners' Boost and small business tax breaks have come to an end, the focus for investors will be squarely on economic fundamentals.

Australian interest rates are expected to rise further until they reach the "normal" range of 5.00–5.25 per cent set by the Reserve Bank. Economists are forecasting moderate economic growth and inflation in the vicinity of 3 per cent and further falls in unemployment. Most currency strategists expect the Aussie dollar to get close to parity with the US dollar before easing back below US90c once the US begins to withdraw its monetary stimulus.

Shares are also expected to make moderate gains. After last year's dramatic rebound, Australian shares are no longer trading at bargain basement prices but most analysts believe they remain fair value. The focus from here will be on corporate earnings, with potential for earnings upgrades now the worst of the financial crisis is behind us.

After the wild ride on global markets over the past two years, investors will be hoping 2010 is tamer than last year. Yet as we head into the Chinese Year of the Tiger, there could be a few unexpected twists and turns before a beastly 2009 can finally be put to rest.

Whatever the circumstances, a successful investor's best defence against the unknown is to have a financial plan tailored to general economic conditions as well as to their personal goals and circumstances, and the discipline to stick with it.

Source: www.tradingeconomics.com

Dynamic Financial Solutions

Dynamic Financial Solutions
PO Box 3746
Tuggerah NSW 2259

P 1300 854 891
F 1300 854 892
E info@dynamicfinancialsolutions.com.au
www.dynamicfinancialsolutions.com.au

General Advice Warning: This advice may not be suitable to you because it contains general advice that has not been tailored to your personal circumstances. Please seek personal financial advice prior to acting on this information. **Investment Performance:** Past performance is not a reliable guide to future returns as future returns may differ from and be more or less volatile than past returns.

Disclosure: John Backhaus and Stuart Mangion are Authorised Representatives of Wealthsure Pty Ltd, AFSL 238030.