CONSUMER WOES AND COLLINS CORNER – JUNE NEWSLETTER 2017

CONSUMER WOES

Earlier this week I came across a story of an Australian Fund Manager who decided to wind up Three Australian Equity Funds and return all monies to investors. Citing impending property market "calamity", China property concerns, an unpredictable US political environment and stretched equity valuations he declared the market risks were too great to remain a part of. The cynic in me suspected there was something sinister behind the decision but at face value there was nothing untoward I could see, all three funds had generated above average returns and investors would all walk away with their capital intact and a reasonable profit. Naturally though it got me thinking, **what was the last straw that forced him to make such a decision? After all the concerns he raised weren't anything we hadn't heard before. *It turns out I may have the answer*, but before you panic and abandon ship bear in mind I'm not predicting economic Armageddon, the authorities still have scope to steer our economy out of these muddy waters, it's just they had better start making the right decisions soon or that fund manager could very well be on his way to being known as a "Stockmarket Genius" (**which we all know is really a spot reserved for me).

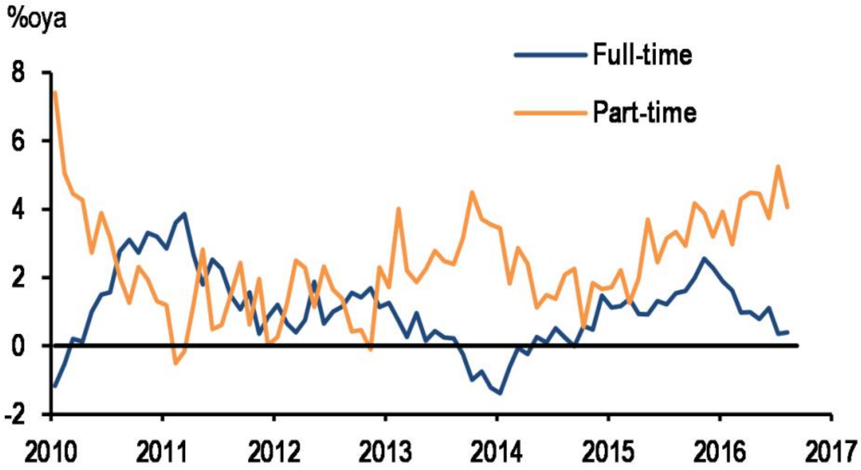
Being glued to the screen on a daily basis I see my fair share of economic data. What I am observing is a concerning rise in the number of challenges faced by today's consumer. Without proper corrective intervention from the authorities we could very well find ourselves headed toward our first recession in 25 years. Why? Let's have a look at the list of challenges today's consumer faces today;

- ***Wage growth remains at its lowest level ever recorded***
- ***Inflation continues to exceed Wage Growth. This means consumers can't keep up with pace of price rises***
- ***Household Debt to Income Ratio remains at a historically high level***
- ***The Bank Levy imposed by the Government will be passed onto consumers in one form or another***
- ***Banks are making rate decisions based on the funding costs charged by large overseas institutions influenced by the rising US interest rate environment, further diminishing the influence of the RBA and contradictory to the health of our own economy***
- ***The housing market has peaked and signs of further weakness are emerging***
- ***Falling Savings Rate among households***

Household spending contributes near 60% to the Australian GDP pie and it's only because of its enduring strength (driven largely by the property market) Australia has been able to avoid a recession. Oddly enough, in the past the RBA has been content for the savings rate to decline because it meant households were spending more money on goods and services, but that was before the Major Banks started adjusting their rates independent to the RBA. I've never understood their view and I'm certain now they would want the trend to stop.

What may have been the final straw for the Fund Manager could be linked to the release of the Unemployment Data on the 18th May and the Political praise that shortly followed (It wasn't too long after this he started to inform clients of his decision). Politicians are always quick to congratulate themselves when there is a decline in the unemployment rate, but they never put it into context with the real world, probably because they often have no idea about the people they govern (hence the rise of the populist movement). The rest of us understand if you were to you lose your full time job and cannot find a full time replacement, without hesitation you're going to find a part-time job to pay the bills. **It's this scenario that is playing out in front of us right now and no one seems to be taking notice of its significance**. Low wage growth, Interest rates moving independently to the health of our own economy, Inflation exceeding Wage Growth, High levels of Household Debt and a lack of savings to fall upon are all real risks to the level of household spending moving forward, and **it's important to note the first place consumers stop spending are those industries households are currently finding their part time employment!;**

Figure 2: Full-time versus part-time employment growth



Source: J.P. Morgan

I admit it all sounds a bit heavy and gloomy but at this stage it only serves as a stern warning to stay cognisant to the changes that occur in economic data as we move toward the latter half of 2017 and to the actions of authorities to counter these challenges. It's one reason why I don't agree with the incumbent's fixation on delivering a budget surplus. What they need to do is throw the idea out the window, loosen up its policy, tell the public the truth and get us out of this muddy water.

In light of this and if you share a similar opinion, Investors may want to consider taking a few steps to hedge their portfolio against potential risks. ***The first step*** could be to focus on sectors likely to be affected by the challenges I've highlighted, making suitable adjustments to increase the proportion of cash held within your portfolio. Despite the recent pullback I believe the market is in the midst of a false "relief rally" and this presents an opportunity to reduce exposure. *Property, Consumer Discretionary and the Financials are sectors investors could consider first in line to make such adjustments*.

The second step could be to shift focus **on alternative sectors such as Health Care, Infrastructure, Utility, Companies with US links, and others likely to benefit from the emerging trends** *i.e. such as Pioneer Credit (PNC), **a debt solution provider** I tipped at $1.80 as early as 2015 and today trades at $2.30.*

Whatever you choose to do, if anything be sure it fits in with your overall strategy and consider the possible risk/outcomes before committing to any decision. **Furthermore if your attitude toward risk has changed, it's very important you inform us to ensure we are able to provide the right advice.**

COLLINS CORNER

Well May is now done and hopefully the worst is over for small juniors relying on gold and other commodity prices, as the Spot Gold price is trying it's best to make a new short term high (US$1,266.11 as I write). Now we may have the June last minute sell off by those electing to crystallize tax losses to offset capital gains in shares and or property before end of the financial year. I am expecting a much better market during July/August onwards to September in relation to gold stocks and then we have our traditional September/October sell off, but we will address that later in the year.

As far as inflation is concerned which benefits Gold, the Oil price is still very low and is contributing to a low inflation rate globally, as the Oil producing nations act as a huge vacuum cleaner sucking dollars from motorists and businesses around the world. But because the oil price is low then inflation is not being spread by the increased cost of doing business or travel, and is helping all sorts of sectors to benefit, such as airlines and transport companies. Albeit at the expense of Oil & Gas companies who are having a hard time maintaining their margins and indeed any net profitability in some cases. Australia in the 60's if I recall was self sufficient in Oil and is now closer to 50%.

Inflation is of course related to other issues and the main one being too much cash or paper money chasing too fewer goods. Sufficient paper money has certainly been printed, but not enough people are interested in borrowing or buying goods sufficient to generate inflation, and the volatility of money is slow as people hang on to their cash and pay down debt instead of spending it. In essence lack of confidence and the fear of not having the cash if and when they need it in an emergency.

Inflation has however been a problem in housing caused by a shortage of affordable stock and a demand by wealthier buyers at the expense of the younger generation. The cost of and shortage of housing is directly related to Sate Governments who will not release sufficient land at the right price and locations, and gain from Stamp Duty and GST receipts from housing, and will support higher GST and Stamp Duty.

This state of mind of course will change in time and then we will have our day in the sun for the bottom end of the junior market, when risk is once again considered necessary to make larger returns in more bullish times. This will contribute to Gold's next rise in price.

A recent article on the junior market highlighted the current transition back to the Resources sector, whereby the failed IT and Tech stocks are now being used as vehicles to back door resource projects.

The NSX (National Stock Exchange) is in recent times receiving above average attention since some in the Blue Blood, Elite ASX continue to forget how BHP, Woodside and Fortescue were grown from penny dreadful companies. For those not paying attention, for a new IPO (Initial Public Offering) or a new float, a company previously needed to have $2m net assets, then it climbed to $3m and recently it was again upgraded to a minimum of $4m after expenses excluding the value of mining exploration assets to list on the ASX. It is hard enough to raise capital in the current market without raising the bar too high, and I suspect the NSX will do a roaring trade in junior companies in the next year or so. As more companies list on the NSX more liquidity will be generated and more investors and brokers will create and generate more trading and liquidity for traders.

Hence our reason for becoming an NSX Participant and transferring our Execution and Clearing services to a company than can execute and clear ASX and NSX companies shares. If you have not yet arranged to transfer your account over you should do so as soon as possible.

The NSX had a stall at the Stockbrokers Conference in Sydney I attended last week and is very dedicated to taking the market for new Junior IPO's and specifically junior resource floats away from the ASX.

At times it is difficult to select a specific stock in a sector that you have a belief in, such as Gold, International shares or indeed a specific metal or commodity.

ETF's (Exchange Traded Funds and LIC's (Listed Investment Companies) are becoming more popular and considered by some to be a safer investment vehicle because they provide protection against a single stock or asset collapsing, as you are invested in a portfolio of stocks in one sector or a spread of sectors in the case of LIC's. Listed Investment Companies have been around for years and are nothing more than a Fund Managers Portfolio of stocks he selects to hopefully outperform the indexes overall, and can also generate dividends and franking credit benefits. But of course they do not have the benefit of one company flying as the result of a specific event either. It is all about your attitude to risk, your stage in life and the funds you have to take risks with if you do not want to die on the vine with boredom, although it is better than dying a pauper.

Funds are also pushing Ethical Investments where the fund managers attempt to select stocks with increasing value or incomes generated by stocks that are not in Oil, Mining, Tobacco, Forestry or other nasties that build homes, generate power, manufacture and drive cars or kill trees for paper. I actually agree with the minimal use of Coal and Oil and I am a big supporter of natural Forests, so I am conflicted. But it will take years or decades for the pure benefits of an Ethical Society, but it is a worthwhile cause as long as we also have a practical debate about how we live in the meantime. Clean air and clean water should never be secondary.

And as usual remember the SAS Motto:

Performance of Key Indices

Equities	*Close*	*Change (M)*	*Change % (M)*
All Ordinaries	**5947.59**	**+43.75**	**+0.74%**
S&P/ASX200	**5924.06**	**+59.15**	**+1.01%**
Dow Jones (US)	**20940.51**	**+277.29**	**+1.34%**
NASDAQ	**6047.60**	**+135.86**	**+2.30%**
S&P500	**2384.20**	**+21.48**	**0.91%**
FTSE 100 Index	**7203.94**	**-118.98**	**-1.62%**
Nikkei 225 (Japan)	**19196.74**	**-287.48**	**-1.52%**
10-year bond rate (US)	**2.28%**	**-0.001**	**-4.38%**

RBA releases

Reserve Bank Board Meeting – Monetary Policy Decision – 6th June
Minutes of June 2017 Monetary Policy Meeting of the Reserve Board – 20th June

ABS releases

Retail Trade (April) – 1st June
Business Indicators (March) – 5th June
Balance of Payments (March) – 6th June
Building Approvals (April) – 6th June
Australian National Accounts (March) – 7th June
International Trade in Goods and Services (April) – 8th June
Housing Finance (April) – 9th June
Lending Finance (April) – 9th June
Labour Force (May) – 15th June

Upcoming US Economic Releases

ISM Manufacturing Index – 1st June
Employment Situation – 2nd June
International Trade – 2nd June
Producer Price Index – 13th June
Consumer Price Index – 14th June
FOMC Announcement – 14th June
FOMC Forecasts - 14th June
Industrial Production – 15th June
Housing Starts – 16th June
Existing Home Sales – 21st June
PMI Composite Flash – 23rd June
Durable Goods Orders – 26th June
International Trade in Goods – 28th June
GDP – 29th June