

# Investment Market Update July 2015



**Our aim at Aspirations Wealth Group is to keep our clients informed regularly about their portfolio, investments and markets. There is significant change occurring in the world, and since these changes have an impact on Australia, we felt it was prudent to provide a review of each of the key markets which are currently experiencing change:**

## Greece

The Greek government has too much debt and it has neither the ability, nor the willingness to repay it. The Greek government owes approximately €350 billion and during the year it took in €81 billion of tax and had €78 billion of expenses (before interest). The €3 billion surplus was not enough to cover its €8 billion interest bill, let alone start paying back debt.

Stories of generous pensions and government waste are not entirely true - the cost cutting (asked for by Germany) has been savage. During the past four years the Greek government expenditure dropped by 31% from €113 billion to €78 billion. Unemployment during this time went from 8% to 28% whilst welfare payments fell by 22%. Tax collection does not appear to be the issue. There are surely loop holes, but tax revenues jumped from 37% of GDP in 2009 to 45% in 2014. This is higher than Germany at 44% or the UK at 37%. Greece is only paying a modest 2.4% interest rate on its debts.

The very simple issue is that Greece has too much debt and its economy has shrunk by 23%. The immediate impacts on Greece of leaving the Euro will be a much weaker currency and a miss-match between Greek banks' loans, which will be denominated in *New Drachma* and their Euro denominated funding from the European Central Bank. The European Central Bank funding arose because it has been propping the Greek banks up by replacing money withdrawn by Greek depositors. For the Greek people, the proximate impacts of a new currency will probably be a significant reduction of their living standards and a period of political turmoil.

It is our view that the long term impacts on global stock and bond markets, beyond Athens, should be contained. Europe can contain a Greek default because Greek government debt is only 3% of Euro area GDP and almost €300 billion of the debt is owed to European entities, which can print Euros.

## Australia

The Australian equity market continues to underperform global markets in recent months, with banks, consumer staples and resources the main laggards. Australian banks and consumer staples are facing increased competition which has led to earnings growth downgrades.

Resources continue to range trade with no real direction.

The May Federal Budget was well received with consumer and business confidence lifting throughout May. However interest rates in the US will have a key impact on Australia: A sustainable recovery seems to be taking hold in the US. With the economy improving, the Federal Reserve has wound up its bond purchasing program, with the first interest rate hike expected in 2015, although the Fed has said that it 'can be patient when beginning to normalise monetary policy'. In response to the Fed gradually tightening monetary policy, the US dollar has rallied 25% in the past six months.

Overall, market conditions remain positive for equities in terms of moderate growth, very low interest rates and low inflation but we acknowledge that listed companies, particularly in the large cap segment, are struggling to generate earnings growth. The FY15 profit season in August 2015 will be the next best chance to assess the FY16 outlook.

There is little income to be found in cash, term deposits and bonds and the yield on equities continues to be attractive, where it is sustainable. This is particularly the case in Australia, where the market dividend yield of 4.5% (78% franked) remains a key attraction for investors.

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## China

There appears to be some evidence that the Chinese economy has stabilised with a range of economic indicators either steadying or showing some modest turnaround. The structural slowdown in their economy is continuing in this transition period to more domestic based growth, and away from exports, property and investment. Consequently the risks remain to the downside.

China faces considerable challenges and while the authorities have cut lending rates on three occasions since November and have lowered the banks' reserve requirement ratio, they are loathe to introduce more significant fiscal stimulus measures for fear of reigniting property prices and putting off the inevitable adjustment to extremely high debt levels.

The authorities have introduced some more specific fiscal measures, for example, the 1 trillion yuan (\$160 billion) local government debt swap plan, lower bond issuance requirement for corporates and local government financing platforms.

However, more interest rates cuts are likely to be required. The traditional mainstays of growth, fixed investment and exports, continue to slow. Business investment grew by 11.4% year-on-year in May, down from 12%. Within that, property investment grew by a lowly 5.1%. Exports were down 2.5% in May while imports were 17.6% lower.

With debt levels high, inflation low and the property sector under pressure we expect further rate cuts in the next 6 months. This easing in policy and the lack of alternatives has supported the Chinese equity market, which is up 80% this year. However we are currently seeing very large levels of share market volatility in China.

## USA

In May, 280,000 jobs were added, which was more than expected, and up on the 221,000 in April. The unemployment rate crept higher to 5.5%. However, given the fact that jobs growth is roughly in line with overall trend GDP growth it would appear that US productivity growth has stalled.

This is important because it has implications for Fed monetary policy settings. If indeed, population growth and productivity growth have slowed then the potential growth rate for the US economy will have also slowed.

This would imply that the pace of growth at which inflation pressures begin to build would be lower than previous, perhaps as low as 2% per annum, not far from the average growth rate actually achieved since the Great Recession.

However, there seems little evidence of inflation pressures at present. Headline inflation for the year was 0.2% although closer inspection reveals that lower energy prices have been a major cause of the decline.

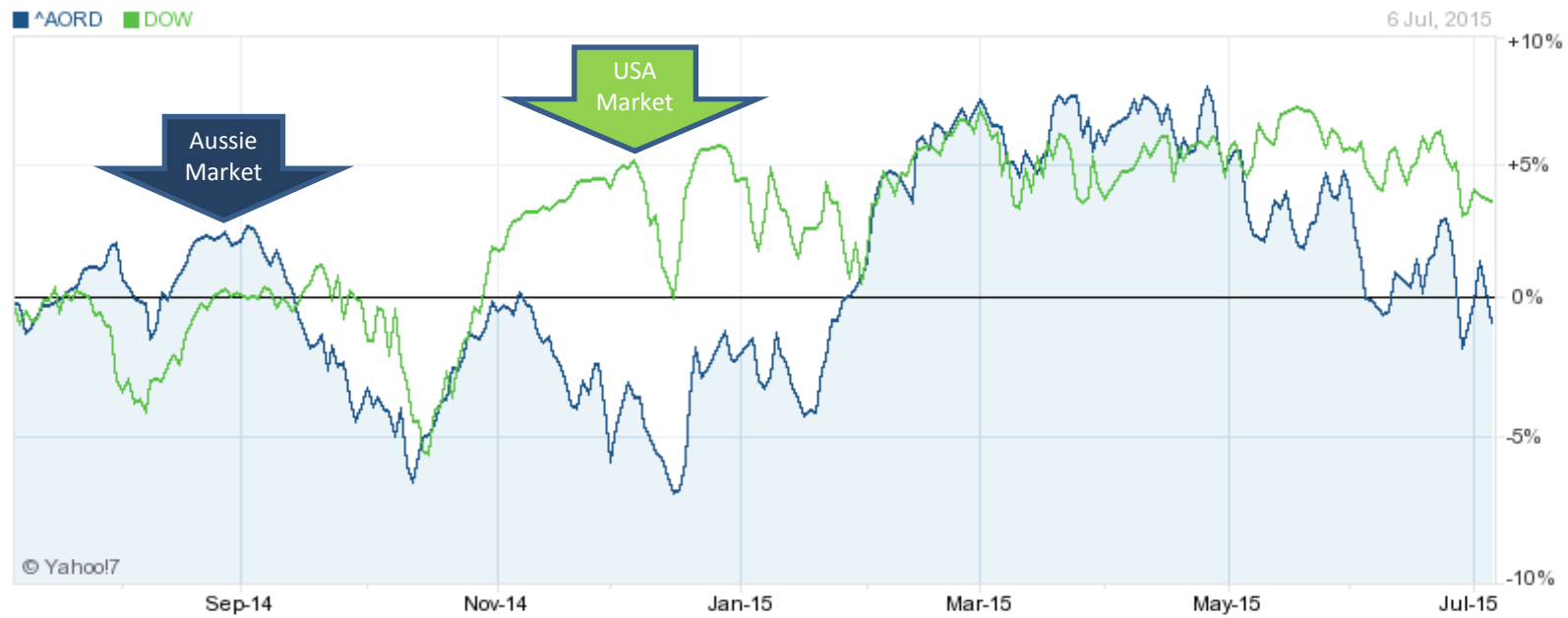
Retail sales bounced in May, up 1.2% while auto sales topped 17 million, the highest since 2005. As in most parts of the world, business investment remains subdued. Although profit growth has broadly slowed the lack of a meaningful recovery in business investment is presenting a quandary for policy makers and investors.

In any event, what is clear is that investment will have to eventually recover if the US is to sustain its longer term growth rates going forward.

# 1 Year Share Market Returns



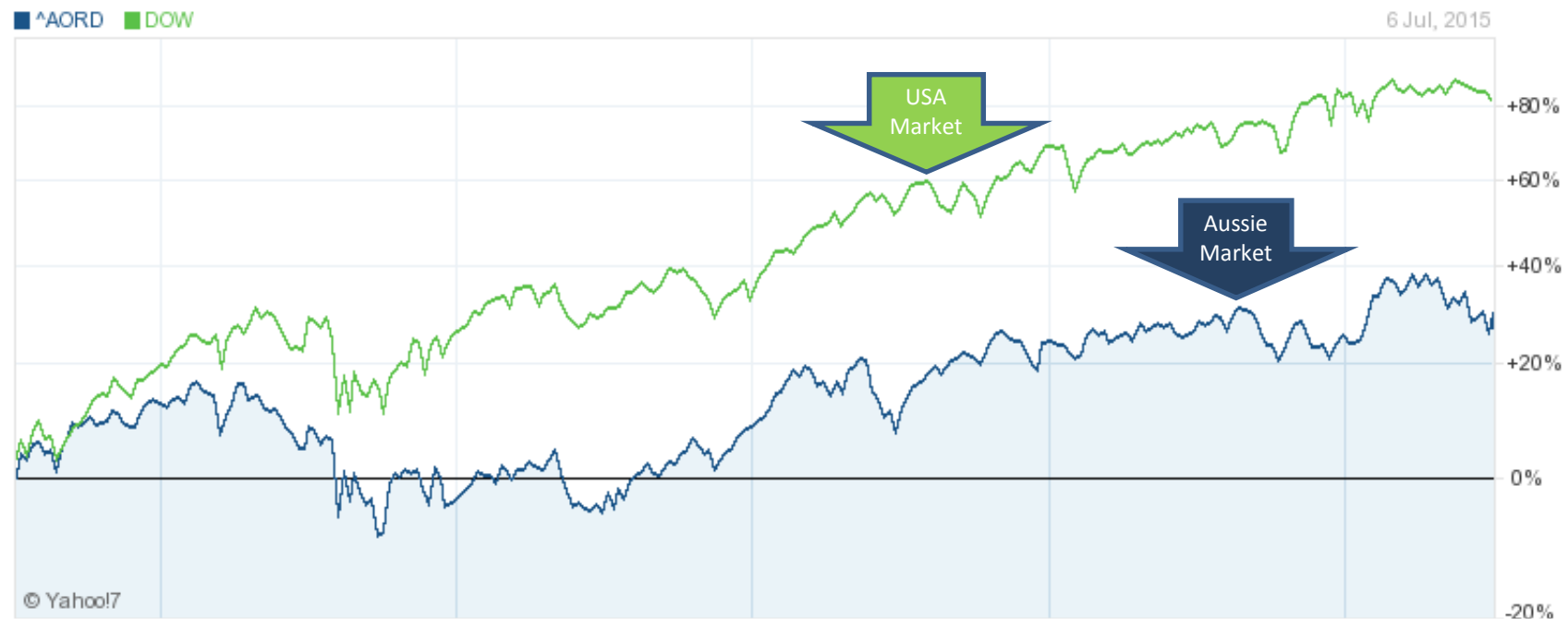
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# 5 Year Share Market Returns



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Note that all charts are ex dividends.

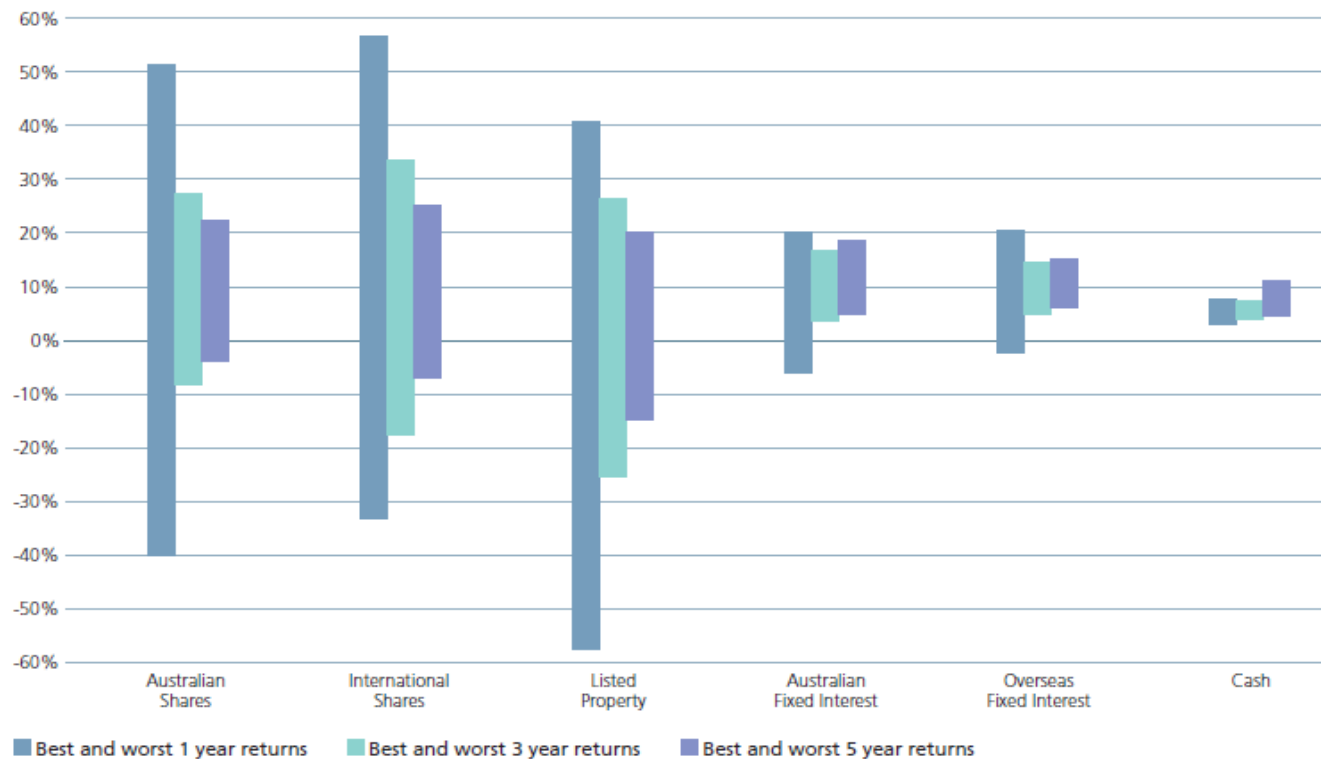
# Summary



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Share market volatility can be managed by looking at things over the longer term. Asset classes move through periods of good returns, great returns, not so great returns and sometimes negative returns. So, if you are investing in shares, for example, and you want to access your money within a couple of years, you may sell out at exactly the wrong point of the cycle – you must let your investments run their course. You need to be sure that your investment horizon is consistent with the asset classes you are investing in because over time, volatility is reduced and returns are smoother.

The chart of the best and worst 1 year, 3 years and 5 years returns over time illustrates this point. By taking your money out after only 1 year (blue bars), you run the risk of receiving a very high return or a very low return. By leaving your money invested for longer (green and purple bars), the difference between the high return and the low return narrows. By investing for longer, returns become smoother.





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