Economic update

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Brian reviews events in Australian and overseas markets during February.

How did markets perform in February?

It was a very strong month for world share markets, with decent gains almost across the board. The eurozone share markets were a highlight, with a return of better than 7% for the month. That's after posting a similar gain in January, so they've had a terrific start to the year.

We also had a great month here in Australia, with a share market return of just under 7%. The biggest contributions to that gain came from financial companies – particularly the banks – but we also saw really good gains from the mining companies.

It was a tougher month for bond markets. Australian fixed income managed a positive return, helped along by the rate cut by the Reserve Bank of Australia (RBA) in early February. However, global fixed income suffered a negative return, as government bond yields rose in the major world markets.

What were the key factors driving global markets?

Two factors stood out. One was the actions of the world's central banks. As I discussed last time, the European Central Bank has decided to start its own quantitative easing (QE) program, and the Bank of Japan's QE program is ongoing. But so far this year we've seen 20 central banks around the world reduce interest rates, including the RBA. The bottom line is that the stance of monetary policy globally – the extraordinarily low level of interest rates – is continuing to provide strong support for share prices.

The second issue was Greece. Negotiations between the new Greek government and the European authorities finally concluded in a deal. Europe essentially agreed to keep the Greek government solvent by extending the terms of the bailout in return for a series of reforms, mostly to do with fighting tax avoidance and public sector corruption. What the deal has done is to prevent an imminent Greek exit from the euro and to that extent, it was greeted positively by financial markets. Greek shares, for example, delivered a 20% return in February. Mind you, they lost 20% in January, and they've still posted a loss of around 44% over the last twelve months.

What about developments in Australia?

The RBA decided to reduce the cash rate in early February, by 0.25% to 2.25%. And remember, we already had the lowest cash rate in living memory.

On balance, the recovery in the non-mining economy is still underway, but some of the data released in February, particularly on business spending intentions, was surprisingly weak. That's cast some doubt on the ability of business investment in the non-mining economy to take up the slack from mining investment, which is still falling.

Certainly, if the RBA decides to do more to boost growth, there's nothing in the economic data or in the inflation outlook to stop them cutting rates further.

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How are MLC's portfolios positioned?

We're still defensively positioned in world bond markets, and that certainly helped the performance of both the MLC Horizon and MLC Inflation Plus portfolios during February.

We continue to prefer foreign currencies over the Australian dollar. It still looks overvalued and vulnerable to further falls, despite its modest recovery in the last month.

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

Given that February was a very strong month for share markets, the MLC Horizon portfolios are very likely to have significantly outperformed the MLC Inflation Plus portfolios.

As a general rule, strong share markets lead to the MLC Horizon portfolios outperforming MLC Inflation Plus. However, the reverse is also true: the MLC Inflation Plus portfolios are better positioned if share markets go through another difficult period.

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