Market Watch

Economic and market developments, August 2010

Below is an edited transcript of a video recorded on 6 August, 2010 by MLC Investment Strategist Brian Parker.

Hello everybody, my name is Brian Parker, and I'm an Investment Strategist with MLC Investment Management. Since we recorded our last video, the world's major share markets recovered some of the ground lost in recent months. Share prices in the developed world are about 8% higher over the last month, while emerging equity markets are up by a little less than that. Here in Australia, share prices are around 6% higher than over the month.

If we turn to debt markets, Government bond yields are mixed over the month. Yields are higher here in Australia, the US and Canada but are lower in a number of other countries. If we look at those countries worst affected by sovereign risk concerns this year, particularly Greece and other countries on the European periphery, bond markets seem to have become a little less concerned over the month. In commodity markets, the price of oil and most key industrial metals have risen over the last month or so, extending the gains they made before our last video.

In currency markets, the Australian Dollar has risen over the month against the major currencies, but is still lower than the highs reached earlier this year. As usual, John Owen, in another recording on this website takes you through the performance of markets in some more detail and how MLC's portfolios have fared.

If we look at the behaviour of financial markets over the last few weeks, it looks as though earlier concerns about the durability of the global recovery and sovereign risk have eased somewhat. This is ironic given that the economic data released in the major economies – particularly in the US have tended to disappoint. In fact, the leading economic indicators, the numbers that tell us where economies are heading rather than where they've been, have been markedly weaker than they were some months ago. This is not to say that the world is about to fall into recession again, but it is consistent with a view we've been advocating for months now. That the global recovery – especially in the major developed economies is going to be a rather anaemic affair, even if the absence of new shocks to the system.

One of the shocks that could easily upset that view is a premature tightening of either monetary or fiscal policy in the major economies. Policy makers have to walk a very fine line here. Yes, large budget deficits are a concern and will require policy tightening over the medium term, but tightening too soon could seriously derail the recovery. As a number of market watchers have noted recently, Governments will have to walk and chew gum at the same time. While steps towards fiscal austerity in some key economies do pose a threat to world growth, we can be more relaxed about monetary policy at this point. Over recent weeks, comments from the US Federal Reserve and other major central banks suggest the monetary policymakers are in no great hurry to reverse the massive monetary stimulus that remains in place.

Let's turn now to Australia. The Reserve Bank of Australia has now left interest rates unchanged for three consecutive months, after raising rates by 25 basis points to 4.5% in early May. In keeping rates unchanged, the RBA is responding to a number of developments. Firstly, the global outlook remains highly uncertain, not withstanding the better performance of share markets over the last month. In addition, the local economic data remains quite mixed. The unemployment rate continues to edge lower, and employment continues to grow. On the other hand, retail sales growth has been pretty subdued, business confidence surveys haven't looked as positive as they did later in 2009 and earlier this year, and some of the leading indicators of housing activity have look quite weak. A benign result for the RBA's preferred inflation measures for the June quarter also took further pressure off interest rates. However, I still think it's prudent to work on the assumption that if Australian official interest rates are going anywhere soon, then they're still going up.

As we record this, we are right in the midst of the federal election campaign. In about twenty years of doing this kind of work, I have never advocated that anyone change their medium to long-term views of the economy or markets, or change their asset allocation or other broad aspects of their investment strategy because of what they hear in an election campaign or of what the eventual outcome is. I don't view this election any differently.

Our medium term estimates of return prospects look reasonable, and have risen closer to long-run norms even after last month's improvement in equity markets. In short, equity markets are still cheaper than they were a month or two ago. Over the medium term, equities still seem to offer the best chance of delivering decent real returns for investors, particularly because traditional safe haven assets, such as Government bonds appear to offer poor return prospects, especially in overseas markets.

Thanks for listening. And we'll talk again in another month.