



Started with a Bang, Ended with a Whimper

Looking back on the last 12 months, it wasn't too bad a year for investors, with all of the major asset classes generating positive returns. However, the downgrading of Greek debt in late May led to a sell-off in sharemarkets, taking the shine off what was looking like a good year for equity returns.

A sell-off in early July 2009 coincided with big falls in US consumer confidence and concerns about the recovery. A subsequent rebound reflected a strong US reporting season. The next sell-off came in late October 2009, with weak US economic and earnings data leading to more nervousness about the pace of the recovery. Another sell-off during January and February was caused by fears that China was about to tighten its monetary policy, coupled with concerns about the fiscal position of some European economies.

The final and largest sell-off began in May 2010 and was triggered by the downgrading of Greek debt and fear that the fiscal tightening required (mainly in advanced economies) would strangle the fragile and two-speed global recovery (where emerging and developing economies recover ahead of developed economies).

Even with these repeated sell-offs, most sharemarkets posted double-digit returns for the financial year. On top were property stocks, global up 42.3% (in local currency terms) and Australian up 20.4%. These benefitted from a recovery in risk appetite and a trend to lower gearing levels. Next were Australian shares, ending the year up 13.1%. Overseas shares in Australian dollar (AUD) terms posted single-digit returns. The strength of the AUD, particularly against the Euro, held returns back.

How Did Defensive Assets Go?

Not bad is the answer. Both overseas and Australian fixed interest recording returns well in excess of the cash rate.

There were two main reasons for the good performance of fixed interest. The first was a narrowing in the spread between non-government debt and government debt. The second was the fall in yields from May onwards, which was driven by flight to quality flows as equity markets fell sharply.

What's in Store for the Next Financial Year?

The Global Economy: To dip or not to dip?

The "easy" growth from rebuilding inventories is already in the bag and the time is coming where countries that borrowed to boost growth will have to pay back debt by tightening their fiscal belts.

The fear this process could be mismanaged or overly harsh lies behind the double-dip recession hypothesis.

What actually is a double dip?

A double-dip recession is an event where the economy enters into a recession within a period less than 12 months following the end of the previous recession.

There have been 33 recessions registered in the US since 1854. Over this entire time frame, there have been only three recorded instances of a double-dip recession by this standard definition. The first one was in 1913, the second in 1920 and the third in 1981. That is only one in the modern era, so history suggests that the chances of a double-dip are low.

The information contained in this document is not intended as advice. It has not taken into account your personal situation or needs. You should seek professional advice before acting upon any of this information.

The content in this document is based upon information in the July 2010 Perennial Perspective Monthly Investment Update produced by Perennial Investment Partners.

Could this time be different, given the systemic nature of the GFC shock and fiscal adjustment task ahead?

If the recent G-20 meeting in Toronto is anything to go by, countries and policy makers are acutely aware they need to get the balance right. As a group, they agreed to follow on what they had started in terms of stimulating their respective economies but also start the process of introducing consolidation packages that would at least halve deficits by 2013 and stabilise or reduce debt to GDP ratios by 2016. In the shorter term, they saw a role for low interest rates. Our take is that policy makers will err on the side of supporting growth and that this should significantly reduce the chance of a double dip recession.

A strong outlook for the Australian economy?

There is no doubt that talk of higher taxes on the resources sector led to a loss of confidence in the robustness of Australia's growth outlook. While a compromise has now been worked out, it is worth reminding ourselves that the Australian economy still has plenty of other things going for it:

- National income has been boosted by recent gains in commodity prices
- Households have benefitted from a round of tax cuts effective from 1 July 2010, a lift in hours worked and a lift in the minimum wage
- With monetary conditions at neutral levels, the RBA will likely only tighten further if growth surprises on the upside
- Business investment is expected to grow strongly over the year ahead
- Australia's trade exposure is weighted to the faster growing emerging and developing economies
- Australia is a low debt country.

So, all in all, we are in reasonably good shape. While we do not predict boom times any time soon, cautious optimism seems fair. Continue to watch out for the highs and lows of markets, but don't panic.