Economic update

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Brian reviews events in Australian and overseas markets during the final three months of 2013

How did markets fare in the last quarter of 2013?

Australian investors enjoyed another quarter of good returns to end 2013. While Australian listed property securities lost ground, all other major asset classes enjoyed positive returns during the quarter.

Global share markets posted very strong gains, despite some disappointing returns from the emerging markets. In the case of unhedged global shares, the final quarter was an exceptional end to an amazing year, with a falling Australian dollar boosting returns.

Australian and global bond markets produced positive returns over the quarter despite yields rising in most major government bond markets. Non-government securities outperformed government bonds over the quarter.

Longer-term investment returns continue to recover. Three and five year returns for most of the major asset classes are now very favourable, despite the fact that the global financial crisis still features in the five year returns.

Economic developments and key market drivers

On balance, the economic news reported in the major world economies pointed to improving growth, particularly in the US.

While better economic news provided some support for share prices, investors also worried that improving economic conditions in the US would prompt the US Federal Reserve (the Fed) to begin unwinding ("tapering") its massive program of asset purchases, or "quantitative easing".

However, financial markets largely shrugged off the Fed's announcement that it would indeed begin tapering its asset purchases in the New Year, particularly as the Fed signalled it would likely keep extraordinarily low official interest rates in place for longer than previously anticipated.

Returns for periods to end Dec 2013 (%)	**3mth**	**1yr**	**2yr**	**3yr**	**5yr**	**10yr**
Cash	0.6	2.9	3.4	3.9	4.0	5.2
Australian bonds	0.4	2.0	4.8	7.0	5.7	6.2
Global investment grade bonds (hedged)	0.8	2.3	5.9	7.4	7.9	7.5
Australian property securities	-1.5	7.1	19.3	12.0	8.6	2.4
Global property securities (hedged)	1.2	9.9	20.4	12.9	18.1	n/a
Australian shares	3.4	20.2	20.2	8.9	12.5	9.6
Global shares (hedged)	8.5	28.4	24.0	14.0	17.5	9.4
Global shares (unhedged)	12.3	43.2	28.5	15.4	9.9	5.9

Source: MLC, Datastream.
Benchmark data include UBS Bank Bill Index (cash), UBS Composite Index (Australian bonds), Barclays Global Aggregate hedged to $A (global bonds), S&P/ASX200 A-REIT Accumulation Index (Australian property securities), MLC global property strategy benchmark hedged to $A (Global property securities), S&P/ASX200 Accumulation Index (Australian shares) and MLC global equity strategy benchmark (MSCI All Country Indices hedged and unhedged in $A).

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Also in the US, some unexpected progress in negotiations between Republicans and Democrats in the US Congress produced a deal designed to fund the US government for the next two years, reverse some of the previous cutbacks in spending and avoid the risk of another government shutdown.

The agreement was greeted favourably by financial markets, despite the absence of an agreement to again lift the US debt ceiling. This could again prove problematic in 2014.

Europe

In Europe, the European Central Bank (ECB) announced a surprise cut to one of its key official interest rates during November, despite signs of improvement in economic and financial conditions in the eurozone over the course of 2013.

In announcing the move, ECB President Mario Draghi cited very low inflation outcomes and the fragile nature of the economic recovery.

Australia

Here in Australia, economic growth remains subdued, the unemployment rate has drifted higher over the past year and inflation remains comfortably within the 2% to 3% target range of the Reserve Bank of Australia (RBA).

However, in recent months the RBA has opted to leave the official cash rate at its multi-decade low of 2.5%, due to a weaker Australian dollar and emerging signs of a recovery in housing and business confidence.