

Economic update

2 February 2015



Brian Parker CFA
Head of the Portfolio Specialists Group

Brian reviews events in Australian and overseas markets during January.

How did markets perform in January?

Share prices rose in most world markets over the month. European shares had a very strong month, and there were pretty decent gains in Japan and the emerging markets. The big exception was the US, where share prices were down around 3%. For Australian investors, unhedged global share returns got another boost from the fall in our dollar, which dropped another 5% or so in January, and went below 80 US cents.

The Australian market produced a return of over 3% in January, and that was despite the fact that it was another bad month for iron ore and oil prices. Apart from energy and IT, most of the major Australian industry sectors performed strongly.

And it was a great month for fixed income investors both here in Australia and globally – bond yields fell sharply in all the major markets, back to or very close to historic lows.

What were the key factors driving global markets?

The main factor was renewed concern about the health of the world economy. The economic data released over the month across the world was mixed. And the weakness we've seen in the price of oil, and some other key commodity prices, raised doubts about the underlying strength of the world economy.

In fact, several of the world's central banks have taken steps to ease monetary policy during January including, most notably, the European Central Bank (ECB).

Quantitative easing (QE) in the US may have ended, but it continues in Japan, and recently, after months of speculation, the ECB announced its own QE program. The ECB has finally responded pretty aggressively to a struggling economy and inflation that remains dangerously low.

And while we're talking about Europe, the Greek elections at the end of January produced a resounding victory for the major left wing, anti-austerity party. It's not clear what will emerge from the negotiations between the new government and its eurozone partners, but it's highly likely that some further restructuring of Greece's debt will happen.

What about developments in Australia?

The economic data over the last month was generally better than expected. We're still seeing signs of a recovery in the non-mining economy coming through – lower interest rates are working. The lower Australian dollar is also a welcome relief for a range of industries.

But on the other hand, mining investment continues to taper off and the sharp fall in the iron ore price is significantly detracting from our national income. And the labour market is still struggling, which is showing up in very weak wages growth.

If the Reserve Bank of Australia decides to do more to boost growth, there's nothing in the economic data or in the inflation outlook to stop them cutting rates further.

How are MLC's portfolios positioned?

This is still a highly uncertain environment, and certainly no time to be taking excessive risks. As a result, in our multi-asset portfolios:

- We're still defensively positioned in world bond markets.
- We continue to prefer foreign currencies over the Australian dollar, which still looks overvalued and vulnerable even after its recent falls.
- In the MLC Inflation Plus Conservative and Moderate portfolios, we've been holding significant allocations to cash and short-term Australian corporate bonds.
- We've had very little exposure to Australian shares in any of the MLC Inflation Plus portfolios for some time, and we've further reduced our exposure in the last month or so.
- We've also added some extra inflation protection to those portfolios.
- Before the escalation of the financial crisis in Russia, we directed the manager of our emerging markets strategy in the MLC Inflation Plus and MLC Horizon portfolios to remove any exposure to Russian equities or debt.
- We've also reduced our overall emerging markets exposure in the MLC Inflation Plus portfolios.

As a general rule, if we see further falls in share markets, the MLC Inflation Plus portfolios are likely to outperform the MLC Horizon portfolios. However, the reverse is still true: the MLC Horizon portfolios are better positioned if markets continue to recover strongly from here.

Important information

This information has been provided by MLC Investments Limited (ABN 30 002 641 661) and MLC Limited (ABN 90 000 000 402), members of the National Australia Bank group of companies, 105–153 Miller Street, North Sydney 2060.

This communication contains general information and may constitute general advice. Any advice in this communication has been prepared without taking account of individual objectives, financial situation or needs. It should not be relied upon as a substitute for financial or other specialist advice.

Before making any decisions on the basis of this communication, you should consider the appropriateness of its content having regard to your particular investment objectives, financial situation or individual needs. You should obtain a Product Disclosure Statement or other disclosure document relating to any financial product issued by MLC Investments Limited and MLC Nominees Pty Ltd (ABN 93 002 814 959) as trustee of The Universal Super Scheme (ABN 44 928 361 101), and consider it before making any decision about whether to acquire or continue to hold the product. A copy of the Product Disclosure Statement or other disclosure document is available upon request by phoning the MLC call centre on 132 652 or on our website at mlc.com.au.

Past performance is not a reliable indicator of future performance. The value of an investment may rise or fall with the changes in the market. Please note that all performance reported is before management fees and taxes, unless otherwise stated.