

Review of Economic Developments & Market and MLC Fund returns to 31 December, 2010

Below is an edited transcript of a video recorded on 6 January 2010, by MLC Investment Specialist John Owen.

Hello everyone and welcome to the new year. I'm John Owen from MLC Investment Management. This video combines the economic insights of my colleague Brian Parker and our usual review of markets and fund performance.

Since we recorded our last video, world share markets as a whole have performed very well. America's S&P500 Index increased by 6.5% in December while the UK's FT100 Index was up by 6.7% (in local currency terms). The French, German and Japanese markets also finished the year on a good note. Overall, the hedged MSCI World Index return in December was substantially positive at +5.8% with the developed markets tending to fare better than those in the emerging world.

Prices for oil and a range of industrial metals are up significantly. What all this means is that financial markets in the last month or so have become considerably more optimistic about world economic growth prospects than they have been for some time.

And the economic data released over the past month seems to back up this improvement in sentiment. Some of the leading indicators that a few months ago were pointing to quite a pronounced slowdown in growth – or even perhaps a renewed recession in the US and elsewhere - now seem to have turned up again.

While economic conditions and prospects for peripheral European countries such as Greece and Ireland remain pretty dire, economic conditions elsewhere have been reasonably favourable. The US economy continues to grow and generate jobs, but not yet at a fast enough rate to bring unemployment down in any meaningful way. However, in a surprising development, prospects for US growth were given a boost in December by the Obama Administration and Congress agreeing on a useful package of budget measures, including cuts to payroll tax and the extension of the Bush-era tax cuts. This helped cap off a reasonable year for the US share market with the S&P500 Index returning +12.8% for the year in local currency terms, making it one of the better developed market performers in 2010.

Germany continues to lead the way in Europe, posting growth of close to 4% for the year to September, with solid growth in both consumer spending and business investment. These favourable economic circumstances helped the German share market rise by 16% for the year.

After experiencing one of the earliest and deepest recessions during the aftermath of the GFC, Japan has enjoyed one of the most impressive rebounds, and is likely to have grown the fastest of the major economies for 2010 as a whole. However, the recovery has been heavily dependant on a rebound in exports and by a relatively large fiscal stimulus which in the year ahead is likely to fade. It's also unclear how much more export-led growth Japan can achieve from here, especially given the effect of a very strong yen. These uncertainties perhaps help explain the 3% drop in the Nikkei index over the last year.

Growth in China and India remains spectacular, despite some slowdown in Chinese growth during 2010. Earlier fears that the Chinese authorities would aggressively tighten policy and potentially slow the country's growth rate have eased of late. However, the decision by the Chinese authorities to increase lending rates by 25 basis points on Christmas Day may signal a new determination by the Chinese to address their rising inflation, which could cloud growth expectations going forward.

Overall, it's been a good year for global shares but only if it was on a hedged basis. The Australian dollar has enjoyed a stellar performance in the year, having risen 13% against the US dollar since the end of 2009 and 22% versus the Euro. This has meant the -1.4% return of the MSCI World Index on an unhedged basis significantly lagged the +13.2% index return on a hedged basis.

Here in Australia, our share market increased by 3.8% in December, bringing to a close a rather mediocre year for local investors. Our market increased by only 1.9% in 2010 which looks poor relative to market returns recorded in the US, the UK and Germany. Note however, our market was up by over 37% in the previous calendar year so a period of consolidation after such a strong 2009 is perhaps not unreasonable.

As for bonds, most sectors of the global bond market produced positive returns in December despite bond yields rising sharply in most major markets. Rising yields have been caused by investors selling bonds as they move into higher risk assets such as shares, the US government's issuance of large volumes of bonds as part of its "Quantitative Easing" program and ongoing concerns with potential sovereign default risk in Europe.

Australian bond yields have also risen. The Reserve Bank remained on the sidelines in the last month of the year, opting not to raise interest rates any further at its December meeting. The economic data we have seen remains reasonably positive. Some of the leading indicators of housing activity that had weakened around mid-year have recovered somewhat and employment growth remains very strong. Over the year to November, total employment grew by 3.7% - the fastest annual rate of jobs growth since August 2005. At the same time, consumers remain somewhat cautious, preferring to save a much greater proportion of what has been very strong income growth, despite also reporting a quite high level of confidence. For business investment, the outlook outside of the resources sector appears quite subdued. In fact, resource related stocks were the main contributors to our market's barely positive return over the year.

As for listed property, the Australian sector is now on more solid ground with some signs of a recovery in distributions while the global listed property market continues to perform strongly.

Let's look now at the returns of our diversified Balanced and Growth Funds. As we have remarked on a number of occasions, a positive single digit return in this post-GFC environment should be considered a good outcome for investors and that is precisely what has occurred in the past year. Using preliminary and unaudited after fees and tax estimates, the Superannuation Fundamentals version of the MLC Balanced Fund returned +1.3% in December and +4.8% for the 2010 calendar year. For the MLC Growth Fund, the returns were +1.6% in December and +4.3% for the year.

Looking ahead, we remain of the view that growth in the major economies is likely to remain reasonable, but unspectacular. The environment remains highly uncertain, but we don't expect a renewed recession in either the US or the other major economies. The improvement seen in the recent economic data have made us, and indeed many other observers, more confident in this view. For those countries on the European periphery, the outlook remains much worse. If we look at Greece and Ireland in particular, what those countries are facing is utterly dire.

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. Broadly speaking, equity markets look to be fairly valued. While share prices have risen of late, so too have corporate earnings, and the outlook for the global economy remains generally supportive for share markets.

January will be an interesting month as we will see the latest round of company profit announcements. It's also a busy month for us as we will be preparing comments on the year just passed as well as our thoughts on where to from here so keep an eye on the MLC website. Thanks for listening and see you again next month.

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