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2013 Year in Review: Many happy returns

Snapshot

It was a year when investors feared the worst. The US teetered on the edge of a fiscal cliff, the Eurozone was at risk of falling apart, China looked set for a hard landing and Australia braced itself for the end of the mining boom. Yet not only did the worst not eventuate, but 2013 provided the best investment returns in years.

In a low inflation, low interest rate environment investors waded back into higher risk growth investments in search of returns, with local and international shares the standout performers.

Once the uncertainty of the September federal election was out of the way, the Australian sharemarket finished the year with a burst of support. The benchmark S&P/ASX 200 Index closed 15 per cent higher while the overall market, measured by the All Ordinaries Index, was up a more restrained 13 per cent. This reflected the fact that bigger companies weathered the difficult economic conditions better than smaller firms. When dividend income is taken into account, the total return from shares grew by 20 per cent.

AUSTRALIAN STOCK MARKET (S&P/ASX 200)

Source: www.tradingeconomics.com | Australian stock exchange

Snapshot

While local share investors were well rewarded in 2013, the really big gains were made overseas. A number of markets recorded their best performance in decades.

The US market rallied 27 per cent, its best performance since 1995; Japanese shares soared 57 per cent, their biggest gain since 1972. And despite Europe's ongoing economic woes, German shares were up 25 per cent, Spanish shares jumped 21 per cent and the French market rose 18 per cent.

Australian Key Indices as at 31st December 2013	
GDP annual growth rate	2.3%
RBA cash rate	2.5%
Inflation (annual)	2.2%
Unemployment rate	5.8%
Consumer confidence index	105

Share Market (% Change) January - December 2013	
Australia (All Ords)	+13.3%
US (Dow Jones)	+26.5%
UK (FTSE 100)	+14.1%
China (SSE Composite)	-7.6%
Japan (Nikkei 225)	+56.72%

Note – Price Indices: excluding dividends

Global growth on the mend

The Australian economy remained on a fundamentally sound footing last year but it failed to fire. Uncertainty leading into the September federal election put the brakes on business investment and consumer spending. More importantly, the economy continued to struggle with the difficult transition from the mining boom to a more balanced economy.

Australia's economic growth rate slowed to 2.3 per cent last year, well below the long-term average of 3.5 per cent. It was also below the global growth rate of 2.9 per cent. While the first phase of the mining boom is over, it is easy to lose sight of the fact that the export phase is just gaining momentum.

Over the past year Australian exports to China hit a record $92 billion and the trade surplus hit a record $45.6 billion. China accounts for a record 35.6 per cent of our exports. Despite concerns about a slowdown in the Chinese economy, it contributed close to one-third of total world growth in 2013. The next biggest contributor, the US, accounted for just 12 per cent of world growth.

While the global economy showed positive signs of growth, the debt overhang and the response of central banks to the problem continued to dominate world markets. After much anticipation the US Federal Reserve finally announced the beginning of the end of easy money. In December it announced that it will 'taper' its US$85 billion a month asset purchase program by US$10 billion a month.

Low inflation, low interest rates

Despite massive stimulus programs in the US, Japan and Europe, inflation remained low in developed countries. In Australia, inflation sat comfortably

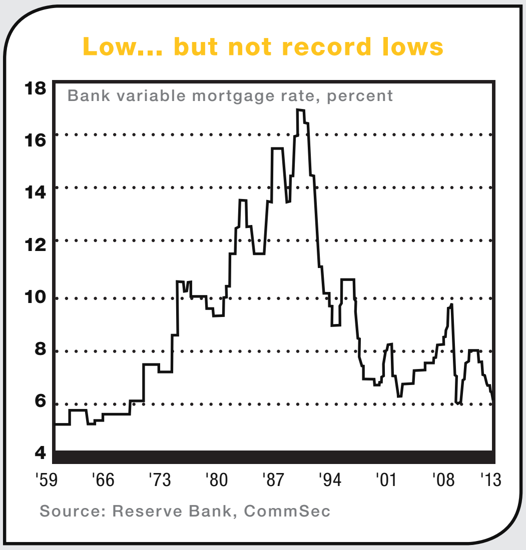
Snapshot

within the Reserve Bank's target range at 2.2 per cent despite strong property prices, which set the scene for further interest rate cuts.

The Reserve Bank cut the official cash rate from 3 per cent to 2.5 per cent in 2013, the lowest level in more than 50 years. Interest rates for bank deposits, government bonds and mortgages followed suit. Bank home loan rates fell to an average of 5.95 per cent.

As the cost of borrowing fell, investors shifted out of bank deposits and bonds into growth assets such as shares and residential property.

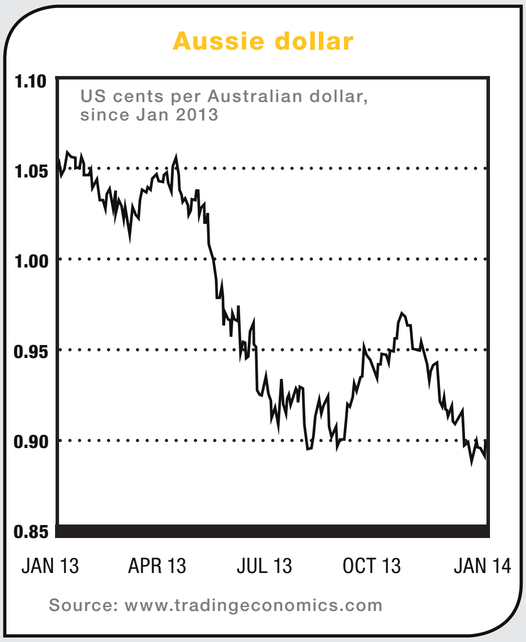
By slashing rates so aggressively the Reserve Bank aimed to wrestle the Aussie dollar back to a more internationally competitive level and kick-start the non-mining economy. And to some extent it succeeded.



Weaker Aussie dollar

The Aussie dollar depreciated close to 17 per cent against the US dollar last year as it tumbled back below parity to finish the year at US89c. This is welcome news for Australian exporters and further falls could boost the economy's growth outlook.

While lower interest rates set the scene for the dollar's fall, it was events in the US that had the biggest impact. Once the taper was announced, signalling a reduction in money printing, the US dollar firmed against other currencies, including our own.



Housing recovery

The Australian residential property market had its strongest run in four years in 2013, fuelled by investors and upgraders as well as low interest rates. Figures from RP Data-Rismark show the housing market finished the year up 9.8 per cent with a median house price of $575,000 and a median unit price of $480,000.

However, the national figures mask a tale of many cities. Sydney was the best performing market with 14.5 per cent price rise, followed by Perth (9.9 per cent) and Melbourne (8.5 per cent).

Snapshot

The median house price in Sydney is now $775,000. The weakest markets were Adelaide (2.8 per cent) and Hobart (2.2 per cent). Hobart is the most affordable city; with a median house price of $350,000 you could buy two houses there in 2013 and have change left over from the sale of one Sydney residence.

Confidence up but jobs key

The housing boom also contributed to a lift in consumer confidence over the course of 2013. The Westpac Melbourne Institute Index of Consumer Sentiment finished the year at 105, an annual increase of five per cent. But Australians have not quite shaken off their concerns about the broader economy.

Consumer sentiment reached a peak of 110.6 in September after the federal election. However the honeymoon ended in December with rising community concerns about job security.

Unemployment edged up slightly to 5.8 per cent as the high dollar, relatively high wages and rapidly changing technology took their toll. Announcements by the Ford Motor Company and General Motors Holden that they would wind down car making in Australia underscored some of the difficulties faced by traditional manufacturers.

The year ahead

Australians have every reason to feel cautiously optimistic in 2014. Global growth is expected to reach 3.5 per cent. China and the developing world remain the key drivers, with economic recovery in the US and Europe expected to continue.

Global inflation and interest rates are low and are likely to stay that way. Now that the US Fed has declared its hand and begun a slow and steady tapering of monetary stimulus, the potential for market shocks has been reduced and investment confidence has improved.

For Australia, the housing recovery, rising consumer and investment confidence and the positive impact of a lower dollar on our exports augur well for the year ahead. Economic growth is expected to cruise along at about 3 per cent, providing a supportive backdrop for the corporate sector and investors alike.

If you would like to discuss any of the investment themes in this article and their impact on your portfolio, don't hesitate to contact us.

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