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2009 Financial Year in Review: half empty or half full?

What a swine of a year it's been – even without a worldwide pandemic of swine flu that has infected countries around the globe as quickly as the recession virus crippled economies more than a year ago. The swine flu appears to be serious, although a lot less deadly than first predicted. Similarly, there are early signs the economic virus infecting world economies might also be less virulent than first feared. Even the normally pessimistic IMF agrees world economic growth in 2010 will be higher than the 2% they had predicted earlier.⁽¹⁾

Before we look at the better news, however, let's see just how bad the last 12 months have been for world markets. Out of the five share markets tracked in this table, only China ended the year in the black.

World Share Market Performance (July 2008 – June 2009)

Index	Actual	% Change
S&P/ASX 200	3797	-21.2
US (Dow Jones)	8300	-24.3
Japan (Nikkei)	9550	-25.1
UK (FTSE)	4230	-17.9
China (Shanghai Comp)	2721	+0.03

Source: tradingeconomics.com

However, if we look at Australian economic indicators for the year as a whole, they are not all that bad.

	June 2009	June 2008	
Official Interest Rates	3.0%	7.25%	Better
Unemployment	5.7% <small>(May 31)</small>	4.3%	Worse
Growth (GDP)	0.4% <small>(March Qtr)</small>	3.0%	Worse

Source: tradingeconomics.com



Official interest rates are at record lows, and the Reserve Bank is determined to keep them there until the economy improves. The unemployment rate has stayed at less than 6% per annum so far – much better than initially predicted. Our dollar has fallen from its dizzy heights of near parity with the US\$ last April, but that's not all bad since it gives us an export advantage – critical given our exports have dropped significantly. Of course falling exports and tax revenues, coupled with large cash stimulus payments earlier this year, mean the government accounts have fallen seriously into the red. When this will turn around is subject to much economic and political debate.

It's important to remember, however, annual statistics are simply numbers that don't describe geography and trading relationships. China is our biggest export market and due to our proximity we are China's favoured supplier of raw materials.

Should we look forward to a happy (Chinese) new year?

Fortunately for us, what has happened in China over the past 12 months is pretty

impressive. China's response to the global financial crisis has been to ignore the loss of the bulk of its export income with key trading partners such as the US, UK and Japan and instead invest massively in infrastructure for the future. So far, this has allowed it to maintain an economic growth rate of 8% per annum – less than half the pre-crisis figure, but far outgunning the rest of the world.⁽²⁾

There are also definite signs of recovery within the Chinese stock exchange where the index has risen by 50% from its low in October 2008, although the index remains well below its previous high in 2007.⁽³⁾ From Australia's point of view, heavy Chinese government investment in infrastructure (power stations for example), has boosted demand for Australian iron ore and copper, even though export prices have dropped.

Meanwhile, closer to home...

In the Australian economy, a number of key measures in the last financial year seem to have kicked-in to achieve a positive growth figure of 0.4% in the March quarter.⁽⁴⁾ This followed a negative 0.8% December quarter, saving us from a technical recession.

The credit for this result rests partly on the recovery of mineral export markets to China, (albeit at lower prices), and on increased agricultural exports. Another major recession buster seems to be the success of several key government stimulus measures. These include a boosted first home buyer's allowance that has buoyed real estate and construction, and direct cash handouts to taxpayers which appear to have kept the retail sector alive. Further stimulus will be provided by next year's increase of around \$3.5 billion in old age pension payments, almost all of which is expected to enter the retail economy.

There is a price to pay for this stimulus in the form of a large ongoing debt, compounded by more borrowings to offset huge tax revenue losses as a result of weak economic growth. The servicing of Australia's recessionary debt load will

siphon the cream off Australia's national revenue until at least 2016.

It is heartening to note the Australian Stock Exchange is showing signs of life, with several small but significant peaks over the past seven months, including a series of minor, but positive reactions to increasing demand for Australian mining and energy resources. On 3 June for example, the ASX temporarily broke through the 4,000 barrier, reflecting not only a renewed export demand for Australian resources, but also the growing financial health of our banking sector.⁽⁵⁾ Of course, this is no guarantee that the ASX is going to recover its major losses any time soon, but it does prove how responsive the market can be to good news.

Overseas, a few cracks in the ice of the US recession.

In the USA, where it all started, there are small but hopeful signs the big financial freeze may just be starting to thaw. These signs include several small share price rallies in the last six months and the emergence of increasing stability in the banking sector. June 11 was something of a red letter day in the USA, when it was announced that 10 of the country's major banks, previously bailed out by the US

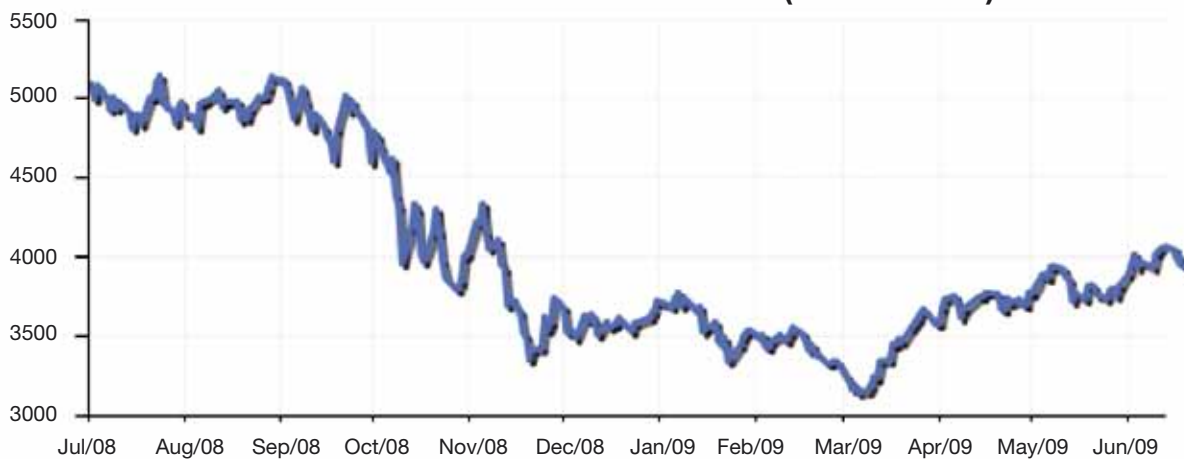
Government, agreed they were strong enough to pay back the \$68 billion they had borrowed and stand on their own feet.⁽⁶⁾ Uncle Sam can use the cash, since the US taxpayer recently laid out \$50 billion to become the major shareholder in General Motors after it filed for bankruptcy. The motivation for the General Motors deal was to protect jobs. Like Australia, the US is also fighting to keep unemployment under 10% next year. On the plus side, the international investment bank ING has predicted an end to the US recession by the end of 2009, noting a growing belief in "the green shoots of a potential recovery".⁽⁷⁾ If they are right, the US economy should be in the black for the first two quarters of the 2009/10 financial year.

"A growing belief in the green shoots of a recovery"

Is this the beginning of the end of the big chill?

The answer to this question is a definite maybe. ING's global overview notes "tentative signs that the worst of the

12 Month Australian Stock Market Chart (S&P/ASX 200)



www.tradingeconomics.com

Snapshot



recession is over,”⁽⁸⁾ but nobody is sticking their neck out to announce a date for the celebration to start. Most commentators are cautiously positive, like John Lipsky of the IMF who commented in Tokyo recently, “Our world economic outlook anticipates a return to global expansion by next year, however, the recovery is likely to be more gradual than in past recessions.”⁽⁹⁾

Australia is currently sheltering from the chilliest winds of recession behind the bulk of China, and that might get us out of this recession faster and smoother than most other countries, but even China can't solve the world's problems single handedly. For China to regain its previous double digit growth figures, it is essential that major trading partners like the USA also recover and re-establish Chinese export markets.

Gazing into the crystal ball...

And where does this tentative optimism leave investors in the next 12 months?

Nobody is denying the Australian share market will recover its losses at some time in the future, but nobody is proposing a time frame either. All we do know, based on a study of past recessions, is it could happen any time. It could happen without warning and anyone who is not in the market when it does happen could miss the best and fastest opportunity to recover their losses.

In the meantime, we are still in a bear market – even if the bear has

yawned a few times and might just be beginning to think about going into hibernation. As Forbes magazine once explained, the rules for surviving a bear market are the same as the basic rules for surviving a real bear attack in the wild: Sit tight. Don't panic. Don't try and run away.

Finally, as Forbes pointed out, if you love the great outdoors you wouldn't spend the rest of your life huddled indoors following an unpleasant encounter with a bear.⁽¹⁰⁾ For investors, this means if you want to benefit from the growth potential of the share market, you should never forget the basics like time frame, diversification and patience.

(1) Wall Street Journal June 11 2009, The Australian June 12 2009 (2) Shane Oliver AMP Capital May 2009 (3) Shane Oliver AMP Capital May 2009 (4) www.tradingeconomics.com (5) The Australian June 12 2009 (6) New York Times June 11 2009 (7) ING Investment Management “House View” April 2009 (8) ING Investment Management “House View” April 2009 (9) Bloomberg News June 2009 (10) Forbes.com March 2008.



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