



Australia on solid ground

2012 Year in Review

Despite walls of worry and fiscal cliffs, the 2012 year managed to end without calamity.

By the end of the year, global sharemarkets were looking fairly solid. In particular, the Australian market managed to advance more than 12 per cent, reversing most of its fall in 2011. Another strong performer was Japan's stock market with the Nikkei index jumping close to 23 per cent. Other major markets were also in positive territory, albeit to a lesser extent.

Key Data: January 2012 – December 2012

Australian Key Indices as at December 2012	
GDP annual growth rate	3.1%
RBA cash rate	3.0%
Inflation	2.2%
Unemployment	5.4%
Consumer confidence index	100.6

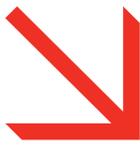
Share Market (% Change) January – December 2012	
Australia (All Ords)	12.3%
US (Dow Jones)	5.7%
UK (FTSE 100)	3.5%
China (SSE Composite)	4.0%
Japan (Nikkei 225)	22.9%

Note – Price Indices: excluding dividends

It was the chase for yield that drove global sharemarkets in 2012. In many developed countries, interest rates reached rock bottom levels with little likelihood of rises anytime soon. In the United States and United Kingdom, the central bank rates reached 0.25 per cent and 0.5 per cent respectively.

By comparison, the 3 per cent rate set by the Reserve Bank in Australia (RBA) looked quite strong. Yet even this pales next to dividend returns of close to 7 per cent from local bank shares.

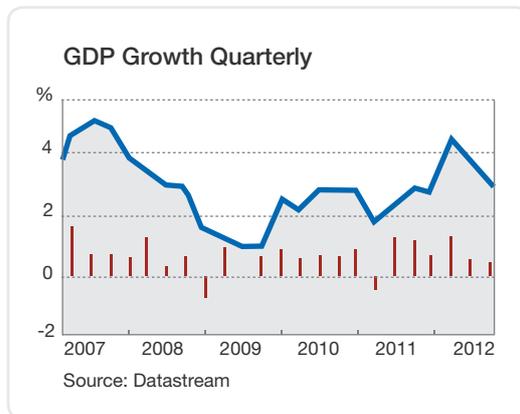
Global sharemarkets were shadowed by uncertainty in 2012, with the European debt crisis and the US fiscal cliff threatening even until the early hours of 2013. Locally, the unwinding of the mining boom saw the softening of Australia's economy.



Economic slowdown

Australian gross domestic product (GDP) fell from 4.3 per cent in the March quarter to 3.1 per cent in September reflecting the slowing of the economy as the year progressed. Nevertheless, our economy ended the year in much better shape than most other western economies, with US gross national product (GNP) growth at 2.5 per cent and the United Kingdom and Japan languishing at less than 1 per cent. China's GDP was running at 7.4 per cent compared with 9.1 per cent in 2011, with the general consensus that its economy has bottomed. A US\$157 billion infrastructure spending package announced in September ensured parts of the Chinese economy could look forward to growth in 2013.

Australia's GDP Growth



The mining boom's slowdown cut into Australian tax receipts prompting the Federal Government to concede in December that a return to a budget surplus was unlikely. Treasurer Wayne Swan said the government did not want to compromise growth and jobs by increasing spending cuts to make up the tax income shortfall.

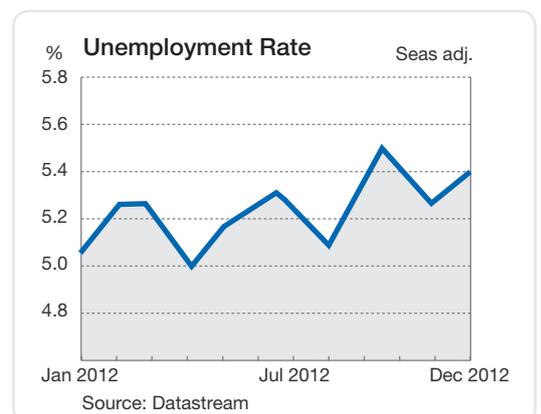
However, a rebound in the iron ore price recently has put back in play the possibility of a surplus by the end of the financial year.



Iron ore tumbled from a peak of \$US190 a tonne in 2011 to just \$US86 in September 2012. Since then it has recovered to more than \$US140 a tonne, but some analysts are forecasting it will soften slightly to between \$US118 and \$US133 a tonne through 2013.



The cracks that emerged in the local economy showed up in the labour force figures. While the jobless numbers mostly hovered just above the 5 per cent mark for most of the year, by December they had risen 0.1 per cent from the previous month to 5.4 per cent. The number of job vacancies trended down in 2012, falling to its lowest level in 30 months by November.





Housing steady

Demand for housing finance has risen steadily throughout the year. November marked the eighth consecutive month of increases in the volume of housing finance commitments to owner occupiers. It rose 1.4 per cent in the month and 4.6 per cent over the year.

But this did not translate to increased demand for new dwellings until towards the end of the year. In November, new home sales jumped 4.7 per cent after a 3.4 per cent rise in October on the back of the government grants favouring new home building. This improvement could augur well for the construction industry in 2013.

Dollar still strong

The Aussie dollar performed fairly consistently, starting the year at \$1.02 and finishing at \$1.05 against the Greenback. While Australia remains one of only seven countries with a AAA rating it is unlikely the dollar will fall below parity with the US currency. Last year, the International Monetary Fund said it was considering elevating the Australian dollar's status among its preferred reserve currencies. This would bolster the already strong demand from foreign investors for the Aussie dollar and lessen any chance of the dollar weakening significantly in the near term.

The local currency has also maintained its strength against other currencies staying above 78 euros and trading around 66 British pence.

In December, Australia posted its biggest trade deficit for almost five years of \$2.64 billion – its 11th consecutive deficit. The recovery in the iron ore price, coupled with a cyclical bottom emerging in world markets, should see the balance of trade figures improve.

Inflation within target band

Inflation edged up to over 2 per cent but was still well within the target band preferred by the RBA.

The rise was largely on the back of increased electricity prices to cover energy companies spending big on infrastructure. Other contributions included higher prices for overseas holidays, means testing of private health insurance and, to a lesser extent, the carbon tax.

While higher inflation might be a deterrent for further cuts in interest rates in 2013, the softer economy could counter this.

The RBA cut the base rate four times during 2012 by a total of 1.25 per cent to 3 per cent. Many analysts are tipping two more cuts in 2013 to 2.5 per cent.

Confidence fluctuating

Consumer confidence swung wildly during the year. In December, the Westpac-Melbourne Institute index fell 4.1 per cent after having been up 5.2 per cent in November.

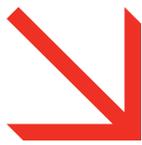
This was reflected to some extent in retail sales, which ended the year flat lining in November; our reluctance to spend going in hand with a greater willingness to save in the aftermath of the GFC.

Australia's savings rate is at a 20-year high with households putting away 10.8 per cent of disposable income. Seven years ago that figure was just 0.3 per cent.

Following a cut in the official interest rate and positive developments in the US and China, Australian business confidence rebounded in December.

The NAB Business Forecast showed business confidence improved in December having reached its lowest level in November since April 2009.





The year ahead

After averting the fiscal cliff at the start of the year, the outlook for the global economy in 2013 appears to be a little stronger than last year. However, this does not mean the fallout from the global financial crisis is completely over.

In the US a housing recovery is evident, oil and gas production is growing and manufacturing is experiencing a renaissance thanks to much cheaper energy prices. Collectively, these are positive indicators although there will be some uncertainty in markets when the Obama administration seeks to lift the debt ceiling.

Europe also seems to be on a more even keel, with the European Community's commitment to support the euro. The Chinese economy appears to have bottomed with growth expected at 7.5 per cent in 2013.

On the local front, the economy is expected to remain subdued in the early part of 2013 until the effects of any further rate cuts kick in and the slowing in the mining sector is replaced by an eventual pick up in other parts of the economy. Growth in 2013 is expected to slow to around 2.5 per cent a year.



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Markets in 2013

Despite the shrinking shadow of the GFC, uncertainty on global sharemarkets in 2013 is unlikely to vanish entirely.

Factors weighing on investors' minds will be the recently announced general election in Australia, concern of a possible relapse in Europe and nervousness over the partisan squabbling over whether to lift the US debt ceiling.

The knowledge that US Federal Reserve chairman Ben Bernanke supports increasing debt to pay the nation's bills will help to calm some jitters.

While difficult to predict, some analysts are forecasting the All Ordinaries index will end 2013 higher and many expect markets will enjoy a reasonable year against the backdrop of a slowly improving global economic landscape.

As always, your asset allocation needs to reflect your risk return profile and the changing nature of your individual circumstances. Please call us if you would like to reflect on your investment mix in light of the outlook for the economy and investment markets.



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