# Economic update

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Ben reviews events in Australian and overseas markets during September

## How did markets perform in September?

Starting off with Australia, the domestic share market held on to August's gains, moving sideways in September.

Global shares, on the other hand, recovered some of the losses we saw in August, ending the month 3% higher. Most regional centres contributed to the rise, with the US's S&P500 up 3%, Europe climbing 4% higher, and volatile Japan jumping 6.5%.

Alongside this, emerging markets bounced back from some fairly steep losses in August to finish up 2-5%, depending on where you look.

As with shares, emerging markets currencies also recovered some ground against a weaker US dollar. The Australian dollar reversed its decline, rising 3.75%.

Globally bonds also rose. Yields fell across most major and developing markets as bond prices were bid higher in a search for yield.

## How is the global economy faring?

The fact that shares ended the month higher masks the increasing uncertainty that's creeping into views on the economic recovery – particularly in the US, but also in Europe and Japan.

The decision by the US Federal Reserve not to reduce bond purchases provided some temporary relief to shares, which was quickly undone as focus turned toward the looming political gridlock that is playing out now. I think it's fairly clear that how this unfolds will have a significant bearing on near term returns for most asset classes.

## How is Australia's economy doing?

There wasn't much domestic dataflow in September, and the data we did get was largely benign. The labour market looks soft, with unemployment trending higher and approaching GFC levels. But retail spending was marginally higher than expected, and consumer confidence has picked up, so it looks like the Reserve Bank of Australia's loose policy is flowing through to consumers.

The employment dynamic is something to keep a close eye on, given the fairly high debt levels of Australian households and the move by corporate Australia to focus on costs.

## What is the outlook for financial markets?

We remain cautious. This is still a difficult and risky environment, with policy risks in nearly all key economic centres.

But the overarching complication for investors is the lack of attractively priced mainstream asset classes. Share prices have run ahead of fundamentals, pushing valuations higher and leaving stocks generally expensive. At the same time, low bond yields elevate the risk in holding fixed income because when yields do rise, the price of bonds will fall.

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The high Australian dollar provides some opportunities for diversification through foreign exchange but it's risky to rely on one tool.

Environments like this actually call for two things: first, finding the most efficient sources of diversification – which is challenging at the moment – and second, a deliberate focus on security selection to find opportunities in expensive markets.

MLC pays a great deal of attention to both of these, helping us to manage risk in what continues to be a difficult environment.