Australian Market Phase Analysis
Bull Market Phase Two: Increasing Earnings

Last reviewed March 2018

We have been in phase two now for quite some time, so the file contains few changes other than that all charts have been updated.

Changes to the comments in this document since the last revision are in blue type

The analysis in this file is in terms of my investment plan. Readers need to assess the relevance of anything in this document to their investment plan, seeking advice from a licensed adviser if unable to make their own assessment of the material.

This document is an example to teach the way I think about investing. In doing so, I am neither making nor implying any investment advice. My thinking about my own strategy should not therefore be seen as making or implying any recommendation for any reader to take, or not take, any action with regard to their investment plan.

Navigating the Document

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to any section in the PDF file:

The document is a PDF file, which allows you to use the zooming tool in Adobe Reader to enlarge detail in the charts.

Terms and acronyms used in this document

See the ***Glossary*** page on the ***Free Resources*** menu for definitions.

If I use a term or acronym that is not in the Glossary, please email me for an explanation and I will add it to the Glossary page.

Note: Some members have commented that sometimes it has been some months since I had updated this document. There are good reasons for that:

1. Updates for the sake of doing them when nothing has changed wastes everyone's time
2. Phase two of bull markets usually takes several years to unfold; the phases do not come around only a few months apart – rather several/many years (it varies greatly)
3. While there has been little or anything new to say about the present phase, I have been focused on many other ways I can spend my time to improve and extend all the ways I teach investing through the website – the free and the members websites

So, do not think I have forgotten the phase analysis. If something changes, I will issue an update.

Many companies announce increased earnings

Yes this is happening. Many companies have reported increased earnings in their last few half years. Mostly this has been the result of cost-cutting, but that is normal for this stage in the cycle. However, the move towards growth has been slow. There are many reasons for this including;

- The end of the resources construction boom and the cyclical decline in commodity prices
- Households reducing debt rather than spending (that may be changing as rising housing prices engender a wealth effect). However, an offset is the low growth in wages
- Pressure on companies to pay higher dividends for savers who have abandoned bank deposits at low interest rates, rather than invest in growth
- Lack of government action on reform to lift productivity and growth
- The reduced net immigration, which is a growth driver
- A lacklustre world economy, though there are signs of a change here

Much of this forms part of my view that the present bull market will be a difficult one – much like the 1990s (it pays to remember the past as a partial model for understanding the present). I have found the market of the last year or so to be one that favours stock-picking rather than index hugging.

Good news is announced

Yes there has been much good news, but there is a general overlay of negative influences – we Australians are routinely dismissive that we live in a truly lucky country.

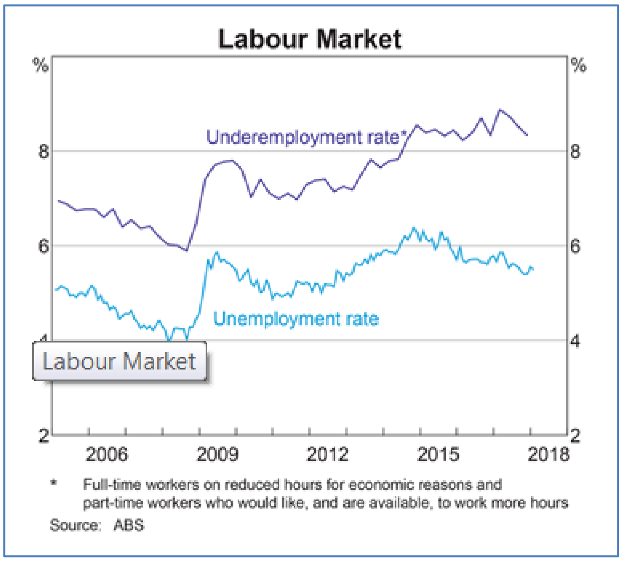
One negative influence is the political uncertainty around the new paradigm of the electorate preferring that governments do not have majority control of parliaments, resulting in government by compromise with minor parties and independents. This is not new in the world, but has come later to Australia and is what the electorate obviously wants; after all we elect our parliaments freely.

The other negative influence is the effect of structural changes working their way through our economy centred on the demise of car manufacturing, the end of the commodities boom and disruption in the energy market on several fronts.

These negative influences happen every cycle - they just take a different form each time. So, bull markets are said to “climb a wall of worry”. Thinking investors work at adjusting their portfolios to avoid the trouble spots and take advantage of the opportunities thrown up by problems. I commend members again to read my article: *Shopping in the Stockmarket* on the Educational Articles page on the Free Resources menu.

Unemployment falls

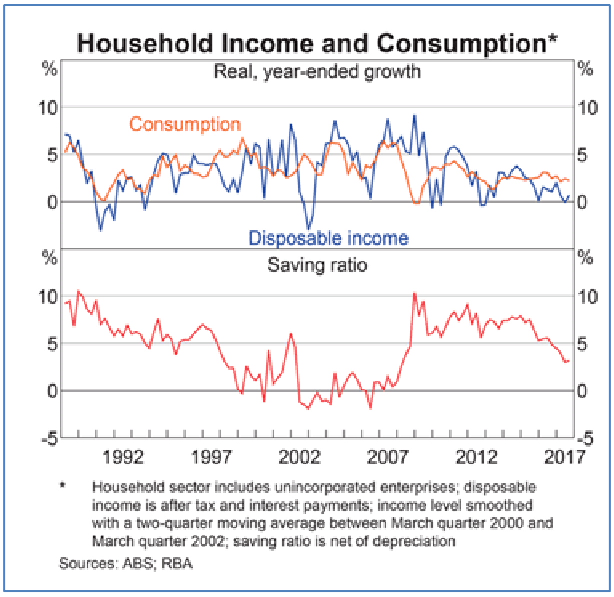
This may now be starting to happen. Unemployment had been stubbornly rising, but the graph has now seemingly peaked and begun to fall. However, underemployment is still a concern.



We worry about this level of unemployment, but it is really quite low compared to most developed economies. This is not a cause for complacency, just a prod to keep a sense of perspective and avoid another of the negative influences I mentioned earlier. Good investors align their thinking to reality, not to their overblown fears. In forming judgements look for facts, not the opinions of uninformed people.

Household savings ratio falling

Households had still been saving strongly, not spending. However, the graph of the savings ratio is ever so gradually and consistently falling:



So, this marker of the second phase is also falling into place.

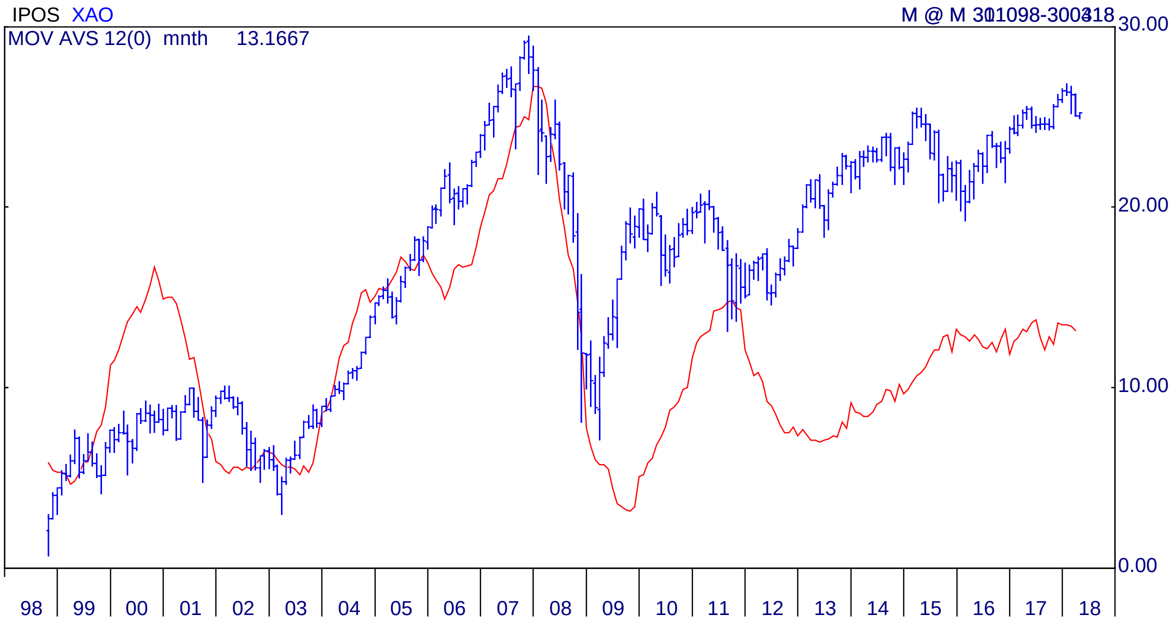
I am often asked whether compulsory superannuation was included in the savings number and was therefore the cause of the rise in the ratio:

- Compulsory super is included in the household savings ratio.
- However, the compulsory super rate was steady at 9% from 2002 to 2013.
- Thus, the increase in the savings ratio 2007 – 2009 was not attributable to an increase in compulsory superannuation.
- The rate of compulsory super is again frozen in recent years, so the gradual fall represents reduced saving and higher spending.

More Companies are being floated in the stock market (IPOs)

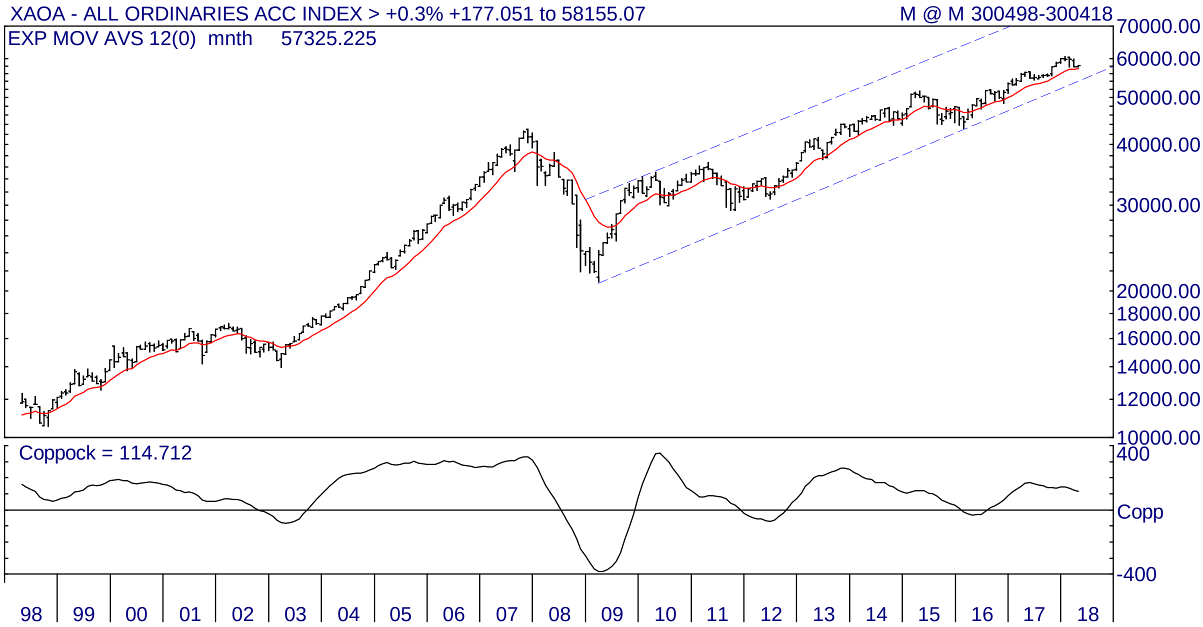
The number of IPOs should not be confused with the amount of money raised in IPOs, which can be distorted by a few large flotations like Medibank. While not dismissing the amount of money raised as being important, past cycles have shown that it is a strong rise in the **number** of new IPOs, many quite speculative and of little merit, that is the best marker of speculative activity.

There has been an increase in the number of IPOs, but much more slowly of late than in previous cycles. There have also been an increasing number of backdoor listings, which are not in these data:



Significant market corrections end higher

The market is continuing to trend upward, although the trend was under considerable pressure in the short term for many months late 2015 – early 2016:

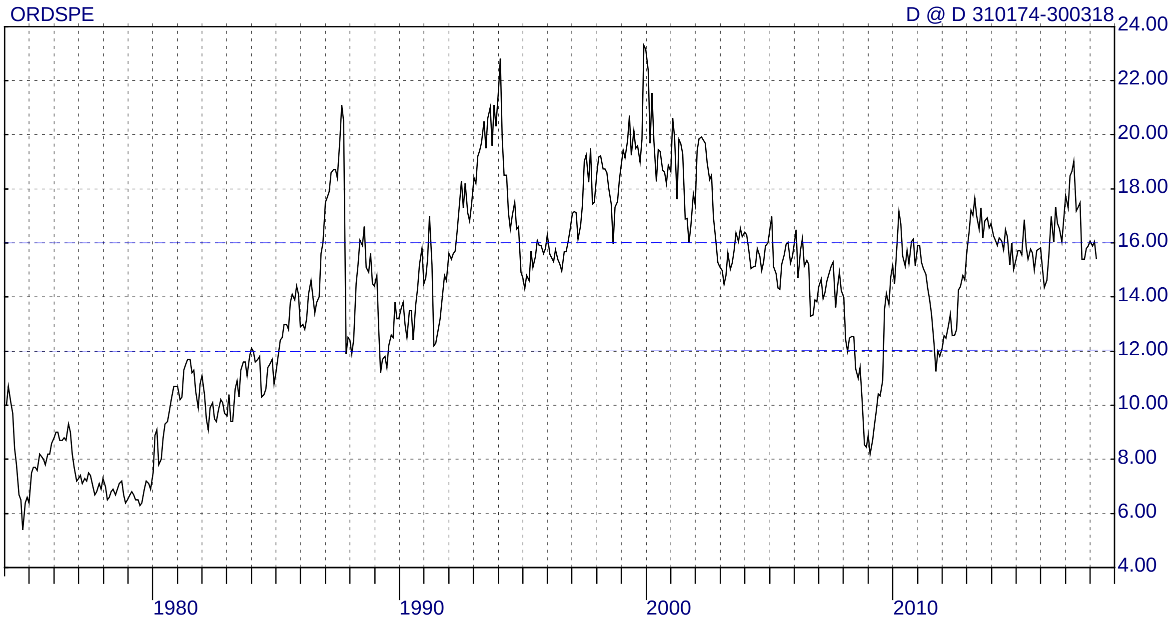


Note that the trend channel shown on the chart is a tentative one and may require some repositioning going forward. However, it does seem to describe the trend fairly well. The test will be in the next significant correction.

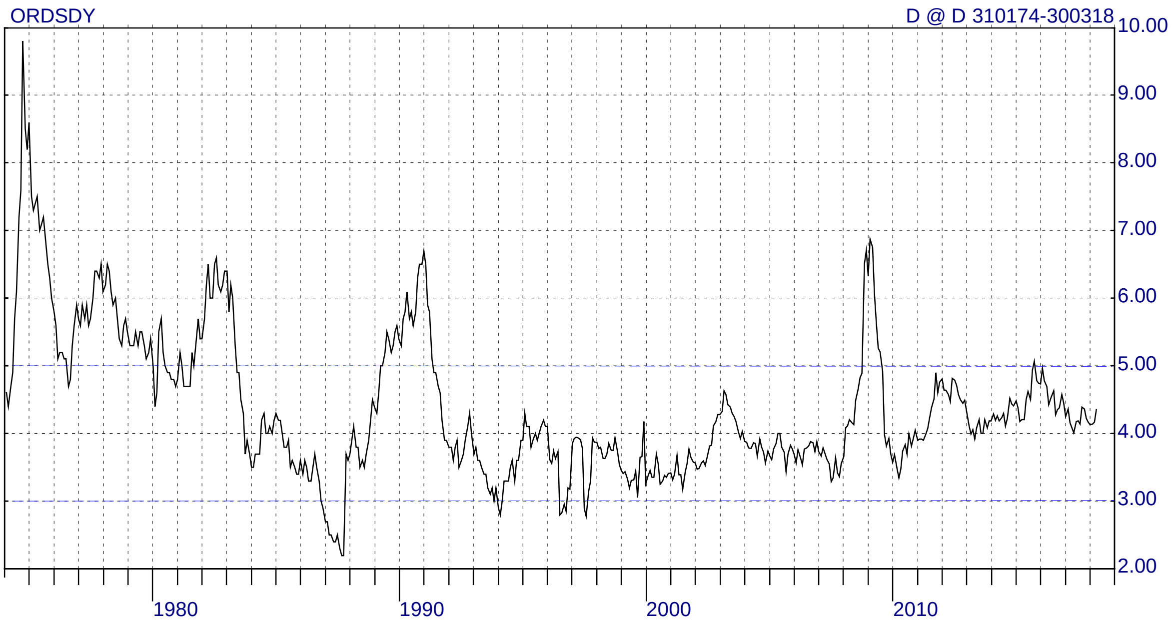
Fundamental values return to normal

Yes, this happened some time ago.

(1) The market average price earnings ratio is now just below the top of the fair value range (between the blue lines is the fair value range). This must be tempered by reference to the very low interest rate climate.



(2) The market average dividend yield is also in the upper half of the fair value range (between the blue dashed lines is the fair value range). Notice how much higher the yield has been this time.



Sector rotation

There some evidence of this, especially around the chase of yield – banks, Telstra, utilities and Hybrids being the most striking. However, this is a rather subjective observation and in some ways the least important of the second phase markers.

General Conclusion

Since the markers for this phase of the bull market have been in place for quite some time, my analysis is that we are now in this phase.

I have assembled over time a listing of markers that seem to point to where we are in each of the phases. However, this does not mean that every one of them must be in place each time. Part of the fascination of market analysis is that it cannot be reduced to a formula. Each cycle will display some differences, so we cannot use an autopilot approach. Instead we have to keep thinking.

Members should note that I assess whether we are in each of the phases separately. It is always important that once we are clearly in a phase, we also look at the next phase to see whether it is emerging. The next phase is in a separate document.