

The Australian election and investors

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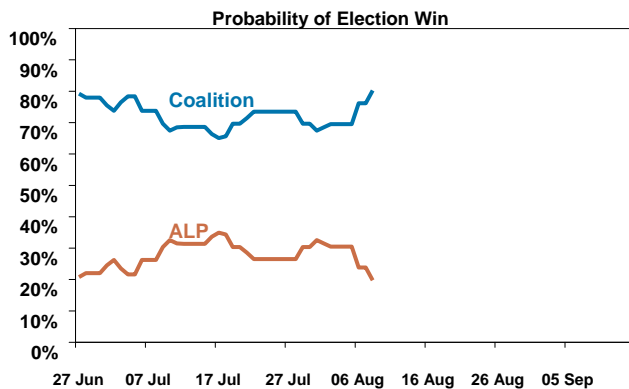


Key points

- > Historically election campaigns result in a period of flat lining for the Australian share market followed by a bounce once the election is out of the way.
- > The likely end to three years of minority Government should be taken favourably by markets as it will likely result in more certain policy making.

The Federal Election

With the much anticipated Australian Federal election now set for 7 September it is natural to wonder what impact, if any, there might be on investment markets – both in terms of the uncertainty created by the election itself and in terms of the outcome. At present while opinion polls have Labor and the Coalition running at around 50% each on a two party preferred basis, according to bets placed on online betting agency Centrebet the Coalition remains the clear favourite.

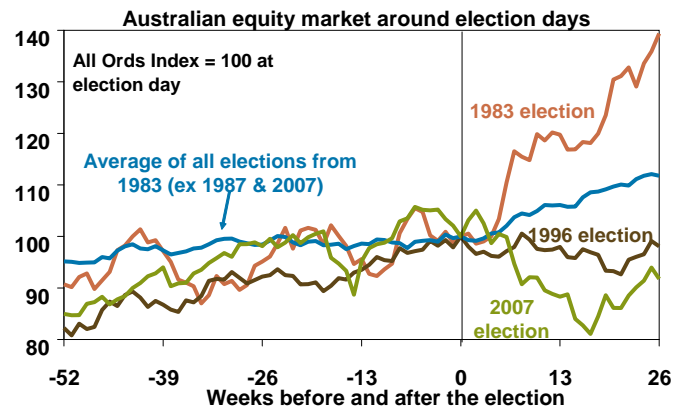


Source: Centrebet

The performance of markets around elections

Elections can potentially have a short-term impact on investment markets. This is because investors don't like the uncertainty associated with the prospect of a change in government during the campaign and then there may be relief once the poll is out of the way and possibly optimism associated with the election of a new Government.

The next chart shows Australian share prices from one year before till six months after Federal elections since 1983. This is shown as an average for all elections (but excludes the 1987 and 2007 elections given the global share crash 3 months after the 1987 election and the start of the global financial crisis in 2007), and the periods around the 1983 and 2007 elections, which saw a change of government to Labor, and the 1996 election, which saw a change of government to the Coalition. The chart suggests some evidence of a period of flat lining in the run up to elections, possibly reflecting investor uncertainty before the poll, followed by a relief rally soon after it is over.



Source: Thomson Financial and AMP Capital

However, the elections when there has been a change of government have seen a mixed picture. Shares rose sharply after the 1983 Labor victory but fell sharply after the 2007 Labor win, with global developments playing a big roll in both. After the 1996 Coalition victory shares were flat to down. The point is that based on the historical experience it's not obvious that a victory by any one party is best for shares in the short term and, in any case, historically the impact of swings in global share markets arguably played a much bigger role than the outcomes of Federal elections.

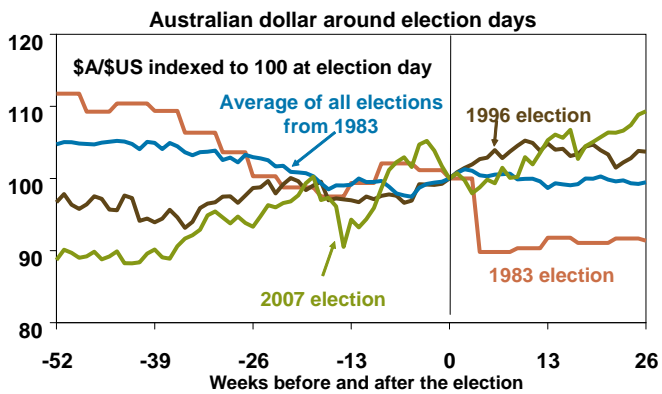
What is clear though is that after elections shares tend to rise more than they fall. The next table shows that 8 out of 11 elections since 1983 saw the share market up 3 months later with an average gain of 5.4%, which is above the 1.8% average 3 monthly gain over the whole period.

Australian share market 3 months after elections

Election	Winner	Aust All Ord's share index 3 months later, %
Mar 1983	ALP	19.8
Dec 1984	ALP	5.4
Jul 1987	ALP	15.9
Mar 1990	ALP	-3.5
Mar 1993	ALP	3.2
Mar 1996	Coalition	-2.0
Oct 1998	Coalition	11.1
Nov 2001	Coalition	5.4
Oct 2004	Coalition	9.9
Nov 2007	ALP	-11.7
Aug 2010	ALP	5.7
Average		5.4

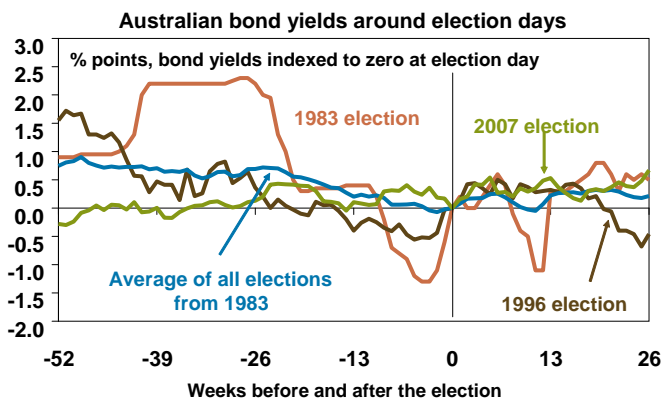
Source: Bloomberg, AMP Capital

The next chart shows the same analysis for the Australian dollar. In the six months or so prior to Federal elections there is some evidence the \$A experiences a period of softness and choppiness which is consistent with uncertainty about the policy outlook, but the magnitude of change is small – just a few percent. On average, the \$A has drifted sideways after elections. While the \$A fell soon after the 1983 Labor victory this was due to a policy devaluation in the dying days of the fixed exchange rate system.



Source: Thomson Financial, AMP Capital

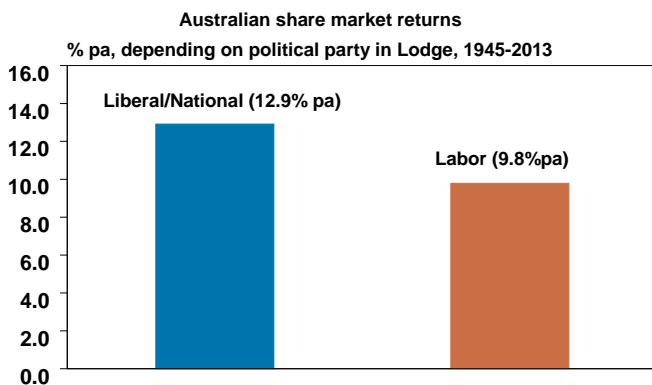
The next chart shows the same analysis for Australian bond yields. Interestingly, on average bond yields have drifted down over the six months prior to Federal elections since 1983. The average decline has been around 0.75% which is contrary to what one might expect if there was investor uncertainty regarding the policy outlook. However, the tendency for bond yields to decline ahead of Federal elections appears to be more related to the aftermath of recessions, growth slowdowns and/or falling inflation prior to the 1983, 1984, 1987 and 1993 elections and the secular decline in bond yields through the 1980s and 1990s in general. More broadly, it's hard to discern any reliable affect on bond yields from Federal elections.



Source: Thomson Financial, AMP Capital

Policy change and shares

Over the post war period shares have had an average return of 12.9% pa under Liberal/National Coalition Governments compared to 9.8% pa under Labor Governments.



Source: Thomson Financial and AMP Capital

Some might argue though that the Labor Governments led by Whitlam in the 1970s and Rudd and Gillard more recently had the misfortune to be affected by severe global bear markets beyond their control and if these periods are

excluded the Labor average rises to 14.6% pa. Then again that may be pushing things a bit too far. But certainly the Hawke/Keating government defied conventional perceptions that conservative governments are always better for shares. Over the Hawke/Keating period from 1983 to 1996 Australian shares returned 17.3% pa, the strongest pace for any post war Australian government.

Once in government political parties of either persuasion are usually forced to adopt sensible macro economic policies if they wish to ensure rising living standards. Both the Coalition and Labor agree on the key macro fundamentals – i.e. the need to keep inflation down, to return the budget to surplus and in the benefit of free markets.

Policy differences

The main areas of difference between the two parties of probable economic significance relate to taxation, climate change, government spending & the budget and regulation.

- in terms of tax the Coalition has promised to cut the company tax rate (although for large companies this is partly offset by a paid parental leave scheme) and abolish the mining tax;
- the Coalition is proposing to abolish the carbon tax/Emissions Trading Scheme and will rather pay companies to reduce emissions;
- the Coalition is likely to take a lighter/more business friendly approach to regulation than a Labor government. This may involve some partial wind back of industry regulation; and
- the Coalition will likely try and speed up the return to a budget surplus by cutting government spending, much as it did under John Howard following the 1996 election.

As a result, perceptions that the Coalition will be lower taxing and less focussed on regulation and hence more business friendly than a Labor government may increase the chance a Coalition victory will result in a typical post election share market bounce. However, it's worth noting that this may be partially offset if it announces aggressive fiscal tightening after the election (given the negative impact this could have on economic growth and profits at a time when the economy is already soft). What's more if a returned Labor Government follows up on its commitment to a National Competitiveness Agenda working to seriously boost productivity growth then it could have a positive long term impact on growth, profits and ultimately share market returns.

However, it does seem that there is the potential for significant sectoral impacts with the Coalition's policies likely to be positive for miners, heavy carbon emitters and small companies (due to the company tax rate cut).

Concluding comments

The historical record points to the strong chance of a post election share market bounce. This may also fit in as we move out of the September quarter, which is often the weakest of the year, into the normally strong December quarter, as the profits reporting season ends in Australia and as uncertainty is removed post a possible September decision by the US Federal Reserve to start tapering its monetary stimulus.

Another potential positive from the election is that it is likely to see the end of minority government in Australia as whoever wins is likely to have a clear majority in the House of Reps. This could help usher in a period of more certain and rational policy making. However, it's not guaranteed as whoever wins may still not have control of the Senate.

Dr Shane Oliver
Head of Investment Strategy and Chief Economist
AMP Capital