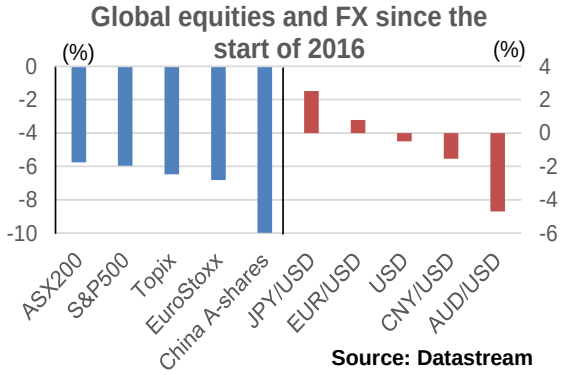
A challenging start to 2016

11 January 2016

Equity and commodity markets have had a poor start to the year. In this article, Tim Rocks discusses the current economic activity and his views on implications for global markets.

The Australian equity market is down 7% at time of writing, closely in line with a 6% fall in the US market and 7% in Europe[1]. A range of commodities have also fallen with oil the most pronounced, down 10% to 12 year lows[1]. The Australian dollar has also been caught up in turmoil, and is now down almost 5% for the year. Chart 1 shows movement downward to market close on 8 January 2016.

Chart 1:



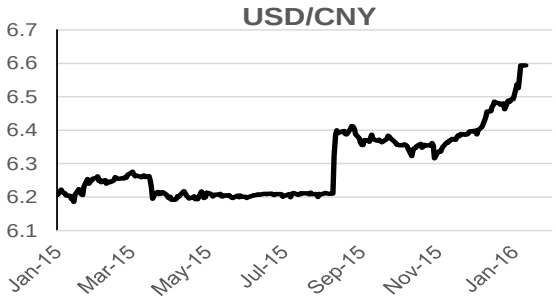
Source: Datastream

Background to the volatility

Concerns over China have been the major issue coupled with some geopolitical concerns over Saudi Arabia severing diplomatic ties with Iran and the North Koreans claiming the successful testing of a hydrogen bomb on 6 January. The local Chinese sharemarket has shed more than 10% this year sparked by changes in rules around government support, floats, insider selling and circuit breakers. Surprisingly, the falls in the local China market have infected other global markets since normally there is little link between the two. Foreign investors normally access China through H-shares listed in Hong Kong rather than through A-shares listed in Shanghai, and the two markets often behave very differently.

At the same time, Chinese authorities have moved to depreciate their currency by around 1.5%. While this will ultimately give a boost to the export sector, it could imply that the authorities are more concerned about the current state of the economy.

Chart 2:



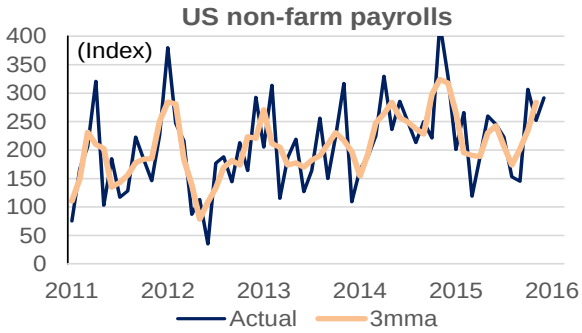
Source: Datastream

Deeper implications or a temporary disturbance

We see these equity market moves as an over-reaction. There has been no significant new information that would cause us to change our view on markets or economies. In fact, the major data release has been US employment data which was very strong. Instead we think a combination of Chinese policy confusion and thin liquidity in markets around the start of the year has caused an exaggerated response that can just as quickly reverse.

We retain a relatively positive view on markets for 2016 but acknowledge we will continue to see periods of high volatility. Aggressive policy action in China, which has continued with the recent currency depreciation, will help stabilise the economy. The falling oil price will be a positive to global growth by reducing transport bills and lowering global inflation that will allow central banks to keep policy easier for longer. A rising US dollar also helps push down the Australian dollar that will assist our economy to cope with the fall in commodity prices. Recent developments give us more confidence that these themes will still dominate through 2016.

Chart 3:



Source: Datastream

Diversified portfolios will have been affected by the fall in equity markets but there are some offsets. There have been positive returns for fixed income portfolios and the fall in the Australian dollar will have helped offset unhedged international equities portfolios.

[1]Source: Bloomberg. 11 January 2016.

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