Economic update

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Brian reviews events in Australian and overseas markets during April.

How did markets perform in April?

World share markets posted reasonable gains in April. Emerging markets enjoyed a strong month, the Japanese market once again performed very well, and the US market fared pretty well after losing some ground in March.

If we look at how those translated in Australian dollar returns, hedged global shares won out in April, and unhedged global shares returns actually lost ground as the Australian dollar rebounded – it was up by nearly 4% against the US dollar.

If we look at our own share market, Australian shares posted a negative return, largely on the back of falls in the banking sector, which more than offset a bit of a rebound in mining stocks, helped along by some rebound in iron ore and other commodity prices.

Bond markets had a disappointing month, yields rose in most of the major world markets and here in Australia. Locally, some doubts about just how much lower official interest rates can go, unsettled the market. Higher bond yields also caused listed real estate securities to lose some ground in April, simply because the yields on those securities aren't quite as attractive to investors as they were.

What were the key factors driving global markets?

The actions of the world's major central banks are still crucial. US markets are grappling with the likelihood of higher US official interest rates over the coming months. The European Central Bank kicked off its quantitative easing (QE) program and the Bank of Japan's QE program is ongoing. Here in Australia, changes in the outlook for monetary policy are having a big impact on the Australian dollar, as well as our bond and share markets.

The bottom line is that the stance of monetary policy globally, the ridiculously low level of interest rates, and QE programs outside of the US, are continuing to provide support for share prices.

What about developments in Australia?

It still isn't entirely clear that the recovery in the non-mining economy will be strong enough to offset the drag from mining investment activity. Certainly 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 from cutting rates further. But given that the cash rate is the lowest in living memory, it's not clear that the level of interest rates is really holding many people back at this point.

How are MLC's portfolios positioned?

During the last month, we've made some further changes to asset allocation.

In both the MLC Horizon and MLC Index Plus portfolios we've further trimmed our exposure to Australian and global bonds, and increased our allocation to cash. All our portfolios remain defensively positioned in world bond markets. Yields in a range of world markets are incredibly low, and, in some cases negative.

We continue to prefer foreign currencies over the Australian dollar, which still looks overvalued and vulnerable to further falls, notwithstanding its rebound in April.

In the MLC Inflation Plus Conservative and Moderate portfolios, we're still holding significant allocations to cash and short-term Australian corporate bonds. We're in a very challenging investment environment.

While investment returns have been strong in recent years, we remain concerned that share prices have run too far ahead of fundamentals. This is the kind of environment when the things we do at MLC to manage risk have to be at least as important as the things we do to generate returns.