Economic and market developments, September 2010

Below is an edited transcript of a video recorded on 3 September, 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 have lost some more ground, despite staging a recovery in recent days. World equity markets are down by around 3% over the month, while the Australian market is only around half a percent lower. Japanese share prices were down quite sharply – by around 6% or so, while prices elsewhere in Asia were more mixed. Some of the smaller emerging markets in the region enjoyed decent gains.

If we turn to debt markets, Government bond yields fell sharply in most major markets, while credit spreads generally widened – particularly for lower quality credits. In commodity markets, the price of oil fell by more than 8% since we last spoke, and some key industrial metal prices also declined in price.

In currency markets, the Australian Dollar has been pretty much rang-bound in the last few weeks but is down by around 1% against the US Dollar as we speak. Against other currencies, we're weaker against a strong Japanese yen, but we have fared better against the Euro and the Pound. 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, the concerns over the durability of the economic recovery are still with us, and this concern has been reinforced by generally weaker than expected economic data from the United States. Elsewhere, economic data in China have also tended to disappoint, but they still paint a picture of an economy growing at a very solid pace.

The Euro-area economies overall are posting very ordinary growth, but this masks a good deal of divergence among the member states. Those countries worst affected by the fiscal crisis facing the continent are still struggling, while Germany in contrast seems to be in rude economic health. Over the year to June, the German economy grew by 3.7%, its best result for several years, and the fastest of the major economies.

If we look at the leading economic indicators, the numbers that tell us where economies are heading rather than where they've been, those numbers are still pointing to weaker growth in the major economies. 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 some time now. That the global recovery, notwithstanding the better news out of Germany, is going to be a rather anaemic affair, even in the absence of new shocks to the system.

Let's turn now to Australia. The Reserve Bank of Australia has left interest rates unchanged for several months now after raising rates by 25 basis points to 4.5% in early May, and as we record this video, we are a few days away from the Bank's September meeting. Last month we reported that a very benign inflation result for the June quarter and a highly uncertain global environment had taken the pressure off official interest rates. In recent days however, Australia's national accounts data for the June quarter showed much stronger than expected growth, underpinned by very solid growth in consumer spending, and an extraordinary boost to our national income courtesy of sharply higher export prices. While that data is now several months out of date, it nevertheless shows that our economy is growing faster, and hence using up spare capacity faster, than previously thought. Consequently, I still believe 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 were hoping to know the result of the federal election campaign. Sadly, we don't. By the time this video goes to air, the three key independents who will determine who governs the country will most likely have given their view. As I mentioned last time, 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 still don't view this election any differently.

Let's conclude by discussing return prospects. The recent weakness in equity markets means that many of the world's share markets are at levels which appear to offer reasonable value for longer term investors. We are still of the view that 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.