



It's dismal: good news is bad news ... and vice versa



BY GRAHAM HAND

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There are valid reasons why economics is called the dismal science, and even the origin of the expression is distasteful. The words were first used by historian and philosopher Thomas Carlyle in a piece in 1849 called 'Occasional Discourse on the Negro Question' when he wrote that economics would justify a return of slavery to improve productivity of plantations. The term was later applied to the theory that population growth would outstrip resources and lead to global misery. An honours degree in economics often does not feel honourable.

In the current day, the dismal label should apply to the ability of economics and finance to draw contradictory conclusions from the same information. Good news is only good news until someone says it is bad.

BEFORE YOU GET STARTED

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The good news is bad news makes it difficult to understand and predict markets. Throw in politics and it's completely confusing, such as:

- If data shows a slowing economy or rising unemployment, the likelihood of interest rate reductions increases, and the stockmarket reacts favourably. So that's weaker economy equals good for equities. Go figure.
- At the same time that the Reserve Bank is increasing rates to slow economic activity and reduce inflation, the Government announces 'cost of living relief' and encourages increasing wages. The economics demands job losses, the politics offers protection. How does that work?

Bad both ways, apparently

There are many other economic perversions. Some of the following examples are drawn from exchanges between Sam Ro and Michael Antonelli, US-based writers and analysts. They have collected examples of what they call bad both ways narratives which prove the market can say anything to justify a movement one way or the other, such as:

1. Retail sales

Falling consumer spending is bad because it signals a slowing economy and risk of a recession, while rising consumer spending is bad because it places upward momentum on prices and inflation, leading to higher interest rates.

When companies such as Coles and Woolworths report strong sales in private label goods, it's a bad sign for the economy because it shows more people are cutting down on major brands. But when Coles and Woolworths report sales below expectations, it's a bad sign because consumers are cutting back.

2. Lending activity

When individuals and businesses borrow more, especially in Australia with a high household debt to income ratios, it's a bad sign because people are overleveraged and

exposed to rising rates and economic downturn. When they borrow less, it's a bad sign because it shows less confidence and a failure to take advantage of investment opportunities.

3. Market volatility

Heightened variation in stockmarket prices is bad because it shows uncertainty and a lack of confidence in the future, while low volatility is bad because investors have become complacent and unrealistic and will suffer setbacks when the market falls.

4. Interest rates

When long-term interest rates rise, it's bad because other assets such as property and shares fall as their future cash flows are discounted at a higher rate. But long-term rates falling is bad, especially when there is an inverse yield curve, as it shows the market is pricing in a slowing economy.

5. Oil prices

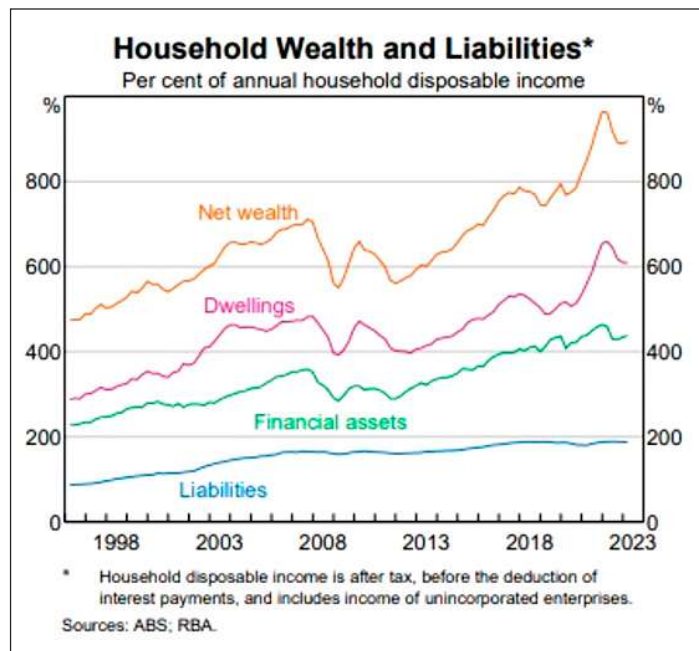
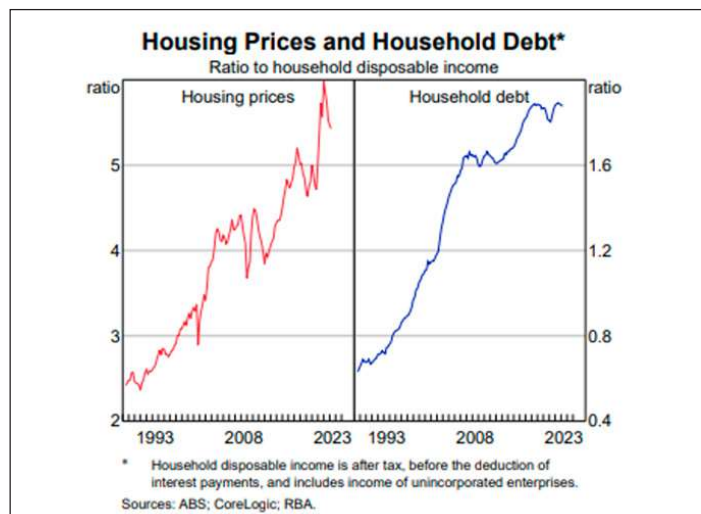
Falling oil prices demonstrate weak demand which is bad for economic activity, while rising oil prices are bad because it heightens inflation fears and higher interest rates.

6. Home prices

Rising home prices are a bad sign because aspiring homeowners are priced out of the market, while falling home prices are bad because owners feel a drop in their wealth and become less optimistic. Most of the net wealth of households is tied up in dwellings, far ahead of other financial assets.

7. Tech-driven market rally

A rally in the market such as driven by the 'Magnificent Seven' (Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla and Meta) is bad because traditional industrial companies (in Australia, the likes of Amcor, Orica, Brambles, Aurizon, CSL) who make and do real things cannot attract capital, and

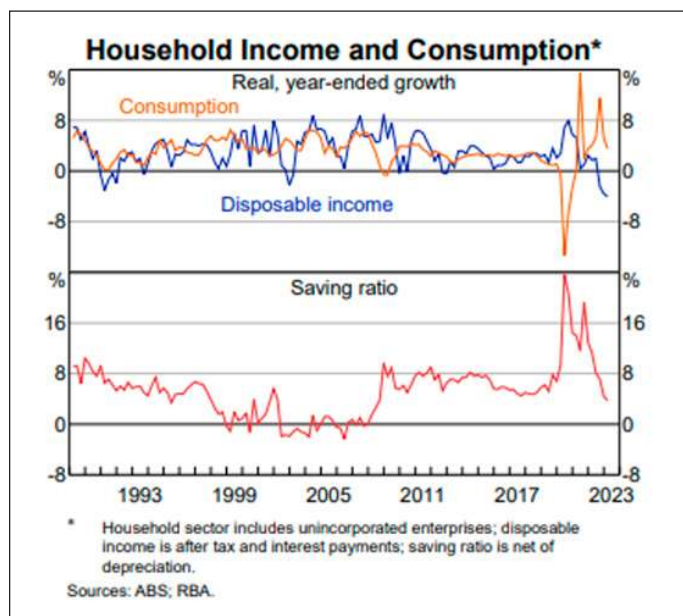


“A high savings ratio is bad because consumers are cautious and not spending, and during the pandemic, too much money was handed out leading to future deficits. But a declining savings ratio is bad because households no longer have the buffers to withstand higher interest rates or a slower economy.”

the techs mask overall market weakness. But it's bad if these tech companies fall because they are all great companies with the strongest growth outlooks and they dominate the index.

8. Individuals saving

A high savings ratio is bad because consumers are cautious and not spending, and during the pandemic, too much money was handed out leading to future deficits. But a declining savings ratio is bad because households no longer have the buffers to withstand higher interest rates or a slower economy.



The good and the bad of generative AI and indexing

Two more good is bad (or this time, is it bad is good?) themes in investing currently are the dramatic impact of generative AI (such as ChatGPT) and the rise and rise of index funds at the expense of active management.

Generative AI is more recent while the growth of index has been ongoing for years, but there is a similarity between the two. In both cases, the winners need the losers to continue to function.

Consider how the winners, generative AI and indexing, operate:

1. Generative artificial intelligence (AI) uses algorithms to create new content by searching existing content in its many forms, such as text, images, audio and video. AI requires content providers, such as journalists, editors, film makers, sound engineers and photographers to produce work from which AI can 'regenerate' another version.

For example, if ChatGPT is asked 'Write 100 words on active versus index investing', it searches for existing content on the subject and produces an AI version as follows:

"Active and index investing represent two distinct approaches in the realm of investment strategies. Active investing involves portfolio managers or individual investors making deliberate decisions to buy and sell securities in an attempt to outperform the market. This method relies on extensive research, market analysis, and timing to achieve higher returns.

On the other hand, index investing follows a passive approach, aiming to replicate the performance of a specific market index. This strategy involves investing in a diversified portfolio that mirrors the index's composition. It generally offers lower fees and reduced risk but might not generate the same potential for significant gains as active investing."

It's a fair summary. The good news for journalists is that AI needs people to write the original content. Without journalists adding continuously to a body of knowledge, AI will itself become out of date. But the bad news is that AI will remove some of the jobs of the people it relies on. Why pay a journalist to write an article on active versus index when ChatGPT will produce it for free in a few seconds?

2. Index investing (as AI conveniently explains) holds stocks in the same weighting as the index it seeks to replicate. It does not attempt analysis of a company's prospects. In contrast, active managers undertake fundamental research on the value of a company, and buy when their analysis suggest the market price is below the intrinsic value. Therefore, active managers are allocating capital based on estimated value, they undertake price discovery

Some good news for content creators is that there are early signs that the initial fascination with ChatGPT and similar is waning, as returning and new users numbers have started to fall. ”

and therefore set the market price. In The Index Revolution, Charles Ellis says indexing relies on:

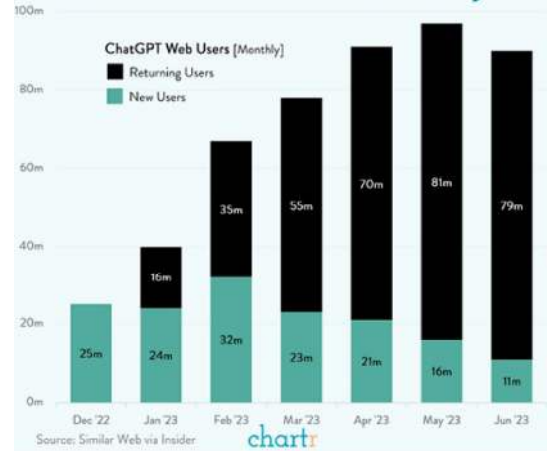
“trusting that active professionals have set securities prices as correctly as possible”

Ellis claims 95% of market trading is done by active investors. The 5% by indexers is more ‘set and forget’ with scheduled rebalancing around the index weights. There is an alternative view that so much money now flows into index funds that they set the valuations by pumping more money into popular stocks.

The bad news for active managers is that indexing needs fundamental analysis to set prices, but the bad news is that fewer active managers are needed as money flows into index.

Some good news for content creators is that there are early signs that the initial fascination with ChatGPT and similar is waning, as returning and new users numbers have started to fall.

ChatGPT's Total Web Users Fell For The First Time In June



The dis

Analysts, journalists and commentators are capable of drawing any conclusion following the release of economic statistics, and generative AI will use the content to produce an ‘on the one hand, on the other hand’ explanation. The market may react either way.

Next time a fund manager or analyst presents their earnest and thoroughly-researched conclusions, know there is an equally-qualified person making the totally opposite argument.

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6 trends driving uranium higher



BY PATRICK POKE

Republished from betashares.com.au

Both uranium equities and the uranium price have been marching higher in recent weeks. Numerco's uranium spot price indicator closed at US\$58.25 last Friday, up 19.8% so far in 2023¹.

Meanwhile, bellwether producer Cameco closed at CAD46.07, a level not seen since 2007. Cameco accounted for more than 11% of global uranium production in 2022, making it the world's second largest producer².

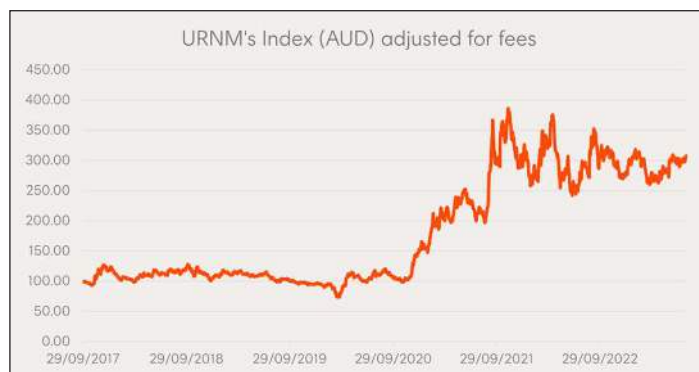
It's not just been a short-term phenomenon either. The Indxx North Shore Uranium Mining Index, which Betashares Global Uranium ETF (ASX: URNM) seeks to track (before fees and expenses) has returned 21.3% per annum over the last five years³, outpacing most major asset classes and equity markets.

So what has been driving prices higher? And what are some of the trends that might influence the price in future?

Contracting at decade highs

Nuclear utilities generally buy most of their uranium through long-term contracts, rather than through the spot market. In recent years, contracting volumes have been low due to a perception of ample supply availability⁴.

However, during the first half of 2023, 118 million pounds (approx. 53,500 tonnes) of long-term contracts were



So : Bloomberg, Betashares. As at 31 July 2023. Past performance is not indicative of future performance of any index or ETF. Graph shows performance of the index that Betashares Global Uranium ETF (ASX: URNM) seeks to track, net of URNM's management fee and cost (0.69% p.a.), and not the performance of URNM. You cannot invest directly in an index.

signed. Based on the current run-rate, Cameco expects 2023 to be the biggest year of contracting in over a decade⁵.

Disruptions to supply

Last month's coup in the West African nation of Niger may cause disruptions to global uranium supplies. Niger accounted for around 4.1% of global uranium in 2022⁶. It's unclear at this stage how this might affect exports from the country.

Question marks also remain over supplies from Kazakhstan and Russia, which accounted for 43.4% and

“ Cameco’s Cigar Lake deposit - the highest-grade uranium mine in the world - was discovered in 1981. Construction on the mine finally started in 2005, and was expected to be completed in 2007. After several delays, commercial production was finally achieved in 2015, eight years later than planned. ”

5.1% of global uranium mine production respectively in 2022. The ongoing war in Ukraine has caused many utilities to consider the security of supplies coming from these countries, as Canaccord Genuity reported last year:

“Even in the absence of sanctions, our discussions with market participants indicate that Western utilities are self-sanctioning and moving to reduce/eliminate their reliance on Russian material.”

Project delays

Operating a mine is a complex business. Building a new mine, or even restarting an idled mine, is even more complex.

For example, Cameco’s Cigar Lake deposit - the highest-grade uranium mine in the world - was discovered in 1981. Construction on the mine finally started in 2005, and was expected to be completed in 2007. After several delays, commercial production was finally achieved in 2015, eight years later than planned⁸.

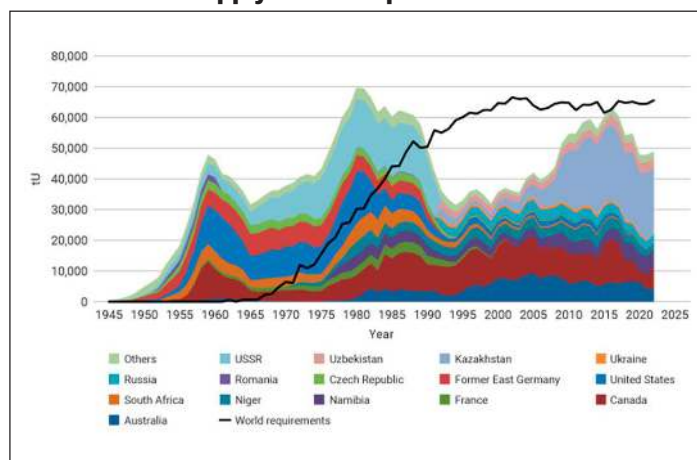
More recently, Peninsula Energy announced delays to the restart of its Lance project in Wyoming, USA. A key service provider had terminated their contract with Peninsula, resulting in them needing to build additional infrastructure so that they could complete the processing on-site. According to an ASX announcement, Peninsula had “been on the verge of a production restart” at the Lance project, which has now been delayed for an unspecified period as they evaluate the required money, time, and equipment to restart the project⁹.

Global uranium inventories depleting

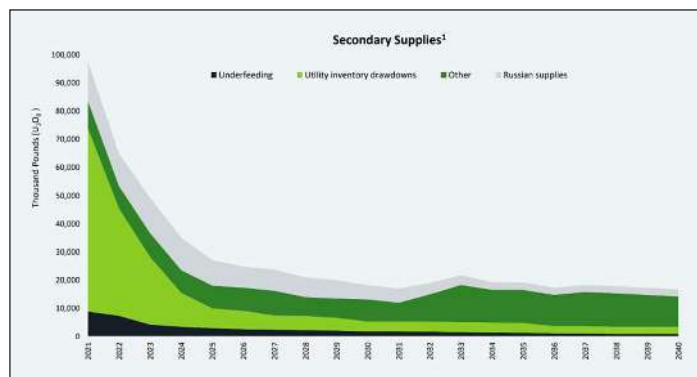
Uranium demand often outstrips mined production. This might seem impossible, but mine production is not the only source of uranium. Utilities’ inventories can be drawn down, spent fuel can be reprocessed, and enrichment facilities can be ‘underfed’ (which I explained here).

But many of these sources of ‘secondary supply’ are dwindling. With reduced levels of secondary supply available, mined supply will need to fill that gap.

Uranium mined supply versus requirements since 1945



Source: OECD-NEA, IAEA, World Nuclear Association. As at nd-2022.



Source: Paladin Energy, UxC Market Outlook, Q2 2023. “Other” includes US Government supplies, MOX and reprocessed fuel.

Decarbonisation

Cars, stoves, and steel production are just a small selection of the processes currently powered by fossil fuels that will need to be electrified if the world is to achieve its climate goals. This would, of course, increase demand for electricity.

Meanwhile, coal fired power stations may need to be retired, further complicating the equation.

Nuclear energy faces challenges, including high capital costs, a history of budget blowouts, and challenges in

implementing permanent storage solutions for nuclear waste.

However, nuclear energy can provide CO₂-free energy, and its ability to produce reliable power over a long lifespan means that it may play an important role in a decarbonised future.

The nuclear energy renaissance

According to the International Atomic Energy Agency, there are currently 57 reactors under construction across 17 nations. The countries with the most reactors under construction are China (21), India (8), and Türkiye (4)¹⁰.

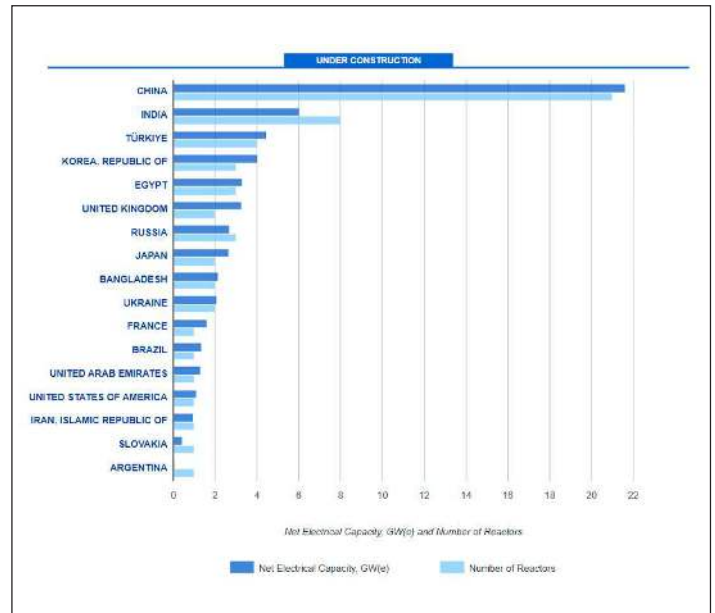
For comparison, there are around 440 reactors currently operating around the world.

Of these 57, seven are expected to be completed in 2023, and another 11 in 2024.

It's not just new reactors being built though. Some reactors have seen increases in power generation capacity, and many have seen extensions to their original planned lifespan¹¹.

With more reactors, higher capacity, and extended lifespans, this could result in a higher demand for uranium.

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Source: IAEA. As at 21 August 2023

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Oliver's insights – China's slowdown and structural challenges and implications for Australia

KEY POINTS

- China's economy is slowing not helped by a property collapse and longer-term structural constraints around poor demographics and threats to productivity growth.
- China needs to save less and spend more, and this requires significant fiscal stimulus. So far policy stimulus has been tepid, but a more forceful response is likely.
- Chinese shares are cheap but short-term risks are high.
- The risks around China's outlook mean Australia can't rely on the China/commodity boom indefinitely.

BY SHANE OLIVER

Republished from amp.com.au

Introduction

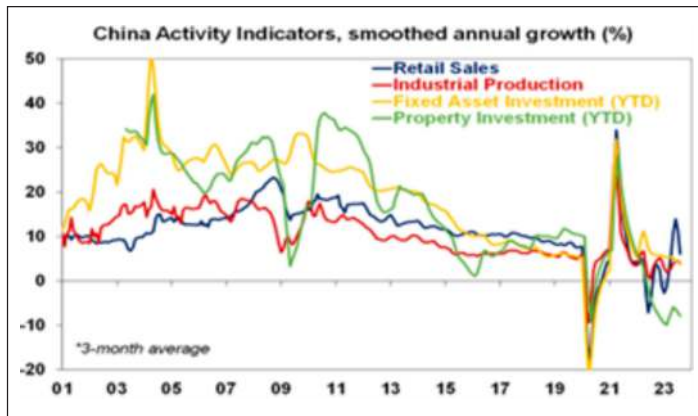
Scepticism about China's economic success has been an issue for years. But it's intensified lately on the back of slowing growth, property problems, high debt and falling long term growth potential with talk that China is "teetering

on the brink" and President Biden describing it as a "ticking time bomb". After strong growth and a big run up in debt there is fear that it's going down the same path as Japan which after a surge in asset prices and debt on the back of what was dubbed a miracle economy in the 1980s slipped into a long period of poor growth and deflation. As the world's second largest economy what happens in China has significant ramifications globally and in Australia. This note

looks at the main issues and what it means for Australia.

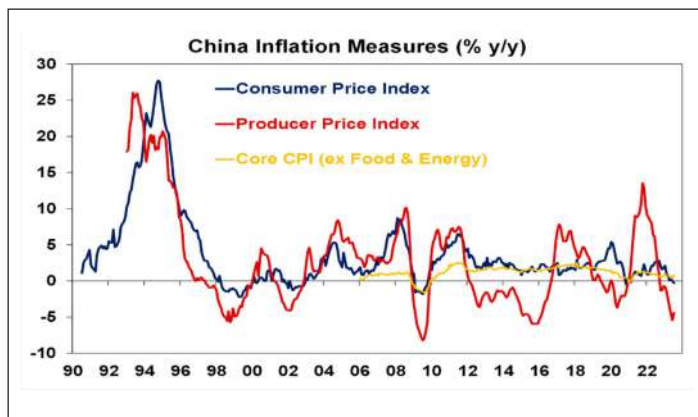
Slowing growth

After China's Covid restrictions were finally eased late last year there was hope its economy would rebound. It did in the March quarter but since then its disappointed with GDP growth slowing to 0.8%qoq (from 2.2% in the March quarter) and July data showing a further slowing in growth in industrial production, retail sales (running at just 2.5%yoy) and investment.



Source: Bloomberg, AMP

Exports and imports are down 14.5% yoy and 12.4% yoy respectively, bank lending and credit growth have slowed despite some monetary easing. Reflecting weaker conditions, business conditions PMIs have also fallen sharply. And youth unemployment has risen from around 12% to 21% over the last five years. Reflecting faltering growth, modest inflation has given way to deflation, although core CPI inflation is slightly positive.



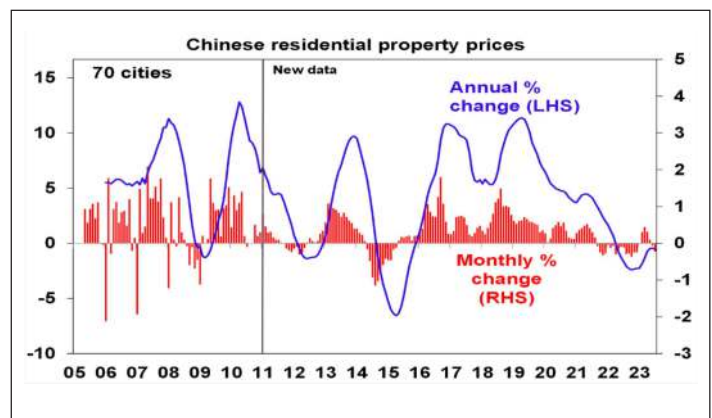
Source: Bloomberg, AMP

The slowdown reflects a combination of factors but high on the list are:

- Many households seeking to rebuild savings which were depleted through the lockdowns - Chinese households

did not have their incomes protected as in most western countries in the lockdowns so did not emerge with lots of excess savings compared to pre-Covid levels.

- A property collapse - after reaching record highs in 2021 new home sales are down sharply, property transactions are down 33%yoy and home prices have fallen reflecting tightening policies and oversupply. This has led to big problems at: developers (eg, Evergrande and Country Garden) that relied on high debt & a steady flow of new buyers; companies that issue investment products which helped finance developers; local governments that rely on land sales for revenue; & households who have seen property related investments sour.



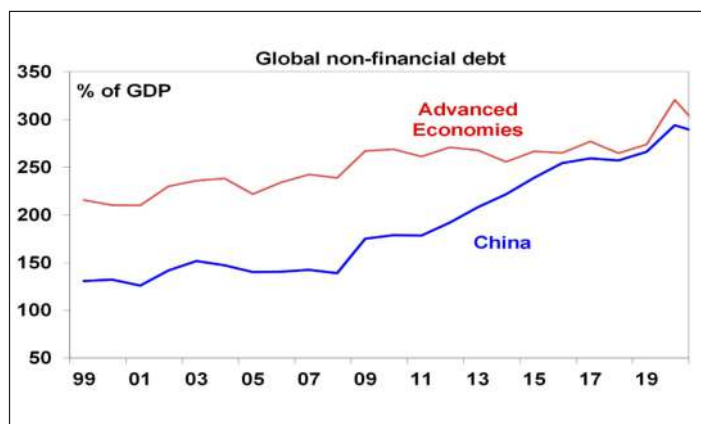
Source: Bloomberg, AMP

Structural problems

However, the slowdown is also being impacted by structural problems:

- The first thing to note is that China has a very high saving rate of around 45% of GDP, which is roughly double that of countries like Australia. This makes China's debt problems very different to other countries as China has borrowed from itself (so there are no foreigners to cause a foreign exchange crisis). But it means the savings have to be recycled (usually via debt) into demand or else weak demand, high unemployment and chronic deflation can result. It did this initially through corporate debt into investment and then into property which has resulted in a rapid rise in China's debt levels since 2008. But this is getting problematic.
- Second, the easy opportunities for capital investment have been taken. China's ratio of fresh capital to GDP and fresh debt to GDP have increased substantially indicating that ever more investment and debt is necessary to achieve the same increase in GDP as in the past.
- Third, this hasn't been helped by geopolitical tensions which have slowed exports. It's also added to a plunge in foreign direct investment (which is down 87%yoy) and restricted access to US technology.

The fear is that China continues to slow causing a spiral of bigger property sector problems with sharp falls in asset prices, more developers “failing”, increased consumer caution, weaker growth, and further falls in asset prices.



Source: BIS, AMP

- Fourth, while some cried wolf too early on China’s property market (recall the SBS Ghost Cities story from 2011!), using property to recycle high savings is souring. This was viable when urbanisation was rapid but analysis based on utility usage and light emissions at night suggest some areas may have 25% of apartments vacant.
- Fifth, China’s demographics are poor as its workforce is now shrinking and it has a rapidly aging population. This also weighs on property demand. But it also removes a key source of economic growth.
- Finally, despite a falling workforce China could still grow quickly because its GDP per capita and output per worker are around 20% of US levels - so it still has a lot of catching up to do. However, the easy gains of industrialisation by putting people in front of machines have been had and China runs the high risk of falling into the “middle income trap” (where countries fail to transition to being high income countries) as a result of increasing state intervention in the economy - with the resurgence of less efficient state owned enterprises (which now account for 60% of investment, up from 30% 10 years ago) and regulatory crackdowns on tech companies and other sectors acting as a disincentive to future entrepreneurs, state intervention on national security grounds and tighter access to foreign technology.

As a result of China’s falling workforce and slowing productivity growth, estimates of its potential real GDP growth have fallen from around 10% in 2006-10 to around 5% now and around 3% next decade.

The policy response and “Japanification”

The fear is that China continues to slow causing a spiral of bigger property sector problems with sharp falls in asset prices, more developers “failing”, increased consumer caution, weaker growth, and further falls in asset prices. Or that a major near crisis is averted but it slides into a decades long period of stagnation and deflation like Japan did after its 1980s boom years.

With opportunities to recycle China’s high saving rate into investment and property starting to diminish it should be saving less and spending more. To achieve this requires aggressive fiscal stimulus to rebalance the economy towards consumer spending. In particular this would involve improving social welfare (in terms of pensions, health and education) in order lower precautionary household saving and support spending.

Despite indications from Politburo meetings that stimulus would be forthcoming so far it’s been mild with only a few cuts to interest rates and relaxation of bank reserve requirements and measures to “promote” consumers to spend more and buy more homes without large scale measures to help them do so. This has led to concern the Government is more focussed on trying to avoid reflating credit and housing bubbles (much as Japan was in the early 1990s) and/or is not aware of the problem.

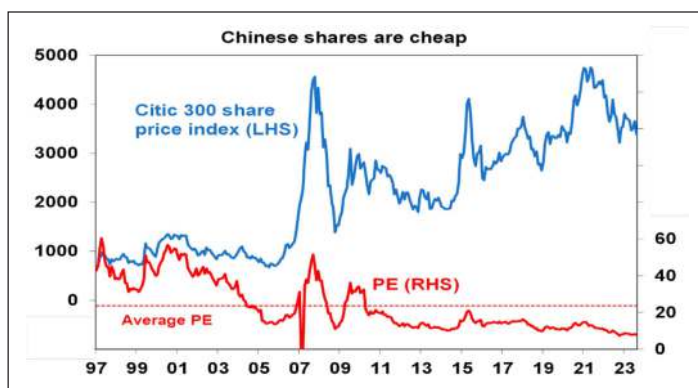
Our assessment though is that the Government is well aware of the need to support growth given the risk of social unrest and will ultimately do so - probably after the summer travel boom comes to an end soon. Furthermore the Chinese Government is unlikely to allow a GFC style collapse in property developers and is likely to continue to manage the problem.

So a collapse in the Chinese economy is unlikely but the risk that policy stimulus is too little or too late can’t be ignored and nor can the broader comparison with Japan at

the end of the 1980s. A key difference with Japan 30 years ago is that China's per capita GDP is still low so it still has lots of catch up potential, but its rapid private debt build up is similar to Japan's, its demographic outlook is a bit worse and the threats to its productivity (with state intervention) and trade (with geopolitical tensions) are greater.

The Chinese share market

Chinese shares are down 36% from their record 2021 high and are cheap when compared to earnings (trading on a PE of just 7.7 times), book value and sales. This suggests significant potential for a bounce if significant stimulus is announced. However, the risks are on the downside.



Source: Thomson Reuters, AMP Capital

Implications for Australia

Uncertainty around China's outlook is a key risk for global growth at present and could be a contributor to a further correction in share markets.

The collapse in the share of Australian goods exports going to China in 2021 and 2022 from around 42% to less than 30% (partly due to trade restrictions) without a major hit to our economy highlights that maybe Australia is not as dependent on China as many think. Nevertheless, a sharp downturn in China would be a double whammy for the Australian economy coming at the same time the lagged impact of big interest rate hikes on household spending comes through. But while it's a risk it's not our base case as ultimately we expect a ramp up in Chinese stimulus measures enabling Chinese growth to settle around 5% this year and 4.5% next year (not great compared to the past experience for China but not a disaster). However, the risks around the Chinese outlook and its longer-term growth mean Australia cannot rely on the China/commodity boom indefinitely driving national income and hence masking our poor productivity performance. This is another reason why Australia needs structural reform to boost our longer-term growth potential.

Shane Oliver is Head of Investment Strategy and the Chief Economist for AMP. This article is general information only.

Q&A = Ask a Question

Question 1

My wife is taking time off work to care for our kids. How can I ensure my wife's super still grows despite her being off work for a bit?

To ensure your wife's superannuation fund remains active during this time, you can consider voluntary contribution strategies such as making personal contributions, spouse contributions and benefitting from the government co-contributions. You should also review her super to consolidate multiple super accounts to reduce fees and choose an investment options that aligns with her long-term goals and streamline growth potential. If or when she returns to work, you can also consider increasing contributions to compensate for missed growth.

During this time, it is a strongly recommended to seek advice from your financial adviser to discuss personalised strategies for maintaining her super's growth as well as any other considerations during the time she is off.

Question 2

Should I keep my dividends or go in a reinvestment plan?

When you're deciding between receiving dividends directly or enrolling in a dividend reinvestment plan (DRP), it's important to consider your financial objectives and circumstances.

DRPs can potentially enhance your investment over time by automatically reinvesting dividends. This means your money keeps working for you, leading to growth through compounded returns. On the other hand, keeping dividends as cash provides you with a regular income stream, which can be useful if you need consistent funds for expenses or other financial goals.

As you weigh your options, think about your investment timeline and whether you're comfortable with the hands-on

management that comes with reinvesting dividends yourself. Evaluate whether you have an immediate need for the cash that dividends provide. If the investment offers a DRP, consider its terms and any associated fees.

If you are unsure which approach suit your needs, we recommend consulting your financial adviser. They can provide personalised guidance that aligns with your situation.

Question 3

I am planning to retire soon, and I've heard people talk about an Account based pensions and annuities. What is the difference between an Account based pension and an annuity?

An account-based pension and an annuity are both retirement income options, but they have distinct differences:

An account-based pension offers the flexibility to access your super savings as regular income payments and lump sum withdrawals. You can set your regular payments based on a percentage or fixed amount of your super account balance. You also have control over how your pension account is invested, and the investment performance. However, this means that if your payments and withdrawals are not managed alongside your balance, your account may deplete during your lifetime and you will no longer have any super to live on later in retirement.

On the other hand, an annuity provides a fixed, regular income set for a certain period or your lifetime in exchange for a lump sum payment. They are less flexible than account-based pensions, with limited ability to adjust payments or accessing lump sums. Investment control rests with the provider, but the income is predictable and stable, unaffected by market changes and almost guaranteed.

To find the option that's suitable for your circumstances, please speak to your financial adviser who can provide advice on these options.

If you have a question that you would like to see answered in **Wealth Adviser**, please send it through to centraladvice@wtfglimited.com.

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