“Avoid Getting Dumped by the 2nd Wave”

By Tim Rocks & Ryan Cormican, Evans & Partners

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With so many issues impacting on the outlook for the Australian and international economies, it was very pleasing and timely that two senior managers from Evans & Partners agreed to give us their perspectives.

Tim Rocks referred to the 20-year period of Australia’s low inflation, which was broken by a surge in mid-2022 resulting from covid-induced goods, prompting the first wave of price inflation.

A second inflation wave has arisen recently in mid 2023, fuelled by wages growth and labour shortages with record job vacancies in the services sector, accentuated by the end May minimum wage case, which has determined wages for 25% of the Australian workforce will rise by 5.8% or more (8.6% for those on the minimum wage).

Another key recent change is the concurence of consumers’ willingness to accept price rises, and also firm’s preparedness to raise prices (e.g., Telstra, Qantas, Woolworths/Coles).

Also rents, house prices and electricity costs are rising.

This implies that the Reserve Bank has big challenges with a lot more work to do to achieve its inflation target in the short term, with Fiscal Policy working against Monetary Policy.

The resilience of the Australian economy to the successive interest rate rises is quite remarkable, boosted by very high job creation (partly from covid bounce-back) and immigration. Many consumers are in a good spot from high employment and wages, plus large amount of savings accrued during covid restrictions (for those with income, including government covid handouts).

Questions arise about potential for financial strains from interest rate hikes. 3 banks have collapsed in the US, where there are approx. 4,000 banks, though only about the top 100 are closely regulated. Also, it is notable that financial regulation (especially required liquidity) has often not kept up with technology changes (e.g., social media can spread bad news very quickly, with risks to rapid on-line withdrawals). Another US financial change is the high vacancies in much of the office sector due to remote/hybrid working. This needs monitoring, as does sovereign debt in second tier countries. In contrast, the Australian economy seems resilient through bank regulation, much lower office vacancies than US, etc.

The green energy push in the auto sector is another major change in global patterns. China has moved from #17 to #2 world car exporter in the past 3 years. This largely arises from Tesla 3 being the world’s largest selling car brand in 1st Qtr. 2023, and 50% of those are made in PRC. In addition, China now controls over 80% of global lithium processing capacity, and a high proportion of batteries production capacity for EVs. So massive shifts are taking place, with China set to dominate, while traditional US majors seem in trouble. Tesla is building a 2 million cars per annum massive plant in Mexico. It was also noted that Wesfarmers is building a lithium processing plant here.

Similarly, China controls about 90% of global solar panel production.

The enormous investment in environmental infrastructure is another key factor in the global economy and is ongoing. This adds to the challenges for central banks.

Artificial Intelligence is another recent phenomenon increasingly impacting on world markets, as it transitions from analytical to generative AI, with positive implications for drug development, easier documentation, etc. Invidia, Amazon, Microsoft have been beneficiaries.

Overall, he foresees the investment market as an uncertain outlook, with wide diversion between the hot tech stocks and the rest of the market, as reflected in PEs. Given high $US, high valuations, and economic risk, one must be cautious investing in US stocks now. Nevertheless, US small caps seem to be oversold (also in Aust) so there may be some good opportunities. Likewise Asian stock markets may be undervalued (especially given AI potential). Albeit noting political risk, in particular PRC seems worth considering for a cautiously reasonable proportion, especially in technology, incl auto, solar etc.

He also noted interest rates were so low pre-covid that corporate or government bonds gave low returns. However recently 6-8% returns are available on a range of high-grade short term floating debt both in US and Australia. However, it is prudent not to be too brave in this sector given macro uncertainties.

Australian equities are not especially exciting now, mostly not too expensive nor cheap. He sees opportunities in some sectors (energy transition), cautioned over-exposure in some sectors (banks), and encouraged using tax-losses before EOFY.

Ryan and Tim referred to their analyst teams, and willingness to follow up with our members wishing to discuss further individually and/or use their investment services. Copies of the excellent presentation slides (which graphically set out the above points) can be obtained by emailing ryan.cormican@evansandpartners.com.au

After the usual dynamic Q&A covering India, copper, coal, long lead times of large mineral projects, currencies, investment purpose/risk, etc, Evan Rees thanked the speakers for their very interesting insights and presentation.

Peter James