Economic update

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Brian reviews events in Australian and overseas markets during September.

How did markets perform in September?

It was generally a disappointing month for investors. World share prices were down by around 2% over the month, and prices in the emerging markets fared quite a lot worse than that – they were down by around 4%. There were also losses in the US and the UK, but markets weren't universally negative: there were some reasonable gains in Europe and a decent jump in the Japanese market.

If we look at the returns for the month in Australian dollar terms, the picture is somewhat better. The Australian dollar fell quite sharply in September, not just against a much stronger US dollar, but against a range of currencies. This meant unhedged global share returns were quite strong.

Our share market had a poor month. The iron ore price fell by nearly 12% in September, down to its lowest level in five years.

And fixed income markets also lost ground over the month. Yields rose here in Australia and in most of the world's major markets.

What were the key factors driving global markets?

There was long list of geopolitical concerns that continued to worry markets.

The crisis in the Ukraine is ongoing and the so-called Islamic State is still in control of large swathes of Iraq and Syria.

There was a lot of uncertainty about the outcome of the Scottish independence referendum, and that hurt UK markets during the month until the 'no' vote came through.

And most recently, there have been very large pro-democracy demonstrations in Hong Kong. It's unclear just how long these will last and how the Hong Kong and Beijing authorities will respond.

The economic news was mixed. The US economic data continued to be quite strong, but elsewhere – in China, Japan, and the eurozone – the news was generally disappointing. In fact, the news in Europe was worrying enough for the European Central Bank to take further steps to boost growth in September, and there's a real chance that they'll be forced to do more.

What about developments in Australia?

Overall, economic growth remains reasonable, but not spectacular. I think we are seeing signs of a recovery in the non-mining economy coming through. Lower interest rates are working, housing activity indicators remain quite solid and there's a pick-up in the demand for credit – most importantly, we're seeing some growth in business credit. And the lower Australian dollar does take some of the pressure off some key export industries.

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.

It's still an uncertain environment, and for the Reserve Bank of Australia, it probably means leaving interest rates on hold for quite a while yet. The economy isn't weak enough to cut rates even further, but it's not strong enough to force them to raise rates either.

How are MLC's portfolios positioned?

A number of the asset allocation positions we've had in our multi-asset portfolios added significant value during September.

We've benefitted from the weaker Australian dollar, as we have preferred foreign currency exposure in our portfolios.

We've long been defensively positioned in world bond markets, which sold off over the month.

And more recently, we reduced our exposure to Australian shares, which were one of the worst-performing share markets in the world in September.

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 also had very little exposure to Australian shares in any of the MLC Inflation Plus portfolios. So September's markets were the kind of environment where we would expect those portfolios to significantly outperform the MLC Horizon portfolios, and that's just what happened. In fact, all three MLC Inflation Plus portfolios produced positive returns over the month.

If there are further falls in share markets, the MLC Inflation Plus portfolios are likely to continue outperforming the MLC Horizon portfolios. However, the reverse is still true: the MLC Horizon portfolios are likely to be better positioned if markets recover strongly.