Economic update

8 April 2016

John Owen
Portfolio Specialist

John reviews events in Australian and overseas markets during March.

How did markets perform in March?

After a weak start to the new calendar year, asset class returns were back in positive territory in March. All of the world's major share markets recorded good gains during the month. The S&P500 Index in the US was one of the best performers, rising by 6.6% (in local currency terms). In Europe, the German and French markets were up by 5.0% and 0.7% respectively. Italy's market was up 2.8%.

Asian share markets also performed well. After recording substantial falls in January and February, Japan's Nikkei Index managed to rise by 4.6% in March. Hong Kong's market performed exceptionally well, increasing 8.7% while in China, the Shanghai Composite Index was up by 11.8%.

After recording large falls last year and in recent months, emerging markets recovered some lost ground in March as conditions in those economies, while still difficult, appear to be stabilising.

Despite the gains recorded by global share markets in local currency terms, the strength of the Australian dollar (AUD) during March detracted from returns of unhedged investments. The AUD had a good month, rising by just over 7% against the US dollar and the yen.

Australia's share market participated in the global rally with the S&P/ASX200 Accumulation Index rising 4.7%. Gains were recorded by all sector indices. Highlights included the Materials sector, which was up 6.1%, and Energy which increased 5.8% as spot prices for iron ore and oil were both up over 10% during the month.

In fixed income markets, the best returns tended to come from global markets where falling inflation expectations resulted in higher bond prices and lower yields. High yield bonds delivered the strongest returns as previous concerns over the financial position of those issuers, particularly energy related companies, have abated.

What were the key factors driving global markets?

While economic news in various parts of the world remain mixed, especially in Europe and Japan, concerns in recent months about China's growth slowdown and the impact on global growth appear to have receded, especially as the US economy continues to perform well. Signs that the US Federal Reserve will act more cautiously in raising interest rates also helped market sentiment.

The actions of central banks continue to have a noticeable influence on markets. Initiatives designed to provide much needed economic stimulus and keep currencies low to assist exports remain in place in Japan, Europe and China.

In Japan, the central bank has imposed a negative interest rate on excess capital it holds on behalf of Japanese banks, a measure designed to encourage them to lend the money instead of leaving it on deposit.

Europe's central bank has had a similar strategy in place for some time to help underpin the eurozone's fragile economic recovery. During March, more stimulus was added.

Locally, the Reserve Bank of Australia (RBA) has left the interest rate policy unchanged. Recent commentary by the RBA suggests the Australian economy continues to rebalance satisfactorily following the mining investment boom.

How are MLC's portfolios positioned?

Despite weakness in local and global share markets in the last year, we remain wary of market fundamentals and valuations. We continue to believe it is appropriate to be defensively positioned where possible in our MLC Horizon and Inflation Plus portfolios.

This defensiveness has been achieved in a number of ways. Our portfolios are holding more cash than is normal, including those managers we have appointed who have the discretion to hold cash to manage risk. For our MLC Horizon and Inflation Plus portfolios, we have increased the allocation to alternative strategies which we believe will help preserve investors' capital in volatile markets and provide potentially better returns for the level of risk we take. More recently, we have taken steps to hedge the risk of a rise in the AUD in our multi-asset portfolios. And we remain selective in the kind of fixed income we own in our portfolios.

While these positions are unlikely to be enough to prevent negative returns in the current market conditions, it should be providing a degree of insulation.

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