

Brian Parker's 30 June Briefing and Outlook

July 2010

MLC's Investment Strategies Brian Parker provides a short market and economic review of financial year just concluded.

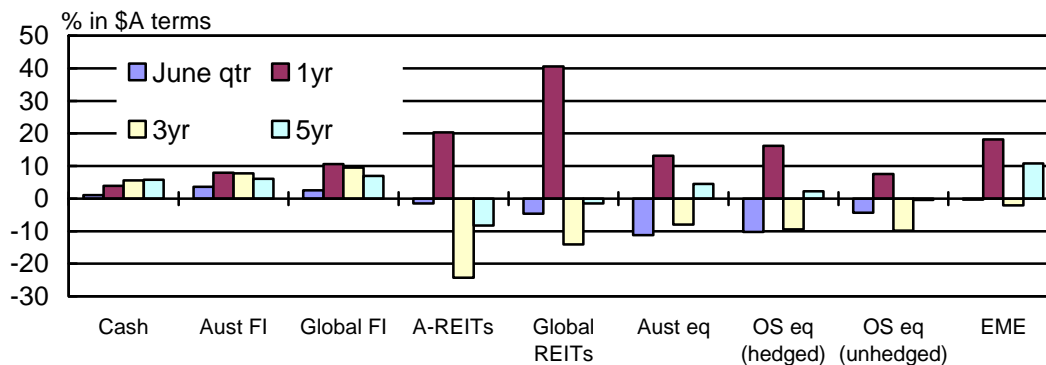


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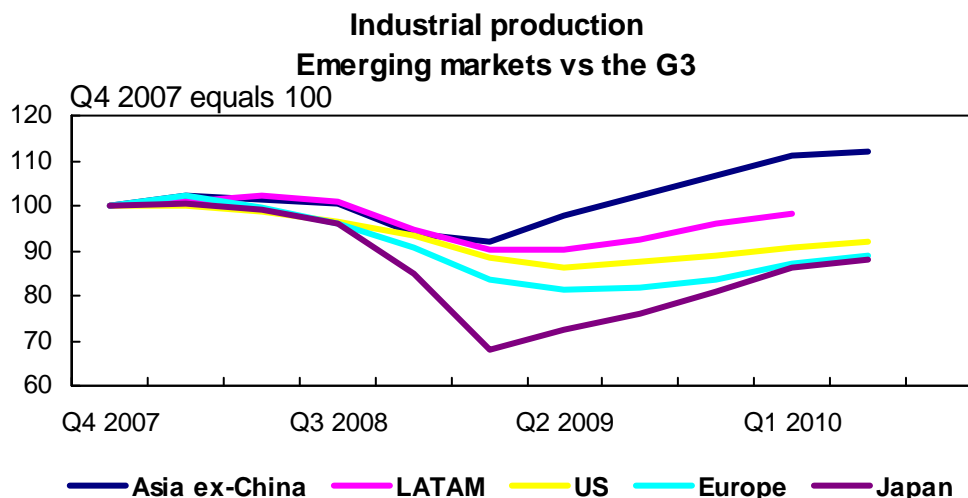
Economic and Market developments

The chart below summarises the returns from the major asset classes for periods up to the end of June 2010. Growth assets lost ground in the final quarter of the financial year, but nevertheless posted solid returns for the year to June. Over the year, the typical diversified fund probably posted a return of around 13%.

Selected asset class returns



The recovery in investment returns over the past year occurred largely in the second half of 2009. World share markets performed strongly, although the strength of the Australian Dollar detracted from unhedged global equity returns. The recovery reflected a renewed appetite for risk on the part of investors, and a growing confidence in prospects for the global economy. Economic growth has improved in the major economies, although the strength of that recovery varies. In the emerging economies, the recovery appears to have been much more robust.



However, the first half of 2010 has been a much more difficult period for financial markets. Investors have become much more risk averse, and sovereign risk concerns have been the dominant factor behind this. In addition, markets have become increasingly concerned about the durability of the global recovery – particularly given the prospect of tighter fiscal policy in many economies, as Government’s attempt to address sovereign risk concerns. Key global leading indicators appear to be signalling somewhat slower growth ahead.

Despite a massive package of measures announced by the European Union earlier this year, markets continue to price in a very high likelihood that Greece, in particular, will end up having to default on its obligations. In the last month or two, we’ve seen Spain, Portugal, and the UK announce packages of austerity measures designed to reign in excessive budget deficits.

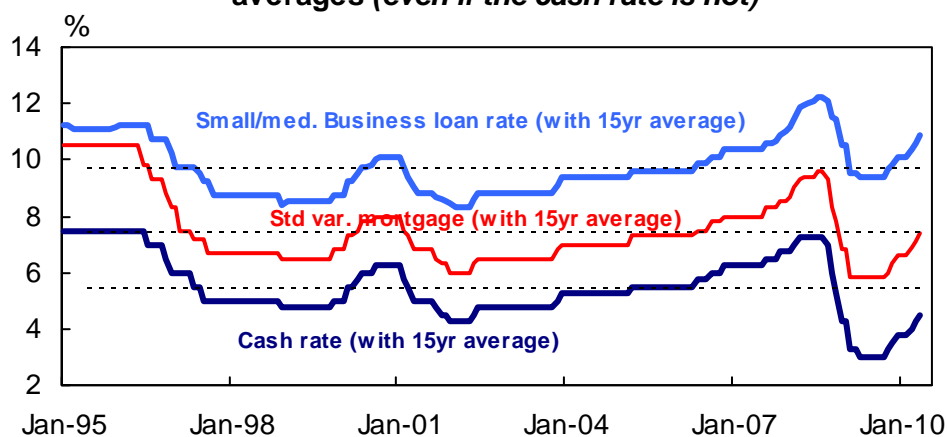
Concerns over the health of Government finances are not solely focused on the Euro-zone or the UK. The reality is that budget deficits and rising public debt levels are a concern elsewhere – most notably in the US and Japan. The new Japanese Government has signalled that it will introduce measures, including higher consumption taxes, to address Japan’s massive budget deficit and public debt. In the US, the political debate has increasingly veered away from the need for policy to support the economy towards the need to take steps to reduce its fiscal deficit.

Austerity packages and the need to reign in fiscal deficits seem to be adding to the market concerns about the sustainability of the economic recovery. All other things being equal, higher taxes and lower Government spending are a drag on economic growth. In recent months, economic data from the major economies have taken a somewhat softer tone, as the effects of past stimulus measures begin to wane. While we remain of the view that the recovery is sustainable, we continue to believe that it will be a modest affair, and that the world remains extremely vulnerable to adverse developments – including a premature tightening of either fiscal a monetary policy.

In Australia, the relatively strong performance of the economy during the worst of the Global Financial Crisis has been well-documented. Australia appears to have been one of the few developed economies to have avoided a recession, although growth did slow markedly during 2008 and 2009. Moreover, fiscal policy – both directly in the form of public works and transfers to households and indirectly in the form of incentives to businesses and home buyers - was responsible for the bulk of the economic growth that occurred during 2009.

Over the course of the year, the Reserve Bank began unwinding the aggressive monetary stimulus measures put in place during the latter half of 2008. The official cash rate now stands at just 4.5% - a level that in previous cycles would have represented the low point for the cash rate. However, key borrowing rates are currently at, or higher than historical averages and the RBA have signalled that they are likely to be cautious in raising rates from here.

Key borrowing rates are at, or higher than historical averages (even if the cash rate is not)



Business survey data suggest that the Australian economy grew at an annual pace of around 3% in the first half of 2010. Over the year ahead, stronger business investment, exports, and an upswing in housing activity are likely to underpin economic growth. On inflation, core inflation rates have remained stubbornly high in recent years. However, there appears to be enough spare capacity in the economy to produce some moderation in inflation over the coming year.



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