

Economic and market developments, March 2010

Below is an edited transcript of a video recorded on 8 March, 2010 by MLC Investment Strategist Brian Parker.

Since we recorded our last video, world sharemarkets have recovered much of the ground lost this year, and in some cases, exceeded their end 2009 levels. I want to focus on some key economic developments around the world and here at home, and how economies and markets might play out over the remainder of 2010.

Starting with the global economy, the impact of severe weather in a number of major economies, most notably in the US has played havoc with the data recently. Despite that, it seems clear that the tentative recovery in private spending that we referred to last time is continuing, and it's critical that it does. A self-sustaining recovery requires more than just a temporary bounce in production and spending, and more than just Government incentives. We need to see stronger spending generating stronger production, employment and incomes, which in turn produce stronger spending. In the US, retail sales have improved, and there are signs that the labour market is starting to stabilise. In Europe and Japan however, the economic data have shown some improvement, but the macroeconomic picture in those economies remains underwhelming. In the emerging markets, particularly in Asia, there has been a solid recovery in exports and in production in the last nine months or so, and prospects for these economies look decidedly brighter than elsewhere – due to the fact that they haven't suffered the kind of financial excesses that we've seen in the US, UK, and elsewhere.

Here in Australia, our economy ended 2009 with a solid 0.9% growth rate for the December quarter, taking our annual economic growth rate up to 2.7%. Government policy measures, whether cash hand-outs or incentives for equipment spending, or direct Government spending, have been largely responsible for our better economic performance. However, 2010 is also shaping up as one of improvement for the local economy, and one in which the performance of the private sector will be responsible for a great share of Australia's growth.

After passing on a February rate hike, the Reserve Bank raised the cash rate by a further 25 basis points in early March to 4%, and they've clearly signalled that there are more rate hikes to come.

What does all this mean for financial markets and for investors?

Firstly, the global economic recovery is likely to be sustainable, but we remain with the view the recovery is going to be more modest than usual. Households in a number of economies, as well as financial institutions still have more work to do to restore balance sheets to healthy levels, which tends to restrain spending as well as the demand for and supply of credit. Governments in many economies will be forced to raise taxes, cut spending, or both in order to rein in budget deficits. The fact that an economic recovery is underway makes these adjustments easier, but doesn't eliminate the need for them.

Finally, our medium-term estimates of returns still look reasonable, and have probably improved a little this year. However, the fact that our prospective return estimates only appear reasonable at this point, speaks volumes about just how far and how fast markets rose during 2009.

I think the best way to describe the market environment going forward, is to say that the easy gains have been made. The huge sigh of relief that investors around the world breathed last year is over. There are still gains to be made, but from here they're likely to be somewhat harder.

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