SIRAGROUP

SIRA VIEWS - Issue 1

AUSTRALIA: AN IMPENDING SLOWDOWN?

Australian growth has been surprisingly strong given weak commodity prices and slow growth in wages and personal incomes. In the four quarters to the end of 2015, real (i.e., inflation-adjusted) GDP grew 3%.

The chart overleaf shows our Australian leading index, which is designed to provide an advance indication of the direction the economy is likely to take. It leads economic activity by about 5 months. In the chart it has been plotted 5 months in advance, so that its turning points coincide with the turning points of GDP on the graph.

As can be seen, for most of the last 14 years—in fact for the last 40 years—our leading index has accurately forecast movements in real GDP over the next 2 quarters. In 2010, it was overoptimistic, and in 2011/12 GDP growth was stronger than the index forecast. But this period involved the GFC recovery and the peak of the commodity boom, and both will have affected the published GDP data. The leading index is constructed from 20 component time series from across the economy. It includes monetary, confidence, financial, and economic momentum indicators. In general, if a majority of indicators are declining, the leading index will decline, and vice versa. The leading index peaked last year, and in recent months it has been falling fast.

AS CAN BE SEEN, FOR MOST OF THE LAST 14 YEARS—**IN FACT FOR THE LAST 40 YEARS**—OUR LEADING INDEX HAS **ACCURATELY FORECAST MOVEMENTS** IN REAL GDP OVER THE NEXT 2 QUARTERS.

AUSTRALIA: AN IMPENDING SLOWDOWN? continued

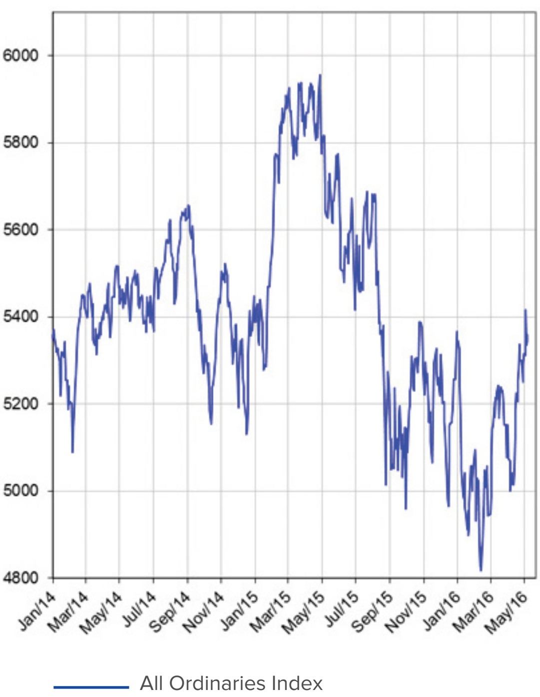
Will there be a recession? On official data, wages growth in Q4 (1.2%) was the lowest in 20 years. Gross National Income (GNI) was much weaker than GDP because of the fall in commodity prices, falling 0.2% over the year. The key, though, is employment and unemployment. The official (ABS) unemployment rate has been falling since the middle of last year. The ANZ job advertisements index led unemployment up (and the unemployment rate down) since 2013 but has recently stopped rising. If the unemployment rate does start to rise, the risk of a recession as opposed to just sluggish growth rises sharply.

In addition, there are three key structural factors impacting employment. Construction and development of new mines and of related infrastructure have ended. This was the employment-heavy part of the mining boom. Although the volume of mineral exports is now growing rapidly, this employs far fewer people. Mining investment in plant and equipment has fallen from 6.5% of GDP in early 2012 to 3.5% last year, but it still has further to fall. The ending of car manufacturing in Australia will directly and indirectly reduce total employment by (estimates vary) 100,000 to 200,000. This will by itself lift the unemployment rate by over 1%. And, finally, the federal fiscal deficit has blown out sharply, which will prevent the traditional response to economic weakness—increased government spending.

In addition—though not a structural fact — the A$ has recently risen, which will negatively affect our growth rate.

It is very likely that growth will slow over the next 9 to 12 months. Unemployment is likely to start rising again. Income growth will remain subdued. Inflation remains tame. As growth slows later this year, the RBA will continue its path of cash rate cuts. The end of the mining boom is casting a long shadow. Slow growth will be likely to continue for

ALL ORDINARIES INDEX

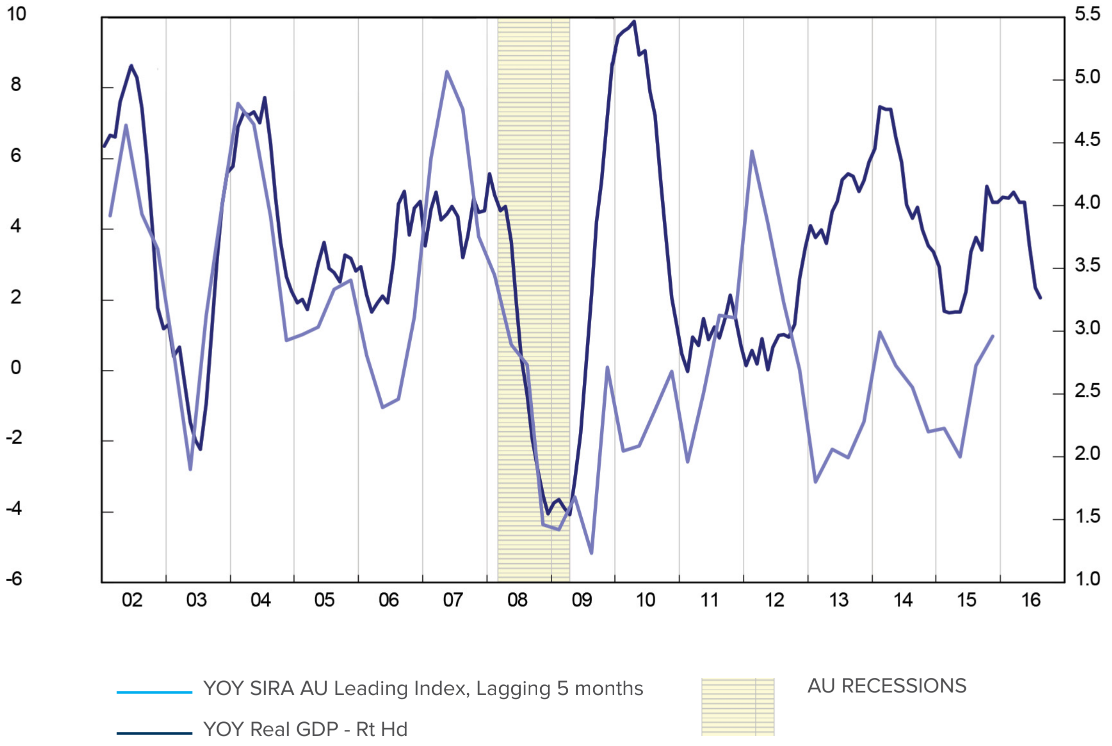


the next few years. This will pose major problems for monetary and fiscal policy.

Meanwhile, the share market is ignoring this impending slowdown, buoyed by easy money overseas, in the US, Japan, Europe and China, and by hopes that the Chinese economy has started a new upswing.

THE SHARE MARKET IS IGNORING THIS **IMPENDING SLOWDOWN, BUOYED BY EASY MONEY OVERSEAS,** IN THE US, JAPAN, EUROPE AND CHINA, AND BY HOPES THAT THE CHINESE ECONOMY HAS STARTED A NEW UPSWING.

AUSTRALIA LEADING INDEX AND GDP
Leading index plotted with 5 month lag



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INTRODUCING SIRA GROUP'S
SMALL CAPS PORTFOLIO:
Outperformance* Relative to the All Ordinaries Index:

17.3%
p.a.

* Since March 2015, annualised — excludes dividends and fees

CONTACT US TO RECEIVE MORE **INFORMATION** OR TO **OBTAIN PORTFOLIO MANAGEMENT** ADVICE

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