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The profits of gloom

“Buy in gloom and sell in boom” is one of those share market pearls of wisdom that is easier said than done, but once again the sage advice has been proved right. When the Australian share market hit a five-and-a-half year low on March 6 this year, only the most intrepid investors were buying shares (....or remaining in them). Six months later (as the accompanying graph shows), the market has rebounded by 41 per cent and those investors with nerves of steel are feeling vindicated.

Of course not everyone is blessed with nerves of steel; lots of Australians have capital ‘sitting on the sidelines’, earning cash returns of 3-4 per cent waiting for clear signs of a recovery in the Australian economy. A common question for these people is, “has the economic recovery started, and is it too late to purchase shares now?”

History suggests you need only a sniff of economic recovery for shares to commence a rebound. Australia has avoided a technical recession to date, growing by a mere 0.6 per cent in the year to June 2009, but that’s actually impressive compared to the rest of the world which looks like a battle zone.

The US economy has contracted by 3.9 per cent and the OECD nations by 4.6 per cent. But that hasn’t stopped their share markets from rising out of the ashes of recession. The US market is up 41 per cent since the gloom of March, Japan is up 40 per cent and European markets have rebounded more than 30 per cent.

The Australian economy relative to its global ‘western’ peers remains very strong. We are the only developed nation to have avoided a recession throughout the last 18 months. In fact, a mighty 18 years have passed since we experienced an official recession. After 1991, Australia has ducked and weaved through a minefield of global wars, financial crises and stock market crashes.

So how did we do it after experiencing the worst global economic crisis since the 1930’s? Luck played a part. Being resource rich and located within easy trading distance of China has helped. China looks set to continue its rapid growth and will need Australian commodities such as iron ore and coal to fuel its development.

Snapshots



But skill played a part too. Australia avoided the worst of the banking crisis thanks to our strong regulatory system, effective handling of interest rates by the Reserve Bank of Australia and sound financial management by successive governments. The Rudd government moved hard and fast to inject cash into the economy and even though this will push the budget into deficit, Australia's public debt will be small by global standards.

With cash in their pockets, Australians managed to keep spending while reducing debt and increasing savings. Interest rate cuts, a lower than feared unemployment rate and a more resilient housing market than elsewhere in the world also boosted consumer confidence.

Australian companies have also fared better than expected. In the latest full-year reporting season, 72 per cent of companies either matched or beat analyst expectations and 42 per cent managed to improve their profitability.

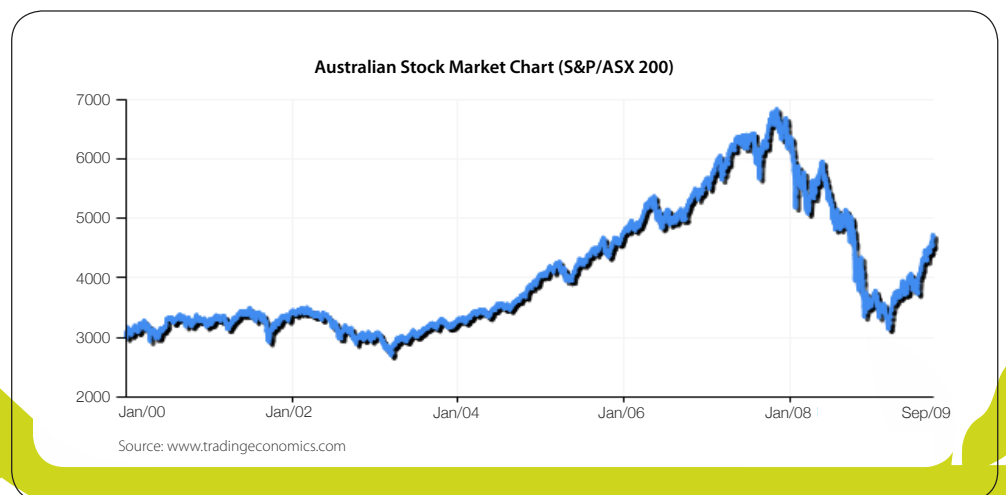
True, this was the worst full-year reporting season since 1991, with aggregate earnings down almost 67 per cent, but it could have been worse. Investors expressed their relief by wading back into the share market.

And yes, share prices may have rebounded too far, too fast and there may be some volatility ahead, but at present the market is back on an upward trajectory. Is it too late to purchase shares? It's never too late to buy good quality shares, but you need to think long term, diversify and carefully consider your own appetite for risk. It's a cliché, but you need to be able to sleep at night through your partner's snoring, all the good economic times (of which there are many), the mediocre times and unfortunately the global economic panics that, from time to time, will continue to unfold in our wonderful but uncertain world.

Looking ahead, Australia's economic growth is likely to continue to outpace its peers, a view put forward recently by no less than the Reserve Bank governor, Glenn Stevens, when he said: "There are rather few countries that have the potential to offer so attractive a proposition to international capital, and to their own citizens, over the years ahead."

In banker-speak, that means Australia is likely to stay ahead of the pack for some time to come.

The facts in this article are sourced from the Reserve Bank, Commonwealth Securities, the ABS and Bloomberg.



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