Economic update

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Brian reviews events in Australian and overseas markets during July.

How did markets perform in July?

World share markets were quite mixed during July. Markets in Asia and the emerging markets posted fairly solid returns but US and European share markets lost ground. For Australian investors, unhedged global shares still managed a positive return in July courtesy of a weaker Australian dollar.

Our share market had a terrific month, with Australian shares producing a return of over 4% in July. Our miners, telecommunication stocks, and listed real estate all produced particularly strong returns, but really all the major industry sectors fared very well.

What were the key factors driving global markets?

Events in Ukraine, particularly after the downing of Malaysian Airlines Flight 17, are unsettling markets, especially European stock markets.

On the economic front, the news on the US continues to be quite positive. The US economy has rebounded very sharply after a poor start to the year (which was weather-related, in any case). Some of the recent Chinese data seem to be signalling that growth in China is stabilising at what is still a very rapid rate.

On the other hand, the European economic news has taken another turn for the worse. The recovery in Europe is very fragile, the uncertainty in the Ukraine is making matters worse, and it's quite possible that the European Central Bank may have more work to do to stimulate growth.

What about Australia's economy?

The key question for our economy is the one I've often mentioned. Mining investment is declining, and is going to be an ongoing drag on growth. Can the combination of exports and the non-mining economy pick up soon enough and fast enough to offset that?

The jury is still out, but there are reasons for optimism. Low interest rates are working. We are seeing a pick-up in housing activity coming through in the data, and some key business surveys are suggesting that investment outside the mining industry will grow – at least modestly – over the next year or so. As long as we continue to see signs of this non-mining recovery, the Reserve Bank of Australia seems likely to leave interest rates unchanged for quite some time, even though the labour market still remains pretty soft.

How are MLC's portfolios positioned?

Across our diversified portfolios we remain defensively positioned in world bond markets, given that we still expect poor future returns from government bonds. And we continue to favour a range of foreign currencies over the Australian dollar, which still looks very vulnerable in a number of adverse scenarios.

After a period of such strong share returns, we've slightly reduced our allocation to Australian shares in most of the MLC Horizon portfolios. That money has been reallocated to cash and to the MLC Inflation Plus strategies, because we think adding some extra inflation protection to portfolios makes sense. Given just how aggressive the stimulus policies of the world's central banks have been, we see some risk of higher inflation over the medium term to longer term, and want to mitigate that risk.

In the MLC Inflation Plus Conservative and Moderate portfolios, we're still holding significant allocations to cash and short-term Australian corporate bonds. This means that if share prices continue to rise, our MLC Inflation Plus portfolios will still deliver solid absolute returns, but they'll underperform the MLC Horizon portfolios. However, if we see a significant correction in share markets, the MLC Inflation Plus portfolios are likely to perform significantly better than MLC Horizon.