Year in Review; Year in Preview

Economic & financial perspectives

- **Record expansion**: Australia’s record economic expansion is now in its 29th year. Interest rates are at record lows; wages are growing near 2.2 per cent; underlying inflation is around 1.6 per cent; the jobless rate is 5.2 per cent.

- **Good year for shares**: Total returns on Australian shares (All Ordinaries Accumulation index) lifted by 24.1 per cent over 2019 (20-year average +9.9 per cent) to a smidgen below record highs.

*The report is useful to assist investors to start planning for year 2020.*

What does it all mean?

- This report updates the preliminary assessment on the 2019 calendar year made three weeks ago and describes how investments, financial markets and economies performed over the past year.

- Overall, the global economy has slowed over the past year, largely restrained by the US-China trade conflict - weighing on business investment and manufacturing activity. Central banks cut interest rates to minimise recession risks at a time of low inflation and low unemployment. The US economy remains in excellent shape supported by resilient consumers and a solid job market. The Chinese economy slowed in response to the trade dispute with the US and on-going deleveraging but authorities have been stimulating their economy, boosting demand for Aussie goods and services. But the US-China Phase 1 trade deal offers hope for the globe in 2020.

- The Australian economy is currently growing at a 1.7 per cent annual pace. Just like other major economies, growth slowed over 2019. Uncertainty over the May 18 Federal Election result led to business investment caution. Consumer spending decelerated to due to tepid wage growth, falling property prices and increasing job insecurity. Arguably only home prices – especially in Sydney and Melbourne – have lifted in the post-poll period. However the sharemarket hit record highs at the end of November, further boosting the “wealth effect”.

- The Reserve Bank re-assessed policy settings in late May in response to stubbornly low inflation and weak private sector demand. The Reserve Bank now believes that unemployment can fall to 4.5 per cent before igniting inflationary pressures. As a result the Reserve Bank cut the cash rate by 25 basis points in June, July and October. Inflation is expected to remain below 2 per cent in 2020 with unemployment near 5.25 per cent.
• Returns on shares lifted by just over 24 per cent in 2019 and further growth of 7-11 per cent is expected in 2020. The Australian dollar should continue to support the record economic expansion, largely holding in the late 60s/early 70-cent range against the greenback.

What does the data show?

Interest rates

• The cash rate was reduced from 1.50 per cent to 0.75 per cent with 25 basis point rate cuts in June, July and October.

• The market-determined 90-day bank bill rate fell from highs near 2.04 per cent in January to record lows of 0.84 per cent and ended 2019 at 0.92 per cent. Yields on the long bond – 10-year government bond – fell from highs of 2.33 per cent in January to lows of 0.87 per cent in early October and ended the year at 1.37 per cent.

Currencies

• The Aussie dollar eased by around 0.7 per cent against the greenback over 2019. The Aussie started the year around US70.6 cents and ended the year near US70.15 cents. The Aussie hit highs of US72.68 cents in late January while lows (also decade lows) of US67.08 cents were set in early October.

• We have calculated that the Aussie was 70th strongest against the US dollar of 120 currencies tracked in 2019. The Syrian pound rose the most against the greenback (up 15.5 per cent) while Egypt, Russia, Israel and Thailand were all up around 7-11 per cent. The weakest currencies were Argentina (down 59 per cent), Zambia (down 18 per cent) and Ghana (down 17 per cent). Only 38 currencies lifted against the greenback over the year. Notably the UK pound rose by 3.8 per cent with Japan up 0.9 per cent.

• The Aussie has gradually trended lower for around three years. Over most of the period US policy interest rates were rising while the Aussie cash rate was left unchanged. Since August the Aussie dollar has generally held US67-70 cents with both the US and Australia cutting policy rates three times since June.

Commodities

• Commodity prices were mixed over 2019. The Commodity Research Bureau futures index rose by 9 per cent over the year, but the CommSec daily index fell by 2.4 per cent, broadly matching a near 1 per cent fall in the Aussie dollar against the greenback.

• At one end of the spectrum, thermal coal fell by 34 per cent with liquefied natural gas (LNG) down by 44 per cent. At the other end of the spectrum, beef prices soared by around 44 per cent, iron ore gained 26 per cent, crude oil lifted by 34 per cent and gold gained 18 per cent.

• Base metal prices were mixed with zinc down 9 per cent while nickel rose by almost 32 per cent.

• Rice rose by 10 per cent with sugar up 11 per cent but cotton lost 4 per cent and wool lost 16 per cent.
Sharemarket

- The Australian sharemarket started 2019 with the All Ordinaries at 5,709.4 and the ASX200 at 5,646.4. The All Ords ended 2019 at 6,802.4 points (up 19.1 per cent) with the ASX200 at 6,684.1 (up 18.4 per cent).
- The ASX200 hit record highs of 6,845.1 in late July but promptly retreated to near 6,400 in mid-August. The ASX200 hit new record highs of 6,864 on November 28 as optimism grew on a US-China trade deal.
- In 2019, Australia was 23rd strongest of 72 global bourses. Overall, 57 bourses recorded gains in 2019. The best performer was hyper-inflation-affected Zimbabwe but Greece, Russia, Argentina and Romania lifted by more than 35 per cent. New Zealand rose 30.6 per cent and was 8th strongest. The US Dow Jones rose by 22.3 per cent.
- The worst performers were Lebanon, Nigeria, Ukraine and Chile. African and Middle Eastern sharemarkets generally underperformed.

Investment returns

- Total returns on Australian shares (All Ordinaries Accumulation index) lifted 24.1 per cent over 2019, hitting record highs in late November. Returns on shares posted the best gains in a decade. Returns on dwellings rose by around 5 per cent in 2019 while returns on government bonds lifted by around 8 per cent.

Sectors & size groupings

- Of the 22 identified industry sub-sectors, only one fell in 2019 – Household & personal products (down 30.5 per cent) – while Capital goods rose just 2.2 per cent.
- Leading the gains was Consumer durables & apparel (up 63.8 per cent) from Pharmaceuticals & biotech (up 46.6 per cent) and Media and Retailing (both up 32.7 per cent).
- Of the size categories, the ASX50 outperformed (up 19.1 per cent) from the ASX100 (up 18.9 per cent), the Small Ordinaries (up 17.9 per cent) and MidCap50 (up 17.7 per cent).

What are the implications for investors?

- Returns on shares are near record highs. In fact sharemarket returns have only fallen once in the past 10 years. So an investor that has employed a diversified strategy across asset classes would be well pleased with the performance over recent years.
- The outlook for the sharemarket remains positive. The Reserve Bank will maintain its stimulatory monetary
policy settings over 2020. The Reserve Bank has scope to cut rates another two times before considering ‘unconventional’ policies like buying government bonds from the private sector.

- But the Reserve Bank stresses that it can’t do it all.
- Certainly Federal and State governments are active in advancing new infrastructure projects. And with budgets broadly balanced or in modest surplus, there is scope for even more fiscal stimulus to be applied.
- And the Federal Government could bring forward tax cuts with an announcement in the May 2020 Budget. The Labor Opposition is offering apparent support.
- Over the coming year, infrastructure building and net exports will add to economic growth. The Reserve Bank hopes that the stimulatory policy settings will lead to stronger household spending as well. Weaker home building will be the main factor weighing on growth in the first half of the year. But mining investment is finally set to make a positive contribution to growth after 6 years.
- Last year we noted: "The Australian ASX 200 share index is expected to rebound by 10-12 per cent in 2019 after a decline of around 6-8 per cent in 2018. Including dividends, total returns are tipped to lift by 14-17 per cent in 2019. While above-normal growth of total return on equities is expected, this must be seen in the context of the below-normal performance in the latter part of 2018."
- The forecasts actually proved a tad conservative – although late year profit-taking was an influence bringing the result closer to forecast.
- Over the coming year CommSec expects the All Ordinaries index to be near 6,900-7,200 points in June 2020 and 7,100-7,400 points in December 2020, supported by the "search for yield". But increased focus on earnings, bank dividends and business profitability could present risks to our outlook.
- Housing markets across the nation are continuing to rebalance to reflect the increase in supply (new home construction). Government grants and rate cuts will ensure that first home buyers remain active. Investors have also returned, and while sharemarkets currently have more attractive investment returns, home prices are tipped to lift over the coming year.
- Over 2019/2020, national home prices may post gains of around 6-9 per cent. Since the Federal Election there have been signs of stabilisation of Sydney and Melbourne home markets with prices up sharply on stronger buyer demand and supply constraints.
- The low inflation/low interest rate environment is entrenched, meaning that lower nominal investment returns are also here to stay. So investors will need to remain flexible and alert to the returns achieved across sharemarket sectors and across asset classes to ensure that their savings are keeping pace with the cost of living.
- The ‘triple L’ theme (low unemployment, low inflation, and low interest rates) will also dominate global markets over the coming year. Central banks still favour rate cuts over rate hikes despite unemployment at or near multi-decade lows in many advanced nations.
- The Aussie dollar is expected to largely trade in the late 60s/early 70s against the US dollar over most of the coming year. But interest rate differentials between the US and
Australia and the US-China trade discussions are the two factors that could move the Aussie out of the tight range. And the potential deployment of unconventional monetary policy by the Reserve Bank – most likely government bond purchases – presents the biggest downside risk to the Aussie dollar should current stimulus fail to lift growth.

- Financial markets have been buoyed in the past few weeks by the successful completion of a ‘Phase 1’ trade deal between the US and China. As a result there is the prospect for stronger global economic growth in 2020, especially given the fact that the US economy is entering 2020 in solid shape.

- Still, there is the question of whether a ‘Phase 2’ deal will follow. And then there are geopolitical issues that may emerge over the year involving Iran, North Korea, Hong Kong and/or Latin America. Also Brexit still has to be navigated by the UK and European Union.

- Of course another significant risk for financial markets in 2020 is the US Presidential election due in November.

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<tr>
<th>FORECASTS</th>
<th>2018/19</th>
<th>2019/20</th>
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<tr>
<td>Economic Growth</td>
<td>1.9%</td>
<td>2.25-2.75%</td>
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<td>Underlying inflation</td>
<td>1.6%</td>
<td>1.50-2.00%</td>
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<td>Unemployment</td>
<td>5.2%</td>
<td>5.00-5.50%</td>
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<th>mid 2020</th>
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<tr>
<td>Cash rate</td>
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<tr>
<td>Sharemarket (All Ords)</td>
<td>6,900-7,200</td>
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<td>Australian dollar</td>
<td>USD66-70c</td>
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