

Lifestyle Newsflash

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www.lifestyle.au.com

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Lifestyle 

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Market Update – June 2010

The Media:

Business Media barons are currently rubbing their hands with glee. Why? Because there is plenty to write about – most of it negative – and that is what sells news stories. Domestically, the Resources Super Profits Tax (RSPT) has provided plenty of fodder since the May Budget. Internationally, sovereign debt default issues in Europe have given journalists a steady flow of drama to feed their readers, many of whom are investors (...speculators?) hungry for volatile share markets upon which to trade.

Why is it that efficient sharemarkets are normally good at absorbing negative news flow with, often, little negative impact on share prices? Because, for every negative news story there are many positive stories that do not go reported. Remember, drama and disaster sells newspapers so there is an over-representation of negativity in the media.

So why have sharemarkets taken the European Debt problems so seriously? There are 2 reasons. Firstly, there is a fear that a focus on repaying debt rather than stimulating economic growth in Europe will prolong recession. Secondly, the extent of sovereign debt problems is unknown. Hungary has now been outed as a potential default nation so, until, the full extent of the problem is known, nervousness will remain.

What about the unreported good news? In America, 78% of the 477 companies in the S&P500 Index reported first quarter (March 2010) earnings in

excess of analyst expectations. In late May, the Paris based OECD (which includes 31 developed economies) said the world economy was recovering faster than expected from recession. It has lifted growth targets for 2010 to 4.6%.

Equity Market Valuations

On most traditional measures of value, stocks are looking cheap all around the world following the most recent sharemarket rout. The charts below depict the PE (price to earnings) multiple of the US and Australian equity markets in recent years. The current market decline has amounted to a 10% decline for the S&P 500 while the ASX 200 is down around 14%. Other major corrections within bull trends in the past fifty years included declines of this magnitude along the way.

Can the market fall further?

Sharemarkets are driven by fundamentals in the long run and sentiment in the short run. By fundamentals, we are referring to the future earnings capability of a company. The clearer this is, the more highly rated that company will be. Currently, short term future earnings are unclear, and that is where sentiment starts driving short term volatility. In a nutshell, yes, sentiment can drive the market lower, but, as the charts below point out, ultimately, sharemarkets will revert to “fundamental” value which, measured as a PE, is around the 15 to 16 mark...well above current levels.

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Lifestyle's View

In our last newsletter, we noted that most sharemarket recoveries are punctuated by mini-corrections as investors get ahead of themselves and push the market upwards too quickly. It is clear from events of the last month or so, that real economic recovery may be a case of "2 steps forward and 1 step backwards". Consequently, alternate bouts of fear and greed will lay the seeds for ongoing volatility.

Meanwhile, behind the scenes, policymakers are working to ensure the world economy emerges in better health. And, business is going back to basics...paying down debt and concentrating on core activities rather than pursuing risky growth strategies financed by high levels of debt. We believe the foundations are being laid for a sustained recovery in sharemarket returns for the future...but, it is unlikely to be a smooth ride.

