

What's Driving the Share Markets?

In our previous *Informer*, we highlighted how the recessionary environment could reap big rewards for those investors who'd stayed true to their investment strategy. Or, as they say, "All good things come to those who wait". In this follow-up *Informer*, we look at what's been driving the share market rallies overseas and at home and reveal that clichés abound when it comes to the markets.

What's in a cliché?

The major falls of 2008 have only been matched by those of the 30s. However, the rallies that have dominated global share markets since March 2009 are also the biggest since that time. In fact, markets have all but recouped their 2008 losses. And the recession? What recession?

If you hadn't seen it, you wouldn't have believed it. Thankfully, patience is a virtue and they always say that slow and steady wins the race.

When it comes down to it, much of the behavioural pattern of the share markets can be perfectly encapsulated with a few choice clichés. Those snappy, short phrases that exist because they're generally true.

However, there's one cliché that hasn't quite done the rounds among investors, but is highly conspicuous by its absence – *buy quality!*

Standing the test of time

Buying quality items – no matter what they are, clothing, appliances, cars – generally costs more upfront. However, due to their typical high standards of excellence (eg workmanship, materials and attention to detail), they tend to last the distance. Ultimately, the upshot is that you've received good value for money.

So, what's this got to do with the share markets? As you'll see, it's quality, not quantity that counts.

What's been driving the markets?

The particularly strong upswings in market performance both here and overseas are down to a few specifics – the various government stimulus packages that have been implemented, better than expected economic data and earnings and, in Australia's case, the surprising resilience of our economy. But that's more or less where the similarities end.

Which stocks are leading the race?

Looking closer, the types of stocks leading the rallies internationally are quite different to those boosting the Australian share market.

At home, the focus has been on companies with strong balance sheets and better than expected earnings and dividends. Quite simply, investors have been buying into good quality companies.

Overseas and, in particular, the US, the focus has been at the opposite end of the spectrum. Investors have been purchasing low quality, riskier, cyclical stocks. Cyclical stocks are those that are sensitive to changes in the economic and business cycles. As a result, their price movement can be swift and not always favourable.

However, there's nothing unusual about this pattern. Historically, share market rallies after major falls have been led by low quality, cyclical stocks. It may come as no surprise then, that with all the hoopla surrounding these stocks, the high quality, blue-chip stocks have been left behind. And this is where the real value is.

When only the best will do

Our research has shown that high quality, US blue-chip stocks are currently one of the best investments in the world.

Since the low quality stocks have been in such strong demand, their share prices are at premium levels. In contrast, the price of high quality stocks has lagged, due to their low demand.

This means investors can now buy into some of the best companies in the world at a significant discount to their usual price.

While it's never easy to predict when a shift in buying sentiment will occur, we believe that high quality stocks will soon be the darling of the share markets once again. And, with good reason.

What's the attraction with the cyclicals?

Investors have been flocking to the low quality, cyclical stocks due to their expected earnings for 2011/2012. In other words, they're banking on the US recovering sooner rather than later.

However, this is a risky strategy, given that the US is not officially out of recession as yet. While recovery signs are looking increasingly promising, things are still tentative and caution needs to be exercised. Any hint of a hiccup in US recovery could result in the earnings expectations of these low quality stocks not materialising.

In contrast, blue-chip stocks are traditionally safer stocks. Their growth, pricing and dividend yields tend to be reliable and they are usually well-managed companies. The result is that their pricing tends to fall less in times of economic uncertainty, thereby better protecting investors' savings.

Your super – where quality really matters

To cite yet another popular phrase, super is a long term investment and, as such, you should always focus on long term performance.

The excessively high returns of the low quality stocks is to be expected given their high levels of risk. However, our research shows that these returns are likely to be short-lived.

We believe our strategy of focusing on good quality companies will generate sustainable long term returns and that the differential in price valuations will eventually correct itself.

With super, it's far more important to ensure you're invested in a good fund with investment strategies that cater for all risk profiles – all of which you receive as an AXIS member.

The end result is that your super will continue to be well-managed and heading in the right direction.

Ask AXIS Financial Group

If you have any queries about this Informer, please give us a call.

You can speak with our friendly Advisory Group or Technical Services team on **08 9426 5800** or **1800 111 299**.

Alternatively, you can email us at info@axisfg.com.au

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