



US economy back on track – what this means for investors

The US economy's upturn is gathering momentum. In this Point of View, AXA's Chief Investment Officer Mark Dutton looks at what's behind the growth story in the world's biggest economy.

Back to 2007

The US economy has finally returned to the same size as before the GFC struck. The fact that it has taken three years for the US economy to return to pre-recession levels highlights how deep the recession was. History shows that once a recovery starts, it usually takes around nine months for growth to return to pre-recession levels. This time it took 18 months.

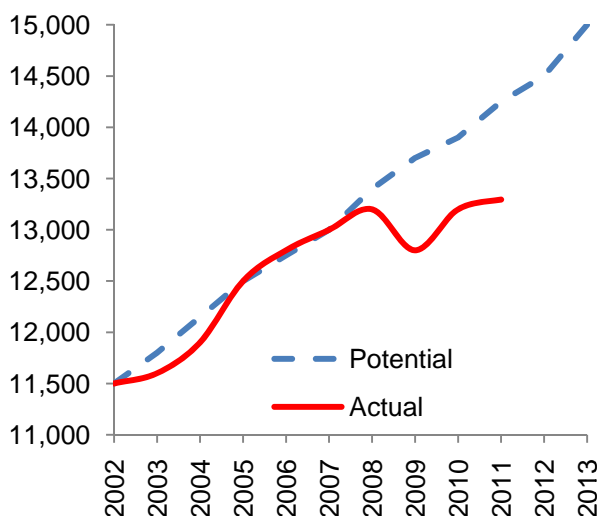
The US is not on the same 'old' growth path

The unusually long recession and corresponding loss of growth mean that while the US economy has once again returned to the size it was before the GFC, it is not on the same growth path as before 2007, as shown by figure 1 below.

For more background to this point see the July 2010 Point of View *The 'new normal' – what does it mean?*

Capital Economics estimates that the US economy is some \$800 billion, or 5.5 per cent, below where it would be if the recession never occurred. Arguably, this is felt most deeply in the employment market, where just 1.1 million of the 8.4 million jobs that vanished during the recession have returned.

Figure 1: US real GDP (\$billion)



Source: Capital Economics, Thomson Datastream, Congressional Budget Office and AXA.

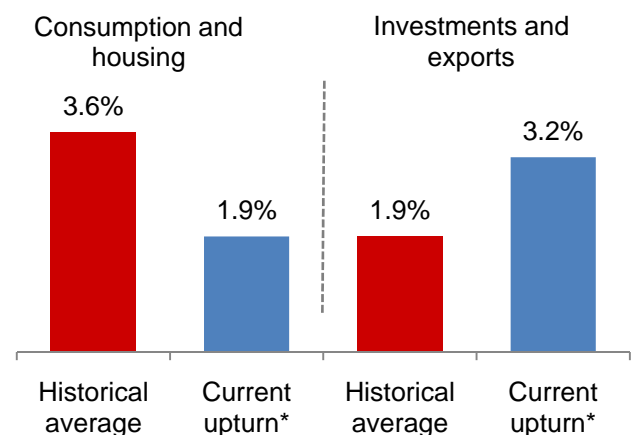
The drivers are very different now

It's now fairly well known that the build up of unsustainable personal debt, particularly in the housing market, and the re-packaging of this debt were a large contribution to the GFC.

What's less well known is that exports and investment spending are replacing consumption and housing as the key drivers of economic growth, as shown by figure 2 below.

This 'new mix' of drivers will not only have important implications for the US recovery, but also for investment markets.

Figure 2: Contribution to economic growth (First six quarters of recovery)



* Annualised change for six quarters from 2Q:2009. Source: Bureau of Economics and AllianceBernstein. Data as of 31 December 2010.

What does this mean for investors?

US exports and investment spending are surging because of strong demand from developing countries.

Nearly 60 percent of US merchandise exports are shipped to developing countries that are expanding at two or three times the pace of the global average.

This is a 10 per cent increase over the past decade, as shown by figure 3.

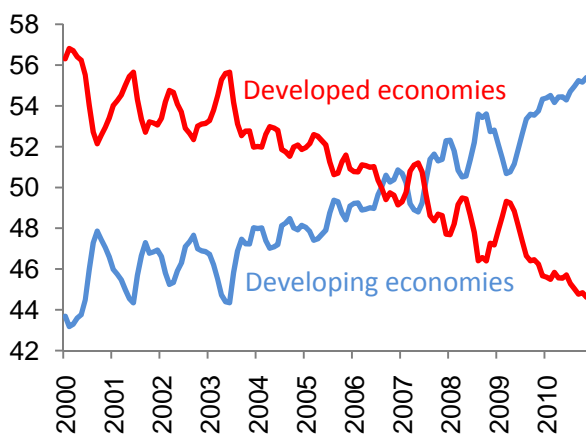
A question that's often asked is "what does America export, since everything is now produced or assembled in China?"

The answer may surprise.

At the top of the list are capital goods. The biggest component in this category is civilian aircraft and parts, followed by a long list of industrial machinery, semiconductors, computers and related equipment.

Other merchandise exports include industrial materials and supplies, automotive vehicles and parts, consumer goods and agricultural products.

Figure 3: Destination of US merchandise exports* (per cent)



* Three month moving average. Source: AllianceBernstein, Census Bureau and Haver Analytics. Data as of November 2010.

US companies benefiting from export growth to developing countries tend to have well established global markets, strong balance sheets and excess cash reserves that can be used to fund aggressive investment plans.

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It will take time for the positive effects of the surge in exports and investments to drive recovery in other parts of the US economy, but there are early signs that this is starting to occur.

The housing market is beginning to stabilise and consumer spending is starting to recover, with retail sales rising at an annualised rate of 12.4 per cent over the last three months of 2010.

The continuing positive developments in the US again illustrate the need to look past the headlines. The US has its problems, but the world's biggest economy is back in growth mode and providing attractive investment opportunities.

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