Economic and market update

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Bob reviews events in Australian and overseas markets during February.

How did markets perform in February?

Global shares made strong gains of 2.9% in local currency terms.

US shares continued their run of record highs. The potential for stronger US economic growth and higher corporate profits in 2017, due to President Trump's bold promises, has buoyed US shares. Positive economic data has also been supportive. US business and consumer sentiment surveys strengthened, and there has been strong consumer spending results and healthy job gains. Yet consumer price pressures are building, with US inflation at a 5 year high. The US Federal Reserve (Fed) has indicated that interest rates are set to rise "*fairly soon*".

European shares rebounded in February after a soft January**.** Encouraging European data in terms of solid economic growth and positive business surveys has temporarily mitigated political concerns. The upcoming Dutch parliamentary election (March 2017) and French Presidential election (April-May 2017) will be the key focus over coming months.

Chinese shares performed solidly with a 2.2% gain in February, benefitting from easy credit conditions and strong business surveys. However Japanese shares were more sedate with a 0.5% return given the stronger yen performance.

Australian shares delivered a solid 2.3% return for February. There were strong gains for Consumer Staples (6.2%) with Wesfarmers and Woolworths delivering favourable profit reports. Financials and Utilities respectively gained 4.1% and 3.2% with investors favouring their attractive yields. The Australian dollar (AUD) made solid gains against the European currencies in February. This stronger AUD performance had a modest negative impact on unhedged global shares, which returned 1.5% for February.

US government bond yields moved sideways in February awaiting more policy detail on President Trump's stimulus plan. Solid US economic data and rising inflationary pressures suggest that the Fed will continue to raise interest rates in 2017. However European government bond yields fell as investors became more cautious on potential European political risks.

Australian government bond yields were essentially stable in February. Mixed Australian economic activity data and slow wages growth has seen investors become more comfortable with holding Australian bonds.

What were the key factors driving markets?

The major themes driving markets in February continued to be President Trump's bold stimulus promises, the prospect of higher US interest rates and the political risks in Europe.

Given solid US economic data and rising inflationary pressures, the Fed is expected to continue raising interest rates in 2017. However financial markets are debating how fast and how high this rise in US interest rates will be. Markets are also keenly awaiting the policy detail behind President Trump's extensive promises.

In Australia, our economic activity remains mixed. While there has been solid part-time job gains, full-time employment is struggling and wages growth remains subdued. Yet the National Australia Bank survey shows strong results for business confidence and conditions. Given this mixed data, the Reserve Bank of Australia has held the cash rate steady at 1.5%.

Have any changes been made to portfolios in February?

We've made a few changes to our Australian shares strategy that we believe should improve return potential.

In our MLC Horizon and MySuper portfolios, we've altered the mandate of Redpoint, an Australian shares manager. We appointed Redpoint as a passive index manager three years ago. Since then, we've been monitoring their additional capability in selecting companies using their 'enhanced index' approach. This is a low risk approach that uses quantitative data techniques to outperform the share market index. We're now allowing Redpoint to use this slightly higher return-seeking approach to select Australian companies for our portfolios.

We've also made changes to our Australian shares strategy for our MLC Index Plus portfolios. We've replaced Vanguard, our passive manager, with our two quantitative Australian shares managers, Redpoint and BlackRock. These two managers are using the same enhanced index approaches that they now use in our other multi-asset portfolios.

Lastly, in our MLC Inflation Plus portfolios we've replaced our emerging markets manager, Capital Group, with a derivatives strategy. Derivatives allow us to maintain the portfolios' emerging markets exposure, but more cost effectively.