Welcome to the Xmas 2015 Edition of the Martin Bros Monitor.

In this edition of the Martin Bros Monitor:

Another Year - Many Changes But Still The Same

As 2015 has been an interesting year on our markets, as they all seem to be, mainly due to the divergent performance of various sectors within our market. The ASX200 is currently down 5.6% year to date with the ASX200 accumulation index (incl. dividends) down 1.3%. However, not all sectors have performed that badly, or that well, this year.

In the 13th year of writing the Martin Bros Monitor (MBM) we have always tried to provide a macro overview of how we currently see domestic and global issues and their likely impact on equity markets. In our quarterly publication there usually seems to be new events or factors to consider and hence write about each quarter. Although these views will often not necessitate any significant change to our long term thinking and investment positioning for clients, they do provide new things to talk about from quarter to quarter.

But in a first for MBM (13 years), we are going to replicate large parts from our Xmas 2014 and September 2015 editions, with a few additional comments (in blue) added in for good measure. When writing these newsletters we look back over previous editions to help turn our brains into “writing mode”. In doing so, we were struck as to how relevant all of the matters discussed in the above two editions still are today.

Apparently the average person is presented with the equivalent information of 147 newspapers per day due to digitisaton. We absorb in one day what our grandparents had to in the space of one year. So we understand if none of our readers will remember what was written in these previous editions. They are, as relevant today, if not more so, than when we first wrote them. So please don’t feel reading on is a waste of time. We've updated some prices (in blue).

Xmas 2014 Edition - The market fall this calendar year is largely a result of the resource sector with the industry heavyweights falling substantially from the start of the year. BHP started the year at $37.99 and is currently $28.90 ($17.16), Rio Tinto $68.18 versus $55.45 ($42.05) currently, Woodside Petroleum $38.90 versus $34.60 ($27.03) currently, Santos $14.63 versus $7.28 ($3.50) currently, Origin $14.07 versus $10.60 ($4.82) currently and Oil Search $8.11 versus $7.13 ($6.35) currently.

As a result of these falls the resources and energy sector weighting as a proportion of the ASX200 has fallen from 20.16% of the index at the start of the year to 16.24% (15.94%) today (it was 24.23% at the start of 2013). So having a tactical underweight position to these sectors as a whole has been of benefit. This positioning has been based on several factors, but one in particular has been our view that the Australian dollar would continue to fall throughout the year. As commodities are priced in US dollars, as the greenback has strengthened, commodity price weakness has been one consequence. Add into the mix a slowing Chinese real estate / construction sector and increased commodity supply and there has been the mixture for softer commodity pricing.

These days the markets are extremely quick to price in any change in sentiment, and in the short term, momentum can mean that good quality stocks with sound medium term earnings outlooks (even taking into account lower commodity prices), will not be exempt from massive swings in their share prices.

Australia's commodities will still be in demand for many decades to come, but with lower realised prices, boom time earnings of the last decade are likely a thing of the past for some time to come. The falling Australian dollar against the US dollar will cushion some of the dramatic falls in commodity prices for Australian companies. But in the short term this is being overlooked.

The falling commodity prices will also have implications for Australia's terms of trade which will make it very hard for the Reserve Bank of Australia to think about raising interest rates anytime soon. This, together with fiscal tightening (government reducing spending, lifting taxes), has several forecasters now predicting further interest rate cuts next year. Our cash rate in Australia is currently 2.5%. This may go to 2.0% next year if the growing chorus of economists are right (it did so in May 2015). Term deposit rates are continuing to fall and may go under 3% for shorter duration deposits (which they did). All of this should support reliable dividend paying banks and industrial companies next year, as it has done for the last couple of years.

Another consequence of our falling terms of trade is a depreciating dollar. This is good for international shares and Australian companies with offshore earnings. Although our dollar has fallen a lot this year, to 83 cents to the US dollar, we expect this will continue next year (currently 72 cents). It won't be good for travels to US denominated countries, but it will be good for our exports and hopefully lead to further pick up in the non mining sectors of our economy. This is beginning to take hold in our view and is likely the cause of recent stronger than expected unemployment numbers. The resources boom was large, but WA and Queensland were the main beneficiaries of this. NSW and Victoria are largely services, agricultural, property, education and tourism based economies. Victoria has been ticking along for many years but NSW has lagged for many, many years. Not any longer, as the above industries, helped by a lower Australian dollar, very slowly start to recover. NSW is a huge (potential) growth engine for Australia as it is our most populated state. If NSW's fires, which it hasn't for the last decade, so will Australia.

September 2015 Edition - As long time readers of Martin Bros Monitors (MBM's) will know, we are now in a seasonally weak period for global equities (Sept / October). This is again holding true as the bull market of recent years, fueled by easy access to cheap money from Quantitative Easing (QE) programs and low interest rates around the world, experiences a correction.

In Australia, this correction has been a little deeper than in the US and Europe (but not China!), with our equity market down 12% from its mid July peak, versus the US down 8.1% and Europe down approximately 10%. As with all corrections they tend to feel worse than perhaps they are when you are in the eye of the storm.

A main factor driving the recent sell off in Australia is the pending increase in official US interest rates. This will be the first increase in official interest rates since pre the GFC (more than seven years ago now). All risk assets globally have had a boost in the last few years from low interest rates and QE programs which seek to encourage investment to stimulate economic activity. This appears to have worked in the US where they now have the best growth rate of any developed nation.

As economic and jobs growth continues to improve in the US (the US continues to add over 200,000 jobs each month. It is estimated only 75,000 per month are needed to maintain employment levels. So above this number means additional jobs are being added), the cheap and easy money "tap" is slowly being turned off by the Federal Reserve. This began with the gradual winding down of the QE program over a 12-18 month period, beginning in 2012. This process was knows as tapering down the QE program. The next stage of this "normalization" process is beginning to raise official interest rates from the historical low level of 0% in gradual increments.

This first increase in official interest rates was expected at the September, October or December Federal Reserve meetings. It did not occur at the first two, widely believed to be due to global market volatility (caused by them!). It does not have to occur at the upcoming December meeting next week, however our Chief Economist, Michael Knox, believes that the improving labour market makes it a necessity that they do. The current unemployment rate in the US is 5.0%. The Federal Reserve have stated that they believe the "natural" level of unemployment is 4.9%. Below this level there is a labour shortage and the result is escalating wages, which leads to inflation. Accordingly, if the US continue to add over 200,000 jobs monthly, they will quickly exceed this natural level of unemployment and they will be forced to raise interest rates faster than they would like to. Hence, starting the process now seems highly probable.

The themes we have been talking about for some time now are not over in our view. That is, falling commodity prices, falling $A and low global cash rates (not necessarily long bond yields) – although the US are expected to begin raising cash rates, they are off a very low, effectively zero, level. Yield and growth will still be sought after. We continue to be positioned for this.

Wishing you a Safe & Merry Christmas

Christmas Hamper Competition

It is that time of year, our traditional Christmas Hamper competition returns for 2015.

For those not familiar with this competition, you must ‘qualify’ to enter the draw by answering each of the questions below. Each of the 5 questions must be answered correctly before your name will be entered into the draw for the hamper.

Please email Stella at stella.moses@morgans.com.au or call on (03) 9947 4140 with your answers.

Rochelle has kindly put together a magnificent hamper for this year's competition, with all the usual festive goodies to ensure the winner has an extra indulgent Christmas!

The competition closing date is Thursday the 17th December at 10.00am AEDST. The winner will be drawn that afternoon and notified by phone, with delivery of the gift basket by Friday of that week.

1. Name Australia’s 25th Governor General?

2. In what year was the painting ‘Blue Poles’ purchased by the National Gallery of Australia?

3. Which two countries straddle the Bering Straight?

4. Name five of the six actors who have played James Bond.

5. Which Olympic sport might require a ‘Foil’ or ‘Epee’?

BONUS QUESTION: If you can tell us where the above 5 questions came from, you will receive entry into the draw regardless whether you have answered the 5 questions correctly!

Good Luck!

ASX Market Hours - Festive Season

Please note the amended ASX trading hours below over the upcoming Christmas and New Year period.

Members of the Martin Bros. Team will be available each day the market is open.

- Thursday 24th December - Reduced Trading (10am to 2.30pm)
- Friday 25th December - Market & Office closed (Christmas Day)
- Monday 28th December - Market & Office closed (Boxing Day Holiday)
- Tuesday 29th December - Normal Trading
- Wednesday 30th December - Normal Trading
- Thursday 31st December - Reduced Trading (10am to 2.30pm)
- Friday 1st January - Market & Office closed (New Years Day)
- Monday 4th January - Market returns to normal trading hours

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