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MARKET OUTLOOK

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Economic Outlook

It is too early to say that recovery is underway, even for the US economy. So far, the data released suggests that the pace of contraction has eased, nothing more. The economic backdrop is poor and the global economy remains in recession. Stabilisation in many leading indicators is a positive sign but further convincing data of a sustained turnaround is needed. Until then the jury is still out.

The cyclical theme faced by many regions in this synchronised recession is quite similar. Global industrial production and trade have collapsed in the face of the sharp inventories de-stocking as a consequence of falling demand. In any normal downturn, inventory adjustment is the normal course of action before the economic downturn sees a bottom. The sharp correction in inventory in the US, as witnessed in the March GDP report, should mark the stage where large inventory overhang is being worked through globally. Global growth will continue to look woeful as this adjustment is taking place. Economists of many prominent organisations like the World Bank, IMF and OECD have continued to downgrade global growth for further contraction this year before positive growth again in 2010.

The challenges for the global economy are not confined to cyclical factors - there are still many structural factors needing to be addressed for a sustainable recovery to occur. These factors, of course, are largely the consequence of the unwinding of leverage that has led to the situation we are in today. The stabilisation of banking sectors is the foremost crucial requirement for reversing the credit crunch affecting households and the corporate world. While there are encouraging signs, many banks remain vulnerable, as the extent of bad assets in balance sheets are still largely unresolved, particularly for many European countries. The unwinding of leverage may yet have a long way to go for the global economy.

Importantly, the challenges facing the global economy do not stop there. Labour market conditions around the globe have deteriorated at the most rapid pace since the Great Depression of the 1930s. Further anecdotal evidence of job losses being announced recently, coupled with the collapse in all leading employment indicators suggests that unemployment has further to go in the coming months. While unemployment is well understood to be a lagging indicator, the sharp pace of job losses suggest that further policy response is needed.

Australian Sharemarket Outlook

With the All Ords continuing its upward movement since early March, for the first time in a long while there is a growing view that the market may have bottomed. In the last month or two, Australia has been perceived to be in recession, unemployment has risen sharply, car sales have slumped and yet the equity market has rallied and maintained its gains. This would suggest that the market has priced in all foreseeable negative data, and that a platform may have been laid from which to rebound.

Equity valuations are more attractive now than they've ever been in the last 20 years; investors' risk appetite appears to have increased, and consumer confidence rose in April.

While this all sounds positive, there is still the possibility of another market retraction. Further fiscal stimulus propping up consumer spending is unlikely, and earnings downgrades and unemployment is likely to escalate as the global financial crisis continues to bite. Recent housing data suggests that prices are falling, problems in the banking sector remain, and the effects of the swine flu outbreak are not yet known.

Earlier predictions of a tough 2009 still seem accurate, however this latest rally and the reasons behind it are grounds for cautious optimism.

International Sharemarket Outlook

With the continued upward trend in global equity markets throughout April, questions have arisen as to whether this is a strong bear market rally or whether we've seen the bottom of global markets. Predicting a recovery at this stage still seems premature while the possibility of a protracted and deepening downturn remains. Large job losses continue, and with countries throughout the world in different phases of the global downturn, any meaningful recovery is likely to be later this year or into 2010.

Australian Fixed Income Outlook

The RBA chose to trim the official cash rate by 0.25% to 3.0% following their April board meeting, stating that globally "assessments of the near-term outlook have been further marked down" but that Australia remains better placed than most. The RBA believes the stance of monetary policy along with "substantial fiscal initiatives" should provide significant support looking ahead. At this stage, the market expects further cuts through the year, pricing in cuts towards an official cash rate of around 2.25% by year end.

The performance and direction of the overall fixed income market will be driven by the outcome of the nearer term economic releases, particularly those relating to "green shoots" overseas which may foreshadow an economic bottom. This offshore influence will be important.

Closer to home, the numbers remain mixed to poor and unfortunately the labour market looks set to deteriorate further through 2009. This will keep alive hopes of further rate cuts here, which should provide support for the domestic fixed income market. We also expect to see continued gradual improvements in credit markets.

International Fixed Income Outlook

Apart from the obvious economic concerns, the oft discussed theme for this year is the growing supply of government bonds being issued to fund the fiscal stimulus packages that have been put in place around the globe. Signs of so called "green shoots" of economic improvement have some fearing that bond yields are too low. Unsurprisingly, periods of "indigestion" are likely as investors face this huge issuance task. Nonetheless, the recovery is not yet assured and may only be sub-par given ongoing deleveraging.

As we noted last month, "longer term fixed income yields still remain historically very low, and for good reason given the environment we have been in." As we move through 2009, market participants will look for signs of better economic times ahead. If this transpires, then 2010 may see bond market yields edge somewhat higher as a result.

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