Economic update

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Brian reviews events in Australian and overseas markets during August.

How did markets perform in August?

All the major asset classes produced positive returns in August. The best-performing asset class was hedged global shares, which delivered a 2.9% return for the month. The Australian dollar rose over August, so unhedged global share returns underperformed.

The Australian market had a positive month, but it didn't fare as well as global markets. Mining stocks were quite a bit weaker over the month due to the lower iron ore price.

What were the key factors driving global markets?

In the face of a very uncertain geopolitical environment, extremely loose monetary policy and very solid economic data from the US continue to support global share markets.

Perhaps the most surprising aspect of the market's performance is that events in the Ukraine and Iraq haven't unsettled markets as much as we might have expected. Whether markets are right to be so relaxed remains to be seen.

The actions of the world's major central banks continue to be crucial. Even though the US Federal Reserve is continuing to unwind its quantitative easing program, interest rates are still extremely low. Other central banks are still keeping monetary conditions very loose, or actually taking further steps to boost growth.

For example, European economic data have taken a turn for the worst in recent months, and inflation rates in Europe are very low. This is forcing the European Central Bank to look at further monetary policy easing.

What about developments in Australia?

The overall economy started 2014 on a fairly strong note. However, the economy continues to experience cross-currents. On the one hand, mining investment is declining and is likely to be an ongoing drag on economic growth. The prices we're receiving for our key resource exports have fallen. And the labour market has been quite weak, with unemployment drifting higher over the past year. On the other hand, there are signs of an improvement in the non-mining economy: both housing activity and business investment outside the mining industry are improving.

As long as the non-mining economy continues to improve, the Reserve Bank of Australia seems likely to keep interest rates unchanged at what are extremely low levels – really the lowest in living memory in Australia.

How are MLC's portfolios positioned?

Although share markets look – at the very least – fully priced to us, share markets could continue to rise for some time if monetary conditions remain supportive.

Our broad positioning in the MLC Horizon and Inflation Plus portfolios hasn't changed significantly in recent months. Across all our multi-asset portfolios we remain defensively positioned in world bond markets, since we still expect poor future returns from government bonds. We still favour a range of foreign currencies over the Australian dollar, which continues to look very vulnerable in a number of adverse potential scenarios.

In the MLC Inflation Plus Conservative and Moderate portfolios, we're still holding significant allocations to cash and short-term Australian corporate bonds.

What this positioning means is that if share prices continue to rise, the MLC Inflation Plus portfolios will still deliver solid absolute returns, but they'll underperform the MLC Horizon portfolios. However, if we see a large fall in share markets, the MLC Inflation Plus portfolios are likely to perform significantly better than the MLC Horizon portfolios.