Australia Stocks Lagging U.S. Most Since ’98 Face Vote Boost

Adam Haigh | Aug 14, 2013 2:27 am

Aug 14 (Bloomberg) — Investors say a change of government in next month’s Australian election would revive business confidence, bolstering a stock market that is lagging U.S. equities by the most in 15 years.

Victory by Tony Abbott’s Liberal-National coalition would boost earnings at utilities companies and construction firms that have suffered from uncertainty under the Labor party’s minority government, said Don Williams, chief investment officer at Platypus Asset Management Ltd.

A change of government at the Sept. 7 vote will encourage firms to resume spending plans, according to David Cassidy of UBS AS.

“Business confidence is as dreadful as I’ve ever seen it,” Williams, who helps oversee about $1 billion at Platypus in Sydney, said in an interview. “Assuming there is a change of government, you’d expect that to improve. Investors have something to look forward to.”

Prime Minister Kevin Rudd’s Labor Party, which for the past three years has been reliant on independent lawmakers to pass legislation, trails the opposition in opinion polls after political turbulence helped keep a National Australia Bank Ltd. index of business conditions near a four-year low. History suggests the election will boost stock prices, with Australia’s All Ordinaries index climbing an average 8.6 percent in the three months following the 11 national votes since 1983, data compiled by Bloomberg show.

The All Ordinaries Index this year has returned about half the Standard & Poor’s 500 Index and remains 25 percent below its record high in 2007 as a raw materials investment boom wanes. The gauge’s 8 percent advance in 2013 through July 31 trailed the S&P 500 by the most since 1998, according to the Bloomberg-compiled data.

Resources Gains

The All Ordinaries Index traded yesterday at 14.9 times estimated earnings, compared with a multiple of 15.3 for the S&P 500 on Aug. 10, the data show. The Australian gauge closed little changed at 5,141 today.

Australia’s economy and currency have been bolstered in recent years by the biggest resources bonanza since a gold rush in the 1850s as Chinese-led demand for iron ore, coal and natural gas created an investment pipeline the government last year estimated to be worth A$550 billion ($485 billion).

That number is now dwindling, with the value of planned business investment projects and those under consideration or possible falling 14.3 percent as of June 30 from the prior quarter, a Deloitte Access Economics report showed last month.

A lack of business confidence is hampering the economy from growing in non-mining sectors, Reserve Bank of Australia Governor Glenn Stevens said in a July 30 speech. “There is no such thing as a confidence policy lever,” said Stevens.

Election Lever

For shareholders, Ballot lever may be the election, bringing greater clarity about how companies will spend and invest, said Cassidy, a Sydney-based equity strategist at UBS.

“A change in government would be positive for the market, giving a lift to business confidence,” said Cassidy, who forecasts Australia’s S&P/ASX 200 Index will rise 4.7 percent to 5,400 by June 30, 2014. “A shift in business confidence will spur some degree of business investment and borrowing, helping to lower currency and lower interest rates. We care more than usual about this election.”

At stake in the election is the management of the world’s 12th-largest economy. Abbott has pledged to cut the company tax rate by 1.5 percentage points, adding to previous promises to abandon Labor’s carbon emissions trading program and a 30 percent tax on coal and iron ore company profits introduced by Labor in 2012. Rudd has also said he would scrap the world’s highest coal price by moving its emissions trading in mid-2014, a year earlier than previously planned.
Labor trailed the opposition by four percentage points in a Newspoll published in the Australian newspaper Age on Aug. 12, compared with a 14-point deficit under former Labor Prime Minister Julia Gillard. Australia’s first female leader lost her job to Rudd in a June spill, their third leadership showdown in three years.

“Australia has a long tradition of pretty stable politics,” Stephen Halsey, Sydney-based head of economic and market research at Colonial First State Global Asset Management, which manages more than A$150 billion, said in an interview. “This is certainly different. The key issue will be getting a majority from whichever side they can proceed with their election platform.”

Aussie Pity

While Labor steered the nation through the aftermath of the U.S. sub-prime crisis without a recession, business sentiment has suffered as the nation’s resources boom fades and manufacturers struggled with a local currency that traded above parity with the U.S. dollar from mid-2012 to May, the longest such stretch since it was fixed in 1983.

The local dollar has dropped since April, slipping as low as 88.34 U.S. cents on Aug. 5 and boosting earnings at Australian exporters that report in dollars. Since the Aussie began declining from a three-month high of 0.9992 reached on April 11, the stock price of Arrium Ltd., Australia’s fourth-largest steel producer, surged 28 percent, compared with a 2.9 percent gain on the All Ordinaries Index.

Arrum Chief Executive Officer Andrew Roberts said last month that every 1 cent decrease in the Aussie against the dollar will probably deliver a benefit of between A$10 million and A$12 million for the company’s earnings before interest, tax, depreciation and amortization.

Australian employers unexpectedly cut payrolls in July and the unemployment rate held at an almost four-year high of 7.7 percent. The Reserve Bank has cut borrowing costs by 2.25 percentage points since November 2011 to a record low 2.5 percent as the local dollar’s strength dragged on growth.

Growing Weary

The U.S. economy grew more than projected in the second quarter, with annualized gross domestic product rising 1.7 percent from a 1.1 percent gain in the prior three months.

The RBA on Aug. 9 lowered its growth outlook to 2.25 percent in the year to December 2013, compared with 2.5 percent forecast three months earlier.

“Historically, Australia’s growth rate is slowing,” said Matthew Sherwood, head of investment markets research in Sydney at Nomura Institutional, which manages about $25 billion. “The rate of growth has not been backed by increased earnings. The key question remains whether cost-reduction drives by companies will outweigh the slowing domestic economy.”

Profits at companies in the S&P/ASX 200 index will rise 10 percent to 11 percent in the year through June 30, 2014, falling from current market consensus for a 13 percent increase, according to UBS estimates.

Stock-market returns increase as business confidence measures pick up, according to a study of 31 countries over a period of more than 20 years by Yichai Sun, an assistant professor at the University of Maryland-Eastern Shore.

Minority Government

Labor has had to rely on the support of independents and the Greens party to pass legislation since forming a minority government after the 2010 election. Labor holds 71 of the 159 seats in the lower house – where government is formed. Abbott’s coalition has 72 seats, with seven held by independents or smaller parties.

“Once you get a government that’s not a minority government, you get clarity,” George Roubouzas, Melbourne-based chief investment officer at Equally Trusteed, where he helps oversee about $2 billion, said in an interview. “With clarity, you’ll see business-confidence conditions improve and therefore households can be a bit more comfortable. When you get that certainty, combined with the other two pre-conditions of lower rates and a stabilized Aussie dollar, that all helps earnings.”

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