psk FINANCIAL SERVICES
50 YEARS Since 1969
50 years of advice that puts you first

Newsletter: Jan/Feb 2020

10 years on from the GFC. Outlook for 2020

10 February 2020
By Rob Dawson – PSK Financial Adviser

The GFC was just over 10 years ago, falling to its lowest point in March 2009.

Where do we stand now?

Since then we have seen globally, ultra-low interest rates, a recovery in investment markets, a recovery in property markets, relatively no inflation and in some countries very low full time unemployment.

So where are we now and what are we most likely to see over the coming 1 – 2 years?

I have waited until the UK election was over before drafting this note.

- In the last few years it has been difficult to make predictions – none more so than in 2019.
  Key areas of concern included UK Brexit, the UK election plus the China / USA trade war which after many false starts and postponements have been resolved with relative benign outcomes at this stage (January. 2020)

  The tensions in Iran in January and missile strikes along with the extreme weather events here in Australia (Bushfires and floods) serve to add further uncertainty to the mix.

- In the past 2 years prominent economic columnists in the Australian Financial Review (AFR) have retired from their positions – or retrenched – (one was Phillip Baker). In their final column they advised that writing regular opinion pieces was a hard ask as neither could work out what was really going on either politically or using standard economic guidelines.
  Making predictions was near impossible.

  Economics is in a state of flux and politics is also in flux – internationally.

The Problem:

Economic text books written in the 1950's – 70's were based on the world at that time and do not reflect the world today.

Back then we enjoyed, Full employment, limited inflation, (later stagflation) and a young working population.

Interest rates sat at around the 5 -10% mark and later (19 - 20% to kill inflation). Investment markets were heavily influenced by interest rates.

Economics in 2020 has a new normal that old text books never grappled with.

- Ageing population: In all OECD western countries the percentage of the population over 65 is now 3 times what it was even in in the 1970's and 80's and growing. This segment of the population saves hard in the final few years of work and lives frugally in retirement in order to make their remaining wealth last.

  This segment is 16% of the population in both Australian and USA and 20% in Europe. It represents an important tipping point in the limitations of growth and general demand in the economy.

- Unemployment and the "gig" economy.

  The formal rate of unemployment is classified as "did you work at least 1 hour in the last week?" It's a long-standing measure dating back to the 1950's when if you worked for 1 hour you likely worked full time for 40 hrs.

  A chronically over simplistic measure in 2020.

  There are 6 levels of unemployment used in the USA statistics the official rate is knowns as U2. The U6 measure includes all those who want to work or work more and is nearly double the U2 measure. And as recently as 2 years ago was nearly 3 times as large.

  A similar analysis is also used in Australia.

  This consistent overhang of labour surplus including some older workers not formally measured in the statistics (because they are over 65) limits wage growth in many areas, since often the job creation is in the part time gig economy.

  The official unemployment rate slides into less significance each year. The combined total unemployment rates at about 6.5% in the USA and 8.5% in Australia further adds to the limited economic demands when added to the

retiree population.

- <u>Technology</u>

  This changes the GDP measure and the inflation measures too at a faster rate than can be tracked and factored into adjusted economic indicators and responses.

  There has been a suspicion in economic circles that the GDP reported in major OECD countries is under measured. GDP has usually been measured on production or on services paid for. As the technology and the Internet has dramatically reduced the cost of products and services the GDP could look as if its stagnant or going backwards while in actual fact much more is being achieved.

  Think about: Digital Photography, the use of Google instead of encyclopedias, Uber lowers the cost of services and deliveries.

  Some economists believe that the productivity increase of some administrative work is also disguised. Mobile banking, online shopping, healthcare processes.

  Medical achievements now mean that patient stays in hospital can be reduced from a week to a few days for some procedures. Others are now just a day visit and back home at night.

  All of this is inadequately tracked and measured. But we report lowish GDP numbers in all OECD countries and lament the "stagnating" economies.

The Solution (?):

So far, we see traditional economics at work, reduce interest rates to near zero, try to boost more spending (usually on credit), rely heavily on the monetary approach run by the US Fed or the RBA.

Seeking to push the economy to higher GDP and maybe find a bit of inflation that signals the economy is doing well. Conservative governments avoid pump priming and Government spending. They seek to get back to a budget surplus.

Many articles in the press are written with a doomsday tone about resurgent inflation suddenly coming back – There is little evidence of this or evidence

that it will appear anytime soon. An analysis of newspaper articles vs reality often shows that doomsday drums beating, especially about investments are invariably wrong or chronically overstated.
Roughly 4 negative articles for 1 positive article.

But asset prices like shares and housing increase on the back of low interest rates.

So, in the short term of the next 2 years there appears to be more of the same, with lower rates to push down unemployment to new lows looking for stronger economic growth and some modest inflation to justify nudging interest rates back up a bit higher.

Increased asset prices in the case of housing seems to be preferred. Since people feel good about themselves when their house goes up in price. Thus, we end up with a new norm where interest rates remain low and equity markets remain high. Dividend yields are only about 4-5% whereas they were normally more like 7% pre GFC.

Pre-Coronavirus view: January 2020.

Generally, the view in early January was positive on the basis of the following:

- Likely win by Trump in November pushing the US economy along further. USA has a lot of internal confidence and great consumer sentiment.

- Geopolitical risk decreasing – China trade war on the mend – or at least on hold.

- US monetary policy looks less threatening – more amenable to growth.

- Share markets not overvalued vs inflation and interest rates. Australia a bit high vs Overseas Markets.

- A Steady as she goes looks highly likely globally and in the USA.

The Coronavirus attack:

This has emerged in the last 4 weeks as an issue of its own accord that could derail the rosy view outlined above. China clearly has not managed the outbreak as well as it could and now is playing catch up.

The extended closure of factories and business through out China is also leading to issues for export industries and the corresponding import industries in China's trading partners in other countries.

Since China is now 17% of world trade any continued quarantining of the country could eventually affect the global economy triggering a mild slow down or even a modest technical recession.

While the virus is not as deadly as SARS in 2003, it is more infectious and so the death rates will look worse. The lock down imposed by the Chinese regime should slow the infection rate while various research labs race to find a solution. BUT - if this drags on for more than 3 months (end of March), then it would be reasonable to assume a mediocre year for investments with various economies flat lining and investment markets as well.

History shows that science always finds a way out - its just a matter of time, so sit tight and wait.

The solution may come faster than is expected - or at least the interim management of the virus and the economic knock on will be limited by alternative options to be found in various markets.

A worst-case scenario globally is the most unlikely outcome of this situation - although it will be hard on China.

Australia will be affected - particularly universities and tourism, but the aftermath of the bushfires and the rebuilding work, along with the rain should assist with mitigating the economic impact from China. The world won’t end.

If you’d like to discuss any of the points raised, please do not hesitate to contact me on 9324 8888 or rdawson@psk.com.au.

PSK Financial Services Group Pty Ltd (ABN 24 134 987 205) are Authorised Representatives of Charter Financial Planning Ltd (AFSL 234666), Australian Financial services Licensee and Australian Credit Licensee.
Information contained in this article is general in nature. It does not take into account your objectives, needs or financial situation. You need to consider your financial situation before making any decisions based on this information.