Economic update

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Brian reviews events in Australian and overseas markets during November

How have world markets fared over the last month?

It was a positive month for world share markets, but there was quite a lot of variation in performance between different markets. The Australian dollar fell back quite sharply, and that gave unhedged global shares another boost over the month.

Here in Australia, share prices fell by nearly 2%. We've seen a lot of companies using the annual general meeting season to hose down expectations about future earnings growth, and market analysts have revised down their forecasts in response.

It wasn't a great month for government bond markets around the world, either – bond yields rose in most of the major bond markets. Non-government bonds fared a little better.

As this is our last update for the year, it's worth highlighting just how strong share market returns have been so far in 2013. In just the first eleven months of 2013, global share prices are already up by nearly 22%, and here in Australia, prices are over 14% higher.

What key events influenced markets?

We've noted for some time how the extraordinary actions of the world's major central banks, or 'quantitative easing' – particularly by the US Federal Reserve (the Fed) – have helped to boost financial markets across the world.

Over the last month, markets have still been very focused on the question of just when and how fast the Fed will start to taper its quantitative easing. We've seen some better than expected US economic data over the last few weeks, and that again led people to think the Fed will taper sooner rather than later.

What's interesting is that this concern now seems to be having a larger impact on markets outside the US. At various stages during the year, US share prices fell whenever people started to worry about tapering. This time they didn't – US shares actually had a positive month.

That was one of the reasons cited by the Fed when it decided to keep its monetary policy unchanged (in other words, to keep on injecting around $85 billion a month into the US financial system, at least for the time being). The massive monetary policy stimulus is continuing to provide very strong support for financial markets.

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What's the outlook?

We still believe share prices have run too far ahead of fundamentals. World share markets as a whole aren't cheap, though they still seem to offer better medium-term return prospects than either bonds or cash.

In the US particularly (but also elsewhere) share prices seem to have run well ahead of corporate earnings, and well ahead of the likely outlook for earnings. Share prices have clearly been supported by the actions of the world's major central banks.

If that support remains in place, we could still see share markets perform well from here. On the other hand, markets could struggle if that central bank support is withdrawn too soon or too aggressively.

What is MLC doing?

With the outlook remaining uncertain, focusing on risk management and having a well-diversified portfolio is crucial. The challenge, however, is that the asset classes we normally use to diversify portfolios – particularly cash and government bonds – still seem to offer poor potential returns.

That's why we've been using some alternative, or non-traditional, assets and strategies to both manage risk in our portfolios and provide investors with greater diversification.

Our next written update will be in January 2014 and our next video in February.

Important information

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