Stock Market & Economic Update

After falling heavily in the immediate aftermath of the “Brexit” vote, global stock markets have staged a solid recovery over the past few weeks.

The initial Brexit ‘shock’ wore off quickly as investors’ focus shifted to the likely lengthy implementation time frame. Investors also took comfort from a chorus of central bank assurances that policy makers stood ready to intervene and stabilise financial markets if required. The Brexit fallout has also been felt on debt markets. Concerns that Brexit could cut business investment and consumer spending around the globe has seen bond yields (debt interest rates) decline in anticipation of more central bank rate cuts and stimulus.

This has been good news for the Australian stock market, a key market and major beneficiary of the global hunt for investment income (yield). Many of our major companies trade on dividend yields of between four and six percent, comparatively high in a global context and about double what is on offer in the US.

However the investment environment of low global interest rates, rising share prices and subdued Australian corporate earnings growth also presents its own challenges. As share prices diverge from fundamentals they become increasingly vulnerable to earnings disappointment and changes in macroeconomic conditions and investor sentiment. While we acknowledge these conditions may persist for a while longer, we believe stock valuations in interest rate sensitive sectors including infrastructure, real estate and telecommunications sectors are looking stretched.

August signals the commencement of the Australian full year reporting season. This is the time when most of Australia’s leading companies release profit results, declare dividends and provide outlook statements. We will be paying close attention to what is said and how it may impact our portfolio investment strategy going forward.

Offshore markets have been relatively calm in recent weeks. US stock markets have rallied to record highs on the back of a better than expected second quarter reporting season and as the probability of a near term interest rate hike has reduced.

As expected initial UK economic data following Brexit has been weak. But it is too early to know the full extent of the economic fallout across Europe with the most important economic facts still to come over the next few months.

In Japan, the government has announced a US$265bn economic stimulus package in a further attempt to boost growth and to counteract the appreciation in the yen (hurting exports) following Brexit. In China, a stronger than expected print of June quarter GDP and better than expected retail sales and industrial production data has helped support commodities prices and taken the focus off the country’s debt problems for the time being.

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