

Economic and market developments, November 2010

Below is an edited transcript of a video recorded on 3 November 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, world share prices enjoyed further gains, with the strongest gains occurring, once again, in the emerging markets. Japanese share prices were a key exception, falling by around 5%, partly due to a stronger Japanese yen, and its impact on Japanese exporters. Share prices here in Australia have underperformed overseas markets but are still up over the month.

In bond markets, Government bond yields have risen in most countries, as have prices for gold, oil and key industrial metals. In currency markets, the US Dollar has weakened, particularly against the Japanese Yen. For Australians, the big news in currency markets was that our Dollar finally achieved parity with the US Dollar for the first time since before the currency was allowed to float in December 1983.

As usual, my colleague John Owen will address the performance of markets and MLC portfolios in more detail in a video elsewhere on the website.

If we look at the behaviour of financial markets over the month, it seems as though markets are putting a good deal of faith in the likelihood of further quantitative easing from the Federal Reserve and in the ability of that further easing to stimulate faster economic growth, prevent deflation from taking hold, and over time, bring about somewhat higher inflation rates. In order for this confidence to be justified, at least some of that extra liquidity has to find its way through the financial system and into demand for goods and services. It may well achieve that, but there are no guarantees of success.

Turning to the economic data released over the last month, the picture of global growth that they paint look quite reasonable. Some of the US data have disappointed, but in Europe and Japan, the economic news has tended to be somewhat better than markets have been expecting. The emerging world continues to outperform. The economic news coming out of Asia and Latin America have tended to beat market expectations. In China, the monetary authorities recently responded to what remains very rapid economic growth and rising inflation pressures with a surprise increase in interest rates.

We remain of the view that growth in the major economies is likely to remain reasonable, but unspectacular, despite the likelihood of further monetary easing measures from the Federal Reserve and perhaps other central banks as well. The environment remains highly uncertain, but we don't expect a renewed recession in either the US or elsewhere.

Turning to the Australian economy, the overall economic picture hasn't changed much since we last spoke. While housing activity seems likely to moderate, employment growth has been strong, consumer confidence and spending remains reasonably solid, the outlook for business investment – particularly in mining and related industries – is still very favourable, and the economy is set receive a substantial boost from a much stronger terms of trade – courtesy of much higher prices for our key resource exports.

Prior to our last video, the Reserve Bank opted to leave interest rates unchanged, surprising almost everybody. Some better than expected news on inflation for the September quarter did convince many that the Bank would avoid a Melbourne Cup Day rate increase. However, the Bank once again surprised most economists – this time by raising the cash rate by 25 basis points to 4.75%. In doing so, the Bank has focused of higher inflation down the track, particularly given that the economy currently has relatively little spare capacity. Key borrowing rates for home owners and small to medium sized business are now higher than longer term averages, even though at 4.75%, the cash rate is clearly not. I'd expect the RBA to be very cautious about raising rates further from here. However, as I've repeated often in recent recordings, it is still prudent to work on the assumption that if Australian cash rates are going anywhere soon, then they are still likely to go up.

When it comes to prospective returns for the major asset classes, we are still of the view that over the medium term, equities still seem to offer the best return prospects for investors, particularly because traditional safe haven assets, such as Government bonds appear to offer poor future returns, especially in overseas markets. Overall investment returns are still likely to be more modest than many investors enjoyed for much of the decade or more leading up to the Global Financial Crisis, and the environment is likely to remain quite volatile.

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

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