OUTLOOK FOR AUSTRALIAN SHARES as at 6/9/2019

In my last Outlook (6/6/19 *updated 5/8/19*) I discussed the possibility of a recession in Australia and Globally. My conclusion was that whilst Australia was not in an official recession – defined as 2 consecutive quarters of negative real (*inflation adjusted*) GDP growth – we were in a slight per capita recession. This means that the Australian economy is growing very slowly, well below its long-term average. Is it going to get worse? I suspect not, as I think we will muddle along as we have been in recent times.

The last official recession in Australia was in 1990/91, but interest rates were way higher then (*home loan rates in 1989 were 17%),* unemployment was much higher (*above 10%)* and inflation was around 7%. In September 2019 the Reserve Bank's official cash rate is now at historic lows of 1%, home loan rates are around 3.5% to 4.5%, unemployment is only 5.2% and inflation at only 1.59%. Add to this the fact that at present the $A is at competitive levels relative to other currencies (*e.g. around 68 cents to the $US*), we have a sizeable trade surplus and possibly soon a current account surplus (*the 1st since about 1975*).

The Australian Government is also looking at a budget surplus which gives it the option to increase spending on such things as infrastructure if need be to stimulate economic growth.

So, whilst things aren't booming there are plenty of reasons to suggest the outlook from here on is not worse.

Let's look at Australian shares through the lens of Price Earnings Ratios (*PER*). A PER is the price a company's shares are selling for on the stock market divided by the earnings per share. If a share price rises without any change to earnings, then the PER will increase indicating that shares in said company are relatively more expensive. The long-term average PER for Australian listed companies is somewhere in the 14's and the current average PER for the Australian market is around 16.1. This on the surface makes prices seem slightly expensive on average but this is not the case because interest rates are at record lows and don't look like changing much in the foreseeable future, meaning higher share valuations can be justified. One method of valuing companies and therefore the share prices is by using discounted future cashflows to determine the current value of expected future profits. The discount rate used in these calculations is based on current and expected interest rates. The lower the interest rate chosen the higher the DCF value. Future profits and dividends generated by a company are worth more when the alternative low risk investment options (*i.e. fixed interest investments*) are paying less. So, at present Australian shares are not in my opinion expensive on "average". However, to obtain an "average", there will be shares that are more expensive and those that are less expensive. This is the case in the Australian market at present. Some examples of this can be seen by comparing similar companies PER's.

Woolworths	27.17	Vs	Coles	15.87
James Hardie	25.02	Vs	Boral	11.44
Oil Search	19.28	Vs	Santos	13.34
TPG Telecom	18.71	Vs	Telstra	9.30
Commonwealth Bank	16.0	Vs	ANZ Bank	11.18
Computershare	16.53	Vs	Link Market Services	12.16

Now it's true that comparing companies is not as simple as comparing PER's, but it does help. Other factors that are important are things like, at what rate a company's profits are growing (*higher growth rates justify higher PER's*) and how much debt is a company carrying. In my opinion there are some Australian shares that are insanely expensive – good companies but at stupidly high prices. For example Wisetech Global is a quality company growing its profits at around 30% per annum but its current pricing puts it on a PER of 198.36; Afterpay Touch has been growing its sales at a rapid rate (*18/19 sales were 90% more than 17/18*) but it has never made a profit to date and its share price is 35 times sales per share (not profit, sales without any expenses account for). On the flip side, it is also true that some shares are cheap for a reason, often referred to as value traps.

So, my conclusion is there is still some decent value investing in Australian shares but you need to be selective to avoid the super expensive stocks, the value traps and the basket cases (*those companies going backwards without any prospect of turning things around*).