THE AUSTRALIAN

SE MarketWatch

HD **No compelling reason to step in yet**

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Bargain-hunters will be keeping a close eye on the local sharemarket after a particularly bad performance this week, but it may be a bit too early to start piling back in.

Plunging **iron ore** prices, lower economic growth forecasts and nervousness about the upcoming report of the Financial System Inquiry, combined with profit warnings in the industrials, healthcare and **mining** services sectors, caused the biggest weekly falls in almost 18 months.

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The S&P/ASX 200 fell 2.8 per cent to a four-and-a-half week low of 5304.3, leaving it in negative territory for calendar 2014.

It was the worst week since June last year, when the index fell 3.8 per cent as global markets suffered from the "taper tantrum" following news of the US Federal Reserve's plan to reduce its quantitative easing, which it completed last month.

On a two-week basis, the local market is down 4.5 per cent — and it's now well on the way to eclipsing the 6.1 per cent pummelling that occurred in the five weeks from late August this year.

To put things into perspective, the Morgan Stanley Capital International index was on track for a 0.6 per cent rise for the week, and the US S&P500 was heading for its second weekly rise in a row.

Under-performance has been a year-long phenomenon for the Australian market. As of yesterday it was down 1 per cent for the year, versus an 11 per cent rise in the US S&P 500.

With the exchange rate also losing ground, the local market has underperformed the S&P 500 by about 15 per cent this year in US dollar terms.

The Australian market has had to contend with a falling **iron ore** price as economic data from Japan and **China** continued to disappoint observers.

Japan slipped back into recession in the third quarter, **China**'s new house prices have continued to fall, non-performing loans have soared, and manufacturing expansion appears to have stalled.

On the positive side, US bond yields have stabilised in the past few weeks and Japan's increased quantitative easing program has reinvigorated the Australian dollar "carry trades" that have underpinned high-yield equities in recent years.

Japan flagged an additional 3 trillion yen ($30 **billion**) stimulus package after the GDP data this week.

However, Australia's banks have suffered from uncertainty about the Financial System Inquiry, which is expected to recommend increased capital reserves for the majors — with a bit of luck, the FSI outcome won't be as bad as expected and banks will rally on the news.

But renewed concern about the domestic economy has also started to weigh on the banks and other domestic growth sensitive sectors, and that could easily trigger another selloff in the Australian dollar, leading offshore investors to stay away from Australian shares in the short term.

Goldman Sachs's Australian chief economist Tim Toohey this week lowered his 2015 GDP forecast to 2 per cent versus a previous forecast of 2.3 per cent and a market consensus of 2.9 per cent.

His GDP growth revision reflects weaker economic growth in Japan, **China** and Europe, sharper than expected falls in commodity prices, a higher probability of an El Nino weather pattern in Australia in 2015 resulting in drought conditions in eastern Australia, tighter financial conditions due to a higher trade-weighted exchange rate index, faltering **equity** prices and widening corporate bond spreads, and a tepid recovery in non-mining economic growth.

The Bureau of Meteorology raised its El Nino warning to "alert" status this week.

"There are few signs of non-**mining** investment accelerating in the near term, housing investment growth looks set to slow, government demand growth appears set to remain strained and consumers are showing few signs of embarking on a materially stronger growth path," Toohey warned."Solid population growth, rising productivity and very strong growth in resource export volumes support the case for medium term optimism; nevertheless, the growth outlook for 2015 remains challenging in our view." Toohey later pushed his expectation of the start of interest rate normalisation in Australia from November 2015 to March 2016.

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