Stock Market & Economic Update

A range of issues have combined to create the perfect storm for stock markets recently:

- Concerns the Chinese economy is growing slower than expected. China's currency devaluation, weaker economic data and an interest rate cut all signal that the Chinese slowdown is more significant than was assumed.
- China's growth issues have heightened concerns about the emerging world, as slower growth and lower commodity prices weigh on commodity producers particularly in South America and the Middle East.
- Falling commodity prices have weighed heavily on the resources and energy sectors and increased downside risks to the Australian economy.
- Substantial Australian bank capital raisings (Commonwealth Bank and ANZ Bank) to meet the additional capital requirements recently announced by the Australian Prudential Regulation Authority (APRA) have sapped funds from the market.
- A largely mixed Australian corporate reporting season has failed to ignite an improvement in investor sentiment.
- The likelihood of the first interest rate rise in the US in more than 6 years in September (albeit due to a resilient domestic economy).

The major risk we see going forward is that the Chinese and emerging market economic slowdown broadens into major developed market economies and significantly disrupts the global economy and company profitability.

There is currently little evidence of this happening in the US (which is largely internally dependent in terms of growth) or in Europe but we need to remain cognisant of the economic challenges confronting the world at a time when many of the world's major Central Banks are at or reaching their limits of what additional stimulus they can provide.

In Australia, we are starting to see the impact of falling mining investment and lower commodities prices flow through to our terms of trade and economic growth numbers. We would argue that these issues are well reflected and understood in the Australian stock market. The Chinese economy is weak and this has been well known by markets for some time.

While the domestic economic outlook remains subdued we also see a number of positives from Australia's perspective including:

- Australian corporate balance sheets are generally in good shape
- Stock valuations are increasingly supportive. In previous years stocks have tended to trade at a premium to their fundamental valuations supported by higher dividends. The recent pullback in the market has only served to improve their value proposition.
- Dividend yields are attractive. A large majority of our blue chip companies are paying solid dividends. Our major banking stocks are currently paying between 5.5% and 6.5% fully franked. Our major retailers are paying about 5% fully franked.
- The Australian economy, whilst softening, continues to remain solid and orderly. A weaker Australian dollar will serve to make our economy more competitive and encourage foreign investment.
- Australia has the ability to stimulate the economy with interest rates at 2% (high compared to other markets) and Government debt at about 20% of GDP (low compared to other markets).

We expect these factors to offer some support and provide for longer term opportunity from Australian shares during the current period of market turbulence.

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