

THE ROAD AHEAD FOR SHARES



Trying to time investment markets is difficult if not impossible at the best of times, let alone now. The war in Ukraine, rising inflation and interest rates and an upcoming federal election have all added to market uncertainty and volatility.

At times like these investors may be tempted to retreat to the “safety” of cash, but that can be costly. Not only is it difficult to time your exit, but you are also likely to miss out on any upswing that follows a dip.

Take Australian shares. Despite COVID and the recent wall of worries on global markets, Aussie shares soared 64 per cent in the two years from the pandemic low in March 2020 to the end of March 2022.ⁱ Who would have thought?

So what lies ahead for shares? The recent Federal Budget contained some clues.

The economic outlook

The Budget doesn't only outline the government's spending priorities, it provides a snapshot of where Treasury thinks the Australian economy is headed. While forecasts can be wide of the mark, they do influence market behaviour.

As you can see in the table below, Australia's economic growth is expected to peak at 4.25 per cent this financial year, underpinned by strong company profits, employment growth and surging commodity prices. Our economy is growing at a faster rate

than the global average of 3.75 per cent, and ahead of the US and Europe, which helps explain why Australian shares have performed so strongly.ⁱⁱ

However, growth is expected to taper off to 2.5 per cent by 2023-24, as key commodity prices fall from their current giddy heights by the end of September this year, turning this year's 11% rise in our terms of trade to a 21 per cent fall in 2022-23.

Australian economy (% change on previous year)

	Actual %	Forecasts %		
	2020-21	2021-22	2022-23	2023-24
Gross domestic product (GDP)	1.5	4.25	3.5	2.5
Consumer prices index (CPI)	3.8	4.25	3.0	2.75
Wage price index	1.7	2.75	3.25	3.25
Unemployment	5.1	4.0	3.75	3.75
Terms of trade*	10.4	11	-21.25	-8.75

*Key commodity prices assumed to decline from current high levels by end of September quarter 2022
Source: Treasury



Commodity prices have jumped on the back of supply chain disruptions during the pandemic and the war in Ukraine. While much depends on the situation in Ukraine, Treasury estimates that prices for iron ore, oil and coal will all drop sharply later this year.

So, what does all this mean for shares?

Share market winners and losers

Rising commodity prices have been a boon for Australia's resources sector and demand should continue while interest rates remain low and global economies recover from their pandemic lows.

Government spending commitments in the recent Budget will also put extra cash in the pockets of households and the market sectors that depend on them. This is good news for companies in the retail sector, from supermarkets to specialty stores selling discretionary items.

Elsewhere, building supplies, construction and property development companies should benefit from the pipeline of big infrastructure projects combined with support for first home buyers and a strong property market.

Increased Budget spending on defence, and a major investment to improve regional telecommunications, should also flow through to listed companies that supply those sectors as well as the big telcos and internet providers.

However, while Budget spending is a market driver in the short to medium term there are other influences on the horizon for investors to be aware of.

Rising inflation and interest rates

With inflation on the rise in Australia and the rest of the world, central banks are beginning to lift interest rates from their historic lows. Australia's Reserve Bank has recently raised the official cash rate after 11 ½ years of no increases.

Global bond markets are already anticipating higher rates, with yields on Australian and US 10-year government bonds jumping to 2.98 per cent and 2.67 per cent respectively. However, the yield on some US shorter-term bonds temporarily rose above 2.7 per cent recently. Historically, this so-called "inverse yield curve" has indicated recession at worst, or an economic slowdown.ⁱⁱⁱ

Rising inflation and interest rates can slow economic growth and put a dampener on shares. At the same time, higher interest rates are a cause for celebration for retirees and anyone who depends on income from fixed interest securities and bank deposits. But it's not that black and white.

While rising interest rates and volatile markets generally constrain returns from shares, some sectors still tend to outperform the market. This includes the banks, because they can charge borrowers more, suppliers and retailers of staples such as food and drink, and healthcare among others.

Putting it all together

In uncertain times when markets are volatile, it's natural for investors to be a little nervous. But history shows there are investment winners and losers at every point in the economic cycle. At times like these, the best strategy is to have a well-diversified portfolio with a focus on quality.

For share investors, this means quality businesses with stable demand for their goods or services and those able to pass on increased costs to customers.

If you would like to discuss your overall investment strategy don't hesitate to get in touch.

i <https://www.comsec.com.au/market-news/the-markets/2022/mar-22-budget-sharemarket-winners-and-losers.html>

ii https://budget.gov.au/2022-23/content/bp1/download/bp1_bs-2.pdf

iii <https://tradingeconomics.com/united-states/government-bond-yield>

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