The year in review

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'As 2015 draws to a close, it's time to review what's happened in investment markets this year and look ahead to 2016.'

Returns for the year were positive, despite considerable volatility

Investors have enjoyed another year of positive returns, despite considerable mid-year volatility. However, the returns shown in Table 1 are below those that were reported in 2014, in some cases materially lower.

Achieving positive returns wasn't without issue as widespread volatility in markets mid-year resulted in some of the worst monthly returns since the global financial crisis. Aside from the latest instalment in the Greek debt crisis, which was ultimately resolved (for the moment) in July, concerns China's economy was slowing faster than markets had anticipated and the uncertainty this caused over the outlook for the global economy led to considerable mid-year market weakness.

However, these factors didn't prevent some global share markets posting reasonable gains for the year, though it's no coincidence that the best share market performers (Japan, Germany, France) tended to be where there were the most significant new monetary stimulus announcements.

Other performance highlights for the year included: the substantial return by unhedged global shares (due largely to the weakness of the Australian dollar (AUD)), the low return by Australian shares and underperformance of many of its global peers, modest returns from bonds, and the ongoing demand for assets such as Australian property trusts with perceived secure and competitive income streams versus bonds, cash and term deposits.

Table 1: Asset class returns (%) in Australian dollars – periods to 30 November 2015

Asset class	Return (%)*				
	2015 to date	1yr pa	3yr pa	5yr pa	10yr pa
Cash	2.1	2.4	2.7	3.4	4.6
Australian bonds	2.2	4.0	4.7	6.6	6.3
Global bonds (hedged)	3.4	4.2	5.4	7.2	7.4
Australian property securities	9.9	14.9	15.4	14.6	2.1
Global property securities (hedged)	4.4	5.9	13.9	13.5	7.0
Australian shares	-0.2	1.9	9.4	7.2	5.7
Global shares (hedged)	5.1	4.4	15.8	13.1	7.7
Global shares (unhedged)	12.8	15.5	23.9	14.8	6.0

*Annualised returns except for 2015 to date.

Sources: FactSet, JANA Corporate Investment Services Limited.

Benchmark data include Bloomberg AusBond Bank Bill Index (cash), Bloomberg AusBond Composite 0+ Yr Index (Aust bonds), Barclays Global Aggregate Index 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 (Aust shares) and MSCI All Country Indices hedged and unhedged in $A (global shares).

Currency was an important contributor to returns as the Australian dollar weakened

The AUD was under pressure as prices for our major exports, in particular iron ore, deteriorated sharply through the year. The AUD fell 15% against the US dollar (USD) and was down 11.8% versus the yen and 11.7% versus sterling in the year to 30 November. It strengthened marginally against the euro.

For Australian investors, having an unhedged global shares strategy (where the value of the portfolio benefits from the AUD's weakness) has been particularly beneficial. In the year to 30 November, unhedged global shares returned 15.5%, outperforming a hedged strategy which returned only 4.4% in the same period. A similar outperformance occurred in the last three years.

Emerging markets continued to underperform

2015 was another tough year for emerging markets, underperforming those in the developed world for the third consecutive year. Many emerging market economies are commodity based and have suffered due to the substantial correction in commodity prices. The potential lift in US interest rates has also led to a withdrawal of capital from emerging markets, causing many emerging market currencies to weaken. This has created debt-servicing difficulties for those emerging economies that have borrowings in foreign currencies (usually USD).

China's share market performance was closely watched, in particular its mid-year volatility which was handled ineptly by policy makers. Amid concerns that China's economic growth was slowing faster than anticipated, the Shanghai Composite fell 34% in the four months to 30 September. However, to put that into better perspective, the market was still up by 28.4% in the year to 30 November.

Quantitative easing and monetary stimulus remained necessary around the world

While America concluded its quantitative easing (QE) program late in 2014, other parts of the world have maintained their own programs to support their economies and encourage growth.

While economic conditions in Japan struggled to improve, policy which has led to a decline in the yen has restored competitiveness and now makes Japanese workers the cheapest in the developed world. However, growth is still struggling to recover from the effects of last year's consumption tax rise. The Bank of Japan (BOJ) is under pressure to deliver further easing. While there remains significant underemployed labour, there are reports of skill shortages and tentative signs of wage increases. If employment continues to rise, workers may at last enjoy higher wages which could lead to higher consumer confidence. In a best case scenario this could lead to rising wages, demand and economic growth. However, it remains uncertain whether government and central bank policies will support this scenario.

The eurozone's economic performance improved this year but it remains fragile, although export oriented economies like Germany's have benefitted from the lower euro. To head off the risk of deflation and provide much needed stimulus to the eurozone economy, the European Central Bank (ECB) started to play catch-up and embarked on a QE program of its own and applied supportive measures through the year. Late in the year, the ECB announced it would extend its QE program by six months into 2017; the announcement however disappointed the market which had anticipated more.

Locally, the Reserve Bank of Australia extended a helping hand to the economy by reducing the official cash rate by 0.25% on two occasions to close the year at 2.0%. China also pulled numerous policy levers to underpin its economy, including cutting official interest rates six times in less than a year. Recently employment data has shown tentative signs of improvement as labour intensive services are buoyed by a weaker currency, offsetting lower demand in capital intensive industries. However, the economy remains vulnerable to a less than smooth transition from an investment to a consumption led growth model.

Despite signalling its intention to begin raising interest rates, the US Federal Reserve maintained its accommodative policy to the end of the year. Expectations are high that it will begin to raise rates at its last meeting for the year.

Looking ahead, modest and tentative growth in the world's major economies suggests a stimulatory bias remains necessary. Inflation also remains weak, though this will tend to fade if energy prices stabilise or rise.

Australia's share market underperformed global peers

Our market produced a disappointing return and underperformed many of its global peers. The pronounced price weakness of mining and energy companies in response to falling commodity prices was the main contributor to this subdued performance, as indicated by the 25.5% fall in the S&P/ASX200 All Resources Accumulation Index over the year. The spot price for iron ore fell over 43% in 2015, aluminium and copper prices were 30% lower and the price of oil fell over 36%, reaching prices last seen in 2009. Banks also delivered very modest returns due to the large equity raisings required to satisfy new capital standards and concerns that earnings and dividend momentum will slow.

Elsewhere in our market, a number of sectors delivered good returns. Healthcare continued to perform well as the AUD's weakness should benefit the profitability of those companies with offshore operations. Stocks such as real estate investment trusts, utilities and infrastructure with sustainable and attractive distribution yields also did well in a low interest rate environment.

Lower bond yields worldwide…

For fixed income investors, returns were generally modest in magnitude. Bonds benefitted from the "risk-off" environment caused by global growth uncertainty and expectations of an interest rate rise in the US. However, higher risk bonds such as global high yield tended to underperform. Yields in the major world bond markets remain close to historic lows. The ongoing delay in the timing of the anticipated US Federal Funds Rate rise was a key focus in bond markets.

Overall, a "defensive" portfolio stance remains appropriate as the outlook continues to be uncertain

The volatility that occurred in recent months highlights the uncertainty in markets about the outlook and the tendency to adjust expectations and portfolio positions as new information is received. For example, with US interest rates poised to rise due to the ongoing strength of the US economy, good economic news is often seen by markets as bad for share prices. Markets have also been very short term in their focus; this obsession about the timing of the first US rate rise provides a good example of this short-termism.

While the global economic outlook appears modest but reasonable in current circumstances, expectations were downgraded as the year progressed and there are still major risks and issues that need to be monitored closely. Despite a range of extraordinary monetary stimulus measures that have been applied or are still in place, growth in the US, UK, Europe and Japan is modest at best and, partly due to the fall in energy prices, inflation has been declining. This highlights a key concern of ours that while QE has led to asset price inflation and underpinned the performance of share markets, the flow through into the real economy has been limited.

Australia's economic performance has been less than stellar. Economic growth remains "below trend". The weak third quarter capital expenditure data where expenditure fell 9.2% to be down 20.0% over the year, was a strong reminder that the transition from the mining and energy investment boom won't be smooth. Australia's substantial trade dependence on China is an ongoing issue. China is the largest or second largest export market for 8 of our 10 largest exports so the state of health of China's economy and its transition to a more consumer and services oriented economy is a significant watchpoint.

Despite these and other concerns, there are also a number of positives. For example, global growth is "OK", the US economy continues to perform well, the eurozone continues to recover slowly, China has considerable 'policy firepower' to respond to weaker than expected economic conditions, corporate balance sheets here and overseas are generally in good shape, and better value opportunities are starting to emerge following recent share market falls. However, they are still not enough to offset the negatives that we see.

How does MLC deal with these uncertainties?

At MLC, we focus strongly on risk management. We believe managing risk for our investors is at least as important as generating returns for them – and in this unpredictable investment environment, it's more critical than ever.

As a result, we design and manage our multi-asset portfolios to be resilient in a wide range of possible market conditions. Using our market-leading investment approach, we constantly test how our multi-asset portfolios are likely to perform in many potential market scenarios, both good and bad. We can then adjust our portfolios to manage possible risks and take advantage of potential return opportunities.

This careful analysis means our portfolios are widely diversified, risk-aware and positioned for many market environments.

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