Economic update

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John reviews events in Australian and overseas markets during January.

How did markets perform in January?

2016 began with considerable market volatility and share market returns in January were broadly negative. They would have been worse, had it not been for a late in the month rally by markets after the Bank of Japan announced it was implementing a new initiative to stimulate the economy.

The US S&P500 Index fell 5.1% during January (in local currency terms). In Europe, the German and French markets were down by 8.8% and 4.8% respectively. Asian market returns tended to be worse. The Shanghai Composite Index experienced substantial volatility and was particularly weak in January, falling by 22.7%. This did little for other Asian markets with Hong Kong falling 10.2% and Japan's Nikkei Index down by 8.0%. Australia's share market was not immune to the global weakness. It fell 5.5% with resource and energy companies continuing to underperform industrials as commodity prices, specifically oil and iron ore, lost more ground over the month.

A number of factors caused markets to fall in January with developments in China a recurrent theme. The month began poorly when disappointing manufacturing data in China was released, heightening long-held market concerns that China's economic slowdown was more pronounced than anticipated and jeopardises the global growth outlook. China's decision to devalue its currency added to those concerns. The reaction of China's share market to these developments was severe, leading to the suspension of trading a number of times which added to impressions of mismanagement and desperation by China's authorities. While the performance of China's share market has little bearing on the global economy, its impact on market sentiment was negative.

These developments coincided with further weakness in commodity markets, especially oil where prices fell to levels not seen for over a decade. Rightly or wrongly, this was a negative influence on markets already concerned about the global economy. As if on cue, the International Monetary Fund trimmed its world growth forecasts for the next two years.

What is the outlook from here?

We remain in an uncertain environment and we believe a cautious approach is warranted. The global economy continues to grow, thanks largely to the US economy, but expectations have been revised downwards. The US economy has been an important driver of the global economy and while it will continue to grow, the best of that growth may be behind us.

Europe continues to recover but it is occurring slowly. Japan is a concern where, despite considerable policy stimulus through 2015, growth is modest at best. As for China, which is vitally important to Australia's economy, its economic growth rate remains the envy of the world. However, recent indicators reminds us that the adjustment China is attempting to engineer for its economy to one with a greater consumer and services orientation won't always be smooth and could have adverse consequences for us.

How are MLC's portfolios positioned?

While it may not be enough to prevent negative returns, the defensive positioning of our multi-asset portfolios is helping provide a degree of insulation in these volatile market conditions. We believe managing risk in our portfolios is the key to delivering on our portfolios' objectives and generating sustainable returns – and in this unpredictable investment environment, we think it's more critical than ever.

However, it's worth acknowledging there are many investors who may have time on their side from a wealth accumulation perspective because they have many years before they enter retirement and commence drawing from their superannuation. For example, weak and volatile share markets represent an opportunity for direct investors to buy at cheaper prices.

Looking ahead, in mid-February we'll be announcing some changes to our MLC Horizon portfolios' exposure to alternative assets that will give us even greater ability to preserve investors' capital in volatile markets.