Economic update

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Brian reviews events in Australian and overseas markets during March

How did markets perform in March?

World share markets generally posted modest gains over the month, led by some decent gains in the US and also shares in emerging markets. But the Australian dollar managed to rebound in March – it was up by around 4% against the US dollar, for example, so unhedged global shares returns were flat for the month.

Australian shares also produced a modest gain in March, largely due to good gains in industrial and financial stocks. Most other sectors actually lost ground, particularly resources, which had a disappointing month.

If we look at the major world bond markets, they were pretty mixed – yields fell in some markets and rose in others, and the net result was a small positive return for bond investors.

What were the key factors driving global markets?

Events in the Ukraine continue to unsettle markets. Markets seem to be taking the view that common sense will prevail, and that there won't be a further escalation of the crisis, but this episode is a reminder that geopolitical risk is something that investors have to deal with from time to time.

Turning to more fundamental drivers, the economic news globally has been pretty mixed: China's data have largely fallen short of market expectations, whereas economic data in Europe and the US have – by and large – continued to improve. In the US, it seems pretty clear that the softer data we saw earlier in the year was largely weather related, and that the underlying US growth story remains intact.

For the US Federal Reserve, under new Chairman Janet Yellen, this means that they've been able to continue gradually unwinding their quantitative easing program.

In Europe, even though the economy continues to recover, it's not exactly impressive. And some of the recent inflation news in the eurozone has added to fears that inflation is too low, running the risk of deflation. That's led to speculation that the European Central Bank might have to do more to stimulate growth.

What about the Australian economy?

Given that the best news from the mining investment boom seems to be largely behind us, the good news is we are seeing signs that lower interest rates are starting to work – in other words, that the non-mining economy is starting to improve. Growth in credit is picking up, retail sales are growing, and housing indicators – things like building approvals and home loan approvals – have also been picking up. All this seems to validate the Reserve Bank of Australia's view that cash rates here don't need to be cut further.

How are MLC's portfolios positioned?

As we've mentioned in previous updates, we've been increasingly concerned about world share prices running too far ahead of fundamentals; in particular, too far ahead of corporate profits. We still have those concerns, and share markets look – at the very least – fully priced to us.

Our broad positioning hasn't changed significantly in recent months, either in the MLC Horizon or in MLC Inflation Plus portfolios.

Over recent years, we've introduced a number of new strategies into the MLC Horizon portfolios that are designed to better manage risk; in particular, to cushion more of the blow in difficult market environments.

We're still defensively positioned in world bond markets, given that we still see poor future returns from government bonds. And despite the rise in the Australian dollar in March, we continue to favour foreign currencies over the Australian dollar, which still looks very vulnerable in a number of adverse scenarios.

We've also included in some of the MLC Horizon portfolios an exposure to our MLC Inflation Plus portfolios. The MLC Inflation Plus portfolios are designed to provide a smoother pattern of returns for investors over time, and most importantly, to produce reliable 'real', or after inflation, returns. We think having that exposure will provide real benefits to our MLC Horizon investors. The MLC Inflation Plus portfolios remain quite defensively positioned, particularly the Conservative and Moderate portfolios, where we're maintaining fairly substantial allocations to enhanced cash and to Australian corporate bonds.