Economic update

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Brian reviews events in Australian and overseas markets during May.

How did markets perform in May?

Returns in May were solid – bond and share markets both performed very well. Bond yields fell in all the major bond markets. We had particularly good share price gains in the emerging markets, particularly in India, where there's a lot of optimism about the new government and new prime minister, who were elected with a massive majority.

Here in Australia, the share market produced a reasonable return. However, the market did lag global markets, especially as the price of iron ore fell substantially over the month and local mining stocks lost quite a bit of ground.

The Australian dollar gained ground against the major currencies, so unhedged global shares faced some headwinds in May.

What were the key factors driving global markets?

Even though the US Federal Reserve is gradually unwinding its quantitative easing program, the reality is that monetary policy is still extremely accommodative: official interest rates are still very low across the world – or virtually zero in some cases. The Bank of Japan has continued its quantitative easing program, and there's some chance the European Central Bank will start one.

There's still plenty of money searching for higher returns, and that's a very positive environment for financial markets, even if some of the recent economic news across the world has been mixed. And markets continue to largely overlook the crisis in the Ukraine, which hasn't been resolved.

What about developments in Australia?

The major event here at home was the Federal Budget, which didn't really produce any lasting impact on financial markets. And that makes sense, given that we don't think the budget really changes the medium to longer term outlook for the economy or financial markets. It's also unclear whether all the government's budget measures will get through the Senate.

In terms of the economy, the economic data released over the month were quite mixed. We're seeing some better numbers on the labour market and some signs of a pick-up in investment outside of the mining industry, and credit is still expanding. On the other hand, consumer confidence fell back after the budget, and growth in retail sales has stepped back a little.

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How are MLC's portfolios positioned?

We're still concerned about world share prices running too far ahead of fundamentals, and in particular, too far ahead of corporate profits. Share markets look – at the very least – fully priced to us, but as long as monetary conditions remain supportive, share markets could continue to run for some time.

Our broad positioning hasn't changed significantly in recent months, either in the MLC Horizon or MLC Inflation Plus portfolios. In the MLC Inflation Plus Conservative and Moderate portfolios, we're still holding significant allocations to cash and short-term Australian corporate bonds.

Across all our multi-asset portfolios we remain defensively positioned in world bond markets, since we still anticipate poor future returns from government bonds. And we still favour foreign currencies over the Australian dollar, which still looks very vulnerable in a number of adverse scenarios.

During May we added some extra inflation protection to portfolios because inflation-linked bonds started to look more attractive. Apart from that there were no significant changes to our portfolio strategy this month.