

Economic update

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John reviews events in Australian and overseas markets during February.

How did markets perform in February?

After a disappointing start to the new calendar year when share markets recorded large falls in January, the investment landscape in February was another challenging one for investors. Most market returns were in negative territory (in local currency terms) though they were nowhere near as severe as those in January. The US S&P500 Index fell 0.4% and in Europe, the German and French markets were down by 3.1% and 1.4% respectively.

Japan's share market was one of the worst performers with the Nikkei Index falling 8.5%, its third consecutive negative monthly return. The Bank of Japan's adoption of a negative interest rate policy indicated how poorly Japan's economy has been performing and the necessity for radical policy measures to prevent it falling back into recession.

Australia's share market also lost ground with the S&P/ASX200 Accumulation Index falling 1.8%. Unlike previous months, resource and energy companies were positive contributors as spot prices for gold, oil and iron ore increased.

In bond markets, yields for major government bonds were lower as prices rose because inflation expectations have fallen and investors look for safe havens. In contrast, bonds of riskier issuers such as emerging markets lost more value. Emerging market bond issues denominated in US dollars have been weak for some time due to investor fears about repayment risk associated with weakening currencies.

What is the outlook from here?

Internationally, economic news was mixed. Overall, global growth has held up well but conditions vary from region to region.

Early in the month, Japan's central bank announced it will impose a negative interest rate on excess capital it holds on behalf of Japanese banks, a measure designed to encourage banks to lend the funds rather than leave it on deposit. Growth in Japan continues to be weak so this is the latest in a range of measures taken to help Japan's economy avoid recession.

Eurozone economic growth is occurring slowly and it remains fragile. The European Central Bank also has a negative interest rate policy as do a number of European countries. It charges banks 0.3% to hold their excess cash overnight. Expectations are growing that this charge may need to be increased to underpin what growth there is.

The US continues to enjoy relatively robust economic circumstances. US households are benefitting from the lower oil price, low unemployment and interest rates, in addition, wages growth is occurring in some sectors. However, the outlook for the business sector is less certain, due partly to the strength of the US dollar and contraction of the Energy sector. Overall, there are signs that US growth is moderating. As a result, expectations for further interest rate rises in the US have been scaled back.

In Australia, economic data was mixed. Consumer confidence improved in February, reversing falls in the previous two months, yet retail sales data for December was weaker than expected. Fourth quarter private capital spending was higher than expected, but forward estimates were disappointing, due in part to falling mining investment.

How are MLC's portfolios positioned?

The Australian dollar has fallen significantly over the past year and while this has been positive for our portfolios' returns we are increasingly concerned about scenarios which could result in the dollar rising again. Therefore we've started to hedge the risk of a rise in the Australian dollar in our multi-asset portfolios.

We've also made further increases to alternatives in the MLC Horizon portfolios. We believe increasing the allocation to alternative strategies provides our Horizon and Inflation Plus portfolios with a greater ability to preserve investors' capital in volatile markets and provide potentially better returns for the level of risk we take. While this positioning is unlikely to be enough to prevent negative returns in the current market conditions, it should be providing a degree of insulation.

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 those investors, weak and volatile share markets represent an opportunity to buy at cheaper prices.

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