

MONITOR

01 Special Edition MBM - August 2011 *Creating Long Term Financial Success For Our Clients*



Uncertainty is winning.....for now.

When we published our first ever special edition of the Martin Bros Monitor in October 2008, post the Lehman Brothers collapse in the US, we did not envisage we would be writing our second ever Special Edition so soon. However, this seems to be a factor of the (finance) world we live in these days, where investors have an ultra short term focus on the daily and weekly movements in equity markets, which in turn has created greater volatility (the degree to which markets move up and down).

In the first special edition readers may remember that we said the ultimate fear of a system wide breakdown was now behind us. By this we meant a complete freezing of credit markets that would lead to a massive and immediate halt to economic activity with prolonged consequences. We wrote that we believed equity markets over time will begin to trade based on the outlook for economic fundamentals. And this is what they did.

We did not see the ultimate bottom in equity markets until mid March 2009. In the final two week period of what turned out to be the ultimate bottom there was sustained selling with few up days. In fact, this activity is quite similar to what we have seen again over the past two weeks. Today, our equity market has opened very weak in response to overseas falls. Many stock movements today are extreme and often signal a short

term bottom is near. By this we mean the extreme intra day volatility where blue chip stocks can trade in a 10% band, despite their outlook being no different from what they were yesterday, last week or last month.

We obviously can not declare with any certainty where the ultimate bottom in this current sell off will be. No matter how bad things currently look, equity markets will not have week in, week out losses for an extended period. There will be a rally very shortly, but the question will be whether it is a "relief rally" or a sustained rally.

Putting this short term(ism) of markets to one side, let's look at the fundamentals of Australian listed companies. In this post GFC world, companies as a whole have very low levels of debt. Australia is growing at over 2% this calendar year (3.5% forecast for 2012) even after the devastating natural disasters, China is still growing at greater than 8%. Most current equity market fears are centered on a double dip recession in the US. Oddly, this is exactly the same fear that caused a sell off in mid 2010. The US is not in recession again as yet and the Federal Reserve will do everything they can to avoid this happening, including a QE3 package (QE1 and QE2 resulted in strong rebounds in global equity markets).

So today, as we are about to enter our reporting season next week,

corporate Australia have lowly geared balance sheets and a growing domestic economy. Interest rates look like they have or are close to topping out. Companies will report record levels of dividends to shareholders over the next few weeks, starting with CBA next Wednesday. This will set the tone for the rest of the banking sector and confirm that industrial Australian companies are still in a strong position, despite an extremely negative short term global outlook.

If you believe we are headed for a prolonged period of economic gloom and recession/depression type scenario in Australia then equity investments are not the place to be.

If you hold the view that Australia will continue to grow at modest GDP rates (2-4%) over the next five to ten years, then Australian companies as a whole will also grow and continue to pay growing dividend streams. We are clearly of the latter view. In March 2009 when the global gloom was at a peak, the markets then rebounded from there lows by over 50% in next six months. This is why "stepping out" of the market during periods of sell off can be very dangerous.

The current short term volatility is merely a very unwelcome sideshow to the longer term growth and prosperity of Australia and personal equity portfolio's.

As always, please feel free to contact us to discuss anything in more detail.

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