

Financial Insights

with Australian Unity Financial Planning

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Sharemarket outlook remains positive

After reaching their lows in March 2009, equity markets around the world started to realise another 1930s style Great Depression would be avoided and a recovery in the global economy would take hold.

All the stocks that were priced to fail doubled and some then doubled again. Traditional stock picking took a back seat and being long in equities proved extremely profitable, almost irrespective of the stock or sector.

Now the so called 'easy gains' seem to be behind us and we believe stock picking will once again come to the forefront in 2010 with handsome rewards only to those who are capable of robust bottom up stock and sector specific analysis.

Equity market gains of 2009 were driven primarily by P/E expansion which is typical of the forward looking nature of equity markets. For these gains to be sustained in 2010 and beyond, investors will need to see evidence that the rebound in corporate earnings now being discounted in the market for fiscal 2011 will be delivered.

The 1H2010 earnings reported by Australian companies in February 2010 will therefore be crucial, as will the accompanying outlook commentary. Markets could face some downside if the earnings recovery or its timing was deemed to be at risk by investors.

Assuming the economic recovery that began some months ago continues to build momentum, the dramatic increase in earnings that is expected in fiscal 2011 will be achieved comfortably. The key risk is that the RBA is overzealous in their efforts to get the cash rate back to 'neutral'.

The risk of tighter monetary conditions negatively impacting equity markets in 2010 remains. A faster than expected recovery in the global economy will put pressure on central banks and governments around the world to withdraw stimulus initiatives.

There is little doubt that easing monetary conditions, especially those in the USA, have contributed to significant asset price gains around the world.

Tightening of liquidity could therefore put downward pressure on global equity markets even as the economic background improves significantly.

It is hard to predict how this risk will play out because it depends on the shape of the recovery and the stance of central bankers and politicians. All eyes are therefore on upcoming key data releases such as the US Nonfarm Payrolls and retail sales that may set the near term direction for this debate.

Commentary courtesy of Platypus Asset Management – an Australian equities joint venture partner of Australian Unity Investments.

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