# Economic update

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Ben reviews events in Australian and overseas markets during July

## How did markets fare in July?

The share price declines we saw in June reversed in July. The Australian market rallied, especially at the smaller end, with miners performing well, and the banks moved higher. All in all, the local market rose 7.5%.

Global shares also climbed, moving up approximately 3.5%. In fact the S&P500 hit new highs towards the end of July. Europe and the UK inched up, as did most other developed markets, but Japan fell back. Still, we need to remember that Japan's stock market was up over 50% in the last year.

On the bond side, returns were positive, but modest. Yields were fairly steady around the globe except in Italy, where yields fell sharply and returns were strong.

The Australian dollar continued to fall in July, finishing down a little over 2% and bringing the 12 month decline to just under 15%. That fall meant unhedged global shares significantly outperformed hedged.

So shares and bonds are moving in the same direction again. This probably means that most investors are looking at the same issue – most likely, the outlook for monetary policy in the US.

Back in June, investors began to worry that the US Federal Reserve would begin to reduce monetary support. This sent shares and bonds lower and the Australian dollar fell.

But in July, weaker economic data meant markets relaxed, and shares and bonds both went up again.

## Why has the Australian dollar continued downwards?

There are two reasons for this.

First there's the obvious one: an increasing perception that growth in China will slow further, though nobody can predict what will happen there.

But just as importantly, there's a growing appreciation of the difficulties facing Australia as the mining boom slows and households struggle with high debt. The 0.25% rate cut by the Reserve Bank of Australia (RBA) on 6 August will help, but there's scope for the RBA to cut further.

## How is the global economy doing?

It depends where you look.

The **US** is showing some encouraging signs, with employment looking okay and manufacturing picking up. Home prices are stronger and consumer sentiment is improving. On the flip side, cutbacks in government spending are pushing against the recovery, but overall things are looking good.

On the other hand, **Europe** is still in recession and struggling with debt levels. The good news, though, is that we're beginning to see very early signs of a recovery in some parts of Europe. So while risks linger, it's not all doom and gloom.

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**Japan** has been the bright spot both in terms of expectations and recent data. But there's still a lot of policy work to be done by Prime Minister Abe and it's a bit too early to judge "Abenomics".

Progress in **China** is really interesting. The new leadership team isn't shying away from making some tough reforms focused on rebalancing the economy away from investment and towards consumption. This means lower growth now, but better and more sustainable growth over the longer term.

China has a lot of problems, and seems to realise they need to solve them before the risk of hard landing becomes too acute.

## What's the outlook?

This is always the tough question. The very near term nearly always looks stable, sometimes deceptively so, and this can be dangerous. At MLC, we think broadly about what might happen in future so that we're less likely to be caught out.

Right now, we think the markets will continue to pay very close attention to data in the US and to any communication from monetary policy makers. While there's a good chance that US growth will be self-sustaining, it's still important to think about alternative future scenarios, especially scenarios with lower monetary support and steady (but below trend) growth.

In this environment, managing risk isn't easy. Foreign currencies have been a very good source of diversification for our strategies, but as the Australian dollar has fallen back, we've lost some of that diversification. And bond yields, while higher, are still relatively low and remain vulnerable to further increases.

Overall, we've positioned MLC's strategies as efficiently as we can to grow our investors' wealth without taking on too much uncertainty.