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Earnings growth the missing ingredient for the ASX rally

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The recovery of the Australian sharemarket since global growth fears sent it spiralling into a bear market has heartened investors, but caution remains due a lack of earnings growth.

Since the ASX fell into an official bear market on February 10, defined as a fall of 20 per cent from its recent high of almost 6000 points in April, the market has rallied 7 per cent.

Leading the rally is a bounce in the materials sector, up 12 per cent in little more than a month on a lift in iron ore and oil.

The market's rally stuttered on Tuesday, after the ASX suffered its biggest one-day fall in three weeks.

Commodities remain volatile: iron ore skyrocketed 19 per cent in one day last week, and has since corrected, sliding six days straight.

Earnings are the missing ingredient in the market, BetaShares chief economist David Bassanese said.

"It's been hard for the local equity market to rise in a sustained way against the backdrop of weak corporate earnings," he said.

"Overall forward earnings for the market have been broadly flat for the past five years, with a declining trend even evident in the past year or so due to the accelerated decline in resource sector earnings."

Oil and iron ore both coming off their lows has given some hope to the market that the worst of the resources rout is over. Brent crude oil has lifted 40 per cent from its mid-January low of $US27.88 a barrel, while iron ore has risen 38 per cent from its December low of $US38.30 a tonne.

BHP Billiton chief executive Andrew Mackenzie told the Australian Financial Review Business Summit on Wednesday that he remained bearish on the prospects for the iron ore price, but that it remained profitable for the mining giant.

But analysts may be too hopeful. Mr Bassanese said consensus estimates from Bloomberg, which suggest forward earnings in materials are expected to rise by 36 per cent in the next 12 months, were "a big ask" without a solid rebound in commodities.

Earnings outside the materials and energy sectors also remains weak. In the 12 months to the end of February, ex-resources forward earnings fell by 0.8 per cent, he said.

Niv Dagan, executive director at Peak Asset Management, says a sustained lift in the market would come from three directions: earnings certainty, stimulus from the Reserve Bank of Australia and interest rates on hold in the US.

"What we really want to see is consumer and business confidence pick up," he said.

"I think if the market as a whole perceives that the economy is in a strong position, that will lead to a boost in spending," he said.

The translation through to economic growth should be at the forefront of the RBA's decision making, and should cut rates rather that "sit on its hands", Mr Dagan said.

The RBA opted to leave interest rates at 2 per cent at its March meeting, the level it has remained since May.

Further, the federal budget is crucial to the market rallying sustainably, Prime Value Asset Management joint chief investment officer ST Wong said.

"A federal budget that incentivises business and is positive for the consumer," he said.

Mr Wong also believes investors need assurance that defaults in the energy credit sector will have a limited negative effect on financial institutions. Concerns of contagion from high yielding corporate credit in US energy companies led to a savage sell off in global banks at the start of this year.

Action from Chinese authorities that would calm fears about a hard landing in China's economy was another ingredient for a sustainable rally, he said.

"[We need] credible evidence of the Chinese government managing China's deteriorating growth outlook without causing capital flight," he said.